

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

In the Matter of the Joint Application of Westar)
Energy, Inc and Kansas Gas and Electric Company) Docket No. 16-WSEE-421-ACA
for Approval of their Annual Energy Cost)
Correction Adjustment Factor.)

**NOTICE OF FILING OF STAFF'S
REPORT AND RECOMMENDATION**

COMES NOW, the Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission," respectively), and files its Report and Recommendation (R&R) dated January 20, 2017, attached hereto and made a part hereof by reference. Staff recommends the Commission approve the Application by Westar Energy, Inc. and Kansas Gas and Electric Company (collectively, Westar) for its Annual Energy Cost Adjustment (ACA) and authorize the use of its ACA factor of \$0.0597 per kWh.

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

Respectfully submitted,

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**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

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

FROM: Tim Rehagen, Senior Auditor
Chad Unrein, Senior Auditor
Kristina Luke Fry, Managing Auditor
Andria Jackson, Managing Auditor
Justin Grady, Chief of Accounting and Financial Analysis
Jeff McClanahan, Director of Utilities

DATE: January 20, 2017

SUBJECT: 16-WSEE-421-ACA: *In the Matter of the Joint Application of Westar Energy, Inc. and Kansas Gas and Electric Company for Approval of their Annual Energy Cost Correction Adjustment Factor.*

EXECUTIVE SUMMARY:

Staff recommends that the Commission approve a refund of \$12,252,003 for Westar's Annual Correction Adjustment (ACA) filing, which results in ACA factor \$(0.0597) per kWh to be refunded to Kansas customers.

BACKGROUND:

On March 22, 2016, Westar Energy, Inc. (Westar North) and Kansas Gas and Electric Company (Westar South) (collectively referred to as "Westar") filed a Joint Application (Application) requesting approval of their respective ACA factors under their Retail Energy Cost Adjustment (RECA) clauses.¹ Accompanying Westar's Application were the testimonies of Rebecca A. Fowler and Grant Wilkerson. Ms. Fowler supports the calculations underlying the requested ACA factor and discusses Westar's non-binding projection of the ECA during the year 2016. Exhibit A attached to Ms. Fowler's testimony summarizes the actual energy costs incurred and all components of the RECA incurred by Westar during the ACA period of January 1, 2015, through December 31, 2015. Exhibit A also shows the over/under-recovery of energy costs and the calculation of the ACA factors for the ACA year ending December 31, 2015, to be reflected in the Westar RECA commencing with the first billing cycle in April 2016. Westar's

¹ In Docket No. 09-WSEE-925-RTS, the Commission approved a Stipulation and Agreement that resulted in 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.

Application stated that it experienced an over-recovery of \$12,252,003. Based on this over-recovery, Westar calculated an ACA factor of 0.0597 cents per kWh to be refunded to Kansas customers. Exhibit B attached to Ms. Fowler's testimony provides the monthly over/under-recovered energy cost calculations for each month in the ACA year ending December 31, 2015. Exhibit C contains the forecasted RECA factor for each month of the calendar year 2016.

Mr. Wilkerson provides testimony describing Westar's fuel supply and generation planning practices during the year 2015. Mr. Wilkerson also discusses Westar's cost of resources for the year 2015 compared to 2014 and discusses how the implementation of the Southwest Power Pool (SPP) Integrated Marketplace (IM) has impacted Westar's cost of serving its customers.

On March 1, 2014, SPP implemented the Integrated Market (IM).² The IM is a regional day-ahead energy and operating reserve market featuring the following major functions:

- Day-ahead energy and operating reserve markets;
- Day-ahead and intra-day Reliability Unit Commitment processes;
- Real-time balancing market;
- Price-based, co-optimized energy and operating reserve procurement;
- Market-based congestion management processes including Transmission Congestion Rights and Auction Revenue Rights;
- Multi-Day Reliability assessment to manage the commitment of long-start resources; and
- Market Monitoring and Mitigation with an internal Market Monitoring Unit.³

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

ANALYSIS:

Traditional Fuel and Purchased Power Review

Staff solicited from Westar, via formal discovery requests, documentation supporting Westar's Application and Exhibits A, B, and C attached to the Application. Staff performed the majority of its 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 Staff's questions and providing requested supporting documentation. Staff audited Westar's actual fuel costs for the following months: June, July, August and September 2015. For these months, Staff conducted an audit of the Application that consisted of:

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).

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

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

SPP Integrated Marketplace Review

As referenced in the Background Section above, Staff's expanded ACA audit includes the review of Westar's participation in the SPP IM during 2015. 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:

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

Processes & Control Procedures

In order to examine Westar's control procedures entailing verification of its SPP IM billing statements, Staff issued formal discovery requests based on the findings found in the SPP audit of the 2014 Westar ACA.⁴

Staff requested information regarding the software application that Westar utilizes to interact with the IM and documentation of Westar's process and control procedures.⁵ Westar continues to use MCG Energy's Integrated Asset Manager software suite to interact with the market and submit load bids and resource offers in the DA & RTBM. Westar's software systems remain unchanged from the 2014 ACA audit, and a detailed review of Westar's software can be found in Staff's Report and Recommendation in Docket No. 15-WSEE-421-ACA.

⁴ See Staff's Report & Recommendation in Docket No. 15-WSEE-421-ACA (March 10, 2016).

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

Staff found that Westar has robust control procedures in place to verify the accuracy of the settlement statements and invoices it receives from SPP for its activity in the IM. Additionally, Westar has a comprehensive process in place to verify meter data with internal and external counterparties and with SPP. Furthermore, Westar has a process in place to verify all Bilateral Settlement Schedules⁶ (BSS) are submitted to SPP, and it has a defined process in place to submit and monitor disputes with SPP.

Market Performance and Operational Risk

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

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

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.⁷ In these responses, Westar

⁶ A Bilateral Settlement Schedule is an agreement between two market participants to transfer energy or operating reserve obligations between the parties.

⁷ Auction Revenue Rights (ARRs) and Transmission Congestion Rights (TCRs) are congestion management products that allow market participants to hedge their exposure to Marginal Congestion Costs (MCCs) in the IM. ARR 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

discussed its strategy was to self-convert ARR's into TCR's based on seasonality, load forecast, and generating path in 2015. Under this strategy, Westar was successful in converting 85.9% of the ARR's to TCR's. Westar actively manages its monthly positions by pursuing TCR products in the SPP monthly TCR auction to close the gaps between awarded TCR and planned positions. Between self-conversion and monthly auctions, Westar offset its day-ahead congestion exposure by successfully hedging 107% of its congestion costs in 2015. Additionally, Westar uses YES Energy Management to provide congestion exposure analysis for ARR/TCR's and congestion valuation. The strategies Westar uses appears to have been successful as the value provided by the self-converted TCR's covered all of Westar's realized day-ahead congestion in the IM during 2015.

Staff finds that Westar has diligently managed the risks and profitability associated with the IM and is taking the steps necessary to be successful in the IM.

ACA Audit of Revenues and Costs

Prior to the go-live date of the IM, Staff implemented a monthly review process to be used to monitor the IM activity of the three vertically-integrated, investor-owned electric utilities in the State of Kansas. That process involves the submission of monthly financial reports to the KCC's Utilities Division that details each company's operations in the SPP IM (KCC Monthly IM Activity Report).⁸ 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

locations in the day-ahead market. ARR's (indirectly) and TCR's (directly) derive their value based on the difference between the congestion price at the source settlement location less the congestion price at the sink settlement location multiplied by the awarded MW quantity over the specific path.

⁸ The monthly reporting requirements were 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.

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 statements and 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 sample months reviewed in the audit.

SPP IM Benefit to Kansas Ratepayers

To evaluate whether Westar's participation in the IM provided benefits to its Kansas customers in 2015, Staff issued formal discovery and examined other publicly-available data. SPP has estimated that the IM has provided a net benefit to the region of \$422 million in 2015. This information suggests Westar's participation in the SPP IM produced benefits for Kansas ratepayers in 2015. At the highest level, Westar's total ECA eligible costs were \$420,788,780 in 2015, which was \$51,499,602 (10.9%) less than the 2014 ACA period. During the same period, the total kWh delivered in Kansas decreased by 3.0%. Therefore, the 2015 total fuel and purchased power per kWh was \$0.0205 or a year-over-year decrease of 8.1%.

Staff issued formal discovery requesting whether Westar had prepared an estimate of the overall cost to serve its retail customers as during the year 2015 under the IM versus the costs to serve retail customers with company generation. In response, Westar provided a modeled cost simulation, which estimates the actual fuel and purchased power to supply native load using Westar-owned generation only. The model Westar uses does not consider access to wholesale energy markets. Inputs to the model include actual fuel prices, renewables output, and actual load. ARR and TCR revenue are then added to the results of the model. The results showed that by participating in the IM, Westar reduced costs by an estimated \$34,840,000 in 2015 and \$68,110,000 from inception of the IM in March of 2014.⁹

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 finds that the IM is benefitting Westar's Kansas customers.

RECOMMENDATION:

Staff recommends that the Commission approve Westar's proposed ACA factor of \$(0.0597) per kWh for the period April 2016 through March 2017 as filed. Staff will continue to monitor Westar's performance and participation in the IM and will provide periodic updates to the Commission regarding this issue as often as is desired.

⁹ Westar estimation of cost savings from the SPP IM were modeled using an energy marketing modeling software. Westar's analysis included benefits resulting from the consolidation of SPP into one balancing authority, which is only a small part of the SPP IM. The estimated benefit is not meant to be comprehensive of all SPP IM activity.

CERTIFICATE OF SERVICE

16-WSEE-421-ACA

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was served by electronic service on this 30th day of January, 2017, to the following:

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