BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Joint Application	)	
of Westar Energy, Inc. and Kansas Gas	)	Docket No. 19-WSEE-355-TAR
and Electric Company for Recovery of	)	
Certain Costs Through Their RECA	)	

REPLY BRIEF OF WESTAR ENERGY, INC. AND KANSAS GAS AND ELECTRIC COMPANY

I. Introduction

As indicated in their Initial Brief, Westar Energy, Inc.'s and Kansas Gas and Electric Company's (together as "Westar") Application for recovery of operating costs and lease payments, related to Westar's extension of a lease agreement for an 8% interest in Jeffrey Energy Center ("JEC") and purchase of that interest, through their Retail Energy Cost Adjustment ("RECA") should be approved because Westar's decision to extend the lease and purchase the interest will benefit customers through the expected retirement date for JEC. Westar's decision represents a reasonable and prudent step for Westar to take in order to bring a business arrangement already found to be prudent by the Commission – and that has, without dispute, provided tens of millions of dollars of benefits to customers – to a close.

In their Initial Briefs, Kansas Industrial Consumers Group, Inc. ("KIC") and Citizens' Utility Ratepayer Board ("CURB") offer no legitimate basis for opposition to Westar's request for cost recovery. Instead, they continue to attempt to characterize Westar's decision regarding the 8% interest as an attempt to shift risk to customers when in reality Westar has acted all along with customers' best interests in the forefront of the decision-making process – by assuming a lease in 2007, of which 100% of the benefits (tens of millions of dollars) were provided to customers, and by negotiating a purchase price for the 8% interest much lower than the price contemplated by the sale/leaseback agreement approved by the Commission. It is KIC and CURB who are trying to shift costs and risk from where they should rightfully be – taking full advantage of a contractual arrangement for over 10 years during which customers received 100% of the benefits from the arrangement but then attempting to shift all of the costs of the arrangement to shareholders in order to bring it to a close at the end of the lease.

KIC offers a number of conclusory statements without any reference to testimony or evidence in the record. With respect to their legal arguments, CURB offers a lot of argument without any legal support for its conclusions. While KIC proports to cite to case law throughout its brief, the case law cited does not whatsoever support the conclusions KIC reaches. In fact, upon close examination, the cases cited by KIC support Westar's and Staff's position that it would be poor regulatory policy and an unreasonable result for the Commission to allow customers to have received tens of millions of dollars in benefits from Westar's assumption of the lease agreement in 2007 but require shareholders to bear the costs of bringing that arrangement to a close. Furthermore, KIC's legal position proffered in its Initial Brief – that customers should not be responsible for the costs of bringing the lease arrangement to a close because market conditions have changed – is a violation of the prohibition against hindsight review and regulation and is completely inappropriate.

CURB and KIC also offer several false or misleading characterizations of the evidence in their Initial Briefs. For example, KIC refers to the 8% interest in JEC as a "new interest" that Westar is acquiring,[1] implying that Westar has sought out and acquired an interest in some new and different generating station when, in reality, the 8% interest in JEC has existed in Kansas since JEC was built and has been used to serve Kansas retail customers since that time.[2] KIC also

[1] KIC Initial Brief, p. 13.

[2] Grady, Tr. at 165-167.

suggests in its executive summary that the business arrangement between Westar and MWP was "non-regulated."[3] This suggestion is simply false. As the Commission is aware and was the subject of extensive testimony at the hearing, the Commission approved the sale/leaseback transaction that resulted in Midwest Power Corporation's ("MWP") ownership of the 8% interest in JEC, approved Westar's assumption of that lease, and issued an order requiring the $3.5 million consent fee payment and all revenue received from the PPA with MKEC for the 8% interest to be credited to retail customers. The suggestion that Westar's and MWP's business relationship was "unregulated" is simply not true – the entire relationship has been conducted for the benefit of Westar's retail customers and with approval from the Commission since Westar became involved in 2007.

Another misstatement from KIC and CURB is the suggestion that the 8% interest is not currently being used to serve Westar's customers[4] when, after the lease extension was executed, Westar began operating the 8% interest just as it does the rest of its 84% interest in JEC for the benefit of its retail customers. Additionally, CURB states that "ratepayers also risked not making a profit during the MKEC PPA and were unable to do anything about it."[5] This statement completely ignores the facts in evidence that the Mid-Kansas Electric Company ("MKEC") purchase power agreement ("PPA") price was set at a level that ensured retail customers would benefit and that all revenues from that PPA were credited to retail customers for a substantial benefit of tens of millions of dollars.[6]

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[3] KIC Initial Brief, p. 1.

[4] CURB Initial Brief, p. 12; KIC Initial Brief, p. 2.

[5] CURB Initial Brief, p. 20.

[6] Grady, Tr. at 161-162 ("So what they do is, all of the revenue that they receive is credited to the cost of service. There's like 200 or $300 million of wholesale revenue credited to the retail cost of service in a Westar rate case. So, I mean, that's just the way it works. There's a WR factor in Westar RECA right now today in the tariff. And the way

Finally, KIC's discussion of the fact that the 8% share of non-fuel operating and maintenance ("NFOM") costs and lease expense are not currently in Westar's rates[7] is misleading. These costs were always in Westar's rates, up until the 2018 General Rate Case, when they were temporarily removed with a specific provision in the settlement agreement allowing Westar to seek recovery of them if and when it entered a new lease or purchase agreement. Customers may have had a break from paying these costs since rates became effective in the 2018 General Rate Case but were clearly on notice that Westar would seek to reinstate them in rates upon execution of a lease or purchase agreement.

KIC and CURB both also completely ignore the reality of the situation facing Westar when it decided to enter into the settlement agreement with MWP. As Staff explained in its Initial Brief, "it is apparent that neither party understands what MWP actually was. Throughout the discovery process in the 19-064 docket it became clear that MWP actually had no assets and no employees."[8] There is substantial evidence in the record, cited by Westar in its Initial Brief, demonstrating that any attempt to collect payment from MWP would have been futile and any pursuit of foreclosure litigation would have simply increased costs and risks and resulted in the same situation the parties face today – Westar's request for recovery of NFOM costs that it has no option but to incur.

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it works is, as their wholesale revenue goes up compared to what was in base rates, that revenue flows in as a credit to the RECA. So that's why Mr. Ives put together that benefit schedule that he did. If you look at it, it's not like 10 percent of the benefit went to the shareholders. It's interesting. They have a FERC-regulated authorized return on that investment for shareholders but it doesn't go to shareholders the way Westar's rates are set. It's all credited back to ratepayers. So I know it's an all-encompassing statement. But aside from maybe timing related, they had the $3.5 million for 18 months before they started giving it back to customers, or something negligible like that. The benefit of this transaction went to ratepayers").

[7] KIC Initial Brief, pp. 4 and 24.

[8] Staff Initial Brief, p. 16.

Once the Commission wades through the inaccuracies and unsubstantiated conclusions in KIC's and CURB's arguments, it is clear that Westar's proposal for cost recovery will result in just and reasonable rates and the Commission should approve Westar's Application in its entirety.

II. Legal Standard

As Staff and Westar both indicated in their Initial Briefs, when reviewing Westar's Application for cost recovery through the RECA, the Commission should determine whether Westar's rates will be just and reasonable if Westar's Application is granted and whether Westar acted prudently when it decided to resolve its disputes with MWP and conclude the lease arrangement by entering into the settlement agreement with MWP and agreeing to extend the lease and purchase the 8% interest in JEC.[9] KIC and CURB do not really dispute the application of this standard but instead cloud the issue by offering discussions of different legal standards that are not relevant to this Application, as discussed below and throughout this Reply Brief.

KIC's and CURB's suggestion that Westar must prove that the capacity and energy from the 8% interest in JEC is needed to serve customers is incorrect. As Westar explained in its Initial Brief, this docket is different from a situation where Westar would have purchased or constructed brand new generation to serve customers and the Commission would review the need for the new asset.[10] In this case, the generation from the 8% interest in JEC has existed in Kansas and has been

[9] K.S.A. 66-101b ("Every electric public utility governed by this act shall be required to furnish reasonably efficient and sufficient service and facilities for the use of any and all products or services rendered, furnished, supplied or produced by such electric public utility, to establish just and reasonable rates, charges and exactions and to make just and reasonable rules, classifications and regulations"); *Kansas Gas & Electric Co. v. Kansas Corp. Comm'n*, 239 Kan. 483, 491 (1986); Grady, Tr. at 176-178 ("Westar has to show that it's a prudent or reasonable decision to extend the lease or to purchase the asset . . . the standard the Commission would apply or should be applying is just, just and reasonable rates standard . . . It would be, it's just efficiency of operations, prudency from the perspective of efficient and sufficient service. And rational prudent management. It's more of a business case or a cost-benefit analysis in my mind").

[10] Westar Initial Brief, pp. 5-6.

used to serve retail customers in Kansas since JEC was constructed.[11] It is not a situation where Westar is talking about adding to the generation portfolio in the state – the generation already exists and the question is whether it should be utilized to benefit customers or left underutilized. Mr. Ives explained:

> This 8 percent is already installed. It's already in place. The question is whether we under-utilize the facility by permanently de-rating it and not maximizing the assets that are out there and in place for the next 20 years or whether we run it in a way that provides energy and capacity that can be a benefit to the customers in Kansas . . . So I do think it's different than a new generator or new capacity. And it's really about whether we under-utilize the asset that's out there today or whether we make it available to the market and utilize the resource to its capability.[12]

Additionally, Westar's purchase of the 8% interest is the result of a long history of transactions, including the initial sale-leaseback agreement and Westar's assumption of the lease, all of which the Commission and parties including CURB and KIC found to be prudent. The Commission should consider Westar's decision to purchase the 8% interest in light of that history.[13] While the Commission is not bound by its previous decisions approving the sale/leaseback transaction in 1991 and Westar's assumption of the lease agreement in 2007,[14] the Commission should make its decision in this docket with recognition of its findings in those dockets. The capacity and energy from the 8% interest will be used to serve Westar's customers and, as discussed above, the question to be decided by the Commission is whether Westar's decision to acquire the 8% interest in order

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[11] Grady, Tr. at 165-167.

[12] Ives, Tr. at 108.

[13] Grady, Tr. at 155-156 ("it would be bad regulatory policy to do that, to disallow costs that a utility cannot avoid that were based on a prudent decision").

[14] *See* Order and Certificate, Docket Nos. 175,456-U and 91-UCUE-226-MER (Sept. 30, 1991); Order Adopting Stipulation and Agreement, Docket No. 06-MKEE-524-ACQ (Feb. 23, 2007).

to resolve and conclude the lease arrangement was reasonable given the facts and circumstances existing when Westar made the decision.

KIC also spends a portion of its Initial Brief arguing that Westar did not obtain statutory preapproval for the transaction at issue in this docket.[15] However, Westar and Staff have been very clear that they are not arguing that the Commission somehow "preapproved" the cost recovery at issue in this docket when it approved the sale/leaseback transaction and Westar's approval of the lease agreement so KIC's argument that Westar is somehow arguing that preapproval occurred falls flat. Instead, as Westar explained in its Initial Brief,

> the Commission is not bound by its previous decisions approving the sale/leaseback transaction in 1991 and Westar's assumption of the lease agreement in 2007,[16] the Commission should make its decision in this docket with recognition of its findings in those dockets. In other words, the Commission should determine whether Westar acted prudently when it decided to resolve its dispute with MWP and bring the lease arrangement with MWP to a close by extending the lease for seven months and purchasing the 8% interest for $3.7 million in August 2019, given the fact that the Commission had already found the original sale/leaseback transaction and Westar's decision to assume the lease to be prudent and that it resulted in substantial benefits for customers.[17]

Staff witness Grady explained this further when he testified at the hearing that "[m]y analysis is not based on the fact that the Commission approved the contract in 2007 and so the Commission's hands are tied. I don't believe that."[18] Instead, Mr. Grady did a "regulatory policy, regulatory

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[15] *See, e.g.,* KIC Initial Brief, p. 28.

[16] *See* Order and Certificate, Docket Nos. 175,456-U and 91-UCUE-226-MER (Sept. 30, 1991); Order Adopting Stipulation and Agreement, Docket No. 06-MKEE-524-ACQ (Feb. 23, 2007).

[17] *Violet v. Federal Energy Regulatory Commission*, 800 F.2d 280, 282-283 (1st Cir. 1986) ("[M]anagers of a utility have broad discretion in conducting their business affairs and in incurring costs necessary to provide services to their customers. In performing our duty to determine the prudence of specific costs, the appropriate test to be used is whether they are costs which a reasonable utility management (or that of another jurisdictional entity) would have made, in good faith, under the same circumstances, *and at the relevant point in time*").

[18] Grady, Tr. at 155-156.

decision-making analysis that suggests it would be bad regulatory policy to do that, to disallow costs that a utility cannot avoid that were based on a prudent decision.[19] Additionally, although Westar did not seek preapproval of the purchase of the 8% interest or cost recovery after the expiration of the initial lease, KIC ignores the fact that the original lease agreement approved by the Commission specifically contemplated Westar's purchase of the 8% interest, although at a much higher price than that negotiated by Westar.[20]

III. Westar's decision to settle with MWP by extending the lease agreement and purchasing the 8% interest in JEC was prudent and will result in just and reasonable rates.

As demonstrated in Westar's Initial Brief, Westar's decision to settle with MWP by extending the lease agreement and purchasing the 8% interest in JEC was the best possible resolution to a contractual dispute that arose from an arrangement the Commission found to be prudent and that created substantial benefits, all of which were provided to customers and the acquisition of the 8% interest will provide net benefits to customers over the life of the plant, when considered on an incremental basis. KIC and CURB continue their attempts to characterize Westar's settlement with MWP as a shifting of risk to customers when, in reality, the settlement with MWP simply represents the prudent resolution of a business arrangement that was executed with the goal of benefitting customers from the start. Customers have received all of the benefits of that arrangement and it is perfectly reasonable for Westar to ask that customers pay the related costs of bringing the arrangement to a close now.

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[19] *Id.*

[20] Ives Rebuttal, at 6.

A. KIC's and CURB's argument that Westar should have done an all-in cost benefit analysis fails.

The Commission should evaluate Westar's decision to acquire the 8% from an incremental cost basis, because Westar will incur the fixed O&M and capital costs regardless of whether it owns 84% or 92% of Jeffrey.[21] In fact, both Mr. Gorman and Ms. Crane agreed with Westar and Staff that a significant amount of the JEC costs are fixed and unavoidable.[22] CURB's and KIC's argument that Westar should do an all-in cost-benefit analysis instead of an incremental analysis fails because their assertion that customers would not have been responsible for paying the costs that MWP failed to pay is unreasonable. Despite Mr. Gorman's and Ms. Crane's agreement that these costs are unavoidable, CURB and KIC still seem to assume that Westar could have somehow avoided incurring the fixed NFOM and capital costs so customers should not be responsible. That is inconsistent on their part and far from the truth. As explained in Westar's Initial Brief, these costs are the result of – were caused by – a contractual arrangement the Commission and all parties involved at the time found to be prudent and beneficial for customers.[23] In other words, Westar's decision to purchase the 8% interest in JEC is not what exposed customers to the O&M costs. Instead, Westar's decision to assume the lease from Aquila exposed customers to those costs (and the related benefits, which far outweighed those costs) and that decision was found to be prudent when it was made.[24] As discussed below, each of the bases KIC and CURB assert to support their conclusion that customers should not be responsible for these costs fails.

[21] Ives Rebuttal, at 3.

[22] Crane, Tr. at 127 ("it is likely that the level of costs that will need to be incurred will not vary greatly depending on who owns that 8 percent interest. So I think Westar is probably right that the bulk of these costs are going to be incurred regardless"); Gorman, Tr. at 139.

[23] Ives Rebuttal, at 8.

[24] Grady Cross-Answering, at 7 ("the only way Westar could have avoided responsibility for the 8% portion of JEC would have been not to assume the lease on the 8% portion of JEC in 2007, instead allowing Mid-Kansas Electric

i. Westar's proposal does not shift risk to customers from shareholders but instead leaves risks in alignment with the receipt of benefits from the transaction.

Contrary to KIC's and CURB's arguments, requiring customers to pay the costs associated with bringing the lease for the 8% interest in JEC to a close places cost responsibility in line with customers' receipt of all of the benefits of the lease transaction. Regulatory precedent makes it clear that if customers receive all of the benefits from the lease arrangement, they should also be responsible for the costs to conclude the arrangement at the end of the lease term and that includes the costs Westar seeks recovery of in this docket.[25] KIC and CURB do not dispute that customers received all of the benefits from Westar's assumption of the lease agreement. Shifting of costs would only occur if KIC's and CURB's proposals were adopted because then customers would receive all of the benefit from Westar's assumption of the lease agreement and shareholders would cover all of the end costs and risks of the arrangement that became apparent as the lease came to a close.[26] Such a result unreasonable and inconsistent with Kansas law and regulatory principles that require a balancing between customers and shareholders.[27] It is highly disingenuous for KIC

Company (MKEC) to assume the lease . . . Westar's decision to assume the lease on the 8% portion of JEC was a prudent decision when it was made, and that decision has benefitted Westar's customers over the last 11 years).

[25] *Application of Duquesne Light Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code*, 1998 Pa. PUC LEXIS 4, *7 (Pa. P.U.C. March 18, 1998) ("One of the central tenets of regulatory policy is to match the cost of a benefit with the benefit itself"); *Midwest Indep. Transmission Sys. Operator*, 133 F.E.R.C. P61,221, 62094 (F.E.R.C. December 16, 2010) (core principle of cost allocation is that "the costs allocated to a beneficiary are at least roughly commensurate with the benefits that are expected to accrue to that entity"); *Illinois Commerce Commission v. Federal Energy Regulatory Commission*, 576 F.3d 470, 476 (7th Cir. 2009) ("FERC is not authorized to approve a pricing scheme that requires a group of utilities to pay for facilities from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its members").

[26] Ives Rebuttal, at 5.

[27] Due process requires the Commission to balance the interests of customers with the interests of investors when making decisions regarding Westar's recovery of costs and allowed return. *See, e.g., Danisco Ingredients USA, Inc. v. Kansas City Power & Light Co.*, 267 Kan. 760, 773 (1999) ("In establishing rates, the KCC is required to balance the public need for adequate, efficient, and reasonable service with the public utility's need for sufficient revenue to meet the cost of furnishing service and to earn a reasonable profit"); *see also Kansas Gas & Electric Co. v. Kansas Corp. Comm'n*, 239 Kan. 483, 488 (1986) ("When determining whether rates are just and reasonable, "the goal should be a rate fixed within the 'zone of reasonableness' after the application of a balancing test in which the interests of all

and CURB to suggest that Westar is somehow shifting risks to customers when the lease arrangement was entered into on behalf of and for the sole benefit of customers from the start and there is no "shifting of costs" involved in having the recipients of the benefits of the lease be responsible for the costs associated with that lease.

ii. KIC's argument that shareholders should be responsible for changes in market conditions is not supported whatsoever by the law and the application of KIC's position would cause an absurd result.

KIC cites a number of court decisions in an attempt to support its position that a change in market forces caused the 8% interest to become unprofitable and that customers do not have an obligation to insulate Westar from market risks so should not have to pay any costs related to the 8% interest in JEC. The cases cited by KIC do not support this proposition whatsoever; instead, they demonstrate that it would be inappropriate for shareholders to bear all costs and risks to bring an arrangement to close when customers have received all of the benefits from that same arrangement.

First, KIC cites to *State of Missouri ex rel. Sw. Bell Tel. Co. v. Pub. Serv. Comm'n of Missouri* to argue that utility investors get a return on their investment,[28] a statement not in dispute in this docket. However, that case goes on to make it clear that "the Commission is not the financial manager of the corporation and it is not empowered to substitute its judgment for that of the directors of the corporation; **nor can it ignore items charged by the utility as operating expenses unless there is an abuse of discretion in that regard by the corporate officers**."[29] (emphasis

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concerned parties are considered. In rate-making cases, the parties whose interests must be considered and balanced are these: (1) The utility's investors vs. the ratepayers; (2) the present ratepayers vs. the future ratepayers; and (3) the public interest"); Grady, Tr. at 161 ("we could require the shareholders to incur the costs but that seems imbalanced given the fact that literally all of the benefit of this transaction, since 2007, has went to ratepayers").

[28] KIC Initial Brief, p. 23.

[29] 262 U.S. 276, 289 (1923).

added). In other words, it would be inappropriate for the Commission to disallow Westar recovery of the lease expense and NFOM costs unless there was evidence that Westar acted imprudently when it made the decision that resulted in those costs and no such evidence exists.[30]

Next, KIC cites to *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.* To argue that investors get a market-based return so market losses should reside with shareholders.[31] The *Bluefield* case does not support KIC's conclusion. KIC's attempt to argue that the risks surrounding Westar's assumption of the lease for the 8% interest in JEC, including risks associated with holding an interest in a coal plant when the SPP market and price of gas impact the value of coal generation, are "market risks" that shareholders should bear is unsupported by *Bluefield* and illogical. The Court in *Bluefield* explains that utility investors are entitled to a return

> on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties . . . The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. **A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.**[32] (emphasis added).

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[30] *See also* Grady, Tr. at 155-156 ("in order for ratepayers not to pay the costs, then I think that there needs to be a finding that, one, the costs are inefficient or the costs are imprudent. And I can't in good conscience make that argument because it was that 2007 decision. If you go back to the chain of events, the only way that they would, that customers would not be – that Westar would not be incurring the costs, the only way Westar would not be incurring the costs is if they had somebody else to bill the costs to. And they would only have somebody else to bill the costs to if they didn't take over the lease in 2007. But we have testimony by KIC witnesses in 2008 that says that was a good decision. And, in fact, you were obligated to do that, Westar, because that's how you create value for your customers. So the way I look at that time is, you know, Westar made a prudent decision").

[31] KIC Initial Brief, p. 23.

[32] 262 U.S. 679, 692 (1923).

In other words, *Bluefield* reaches the opposite conclusion from that asserted by KIC – the appropriate rate of return to be authorized for a utility and its shareholders is in fact affected by market conditions and should be adjusted as a result of changes in those market conditions.

Furthermore, when *Bluefield* discusses use of a market-based return for utility investors, it is referring to market losses and gains in the value of the utility stock and the value of the company overall, not specific contractual risks incurred as part of the utility's efforts to provide reliable and cost-effective service to its customers. KIC's suggestion that shareholders should be required to bear all "market risks" if market conditions – such as the market for coal generation – change after Westar has made a prudent decision in order to serve its customers is illogical and overreaching. This would mean that shareholders would have to bear the costs of any contract risk even when the contract was prudently entered to serve customers and apparently that customers would keep all of the benefits received up until the time the market conditions changed. This is a textbook example of hindsight regulation, which is clearly prohibited.[33] If KIC's proposition were to be applied broadly to all of Westar's contracts, there is no way a utility could operate and continue to provide reliable service to customers and a reasonable return to shareholders. For example, under KIC's interpretation, if the utility entered a PPA that was clearly a prudent investment at the time it was entered but market conditions subsequently changed making the PPA less competitive, KIC would propose disallowance of the PPA costs. This is, as indicated above, clearly hindsight review and inappropriate under Kansas law and regulatory policy.

[33] *See, e.g., City of New Orleans v. Federal Energy Regulatory Commission*, 67 F.3d 947, 954 (D.C. Cir. 1995) ("Neither FERC nor this court can properly use hindsight in evaluating the reasonableness of a decision's effect on rates . . . We note that while in hindsight it may be clear that a management decision is wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses").

Next, KIC cites *Duquesne Light Co. v. Barasch* to argue that customers do not have to insulate shareholders from market risks, even for an initially prudent investment.[34] This is a complete mischaracterization of the conclusions reached in *Duquesne*. In that case, the Court made two significant findings – first, that hindsight review of a utility's decisions is not appropriate, and second, that it is inappropriate to force shareholders to bear all costs of an investment and allow customers to keep all of the benefits. Specifically, with respect to hindsight review, the Court stated that "[u]nder the prudent investment rule, the utility is compensated for all prudent investments at their actual cost when made (their 'historical cost'), irrespective of whether individual investments are deemed necessary or beneficial in hindsight."[35] And with respect to market risks, the Court explained that "a State's decision to arbitrarily switch back and forth between methodologies in a way which **required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others would raise serious constitutional questions**."[36] (emphasis added).

Duquesne makes it clear – contrary to KIC's suggestion – that the Commission cannot review Westar's decision to assume the lease for the 8% interest in JEC – and any resulting consequences of that decision – based on hindsight, even if generation market conditions have changed over time. Instead, the Commission should evaluate the prudency of Westar's decision to settle with MWP and purchase the 8% interest in light of the fact that Westar's assumption of the lease was prudent when it occurred and caused Westar to incur certain costs related to the 8% interest. Additionally, *Duquesne* makes it clear that it is appropriate to consider the fact that

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[34] KIC Brief, p. 23.

[35] *Duquesne*, 488 U.S. 299, 309 (1989).

[36] *Id*. at 315.

customers received all benefits from Westar's assumption of the lease agreement when assigning responsibility for the related costs.

Finally, KIC cites to *Market Street Railroad. Co. v. R.R. Comm'n of State of Cal.* in order to argue that due process does not require insurance of a utility's value or restoration of value that has been lost by operation of economic forces.[37] KIC's reliance on this case is misplaced because the decision in *Market Street* was based on a very specific and unusual set of facts and that decision is completely inapplicable in this docket. As the D.C. Circuit Court of Appeals explained, the *Market Street* case involved a railway company that was "a particularly ailing unit of a general sick industry whose property had been reduced in value by economic forces beyond the possibility of regulatory repair."[38] The Court in *Market Street* found that concerns about authorizing a return sufficient to maintain credit and attract capital were "inapplicable to a company whose financial integrity already is hopelessly undermined, which could not attract capital on any possible rate, and where investors recognize as lost a part of what they have put in."[39] As the D.C. Circuit Court explained, the *Market Street* holding has no application to a "dynamic industry" that is not suffering from the same ailments that the street car industry was suffering in 1945.[40] As a result, *Market Street* has no relevance whatsoever to the issues before the Commission in this docket involving a request for cost recovery from a healthy company participating in a healthy and dynamic industry.

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[37] KIC Brief, p. 23-24.

[38] *Cincinnati Gas & Electric Co. v. Federal Power Comm'n*, 246 F.2d 688, 691-692 (D.C. Cir. 1957) (discussing *Market Street*, 324 U.S. 548 (1945)).

[39] *Market Street*, 324 U.S. 548, 566 (1945).

[40] *Cincinnati Gas & Electric Co.*, 246 F.2d at 691-692.

iii. KIC and CURB misunderstand the relevance of customers' receipt of tens of millions of dollars of past benefits from Westar's assumption of the lease agreement.

KIC and CURB argue that because Kansas sets rates prospectively based on a historical test year using the current cost of serving customers, the fact that customers have received substantial benefits from Westar's assumption of the lease for the 8% interest should not be relevant to the Commission's decision in this case.[41] This assertion is wrong and reflects a misunderstanding by KIC and CURB of the relevance of these substantial benefits. Westar and Staff are not suggesting that the benefits received by customers since 2007 as a result of Westar's assumption of the lease should be included in a calculation to set rates (i.e., somehow increase Westar's revenue requirement by the amount of past benefits customers have received). Instead, Westar's and Staff's position is that because customers have received all of the benefits of the lease arrangement since Westar assumed it in 2007, customers should be responsible for the costs of concluding that arrangement. Even the case law cited by KIC makes it clear that it is appropriate to consider receipt of past benefits when determining responsibility for costs related to the transaction that created those benefits.[42] Additionally, in this case, Westar and Staff have gone even further to demonstrate that current customers will benefit on a prospective basis from Westar's purchase of the 8% interest when considered on an incremental basis through the life of JEC.

[41] KIC Initial Brief, p. 26; CURB Initial Brief, p. 14.

[42] *Duquesne*, 488 U.S. 299, 315 (1989); *see also Application of Duquesne Light Company for Approval of Its Restructuring Plan Under Section 2806 of the Public Utility Code,* 1998 Pa. PUC LEXIS 4, *7 (Pa. P.U.C. March 18, 1998) ("One of the central tenets of regulatory policy is to match the cost of a benefit with the benefit itself"); *Midwest Indep. Transmission Sys. Operator*, 133 F.E.R.C. P61,221, 62094 (F.E.R.C. December 16, 2010) (core principle of cost allocation is that "the costs allocated to a beneficiary are at least roughly commensurate with the benefits that are expected to accrue to that entity"); *Illinois Commerce Commission v. Federal Energy Regulatory Commission*, 576 F.3d 470, 476 (7th Cir. 2009) ("FERC is not authorized to approve a pricing scheme that requires a group of utilities to pay for facilities from which its members derive no benefits, or benefits that are trivial in relation to the costs sought to be shifted to its members").

B. There is no requirement for Westar to prove it pursued cost recovery from MWP and KIC's and CURB's focus on this issue completely disregards the reality of the situation.

KIC and CURB seem to suggest that Westar is required to prove that it pursued every possible avenue for cost recovery from MWP before requesting rate recovery in this docket. That is clearly not the applicable standard. Instead, as discussed above, Westar is required to prove that it acted prudently given the existing facts and circumstances when it entered into the settlement agreement with MWP to purchase the 8% interest in JEC and that rates will be just and reasonable if Westar's Application in this docket is approved.

KIC's and CURB's focus on whether Westar pursued cost recovery aggressively enough from MWP demonstrates that they are conveniently ignoring the circumstances that faced Westar when it chose to enter into the settlement with MWP to purchase the 8% interest. As both Mr. Ives and Mr. Grady explained during the hearing, MWP representatives, while testifying under oath before the Commission, clearly indicated that MWP did not intend to pay its share of NFOM and capital costs for JEC even if it remained an owner of the 8%[43] and it was clearly established in the MWP Certificate Docket that the Trust holding the 8% interest for MWP's benefit had no assets and did not intent to pay its share of costs and that MWP, as the beneficiary of the Trust, and KeyCorp, MWP's parent company, did not intend to cover any costs.[44] Any attempt by Westar to "force" MWP to pay its share of costs at JEC would have simply resulted in an inability of the Trust to pay, a refusal by MWP and KeyCorp to pay, litigation between MWP and Westar, and a delay in Westar's ability to effectively resolve the dispute with MWP in a beneficial manner for

[43] Ives, Tr. at 42-43; Grady, Tr. at 150.

[44] *See* Westar Initial Brief, p. 22.

customers.[45] Given that customers would have been responsible for the same NFOM expenses either way – whether Westar pursued foreclosure and litigation or whether Westar entered a settlement with MWP[46] – it was entirely reasonable for Westar to seek to avoid the time and expense, as well as litigation risk, of pursuing foreclosure and instead settle with MWP in an effort to obtain the best outcome possible for customers.

C. The impact of Westar's proposal on future approval of energy efficiency programs is not supported by evidence and is irrelevant.

KIC's attempt to argue that Westar's Application in this docket will somehow impact the future approval of energy efficiency programs completely fails. KIC cites to the record from the evidentiary hearing where KIC's counsel asked Westar witness Mr. Ives about this argument. However, when the record is reviewed, it becomes clear that Mr. Ives did not agree with the proposition regarding energy efficiency that was being asserted by KIC's counsel. In fact, Mr. Ives explained to counsel that he had misread the Commission order he was quoting from during questioning and that the order counsel was referring to focused on "postponing future construction of generation" not on "acquisition of existing generation that is a Kansas resource already."[47] Contrary to the suggestion in KIC's Initial Brief, upon further questioning, Mr. Ives made it clear that he <u>did not believe</u> the purchase of the 8% interest in JEC <u>would have any impact</u> on whether energy efficiency would have value in Westar's portfolio: "I would tell you, we evaluate kind of the robustness of our portfolio, and have across our entities, and continue to believe today, with

[45] *Id*.

[46] Ives, Tr. at 110-111.

[47] Ives, Tr. at 58.

the capacity levels we have in place, that inclusion of energy efficiency would be of benefit to the customers and would fit with our existing portfolio. They're not exclusive."[48]

Given that KIC presents no evidence of its own to support its argument regarding impact on energy efficiency programs – Mr. Gorman does not mention it at all in his testimony – and the testimony cited by KIC is directly contrary to KIC's position, there is no basis in the record for the Commission to conclude that Westar's purchase of the 8% interest in JEC would have any impact on future approval of energy efficiency programs. In fact, because the capacity associated with the 8% interest in JEC was already included as a generation asset in Westar's capacity reporting (since Westar has historically controlled that generation through the lease since 2007),[49] it is more likely that Westar's purchase of the same generation will have no impact whatsoever on the valuation of energy efficiency as part of Westar's portfolio.

D. KIC's discussion of environmental costs and risks is irrelevant to the benefit-cost analysis for the 8% interest.

KIC repeats the argument made by Mr. Gorman in testimony about increased environmental costs and risks associated with the 8% interest in JEC but fails to respond to the Rebuttal Testimony of Mr. Ives on this issue, where he explains:

> Mr. Gorman seems to be suggesting that Westar will incur additional costs to comply with environmental requirements and additional decommissioning costs as a result of its acquisition of the 8% interest of JEC. If true, these costs would all be incurred by Westar as the operator of the plant and, similar to the other fixed NFOM and capital costs discussed above, should be considered sunk or fixed costs, not relevant to the incremental cost-benefit analysis because they are costs that Westar would have incurred (and customers would have been responsible for) regardless of whether Westar purchased the 8% interest from MWP or not.[50]

[48] Ives, Tr. at 59.

[49] Ives, Tr. at 85-86.

[50] Ives Rebuttal, at 11.

In other words, because any environmental-related costs would have been incurred by Westar regardless of whether Westar purchased the 8% interest in JEC or not, it is not necessary to include those costs in the benefit-cost analysis in this case.

E. KIC's argument regarding the fact that the sale/leaseback transaction did not include a parental guaranty is unreasonable and constitutes improper hindsight regulation.

KIC argues that Westar should have included a parental guaranty in the sale/leaseback agreements and that this means customers should not be responsible for the costs at issue in this docket.[51] Westar clearly addressed this argument and its fallacies in its Initial Brief. As explained there, KIC's argument fails for a number of reasons:

- KIC's argument is factually inaccurate. Westar was not a contracting party in 1991 when the sale/leaseback agreements were created and signed and would have had no control over what guarantees were included in the agreements.[52] Westar did not become involved in the arrangement until 2007 when it assumed the lease, already signed and in place, from Aquila.[53]
- Just because Westar might include guarantees in certain types of agreements it enters today or SPP requires guarantees in certain situations does not mean it was bad practice for the contracting parties (which did not include Westar) not to include a guaranty that would have covered the exact situation Westar is in today in the sale/leaseback agreements. The sale/leaseback arrangement involved a complex set of agreements[54] and KIC has provided no legal or factual basis to

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[51] KIC Initial Brief, pp. 31-32.

[52] Ives Direct, at 3.

[53] *Id*.

[54] Ives, Tr. at 45 ("transaction involved "relatively unique and complicated sale-leaseback arrangement").

demonstrate that it would have been standard practice to include the type of guaranty it discusses in such a set of contracts.

- KIC's attempt to characterize the sale/leaseback arrangement as poor contracting now – after its members have enjoyed millions of dollars in benefits from the very same arrangement and which its witnesses have testified in support of in previous dockets – is disingenuous and would result in hindsight review. The Commission approved the set of contracts that resulted in the sale/leaseback in their entirety in 1991 and to now suggest that the fact that those contracts did not include one specific type of guaranty and to hold that against Westar, who wasn't even a party to the contracts at the time, would be completely unreasonable.[55]

IV. Deregulation of the 8% interest in JEC is unsupported, unreasonable and unprecedented and should be rejected by the Commission.

Both KIC and CURB suggest that the Commission should deny Westar's Application and instead allow Westar to operate the 8% interest as deregulated, making shareholders responsible for all related costs but allowing them to retain any profit attributable to the 8% interest.[56] As Westar explained in its Initial Brief, it is unnecessary and inappropriate for the Commission to consider these alternative recommendations. As discussed above, it would be bad regulatory policy to find Westar's assumption of the lease in 2007 to be prudent and allow customers to receive all of the tens of millions of dollars in benefits from the lease but then force Westar to treat

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[55] *See, e.g., City of New Orleans v. Federal Energy Regulatory Commission*, 67 F.3d 947, 954 (D.C. Cir. 1995) ("Neither FERC nor this court can properly use hindsight in evaluating the reasonableness of a decision's effect on rates . . . We note that while in hindsight it may be clear that a management decision is wrong, our task is to review the prudence of the utility's actions and the costs resulting therefrom based on the particular circumstances existing at the time the challenged costs were actually incurred, or the time the utility became committed to incur those expenses").

[56] KIC Initial Brief, p. 33-34; CURB Initial Brief, p. 20-21.

the 8% interest in JEC as unregulated so that shareholders incur all of the costs and risks of bringing the lease arrangement to a close.[57] KIC's and CURB's proposal regarding deregulating the 8% interest is also completely unsupported by any precedent in the record. When KIC witness Mr. Gorman was asked whether he could provide any examples where this type of "deregulation" for a portion of a generating asset had been done before, he failed to answer the question directly or provide any specific examples and instead discussed the entirely different concept of allocating costs among different rate jurisdictions.[58]

Deregulating the 8% and allowing Westar to "play the market" to recover its cost and earn a profit for shareholders is not workable and would, as Staff states in their Initial Brief, leave Westar in the same unworkable financial position as MWP would have been if it retained ownership of the 8% interest. This approach would result in a regulatory injustice as explained by Mr. Grady at the evidentiary hearing[59] and, ultimately, a permanent de-rate of the JEC units to 92% of capacity, wasting generation that already exists in the State and could otherwise be operated to benefit Westar's customers.[60] Staff accurately explained:

> Deregulating the asset will not change the fact that current wholesale market revenue will not fully cover these costs. Thus, KIC and CURB's position only attempts to shift these costs on to Westar's shareholders. **To disallow costs that a utility cannot avoid that were based on a prudent decision is unprincipled regulatory policy**.[61] (emphasis added).

[57] Grady, Tr. at 155-156, 161 ("we could require the shareholders to incur the costs but that seems imbalanced given the fact that literally all of the benefit of this transaction, since 2007, has went to ratepayers").

[58] Gorman, Tr. at 137-138.

[59] Grady, Tr. at 155-156, 161.

[60] Ives, Tr. at 108.

[61] Staff Initial Brief, p. 16 (citing Grady, Tr. at 156).

Westar has demonstrated that its extension of the lease agreement and purchase of the 8% interest in JEC will provide net benefits to customers through the life of JEC and Staff supports this conclusion. There is no basis whatsoever to deny Westar's Application for recovery of costs and adopt the alternative proposals regarding treated the 8% interest as unregulated. Such a result would create a permanent derating of the 8% interest in JEC and a loss of that capacity for Kansas.

V. Conclusion

The Commission should approve Westar's Application because Westar's decision to enter into a settlement with MWP to extend the lease agreement and purchase the 8% interest in JEC will create a net benefit for customers over the remaining life of JEC and it is, therefore, just and reasonable for Westar to recover the lease expense and associated NFOM costs from customers. KIC and CURB present factually and legally unsupported arguments in support of their contention that customers should not be responsible for the costs that flow directly from a contractual arrangement that all parties found to be prudent at the time it was entered and that has provided tens of millions of dollars in benefits to customers. Those arguments fail and the Commission should therefore approve Westar's Application for such recovery in its entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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