

UNITED STATES OF AMERICA  
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Pat Wood, III, Chairman;  
Nora Mead Brownell, Joseph T. Kelliher,  
and Suedeem G. Kelly.

Kansas City Power & Light Company

Docket Nos. ER03-997-000 and  
ER03-997-001

ORDER ON CAPACITY PURCHASE EXTENSION AGREEMENT AND  
ESTABLISHING HEARING AND SETTLEMENT JUDGE PROCEDURES

(Issued June 23, 2004)

1. On June 27, 2003, Kansas City Power & Light Company (KCPL) filed a Capacity Purchase Extension Agreement (Extension Agreement) between KCPL and the City of Independence, Missouri (City), which would permit the City to exercise its option to extend the purchase of 90 MW of capacity and associated energy, as provided for in Amendatory Agreement No. 7 to a 1965 Municipal Participation Agreement (MPA) between and the City and KCPL, for six years beginning June 1, 2005. As discussed below, we will accept the Extension Agreement for filing and establish hearing and settlement judge procedures. This order benefits customers because it provides parties with a forum to resolve their disputes.

**BACKGROUND**

2. In 1965, the City and KCPL entered into the MPA, which establishes the terms and conditions of the utilities' interconnected operations and has served as an umbrella agreement for reserve sharing and other transactions at cost-based rates. Under Amendatory Agreement No. 2 to the MPA, dated August 21, 1985, Service Schedule H-MPA was added to the MPA, providing for, among other things, a ten-year sale to the City by KCPL of 75 MW of capacity from KCPL's Montrose No. 2 coal-fired steam unit. Service Schedule H-MPA further provided that energy would be made available to the City for at least 80 percent of the days of the year. The energy charge for this sale was based on the costs of the Montrose No. 2 unit whenever Montrose No. 2 was available, even if KCPL chose not to run the unit for economic reasons. In the event of a forced outage of the unit, the energy charge was based on the costs of the Montrose No. 2 unit, unless such outage occurred during the summer peak season at a time when KCPL was

running its combustion turbines or purchasing energy in lieu of running its combustion turbines. In the latter event, the energy charge was based on 110 percent of KCPL's incremental cost of supplying such energy. The capacity charges were graduated from \$48/kW/year in the early years to \$84/kW/year in the last year of the sale (ending May 31, 1996).

3. In Amendatory Agreement No. 6 to the MPA, dated May 17, 1995, the parties agreed to new Service Schedule H-MPA-2 providing for a multi-year extension of the capacity sale from the Montrose No. 2 unit, in an amount ranging from 20 MW to 90 MW, for four years (through May 2000), with an option, which could be exercised no later than June 1, 1998, to extend the purchase through a fifth year (through May 2001). The City exercised this option. The capacity charge for these extensions was \$84/kW/year. The energy price provisions remained substantially unchanged from the initial term of the Montrose No. 2 unit sale.

4. In addition, Amendatory Agreement No. 6, as amended by Addendum A dated November 17, 1997, contained additional options for the City to extend the purchase of 20 MW to 90 MW of capacity from the Montrose No. 2 unit for two consecutive periods beginning June 1, 2001. The first option, which could be exercised by June 1, 1999, allowed the City to extend the purchase for up to four years beyond May 30, 2001, at the \$84/kW/year capacity charge and the energy charge set forth in Service Schedule H-MPA-2. The City gave notice to exercise this option for 90 MW on May 1, 1999.

5. The second option allowed the City to extend the purchase for a subsequent period of up to six years beginning June 1, 2005, to be exercised at least two years in advance of the commencement of that period (*i.e.*, by June 1, 2003). Amendatory Agreement No. 6 stated that the price for the extension pursuant to this second option would be negotiated by the parties, provided that in no event would the capacity charge, including transmission capacity costs, exceed \$126/kW/year, and energy charges would be based on the Montrose No. 2 unit fuel costs and heat rate curves to be established during negotiations. Amendatory Agreement No. 6 stated that the parties understood that the prices negotiated at that time may be subject to additional regulatory approvals.

6. On February 7, 2002, the parties executed Amendatory Agreement No. 7 to the MPA, which revised the option to extend the purchase beginning June 1, 2005, to spread the capacity sale among KCPL's Montrose Nos. 1, 2 and 3 units. Specifically, Amendatory Agreement No. 7 states that:

[t]he City has the option, to be exercised on or before June 1, 2003, to extend the purchase established by Service Schedule H-MPA-2 for a six year period beginning June 1, 2005 in an amount ranging from 20 MW to 90 MW. The Capacity Charge for this extension shall be negotiated by the parties, however, in no event shall the capacity charges, including

transmission costs, exceed \$126/kW/year. Energy prices shall be those contained in Service Schedule H-MPA-2. The parties understand that the prices negotiated at that time may be subject to additional regulatory approvals. Non-price terms and conditions would be those contained in Service Schedule H-MPA-2.

7. Amendatory Agreement No. 7 also revised Service Schedule H-MPA-2 to provide that the capacity sale will consist of up to 30 MW from each of KCPL's three Montrose units and revised the energy charges in Service Schedule H-MPA-2 to reflect the cost of all three Montrose units instead of just the costs of the Montrose No. 2 unit.

8. Amendatory Agreement No. 7 was filed with the Commission on February 25, 2002, in Docket No. ER02-1082-000. In the transmittal letter, KCPL stated that the proposed rates were negotiated rates based on KCPL's baseload capacity with energy costs based on the costs of the Montrose generating units.<sup>1</sup> Amendatory Agreement No. 7 was accepted for filing by the Commission in a letter order issued pursuant to delegated authority on April 18, 2002.<sup>2</sup>

### **THE PROPOSED EXTENSION AGREEMENT**

9. On June 27, 2003, KCPL filed the instant Extension Agreement. In its transmittal letter, KCPL states that, in the process of the City's exercising its option to extend the purchase of Montrose Nos. 1, 2 and 3 unit capacity beyond May 30, 2005, the City and KCPL were unable, among other things, to agree on the basis for determining the capacity charges under the MPA. KCPL states that the City asserted that the capacity price must be a cost-based price based on the costs of the Montrose units. KCPL contends that Amendatory Agreement No. 7 allows it to negotiate a capacity charge up to \$126/kW/year without reference to costs of any specific capacity unit. KCPL maintains that this ability to "negotiate" a capacity charge allows it to charge market-based rates for the extension.

10. In a compromise, the parties agreed that KCPL file the Extension Agreement. The Extension Agreement allows the City to exercise its option to extend the purchase of 90 MW of capacity at a charge of \$126/kW/year, the maximum rate provided for in Amendatory Agreement No. 7, for six years beginning June 1, 2005; however, it reflects the parties' acknowledgement that the proposed capacity charge is being filed under protest and both parties are given various rights to take issue with the disputed capacity

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<sup>1</sup> KCPL Transmittal letter, Docket No. ER02-1082-000, at 2.

<sup>2</sup> See Kansas City Power & Light Co., Docket No. ER02-1082-000 (April 18, 2002) (unpublished letter order).

charge before the Commission. KCPL states in its transmittal letter that the Extension Agreement is being filed under KCPL's market-based rate authority.

11. KCPL requests waiver of the prior notice requirements in Section 35.3(a) of the Commission's regulations to permit an effective date of June 1, 2005. KCPL explains that the Extension Agreement is being filed almost two years before its effective date to allow the Commission time to resolve the dispute.

12. Finally, KCPL requests a waiver of the requirements of Order No. 614.<sup>3</sup> KCPL states that, under Order No. 2001,<sup>4</sup> agreements that are entered into under a company's market-based rate authority do not need to be filed with the Commission and that, if it were not for the need to have the Commission resolve the dispute between the parties, the Extension Agreement would not have been filed and designations would not have been required under Order No. 614.

### **NOTICE OF FILING AND RESPONSES**

13. Notice of KCPL's June 27, 2003 filing was published in the Federal Register, 68 Fed. Reg. 41,122 (2003), with comments, interventions and protests due on or before July 18, 2003.

14. On July 2, 2003, the City filed a motion to intervene and preliminary comments, and on July 18, 2003, the City filed a protest. The City argues that the rates should be cost-based, not market-based, and that the capacity charge should be based on the costs of the Montrose units, in accordance with the Commission's matching principle that the demand and energy charges must reflect the cost of the same generating units. The City submits numerous documents which it believes show that the agreement has been historically cost-based and that the City has rights to cost-based rates for the extension beyond May 30, 2005. In addition, the City requests that KCPL be required to submit the appropriate cost support for the proposed \$126/Kw/year capacity charge. Finally, the City requests that the capacity charge be unbundled, with the City becoming the transmission customer for the extension period with the ability to exercise rollover rights and obtain firm transmission rights associated with the Montrose purchase. On August 4, 2003, KCPL filed an answer to the City's protest.

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<sup>3</sup> Designation of Electric Rate Service Schedule Sheets, FERC Stats. & Regs., Regulations Preambles, July 1996-December 2000 ¶ 31,096 (2000).

<sup>4</sup> Revised Public Utility Filing Requirements, Order No. 2001, 67 Fed. Reg. 31,043, FERC Stats. & Regs. ¶ 31,127, reh'g denied, Order No. 2001-A, 100 FERC ¶ 61,074 (2002).

15. In a letter order dated July 18, 2003,<sup>5</sup> the Commission directed KCPL and the City to engage in discussions to attempt to settle the issues utilizing the Commission's Dispute Resolution Service. However, on October 28, 2003, the parties filed a status report stating that they had reached an impasse and that it would not be possible to reach an agreement to resolve the issues. The parties requested that, given the extensive negotiations that have already occurred, a settlement judge not be utilized in this matter.

16. On November 12, 2003, in Docket No. ER03-997-001, KCPL filed proposed procedures regarding the disputes in this proceeding. KCPL states that the Commission should resolve the legal issue of whether Amendatory Agreement No. 7 obligates KCPL to base the rate it charges under the Extension Agreement on KCPL's costs. KCPL believes that this issue can be resolved based on the pleadings without an evidentiary hearing. KCPL states that the Commission already has in the record before it all of the relevant preceding agreements between the parties.

17. If the Commission decides that cost justification is required, KCPL states that a hearing could be conducted on the cost issue. If the Commission does not decide the preliminary issue on the existing record, then KCPL requests that the hearing be phased so that the preliminary issue of whether Amendatory Agreement No. 7 obligates KCPL to base the rate it charges under the Extension Agreement on KCPL's costs is decided before any hearing on costs is conducted. KCPL maintains that such procedures should lead to more efficient resolution of the entire proceeding.<sup>6</sup>

18. On November 18, 2003, the City filed an answer to KCPL's proposed procedures. The City agrees with KCPL that the issue of whether the City's purchase of capacity from the Montrose units is pursuant to a cost-based or market-based contract can be decided summarily by the Commission. The basis for the cost-based capacity charge is also a question that the Commission should decide summarily, according to the City, based on the application of the Commission's matching principle. The City maintains that the issue of who should receive unbundled transmission rights can also be decided without the need for an evidentiary hearing.

19. If the Commission decides these three issues, the City believes that the parties can avoid a full-blown rate hearing. Rather, according to the City, it is more likely that the guidance in the Commission order will permit the parties to reach a settlement. If the Commission determines that it is not appropriate to summarily decide the threshold issues, then the City agrees with KCPL that a phased hearing would be appropriate, with

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<sup>5</sup> 104 FERC ¶ 61,088 (2003).

<sup>6</sup> Notice of KCPL's November 12, 2003 filing of proposed procedures was published in the Federal Register, 68 Fed. Reg. 66,407 (2003), with comments, interventions and protests due on or before December 3, 2003.

the contract interpretation issues and transmission issues addressed in the first phase of the hearing.

20. On November 26, 2003, KCPL filed an answer to the City's November 18, 2003 answer. KCPL disagrees that the issue of the appropriate cost-basis of the capacity charge can be decided summarily based on the Commission's matching principles. Instead, KCPL states that determining what the capacity and energy charges should be as a result of the application of the matching principle is necessarily a fact-based inquiry. KCPL also states that the legal issues underlying the unbundling issue are no longer contested. KCPL agrees that the capacity charge should be unbundled and that the transmission rights should be transferred to the City. However, the remaining issues of how the unbundling should be performed, the level of the City's capacity charges, and what the City should pay for transmission are factual issues that must be resolved at hearing, according to KCPL. On December 3, 2003, the City filed an answer to KCPL's November 26, 2003 answer.

## **DISCUSSION**

### **A. Procedural Matters**

21. Pursuant to Rule 214 of the Commission's Rules of Practices and Procedure, 18 C.F.R. §385.214 (2003), the City's timely, unopposed motion to intervene serves to make it a party to this proceeding.

22. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385(a)(2)(2003), prohibits an answer to a protest and an answer to an answer unless otherwise ordered by the decisional authority. We will accept KCPL's and the City's answers because they have provided information that assisted us in our decision-making process.

### **B. Cost-Based Rates vs. Market-Based Rates**

#### **City's Protest**

23. The City argues in its protest that the rates under the Extension Agreement should be cost-based, not market-based. The City argues that the Extension Agreement is neither a new sale nor a freestanding agreement under KCPL's market-based rate tariff. Rather, the Extension Agreement continues the City's long-standing purchase since 1985 of capacity under the cost-based MPA, which the City submits was entered into before the concept of market-based rates was seriously considered. Accordingly, the City believes that it is contractually entitled under Service Schedule H-MPA-2 to continued cost-based rates for service during the extension period. The City points to the fact that Amendatory Agreement No. 7 expressly contemplates regulatory review of the rates once

negotiated, and states that, consistent with the MPA's terms and its history as a cost-based contract, KCPL represented to the Commission as recently as 1996 that any rate increase applicable to the 2001-2011 extension period would require cost support which it pledged to submit when it filed for the extension.<sup>7</sup>

24. According to the City, in 1995, when the City's option to extend the Montrose purchase beyond June 1, 2005 was established in Amendatory Agreement No. 6, KCPL's market-based rate authority was restricted to the sale by KCPL of: (1) up to 50 MW of system firm capacity and associated energy; (2) all available non-firm energy from KCPL-owned generation; and (3) up to 700 MW of firm capacity and associated energy from a new generating unit (Iatan II) to be built in the year 2000.<sup>8</sup> The City notes that its purchase of more than 50 MW from the Montrose plant does not fit any of these categories. In addition, the City argues that while the Commission accepted an amended market-based rate tariff for KCPL in 1999 that expanded the scope of KCPL's market-based rate authority prospectively, it did not authorize KCPL to make market-based sales outside its approved market-based rate tariff or to convert existing cost-based agreements to market-based rate contracts. Moreover, the City argues, Amendatory Agreement No. 7, which was entered into in 2002, after KCPL's market-based rate authority was amended, expressly provides that the City's extension option is to be under the terms of Service Schedule H-MPA-2, not the terms set forth in KCPL's market-based rate tariff, and the City has not agreed to enter into the Extension Agreement under KCPL's market-based rate tariff.

25. The City states that the fact that the parties agreed to negotiate the capacity charge in the first instance does not make the contract or capacity charge a market-based arrangement. Rather, according to the City, the capacity charge under Schedule H-MPA-2 has always been the product of negotiation and such negotiation is not a new concept tied to market-based rate authority. Nor, the City contends, is the existence of the

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<sup>7</sup> See City's protest at 17-18, quoting KCPL's April 12, 1996 letter filed in ER96-1412-000 in response to a Commission staff inquiry concerning Amendatory Agreement No. 6:

Amendatory Agreement No. 6 to the original filing provides for an extension to be negotiated for up to a 10 year period beginning June 1, 2001 with a capacity charge not to exceed \$126/kW/year. KCPL understands that such a transaction would require regulatory filings with appropriate cost support when such an extension is negotiated and is not requesting approval of such a transaction at this time.

<sup>8</sup> See City's protest at 18, citing Kansas City Power & Light Co., 67 FERC ¶ 61,183 at 61,553 (1994).

\$126/kW/year price cap inconsistent with a cost-based contract. Rather, the City continues, the price cap protects it from bearing significant additional costs as a result of environmental compliance or other upgrades, or catastrophic equipment failure, and the parties could not have known, in 1995 or 2002 when Amendatory Agreement Nos. 6 and 7 were executed, whether the costs of the Montrose station would increase or by how much.

### **KCPL's Answer**

26. In its answer, KCPL maintains that nothing in Amendment No. 7 requires that the capacity charge be cost-based. KCPL believes that the only requirement is for the capacity charge to be negotiated and be capped at \$126/kW/year. KCPL further maintains that the option to extend the purchase beyond May 30, 2001 in Amendatory Agreement No. 6 similarly provided for a “negotiated” capacity charge and a cost-based energy charge, and that prior agreements concerning the Montrose capacity under Service Schedule H-MPA-2 have always provided for a “negotiated” capacity charge and a cost-based energy charge. Moreover, KCPL argues that the City attempts to divert the Commission’s attention from the controlling language in Amendatory Agreement No. 7 by reciting at length the history of prior transactions that were entered into when KCPL did not have market-based rate authority. However, according to KCPL, that history is irrelevant to the question of what the parties agreed to in 2001, when KCPL did have market-based rate authority.

27. In addition, KCPL challenges the City’s reliance on the April 12, 1996 letter filed in Docket No. ER96-1412-000, in which KCPL stated that it would need to make regulatory filings with the “appropriate cost support” when an extension is negotiated. KCPL states that the fact that it could not use its market-based rate authority to justify the extension in 1996 should not bar KCPL from relying on its market-based rate authority to justify the rate in the proposed Extension Agreement. According to KCPL, the fact that the Commission required rates under Service Schedule H-MPA-2 to be justified on the basis of costs in the past does not change the negotiated nature of the capacity charges or prevent KCPL from relying on its market-based rate authority to justify the most recent negotiated rates. KCPL states that as a regulated utility, it has an obligation to demonstrate that its jurisdictional power sales agreements are just and reasonable, and at the time these agreements were filed, the only way that KCPL could make that showing was to demonstrate that the rate did not exceed KCPL’s costs. According to KCPL, the distinction between what is in the agreements and what is required to gain Commission approval of the agreement is crucial here, and today, KCPL does not have to provide any cost basis to support its \$126/kW/year capacity charge. Rather, KCPL maintains, the Commission already found, when it granted KCPL market-based rate authority, that rates negotiated by KCPL at arms length are just and reasonable. KCPL contends that that finding applies to all of KCPL’s negotiated rates, including Amendatory Agreement No. 7 and the Extension Agreement.

28. Moreover, KCPL argues, Amendatory Agreement No. 7 and the prior agreements demonstrate that the parties knew how to require a cost basis for a rate if that was what they intended. In this regard, according to KCPL, it is telling that in these agreements, the parties expressly provided that the energy charges associated with the Montrose unit sale were to be cost-based, but did not include similar language for the capacity charge. KCPL maintains that, given the language in the agreements requiring a cost basis for the energy charge, the failure to include language requiring a cost basis for the capacity charge cannot be considered an oversight.

29. Finally, KCPL claims that, given that it has market-based rate authority, the only reason that the Commission might review its negotiated rates would be if KCPL somehow has abused market power to charge an above-market rate. KCPL argues that its \$126/kW/year price is below the market price and that the City had the option to look elsewhere and was unable to find a better deal. KCPL points out that the City has not alleged that capacity in the Midwest is uncompetitive or that KCPL is improperly exercising market power.

### **Commission's Ruling**

30. The Extension Agreement and Amendatory Agreement Nos. 6 and 7 extend the rates, terms and conditions of a long-standing power sales agreement between KCPL and the City, the MPA. The MPA and Service Schedules H-MPA and H-MPA-2 were operational before KCPL had market-based rate authority and were historically regulated on a cost-of-service basis, as KCPL recognizes. KCPL's attempt to transition from cost-based rates to market-based rates by the unilateral application of its market-based rate tariff with its specific terms and conditions to the Extension Agreement is not consistent with its market-based rate tariff and would transform the MPA (and its various amendments) into an entirely different agreement.

31. KCPL's market-based rate tariff expressly provides that it governs voluntary transactions between KCPL and eligible customers pursuant to executed service agreements between KCPL and the customers. Nothing in Amendatory Agreement Nos. 6 or 7, which establish the option to extend the Montrose capacity purchase beyond May 31, 2005, indicates that such extension would be pursuant to KCPL's market-based rate authority, or would require the customer to execute a service agreement under KCPL's market-based rate tariff; nor has KCPL presented any documentation to indicate that the City agreed to be placed under KCPL's market-based rate tariff as required by the tariff. If KCPL intended for Amendatory Agreement No. 7 to modify the extension option to bring it under its market-based rate tariff, it should have explicitly provided for that in the agreement. Having failed to do so, it would unreasonably alter the City's right in Amendatory Agreement No. 7 to extend the Montrose capacity purchase under the MPA to now impose a requirement that the extension of the purchase be under KCPL's

market-based rate tariff.

32. In addition, KCPL's reliance on the "negotiated" character of the capacity charge under Amendment No. 7 as proof of its contractual right to charge market-based rates is misplaced. Even though the rates could be up to \$126/kW/year under the original provision, such rates are not an indication that KCPL has market-based rate authority pursuant to which KCPL could charge the City whatever the market, *i.e.*, the City, would bear, as asserted by KCPL; rather, the rates are subject to a cost-based rate ceiling and are cost-based rates.<sup>9</sup>

33. This analysis is confirmed by KCPL in its April 12, 1996 letter in response to a staff inquiry in Docket No. ER96-1412-000. In response to staff's inquiry concerning cost support for the rate for the 2001-2011 extension period, KCPL stated:

Amendatory Agreement No. 6 to the original filing provides for an extension to be negotiated for up to a 10 year period beginning June 1, 2001, with a capacity charge not to exceed \$126/kW/year. KCPL understands that such a transaction would require regulatory filings with appropriate cost support when such an extension is negotiated and is not requesting approval of such a transaction at this time.

34. It is apparent that, under that agreement, the rates to be charged were to be negotiated cost-based rates up to a cost-based ceiling rate of \$126/kW/year, contingent on the future filing of cost support for the specific rate proposed to be charged. This is consistent with the fact that KCPL's market-based rate authority did not cover the sale under Service Schedule H-MPA-2 at the time that the option for the 2001-2011 extension was established in 1995.

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<sup>9</sup> Indeed, there is nothing unusual about a cost-based rate schedule providing for "negotiated" rates up to a cost-based rate ceiling. Over the years, the Commission has accepted many such rate schedules for cost-based power sale transactions; they have never been considered to provide for market-based rates. *See, e.g.*, Consumers Energy Co., 80 FERC ¶ 61,283 (accepting power sales tariff providing for negotiated rates under a cost-based rate ceiling and dismissing intervenor concerns about potential abuse of market power because applicant was not requesting market-based rate authority), *reh'g denied*, 81 FERC ¶ 61,396 (1997); *accord* Jersey Central Power & Light Co., 38 FERC ¶ 61,275 at 61,928, *reh'g denied*, 40 FERC ¶ 61,236 (1987) (accepting, suspending and setting for hearing cost-based ceiling rate whose purpose was to allow parties to transact without further Commission review); *see generally* Terra Comfort Corp., 52 FERC ¶ 61,241 at 61,839 (1990) (most utilities have on file demand charge rate ceilings designed to reflect a 100 percent contribution to fixed costs, pursuant to which they also can make sales at lower rates when circumstances warrant).

35. Accordingly, we find that the rates under the Extension Agreement are required to be cost-based and thus, the Extension Agreement was not properly filed under KCPL's market-based rate authority. Given that the rates are to be cost-based but were not to be justified until the option to extend is exercised, the Commission must ensure that the rates in the proposed Extension Agreement are cost justified in order to ensure that they are just and reasonable under section 205 of the Federal Power Act.<sup>10</sup> As a result, as discussed more fully below, the level of the charges is an issue to be addressed in the hearing proceeding ordered below.

### **C. Cost Basis for Proposed Capacity Charge**

#### **City's Protest**

36. The City argues that because the energy charges for the City's Montrose purchase are based on the variable fuel costs of the Montrose units, the capacity charge must also be based on the costs of the Montrose units consistent with the Commission's matching principle.<sup>11</sup> The City further argues that high energy costs associated with the Montrose units, in comparison to KCPL's other baseload units, make it inappropriate to allow a mismatch in capacity and energy pricing.

#### **KCPL's Answer**

37. KCPL answers that even if the Commission determines that the capacity charge is cost-based, since 1996 the capacity charge has been based on all of KCPL's baseload units, not just the Montrose units. KCPL states that the matching principle does not apply here. Rather, it argues that the matching principle applies to umbrella coordination sales agreements that are not intended to fix rates for specific transactions but instead establish formula rate caps that apply when the parties enter into specific transactions. According to KCPL, the point of the matching principle is that formula rate caps under umbrella sales agreements cannot use both average capacity costs and incremental energy costs. KCPL argues that the matching principle does not apply in this instance because: (1) the proposed Extension Agreement does not involve formula rate caps under an umbrella sales agreement but involves rates for a specific transaction; (2) the proposed capacity charge is fixed and not based on a formula rate; and (3) the Montrose unit fuel costs are relatively inexpensive compared to KCPL's incremental energy costs. Finally,

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<sup>10</sup> 16 U.S.C. § 824d (2000).

<sup>11</sup> See City's protest at 28, citing *Indiana & Michigan Electric Co.*, 10 FERC ¶ 61,295 at 61,591 (1980).

KCPL argues that the Commission must recognize that Schedule H-MPA-2 requires KCPL to deliver energy at an 80 percent availability factor whether or not the Montrose units are actually available. Therefore, KCPL maintains, the sale is supported by all of KCPL's baseload capacity and not just the Montrose units.

### **Commission's Ruling**

38. We disagree with KCPL that the matching principle does not apply here. While the Commission has explicitly discussed the matching principle in the context of pricing opportunity transactions under coordination umbrella sales agreements, the same principle applies in performing a cost-of-service for a specific transaction. There is typically a trade-off between capacity costs and energy costs in power production (e.g., units with higher capacity costs typically produce energy at lower variable cost). It would be unfair, for example, to charge the City a capacity charge that includes the higher capacity costs of KCPL's nuclear plants while charging an energy charge that does not afford the City the benefit of the relatively lower energy costs of such plants.

39. We disagree with KCPL that the 80 percent availability factor for the sale necessitates a different result. To the extent that KCPL relies on other units to back-up the Montrose sale to the City to meet the 80 percent minimum availability factor, it would be appropriate to reflect a portion of the costs of such other units in the capacity charge. However, this would not violate the matching principle. For example, as noted above, when there is a forced outage of the Montrose units during the summer peak season at a time when KCPL is running its combustion turbines or purchasing energy in lieu of running its combustion turbines, the proposed energy charge is based on 110 percent of KCPL's incremental cost of supplying such energy. Given this proposed energy charge, it would be reasonable and consistent with the matching principle to reflect in the capacity charge a portion of the fixed costs of peaking units or peaking power purchases that would be relied upon by KCPL to supply energy under the Extension Agreement in such events.

## **D. Unbundling of Montrose Capacity Sale**

### **City's Protest**

40. The City requests that the capacity charge be unbundled, with the City becoming the transmission customer during the extension period. This would allow the City to exercise rollover rights and to receive firm transmission rights associated with the long-term Montrose purchase. The City argues that it will not have the full ability to hedge congestion costs by use of financial transmission rights or other forms of firm rights unless it is the transmission customer for the Montrose purchase. The City argues that its request to be the transmission customer during the extension period is supported by

Commission precedent.<sup>12</sup> However, the City states that during negotiations KCPL disagreed and proposed that the City be required to make a separate transmission request without the benefit of the rollover rights. In addition, the City states that KCPL maintains that regardless of whether it or the City is the transmission customer, the City should be responsible for congestion costs. The City counters that if it is to bear the congestion risk, it should be entitled to firm transmission rights and rollover rights.

### **KCPL's Answer**

41. KCPL states that it is surprised that the City has protested the Extension Agreement on the grounds that it should be unbundled because, during negotiations, the City opposed unbundling. KCPL declares that it agrees that the capacity charge should be unbundled and that the transmission rights should be transferred to the City. KCPL states that, therefore, the legal issues underlying the unbundling issue are no longer contested. However, the remaining issues as to how the unbundling should be performed, the level of the City's capacity charge, and what the City should pay for transmission, are factual issues that must be resolved at hearing, according to KCPL.

### **Commission's Ruling**

42. We observe that KCPL is responsible for the delivery of power to the City with transmission costs included in the capacity charge. As noted above, KCPL has agreed that the capacity charge should be unbundled and that the City should become the transmission customer. As a result, the only remaining issues involve how the unbundling should be performed, including the level of the City's capacity charge and what the City should pay for transmission. We believe that these are factual issues that should be resolved in the course of the evidentiary hearing we order below.

### **E. Hearing and Settlement Judge Procedures**

43. In this order, the Commission finds that the Extension Agreement was not properly filed under KCPL's market-based rate authority and that the rates under the Extension Agreement are required to be cost-based. In addition, we find that the matching principle applies here for purposes of determining the cost basis for the rate. However, a number of issues of material fact remain concerning the proposed Extension Agreement that cannot be resolved based on the record before us, and are more appropriately addressed in the hearing ordered below.

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<sup>12</sup> See City's protest at 33, citing Southwest Power Pool, 99 FERC ¶ 61,379, reh'g denied, 101 FERC ¶ 61,233 (2002).

44. Our preliminary analysis indicates that the proposed Extension Agreement has not been shown to be just and reasonable, and may be unjust, unreasonable, unduly discriminatory or preferential, or otherwise unlawful. Accordingly, we will accept the Extension Agreement for filing, suspend it for a nominal period, make it effective June 1, 2005,<sup>13</sup> subject to refund and, as to the issues not summarily resolved above, set it for hearing as ordered below.

45. As noted above, the City believes that, if the Commission decides the threshold issues concerning the appropriate basis for the rate under the Extension Agreement, it is likely that the parties can settle the remaining issues and avoid a hearing. While we are setting those issues not summarily resolved above for a trial-type evidentiary hearing, we encourage the parties to make every effort to settle their dispute before hearing procedures commence. To aid the parties in their settlement efforts, we will hold the hearing in abeyance and will direct that a settlement judge be appointed, pursuant to Rule 603 of the Commission's Rules of Practice and Procedure.<sup>14</sup> If the parties desire, they may, by mutual agreement, request a specific judge as the settlement judge in this proceeding; otherwise, the Chief Judge will select a judge for this purpose.<sup>15</sup> The settlement judge shall report to the Chief Judge and the Commission within 60 days of the date of this order concerning the status of settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions or provide for commencement of a hearing by assigning the case to a presiding judge.

The Commission orders:

(A) KCPL's proposed Extension Agreement is hereby accepted for filing and suspended for a nominal period, to become effective June 1, 2005, subject to refund, as

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<sup>13</sup> We find good cause to grant KCPL's requested waiver of the 120-day advance notice requirement.

<sup>14</sup> 18 C.F.R. § 385.603 (2003).

<sup>15</sup> If the parties decide to request a specific judge, they must make their joint request to the Chief Judge by telephone at (202) 502-8500 within five days of this order. The Commission's website contains a list of Commission judges and a summary of their background and experience. ([www.ferc.gov](http://www.ferc.gov) - click on Office of Administrative Law Judges).

discussed in the body of this order.

(B) Pursuant to the authority contained in and subject to the jurisdiction conferred upon the Federal Energy Regulatory Commission by section 402(a) of the Department of Energy Organization Act and the Federal Power Act, particularly sections 205 and 206 thereof, and pursuant to the Commission's Rules of Practice and Procedure and the regulation under the Federal Power Act (18 C.F.R. Chapter 1), a public hearing shall be held concerning the justness and reasonableness of the proposed Extension Agreement. However, the hearing shall be held in abeyance to provide time for settlement judge procedures, as discussed in Ordering Paragraphs (C) and (D) below.

(C) Pursuant to Rule 603 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.603 (2003), the Chief Administrative Law Judge is hereby directed to appoint a settlement judge in this proceeding within fifteen (15) days of the date of this order. Such settlement judge shall have all powers and duties enumerated in Rule 603 and shall convene a settlement conference as soon as practicable after the Chief Judge designates the settlement judge. If the parties decide to request a specific judge, they must make their request to the Chief Judge in writing or by telephone within five (5) days of the date of this order.

(D) Within sixty (60) days of the date of this order, the settlement judge shall file a report with the Commission and the Chief Judge on the status of the settlement discussions. Based on this report, the Chief Judge shall provide the parties with additional time to continue their settlement discussions, if appropriate, or assign this case to a presiding judge for a trial-type evidentiary hearing, if appropriate. If settlement discussions continue, the settlement judge shall file a report at least every sixty (60) days thereafter, informing the Commission and the Chief Judge of the parties' progress toward settlement.

(E) If settlement judge procedures fail and a trial-type evidentiary hearing is to be held, a presiding judge, to be designated by the Chief Judge, shall, within fifteen (15) days of the date of the presiding judge's designation, convene a conference in these proceedings in a hearing room of the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, DC 20426. Such conference shall be held for the purpose of establishing a procedural schedule. The presiding judge is authorized to establish procedural dates, and to rule on all motions (except motions to dismiss) as provided in the Commission's Rules of Practice and Procedure.

By the Commission.

( S E A L )

Linda Mitry,  
Acting Secretary.