PUBLIC VERSION

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE 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.	))))	Case No. ER-2010-0356

Reply Brief of KCP&L Greater Missouri Operations Company

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1. Capacity Planning

a. Introduction

The issue concerning GMO's capacity planning focuses on two decisions made by the Company:

(1) The 2004 decision to pursue the construction of three 105 MW combustion turbines (CTs) at South Harper and pursue a 200 MW system-participation based purchased power agreement (PPA); and

(2) The 2008 decision to add the Crossroads generating facility to the MPS generation fleet.

The history of these decisions is set out in detail on pages 1-2 of the Company's Initial Post-Hearing brief and won't be repeated here.[1] The Company has demonstrated that both of these decisions, which result in a low-cost, diversified fuel mix, were reasonable and prudent. Staff, Dogwood and the Industrials have failed to demonstrate that the Company's actions were unreasonable or imprudent. Therefore, the Commission should allow GMO to recover the costs of its used and useful, in-service generating resources in rates.

[1] Likewise, the Company will not repeat all of the arguments contained in its Initial Post-Hearing Brief; but rather will confine its reply to the more egregious errors contained in the other parties' initial briefs. Lack of response should not be construed as acquiescence.

b. Response to Staff

i. The Company's 2004 Resource Plan Was Reasonable and Prudent

In its Initial Brief, Staff states that it expressed concern with GMO's 2004 capacity plan to build three 105 MW CTs and enter into a system-participation based PPA, and that "GMO needed to be evaluating adding baseload generation because GMO should not become overly dependent on short-term purchased power agreements." Staff's Initial Brief at 32. That's exactly what GMO's preferred plan did. The Company evaluated its need for additional generation and opted for a plan which included a long-term PPA, in addition to building peaking units, rather than pursue a plan which wholly relied on natural gas-fired peaking CTs. The plan resulted in a 9-year base load contract that Staff considers "very favorable." Hearing Exhibit GMO-11, Crawford Rebuttal at 6, citing Featherstone Surrebuttal, Case No. ER-2007-0004, at 89. Nonetheless, Staff contends that GMO should have pursued construction of five CTs in 2005 instead of the plan GMO pursued and has imputed to the Company the cost of two non-existent, "phantom" CTs. Staff can't have it both ways. It's unreasonable to advise the Company that it needs additional base load generation, and then punish the Company for following its advice. The Company has demonstrated that its preferred plan reduced the risks associated with natural gas prices at a reasonable cost. Id. at 5.

Staff further states that "[t]his decision not to build two more 105 MW combustion turbines was, for a regulated utility, imprudent." Staff's Initial Brief at 33. That's the essence of this debate: whether the Company's 2004 resource decision was prudent. Staff provides pages of history and information on completely unrelated transactions, however its proof of imprudence rests solely on an analysis performed by the Company in 2004.[2] This is the same

[2] Pursuant to the Company's analysis, under base natural gas price assumptions, the five CT option had the lowest net present value of revenue requirements (NPVRR). The Company's

analysis wherein Staff testified at the evidentiary hearing that the cost difference between Staff's proposed five CT plan and the Company's three CT/system-participation PPA plan was not significant enough to be imprudent. See Hearing Tr. at 4090-91; see also Hearing Exhibit GMO-217, Featherstone Surrebuttal, Schedule 119. Based on the analysis performed by the Company at the time it made its resource planning decision in 2004, it was reasonable to accept the insignificant difference in plan costs in exchange for lower gas cost exposure and the addition of base load capacity resources.

ii. The Company Should Be Allowed to Recover the Costs Associated with Crossroads

Staff states that it "disputes GMO's claim that Crossroads is the least cost solution to GMO's capacity needs." Staff's Initial Brief at 34. Therefore, Staff removed Crossroads from the Company's cost of service. Staff provides no support to dispute the analysis completed by the Company that demonstrates that Crossroads was indeed the lowest cost option. In 2007, the Company completed a thorough analysis based on RFP responses and self-build options and determined that Crossroads minimized the net present value of revenue requirements (NPVRR). Hearing Exhibit GMO-11, Crawford Rebuttal at 12-14. Not only does Staff fail to provide support for its dispute, Staff states that "there is nothing wrong with the 2007 RFP process that GMO conducted to determine its future planning needs." Hearing Exhibit GMO-217, Featherstone Surrebuttal at 8-9.

Alternatively, Staff argues that if the Commission decides to allow recovery of Crossroads, the value for ratemaking purposes should be $51.6 million. Hearing Exhibit GMO-216, Featherstone Rebuttal at 3; see also Exhibit GMO-25, Ives Surrebuttal at 12-13. Staff

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chosen plan was the second lowest cost plan and had the benefit of base load generation. See Hearing Exhibit GMO-11, Crawford Rebuttal at 2-5.

attempts to support its position by arguing that "[t]he market value of Crossroads is less than its booked value." Staff's Initial Brief at 36. Staff has looked at the value of Crossroads from the wrong perspective. Staff looked at the value based on previous attempts to sell the facility and not as a viable, operating facility used to serve the capacity needs of GMO customers. See Hearing Exhibit GMO-12, Crawford Surrebuttal at 3; Hearing Exhibit GMO-25, Ives Surrebuttal at 12-15, Hearing Exhibit GMO-47 at p. 2; and Hearing Tr. at 4103. Staff points to the affiliate transaction rules that when transferring assets between regulated and non-regulated affiliates, that the transfer occur at the lower of cost or market. Staff's Initial Brief at 36. The analysis completed by the Company demonstrated that the cost of Crossroads was less than both the cost for GMO to provide this service to itself and the cost of that service from the marketplace. See Hearing Exhibit GMO-12, Crawford Surrebuttal at 1-3; see also Hearing Exhibit GMO-25, Ives Surrebuttal at 12-14. Attempts to sell the facility to unrelated parties has no bearing on the value of the facility to GMO customers. Obtaining firm transmission service for this facility allowed access to what was demonstrated as the lowest cost resource option for GMO. Hearing Exhibit GMO-12, Crawford Surrebuttal at 3.

Staff next argues that "GPE did not pay book value for Crossroads." Staff's Initial Brief at 37. This statement is entirely unsubstantiated and false. The Company has presented evidence regarding the value of the facility. The Company engaged a third party, PricewaterhouseCoopers LLP (PWC), to complete a valuation engagement as of the acquisition date of July 14, 2008. The sole purpose of the PWC valuation was to determine fair value for financial statement reporting in accordance with Statement of Financial Accounting Standards (SFAS) 141. PWC concluded that the estimated fair value of Crossroads was $121 million at the acquisition date. See Hearing Exhibit GMO-25, Ives Surrebuttal at 21-22. The Company's 2007 analysis also demonstrated the significant value this facility has for GMO customers. See

Hearing Exhibit GMO-11, Crawford Rebuttal at 1-2, 12-14. Notwithstanding the PWC valuation, the Company has included the cost of Crossroads at the net book value of $104 million in its cost of service. Hearing Exhibit GMO-12, Crawford Surrebuttal at 3.

If the Commission disagrees with using the $51.6 million value, Staff wants the Commission to use the sale of Goose Creek and Raccoon Creek as the basis for value. Staff's Initial Brief at 37. These transactions have no connection to the value of Crossroads to GMO customers or connection to what GPE paid for the facility. In addition, Staff's alternative valuation proposals ignore the operation and maintenance costs as well as the transmission costs that will be incurred by GMO. For this reason alone, staff's position does not reflect reality. Moreover, corporate acquisitions are not priced on an asset by asset basis. There are many considerations that go into the determination of an appropriate price. This is why companies use third party valuation firms to provide valuations for fair value of acquired assets. GMO did this, and the PWC valuation for Crossroads was in excess of net book value. The Company used net book value (lower than fair value) because of its request for rate base treatment. Regulated assets are recorded at net book value in an acquisition based on industry practice.

Staff states that "[h]istorically the prices paid for natural gas delivered to Crossroads (Clarksdale, Mississippi) have been ***higher*** than the prices of natural gas delivered to South Harper." Staff's Initial Brief at 39 (emphasis added). Then Staff states that "[t]he ***lower*** natural gas prices at Crossroads are offset by much higher electric transmission costs … ." Id. (emphasis added). It appears that Staff now acknowledges that the price of natural gas delivered to Crossroads is, in fact, lower than the price of natural gas delivered to South Harper. GMO customers benefit from the lower gas prices delivered to Crossroads and from the flexibility that this geographically diverse asset provides to the Company.

Staff next takes issue with the transmission costs paid by GMO to move energy from Crossroads to GMO's service territory. Id. Staff's argument ignores the fact that transmission costs were factored into the analysis when considering capacity options in 2007. When all costs are considered, Crossroads is the lowest **total** cost option. Hearing Exhibit GMO-11, Crawford Rebuttal at 10. Singling out one cost component, like transmission costs, that is higher than what it may be with other resource alternatives is not a valid basis for disallowing the entire facility, particularly when the all-in costs of the facility result in minimizing the NPVRR over 20 years when compared to the available alternatives.

Crossroads is subject to a special protection scheme to ramp down the output of one of its four CTs if one of the two transmission lines used to move energy from Crossroads to MPS becomes unavailable. Staff states that "[t]his risk of capacity loss is one of the transmission-related risks of Crossroads" and "MPS retail customers should bear neither the costs nor risks associated with the transmission limitations in getting electricity from Crossroads to MPS." Staff's Initial Brief at 40-41. There are two transmission lines coming out of the plant. If one particular line is down at the same time that all four CTs are running, one CT would need to be curtailed. It would be extremely rare for these two events to occur simultaneously. Regardless, a special protection scheme does not negate the fact that the Company has firm transmission service for the entire plant. Hearing Tr. at 4050-51. This issue is not isolated to GMO. All generating plants are subject to curtailment for transmission failures.

Staff expresses concern that "[t]he ability of GMO to properly provide managerial oversight to the plant is greatly hampered by the long distance location of the plant facilities." Staff's Initial Brief at 41. It is not uncommon in the industry to have plants run by someone other than the owner. For example, KCP&L runs plants for Westar, Empire, GMO and MJMEUC. Further, other utilities run Wolf Creek and Jeffrey Energy Center, of which KCP&L

and GMO, respectively, are minority owners. This has not proven to be a problem. Staff has failed to demonstrate that this is a valid basis for denying inclusion of a plant in rates.

c. Response to Dogwood

i. The Cost of Delivered Natural Gas is Less to Crossroads than Dogwood

Dogwood argues "that natural gas prices for supply to GMO's load area, where Dogwood is located, have been significantly lower than for supply to Crossroads." Dogwood's Initial Brief at fn. 7, citing Hearing Exhibit GMO-3601, Janssen Rebuttal at 11. This statement is not accurate. As demonstrated by the Company, in the first 10 months of 2010, for example, the average commodity cost for natural gas shipped to Crossroads was less than gas shipped on Panhandle Eastern Pipeline to South Harper. Moreover, the average delivered cost of natural gas to Crossroads was about half the average delivered cost of natural gas to South Harper. Hearing Exhibit GMO-8, Blunk Rebuttal at 2. Staff also acknowledged that delivered prices to South Harper were higher than to Crossroads in 2009 and 2010. Staff's Initial Brief at 39-40.

Dogwood states that "GMO submitted rebuttal testimony attempting to defend its decision to rely on Crossroads, purporting to demonstrate that Crossroads has a cheaper source of natural gas but actually masking differences in variable commodity costs with sunk transportation costs. (Blunk Rebuttal)." Dogwood's Initial Brief at fn. 7. In its testimony, however, the Company clearly demonstrates that it does not mask the differences in variable commodity costs with transportation costs, as suggested by Dogwood. Specifically, GMO's witness Wm. Edward Blunk stated that the "average commodity cost for natural gas shipped to Crossroads was ** [redacted] **. The average cost of natural gas purchased on Panhandle Eastern Pipeline Co. (PEPL) for South Harper was ** [redacted] **." Hearing Exhibit GMO-8, Blunk Rebuttal at 2.

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Dogwood believes that the surrebuttal testimony of its witness Robert Janssen contradicts GMO's testimony by "showing in detail" that Dogwood has a cheaper and more reliable natural gas supply. Dogwood's Initial Brief at fn. 7. Mr. Janssen's beliefs regarding natural gas pricing do not constitute a "showing in detail." On page 2 of his Surrebuttal Testimony, Mr. Janssen states: "I support the Staff's conclusion that the price of natural gas delivered to Crossroads would be higher than the price of natural gas delivered to the area in which South Harper and Dogwood are located." Hearing Exhibit GMO-3602. Neither does supporting Staff's conclusion constitute a "showing in detail." Moreover, Staff changed its position in its Initial Brief at pages 39-40, acknowledging that delivered prices to South Harper were higher than to Crossroads in 2009 and 2010. In short, Dogwood has provided no proof to substantiate its claim that natural gas to Dogwood is cheaper than to Crossroads. Further, Dogwood's reliance on Staff's position is contrary to its claims.

Dogwood testified "that GMO's witness failed to take into account the greater cost of transmission to get electricity from Mississippi to western Missouri, which would over shadow any temporary advantage in natural gas prices that might occur. GMO witness Crawford testified that that [sic] transmission costs that GMO included in its studies were $406,000 per month. (Tr. 4050). GMO witness Blunk conceded that he did not take such costs into account concluding that Crossroads would be a superior choice in terms of natural gas supply. (Tr. 4067)." Dogwood's Initial Brief at fn. 7. Dogwood misrepresents the Company's testimony. Mr. Crawford is the Company's witness regarding the total costs for evaluating the Crossroads decision, which includes transmission costs. Mr. Blunk is not the Company's witness regarding transmission costs or the total costs for evaluating the Crossroads decision. Rather, Mr. Blunk's testimony showed natural gas market benefits of Crossroads being a part of GMO's fleet. Mr.

Crawford's testimony showed the prudence and financial benefits of Crossroads over all other alternatives.

Dogwood states that "Mr. Janssen shows that comparatively high gas prices and long-distance and less reliable transmission remain reasons not to include Crossroads in rate base notwithstanding Mr. Blunk's testimony. (Janssen Surrebuttal, p. 1-10)." Id. Not only is Dogwood unable to prove that delivered prices to Crossroads are higher than to South Harper, but further, Dogwood ignores the market reality that natural gas prices vary by day and pricing point. See Hearing Exhibit GMO-3602, Janssen Surrebuttal at 7, Table 1. At pages 4-5 of his Rebuttal Testimony, Mr. Blunk explains how prices averaged over a period of time can be significantly different than daily prices used for actual natural gas purchases. Hearing Exhibit GMO-8.

ii. GMO Complied with Stipulation in Case No. ER-2009-0090

Dogwood testified that GMO did not fulfill its obligations under the stipulation that led to the settlement of its prior rate case, Case No. ER-2009-0090. According to Dogwood, in that stipulation, "GMO agreed to reevaluate Crossroads by exploring 'all reasonable options to add generating capacity to GMO's system and use its best efforts to determine the best terms available for each such option.'" Dogwood's Initial Brief at 8, citing Hearing Exhibit GMO-3601, Janssen Rebuttal at 17-18, Dogwood appears to base its claims that GMO did not fulfill its obligation to reevaluate the Crossroads decision on the fact that Dogwood was not contacted when GMO performed its study. Id. at 8, 10, 14-15.

As correctly cited by Dogwood, GMO agreed to "explore all reasonable options to add generating capacity to GMO's system." Id. at 8; see also Hearing Exhibit GMO- 11, Crawford Rebuttal at 9, citing Non-Unanimous Stipulation and Agreement in Case No. ER-2009-0090 at 6. As part of its analysis, GMO evaluated several options, including purchasing Dogwood at

different increments (e.g., 655 MW, 300 MW and 150 MW shares). Hearing Exhibit GMO- 11, Crawford Rebuttal at 9. The Company also explored adding an additional share of Iatan 2 and adding Wartsila engines. According to Company witness Burton Crawford, "[e]ach capacity option was evaluated over 42 different scenarios that varied assumptions such as natural gas prices and the retail load forecast." Id. The study showed that "[o]n an expected value basis over the 42 scenarios analyzed, the inclusion of Crossroads resulted in the lowest cost to retail customers over a 20-year period." Id. For more detail, the results of the study appear on Schedule 3 attached to Mr. Crawford's Rebuttal Testimony. Hearing Exhibit GMO-11. These results were consistent with Company's prior findings in its 2007 RFP. Id. at 10.

There is no basis for Dogwood's claim that GMO's study as required by the Stipulation and Agreement in Case No. ER-2009-0090 did not fully comply with the Stipulation and subsequent order. Dogwood's claim relies solely on its argument that Dogwood wasn't contacted by GMO. Personal contact was not a requirement under the Stipulation. Rather, GMO was required to use its best efforts when exploring all reasonable options to add generating capacity. See Dogwood's Initial Brief at 8. In analyzing a variety of scenarios that included Dogwood other local power plants and self-build options, Dogwood was not the most cost-effective choice. Arguing that the Company didn't personally contact Dogwood doesn't alter the results of the analysis. Dogwood simply wasn't the lowest cost option.

iii. Dogwood's Transmission-Related Concerns are Baseless

Dogwood claims that one of the reasons the Commission should disallow inclusion of Crossroads in rates is higher cost and insufficient transmission. Dogwood's Initial Brief at 9, 10. With regard to the cost of transmission, Dogwood appears to base its claim on its belief that GMO erred in its analysis regarding transmission costs. Id. at 8-9. In fact, it is Dogwood's analysis that contains several errors which, when corrected, demonstrate that its all-in costs are

much higher than Crossroads. The most egregious error in Dogwood's analysis is the input it used for Crossroads' transmission cost. Dogwood significantly overstated the transmission cost input it used in its analysis of Crossroads. GMO takes firm point-to-point transmission service from Entergy at a rate of $16.56 per kW/year. See Hearing Exhibit GMO-49 at 7. The input used by Dogwood for Crossroads' transmission rate is **[redacted]** per kW/year. Hearing Exhibit GMO-3603, Rose Surrebuttal at 60. Thus, the actual amount paid for transmission service is less than one-third the amount Dogwood used in its analysis. Using Dogwood's own analysis and simply correcting for this one error alone causes Crossroads to have a net cost **[redacted]** per kW/year compared to Dogwood's cost of **[redacted]** per kW/year demonstrating Crossroads as the lower-cost alternative.

With regard to adequacy of transmission service, Dogwood appears to suggest that proximity equates to sufficiency and cites to GMO's Special Protection Service as support. Dogwood's Initial Brief at 9; see also Hearing Exhibit GMO-3603, Rose Surrebuttal at 14 As explained previously in response to a Staff argument, there are two transmission lines coming out of Crossroads. If one particular line is down at the same time that all four CTs are running, one CT would need to be curtailed. According to Company witness Burton Crawford, it would be extremely rare for these two events to occur simultaneously. Regardless, a special protection scheme does not negate the fact that the Company has firm transmission service for the entire plant. Hearing Tr. at 4050-51. Further, all generating plants everywhere are subject to curtailment for transmission failures. In other words, this issue is not isolated to GMO. It would be inappropriate to deny GMO recovery of Crossroads based on a contingency that is unlikely to occur and therefore Dogwood's argument should be rejected.

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iv. Off-System Sales

Dogwood claims that in its evaluations of power supply alternatives, GMO has improperly ignored off-system sales Dogwood's Initial Brief at 9, citing Hearing Exhibit GMO-3603 at 7-8, 15-16. This is based on Dogwood's belief that GMO failed to address off-system sales in its "Stipulation 8 Capacity Study."[3] Hearing Exhibit GMO-3603 at 7. Dogwood's understanding of the Stipulation 8 Capacity Study is inaccurate. GMO did include the impact of off-system sales in the analysis. Historically, the Company has always taken off-system sales into consideration when making resource decisions. See Hearing Exhibit GMO-11, Crawford Rebuttal at 8 and Schedule BLC2010-9 (HC). GMO's analysis per the Stipulation 8 Capacity Study, including consideration of off-system sales, concludes that Crossroads would result in the lowest 20-year NPVRR of all scenarios analyzed. Hearing Exhibit GMO-11, Crawford Rebuttal at 8.

v. Legal Arguments

Dogwood's legal arguments attempt to confuse the Commission as to the legal and regulatory approval status of the Crossroads facility. Crossroads is controlled by GMO through a long-term tolling agreement. See Schedule 1-1 to Hearing Exhibit GMO-216, Featherstone Rebuttal at 1. GMO holds a purchase option that provides the opportunity for GMO to purchase the plant from the City of Clarksdale for a nominal amount. Id. Crossroads is recorded on the Company's books and records as a capital lease. Id. 3. Per the Code of Federal Regulations 18, Part 101, capital leases are recorded to property account 101.1 and then classified in functional plant accounts 301-399 prescribed for electric plant in service. GMO has included the

[3] The Stipulation 8 Capacity Study is the 2010 study performed by GMO to explore all reasonable options to add generating capacity to GMO's system as required by the Stipulation and Agreement in GMO's last rate case, Case No. ER-2009-0090.

Crossroads facility in its rate base for the same reason that it has consistently, and without objection from any party in this or prior rate cases, included its South Harper facility in rate base. Both are long-term agreements for capacity and energy properly classified as capital leases in property asset account 101.1 on the Company's books and includable in rate base like any other generating facility. Because capital leases are appropriate for rate base treatment in Missouri, Dogwood's argument must be rejected.

Next, Dogwood argues that Crossroads needs a certificate of convenience and necessity (CCN) from the Commission under §393.170 RSMo. CCNs are only required for electrical plants that exist within the state of Missouri as this is the extent of the Commission's jurisdiction. No CCN was issued by the Commission for Wolf Creek or the Spearville wind turbines or any other plant outside the state of Missouri that is used to serve Missouri customers. While a CCN is not required, the Commission staff has toured Crossroads, much like they did the Spearville wind turbines, and determined that the plant meets the Staff's in-service criteria. Hearing Exhibit GMO -11, Crawford Rebuttal at 10.

Finally, Dogwood's FERC argument, like its ratemaking treatment and CCN arguments, is premised upon a faulty jurisdictional understanding. Dogwood's reference to a possible need for FERC approval under FPA section 205 for transfer of the purchase obligations under the Crossroads tolling agreement to GMO is misplaced. Assuming arguendo any FERC approval was required, it would be under FPA section 203 not section 205 (which deals with the rates, terms and conditions of jurisdictional contracts, not the transfer or assignment of those contracts). As indicated above, the agreement between the City of Clarksdale and GMO is a tolling agreement. For FERC jurisdictional purposes, GMO is viewed as a purchaser of the rights to the Crossroads output. Under *New England Power*, 83 FERC ¶61,275 at pp 6-7 [mimeo] (1998), no authorization under Section 203 of the Federal Power Act is required for the

transfer of the rights to purchase under a power sales agreement or a tolling agreement. "Because a right to purchase power under a contract is not a facility used for the transmission of electric energy or for the sale of electric energy at wholesale, the transfer (disposition) of such a purchase right is not subject to section 203 authorization." Id. Thus, the transfer of the purchase rights under the Crossroads tolling agreement that occurred between an Aquila affiliate and GMO did not require FERC authorization under FPA section 203.

vi. Conclusion

The testimony and evidence presented in this case clearly demonstrates that the delivered cost of natural gas is cheaper to Crossroads than to Dogwood, that GMO's firm transmission service is reliable and sufficient and that GMO has repeatedly considered Dogwood Energy, LLC in its resource planning decisions, including the Company's recent 2010 Stipulation 8 Capacity Study. The simple fact is, Dogwood has not been the lowest cost resource option. No amount of faulty legal or economic analysis alters this reality. Dogwood, therefore, has provided the Commission no basis to deny the inclusion of Crossroads in GMO's rate base.

d. Response to Industrials

The Industrials devoted the entirety of their brief to GMO's capacity planning issues. The Company will respond to the more egregious positions taken by the Industrials.

First, the Industrials claim that the Company ignores fair market value for Crossroads. Industrials' Initial Posthearing Brief at 6. This claim is untrue and unsupported. There is substantial evidence in the record regarding the 2007 RFP process which established that the fair value was in excess of net book. See Hearing Exhibit GMO-11, Crawford Rebuttal at 1-2, 12-14. Additionally, the Company provided testimony indicating that the fair value recorded at the Aquila acquisition date was net book value. In actuality, according to PWC, valuation for Crossroads was in excess of net book value. See Hearing Exhibit GMO-25, Ives Surrebuttal at

21-22. In fact, this would have been an asset write up if not for the Company's decision to request regulatory rate base treatment. The Company used net book value (lower than fair value) because of its request for rate base treatment. As stated previously, regulated assets are recorded at net book value in an acquisition based on industry practice.

The Industrials state: "In fact, given the lack of any market for Crossroads, Great Plains has admitted in several filings with the Securities Exchange Commission that the 'fair market value' of the Crossroads unit approximates the actual salvage value of that unit." Industrials' Posthearing Brief at 7. This statement is purposefully misleading. This valuation is based on a preliminary S-4 filing the Company made with the Securities Exchange Commission (SEC) which recognized a conservative, "worst case scenario," preliminary estimate of dismantling and selling the plant. As explained in the Company's initial brief, during the Aquila acquisition process, Great Plains Energy was required to produce a fair value disclosure as part of its S-4 filing at the SEC. In preparing the May 2007 S-4 disclosure statement, Great Plains Energy, among other things, performed a high level analysis of different alternatives for the Crossroads facility. In order to reflect the uncertainty regarding whether any of the alternatives was achievable, the Company opted to disclose the value of the plant based on dismantling it and selling the turbines and other equipment for salvage. According to that S-4 filing, the salvage value of Crossroads is $51.6 million. Hearing Exhibit GMO-12, Crawford Surrebuttal at 3; see also Hearing Exhibit GMO-25, Ives Surrebuttal at 12-15; Hearing Exhibit GMO-47 at p. 2; and Hearing Tr. at 4103.

The Industrials' position ignores the reality that the plant was not dismantled and sold, but rather is fully operational and in service. It further ignores the valuation of Crossroads at the time of acquisition, performed by third-party PWC. This independent, third party valuation appeared in GMO's September 2008 rate case in Case No. ER-2009-0090. Hearing Exhibit

GMO-25, Ives Surrebuttal at 12-14. According to the valuation scenario that the plant remained operational and GMO was able to obtain transmission from Crossroads to GMO, the value of the plant was $94.75 million (assuming that $20 million in transmission upgrades would be required). GMO was ultimately able to obtain transmission service with only a minimal transmission investment of $145,000, bringing the estimated value of Crossroads to $114.60 million. Hearing Exhibit GMO-12, Crawford Surrebuttal at 3. This value is even more than the $104 million GMO has requested for ratemaking treatment in this case and highlights the Industrials' absurd position that the plant should be valued at its salvage value.

The Industrials repeatedly bleat about the fair value of Crossroads as $51.6 million. See Industrials' Posthearing Brief, e.g., at 17-18, 20. The Industrials go so far as to state "at the time of acquisition by Great Plains, the value of Crossroads had to be reduced by $66.3 million to reflect 'fair value.' That said, however, GMO refuses to recognize this fair value or the write off that occurred. Instead, GMO returns to the original net book value for ratemaking purposes." Id. at 20. There was not a reduction at the time of acquisition, there was no write off, and the $51.6 million was not fair value. As has been clearly evidenced in this brief, the $51.6 million in no way represents fair value at the acquisition date. In his Surrebuttal Testimony, Company witness Darrin R. Ives provides a full SEC timeline and explanation for the change from the $51.6 million in the initial S-4 to what was actually the $117 million net book value (fair value) at the acquisition date. Hearing Exhibit GMO-25 at 14-15. To persist in arguing that the fair value of Crossroads is its salvage value is not only ridiculous, but deceitful.

The Industrials attempt to show that early efforts to sell Crossroads somehow have any bearing on whether the Commission should allow recovery of Crossroads in the Company's cost of service. The Industrials state:

> Later, following its announced acquisition of Aquila, Great Plains also attempted to sell the Crossroads unit. In a webcast call with investors, Great Plains management was asked specifically about its intentions for the Crossroads unit. In response, Great Plains Chief Financial Officer indicated "[w]e looked at the ability to utilize that or sell it. Our preference would be probably to get value through monetizing it." As Staff notes, the fact that Great Plains did not sell Crossroads, despite its stated preference, "means that like Aquila, it could not find a buyer."

Industrials' Posthearing Brief at 23 (citations omitted). GMO is unaware of any attempt by Great Plains Energy to sell Crossroads. Staff's statement, cited by the Industrials above, appears to be nothing more than pure speculation on its part. The singular, isolated statement purportedly made by Great Plains Energy's chief financial officer does not offer any proof that GPE could not sell Crossroads or that it made serious attempt to do so.

e. Conclusion

The Company's 2004 decision to pursue the construction of three 105 MW CTs at South Harper and pursue a 200 MW system-participation based PPA, and the Company's 2008 decision to add the Crossroads generating facility to the MPS generation fleet were both reasonable and prudent. These separate decisions took place at different times. Staff's pursuit of imputing Phantom Turbines has nothing to do with Crossroads. Staff would have pursued the Phantom Turbine issue regardless of whatever capacity decision the Company would have made. Since both decisions were prudent, the Commission should reject Staff's Phantom Turbine adjustments and allow GMO to fully recover the costs associated with its preferred resource plan, the construction of three 105 MW CTs and a purchased power agreement that includes base load generation and should reject Staff's adjustment to disallow the recovery of Crossroads in the Company's cost of service.

1.) While Staff argued that the Company should have built five CT's at South Harper instead of the three CT/system-participation PPA plan, Staff testified at the evidentiary hearing that the cost difference between the two alternatives was not significant enough to be imprudent.

2.) When all costs are considered, Crossroads is the lowest cost option capacity addition. Staff's argument ignores the fact that transmission costs were factored into the analysis when considering capacity options in 2007. Additionally, PWC concluded that the estimated fair value of Crossroads was higher than the net book value requested in this case. The Company's 2007 analysis also demonstrated the significant value this facility has for GMO customers.

2. Jeffrey Energy Center FGD Rebuild Project

Contrary to the arguments contained in Staff's Initial Brief (pp. 42-51), Westar acted prudently in the construction of the Jeffrey Energy Center FGD Rebuild Project, and the Commission should reject Staff witness Keith Majors' proposed prudent disallowance related to this Project.

As explained in GMO's Initial Brief at pp. 20-23, Mr. Majors is proposing a prudence disallowance of ** [redacted] ** (Hearing Exhibit GMO-210 (NP), pp. 42-47, COS Report; GMO-21 (HC), p. 3, Hedrick Rebuttal). This Staff disallowance is based upon hindsight, unreasonable and not supported by competent and substantial evidence. Staff's position therefore should be rejected by the Commission.

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Staff's first argument is that: "Westar imprudently contracted with a vendor whose financial instability and poor performance report resulted in additional costs to the project." (Staff Initial Br. at 44)

Contrary to Staff's position, GMO's outside expert, Mr. Leonard Ruzicka, concluded that Westar/GMO had acted appropriately and reasonably in its decision to award the general construction contract to PSMI. (Hearing Exhibit GMO-36 (NP), p. 2-5, Ruzicka Rebuttal). Mr. Ruzicka explained the reasons why it was appropriate to award the contract as Westar/GMO did, based upon the facts and circumstances that were known at the time:

> When the spread between low and second low bidder is substantial, it would be appropriate and reasonable to consider waiving the bonding requirement but only after conducting the same type of due diligence that is conducted by the sureties. ** [redacted] ** In accepting that recommendation, Westar/GMO acted appropriately and reasonably and consistent with what a prudent owner would do in similar circumstances. (*Id.* at 3)

Secondly, Staff argues that "It was unreasonable of Westar and GMO not to require PMSI to obtain a performance bond, and this failure to require a performance bond exposed GMO to inappropriate, unreasonable and unnecessary level of financial risk, risk that materialized." (Staff Initial Br. at 47-48) Staff's second argument is also incorrect and improperly based upon hindsight.

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Mr. Terry S. Hedrick, KCP&L's Director of Supply Engineering, explained the reasons why Westar and GMO did not require PMSI to obtain a performance bond as follows:

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** (Hearing Exhibit GMO-21 (HC), pp. 3-4, Hedrick Rebuttal; Hearing Tr. p. 4268) Since these were the facts and circumstances that Westar faced at the time the decision to hire PSMI was made, it is unreasonable and unlawful for the Commission to adopt Staff's adjustment with its hindsight review of those facts and

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circumstances. There was nothing inappropriate or unreasonable about Westar's hiring of PSMI.

Third, Staff argues that: "Westar failed to conduct proper due diligence when evaluating PMSI as a potential contractor." This position is simply incorrect. Westar did perform reference checks on prior work performed by PMSI as well as obtained reports from Dun & Bradstreet. (Majors Surrebuttal, p. 37) In addition, Westar conducted an extensive evaluation of PMSI and was aware of the fact that it could not obtain a performance bond due to its financial condition. (Hearing Exhibit GMO-21 (HC), Hedrick Rebuttal, pp. 3) However, given the substantial difference in the PMSI bid and the next lowest bid, it was clearly reasonable for Westar to proceed with the acceptance of the PMSI bid without a performance bond. (Hearing Tr. 4356-47).

Staff also criticizes Westar for not applying the Federal Acquisition Regulations which Staff admits does not have any applicability to private industry. (Staff Br. at 48-49). In addition, Staff criticizes Mr. Ruzicka for not following "any auditing standards when reviewing the work related to PMSI, thus creating serious concerns to the value of his opinion testimony." (Staff Br. at 49). Staff fails to recognize that it takes more than "auditing" expertise to judge the prudence of construction project decisions. Mr. Ruzicka is an experienced construction law expert, and did not conduct an audit. Instead he reviewed the prudence of the decisions made by Westar, based upon extensive documentary evidence and interviews with Westar personnel. Ultimately, he concluded that Westar and GMO were indeed prudent in their decision-making related to the Jeffrey Energy Center FGD Rebuild Project. (Hearing Exhibit GMO-36 (NP), p. 2-5, Ruzicka Rebuttal, pp. 2-3)

Mr. Ruzicka explained that other factors were important in the decision to hire PMSI: **

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** (Hearing Tr. 4347) In addition, Mr. Ruzick explained that **

** (Hearing Tr. 4347)

Next, Staff asserts that "Mr. Ruzicka testified that PMSI could easily have been replaced." (Staff Br. at 49). However, Staff fails to note that after Staff intentionally cut off the witness during his explanation, Mr. Ruzicka was permitted to give a more complete answer later in the hearing when he explained that it would have been costly and imprudent to have replaced PMSI:

> So in order to replace a contractor, you would have had to terminate PMSI for Westar's convenience and paid them in full for whatever he owed them and then started with another contractor. And most contractors are very reluctant to pick up other contractor's work and move forward with it. They certainly won't do it on a lump sum basis. And if they do it on a cost plus basis, it's going to be very costly because they're going to have to review and analyze the work in place and start all over again. So it just made absolutely no sense to even consider it. (Hearing Tr. 4343)

Staff also criticized Westar for failing to seek liquidated damages against PSMI. (Staff Br. at 50) Staff again ignores the testimony of Mr. Ruzicka when he explained that **

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As a result, there was no basis for a claim of liquidate damages. (Hearing Tr. pp. 4349-52; *See*

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also Hearing Tr. p. 4266; 4356-57) Typically, a principal will be found in default under a construction contract for failure to timely perform; or for performing the work defectively and refusing to cure the defect; or a combination of both. ** [redacted] ** (Hearing Exhibit GMO-36 (NP), p. 6, Ruzicka Rebuttal).

For the foregoing reasons, the Commission should reject the Staff's adjustment related to the Jeffrey Energy Center FGD Rebuild. The competent and substantial evidence in the whole record supports a finding that Westar/GMO acted prudently in managing the Jeffrey Energy Center Project, including awarding the contract to PMSI as discussed herein.

3. Allocation of Iatan 2 Between L&P and MPS Service Areas

The Company believes that the following factors should be strongly considered by the Commission when deciding this issue: 1) GMO's allocation process that was specifically designed to look at the base load needs of the MPS and L&P customers and allocate Iatan 2 capacity accordingly; 2.) an appropriate balancing of the rate impacts on the Company's MPS and L&P customers; and 3) the flexibility to meet future capacity and energy needs of the respective divisions.

GMO agrees with Staff that this issue is how to fairly assign and apportion between GMO's two rate districts—MPS and L&P –the impacts of GMO's investment in Iatan 2 on rate base and fuel costs. (Staff Br. at 19) From GMO's perspective, the Iatan 2 Allocation issue is more akin to a rate design issue since it determines the relative amount of the rate increase that will be received by both the MPS and the L&P service areas rather than the overall revenue requirement impact of Iatan 2. (Tr. p. 3821) This issue is also closer to a rate design issue

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because the rate impact on customers is a very important factor for the Commission to consider in rendering its decision.

The amount of the MPS service area rate increase proposed by GMO is $75.8 million dollars or 14.43%. The amount of the L&P rate increase proposed by the Company is $22.1 million dollars or 13.87%. (Blanc Direct at 2). However, Staff is proposing to substantially increase the rates to the L&P district in this proceeding above the Company's requested rate increase.

Staff's Brief candidly admits that "Staff's proposal [related to the Iatan 2 Allocation] shifts about $18 million of revenue responsibility from MPS to L&P" and that its proposal results in the "cost of service for MPS is about $18 million less that's GMO's."[4] (Staff Br. at 20). If the Commission adopts Staff's proposal on the Iatan 2 Allocation, according to Staff's own analysis, then the L&P customers "will potentially cause the rate increase to L&P customers to be almost four times the rate increase to MPS customers." (Hearing Exhibit GMO-210 (NP), p. 102, COS Report) But, this statement by Staff understates the magnitude of the Staff's proposed rate increase if the Commission would also adopt Staff's proposal to re-base the fuel costs in this case.

If the Commission also adopted Staff's proposal to re-base the fuel costs, then the rate impact on GMO's L&P customers would be further exacerbated. Based on information known as of December 31, 2010, matching the base energy costs in GMO's fuel adjustment clause to match the base energy costs in the test year total revenue requirements Staff recommends be used for setting rates has the impact of increasing GMO's fuel adjustment clause base energy cost for MPS and L&P by 2.3% and 30.1%, respectively. (Staff's Initial Brief page 11.)

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[4] As explained in the Company's Initial Brief, GMO believes that the rate impact of Staff's proposal is closer to $20 Million. (GMO Br. at 24; Hearing Tr. 3820)

If the Commission adopted both of the Staff's proposals--the Allocation of Iatan 2 and the re-basing of fuel costs--then it will have an extreme, adverse impact upon GMO's customers that live in St. Joseph and other L&P service areas. (Hearing Tr. p. 3820) In addition to the rate increase proposed by the Company of $22.1 million dollars or 13.87% for increases in the overall cost of service, Staff is proposing to increase the L&P rates by $18-20 million related to the Iatan 2 Allocation issue. This will result in an increase to the L&P division of nearly 25%. On top of that, if the Commission determines that the Company should rebase its fuel cost adjustment, then based on the Staff brief using updated the true-up data, L&P could see an increase in the base energy cost of an additional 30.1%. This would be on top of the 25% increase in base rates.

Another problem with the Staff's proposed allocation is the impact that this will have on the FAC. Currently, GMO jointly dispatches the fuel and purchased power for both L&P and MPS divisions. At the end of the month, an assignment and allocation is made to determine the fuel and purchased power costs for MPS and L&P consistent with the FAC tariffs. The assignment and allocation of fuel and purchased power is done from a least cost to highest cost based on the assignments of the plants. For example, the Iatan 1 and Lake Road power plants are assigned 100% to L&P. The MPS division includes a number of plants including Jeffery, Sibley, South Harper, Crossroads, etc. Using the Staff assignment of 100 MWs to Iatan 2, L&P will have substantial times when it will not need all of the baseload energy from Iatan. Based on the FAC tariffs, it will then provide the first opportunity to the MPS division for the energy from Iatan, before it would consider selling the energy in the open market. Rather than charge MPS at market prices or an all-end cost, it will provide the energy to MPS at the variable cost, thus benefiting the MPS division. (Hearing Tr. 3809-10).

Staff's Brief confirms that Staff looked back about a decade to make its determination about the proper allocation of Iatan 2 for the future: "This issue originates with the merger of UtiliCorp United, Inc., and St. Joseph Light & Power Company in 2000." (Staff Br. at 21) Staff makes much of the fact that the costs of South Harper were assigned to MPS. But assigning a fixed portion of Iatan 2 to MPS and L&P districts makes little sense today, as the relative load conditions of the MPS and L&P districts change over time. As Mr. Rush explained during the hearings, if the Commission adopted Staff's proposal to fix the portion of Iatan 2 allocated to the MPS and L&P districts, it would not be consistent with the allocation process used by KCP&L for all of its generation plants. (Hearing Tr. 3817) KCP&L goes through an analysis to determine the appropriate allocation of its generation units, depending upon needs of its customers. (Id. at 3817-18)

The Company recommends that the GMO portion of the Iatan 2 plant be placed in its E-Corp business unit and that the allocation of Iatan 2 be established in this case until it is changed in a future case. This would allow for the fuel adjustment clause to be established using the proper plant assignments. This allows the Company and the Commission to maintain flexibility to address the changing needs of GMO's customers between the MPS and L&P districts over time. The Company's proposal would allow the Commission to maintain this flexibility since the Commission could allocate its costs differently as conditions change. (GMO-Exh.12 (NP), Crawford Rebuttal, p. 14) This is consistent with how the Kansas City Power & Light Company treats its generation fleet in the allocation between the Missouri and Kansas rate jurisdictions.

Contrary to Staff's arguments, GMO's proposal for Iatan 2 is not "an attempt by GMO's officers to maximize the revenues GMO receives from its retail customers as a result of new rates in this case, not because of any ratemaking principle, or principles." (Staff Br. at. 24). From GMO's perspective, this allocation issue is a zero sum game. GMO will not receive more

or less revenues if the Commission adopts either the Company's or Staff's proposal. (Hearing Tr. at 3821) However, as discussed herein, it is clearly not a zero sum game for GMO's customers. The Commission should take the rate impact on customers, especially in the L&P district into account when it decides this issue.

During the hearing and the cross examination of witness Rush, Commission Davis asked the following: "Okay. And when you take all of that into account, I mean, is there some way that your formula maximizes revenues for the Company versus Ms. Mantle that maximizes lower costs to the ratepayers, you know, in the form of more off-system sales or something like that? I mean, I'm trying to figure out what the difference is here." (transcript 3810). In response, Mr. Rush tried to emphasis that the proposal presented by the Company is not designed to maximize revenues for the Company. Neither proposal presented by the Company or the Staff will result in additional revenues. The real issue is the impact that the allocation will have on consumers. Neither proposal results in additional off-system sales because GMO jointly dispatches energy and the allocation of Iatan 2 will have no impact.

Staff also criticizes GMO's previous management for not working with Staff and other stakeholders on an appropriate sharing of Iatan 2 between MPS and L&P. (Staff Br. at 24) The current GMO management has met and is willing to meet in the future to discuss with Staff and other interested stakeholders an appropriate methodology for allocating Iatan 2 between its various rate districts over time. The Company's proposal in this case would maintain the flexibility needed to accomplish that goal. However, GMO believes that customer impact should be a significant factor in developing a methodology for allocating Iatan 2, and should not be ignored in the pursuit of a uniform tariff throughout the GMO service area.

In this case, GMO's allocation process was specifically designed to look at the base load needs of the MPS and L&P customers and allocate Iatan 2 capacity accordingly. The

Company's proposal considers contract expirations, current baseload capacity of the different districts, customer load growth, and customer load factor, over the next several years and attempts to balance meeting the customer needs in the L&P and MPS areas. (GMO-Exh.12 (NP), Crawford Rebuttal, p. 14) The table below is a comparison of the factors the company directly included in its calculation of the appropriate allocation of Iatan 2 compared to Staff's allocation.

Factor	Included in Company Calculation	Included in Staff Calculation
L&P Retail Customer Long-Term Load Forecast	Yes	No
MPS Retail Customer Long-Term Load Forecast	Yes	No
L&P Retail Customer Load Factor	Yes	No
MPS Retail Customer Load Factor	Yes	No
100 MW NPPD Contract Expiration in 2011	Yes	Yes
75 MW NPPD Contract Expiration in 2014	Yes	No
L&P Existing Base Load Resource Capacity	Yes	No
MPS Existing Base Load Resource Capacity	Yes	No

As a result of Staff's simplified allocation approach, in 2014 L&P's peak load would be met with 75% base load capacity, leaving MPS peak load being met with only 47% base load capacity. This is in contrast to the Company's proposal that would result in 61% of L&P's peak load being met with base load capacity and 51% of MPS peak load being met with base load capacity. It is this over-allocation of base load resources to L&P by Staff that results in the disproportionally higher rate increase proposed by Staff. Therefore, from a rate impact perspective and a resource planning perspective, Staff's allocation proposal simply allocates too much Iatan 2 capacity to L&P customers.

For all of the foregoing reasons, GMO respectfully requests that the Commission equitably balance the interests of its MPS and L&P customers, and adopt GMO's proposed allocation of Iatan 2 in this proceeding.

4. Rebasing: GMO Should Not be Required to Rebase its Base Energy Costs Above the Costs that are Proposed for GMO's Base Rates

In unnecessarily heated rhetoric, Staff claims that Base Energy Costs should be rebased because (a) retail customers will otherwise be billed twice for the same fuel costs and (b) GMO is attempting to maximize revenue. There is no basis for either claim.

Although footnote 5 in Staff's brief cites three sources for its claim that "GMO's retail customers will be billed twice for the same fuel cost," this allegation was contained in only one sentence in the Surrebuttal Testimony of Staff witness John Rogers at page 7, lines 14-17. It contains absolutely no explanation or support. Staff cites no actual evidence indicating where any element of GMO's Base Energy Costs contained in its base rates is somehow collected a second time in the FAC. The argument appears to be premised on "lower" energy costs that flow through the FAC compared with "actual" fuel and purchased power costs that are net of off-system sales. Mr. Rogers provides no analysis or concrete example of any alleged double-billing. Certainly, the issue of double-billing was not raised in any of GMO's FAC proceedings, either during the true-up process or during a prudence review. See Order Approving Staff's Prudence Review, File No. EO-2010-0167 (July 15, 2010); Order Approving Annual Fuel Adjustment Clause True-Up, File No. EO-2009-0431 (July 29, 2009); Order Approving Staff's Prudence Review, File No. EO-2009-0115 (April 22, 2009).

The Company would have expected Staff to raise such issues during those proceedings, but instead Staff stated without reservation that it "found no evidence of imprudent decisions by the Company's management related to procurement of fuel for generation, purchased power and

off-systems sales." See Ex. 210, Staff Report at 193. There is also no allegation in the Staff Report regarding over-collections or double-billing. See Staff Report at 190-201. None of Staff's recommendations indicate that such over-collections have occurred or will occur in the future. Id. at 201.

Staff then claims that GMO's failure to ask for a rebasing of Base Energy Costs is somehow driven by a goal of "maximizing" revenues from customers. Ironically, it is Staff that ultimately concedes in the final sentence of its argument addressing this issue that the impact of rebasing energy costs will lead to an increase for both of GMO's divisions, including an eye-popping 30.1% for the L&P Division. See Staff Brief at 11.

Staff accurately quotes Mr. Rush's testimony where he advised the Commission at the evidentiary hearing that the Company was proposing to continue with current Base Energy Costs and not to rebase which "would've put a significant increase to the consumer on an immediate basis." Tr. 4433. He correctly noted that using the FAC will decrease the impact to the consumer by "spreading that [increase in fuel costs] out over a longer period of time" after the increases related to Iatan 2 and other components of this pending rate request go into effect. Tr. 4433.

Finally, Staff appears to argue that Base Energy Costs were changed in the last case, No. ER-2009-0090, even though their witness retracted all of his testimony on the issue at the evidentiary hearing (Tr. 4464-67 [Rogers]). Mr. Rush clearly testified in response to a question from Public Counsel that there were no changes to Base Energy Costs:

> Q: ... Is your testimony that the base energy costs were exactly those numbers before the stipulation and agreement as they were after the stipulation and agreement?
>
> A: The component of the base energy costs were, yes.

[Tr. 4445.]

Responding to related questions from Mr. Mills, Mr. Rush noted that there were "very minor modifications made to the fuel adjustment clause, which was not rebased" (Tr. 4444). He advised that there "were several additions included in the fuel adjustment that were not previously included, but the numbers that made that up were identical. All the other components were the same." Tr. 4446. Plainly, the components of the Base Energy Costs were the same pursuant to the Stipulation and Agreement filed in that case and approved by the Commission. Tr. 4443-46.

No other party has proposed rebasing Base Energy Costs, and Staff has not provided any sufficient reason to implement a further increase in those rates.

5. Fuel Adjustment Clause Sharing Mechanism: The Commission Should Continue to Set the Sharing Mechanism at a 95% to 5% Ratio

Staff continues to recommend that the FAC sharing mechanism be changed from the current 95% to 5% ratio to a 75/25 ratio, with the Company absorbing *one-quarter* of any future increases in its prudently incurred fuel and purchased power costs. Intervenors AARP and Consumers Council say they agree with Staff, but apparently have misunderstood Staff's proposal. These Intervenors recommend an even more unbalanced 70/30 sharing ratio, with GMO absorbing almost *one-third* of any future increases. See AARP Brief at 4-5; Consumer Council Brief at 4-5.

Staff finally admits that the primary purpose behind its recommendation for a radical shift in sharing of costs has little to do with the FAC, but rather GMO's failure to propose an increase in Base Energy Costs. See Staff Initial Brief at 12.[5] As noted in the previous argument, the Company is unable to understand Staff's argument to build into base rates a new level of

[5] "Primarily because the 95%/5% sharing mechanism currently in place is not sufficient incentive to cause [GMO] to file to reset the base energy cost ... , the sharing mechanism should be changed to a 75%/25% sharing."

Base Energy Costs (which particularly hits hard L&P Division consumers), while the current system passes only 95% of such costs to consumers through the FAC. Clearly, Mr. Rush was correct in his testimony that the Staff was seeking "to discipline the Company for its position" not to rebase Base Energy Costs. See GMO Ex. 34 (Rush Surrebuttal) at 4.

However, the more significant point is Staff's misunderstanding of the law regarding what are proper incentives under Section 386.266. This law gives the Commission the power to include in FAC rate schedules "features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities." See § 386.266.1. The law also permits the Commission to approve such rate schedules "after considering all relevant factors which may affect the costs or overall rates and charges of the corporation, provided" that the FAC, among other things, is "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." See § 386.266.4(1).

The Commission first applied these principles in the Company's 2007 general rate case, when an FAC was proposed by Aquila. On the one hand, the Commission found that "after-the-fact prudence reviews alone are insufficient to ensure Aquila will continue to take reasonable steps to keep its fuel and purchased-power costs down, and the easiest way to ensure a utility retains the incentive to keep fuel and purchased-power costs down is not to allow a 100% pass-through of those costs." See In re Aquila, Inc., Report and Order, Case No. ER-2007-0004 (May 17, 2007) at 54 ("Aquila Report and Order"). At the same time, the Commission was cognizant of the restrictions in the law, when it concluded "that a 95% pass-through would not violate Section 386.266.4(1), in that it would still afford Aquila a sufficient opportunity to earn a fair return on equity." Id. at 55. In adopting the 95/5 ratio, the Commission found:

> . . . Aquila will be protected from extreme fluctuations in fuel and purchased power costs, yet retain a significant incentive to take all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment.

See id. at 54 (emphasis added).

As the Commission realized when it permitted Aquila to implement an FAC, any incentive to encourage prudent acquisition of fuel and purchased power must be balanced with the purpose of Section 386.266 and the intent of the legislature when it enacted Senate Bill 179 in 2005. Clearly, the major purpose of the act was to permit the timely recovery of fuel and purchased-power costs, including transportation. While a variety of consumer protection provisions for a true-up process, prudence reviews, and interest payments on refunds were included in the law, it is clear that the Commission was not given any power or authority to impede prudent cost recovery.

The Commission found in the 2007 Report and Order:

> The price of natural gas, coal, and railroad freight rates to transport that coal are established by national, and in some cases, international markets. Aquila does not have control over those prices. Similarly, Aquila does not have control over the prices it must pay for purchased power.

See Aquila Report and Order at 36. Both Staff, as well as OPC and the Intervenors disagree with that obvious proposition, arguing that the sharing mechanism should be tilted so that customers essentially get a free ride on 25% or even 30% of prudently incurred fuel and purchased-power costs in the future. Establishing such an imbalanced ratio would clearly violate Section 386.266.

Staff additionally argues that a dramatic shift in the sharing mechanism is justified by its view that natural gas prices "are expected to remain relatively stable in the future due to the very large potential of shale gas plays." See Staff Brief at 14. As Company witness Michael

Schnitzer of the NorthBridge Group testified, natural gas prices have not and are not expected to become stable anytime soon. Indeed, they will continue to be the volatile commodity that they have been for the past 10 years. See Tr. 3306, 3339. As Mr. Schnitzer testified: "Natural gas prices continue to be volatile, and there are a number of measures of that. So I think there's no evidence that I'm aware of that volatility has declined ...." He noted that while prices are low relative to price levels of several years ago, "they're not low relative to $3 or even below $3, where they have also been for short periods of time in the last couple of years." Tr. 3339.

Finally, Staff and the other proponents of a change in the 95/5 sharing mechanism failed to discuss the financial implications for GMO if the ratio were changed to 75/25. The purpose of Section 386.266 is to permit timely recovery of prudently incurred fuel and purchased-power costs, and to enhance the financial stability of an electric utility that receives an FAC. As Gary Rygh from Barclays Capital testified (as well as GMO's Tim Rush and Curtis Blanc), accepting Staff's recommendation would place GMO in stark contrast with other electric utilities in the Midwest, as well as in Missouri. Mr. Rygh noted that a "reduction of the established pass-through mechanism in this proceeding would have material negative consequences to investor perception of GMO, the Commission and the quality of the regulatory process in Missouri." See GMO Ex. 37 (Rygh Surrebuttal) at 13. He noted that a shift from the current mechanism to Staff's proposal "without a significant basis in fact" would lead to "negative perceptions of the regulatory climate in Missouri and jeopardize the financial stability of GMO, causing significant harm to the ratepayers over the long term." Id. at 15-16.

Mr. Rygh's view is consistent with Mr. Rush's testimony, supported by GMO Ex. 51, which noted that of 36 fuel adjustment clauses utilized by electric utilities in other Midwestern states, none involve sharing of total net fuel costs. See GMO Ex. 34 (Rush Rebuttal [Rate Design]) at 21. The only sharing mechanisms in these other FACs pertain to off-system sales

margin. Id. See Ex. 6 (Blanc Surrebuttal) at 2 ("Increasing the portion of GMO's incremental, net fuel costs that it cannot recover from 5% to 25% would only serve to penalize the Company . . . .").

No party has presented any evidence critical of GMO's decisions related to procurement of fuel for generation, purchased-power and off-system sales. Indeed, the Staff Report (Ex. 210) at page 193 states the opposite. There is simply no basis in fact to adjust the current 95/5 sharing mechanism. As a legal matter, the discussion by Staff and other parties of "incentives" is flawed, not merely from an economic and practical standpoint, but as a matter of law.

Increasing the amount of costs that GMO is forced to bear, without providing any benefit or reward, is simply another disallowance or, at worst, a penalty. Moreover, given the purpose of Section 386.266, and the Commission's careful analysis of what would be a proper incentive when it first implemented the sharing mechanism in the 2007 Aquila Report and Order, adoption of Staff's proposal would be contrary to law.

A number of issues were raised by Staff during this proceeding regarding the Fuel Adjustment Clause mechanism and how it is to be applied. Here are the Company's responses:

a. Crossroads generating station factor – The Staff is correct in its Initial Brief that the Company is opposed to its "CPG" factor. The evidence presented by Company witness Wm. Edward Blunk demonstrates how the natural gas commodity prices and transportation costs for Crossroads Energy Center are actually lower than the costs at South Harper. As discussed in this reply brief on the Crossroad capacity issue, Staff states that "[h]istorically the prices paid for natural gas delivered to Crossroads (Clarksdale, Mississippi) have been ***higher*** than the prices of natural gas delivered to South Harper." See Staff's Initial Brief at 39 (emphasis added). Then Staff states that "[t]he ***lower*** natural gas prices at Crossroads are offset by much higher electric transmission costs . . ." Id. (emphasis added). Not only does Staff contradict itself with regard to

whether the prices paid for natural gas delivered to Crossroads is higher or lower than the price paid for natural gas delivered to South Harper, Staff provides no proof for these statements. Now Staff wants to incorporate an unfounded penalty clause in the FAC to reflect an unfounded, unsupported value. This "CPG" factor should not be included in the FAC computation. This proposal by Staff is simply another addition to reducing the recovery of the prudently incurred actual costs included in the FAC in addition to the sharing mechanism of 95/5 or 75/25 as proposed by Staff.

b. Forecasted Retail Net System Input Definition – The Company is not in disagreement with Staff's clarification.

c. Only Sales to Missouri Municipalities Excluded From Off-System Sales Revenue - The Company is not in disagreement with Staff's clarification.

d. Clarifications - The Company is not in disagreement with Staff's suggested changes with the exceptions of those noted in the context of this reply brief.

e. Transmission Expenses – The Company opposes the Staff's proposed exclusion of expenses currently included in the FAC tariffs, including the transmission expenses that are now in the FAC. No where in its modeling or tariff design has Staff addressed this issue, except to note it as a deleted item in the tariff modification. The Company had requested in its initial filing that all transmission costs be included in the FAC tariff or, in the alternative, that a transmission tracker be established to ensure the appropriate recover of transmission costs. The Company settled the issue of a transmission tracker in the Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues, filed in this case on February 3, 2011 ("Miscellaneous Issues Stipulation"). In the section related to Transmission Expense and Revenue Tracker, the stipulation provides: "The Signatories agree that a tracker for changes in certain transmission-

related expenses should not be implemented in this case." See Miscellaneous Issues Stipulation at 8.

For this issue, the only portion of transmission costs currently included in the FAC are those costs attributable to off-system sales. See Rush GMO Direct at 19. As these costs are essential to determine overall off-system sales cost and margins, to exclude them would be inappropriate. The transmission costs associated with off-system sales are variable costs and are and only incurred when an off-system sales is made.

The FACs utilized by both The Empire District Electric Company and Ameren-Missouri contain similar transmission cost recovery language as does GMO's proposed tariff. Below is the relevant portion of the tariffs of Empire and Ameren that include the transmission costs that Staff is now recommending be removed from the GMO FAC tariffs. Under the Ameren tariff, the reference to transmission costs is found in the description of Account 565, which is the FERC account containing transmission costs.

The Empire District Electric Company:

P.S.C. Mo. No. 5 Sec. 4 7th Revised Sheet No. 17

COSTS: Costs eligible for Fuel Adjustment Clause (FAC) will be the Company's total book costs as allocated to Missouri for fuel consumed in Company generating units, including the costs associated with the Company's fuel hedging program; purchased power energy charges, **including applicable transmission fees; Southwest Power Pool variable costs**, and emission allowance costs during the Accumulation Period. Eligible costs do not include the purchased power demand costs. These costs will be off-set by off-system sales margin and any emission allowance revenues collected in the Accumulation Period.

Ameren-Missouri:

MO.P.S.C. SCHEDULE NO. 5 1st Revised SHEET NO. 98.1

CPP = Costs of purchased power reflected in FERC Account Numbers 555, **565,** and 575, excluding MISO administrative fees arising under MISO Schedules 10, 16, 17, and 24, and excluding capacity charges for contracts with terms in excess of one (1) year, incurred to support sales to all Missouri retail customers and Off-System Sales allocated to Missouri retail electric operations. Also included in factor "CPP" are insurance premiums in FERC Account Number 924 for replacement power insurance (other than relating to the Taum Sauk Plant) to the extent those premiums are not reflected in base rates. Changes in replacement power insurance premiums (other than those relating to the Taum Sauk Plant) from the level reflected in base rates shall increase or decrease purchased power costs. Additionally, costs of purchased power will be reduced by expected replacement power insurance recoveries (other than those relating to the Taum Sauk Plant) qualifying as assets under Generally Accepted Accounting Principles. Notwithstanding the foregoing, concurrently with the date the "TS" factor is eliminated as provided for in this tariff, the premiums and recoveries relating to replacement power insurance coverage for the Taum Sauk Plant shall be included in this CPP Factor.

Staff's position that the transmission costs necessary to make off-system sales should somehow be excluded from the FAC is extreme and must be rejected.

6. Off-System Sales Should Be Set on a Normalized Basis using Test Year 2009 MIDAS™ data, Not on 2007-08 Levels of Such Sales

GMO replies in this section to the argument that Staff set forth beginning at page 82 of its Initial Brief filed on March 7, 2011, addressing joint issues in this proceeding, as well as in Kansas City Power & Light Company's Case No. ER-2010-0355.

The Staff's argument that outdated off-system sales margins from 2007-08 should be used to set rates in 2011 is based solely and simplistically on the fact that margins have declined in recent years. Beyond the fact that such recommendation violates the test-year concept and its traditional exceptions which are invoked to reflect current events or be "more representative of future expenses,"[6] the proposal fails to recognize the undisputed fact that electricity prices in the SPP-North Region have been in decline since that time.

Staff speculates that such declines have occurred because of the fuel adjustment clause mechanism, without citation to any data or other evidence. It also ignores Company witness Burton Crawford's unrebutted testimony that the operating costs of the units that sell excess generation into the wholesale market have risen since 2007, and that historical levels of off-system sales and margins from several years ago are irrelevant to 2011 off-system sales, given the expiration of GMO's purchased-power contracts and its additional capacity at Iatan 2. See Ex. 11 (Crawford Rebuttal) at 16-17.

Staff also ignores FERC's policy that utilities are forbidden to use network transmission service to advance their own off-system sales, as discussed at length in MidAmerican Energy Co., 112 FERC ¶ 61, 346, 2005 WL 2430182 (2005). As that FERC decision clearly indicates, any return by GMO to earlier days when utilities used network service to enhance their off-system sales, and not to satisfy their native load, would place the Company in jeopardy with federal regulatory authorities.

As noted in the Company's Initial Brief, Staff had failed to address any of these issues, and simply based its analysis on the decline in off-system sales since 2007 and GMO's acquisition by Great Plains Energy in 2008. Clearly, Staff has articulated no facts to depart from the Company's proposal to use test-year data generated during 2009 by the MIDAS™ model to

[6] In re Union Elec. Co., Report and Order, Case No. ER-2010-0036 (May 28, 2010) at 50.

set off-system sales. As a matter of law, there is no good reason to depart from the test-year concept in this case, particularly when Staff's recommendation is not at all forward-looking to anticipate future expenses, but rather backward-looking to a time when electricity prices in the SPP-North region, as noted in KCP&L Ex. 122, were substantially higher than they are today.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 4th day of April, 2011, to all counsel of record.

/s/ Roger W. Steiner
Attorney for KCP&L Greater Missouri Operations Company