BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

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

REPLY BRIEF OF COMMISSION STAFF

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Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission", respectively), submits its Reply Brief regarding the Joint Application of Westar Energy, Inc. and Kansas Gas and Electric Company for recovery of certain costs through their RECA.

I. INTRODUCTION

1. In this Reply Brief, Staff responds to the Initial Briefs of The Citizens' Utility Ratepayer Board (CURB) and Kansas Industrial Consumers Group Inc., (KIC). For brevity and remaining in the scope of the docket, this brief will only address issues relevant to this docket and will not address some of the more superfluous issues raised by KIC and CURB. Staff's lack of response to any point raised by CURB's or KIC's initial briefs should not be interpreted as agreement with either party.

II. Staff Response to KIC

2. KIC makes an abundance of arguments in its Initial Brief. For the sake of brevity and clarity of the record, Staff will not respond to the majority of KIC's arguments that are not related to the crux of the issues in this proceeding. Staff asserts that KIC is attempting to confuse the situation of this Docket and present an oversimplified legal interpretation of agreements related to the sale-leaseback transaction. Staff disagrees with KIC's elucidation of the Westar transaction as being a purchase or transaction for more or new generation capacity. Staff also disagrees with KIC's simplified legal analysis of agreements entered into by the Westar's predecessors in 1991. Lastly, Staff stresses that KIC is misleading the record with continuous attempts to compare Mr. Gorman's flawed cash flow model with Westar's circumstances. Overall, Staff contends that KIC's arguments fail on two points: first, Westar is not entering into a contract for brand new generating capacity or energy, it is simply trying to

wrap up the sale-leaseback transaction started in 1991, and assumed in 2007, second, given the options available to Westar, it made a prudent decision by entering into a new lease and purchase agreement with Midwest Power Company (MWP). This new lease and purchase agreement avoided delay, costs, and uncertainty associated with a default and litigation scenario, which Staff asserts would have left Westar in the same position as it is in today. That is, asking the Commission to recover the same bucket of contested and unrecovered non-fuel operations and maintenance (NFOM) costs.

a. KIC asserts Westar is asking the Commission to approve an acquisition for additional generating capacity in violation of the predetermination statute, K.S.A. 66-1239.

3. KIC has mischaracterized the nature of this docket and the nature of the 8% undivided interest in JEC. The transaction at issue in this docket does not fall within the parameters of K.S.A. 66-1239 as KIC insists.[1] KIC asserts that this docket is about Westar contracting for new generation capacity and energy. Westar's lease extension of the 8% undivided interest in Jeffrey Energy Center (JEC) is not a contract for the purchase of new electric energy or capacity; it is simply the conclusion of the original financing arrangement started in 1991 with a sale leaseback transaction when UtiliCorp sold its 8% interest in JEC to MWP's predecessor. In 2007, Westar assumed the obligations from Aquila and had been selling the output to MKEC through a PPA. The original transaction contained provisions for Westar to extend the lease and/or purchase MWP's 8% interest and included a calculation methodology for the plant's residual value. While Westar chose to decline its purchase option under the sale-leaseback transaction, Westar continued negotiations for the purchase of the 8% interest based on a more realistic evaluation of its reasonable value. While technically Westar's purchase adds generating capacity and energy, this capacity was already installed and Westar was simply acting

[1] Initial Brief of KIC at 11, ¶ 27 (July 31, 2019).

to reduce its customers' exposure to the fixed NFOM expenses that it will inevitably incur whether it owns the 8% interest or not.[2] Additionally, in direct contradiction to KIC's arguments, the capacity has always been used to serve Kansas retail customers.[3] Staff views this docket as the completion of the sale leaseback from 1991, which Westar assumed in 2007, and Staff disagrees with KIC assertion that Westar's purchase of the 8% undivided interest in JEC should fall under the standards discussed in K.S.A. 66-1239. Lastly, K.S.A. 66-1239 sets out a process whereby a utility may seek predetermination by the Commission of the reasonableness of a new generation addition. Even if the 8% interest in JEC could be characterized as new generation, and it cannot, there is no requirement for Westar to file for Commission approval under that process. Given that Westar did not file its Application under K.S.A. 66-1239, KIC's arguments regarding the standards presented in this statute should be given no weight.

4. This docket is not a typical tariff filing and the decision on how to handle the 8% undivided interest in JEC is a unique policy issue for the Commission to consider. This financing arrangement was initiated in 1991 with a sale-lease back transaction when UtiliCorp sold its 8% interest in JEC to MWP's predecessor. Westar assumed the obligations of UtiliCorp in 2007. This sale-leaseback transaction took the asset and held it in trust and then leased the 8% portion back to the Westar, the facility operator. JEC continued to operate serving retail customers in the same way it always has. The sale-leaseback was just a financing transaction that allowed access to capital. As one of the key findings in the Docket No. 91-UCUE-226-MER, the Commission found the owner trustee Wilmington Trust Company and the owner participant, MWP's predecessor should not be "public utilities" under Kansas Law, reasoning as follows:

[2] Tr. at 108, ll. 1-4 (Ives).
[3] Tr. at 166, ll. 16-23 (Grady); 19-064 Tr. at 128, ll. 12-19. (Unrein).

> Under the circumstances in this preceding, it is clear the agreements are financial instruments and do not confer sufficient managerial or operational control over the JEC interest to constitute a public utility. The Commission finds the owner trustee, the owner participant (and any guarantor of the obligations of the owner participant), the indenture trustee and the note purchasers will not become utilities pursuant to K.S.A. 66-104 or K.S.A. 66-158(c), or otherwise subject to the jurisdiction of the Commission solely by reason of their participation in the sale and lease financing arrangements.[4]

Thus, it can be argued that the Commission never contemplated the owner trustee or the owner participants becoming regulated public utilities.

5. Typically, in this type of financial transaction, at the end of the sale-leaseback terms, the operator will purchase the portion that was leased.[5] While Westar declined its right to exercise its purchase option under the sale leaseback provisions, it continued to negotiate with MWP based on the fair market value of the ownership interest.[6] Staff contends this was a prudent decision as the fair market value is based on the plant's current ability to produce revenue from the SPP wholesale market where the residual value methodology was based on the future market revenue at the time the contract was signed. Ultimately, it was the current SPP wholesale market environment that drove Westar and MWP's decision making in wrapping up this original financial transaction.[7] If the SPP wholesale market could have produced enough revenue for the ownership interest to fully support its operations, MWP would have sold the 8% interest to another party long before applying for a Certificate to become a public utility.[8] Ultimately, Staff recommend denial of the requested certificate because MWP failed to demonstrate it had the financial resources necessary to operate as a public utility. This docket is the result of Westar making a decision to wrap up that financing transaction in the most optimal

[4] Docket No. 19-MPCE-064-COC Direct Testimony of Chad Unrein at 10, ll. 4-15 (Nov. 9, 2018).
[5] 19-064 Tr. at 132, ll. 14-17 (Unrein).
[6] Tr. at 81, ll. 3-16 (Ives).
[7] 19-064 Tr. at 132, ll. 17-23 (Unrein).
[8] *Id.* at 137, ll. 1-8.

way. The sale-leaseback agreement never contemplated that MWP would be a utility company until Westar did not exercise its right to purchase the 8% portion of JEC.

6. The assertion by KIC that Westar is contracting for new generation is incorrect. This 8% undivided interest has always been a part of JEC and the energy has always served Kansas retail customers. Westar is not adding generation capacity because the 8% undivided interest has been installed since the JEC was constructed several decades ago.[9] The sale lease-back was never meant to insinuate the financial institution would be a utility company in the state. This is clearly a transaction to effectuate a completion of the sale-lease back from 1991, and a wrapping up of the lease assumption in 2007, not as purchasing new generation. Ultimately, Staff believes it is not in the best interest of ratepayers to let the ownership interest sit idle, which Staff has supported through its NPV analysis.[10]

b. KIC's assertion that Westar purposefully ignored the opportunity to hold MWP responsible for costs associated with the 8% portion of JEC to protect Westar's shareholders is oversimplified and disregards the actual contracts associated with the 8% of JEC.

7. KIC's argument relies heavily on the fact that Westar has not instigated a legal dispute or foreclosure proceedings against MWP. KIC contends the legal liability of MWP and Westar are unresolved and untested.[11] KIC's assertion that Westar did not sue MWP just to protect shareholders does not properly characterize the actual language in the contracts and the reality of the situation.

8. The relevant clauses from the contracts that KIC is referring to clearly explain the position MWP took and Westar's decision not to pursue legal action against MWP.

Section 3.1 Ownership Agreement:

[9] Tr. 19-355 at 108 ll. 1-4 (Ives).
[10] 19-064 Tr. at 134, ll. 4-7. (Unrien).
[11] Initial Brief of KIC at 18.

Owner Trustee hereby assumes and agrees for the benefit of each of the Consenting Owners to pay and perform all liabilities and obligations arising under the ownership Agreement from and after delivery of the Transfer Documents solely in connection with the Undivided Interest; provided, however, that the foregoing assumption shall not apply to Unit 4 if and when built (which obligations to the extent they relate to Unit 4 will be the sole responsibility of UtiliCorp).

Section 3.2 Operating Agreement:

Owner Trustee hereby assumes and agrees for the benefit of each of the Consenting Owners to pay and perform all liabilities and obligations arising under the Operating Agreement solely in connection with the Undivided Interest, from and after the Lessor Possession Date.

Section 3.3 UtilitCorp Liability:

UtiliCorp hereby agrees, for the benefit of each of the Consenting Owners, to promptly pay and perform all liabilities and obligations arising out of the Transfer Documents with respect to the Ownership Agreement and the operating Agreement relating to the Undivided Interest.[12]

The agreements of this subsection 3.3 by UtiliCorp shall survive the expiration or termination of the Lease and/or any or all of the other Transfer Documents between UtilitCorp and others.

Section 4. Liability of Owner Trustee:

Each of the undersigned agrees that all payments to be made by Owner Trustee under the Ownership Agreement or (after expiration or termination of the Lease) the Operating Agreement shall be made only from the Trust Estate. Each of the undersigned shall look solely to the Trust Estate for the payment of any amounts payable by the Owner Trustee under the Ownership Agreement or (if any) the Operating Agreement and agrees and confirms that neither the Owner Trustee in its individual capacity nor Owner Participant is or shall be in any way personally liable for any such amounts. Owner Participant shall have no liability, obligation, responsibility or duty to any of the undersigned whatsoever for or with respect to any of the transactions contemplated by the Ownership Agreement or (after termination of the Lease) the Operating Agreement, whether as a result of the negligence or willful

[12] Docket No. 19-MPCE-064-COC, Midwest Power Company Application, Exhibit D, Consent and Assumption Agreement, at 200.

misconduct of the Owner Trustee in its individual capacity or otherwise.

9. MWP, as the Owner Participant, had no actual liability according to the plain language of the agreements. KIC ignores the reality of these non-recourse clauses or perhaps does not understand what assets the Trust Estate actually possessed. The Consent and Assumption Agreement clearly states that MWP, the Owner Participant, cannot be held personally liable in any capacity and will have no liability, obligation, responsibility or duty to Westar. Once the Owner Trustee (Wilmington Trust) or MWP defaults on required payments, it would have had five months to remedy the default or have its rights terminated and forfeit the 8% interest.[13] Based on these agreements the only party Westar can hold responsible is the Owner Trustee (Wilmington Trust) to the extent of the assets in the Trust Estate and not the Owner Trustee in its individual capacity.

10. This was Staff's central concern in Docket No. 19-MPCE-064-COC. Staff would not recommend allowing MWP to become a public utility company until the parent company, KeyCorp, could guaranty to cover these obligations that the Consent and Assumption clearly state MWP had no responsibility for.[14]

11. Technically KIC is correct, when stating the contracts have not been tested, but it would have been imprudent to go down a path of time consuming and expensive litigation when there was nothing for Westar to gain. According to the agreements, the Wilmington Trust Company is only liable to the extent of the assets held in the Trust Estate. The Trust Estate had only one asset and that is the 8% interest in JEC.[15] The Trust Estate had a cash balance of $100

[13] Docket No. 19-MPCE-064-COC, MWP Application, Exhibit D p. 210.
[14] 19-064 Tr. at 134, ll. 7-14 (Unrein).
[15] Docket No. 19-MPCE-064-COC Westar Energy's Data Request 3.02 to MWP.

dollars.[16] While the Trust Estate would be held responsible for those costs, the Trust Estate had no revenue to draw upon other than the SPP market revenue and potential capacity revenue associated with the 8% interest, and as the saying goes "you cannot squeeze blood from a turnip."

12. In the 19-064 Docket, Westar argued that they would be liable for unpaid costs temporarily, however, this does not let MWP off the hook permanently, and eventually MWP would have lost that 8% interest in JEC through foreclosure proceedings.[17] Westar argued that Sections 3.1 and 3.2 of the Consent and Assumption Agreement specifically state that the Owner Trustee consented for the benefit of the consenting owners to pay and perform all liabilities and obligations under the Ownership and Operating Agreements.[18] Thus, in the interim, Westar would cover any cash shortfalls associated with the 8%, but Wilmington Trust would ultimately be responsible for these expenses.[19] However, because Wilmington Trust holds no other assets aside from the 8% interest, Westar could only hope to recover the interest in the plant. Westar knew the contracts protected Keycorp and Midwest Power from any liability and singles out the Wilmington Trust as the only entity with liability, and even then, only to the extent of the assets in the Trust Estate.[20] The only compensation Westar could hope to attain was the plant after at the minimum five months and that is if MWP did not prevail in its litigation position that Westar was required to cover all shortfalls indefinitely. The best possible outcome is Westar would get plant back after a few years of expensive litigation. A detailed review of the record in the 19-064 Docket, and the contractual terms at issue in that proceeding will reveal that there was no

[16] *Id.*
[17] Docket No. 19-MPCE-064-COC, Direct Testimony of Darrin Ives at 8.
[18] 19-064 Tr. at 97, ll. 1-6 (Ives).
[19] *Id.* Tr. at 100, ll. 1-4 (Ives).
[20] *Id.*

chance of Westar recovering costs from MWP or KeyCorp (absent an agreement by MWP and KeyCorp to modify the existing parental guarantee as Staff recommended in that Docket).

13. Had Westar chosen to go down the litigation route, the earliest Westar could have sought damages under the default provisions of the Ownership Agreement was five months after payment was due on the fixed NFOM and capital costs. In that five months, Westar would begin to accrue fixed NFOM and capital costs into the regulatory asset mechanism provided in the S&A in 18-328 Docket. At the time of the next rate case Westar could seek recovery of the regulatory asset if it could demonstrate that it first sought recovery from MWP (or Wilmington Trust). In addition to accruing these unpaid expenses, Westar would have lost out on any market revenue that could have been generated to offset the fixed NFOM and capital costs. Ultimately, it would have been up for the Commission to decide whether Westar acted prudently in seeking cost recovery from MWP and Wilmington Trust and whether Westar's shareholders or ratepayers should be responsible for recovering these unrecovered costs.

14. Staff views Westar's decision to negotiate a new lease and purchase of the 8% as the best possible outcome, given the options available to Westar. Because of Westar's status as the Owner Operator of JEC, Westar would be responsible for those costs associated with the 8% interest whether it had access to the capacity and energy sales to help cover some of those costs, or not. Why not, therefore, attempt to cover some of those fixed costs, even if the market revenues from the 8% interest will not cover all the fixed costs? Without extending the lease or purchasing the 8% interest, Westar would be responsible for the costs of the 8%, but have no ability to recover some of the expenses through energy sales. In those five months, Westar would lose out on the opportunity to cover some costs with energy sales. NFOM expenses continue to accrue for an unknown amount of time, being put into a regulatory asset that Westar

would have eventually asked to recover in rates the same as this docket. Instead, because Westar negotiated a lease extension and purchase, it has access to market revenue right away to help cover some of those costs.

15. The path KIC suggests Westar should have went down is to go get the plant back from MWP similar to a bank foreclosing on a home.[21] Westar may have recovered the asset for a $0 purchase price, but Westar would have lost out on the opportunity costs of the revenue produced from the 8% ownership, incurred litigation costs, and taken on litigation risks of any suboptimal outcome. Predictably, Westar would have never recovered the NFOM and capital costs from MWP, given the plain language in the contract limiting liability to the Trust Estate. Thus, it is Staff's opinion that Westar acted prudently in purchasing the asset rather than choosing a path of litigation.

c. KIC's assertion that acquiring the 8% interest in JEC will increase retail rates by $138 million is misleading and cannot be accurately compared to the tens of millions of dollars in ratepayer benefits the 2007 deal provided.

16. KIC continuously makes the distorted claim that Westar's acquisition of the 8% undivided interest in JEC will increase rates by $138 million.[22] KIC attempts to confuse the record by comparing KIC witness Michael Gorman's cash flow model (which he adopted from the 19-064 Docket without modification) with the tens of millions of dollars in past ratepayer benefits from Westar's assumption of the lease in 2007. The $138 million value asserted by KIC cannot be compared to benefits ratepayers have received from the lease assumption since 2007 for several reasons. First, the values contained in Ives testimony are based on a rate case by rate case review of the actual reductions to the revenue requirement ratepayers experienced as a result of Westar's assumption of the lease on the 8%. Second, Mr. Gorman's $138 million value is an

[21] *Id.* at 9.
[22] Initial Brief of KIC at 13 ¶ 31.

evaluation of the cash flow impact that MWP would have faced as a new utility in Kansas.[23] This cash flow analysis is not the same as how the underlying costs of operating the 8% portion of JEC would affect Westar's revenue requirement. This is because the predicted $138 million negative cash flow contains a mixture of capital costs and operating costs. As the Commission is aware, capital costs do not impact the revenue requirement dollar for dollar in the year they are incurred in the same fashion as operating costs. Instead these costs are capitalized, and they impact the revenue requirement over a number of years through depreciation expense at the time of the next rate case. This fact alone renders any comparison of the $138 million cash flow number to Mr. Ives' revenue requirements number (a number which no party to this proceeding has disputed) completely baseless. Finally, the $138 million negative cash flow number contains costs that Westar will not incur, but that MWP would have incurred (power marketing expenses, land lease expenses, etc.). This fact was acknowledged by Mr. Grady on the witness Stand during cross examination by KIC's attorney, yet KIC continues to rely on this $138 million negative cash flow number in its arguments to the Commission.[24]

17. In summary, because Mr. Gorman's cash flow model is based on the cash flow impacts that MWP would experience, it has several blatant errors and the $138 million value is incorrect. Westar will not incur costs for an "Energy Marketing Agreement" or "JEC 8% Land Lease". Those values account for over $2.3 million dollars in Mr. Gorman's model.[25] Second, the "Capital Spend" values are capital costs and will not be recovered from ratepayers dollar for dollar in the year that they occur. Those values will be spread out over a decade or more through depreciation expense at Westar's next rate case. The first of which cannot occur until after the

[23] Tr. at 106 ll. 1-5, (Ives).
[24] *Id*. at 149, ll. 5-14, (Grady).
[25] Exhibit MPG-1, $2,313,936.

rate moratorium has lifted.[26] Finally, KIC's $138 million negative cash flow calculation includes over $10 million dollars in "dismantling costs". In total, capital costs and dismantling costs account for over $43 million dollars of KIC's exaggerated $138 million value. While these are real costs that ratepayers will be exposed to overtime (if they occur to the extent that Westar believes they will), ratepayers will not be exposed to them in the year that they occur on, and the $138 million value should not be confused for a revenue requirement impact, like KIC has attempted to do. Importantly, the only rate impact associated with this transaction that ratepayers will experience between now and the end of the rate moratorium is provided in Mr. Grady's exhibit JTG-2. The Commission should not be persuaded by KIC's exaggerated rate impact claims.

III. Staff Response to CURB's Brief

18. Staff will address two prevalent issues presented in CURB's initial brief. First, CURB has relied on an outdated interpretation of the "used and useful" principle in an attempt to limit the Commission's discretion for determining when investments in utility property can be recovered in rates. Second, CURB has misrepresented Staff's NPV analysis in support of its arguments that Westar shareholders should be eager to earn the additional "profit" that can be had by deregulating the 8% interest in JEC. Staff asserts the plain language of the current K.S.A. 66-128 statute gives the Commission broad discretion in determining the application of the "used and useful" principle when setting rates and balancing the interest of ratepayers and shareholders. Finally, Staff corrects the record by explicitly denying any inference that we are supportive of the concept of the 8% portion of JEC being deregulated.

a. K.S.A. 66-128 allows for Commission to exercise its discretion in deciding how the 8% undivided interest in JEC should be treated in rates.

[26] *Id.* $22,977,681 before rate moratorium and $43,168,002 total.

19. CURB's argument that the Commission should find Westar is required to prove that capacity and energy from the 8% interest is needed to serve customers today, is not the appropriate standard for whether Westar's decision is prudent for ratepayers and whether Westar should be allowed to include the costs associated with the 8% interest in the RECA. However, CURB insists a capacity necessity evaluation must be done in order to meet the requirement in K.S.A. 66-128. CURB has misinterpreted the plain language of K.S.A. 66-128, and CURB's arguments are counter to the KCC's recent decisions pertaining to this subject.

20. A plain reading of K.S.A. 66-128 should be applied to determine when to include property in rate base. CURB is incorrect when explaining what K.S.A. 66-128 actually requires of the Commission. Generally, CURB has made an inaccurate de facto assertion that K.S.A 66-128 binds Commission authority when deciding when to include utility property in rates.[27] CURB states "In order for an electric public utility to include property into rates, the property must be used and required to be used." The term "must" is never used anywhere in K.S.A. 66-128 and is an incorrect, overgeneralized, conclusion to the true words of the statute. In fact, the Commission is required to determine the reasonable value of all or whatever fraction or percentage of the property of a public utility is used and required to be used in its services to the public whenever the Commission deems the finding of such value necessary in order to enable the setting of fair and reasonable rates.[28] But it does not follow that the Commission is required to remove from rate base any property that is not used and required to be used, with the exception of certain categories of property still under construction. Surprisingly, to support their position, CURB cites Kansas Industrial Consumers Grp., Inc., v. State Corp. Comm'n of State of

[27] Initial Brief of CURB at 8, ¶ 15.
[28] K.S.A. 66-128.

Kan., 36 Kan. App. 2d 83, 138 P.3d 338 (2006).[29] Specifically CURB states from that case, "capital costs for new plants, generator or other facilities are allowed into rates only when they become 'used and required to be used' in service to ratepayers." Interestingly, CURB has neglected to cite the full quote and the outcome of the issue of that case. In Kansas Industrial Consumers Grp., Inc., v. State Corp. Comm'n of State of Kan., KIC appealed a Commission decision to allow Westar recovery of the Environmental Cost Recovery Rider (ECRR) in its rates.[30] The Kansas Court of Appeals states "Normally capital costs for new plants are allowed into rates only when they become "used and required to be used"."[31] The Court noted that Commission found the environment upgrades did not enhance the efficiency of the production of electricity and affirmed the Commission's decision to permit the ECRR in rates.[32] This case highlights the complete opposite of CURB's arguments in the present docket, which is that only property which is found to be used and useful can be included in rates. To the contrary, the ECRR (affirmed by the Court in this ruling) allowed the rate recovery of environmental upgrades that were not even in service yet. CURB's hard line interpretation of K.S.A. 66-128 is simply wrong and contrary to Commission decisions that have been upheld by the Courts.

21. The 8% undivided interest in JEC should be included and recovered in rate base and must be evaluated as a rate schedule, insuring that the Commission's decision will result in just and reasonable rates.[33] K.S.A. 66-128 says the Commission "**shall determine** the reasonable value of all or whatever fraction of percentage of the property of any public utility governed by the provisions of this act **which property is used and required** to be used in its

[29] Initial Brief of CURB at 8, ¶ 15.
[30] Kansas Industrial Consumers Grp., Inc., v. State Corp. Comm'n of State of Kan., 36 Kan. App. 2d 83, 97 138 P.3d 338, 350 (2006).
[31] *Id.*
[32] *Id.*
[33] Initial Brief of CURB at 11-12, ¶¶ 18-19 (Jul. 31, 2019).

services to the public within the state of Kansas, **whenever the commission deems** the ascertainment of **such value necessary** in order to enable the commission to fix fair and reasonable rates" (emphasis added).[34]

22. When using a rate base rate of return rate setting methodology, the Commission is required to identify the value of any property that is used and required to be used in order to include that amount in rate base. It does not follow however that, the Commission is required to exclude from rate base the value of all property that is no longer used and required to be used – but rather, the Commission may exercise its own discretion and judgement in determining how such property should be treated for ratemaking purposes. K.S.A. 66-128 does not create a presumption that the Commission must disallow all property that is not clearly used and required to be used, the statute actually allows the Commission broad discretion to decide the issue in the manner that best balances the interests of shareholders and its ratepayers.

23. This principle understanding of K.S.A. 66-128 has most recently been illustrated in Docket No. 15-KCPE-116-RTS, when the Commission allowed the inclusion in rates of the costs of retired analog meters made obsolete when KCPL installed newer AMR meters.[35] While the meters were retired early, the Commission recognized KCP&L's prudent decision and allowed the return of its investment.[36]

24. This docket has an analogous fact pattern. All parties agreed that Westar's decision in 2007 to assume the lease was a prudent financial transaction and business decision.[37] KIC's witness even testified that Westar was <u>obligated</u> to make decisions like the assumption of

[34] K.S.A. 66-128.
[35] Order on KCP&L's Application for Rate Change, at 21-22 (Sep, 10, 2015).
[36] *Id.* at 22.
[37] Direct Testimony of Justin T. Grady, p 16, ll. 1-8 (Jun. 14, 2019).

the Aquila 8% lease.[38] The costs at issue in this proceeding are the outcome of the initial prudent decision. Regardless of whether the capacity and energy is "used and required to be used" today, the Commission, in its discretion, can now decide whether to allow recovery through the RECA based on a balancing of interests between current ratepayers, future ratepayers and shareholders. Staff agrees that Westar may not need the 8% capacity today but it does need the other 92% to efficiently serve customers.[39] Combined with the fact that Westar cannot avoid paying for 100%[40] of the plant, it is most efficient to run 100% of the plant in order to minimize costs (because the 8% interest is likely to create value by exceeding its variable costs and contributing to fixed costs). Staff's NPV analysis shows some fixed costs will likely be recovered by running the 8% portion of JEC, which optimizes the situation Westar is in.[41]

25. Taking this issue at a 30,000 foot level, the Commission should look at the eminent principle in utility regulation called the "prudent investment test".[42] This principle states that the investment, in order to gain recognition in the rate base, must have been prudently incurred in the light of foresight rather than hindsight.[43] Capital honestly and prudently invested must be taken as the controlling factor in fixing the basis for computing fair and reasonable rates.[44] Conditions change which in hindsight would mean a utility might not make the same decision if it could see the future. Utilities should not be penalized for prudent decisions based

[38] *Id.*
[39] *Id.*
[40] Tr. at 176, ll. 5-7 (Grady).
[41] Confidential Staff Exhibit JTG-1.
[42] James C. Bonbright, Albert L. Danielsen, David R. Kamerschen, *Principles of Public Utility Rates*, 2nd Edition, p. 292 (1988).
[43] *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission of Missouri et al.,* 262 U.S. 276, 43 S.Ct. 544 (1923).
[44] *Id.* at 302, 551 (1923).

on hindsight information.[45] Failure to allow full recovery of prudent investments gives managers disincentives to make economically inefficient decisions in the future.[46]

26. Finally, as mentioned early in this brief's response to KIC, CURB's capacity argument mischaracterizes the situation Westar is actually in. CURB is looking at this as if Westar is building new capacity. This is not new capacity. This sale-leaseback has always only been a financial transaction. Typically there is always a buy back after the lease. When the Commission approved this financing arrangement, it was not contemplated the result would end with a separate certified utility. Because of the unique market circumstances where the full cost of the plant will not be recovered from market revenue, there is no other party to purchase this 8% interest. We are not evaluating a decision to purchase or construct new capacity like CURB and KIC suggest. We are winding down a transaction from 1991, Staff is looking at the most efficient way to optimize the facility going forward.[47]

b. CURB has erroneously suggested Staff's incremental NPV analysis can be used to show support for CURB's proposal that Westar deregulate the 8%.

27. CURB has made an erroneous statement on page 20 under paragraph 32 of its brief and must be addressed.[48] "Based on the RECA proponents' analysis and revenue forecasts, there is an expected profit to come from buying this 8% for most of JEC' remaining life." This assertion is inaccurate because as CURB knows, Staff and Westar's NPV analysis did not include the fixed costs associated with the 8% interest in JEC. CURB's recommendation is for a complete disallowance of all costs associated with the 8% interest, variable and fixed NFOM expenses, capital costs, etc. Neither Staff nor Westar have attempted to show that the market revenue from the 8% portion of JEC would cover all of these costs and create a profit. The

[45] *Principles of Public Utility Rates*, 2nd Edition, p. 292 (1988).
[46] *Id.*
[47] Tr. at 169 ll. 23-25 (Grady).
[48] Initial Brief of CURB at 20 para 32 (Jul. 31, 2019).

Commission should not be persuaded by CURB's attempt to minimize the significance of its recommendation for a full disallowance of all costs associated with the 8% interest in JEC. CURB goes so far as to assert that once deregulated, if sold on the wholesale market, Westar shareholders will earn a profit from the 8% undivided interest, "Westar would still be able to recoup its expenses and enter into another favorable wholesale agreement that Westar alone may enjoy".[49] While Westar may be able to cover the variable costs associated with the 8% JEC interest, it is unlikely that the market revenue from this unit will also cover its fixed costs. This is unsurprising given that the SPP integrated marketplace is an energy market, not a capacity and energy market. Staff has performed an incremental NPV analysis for evaluation of the 8% interest from the customer's perspective considering all incremental costs and benefits associated with the ownership and operation of the 8% interest.[50] No party to this docket has performed analysis or created a model to reflect the impact to shareholders associated with a full deregulation scenario suggested by CURB and KIC.

28. Finally, both CURB and KIC have made separate claims that Staff somehow supports deregulating the 8% interest.[51] KIC has chosen to take a quote from the transcript of Justin Grady out of context.[52] CURB uses the same quote and simply says Staff recognizes the potential. To be very clear, Staff does not support this option as the parties suggested.[53] For context Mr. Grady was only trying to explain to the Commission the technical feasibility behind the recommendation, which includes discussing the ability to disallow these costs from

[49] *Id.*
[50] Confidential Exhibit JTG-1.
[51] Initial Brief of CURB at 20 ¶ 31; Initial Brief of KIC at 33 ¶.
[52] *Id.*
[53] Initial Brief of CURB at 20 ¶ 31.

ratepayers.[54] Mr. Grady's explanation of how the Commission could do something should not be misinterpreted as support for the Commission taking that action.

IV. STAFF'S RECOMMENDATION

29. Staff recommends the Commission approve Westar's application to recover deferred lease expenses associated with the seven-month JEC lease extension, deferred NFOM expenses associated with the 8% portion of JEC, and ongoing NFOM expenses associated with the 8% undivided portion of JEC.

CONCLUSION

The Commission should find that Westar's Application for recovery of NFOM and lease expenses through its RECA will result in just and reasonable rates and approve the tariff revision as requested.

WHEREFORE, Staff respectfully submits its Reply Brief and requests the Commission approve the Joint Application of Westar Energy, Inc. and Kansas Gas and Electric Company for recovery of certain costs through their RECA.

Respectfully submitted,

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ATTORNEY FOR COMMISSION STAFF

[54] Tr. at 173, ll. 14-19 (Grady). Mr. Grady agrees that it is a potential solution but the solution does not make sense unless you want to tell a regulated utility they cannot recover their regulated costs.

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Cole Bailey, being duly sworn upon his oath deposes and states that he is Litigation Counsel for the Kansas Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *Reply Brief of Commission Staff*, and attests that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Cole Bailey
Litigation Counsel
State Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 7th day of August, 2019.

Ann Murphy

My Appointment Expires: 4-28-21

STATE OF KANSAS NOTARY PUBLIC
ANN M. MURPHY
My Appointment Expires
April 28, 2021

CERTIFICATE OF SERVICE

19-WSEE-355-TAR

I, the undersigned, certify that a true and correct copy of the above and foregoing Reply Brief of Commission Staff was served via electronic service this 7th day of August, 2019, to the following:

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