BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan	)	Case No. ER-2010-0355

and

In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges For Electric Service	)	Case No. ER-2010-0356

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

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INDUSTRIAL INTERVENORS

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COME NOW Praxair, Inc., the Midwest Energy Users' Association, Ag Processing, Inc. a cooperative, and the Sedalia Industrial Energy Users' Association (collectively referred to herein as "MEUA" or "Industrial Intervenors") by and through the undersigned counsel, pursuant to the Commission's August 18, 2010 Order Setting Procedural Schedule, and submit their Proposed Findings of Fact and Conclusions of Law on the issues set forth below.

I. BURDEN OF PROOF

1. Section 393.150(2) provides that, in any rate increase proceeding, the burden of proof is on the party seeking the increased rate. In considering the appropriate schedule for this proceeding, the Commission adopted KCPL's based upon its acknowledged burden of proof.

> Furthermore, the Commission will adopt the order of issues proposed by KCP&L. While the Commission understands the positions argued by Staff and MEUA, the Commission concludes that KCP&L has the burden to put on its case, and should be granted considerable leeway in the order in which it would like to present its evidence.[1]

Burden of proof, however, does not only mean that the utility gets the advantages when it comes to presenting its evidence. Burden of proof also means that the utility must accept the "burden" of proving its case.

2. In this regard, the Supreme Court has provided a great deal of insight regarding burden of proof. Specifically, as it applies to Commission proceedings, the Supreme Court has told us: (1) that burden of proof is a "substantial right" of the customers and (2) that burden of proof should be "rigidly enforced" by the Commission.

> The rules as to burden of proof are important and indispensable in the administration of justice, and constitutes a substantial right of the party of whose adversary the burden rests; they should be jealously guarded and rigidly enforced by the courts.[2]

3. The Supreme Court has also provided definition for the burden of proof.

> The burden of proof meaning the obligation to establish the truth of the claim by a preponderance of the evidence, rests throughout upon the party asserting the affirmative of the issue. The burden of proof never shifts during the course of the trial.[3]

[1] *Order Setting Blocks of Exhibit Numbers*, Case No. ER-2010-0355, page 2 (issued January 12, 2011).
[2] *Highfill v. Brown*, 320 S.W.2d 493 (Mo. 1959).
[3] *Clapper v. Lakin*, 123 S.W.2d 27 (Mo. 1938).

As such, the burden of proof means that the proponent of higher rates in a Commission proceeding has the "obligation to establish the truth" of its need for the higher rates. In this regard, customers are given the benefit of the doubt that the utility only needs the lower rate and that the utility must "prove" that the higher rate is necessary. Therefore, if there is any question regarding the legitimacy of a cost or expense; if the Commission does not adequately understand an issue; or if the Company fails to adequately explain its need for the higher rate, then the utility has failed to meet its burden of proof.

4. Finally, the Supreme Court has provided insight as to the implications to a party that fails to meet its burden of proof: "the failure of the plaintiff to sustain such burden ***is fatal*** to his or her relief or recovery."[4]

[4] *Id.*

II. RETURN ON EQUITY

A. FINDINGS OF FACT

1. This issue concerns the rate of return that KCPL / GMO will be authorized to earn on its rate base. Rate base includes things like generating plants, electric meters, wires and poles, and the trucks driven by KCPL / GMO repair crews. In order to determine a rate of return, the Commission must determine KCPL / GMO's cost of obtaining the capital it needs.

2. Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, in determining a return on equity, the Commission must consider the expectations and requirements of investors when they choose to invest their money in KCPL / GMO rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate of return that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for KCPL / GMO's ratepayers. In order to obtain guidance about the appropriate return on equity, the Commission considers the testimony of expert witnesses.

3. Three financial analysts offered recommendations regarding an appropriate return on equity in this case. Dr. Samuel Hadaway testified on behalf of

KCPL / GMO. In his testimony,[5] Dr. Hadaway relies exclusively on three variations of the DCF analysis.[6] First, Dr. Hadaway conducted a constant growth DCF analysis relying on analysts' growth estimates which resulted in a return on equity of 10.2% to 10.4%.[7] Second, Dr. Hadaway conducted a constant growth DCF analysis that substituted his own subjective estimation of the long-term GDP growth rate. The result of this analysis is a return on equity of 10.7% to 10.8%.[8] Finally, Dr. Hadaway combines the analysts' growth estimates and his own estimation of long-term GDP growth into a multi-stage DCF analysis. The result of his multi-stage DCF analysis is a return on equity of 10.5%.[9] Thus, Dr. Hadaway recommends a return on equity range of 10.2% - 10.8%, with a midpoint of 10.5%.[10]

4. In its testimony, however, KCPL asks that the Commission set its return on equity at 10.75%, at the top end of Dr. Hadaway's recommended range.[11] KCPL / GMO make their request "to reflect the Company's reliability and customer satisfaction achievements."[12]

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[5] Dr. Hadaway initially provided the results of his analysis in his direct testimony. In his rebuttal testimony, Dr. Hadaway "updated" his analysis "to take into account recent data and current conditions in the capital markets." (Ex. 28, page 22).
[6] While Dr. Hadaway initially included the results of his risk premium analysis in his direct testimony (Ex. 27, page 43), he subsequently recommended that the results of his updated risk premium analysis in his rebuttal testimony should be discounted (Ex. 28, page 23). The results of that updated risk premium analysis indicate an ROE range of 10.05% - 10.24%. (*Id.*)
[7] Ex. 28, Schedule SCH2010-11
[8] *Id.*
[9] *Id.*
[10] *Id.* at page 22.
[11] In KCPL / GMO's testimony, they refer to their request as a "return on equity commensurate with the top of Dr. Hadaway's range." (Ex. 7, page 10). In their brief, however, KCPL / GMO refers to their request as "an additional 25 basis points be added to the midpoint." (KCPL / GMO Brief at page 151). While the methods of getting to the actual request are different, the practical effect of either methods is a requested return on equity of 10.75%
[12] Ex. 7, page 10.

5. Michael Gorman testified on behalf of MEUA, MIEC and the Department of Energy.[13] In his testimony, Mr. Gorman conducts three versions of the DCF analysis, a risk premium analysis and a CAPM analysis. First, Mr. Gorman conducts a constant growth DCF analysis based upon analysts' growth rates resulting in a return on equity of 10.39%.[14] Second, Mr. Gorman conducts a sustainable growth DCF analysis which resulted in a return on equity of 9.38%.[15] Third, Mr. Gorman conducts a multi-stage DCF analysis which results in a return on equity of 9.86%.[16] Thus, the average of Mr. Gorman's three DCF analyses is a return on equity of 9.88%.[17] Next, Mr. Gorman undertook a risk premium analysis with a return on equity range of 9.41% to 9.94% with a midpoint of 9.68%.[18] Finally, Mr. Gorman conducts a CAPM analysis resulting in a return on equity of 9.40%.[19] The ultimate result of Mr. Gorman's multiple analyses is a recommended return on equity of 9.40% to 9.90% with a midpoint of 9.65%.[20] The results of each of Mr. Gorman's studies are as follows:

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[13] Mr. Gorman initially presented the results of his return on equity analysis in the context of his KCPL Direct Testimony (Exhibit 1203). His recommendation in his Direct Testimony is a midpoint return on equity of 9.65%. Like Dr. Hadaway, Mr. Gorman subsequently updated his analysis in his GMO Direct Testimony resulting in a midpoint return on equity of 9.50%. (Exhibit 1403). On the stand, however, Mr. Gorman restored his original recommendation of 9.65% to account for the subsequent increase in capital market bond yields. (Tr. 2852-2853). Therefore, the results set forth in this order reflect the "restored" position contained in Mr. Gorman's KCPL Direct Testimony of 9.40% to 9.90% with a midpoint of 9.65%. (Ex. 1203, page 37).
[14] Ex. 1203, pages 20 and 27.
[15] *Id.* at pages 24 and 27.
[16] *Id.* at pages 26 and 27.
[17] *Id.* at page 27.
[18] *Id.* at page 32.
[19] *Id.* at page 37.
[20] *Id.*

MODEL		RESULT
DCF		
	Constant Growth (analyst's growth rates)	10.39%
	Constant Growth (GDP growth rate)	9.38%
	Multi-Stage	9.86%
	AVERAGE	9.88%
Risk Premium		9.68%
CAPM		9.40%
Average		9.65%

7. A utility's cost of common equity is the return investors require on an investment in that company. Investors expect to achieve their return by receiving dividends and stock price appreciation. Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow (DCF) method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows.[21] The Risk Premium method assumes that all of the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds.[22] The Capital Asset Pricing Method (CAPM) assumes the investor's required rate of return on equity is equal to a risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio.[23] No one method is any more "correct" than any other method in all circumstances. Analysts balance their use of all three methods to reach a recommended return on equity.

8. In reviewing the various return on equity recommendations, it becomes apparent that the Commission's analysis boils down to: (1) the determination of the

[21] Ex. 1203, pages 13-14.
[22] Ex. 27, page 14.
[23] Ex. 1203, page 32.

appropriate growth rates for use in the various DCF analyses and (2) whether the Commission wants to limit their return on equity analysis to solely DCF methods or whether it wishes to consider the results of the risk premium and CAPM analyses.

<u>GROWTH RATES</u>

9. As previously mentioned, all three experts rely upon analysts' growth rates for use in their initial constant growth DCF. As the Commission found in its recent AmerenUE decision, these analysts' growth rates are currently troublesome in that they are "based on a unsustainably high dividend yield and median growth rate."[24] While the DCF methodology is intended to be perpetual in nature, these underlying analyst growth estimates are only focused on the short-term. As Mr. Gorman explains, therefore, these current short-term growth rates are based upon the expectation of increased earnings resulting from the large construction cycle currently seen in the electric industry. Such growth rates are not reflective of more normalized levels of construction and are therefore not sustainable.[25] Therefore, while the Commission is not willing to completely eliminate the results of the constant growth DCF based upon analysts' growth estimates, it is mindful of the fact that, given current conditions in the electric industry, the results of that analysis are likely to be overstated.

10. In order to avoid the short-term nature of analysts' growth rates, Dr. Hadaway replaces the analysts' growth rates with an estimate of long-term GDP growth. While the use of a long-term GDP growth rate certainly appears more reasonable than the analysts' growth estimates, the GDP growth estimation provided by Dr. Hadaway is troublesome. As pointed out by Mr. Gorman, Dr. Hadaway rejects all recognized

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[24] *Report and Order*, Case No. ER-2010-0036, ("*AmerenUE*") page 21.
[25] Ex. 1203, page 22.

measures of GDP growth and instead provides his own estimate of GDP growth (6.0%)[26] based upon historical average GDP growth rates.[27] In this regard, Dr. Hadaway ignores numerous publicly available estimates of GDP growth.

The Commission is aware of its recent AmerenUE decision in which we stated an obvious preference for the use of publicly available assumptions as opposed to subjective assumptions. The Commission's rationale being that only such publicly available assumptions could be actually relied upon by the investment community in making its market decisions.

> Murray's reliance on analyst reports to support his recommendation is misplaced. ***Most investors do not have access to the specific analyst reports that Murray examined and thus they cannot rely on them in deciding where to invest their money.***[28]

As Mr. Gorman notes, if Dr. Hadaway's subjective estimate of GDP growth (6.0%) is replaced with publicly available estimate of GDP growth (Mr. Gorman uses the 4.75% estimate provided by *Blue Chip Economic Indicators*), the result of Dr. Hadaway's constant growth (GDP) DCF analyses drops from 10.7% to 9.6%.[29] The Commission notes that it has previously expressed concern with Dr. Hadaway's "transparent effort to inflate the company's proposed return on equity."[30] The use of such subjective growth estimates to the complete disregard of publicly available estimates of GDP growth appears to be such a "transparent effort to inflate" the recommended return on equity.

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[26] Ex. 27, page 41.
[27] Ex. 1204, pages 7-8.
[28] *AmerenUE* at page 20, paragraph 18 (emphasis added).
[29] Ex. 1205, page 10.
[30] *Report and Order*, Case No. ER-2007-0004 (issued May 17, 2007).

11. Ultimately, the Commission notes that, simply by replacing his subjective GDP growth estimate with a publicly available GDP growth estimate, Dr. Hadaway's DCF analysis leads to results that fall comfortably within the range recommended by Mr. Gorman (9.4% - 9.9%).

MODEL	HADAWAY RESULT	ADJUSTED HADAWAY RESULT
CONSTANT GROWTH DCF (Analysts' Growth Rates)	10.2 – 10.4%	10.2 – 10.4%
CONSTANT GROWTH DCF (Long-Term GDP Growth Rate)	10.7 – 10.8%	9.5 – 9.6%
TWO-STAGE GROWTH DCF	10.5%	9.4%
AVERAGE	10.5%	9.75%

Source: Exhibit 1205, page 12.

OTHER RETURN ON EQUITY METHODOLOGIES

12. As mentioned, KCPL's return on equity relies exclusively on various versions of the DCF analysis. In contrast, Mr. Gorman conducted and considered the results of his DCF analyses as well as the risk premium and CAPM analysis. Although not as egregious as the situation confronted in the recent AmerenUE decision,[31] the Commission has, at least implicitly, stated a desire to consider the results of other methodologies. Interestingly, Dr. Hadaway initially conducted a risk premium analysis. As contained in his direct testimony, Dr. Hadaway considered the results of the risk premium analysis when it resulted in a return on equity of 10.61% to 10.82%.[32] Given the significant passage of time (six months between filing direct testimony and rebuttal

[31] In that case, the Commission discussed the recommendation provided by AmerenUE that relied solely on the constant growth DCF analysis. Instead of relying simply on a constant growth analysis that relied upon "unsustainably" high growth rates, the Commission also considered the results of other DCF analyses. *AmerenUE* at page 22.

[32] Ex. 27, page 43.

testimony), Dr. Hadaway updated his analysis in his rebuttal testimony.[33] In that testimony, Dr. Hadaway's risk premium analysis decreased significantly to 10.05% to 10.24%.[34] Based upon his belief that "current utility bond yields are artificially depressed by government monetary policy," Dr. Hadaway decided to "discount these results."[35] Based upon his stated range of 10.2% - 10.8%,[36] it is apparent that Dr. Hadaway did not only discount such results, he ignored them completely. Furthermore, it is noticeable that Dr. Hadaway did not elaborate on the government monetary policies that were not in effect at the time he considered the risk premium results in his direct testimony that suddenly went into effect by the time he "discounted" the results in his rebuttal testimony.

13. Just as the Commission believes it appropriate to consider the results of the constant growth DCF analysis based upon unsustainable analysts' growth estimates, it also believes that it should consider the results of the risk premium and CAPM analyses. In this light, the Commission notes that Mr. Gorman's risk premium analysis results in a return on equity of 9.68%[37] and a CAPM result of 9.40%.[38] Given the foregoing analysis, the Commission again finds that the return on equity range recommended by Mr. Gorman (9.40% - 9.90%) to be the "balanced analysis that the Commission seeks."[39]

14. While the Commission believes that it fulfills the requirements of *Hope*[40] and *Bluefield*[41] through the comparable company analysis, it is also cognizant of the

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[33] Ex. 28, page 22.
[34] *Id.* at page 23.
[35] *Id.*
[36] *Id.*
[37] Ex. 1203, page 32.
[38] *Id.*
[39] *Report and Order*, Case No. ER-2007-0004, issued May 17, 2007.
[40] *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).
[41] *Bluefield Waterworks & Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692 (U.S. 1923).

requirement that any awarded return on equity be "equal to that generally being made at the same time ***<u>and in the same general part of the country</u>*** on investments in other business undertakings which are attended by corresponding risks and uncertainties.[42] With this in mind, the Commission notes that it awarded a return on equity of 10.1% for AmerenUE in an order issued May 28, 2011. Furthermore, the Commission is aware that the Kansas Corporation Commission awarded KCPL a return on equity of 10.0% in a decision dated November 22, 2011.[43] These two decisions are insightful in that they both involve utilities operating in the "same general part of the country." Furthermore, the AmerenUE decision is relevant because it is a utility operating in Missouri and, given the similar business environment and policies implemented by the Missouri Commission, has "corresponding risks and uncertainties." Similarly, given that the Kansas decision involves the exact same utility as being considered by this Commission, it obviously constitutes "corresponding risks and uncertainties."

The Commission must also consider the change in market conditions that have occurred in the past 10 months since the issuance of the AmerenUE decision. Along these lines, what is important to realize is that bond yields are still lower than at the time the Commission issued the Ameren decision. As Mr. Gorman explains, "capital market costs have decreased in the range of 20 to 30 basis points since that time."[44] Thus, all else being equal, a 10.1% return on equity in May should equate to a 9.8 to 9.9% return on equity today. Therefore, these two recent decisions involving utilities of

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[42] *Id.* at 692 (emphasis added).

[43] *Order Addressing Prudence, Approving Application, in part, and Ruling on Pending Requests*, Docket No. 10-KCPE-415-RTS, 2010 Kan. PUC Lexis 1132 (Kansas Corporation Commission, issued November 22, 2010).

[44] Tr. 2853 and 2879.

"corresponding risks and uncertainties" are consistent with the range recommended by Mr. Gorman.

15. As indicated, KCPL / GMO ask that the Commission set its return on equity at the upper half of the recommended range of return on equity "to reflect the Company's reliability and customer satisfaction achievements."[45] In its Direct Testimony, KCPL / GMO allege heightened customer satisfaction and reliability. In support of this claim, KCPL / GMO reference the Commission to an annual Edison Electric Institute Reliability Survey and recent JD Power awards.

16. Evidence provided by Staff, however, provides real world evidence that KCPL / GMO's performance is the lowest among the Missouri electric utilities. As Staff Witness Kremer pointed out, while KCPL's current rating is 655, this represents a dramatic decrease from the 697 score received in just 2007.[46] Furthermore, Ms. Kremer pointed out during cross examination that KCPL's customer satisfaction, as measured by Commission complaints is the worst in the state.

> And KCPL from 2008, 2009, 2010, if I calculated this correctly, they are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase. ***But KCPL dramatic increase in customer complaints***.[47]

Certainly this evidence is not reflective of a utility with high customer satisfaction. Given the "dramatic increase in customer complaints," KCPL has not justified its request for a return on equity at the high end of the recommended range.

17. Based upon its consideration of the testimony of all the experts, and consistent with the findings expressed herein, the Commission finds that a reasonable

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[45] Ex. 7, page 10.
[46] Tr. 2960-2961.
[47] Tr. 2962.

range of return on equity is 9.40% to 9.90% with an awarded return on equity of 9.65%. That is the return on equity recommended by Mr. Gorman and the Commission finds that Mr. Gorman was the most credible and reliable expert witness. However, 9.65% is a reasonable return on equity aside from the fact that it happens to match the recommendation of one of the witnesses. The Commission's decision to use the return on equity recommended by Mr. Gorman should not be taken to disparage the credibility of the other witnesses.

B. CONCLUSIONS OF LAW

A. In assessing the Commission's ability to use different methodologies to determine just and reasonable rates, the Missouri Court of Appeals has said:

> Because ratemaking is not an exact science, the utilization of different formulas is sometimes necessary. … The Supreme Court of Arkansas, in dealing with this issue, stated that there is no 'judicial mandate requiring the Commission to take the same approach to every rate application or even to consecutive applications by the same utility, when the commission in its expertise, determines that its previous methods are unsound or inappropriate to the particular application' (quoting *Southwestern Bell Telephone Company v. Arkansas Public Service Commission,* 593 S.W. 2d 434 (Ark 1980).[48]

Furthermore,

> Not only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses' testimony.[49]

B. In another case, the Court of Appeals recognized that the establishment of an appropriate rate of return is not a "precise science":

> While rate of return is the result of a straight forward mathematic calculation, the inputs, particularly regarding the cost of common equity, are not a matter of 'precise science,' because inferences must be made about the cost of equity, which involves an estimation of investor expectations. In other words, some amount of speculation is inherent in

[48] *State ex rel. Assoc. Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880 (Mo.App. W.D. 1985).
[49] *Id.*

> any ratemaking decision to the extent that it is based on capital structure, because such decisions are forward-looking and rely, in part, on the accuracy of financial and market forecasts.[50]

DECISION:

Based on the evidence in the record, on its analysis of the expert testimony offered by the parties, and on its balancing of the interests of the company's ratepayers and shareholders, as fully explained in its findings of fact and conclusions of law, the Commission finds that 9.65 percent is a fair and reasonable return on equity for KCPL and GMO. The Commission finds that this rate of return will allow KCPL and GMO to compete in the capital market for the funds needed to maintain their financial health.

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[50] *State ex rel. Missouri Gas Energy v. Public Service Commission*, 186 S.W.3d 376, 383 (Mo.App. W.D. 2005).

III. OFF-SYSTEM SALES MARGINS

1. This issue concerns the appropriate method and level for setting off-system sales margins. All parties to this case recommend that the Commission set off-system margins based upon a forecasted model. In fact, all parties rely upon the same model and analysis conducted by KCPL's witness Schnitzer. While KCPL recommends that the Commission continue to set off-system sales margins using the 25th percentile of Schnitzer's true-up analysis, Staff asserts that the Commission should utilize the 40th percentile of that same analysis. MEUA recommends, in light of some claimed flaws in the assumptions of the true-up analysis, that the Commission utilize the 40th percentile of the Schnitzer analysis provided in Direct Testimony.

2. This issue was first presented to the Commission in the context of KCPL's 2006 rate case. In that order, the Commission set off-system sales margins at the 25th percentile. The rationale for that Commission decision appeared to be based upon: (1) the fact that off-system sales margins constituted over 50% of KCPL's total earnings[51] and (2) the large construction program that KCPL was implementing under the Regulatory Plan.[52] Given the large capital commitments KCPL had made under the Regulatory Plan, the implications of KCPL not reaching the same level of off-system sales margins was increasingly risky.[53]

3. With the completion of the construction projects called for in the Regulatory Plan, Staff and MEUA assert that the Commission should set heightened expectations for KCPL to perform in the wholesale market. In contrast, KCPL's proposal to continue to use the 25th percentile is based upon the fact that this level is "consistent

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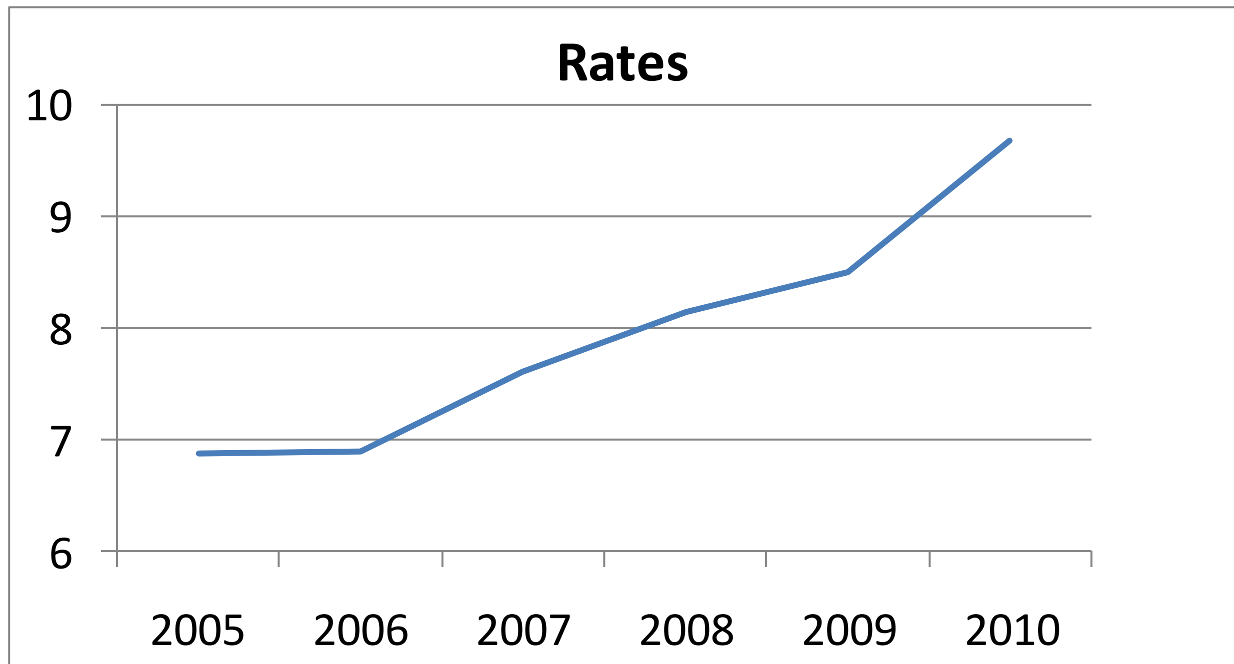
[51] *Report and Order*, Case No. ER-2006-0314, issued December 22, 2006, at page 31.
[52] *Id.* at page 34.
[53] *Id.* at page 35.

with the Commission's orders in KCP&L's last three cases."[54] In fact, KCPL readily admits that the completion of the Regulatory Plan was not even considered in its determination of the appropriate point to set off-system sales margins.[55]

4. The evidence presented in this case regarding KCPL's recent performance in the wholesale market is troubling. As MEUA points out, KCPL's retail rates have increased dramatically in the last five years.



Source: Ex. 215, page 46.

While this increase in retail rates has undoubtedly been affected by the construction projects in the Regulatory Plan, it is also unquestioned that they have been affected, at least in part, by KCPL's decreased profits in the wholesale market. As the following chart indicates, KCPL's off-system sales margins have decreased dramatically during that same timeframe.

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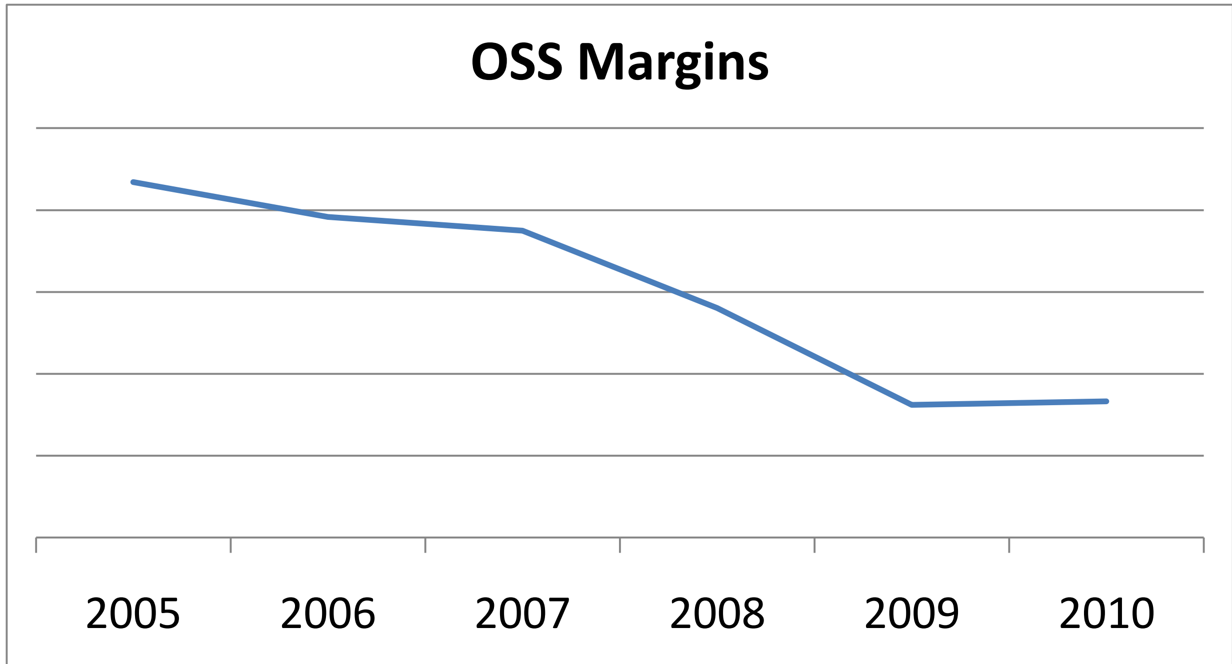
[54] Ex. 7, page 10.
[55] Tr. 3371.



Source: Ex. 1210

5. While this slip in KCPL's wholesale performance may be blamed in part on the decrease in natural gas prices and the attendant decrease in wholesale market prices, the undisputed evidence also indicates that the slip in KCPL's performance has coincided with two regulatory decisions. First, in 2006, KCPL recommended and the Kansas Commission adopted a different jurisdictional allocator for off-system sales margins. Second, as indicated, at the same time, this Commission set lower expectations for KCPL by setting rates based upon the 25th percentile and returning any additional margins through a tracking mechanism.

6. Prior to 2006, Kansas and Missouri both allocated off-system sales margins on the basis of the energy allocator. Through the use of the same allocator, a consistent allocation was assured between Missouri and Kansas. In 2006, KCPL proposed the use of the unused energy allocator in Kansas and Missouri.[56] Because this

[56] Tr. 3365.

methodology allocated a greater percentage of off-system margins to Kansas, the Kansas Commission adopted the proposed methodology.[57] This Commission, however, found the unused energy allocator to be problematic.

> A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the unused energy allocator rewards the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that jurisdiction. Load Factor is average energy usage divided by peak demand. The higher the load factor, the closer the average load is to peak demand. The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales.[58]

Thus, while Kansas moved to the unused energy allocator, Missouri continued to use the energy allocator.

7. Interestingly, KCPL now recognizes the same flaws in the unused energy allocator expressed by this Commission in its 2006 Order. As KCPL's witness in Kansas recently acknowledged:

> I believe that KCP&L proposed the unused energy allocator without sufficient study of its implications and reasonableness. Since the unused energy allocator allocates more off-system sales margins (and hence, lower overall costs) to the Kansas jurisdiction, the other parties may not have devoted the resources to study its reasonableness. Based on the analysis that I present here, I believe that the unused energy allocator is not an appropriate method for allocating off-system sales margins.[59]

Given the flawed nature of the unused energy allocator, KCPL asked the Kansas Commission to discontinue its use. The Kansas Commission recognized, however, the

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[57] *Id.*

[58] *Id.* at pages 38-39. The Missouri Commission also found that the unused energy allocator creates a disincentive for demand side management programs which are "aimed at increasing load factor" and ignores the fact that fuel costs, the primary component of off-system sales, are allocated via the energy allocator. (*Id.*).

[59] Tr. 3367-3368.

beneficial nature of the unused energy allocator to Kansas ratepayers.[60] As such, the Kansas Commission recently rejected KCPL's request to eliminate the unused energy allocator.[61]

8. The practical effect of the different allocators in Missouri and Kansas is not inconsequential. As KCPL witnesses testified, this difference, caused by KCPL proposing the unused energy allocator "without sufficient study," has now created a disincentive for KCPL to engage in off-system sales.

> By that, I mean that for every dollar of off-system sales margin that the Company makes from selling off-system sales, it costs the Company one dollar and five cents, or a loss of five cents on the dollar. ***This does not make any sense, and serves as an economic disincentive for the Company to pursue off-system sales.***[62]

Therefore, as a result of proposing the unused-energy allocator in Kansas, and KCPL's inability to subsequently convince the KCC that its continued use is inappropriate, KCPL must now return $1.05 for every dollar that it makes in the wholesale market. This has created a financial disincentive to participate in the wholesale market. Not surprisingly, as a result of this financial disincentive, KCPL's performance in the wholesale market has slipped dramatically in the last five years.

9. Furthermore, it is important to realize that nothing this Commission does in this case can remedy the different allocators used by the states. As indicated, the Kansas Commission has recently adopted the unused energy allocator again.

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[60] Elimination of the unused energy allocator would reduce the allocation of off-system sales margins from 47.70% to 45.64%. *Order: 1) Addressing Prudence; 2) Approving Application, In Part; and 3) Ruling on Pending Requests*, Case No. 10-KCPL-415-RTS, page 126 (Kansas Corporation Commission, issued November 22, 2010).

[61] *Id.* at page 127.

[62] Tr. 3367 (emphasis added). See also, Exhibit 7, Blanc Rebuttal, page 46 ("Because Missouri and Kansas adopt different allocation methodologies to derive what portion of the margins KCP&L's Kansas and Missouri customers should receive, KCP&L presently gives to its customers about 105% of its off-system sales margins. That is punitive and should stop, but requires this Commission and the KCC to adopt the same allocation methodology, which to date they have chosen not to do.").

Furthermore, KCPL has agreed to the continued use of the energy allocator in Missouri.[63] Therefore, for the indefinite future, there will continue to exist a difference in allocation methodologies between Missouri and Kansas.

10. The second regulatory decision that affected KCPL's performance in the wholesale market was this Commission's decision to decrease its expectations for KCPL in the wholesale market and set rates using the 25th percentile. As the 2006 order indicates:

> The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case.[64]

Ultimately, the Commission's use of the 25th percentile signaled to KCPL that the Commission did not expect KCPL to perform in the wholesale market at levels consistent with history.

In that case, the Commission believed that the use of the 25th percentile would result in "a fairly substantial chance that KCPL will meet or exceed that 25th percentile."[65] The Commission, however, was not aware and failed to account for the disincentives caused by KCPL proposing the unused energy allocator in Kansas "without sufficient study." Thus, while KCPL would ordinarily be expected to exceed the 25th percentile 3 out of every 4 years, and exceed the 50th percentile every other year, the lower expectations in conjunction with the financial disincentive now existing for KCPL

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[63] See, *Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues*, filed February 3, 2011, at page 5 ("Staffs energy allocator of 56.94% shall be used for allocating off-system sales margins to the Missouri jurisdiction.").

[64] *2006 Order* at page 33, as modified by *Order Regarding Motions for Rehearing*, issued January 18, 2007, at pages 2-3.

[65] *Id.* at page 34.

meant that KCPL had no motivation to perform above the threshold level established by this Commission. Thus, it is not surprising that KCPL has continually only achieved the level set by this Commission.

11. Given the financial disincentive and the low expectations set by the Missouri Commission, KCPL has only participated in the wholesale market to the levels expected by this Commission. Despite the "fairly substantial chance" envisioned by the Commission in 2006, as the following chart indicates, additional margins never fully materialized.

KCPL'S RECENT OFF-SYSTEM SALES PERFORMANCE	
Case No. ER-2006-0314	Set at 25th percentile: **__________**
	Achieved: **__________**
Case No. ER-2007-0291	Set at 25th percentile: **__________ **
	Achieved: **__________**
Case No. ER-2009-0089	Set by Stipulation at: **__________**
	Achieved: **__________**

Source: Ex. 7, Blanc Direct, pages 12-13 and Exhibit 1209.

12. The interesting part of KCPL's recent performance, however, is that it has demonstrated the ability to achieve increased levels of off-system sales margins when expectations are increased. As the chart indicates, expected levels of off-system sales margins in the 2006 and 2007 cases were both set at the 25th percentile. KCPL's performance achieved this level, but the prospect of significantly more off-system sales never materialized. In 2009, however, KCPL agreed to a specified level of off-system sales to include in rates. The evidence indicates that this specified level of off-system

sales was equivalent to the 44.5 percentile. Despite the increased expectations, the evidence indicates that KCPL achieved and even slightly exceeded this level of off-system margins. Thus, KCPL's recent performance indicates that, when expectations are increased, KCPL is capable of overcoming the financial disincentives and earn increased profits in the wholesale market.

13. Fortunately, the reasons for once setting rates at the 25th percentile are no longer applicable. The evidence indicates that both reasons provided by the Commission in the 2006 order are no longer in existence. For instance, off-system sales margins no longer comprise such a significant portion of KCPL's overall earnings. Where off-system sales margins once represented over 60% of KCPL's earnings, today those margins barely make up 20% of KCPL's earnings.

OFF-SYSTEM SALES AS A PERCENTAGE OF KCPL EARNINGS			
	Earnings	Off-System Sales Margins	Percentage
2005	$144 million	**__________**	60.31%
2006	$149 million	**__________**	52.55%
2007	$157 million	**__________**	47.75%
2008	$125 million	**__________**	44.84%
2009	$129 million	**__________**	25.14%
2010	$163 million	**__________**	20.41%

Source: Earnings: Ex. 1212 (years 2005-2009) and Ex. 1213 (year 2010)
Off-System Margins: Ex. 1210 (years 2005-2009) and Ex. 1209 (year 2010)

14. Furthermore, KCPL no longer faces the capital pressures associated with the construction projects in the Regulatory Plan. As can be seen from the following chart, at various points during the Regulatory Plan, KCPL's five year capital expenditures

were expected to more than double KCPL's existing plant in-service. Today, however, projected capital expenditures have returned to more normal levels.

KCPL CAPITAL EXPENDITURES			
	Plant Balance	5 Year Capital Expenditures	Percentage
2005	$2.63 Billion	**__________**	82.55%
2006	$2.81 Billion	**__________**	95.02%
2007	$2.84 Billion	**__________**	129.71%
2008	$2.92 Billion	**__________**	117.90%
2009	$3.34 Billion	**__________**	71.12%

Source: Plant Balances: Exhibit 1215
Capital Expenditures: Exhibit 1211

15. As can be seen, then, the reasons for setting rates at the 25th percentile are no longer applicable. The Commission cannot fix the disincentives caused by the varying allocation methodology that exists between Missouri and Kansas. The Kansas Commission has again approved the continued use of the flawed unused energy allocator, and the parties to this case have agreed to the continued use of the energy allocator in Missouri. That said, however, much as KCPL voluntarily did in its last case, the Commission can increase its expectations for KCPL in the wholesale market and require it to overcome its financial disincentives. For this reason, the Commission agrees with Staff and MEUA's request to set rates using the 40th percentile.

16. The evidence indicates that the 40th percentile recommendation: (1) will cause KCPL to participate more fully in the wholesale market and (2) is still conservative in that it is readily achievable. In fact, the evidence shows that the use of the 40th percentile is actually a slight step backwards from the expectations agreed to by KCPL in

the Stipulation from the last case. As previously indicated, in the Stipulation and Agreement in the last case, KCPL expressly agreed to setting rates based upon the 44.5 percentile.[66] Ultimately, KCPL was able to meet these heightened expectations.[67] As such, KCPL has demonstrated that it is able to achieve more in the wholesale market when more is expected and required. While the use of the 40th percentile constitutes a small step backwards, it still appears to be reasonable.

17. The 40th percentile is also conservative and easily achievable in that it represents a point where KCPL has a better than equal probability of meeting or exceeding expectations. While the median point (50th percentile) provides an equal opportunity to exceed or fall short, the 40th percentile provides KCPL a 60% probability of exceeding.[68] Therefore, by pure statistics, MEUA's recommendation is conservative and easily achievable.

18. In addition, the 40th percentile is the appropriate amount of off-system sales margins to include in rates because it represents the single most likely outcome of the Schnitzer analysis. As shown in Schnitzer's testimony, the possible outcomes of his analysis form a bell curve.[69] In this case, the "single most likely outcome" is the result represented by the 40th percentile.[70]

19. Finally, it is important to note that, unlike in previous years, the Commission will not have an immediate opportunity to correct its low expectations. As a result of the Regulatory Plan, KCPL was scheduled to file annual rate cases.[71] Given

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[66] Ex. 121, page 3.
[67] Ex. 1209.
[68] Ex. 1216, Meyer True-Up Rebuttal, page 9.
[69] Ex. 58, Schnitzer Direct, Schedule MMS2010-3.
[70] Ex. 121, page 2.
[71] Tr. 3372.

this, the Commission was assured that it would have an opportunity within a year, to fix the level of off-system sales margins. With the completion of the Regulatory Plan, KCPL has stated that it has no definite plans for its next rate case.[72] As such, it is critical that the Commission use this opportunity to increase expectations and provide relief to the ratepayers.

20. Having decided on the 40th percentile, the Commission must choose between the Schnitzer's true-up analysis, as advocated by Staff, or the analysis contained in Mr. Schnitzer's Direct Testimony as recommended by MEUA. MEUA has alleged two fundamental problems with the assumptions provided by KCPL to Mr. Schnitzer for use in his true-up analysis. First, MEUA notes that KCPL assumed a higher than expected amount of planned outages. Effectively, by having the model assume that its baseload units are unavailable due to a planned outage, the model will be unable to model any off-system sales from that unit. In its true-up testimony, MEUA compared the level of planned outages in the KCPL model against KCPL's actual planned outage schedule.[73] By comparing to the actual KCPL planned outage schedule, it became apparent that KCPL's assumed level of planned outages in the Schnitzer model is inflated.

21. Second, MEUA expressed concerns with KCPL's level of Firm Load Obligations in the Schnitzer model. In making this determination, MEUA compared KCPL's Firm Load Obligation in its off-system sales model against the actual firm load obligation contained in the KCPL fuel model. Again, KCPL's assumption in its wholesale model is unnecessarily high. As Mr. Meyer explains, "by causing the off-system sales model to believe that these units are needed to provide energy for native

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[72] Tr. 3373.

[73] Ex. 1216, Meyer True-Up Rebuttal, Schedule GRM-TU-2 (pages 1 and 2).

load that does not truly exist, KCPL has artificially lowered the projected off-system sales margins."[74] While it raises some question whether MEUA properly considered the impact of spinning reserves, KCPL acknowledges that at least a portion of MEUA's claim is appropriate. Therefore, by KCPL's own admission, the Firm Load Obligation in the Schnitzer model is inflated.

22. Given the acknowledged flaws in the assumptions provided by KCPL to Mr. Schnitzer for use in his True-Up Analysis, the Commission agrees that Mr. Schnitzer's Direct Testimony analysis is the appropriate model to use in this case. Furthermore, as previously held, the Commission believes that the 40th percentile is the appropriate point in that model to set retail rates. For all these reasons, the Commission finds that it will include in retail rates a level of off-system sales margins of **_____ ______**.

[74] Ex. 1216, Meyer True-Up Rebuttal, page 7.

IV. OFF-SYSTEM SALES ADUSTMENTS

1. Once the Commission establishes an appropriate level of off-system sales margins based upon Schnitzer's forecasted analysis, it must consider three adjustments that KCPL asserts should be made to that level of off-system margins. Each of these three adjustments serves to reduce the expected level of off-system margins. Specifically, KCPL makes adjustments associated with: (1) SPP Line Loss Charges; (2) Purchases for Resale; and (3) Revenue Neutrality Uplift Charges.

SPP LINE LOSS CHARGES

2. Through its SPP Line Loss adjustment, KCPL attempts to account for the fact that it is charged a line loss charge by SPP for any wholesale transactions that occur outside the SPP footprint.[75] On the other hand, Staff and MEUA oppose the KCPL adjustment on the basis that it only attempts to recognize the line loss charge, but fails to account for the revenues that will be associated with these transactions outside the SPP footprint.[76]

3. In undertaking his analysis, Mr. Schnitzer assumes that all off-system sales will occur within the SPP region.[77] In reality, however, KCPL makes wholesale transactions outside of the SPP region. As such, the Schnitzer model fails to account for any of the increased costs ***and revenues*** that occur as a result of transactions which occur outside of SPP.

4. Through its adjustment, KCPL proposes to only recognize the cost side of any transactions which occur outside of the SPP region. KCPL fails to account for the

[75] Ex. 15, pages 14-15.
[76] Ex. 1201, pages 6-8.
[77] Tr. 3307.

fact that, in addition to the cost, there are increased revenues associated with these transactions as well.[78] As Mr. Meyer explains:

> To the extent that KCPL makes an OSS outside of the SPP footprint, KCPL should receive a premium above the SPP-North market prices to offset the additional transmission charge that will be charged to KCPL. If KCPL didn't receive such a premium, then it would not make the sale and would avoid the associated loss charge.[79]

5. KCPL has not disputed that these additional revenues are a fact. Rather, KCPL simply fails to account for these revenues. These revenues, however, are a fact that must be accounted for in conjunction with the associated cost.

> If the sale outside the SPP footprint did not cover the additional SPP line loss charges, KCPL would be better to forego these sales and instead sell their excess power within the SPP footprint. In such a situation, the OSS margin generated from a sale inside the SPP footprint would generate greater margins. Therefore, before KCPL makes an OSS outside the SPP footprint, it should verify that the price (revenues) received for the sale will recover the SPP line loss charges which will be assess to that sale. If KCPL cannot meet that threshold, then KCPL should sell its power inside the SPP footprint as modeled by Mr. Schnitzer.[80]

6. The Commission finds that, while the SPP line loss charges actually occur, it is inappropriate to simply reflect the cost associated with these sales without also reflecting the increased price that KCPL will receive from these sales."[81] In fact, as Mr. Meyer notes, the increased revenues for these sales outside the SPP footprint should exceed this line loss charge. Otherwise, "KCPL would be better to forego these sales and instead sell their excess power within the SPP footprint."[82] Given its incomplete nature, the KCPL adjustment should be rejected.

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[78] *Id.*
[79] *Id.* at pages 7-8.
[80] Ex. 1202, Meyer Surrebuttal, page 4.
[81] *Id.*
[82] *Id.*

PURCHASES FOR RESALE

7. KCPL also proposes a reduction in off-system sales margins to account for the loss it incurs when it makes a bilateral purchase and subsequently sells a portion of the purchased energy in the wholesale market at a loss.[83] While MEUA does not contest that KCPL may incur a loss associated with the sale of the energy in the wholesale market, KCPL's adjustment ignores the gain that occurs when KCPL makes the initial purchase. Given that KCPL's adjustment attempts to separate the loss from the gain, MEUA claims that it should be rejected.

8. In his direct testimony, Mr. Meyer provides an excellent example that demonstrates KCPL's proposed adjustment as well as the underlying transaction.[84] KCPL needs to purchase 100 MWs of power to meet its peak load requirements from 2:00 p.m. to 6:00 p.m. KCPL can fulfill that power need by purchasing 4 hours of 100 MWs at $90 per MW. Thus the total cost would be $36,000.[85] A cheaper alternative exists by which KCPL can purchase 100 MWs for 8 hours (from 2:00 p.m. until 10:00 p.m.) for $40 per MW. Recognizing that this alternative only costs $32,000,[86] KCPL makes the 8 hour transaction.

Since KCPL does not need this power during the other four hours (6:00 p.m. until 10:00 p.m.), KCPL sells the extra power into the SPP market at $35 / MW. Ultimately, the KCPL fuel model does not include the $40 / MW actual cost, but instead reflects the $90 market price for the 4 hours that power was needed. As such, the practical effect of

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[83] Ex. 1201, page 9.
[84] Ex. 1201, Meyer Direct, page 10.
[85] $90 / MW * 100 MWs * 4 hours = $36,000.
[86] $40 / MW * 100 MWs * 8 hours = $32,000.

this transaction is that there is a $50 gain for every MW of power purchased during the peak 4 hour period. Therefore, the total gain is $20,000.[87]

On the other hand, there is a small loss associated with the sale of the extra power during the non-peak hours at a price that was less than the purchase price. This loss of $5 / MW for every MW of power sold is a result of purchasing the power at $40 and selling it at $35. Therefore, the attendant loss is $2,000.[88]

9. By its adjustment, KCPL asks ratepayers to compensate it, through a reduction in off-system sales, for the $2,000 of loss. KCPL forgets to consider, however, that there is an offsetting $20,000 gain to the same transaction. MEUA does not dispute that KCPL should be compensated for such loss, but asserts that KCPL is compensated by keeping the entirety of the gain. As Mr. Meyer explains:

> Through its adjustment, KCPL is attempting to separate the loss from the gain. KCPL effectively proposes that the gain remain with the shareholders, but that it be allowed to recover the loss (in this example, $2,000) from ratepayers by reducing Mr. Schnitzer's OSS margin levels. This adjustment should not be recognized because there is no consideration given to the savings generated by the purchase during the peak hours. Since KCPL does not operate under a fuel adjustment clause, any savings that it recognizes in fuel and purchase power expense, relative to the cost built into rates, will inure directly to the benefit of its shareholders. Historically, KCPL shareholders would receive the net benefit (i.e., the gain portion less the loss portion). By this adjustment, however, KCPL wants to separate the gain portion of the transaction from the loss portion of the transaction.

10. KCPL's proposed adjustment is decidedly one-sided. Specifically, the adjustment seeks to allocate the gain and assign it to the shareholders while subsequently saddling the ratepayers with the loss. For this reason, the Commission rejects KCPL's proposed adjustment.

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[87] $50 / MW savings * 100 MWs * 4 hours = $20,000
[88] $5 / MW * 100 hours * 4 hours = $2000.

REVENUE NEUTRALITY UPLIFT CHARGES

11. By way of its association with SPP, KCPL incurs certain revenue neutrality charges and revenues. Specifically, when SPP settles the energy imbalance market, SPP does not always collect the exact amount of revenues needed to disburse back to market participants. If SPP is short, then a charge is imposed on market participants. If SPP has collected too much, a credit is given to market participants. KCPL proposes to record any charge as purchased power expense and any credit as OSS revenue.[89] In contrast, MEUA claims that KCPL's proposed adjustment is not related to off-system sales. Rather, KCPL incurs these charges whether it engages in any off-system sales. In essence, KCPL will incur these charges simply because of its association with SPP.

12. As Mr. Meyer explains, "the settlement of the Energy Imbalance Service market is more related to native load circumstances and not driven by OSS. Energy to serve native load is clearly greater than energy needed to make OSS, and it is that energy that creates the Energy Imbalance Service market."[90] Given this, these revenue neutrality uplift charges should <u>not</u> be considered as an adjustment to off-system sales margins, but rather as a cost of KCPL's annualized fuel expense.[91]

13. The reason underlying KCPL's adjustment is its desire to continually expand the scope of its various tracker mechanisms to include new costs. In this case, KCPL does not have a fuel adjustment clause. Therefore, KCPL seeks to include these

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[89] Ex. 1201, Meyer Direct, page 12.
[90] Exhibit 1202, Meyer Surrebuttal, page 8.
[91] Ex. 1201, Meyer Direct, page 12. ("I am proposing that these net costs be included in annualized fuel expense and not reflected as a reduction to KCPL's OSS margins). See also, Exhibit 1202, Meyer Surrebuttal, page 7.

costs that are more properly associated with fuel and purchased power and include them in the off-system sales tracker.

> By reducing OSS margins for [revenue neutrality uplift] charges, KCPL is seeking to have a component of fuel expense tracked and its fluctuations captured in between rate cases. This is not a proper expense item to offset OSS margins. I continue to support placing this level of expense in base rates and not reduce OSS margins.[92]

14. The Commission finds that KCPL's proposed adjustment is not related to off-system sales, but is incurred for the purpose of serving native load. As such, these neutrality revenues and charges should be considered in the fuel normalization model. KCPL's adjustment is simply an attempt to expand the scope of the off-system sales tracker to include aspects of fuel that KCPL is not allowed to track because it does not have a fuel adjustment clause. The Commission finds KCPL's proposed adjustment is not appropriate.

[92] Exhibit 1202, Meyer Surrebuttal, pages 8-9.

<u>V. MERGER TRANSITION COSTS</u>

1. In July of 2008, the Commission approved the acquisition of Aquila by Great Plains Energy.[93] In consummating that transaction, Great Plains Energy incurred certain costs. These costs have been labeled as either transaction costs of transition costs. As described by KCPL, "transaction costs include investment bankers' fees, as well as consulting and legal fees associated with the evaluation, bid, negotiation and structure of the transaction."[94] Transition costs, on the other hand, are "costs incurred to successfully coordinate and integrate the utility operations of KCP&L and GMO. . . These costs include non-executive severance costs for employees terminated as a result of the merger, facilities integration costs, and incremental third-party and other non-labor expenses incurred to support the integration of the companies."[95]

2. In that Report and Order, the Commission expressly precluded any recovery of transaction costs.[96] Pertaining to transition costs, however, the Commission left open the possibility of future recovery of these costs.

> The Commission will give consideration to their [transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCPL and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.[97]

While leaving the possibility for future recovery, the Commission expressly reserved that decision for a "later proceeding."

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[93] See, *Report and Order*, Case No. EM-2007-0374 (issued July 1, 2008).
[94] Ives Direct, Ex. 35, page 6.
[95] *Report and Order*, Case No. EM-2007-0374, at page 4.
[96] *Id.* at pages 239-240.
[97] *Id.* at page 241, footnote 930.

> Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.[98]
>
> The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.[99]

3. In its testimony, KCPL / GMO assert that, so long as synergy savings exceed transition costs, and those costs are found to be reasonable and prudent, the Commission is bound to allow recovery. On the other hand, Staff and MEUA argue that the shareholders' retention of synergy savings resulting from regulatory lag has greatly exceeded transition costs. Therefore, KCPL / GMO have already recovered these transition costs. In additional recovery would be unreasonable and inequitable.

4. Given the statutory scheme in place in Missouri, it is well established that there is a lag between when a cost or revenue is incurred and when that cost or revenue is reflected in rates. This is known as regulatory lag.[100] As a result of regulatory lag, if a utility experiences a cost decrease, there is a lag in time until that reduced cost is reflected in rates. During that lag, the Company shareholders reap, in the form of increased earnings, the entirety of the benefit associated with reduced costs.

5. In the case at hand, KCPL / GMO began to synergy savings, in the form of reduced costs, immediately upon the closing of the acquisition. Given that KCPL and GMO did not have its next rate case completed until September 1, 2009, the Great Plains shareholders retained the entirety of these synergy savings for that 14 month period of time. In fact, the following KCPL document clearly reflects the Company's clear understanding of the benefits to shareholders associated with the application of regulatory lag to synergy savings.

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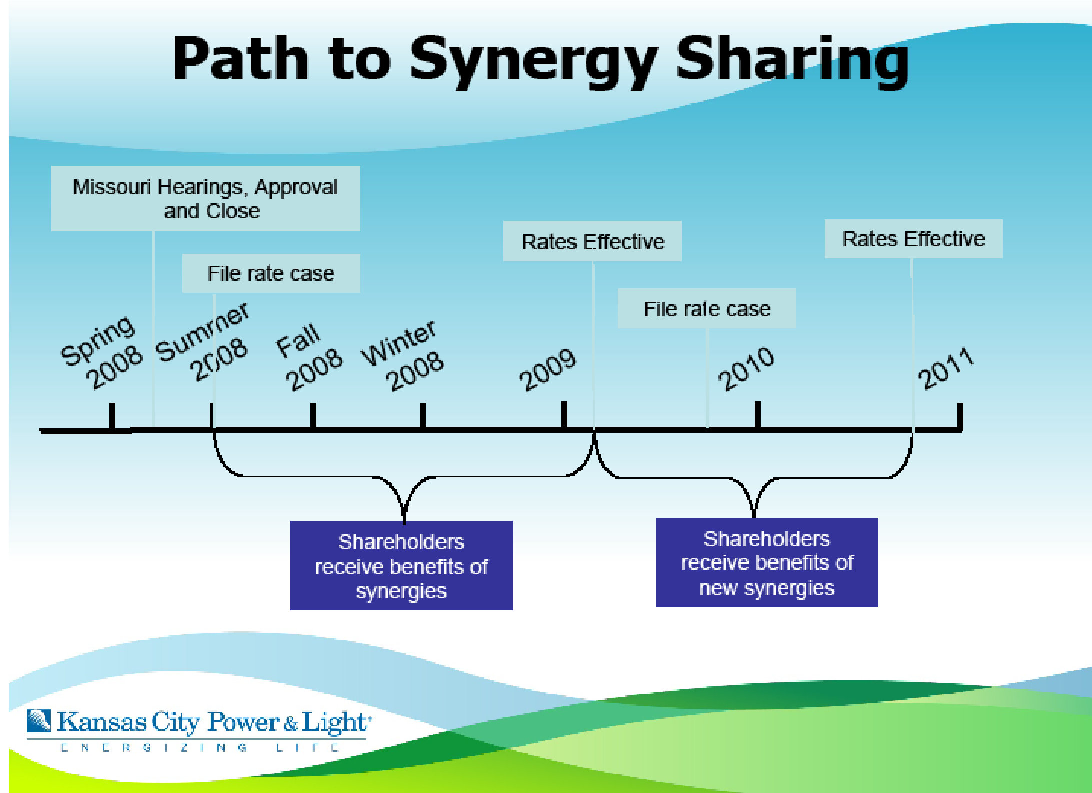
[98] *Id.* at page 284.
[99] *Id.*
[100] Ex. 210, Staff Cost of Service Report, page 190.



Source: Ex. 230, Majors Rebuttal, Schedule 1-3.

Thus, for the period of time between the incurrence of a synergy saving and the reflection of that reduced cost in rates, the shareholders received the entirety of the benefits.

6. In the case at hand, KCPL / GMO quantify that, as of September 1, 2009, they had already realized over $59.3 million in synergy savings.[101] For this period of time, shareholders received the entirety of this benefit. Furthermore, KCPL / GMO estimate that, as of June 30, 2010, they have realized approximately $121 million in retained synergy savings.[102] Finally, KCPL / GMO project total synergy savings through 2013 of $344 million.[103] Of that amount, KCPL / GMO project that ratepayers will only

[101] Ex. 230, Majors Rebuttal, page 12.
[102] *Id.* at page 9.
[103] *Id.* at page 14.

receive $150 million.[104] Therefore, over $194 million of synergy savings will be retained solely by KCPL / GMO shareholders.[105]

7. It is important to note that KCPL / GMO have not disputed any of these figures. In fact, as indicated, each of these estimates and projections were taken directly from Company documents. Nevertheless, KCPL / GMO assert that shareholders should receive even more and that ratepayers should pay the $51.8 million of transition costs.

8. The Commission disagrees. The evidence conclusively shows that KCPL / GMO shareholders have benefitted greatly from regulatory lag and that attendant retention of synergy savings. In fact, as of September 1, 2009, KCPL / GMO shareholders have already retained synergy savings that would exceed the requested level of transition costs. These shareholders will continue to benefit from these retained synergies. Ultimately, these retained synergies will dwarf the level of transition costs. Given that shareholders have already recovered these costs, it would be unreasonable to impose these costs on ratepayers.

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[104] *Id.*
[105] *Id.*

VI. RATE CASE EXPENSE

1. In this case, KCPL / GMO seek recovery of over $7 million of rate case expense. As the Company readily admits, this amount was incurred as of December 30, 2010. The Company projects an additional $6.1 million in rate case expense after the close of the true-up period.[106] KCPL / GMO ask that it be allowed to recover the entirety of these costs from ratepayers. In response, Staff and MEUA propose to disallow a certain portion of those costs. Specifically, Staff proposes specific disallowances in the amount of $1.2 million with the remaining amount amortized over 2 years.[107] On the other hand, MEUA proposes, given the lack of evidence regarding cost containment and the obvious benefit received by shareholders associated with rate case expense, that the Commission disallow 33% of the costs and normalize over a four year period.

2. In a 1993 Missouri-American decision, the Commission attempted to provide some definition by which to measure whether rate case expense is necessary and prudently incurred. In that case the Commission based its decision on whether actual evidence exists of cost containment.

> The Commission must continue to look to the record for evidence in support of rate case expense and in this case that evidence is lacking. Disallowing all expense, or perhaps even disallowing any prudently incurred rate case expense could be viewed as violating the Company's procedural rights. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. ***The operative words here, however, are necessary and prudently incurred. The record does not reflect efforts at cost containment and consequently it does not support that these expenses have been prudently incurred.***[108]

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[106] Tr. 3634.
[107] Ex. 309, Majors True-Up Direct, page 9.
[108] *Report and Order*, Case No. WR-93-212 (issued November 18, 1993).

Absent evidence of cost containment, the Commission in that case disallowed approximately one-third of Missouri American's rate case expense.

3. The Commission is concerned with the continued increase of rate case expenses. It is undisputable that shareholders benefit from such costs in their ability to argue for a higher return on equity as well as the recovery of imprudent or unreasonable costs. Nevertheless, the utility continues to believe that ratepayers should pay the entirety of these costs.

4. In the case at hand, there is no evidence that KCPL / GMO engaged in any significant level of cost containment associated with the incurrence of rate case expenses. The Commission notes that in its last rate litigated rate case, KCPL in-house attorneys shared in a great deal of the work associated with litigating that case. Those attorneys, whose salary and benefits are already recovered through rates, litigated issues associated with policy, off-system sales margins, Hawthorn 5 settlement costs and uranium enrichment overcharges.[109] Similar effort was not seen in this case. While in-house counsel was present for the entirety of the hearings, the responsibility for the litigation of this matter was abdicated to outside counsel. All told, at least eight outside attorneys entered an appearance for KCPL / GMO in this case.

5. As KCPL / GMO admit, through December 31, 2010, and therefore not counting any of the litigation and briefing time that will be incurred, KCPL / GMO has already paid the following amounts to law firms:

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[109] Ex. 1217

Firm	KCPL Case[110]	MPS Case[111]	L&P Case[112]
Schiff Harden	$988,000	$275,000	$89,000
Stinson Morrison	$92,000	$18,000	$28,000
SNR Denton	$423,000	$131,000	$123,000
Fischer & Dority	$310,000	$170,000	$123,000

Clearly, given that these amounts were incurred prior to the start of the evidentiary hearing in this matter, these amounts are expected to increase significantly.

6. The excessiveness of rate case expense is not only seen in the form of legal expenses. Instead, it is also seen in the reliance KCPL / GMO placed on the use of outside consultants. While these Companies have used in-house personnel for the presentation of certain issues in the past, this case saw an increased reliance on outside personnel. For instance, KCPL / GMO relied on the following consultants who each filed testimony in this matter: Chris Giles;[113] Gary Goble;[114] Samuel Hadaway;[115] Steven Jones;[116] Larry Loos;[117] Daniel Meyer;[118] Kris Nielsen;[119] Paul Normand;[120] Kenneth Roberts;[121] Michael Schnitzer;[122] John Spanos;[123] and Ken Vogl.[124]

[110] Tr. 3636-3637. It is important to remember that these are the expenses from Schiff, Harden associated with presentation of this rate case and do not reflect the millions of dollars of other expenses that have been capitalized into the cost of Iatan 1 and Iatan 2.
[111] Tr. 3639
[112] Tr. 3639
[113] Ex. 24 and 25.
[114] Ex. 26.
[115] Ex. 27-29.
[116] Ex. 38.
[117] Ex. 39-41.
[118] Ex. 43-45.
[119] Ex. 46.
[120] Ex. 47-49.
[121] Ex. 50-53.
[122] Ex. 58.
[123] Ex. 59-61.
[124] Ex. 62.

7. Ultimately, KCPL / GMO's lackadaisical approach to containment of rate case expenses is best seen by the following conversation between KCPL / GMO's chief policy witness and a Commissioner.

> Q. Okay. Was there ever a time when you objected to Shiff Hardin's bills and asked them to make adjustments?
>
> A. No. There were times that I would talk to the people who were working closely with them and make sure the type of work they were describing, just to verify what was going on, so I questioned. But did I ever challenge in the sense of ask them for a deduction; no. I never asked for a deduction or recommended a deduction would have been my role.
>
> Q. Are you aware of anybody that did in the legal department?
>
> A. I don't know that.
>
> Q. You're not personally aware of any circumstances at which some bill was objected to and asked for an adjustment?
>
> A. No. I'm just not aware of any.
>
> Q. How about with respect to the outside consultants' bills?
>
> A. Similar. I remember there certainly were discussions around, you know, was so-and-so in town that week. What were they working on? What were they doing? But as far as if there was ever a formal challenge, I just don't know. I wasn't part of that process.[125]

Certainly, given the magnitude of these expenses, one would expect to see some evidence that KCPL / GMO has engaged in some cost containment. Absent such evidence, given the previous Commission decision in the Missouri-American rate case as well as the obvious benefit to shareholders, the Commission finds that MEUA's proposal to disallow 33% of these costs is reasonable and should be adopted.

8. Finally, the Commission recognizes that, unlike the period during the Regulatory Plan, KCPL / GMO have no definitive schedule for their next rate case. In

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[125] Tr. 267-268.

fact, KCPL / GMO openly acknowledged that it has no plans to file its next rate case.[126] Given this, the Commission finds that that KCPL / GMO's request to amortize these costs over an abbreviated two year period is unreasonable. Instead, the Commission will adopt MEUA's request to normalize these costs over a four-year period.

[126] Tr. 3373.

VII. ADVANCED COAL CREDIT ARBITRATION COSTS

1. In 2008, KCPL applied for and received a $125 million qualifying advanced coal tax credit from the IRS associated with the construction of Iatan 2.[127] Although KCPL had several other partners in the project, including Empire, GMO and MJMEUC, KCPL sought to keep the entirety of the tax credit for itself.[128] Upon realizing that KCPL intended to keep the entirety of this credit, Empire filed a notice of arbitration in 2009 seeking its proportionate share of the tax credit (or the monetary equivalent).[129] On December 30, 2009, the Arbitration Panel issued its Final Arbitration Award. In its decision, the Panel found that KCPL's actions constituted **________ __________**.[130]

**____
____
____
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____
____**[131]

2. Despite this finding, KCPL charges ratepayers for the costs of defending itself in this arbitration. As of October 31, 2010, KCPL had paid the SNR Denton firm over $617,000 for "both the arbitration proceedings and its appeal of the arbitration panel's decision."[132]

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[127] Ex. 223, Harrison Surrebuttal, page 4.
[128] *Id.*
[129] *Id.* at pages 4-5.
[130] *Id.* at Schedule 1-3.
[131] *Id.* at Schedule 1-4.
[132] Ex. 231, Majors Surrebuttal, page 19.

3. As Staff notes, ratepayers have been provided no benefit associated with this expense.[133] Given this lack of benefit, and recognizing that KCPL's conduct has been labeled as "willful misconduct," the Commission refuses to impose such costs on the ratepayers.

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[133] *Id.*

VIII. UNSUPPORTED RATE INCREASES

1. In its True-Up Testimony, KCPL readily acknowledges that, despite originally asking for $92.1 million, it can now only justify an increase of $55.8 million. "KCP&L's true-up reflects a revenue deficiency of $55.8 million."[134] Suddenly, at the time it made its opening statement at the true-up hearing, and without making any corrections to its true-up testimony, KCPL was inexplicably asking for an increase of $66.1 million.[135] KCPL's request for $66.1 million is not supported by the testimony.

2. It appears from the briefs in this matter that KCPL has attempted, without litigating this matter or bringing it to the Commission's attention, to pick and choose aspects of Staff's case which will increase its revenue requirement. A review of the true-up reconciliation[136] indicates that through this selective process, KCPL has sought to artificially increase its revenue requirement by $9,783,534.

3. The bottom line, however, is that there is no evidentiary justification for this higher increase. KCPL's acknowledged revenue deficiency is $55.8 million. Staff on the other hand acknowledges a maximum revenue deficiency of $10.9 million.[137] Therefore, every decision made by the Commission which deviates from the position recommended by KCPL ultimately represents a reduction from this claimed $55.8 million revenue deficiency.

4. The Commission is cognizant of the statutorily imposed burden of proof in this case. As indicated at the beginning of this order, the burden of proof "constitutes a substantial right" of the customers in Commission cases. The Commission has been

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[134] Ex. 114, Rush True-Up Direct, page 1.
[135] See, Exhibit 119, page 2.
[136] Ex. 328.
[137] Ex. 302.

charged with “jealously guarding” this right. At the end of the day, the Commission, not KCPL, is the entity that is responsible for deciding the appropriate level of each expense. In this case, there is no basis in the record for the Commission to decide the appropriate level for each of the expenses encompassed by $9.783 million that KCPL now seeks. Given this burden of proof as well as the lack of evidentiary support, the Commission refuses to grant KCPL any rate increase above the $55.8 million for which it filed evidentiary support.

Respectfully submitted,

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ATTORNEYS FOR THE INDUSTRIAL INTERVENORS

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

David L. Woodsmall

Dated: March 18, 2011