

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

STATE CORPORATION COMMISSION

SEP 10 2009

In the Matter of the Future Supply, Delivery)
and Pricing of the Electric Service Provided)
by Kansas City Power & Light Company.)

Docket No. 04-KCPE-1025-GIE



**BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD
ON PRUDENCE REVIEW LEGAL STANDARDS AND FACTORS**

COMES NOW the Citizens' Utility Ratepayer Board ("CURB") and files its Brief on the legal standards and statutory factors applicable to the Kansas Corporation Commission's ("Commission") prudence review of Kansas City Power & Light Company's ("KCPL") generation facility construction projects.

1. On July 24, 2009, the Commission issued its Order 1) Approving Stipulation and Agreement; and 2) Addressing Scope of Final Rate Cases Under the Approved 2005 Regulatory Plan ("July 24th Order") in KCC Docket No. 09-KCPE-246-RTS ("246 Docket"). The July 24th Order directed the parties to address the following with respect to the prudence issue to be tried in the fourth and final rate case in KCPL's regulatory plan:

- I. Does K.S.A. 66-128g, or other statute, set the legal standard for determining imprudency in this case given that none of the construction projects will generate nuclear power?
 - A. If "yes", are there any statutory factors contained in that standard that can be legally excluded in determining imprudency and on what basis?
 - B. If "no", then what legal standard should be used for determining imprudency, and what is its basis?
- II. Can the specific legal standard developed above be applied to all types or categories of costs, (*e.g.* environmental upgrades) alleged as imprudent?
- III. What party bears the burden of proof—Staff to prove imprudency or KCPL to prove prudency—and is either party entitled any presumptions or permitted to shift the burden?¹

¹ Order 1) Approving Stipulation and Agreement; and 2) Addressing Scope of Final Rate Cases under the Approved 2005 Regulatory Plan, KCC Docket No. 09-KCPE-246-RTS, ¶23.

2. The Commission further requested that the briefs should, 1) refer to testimony in the record on the prudence standard; 2) cite to relevant legislative history; and 3) summarize how FERC and select state commissions (e.g., Missouri) define the standard and apply it.

3. On August 20, 2009, the Commission issued its Order Designating New Prehearing Officer and Directing Briefs Ordered in 09-KCPE-246-RTS to be Filed in this Docket (“August 20th Order”).

4. Pursuant to the July 24th and August 20th Orders, CURB submits its briefing on the prudence issue.

I. DOES K.S.A. 66-128g, OR OTHER STATUTE, SET THE LEGAL STANDARD FOR DETERMINING IMPRUDENCY IN THIS CASE GIVEN THAT NONE OF THE CONSTRUCTION PROJECTS WILL GENERATE NUCLEAR POWER?

5. K.S.A. 66-128g *does not* set the legal standard for determining imprudence with respect to KCPL’s generation facility constructions projects, irrespective of the fact they will not generate nuclear power. K.S.A. 66-128g *does* provide a list of factors to be considered by the Commission in making the determination of prudence, or lack thereof, in determining the reasonable value of electric generation property. However, these factors do not set the legal standard for prudence reviews nor is the list an exhaustive or exclusive list to which the Commission is limited.

6. As Staff noted in Staff’s Brief on Prudence Review and Legal Standards (“Staff’s Brief”), K.S.A. 66-128g applies to the construction of all generation facilities, not just nuclear generation facilities. While the law review article cited by Staff supports this conclusion,² the express language contained in K.S.A. 66-128g likewise supports the same conclusion:

² 33 U. Kan. L. Rev. 475, 476 (1984-1985).

(a) The factors which shall be considered by the commission in making the determination of “prudence” or lack thereof in determining the reasonable value of *electric generating property*, as contemplated by this act shall include without limitation the following: ...³

7. It is noteworthy that the legislature utilized the broad phrase, “electric generating property” in K.S.A. 66-128g, but used the more specific phrases, “nuclear power generating facility”⁴ or “nuclear fission power plant”⁵ in other provisions of the act. This demonstrates the legislature intended the phrase “electric generating property” in K.S.A. 66-128g to encompass *all* electric generating property, as opposed to the more specific phrases, “nuclear power generating facility” or “nuclear fission power plant” used elsewhere in the act.

A. If "yes", are there any statutory factors contained in that standard that can be legally excluded in determining imprudency and on what basis?

8. While the answer to question I is “no,” this additional question requires a response because there are factors contained in K.S.A. 66-128g that can be legally excluded in determining prudence.

9. The factors contained in K.S.A. 66-128g are to be considered by the Commission as it applies the prudence standard applicable to the reasonable value of electric generating property.⁶ However, the Commission is afforded wide and considerable discretion in order to regulate utilities in the public interest, and in the methodology to be utilized in approaching the complex problems involved.⁷

10. In exercising its authority pursuant to this statutory framework, the Commission must set rates within the "zone of reasonableness" after balancing the interests of all parties

³ K.S.A. 66-128g(a).

⁴ K.S.A. 66-128l; K.S.A. 66-128m; K.S.A. 66-128n; K.S.A. 66-128o; K.S.A. 66-128p;

⁵ K.S.A. 66-128h.

⁶ The legal standard applicable to determining prudence in relation to the reasonable value of electric generating property will be discussed in the next section.

⁷ *Kansas Gas & Electric Co. v. Kansas Corporation Commission*, 239 Kan. 483, 495, 720 P.2d 1063 (1986) (“*Wolf Creek*”).

involved. This “zone of reasonableness” has been defined by the Kansas Supreme Court as follows:

There is an elusive range of reasonableness in calculating a fair rate of return. A court can only concern itself with the question as to whether a rate is so unreasonably low or so unreasonably high as to be unlawful. The in-between point, where the rate is most fair to the utility and its customers, is a matter for the State Corporation Commission's determination.⁸

11. Beyond the "zone of reasonableness" restriction, the only further limitation on the Commission in determining the appropriate rates is that the Commission's order must be in writing, stating its finding of facts and conclusions of law.⁹ Thus, the Commission has very broad discretion in reaching its determination in rate cases. As stated by the Kansas Supreme Court,

In arriving at its decision, the KCC, of necessity, must be afforded wide discretion in the methodology to be utilized in approaching the complex problems involved. The field of public utility regulation is a highly complex field and requires a great amount of expertise in arriving at a result which is fair and just to all interested parties.¹⁰

12. It is only when the Commission's determination is “so wide of the mark as to be outside the realm of fair debate that the court may nullify it.”¹¹

13. As a result,

A public utility has no vested right in any one particular formula or method, and the State Corporation Commission is not bound to use any particular formula, or combination of formulae, in valuing a public utility's property for ratemaking purposes. The State Corporation Commission should receive and consider all evidence which has a relevant bearing on reasonable value and then determine what formula, or combination of formulae, it believes should be used under the facts and circumstances of the case to arrive at a reasonable value of the property for rate making purposes.¹²

⁸ *Southwestern Bell Telephone Co. v. State Corp. Comm'n*, 192 Kan. 39, Syl. ¶17 (1963).

⁹ *Kansas Gas & Electric Co.*, 239 Kan. at 495. See also K.S.A. 66-101f.

¹⁰ *Kansas Gas & Electric Co.*, 239 Kan. at 495.

¹¹ *Kansas Gas & Electric Co.*, 239 Kan. at 497 (citing *Kansas-Nebraska Natural Gas Co. v. State Corp. Comm'n*, 217 Kan. 604, 617 (1975)).

¹² *Id.*, at 496 (citing *Southwestern Bell Tel. Co. v. State Corp. Comm'n*, 192 Kan. 39, Syl. ¶ 3.)

14. The Commission has wide discretion to utilize the factors contained in K.S.A. 66-128g that it deems relevant, and disregard those it deems irrelevant. In addition, the Commission may utilize factors not included in K.S.A. 66-128g, pursuant to its authority to consider “any other fact, factor or relationship which may indicate prudence or lack thereof as that term is commonly used.”¹³ As noted by the Kansas Supreme Court, while the Commission has considerable discretion to regulate utilities in the public interest, the statutes also contain a protection against arbitrary action by the Commission, requiring the Commission to state expressly its findings of fact and conclusions of law. “Such a provision prevents arbitrary action and facilitates judicial review, thus insuring a lawful exercise of legislative authority.”¹⁴

B. If "no", then what legal standard should be used for determining imprudency, and what is its basis?

15. The Commission has been granted the statutory authority to determine the reasonable value of all or a fraction of any utility property that is used to provide services to the public.¹⁵ Moreover, nothing in K.S.A. 66-128b through 66-128i are to be construed to limit the authority of the state corporation commission to “review and evaluate the *efficiency* or *prudence* of any actions,” including acquisition of excess capacity, or operating practices of any public utility or common carrier for the purpose of establishing fair and reasonable rates.¹⁶

16. The Commission has broad discretion in determining whether costs incurred by a utility due are incurred inefficiently or imprudently - as long as the Commission’s decision is

¹³ K.S.A. 66-128g(a)(12).

¹⁴ *Wolf Creek*, 239 Kan. at 495.

¹⁵ K.S.A. 66-128.

¹⁶ K.S.A. 66-128a.

based on substantial competent evidence, the Commission has the power and authority to exclude all or a portion of those costs from the revenue requirement of the utility.¹⁷

17. The parties were not asked to brief the legal standard for determining efficiency under K.S.A. 66-128a through 66-128i. However, the Commission is clearly authorized to evaluate electric generating property not only for prudence, but also for efficiency under K.S.A. 66-128a, 66-128c, 66-128e and 66-128j. In addition, the Commission's September 27, 1985 decision in the Wolf Creek docket addressed both efficiency (inefficiency) and prudence (imprudence).¹⁸ While the terms are somewhat inter-related, the legislature included both terms in K.S.A. 66-128a through 66-128i for a reason, and the Commission should consider both efficiency and prudence in evaluating KCPL's generation facility construction projects .

18. While the legal standard for determining prudence, or imprudence, is not expressly set by K.S.A. 66-128g, the statute does provide factors to be considered by the Commission. However, the Commission is not limited to the factors specifically listed in K.S.A. 66-128g (a)(1)-(10), since K.S.A. 66-128g(a)(1)(11) specifically states that the Commission may consider "*any other fact, factor or relationship* which may indicate prudence or lack thereof *as that term is commonly used.*"¹⁹

19. The legal standard to be used for determining prudence, or lack thereof, was considered by the Kansas Supreme Court in the *Wolf Creek* decision. In addressing claims by KCPL and other utilities that the provisions of K.S.A. 66-128 *et seq.* were unconstitutionally vague, the Kansas Supreme Court stated:

¹⁷ K.S.A. 66-128c.

¹⁸ Order, *In the Matter of a General Investigation by the Commission of the Projected Costs and Related Matters of the Wolf Creek Nuclear Generation Facility at Burlington, Kansas*, Docket No. 120,924-U; *In the Matter of the Application of Kansas Gas and Electric Company Requesting Proposed Changes in its Charges for Electric Services*, Docket No. 84-KG&E-197-R (142,098-U), September 27, 1985 (efficient, efficiency, inefficient, or inefficiency cited at pages 7-8, 10, 12-13, 18-19, 25, 28, 44, 46-48, 55-58, 79, 88-89, 104, 130).

¹⁹ K.S.A. 66-128g(a)(12)(emphasis added).

We find no merit in this contention. The thrust of the KCPL argument claiming vagueness is that “prudence” is not defined anywhere in the statutes. In our judgment, the statutory provisions are as definite and clear as reasonably could be expected in a statute of this type. The Kansas statutory provisions are much more definite and certain than statutes involving the same subject matter found in other jurisdictions. We also note that K.S.A. 66-128g(12), in effect, states that “*prudence or lack thereof*” means as that term is commonly used. Black’s Law Dictionary 1104 (5th ed. 1979) defines “prudence” as “[c]arefulness, precaution, attentiveness and good judgment.”²⁰

20. The Kansas Supreme Court further addressed the claims by the utilities in *Wolf Creek*:

In construing statutes, words and phrases should be construed according to context and approved usage of the language, and words in common usage are to be given their natural and ordinary meaning. *Jackson v. City of Kansas City*, 235 Kan. 278, 680 P.2d 877 (1984). As noted heretofore in this opinion, the word “prudence” has a common and ordinary meaning. The various factors listed in K.S.A. 66-128g(a) provide sufficient guidelines for determining prudence which obviates the need for a definition of the term.²¹

21. Staff cites the further defining of “prudence” by Black’s Law Dictionary, as “commonly associated with Care and Diligence and contrasted with Negligence.”²² Staff further notes that equating imprudence with negligence, as Staff witness Walter P. Drabinski did in his testimony, is also consistent with the standard utilized by the Federal Energy Regulatory Commission (“FERC”) and Missouri.²³ CURB believes this prudence standard is appropriate and the Commission should apply this prudence standard to KCPL’s electric generating projects, in addition to evaluating the projects for efficiency as required by K.S.A. 66-128a, 66-128c, 66-128e and 66-128j.

²⁰ *Wolf Creek*, 239 Kan. at 495.

²¹ *Id.*, at 503.

²² Staff Brief, p. 7 (citing Black’s Law Dictionary, 1226 (6th ed. 1990)).

²³ Staff Brief, p. 8-10, 17.

II. CAN THE SPECIFIC LEGAL STANDARD DEVELOPED ABOVE BE APPLIED TO ALL TYPES OR CATEGORIES OF COSTS, (E.G. ENVIRONMENTAL UPGRADES) ALLEGED AS IMPRUDENT?

22. Although the factors contained in K.S.A. 66-128g apply only to electric generating property, the legal standard of prudence applies to the Commission's authority to determine the reasonable value of all of a utilities property for ratemaking purposes. The legal standard defining prudence or lack thereof as the term is commonly used, i.e., "carefulness, precaution, attentiveness and good judgment," as well as, "commonly associated with care and diligence and contrasted with negligence" should be applied to all types of costs the utility believes to be prudent and/or Staff and intervenors believe to be imprudent.

III. WHAT PARTY BEARS THE BURDEN OF PROOF—STAFF TO PROVE IMPRUDENCY OR KCPL TO PROVE PRUDENCY—AND IS EITHER PARTY ENTITLED ANY PRESUMPTIONS OR PERMITTED TO SHIFT THE BURDEN?

23. KCPL bears the burden of proof on prudence issues related to its generation facility construction projects. In Staff's Brief, Staff states that "[a]lthough there is no direct authority in Kansas stating such, it appears Staff bears the burden of proof on claims of imprudence."

24. CURB respectfully disagrees. Contrary to Staff's statement, there is direct authority in Kansas on this issue. The Kansas Commission has previously held that the utility filing the application bears the burden of proof to establish the basic facts to make a *prima facie* showing that *it has acted prudently*. In KCC Docket No. 02-KGSG-329-PGA ("02-329 Docket"), Kansas Gas Service Company ("KGS") made an application for a Cost of Gas Rider ("COGR"). During the course of the proceeding, KGS filed a Petition for Specific Reconsideration in which it requested the Commission to revise a February 8, 2002 Order to state that KGS does not have the burden of proof to show the prudence of its choice of actions to

enforce or ensure compliance with the terms and conditions of a Settlement Agreement approved in a prior docket (Docket No. 97-WSRE-312-PGA). KGS argued that it is entitled to a presumption of prudence, but the Kansas Commission disagreed:

5. Generally, the burden of proof can refer to either the burden of persuasion or the burden of going forward with evidence. Under Kansas rules of evidence, the term "burden of proof" is synonymous with "the burden of persuasion." K.S.A. 60-401(d). The burden of persuasion means a party has an obligation to meet the requirements of a rule of law that the fact to be established must be proven by a requisite degree of belief. K.S.A. 60-401(d). As a general rule, burden of persuasion or the burden of proof lies with the party who initiates an action. The initiating party must prove the allegations of its application by a preponderance of the evidence. *In re Estate of Robison*, 236 Kan. 431, 439, 690 P.2d. 1383 (1984).

6. The burden of going forward with evidence is the duty to a case to refute or explain a particular point, such as the need to make a *prima facie* showing. The burden of producing evidence is the obligation of a party to introduce evidence sufficient to avoid a ruling against the party on the issue. Under traditional legal theory, the burden of persuasion does not shift at any stage of the proceeding while the burden of coming forward with evidence may shift back and forth as the case progresses. Black's Law Dictionary, West Publishing Co., 5th Ed., p. 178. If facts which give rise to a presumption are established, the burden is placed on the party against whom the presumption operates to put forth sufficient evidence to rebut the presumption; if sufficient rebuttal evidence is presented, the presumption vanishes. *Matter of Estate of Lewis*, 549 N.E.2d 960, 962 (1990).

7. This proceeding was initiated upon application of KGS to set the gas sales rate under its COGR tariff. That application incorporates the transportation charges of Kansas Pipeline Company that were incurred under contracts, which were the subject matter of the Commission's investigation in Docket No. 97-WSRE-312-PGA. KGS must be prepared to establish the basic facts to make a *prima facie* showing that it has acted prudently to preserve its contract rights against the Kansas Pipeline Company.²⁴

25. Like KGS in the 02-329 Docket, KCPL is the party initiating the proceeding upon application.²⁵ As such, it is KCPL that "must be prepared to establish the basic facts to make a *prima facie* showing that it has acted prudently" in the construction of these generation facilities.

²⁴ Order Denying Reconsideration, KCC Docket No. 02-KGSG-329-PGA, March 26, 2002, ¶¶ 5-7 (emphasis added).

²⁵ In the 02-329 Docket, KGS was seeking to set its gas sales rate under its COGR tariff; here, KCPL is seeking rate increases to recover the cost of its generation facility projects.

26. This burden of proof, or burden of persuasion, remains with KCPL. However, in the event KCPL makes a *prima facie* showing that it has acted prudently, the burden of going forward with evidence of imprudence may shift to Staff, CURB, and other intervenors.

IV. TESTIMONY IN THE 246 DOCKET ON THE PRUDENCE STANDARD.

27. CURB agrees generally with the description of the testimony of Staff and KCPL witnesses discussing the prudence standard. However, CURB disagrees with certain statements made by KCPL witness Dr. Kris R. Nielsen.

28. First, Dr. Nielsen states:

Prudence cannot be judged from a hindsight perspective. The substantive decision quality is only an element to be considered. The issue is whether the decision was reasonable when made, not that the result of that decision is less desirable than other results. Thus, there is a zone of reasonableness, as prudence is not a test of optimality.²⁶

29. Contrary to Dr. Nielsen's testimony, there are hindsight factors and comparison to other results the Commission is statutorily authorized to consider in determining prudence of electric generating property. Specifically:

- K.S.A. 66-128g(a)(2) allows comparison of the rates of other utilities in the state that have no ownership interest in the facility under construction with the rates that would result if the entire cost of the facility were included in the rate base;
- K.S.A. 66-128g(a)(3) allows comparison of the final (hindsight) cost of the facility under consideration to the final cost of other facilities constructed within a reasonable time before or after construction of the facility under construction;
- K.S.A. 66-128g(a)(4) allows comparison of the original cost estimates made by the owners of the facility under consideration with the final (hindsight) cost of such facility;
- K.S.A. 66-128g(a)(5) allows consideration of the ability of the owners of the facility under consideration to sell on the competitive wholesale or other market electrical power generated by such facility if the rates for such power were determined by inclusion in the entire cost of the facility in the rate base;
- K.S.A. 66-128g(a)(6) allows a comparison of any overruns in the construction cost of the facility under consideration (hindsight) with any cost overruns of any

²⁶ Nielsen February 23, 2009, Redacted Direct Testimony, p. 17.

other electric generating facility constructed within a reasonable time before or after construction of the facility under consideration;

- K.S.A. 66-128g(a)(9) allows consideration of whether inclusion of all or any part of the cost of construction of the facility under consideration, and the resulting rates of the utility therefrom, would have an adverse economic impact upon the people of Kansas (hindsight);
- K.S.A. 66-128g(a)(12) allows consideration of any other fact, factor or relationship which may indicate prudence or lack thereof as that term is commonly used.

30. Each of the above statutory factors involves hindsight or evaluating whether the outcome was more or less desirable than other results, contrary to the standard advocated by Dr. Nielsen.

31. Dr. Nielsen further advocates a prudence review that doesn't consider efficiency. "Prudence is not synonymous with efficiency and does not require that decisions be made and executed in the most efficient manner."²⁷ However, in discussing the valuation of property for rate making purposes, K.S.A. 66-128c specifically gives the Commission the "power to evaluate the *efficiency* or prudence of acquisition, construction, or operating practices of that utility." The statute goes on to state,

"In the event the state corporation commission determines that a portion of the costs of acquisition, construction or operation were incurred due in whole or in part to a *lack of efficiency* or prudence ... it shall have the power and authority to exclude all or a portion of those costs from the revenue requested by the utility."

32. As a result, efficiency is an issue to be considered along with prudence by the Commission when determining the reasonable value of utility property, contrary to Dr. Nielsen's testimony.

²⁷ *Id.*, at p. 19.

V. REQUEST FOR ORAL ARGUMENT.

33. The Prehearing Officer has granted the parties' request for oral argument on the prudence standard and whether the Commission should take any action on the prudence standard prior to a final decision in the fourth and final rate case to be filed by KCPL. Litigants rarely find themselves in complete agreement on an issue, but KCPL, Staff, and CURB all share the opinion that an order from the Commission specifically stating the prudence standard to be applied in the next KCPL rate case will likely cause an appeal of that ruling that may remove jurisdiction from the Commission pending the outcome of the appeal.

34. As a result, CURB respectfully requests that the Commission take the prudence standard issue under advisement and issue its decision on the applicable standards contemporaneously with its final decision in the next rate case.

VI. CONCLUSION.

35. CURB respectfully submits its brief on the legal standards and statutory factors applicable to the Commission's prudence review of KCPL's generation facility construction projects and requests oral argument on whether the Commission should issue an order setting the prudence standard prior to its final decision in the next KCPL regulatory plan rate case.

Respectfully submitted,


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CERTIFICATE OF SERVICE

04-KCPE-1025-GIE

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, e-mailed, or hand-delivered this 10th day of September, 2009, to the following:

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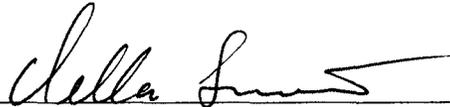
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