THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

STATE CORPORATION COMMISSION

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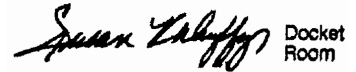


Before Commissioners: Brian J. Moline, Chair
Robert E, Krehbiel
Michael C. Moffet

In the Matter of the Applications of Westar Energy, Inc and Kansas Gas and Electric Company for Approval to Make Certain Changes in their Charges for Electric Service.	) Docket No. 05-WSEE-981-RTS

PETITION FOR RECONSIDERATION OF THE CITIZENS' UTILITY RATEPAYER BOARD

Pursuant to K.A.R. 82-1-235, the Citizens' Utility Ratepayer Board (CURB) respectfully requests that the Commission reconsider several provisions of its *Order on Rate Applications,* filed in the above-captioned docket on December 28, 2005, and to review its various decisions in this case to verify that they achieve the result intended by the Commission.

I. Adopting Westar's position on terminal net salvage was arbitrary and capricious, because it was not supported by substantial and competent evidence, and was overwhelmingly contradicted by substantial and competent evidence that funds will not be expended on dismantlement and removal.

1. Terminal net salvage is the net cost of dismantling and removing a utility plant down to the bare ground ("green field") after it is retired, less any salvage value reaped from the components that were dismantled, whether they are buildings, generation units or parts thereof. (Holloway, D. Test., at 5 – 6). There is no Westar plan for dismantlement of any of its plants.

(Spanos, Tr. Vol. 6, at 1126). Furthermore, according to the testimony of Westar witness Mr. Spanos, he has not documented any instance where an electric plant has been dismantled in order to construct a new plant on the same land. (Spanos, Tr. Vol. 6, at 1150).

2. By contrast, Mr. Majoros conducted a nationwide study of electrical generation units 50 mw or larger that had been retired during the years 1982 - 2000. (Hrg. Exhibit Staff 10). Given that 20 of the 26 generation units owned by Westar are 50 mw or larger, the units studied present a fair comparison to the majority of Westar's units. (Actual MW size of Westar's units can be found at Holloway, D. Test., at 16, Table 2). Mr. Majoros' study confirmed that the vast majority of units that were retired during that period were left in place. In other words, few were actually dismantled following retirement, and the vast majority of plant sites were not returned to green fields.

3. The study revealed that, out of 140 generation units (50 mw or larger) retired between 1982 and 2000 for which Mr. Majoros could obtain data:

—only 6 (4%) had been returned to green fields

—only 41 units (29%) were dismantled, creating space in the building available for other uses;

—8 of the units had been put back into service;

—91 retired units were still in place;

In other words, the study revealed that, of all retired units, **65% had not been dismantled, and over 96% had not been returned to green-field status.**

4. Additionally, it should be mentioned that there were **no** instances reported of a utility building a brand new plant on the site of a plant that had been totally dismantled and taken

down to green field.

5. Mr. Majoros noted that there were a number of reasons why utilities do not dismantle the majority of their retired units, and rarely dismantle plants down to green fields. He said,

> In some cases, the retired plant shared a common building structure with other units that were still operational. To dismantle one would halt the normal maintenance routine of the other units because of the demolition. Many of the old units had extensive asbestos pipe insulation that would have to be removed under strict OSHA guidelines. The conclusion was becoming evident that the only reason for dismantlement was when the SPACE was needed for another purpose.

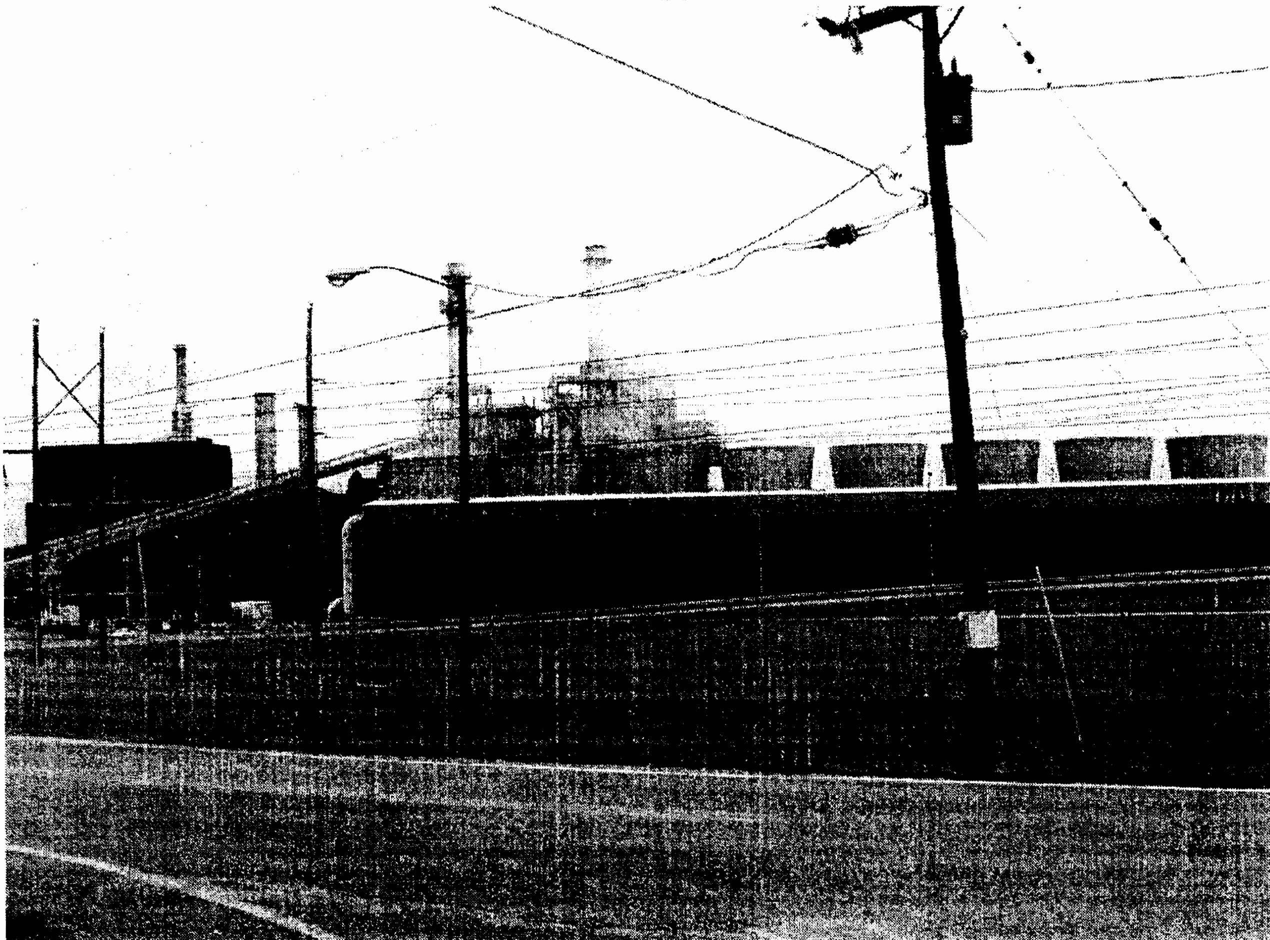
(*Id.*, at 3). He concluded that the study established, "the dismantlement costs that ratepayers are traditionally burdened with, are more often than not . . . never spent." (*Id.*, at 4).

6. Additionally, at the hearing, Staff witness Holloway at the hearing, under questioning by counsel for Kroger, agreed that siting a power plant is "a pretty complicated, contentious matter," and that a power plant "site that has power lines running to it, barge unloading facilities . . . . gas pipes . . . .would [likely] be a valuable asset rather than a liability." (Holloway, Tr. Vol. 12, at 2584). In his direct testimony, Mr. Holloway noted that a utility plant site with substations, and access to natural gas pipelines and transmission lines would likely be an attractive asset to entities needing such facilities. (Holloway, D. Test., at 10). Again, this establishes that there are compelling reasons to leave an electric plant site with all or part of its original plant and infrastructure in place, even if it needs updating, rather than returning it back to bare land.

7. Mr. Spanos echoed this reasoning when he said, "It is very difficult to find areas of land that are ideal to have a power plant on, so to walk away from those power plants without

SITE VISIT TO WESTAR PLANTS
August 23, 2005

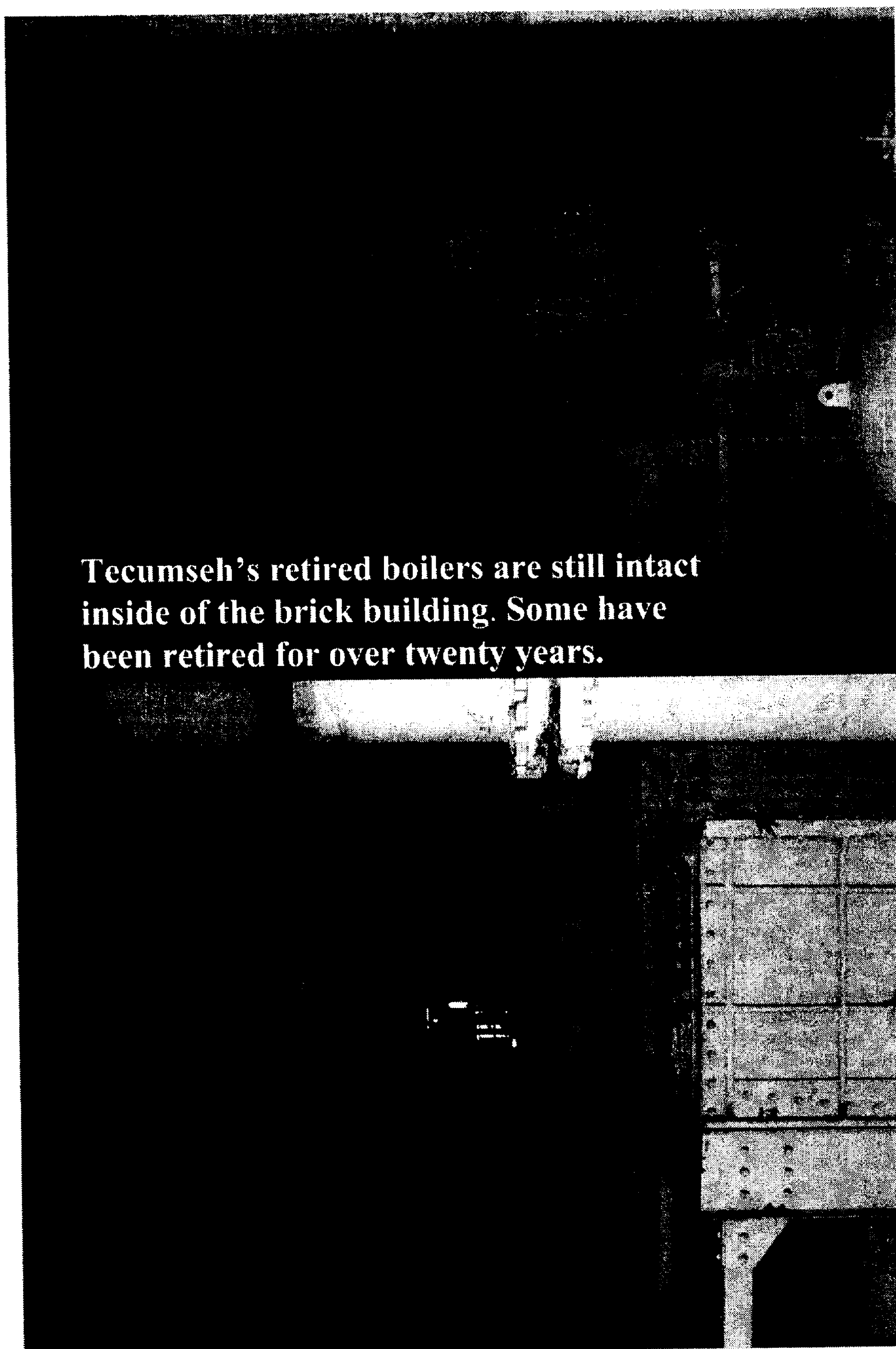
Tecumseh Energy Center



Tecumseh Energy Center has their retired boilers housed in the red brick building to the left. They remain intact. The asbestos covering on the piping has been removed and the pipes painted white. The turbine deck has been cleared of its turbines and the area is a machine shop. The two units to the right are reliable base-load units.

SITE VISIT TO WESTAR PLANTS

August 23, 2005



SITE VISIT TO WESTAR PLANTS

August 23, 2005

The old building provides the space for the plant's excellent machine shop. This part is still maintained and any possibility of dismantlement is highly remote.

SITE VISIT TO WESTAR PLANTS

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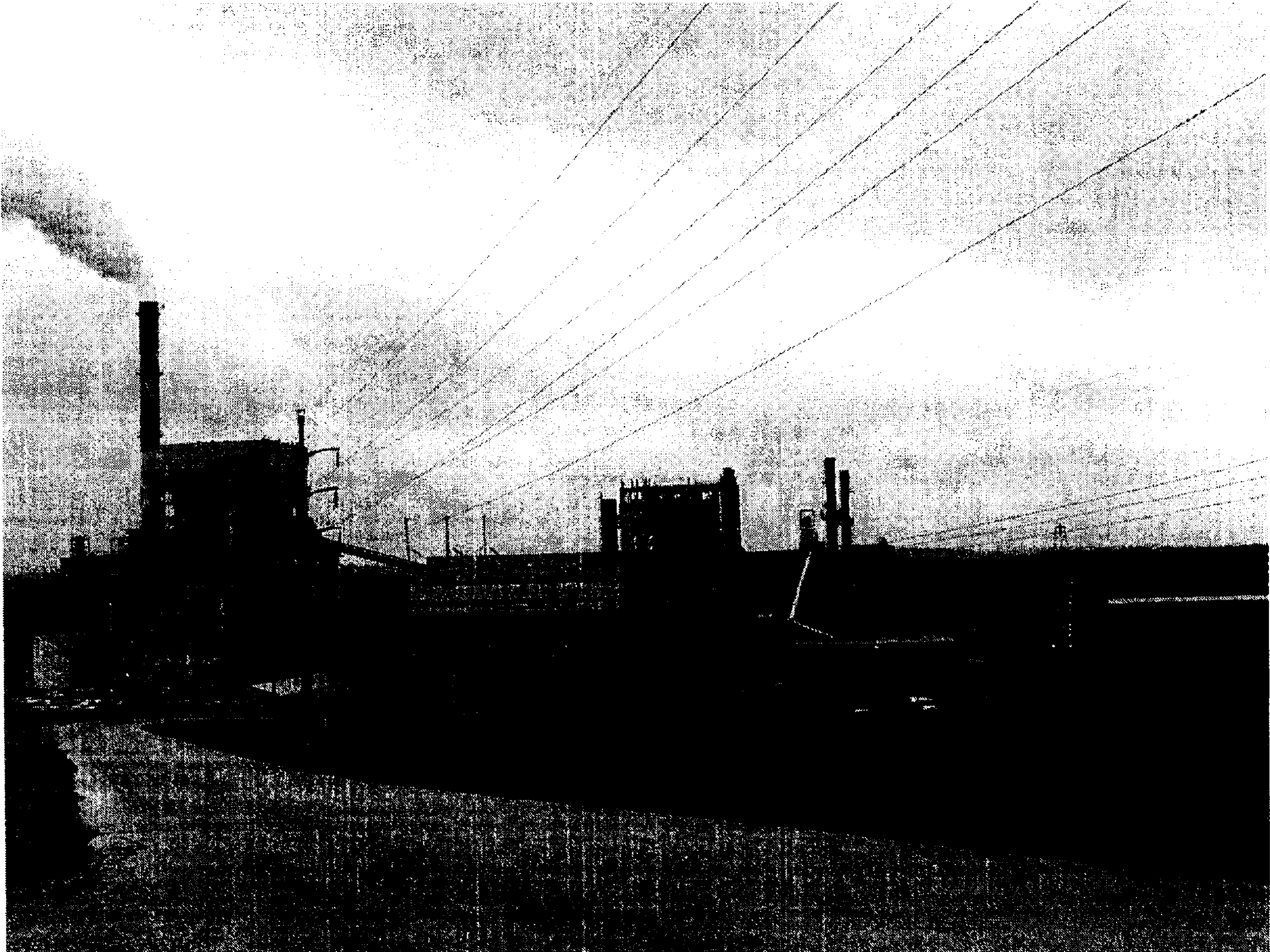
Lawrence Energy Center



Lawrence Energy Center presently has three units that are reliable base-load units. Unit 5 is to the far left, with smoke coming out the stack. Unit 4 is to the far right of the photo. Housed in the building in the middle are units 1, 2 and 3, with 3 being the only one running. Units 1 and 2 have been retired in place.

SITE VISIT TO WESTAR PLANTS

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This photo was taken while standing on the grating of the retired boiler Unit 1. The boiler is intact, with no plans for dismantlement, but the turbine has been removed.

SITE VISIT TO WESTAR PLANTS

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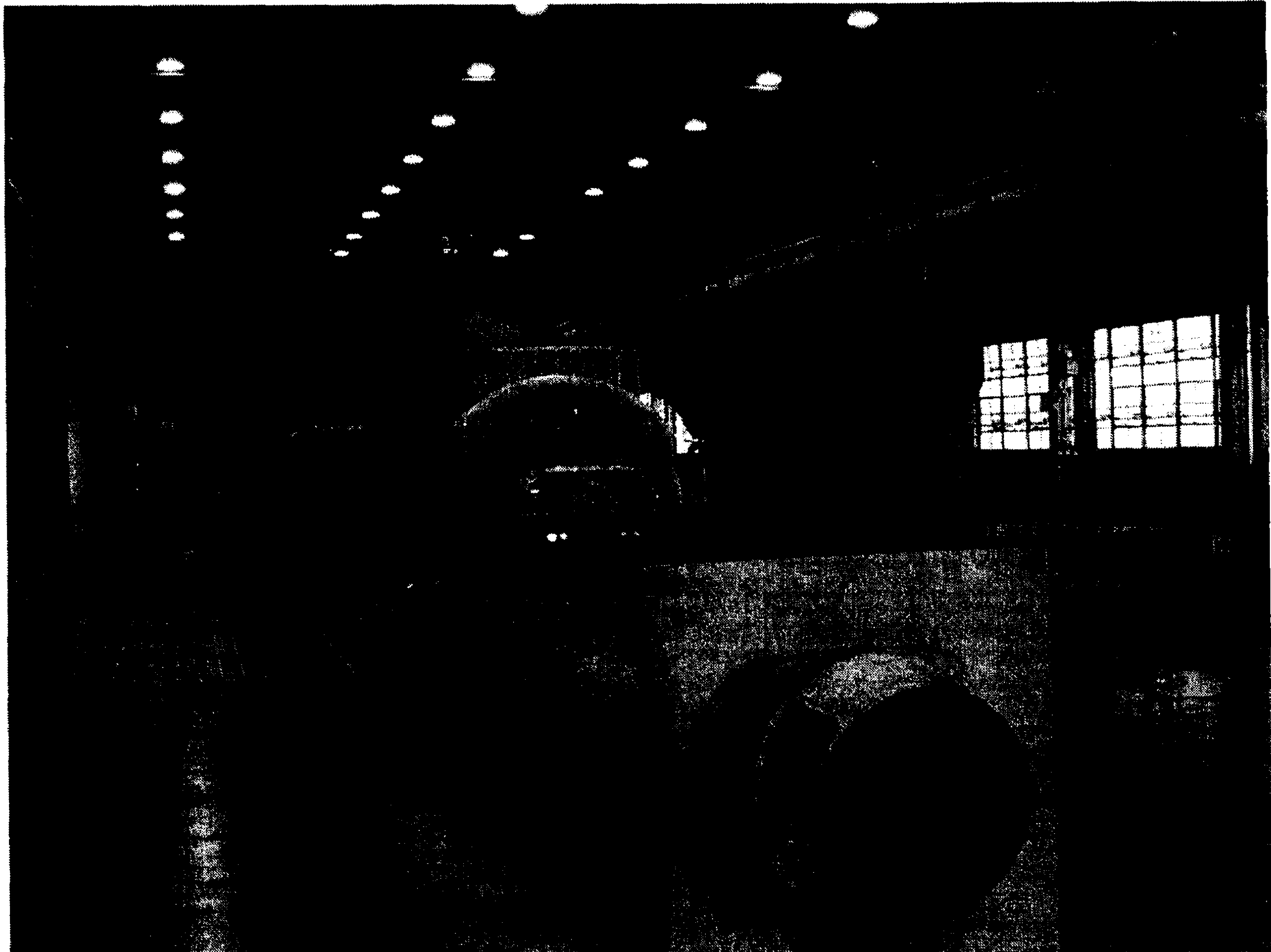

This photo was taken from where the turbine from Unit 1 once stood. Retired Unit 2 remains intact from the boiler to the turbine. The turbine for Unit 3 can be seen in the distance.

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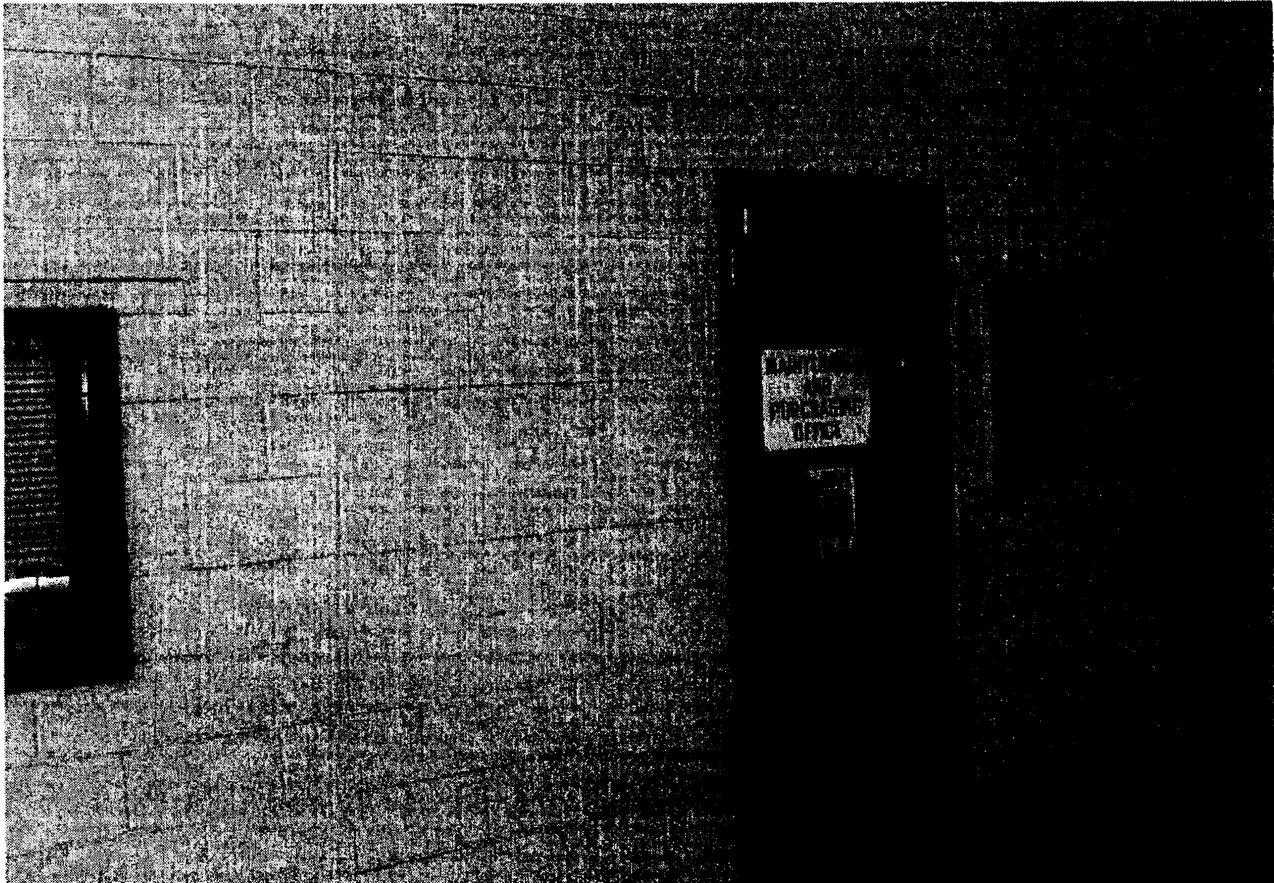

This Maintenance and Purchasing Office is a conversion from the former Unit 1 control room at Lawrence.

SITE VISIT TO WESTAR PLANTS
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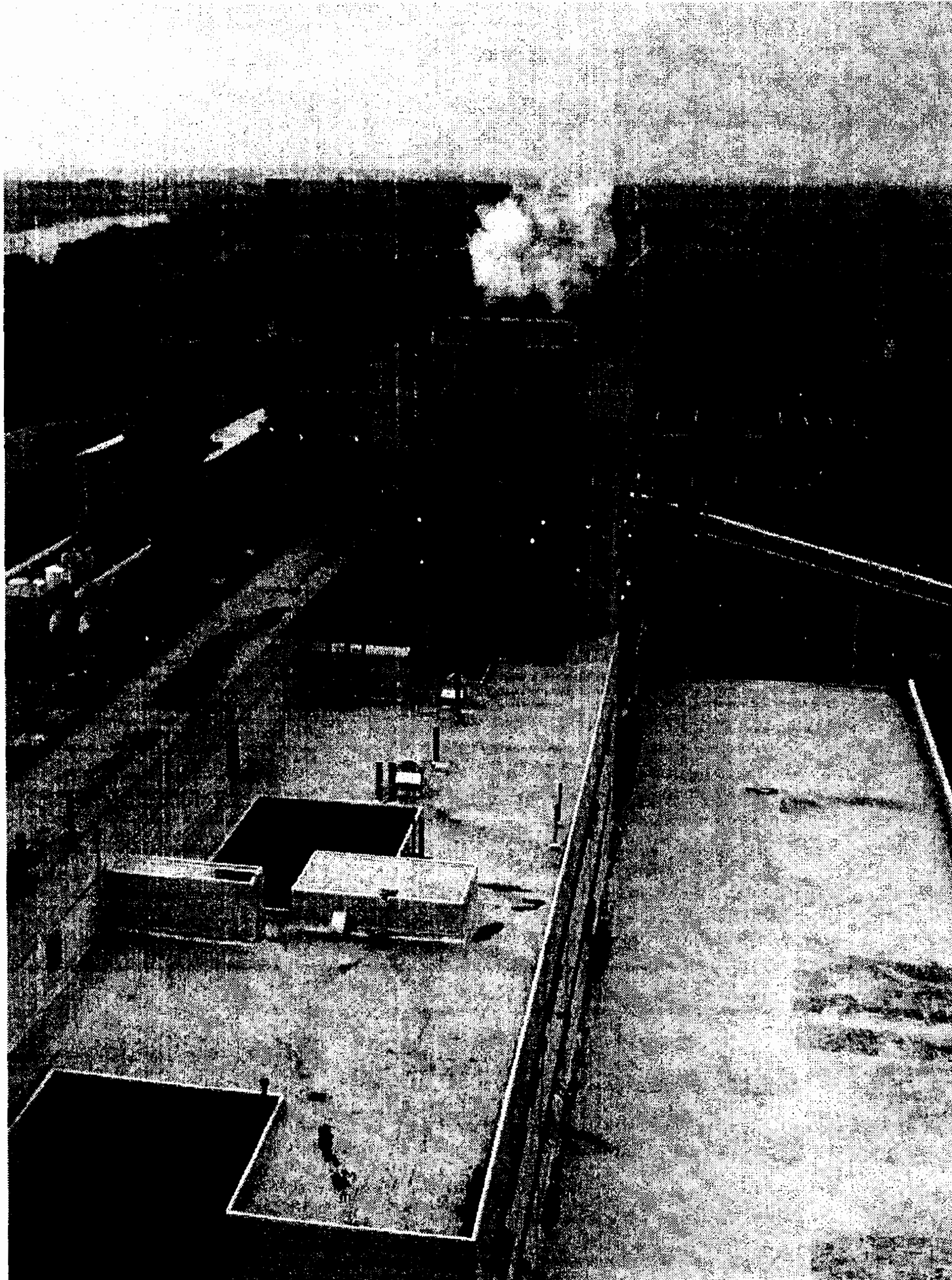

This building, between units 5 & 4 at Lawrence, has units 1, 2 and 3 sharing the common area. Dismantlement of units 1 and 2 would disrupt the operation of unit 3. It is obvious that dismantlement will not occur.

a specific plan is very risky for a utility business because they might not get another plot of land to be able to generate electricity if needed . . ." (Tr. Vol. 6, at 1174).

8. A site visit to Westar's Lawrence and Tecumseh plants conducted by Mr. William M. Zaetz, a consultant with Mr. Majoros' firm, confirmed that Westar is in line with the national trends revealed by the study. (*See generally,* D. Test., Majoros, Exh. MJM-3). Boilers that were retired over twenty years ago at the Tecumseh Energy Center are intact. (MJM-3, at 17, 20). Turbines were removed from the building that contains these old unused boilers to make room for a machine shop, which is still in use. (*Id.*, 17, 19). At the Lawrence Energy Center, boilers for retired units 1 and 2 remain in place. (*Id.*, at 23, 24, 25). The former control room of unit 1 has been converted to the maintenance and purchasing office. (*Id.,* at 26). The turbine for unit 2 remains intact. (*Id.*, at 25). Mr. Zaetz noted that "dismantlement of units 1 and 2 would disrupt the operation of unit 3. It is obvious that dismantlement will not occur." (*Id.*, at 27).

9. Additionally, Mr. Spanos noted that Westar's Ripley plant is still being used for purposes other than generation, even though its generating units were retired in the late 1980s. (Tr. Vol. 6, at 1174). Mr. Spanos testified that although he estimates that the Ripley plant will be retired from use in 2008, Westar has yet to formulate a plan for modifying or selling the Ripley site. (*Id.*, 1176). However, while he stated that "there's a desire to either sell the land or build something else there" by 2008, he also testified that he was not aware of any plan to dismantle the plant or build a new one there. (*Id.*, at 1176), and no one else testified that Westar has plans to alter the current use of Ripley.

10. Given that utilities must make plans for construction of new plant several years in

advance of the commencement of construction, Spanos' assertion that Westar might build something else at the Ripley site beginning in 2008 that would require dismantling the plant is highly speculative, especially given its current usefulness for other purposes. Mr. Spanos made the point that detailed studies of dismantlement are not made until "a few years prior to doing it." (*Id.*, at 1166). If dismantlement is planned at the Ripley site for 2008, it is logical to conclude that Westar would have begun a dismantlement study by now. Mr. Spanos, who had access to all relevant records, apparently discovered no such study, and none was offered by any other witness. (*Id.*).

11. Thus, the assumption that a retired plant must be dismantled to make the site valuable again is belied by the facts in evidence: there are several facilities in the Westar system that contain retired units, but that serve other valuable purposes. In fact, Mr. Majoros presented expert evidence that dismantling some of Westar's old units would actually disrupt the operation of other functional units: it would hardly be prudent for Westar to remove them while it continues to rely on the functional units to meet demand. The assumptions that the value of the site of a retired utility plant is enhanced by removal of all of its facilities, or that the sale price of such a site will be discounted by the cost of the removal of the facilities left in place are belied by the facts in evidence: even Mr. Spanos admits that another utility or a company in need of access to transmission or distribution facilities may find the presence of such facilities to be a plus rather than a minus, and that is often difficult for a utility company to find ideal new sites.

12. Mr. Spanos speculated that Westar is likely to dismantle its plants. By contrast, Mr. Majoros offered hard evidence that less than one-half of one percent of similar plants is ever dismantled down to the ground, and that two-thirds of them are not even dismantled within the

facilities that contain them. His study did not reveal a single instance of a new plant being built on the green field site of a removed and dismantled plant.

13. Mr. Spanos did not know of any dismantlement studies or plans for Westar to dismantle any of its plants upon their retirement, even for Ripley, which he "expects" to be retired in 2008. By contrast, Mr. Majoros offered hard evidence that Westar has left numerous retired units in place, and has removed parts of others so that it may utilize the facilities for other purposes.

14. Mr. Spanos opined that terminal net salvage costs must be included in rates so that Westar will recover the costs of dismantling plants down to green fields, but presented not one iota of evidence that Westar will ever incur any such costs. By contrast, Mr. Majoros presented credible evidence based on national trends, as well as Westar's actual practice, that complete dismantlement and removal of retired plants is extremely rare.

15. Furthermore, Mr. Spanos, in attempting to excuse the lack of existing plans for dismantling Ripley by saying that Westar would not walk away from an existing plant site because it might not find a better one, inadvertently admitted that Mr. Majoros and Mr. Holloway were right: there are a lot of good reasons for a utility to choose not to dismantle a retired plant. It is cheaper to do so. It also may be safer to do so, if asbestos removal would be required. So long as the facility can be used for another purpose without doing so, it simply makes no sense to incur the additional expense. The trouble and cost involved in locating suitable new sites is avoided. Additionally, the retired plant or its attendant infrastructure may have value to another buyer in the future. And finally, as Mr. Majoros pointed out, if the utility is allowed to continue to collect revenues to dismantle and remove plants, but never has to spend the money, the utility

gets the use of those revenues in the meantime.

16. It bears noting that Mr. Majoros did not object to the inclusion of interim net salvage in rates, and,in fact, presented evidence that Westar has apparently salvaged parts of some of the retired units, as he noted in his study that other utilities have done. It must be remembered that interim net salvage involves the removal of a generation unit or other part of a plant; terminal net salvage involves complete removal of all traces of the entire plant, down to the bare ground, or green field.

17. However, Mr. Majoros clearly established that the company's claim that it will incur terminal net salvage is highly speculative and not supported by the evidence. His position was supported, as noted above, by the testimony of Mr. Holloway and even by portions of the testimony of Mr. Spanos. Westar simply did not meet its burden on this issue. Without credible evidence that a cost will be incurred, it is not apparent, therefore, why the Commission concludes that terminal net salvage should be included in rates, or why it states that "it does not have a credible alternative as to the treatment of terminal net salvage." (Order, at ¶92).

18. It must be noted that there is a dispute among the parties as to whether Westar's current rates include terminal net salvage. It is CURB's position that it really does not matter. If there is credible evidence that the company is unlikely to incur certain kinds of future costs, then the costs are so speculative that they cannot be deemed reasonable to ask ratepayers to pay them. It is incumbent upon the Commission to deny their recovery, even if such costs have been included in rates in the past. By accepting Mr. Spanos' position on terminal net salvage, despite the overwhelming evidence that Westar is highly unlikely to incur such costs, the Commission is ordering the ratepayers to contribute funds for speculative costs for which there is no evidentiary

support. This is contrary to every principle of ratemaking, all of which call for ratepayers to pay only for the costs of service prudently incurred, and to provide the utility's investors a reasonable return on their investment.

19. Furthermore, the Commission's decision to include amounts for terminal net salvage in depreciation rates as proposed by Westar is in direct contradiction with its decision to order Westar in the future to "make the showings proposed by Staff" **prior** to recovering terminal net salvage in depreciation. (Order at ¶92). The showings that Westar is required to make under these requirements include:

- The cost estimate for dismantling and removing the facilities is well supported and reasonable;
- The utility has a reasonable and detailed plan including a schedule of activities and related expenditures necessary to dismantle and remove the facilities, and to dispose or reuse the property;
- The utility has explored competitive options to dispose of the property without dismantling and removing the generation facilities; and
- Dismantling and removing the generation facilities is the least cost option and provides the most benefit to the utility and its ratepayers.

(Holloway, D. Test., at 18).

20. Since Westar's depreciation witness testified that, to his knowledge, Westar has **no plans whatsoever to dismantle and remove generation facilities,** let alone in a manner that would meet the definition of terminal net salvage, how can the decision to follow Mr. Spanos' recommendation on the amount to include for terminal net salvage possibly be reconciled with

the decision to order Westar in the future to meet the above requirements **before** including terminal net salvage in rates? The Commission apparently recognizes that the purported need to incur them is highly speculative, absent evidence in the record that there are concrete plans in place for dismantling and removing a particular plant: there is simply no reason whatsoever to allow Westar to collect these amounts now. Even if the company had established that there are concrete plans for dismantling and removing a particular plant, there is no proof whatsoever that each plan is a prudent plan, and represents the least-cost option that best serves the needs of the utility and its ratepayers. CURB supports the Commission's decision to implement a set of evidentiary standards, and believes that they are vital to protect the ratepayers. But the decision to wait until the next rate case to implement them is puzzling: **why does the Commission believe that ratepayers are entitled to be protected next time, but not now?**

21. Quite simply put: if Westar was required in *this* case to comply with the Commission's guidelines in order to collect terminal net salvage in depreciation rates, Westar would completely fail to meet its evidentiary burden, as the following analysis illustrates.

22. Mr. Spanos admitted that his estimates for terminal net salvage are based on "studies of similar facilities," (Tr. Vol. 6, at 1126), not on any specific facility of Westar. However, Mr. Majoros's study of similar facilities is the *only* such study in the record–and it established that there was little-to-no likelihood of the company incurring terminal net salvage at all. Westar has failed to meet the burden of the first requirement.

23. Again, the evidence was clear that Westar currently has no plans or studies indicating that it has plans to dismantle any of its plants down to green fields. Westar thus has failed to meet the burden of the second requirement.

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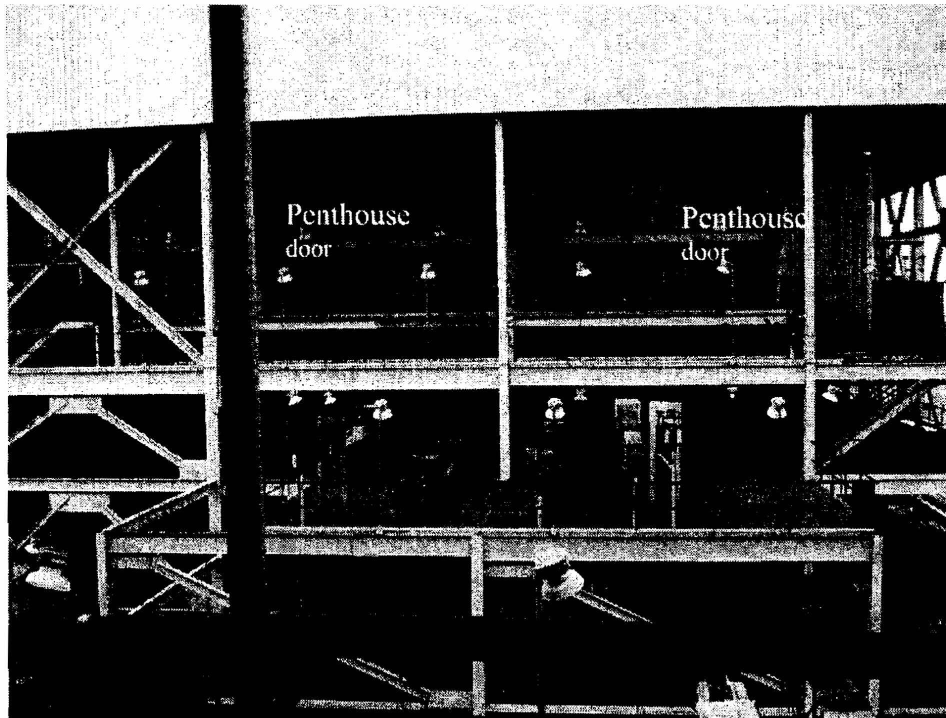

This is a side view photo taken between units 2 and 3. Two of the modifications to the unit are the installation of the penthouse doors (at the top of the photo) and the installation of additional soot blowers to prevent welds from cracking in the reheat and superheater sections of the boiler.

24. There is no evidence in the record that Westar has explored any competitive option to dismantling and removing any generation facilities, so it has failed to meet the burden of the third requirement.

25. There is no evidence in the record that incurring terminal net salvage costs is the least cost option and provides the most benefit to the utility and its ratepayers, so Westar has failed to meet this fourth requirement, as well.

26. Furthermore, there is an abundance of evidence in the record that taking a plant down to green field is not necessarily the least-cost option. Westar's current practices of working around old boilers and removing only what is necessary to allow retired plants to serve new uses are likely more prudent practices than tearing them down. Furthermore, a utility need not tear down and start over to improve operations: Westar has upgraded facilities to improve maintenance efficiencies, such as at Jeffrey Energy Center, where the addition of penthouse doors now allows easier access for maintenance of the boilers and new blowers help prevent cracks from developing in them. (Majoros, D. Test., Exh. MJM-3, at 10). Westar's conduct in dealing with plant retired thus far, the conduct of utilities nationwide, and the testimony of Mr. Spanos and Mr. Holloway all indicate that there are numerous benefits to upgrading current plant over developing new sites, and that even if Westar wants to sell a plant site, that a potential buyer might want all or some of the plant or its infrastructure left in place for future use.

27. Lastly, it must be noted that the fourth requirement requires that the company make a choice that brings the most benefits to the utility *and* its ratepayers. In this case, Westar requests millions more in depreciation costs over the previous case, most of which is attributable to the company's positions concerning terminal net salvage. How can a decision to

incur increased costs of million of dollars for terminal net salvage benefit the ratepayers? Westar has made no showing whatsoever that its purported plans to eventually retire each and every plant (which are not in evidence) and turn every site into green fields, are outcomes that would bring the most benefits to the utility and ratepayers alike. Of course, collecting those additional millions in rates is good for the utility, but it is a lousy deal for ratepayers.

28. CURB respectfully requests that the Commission reconsider the evidence presented and adopt the position of Mr. Majoros on terminal net salvage, a position that was consistent with Staff's own witness, Mr. Holloway.

II. Adoption of Westar's claim for future cost of removal will cause overcompensation of Westar, thereby violating the requirement that rates must be just and reasonable.

29. In the event that the Commission declines to reconsider allowing Westar to collect for terminal net salvage, CURB seeks reconsideration of the Commission's decision to adopt Mr. Spanos' calculation for terminal net salvage. Mr. Majoros proposed to adjust the claim for terminal net salvage to remove the 3% annual inflation that Mr. Spanos admits that he used to calculate the claim. As Mr. Majoros noted, including inflation—without then adjusting back to net present value—allows the company to over-recover for terminal net salvage.

30. The reasoning for adjusting the claim back to net present value is NOT to eliminate the inflation that Mr. Spanos factored in: it is to recognize the value in receiving money earlier rather than later. Net present value adjustments are inherent in many types of calculations in law where the party is awarded monies now for projected future expenditures. For example, suppose that a person is injured in an accident that is proven in court to be the fault

of another party. The person is now permanently disabled and unable to work. The court will commonly calculate the damages owed to the person for lost earning potential by estimating the earnings the person would likely have made during his or her career, had it not been for the injury. Estimated inflation in wages is factored in; typically, the court will recognize that a typical wage earner will earn more in later years of a career than in the earlier years.

31. Then, because the person is being awarded the damages now, not in the future, as he or she would have received them had they been earned as wages, the court adjusts the amount awarded back to net present value. This recognizes the value of receiving the money now, rather than having to wait. It also recognizes that a prudent individual who receives the money now, not later, has an opportunity to invest the money and increase the size of the award, or to use it in other ways that will enhance the award's value over time.

32. Similarly, persons who have paid-up life insurance are often permitted under the terms of the policy to cash it in—but at a discount from the face value of the policy. The discount is the price paid for having the use of the money now, rather than having to wait until later. The concept of discounting amounts owed in the future to net present value at the time they are paid is not unusual, and in fact, is standard practice in many situations.

33. In this case, although Westar will not receive lump sum payments of the entire amounts for terminal net salvage in its claim, the company will receive large amounts of money far in advance of the date they are anticipated to be needed. Mr. Majoros recognized in his adjustment of Mr. Spanos' claim, which was inflated by 3% annually for each year of the expected life of each plant, that there is value to Westar in receiving the money in advance. And because Westar has a history of coming in for new rate cases about every five years, Mr. Majoros

reasoned that it is not necessary to adjust the claim for inflation beyond the present rate, because Westar will no doubt come in with a claim in its next rate case that will request an increase in terminal net salvage based on the inflation rates then current. Each rate case, Westar will have an opportunity to argue that the amounts should be adjusted to take into account the affects of inflation.

34. It is important to understand that future ratepayers will not be stuck with paying more than their share, but will pay amounts that are reasonably related to the value of the dollars they contribute. This is only fair: today's cost of service is paid for by each generation of ratepayers with today's dollars, just as each wage earner is paid with today's dollars. A dollar may have bought a lot more in 1900 than it did in 2000, but most people had a lot more dollars to spend in 2000 than people did in 1900. Ratepayers in the future will have more of them than we do. Thus, it is fair to take the declining worth of dollars into account in calculating what removal costs will be in the future by factoring in current inflation.

35. However, the total amount should be adjusted at each rate case to the then-current rate of inflation. That will ensure that the amounts that each generation of ratepayers pay in will be adjusted so that they are covering the inflation that is occurring during their tenure, but that they are not paying for the next decade's costs with today's dollars.

36. It is also important to understand that adjusting the claim back to present net value does NOT place the responsibility for paying for plant removals solely on the shoulders of future ratepayers. The total amount is still calculated taking into account inflation over time: no one expects that removal 30 or 40 years from now will cost the same as it does now. When those amounts are adjusted back to net present value, it does not eliminate the recognition of inflation,

but simply recognizes the advantage to the company in receiving payments on those amounts now, long before they will actually be needed. As Westar builds its reserves for removal over time, it will have the opportunity to invest the money or use it to such purposes as it sees fit, until the time for removal arrives. It is only right that when the company is going to be receiving funds far in advance of need, that the amount be reduced to account for the benefits to Westar of receiving those funds in advance and having the opportunity to use them for the utility's benefit.

37. Finally, it is important to remember that the decision of the Commission to require Westar to record a regulatory liability for terminal net salvage does not prevent Westar from benefiting from using or investing the funds in the interim between receipt and expenditure. Therefore, even though the funds will be accounted for as regulatory liability, Westar will still benefit from receipt of the funds far in advance of need. Accounting for the funds as a regulatory liability is merely a measure to insure that ratepayers receive proper credit for the funds they have paid towards removal costs in the event that the company is deregulated or changes hands, or in the event that it admits that it will not be using the funds for dismantling and removing plants. The amounts granted for terminal net salvage should still be adjusted back to net present value, even if they are recorded as a regulatory liability, because the method ordered by the Commission of accounting for the funds does not eliminate or diminish in any way the benefits the company receives by receiving the money in advance of need.

38. For all the reasons above, should the Commission allow the company to collect terminal net salvage in depreciation rates, CURB respectfully requests that the Commission reconsider its decision to disallow CURB's adjustment of Mr. Spanos' terminal net salvage calculation back to net present value. If Westar is to receive payments now—not in the distant

future—the benefit to Westar of receiving them now should be recognized by reducing the payments to net present value.

III. Allowing Westar to collect terminal net salvage is illogical, arbitrary and capricious, because it directly contradicts the Commission's recent policy decision to deny Empire to collect terminal net salvage.

39. A review of a recent Commission order is necessary here in order to articulate CURB's argument that allowing terminal net salvage costs in depreciation rates is a complete reversal of recent Commission policy. Less than a month prior to the issuance of the order in dispute here, the Commission issued an order in the Empire District Electric Company rate case. (*Order*, Dec. 9, 2005, Docket No. 05-EPDE-980-RTS, a/k/a the "980 Docket"). Empire serves customers in Missouri as well as Kansas, and had earlier filed a rate request with the Missouri Public Service Commission. In the course of the Missouri rate case, the company filed a depreciation study with the Missouri commission. As a matter of policy, the Missouri commission explicitly excluded costs of terminal net salvage in setting depreciation rates for Empire. (980 Docket, Holloway, D. Test. at 3). When Empire later filed its Kansas rate case, the company requested that this Commission establish the depreciation rates that were approved in Missouri. (980 Docket, Gibson, D. Test. at 6).

40. Staff supported the company's proposal. Staff witness Larry Holloway testified "by explicitly excluding the cost of dismantling and removing production plant facilities from Empire's Missouri depreciation rates, that Missouri set depreciation rates using sound regulatory principles." (980 Docket, Holloway, D. Test. at 3). Mr. Holloway characterized terminal net

salvage costs as "speculative," just as he has in this case, and presented Staff's arguments that inclusion of such speculative costs violates numerous regulatory principles. (*Id.,* at 4 - 5). His arguments against inclusion of terminal net salvage costs in depreciation rates closely tracked his arguments against them in this case.

41. In the course of the docket, Staff and Empire reached a settlement, and in due course, the Commission heard arguments for and against approving the settlement, and issued its order. Although the revenue requirement was settled in "black box" fashion—*i.e.*, without stipulation as to what components of the company's request were included or excluded—the stipulation and agreement between Staff and Westar specifically stated, among other provisions, that Empire would implement depreciation rates as filed by the company in the case. (980 Docket, Stipulated Settlement Agreement, Oct. 4, 2005, ¶11.) In other words, Empire requested, and Staff agreed, that its depreciation rates should be set like they are in Missouri—which denies inclusion of terminal net salvage. At the hearing, Staff witness Larry Holloway stated that Staff would take this position with any of the utilities that the Commission regulates in Kansas, because "it's a sound regulatory policy" and that it is "in the public interest" to exclude terminal net salvage from rates. (980 Docket, Holloway, Tr., at 191).

42. In approving the settlement agreement, the Commission noted that Staff had concluded that "depreciation rates approved by the Missouri Commission were reasonable and based on sound regulatory principles." (980 Docket, *Order*, Dec.9, 2005, ¶37). The Commission stated that it "finds that the recommendation to adopt depreciation rates approved by the Missouri Public Service Commission is appropriate . . ." (*Id.*, at ¶38). Therefore, less than a month prior to deciding this case, this Commission made a policy decision to adopt Missouri's

"reasonable" and "appropriate" method of establishing depreciation rates, which specifically excludes terminal net salvage.

43. Then, the Commission reversed this policy entirely in this case, explaining that it would be a "reversal of prior policy not supported by the evidence." (¶92). This was a reference to the Commission's acceptance of Westar's assertion that terminal net salvage was previously included in rates, a matter that was in dispute. As a matter of fact, the words "terminal net salvage" do not appear in the order in Westar's last rate case and do not appear in the order on reconsideration. Without some specific reference to terminal net salvage, the previous rate case order could hardly have established a "policy" on the matter.

44. Although Staff's recommendation to deny recovery for terminal net salvage in this case was entirely consistent with its position in the Empire case, the Commission, which found Staff's position "reasonable" and "acceptable" policy on December 9, found Staff's position was not a "credible alternative" in this case on December 28. (*Id.*). It is impossible to discern why. While admittedly, recognition of relevant differences in utilities may permit reasonable differences in the Commission's regulatory treatment among them, there is absolutely nothing to explain to the parties why the Commission favorably cited Staff's arguments in favor of denying speculative costs such as terminal net salvage, deeming it a reasonable and appropriate policy, then—less than a month later—finding that the very opposite is true.

45. Frankly, the only consistency between the two orders on this issue is that the Commission gave the utilities in both cases what they asked for. However, such consistency cannot be the basis of logic that is required to sustain Commission orders. There is no apparent

reason why the parties should have anticipated that the Commission would reach totally opposite conclusions in two back-to-back rate cases. Without explicit guidance as to what facts or circumstances the Commission found supported its decision to adopt an entirely different policy for Westar than for Empire, the latter decision can only be characterized as arbitrary and capricious. CURB therefore respectfully requests that the Commission reconsider this issue and adopt a policy consistent with the policy adopted for Empire.

IV. The Commission's decision not to credit 100% of Westar's off-system sales to ratepayers was arbitrary and capricious, because it contradicts the recent decision to credit Empire's ratepayers with 100% of its off-system sales.

46. Similarly to the issue above, the Commission in this case adopted a policy on treatment of off-system sales that is entirely different than that approved in the Empire case a few weeks before. The Commission approved crediting ratepayers with 100% of Empire's margins on annual off-system sales, a compromise that was crafted by Empire and Staff in their settlement agreement. (980 Docket, Order, Dec. 9, 2005, at ¶33). The Commission agreed with Empire and Staff that this treatment of off-system sales is "beneficial to Kansas consumers and should be approved . . ." (*Id.*, at ¶34).

47. Again, however, in the Westar case the Commission adopted a different treatment for Westar's off-system sales, crediting ratepayers with only a three-year rolling average of such sales, allowing Westar to keep amounts above the three-year average. (¶46, 26). This was

Staff's proposal, and it wasn't entirely clear in Staff's testimony why it supported this proposal rather than crediting ratepayers with 100% of Westar's margins on off-system sales, as it had in the Empire case: if this is good policy for Empire's ratepayers, why is it not good policy for Westar's ratepayers?

48. Admittedly, there are operational differences in Empire and Westar that justify some differences in regulatory treatment of non-asset-based sales—Westar has an entire section of its company dedicated to off-system sales, and possesses the expertise and experience to engage in extensive non-asset based sales, something Empire apparently conceded merited different treatment of non-asset based sales at the two utilities. However, it is unclear why asset-based off-system sales should be treated differently at the two utilities. Nothing in the Commission's order explains why it reached the conclusion that Empire's ratepayers should get 100% but Westar's customers should not. Given that the Westar order was issued less than three weeks after the Empire order, the Westar order was arbitrary and capricious, because it was inconsistent with policy set in the Empire case and lacking any logical foundation for the inconsistency. CURB therefore respectfully requests that the Commission adopt a policy for Westar's asset-based off-system sales consistent with that adopted for Empire.

V. Request for Clarification

49. CURB requests that the Commission review its various decisions in the rate case order and clarify that they achieved the result intended by its order. Specifically, the

Commission's News Release Number 05-20 entitled, "KCC Trims Westar Energy's request for Rate Increase," stated that "Today, the Kansas Corporation Commission issued an order granting Westar an overall annual rate increase of approximately $3 million." Unfortunately, if the Commission's intent was to grant only a $3 million annual increase, it failed to do so.

50. The impact of granting an energy charge adjustment, an environmental rider and the Commission's decision to credit ratepayers with a three-year rolling average of asset-based off-system sales will be a much larger increase than just $3 million. When one factors in the impact of current fuel prices that will have immediate impact with the implementation of the energy charge adjustment (ECA), decreases in off-system sales since the test year, and the costs of environmental projects that are completed or soon to be completed, the actual increase to be paid by ratepayers is much greater. If the Commission failed to take these impacts into account in intending to grant a $3 million increase, CURB respectfully requests that the Commission reconsider its order and revise it to reflect a result that is consistent with the Commission's intent.

51. One must keep in mind that when the cost of fuel is adjusted out of base rates to implement the ECA, the cost of fuel that is adjusted out will be based on test year (2004) fuel prices. The ECA will be based on current fuel prices, which are much higher. Westar witness Doug Sterbenz testified that the fuel costs for Westar from August 2004 to August 2005 had risen about $50 million. (Sterbenz, R. Test., at 10). One must keep in mind that the most recent figures available that he had for Westar's fuel costs (August 2005) represented costs incurred BEFORE Hurricanes Katrina and Rita, after which fuel prices steeply escalated. Although they

have trended slightly downward from recent peaks, they have not gone back to pre-August 2005 levels and are not expected to any time soon.

52. One must also keep in mind that although Westar's heavy reliance on coal for generation protects its customers from the extremely high prices experienced by customers whose utilities rely more heavily on natural gas, the upswing in transport fuel has increased the cost of coal significantly. Mr. Sterbenz testified at the hearing that the price indexes indicated that the company's cost of coal for 2006 would be $21.5 million higher year than it had anticipated while preparing the rate case. (Sterbenz, Tr. Vol. 4, at 718). He noted that Westar's reliance on coal would not prevent its fuel costs from being vulnerable to steep increases, because Westar's rail contracts are subject to escalator clauses to cover the increases in coal transport costs, such as for diesel fuel. (Sterbenz, R. Test., at 8). Mr. Sterbenz estimated that Westar's fuel costs had risen about $50 million from August 2004 to August 2005. (*Id.*, at 10).

53. Given the trend in prices since then, one can only hope that Westar's fuel bill for 2006 will merely be $50 million higher. When the ECA takes effect in March 2006, Westar's current—not test year—fuel costs will be what customers will pay. Therefore, the "modest" increase of $3 million will be at least $53 million, taking into account the actual impact of the ECA.

54. Next, the decision of the Commission to credit ratepayers with a three-year rolling average of asset-based off-system sales will have an impact on actual rates charged, as well. Demand on Westar's system is increasing 2 – 3% a year, which diminishes its capacity to make asset-based off-system sales. (Sterbenz, Tr. Vol. 4 at 784). Additionally, as environmental

equipment is added over the next few years, additional outages and parasitic load will decrease generation output, which will also leave less excess power to sell. (Harrison, D. Test., at 22). Sales have been in decline since 2003, and Westar's projections indicate that they will sharply decline in 2006. The three-year average for projected and actual sales 2002 – 2005 was $35.9 million. But the three-year average for 2003 – 2006, based on Westar's projections in its application for sales in 2005 and 2006 will be $29.1 million. (Sterbenz, D. Test., 31).

55. If one uses the actual sales for the first nine months of 2005, which was $19.5 million, to estimate total sales for 2005, Westar's projections were high: the three-year rolling average for 2003 – 2006 will be only $27.5 million. (Sales Jan. – Sep. 2005 were $19.5 mill., Sterbenz, Tr. Vol. 4, at 786). The Commission based its calculation of the net overall increase of $3 million on the $35.9 million figure. However, with the decrease in off-system sales, the credit to ratepayers will actually be about $8.4 million less than that—and be even less in coming years. Adding $8.4 million to the increase of $53 million brings the net impact on ratepayers of the Commission's order to at least $61.4 million.

56. The Commission's decision to allow Westar to pass through the cost of environmental projects will also have an immediate impact on consumer rates. Assuming that installation of the low NOx burner at Jeffrey Energy Center that was scheduled to be completed last fall has been accomplished, the immediate impact of that on consumer rates will be $2.5 million. (Harrison, D. Test., at 23). Furthermore, Westar has obligations to KCPL to pay for half of the costs of adding a selective catalytic reduction unit at LaCygne, which is scheduled for completion in May 2007. That will add another $19.9 million to the rates of Westar South

customers just a little more than a year after the rates from this case take effect. As other projects are added, Westar has estimated that the average annual revenue requirement for all the planned projects is $103.9 million. (*Id.*) Thus, the net impact of the Commission's order will be that consumer rates will be, at minimum, $63.9 million, and the impact a year from now will be, at minimum, $83.8 million. As other projects are added, the impacts will be felt immediately by consumers.

CURB therefore respectfully requests that the Commission reconsider its order to implement rates in line with its intent to grant only a $3 million net increase to Westar customers.

Respectfully submitted,

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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

I, Niki Christopher, of lawful age, being first duly sworn upon her oath states:

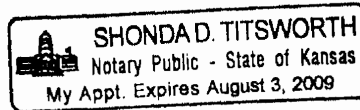
That she is an attorney for the above named petitioner; that she has read the above and foregoing, and, upon information and belief, states that the matters therein appearing are true and correct.

Niki Christopher

SUBSCRIBED AND SWORN to before me this 12th day of January, 2006.

Notary of Public

My Commission expires: 8-03-2009 .



CERTIFICATE OF SERVICE

05-WSEE-981-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was placed in the United States mail, postage prepaid, or hand-delivered this 12th day of January, 2006, to the following:

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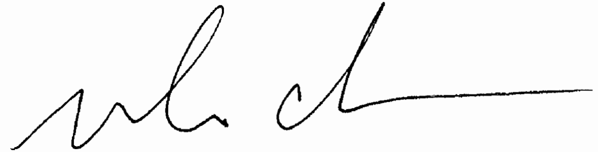

Niki Christopher

News Release

December 28, 2005

KCC trims Westar Energy's request for rate increase

On May 2, 2005, Westar Energy Inc. (Westar) filed an application with the Kansas Corporation Commission (KCC) requesting a comprehensive review of its electric rates which included an overall annual revenue increase of approximately $84.1 million. This represented an increase of 9 percent or $47.8 million for its northern region, and a 6 percent or $36.3 million increase in rates for its southern region customers.

Today, the Kansas Corporation Commission issued an order granting Westar an overall annual rate increase of approximately $3 million. Today's action will increase Westar's northern region rates by approximately 4.7 percent or $24.2 million, and decrease its southern region rates by approximately 4.2 percent or $21.2 million.

In its order the Commission stated, "While this outcome results in rate increases in the North and rate decreases in the South, our determinations set forth above will generate overall revenues quite close to those existing from current rates. These current revenues have enabled Westar to improve its balance sheet, attract investors, refinance debt, move toward investment grade credit ratings, and yet generate electricity at the cheapest rates in Kansas." The Commission indicated that its determinations should enable the company to continue to meet those goals, stating "…this order will allow Kansans and our state's economy to continue to benefit from a strong utility that efficiently generates electricity, encourages conservation, and meets its environmental responsibilities, all at just and reasonable rates."

For customers in the northern region, the average residential customer's monthly bill will increase approximately $3.00 from $58.50 to $61.50 or 5.1 percent. For customers in the southern region, the average residential customer's monthly bill will decrease approximately $3.47 from $72.00 to $68.53 or 4.8 percent. The average bill calculations are estimates based on the company's average monthly residential revenue in each region, divided by the number of residential customers in each region.

The Commission also approved the implementation of an Energy Cost Adjustment (ECA) charge. Historically, fuel costs were included in the per Kwh (kilowatt hour) energy charge and were only adjusted at the time of the company's next rate case. Under an ECA process fuel costs incurred by the company for the generation of electricity will be passed more directly and quickly to customers through the ECA charge. The ECA charge will be reflected as a separate line item on the customer bill and will fluctuate on a monthly basis. This method allows for consumers to benefit from fuel cost declines, and when fuel costs go up, it serves to give consumers better "price signals" regarding their energy usage and thereby encourages conservation.

The Commission approved a Return on Equity (ROE) of 10 percent and an overall Rate of Return (ROR) of 7.8907 percent. Westar had requested a ROE of 11.50 percent and a ROR of 8.8350 percent.

The ROE is the amount of money a company has the opportunity to earn on its common equity provided by stockholders and the ROR is the combined cost of debt and equity used to finance assets.

In determining the ROE, the Commission relied on the range recommended by KCC Staff, finding a 10 percent ROE to be appropriate based on the extensive testimony provided by the various parties in the case, and taking into account a reduction in risk to the company resulting from the use of an ECA process to recover fuel costs.

In its order, the Commission clearly states that it is confident that costs associated with the misdeeds of prior Westar management have been excluded from this rate case and that ratepayers are not being asked to bear the burdens of those prior actions.

The new rates will be effective for usage on or after approval of the company's new tariff filings.

The company's last rate case was in 2001, when it filed for an overall increase of $151 million. The Commission ordered a total company decrease of approximately $22.7 million.

The northern and southern regions are the geographical areas historically served by KPL and KG&E, respectively. Westar provides retail electric service to approximately 352,000 customers in the northern region and approximately 303,000 customers in the southern region.

Docket No. 05-WSEE-981-RTS

2005.12.09 08:54:39
Kansas Corporation Commission
/S/ Susan K. Duffy

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

Before Commissioners: Brian J. Moline, Chair
Robert E. Krehbiel
Michael C. Moffet

In the Matter of the Application of The Empire District Electric Company for Approval of the Commission to Make Certain Changes in its Charges for Electric Service.	))))	Docket No. 05-EPDE-980-RTS

ORDER ADOPTING STIPULATED SETTLEMENT AGREEMENT

The above-captioned matter comes before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having reviewed the files and being fully advised of all matters of record, the Commission summarizes the arguments of the parties and finds and concludes as follows:

1. On April 29, 2005, The Empire District Electric Company (Empire) filed an application for a rate increase pursuant to K.S.A. 66-117. The parties proposed a procedural schedule, which the Commission approved in an order issued June 13, 2005. Pursuant to this schedule, a prehearing conference was conducted on October 4, 2005, and an evidentiary hearing was scheduled before the Commission for October 11, 12, and 14, 2005.

2. On October 4, 2005, the staff of the State Corporation Commission of the State of Kansas (Staff) and Empire filed a Motion to Approve Joint Stipulated Settlement Agreement. The Citizens' Utility Ratepayer Board (CURB), which intervened in this proceeding, did not join in the Stipulated Settlement Agreement. Staff and Empire filed testimony supporting the Agreement on October 6, 2005; CURB filed testimony opposing the Agreement on October 10, 2005.

3. The Commission conducted a hearing on October 11, 2005. Appearances at the hearing were as follows: J. Michael Peters on behalf of Staff and the public generally; James G. Flaherty on behalf of Empire; and David Springe and Niki Christopher on behalf of CURB. Transcript of Proceedings Held October 11, 2005 (Tr.), 4. CURB objected to notice of the hearing on grounds that in the Agreement Staff and Empire sought to conditionally waive cross examination depending on the outcome of the Commission's decision on the joint motion to approve the settlement. The Commission overruled CURB's objection. Tr., 5.

4. Parties agreed to the presentation of witness testimony and cross examination of witnesses. Testimony of the following witnesses was entered into the record without cross examination of witnesses: Empire witnesses Murry, Gipson, Walters, Berkstresser and Vogl; Staff witnesses Baldry, Gatewood, and Sanderson. Testimony of Empire witness Vander Weide was withdrawn. Empire waived cross examination of issues regarding capital structure and cost of capital, but it reserved the right to ask questions on fuel costs, ECA issues, and opposition to the settlement agreement. Tr., 5. Testifying at the hearing were Empire's witnesses Tarter and Keith; Staff's witnesses Cita, Bell, Cushinberry, and Holloway; and CURB's witness Crane. At the close of the hearing, parties presented oral closing arguments in lieu of filing post-hearing briefs.

5. The Commission may take official notice of the record of other proceedings before this agency. K.S.A. 77-524(f)(2). At the request of Empire, Tr. 108-09, 112, the Commission during the hearing took notice of the following:

a) Direct Testimony of John Cita, filed April 6, 2001, in *In the Matter of Western Resources, Inc., for Approval to Make Changes in its Charges for Electricity Rates,* KCC Docket No. 01-WSRE-436-RTS.

b) Order on Rate Applications, issued July 25, 2001, in *In the Matter of Western Resources, Inc., for Approval to Make Changes in its Charges for Electricity Rates,* KCC Docket No. 01-WSRE-436-RTS.

6. The Commission has jurisdiction over this proceeding pursuant to K.S.A. 66-104(a) and K.S.A. 66-117. Under K.S.A. 66-117, the Commission is required to issue an order by December 25, 2005; because this is a Sunday, followed by a legal holiday, the Commission's deadline for filing an order is December 27, 2005. K.A.R. 2005 Supp. 82-1-217(a).

FINDINGS AND CONCLUSIONS

A. Objection to Notice

7. During its opening statement, CURB renewed its objection to notice, arguing that confusion existed about whether testimony placed on the record at the hearing was actually part of the record. Tr., 17-18. CURB argued that, if a party waived cross examination of a witness at the hearing, the party should not be allowed to reopen the hearing at a later time to call that witness for cross examination; however, CURB recognized that the Commission has the prerogative to grant or deny a party's subsequent request to reopen the record and take more evidence. Tr., 17-19. CURB urged the Commission to reject any attempt by Staff and Empire to condition waiver of cross examination of witnesses on the outcome of the hearing. Tr., 20-23. The Commission took CURB's renewed objection under advisement and asked CURB to proceed with opening statements. Tr., 23.

8. Regarding CURB's objection, the Commission notes that the parties, including CURB, filed a Joint Motion on May 24, 2005, asking the Commission to adopt a proposed procedural schedule for this docket that involved Empire's application to revise its rate schedule. Joint Motion to Adopt Proposed Procedural Schedule, filed May 24, 2005. The Commission adopted the proposed procedural schedule. Order Setting Procedural Schedule, filed June 13, 2005. The customers of Empire received a bill insert notifying them of a public hearing on September 27, 2005, in Baxter Springs, concerning Empire's requested rate increase for electric service and of the technical hearing before the Commission scheduled to begin October 11, 2005. Affidavit of Mailing, filed October 7, 2005, Exhibit A. This notice was also published in the Columbus Daily Advocate. Affidavit of Publication, filed October 7, 2005, Exhibit A. Clearly

the parties and Empire's customers were notified that a substantive proceeding would take place on October 11, 2005, regarding Empire's request for a rate increase.

9. Pursuant to the Commission's regulations, a hearing is considered closed after briefs have been submitted and oral arguments completed. If no briefs are submitted and no oral arguments are made, a hearing is considered concluded and submitted to the Commission when the presiding officer announces the record of exhibits and testimony is closed; the matter is then taken under advisement. K.S.A. 2005 Supp. 82-1-230(j). However, under this regulation, the Commission can reopen a record after testimony has been closed if good cause is shown. A party can request that the record be reopened, or the Commission, on its own motion, can order the record of a hearing to be reopened. K.S.A. 2005 Supp. 82-1-230(k).

10. A review of the Stipulated Settlement Agreement indicates Staff and Empire mutually agreed to ask the Commission to reopen the docket and schedule a hearing on the merits if the entire Stipulated Settlement Agreement was not approved. Such an agreement among parties is not forbidden; however, it does not bind the Commission. Parties risk the Commission rejecting such a request to reopen the docket. The Commission finds the agreement of Staff and Empire did not negate the previous notice of hearing. This notice properly advised interested parties and Empire electric customers that the Commission would consider Empire's request for a rate increase in a hearing beginning on October 11, 2005. This is what occurred. The Commission overrules CURB's objection to notice.

B. Stipulated Settlement Agreement

11. The Commission must decide whether to approve the Stipulated Settlement Agreement reached by Staff and Empire. The Agreement contained several components, which will be addressed separately.

1. Black-Box Settlement of Empire's Request for Rate Increase

12. Staff and Empire agreed to a black-box settlement of Empire's request for a rate increase. In a black-box settlement, parties agree to include a specific amount in rates without setting forth individual components of how this amount was reached. Staff and Empire agreed to

recommend the Commission authorize an annual rate increase of $2.15 million for Empire, to become effective for service rendered on and after January 1, 2006. Agreement, ¶ 17; Tr., 7. Agreement to an overall revenue deficiency of $2.15 million resolved all accounting, capital structure, and rate of return issues between Empire and Staff. Testimony of W. Scott Keith, filed October 6, 2005 (Keith, Oct. 6), 3.

13. Empire pointed out that, since it last requested a rate increase in June of 2002, the company had increased its investment in the electric system used to service its Kansas electric customers and fuel prices had escalated to historically high levels. Keith, Oct. 6, 3. Empire argued the amount of $2.15 million reached in the Agreement was reasonable in light of Empire's request for a rate increase contained in testimony supporting its application and compared with testimony presented by witnesses for Staff and CURB recommending a lesser amount. Keith, Oct. 6, 4-5; Tr., 7-8. Empire supported the compromised rate increase proposed in the agreement given the litigation risks and costs associated with a fully contested proceeding. Keith, Oct. 6, 4.

14. Staff noted that Empire's original request for a rate increase contained a pro-forma adjustment for fuel and purchase power. Once this pro-forma adjustment is removed from parties' calculations of Empire's revenue requirement, Empire's recommended rate increase becomes $2.8 million, Staff's becomes $1.8 million, and CURB's becomes $1.5 million. When litigation risk inherent in each party's position is taken into account, Staff asserted an annual rate increase of $2.15 million contained in paragraph 7 of the Agreement is a very reasonable outcome. Testimony of John S. Bell, filed October 6, 2006 (Bell, Oct. 6), pp 2-3, 6. In the agreed upon rate design, the revenue increase was allocated among nine customer classes in a manner that moved each customer class closer to the system average rate of return. Testimony of Sonya A. Cushinberry, filed October 6, 2005 (Cushinberry, Oct. 6), 1-2.

15. CURB disagreed that the proposed $2.15 million rate increase was appropriate in this case. CURB urged the Commission to recognize that actual rate increases resulting from the settlement will increase rates over 17% without consideration of increases from fuel and purchased power costs, which are proposed to be recovered through an Energy Cost Adjustment

(ECA) rider. Testimony of Andrea C. Crane, filed October 10, 2005 (Crane, Oct. 10), 3-4. CURB argued the actual rate increase resulting from the Agreement will not be $2.15 million as asserted in paragraph 7, but instead will be approximately $3.9 million, or 25.5% over the existing rate revenue asserted by Staff, and could possibly exceed this amount. Crane, Oct. 10, 4. Instead of adopting the Agreement, CURB urged the Commission to reject the Agreement and determine a fair and appropriate revenue requirement for Empire based upon issues discussed by the parties. Crane, Oct. 10, 4.

16. At the hearing, Staff noted that it did not try to calculate the overall percentage increase in consumer rates because it cannot determine that amount if fuel cost is collected through an ECA mechanism. Tr., 174-76 (Cushinberry). Staff chose to support Empire in recommendation adoption of an ECA after reviewing Empire's costs for a long time period and observing that Empire's fuel costs and purchased power costs were very volatile. Tr., 180 (Holloway). Staff asserted that a utility with an ECA mechanism should have a lower cost of carry expense that will benefit customers. Tr., 116-17 (Cita).

17. The Commission has reviewed the proposed black box settlement of accounting, capital structure, and rate of return issues through a rate increase of $2.15 million. The Commission finds that the rate increase of $2.15 million is a fair and reasonable resolution of all accounting, capital structure and rate of return issues in this proceeding, and that the rate increase agreed upon is in the public interest.

2. Tracking of Annual FAS 87 Costs

18. Empire and Staff urged the Commission to approve terms of the Agreement that allow Empire to use a procedure for tracking increases or decreases in annual Financial Accounting Statement (FAS) 87 costs after the ratemaking test year. FAS 87 costs refer to pension expense, which Staff noted are very difficult to pin down. Tr., 164 (Bell). The tracking mechanism the Commission is urged to approve would cover future rates charged customers for increases or decreases in Empire's annual FAS 87 pension expenses only. Empire initially requested tracking be used for FAS 106 costs, which relate to other post-employment benefits

(OPEB), but the Agreement specifically states this tracker will not apply to FAS 106 costs. Agreement, ¶ 8. Empire noted the Agreement included an accounting procedure that will allow Empire to record a regulatory asset or liability when the actual FAS 87 costs vary from the amount recorded during the test year in its last general rate case. The amount deferred between rate cases will be included for consideration in a follow up rate case. Keith, Oct. 6, 9.

19. Empire proposed tracking FAS 87 costs after Staff proposed adjustments that required Empire to recover its pension and OPEB based on its 2004 costs because 2005 actuarial valuations had not been complete and were not available. Direct Testimony of William E. Baldry, filed August 22, 2005 (Baldry Direct), 27-32 (discussing Staff Adjustments to Income Statement Numbers 6 and 7). In response, Empire urged adoption of a procedure to ensure that any increase or decreases in annual FAS 87 and FAS 106 costs after the ratemaking test year be included in future rates charged to customers. Rebuttal Testimony of C. Kenneth Vogl, filed September 13, 2005 (Vogl Rebuttal), 3. This procedure would ensure that increases or decreases in Empire's costs that occur in interim years between rate cases would be included in rates (as either a charge or a credit) at the time of the next rate filing. Vogl Rebuttal, 4. Empire set forth its proposed procedures and gave several examples of how this procedure would operate. Vogl Rebuttal, 4-7 and Exhibit 1.

20. In support of the Agreement's adoption of the tracking procedure for FAS 87 costs, Staff noted that the tracking mechanism will record changes in Empire's annual FAS 87 pension expense. This will ensure that, if approved by the Commission in future rate cases, ratepayers in future rates will pay actual FAS 87 pension expense that exceeds the amount included in rates, or benefit from a decrease, or negative pension expense, when the amount included in rates exceeds annual FAS 87 pension expense as set in the last rate case. Thus, incremental post test year increases in pension expense would be recorded to a regulatory asset account and eligible for inclusion in rate base during the next rate case and amortized over five years, while post test year decreases would be recorded as a regulatory liability account and used to decrease any positive pension expense in future periods. Bell, Oct. 6, 3-4. Staff proposed that,

during Empire's next rate case, Staff could audit the pension tracker accounting treatment and the Commission could then decide whether to continue the pension tracker. Bell, Oct. 6, 4. Staff noted the Missouri Public Service Commission has required Empire to treat its pension expense under FAS 87. Considering Empire's relatively small percentage of operations in Kansas, Staff recommended the Commission allow Empire to use the same tracker mechanism approved by the Missouri Public Service Commission for tracking FAS 87 pension costs. Bell, Oct. 6, 5; Tr., 163-64 (Bell).

21. CURB opposed treatment of Empire's FAS 87 costs as proposed in the Agreement, cautioning this procedure mandates certain regulatory treatment of assets in rate base. Crane, Oct. 10, 6. CURB argued that approval of this tracking mechanism will allow Empire to defer costs for future recovery even if the company has earned more than its authorized return. Crane, Oct. 10, 6. In response to Empire's initial proposal of this tracking mechanism, CURB noted it constituted such a significant change in regulation of the company's pension and OPEB costs that its details should have been included in the company's application, rather than raising it for the first time in rebuttal testimony. If the Commission ruled on the merits of this proposal, CURB recommended that the Commission deny Empire's request for a true-up mechanism, which would significantly reduce Empire's risk; instead, CURB recommended the proposal include a return on equity reduction to reflect the shifting of risk from shareholders to ratepayers. Surrebuttal Testimony of Andrea C. Crane, filed September 23, 2005 (Crane Surrebuttal), 2-4.

22. In reviewing the recommendation of the Agreement to allow Empire to use its tracking mechanism for FAS 87 costs, the Commission is mindful of the concerns expressed by CURB. However, the settlement only allows Empire to use this mechanism to track pension expenses, which the Commission will review during Empire's next rate case and, at that time, decide whether recovery will be allowed in rates. Tr., 169 (Bell). This procedure should lead to a more accurate reflection of pension costs in rates. Also, the Commission notes that the Agreement has limited use of the tracking mechanism to FAS 87 costs and specifically excludes

its application to FAS 106 costs. Thus, the Commission finds that approval of the tracking mechanism for FAS 87 costs only, as set forth in paragraph 8 of the Agreement, is appropriate.

3. Energy Cost Adjustment

23. Empire and Staff urged the Commission to approve the Energy Cost Adjustment (ECA) Clause, as set out in Exhibit 1 to the Agreement, to become effective for service provided on or after January 1, 2006. Agreement, ¶ 9. Staff explained that Staff and Empire designed the Energy Cost Adjustment Rider ECA tariff sheet contained in Exhibit 1 for Empire. Although the resulting ECA is similar to Staff's proposal contained in prefiled testimony, Staff noted Exhibit 1 appears on tariff sheets, clarifies many formulas and definitions contained in Staff's proposal, and incorporates suggestions by Staff regarding implementation of an Annual Cost Adjustment, or Annual Settlement Factor (ACA), calculation. Testimony of Larry W. Holloway, filed October 6, 2005 (Holloway, Oct. 6), 6. Exhibit 1 to the Agreement also includes a settlement regarding treatment of off-system sales margins, which will be discussed more fully below.

24. Empire asserted the most significant difference between CURB's position in this proceeding and the Agreement reached by Staff and Empire concerns implementation of the ECA. Empire argued that, by implementing an ECA, new rates would reflect actual fuel and energy costs it incurred and not be fixed at current, historically high prices. According to Empire, an ECA gives better price signals to customers in the future and, in the long run, reduces the need for multiple rate cases to recover increased fuel costs. Also, Empire claimed the ECA would contribute to maintenance of its financial profile as investment grade. Keith, Oct. 6, 4-5. Empire recognized the ECA factor will be adjusted monthly and, once a year, the recovery or return of under/over energy cost collections will take place after an audit of the calculation and a review of its energy procurement process. Empire noted this once a year true-up procedure will allow in depth review of its purchasing and operating practices, which addresses one of CURB's criticisms. Keith, Oct. 6, 6; Tr., 101-03 (Keith). Empire noted its annual ECA filing, which will be public, can be communicated to its customers in advance of actual billings to reduce customer uncertainty and can provide interested parties an advance look at its generation, fuel and

purchased power mix for the upcoming year, thus addressing concerns raised by CURB. Keith, Oct. 6, 6-7.

25. At the hearing, Empire noted the changes that occurred when it calculated 36-month NYMEX average prices illustrates how volatile gas prices have been. Tr., 68-72 (Tarter) and Empire Exhibits 1, 2, and 3. Empire pointed out that, even with an ECA, the company needs to maintain the cost of electricity as low as possible to promote economic development in its service territory. Tr., 79 (Tarter); see also Tr. 147-48 (Cita, concurring). Empire also stated it understood that it would be subject to a prudence review when operating under the ECA. Tr., 81 (Tarter), 93-94 (Keith). Yet Staff recognized that determination of the prudence of Empire's purchase power decisions would be challenging. Tr., 141 (Cita).

26. Staff supported implementation of a properly designed ECA mechanism for Empire if ongoing operations were subject to Commission oversight. To provide electric service, a utility must incur fuel, purchase power, and related expenses. Staff recognized that, when costs are relatively stable, setting the amount a utility may recover between rate cases may make sense. However, Staff asserted an ECA more correctly reflects monthly fuel and purchase power costs, providing a better price signal to electric customers. Holloway, Oct. 6, 13. See also Direct Testimony of John Cita, filed August 22, 2005 (Cita Direct), 8-15 (discussing economic rationale for implementing ECA mechanisms). Staff pointed out that rising ECA inputs do not protect a utility from financial harm and volatile fuel prices make it difficult to set rates that are not stale and wrong for the company and its customers by the time these rates are in place. When fuel costs are volatile and an ECA mechanism is not in place, rate cases are more frequent and associated expenses are far greater. Holloway, Oct. 6, 13-14.

27. Staff recognized the concern that a utility has less incentive to operate in the most efficient manner possible when fuel costs are directly passed through to consumers, as with an ECA. However, Staff argued the regulatory framework included in Empire's ECA allows adequate Commission oversight through a monthly and annual review of Empire's fuel and purchase power procurement and its generation operations. Holloway, Oct. 6, 14-15. Staff

asserted its recommendation to allow Empire to implement an ECA included analysis of Empire's cost of capital because the ECA was taken into account at the time Empire's cost of capital was considered. Holloway, Oct. 6, 15. The impact of an ECA mechanism on Empire's cost of equity was discussed in Staff's direct testimony. Direct Testimony of Adam Gatewood, filed August 22, 2005 (Gatewood Direct), 23-24. In discussing Empire's cost of capital, Staff stated:

> The ECA will reduce Empire's exposure to fluctuations of fuel prices; the consumers will now bear that risk instead of the shareholders. Insulating Empire from the fluctuations in its fuel prices will reduce the volatility in its cash-flow used to pay interest and ultimately its earnings. The precise [effect] of an ECA mechanism on a utilities' cost of equity capital is difficult to quantify, but there is little doubt that, especially for utility companies, that pay out a large percentage of their earnings in dividends, insulation from fluctuating fuel costs makes for a less risky utility.

Gatewood Direct, 23 (footnote omitted). The difficulty in quantifying the impact an ECA mechanism has on a company's cost of equity capital is one of the issues subsumed in the proposed black box settlement.

28. The Agreement provides for ongoing Commission review, as discussed in Paragraph 5.A and 5.B of Exhibit 2 to the Agreement. Paragraph 5.A references filing and regulatory requirements that involve the annual filing and review of Empire's true-up process, or ACA factor, as well as Empire's procurement and operating practices. Paragraph 5.B addresses the filing requirements for Empire's annual ECA forecast. Holloway, Oct. 6, p. 12. These paragraphs incorporate Staff's recommendations, which are explained in detail in prefiled, direct testimony. Cita Direct, 15-32. See also, Tr., 133-42 (Cita, discussing review process).

29. At the hearing, Staff recognized its objective would be for the Commission to adopt an ECA review process that is uniform and can be applied to all utilities that choose to have an ECA mechanism. Tr., 113 (Cita), 180-81 (Holloway). Staff stated the Commission has allowed utilities to use pass through mechanisms for decades and, therefore, the ECA

recommended for Empire is consistent with prior commission policy. Tr., 129 (Cita). Yet Staff recognized some details of this ECA still need to be specified. Some issues have been resolved through compromise. For example, Empire originally proposed that its ECA factor be adjusted on a quarterly basis, but the parties agreed to follow Staff's recommendation of monthly filings. Tr., 87-90 (Keith), 185-86 (Holloway). Other issues may need to be further defined. For example, at the hearing Staff agreed with CURB that Staff understood the monthly ECA costs are based on forecasts, not actual costs, and, therefore, would be subject to refund at the end of the ACA year. Tr., 144 (Cita), 192-94 and 198-99 (Holloway).

30. CURB warned the Commission that terms of the Agreement have the potential to significantly increase utility rates and severely limit the Commission's ability to oversee rates charged customers in Kansas' jurisdiction. CURB asserted that adoption of the ECA will eliminate all risk to Empire for a substantial portion of its revenue requirement. CURB noted Staff's estimated increase in rates from the Agreement do not account for increases resulting from establishment of an ECA, projecting that overall rates could exceed 35-40%. Also, CURB expressed concern that the impact on ratepayers will be compounded as hedged positions settle and new hedges are taken at current market rates. Crane, Oct. 10, 3-4. CURB further cautioned that once an ECA formula is approved, the Commission will be required to approve rates that comply with the formula and will lose its ability to evaluate the impact of rate increases on ratepayers before increases are approved. Crane, Oct. 10, 5.

31. At the hearing, CURB noted that the company planned to file another rate case in 2006 and questioned why the Commission needed to implement an ECA now. CURB argued the ECA is not good for customers and does not reflect competition. Furthermore, the ECA sends the wrong incentive to the company by allowing a dollar-for-dollar pass through of its fuel costs. Tr., 202-03 (Crane). CURB opined that prudence reviews seldom result in a disallowance and stressed the utility's obligation as a regulated utility to provide service at the lowest possible cost. Tr., 209 (Crane). CURB suggested a stronger incentive would be allowing a company, and thus shareholders, to retain off-system sales that exceed a certain level of base rates; however, if the

company is allowed to pass through all its fuel costs with an ECA, CURB agreed the company should pass through 100% of its off-system sales margin. Tr., 206-08 (Crane). CURB expressed doubt that adopting an ECA would result in savings for consumers. Tr., 211-12 (Crane).

32. After reviewing evidence offered in support of and in opposition to adoption of the ECA for Empire, the Commission finds the ECA formulation set forth in Exhibit 1 of the Agreement is appropriate. The Commission notes that the formulation and associated ECA tariff provisions attempt to address many concerns that have arisen with other ECA clauses. The Commission also recognizes the need to monitor and evaluate the costs and expenses that would pass-through the ECA mechanism no matter how it is formulated. For that purpose, the Commission directs Staff to work with Empire and CURB to develop both the reporting requirements and criteria that would facilitate a full review and examination of those costs and expenses. The Commission finds the "basic regulatory framework" proposed by Staff, consisting mainly of a *Preliminary ECA Pricing Report* and an *Annual Generation Performance Report*, to be a reasonable point of departure, but the Commission also understands the need to work out the details of those reports. Once the details and possible review criteria have been developed, Staff is directed to report on them to the Commission. The Commission expects this report to be submitted prior to or in connection with Staff's recommendations regarding the 2006 Empire ACA filing. Generally, the Commission agrees with Staff's testimony supporting adoption of an ECA for Empire. Therefore, based on the evidence in this docket, the Commission approves implementation of an ECA for Empire as described in the Agreement and the attached exhibits. The Commission's approval of this ECA formula for Empire should not be construed as adoption of a uniform ECA to be applied to all Kansas utilities.

33. In addition, the ECA set out in Exhibit 1 of the Agreement deducts the actual off-system margins earned by Empire. Empire asserted this deduction results in a lower overall rate and ECA factor for Kansas electric customers. The procedure developed for Empire's off-system sales is unlike any other ECA used by Kansas electric utilities. The Kansas share of off-system sales margins will be returned to retail customers as a kWh credit to the ECA. Keith, Oct. 6, 8.

Thus, the Kansas share of the margin from all off-system sales during every year ending October 31 is refunded the next calendar year, beginning January 1, by dividing the amount by the Kansas retail kWh sales over the same year ending October 31. The ACA will true-up any amount over or under recovered. Holloway, Oct. 6, 7-8. Staff explained that it would be difficult for Empire to develop a system for classifying off-system sales as asset-based and non asset-based, as was done with Westar. Holloway, Oct. 6, 9-12. Therefore, Staff and Empire developed a mechanism based on Empire's organization and classification procedure that Staff concluded is more beneficial to Empire's Kansas retail customers. Holloway, Oct. 6, 8. Staff suggested this treatment of off-system sales profits can help keep Empire rates competitive. Tr., 148 (Cita).

34. The Commission finds the procedure developed for Empire's off-system sales is beneficial to Kansas consumers and should be approved in this docket.

4. Hedge Program

35. Pursuant to the Agreement, no later than March 1, 2006, Empire will seek Commission approval of an explicit hedge program in a separate docket. Agreement, ¶ 10. With its application, the company filed testimony describing its natural gas hedging program and included its Energy Risk Management Policy that described its hedging strategy. Direct Testimony of Todd W. Tarter, filed April 29, 2005 (Tarter Direct), 2-4 and Schedule TWT-1, 8-9. Staff recommended that the Commission explicitly evaluate Empire's Hedge Program in conjunction with any ECA mechanism approved for Empire. To this end, Staff provided a discussion of what information should be provided to facilitate Commission review of a hedge program. Cita Direct, 32-34. In response to Staff's testimony, the company attempted to quantify the benefits associated with its hedging program that were included in its filing. Empire noted that benefits of its hedging program are substantial and would be transferred to its Kansas customers, not retained by Empire or its shareholders as suggested by Staff. Rebuttal Testimony of W. Scott Keith, filed September 13, 2005 (Keith Rebuttal), 17-20. At the hearing, Empire noted that, based on its estimated gas burns through 2013, it has hedged 22 percent of its gas requirements. Tr., 48-49 (Tarter).

36. The Commission approves the parties' agreement that Empire will file a separate docket for review and approval of its explicit hedging program by March 1, 2006.

5. Depreciation Rates

37. Regarding depreciation rates, Staff agreed with the company's request to implement rates filed in Section 10 of Empire's application. Staff and Empire had disputed prior depreciation rates for Empire's Kansas retail electric operations and agreed depreciation rates should be specified going forward. Empire proposed rates the Missouri Public Service Commission approved on April 7, 2005. After reviewing the study Empire filed in Missouri and comments filed in response thereto, Staff concluded depreciation rates approved by the Missouri Commission were reasonable and based on sound regulatory principles. Holloway, Oct. 6, 2-5; Tr., 187-91 (Holloway). See also Baldry Direct, 16-19 (explaining Staff Adjustment to Rate Base-5 based on depreciation rates for Empire approved by the Missouri Commission).

38. The Commission finds that the recommendation to adopt depreciation rates approved by the Missouri Public Service Commission is appropriate and resolves Staff concerns regarding Empire's use of out-of-date rates.

6. Overall Approval of the Stipulated Settlement Agreement

39. The Commission notes that the law favors compromise and settlement of disputes. *Bright v. LSI Corp.*, 254 Kan. 853, 858, 869 P.2d 686 (1994). The Commission recognizes that Staff and Empire negotiated in good faith to reach this agreement. CURB initially participated in the settlement negotiations but concluded that it could not support the Agreement. CURB has raised numerous concerns about terms of the Agreement, which the Commission has considered in evaluating the proposed settlement. After reviewing the testimony offered concerning the Agreement and the issues raised in this docket, the Commission concludes that the Stipulated Settlement Agreement is fair and reasonable and its adoption is in the public interest.

IT IS, THEREFORE, BY THE COMMISSION ORDERED THAT:

(A) The Commission overrules CURB's objection to notice, as set forth above.

(B) The Commission approves the Stipulated Settlement Agreement between Staff and Empire, as set forth above.

(C) A party has fifteen days from the date of service of this Order, plus three additional days if service is by mail, in which to petition the Commission for reconsideration of any matter decided herein. K.S.A. 66-118b; K.S.A. 2004 Supp. 77-529(a)(1).

(D) The Commission retains jurisdiction over the subject matter and parties for the purpose of entering such further order or orders as it may deem necessary.

BY THE COMMISSION IT IS SO ORDERED.

Moline, Chr; Krehbiel, Com.; Moffet, Com

Dated: DEC 0 9 2005

ORDER MAILED

DEC 0 9 2005

Executive Director

Susan K. Duffy
Executive Director

mjc