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BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Westar Energy, Inc.	)	
for Approval of an Accounting Authority Order to	)	Docket No. 11-WSEE-610-ACT
record and defer costs related to Westar Energy's	)	
SmartStar Lawrence Project.	)	

2011.08.25 15:59:36
Kansas Corporation Commission
/S/ Patrice Petersen-Klein

STAFF'S REPLY TO WESTAR'S RESPONSIVE COMMENTS TO STAFF'S REPORT AND RECOMMENDATION

COMES NOW, the Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission," respectively) and submits the following in reply to Westar Energy, Inc.'s Responsive Comments to Staff's Report and Recommendation, filed on August 15, 2011. Staff states as follows.

1. Westar filed an application on March 2, 2011 seeking an approval of an accounting authority order ("AAO") to record and defer costs related to Westar's SmartStar Lawrence project.

2. On June 20, 2011, Staff filed its Report and Recommendation. Staff recommended that the Commission approve an AAO to defer non-labor expenses attributable to the project, and Staff recommended that the Commission not approve the deferral of depreciation expenses and carrying charges. Staff also recommended that the Commission not approve recovery of deferred expenses through Westar's Energy Efficiency Rider.

3. Westar filed responsive comments to Staff's Report and Recommendation on August 15, 2011. In short, Westar argues that it should be allowed to record carrying charges and depreciation of the SmartStar project assets.

4. Staff believes clarification is needed to reiterate why deferral of depreciation expenses and the accrual of carrying charges should not be approved in the Commission's order in this docket.

5. Westar argues that it should be allowed carrying charges. Westar references an indication from the Commission's final order in docket No. 08-GIMX-441-GIV ("441 docket"), that prudent smart meter expenditures would be considered favorably for cost capitalization. Westar's Responsive Comments to Staff's Report and Recommendation, ¶ 6. Staff takes the position that footnote 8 in the final order in the 441 docket is in the context of the Commission stating opposition to unnecessary capitalization of program costs in such a manner that would be more extensive than that provided in normal rate cases.[1] Staff does not argue that these capital expenses should not be placed in rate base when applicable in upcoming rate cases. Staff recommends to the Commission that the nature of the expenses in the present application do not warrant carrying charges.

6. Westar previously stated in its response to Staff's DR 014 (attached as Exhibit 1) that this application is not meant to be considered a request for approval of an energy efficiency program. Footnote 8 to the final order in the 441 docket specifically says "approved energy efficiency program." These investments can be placed in rate base if allowed to be recovered through the EE Rider or during a traditional rate case.

[1] Footnote 8 of the Final Order in 441 is as follows: "Of course, prudent investments in such capital expenditures as smart-metering technology, in the context of an approved energy efficiency program or suite of programs, which are in the nature of capital expenditures that are traditionally rate based will be favorably considered for such treatment."

The Commission's order in the 441 docket is silent on whether smart-metering investments deserve to be rate based prospectively (through the allowance of carrying charges) outside of rate cases. Therefore, Staff believes that this is a completely separate issue from allowing carrying charges to accrue for the time period between when an asset goes into service and when it goes into rate base.

7. In furtherance of this position, Staff notes that, Westar's Environmental Cost Recovery Rider ("ECRR") permits environmental projects to be "rate based" after Westar makes an ECRR filing that is approved by the Commission. These projects do not include deferred depreciation expenses or carrying charges during the time between when the asset goes into service and when rates become effective. If the smart-meter projects had been a part of an approved suite of energy efficiency programs, and the Commission agreed to allow Westar to recover these projects through the EER, they easily could have been "rate-based" in the same fashion as ECRR projects are, without deferred depreciation or carrying charges. Again, the issue of "rate-basing" a project is completely separate from allowing deferred depreciation expense and carrying charges to accumulate. Westar will have an opportunity to argue for rate base inclusion of the projects at the next available opportunity; likely Westar's upcoming rate case.

8. Staff is pleased that Westar has made efforts to secure federal funds for the Smart Meter project, as it reduces the direct impact to ratepayers for this pilot program. However, Staff disagrees with Westar's statement that, "there should be no question that the project investment ultimately recoverable through rates is a prudent expenditure on behalf of Westar's customers." Westar Response, ¶6. Staff does not dispute that certain smart grid investments bring benefits to Kansas and to Kansas

ratepayers, but there should be no assumption that the Commission should rubber-stamp approval of an application to recover costs from Kansas ratepayers simply because the U.S. Department of Energy provided Westar, or any other utility, funding for a portion of the project. The U.S. Department of Energy and the Commission may have different policy goals and direction. Staff believes that, while all circumstances should be considered and weighed by the Commission in making a decision, as a Kansas regulatory agency, the Commission has the ability to independently review the prudency of expenditures.

9. Westar argues in paragraph 7 of its response that Westar has been approved to defer and accrue carrying charges in prior dockets. Staff clarifies that the statement in its Report and Recommendation was in reference to capital investments, not regulatory assets for operating expenses.

10. Westar and Staff have different definitions of "non-recurring and unusual." Staff believes "non-recurring and unusual" means expenses (associated with smart meter installation) that are a one-time expense. Staff argues that normally such non-recurring and unusual expenses are amortized or removed entirely from test year expenditures. Deferral of these expenditures into a regulatory asset will allow for the costs to be examined in Westar's next rate case and not just the costs incurred during the chosen test year.

11. Staff reads Westar's responsive comments as suggesting that the mere fact that the SmartStar project is "non-recurring and unusual" supports deferral of depreciation expense associated with the capital portion of the investment. Staff does not agree. This is a qualification for deferral of operating expenses, but not necessarily

depreciation on capital costs. The operating expenses associated with this project are non-recurring and unusual and therefore may need to be amortized in a rate case. Staff typically recommends the Commission amortize or remove entirely non-recurring and unusual expenses from a Utility's expenses during a rate case proceeding. Therefore, it would be beneficial to be able to examine the entirety of this non-recurring expense during Westar's next rate case; not just the amount incurred during the test year. The mere fact that a capital item is non-recurring and unusual does not automatically make it eligible for the deferral of depreciation expenses.

12. Staff noted in its Report and Recommendation that with depreciation that occurs on Westar facilities between rate cases, the company earns a return on a higher rate base than what is actually invested. Staff noted as an example the Wolf Creek plant. Westar's responsive comments counter that it has made other investments in plant that exceed depreciation. Westar Response ¶9. Such changes in actual rate base investments between rate cases are merely the ebb and flow of capital investments within the business model of a public utility. Staff's example of Wolf Creek was meant as illustrative, not demonstrative, and that it would be inequitable to isolate one single transaction or group of transactions in the changes to net plant. Therefore, special treatment should not be given to the accounting of capital investments associated with the smart meter project.

13. Westar's comments in paragraph 10 of its Response incorrectly tie the "matching principle" to both depreciation expense and operating expenses; where it is only properly tied to operating expenses. While deferral is appropriate for one time operating expenses as a regulatory asset so that those costs may be expensed over a time period commensurate with their benefits, this is not appropriate or necessary with

depreciation expenses. Depreciation expenses are already naturally spread over the life of an asset so the costs should match that period. There is no need to further shift around the expense recognition, which is the reason why utilities seek permission to create a regulatory asset for one-time operating expenses. The effect is permission to create a regulatory asset that may be amortized over some time period of benefits, similar to the treatment already afforded capital assets, including Westar's Smart Star Lawrence project.

14. Staff further submits that depreciation expense is the result of Westar making capital investments, upon which it will earn a Commission authorized rate of return, including the weighted average rate of return on equity. Regulatory lag is commonly known and understood throughout the utility industry. On occasion the date that an asset goes into service (and begins depreciation) falls before the date when the utility is able to recover the costs of that asset through higher rates. This same regulatory lag can also inure to the benefit of a utility. When an asset is retired between rate cases, the utility continues to collect depreciation expense and a rate of return on an asset that is no longer used and useful and providing service to utility customers. This risk of regulatory lag is surely factored into the rate of return on equity afforded a public utility, and thus Westar's shareholders are being adequately compensated for this risk.

15. Westar further states in paragraph 10 of its response that the full range of customer benefits (from the Smart Star project) will not be realized until late 2012 or early 2013. Staff has been informed that Westar plans to file rate case in the near future. If customer benefits are not realized until the year 2012 or 2013 (presuming that the benefits are in the form of lower costs, and thus, lower rates) Westar's customers will

have to wait until a future rate case (several years into the future) to realize these benefits. As a result, Westar will carry the benefits of these cost savings between rate cases. Therefore, Staff believes that it is fair and equitable to ask Westar to carry the costs of the depreciation expense on these capital projects until rates can become effective after its next rate case.

16. Westar's proposal would have ratepayers incurring all the costs, from the beginning of the project until its completion, with the promise of future benefits (lower rates), which are not forecasted to materialize until well outside of the test period expected to be utilized for its soon to be filed rate case; thus pushing the realization of benefits for customers out even further; perhaps years.

WHEREFORE, the Staff of the State Corporation Commission of the State of Kansas submits these comments in reply to Westar's responsive comments and asks the Commission to approve Westar's application for an accounting authority order with the changes recommended by Staff in its Report and Recommendation filed on June 20, 2010.

Respectfully Submitted,

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KCC
SmartStar
11-WSEE-610-ACT
04/20/2011

Data Request: KCC-14: SmartStar approval
Consistent with paragraphs 34 and 39 of the Commission's final order in Docket 08-GIMX-441-GIV, is it the Company's intention that this filing be seen as a request for Commission approval of the SmartStar program in addition to a request to defer expenses associated with the program as a regulatory asset?

Response:
No. The application filed by Westar is for the deferral of expenses and a return on the deferred expenses including depreciation expenses until such a time that the costs associated with the program can be recovered in rates.

Prepared by or Under Supervision of: Rohlfs, Dick F.

Verification of Response
I have read the foregoing Data Request and Answer(s) thereto and find answer(s) to be true, accurate, full and complete and contain no material misrepresentations or omissions to the best of my knowledge and belief; and I will disclose to any matter subsequently discovered which affects the accuracy or completeness of the answer(s) to this Data Request.

Signed by: Dick F Rohlfs

Dated: 4-20-2011

STATE OF KANSAS)
) ss.
COUNTY OF SHAWNEE)

VERIFICATION

Matthew A. Spurgin, being duly sworn upon his oath deposes and states that he is Litigation Counsel for the State Corporation Commission of the State of Kansas, that he has read and is familiar with the foregoing *STAFF'S REPLY TO WESTAR'S RESPONSIVE COMMENTS TO STAFF'S REPORT AND RECOMMENDATION* and that the statements contained therein are true and correct to the best of his knowledge, information and belief.

Matthew A. Spurgin, #20470
Kansas Corporation Commission of the
State of Kansas

Subscribed and sworn to before me this 25th day of August, 2011.

PAMELA J. GRIFFETH
Notary Public - State of Kansas
My Appt. Expires 08-17-2015

Pamela J. Griffeth
Notary Public

My Appointment Expires: August 17, 2015

CERTIFICATE OF SERVICE

11-WSEE-610-ACT

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing Staff's Reply Comments was placed in the United States mail, postage prepaid, or hand-delivered this 25th day of August, 2011, to the following:

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