BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	**File No. ER-2010-0356**

STAFF'S REPLY BRIEF OF ISSUES SPECIFIC TO KCP&L GREATER MISSOURI OPERATIONS COMPANY

Respectfully submitted,

Nathan Williams
Deputy Counsel
Missouri Bar No. 35512

Attorney for the Staff of the
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
(573)751-8702 (Telephone)
(573)751-9285 (Facsimile)
nathan.williams@psc.mo.gov

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COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its Reply Brief of Issues Specific to KCP&L Greater Missouri Operations Company, states as follows:

INTRODUCTION

As stated in its Initial Brief of Issues Specific to KCP&L Greater Missouri Operations Company, the issues specific to KCP&L Greater Missouri Operations Company ("GMO") are:

1) GMO's fuel adjustment clause (the "fuel adjustment clause" issues), including the following: (a) continuation of GMO's fuel adjustment clause; (b) the appropriate net base fuel cost; (c) the level of changed net costs at risk in the clause—characterized as a "sharing" mechanism; (d) whether transmission costs should be included in the clause; (e) a clarification of the definition of forecasted retail net system input ("RNSI"); (f) a clarification of the definition of off-system sales revenue ("OSSR"); (g) adding a factor to exclude fuel costs attributable to GMO's Crossroads generating station; and (h) other miscellaneous changes;

2) For determining the respective costs of service of MPS and L&P, the allocation between MPS and L&P of GMO's investment in, and the capacity and energy from Iatan 2,

including the related impacts on fuel costs and off-system sales margins (the "Iatan 2 allocation" issue);

3) The level of investment, capacity, fuel, transmission, and related costs that should be included in MPS's cost of service for setting rates (the "Crossroads" issue)—for which Staff imputes costs based on two 105 MW combustion turbines built in 2005, and for which GMO relies on the costs of its Crossroads generating facility as a resource it owns which it dedicated to serving its retail load in August of 2008; and

4) The level of costs incurred for the Jeffrey Energy Center Flue Gas Desulphurization Rebuild Project that should be treated as investment and included as rate base in MPS's cost of service used for setting rates in this case (the "Jeffrey FGD Rebuild Project" issue).

In its GMO specific issues initial brief, despite insisting the *Motion for Extension of Time for Filing of Posthearing Briefs* filed March 3, 2011, in this case explicitly state the issues for which the briefing extension was being requested before it would join the motion and without providing any advance notice it was doing so, GMO alone has included argument on the issue of off-system sales margins. The issues listed in the motion follow:

a) Iatan Allocation to L&P and MPS;

b) All Crossroad Issues;

c) All FAC Issues (including sharing and rebasing); and

d) Jeffrey Energy Center FGD Project.

While Staff objects to GMO, without any advance notice, briefing a new issue, Staff is replying to GMO's argument regarding off-system sales margins in this brief. Therefore, there is an additional issue:

5) How should GMO's off-system sales margins be determined for setting rates for MPS and L&P?

Following, minimizing repetition of arguments Staff presented in its initial brief on GMO specific issues, are Staff's responses to the arguments of GMO.

FUEL ADJUSTMENT CLAUSE ISSUES

GMO limits its briefing of fuel adjustment clause issues to Staff's proposal to change the "sharing" mechanism of GMO's fuel adjustment clause from 95%/5% to 75%/25%. Strangely, on page 30 of its initial brief, GMO states, "GMO's Fuel Adjustment Clause was established and approved in the final rate case of its ***predecessor*** Aquila, ..." (Emphasis added.) GMO ***is*** Aquila, with a different name and a different management; therefore, the reference to a predecessor is nonsensical. GMO argues that since its fuel adjustment clause was first implemented, it has absorbed $6 million due to the 95%/5% "sharing" mechanism and, therefore, Staff's proposal to change the "sharing" mechanism to 75%/25% would, historically, amount to increasing that $6 million by $24 million, and is intended to penalize GMO, for not rebasing net base fuel costs in its fuel adjustment clause.[1] As Staff stated in its initial briefing of this issue, Staff's recommendation is not intended to punish GMO. Instead, it is intended to provide GMO with appropriate incentives designed to accomplish what the Commission has described as to "keep its fuel and purchased power costs down."

Staff's "sharing" mechanism recommendation is primarily intended to provide GMO with more incentive to file to reset the base energy cost in its fuel adjustment clause to match the base energy cost used to set rates in the rate case. It is also intended to incent GMO to "keep its fuel and purchased power costs down" by developing and managing an effective energy

[1] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company*, pp. 30-32.

procurement process that minimizes energy costs and, at the same time, manages the risk of losing energy supplies. And it is intended to create a sufficient risk of revenue loss that GMO would not "absorb" that loss to obtain a larger increase in its general rates—GMO demonstrated with its initial filing that started this case it is willing to "absorb" that loss by not filing in this case to match the base energy cost used to set rates in the rate case. As Mr. Tim M. Rush testified in rebuttal testimony, "This is somewhat of a complicated issue, but essentially, the Company in its initial filing did not request an increase in rates for the portion of fuel and purchased power expenses, net of off-system sales, in excess of such amounts built into base rates."[2] GMO should not be allowed to use its fuel adjustment clause to distort the purpose of a fuel adjustment clause—to protect a utility from the regulatory lag associated with recovery through retail rates of increasing fuel-related costs and its customers from the regulatory lag associated with reductions in retail rates due to decreasing fuel-related costs—to allow it to obtain greater increases in its general rates than the Commission would permit if all of GMO's fuel and purchased power costs are included in its cost of service used for setting general rates.

GMO's argument that, because Staff has not uncovered any imprudence in its reviews of GMO fuel procurement practices, Staff's recommendation to change the "sharing" mechanism is "contrary to and undermines Missouri law and public policy" is wrong.[3] Section 386.266.1, RSMo. Supp. 2010, provides:

> Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical

[2] Ex. GMO—33, p. 3.
[3] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company*, pp. 31-32.

> corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

The link the Legislature has forged between incentives and fuel and purchased-power procurement is that the Commission may include "features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities," not that if no imprudence is found the "sharing" mechanism should not be changed. The current 95%/5% "sharing" mechanism is such a feature the Commission designed to provide GMO with an incentive to improve the efficiency and cost-effectiveness of its fuel and purchased power procurement activities. Staff believes changing the current 95%/5% "sharing" mechanism to 75%/25% would better incent GMO to "improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities." While GMO dwells on the potential impact based on its past experience—where Staff believes it was inadequately incented—it ignores the potential benefits from the 25% of off-system sales revenues it would get under Staff's proposal, a benefit Staff believes better incents GMO to "improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities." Staff believes that changing the "sharing" mechanism to 75%/25% will give GMO a strong incentive to move from the current test year negative net off-system sales margins to positive net off-system sales margins in the future and give GMO a strong incentive to reduce its future fuel and purchased power costs.

IATAN 2 ALLOCATION

GMO absurdly argues it "allocated 41 MW of Iatan 2 to the L&P service area, and the remaining 112 MW to the MPS service area, based upon the balancing of the respective baseload capacity needs of L&P and the MPS service areas, as well as the resulting rate impacts upon its

customers," but that the Commission should ignore analysis of the allocation of Iatan 2 "based upon an assumption that St. Joseph Light & Power Company was still existence as a stand alone company."[4] As Staff pointed out in its initial brief, as a matter of fairness, since GMO and St. Joseph Light & Power Company merged in 2000, the premerger ownership of assets has been used as the basis for assigning and allocating costs and revenues for determining rates for GMO's MPS and L&P rate districts.[5] It is absurd for GMO to argue the Commission should ignore the history of how generation assets have been assigned to MPS and L&P for setting rates when it considers the appropriate assignments of Iatan 2 to MPS and L&P when it is the historical assignment of generating assets to MPS and L&P that GMO relies on for ascertaining what it asserts are the baseload capacity needs of MPS and L&P.

While GMO asserts it is "balancing" the respective baseload capacity needs of L&P and MPS when considering the allocation of Iatan 2, when GMO adds Crossroads to its generation mix it assigns Crossroads to MPS, *i.e*., GMO does not "balance" the respective peaking capacity needs of L&P and MPS or the impacts on L&P and MPS customer rates in its proposed addition of Crossroads to its generation portfolio.

As Staff noted in its initial brief, GMO jointly dispatches all of its generating units to serve load in both MPS and L&P.[6] Therefore, there is no operational basis for maintaining different rates in MPS and L&P, only one based on history and fairness to the ratepayers who initially paid higher rates for generating facilities still being used to serve them—primarily Iatan 1—and, therefore, should get the benefit in their rates of the now relatively lower cost of those units to generate electricity.

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[4] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company*, pp. 24 and 27.
[5] Ex. GMO-210, Staff Revenue Requirement Cost of Service Report, pp. 94-95 and Appendix 5, Sch. LMM-3.
[6] *Id*. at p. 95.

<u>CROSSROADS</u>

As a threshold matter, Staff first addresses GMO's legal arguments. GMO's argument section 393.135, RSMo 2000, precludes the Commission from imputing costs to GMO based on two additional 105 MW combustion turbines installed at South Harper in 2005 instead of Crossroads is baseless. Section 393.135, RSMo. 2000, provides:

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

Staff is not arguing the costs of anything being constructed that is not fully operational and used for service be included in GMO's cost of service, Staff is arguing that, instead of costs of the Crossroads generation facility GMO is actually using for capacity and power be included in MPS's cost of service, the Commission base the costs for that capacity and power on two 105 MW combustion turbines installed at South Harper in 2005.

Issues of prudency necessarily turn on assuming circumstances that differ from what they actually are. Despite GMO's argument to the contrary, Staff is not attempting to manage GMO, it is advocating the Commission insulate GMO's retail customers from the rate impacts of GMO's imprudent generation resource planning and execution. This is exactly the type of imputation the Commission did in *State ex rel. Capital City Water Company v. Missouri Public Service Commission*, 850 S.W.2d 903 (Mo. App. 1993). In that case, in setting rates, the Commission imputed the costs of an owned storage tank built in 1977, rather than the costs of a lease contract Capital City Water Company actually executed in 1977 with Public Water Supply District No. 2 of Cole County, Missouri, for storage and backup water supply. On appeal, the Western District Court of Appeals upheld the Commission's *Report and Order*. GMO's

arguments section 393.135, RSMo. 2000, precludes imputing two combustion turbines for purposes of establishing appropriate rates in this case and that imputing them infringes on the management of GMO which the Commission does not have authority to do are meritless.

Staff disagrees with GMO that the Crossroads issues boil down to two decisions by GMO—one to build only three 105 MW combustion turbines in 2005 and rely on purchased power agreements for the 200 MW balance of its capacity needs and the other to, in 2008, add Crossroads to its generation fleet assigned to MPS. The Crossroads issues are, as GMO states, the prudency of its decision to build only three 105 MW combustion turbines in 2005 and rely on purchased power agreements for the 200 MW balance of its capacity needs, but if the Commission finds against Staff on that issue, then the other issues before the Commission are the appropriate costs to include in MPS's cost of service based on including the Crossroads facility as a rate base asset assigned to MPS.

The first issue is perhaps best understood through a timeline of events:

1983

- GMO embarks on a corporate policy not to build regulated generation.[7]

1992

- GMO identifies through resource planning the need for adding a combined cycle ("intermediate" unit) by 2000.[8]

1997

- GMO seeks Commission authority to transfer all of its generating assets to an affiliate to operate as an exempt wholesale generator (EWG), Case No. EM-97-395. The application is withdrawn after Staff opposes it.[9]

[7] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 18.
[8] *Id*. at pp. 18-19 and 28-29.
[9] *Id*. at p. 18.

Mid-1990's to 1998

- GMO does most of the preliminary work for building a natural gas-fired, 585 MW, combined-cycle, intermediate generating facility within GMO's service area, but an unregulated affiliate—Aquila Merchant, with Calpine, build the facility ("Aries") as an exempt wholesale generator.[10]

2000

- A GMO affiliate purchases four combustion turbines ("peaking" units) located at Greenwood that GMO built in 1975 and 1976, then sold to an affiliate and leased back with the option to repurchase them at the end of the lease for the prevailing market value. That prevailing market price was higher than the original cost although the units were then 25 years old. The GMO affiliate then sells power from the Greenwood combustion turbines to GMO through a 15-year purchased power agreement, which was ultimately terminated and ownership of the combustion turbines transferred to GMO. These over 35-year-old units are now in MPS's rate base.[11]

- GMO enters into a five-year purchased power agreement with Aquila Merchant and Calpine to take power from Aries from 2001 to 2005 ("Aries contract").[12]

2001

- Combustion turbine market prices are relatively very high.[13]

- Aquila Merchant purchases eighteen 75 MW combustion turbines ("peaking" units) and three 105 MW combustion turbines ("peaking" units).[14]

- ** [redacted] **

- GMO issues a Request For Proposals (RFP) for capacity for delivery in June of 2005.[16]

2002

- Aquila Merchant sells one of its 75 MW combustion turbines to a utility in Colorado at well below book value.[17]

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[10] *Id*. at pp. 18-19 and 27-29.
[11] *Id*. at pp. 19-20 and 26.
[12] Ex. GMO-210, Staff Revenue Requirement Cost of Service Report, p. 91; Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 19.
[13] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 14.
[14] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 39, 48.
[15] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, p. 13.
[16] Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, Appendix 5, Sch. LMM-1, p. 1.

- Aquila Merchant sells two of its 75 MW combustion turbines to a utility in Nebraska at well below book value.[18]

- Aquila Merchant unsuccessfully attempts to sell at steep discounts three 105 MW combustion turbines ("Aries II") it had intended to install at the Aries combined-cycle unit site.[19]

2003

- Because of changes in the electric industry and at the urging of Staff GMO reissues its 2001 RFP in early 2003.[20]

- Staff files rebuttal in EF-2003-0465 expressing its concerns regarding GMO's need to replace the Aries contract.[21]

2004

- Combustion turbine market prices are depressed.[22]

- On January 27, 2004, GMO tells Staff it plans to build three 105 MW combustion turbines and enter into three- to five-year purchased power agreements to replace the 500 MW of capacity in the summer and 320 MW of capacity in the winter it is getting from Aries under the five-year purchased power agreement that expires in May of 2005, even though GMO's analysis shows that the least cost plan is to build five 105 MW combustion turbines.[23]

- On January 30, 2004, Staff expresses its concern regarding GMO's short-sighted approach to meeting its capacity needs and Staff's belief that GMO needs to be looking at base-load, not peaking, generation.[24]

- In February and in June of 2004, GMO's least cost resource plans include building 515 MW of combustion turbine generation by the summer of 2005 to replace the Aries purchased power agreement that expires in May of 2005.[25]

- Aquila Merchant sells its 50% share of Aries to Calpine for ** [redacted] **[26]

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[17] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 47-48.
[18] *Id*. at pp. 47-48.
[19] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 19.
[20] Ex. GMO-210, Staff Revenue Requirement Cost of Service Report, Appendix 5, Sch. LMM-1, p. 1.
[21] *Id*. at p. 2.
[22] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 43-44; Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 14.
[23] Ex. GMO-210, Staff Revenue Requirement Cost of Service Report, Appendix 5, Schedule LMM-1, p. 2.
[24] *Id*.
[25] *Id*. at pp. 2-3.
[26] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, pp. 19 and 40.

2005

- GMO builds the 315 MW South Harper combustion turbine ("peaking" units) facility using the three "Aries II" 105 MW combustion turbines which are included in MPS's rate base at a significant discount below their book value.[27]

- ** [redacted] **

- GMO enters into a long-term 75 MW baseload, purchased-power agreement with Nebraska Public Power District.[29]

- GMO enters into a short-term purchased-power agreement with Aquila Merchant for power from Crossroads Energy Center to meet its capacity needs for 2005.[30]

2006

- GMO unsuccessfully attempts to buy Aries (an "intermediate" facility).[31]

- Aquila Merchant sells its 450 MW six 75 MW combustion turbine ("peaking" units) Goose Creek Energy Center located in Illinois to AmerenUE at a steep discount below book value.[32]

- Aquila Merchant sells its 300 MW four 75 MW combustion turbine ("peaking" units) Raccoon Creek Energy Center located in Illinois to AmerenUE at a steep discount below book value.[33]

2007

- Combustion turbine market prices are significantly greater the immediately prior years.[34]

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[27] Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, pp. 39-40 and 104; Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, pp. 5-6, 19 and 40-41.
[28] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, p. 13.
[29] Ex. GMO-210, Staff Revenue Requirement Cost of Service Report, Appendix 5, Schedule LMM-1, p. 3.
[30] *Id*.
[31] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 12.
[32] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 47-54; Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 15, 19 and 43.
[33] *Id*.
[34] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 44-46.

- In February of 2007 Great Plains Energy, Inc. publicly announces its agreement to acquire GMO.[35]

- In February of 2007, during a joint webcast call Mr. Terry Bassham, Executive Vice-President and Chief Executive Officer of Great Plains Energy stated it was the intention of Great Plains Energy, Inc., to "monetize" Crossroads, *i.e.*, sell it.[36]

- In May of 2007 Great Plains Energy, Inc. and GMO file a Joint Proxy Statement/Prospectus with the SEC and tell the SEC, financial community, and their shareholders that $51.6 million is an appropriate estimate of the fair value of Crossroads ("peaking" units)—the proceeds of the sale of Crossroads to an unrelated party of similar capacity in the then current marketplace.[37]

- GMO meets its capacity requirement needs for the summer of 2007 through a short-term purchased power agreement for power from Crossroads.[38]

- In June and August of 2007 Great Plains Energy makes filings with the SEC in which it tells the SEC, financial community, and its shareholders that $51.6 million is an appropriate estimate of the fair value of Crossroads.[39]

2008

- Combustion turbine market prices are significantly higher than in 2006.[40]

- GMO meet its capacity requirement needs for the summer of 2008 through a short-term purchased power agreement for power from Crossroads.[41]

- Great Plains Energy acquires GMO on July 14, 2008.[42]

- In August of 2008 GMO transfers to MPS at book value the 300 MW Crossroad four 75 MW combustion turbine ("peaking" units) facility located near Clarksdale, Mississippi.[43]

- In September of 2008 GMO files a general rate increase case that is designated Case No. ER-2009-0090 where it includes in its case Crossroads as a "peaking"

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[35] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, p. 5.
[36] *Id*. at pp. 13-14.
[37] *Id*. at p. 5.
[38] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 13; Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, Appendix 5, Schedule LMM-1, p. 3.
[39] *Id*.
[40] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 44-46.
[41] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 13.
[42] Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, p. 3.
[43] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, p. 5.

facility assigned to MPS for ratemaking purposes at a net book value of $117 million.[44] That case settles.

2010

- On June 4, 2010, GMO files this rate case, File No. ER-2010-0356, where it includes in its case Crossroads as a "peaking" facility assigned to MPS for ratemaking purposes at a net book value of $119 million, less accumulated depreciation.[45]

GMO argues it was prudent and appropriate for it to build 315 MW of combustion turbine peaking generation in 2005 and rely on purchased power agreement for the remaining 200 MW because it could obtain *baseload capacity* for part of that 200 MW. It did obtain 75 MW of baseload capacity through a purchased power agreement that expires in 2014.[46] However, now it is arguing the Commission find GMO's retail customers in MPS should pay costs based on GMO to adding 300 MW of *peaking capacity* it owns located in Mississippi in 2008 to replace that 200 MW of capacity it was obtaining, largely from Crossroads, through purchased power agreements starting in 2005.

The obvious questions GMO's argument raises are "If combustion turbine *peaking capacity* was inappropriate for the 200 MW in 2005 because MPS needed *baseload capacity*, why is adding 300 MW of *peaking capacity* in 2008 appropriate?," and "Why should retail customers pay more in rates for the same combustion turbines that were originally purchased during a "sellers' market" in 2001and installed in 2002 just because GMO transferred them to MPS on its books in 2008 instead of in 2005, when the market value of Crossroads was lower, but when GMO needed the capacity for MPS?" GMO does not have good answers to these questions, because, as Staff has explained in its initial brief on GMO specific issues, (1) GMO's

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[44] *Id.*
[45] *Id.* at pp. 5-6.
[46] Ex. GMO—11, Rebutal Testimony of Burton L. Crawford, pp. 6-7; Ex. GMO—33, Rebuttal Testimony of Tim M. Rush, p. 11, Tim M. Rush, Tr. Vol. 36, p. 3880; Mantle Tr. Vo. 36, pp. 3867-68.

reliance on purchased power agreements for the 200 MW in 2005 was imprudent and (2) the four 75 MW combustion turbines at Crossroads are not worth their booked value.

GMO's argument that begins on pages four and five of its GMO specific issues initial brief based on both Staff and the Commission recognizing GMO's need for base load generation is a red herring.[47] Both Crossroads and the two combustion turbine units that Staff has imputed are natural gas-fired, peaking units and no party is arguing adding 200 to 300 MW of peaking capacity is imprudent. As stated above, the dispute is over when it was prudent to add the peaking capacity and how much the peaking capacity should cost MPS retail customers.

The table following shows, on a cost per kW basis, the sale prices of combustion turbines, primarily that Aquila Merchant bought and sold, in comparison to what GMO seeks for similar combustion turbines here and what Staff recommends:

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[47] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company*, pp. 4-5.

Year	Transaction	$/kW
2001	Aquila Merchant purchase of 75MW CTs	** **[48]
2002	Aquila Merchant sale of 75 MW CTs to Nebraska utility	** **[49]
2002	Aquila Merchant sale of two 75 MW CTs to Colorado utility – turbine only	** **[50]
2002	Aquila Merchant offers to sell four 75 MW CTs to KCPL – turbines only	** **[51]
2005	South Harper in-service, installed production costs	383 (Installed)[52]
2006	Aquila Merchant sale of ten 75 MW CTs to AmerenUE in Illinois (Goose Creek & Raccoon Creek)	205.88 (Installed)[53]
2007	PSEG sale to AEP of 1,096 MW combined cycle plant in Indiana	296.53 (Installed)[54]
2007	Mirant sale to LS Power of six gas-fired plants located throughout the U.S.	388.78 (Installed)[55]
2007	Great Plains Energy and GMO SEC disclosure of $56.1 million valuation of Crossroads (production and transmission)	187 (Installed)[56]
2010	GMO's position on Crossroads (production plant and transmission)	469.61 book, 357.05 net book (depreciated) (Installed)[57]
2011	Staff's positions on Crossroads (production plant and transmission)	187[58] or, alternatively, 205.88 (Installed)

The primary driver behind GMO's decisions not to build five 105 MW combustion turbines at South Harper in 2005 and to transfer Crossroads to MPS on its books in 2008 are cash and credit constraints—GMO's lack of cash and its lack of access to reasonably priced credit. Purchased power agreements do not require as much upfront cash as building a generation

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[48] Ex. GMO—215, Direct Testimony of Cary G. Featherstone, p. 47.
[49] *Id*.
[50] *Id*.
[51] Ex. GMO – 215-A, Direct Testimony of Cary G. Featherstone, Sch. 4-49.
[52] Ex. GMO – 215, Direct Testimony of Cary G. Featherstone, p. 53.
[53] *Id*. at pp. 50-51.
[54] *Id*. at p. 53
[55] *Id*. at p. 54.
[56] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, p. 5.
[57] *Id*. at pp. 5-7.
[58] *Id*. at p. 7.

facility, and are less expensive in the short-run, but more costly in the long-run. Before, during, and after 2005 GMO was severely cash strapped as a result of nonregulated activities, and nearly followed Calpine into bankruptcy. If GMO and its affiliates had not already paid for and had in their possession the three 105 MW combustion turbines GMO installed at South Harper, it is unlikely GMO would have purchased similar combustion turbines in 2004 for installation by the summer of 2005. Likewise, if GMO and its affiliates did not already own Crossroads, because GMO is still financially strapped, and with the construction of the Iatan 1 AQCS and Iatan 2, Great Plains Energy is fiscally constrained, it is unlikely GMO would have purchased on the open market the 300 MW peaking generation facility located near Clarksdale, Mississippi, some 400-500 miles from GMO's load center near Kansas City, Missouri to serve its retail customers in Missouri.

GMO's retail customers should not be required to pay for GMO's actions that were driven by its cash and credit constraints caused by its nonregulated activities. Instead, the costs retail customers should be required to bear should be based on the actions of a financially sound GMO. As Staff has demonstrated, a financially sound GMO would have built two more 105 MW combustion turbines at South Harper in 2005. And like AmerenUE, which only acquired existing generating facilities located in Illinois to serve its Missouri retail customers when it could acquire them at steep discounts, a financially sound GMO would only have acquired Crossroads if it could have done so at a steep discount from its cost less accumulated depreciation. As Staff has pointed out, Crossroads is located near Clarkdale, Mississippi, precisely because that is a transmission constrained location which causes reliability issues that do not exist with a generation facility sited near the retail customer load GMO serves, reliability

issues that include a special protection scheme in SPP that requires shutting down one of the combustion turbines if a particular transmission line is unavailable.

Staff agrees with GMO's statement on page 9 of its brief, that the purpose as stated in the purpose statement accompanying Rule 4 CSR 240–20.015 in the Code of State Regulations is, *"This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations."* Despite GMO's arguments, it has complied with the requirement of Rule 4 CSR 240–20.015 that such transfers to be reflected on the books of regulated entity at the lower of cost or fair market value, if Crossroads is included in MPS's cost of service at book value, then, GMO's non-regulated affiliates will have been subsidized by not having to recognize the reduction in the fair market value of Crossroads before it was transferred to the books of MPS.

GMO relies on two studies for its argument on pages 10 through 15 of its brief that Crossroads was its lowest cost option—one conducted in 2007 and the other conducted in 2010. Both studies are based on acquiring the capacity in 2008, not 2004 to early 2005 when GMO needed the capacity; therefore, both are flawed. It is no surprise Crossroads is the favorable outcome in these studies. It is expected that the acquisition cost of a 10-year-old generating facility would compare favorably to new facility. Both the 2007 and 2010 studies are based on a bad premise—the appropriate date for additional capacity. Crossroads is the wrong plant at the wrong place for serving GMO's native load, and built at the wrong time—the height of the "sellers'" combustion turbine market. It was built as a merchant plant, in a transmission constrained location in Mississippi, in 2002—at the height of the "sellers'" combustion turbine market.[59]

[59] Ex. GMO—217, Surrebuttal Testimony of Cary G. Featherstone, p. 7; Ex. GMO—215, Direct Testimony of Cary G. Featherstone, pp. 44-45.

Staff is offended by GMO's characterizations of Staff's adjustments on this issue as being "inconsistent" and "punitive" that it makes on page four of its brief. Staff has consistently imputed two 105MW combustion turbines to GMO for MPS in GMO's electric rate cases since GMO needed that capacity beginning in the summer of 2005, even when GMO's purchased power agreements were less costly from a cost of service perspective, *i.e.*, all other factors being the same, the purchased power agreements would result in lower rates.[60]

Therefore, Staff continues to recommend the Commission include, in lieu of Crossroads, two 105 MW combustion turbines in 2005 that result in an impact on MPS's costs of service as of December 31, 2010, of $62.2 million—$37.4 million as of May 31, 2005, less accumulated depreciation, for the combustion turbines themselves. And, alternatively, if the Commission does not agree with Staff's primary recommendation and includes Crossroads in MPS's rate base, Staff recommends the Commission value Crossroads at the $51.6 million both Great Plains Energy and GMO valued it in SEC filings made in connection with Great Plains Energy's acquisition of GMO in 2008 less depreciation accumulated since then.

GMO argues, starting on page 15 of its brief, that the $51.6 million valuation it disclosed in its SEC filings is "a conservative, 'worst case scenario' estimate of dismantling and selling the plant." At the time, Crossroads had a total book value of about $117 million (production and transmission plant), and Aquila Merchant already had unsuccessfully attempted to sell Crossroads in ** [redacted] **[61]

Following in full is the disclosure of the Crossroads valuation made in the May 8, 2007, SEC filing:

> D - The *pro forma* adjustment represents the adjustment of the estimated fair value of certain Adjusted Aquila non-regulated tangible assets and reduction

[60] Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, pp. 108-09.
[61] Ex. GMO—216, Rebuttal Testimony of Cary G. Featherstone, pp. 6 and 13.

> of depreciation expense associated with the decreased fair value. The adjustment was determined based on Great Plains Energy's estimates of fair value based on estimates of proceeds from sale of units to an unrelated party of similar capacity in the current market place. The preliminary internal analysis indicated a fair value estimate of Aquila's non-regulated Crossroads power generating facility of approximately $51.6 million. This analysis is significantly affected by assumptions regarding the current market for sales of units of similar capacity. The $66.3 million adjustment reflects the difference between the fair value of the combustion turbines at $51.6 million and the $117.9 million book value of the facility at March 31, 2007.
>
> **Great Plains Energy management believes this to be an appropriate estimate of the fair value of the facility.** (Emphasis added.) The adjusted value will be depreciated over the estimated remaining useful lives of the underlying assets and could be materially affected by changes in fair value prior to the closing of the merger. An additional change in the fair value of the facility of $15 million would result in an additional change to annual depreciation expense of approximately $0.5 million.[62]

GMO's self-serving testimony is not supported by its public statements disclosed to the SEC. Staff notes that, in addition to the value of the two 105 MW combustion turbines it imputes to GMO, Staff has included the operating costs of the two 105 MW combustion turbines in its case—including fuel costs, maintenance costs, insurance costs, pilot and depreciation.

As a secondary alternative, Staff recommends the Commission value the combustion turbines at Crossroads at $61.8 million based on the installed cost per kW AmerenUE paid for the similar Goose Creek Energy Center and Raccoon Creek Energy Center facilities in Illinois in 2006, disallow the over $4.8 million annual transmission costs associated with Crossroads from MPS's cost of service, and offset against MPS's rate base all the accumulated deferred income taxes associated with Crossroads.

JEFFREY FGD REBUILD PROJECT

Westar and GMO let a contract without performing a thorough due diligence search on PMSI. This imprudence resulted in substantial increase to the contract cost to the detriment of

[62] *Id*. at p. 12.

GMO's retail customers, if reflected in their rates. They should not have to bear the cost of imprudent contracting on behalf of the owner of Jeffrey Energy Center.

GMO makes the irrelevant argument that because Staff Engineers found no engineering concerns there should be no concerns with the Jeffrey FDG rebuild project. The nature of Staff's adjustment was not of engineering; rather Westar's contracting methodology and management of the PMSI contract. Neither of the Staff Engineers mentioned in GMO's initial brief stood cross-examination on these issues. Staff's examination of the in-service criteria of the Jeffrey scrubbers by Staff engineers is irrelevant to Staff's proposed adjustments.

GMO also makes the irrelevant argument that since the Kansas Corporation Commission (KCC) made no disallowances on the Jeffrey FDG rebuild project, this Commission should follow suit. Nowhere in the record has GMO established that the KCC evaluated the prudence and reasonableness of the cost of the Jeffrey FGD rebuild project before including it in rates in Kansas. GMO's arguments should be dismissed as they are wholly irrelevant to Staff's proposed adjustment.

GMO's witness, Leonard Ruzicka, testified that "when the spread between the low and the second low bidder is substantial, it would be appropriate and reasonable to consider waiving a bonding requirement, but only after conducting the same type of due diligence that is conducted by sureties."[63] In conducting a due diligence investigation, Mr. Ruzicka admitted that the criminal activity of a Chief Executive Officer (CEO) or of an employee of the corporation would raise concerns.[64] However, Mr. Ruzicka, the individual retained by KCPL to determine the appropriateness of the award of the contract to PMSI, failed to have any knowledge of

[63] Ex. GMO—36, Rebuttal Testimony of Leonard Ruzicka, p. 3; Tr. Vol. 40, p. 4272, ll. 20-25.
[64] Tr. Vol. 40 p. 4430, l. 1 to p. 4331, l. 5.

PMSI's CEO's criminal activity.[65] PMSI's CEO, Richard G. Engel was prosecuted by the United States of America for failing to pay taxes in the amount of $3,856,190.19.[66]

Further, Westar failed to conduct proper due diligence when evaluating PMSI as a potential contractor. Westar engaged Jefferson Wells to conduct a financial stability memorandum *after* Westar and PMSI had entered into a contract addendum; a year and a half after the contract was executed with PMSI[67]. ** [redacted]

[redacted] **[68] Coincidently, the CEO of PMSI prosecuted for failure to pay taxes, and PMSI, itself owed a substantial sum of money to the IRS. This readily available information was not discovered by Company witness Mr. Ruzicka, thus providing evidence to the inadequacy of his due diligence review.

Staff agrees GMO is only an 8% owner in the Jeffrey Plant, but its small ownership percentage does not alleviate GMO from its obligation to ensure that the Jeffrey FGD rebuild project was constructed in a prudent and reasonable manner. Regardless that GMO was only an eight percent owner of the Jeffrey Plant, it still had an obligation to ensure the project was constructed in a prudent manner.[69] The Empire District Electric Company (Empire) has proven just the opposite mentality with the Iatan Construction Project. Empire is a 12% (twelve percent) owner of Iatan 2, but yet has been actively involved in the construction project. Empire's involvement was further demonstrated in its vigorous attempt to secure its share of the Iatan 2 Advanced Tax Coal Investment Credit. GMO is a Missouri regulated electric utility subject to

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[65] *See* Tr. Vol. 40, pp. 4433 and 4336; Ex. GMO—265, Official Notice of United States District Court, Central District of California, Western Division, Case No. CV 05-5422, *United States of America v. Richard G. Engel.*
[66] Ex. GMO—265(c), Official Notice of United States District Court, Central District of California, Western Division, Case No. CV 05-5422, *United States of America v. Richard G. Engel.*
[67] Ex. GMO—230, Surrebuttal Testimony of Keith Majors, p. 37, ll. 8-9.
[68] *Id.*, ll 1-6.
[69] Tr. Vol. 40, p. 4267, ll. 5-7.

Commission regulation regardless of its ownership share in a particular plant. Thus, GMO had an obligation to act prudently with the Jeffrey FGD Rebuild Project, which it did not.

GMO argues in its initial brief that its witness Terry Hedrick explained why Westar and GMO did not require PMSI to obtain a performance bond. However, when Mr. Hedrick was cross-examined on the reasons why a contractor could not obtain a performance bond, he deferred the subject matter to GMO witness Leonard Ruzicka, specifically stating "[T]hat's not my area of expertise."[70] GMO's attempt to use Mr. Hedrick's explanation of why ** [redacted] ** is fruitless.

Westar and GMO failed to act reasonably by not requiring PMSI to obtain a performance bond, and this failure exposed Missouri ratepayers to the possibility of paying for, in rates, an inappropriate, unreasonable and unnecessary level of financial risk.[71] However, Westar imprudently contracted with a vendor whose financial instability and poor performance report resulted in additional costs to the project. This imprudence did not benefit the ratepayers, and thus should remove $4.5 million from GMO's cost-of-service related to the imprudent, harmful and inappropriate cost of the Jeffrey FGD Project.

OFF-SYSTEM SALES MARGINS

Off-system sales ("OSS") are a thing of the past since Aquila renamed itself GMO. First, a different management team is now making the decisions. Second, GMO now has a Fuel Adjustment Clause ("FAC") that includes OSS.[72] GMO now has little incentive to make OSS and, not surprisingly, they aren't happening.[73] Here, at least, is one "synergy saving" that GMO's captive ratepayers have been denied.

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[70] Tr. Vol. 40, pp. 4251-52.
[71] Ex. GMO—210, Staff Revenue Requirement Cost of Service Report, p. 46, ll. 6-8.,
[72] Ex. GMO—220, Rebuttal Testimony of V. William Harris, pp. 3-4.
[73] Tr. Vol. 38, p. 4226.

GMO urges the Commission to discount Staff's position as based on "stale and irrelevant historical data from 2007-08, which ignores recent economic facts and trends pertaining to the test year, as well as off-system sales policy set forth by the Federal Energy Regulatory Commission regarding wholesale electricity sales."[74] But GMO's use of the MIDAS system is itself a violation of the test year concept, as Staff witness Erin Maloney testified.[75] GMO says, "Without any particular reason, apart from what Mr. Harris judged to be a puzzling decline in sales, he arbitrarily chose to take data from 2007-08 to set rates."[76] In truth, Mr. Harris made the reason underlying his methodology choice perfectly clear. Because GMO's OSS margins in 2009 and 2010 were negative, Staff used data from 2007 and 2008, when the OSS margins were positive. You can't annualize negative numbers.[77]

As Staff witness V. William Harris testified, the level of OSS dropped immediately following the closing of Great Plains Energy's acquisition of Aquila in July of 2008.[78] That reflects a management decision and nothing else, as GMO admits.[79] GMO's OSS margins were negative in 2009 and 2010,[80] although GMO had positive OSS margins every year from 2002 to 2008.[81] In 2006, the OSS margin was positive to the tune of ** [redacted] **.[82] As Staff witness Harris put it,[83]

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[74] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company,* p. 34.
[75] Ex. GMO—231, Rebuttal Testimony of Erin L. Maloney, *passim.* It is also contrary to the methods used by Aquila before the acquisition. Ex. GMO—220, Rebuttal Testimony of V. William Harris, p. 2.
[76] GMO's *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company,* pp. 34-35.
[77] Ex. GMO—221, Surrebuttal Testimony of V. Williams Harris, p. 2.
[78] Ex. GMO—221, Surrebuttal Testimony of V. William Harris, p. 3; Ex. GMO—220, Rebuttal Testimony of V. William Harris, p. 3.
[79] *See GMO*'s *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company,* p. 37, citing testimony of Burton Crawford at Tr. Vol. 38, pp. 4221-22; Ex. GMO—221, Surrebuttal Testimony of V. William Harris, pp. 2-3.
[80] Tr. Vol. 38, pp. 4219 and 4230; Ex. GMO—220, Rebuttal Testimony of V. William Harris, p. 4.
[81] Tr. Vol. 38, pp. 4228-29.
[82] Ex. GMO—220, Rebuttal Testimony of V. William Harris, p. 3.
[83] Tr. Vol. 38, pp. 4231-32.

> Q. Mr. Harris, in your 16 years of practice as a regulatory auditor, have you ever encountered negative margins?
>
> A. No, I've never, and I might add to that 16 years I spent about four-and-a-half years with FERC myself.
>
> Q. And did you encounter negative margins in your audit of GMO?
>
> A. Based on the general ledger, yes. The negative—margins have been negative basically since the—well, the latter part of 2008, like about two months after the acquisition, and they are continuous.
>
> As I started to say to Mr. Zobrist's question, they continue to grow larger and larger negatively, and I can't imagine why—I can't understand what the Company's motivation in continuing the sales at a larger loss can—would be rather than just stopping the sales and refusing to, you know, slit—you know, slit their own throat, if you will.

As Mr. Harris' testimony indicates, not only are GMO's OSS margins now negative, but the sales **are made at a loss.**[84] Mr. Harris testified, "I've never experienced that before. In some ways I have to wonder about the validity of the ledgers because, again, I don't know—I can't understand what the motivation would be in continuing to make sales at continuingly [sic] larger losses."[85] The Commission too should wonder what motivates GMO.

Under previous management, the utility now known as GMO had healthy, positive OSS margins, which served to reduce the revenue requirement that the ratepayers must provide. Now, oddly, the margins are actually negative—GMO makes these sales today **AT A LOSS**! Thus is the world turned upside-down— GMO's captive ratepayers are now paying **MORE** because of GMO's OSS activities, not less. What answer to this startling revelation of corporate mismanagement does GMO make in its brief? Only this: "Mr. Harris's questions about GMO's

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[84] Tr. Vol.38, p. 4235.
[85] *Id.*

recent off-system sales revenue and margins, given his lack of research and analysis, is mere speculation and not credible evidence."[86]

For the same reasons KCPL should expect its levels of off-system sales to increase over its recent historical experience due to the addition of the inexpensive to run base load capacity of Iatan 2, GMO should also experience increased levels of off-systems sales due to its 153 MW share of Iatan 2. Since GMO joint dispatches generation assigned to MPS and L&P for ratemaking purposes, there is no reason to believe both MPS and L&P will not have increased off-system sales levels, to the benefit of both GMO and all of its retail customers.

The evidence that GMO's OSS margins dropped precipitously when Great Plains Energy acquired Aquila is unrefuted. No one disputes that the decline occurred. The only dispute is why it occurred. Company witnesses Blanc and Crawford blame a drop in energy prices. They do not, however, explain why GMO has made OSS at a net loss. Staff suggests that there is no rational explanation. For this reason, the Commission should reject GMO's position in favor of Staff's.

CONCLUSION

WHEREFORE, for the reasons set forth in Staff's initial brief and above, the Staff requests the Commission to adopt the Staff's position on each and every KCP&L Greater Missouri Operations Company specific issue in this case.

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[86] *GMO*'s *Initial Post-Hearing Brief of Issues Related Only to KCP&L Greater Missouri Operations Company,* p. 37.

Respectfully submitted,

/s/ Nathan Williams____

Nathan Williams
Deputy Counsel
Missouri Bar No. 35512

Attorney for the Staff of the
Public Service Commission of Missouri
P.O. Box 360
Jefferson City, MO 65102
(573)751-8702 (Telephone)
(573)751-9285 (Facsimile)
nathan.williams@psc.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 4th day of April, 2011.

/s/ Nathan Williams____