**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of Kansas City Power & Light Company for Approval of its 2015 Actual Cost Adjustment ("ACA").	)))	Docket No. 16-KCPE-388-ACA

**NOTICE OF FILING OF STAFF'S
REPORT AND RECOMMENDATION-PUBLIC VERSION**

COMES NOW, the Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission," respectively), and files its Report and Recommendation (R&R) dated January 19, 2017, attached hereto and made a part hereof by reference. Staff recommends the Commission approve the Application by Kansas City Power & Light Company (KCP&L) for its annual Actual Cost Adjustment (ACA) and authorize the use of its ACA factor of $0.00105 per kWh.

WHEREFORE, Staff submits it's Report and Recommendation for Commission review and consideration, and for such other relief as the Commission deems just and proper.

Respectfully submitted,

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Shari Feist Albrecht, Commissioner
Jay Scott Emler, Commissioner

Sam Brownback, Governor

REDACTED
REPORT AND RECOMMENDATION
UTILITIES DIVISION

[redacted] Denotes Confidential Information

TO: Chairman Pat Apple
Commissioner Shari Feist Albrecht
Commissioner Jay Scott Emler

FROM: Kristina Luke Fry, Managing Auditor
Katie Figgs, Senior Auditor
Chad Unrein, Senior Auditor
Justin Grady, Chief of Accounting and Financial Analysis
Jeff McClanahan, Director of Utilities

DATE: January 19, 2017

SUBJECT: Docket No. 16-KCPE -388-ACA – In the Matter of the Application of The Kansas City Power and Light for Approval of its Annual Energy Cost Adjustment (ACA) Filing.

EXECUTIVE SUMMARY:

On March 1, 2016, Kansas City Power and Light Company (KCP&L) filed an Application for approval of its annual Actual Cost Adjustment (ACA). KCP&L requested an ACA factor of $0.00105 per kWh, reflecting an under collection of fuel and purchased power costs from retail customers during the calendar year 2015 of $6,704,445. Staff conducted an audit, discussed below, and recommends approval of KCP&L's requested 2015 ACA factor.

BACKGROUND:

On March 1, 2016, KCP&L filed an Application requesting approval of its ACA for the Energy Cost Adjustment (ECA) year ending December 31, 2015. Accompanying KCP&L's Application are the testimonies of KCP&L witnesses Wm. Edward Blunk and Elizabeth Herrington. Ms. Herrington, Director of Energy and Revenue Accounting for KCP&L, supports the specific monthly calculations of the over/under recovery calculations for each month in 2015.[1] She also discusses the specific revenues and expenses that impacted the ACA calculation during the year 2015.[2] As Ms. Herrington supports, KCP&L's Application reflects an under-recovery of

[1] Schedule EAH-2, attached to Ms. Herrington's testimony, provides the monthly calculation of the annual over/under-recovery of energy costs for the 2015 ECA year.

[2] Schedule EAH-3, attached to Ms. Herrington's testimony, provides the detail for each of the components that make up the total energy costs to be recovered, total ECA revenue collected, and the resulting ACA amount.

$6,704,444 in fuel and purchased power costs for the 2015 ECA calendar year. This under-recovery translates into a positive ACA factor of $.00105 per kWh, which will increase KCP&L's ECA factors for the months of April 2016 through March 2017. Mr. Blunk, Generation Planning Manager for KCP&L, provides testimony on KCP&L's fuel procurement planning and practices. Mr. Blunk also discusses the high level differences between KCP&L's projected fuel and purchased power expenses for the year 2015 and the actual fuel and purchased power expenses experienced by KCP&L.

On March 1, 2014, SPP implemented the Integrated Market (IM).[3] The IM is a regional day-ahead energy and operating reserve market featuring the following major functions:

- Day-ahead energy and operating reserve markets;
- Day-ahead and intra-day Reliability Unit Commitment processes;
- Real-time balancing market;
- Price-based, co-optimized energy and operating reserve procurement;
- Market-based congestion management processes including Transmission Congestion Rights and Auction Revenue Rights;
- Multi-Day Reliability assessment to manage the commitment of long-start resources; and
- Market Monitoring and Mitigation with an internal Market Monitoring Unit.[4]

With the implementation of the IM, KCP&L sells energy and operating reserves produced from its company-owned generating resources to SPP in the Day-Ahead (DA) and Real-Time Balancing Market (RTBM) and it purchases the energy and operating reserves it needs to serve its native load obligations on a daily basis. Revenues and expenses from the IM are recorded in FERC accounts allowed to be recovered under KCP&L's ECA tariff; therefore, Staff expanded the scope of the ACA audit in 2014 to include a review of KCP&L's participation in the SPP IM. Staff continues to monitor and review KCP&L's monthly market activity and performs a yearly review of controls, procedures, and performance as part of the Annual ACA audit.

ANALYSIS:

Traditional Fuel and Purchased Power Review

Staff solicited from KCP&L, via formal discovery requests and e-mails, documentation supporting its Application and Schedules EAH-2 and EAH-3. Staff performed the majority of its audit in-house using the information gathered through this process. Once Staff's desk audit was complete, we met with KCP&L at its corporate offices in Kansas City, Missouri. This meeting allowed Staff to further question KCP&L about information provided in response to data requests and to verify KCP&L's coal and rail transportation contracts. Staff notes that KCP&L personnel were cooperative and helpful when answering Staff's questions and provided requested supporting documentation. Staff audited KCP&L's actual fuel costs for the following

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[3] *See* FERC, *Order on Compliance Filing*, January 29, 2014, Docket Nos. EL12-1179 and EL13-1173; http://elibrary.ferc.gov/idmws/file_list.asp?accession_num=20140129-3063.

[4] *Southwest Power Pool, Inc.*, 141 FERC ¶ 61,048 (2012) (October 2012 Order).

months: April, August, October, and December 2016.[5] For these months, Staff conducted an audit of the Application that consisted of:

- Verifying the accuracy of each of the monthly settlement computations by ensuring the ACA factor calculated by KCP&L reflects the actual over/under recoveries and the actual kWh sales to Kansas jurisdictional customers;
- Ensuring that the actual fuel, purchased power, and emissions costs recovered through the ECA are actual costs supported by vendor invoices and general ledger entries;
- Verifying that sample costs reviewed are just and reasonable; and
- Verifying that the ECA factor used to calculate the customer's bill agrees with the calculation that the Company files with the Commission.

During this portion of Staff's audit, no material irregularities were found in the information provided.

<u>SPP Integrated Marketplace Review</u>

As referenced in the Background Section above, Staff's expanded ACA audit includes the review of KCP&L's participation in the SPP IM during 2015. Staff solicited formal discovery requests to document KCP&L's processes and procedures involving its day-to-day operations within the IM.

The objectives of Staff's audit of KCP&L's participation in the IM were as follows:

1. Review KCP&L's process and control procedures in place to validate the accuracy of SPP invoices and statements.
2. Examine KCP&L's management of market performance and operational risk within the SPP IM.
3. For the months being audited in this year's ACA audit, evaluate whether KCP&L has accurately accounted for Kansas' actual share of IM costs/revenues pursuant to the provisions of the current ECA tariff.
4. Determine whether KCP&L's participation in the IM is providing benefits to KCP&L's Kansas ratepayers.

<u>Processes & Control Procedures</u>

In order to examine KCP&L's control procedures entailing verification of its SPP IM billing statements, Staff issued formal discovery requests based on the findings found in the SPP audit of the 2014 KCP&L ACA.[6]

Staff requested information regarding the software application that KCP&L utilizes to interact with the IM and documentation of KCP&L's process and control procedures.[7] KCP&L

[5] Since the reimplementation of KCP&L's ECA in 2008, it has been Staff's practice to audit four sample months in the ECA year. This typically involves at least two high-volume summer months and two shoulder months.
[6] *See* Staff's Report & Recommendation in Docket No. 15-KCPE-388-ACA (March 29, 2016).

continues to use Power Costs, Inc. (PCI) software suite, which includes PCI's GenBase and GenManager to manage its generation portfolio and Application Programmable Interface (API) interactions with the SPP IM. KCP&L's software systems remain unchanged from the 2014 ACA audit, and a detailed review of KCP&L's software can be found in Staff's Report and Recommendation in Docket No. 15-EPDE-381-ACA.

KCP&L provided Staff with detailed documentation of KCP&L's processes, procedures, and controls encompassing all SPP IM activities. Staff examined KCP&L's processes for DA and RTBM activities, shadow settlement, bilateral settlement, verification of settlement statements, and booking the monthly activity into the General Ledger. As part of KCP&L's shadow settlement system, KCP&L uses its own meter data to independently calculate SPP IM activity which is then checked against the daily settlement statements produced by SPP. The daily settlement statement contains all of the daily charges related to the IM for that operating day by charge type. If the shadow settlement calculation deviates from the SPP Invoice, KCP&L reviews the internal shadow settlement calculation and meter data and, if necessary, files a dispute in the SPP marketplace portal.

In Staff's opinion, KCP&L has robust control procedures in place to verify the accuracy of the settlement statements and invoices it receives from SPP for its activity in the IM. Additionally, KCP&L has a comprehensive process in place to verify meter data with internal and external counterparties and with SPP. Furthermore, KCP&L has a process in place to verify all Bilateral Settlement Schedules[8] (BSS) are submitted to SPP, and it has a defined process in place to submit and monitor disputes with SPP.

Market Performance and Operational Risk

In order to examine whether KCP&L was diligently managing its risks associated with the IM in 2015, Staff issued formal discovery requests regarding KCP&L's procedures for determining the profitability of incremental market sales associated with the SPP IM. The actual accounting processes, calculations and strategies are complex and highly confidential; however, this information remains available for the Commission's review should the need arise.

Staff also issued formal discovery requests regarding KCP&L's strategy for offering its generating resources into the IM and bidding for the daily load necessary to serve customers. Staff examined KCP&L's practices for developing and updating fuel costs and variable operating and maintenance costs associated with developing its resource offers. KCP&L use PCI P&L Analyzer to calculate and track the profitability of its generating units for both DA and RT markets. KCP&L summarizes market activity in a monthly report containing a profit and loss analysis and revenue deficiencies by unit. While the details of KCP&L's strategies are confidential due to their competitive and market-sensitive nature, Staff finds that KCP&L has developed strategies that allow it to manage risks (including risks of recovery of variable O&M costs and fuel cost changes) and evaluate profitability to be successful in the IM.

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[7] Shadow settlements are settlement statements independently recalculated by the utility to check against the daily settlement statements produced by SPP. A settlement statement contains all of the daily charges related to the IM for that operating day by charge type.

[8] A Bilateral Settlement Schedule is an agreement between two market participants to transfer energy or operating reserve obligations between the parties.

Staff issued several formal discovery requests regarding KCP&L's hedging strategies and procedures regarding the Auction Revenue Rights (ARRs) and Transmission Congestion Rights (TCRs) congestion management processes within the SPP IM.[9] In these responses, KCP&L discussed that its strategy was to self-convert its ARRs into TCRs within the expected unit capacity requirements in 2015. Under this strategy, KCP&L was successful in converting 99.8% of the ARRs which provided a 108.6% congestion hedge to offset the day-ahead congestion exposure of the day-ahead load for 2015. KCP&L actively manages its monthly positions by pursuing TCR products in the SPP monthly TCR. KCP&L provided a summary of congestions market changes in 2015, which included the availability of Long-Term Congestion Rights in SPP, the combination of KCP&L and GMO's respective Network Integrated Transmission Service, and the activation of the Iatan-Nashua transmission line reducing the level of congestion in the KCP&L area. The strategies KCP&L uses appears to have been successful as the value provided by the self-converted TCR's covered all of KCP&L's realized day-ahead congestion in the IM during 2015.

In Staff's opinion, KCP&L diligently managed the risks and profitability associated with the IM and is taking the steps necessary to be successful in the IM.

ACA Audit of Revenues and Costs

Prior to the go-live date of the IM, Staff implemented a monthly review process to be used to monitor the IM activity of the three vertically-integrated, investor-owned electric utilities in the State of Kansas. That process involves the submission of monthly financial reports to the KCC's Utilities Division that details the company's operations in the SPP IM (KCC Monthly IM Activity Report).[10] These reports provide a summary-level view of how each electric utility is faring in the marketplace by IM charge type. For example, Staff can view at a glance the amount of MWhs of day-ahead or real-time asset energy KCP&L sold into the IM and for what total dollar amount. Likewise, the report summarizes by charge type what energy and operating reserve products KCP&L purchased from the IM for the month, the MWhs associated, and the net dollar impact of those products. Not only do these monthly reports provide Staff the ability to monitor on a monthly basis how Kansas electric utilities are performing in the IM, the reports also serve as a useful audit tool during the ACA audit. These reports provide the foundation for reconciling the monthly IM charges from SPP settlement statements and invoices to the journal entries recorded in the company's general ledger and ultimately back to the company's ACA Application to true-up over/under recovery of actual costs.

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[9] Auction Revenue Rights (ARRs) and Transmission Congestion Rights (TCRs) are congestion management products that allow market participants to hedge their exposure to Marginal Congestion Costs (MCCs) in the IM. ARRs are allocated to entities with firm transmission rights on the transmission system, for example, a vertically-integrated, investor-owned utility that uses its Network Integrated Transmission Service (NITS) to serve its retail load. An ARR entitles the holder to a share of revenues generated in an applicable TCR auction, or the ARR may be converted into a TCR. A TCR allows a holder to be compensated or charged for congestion between two settlement locations in the day-ahead market. ARRs (indirectly) and TCRs (directly) derive their value based on the difference between the congestion price at the source settlement location less the congestion price at the sink settlement location multiplied by the awarded MW quantity over the specific path.

[10] Empire and Kansas City Power & Light each voluntarily agreed to the reporting requirements originally approved by the Commission for Westar Energy in Docket No. 14-WSEE-208-TAR (14-208 Docket). *See* items 15 and 16 in Attachment A of the Order Approving Tariff Revisions issued on February 25, 2014, in the 14-208 Docket.

In addition to the KCC Monthly IM Activity Report detailing IM energy and operating reserve activity, Staff also receives a monthly report from each Kansas jurisdictional electric utility detailing any virtual transactions undertaken in the SPP day-ahead market (KCC Monthly Virtual Transaction Report). These reports are reviewed to ensure that only virtual transactions with a legitimate hedging basis are recovered from Kansas ratepayers.

During Staff's audit of KCP&L's participation in the IM, KCP&L provided Staff with a reconciliation that documented and verified all KCP&L IM activity for the audited months. This reconciliation relied on the KCC Monthly IM Activity Report discussed above, weekly SPP settlement statements, and a reconciliation spreadsheet prepared by KCP&L that tied net general ledger accounting data for the month back to the corresponding settlement statement and KCC Monthly IM Activity Report. Staff verified the weekly settlement invoices and compared the invoice totals with those in the invoice reconciliation spreadsheet. Staff also verified KCP&L's IM purchase and sales amounts were as presented in the KCC Monthly IM Activity Report. Staff was also able to verify that the financial impact of the SPP statements and KCC Monthly IM Activity Report were accurately reported on KCP&L's general ledger. Ultimately, this data was tied back to KCP&L's ACA Application for the sample months reviewed in the audit.

<u>SPP IM Benefit to Kanas Ratepayers</u>

To evaluate whether KCP&L's participation in the IM provided benefits to its Kansas customers in 2015, Staff issued formal discovery and examined other publicly-available data. SPP has estimated that the IM has provided a net benefit to the region of $422 million in 2015. This information suggests KCP&L's participation in the SPP IM produced benefits for Kansas ratepayers in 2015. At the highest level, KCP&L's total ECA eligible costs were $137,570,062 for the ACA year ending December 31, 2015, which was $7,020,438 or 5.4% greater than the 2014 ACA period. During the same period, total kWh delivered to Kansas decreased by 1.9%. Therefore, the 2015 total Kansas fuel and purchased power per kWh was $0.0194 or a year-over-year increase of 9.3%.

The primary driver of the year-over-year cost increase was KCP&L's negative off-system sales margin (OSSM) of **[redacted] or a decrease of **[redacted]** from the margin levels experienced by KCP&L in 2014. KCP&L's negative OSSM was driven by the much-publicized, much-lower wholesale market prices in 2015. Kansas OSSM is based on a calculation similar to "gross margin", which includes both fixed and variable production costs; however, off-system sales (OSS) decisions are based on "contribution margin", which includes only variable costs. The rationale for decision to sell based on a contribution margin is that any incremental sale which contributes to the recovery of fixed production costs is better than no contribution. In 2015, KCP&L's OSS was able to contribute **[redacted]** to the recovery of fixed production costs after recovering all variable production costs. If Staff removes the impact of OSSM, KCP&L's total ECA eligible costs were **[redacted]** a decrease of **[redacted]** or **[redacted]** from the cost levels experienced during 2014.

Staff issued formal discovery requesting whether KCP&L had prepared a 2015 estimate of the overall cost to serve its retail customers under the IM versus the costs to serve retail customers with company generation and access to wholesale market. In response, KCP&L stated that it had not conducted an analysis to evaluate the benefits of the IM in 2015. KCP&L had conducted a quick study of the benefit of the consolidated balancing authority aspects of the SPP IM using 2014 data, which estimated a net benefit of $6 million for Kansas ratepayers.[11] While studies of this nature take time and utility resources to conduct, the modeled results provide valuable insight into the impact of the SPP IM on Kansas ratepayers. This information would have been especially insightful in a year like 2015 in which KCP&L experienced a significant decline in costs of production and off-system sales margins. As a result, Staff recommends the Commission order KCP&L to provide a yearly evaluation of how the SPP IM is affecting its Kansas ratepayers as part of the Application it files in its annual ACA filing. This evaluation could be similar to the evaluation KCP&L provided in response to Staff Data Request No. 50S1 during Docket No. 15-KCPE-388-ACA.

At this time, it is not clear the extent to which the SPP IM benefitted KCP&L's Kansas customers during the year 2015. While KCP&L's production costs declined significantly in 2015, so did the off-system sales margins that would otherwise be an offset to those production costs. Staff recommends that KCP&L include in future ACA dockets an estimate of the impact of the SPP IM on its Kansas customers. This has been provided by Westar and Empire, and was prepared by KCP&L in response to Staff Discovery during last year's ACA audit. KCP&L should be prepared to provide this information to aid in Staff's ACA audit in future years.

RECOMMENDATION:

Staff recommends that the Commission approve KCP&L's Application authorizing the use of its 2015 ACA factor. Additionally, Staff is recommending the Commission to order KCP&L to provide a yearly evaluation of the impact of the SPP IM on Kansas ratepayers as part of its Annual ACA filing. Staff will continue to monitor KCP&L's performance and participation in the IM and will provide periodic updates to the Commission regarding this issue as often as is desired.

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[11] KCP&L's estimation of cost savings from the SPP IM were modeled using PROMOD, an energy marketing modeling software, KCP&L's analysis included benefits resulting from the consolidation of SPP into one balancing authority, which is only a small part of the SPP IM. The estimated benefit is not meant to be comprehensive of all SPP IM activity and does not include any OSSM offsets.

CERTIFICATE OF SERVICE

16-KCPE-388-ACA

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 31st day of January, 2017, to the following:

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