

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

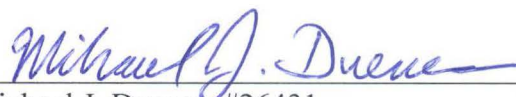
In the Matter of the Joint Application of)
Westar, Inc. and Kansas Gas and Electric) Docket No. 15-WSEE-421-ACA
Company for Approval of Their Annual)
Energy Cost Correction Adjustment Factor.)

NOTICE OF FILING STAFF'S REPORT AND RECOMMENDATION

The Staff of the State Corporation Commission of the State of Kansas (Staff and Commission, respectively) files its Report and Recommendation on Westar Energy, Inc. and Kansas Gas and Electric Company's (collectively, Westar) request for Commission approval of its 2014 ACA. Staff recommends the Commission approve Westar's Application authorizing the use of its 2014 ACA factor.

WHEREFORE Staff requests the Commission consider its Report and Recommendation recommending approval of Westar's Application and grant such other and further relief as the Commission deems just and proper.

Respectfully submitted,



Michael J. Duenes, #26431
Litigation Counsel
Kansas Corporation Commission
1500 SW Arrowhead Road
Topeka, Kansas 66604
(785) 271-3181 (Telephone)
(785) 271-3124 (Facsimile)
m.duenes@kcc.ks.gov (E-mail)

For Commission Staff

**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

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

FROM: Katie Figgs, Auditor
Chad Unrein, Auditor
Bill Baldry, Senior Auditor
Andria Jackson, Managing Auditor
Justin Grady, Chief of Accounting and Financial Analysis
Jeff McClanahan, Director of Utilities

DATE: March 7, 2016

SUBJECT: Docket No. 15-WSEE-421-ACA – *In the Matter of the Joint Application of Westar, Inc. and Kansas Gas and Electric Company for Approval of Their Annual Energy Cost Correction Adjustment Factor*

EXECUTIVE SUMMARY:

On March 18, 2015, Westar Energy, Inc. (Westar North) and Kansas Gas and Electric Company (Westar South) (collectively referred to as "Westar") filed an Application requesting approval of an Annual Correction Adjustment (ACA) factor under Westar's Retail Energy Cost Adjustment (RECA) tariff.¹ Westar requests an ACA factor of \$(.001586) per kWh in order to effectuate a refund of \$33,555,318 of over-recovery of fuel and purchased power expenses from retail customers during the year 2014. Staff conducted an audit of Westar's Application, as discussed below, and recommends approval of Westar's requested 2014 ACA factor.

BACKGROUND:

On March 18, 2015, Westar filed an Application requesting approval of an ACA factor under its Retail Energy Cost Adjustment (RECA) tariff. Accompanying Westar's Application were the testimonies of Rebecca A. Fowler and Jerry D. Kroeker. Ms.

¹ In Docket No. 09-WSEE-925-RTS, the Commission approved the consolidation of the majority of Westar North's and Westar South's rates, including the RECA's and all other riders and surcharges. Thus, the ACA proposed in this Application was calculated on a consolidated basis and will be applied to all customers in Westar's combined service territory.

Fowler, Regulatory Analyst for Retail Rates at Westar, supports the specific calculations underlying the requested ACA factor and discusses Westar's non-binding projection of the ECA during the year 2015. Attached to Ms. Fowler's testimony is Exhibit A which summarizes the actual energy costs incurred and all components of the RECA incurred by Westar during the 2014 calendar year. This Exhibit also shows the calculation of the over/under-recovery of energy and purchased power costs and the calculation of the ACA factors for the ACA year ending December 31, 2014. Westar's Application supported an over-recovery of \$33,555,318 during 2014. Based on this over-recovery, Westar calculates an ACA factor of (0.1586) cents per kWh. This amount has reduced Westar's ECA factors for each month from April 1, 2015, through March 31, 2016. Exhibit B attached to Ms. Fowler's testimony provided the monthly over/under energy cost calculations for each month of the 2014 ACA year.

Mr. Jerry Kroeker, Executive Director of Fossil Fuels for Westar, provides testimony describing Westar's fuel supply and generation planning practices during the year 2014. Mr. Kroeker also discusses Westar's cost of generation resources for the year 2014 compared to 2013 and discusses how the implementation of the Southwest Power Pool (SPP) Integrated Marketplace (IM) has impacted Westar's cost to serve retail customers.

On March 1, 2014, the SPP implemented the IM.² The IM is a regional day-ahead 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;
- Consolidation of 16 Balancing Authority Areas in the SPP footprint into a single Balancing Authority Area operated by SPP;
- Multi-Day Reliability assessment performed prior to the day-ahead market to manage the commitment of long-start resources; and
- Market Monitoring and Mitigation with an internal Market Monitoring Unit.³

With the implementation of the IM, Westar now sells all of the energy and operating reserves produced by company owned generation to SPP in the day-ahead and Real-Time Balancing Markets (RTBM). In turn, Westar purchases all of the energy and operating reserves it needs to serve its native load obligations, including retail customers. This

² 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.

³ *Southwest Power Pool, Inc.*, 141 FERC ¶ 61,048 (2012) (October 2012 Order).

occurs on a daily basis with the day-ahead markets clearing on an hourly basis and the RTBM clearing every five minutes. Because Westar is allowed to recover revenues and expenses associated with participation in the SPP IM under its RECA tariff, Staff expanded the scope of our typical ACA audit in order to include a review of Westar's participation in the SPP IM during the year 2014.

ANALYSIS:

Traditional Fuel and Purchased Power Review

Staff solicited from Westar, via formal discovery requests, documentation supporting Westar's Application and Exhibits A and B attached to the Application. Staff performed the majority of this audit in-house using the information gathered through this process. Once the desk audit was complete, Staff met with Westar at Westar's corporate office in Topeka, Kansas. This meeting allowed Staff to further question Westar about information provided in response to data requests and to review Westar's coal and rail transportation contracts. Staff notes that Westar personnel were open and forthcoming when answering questions and providing requested supporting documentation. Staff audited Westar's actual fuel costs for the following months: June, July, August and September 2014.⁴ 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 Westar 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;
- Verifying that the ECA factor used to calculate the customer's bill agrees with the calculation that the Company files with the Commission.

For this first portion of Staff's audit, there were no material irregularities discovered.

SPP Integrated Marketplace Review

As referenced in the Background Section above, Staff expanded the scope of our typical ACA audit to include Westar's participation in the SPP IM during the year 2014. In order to complete this review, Staff conducted interviews and in person meetings with Westar, both at the KCC offices and Westar's headquarters. Additionally, Staff solicited formal discovery requests to document Westar's processes and procedures involving its day to day operations within the IM. The objectives of Staff's audit of Westar's participation in the IM were as follows:

⁴ Staff typically audits four months out of the ACA year in these audits. The four months usually consist of at least two months from the summer cooling season.

1. Determine whether Westar has robust control procedures in place to validate the accuracy of the billing statements it receives from SPP.
2. Determine whether Westar is diligently managing the risks associated with the IM and taking the steps necessary to maximize the possibility for success in the IM.
3. For the months being audited in this year's ACA audit, determine whether Westar has accurately accounted for IM costs/revenues pursuant to the provisions of the current RECA tariff.
4. Determine whether Westar's participation in the IM is providing benefits to its ratepayers.

Each of the four objectives of the audit, including Staff's findings on each objective, is discussed below.

1. Determine whether Westar has robust control procedures in place to validate the accuracy of the billing statements it receives from SPP

In order to examine Westar's control procedures entailing verification of its SPP IM billing statements, Staff issued several formal discovery requests and interviewed personnel from Westar's Settlements and Fuel Accounting Departments. Staff requested information regarding the software application that Westar uses to interact with the IM on a daily basis and to perform shadow settlement calculations of the SPP Settlement Statements.⁵ In response to Staff Data Request No. 58, Westar confirmed that it uses MCG Energy's Integrated Asset Manager (IAM) software product to interact with the SPP IM on a daily basis. Westar explained that the software product allows Westar to prepare and submit load bids and generating resource offers for the day-ahead and RTBM for each applicable load and resource in Westar's fleet. Additionally, the software allows Westar to perform shadow settlements for the daily activity in the SPP IM. Shadow settlement calculations are prepared for initial, final, and resettlement statements. This process allows Westar to perform an independent check against the SPP IM invoices it receives and investigate differences should they arise. Additionally, Westar reconciles all SPP IM data received from SPP's Electric Quarterly Report (EQR) back to Westar's internal Triplepoint system in order to verify that the data being reported is accurate and complete.

Westar also explained that it acts as its own meter agent for the SPP IM. In response to Staff Data Request No. 59, Westar explained that it uses MCG Energy's Energy Accounting Software to collect and analyze meter data from various sources. Westar explained that this software helps to catch errors and anomalies in the data and that Westar also performs daily and monthly checks internally and with external entities to ensure accuracy of the meter data. This process also involves the verification by

⁵ 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.

Westar's Transmission Accounting group of the SPP Meter Agent Report Card, the Calibration Report, and the Interchange Report.⁶

Staff examined the processes that Westar has in place to verify that all Bilateral Settlement Schedules⁷ (BSS) involving Westar as a party are submitted to the SPP IM Portal. Westar was able to provide a report verifying all of its BSS submissions were submitted to SPP during the months we audited. Additionally, Staff examined the dispute processes that Westar has in place to submit and monitor disputes that it files with SPP. Westar provided Staff a list of the disputes it submitted in 2014 and the results of the disputes. Westar submitted several disputes that were granted in 2014 involving incorrect meter data, incorrect make whole payment eligibility determinations, and incorrect billing for specific charge types in the RTBM.

Staff believes Westar has several 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, Westar has a comprehensive process in place to verify meter data with internal and external counterparties and with SPP. Lastly, Westar has a process in place to verify all BSS are submitted to SPP, and it also has a defined process in place to submit and monitor disputes with SPP.

2. Determine whether Westar is diligently managing the risks associated with the IM and taking the steps necessary to maximize the possibility for success in the IM

In order to examine whether Westar was diligently managing its risks associated with the IM during 2014, Staff issued formal discovery requests designed to elicit the details of Westar's procedures for determining the profitability of incremental sales into the SPP IM. In response, Westar discussed that it views all market activity at its generators as incremental activity. Westar also explained that it produces a daily profit and loss (P/L) calculation for each generating unit that compares market revenues for each unit to variable costs of the units for both the day-ahead market and RTBM. Variable costs are calculated by unit based on the heat rate particulars of the units, updated fuel costs, and unit-specific variable operating and maintenance costs. Westar also performs a comparison between the day-ahead P/L and the real-time P/L in order to track leakage (or lost opportunity) between what the unit was cleared to run in the day-ahead, versus what actually occurred in the RTBM.

Staff also issued formal discovery requests regarding Westar's strategy for offering its generating resources into the IM and bidding for the daily load necessary to serve customers. Staff examined Westar's practices for updating fuel costs and developing the variable operating and maintenance costs that would be associated with its resource

⁶ These are all private reports that can be viewed by a utility or its meter agent. The reports provide verification of the meter data submissions for load, generation, interchange, etc. for each Meter Data Submission Location that a utility or meter agent is responsible for submitting.

⁷ A Bilateral Settlement Schedule is an agreement between two Market Participants to transfer energy or operating reserve obligations between the parties. These agreements can be arranged through the SPP IM.

offers. Westar explained that its Plant Support Engineering Department develops its unit specific heat rate curves to be utilized in the development of resource offers. These heat rate coefficients are monitored continuously and adjusted if actual unit performance deviates from expectations and the calculated coefficients. Westar's Fuel Department is responsible for updating its fuel pricing, sometimes as often as daily, based on recent actual prices experienced by Westar. Westar calculates its variable operating and maintenance costs based on its actual inflation-adjusted historical costs.⁸ Westar indicated it forecasts its hourly load on a day-ahead basis. Westar's guideline is to enter fixed demand bids for at least 95% of its forecasted load in the day-ahead market. When appropriate, Westar will submit price sensitive or fixed demand bids in the day-ahead market for up to 105% of the hourly load forecast amount.

Staff issued several formal discovery requests regarding Westar's hedging strategies and procedures regarding the Auction Revenue Rights (ARRs) and Transmission Congestion Rights (TCRs) congestion management processes within the SPP IM.⁹ Westar explained that its strategy surrounding the ARR and TCR markets during 2014 was mainly concerned with operational hedging (hedging congestion costs associated with generation to load source/sink paths) based on seasonal load forecasts and accounting for the economic dispatch of Westar's generators. Westar stated that through this process, 90% of its ARRs were self-converted into TCRs during 2014. Because a TCR entitles the holder to payment based on congestion revenue collected over a path between source/sink settlement locations, this strategy allows Westar to hedge its exposure to congestion costs incurred between generator source locations and load sink locations. During 2014, Westar retained a consultant, Customized Energy Solutions, to evaluate the expected value of individual ARR/TCR paths. Westar continuously evaluates the decision to convert ARRs to TCRs, or to purchase additional TCRs, based on Westar's operational needs factoring in historical load and generation, and historical pricing of ARR/TCR paths. Using these strategies, Westar was able to hedge against 98% of its day-ahead congestion costs in 2014.¹⁰

Staff believes Westar diligently managed the risks associated with the IM in 2014 and is taking the steps necessary to be successful in the IM.

⁸ Westar explained that it has experienced a 12.4% increase in total operating and maintenance expenses for year 2014 over 2013, although it has not been able to attribute that increase exclusively to the implementation of the IM.

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 (MCC) 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 that specific path.

¹⁰ Westar was able to offset \$23,729,011 of the total \$23,759,449 congestion costs realized in the day-ahead market in 2014.

3. For the months being audited in this year's ACA audit, determine whether Westar has accurately accounted for IM costs/revenues pursuant to the provisions of the current RECA tariff

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 detailing each company's operations in the SPP IM (KCC Monthly IM Activity Report).¹¹ 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 Westar sold into the IM and for what total dollar amount. Likewise, the report summarizes by charge type what energy and operating reserve products Westar 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.

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 Westar's participation in the IM, Westar provided Staff with a reconciliation that documented and verified all Westar 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 Westar 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 Westar'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 Settlement Statements and the KCC Monthly IM Activity Report were accurately reported on Westar's general ledger. Ultimately, this data was tied back to Westar's ACA Application for the months covered in the audit.

¹¹ KCP&L and Empire District Electric Company 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.

4. Determine whether Westar's participation in the IM is providing benefits to its ratepayers

To evaluate whether Westar's participation in the IM provided benefits to its Kansas ratepayers in 2014, Staff issued formal discovery and examined other anecdotal data. This information all suggests Westar's participation in the SPP IM produced benefits for Kansas ratepayers in 2014. At the highest level, Westar's total RECA eligible costs (after accounting for off-system sales margins prior to the IM) were \$472,288,382 for the year 2014. This is \$400,453 (.08%) *less* than the 2013 calendar year. However, during 2014, Westar's native load increased by 1.56%, gas prices experienced by Westar were higher, and Westar's generation from company-owned and operated units was lower. Each of these factors alone should have increased Westar's total cost to serve retail customers. However, Westar's all-in RECA factor was 1.62% less than the equivalent factor in 2013. This is impressive considering this occurred during a period in which the average on-peak, day-ahead, spot price of electricity increased 18% in the SPP region.¹²

The SPP has estimated that the IM has provided a net benefit to the region of \$210 million over the 12-month period from April 2014 to March 2015. Staff issued formal discovery requesting whether Westar had prepared an estimate of the overall cost to serve its retail customers during the year 2014 under the IM versus the costs to serve retail customers with company generation. In response, Westar provided a modeled cost to serve retail customers from March 1, 2014, through December 31, 2014, both with the IM and without. The results were an estimated \$29.5 million savings during that time period associated with Westar's participation in the IM. Even with the increased operating and maintenance expenses Westar appears to be incurring due to the more frequent cycling of Westar's generating units under centralized SPP dispatch compared to Westar's previous dispatching methods, the IM appears to be providing significant benefits to Westar's Kansas ratepayers.

Based on the data that Staff has observed regarding Westar's overall cost to serve its load after the implementation of the IM and the modeled results that Staff has observed from both SPP and Westar, Staff is convinced that the IM benefited Westar's Kansas customers during 2014.

RECOMMENDATION:

Staff recommends the Commission approve Westar's ACA factor of (0.1586) cents per kWh for the period April 2015 through March 2016 as filed. Staff will continue to monitor Westar's performance and participation in the IM and provide periodic updates to the Commission regarding this issue as often as is desired.

¹² Annual SPP State of the Market Report, delivered to FERC Commissioners (March 19, 2015).

CERTIFICATE OF SERVICE

15-WSEE-421-ACA

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing Staff's Report and Recommendation was served via electronic service this 10th day of March, 2016, to the following:


DELLA SMITH
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
d.smith@curb.kansas.gov

SHONDA SMITH
CITIZENS' UTILITY RATEPAYER BOARD
1500 SW ARROWHEAD RD
TOPEKA, KS 66604
Fax: 785-271-3116
sd.smith@curb.kansas.gov

MICHAEL DUENES, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD RD
TOPEKA, KS 66604-4027
Fax: 785-271-3354
m.duenes@kcc.ks.gov

CATHRYN J DINGES, CORPORATE COUNSEL
KANSAS GAS & ELECTRIC CO.
D/B/A WESTAR ENERGY
818 S KANSAS AVE
PO BOX 889
TOPEKA, KS 66601-0889
Fax: 785-575-8136
cathy.dinges@westarenergy.com

JEFFREY L. MARTIN, VICE PRESIDENT, REGULATORY
AFFAIRS
WESTAR ENERGY, INC.
818 S KANSAS AVE
PO BOX 889
TOPEKA, KS 66601-0889
jeff.martin@westarenergy.com


Vicki Jacobsen
