BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City	)	
Power & Light Company's Request	)	**Case No. ER-2014-0370**
for Authority to Implement a General	)	
Rate Increase for Electric Service	)	

INITIAL POST-HEARING BRIEF OF MISSOURI INDUSTRIAL ENERGY CONSUMERS

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Come now, the Missouri Industrial Energy Consumers ("MIEC"), and for their initial post-hearing brief state as follows:

I. RETURN ON EQUITY

A. Introduction

"A fair analysis of utility securities shows that market generally regards utility securities as low-risk investment instruments and supports the finding that utilities' cost of capital is very low in today's marketplace."[1] Since KCP&L's last rate case when the Commission authorized a 9.7 percent return on equity ("ROE"), utility bond yields have declined.[2] And, contrary to the assertions of KCP&L's counsel, Treasury bond yields and forecasted levels of Treasury bond yields have also declined.[3] These factors support the conclusion that KCP&L's costs of capital have declined since the last rate case. The ROE authorized in this case should reflect that decline.

A careful analysis of independent market evidence shows that KCP&L's current market cost of equity is within the range of 8.8 percent to 9.4 percent.[4] An ROE within this range would balance the interests of ratepayers and the company by giving ratepayers the benefit of today's

[1] Gorman Rebuttal, Ex. 551, p. 23, ll. 1 – 3.
[2] Tr. p. 300, ll. 21 - 25.
[3] Tr. p. 301, l. 1 – p. 302, l. 12.
[4] Gorman Rebuttal, Ex. 551, p. 2, ll. 8 – 13.

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low capital costs while providing the company with fair compensation and access to the capital needed to fund its infrastructure investments.

Four witnesses provided testimony on the issue of KCP&L's current market cost of equity. Three of the witnesses recommended returns on equity reasonably consistent with one another, while KCP&L's witness provided an estimate that was a clear outlier—and that, rather than reflecting the decline in the cost of capital since the last KCP&L rate case, represents a significant ***increase*** from the company's currently authorized ROE. The non-KCP&L witnesses' point estimate ROE recommendations range from 9.0 percent to 9.25 percent. KCP&L's ROE recommendation is a range of 10.0 percent to 10.6 percent, with a midpoint estimate of 10.3 percent. The witnesses' recommendations in this proceeding are outlined in the table below.

Recommended Return on Equity

Witness	Return on Equity Range	Point Estimate	Cite
KCP&L Witness Hevert	10.0% - 10.6%	10.3%	Hevert Rebuttal, p. 2
MIEC Witness Gorman	8.8% - 9.4%	9.1%	Gorman Direct, p. 2
Staff Witness Marevangepo	9.0% - 9.5%	9.25%	Staff Report, p. 58
DOE Witness Reno	8.2% - 9.6%	9.0%	Reno Direct, p. 4

As Gorman explained in his testimony, the recommendations of all the non-KCP&L witnesses "are reasonable and an accurate estimate of the current market cost of capital for KCPL."[5] Their testimony relies on "verifiable and independent market data and accepted market-based rate of

[5] Gorman Surrebuttal, Ex. 552, p. 2, ll. 17 – 18.

return models."[6] In contrast, KCP&L Witness Hevert's recommendation "are simply based on inflated data and artificially adjusted models – his results are not reliable."[7]

B. Recent Changes in the Economy Do Not Support an Increase in KCP&L's Authorized ROE in this Case

In his Surrebuttal Testimony, Hevert listed a number of "general economic indicators" which he asserted "increased required returns" in the period just prior to the hearing in this case.[8] KCP&L's counsel stressed these recent developments in his opening statement and questioned MIEC witness Gorman about them. As Gorman explained, however, the cost of capital remains very low, and is lower now than it was at the time of KCP&L's last rate case.[9] As he noted, while Treasury bond yields had indeed increased in the months just prior to the hearing in this case, at the time of the hearing, they were still lower than the yield used by Hevert in his analysis of the cost of capital in his direct testimony.[10] Also, an increase in Treasury bond yields was expected and included in the ROE estimates made by the other witnesses in this case. For example, MIEC witness Gorman's study relied on a projected 30 year Treasury bond yield of 3.7 percent, which is still higher than the actual yield of 3.1 percent at the time of the hearing. As Gorman explained, "there's nothing unexpected here."[11] The factors noted by KCP&L were included in all the witnesses studies and were "fully accounted for."[12] Gorman further explained, that "the increase in Treasury bond yields is actually lower than the projected Treasury bond yields" that the ROE witnesses, including Hevert and Gorman, used in their analyses.[13]

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[6] Gorman Surrebuttal, Ex. 552, p. 2, ll. 18 – 19.
[7] Gorman Surrebuttal, Ex. 552, p. 2, l. 24 – p. 3. l. 1.
[8] Hevert Surrebuttal, Ex. 117, p. 46, l. 13 – p. 47, l. 17.
[9] Tr. p. 265, l. 13 – p. 266, l. 10; p. 300, l. 21 – p. 302, l. 12.
[10] Tr. p. 301, l. 11 – p. 302, l. 12.
[11] Tr. p. 302, l. 8.
[12] Tr. p. 302, l. 9.
[13] Tr. p. 302, ll. 9 – 12.

The list of economic indicators highlighted by KCP&L were also considered by the ROE witnesses in this case. Both Hevert and Gorman used GDP growth rates in their DCF studies. Gorman's GDP growth projections reflected accelerated economic growth over the next five years, followed by a period of slower growth. Gorman used a long term GDP growth rate of 4.7 percent, which is lower than the 4.89 percent short term growth rate used in his constant growth and multistage growth DCF studies. In both instances, Gorman used a short term growth rate of 4.89 percent, which is higher than his estimate of a maximum sustainable growth rate.[14] This increased short term growth rate reflects the accelerated improvements in the economy noted by Hevert. Thus, contrary to Hevert's assertions, Gorman's analyses are not undermined by these factors, but instead, they were considered and taken into account in his analysis of KCP&L's cost of capital.

C. If an FAC is Authorized for KCP&L in this Case, then the Authorized ROE should Reflect a Lower Cost of Equity

KCP&L has requested the implementation of a Fuel Adjustment Clause ("FAC") in this case; a request that is opposed by MIEC and other parties in this case. As Gorman explained, an FAC shifts risks associated with fuel costs from the utility to its customers.[15] This can have the effect of reducing the utility's risk going forward, which in turn, reduces the company's cost of capital.[16] Specifically, as Gorman explained, a decision by this Commission to grant KCP&L's request for an FAC "could result in an upgrade in [the] utility's bond rating."[17] And, if the company's bond rating were increased:

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[14] Gorman Direct, Ex. 550, p. 18, ll. 1-6; and p. 21, ll. 20 – 21.
[15] Tr. p. 258, l. 13 – p. 259, l. 15.
[16] *See* Tr. p. 259, l. 16 – p. 260, l. 6.
[17] Tr. p. 281, l. 25 – p. 282, l. 6; p. 303, ll. 9 – 24.

> "their cost of debt would be reduced, because their default risk . . . would be lower and their cash flows would be stronger in relationships [sic] to their financial obligations. In other words, their operating risk would be lower with a fuel adjustment clause than without one. And if that results in improved bond rating, then their cost of capital would also be lower to reflect that reduction in risk."[18]

Accordingly, if the Commission authorizes an FAC in this case, the Commission should recognize this reduction in KCP&L's cost of capital. As Gorman explained, the authorized ROE should still be within the recommended range of 8.8 percent to 9.4 percent, but should be set below the midpoint of that range.

D. All Reasonable Market Cost of Equity Estimates Support a Finding that the Current Market Cost of Equity for KCP&L is below 9.6 percent

The only witness in this proceeding who recommended an ROE above the range of 8.2 percent to 9.6 percent was KCP&L witness Hevert. Hevert's market cost of equity studies contain significant flaws and biases, which overstated his market return estimate for various reasons, including: (1) his use of excessive and unsustainable growth rates in his constant growth DCF analysis; (2) his reliance on flawed accelerated dividend cash flow timing and an inflated Gross Domestic Product ("GDP") growth estimate in his multi-stage DCF study; (3) his use of inflated market risk premiums in his CAPM analysis; and (4) his use of inflated utility risk premiums in his Bond Yield Plus Risk Premium analysis.[19] When corrected, Hevert's DCF and risk premium studies support an ROE in the range of 8.7 percent to 9.1 percent.[20]

E. Constant Growth DCF

KCP&L witness Hevert's recommended ROE of 10.3 percent is partly based on his DCF studies. Hevert performed both a constant growth and a multi-stage growth DCF study. Hevert's constant growth DCF study reflected low, mean and high growth rate estimates.

[18] Tr. p. 303, l. 23 – p. 1269, l. 13

[19] Gorman Rebuttal, Ex. 551, p. 6, l. 16 – p. 7, l. 2.

[20] Gorman Rebuttal, Ex. 551, p. 8, Table 1.

Hevert's mean and high DCF growth rate estimates were 5.64 percent and 6.81 percent, respectively.[21] The high DCF result produced by Hevert in his constant growth DCF analysis simply was not credible, in that it is based on a growth rate that exceeds the 5.29 percent, 5.35 percent and 5.89 percent growth rates projected by consensus equity analysts for the proxy group companies, as reported by First Call, *Value Line*¸ and Zacks, respectively.[22] Hevert's growth rate estimates are also substantially higher than the consensus economists' long-term growth outlook for the U.S. economy. It is simply not reasonable to assume that a utility company's stock will grow at a rate that exceeds the growth of the economy in which it operates.[23] Therefore, Hevert's high-end growth rate DCF analysis is simply not credible, and overstates a reasonable estimate of KCP&L's current cost of equity. Excluding his high-end growth rate estimate, Hevert's DCF studies support an ROE in the range of 8.46 percent to 9.65 percent, with a midpoint of approximately 9.05 percent for KCP&L in this case.[24]

F. <u>Multi-Stage Growth DCF</u>

Hevert's multi-stage growth DCF analysis produced results of 9.52 percent to 10.03 percent. However, there were material flaws in the inputs and structure of Hevert's multi-stage growth DCF study. First, the long-term sustainable growth rate of 5.65 percent included in Hevert's analysis is not reasonable. This growth rate is based on a nominal GDP growth rate that is considerably higher than the GDP growth outlooks reflected in consensus analysts' projections.[25]

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[21] Gorman Rebuttal, Ex. 551, Schedule MPG-R-1

[22] Gorman Rebuttal, Ex. 551, p. 9, ll. 9 – 15.

[23] Gorman Rebuttal, Ex. 551, p. 10, ll. 1 – 12.

[24] Gorman Rebuttal, Ex. 551, p. 10, l. 13 – p. 11, l. 13.

[25] Gorman Rebuttal, Ex. 551, p. 11, ll. 14 – 19; p. 12, l. 1 – p. 13, l. 7 and Table 2.

In addition, Hevert erroneously accelerated cash flows in his multi-stage growth DCF model by assuming investors will receive four quarters of dividend payments after owning the stock for only two quarters.[26] This flawed assumption was included in each year of the DCF forecast, and significantly accelerated dividend payments relative to the stock purchase date. For obvious reasons, this assumption does not reflect reality, and produces an inaccurate and inflated DCF return estimate.[27]

A third erroneous assumption included in Hevert's analysis concerns the dividend payout ratio. A company's "dividend payout ratio" represents the percentage of earnings paid to shareholders as dividends. Hevert's multi-stage DCF model assumes that the dividend payout ratio will increase, notwithstanding the fact that payout ratios for the proxy group companies are projected to be at their steady-state rate.[28] By including this increase in payout ratio in his analysis, Hevert overstates dividend payments, resulting in an overstated DCF return estimate.[29]

By leaving all other parameters used by Hevert intact and correcting for these three deficiencies, Hevert's multi-stage growth DCF model produces an ROE in the range of 8.74 percent to 8.82 percent[30] This is in line with the low end of the range of 8.8 percent to 9.4 percent recommended by Gorman.

G. <u>CAPM</u>

KCP&L's recommended ROE is also based in part on Hevert's Capital Asset Pricing Model ("CAPM"). Hevert's model produced an overstated estimate of ROE due to his use of an unreasonably high market risk premium. Hevert used market risk premiums of 10.50 percent

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[26] Gorman Surrebuttal, Ex. 552, p. 13, l. 8 – p. 14, l. 11.

[27] *Id.*

[28] Gorman Rebuttal, Ex. 551, p. 14, l. 12 – p. 15, l. 24. *See* Gorman Errata Sheet, Ex. 560.

[29] *Id.*

[30] Gorman Rebuttal, Ex. 551, p. 16, ll. 1 – 11.

and 10.19 percent in his CAPM studies.[31] These are significantly higher than historical actual achieved market risk premiums, which have ranged from 6.2 percent to 7.0 percent.[32] Hevert's market risk premiums were also based on flawed DCF studies, which included expected market growth estimates of approximately 11.31 and 11.89 percent that cannot be sustained indefinitely as required by this DCF model.[33] Corrections to Hevert's market risk premiums and use of his other CAPM parameters produce an estimated ROE for KCP&L in the range of 8.28 percent to 9.29 percent, with a midpoint of approximately 8.80 percent.[34]

H. Bond Yield Plus Risk Premium

KCP&L's recommended ROE of 10.3 percent is also founded on a flawed risk premium analysis included in Hevert's testimony. As MIEC witness Gorman explains in his testimony, Hevert's analysis is based on the view that "there is a simplistic inverse relationship between risk premiums and interest rates."[35] This conclusion is not supported by academic research.[36] By focusing solely on interest rates, Hevert failed to properly measure the way in which the market gauges equity risk premiums. While interest rates are one factor that can impact the level of equity risk premiums, they are not the only factor. It is well-established that relative changes to the investment risk of equity versus debt securities investments also cause changes to market risk premiums.[37]

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[31] Gorman Rebuttal, Ex. 551, p. 17, ll. 1 – 9.

[32] Gorman Direct, Ex. 550, p. 37, l. 3.

[33] Gorman Rebuttal, Ex. 551, p. 17, l. 10 – p. 18, l. 6.

[34] Gorman Rebuttal, Ex. 551, p. 19, ll. 1 – 7.

[35] Gorman Rebuttal, Ex. 551, p. 19, ll. 19 – 20.

[36] Gorman Rebuttal, Ex. 551, p. 19, l. 20 – p. 20, l. 2.

[37] Gorman Rebuttal, Ex. 551, p. 20, ll. 13 – 16 and note 13, citing, "The Market Risk Premium: Expectational Estimates Using Analysts' Forecasts," Robert S. Harris and Felicia C. Marston, *Journal of Applied Finance,* Vol. 11, No. 1, 2001 and "The Risk Premium Approach to Measuring a Utility's Cost of Equity," Eugene F. Brigham, Dilip K. Shome, and Steve R. Vinson, *Financial Management,* Spring 1985.

Correcting Hevert's bond yield risk premium study to reflect the market's current risk and valuation assessments of equity and debt securities results in risk premium return estimate of 8.14 percent.[38] This is clearly a low estimate of KCP&L's cost of equity, and is the result of the current low-cost interest environment.[39] Like other anomalous results, this risk premium-based estimate of KCP&L's cost of equity can reasonably be disregarded in the determination in this case.[40]

I. **The Company's Claim that the Non-KCP&L Witnesses' Models Have Not Produced Reliable Return Estimates is Without Merit**

KCP&L witness Hevert criticized the findings of the other experts in this case, and biased his own findings upward, based on a number of unsupported justifications for setting aside the results of market-based models. In particular, Hevert alleges that current price to earnings ("P/E") ratios of utility stocks render the non-KCP&L witness' DCF estimates unreliable. He also places undue emphasis on average authorized returns on equity issued by other regulatory commissions, which as Gorman's testimony demonstrates, are overstated by Hevert's analysis.

Hevert asserts that "there is no dispute" that utility stock P/E ratios "have undergone an 'abnormal expansion.'"[41] Based on this erroneous assertion, he concludes that DCF analyses that fail to recognize and adjust for this abnormal expansion are unreliable.[42] But as Gorman explains, "[w]hile current P/E ratios are high compared to historical periods, current valuations could be maintained with expected growth in earnings and continued valuation metrics that could

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[38] Gorman Rebuttal, Ex. 551, p. 21, l. 13.
[39] Gorman Rebuttal, Ex. 551, p. 21, ll. 13 – 16.
[40] Tr. p. 302, l. 13 – p. 303, l. 8.
[41] Hevert Rebuttal, Ex. 116, p. 76, ll. 10 – 13.
[42] *Id.*

collapse to more historical normal levels going forward."[43] More importantly, as Gorman notes, high utility stock P/E ratios are the result of high stock prices, which in turn, demonstrate that the cost of capital is very low today.[44] High stock prices demonstrate that investors are willing to pay more for utility stock – and hence from the standpoint of the utility companies, the cost of equity is very low. The P/E ratios noted by Hevert do not support his unreasonably high recommended ROE in this case.

Nor do recently authorized returns on equity support Hevert's position in this case. As Gorman explained, "if you look at actual litigated findings by regulatory commissions," as he did in his analysis, then it is clear that average authorized returns on equity have been declining over time.[45] In his analysis, Gorman takes into consideration all electric utilities – both vertically integrated as well as distribution companies—with comparable levels of investment risk. This increases the number of data points included in his analysis, which, in general, has the effect of decreasing the impact of any anomalous results. The electric utility companies selected by Gorman for consideration all have similar credit ratings, which demonstrates that they have similar levels of investment risk.[46] Gorman eliminated from consideration those commission determinations of ROE that were not the result of litigation, but were instead determined through settlement, or were simply carried over from prior cases.[47] This ensures that all of the results considered by Gorman were based on evidence concerning market factors.

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[43] Gorman Surrebuttal, Ex. 552, p. 8, ll. 11 – 13.
[44] Gorman Surrebuttal, Ex. 552, p. 8, ll. 14 – 17.
[45] Tr. p. 298, ll. 19 – 24; Gorman Surrebuttal, Ex. 552, Schedule MPG-SR-1.
[46] Gorman Surrebuttal, Ex. 552, Schedule MPG-SR-1, p. 1.
[47] Gorman Surrebuttal, Ex. 552, p. 3, l. 14 – p. 4, l. 15; Tr. pp. 1275 – 1276.

Gorman's analysis indicates that ROEs authorized in 2014 for all electric companies, where this issue was fully litigated, ranged from 9.17 to 10.20 with an average of 9.63 percent.[48] For the first quarter of 2015, the average for all fully litigated electric utility rate cases dropped slightly to 9.62 percent.[49] This does not mean, however, that any estimate of the current market cost of equity below 9.62 percent is inaccurate or unreasonable. Average commission-authorized returns are simply one data point to consider in determining the reasonableness of the witnesses' testimony in this case. They should not be used to exclude from consideration reasonable analyses that use observable and verifiable market-based evidence to estimate KCP&L's current market cost of equity.[50]

Hevert states that "there has been no meaningful downward trend in authorized returns for vertically integrated electric utilities since January 2013.[51] But Hevert's analysis included litigated as well as settled cases, and cases in which the utility commission carried forward a previously authorized return on equity without considering current market factors.[52] Hevert's assertion is clearly refuted by Gorman's analysis.

J. <u>Conclusion</u>

The Commission should award KCP&L an ROE in the range of 8.8 percent to 9.4 percent in this proceeding. An ROE in this range is supported by competent and substantial evidence in this case, including the testimony of MIEC witness Gorman who recommends the Commission authorize an ROE of 9.1 percent for KCP&L in this case. Moreover, when corrected as described above, the testimony of KCP&L witness Hevert also supports an ROE in this range.

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[48] Gorman Surrebuttal, Ex. 552, Schedule MPG-SR-1, p. 1.

[49] Gorman Surrebuttal, Ex. 552, Schedule MPG-SR-1, p. 1.

[50] Gorman Surrebuttal, Ex. 552, p. 4, l. 22 – p. 5, l. 2.

[51] Hevert Surrebuttal, Ex. 117, p. 9, ll. 4 – 5.

[52] Tr. p. 298, l. 18 – p. 299, l. 16. .

The evidence in this case is clear that KCP&L's cost of equity has declined since its last rate case. The company's ratepayers should receive the benefit of the current low cost of equity through a lower authorized return on equity in this case.

II. FUEL ADJUSTMENT CLAUSE

A. KCP&L's Fuel Adjustment Clause Request Violates the Stipulation and Agreement form Case No. EO-2005-0329, and Should Be Rejected.

On May 15, 2005, a stipulation and agreement ("Agreement") was entered into by the following parties in Case No. EO-2005-0329: MIEC; OPC; the Staff of the Missouri Public Service Commission; Missouri Department of Natural Resources; Praxair, Inc.; Ford Motor Company; Aquila, Inc.; the Empire District Electric Company; Missouri Joint Municipal Electric Utility Commission; Jackson County, Missouri; City of Kansas City, Missouri; and Kansas City Power & Light Company ("KCP&L") (collectively, "Signatory Parties"). Because the Agreement was opposed by Concerned Citizens of Platte County and the Sierra Club, who were also parties to Case No. EO-2005-0329, the Commission considered the provisions of the Agreement pursuant to the procedures set out in 4 CSR 2.115(2) relating to Non-unanimous Stipulations and Agreements.[53]

The Agreement, paragraph III.B.1.c., included the following provision that limits KCP&L's authority to request a fuel adjustment clause ("FAC") or other similar regulatory mechanisms:

> KCPL agrees that, ***prior to June 1, 2015, it will not seek to utilize any mechanism in current legislation known as 'SB 179' or other change in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors.*** In exchange for this commitment, the Signatory Parties agree that if KCPL proposes an Interim Energy Charge ("IEC") in a general rate case filed before

[53] *See In the Matter of a Proposed Regulatory Plan of Kansas City Power & Light Company,* Case No. EO-2005-0329, Report and Order, p. 9 (Effective date August 7, 2005).

> June 1, 2015 in accordance with the following parameters, they will not assert that such proposal constitutes retroactive ratemaking or fails to consider all relevant factors: . . . . (Emphasis added).

The term "SB 179" as used in the Agreement refers to Senate Bill 179, which was truly agreed to and finally passed by the General Assembly in 2005. Senate Bill 179 enacted section 386.266, RSMo, which among other things, gives electric corporations the authority to make an application to the Commission to approve rate schedules that include an FAC. Section 386.266, RSMo., authorizes the approval of rate schedules that include an FAC ***only*** upon application by an electric corporation. Therefore, unless requested by KCP&L in its Application and proposed tariffs, an FAC cannot be granted to KCP&L in this case.

The Agreement resulted from negotiations between the Signatory Parties, and its provisions are interdependent.[54] The provisions of the Agreement demonstrate that it was freely negotiated and consideration was given and received by the Signatory Parties. In addition, paragraph 10.f. of the Agreement provides:

> When approved and adopted by the Commission, this Agreement ***shall constitute a binding agreement*** among the Signatory Parties hereto. The Signatory Parties shall cooperate in defending the validity and enforceability of this Agreement and the operation of this Agreement according to its terms. (Emphasis added).

As paragraph III.B.1.c. of the Agreement evidences, "**in exchange for**" KCP&L's agreement that prior to June 1, 2015, it would "not to seek to utilize" any mechanism authorized by section 386.266, RSMo, including an FAC, the Signatory Parties consented not to object to any IEC sought ***prior to*** June 1, 2015, if the IEC complied with the six requirements listed in the Agreement. If the Agreement is read to allow KCP&L to seek an FAC prior to June 1, 2015 so long as the FAC is not effective until after June 1, 2015 (as advocated by KCP&L), then there is

[54] *See Agreement* ¶10.e.

no mutuality of consideration with respect to these two provisions, and this construction would be inconsistent with any reasonable intent of the parties.

Clearly the intent expressed in the plain language of the Agreement is that in any rate case filed prior to June 1, 2015, KCP&L would be prohibited from seeking an FAC but permitted to seek an IEC. Under KCP&L's incorrect reading of the Agreement, KCP&L could request ***both*** an IEC and an FAC in any rate case, so long as the effective date of the FAC were on or after June 1, 2015. In addition, in return for this limitation on its right to file an application for an FAC and its other obligations under the Agreement, KCP&L received a number of other concessions from the Signatory Parties, including their consent to a financial plan and an amortization designed to ensure that KCP&L would have adequate resources for making its planned capital investments that included the construction of new generation capacity, Iatan 2.

The Commission reviewed the terms of the Agreement and approved and adopted all of the provisions of the Agreement in its Report and Order in Case No. EO-2005-0329. In particular, the Report and Order expressly adopted the limitation on KCP&L's authority to seek an FAC by stating that "KCPL has agreed that before June 1, 2015, it will not seek to use any mechanism authorized in SB 179, enacted this year, or other change in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors."[55] The Commission also ordered the Signatory Parties to abide by all the terms and requirements of the Agreement.[56]

On October 30, 2014, KCP&L filed its Application with the Commission initiating the instant rate case. Paragraph 9 of the Application states that KCP&L "proposes to implement a fuel adjustment clause." Appendix 1 to the Application includes KCP&L's Proposed Tariff

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[55] Case No. EO-2005-0329, Report and Order, p. 15.
[56] *Id.* at p. 42.

Sheets, and Sheets 50 through 50.5 of the Proposed Tariff Sheets set out an FAC Rate Schedule. On October 30, 2014 and May 7, 2015, KCP&L filed direct and rebuttal testimony, respectively, which among other things, refer to and offer support for KCP&L's request for an FAC.

KCP&L's October 30, 2014 request for an FAC is barred by the express terms of this Commission's Report and Order in Case No. EO-2005-0329 and by the express terms of the Agreement. The FAC requested by KCP&L is not an "Interim Energy Charge" as described in the paragraph B.1.c. of the Agreement, and therefore KCP&L is barred from seeking the FAC prior to June 1, 2015.

This Commission has the authority to enforce the terms of its Report and Order in Case No. EO-2005-0329 and the Agreement by striking paragraph 9 of the Application, rejecting KCP&L's Proposed FAC Tariff Sheets, and striking the testimony filed by KCP&L in support of its request for an FAC in this case. The Commission has exercised such authority in connection with a similar issue in the past. In Case No. ER-2006-0315, the Commission issued an order rejecting tariffs and striking testimony based on a Stipulation and Agreement entered into by the electric corporation.[57] In addition, the Commission issued an order that expressly recognized that a Stipulation and Agreement that is freely negotiated, for which consideration is given and received, and that is approved by the Commission, is binding on the parties. If a utility submits pleadings and filings ***making a request that it has consented not to make***, as is true in this instance, the Commission has the authority to remove such pleadings and filings.[58] The Commission's authority to enforce the Agreement is also supported by the Missouri Supreme

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[57] *See In the Matter of The Empire District Electric Company,* Case No. ER-2006-0315, Order Rejecting Tariffs and Striking Testimony (June 25, 2006).

[58] *See In the Matter of The Empire District Electric Company,* Case No. ER-2006-0315, Order Clarifying Continued Applicability of the Interim Energy Charge, p. 3 (May 12, 2006).

Court's ruling in *State ex rel. Riverside Pipeline Co. v. Public Service Commission,*[59] in which the Court ruled that a stipulation entered into by the pipeline company, the staff of the Commission, and other parties precluded the Commission from conducting an Actual Cost Adjustment prudence review. The Court ruled that by failing to disallow the prudence review as required by the terms of the stipulation, the Commission acted unlawfully.[60]

To enforce the express terms of the Report and Order in Case No. EO-2005-0329 and the Agreement, the Commission should reject KCP&L's request for an FAC, grant the Motion to Strike filed by MIEC and OPC in this case, and strike the following pleadings and testimony from the record in this case:

A. Paragraph 9 of the Application filed by KCP&L.

B. The following tariff sheets filed by KCP&L:

1) P.S.C. Mo. No. 7, Second, Revised Sheet No. 50, Canceling P.S.C. Mo. No 7, First, Revised Sheet No. 50;

2) P.S.C. Mo. No. 7, Original Sheet No. 50.1;

3) P.S.C. Mo. No. 7, Original Sheet No. 50.2;

4) P.S.C. Mo. No. 7, Original Sheet No. 50.3;

5) P.S.C. Mo. No. 7, Original Sheet No. 50.4; and

6) P.S.C. Mo. No. 7, Original Sheet No. 50.5.

C. The following testimony concerning KCP&L's request for an FAC:

1) Direct Testimony of Tim M. Rush:
Page 2, lines 19 – 20;
Page 6, lines 19 – 21;
Page 7, lines 10 – 14;
The words "the FAC" on Page 8, line 6;

[59] 215 S.W.3d 76 (Mo banc 2007).
[60] *Id.* at 85.

Page 9, line 4 through page 27, line 11;
Schedules TMR-1, TMR-4, TMR-6;
Paragraph 5 on page 1, page 2 and page 3 of Schedule TMR-2.

2) Rebuttal Testimony of Tim M. Rush:
Page 6, line 14 through page 29, line 1.

3) Direct Testimony of Wm. Edward Blunk:
Page 20, line 16 through page 34, line 5.

4) Rebuttal Testimony of Wm. Edward Blunk:
Page 9, line 1 through page 35, line 7.

5) Direct Testimony of Burton L. Crawford:
Page 13, line 13 through page 16, line 18.

6) Rebuttal Testimony of Darrin R. Ives:
Page 8, line 4 through page 15, line 5; and

D. Any other testimony, schedule, tariff sheet or other information submitted to the Commission by KCP&L that is based on or supports the imposition of an FAC in this case should be stricken from the record or revised by KCP&L to comply with the Commission's Report and Order in Case No. EO-2005-0329 and the Agreement.

The MIEC is mindful of the Commission's Report and Order in Case No. ER-2014-0258, in which the Commission ruled that it would not grant Ameren Missouri's motion to strike testimony on the solar rebate issue.[61] But as demonstrated by the Commission's rulings in *In the Matter of The Empire District Electric Company,* Case No. ER-2006-0315, and the Missouri Supreme Court's ruling in *State ex rel. Riverside Pipeline Co. v. Public Service Commission,* 215 S.W.3d 76 (Mo banc 2007), discussed above, the motion to strike should be sustained in this case to enforce KCP&L's agreement that prior to June 1, 2015, it would not seek to utilize an FAC.

B. <u>In the Event that KCP&L is Granted an FAC Surcharge Tariff, the Cost to Transmit Self-Generated Power to Its Customers Should Not Be Included in that Surcharge Mechanism</u>

[61] *In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service,* Case No. ER-2014-0258, Report and Order, p. 30.

This issue is simple and straightforward. Legally, for purposes of section 386.266.1, is power that KCP&L produces with its power-generation equipment to serve its load "purchased power?" This question leads to sub-issues. If, as KCP&L argues, all of its self-generated power is sold to the SPP, is all of that power for off-system sales? Then, is all of the power that serves its load purchased power? Factually, does KCP&L report its power production as if it is all for off-system sales? Does it report all of its fuel purchases as purchases for off-system sales? Does it report none of its fuel purchases as fuel for load? The answer to all of these questions is "no." Because the answer to the first question in particular is no, then the SPP transmission charges at issue are not transportation costs of purchased power and **are** ineligible for surcharge through the FAC under section 386.266.1. They must be recovered as most of KCP&L's costs are recovered, namely by building them into base rates in a rate case. Even if the subject charges were purchased power charges within the meaning of section 386.266, does this Commission have discretion to deny recovery of the charge through an FAC surcharge. The answer to this question is yes.

Missouri law is clear that utilities may not surcharge increased costs between rate cases unless the General Assembly expressly allows it. See *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission of Missouri ("UCCM")*:[62]

> It is for the legislature, not the PSC, to set the extent of the latter's jurisdiction. The mere fact that the commission has approved similar clauses in the past, or that other states permit them, is irrelevant if they are not permitted under our statute[.]

After *UCCM*, the Missouri General Assembly enacted section 386.266.1. It provides:

> 2. Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate

[62] 585 S.W.2d 41, 54 (Mo. banc 1979).

> proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation[.]
>
> ***
>
> 4. …The commission may approve such rate schedules after considering all relevant factors which may affect the costs or overall rates and charges of the corporation[.][63]

Therefore, a surcharge is allowed only to the extent that section 386.266.1 authorizes it and the Commission, in the exercise of its discretion, agrees to allow the surcharge. Notwithstanding KCP&L's position here, this Commission has previously concluded, multiple times, that the statute was not intended to allow all transmission charges to be surcharged.

Purchased power is only that power needed to serve load that is in addition to the power that KCP&L self-generates. This Commission recognized as much in *In re Kansas City Power & Light, Greater Missouri Operation*:

> 76. The Commission concludes that all transmission costs should not be included in GMO's adjustment clause because they are not included in section 386.266, RSMo. Supp. 2010, as a type of cost to be recovered through a fuel adjustment clause, they are inconsistent with the definitions of fuel and purchased power cost in 4 CSR 240-20.090(1)(B), and elsewhere, and they do not vary in a direct relationship with fuel or purchased power. With regard to the transmission costs specifically related to [off-system sales], however, those costs shall be allowed[.][64]

KCP&L's position here is akin to GMO's, namely that all transmission charges may be surcharged. Moreover, this Commission's recent decisions in ER-2014-0258 and ER-2014-0351 provide that the cost to transmit self-generated power to ratepayers should not flow through the FAC. In ER-2014-0258, this Commission concluded:

> The evidence demonstrated that for purposes of operation of the MISO tariff, Ameren Missouri sells all the power it generates into the MISO market and buys back whatever power its needs to serve its native load. From that fact,

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63 Emphasis added.

64 Case No. ER-2010-0356, p. 218-219 (emphasis added).

Ameren Missouri leaps to its conclusion that since it sells all its power to MISO and buys all that power back, all such transactions are off-system sales and purchased power within the meaning of the FAC statute. The Commission does not accept this point of view.

The drafters of the FAC statute likely did not envision a situation where a utility would consider all its generation purchased power or off-system sales. In fact, the policy underlying the FAC statute is clear on its face. The statute is meant to insulate the utility from unexpected and uncontrollable fluctuations in transportation costs of purchased power. At the time the statute was drafted, and even in our more complex present-day system, the costs of transporting energy in addition to the energy generated by the utility or energy in excess of what the utility needs to serve it load are the costs that are unexpected and out of the utility's control to such an extent that a deviation from traditional rate making is justified.

Therefore, of the three reasons Ameren Missouri incurs transmission costs cited earlier, the costs that should be included in the FAC are 1) costs to transmit electric power it did not generate to its own load (**true purchased power**) and 2) costs to transmit excess electric power it is selling to third parties to locations outside of MISO (off-system sales). Any other interpretation would expand the reach of the FAC beyond its intent.[65]

Similarly, in ER-2014-0351, this Commission concluded:

Section 386.266 authorizes the use by an electrical corporation of an interim energy charge or periodic rate adjustment outside of a general rate proceeding to reflect increases and decreases in prudently incurred fuel and purchased-power costs, including transportation. The statute authorizes the Commission to include features in an FAC designed to provide an electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities. This FAC is not a statutory right granted to electric utilities; it is granted based on the Commission's discretion after examination of the expenses.

Under Commission Rule 4 CSR 240-20.090(2), the Commission may approve the establishment, continuation or modification of an FAC and associated rate schedules. In determining what cost components to include in the FAC, the Commission will consider the magnitude of the costs, the ability of the utility to manage the costs, the volatility of the cost components and the incentive provided to the utility as the result of an inclusion or exclusion of a cost component. The Commission is not limited to only those considerations when evaluating a requested FAC. It is within the Commission's discretion to determine what

[65] In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service (File No. ER-2014-0258)(Issued on April 29, 2015 and Effective on May 12, 2015) pp. 115-116 (emphasis added).

> portions of prudently incurred fuel and purchased power costs may be recovered in the FAC and what portion shall be recovered in base rates.
>
> ***
>
> Empire's interpretation of "purchased power" under the SPP IM includes the power that Empire generates and then offers through the SPP IM, even if it is used for its native load.
>
> The Commission recently issued a Report and Order in an Ameren Missouri rate case, File No. ER-2014-0258, where it determined it is unlikely the drafters of the FAC envisioned a situation where a utility would consider all its generation either purchased power or off-system sales. In fact, the policy underlying the FAC statute is clear on its face: § 386.266, "…is meant to insulate the utility from unexpected and uncontrollable fluctuations in transportation costs of purchased power." Nowhere in the record do the facts support a finding that all SPP IM related transmission costs are unexpected and uncontrollable. Furthermore, as has been the case since the FAC statute was created, the costs of transporting energy in addition to the energy generated by the utility or energy in excess of what the utility needs to serve its load are the costs that are unexpected and out of the utility's control to such an extent that a deviation from traditional rate making is justified. Therefore, the costs Empire incurs related to transmission that are appropriate for the FAC, from a policy perspective and by statute, are:
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> 1) Costs to transmit electric power it did not generate to its own load ("true purchased power"); or
> 2) Costs to transmit excess electric power it is selling to third parties to locations outside of its RTO ("Off-system sales").
>
> Empire argues that the Commission cannot make the same determination that it made in the Ameren Missouri rate case (File No. ER-2014-0258) since the parties did not present factual evidence related to such an argument. Empire is incorrect. The determination the Commission made in Ameren Missouri's rate case was based on its legal analysis of the FAC statutes, and the analysis in that case applies equally to the question of what transmission costs should be included in Empire's FAC. The legal analysis does not change with the facts submitted.[66]

A plain reading of section 386.266.1 supports this Commission's above three decisions. If all power provided to ratepayers is "purchased power," as KCP&L now claims, then why would section 386.266 even allow a surcharge for fuel costs since ratepayers would be served

[66] In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area (File No. ER-2014-0351)(Issued on June 24, 2015 and Effective on July 24, 2015) pp. 25-28. (emphasis added)

solely by purchased power? KCP&L's current construction of the statute makes no sense. If KCP&L's current construction were correct, the statute would have simply allowed a surcharge of all increases in purchased power costs and the costs to transmit purchased power.

Mr. Dauphinais recognized that KCP&L's position that it sells all self-generated power to SPP and buys it back to serve its load is belied by its own reporting to FERC:

> As I discussed in detail in my rebuttal testimony, under FERC Order No. 668, KCPL in each hour of the day-ahead and real-time market must net its cleared generation and load into either an off-system sale (if KCPL cleared more MWh of generation than load in that hour) or a power purchase (if KCPL cleared more MWh of load than generation in that hour) (Dauphinais Rebuttal at 20). Furthermore, Schedules JRC-1 through JRC-3 do not correspond with KCPL's MWh of Account 447 Sales for Resale to SPP and KCPL's MWh of Account 555 Purchased Power from SPP that are reported by KCPL for calendar year 2014 in the Form 1 filing that KCPL made to FERC on April 20, 2015.
>
> On Line 2, Column (g) of Page 311.2 of its FERC Form 1 filing, KCPL reported only 6,175,961 MWh of Account 447 Sales for Resale to SPP in calendar year 2014, and on Line 7, Column (g) of Page 327.2 of its FERC Form 1 filing, KCPL reported only 1,243,020 MWh of Account 555 Power Purchases from SPP in calendar year 2014. By comparison, in that same FERC Form 1 filing, KCPL identified it generated a total of 20,592,086 MWh in calendar year 2014 and had total retail load sales of 14,919,674 MWh for calendar year 2014 (KCPL 2014 FERC Form 1 (April 20, 2015) at Page 401a, Lines 9 and 22). Considering the SPP Integrated Marketplace was in operation for 10 of the 12 months of calendar year 2014, if KCPL sold all of its generated power to SPP as an off-system sale, its total reported off-system sales to SPP would be far more than approximately 30% of its total reported generation. Similarly, if KCPL purchased all of the power for its retail load, its total reported purchased power from SPP would be far more than approximately 8% of its total reported retail load sales.[67]

In summary, the facts, prior decisions of this Commission, and KCP&L's own FERC filings demonstrate that it should not be allowed to surcharge transmission costs for power generated by its own generators and provided to its load. Mr. Dauphinais calculated the portion of transmission charges that should be excluded from surcharge (92.7%) and which portion

[67] Dauphinais Surrebuttal, Ex. 558, p. 7, l. 10 – p. 8, l. 6.

should be allowed (7.3%).[68] The Commission should adopt those calculations in setting KCP&L's Base Factor for the FAC and the terms and conditions of the FAC itself should this Commission conclude that an FAC is allowed at this time.[69]

III. NO TRANSMISSION COST TRACKER SHOULD BE APPROVED

KCP&L witness Tim Rush proposed a transmission cost tracker.[70] If granted, KCP&L would be the only investor owned electric utility in Missouri to have one.[71] The MIEC opposes that tracker for many reasons. First, as repeatedly noted in arguments to this Commission, cost trackers involve illegal single-issue ratemaking that effectively allows the utility to charge more to tomorrow's ratepayers to recover extra tracked costs incurred to serve today's ratepayers. And the tracker does so without any meaningful consideration of other costs that may have declined between rate cases or revenues that may have increased between rate cases. Stated differently, recovery of tracked cost is unlikely to be based on any meaningful "all relevant factors" analysis. See *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission of Missouri.*[72] Second, the requested tracker does not meet the standard that this Commission set for cost trackers in general. Particularly, as noted in the testimony of Jim Dauphinais, the transmission costs at issue are not volatile. They are not volatile because the changes in transmission costs are not unexpected in any meaningful sense. To prove that point, Mr. Dauphinais calculated the Coefficient of Variance ("COV"), which showed that actual costs had little variability from near term projections. That means that KCP&L can easily address these known changes in costs by timing its rate cases accordingly. Mr. Dauphinais concluded:

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[68] *Id.*, p. 11, l. 20 – p. 14, l. 11.
[69] Dauphinais Rebuttal, Ex. 557, p. 3, l. 19 – p. 48, l. 3.
[70] Rush Rebuttal, Ex. 135, pp. 46 – 47.
[71] Tr. 1648, ll. 11 – 23.
[72] 585 S.W.2d 41, 54 (Mo. banc 1979).

> This phenomenon is also seen in the chart presented on page 8 of Mr. Carlson's rebuttal testimony. The estimates made years in advance have far greater variability to the actual cost, and the estimated costs converge toward the actual costs as the estimated periods become closer in time to the present. In fact, using the 2014 example that Mr. Carlson discussed on page 7 of his rebuttal testimony, the estimates for the 2014 costs prepared between January 2013 and July 2014 have a Coefficient of Variance ("COV") of roughly 10% and produced an expected value that is 17% above the actual 2014 cost. This is hardly volatile, especially when compared to the volatility in the wholesale electricity and natural gas markets.
>
> Furthermore, as Mr. Carlson states on pages 4-5 of his rebuttal testimony, KCPL and other stakeholders participate in an open and transparent process which determines whether a project will be approved and pursued. This process, like most regulatory processes, takes time. The potential changes in approved projects do not fluctuate rapidly, for instance when compared to the rapid hourly fluctuations in the market price for electric energy, or daily fluctuation for the price of natural gas. Even if new federal energy policy requires extensive action, the roll out and reactions to policy changes will take time to plan and implement. This ensures that KCPL will have ample opportunity to determine, when considered alongside all other operation earnings, whether these changes would warrant the filing of a rate case.
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> ***
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> SPP transmission costs are not volatile when the definitions and analytical techniques discussed by KCPL are properly applied. The cost estimates do not have high levels of unexpected variance and the cost estimates for the charges are routinely updated and disseminated by SPP. In addition, the stakeholder and regulatory process for approval of transmission projects combined with these cost estimates provides KCPL more than enough time to analyze the costs in conjunction with the costs of all of its other operations and, if necessary, react by filing a rate case. Therefore, these are not costs that need to be included in an FAC or tracker.[73]

In summary, for both legal and factual reasons as set forth above, this Commission should deny the requested transmission cost tracker.

IV. THE CLASS COST OF SERVICE AND RATE DESIGN DETERMINATIONS SHOULD BE RESOLVED BY THE STIPULATION DATED JUNE 16, 2015

Although MIEC and Staff witnesses had disagreement over the approach to determining class cost of service, both Staff and MIEC agreed in a Non-unanimous Stipulation filed June 16,

[73] Dauphinais Surrebuttal, Ex. 558, p. 4, ll. 3 – 22, p. 5, l. 22 – p. 6, l. 4. Emphasis added.

2015, to an equal percentage allocation among classes of any rate increase ordered in this case, thus mooting their disagreement on class cost of service. The only party to object to the Stipulation was KCP&L and its objection did not reach the issues of the method for determining class cost of service. MIEC believes that the Non-Unanimous Stipulation and Agreement filed on June 16, 2015 is a fair and equitable resolution for all classes and customers. It represents the work and trade-offs of the numerous parties involved. The Non-Unanimous Stipulation and Agreement is reasonable. It does not award any party all they sought, but is a fair and equitable recommendation acceptable to all the parties except KCP&L.

MIEC recommends that the Commission make no factual findings regarding the general suitability of any class cost-of-service study method over any other. MIEC believes that a CCOS study is not precise and should be used only as a guide in designing rates along with other considerations. The Non-unanimous Stipulation and Agreement does not recommend that the Commission use any particular methodology, but instead that the Stipulation relied upon one or more of the submitted CCOS studies as achieving a reasonable allocation of production capacity costs and allocating net cost of service among the customer classes.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 22nd day of July, 2015, to all counsel of record.

*/s/ Edward F. Downey*______