

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

FEB 25 2011



In the Matter of a General Investigation Into )  
KCP&L and Westar Generation Capabilities, ) Docket No. 11-GIME-492-GIE  
Including as these Capabilities May Be )  
Affected by Environmental Requirements. )

**INITIAL COMMENTS OF THE CITIZENS' UTILITY RATEPAYER BOARD**

The Citizens' Utility Ratepayer Board (CURB) offers the comments below in response to the Kansas Corporation Commission's (KCC or Commission) order initiating an investigation into the generation capabilities of Westar Energy (Westar) and Kansas City Power & Light (KCPL) and whether their capabilities may be affected by environmental requirements.

The Commission requested comments from interested parties, including CURB, offering specific questions to address, as well as inviting the parties to address any additional information that the Commission should consider regarding the potential environmental upgrade requirements on the electric generation units owned by KCPL and Westar.

**I. Responses to questions in paragraph 15 of the order**

**(a) If a utility has selected a specific option (i.e., mothball, retrofit, decommission, and/or build new plant), why were other options rejected, not just why the option chosen was appropriate.**

**A:** CURB cannot answer this question on behalf of the utilities, but suggests that sale of a plant should be among options considered, as discussed further below. Also discussed

further below is the need for full analysis of alternative actions, and the need for advanced planning for anticipated needs, as well as early involvement of the KCC and interested parties whenever a utility anticipates having to take action in response to environmental regulations.

**(b) If a utility is successful in a predetermination proceeding, then it has shifted some risk from its shareholders to its ratepayers. Should the utility's stake in the generating facility, which was the subject of the predetermination proceeding, have different rate-making principles and treatment applied than would have been applied in a traditional rate case?**

**A:** While predetermining the rate treatment and rate of return on equity (ROE) for a project before the project is completed and in service is somewhat of a departure from tradition, setting the ROE at a level that is commensurate with the level of risk is precisely what traditional ratemaking strives to accomplish. If, for example, the ROE is reduced to recognize reduced risk, the reduction is not a departure from traditional ratemaking principles at all, nor is it according different treatment for capital projects that are the subject of predetermination proceedings. To the extent that predetermination procedures are a departure from tradition, the departure was actively promoted and supported by utilities at the legislature for the express purpose of reducing the risk to shareholders that their investments would be recovered in a timely manner. There is no need to further depart from "tradition"—especially given how little traditional ratemaking remains in an era of surcharges, line-item riders and energy charge adjustments. As discussed below, the

traditional ratemaking process, in tandem with the predetermination process, should result in recognition of the reduced risk through incremental reductions in the ROE.

**(c) Will pre-approval reduce the utility's risk profile going forward? If so, should an adjustment be made to the utility's return on equity in connection with whatever preapproval is granted to the utility?**

**A:** A utility receives a significant benefit in obtaining upfront assurance that it will be fairly compensated for capital projects in a timely manner. Further, if the utility does not believe the Commission's predetermination is fair or timely, the company may have the option to appeal, to revise the project to improve its prospects of approval by the Commission, to delay it, or possibly to cancel the planned project altogether or (for a multi-state utility) propose a project in another jurisdiction. In any case, the utility has one year from the determination of the Commission to decide whether it will construct or participate in the construction of the project. K.S.A. 66-1239(d). Whatever the utility decides to do, getting the bad news before the utility commits large amounts of capital to a project reduces the utility's risk, just as receiving good news does.

And, any time a utility reduces its risk, the risk is shifted elsewhere—usually to its ratepayers. Ratepayers should be compensated for shouldering additional risk, and utilities should pay for the benefit of reducing their risk. This tradeoff is accomplished by: (1) in a predetermination docket, ordering a reduced ROE on the capital to be invested by the company in the specific project at issue, (2) in a rate case, ordering a reduction in the authorized ROE, or (3) a combination of both. Certainly, if a utility consistently seeks

predetermination of the ratemaking treatment for each project the utility undertakes, the effect should be downward pressure on the authorized rate of return awarded in subsequent rate cases, because more and more of the shareholders' investment is subject to reduced risk.

It may be suggested that it would be simpler just to wait until the utility's next rate case to reduce the overall return, rather than determine the reduction in ROE as a part of the predetermination hearing. However, CURB is concerned that ratepayers will be denied compensation for the specific reductions in risk attached to each project if the assumption is made that these reductions will be taken into account in determining the appropriate ROE. If ratepayers furnish a reduced level of risk for a specified project, they should receive a commensurate reduction in the return for that project. Allowing the reductions to be subsumed into the contentious and complex negotiations concerning the overall rate of return on equity puts ratepayers at further risk of not receiving the compensation that is their due for shouldering the additional risk.

Therefore, the discount on the return authorized in the predetermination proceeding should not be subject to further revision in subsequent proceedings. Regardless of the authorized ROE in subsequent rate cases, the ROE for these projects that received preapproval should be subject to a discount relative to the ROE approved for projects that are recovered solely through the traditional ratemaking process.

Tracking a separate rate of return for specific projects that were preapproved should not be difficult, given that each capital project is already accounted for in depreciation rates in an individualized manner. This is similar to tracking the individual interest rates on the multiple debt instruments to determine the utility's cost of debt. When the utilities and other

parties file their testimony in rate cases, they will apply their recommended ROE, less a discount of X, to the amount of the rate base subject to the discount in calculating the recommended revenue requirement.

It should be remembered that a predetermination proceeding is conducted at the option of the utility, but not at the option of the ratepayers. If the utility wants assurance that the Commission will provide consistency in rate treatment throughout the depreciated life of the project, then ratepayers should receive the same assurance that the reduction on the ROE on the capital they provide to reimburse shareholders for the project will be preserved throughout the depreciated life of the project.

So long as the reduction to the ROE is preserved, then incremental reductions in the utility's authorized overall rates of return should follow as a natural consequence of increasing the proportion of the company's capital projects that are shielded from risk. Additionally, overall reduction of the utility's risk may result in an incremental reduction in the utility's cost of debt, as well, which would also exert downward pressure on the overall rate of return authorized in subsequent rate cases. Recognizing that interest rates and perception of investment risk are impacted by multiple forces outside the ratemaking arena, reduced rates of return on specific projects may not necessarily reduce the overall rate of return, but preserving the reduced rate over the lives of projects will exert downward pressure on returns and help stabilize returns during periods of market instability.

**(d) Given the broad selection of alternatives (i.e., mothball, retrofit, decommission, and/or build new plant), what are the forecasted effects on rates and on the financial**

**performance of the respective company with traditional regulatory treatment and with predetermination treatment?**

**A:** As discussed above, predetermination should, over the long term, exert downward pressure on rates of return, and thus, rates, helping to moderate the increases in rates that are a natural consequence of adding capital projects to the rate base. However, predetermination should, over the long term, also promote stability and reduce investor risk, which should attract more investors who are averse to risk.

**II. Additional issues**

**(1) Early review of project proposals is critical**

It is critical that the KCC and the parties have the opportunity to review a utility's environmental upgrade proposals *before* final decisions are made or costs are incurred. However, it's unlikely that a decision in this docket that LaCygne should not be upgraded could prevent at least some significant costs from being incurred. Counsel has heard that there is construction work underway on roads and parking lots at the LaCygne plant, apparently in preparation for the planned environmental upgrade. One also presumes that there are other planning and preparation activities that are currently generating costs in anticipation of the project at the plant. Thus, it may be too late to prevent significant costs from being incurred in this case. However, regarding other projects yet to be proposed, the KCC should adopt a policy that requires utilities to present environmental upgrade proposals for review *before* the utility makes a commitment to construct and before the utility incurs significant costs in anticipation of such a commitment.

**(2) Determine rate treatment of costs already incurred if the project is rejected**

As noted above, KCPL has no doubt already incurred significant costs in preparing for the proposed environmental work at LaCygne. In this investigation, the KCC should also consider what policy should apply to such costs in the event that the Commission determines that KCPL should not go forward with the upgrade. If, as CURB recommends, the KCC adopts a policy of requiring early review of proposed environmental projects, then it will be less likely in the future that a utility will have already expended significant amounts on a proposed project before the KCC determines it should not go forward.

**(3) Full financial analyses of the project and alternatives considered is essential**

Additionally, it is critical that a full financial analysis be submitted, along with the financial impacts of all alternatives considered. Moreover, associated work papers and supporting calculations and assumptions should be submitted simultaneously. This financial analysis should be provided, by year, on both a nominal and net present value basis for the entire life cycle of the plant/retrofit.

Similarly, to the extent that the utility has initiated environmental upgrades at certain facilities, the above-referenced financial analysis should be provided as soon as possible (if it has not previously been filed) for these facilities. Again, this should include a financial analysis of all reasonable alternatives. The utility should also clearly identify all non-financial drivers impacting its recommendation and should provide information about how those non-financial drivers were weighted in the decision-making process.

**(4) Annual reporting is essential for planning for future needs**

The KCC should require each utility to file a summary document identifying each of its plants and the current timeline for action for each of them. The Commission should further require that the utility update this document annually. In this way, interested parties can become more proactive in the decision-making process and will not have to wait until the utility files for pre-approval of a specific project to begin consideration of the pros and cons involved. Further, it is much less costly to anticipate and address problems at the front end of the planning process than after the company has expended significant sums to commit to a prescribed course of action.

**(5) Sale of the plant should be considered as an option**

CURB also recommends that another option to upgrading or decommissioning a plant should be considered: an “as-is, where-is” sale. While this option is not likely to be viable except in a few cases, it should be considered. Even if the sale price were deeply discounted to reflect the plant’s problems, a sale might be a more economical alternative to decommissioning and removing it. A utility such as a cooperative or municipal utility, without the pressure to produce profit margins, might be able to make beneficial use of the plant. There may be legal or economic obstacles to this option, but unless this option is investigated and deemed unviable, selling a plant should be considered as an option along with upgrading or decommissioning the plant. If sale of the plant appears to be a viable option, it could relieve the customers of the regulated utilities in Kansas of the tremendous financial burden of upgrading the plant or paying for its removal.

**(6) The KCC must establish an evidentiary basis for overriding a utility's decision to build, upgrade, sell or decommission a plant**

In current practice at the KCC, not much time is spent questioning the decision of a utility to build something or tear it down. For most projects, the need is evident, and it's simply a matter of reviewing the costs afterwards for reasonableness. However, with millions, perhaps billions of dollars at stake in meeting current and future environmental requirements, the Commission must be prepared to examine whether the utility's selected course of action is reasonable—and to successfully support and defend that decision. While it is clearly a legitimate function of the Commission to ensure that utilities do not make bad economic choices that ratepayers will have to pay for, sustaining a challenge to the Commission's decision to pre-empt a traditionally corporate function will require sound evidence that the Commission is at least as well-positioned as the utility to determine what is the best course of action for the utility to take. The Commission, its staff and other interested parties will need the assistance of consultants with at least as much expertise as the utility's environmental compliance experts. Again, as noted above, this level of inquiry will require that the Commission develop an assessment procedure for proposed projects that begins early in the planning process.

**(7) Further rounds of comments may be useful**

CURB would prefer the option of responding to other parties' responsive comments. Therefore, CURB suggests that the Commission consider scheduling a further round of comments that permits the parties to respond to the responsive comments to be filed by March 4, 2011.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'David Springe', written over a horizontal line.

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**CERTIFICATE OF SERVICE**

11-GIME-492-GIE

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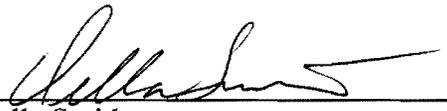
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