BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	**)** **)** **)** **)**	**Case No. ER-2016-0285**

STAFF'S POST-HEARING BRIEF

Respectfully submitted,

KEVIN THOMPSON, Mo Bar 36288
Chief Staff Counsel

ROBERT S. BERLIN, Mo Bar 51709
Deputy Staff Counsel

NICOLE MERS, Mo Bar 66766
Assistant Staff Counsel

JAMIE MYERS, Mo Bar 68291
Assistant Staff Counsel

WHITNEY PAYNE, Mo Bar 64078
Assistant Staff Counsel

Attorneys for the Staff of the
Missouri Public Service Commission

March 22, 2017

NP

TABLE OF CONTENTS

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	))))	**Case No. ER-2016-0285**

STAFF'S POST-HEARING BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Post-Hearing Brief,* states as follows:

INTRODUCTION

In this general rate case, the Commission must exercise its delegated authority to set prospective rates for Kansas City Power & Light Company ("KCPL"), a task that involves balancing the interests of ratepayers, the utility, and a myriad of other intervening parties with disparate interests and differing ideas about the issues and policies presented. The Commission must weigh the evidence presented before it to come to its ultimate goal in setting rates that are "just and reasonable", which is a rate that provides sufficient revenue to cover KCPL's costs in providing electric service, allows KCPL shareholders a reasonable opportunity to earn a fair return on their investment, but is no more than necessary to meet those goals, which protects the rate-paying residents and businesses KCPL serves.[1]

[1] Mo. Rev. Stat. § 393.130 and § 393.140.

Settled and Non-Contested Issues:

As part of a partial stipulation and agreement, approved March 8, 2017,[2] the parties settled several issues. These issues are as follows:

- Transmission Fees Expense and Transmission Revenues (Issue IV, sections B, C, D, F, H, and I)
- Transmission Revenue ROE adjustment (Issue V)
- Property Tax Expense (Issue VI, sections B and C)
- Incentive Compensation (Issue VII)
- SERP (Issue VIII)
- Severance (Issue IX)
- Kansas City Earnings Tax (Issue X)
- Trackers in Rate Base (Issue XI)
- Bad debt gross up (Issue XII)
- Dues and Donations(Including EEI and EPRI) (Issue XIII)
- Credit Card Acceptance Fees (Issue XIV)
- Bank Fees (Issue XV)
- Depreciation Study expense (Issue XVII)
- Greenwood Solar Energy Center (Issue XIX)
- Management Expense (Issue XXV)
- Economic Relief Pilot Program (Issue XXIII)
- Cost Allocation Manuel (Issue XXIV)
- Rate Case Expense (Issue XVI)

[2] ***Order Approving Stipulation and Agreement Regarding Certain Issues*****,** filed March 8, 2017.

- Customer Disclaimer (Issue XXVI)

Furthermore, Staff provided information in its *Staff's Report Responding to Certain Commission Questions*, filed on December 14, 2016. Although not specifically addressed in this brief, Staff believes the information and programs discussed within that report are important, and will work with the parties to fulfill whatever proposal the Commission should direct or design using the information provided.

The Company:

KCPL is a traditional, integrated electric utility serving 527,000 customers, 465,200 of which are residential customers, in Kansas City and the surrounding counties, in both the Missouri and Kansas jurisdictions.[3] KCPL serves these customers with four large coal-fired generating stations in which KCPL owns a combined share of over 2,500 mega-watts ("MW"), the Wolf Creek nuclear power generation station, around 1,200 MW of natural gas- and oil-fired peaking capacity, and 749 MW of owned or contracted wind capacity.[4] KCPL operates and maintains 12,000 miles of distribution lines and 1,800 miles of transmission lines.[5] KCPL employs 2,899 employees, 1,789 of which are members of the International Brotherhood of Electrical Workers.[6] KCPL is a wholly owned subsidiary of Great Plains Energy Incorporated ("GPE") and is an affiliate of KCP&L Greater Missouri Operations Company ("GMO").[7]

[3] Ex. 200, *Staff Direct Revenue Requirement Report,* p. 2.
[4] Ex. 125, Direct Testimony of Scott H. Heidtbrink, p. 4, ll. 3-10.
[5] *Id.* at p. 4, ll. 16-17.
[6] Ex. 200, *Staff Direct Revenue Requirement Report,* p. 2, ll. 6-8.
[7] *Id.* at p. 1, ll. 14-16.

The Customers:

The overwhelming majority of KCPL's customers are residential, and therefore, it is the residential customers who will be shouldering the bulk of the increase. Missouri experienced low growth in its real gross domestic product ("GDP") for the past 5 years.[8] These residential customers have only experienced a 17.62% increase in their average weekly wages from 2007 to 2015.[9] In the same time frame, the price of household goods and services that residential customers depend upon increased by 14.31%.[10] This is in addition to the 76.23% increase in electric rates that KCPL customers experienced in those years.[11] An increase of that magnitude means residential customers saw their wages increase at ¼ the rate of their electric bills.

KCPL also serves 33,580 commercial customers and 987 large power and large general service customers. These customers provide economic growth and prosperity to the region in the form of jobs and taxes, and affordable electric rates help enable them to do so.

Between the utility's need for rates to meet its cost of service and earn a return and the customers' need for rates that are not overly burdensome, the Commission must find a balanced approach to setting rates.

[8] *Id.* at p. 5, l.10.

[9] *Id.* at p. 7, ll. 15-16.

[10] *Id.* at p. 8.

[11] *Id.*

Ratemaking:

The Commission's duty is to consider all relevant factors[12] to set "just and reasonable" rates.[13] A "just and reasonable" rate is one that balances the interests of the various parties in a manner that best benefits overall public interest.[14] A just and reasonable rate is fair to both the utility and to its customers[15] and is no more than is necessary to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[16]

The Commission sets just and reasonable rates via a two-step process using traditional cost-of-service ratemaking.[17] First, the "revenue requirement" must be determined, that is, the amount of income the utility needs on an annual basis. This is determined by matching expenses, investments, and revenue,[18] and the relationship between the three is the fundamental building block of Missouri ratemaking.[19] This relationship is examined during the test year, and the Missouri Court of Appeals described the test year as follows:

> The test year is the primary mechanism through which the PSC determines appropriate rates. The PSC focuses on four factors during the test year: (1) the rate of return the utility has an opportunity to earn; (2) the

[12] ***State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("the commission must of course consider all relevant factors including all operating expenses and the utility's rate of return").

[13] Mo. Rev. Stat. § 393.130 and § 393.140.

[14] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").

[15] ***St. ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

[16] ***St. ex rel. Washington University et al. v. Public Service Commission,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[17] *See* L.E. Alt, ***Energy Utility Rate Setting,*** 18 (2006).

[18] Ex. 215, Rebuttal Testimony of Karen Lyons, p. 19, ll. 18-19.

[19] *See* ***State ex rel. GTE N., Inc. v. Missouri Pub. Serv. Comm'n,*** 835 S.W.2d 356, 368 (Mo. Ct. App. 1992).

> rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. These factors are considered to determine the utility's revenue requirement, which is the amount of revenue taxpayers must generate to pay the costs of producing the utility's services they receive while yielding a reasonable rate of return. The PSC's use of a true-up audit and hearing is designed to balance the historical data with known and measureable subsequent and future changes; these are generally limited only to accounts affected by a significant known and measurable change, such as a new labor contract, new tax rate, or the completion of a new capital asset. This procedure is designed to reduce regulatory lag.[20]

In considering the Company's test year expenses, the Commission should consider whether they are reasonable, necessary and beneficial to ratepayers. Any unreasonable or unnecessary costs should be removed from rates, and, instead, charged to the shareholders. The threshold for reasonable is if the value received from expenditure is commensurate to the amount paid.[21] An expenditure is necessary, if, without it, the utility's ability to provide safe and adequate services within its service territory would be impaired. Finally, expenses that provide no benefits to the ratepayers should be excluded from rates and charged to the shareholders.

In the same vein, the Commission should consider whether the Company's expenditures are lawful and prudent. Any found to be imprudent or unlawful should be excluded from rates. An expenditure is unlawful if it violates a statute or regulation or a Commission order. An expense is imprudent if it is harmful to ratepayers and, if viewed in the context of what the Company and its officers knew or should have known at the

[20] ***In Matter of Kansas City Power & Light Co.'s Request for Auth. to Implement a Gen. Rate Increase for Elec. Serv. v. Missouri Pub. Serv. Comm'n***, No. WD 79125, 2016 WL 4626933, at *5 (Mo. Ct. App. Sept. 6, 2016), *reh'g and/or transfer denied* (Nov. 1, 2016), *transfer denied* (Feb. 28, 2017).

[21] ***State ex rel. Office of the Pub. Counsel v. Pub. Serv. Comm'n of Missouri****,* 938 S.W.2d 339, 342 (Mo. Ct. App. 1997)("If the costs to the Company associated with the existence of the contract exceed the benefits that accrue to the Company, the Commission will make an adjustment to the Company's revenue requirement to compensate the Company's ratepayers for the excessive value transferred by the Company to the District. If, on the other hand, the benefits associated with the existence of the contract exceed the costs associated with the contract, the Commission will make no adjustment.").

time the Company made the expenditure, a reasonable prudent person would not have made the expenditure.

To summarize, the ratemaking recipe is often expressed by the following formula:

$$\mathbf{RR = C + (V - D) R}$$

where: RR = Revenue Requirement;
C = Prudent Operating Costs, including Depreciation Expense and Taxes;
V = Gross Value of Utility Plant in Service;
D = Accumulated Depreciation; and
R = Overall Rate of Return or Weighted Average Cost of Capital (WACC).

Cost-of-service ratemaking establishes the utility's cost of providing service on an annual basis, based upon annualized and normalized test year expenses, and adds to that amount a reasonable allowance for a profit to the shareholders on the value of their investment. The profit allowance, in turn, is calculated by multiplying the value of the utility's plant-in-service less accumulated depreciation by a rate of return. This sum is the revenue requirement, that is, the amount of money the company must earn annually to cover its cost of service and provide a reasonable return to its investors. Determining the revenue requirement is the first half of the ratemaking process.[22]

After the revenue requirement is determined, rates must be designed in a manner that, given the usage characteristics of the utility's customers, will produce the necessary revenue, with no class significantly under- or over-contributing to the overall

[22] Edison Electric Institute (EEI), ***Rate Shock Mitigation*** (June, 2007) p. 5 ("In simple terms, a utility's cost of service or revenue requirement consists of three primary elements: (1) operating costs, such as fuel costs, purchased power costs, operations and maintenance (O&M) costs and customer service costs; (2) a return of capital cost, otherwise known as depreciation expense; and (3) a return on capital cost, including applicable income taxes.").

revenue produced.[23] The appropriate rate design is shaped in the context of a class cost of service study ("CCOS"), which is designed to determine what rate of return is produced by each customer class on that class's currently tariffed rates, for recovery of any calculated revenue requirement amount. From there, recommended interclass revenue responsibility shifts, as applicable, are designed to reasonably bring each class closer to producing the system-average rate of return used in determining the recommended revenue requirement. Any recommended intra-class shifts will, where appropriate, redesign the rates that collect a particular class's revenues to better align that class's method of recovering revenue with the cost-causation for that class that was indicated by the class cost-of-service study. A well-designed CCOS will produce rates that are non-discriminatory and based upon principles of cost causation. That is not to say that that rates or rate increases must be the same for each class, as "discrimination as to rates is not unlawful where based upon a reasonable classification corresponding to actual differences in the situation of the consumers or the furnishing of the service."[24]

Rate design may be driven by considerations additional to recovering the necessary revenue requirement in a fair and equitable manner. These objectives may be fairness, simplicity, stability, avoidance of undue discrimination or preferences, efficiency, and conservation.[25] Avoidance of "rate shock", that is, an increase that is simply too large and impactful to be easily accepted by ratepayers, is another consideration in rate design. Fair rates match costs and cost causers, so that similarly

---

[23] *See* ***State ex rel. Missouri Office of Pub. Counsel v. Pub. Serv. Comm'n of State***, 293 S.W.3d 63, 73 (Mo. Ct. App. 2009).

[24] ***Smith v. Pub. Serv. Comm'n***, 351 S.W.2d 768, 771 (Mo. 1961).

[25] Alt, *supra,* 58-60; J.C. Bonbright *et al.,* ***Principles of Public Utility Rates,*** 85-179 (PUR: Arlington, VA, 2nd ed. 1988).

situated customers pay the same rates. Simple rates are easy to understand and administer. Efficiency and conservation mean that prices send appropriate cost signals at the appropriate times to the customers to safeguard society's scarce resources and to avoid waste and other societal harms from over-generation.

In summary, Staff urges the Commission to set just and reasonable rates for KCPL, after due consideration of all relevant factors, by adopting Staff's recommendations as discussed herein.

- *Nicole Mers*

ARGUMENT

I. Cost of Capital:

Introduction:

Staff recommends that the Commission allow KCPL a Return on Equity ("ROE") in the range 7.90% to 8.75%, specific point recommendation 8.65%, based upon its expert analysis of market-driven data using traditional analytical tools.[26] This ROE should be combined with GPE's June 30, 2016, consolidated capital structure (50.8% debt and 49.2% equity) and GPE's consolidated embedded cost of debt of 5.42% to arrive at the allowed rate of return ("ROR") in this case of 7.01%.[27]

[26] Ex. 200, *Staff's Revenue Requirement Cost-of-Service Report,* pp. 10, 43, 46 ("*Staff RR Report*"). Dr. Woolridge used the Discounted Cash Flow Model ("DCF") and the Capital Asset Pricing Model ("CAPM") applied to a proxy group of comparable companies that he assembled, as well as to the proxy group used by Mr. Hevert.

[27] Ex. 200, *Staff RR Report,* p. 11; App. 2, Ex. JRW-1; *see* Table 2, *below.*

Party & Expert	Recommendation
KCPL (Robert Hevert)[28]	9.75%-10.50%, **9.90%**
MIEC (Michael Gorman)[29]	8.90%- 9.50%, **9.20%**
Staff (J. Randall Woolridge)[30]	7.90%- 8.75%, **8.65%**
TABLE 1 – EXPERT ROE RECOMMENDATIONS.	

As the chart above demonstrates, the ROE recommendations before the Commission in this case range between 7.90% and 10.50%, a spread of 260 basis points.[31]

What is the Significance of This Issue?

Cost of capital is a significant issue in this case – the difference between Staff's position and the Company's is worth over $26 million.[32] Cost of capital is always a large issue in terms of the amount of revenue requirement and also a contentious issue in a general rate case; this case is no exception. The term "cost of capital" refers to the cost of each component of the capital structure, typically long-term debt, preferred equity and common equity.[33] The cost of both long-term debt and preferred equity is historic or "embedded" and can be readily determined from the controlling instruments.[34] The cost of common equity, on the other hand, is driven by the market and must be estimated through expert analysis and judgment.[35]

[28] Ex. 127, Hevert Direct, pp. 3, 63; Ex. 128, Hevert Rebuttal, pp. 2, 11, 68; Ex. 129, Hevert Surrebuttal, pp. 2-4, 28.

[29] Ex. 650, Gorman Direct, p. 2 (9.00%, range 8.80%-9.20%); Ex. 651, Gorman Rebuttal, p. 29; Ex. 652, Gorman Surrebuttal, p. 2.

[30] Ex. 200, *Staff RR Report,* pp. 10, 43, 46; Ex. 233, Woolridge Surrebuttal, pp. 18, 20.

[31] Three other parties took positions on the cost of capital, but did not offer expert testimony: OPC, 7.9%-8.75%; Consumers' Council, 8.65%; and MECG, 9.20%. *See* the *Statement of Positions on the Issues* filed by each party.

[32] *Staff Reconciliation,* filed February 2, 2017 (as of June 30, 2016).

[33] Short-term debt, that is, debt payable in less than one year, is typically excluded.

[34] Although in this case, the cost of debt is also a contested issue.

[35] Ex. 127, Hevert Direct, p. 8, lines 6-7; Ex. 200, *Staff RR Report,* p. 27, line 26, through p. 28, line 1.

The Experts

Three expert financial analysts testified before the Commission in this case and offered estimates to the Commission for the cost of common equity. Mr. Hevert and Mr. Gorman have MBAs and hold the Chartered Financial Analyst ("CFA") designation.[36] Both Mr. Hevert and Mr. Gorman have testified before the Commission concerning ROE many times.[37] Dr. Woolridge is Professor of Finance and the Goldman, Sachs & Co. and Frank P. Smeal Endowed Faculty Fellow in Business Administration in the College of Business Administration of the Pennsylvania State University.[38] In addition to a MBA, Dr. Woolridge has a Ph.D. in Business Administration (major area: finance) from the University of Iowa.[39] He has authored numerous articles in the area of finance as well as several books.[40] He has testified before numerous state commissions over the past twenty-five years, including this Commission.[41] All three experts are independent consultants. Mr. Hevert provides ROE testimony solely on behalf of utilities.[42] Mr. Gorman provided ROE testimony in this case on behalf of an incorporated association reflecting the interests of large commercial and industrial customers.[43] Dr. Woolridge testified for Staff in this case, but has appeared for other non-utility parties in prior cases.

---

[36] Ex. 127, Hevert Direct, p. 1; Ex. 650, Gorman Direct, App. A, pp. 1 and 4.

[37] The case participation experience of these witnesses is detailed at Ex. 127, Hevert Direct, Attachment A; Ex. 650, Gorman Direct, App. A, p. 3.

[38] Ex. 200, *Staff RR Report,* App. 1, p. 57.

[39] *Id.*

[40] *Id.*

[41] *Id.*

[42] Robert Hevert, Tr. 7:123-124.

[43] Michael Gorman, Tr. 7:227-230; Ex. 650, Gorman Direct, p. 1, lines 12-14.

OPC presented the testimony of Charles Hyneman, a regulatory accountant, on the issue of Missouri's regulatory environment.[44] Mr. Hyneman rebutted testimony by Mr. Hevert and KCPL witness Darrin Ives that KCPL has performed poorly in terms of profitability because the Missouri Commission is unsupportive.[45] Mr. Hyneman did not calculate a ROE.

What is the Rate of Return?

In addition to the Company's prudent operating and maintenance expenses, revenue requirement includes both a return "of" and a return "on" the net current value of the shareholders' investment.[46] The former is provided by depreciation expense; the latter by the rate of return.[47] The rate of return is a multiplier which, applied to the net current rate base, results in the return or "profit" allowed to the investors in return for the use of their private property in serving the public.[48] The Due Process Clause requires that the shareholders be allowed an opportunity to earn a reasonable return on their investment;[49] likewise, the Due Process Clause bars excessive rates.[50] Pursuant to financial theory, a fair rate of return is an amount sufficient to meet the utility's capital

[44] Ex. 303, Hyneman Rebuttal, pp. 2-11; 48-51.

[45] *Id.*

[46] Edison Electric Institute (EEI), ***Rate Shock Mitigation*** (June, 2007; available on the Internet) p. 5 ("In simple terms, a utility's cost of service or revenue requirement consists of three primary elements: (1) operating costs, such as fuel costs, purchased power costs, operations and maintenance (O&M) costs and customer service costs; (2) a return of capital cost, otherwise known as depreciation expense; and (3) a return on capital cost, including applicable income taxes.").

[47] *Id.*

[48] Ex. 200, *Staff RR Report,* pp. 9-10.

[49] ***St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("***UCCM***").

[50] ***Zinermon v. Burch,*** 494 U.S. 113, 125, 110 S.Ct. 975, 983, 108 L.Ed.2d 100, ___ (1990): "Given that public utilities are state-regulated monopolies and that their rates are subject to state approval, it is clear that excessive rates would violate the Due Process Clause. '[T]he Due Process Clause contains a substantive component that bars certain arbitrary, wrongful government actions regardless of the fairness of the procedures used to implement them.'"

costs.[51] The Commission does not set the rate of return directly, but sets the ROE, which is a component of the rate of return. In this way, the Commission indirectly sets the rate of return.[52]

	Ratio	Cost Rate	Weighted Cost Rate
Long Term Debt	50.80%	5.42%	2.75%
Common Equity	49.20%	8.65%	4.26%
TOTAL:	100.00%	--	7.01%
TABLE 2 – CALCULATION OF THE RATE OF RETURN.			

Determination of the Cost of Common Equity:

A. What return on common equity should be used for determining rate of return?

Staff's position: ***The allowed ROE should be set at 8.65%.***[53]

As noted, the cost of common equity capital must be estimated. This is a difficult task, as academic commentators have recognized.[54] It is said that this "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."[55] The evaluation of expert testimony is left to the Commission, which "may adopt or reject any or all of any witness's [sic] testimony."[56]

[51] Ex. 200, *Staff RR Report,* p. 9.

[52] The Rate of Return is identical to the Weighted Average Cost of Capital ("WACC"), which is calculated by multiplying the cost of each capital component by the percentage reflecting its proportion in the capital structure and summing the results.

[53] *Staff's Statement of Positions on the Issues.*

[54] C.F. Phillips, Jr., ***The Regulation of Public Utilities: Theory & Practice*** 394 (PUR: Arlington, VA, 1993); L.S. Goodman, 1 ***The Process of Ratemaking***, 606 (PUR: Vienna, VA, 1998).

[55] Goodman, *supra,* 606.

[56] ***State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission of Missouri,*** 116 S.W.3d 680, 690 (Mo. App., W.D. 2003); ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 37 S.W.3d 287, 294 (Mo. App., W.D. 2000) (quoting ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985)).

Cost of Equity ("COE") v. Return on Equity ("ROE")

Staff has consistently maintained that the cost of equity ("COE") is distinct from the return on equity ("ROE") set by the Commission.[57] The COE is the return necessary to induce investors to invest in the utility's common stock rather than some other investment of similar risk; it is a market-driven value that must be discerned by the experts through analysis and judgment.[58] The ROE, on the other hand, is the figure set by the Commission; it is the allowed level of profit granted to the utility by the regulator.[59] The ROE is often referred to as the "allowed ROE" or "authorized ROE" in contradistinction to the COE, which is determined by the market, and the "earned ROE," which is a measure of the utility's actual financial performance over some past period of time.[60] The COE and the authorized ROE may be the same number, but they don't have to be. It is Staff's consistent view that the allowed ROE is uniformly set significantly higher than the COE by regulatory commissions across the nation. In the present case, Dr. Woolridge's recommended ROE is identical to KCPL's COE, which explains why it may seem unduly low. As he observed, "In equilibrium, the expected and required rates of return on a company's common stock are equal."[61]

Dr. Woolridge also pointed out that profitable firms have a market-to-book ratio higher than one, indicating that the firm is earning more than its cost of capital; while unprofitable firms have a market-to-book ratio below one, indicating that they are not

[57] Ex. 200, *Staff RR Report,* p. 9, lines 11-12. This is not a distinction recognized by all of the experts; for example, Mr. Hevert notes that he uses the terms "ROE" and "cost of equity" interchangeably. Ex. 127, Hevert Direct, p. 2, n. 1.

[58] Ex. 200, *Staff RR Report,* p. 10, lines 10-16; Ex. 127, Hevert Direct, p. 3, lines 11-12, p. 7, lines 10-16.

[59] Ex. 200, *Staff RR Report,* p. 9, line 13, and p. 10, lines 3-4.

[60] *See* Ex. 127, Hevert Direct, p. 3, lines 6-10.

[61] Ex. 200, *Staff RR Report,* p. 24, lines 28-29.

earning their cost of capital.[62] Dr. Woolridge presented a table demonstrating that the average market-to-book ratio in 2015 for electric utilities was 1.55X, demonstrating that, in general, regulated electric utilities earn well above their actual cost of capital.[63] The flip side of this observation, Dr. Woolridge points out, is that "customers have been paying more than necessary to support an appropriate profit level for regulated utilities."[64]

Constitutional Parameters

The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must be met in setting the cost of common equity.[65] Each of the experts has affirmed that he conducted his studies and made his recommendations with these parameters in mind.[66] In the earlier of these two cases, ***Bluefield Water Works***, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[67]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the

[62] Ex. 200, *Staff RR Report,* pp. 25, line 18, through p. 26, line 26.

[63] Ex. 200, *Staff RR Report,* p. 27, lines 20-23, and App. 2, Ex. JRW-7, p. 3.

[64] Ex. 200, *Staff RR Report,* p. 27, lines 21-23.

[65] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, *43 S.Ct. 675, 67 L.Ed. 1176* (1923).

[66] Ex. 127, Hevert Direct, p. 9, lines 3-10; Ex. 200, *Staff RR Report,* p. 10, lines 6-9; Ex. 650, Gorman Direct, p. 24, lines 9-18.

[67] ***Bluefield***, *supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

> public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[68]

The Court restated these principles in ***Hope Natural Gas Company***, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[69]

From these two decisions, three guiding principles can be discerned:[70]

(1) An adequate return is commensurate to the returns realized from other businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain the utility's credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

---

[68] *Id.,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

[69] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

[70] Ex. 200, *Staff RR Report,* p. 10, lines 4-9.

The first of these principles is based on risk and unmistakably requires a comparative process. The return on common equity set by the PSC must be about as much as investors would realize from other investments with similar risks.[71] What entities are those? Other public utilities. Financial analysts and investors recognize that every line of business is, by its very nature, subject to a set of unique risks. Consequently, the business entities that face corresponding risks and uncertainties to the utility under consideration are necessarily other utilities engaged in delivering the same service under similar conditions. Therefore, the Commission must look to the returns required from a proxy group of comparable companies in setting the utility's return on common equity.[72]

The second principle, simply stated, refers to the effect of the PSC's decision on the utility's credit rating. If the Commission's decision will not cause it to drop, then the utility's credit is maintained and confidence that the utility will continue in business in the future, meeting its obligations as they come due, providing safe and adequate service to its customers, and yielding a fair return to its shareholders is unimpaired.

The third principle refers to the utility's ability to compete in the market place for necessary capital. KCPL competes for capital with other utilities and utilities likewise compete with unregulated businesses.

Proxy Groups

Because the constitution requires a comparative analysis, the ROE is a market-based concept and KCPL is not publicly traded, each of the experts applied well-

[71] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted): "By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."

[72] Ex. 127, Hevert Direct, p. 8, lines 9-11: "… because the Cost of Equity is premised on opportunity costs, the models typically are applied to a group of 'comparable' or 'proxy' companies …."

established financial analytical methods to one or more proxy groups.[73] The goal in constructing these proxy groups is to approximate the profile of KCPL as closely as possible.[74] This is achieved by using comparable companies that are in the same line of business as KCPL and which are perceived by investors as having the same degree of risk.[75]

Mr. Hevert used a proxy group of 16 electric utilities, starting with all companies classified as electric utilities by *Value Line* and excluding those that do not consistently pay quarterly cash dividends, those not covered by at least two utility industry equity analysts, those lacking investment grade senior unsecured bonds or an investment grade credit rating, those that are not vertically-integrated, those whose regulated operating income over the most recently reported three years did not comprise at least 60% of the total, and those involved in a merger or acquisition.[76] Dr. Woolridge used Mr. Hevert's proxy group and a group of his own devising that included 30 companies, but eliminating Great Plains Energy and Westar Energy due to their announced merger.[77] Mr. Gorman also used Mr. Hevert's proxy group, but excluded Otter Tail because he did not have analysts' growth rates from Zacks, SNL Financial or Reuters for it.[78]

[73] Ex. 127, Hevert Direct, p. 12, lines 3-8; Ex. 200, *Staff RR Report,* pp. 22-23, and App. 2, Ex. JRW-4; Ex. 650, Gorman Direct, p. 25, line 6, through p. 26, line 15.

[74] Ex. 127, Hevert Direct, p. 12, lines 11-16; Ex. 200, *Staff RR Report,* pp. 22-23; Ex. 650, Gorman Direct, p. 25, lines 2-4; p. 26, lines 3-15.

[75] *Id.*

[76] Ex. 127, Hevert Direct, pp. 12-14.

[77] Ex. 200, *Staff RR Report,* pp. 22-23.

[78] Ex. 650, Gorman Direct, p. 25, lines 9-11.

Analytical Methods:

Two principal methods have emerged for determining the cost of common equity, the "market-determined" approach and the "comparable earnings" approach.[79] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[80] Examples of market-determined methods are the Discounted Cash Flow method ("DCF"), the Capital Asset Pricing Model ("CAPM") and the Risk Premium method.[81] The comparative earnings approach is a comparative method and relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[82]

None of the analysts in this case used the comparative earnings approach. Mr. Hevert used two varieties of the DCF (constant growth and multi-stage), the CAPM, and a version of the Risk Premium method.[83] Dr. Woolridge used the constant growth version of the DCF and the CAPM.[84] Mr. Gorman used three versions of the DCF (constant growth using consensus analysts' growth rate projections, constant growth using sustainable growth rate estimates, and multi-stage), a Risk Premium model and the CAPM.

In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional

[79] Phillips, *supra,* 394.
[80] *Id.*
[81] *Id.*
[82] *Id.,* at 397.
[83] Ex. 127, Hevert Direct, p. 5, lines 7-10.
[84] Ex. 200, *Staff RR Report,* pp. 11-12.

requirements.[85] The United States Supreme Court noted, "If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end."[86] Likewise, the Missouri Court of Appeals has stated, "It is the impact of the rate order which counts; the methodology is not significant."[87] Within a wide range of discretion, the Commission may select the methodology used in ratemaking, including fixing the ROE.[88] The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.[89] It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.[90] "No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use different approaches in different cases."[91] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[92]

The expert witnesses in this case all used variants of the same analytical methods, relying on market-based data to quantify investor expectations regarding

---

[85] ***State ex rel. Arkansas Power & Light Company v. Missouri Public Service Commission,*** 736 S.W.2d 457, 462 (Mo. App., W.D. 1987); ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[86] ***Hope***, *supra,* 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at ___ .

[87] ***State ex rel. GTE North, Inc. v. Public Serv. Commission,*** 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

[88] ***Missouri Gas Energy v. Public Service Commission***, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); ***State ex rel. Missouri Public Service Company v. Fraas***, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

[89] ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[90] ***State ex rel. City of Lake Lotawana v. Public Service Commission***, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

[91] ***Arkansas Power & Light,*** *supra,* 736 S.W.2d at 462.

[92] ***Federal Power Commission v. Natural Gas Pipeline Company***, 315 U.S. 575, 586, *62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50* (1942); *see* ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

required equity returns. However, while the methods were similar, the data inputs were different, leading to significantly different results between Mr. Hevert, Mr. Gorman and Dr. Woolridge. Mr. Hevert noted, "Equity is unobservable and must be estimated based on observable capital market data. As a consequence, there may be differences of opinion among analysts as to the data, assumptions and models used in the estimation process."[93] Dr. Woolridge noted that "judgment is required in selecting appropriate financial valuation models to estimate a firm's cost of common equity capital, in determining the data inputs for these models, and in interpreting the models' results."[94]

- **Discounted Cash Flow ("DCF") method:** The DCF method is based on the theory that a stock's current price reflects the present value of all expected future cash flows.[95] In its "constant growth" form, the DCF is simply the sum of the dividend yield (current dividend/current stock price) and a growth rate.[96] The dividend yield is calculated by dividing the annualized dividend by the current stock price.[97] The selection of a growth rate is critical. The Constant Growth DCF assumes stable growth into perpetuity.[98] Because of the limitations inherent in that assumption,[99] Mr. Hevert and Mr. Gorman each also performed a Multi-Stage DCF, in which

[93] Ex. 127, Hevert Direct, p. 3, lines 10-12.

[94] Ex. 200, *Staff RR Report,* p. 28, lines 10-12.

[95] Ex. 127, Hevert Direct, p. 16, lines 12-13; Ex. 200, *Staff RR Report,* p. 29, lines 11-12.

[96] Ex. 200, *Staff RR Report,* p. 31, lines 8-14.

[97] Ex. 200, *Staff RR Report,* p. 31, lines 16-17.

[98] Ex. 127, Hevert Direct, p. 18, lines 8-9, and p. 21, lines 5-7; Ex. 200, *Staff RR Report,* p. 30, lines 22-24.

[99] Ex. 650, Gorman Direct, p.32, line 17-20:"The limitation on this constant growth DCF model is that it cannot reflect a rational expectation that a period of high or low short-term growth can be followed by a change in growth to a rate that is more reflective of long-term sustainable growth."

a different growth rate is specified for each of several stages.[100] "A long-term sustainable growth rate for a utility stock cannot exceed the growth rate of the economy in which it sells its goods and services."[101] The terminal stage growth rate is typically not higher than projected GDP.[102]

- **Capital Asset Pricing Model ("CAPM"): "**The CAPM method of analysis is based upon the theory that the market-required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific security."[103] It is a type of risk premium analysis.[104] The CAPM's inputs are the risk-free rate, the market-risk premium, and beta, a coefficient unique to each company that expresses its risk compared to that of the market as a whole.[105]
- **Risk Premium method:** This model is based on the principle that investors require a higher return to assume greater risk.[106] The inputs are a risk-free rate and the equity risk premium.

Analytical Results

The inputs used by the three experts that actually performed analyses, and the results that they obtained, are described below.

[100] Ex. 200, *Staff RR Report,* p. 29, line 26, to p. 30, line 20.

[101] Ex. 650, Gorman Direct, p. 30, lines 13-14.

[102] Ex. 650, Gorman Direct, p. 31, lines 3-5: "[R]ecognizing the long-term GDP growth rate as a maximum sustainable growth [rate] is logical, and is generally consistent with academic and economic practitioner accepted practices."

[103] Ex. 650, Gorman Direct, p. 47, lines 3-5.

[104] Ex. 200, *Staff RR Report,* p. 37, lines 13-23.

[105] Ex. 650, Gorman Direct, p. 48, lines 2-3; Ex. 127, Hevert Direct, p. 33, lines 16-19.

[106] Ex. 127, Hevert Direct, p. 38, lines 7-11; Ex. 650, Gorman Direct, p. 40, lines 6-7.

Constant Growth DCF:

For his Constant Growth DCF, Mr. Hevert used three growth rates and applied each of them to three different stock price calculations (30-day average, 90-day average, and 180-day average): the Zacks consensus long-term earnings growth estimates (proxy group mean 5.44%, proxy group median 5.30%); the First Call consensus long-term earnings growth estimates (proxy group mean 5.31%, proxy group median 5.10%); and the Value Line long-term earnings growth estimates (proxy group mean 5.09%, proxy group median 5.00%).[107] The average growth rate Mr. Hevert used was 5.29%.[108] Mr. Hevert's results ranged from 8.25% to 9.48%.[109] Mr. Gorman used the mean of professional security analysts' earnings growth estimates from Zacks, SNL and Reuters.[110] The proxy group average was 5.41%.[111] Mr. Gorman's results were 8.80% (average) and 8.79% (median).[112] Mr. Gorman also performed a Sustainable Growth DCF, using an average sustainable growth rate of 4.29%.[113] Mr. Gorman's sustainable DCF results were 7.65% (average) and 7.32% (median).[114] Dr. Woolridge, after long consideration, used an average growth rate of 5.0% for his Electric Proxy

[107] Ex. 127, Hevert Direct, p. 20, line 18, to p. 21, line 1; and Sch. RBH-1, pp. 1-3, columns 5-7; and see page 20, lines 14-15.

[108] Ex. 127, Hevert Direct, Sch. RBH-1, pp. 1-3, column 8.

[109] Ex. 127, Hevert Direct, p. 22, Table 2. Mr. Hevert's analysis produced nine results, a mean low, mean, and mean high for each of his three stock price calculations: 30-Day: 8.25%, 8.76%, 9.24%; 90-Day: 8.31%, 8.82%, 9.30%; 180-Day: 8.49%, 9.00%, 9.48%.

[110] Ex. 650, Gorman Direct, p. 29, lines 6-9.

[111] Ex. 650, Gorman Direct, p. 29, line 23; and Sch. MPG-5.

[112] Ex. 650, Gorman Direct, p. 30, lines 2-3; Sch. MPG-6.

[113] Ex. 650, Gorman Direct, pp. 31-32, esp. p. 32, lines 5-6.

[114] Ex. 650, Gorman Direct, p. 32, lines 9-12; Sch. MPG-8.

Group and 5.30% for Mr. Hevert's proxy group.[115] Dr. Woolridge's results were 8.45% for the Electric Proxy Group and 8.74% for the Hevert Proxy Group.[116]

	Growth Rate	Results
Hevert	5.29%	8.25% - 9.48%
Gorman	5.41%	8.80%, 8.79%
	4.29%	7.65%, 7.32%
Woolridge	5.0%, 5.30%	8.45%, 8.74%
TABLE 3 – CONSTANT GROWTH DCF RESULTS.		

A comparison of the experts' growth rates and results for the Constant Growth DCF shows that they are substantially similar, with the exception of Mr. Gorman's very low Sustainable DCF results (7.65%, 7.32%) and Mr. Hevert's "Mean High" results (9.24%, 9.30%, 9.48%).

Multi-Stage DCF:

For the terminal stage of his Multi-Stage DCF, Mr. Hevert used a long-term growth rate of 5.28%, which he described as the real GDP growth rate for 1929 through 2015 of 3.24% plus an inflation rate of 1.98%.[117] Mr. Hevert's analysis again produced nine results, ranging from a low of 9.15% to a high of 10.36%.[118] Mr. Gorman did perform a Multi-Stage DCF analysis and he used a consensus economists' projected growth rate for nominal GDP, found in *Blue Chip Economic Indicators,* as his terminal stage growth rate: 4.10%.[119] Mr. Gorman's results were 7.74% (average) and 7.82% (median).[120] Dr. Woolridge did not perform a Multi-Stage DCF because, in his opinion,

[115] Ex. 200, *Staff RR Report,* pp. 32-36, esp. p. 36, lines 17-19 and lines 25-27.

[116] Ex. 200, *Staff RR Report,* p. 37, Table 1.

[117] Ex. 127, Hevert Direct, p. 28, lines 3-6.

[118] Ex. 127, Hevert Direct, p. 32, Table 5. Mr. Hevert's analysis again produced nine results, a mean low, mean, and mean high for each of his three stock price calculations: 30-Day: 9.15%, 9.45%, 9.73%; 90-Day: 9.30%, 9.60%, 9.88%; 180-Day: 9.78%, 10.08%, 10.36%.

[119] Ex. 650, Gorman Direct, p. 36, lines 15-21, through p. 37, lines 1-7. The figure of 4.10% is composed of projected real growth of 2.1% and projected inflation of 2.0%.

[120] Ex. 650, Gorman Direct, p. 39, lines 16-18.

the Constant Growth version is most appropriate for the "mature" electric utility industry: "In my opinion, the economics of the public utility business indicate that the industry is in the steady-state or constant-growth stage of a three-stage DCF."[121]

	Terminal Growth Rate	Results
Hevert	5.28%	9.15% to 10.36%
Gorman	4.10%	7.74%, 7.82%
Woolridge	--	--
TABLE 4 – MULTI-STAGE DCF RESULTS.		

A comparison of Mr. Hevert's terminal growth rate and results to Mr. Gorman's terminal growth rate and results reveals significant divergence. Mr. Hevert's terminal growth rate is 118 basis points higher than Mr. Gorman's. Mr. Hevert's lowest result is 141 basis points *higher* than Mr. Gorman's lowest result. Mr. Hevert's highest result is 254 basis points *higher* than Mr. Gorman's highest result. Note that Mr. Hevert's terminal stage growth rate is based on *historic GDP growth* while Mr. Gorman's is based on *projected GDP growth.*[122] It is frankly unrealistic to expect the American economy to grow in the future at the same rate that it did between 1929 and 2015, so Mr. Gorman's terminal growth rate is to be preferred.[123]

CAPM:

All three experts performed a CAPM analysis. Mr. Hevert used an average market-risk premium of 10.80%[124] and his results were 9.49%, 9.92%, 11.18%, and

[121] Ex. 200, *Staff RR Report,* p. 30, lines 35-36; Tr. 11, p. 758, lines 3-6.

[122] Ex. 127, Hevert Direct, p. 28, lines 3-6; Ex. 650, Gorman Direct, p. 36, lines 15-21, through p. 37, lines 1-7.

[123] *See* Mr. Hevert's own criticism of the use of a historical rather than forward-looking market-risk premium, Ex. 127, Hevert Direct, p. 35, line 12, through p. 36, line 9; *see also* Dr. Woolridge at *Staff RR Report,* Ex. 200, p. 39, line 28, through p. 40, line 27; Tr. 11, p. 759, lines 14-18 ("we're not going to see GDP growth of 7 percent anymore. We're looking at 4 to 5 percent.")

[124] Ex. 127, Hevert Direct, p. 36, line 16. The actual market-risk premia that Mr. Hevert used were 9.11%, 9.55%, 10.72%, and 11.15%. Ex. 127, Hevert Direct, p. 38, Table 6.

11.62%.[125] Mr. Gorman used two market-risk premia, 6.00% (historical) and 8.10% (forward-looking),[126] and his results were 7.38% and 8.88%.[127] Mr. Gorman rounded the higher of his results to 8.90% and selected it for his recommendation because "it closely aligns the market risk premium with the prevailing risk-free rate."[128] Dr. Woolridge used a market-risk premium of 5.5%, which he described as "in the upper end of the range,"[129] and his result was 7.9% for each of his proxy groups.[130]

	Market Risk Premium	Results
Hevert	10.50%, 11.10%	9.11% to 11.62%
Gorman	6.00%, 8.10%	7.38%, 8.88%
Woolridge	5.5%	7.9%
TABLE 5 – CAPM RESULTS.		

Again, a comparison reveals significant divergence in the inputs and results. Mr. Hevert's average market-risk premium is 530 basis points *higher* than Dr. Woolridge's and 480 and 270 basis points *higher* than Mr. Gorman's historical and forward-looking market-risk premia, respectively. It is therefore not surprising that Mr. Hevert's results are 159 to 372 basis points *higher* than Dr. Woolridge's and 211 to 273 basis points higher than Mr. Gorman's, even though Mr. Hevert used *lower* risk-free rates than did the other two experts.[131]

[125] Ex. 127, Hevert Direct, p. 38, Table 6.

[126] Ex. 650, Gorman Direct, p. 49, line 7, through p. 50, line 6.

[127] Ex. 650, Gorman Direct, p. 52, lines 6-12.

[128] Ex. 650, Gorman Direct, p. 52, lines 10-11.

[129] Ex. 200, *Staff RR Report,* p. 42, lines 5-7.

[130] Ex. 200, *Staff RR Report,* p. 42, Table 2.

[131] The risk-free rates used by the experts were 2.15% and 3.08% (Mr. Hevert), 3.10% (Mr. Gorman) and 4.0% (Dr. Woolridge). Ex. 127, Hevert Direct, p. 38, Table 6; Ex. 650, Gorman Direct, p. 48, lines 5-8; Ex. 200, *Staff RR Report,* p. 42, Table 2.

Risk Premium Method:

Mr. Hevert and Mr. Gorman each performed a Bond Yield Plus Risk Premium analysis; Dr. Woolridge did not. Mr. Hevert defined the risk premium as the difference between the authorized ROE and the then-prevailing 30-year Treasury yield and gathered data from 1,471 rate proceedings occurring between January 1980 and May 31, 2016.[132] Mr. Hevert's risk-free rates were 2.65%, 3.08%, and 4.45%, his equity-risk premia were 7.39%, 6.97%, and 5.94%, and his results were 10.04%, 10.05%, and 10.39%.[133] Mr. Gorman first calculated the equity-risk premium as the difference between commission-authorized ROEs and a Treasury bond yield for every year from January 1986 through September 2016.[134] Mr. Gorman also calculated the equity-risk premium as the difference between commission-authorized ROEs and contemporary "A" rated utility bond yields by Moody's for the same period.[135] Mr. Gorman's average equity-risk premia were 5.47% and 4.09%.[136] Mr. Gorman weighted his high-end result at 75% and his low end result at 25% because "greater risk securities appear to support an above-average risk premium relative to historical averages."[137] Applying these weighted equity-risk premia of 6.1% and 4.9% to the risk-free rate of 3.1% and the current Baa observable utility bond yield of 4.28%, Mr. Gorman's result in each case was 9.20%.[138]

[132] Ex. 127, Hevert Direct, p. 39, lines 4-7.

[133] Ex. 127, Hevert Direct, p. 41, Table 7. The equity-risk premia are calculated by subtracting the risk-free rate in column one from the result in column two.

[134] Ex. 650, Gorman Direct, p. 40, line 13, through p. 41, line 5.

[135] Ex. 650, Gorman Direct, p. 41, lines 6-10.

[136] Ex. 650, Gorman Direct, p. 41, line 19, and p. 42, line 7.

[137] Ex. 650, Gorman Direct, p. 45, line 16, through p. 46, line 1; and p. 46, lines 5-17.

[138] Ex. 650, Gorman Direct, p. 46, lines 5-19.

	Equity Risk Premia	Results
Hevert	7.39%, 6.97%, 5.94%	10.04%, 10.05%, 10.39%
Gorman	6.1%, 4.9%	9.20%
Woolridge	--	--
TABLE 6 – RISK PREMIUM RESULTS.		

Table 6 also reveals significant divergence between the analytical results obtained by each expert. Mr. Hevert's results range from 84 basis points to 119 basis points *higher* than Mr. Gorman's and his equity-risk premia are generally higher as well.

Developing a Recommendation:

Each expert developed a recommendation from his raw analytical results.

Mr. Hevert noted that his mean analytical results "do not necessarily provide an appropriate estimate of the Company's Cost of Equity. In my view, there are additional factors that must be taken into consideration when determining where the Company's Cost of Equity falls within the range of results."[139] Mr. Hevert went on to identify these "risk factors" as the regulatory environment, the Company's generation portfolio, and the Company's capital expenditure plans.[140] With respect to regulatory environment, Mr. Hevert asserts that S&P has classified Missouri in the lowest 25% of 53 regulatory jurisdictions in the United States, indicating that "the Cost of Equity for utilities in Missouri is higher than [for] many other states' utilities."[141] Mr. Hevert also noted Missouri's refusal to include CWIP in rate base and its use of a historical test year in ratemaking.[142] With respect to the Company's generation portfolio, Mr. Hevert noted that KCPL's heavy reliance on coal-fired generation (75%) results in increased risk from

[139] Ex. 127, Hevert Direct, p. 43, lines 3-6.

[140] Ex. 127, Hevert Direct, p. 43, lines 6-8.

[141] Ex. 127, Hevert Direct, p. 44, line 15, through p. 45, line 3.

[142] Ex. 127, Hevert Direct, pp. 45-47. "CWIP" is Construction Work In Progress.

changing market dynamics and more stringent environmental and safety regulations.[143] With respect to planned capital expenditures, Mr. Hevert noted that KCPL's parent, Great Plains Energy, plans approximately $3.04 billion in capital expenditures over the next five years.[144] In light of these risks, Mr. Hevert determined that "an ROE in the range of 9.75 percent to 10.50 percent is reasonable, if not conservative."[145]

Mr. Gorman stated that, based on his analyses, he estimated "KCPL's current market cost of equity to be 9.00%,"[146] the midpoint of his range of 8.80% to 9.20%.[147] Mr. Gorman went on to say:

> My return on equity estimates reflect observable market evidence, the impact of Federal Reserve policies on current and expected long-term market costs, an assessment of the current risk premium built into current market securities, and a general assessment of the current investment risk characteristics of the electric utility industry, and the market's demand for utility securities.[148]

In considering many of the same factors that Mr. Hevert considered, Mr. Gorman did not find any need to raise his ROE recommendation to reflect additional risks faced by KCPL. In his Rebuttal Testimony, based on data through October 28, 2016, Mr. Gorman updated his recommendation to 9.20% and his range to 8.9% to 9.5%.[149]

Dr. Woolridge considered his DCF and CAPM results and determined that "the appropriate equity cost rate for companies in the Electric and Hevert Proxy Groups is in the 7.90% to 8.75% range."[150] Because Dr. Woolridge relied primarily on his DCF

[143] Ex. 127, Hevert Direct, pp. 47-50.
[144] Ex. 127, Hevert Direct, p. 50, line 6.
[145] Ex. 127, Hevert Direct, p. 53, lines 13-14.
[146] Ex. 650, Gorman Direct, p. 52, line 17.
[147] Ex. 650, Gorman Direct, p. 53, lines 1-2.
[148] Ex. 650, Gorman Direct, p. 53, lines 5-9.
[149] Ex. 651, Gorman Rebuttal, p. 2, lines 12-15; pp. 28-29 and Table 4.
[150] Ex. 200, *Staff RR Report,* p. 43, lines 9-10.

model, he selected a specific point recommendation near the high end of his range at 8.65%.[151] Although Dr. Woolridge did not update his ROE recommendation in his written testimony, he explained to the Commission on the stand that recent market conditions justify a 10-basis point increase to the high end of his recommended range, which is consistent with the analysis he provided in written testimony in the concurrent Ameren Missouri rate case, Case No. ER-2016-0179.[152]

Evaluating the Experts

Each of the analytical methods used by the experts depends on inputs that must be selected through the exercise of professional judgment and are, consequently, subject to manipulation. For the various varieties of the DCF, it is the growth rate. For the Risk Premium and CAPM, it is the equity risk premium and the market risk premium. The dividend yield component of the DCF and the risk-free rate used in the CAPM and Risk Premium are also subject to manipulation. The wide variations in the results obtained by the three experts in this case are understandable when these components are compared, as has been demonstrated above. Frankly, Mr. Hevert produced higher results by using higher inputs.

Mr. Gorman described Mr. Hevert's recommendation as "overstated and unreasonable."[153] Elsewhere, Mr. Gorman states that "Mr. Hevert's estimated return on equity is overstated and should be rejected."[154] Mr. Gorman listed the flaws in Mr. Hevert's analyses:[155]

[151] Ex. 200, *Staff RR Report,* p. 43.
[152] Tr. 11, p. 746, lines 3-15.
[153] Ex. 651, Gorman Rebuttal, p. 2, lines 6-7.
[154] Ex. 651, Gorman Rebuttal, p. 3, line 6; Gorman Surrebuttal, p. 2, lines 5-8.
[155] Ex. 651, Gorman Rebuttal, p. 3, lines 9-18.

1. Mr. Hevert's constant growth DCF results are based on unsustainably high growth rates;
2. Mr. Hevert's multi-stage growth DCF is based on:
    a. An unrealistic long-term Gross Domestic Product ("GDP") growth estimate that is not aligned with market participants' outlooks,
    b. A manipulated dividend payout ratio adjustment, and
    c. A terminal stock price that is produced by an unjustified price-to-earnings ("P/E") ratio assumption;
3. Mr. Hevert's CAPM is based on inflated market risk premiums; and
4. Mr. Hevert's Bond Yield Plus Risk Premium studies are based on inflated utility equity risk premiums.

Dr. Woolridge explained that Mr. Hevert's analyses and ROE recommendations are based on the assumption of higher interest rates and capital costs, an assumption that Dr. Woolridge does not share.[156] Dr. Woolridge criticizes Mr. Hevert's failure to give appropriate weight to his Constant Growth DCF results and his reliance, in his DCF studies, on "overly optimistic and upwardly biased EPS growth rate forecasts of Wall Street analysts and *Value Line."*[157] Dr. Woolridge points out that Mr. Hevert's terminal stage growth rate in his Multi-Stage DCF of 5.28% "is about 100 basis points above the projected long-term growth in U.S. GDP."[158] Finally, Dr. Woolridge states that the projected long-term interest rate and market and equity risk premiums used by Mr. Hevert in his CAPM and Risk Premium analyses "are inflated and not reflective of

[156] Ex. 232, Woolridge Rebuttal, p. 2, lines 19-22.
[157] Ex. 232, Woolridge Rebuttal, p. 3, lines 1-4.
[158] Ex. 232, Woolridge Rebuttal, p. 3, lines 5-7.

market realities or expectations."[159] For his CAPM, Mr. Hevert computed the market-risk premium by using the DCF model with Wall Street analysts' 5-year projected EPS growth rate as the growth rate.[160] Dr. Woolridge commented, "this produces an overstated market return and equity risk premium."[161] The Wall Street analysts' 5-year projected EPS growth rates are "overly optimistic and upwardly biased."[162] Dr. Woolridge further explained:

> Long-term EPS growth rates of 11.03% and 11.71% are not consistent with historic or projected economic or earnings growth in the U.S. for several reasons: (1) long-term growth in EPS is far below Mr. Hevert's projected EPS growth rates; (2) more recent trends in GDP growth, as well as projections of GDP growth, suggest slower long-term economic and earnings growth in the future; and (3) over time, EPS growth tends to lag behind GDP growth. The long-term economic, earnings and dividend growth rate in the U.S. has only been in the 5% to 7% range.[163]

Projections of future growth by government agencies and reputable economists are in the 4.1% to 4.5% range.[164] Dr. Woolridge summarized, saying "with a more realistic equity or market risk premium, the appropriate equity cost rate for a public utility should be in the 8.0% to 9.0% range and not in the 10.0% to 11.0% range."[165]

Dr. Woolridge also criticized Mr. Hevert's Risk Premium analysis, explaining "[t]he methodology produces an inflated measure of the risk premium because the approach uses historic authorized ROEs and Treasury yields, and the resulting risk premium is applied to projected Treasury yields."[166] Dr. Woolridge also criticized Mr.

---

[159] Ex. 232, Woolridge Rebuttal, p. 3, lines 8-10; p. 15, line 15; p. 19, lines 1-2.

[160] Ex. 232, Woolridge Rebuttal, p. 15, lines 18-21.

[161] *Id.*

[162] Ex. 232, Woolridge Rebuttal, p. 16, line 4.

[163] Ex. 232, Woolridge Rebuttal, p. 16, lines 8-15, and Table 2.

[164] Ex. 232, Woolridge Rebuttal, p. 17, lines 17-18; Ex. JRW-14, p. 5.

[165] Ex. 232, Woolridge Rebuttal, p. 19, lines 11-13.

[166] Ex. 232, Woolridge Rebuttal, p. 20, lines 16-18.

Hevert's Risk Premium analysis because it measured *commission* behavior rather than *investor* behavior.[167] Finally, Dr. Woolridge noted that Mr. Hevert's Risk Premium analysis produced an inflated required rate of return because, as the market-to-book ratio indicates, state utility regulatory commissions have been setting ROEs *above* the actual cost of equity for many years.[168]

Mr. Gorman approved of Mr. Hevert's Constant Growth DCF results, as did Dr. Woolridge.[169] When the growth rates and results of the experts were compared, above, they were found to be substantially similar. However, Mr. Gorman considered Mr. Hevert's Multi-Stage DCF to be "simply inflated";[170] Dr. Woolridge called it "excessive."[171] Mr. Gorman explained:

> Mr. Hevert's long-term steady-state growth rate used in his multi-stage DCF analysis was 5.28%. This long-term growth rate is nearly identical to the average growth rate used in his constant growth DCF study of 5.29% as reflected in his Schedule RBH-1 under Column 8. While using a virtually identical growth rate, the results of his multi-stage growth DCF analysis were considerably higher than his constant growth DCF study. This inflation to the multi-stage growth DCF results largely reflects assumptions and inputs made by Mr. Hevert to manipulate dividend payout ratios and hence cash flow projections during the transitional stage of his model, and to use an artificial P/E ratio estimate to produce an inflated terminal value stock price in the steady-state growth period.[172]

Mr. Gorman pointed out that Mr. Hevert's manipulations are revealed by the fact that his Multi-Stage DCF results are 75 to 100 basis points *higher* than his Constant Growth DCF results, despite the fact that the terminal growth rate and dividend yields

[167] Ex. 232, Woolridge Rebuttal, p. 21, lines 1-12.

[168] Ex. 232, Woolridge Rebuttal, p. 21, lines 13-20.

[169] Ex. 651, Gorman Rebuttal, p. 5, lines 12-20; Woolridge Rebuttal, p. 4, lines 3-4.

[170] Ex. 651, Gorman Rebuttal, p. 6, line 5.

[171] Ex. 232, Woolridge Rebuttal, p. 4, line 7.

[172] Ex. 651, Gorman Rebuttal, p. 6, lines 5-15.

"are nearly identical between the two studies."[173] Mr. Gorman noted further that Mr. Hevert's terminal stage growth rate "does not reflect consensus market participant outlooks for future GDP growth"; that "his dividend payout assumption is flawed and simply inflates dividend payments and DCF return estimates"; and that his "arbitrary terminal value P/E ratio input has the effect of further inflating Mr. Hevert's multi-stage growth DCF return estimate."[174] Mr. Gorman criticized Mr. Hevert's use of the historical GDP in calculating his terminal stage growth rate as being "considerably higher than the real GDP growth projection of 2.2% provided by consensus economists and published in the *Blue Chip Financial Forecasts.*[175] Dr. Woolridge also criticized Mr. Hevert's inflated initial stage growth rate as "upwardly biased and overly optimistic"[176] and his terminal stage growth rate as being about 100 basis points too high.[177]

With respect to Mr. Hevert's CAPM, Mr. Gorman stated that his "major concern with Mr. Hevert's CAPM analysis is his use of an inflated market return …."[178] Dr. Woolridge agreed, stating "[t]he primary issue is Mr. Hevert's estimate of the market risk premium. Mr. Hevert's market risk premium is excessive and does not reflect current market fundamentals."[179] Mr. Gorman explained that, in calculating his two market-risk premia, Mr. Hevert used a DCF analysis with growth rates of 11.08% and 11.71%, "far too high to be a rational outlook for sustainable long-term market growth."[180] Mr.

[173] Ex. 651, Gorman Rebuttal, p. 6, lines 15-24.
[174] Ex. 651, Gorman Rebuttal, p. 7, lines 1-11.
[175] Ex. 651, Gorman Rebuttal, p. 8, lines 11-14.
[176] Ex. 232, Woolridge Rebuttal, p. 7, lines 15-19; p. 9, lines 5-18; p. 10, lines 4-7.
[177] Ex. 232, Woolridge Rebuttal, p. 11, line 3, through p. 14, line 7.
[178] Ex. 651, Gorman Rebuttal, p. 13, lines 12-13.
[179] Ex. 232, Woolridge Rebuttal, p. 4, lines 16-18.
[180] Ex. 651, Gorman Rebuttal, p. 14, line 16.

Gorman noted that Mr. Hevert's growth rates "are more than two times the growth rate of the U.S. GDP long-term growth outlook of 4.25%."[181] The not unexpected result, Mr. Gorman points out, are returns that are inflated and unreliable and which should be given minimal weight.[182] Dr. Woolridge's reaction is similar; he notes that Mr. Hevert's "expected market returns and risk premiums include unrealistic assumptions regarding future economic and earnings growth and stock returns."[183] Dr. Woolridge explains that "[t]he primary errors in Mr. Hevert's CAPM analysis are the market premiums of 10.50% and 11.10% which are based on the upwardly-biased long-term EPS growth rate estimates of Wall Street analysts."[184]

Mr. Gorman also criticizes Mr. Hevert's two Risk Premium studies. Mr. Gorman explains that Mr. Hevert's Bond Yield Plus Risk Premium simply ignores investment risk differentials and is based exclusively on changes in nominal interest rates.[185] This is, Mr. Gorman states, a "flawed methodology that does not produce accurate or reliable risk premium estimates."[186] Elsewhere, Mr. Gorman calls it a "simplistic and incomplete notion."[187] Mr. Gorman also criticized Mr. Hevert's Alternative Bond Yield Plus Risk Premium study.[188]

Dr. Woolridge explains that Mr. Hevert's Risk Premium studies measure commission behavior and not investor behavior.[189] Dr. Woolridge also notes that "Mr.

[181] Ex. 651, Gorman Rebuttal, p. 14, lines 17-18.
[182] Ex. 651, Gorman Rebuttal, p. 14, lines 19-23.
[183] Ex. 232, Woolridge Rebuttal, p. 4, line 23, through p. 5, line 1.
[184] Ex. 232, Woolridge Rebuttal, p. 15, lines 1-3.
[185] Ex. 651, Gorman Rebuttal, p. 18, lines 11-14.
[186] Ex. 651, Gorman Rebuttal, p. 18, lines 13-14.
[187] Ex. 651, Gorman Rebuttal, p. 19, line 6.
[188] Ex. 651, Gorman Rebuttal, pp. 20-21.
[189] Ex. 232, Woolridge Rebuttal, p. 5, lines 13-14.

Hevert's methodology produces an inflated measure of the risk premium because his approach uses historical authorized ROEs and Treasury yields."[190] Finally, Dr. Woolridge points out that Mr. Hevert's risk premium is inflated because electric utilities have been selling at market-to-book ratios in excess of 1, indicating that the authorized rates of return have been greater than the return that investors require.[191]

Mr. Gorman also disagrees with the additional, KCPL-specific risk factors considered by Mr. Hevert.[192] Mr. Gorman notes that all of the risk factors identified by Mr. Hevert are considered by rating agencies when establishing corporate bond and credit ratings.[193] In particular, Mr. Gorman states that Mr. Hevert ignores the fact that the market views utility securities as low risk and the fact that utilities' cost of capital is very low in today's marketplace.[194] Contrary to Mr. Hevert's position, Mr. Gorman states that it is "clear that consensus economists' outlooks are expecting much lower interest rates out over the next five to ten-year horizon in 2016 than they were expecting in 2014 and in 2015. This is clear evidence that consensus market participants are more accepting of the sustainability of today's low capital market costs."[195] Dr. Woolridge also disagreed with Mr. Hevert with respect to the likelihood of increased interest rates.[196] Dr. Woolridge recommended "that the Commission set an equity cost rate based on current market cost rate indicators and decline to speculate on the future direction of

[190] Ex. 232, Woolridge Rebuttal, p, 5, line 22, through p. 6, line 2.

[191] Ex. 232, Woolridge Rebuttal, p. 6, lines 2-5.

[192] Ex. 651, Gorman Rebuttal, p. 23.

[193] Ex. 651, Gorman Rebuttal, pp. 23-24.

[194] Ex. 651, Gorman Rebuttal, p. 25, lines 6-10; Ex. 652, Gorman Surrebuttal, p. 3, lines 19-23, p. 4, lines 8-14; p. 5, lines 15-16.

[195] Ex. 652, Gorman Surrebuttal, p. 8, lines 1-5.

[196] Ex. 233, Woolridge Surrebuttal, p. 3, line 8, through p. 4, line 6.

interest rates."[197] As Dr. Woolridge indicated in his testimony, investors would not be buying 30-year Treasuries yielding 3.0% today if they expected interest rates to increase to 4.0% in the next year, resulting in a negative return.[198] Investors do not buy securities expecting a negative return.[199]

Mr. Hevert criticized Dr. Woolridge's ROE recommendation of 8.65%.[200] Dr. Woolridge explained that his recommended ROE reflects the current low capital costs for utilities.[201] Dr. Woolridge testified that electric utilities are presently earning ROEs of 8.5% to 9.0%, their stock prices are up 16%, their bonds are being upgraded and they are raising 50 to 60 billion dollars annually of capital with no difficulties.[202] Great Plains is itself earning an ROE of 5% to 6% and yet has raised a very large amount of capital for its intended acquisition of Westar.[203] In fact, Dr. Woolridge provide evidence that Goldman Sachs estimated a cost of equity of ** ____ ** when advising Great Plains Energy on a fair price to pay for Westar Energy.[204] In consideration of these undeniable facts, Dr. Woolridge concluded that his recommended ROE of 8.65% meets the standards announced in *Hope* and *Bluefield.*[205] Dr. Woolridge noted that if the Commission authorizes an ROE above the actual cost of equity, then ratepayers will

[197] Ex. 233, Woolridge Surrebuttal, p. 4, lines 10-11.

[198] Ex. 200, *Staff RR Report,* p. 21, lines 17-25.

[199] Ex. 200, *Staff RR Report,* p. 21, lines 24-25.

[200] Ex, 128, Hevert Rebuttal, p. 14, line 15, through p. 15, line 22.

[201] Ex. 233, Woolridge Surrebuttal, p. 18, lines 14-16.

[202] Tr. 11, p. 752, lines 5-19; p. 753, lines 10-12' p. 756, lines 8-9.

[203] Tr. 11, p. 752, line 22, through p. 753, line 1; p. 753, lines 18-20.

[204] Ex. 233, Woolridge Surrebuttal, p. 20, lines 18-19.

[205] Tr. 11, p. 753, lines 2-5' referring to ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

NP

pay more than necessary.[206] Mr. Gorman pointed out that an authorized ROE that is higher than the actual cost of equity not only means higher rates for ratepayers but stifles economic growth and sales.[207] Mr. Gorman also pointed out that utilities in general are enjoying unfettered access to capital.[208]

Other Considerations

Things look good for KCPL and other regulated electric utilities. Although authorized ROEs continue to trend downward nationally, electric utilities have been able to access large amounts of capital at low cost.[209] Mr. Gorman testified that market evidence is "quite clear" that capital market costs are near historically low levels.[210] Utility investment grade credit standings are stable to improving.[211] As we are well-aware at this Commission, the ratemaking process has been increasingly rebalanced in the utilities' favor as such mechanisms as the Fuel Adjustment Clause are implemented to significantly reduce operating risk.

Things don't look quite so good for KCPL's customers. The economy in the Kansas City area is improving, but slowly. The real GDP growth of Missouri has averaged less than 1% per annum from 2010 to 2015, lagging behind that of the nation as a whole.[212] On the other hand, the unemployment rate in Missouri is now below pre-recession levels, better than the U.S. as a whole.[213] However, the unemployment rate is

[206] Tr. 11, p. 760, lines 10-11.
[207] Tr. 7, p. 264, lines
[208] Tr. 7, p. 265, line 16, through p. 266, line 5.
[209] Ex. 650, Gorman Direct, p. 13, lines 21-25.
[210] Ex. 650, Gorman Direct, p. 14, lines19-20.
[211] Ex. 650, Gorman Direct, p. 14, line 22, through p. 15, line 1.
[212] Ex. 200, *Staff RR Report,* p. 5, lines 4-5, and Figure 1.
[213] Ex. 200, *Staff RR Report,* p. 5, lines 10-14.

higher in the counties that KCPL serves than in the state as a whole.[214] Economic indicators suggest that slow growth will continue in the future.[215]

From 2007 to 2015, the Missouri counties served by KCPL saw an average 17.62% increase in average weekly wages, about 3% *above* the increase in the Consumer Price Index ("CPI").[216] During the same period, KCPL filed six rate cases, which resulted in cumulative electric rate increases of 57.69%.[217] KCPL has also experienced inflationary pressure illustrated by a 10.31% increase in the Producer Price Index ("PPI") for Industrial Commodities from 2007 to 2015.[218] KCPL is currently requesting an additional $90.1 million or a 10.77% increase in rates.[219] If KCPL receives its requested 10.77% increase, the increase in average weekly wages would be less than one-fifth of the increase in electric rates.[220]

Conclusion:

Based on all of the foregoing, Staff recommends that the Commission authorize an ROE for KCPL in the range of in the range 7.90% to 8.75%, specific point recommendation 8.65%, as recommended by Staff's expert witness Dr. J. Randall Woolridge. Dr. Woolridge's recommendation is based on direct evidence from the capital markets that clearly shows the cost of capital has declined since KCPL's last rate

[214] Ex. 200, *Staff RR Report,* p. 5, lines 10-14.
[215] Ex. 200, *Staff RR Report,* p. 7, lines 1-12.
[216] Ex. 200, *Staff RR Report,* p. 7, lines 15-18.
[217] Ex. 200, *Staff RR Report,* p. 7, lines 18-20.
[218] Ex. 200, *Staff RR Report,* p. 7, line 20, through p. 8, line 1.
[219] Ex. 200, *Staff RR Report,* p. 8, lines 1-2.
[220] Ex. 200, *Staff RR Report,* p. 8, lines 4-6.

case. In particular, KCPL and its parent are able to access very large amounts of capital on favorable terms, although their earned ROEs are 5% to 6%.[221]

The analyses performed by KCPL's expert witness, Mr. Robert Hevert, do not pass close scrutiny. In those areas where professional judgment was required, he chose to skew the data in his client's favor. Consistently, Mr. Hevert selected higher values rather than lower values. His growth rates are too high; his market risk premia and equity risk premia are too high. While nationally, authorized ROEs have undeniably trended downward, Mr. Hevert's recommendation is suspiciously high.

The Commission must balance the investors' interests against the ratepayers' interests. From 2007 to 2015, KCPL has enjoyed cumulative electric rate increases of 57.69%.[222] Its customers, over the same period, have seen wages increase by an average of 17.62%.[223] ROE is one of the largest issues in this case and it is the issue where the Commission has the most discretion. That is not an unfettered discretion, however, because the Commission's decision must be supported by substantial evidence of record. As demonstrated by the foregoing, the substantial evidence in this record supports an allowed ROE in the range 7.90% to 8.75%, specific point recommendation 8.65%.

B. Capital structure – what capital structure should be used for determining rate of return?

Staff's position: ***The capital structure should be based on GPE's consolidated capital structure, which consists of 50.8% long-term debt and 49.2% common equity.***

[221] Tr. 11, p. 752, line 22, through p. 753, line 1; p. 753, lines 18-20.

[222] Ex. 200, *Staff RR Report,* p. 7, lines 18-20.

[223] Ex. 200, *Staff RR Report,* p. 7, lines 15-18.

C. Cost of debt – what cost of debt should be used for determining rate of return?

Staff's position: ***The cost of debt should be based on GPE's consolidated embedded cost of debt, which correctly calculated is 5.42%.***

Introduction:

The capital structure of a utility is a conceptualization of its capital financing. The capital structure consists of equity, financed by the sale of stock to shareholders, and debt, financed by the sale of bonds to creditors. Both types of investors expect a return on their investment. The Rate of Return ("ROR") is the Weighted Average Cost of Capital ("WACC") and is multiplied by the rate base to produce a return to the equity and debt investors. The higher the cost of either component, the higher the revenue requirement necessary to service the capital. Equity necessarily costs more than debt, so the higher the percentage of equity in the capital structure, the higher the revenue requirement necessary to service the capital. While the ROE is always contested, in this case, both the percentage of equity and the cost of debt are contested as well.

	STAFF	KCPL
Equity Percentage:	49.20%	49.88%
Cost of Debt:	5.42%	5.51%

Argument:

In past rate cases, KCPL and its affiliate, KCP&L Greater Missouri Operations Company ("GMO"), have both proposed the use of Great Plains Energy's ("GPE") consolidated capital structure for ratemaking purposes.[224] This was -- and continues to be – the most appropriate option because ratings agencies such as Standard and

[224] Ex. 220, Murray Rebuttal, p. 2, lines 6-7; Ex. 221, Murray Surrebuttal, p. 1, lines 18-21; p. 5, lines 3-7.

Poor's ("S&P") assign credit ratings to both KCPL and GMO based on GPE's consolidated financial and business risk profile.[225] Furthermore, GPE operates KCPL and GMO as a consolidated entity for GPE's advantage.[226] This is demonstrated by GPE's manipulation of KCPL's and GMO's dividends.[227] KCPL's proposal in this case, to use a subsidiary-specific capital structure, is therefore illogical.[228]

KCPL's witness Kevin Bryant testified that, since GMO issues its own debt, then KCPL's subsidiary capital structure should be used because the debt issuance is evidence of separate financial management.[229] Mr. Bryant is attempting to misinform the Commission. The reality is that GPE has used KCPL's credit capacity to issue debt on behalf of GMO.[230] One danger of using a subsidiary capital structure for ratemaking is that the holding company may artificially create an equity-rich subsidiary capital structure to create value for shareholders.[231] For that reason, Staff generally recommends the use of the parent's capital structure for ratemaking.[232]

Staff notes that on one occasion, KCPL issued a longer tenor debt at a higher cost in order to help lengthen the average-weighted maturity of GPE's consolidated debt portfolio.[233] Had KCPL issued 10-year debt rather than 30-year debt, its Cost of Debt in this case would be only 5.26%.[234] Rating agencies, such as S&P, consistently rate

[225] Ex. 220, Murray Rebuttal, p. 2, lines 9-11.
[226] Ex. 220, Murray Rebuttal, p. 8, line 19, through p. 9, line 2.
[227] Ex. 221, Murray Surrebuttal, p. 9, lines 1-21.
[228] Ex. 220, Murray Rebuttal, p. 2, lines 7-11.
[229] Ex. 221, Murray Surrebuttal, p. 1, line 23, through p. 2, line 2.
[230] Ex. 221, Murray Surrebuttal, p. 2, lines 23-24.
[231] Ex. 220, Murray Rebuttal, p. 3, line 22, through p. 4, line 5.
[232] Ex. 220, Murray Rebuttal, pp. 4-7; Murray Surrebuttal, p. 5, lines 3-7.
[233] Ex. 221, Murray Surrebuttal, p. 3, lines 9-12; p. 5, line 17, through p. 6, line 5.
[234] Ex. 221, Murray Surrebuttal, p. 6, lines 9-13.

GPE and its subsidiaries based on GPE's consolidated capital structure.[235] S&P stated on May 31, 2016:

> There are no meaningful insulation measures in place that protect KCP&L and GMO from their parent and therefore, KCP&L's and GMO's issuer credit ratings are in line with GPE's group credit profile of "bbb+."[236]

In the case of KCPL, Staff recommends the Commission use the capital structure most advantageous to the ratepayers.[237] Why? Because KCPL's ratepayers subsidized GPE's acquisition of GMO.[238] Staff's recommendation is also based on the fact that GPE artificially reduced GMO's cost of debt below that of KCPL by use of KCPL's strong credit position, a manipulation that was inherently unfair to KCPL's ratepayers because it resulted in higher rates for them.[239] As of December 31, 2015, about 60% of GMO's debt was actually issued by GPE and assigned to GMO.[240] GPE also guarantees GMO's debt, and commercial paper.[241] GMO's credit rating is based on GPE's consolidated capital structure, as is KCPL's.[242] The equity composition of GPE's capital structure is identical to that of KCPL, but the use of GPE's capital structure for ratemaking would nonetheless result in a lower revenue requirement because GPE's

[235] Ex. 221, Murray Surrebuttal, p. 3, lines 22-23.

[236] Ex. 221, Murray Surrebuttal, p. 4, lines 10-13; *quoting* "Great Plains Energy Ratings Affirmed, Outlook Revised To Negative On Proposed Acquisition Of Westar Energy," May 31, 2016, S&P Capital IQ.

[237] Ex. 220, Murray Rebuttal, p. 7, line 21, through p. 8, line 3; Ex. 221, Murray Surrebuttal, p. 10, lines 1-7.

[238] Ex. 221, Murray Surrebuttal, p. 10, line 11, through p. 11, line 3.

[239] Ex. 220, Murray Rebuttal, p. 8, lines 6-16; Ex. 221, Surrebuttal, p. 6, line 21, through p. 8, line 19.

[240] Ex. 220, Murray Rebuttal, p. 10, lines 5-6.

[241] Ex. 220, Murray Rebuttal, p. 10, lines 7-8.

[242] Ex. 220, Murray Rebuttal, p. 10, lines 12-22.

cost of debt is lower than KCPL's.[243] Staff's goal is to allow KCPL's ratepayers to benefit from the use GPE has made of KCPL's strong credit rating.[244]

There is a problem with the cost of debt proposed by the Company, 5.51%.[245] KCPL's method of computing its Cost of Debt double counts debt issuance expenses and discounts.[246] It is Staff's position that KCPL has added an extra and unnecessary step to its calculation that results in an inflated and inaccurate cost of debt.[247] The result is that the Cost of Debt sponsored by KCPL is three basis points higher than it should be.[248] Staff's proposed Cost of Debt is 5.42%, which is GPE's consolidated Cost of Debt as of June 30, 2016, calculated correctly with no double counting.[249] KCPL denies that it double counted anything, but says it is willing to use the simple interest/amortization computational method, which yields a Cost of Debt of 5.42% for GPE on a consolidated basis.[250]

Conclusion:

On account of all the foregoing, Staff urges the Commission to use GPE's consolidated capital structure and Cost of Debt for ratemaking purposes in this case. These are the values that Staff and the Company both have recommended be used in the past; these are the values that the Commission has accepted and used in the past; and these are the values that are most advantageous to KCPL's ratepayers. It is a

[243] Ex. 220, Murray Rebuttal, p. 11, lines 10-20.

[244] Ex. 220, Murray Rebuttal, p. 11, line 21, through p. 12, line 4.

[245] Ex. 220, Murray Rebuttal, p. 12, line 16, through p. 13, line 18; *see* Schedule RBH-10 to Hevert Direct, Ex. 127.

[246] Ex. 220, Murray Rebuttal, p. 12, lines 16-17. Staff describes KCPL's methodology as an improper blending of the two accepted computational methods. P. 13, lines 1-2; p. 14, lines 3-4.

[247] Ex. 220, Murray Rebuttal, p. 12, line 19, through p. 13, line 2; p. 13, lines 11-15.

[248] Ex. 220, Murray Rebuttal, p. 13, lines 13-14.

[249] Ex. 220, Murray Rebuttal, p. 14, lines 14-22; *see* Ex. 200, *Staff RR Report,* App. 2, Ex. JRW-1.

[250] Ex. 221, Murray Surrebuttal, p. 11, line 19, through p. 12, line 5.

simple matter of fairness given that those ratepayers have for paid $146.7 million in higher rates to support KCPL's credit.[251] There is no good reason to adopt either the capital structure or the Cost of Debt sponsored by KCPL in this case and it would be unjust.

- Kevin A. Thompson

II. Fuel Adjustment Clause ("FAC"):

A. Has KCPL met the criteria for the Commission to authorize it to continue to have an FAC?

Yes, Staff witness David Roos recommends continuation of the FAC with modifications that will allow the FAC Base Factor to be reset with updated cost and loss factor information.[252]

B. Should the Commission authorize KCPL to continue to have an FAC?

Yes, Mr. Roos testified that KCPL's Actual Net Energy Costs continue to be relatively large. KCPL's proposed Base Energy Cost in this case represent 37% of KCPL's total cost to be recovered in rates. These costs continue to be volatile and beyond the control of the Company,[253] thus meeting the requirements of Commission Rule 4 CSR 240-20.090(2)(C).

C. What costs should flow through KCPL's FAC?

Staff supports the *Non-Unanimous Partial Stipulation And Agreement* (para. 9) filed on February 10, 2017 and approved by the Commission in its *Order Approving Stipulation And Agreement Regarding Certain Issues* effective March 8, 2017. Staff

[251] Ex. 221, Murray Surrebuttal, p. 8, lines 6-9.
[252] Ex. 200, *Staff RR Report,* p. 162, lines 8-13.
[253] Ex. 200, *Staff RR Report,* p. 164, lines 11-14.

continues to recommend no change to the remaining costs flowing through KCPL's current FAC.

D. What revenues should flow through KCPL's FAC?

Staff witness Roos testified that it recommends no change to the revenues flowing through KCPL's current FAC.[254]

E. What is the appropriate sharing mechanism of the difference between actual and base fuel costs in KCPL's FAC?

The Staff recommends no change to the current 95/5 sharing mechanism.

F. What FAC-related reporting requirements should the Commission impose?

Staff FAC witness David Roos testified that due to the accelerated Staff review process necessary with FAC adjustment filings[255] Staff recommends the Commission again order[256] KCPL to continue to provide the following information as part of its monthly reports:[257]

1. As part of the information KCPL submits when it files a tariff modification to change its Fuel and Purchased Power Adjustment rate, include KCPL's calculation of the interest included in the proposed rate;

2. Maintain at KCPL's corporate headquarters or at some other mutually agreed upon place and make available within a mutually-agreed-upon time for review, a copy of each and every coal and coal transportation, natural

[254] Ex. 226, Roos Rebuttal, p. 2, line 1, through p. 3, line 4.

[255] The company must file its FAC adjustment 60 days prior to the effective date of its proposed tariff sheet. Staff has 30 days to review the filing and make a recommendation to the Commission. The Commission then has 30 days to approve or deny Staff's recommendation.

[256] ***In the Matter of Kansas City Power & Light Company,*** Case No. ER-2014-0370 (***Report & Order,*** issued September 2, 2015) pp. 47 – 48.

[257] Ex. 200, *Staff RR Report,* p. 161, lines 6-10, and p. 170, line 9, through p. 171, line 17.

gas, fuel oil and nuclear fuel contract KCPL has that is in or was in effect for the previous four years;

3. Within 30 days of the effective date of each and every coal and coal transportation, natural gas, fuel oil and nuclear fuel contract KCPL enters into, provide both notice to the Staff of the contract and opportunity to review the contract at KCPL's corporate headquarters or at some other mutually-agreed-upon place;

4. Provide a copy of each and every KCPL hedging policy that is in effect at the time the tariff changes ordered by the Commission in this rate case go into effect for Staff to retain;

5. Within 30 days of any change in a KCPL hedging policy, provide a copy of the changed hedging policy for Staff to retain;

6. Provide a copy of KCPL's internal policy for participating in the Southwest Power Pool's Integrated Market;

7. Maintain at KCPL's corporate headquarters or at some other mutually agreed-upon place and make available within a mutually agreed-upon time for review, a copy of each and every bilateral energy or demand sales/purchase contract;

8. If KCPL revises any internal policy for participating in the Southwest Power Pool, within 30 days of that revision, provide a copy of the revised policy with the revisions identified for Staff to retain; and

9. The monthly as-burned fuel report supplied by KCPL required by 4 CSR 240-3.190(1)(B) shall explicitly designate fixed and variable components

of the average cost per unit burned including commodity, transportation, emissions, tax, fuel blend, and any additional fixed or variable costs associated with the average cost per unit reported.

G. What is the appropriate base factor?

Staff witness Ashley Sarver testified under signed affidavit that she has applied updated information regarding Revenue Requirement for coal and freight (less test year unit trains, depreciation, and property taxes), purchased power energy, percentage of purchased power, sales for resale (non-firm) off system sales, and net system input. As a result of these changes the Staff recommends a true-up base factor for KCPL of $0.01545.[258]

H. Should the Commission direct the parties to determine baseline heat rates for each of the utility's nuclear and non-nuclear generators, steam and combustion turbines and heat recovery steam generators?

The Commission promulgated rules that require an electric utility with an established FAC to submit a schedule and testing plan for heat rate tests,[259] and in subsequent rate cases, submit the results of the heat rate tests.[260] KCPL provided the Commission with the required testing plan in ER-2014-0370.[261] In the current case, KCPL witness Burton L. Crawford included heat rate test results in Schedule BLC-6.[262] Staff witness J Luebbert reviewed Schedule BLC-6 and sent two data requests asking KCPL to submit additional heat rate test results.[263] Mr. Luebbert then compared all of the heat rate test results KCPL provided in this current case to the heat rate test results

[258] Ex. 253, Sarver True up Rebuttal, pp. 1-2.
[259] 4 CSR 240-3.161(2)(P).
[260] 4 CSR 240-3.161(3)(Q).
[261] *See* Ex. 214, Luebbert Surrebuttal, p. 2, lines 14-16.
[262] Ex. 116, Crawford Direct.
[263] Ex. 200, *Staff RR Report,* pp. 171-172.

previously provided[264] and determined that KCPL had satisfied the requirements of 4 CSR 240-3.161(3)(Q).[265]

No party is asserting that KCPL has not complied with the applicable Commission rules for heat rate tests. Instead, OPC is asking the Commission to direct the parties to create baseline heat rates for each of KCPL's generating units. OPC's request is beyond the current scope of the rules, and furthermore, OPC provides no definition or insight as to what would constitute a "baseline" heat rate nor does OPC provide any proof that baseline heat rates would be a useful metric. As such, OPC has not provided the Commission with evidence that it is in the public's interest to direct the parties to determine baseline heat rates for each generating facility.

Simply, the rules require KCPL to have a heat rate testing procedure,[266] to follow that procedure, and to submit the results to the Commission.[267] KCPL has complied with these rules. Staff suggests that should the Commission find some merit in OPC's request to develop baseline heat rates, a rulemaking docket is the proper forum.

- *Jamie Myers*

I. If the Commission authorizes KCPL to have a FAC, should KCPL be allowed to add cost and revenue types to its FAC between rate cases?

Yes. Staff's position is that the FAC should continue to allow for the addition of cost and revenue types for the FAC between rate cases as provided for on Pages 5 and 6 of Schedule TMR-3 of the Direct Testimony (Ex. 142) of Tim M. Rush.

- *Bob Berlin*

[264] Tr. p. 587, lines 5-10.
[265] Ex. 200, *Staff RR Report,* pp. 171-172.
[266] 4 CSR 240-3.161(2)(P).
[267] 4 CSR 240-3.161(3)(Q).

XVII. Depreciation:

A. Should the Commission allow terminal net salvage in the calculation of KCPL's depreciation rates?

Staff's position: ***Staff opposes the inclusion of terminal net salvage in the calculation of deprecation rates; the costs are not known and measureable.***

Staff opposes the inclusion of any amount for terminal net salvage in depreciation rates because the actual cost that will be incurred is unknown, cannot be measured, and is thus speculative.[268] The amount in question in this case is the cost to retire production plants from service, not including any cost to actually dismantle them.[269] The Commission has previously excluded terminal net salvage from rates for exactly that reason.[270] Nothing has changed in the interim and there is no good reason to admit it to rates now.[271]

KCPL has attempted to pose the issue as a matter of intergenerational equity: if the cost to retire the plant is not accrued while it is operating, then the people that cost is eventually collected from will be people that never received any benefit from the plant they are paying to retire. However, as with any speculative cost, if the amount accrued for retirement during the plant's operation in fact exceeds the actual cost of that retirement, there will be no feasible way to return that money to the ratepayers that paid too much.[272] So there is a possibility of an intergenerational inequity however the

[268] Ex. 223, Patterson Surrebuttal, p. 4, lines 14-16; Tr. 8, p. 336, lines 20-22; p. 350, line 25, through p. 351, line 4; p. 363, line 22, through p. 364, line 1.

[269] Ex. 223, Patterson Surrebuttal, p. 3, lines 19-20; Tr. 8, p. 337, lines 13-17.

[270] Ex. 223, Patterson Surrebuttal, p. 4, lines 7-9, 13; *see* ***In the Matter of The Empire District Electric Company,*** Case No. ER-2004-0570, 13 Mo.P.S.C.3d 350 (Mar. 10, 2005).

[271] Tr. 8, p. 353, line 21, through p. 354, line 9.

[272] Tr. 8, p. 364, line 16, through p. 365, line 11.

Commission slices this pie. Staff urges the Commission to reject KCPL's effort to include in rates an accrual for utterly speculative terminal net salvage.

B. What depreciation rates should the Commission order KCPL to use?

Staff's position: ***Staff recommends that KCPL continue to use depreciation rates for production plant that the Commission approved in Case No. ER-2014-0307 except as noted in the COS Report to acknowledge the retirement of Montrose Generating Unit 1 and to address the portion of the Greenwood Solar Facility allocated to KCPL. Staff's recommended depreciation schedule strikes out lines associated with the retired Montrose Generating Unit 1. Leaving or removing these lines has no effect on the depreciation expense because the plant in service associated with the unit is zero. Staff also recommends including in the KCPL depreciation rate schedule rates for the Greenwood Solar Facility that the Commission approved for GMO in Case No. ER-2016-0156.***

Staff urges the Commission to resolve the issue of depreciation rates as recommended herein by Staff.

- Kevin A. Thompson

XVIII. Revenues:

A. Should KCPL be permitted to make a $6.6 million adjustment[273] to annualize kWh sales in this rate case as a result of KCPL's Missouri Energy Efficiency Investment Act ("MEEIA") Cycle 1 demand-side programs?

No. KCPL's proposed annualization adjustment for its kWh sales resulting from its Cycle 1 demand-side programs is not permitted under:

1) the *Non-Unanimous Stipulation and Agreement Resolving Kansas City Power & Light Company's MEEIA Filing* filed on May 27, 2014 [*Order Approving*

[273] Ex. 143 Rush Reb, Sched TMR-7, KCPL seeks $6,643,084 proposed MEEIA Cycle 1 adjustment.

Stipulation and Agreement effective June 15, 2014] in Case No. EO-2014-0095 (hereafter "Cycle 1 Stipulation"),

2) the Non-Unanimous Stipulation and Agreement Resolving MEEIA Filings filed on November 23, 2015 [approved by Report and Order effective March 12, 2016] in Case Nos. EO-2015-0240 and EO-2015-0241 (hereafter "Cycle 2 Stipulation"); and,

3) KCPL's Cycle 2 DSIM [Demand-Side Investment Mechanism] Rider, P.S.C. MO. No. 7, Original Sheet Nos. 49F through 49P.274

KCPL has recovered all of its lost margin revenue due it through its Throughput Disincentive – Net Shared Benefits ("TD-NSB") Share model under the Cycle 1 Stipulation

Staff witness John Rogers testified KCPL has recovered its lost margin revenues entitled to it under the TD-NSB Share recovery model set out in the Cycle 1 Stipulation:

> The company has been compensated already under the agreement for Cycle 1 their entire throughput disincentive. If they were to annualize savings again for Cycle 1 programs, they would actually be double recovering.[275]

KCPL earned $17.8 million from its deemed cumulative TD-NSB Share through September 30, 2016.[276]

The Cycle 1 Stipulation allows KCPL to recover its TD-NSB Share by collecting in rates the sum of the net shared benefits over the MEEIA plan period multiplied by 26.36%. The energy and demand savings are based on the actual measures installed and tracked each month and their associated deemed energy (kWh) savings and deemed demand (kW) savings and deemed lifetimes. The total dollar amount of net shared benefits is the sum of the 2014 present value of avoided utility costs over the measures' lives less 2014 present value of all programs' costs discounted using KCPL's

[274] Tr. Vol. 13 p. 1677 lns 12 – 19 and Ex. 225 Rogers Surr. p. 1 ln20 – p. 2 ln 3.

[275] Tr. Vol. 13 p. 1676 ln 24 - p. 1677 ln 3.

[276] Ex. 225 Rogers Surr. p. 8 ln 1 – p. 9 ln 4. Through September 30, 2016, KCPL's actual cumulative billed TD-NSB Share was $13,551,514 or $4,263,877 less than actual deemed TD-NSB of $17,815,391. With an earned interest amount of $47,818, KCPL will recover in KCPL's Cycle 2 DSIM Rider both the $4,263,877 and the $47,818 as unrecovered balances remaining from the MEEIA Cycle 1 Plan.

approved weighted average cost of capital rate of 6.961%.[277] Because deemed values are used for all measures to calculate the net shared benefits ("NSB") in Cycle 1, there is no evaluation, measurement, and verification ("EM&V") for purposes of determining KCPL's TD-NSB Share amount.[278]

Key to the Cycle 1 Stipulation is the use of deemed values because they guarantee the Company receives 26.36% of the net benefits of lifetime energy savings for each measure. Deemed values are applied for calculating the Cycle 1 TD-NSB Share and include for each installed Cycle 1 energy efficiency measure its: annual energy saving, annual demand savings, annual avoided energy costs, annual avoided demand costs, and measure life.[279]

The TD-NSB share model compensates KCPL for each installed measure. Nowhere in the Cycle 1 Stipulation is there language that purports to provide for an annualization to recoup additional lost revenues. Because the TD-NSB share model has compensated KCPL for its lost revenues, there is no cause or support for an additional annualization adjustment.

The Cycle 1 Stipulation was built on an 18 month planned program implementation period.[280] Under the 18 month plan KCPL was estimated to recover only a total TD-NSB Share of $8,885,678 for its lost margin revenue.[281] Due to the flood of applications for the Cycle 1 Commercial and Industrial ("C&I") Custom Rebate program

[277] Cycle 1 Stipulation, p. 4.

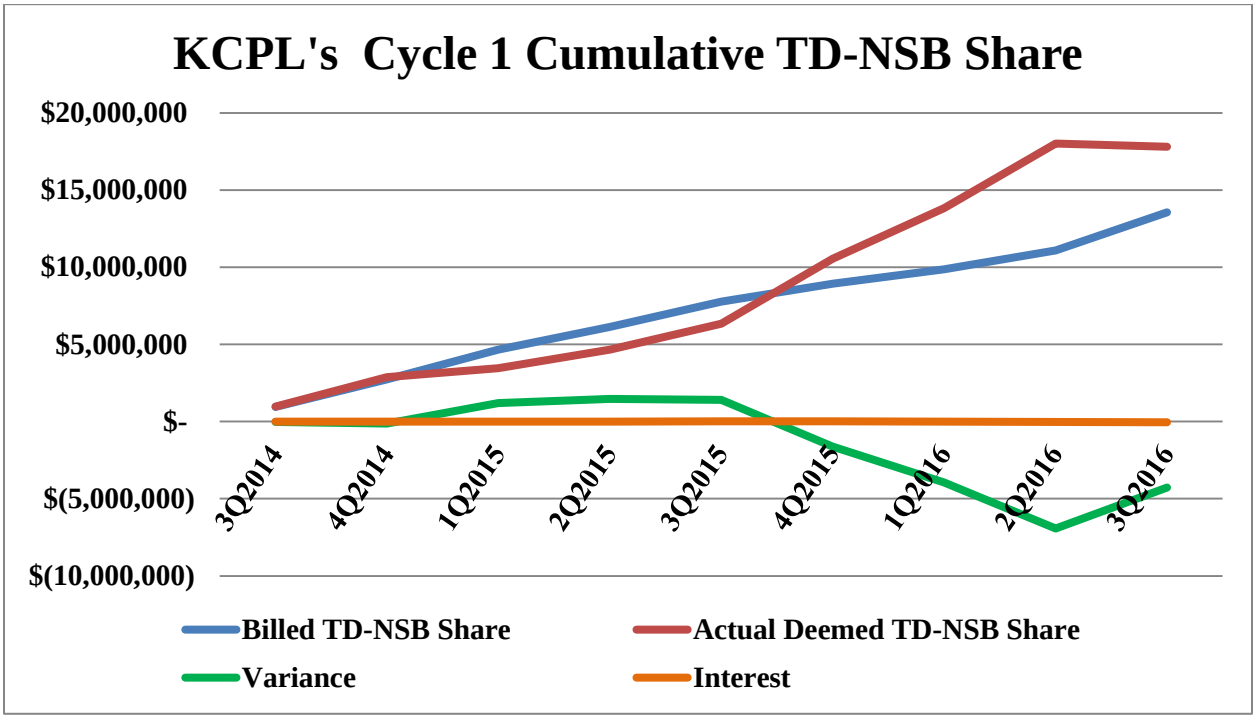
[278] Cycle 1 Stipulation, p.7.

[279] Ex. 225 Rogers Surr. p. 9, FN 11.

[280] Tr. Vol. 13 p. 1686 ln 23 – p. 1687 ln 4.

[281] Ex. 225 Rogers Surr. p. 7 ln 1 –p. 8 ln 11 and Cycle 1 Stipulation p. 4. $8,885,678 is the planned/estimated total TD-NSB share, or 26.36% of the total estimated annual net shared benefits of $33,702,693.

and anticipated changes in the Cycle 2 C&I program, KCPL's total TD-NSB share grew quickly to $17.8 million as shown on the chart below:[282]



The spiked increase in billed and actual TD-NSB share earned by KCPL through September 30, 2016 is reflected in substantially higher rates (effective August 21, 2016 and nearly 2.5 times the April 1, 2016 rate) billed and collected by KCPL from its Non-Residential Service customers over about a 5 month period:[283]

Non-Residential Service	NTD/PE ($/kWh)
Rate effective 4/1/16	$0.00097
Rate effective 8/21/16	$0.00234
Rate effective 2/1/17	$0.00053

[282] Ex. 225 Rogers Surr. p. 8 ln 1 – p. 9 ln 4.

[283] Ex. 240, KCPL Tariff Sheet No. 49O: Original effective April 1, 2016; First Revised effective August 1, 2016; and, Second Revised effective February 1, 2017.

The above chart and the tariffed NTD ("net throughput disincentive") rates show that KCPL has been paid in its entirety for its Cycle 1 lost margin revenues. KCPL has collected in rates its TD-NSB Share for all installed Cycle 1 energy efficiency measures.

The TD-NSB Share model adopted by KCPL and Ameren Missouri does not provide for an annualization adjustment.

Staff witness Rogers testified:

> The [TD-NSB] mechanism allows the utility to recover its throughput disincentive for all energy savings lost for the life of the measure over the course of multiple rate cases assumed to occur at a frequency of 18 months, and it's modeled so that the utility recovers the share of net shared benefits in Cycle 1.[284]

Unlike the Cycle 2 TD mechanism which calls for an annualization adjustment, the Cycle 1TD-NSB Share model does not allow annualization because it recovers all lost margin revenue for the life of the energy-efficiency measure.[285]

Mr. Rogers also testified that the KCPL and Ameren Missouri Cycle 1 TD-NSB Share mechanisms are both based on Ameren Missouri's throughput disincentive electronic spreadsheet model with assumed rate case frequency of 18 months and no annualization of energy efficiency savings during future rate cases. [286] On the workings of the TD-NSB model used by both KCPL and Ameren Missouri, Mr. Rogers cites an explanatory discussion from Ameren's 2012 MEEIA Filing Report that concludes "… *Ameren's proposed DSIM does not assume the energy efficiency savings have been annualized for the test year*."[287] Recognizing the TD-NSB Share model allows no annualization, Ameren Missouri did not propose a similar MEEIA Cycle 1 annualization

[284] Tr. Vol. 13, p. 1670 ln 25 – p. 1671 ln 6.

[285] Tr. Vol. 13, p. 1671 lns 7 – p. 1673 ln 5.

[286] Ex. 225, Rogers Surr. p. 7 lns 17 – 22.

[287] Ex. 225, Rogers Surr. Exhibit JAR-s4 Page 5 of 5, *Ameren Missouri's 2012 MEEIA Filing Report*, lns 20-21.

adjustment in its general rate case.[288]

KCPL misapplies the isolated phrase "all active MEEIA programs"[289] in the Cycle 2 Stipulation to wrongly include a annualization of Cycle 1 programs against the clear meaning of contrary provisions within the four corners[290] of the Cycle 2 Stipulation.

The Cycle 2 Stipulation addresses Cycle 1 in only two ways. First, it provides for KCPL to recover Cycle 1 unrecovered balances[291] for Cycle 1 program costs and Cycle 1 TD-NSB share and any approved Cycle 1 performance incentive award through the Cycle 2 DSIM Rider.[292]

Second, the Cycle 2 Stipulation provides a clear transition between Cycle 1 and Cycle 2 to accommodate prior approved Cycle 1 C&I Custom Rebate program projects completed after the Cycle 1time period. The Cycle 2 Stipulation paragraph 12: Transition Between MEEIA Cycles (subpara. a.) sets plain terms for completion of the Cycle 1 C&I Custom Rebate program:[293]

> a. … …The last day to submit an application for the Cycle 1 C&I Custom Rebate program is December 15, 2015. The last day for approval of an application for the Cycle 1 C&I Custom Rebate program is January 31, 2016. The last day for completion of customer projects and submission of complete paperwork by customers is June 30, 2016. The final payment by KCP&L/GMO of rebates for all Cycle 1 projects is July 31, 2016.

[288] Ex. 225, Rogers Surr. p. 10 lns 1-5.

[289] Ex. 143, Rush Reb. p. 15 lns12-15. Mr. Rush tortures the phrase "all active MEEIA programs" to sway the Commission that the language is broad enough to include MEEIA Cycle 1 programs with the allowed annualization of Cycle 2 programs. Mr. Rush ignores all explicit contrary provisions in the Cycle 1 and Cycle 2 Stipulations and the Cycle 2 DSIM Rider.

[290] "[w]hen the language is unambiguous, the intent of the parties is reflected within the language of the contract and the court will determine the parties' intent from the **four corners** of the document itself." *J.H. Berra Construction Co., Inc, v. Missouri Highway & Transportation Commission*, 14 S.W.3d 276 at 279 (2000) (citing *CB Commercial Real Estate Group, Inc.,* 917 S.W.2d at 646).

[291] Cycle 2 Stipulation, p. 12(ii) **Recovery Mechanism**.

[292] Ex. 225, Rogers Surr. p. 3 lns 15 – 19.

[293] Ex. 2225, Rogers Surr. p. 4 lns 21 – 32. Cycle 2 Stipulation p. 15, para. 12.

Finally, the Cycle 2 Stipulation's paragraph 12.d. sets a bright line condition that further distinguishes the difference in recovery of Cycle 1 DSIM costs from recovery of Cycle 2 costs:[294]

> d. … …***Recovery of all Cycle 1 DSIM costs including all program costs, all throughput disincentive and any performance incentive for Cycle 1 C&I Custom Rebate program projects will be achieved through the Cycle 1 DSIM subject to prudence review for Cycle 1 DSIM costs.*** *As the result of the agreements in this Stipulation, KC P&L and GMO shall use their respective Cycle 1 2015 DSMore files to calculate the Cycle 1 gross benefits to determine the TD-NSB between January 1, 2016 and June 30, 2016. These projects will be modeled in DSMore with a completion date of December 31, 2015.* The Cycle 1 performance incentive amounts will result from full retrospective EM&V. [***Emphasis added.***]

Other than Cycle 1's unrecovered balances being recovered through the Cycle 2 DSIM, Cycle 1 programs and Cycle 2 programs are mutually exclusive of each other and are not commingled as explicitly set out in Cycle 2 Stipulation paragraphs 12.a. and 12.d. The Cycle 2 Stipulation and Cycle 2 DSIM Rider contain no provision, clear or implied, that allow the annualization of Cycle 1 demand-side programs.[295] The Cycle 2 Stipulation specifies that the steps needed to annualize kWh sales for "all active MEEIA programs" is the methodology contained in KCPL's Tariff Sheet 49K and 49L.[296]

"…[A] tariff that has been approved by the Commission becomes Missouri law…As a result, the tariffs have the same force and effect as a statute directly prescribed from the legislature." Allstates Transworld Vanlines, Inc. v. Southwestern Bell Telephone Company, 937 S.W.2d 314,317.

KCPL's **Tariff Sheet 49L** of its DSIM Rider defines "Programs" as only Cycle 2 programs and does not include Cycle 1 programs in its definition:

[294] Ex. 225 Rogers Surr. p. 4 ln 33 – p.5 ln 9. Cycle 2 Stipulation, p. 17, para. 12.d.

[295] Ex. 225 Rogers Surr. p. 5 lns 18 – 20.

[296] Ex. 225 Rogers Surr. p. 2 lns 18 – 20 and Cycle 2 Stipulation, p. 13, para. 10(a)(i).

"Programs-MEEIA Cycle 2 programs listed in **Tariff Sheet 1.04C** and added in accordance with the Commission's rule 4 CSR 240-20.094(4)."[297]

KCPL's **Tariff Sheet 1.04C** lists a table of contents and refers only to "MEEIA CYCLE 2 PROGRAMS" with no mention of Cycle 1 programs.[298]

More to the point, KCPL's Cycle 2 DSIM Rider contains many clear and unambiguous provisions dealing with the collection of unrecovered Cycle 1 balances through the Cycle 2 Rider. There is no mistaking the treatment of Cycle 1 programs from the treatment of Cycle 2 programs. For example, **Tariff Sheet 49 F** provides:[299]

> Charges passed through this DSIM Rider reflect the charges approved to be collected from the implementation of the Missouri Energy Efficiency Investment Act (MEEIA) Cycle 2 Plan ***& any remaining unrecovered charges from the MEEIA Cycle 1 Plan DSIM.*** Those charges include:
>
> 1) Program Costs, Throughput Disincentive (TD) and Earnings Opportunity Award (if any) for the MEEIA Cycle 2 Plan; ***as well as, Program Costs and TD-NSB Share for commission approved C&I program projects completed by June 30, 2016 that will be counted under the MEEIA Cycle 1 Plan, as outlined in S&A found in EO-2015-0240; and any earned Performance Incentive earned (and ordered) attributable to MEEIA Cycle 1 as set out in File No. EO-2014-0095.***
> 2) Reconciliations, with interest, to true-up for differences between the revenues billed under this DSIM Rider and total actual monthly amounts for:
>
> *i)* Program Costs incurred in Cycle 2 ***and/or remaining unrecovered amounts for MEEIA Cycle 1,***
>
> ii) TD Share incurred in Cycle 2, ***and/or true-ups or unrecovered amounts for MEEIA Cycle1, and***
>
> iii) ***Amortization of any Performance Incentive (PI) Award or Earnings Opportunity ordered by the Missouri Public Service Commission (Commission)*** [***Emphasis added.***]

[297] Ex. 225 Rogers Surr. p. 3 lns 4 – 9. KCPL Tariff Sheet 49L as Ex JAR-s3 Page 7 of 11.

[298] Ex. 225 Rogers Surr. p. 3 lns 4 – 9. KCPL Tariff Sheet 1.04C as Ex JAR-s2 Page 1 of 1.

[299] Ex. 225 Rogers Surr. p. 3 ln 19 – p. 4 ln 20 and KCPL Tariff Sheet 49F as Ex JAR-s3 Page 1 of 11.

Allstates v. Southwestern Bell instructs the court, and the Commission as well, to analyze a tariff as it does a statute. If a tariff is clear and unambiguous, it cannot be given another meaning. In determining whether the language of a tariff is clear and unambiguous, the standard is whether the tariff's terms are plain and clear to one of ordinary intelligence.[300] The law is clear. The Commission cannot read into the DSIM Rider a Cycle 1 annualization adjustment for which there are no explicit provisions authorizing its calculation and collection from customers.

The effect on billing determinants from rejecting KCPL's proposed Cycle 1 sales annualization adjustment is slight and is a part of the bargain accepted by KCPL in return for it to receive a Cycle 1 TD-NSB Share payout of 26.36% of the net shared benefits for the lifetime of each installed demand-side measure.

When asked at hearing about the effect of Staff's position on billing determinants going forward, Staff witness Rogers admitted "They'll actually be a little bit higher than they should be…" but that is the outcome of the Cycle 1 Stipulation, the Cycle 2 Stipulation, and the Cycle 2 DSIM Rider.[301]

Mr. Rogers further testified that the proposed Cycle 1 sales annualization adjustment cannot be considered the same way as annualizations that are done for gained or lost customers or done for weather. This is because KCPL seeks an adjustment resulting from the savings deemed from MEEIA Cycle 1 energy efficiency programs. The Company has already received its entire Cycle 1 throughput disincentive. "If they were to annualize savings again for Cycle 1 programs, they [KCPL] would actually be double recovering."[302] For example, the MEEIA Cycle 2 throughput disincentive is rebased to remove the level of savings that were annualized in billing

[300] *Allstates v. Southwestern Bell*, 937 S.W.2d 314 at 317.

[301] Tr. Vol. 13, p. 1677 lns 4 – 19.

[302] Tr. Vol. 13, p. 1666 ln 14 – p. 1677 ln 3.

determinants in the rate case. There is no rebasing adjustment of the MEEIA Cycle 1 throughput disincentive, since the entire Cycle 1 TD-NSB Share has already been recovered by KCPL.

Conclusion:

The Commission must reject KCPL's proposed $6.6million Cycle 1 kWh sales annualization adjustment.

There is no doubt that KCPL's DSIM Rider (Tariff Sheets 49K and 49L) complies with and enacts the Cycle 2 Stipulation paragraph 10. Taken together the tariff sheets and stipulation provide for annualization adjustments of kWh and kW savings resulting from Cycle 2 programs - and only Cycle 2 programs.

Tariff Sheets 49K and 49L carry the "force and effect of law" and clearly set out the process and calculations required for the annualization adjustments to be made for KCPL to collect its throughput disincentive ("TD") for its MEEIA Cycle 2 demand-side programs only. Sheets 49K and 49L do not include provisions for the calculation and collection of a Cycle 1 program sales annualization adjustment.

No person of ordinary intelligence, as the standard requires – or even a skilled MEEIA programs practitioner – can read into the Cycle1 and Cycle 2 Stipulations or the Cycle 2 DSIM Rider a Cycle 1 annualization requirement. It is not to be found in either document. Yet that is what KCPL asks the Commission to do. KCPL urges the Commission to latch on to an isolated phrase to order its unjustified $6.6 million adjustment, ignoring the clear contrary provisions within the four corners of the Cycle 2 Stipulation and Cycle 2 DSIM Rider.

Missouri case law is crystal clear on rejecting the use of isolated phrases to strap on new, unintended, unsupported, and unexplained requirements into an agreement.

When several documents – in this case the Cycle 1 and Cycle 2 Stipulations and the Cycle 2 DSIM Rider – make up the agreement between the parties, the parties' intent and the meaning of those documents must be determined from the entire transaction and not simply from isolated portions of particular documents.[303] Under no reading of the Cycle 1 Stipulation, the Cycle 2 Stipulation and the Cycle 2 DSIM Rider can a reasonable person conclude that a Cycle 1 kWh sales annualization adjustment is permitted.

Should the Commission grant the proposed Cycle 1 $6.6 million kWh sales adjustment, the effect would hurt customers by letting KCPL double recover from them an unjustified $6.6 million above the ordered $17.8 million it collected as the agreed-upon compensation for its Commission-approved Cycle 1 TD-NSB Share. For all the above-stated reasons, the proposed Cycle 1 $6.6 million adjustment is not a "just and reasonable" charge within the meaning of Sect. 393.130.1 RSMo 2013[304] and must be rejected by the Commission.

- Bob Berlin

Billing Determinants:

KCPL tries to reframe the issue as an issue over setting correct billing determinants, to try to sidestep the issue of double recovery and the language of the stipulations. However, this claim is a smokescreen for KCPL collecting an additional 6.6

[303] *J.H. Berra Construction Co., Inc, v. Missouri Highway & Transportation Commission*, 14 S.W.3d 276 at 279 (2000) (*citing* to *Norcomo Corp. v. Franchi Constr. Co.,* 587 S.W.2d 311 (Mo.App.1979)).

[304] Section 393.130.1 states "…All charges made or demanded by any such…electrical corporation…for…electricity…or any service rendered or to be rendered shall be *just and reasonable* and not more than allowed by law or by order or decision of the commission."

million dollars on top of what they have already collected through the Cycle 1 throughput disincentive net-shared benefits mechanism ("TD-NSB").[305]

The Cycle 1 TD-NSB, part of a Stipulation and Agreement signed by KCPL, Staff, OPC, and other parties, was agreed upon as the method to recover lost margin revenues and performance incentive award for the MEEIA Cycle 1 programs. Lost revenues is defined by 4 CSR 240-20.094 (1)(U) as the:

> net reduction in utility retail revenue, taking into account all changes in costs and all changes in any revenues relevant to the Missouri jurisdictional revenue requirement, that occurs when utility demand-side programs approved by the commission in accordance with 4 CSR 240- 20.094 cause a drop in net system retail kWh delivered to jurisdictional customers below the level used to set the electricity rates.

The parties agreed to deem the energy and demand savings of each program, and deem their lifetime. The parties, including KCPL, agreed this deeming of savings would fully compensate KCPL for any impacts due to MEEIA Cycle 1, to the amount of $33,702,693.[306] Any shortfall in revenues due to lower unit sales or billing determinants was to be paid upfront by ratepayers.[307] Since ratepayers have already paid upfront for the entire lifespan of the deemed savings from the impact of MEEIA Cycle 1 programs on sales and billing determinants, it is patently unfair to have ratepayers pay an additional 6.6 million dollars as a result of an additional MEEIA Cycle 1 adjustment in this case.

A second problem with trying to set accurate billing determinants based on the impacts of MEEIA Cycle 1 is that there is no agreed upon level of savings associated with the programs for adjusting billing determinants. This lack of agreement on savings

[305] Tr. 13:1675, ll. 19-25.

[306] ***Non-unanimous Stipulation and Agreement Resolving Kansas City Power & Light Company's MEEIA Filing,*** filed April 17, 2014, in Case No. EO-2014-0095.

[307] Tr. 13:1746, ll. 19-24.

levels is a driver behind the use of deemed savings in the MEEIA Cycle 1 Stipulation and Agreement and the use of deemed loadshapes in the MEEIA Cycle 2 Stipulation and Agreement, instead of capturing actual changes in consumption.[308] As OPC's witness Dr. Geoff Marke testified at hearing, there is not agreement on the level of savings produced from a MEEIA package or program.[309] Even the most basic and standard of efficiency products, a lightbulb, does not have an agreed upon level of impact on energy (kWh) or demand (kW).[310] As it stands, no party to this case can determine the precise level of impact MEEIA Cycle 1 programs had on billing determinants. Staff witness Michael Stahlman testified that he could not say for certain MEEIA programs had reduced kWh and KW, and that although the average amount of usage for residential customers had gone down slightly, there are other changes that can cause this decline.[311] 4 CSR 240-20.094 (1)(U) makes it clear that

> Lost revenues are only those net revenues lost due to energy and demand savings from utility demand-side programs approved by the commission in accordance with 4 CSR 240-20.094 Demand-Side Programs and measured and verified through EM&V.

Outside of a stipulation and agreement or an application to the Commission for a variance, KCPL cannot collect lost revenues due to impacts that it cannot prove are only due to MEEIA Cycle 1 energy and demand savings, especially if there are not measured and verified EM&V savings. The only savings number for Cycle 1 is a deemed number negotiated by the parties as part of the Stipulation and Agreement

---

[308] *See* ***Non-unanimous Stipulation and Agreement Resolving Kansas City Power & Light Company's MEEIA Filing,*** filed April 17, 2014, in Case No. EO-2014-0095, ***Non-unanimous Stipulation and Agreement Resolving MEEIA Filings***, filed November 23, 2015 in Case Nos. EO-2015-0241 and EO-2015-0240.

[309] Tr. 13:1746, l. 25, 13:1747 ll. 1-5.

[310] Tr. 13:1747, ll. 6-8.

[311] Tr. 13:1728, ll.22-25, 13:1729, ll. 1-6.

process.[312] KCPL should not be allowed to alter the terms of the Stipulation and Agreement by collecting additional funds for impacts that cannot be quantified with certainty or even attributed to MEEIA Cycle 1 with certainty.

- *Nicole Mers*

B. How should the Large Power class kW demand billing units be adjusted when a customer leaves the Large Power class?

When a customer leaves the Large Power ("LP") class during the test period that customer's normalized actual kW demand billing units should be removed from the calculations of ending billing units for the LP class going forward to account for the loss. In performing calculations for KCPL's other remaining classes, Staff must use estimates and approximations due to the impossibility of pinpointing exactly how much average demand a customer requires. Staff recognizes that for some rate case elements, the exact amounts will be unavailable; however, for the LP class the exact average demand is readily available due to the necessity of individually examining each customer's energy usage and demand in the LP class.[313] If the tables were turned and Staff was recommending that estimated costs be used for a rate case element over actual costs to the detriment of the company, KCPL would certainly be supporting the use of actual costs. Ignoring the actual kW demand amounts of those LP customers leaving or switching, which the Company made available to the Commission, and which were accounted for in Staff's recommendation would be as impractical as ordering food and paying the waiter's best-guessed price instead of the price printed on the menu. KCPL

[312] Tr. 13:1734, ll. 19-23.

[313] Ex. 200, *Staff RR Report,* p. 68, lines 16-19.

did not deny that it failed to remove the actual kW demand[314] and agreed to review its process.[315]

C. How should customers who left the Large Power class and switched into the Large General Service and Medium General Service classes be annualized?

In the case of rate switchers from the LP class to the Large General Service ("LGS") or Medium General Service ("MGS") classes a customer's normalized actual billing units and revenue should be removed from the LP class and added to the billing units and revenue for whichever of the classes the customer is moving into. As emphasized above, whenever the actual usage amount that a class will lose/gain as a result of a customer leaving or switching can be determined, it should be applied. In this scenario that requires removal and reapplication of the actual billing unit and revenue amounts for those affected customers. Those customers' new revenues will be priced using the rates applicable to the class the customer is moving into.

D. What method should be utilized to measure customer growth?

Customer Charge counts should be used to measure customer growth from the beginning to the end of an investigation related to a request for an increase in rates. The Company disagrees with this, and yet, its initial study conducted for the test year also uses customer charge counts. Only for the update period did KCPL use customer bill counts to account for its customer growth. In contrast to charge counts, customer bill counts tally for each individual bill sent out to KCPL customers, regardless of whether a customer receives one or several bills in a given month. However, customer charges are prorated when the same customer receives multiple bills, permitting Staff to

[314] Tr. 13, p.1623, lines 7-13.

[315] Ex. 205, Bocklage Surrebuttal, p. 2, lines 15-16.

recognize in its calculations a more accurate reflection of the actual number of customers KCPL is expected to provide service to going into the future.

- *Whitney Payne*

XIX. Rate Design/Class Cost of Service:

The parties have produced much outcry against Staff's detailed Base, Intermediate and Peak ("BIP") class cost of service ("CCOS") study. A CCOS study attempts to allocate or assign a utility's total cost of providing service to all customer classes such that it reasonably reflects cost causation.[316] The truth is there is no right or wrong when it comes to CCOS studies. Each type of study is a different boat to a different island and every boat is powered in a different manner; it is nearly impossible to prove the superiority of one study over another, but certain qualities of the BIP study are more applicable to the KCPL structure. The results of a CCOS study are only one of the elements that should be considered when determining rates, as KCPL witness Ms. Miller stated at the evidentiary hearing.[317] Staff, and likely the other parties, also takes into consideration the customers' ability to understand their rates, rate continuity, rate stability, revenue stability, a minimization of rate shock and the ability to meet incremental costs, such as the market cost of energy.[318]

Staff's motivation behind utilizing the BIP study is an attempt to most accurately allocate the capacity costs of plants which run at a stable level much of the year, those that run only a few hours a year, and those that fall in between the two extremes,[319] specifically in consideration of the varying construction and fuel costs of those plants, to

[316] Ex. 202, *Staff Rate Design and Class-Cost-of-Service Report* ("*Staff RD Report"*), p. 6, lines 10-11.
[317] Tr. 11, p. 889, lines 17-19.
[318] Ex. 202, *Staff RD Report,* p. 27, lines 1-35.
[319] Ex. 202 *Staff RD Report,* p.9, lines 1-4.

the rate class proportionate to each class' use of each plant type.[320] Of all the studies filed in this matter, only Staff's BIP study recognizes disparity in capacity and fuel costs.[321] Among the submitted studies, Staff's BIP study also best accounts for KCPL's participation in the SPP integrated energy market through its recognition of the variability of fuel costs.[322]

A few parties suggest that the BIP study is not commonly used among regulatory agencies. However, as Staff points out in Appendix 3 of its Class Cost of Service Report[323] and attorney for the Consumers Council of Missouri, Mr. Coffman, stated in his opening, in fact the BIP study can be found in NARUC's cost allocation manual[324] and is regularly used by the Commission in Texas.[325]

MIEC witness Mr. Brubaker also mischaracterizes Staff witness Sarah Kliethermes' use of dollar weighted capacity costs. Despite Mr. Brubaker consistently arguing that Staff's study separately allocates base plant capacity costs, Ms. Kliethermes does not separately allocate each type of plant in her application of the BIP study results. Rather, Staff uses dollar weighted capacity costs to allocate the costs of all plants. [326]

One of the clear differences between Staff's study and the other parties' is that Staff conducted its own Cost of Service study, while the other parties applied KCPL's Cost of Service study. KCPL's study included its revenue requirement calculation, which

[320] *Id*. at 13, lines 19-22.

[321] Ex. 212, *Sarah Kliethermes Rebuttal,* p. 2, lines 10-12.

[322] Ex. 202, *Staff RD Report,* p.13, lines 9-22.

[323] Ex. 202, *Staff RD Report,* Appendix 3.

[324] *Electric Utility Cost Allocation Manual*, National Association of Regulatory Utility Commissioners, January 1992, pp. 55-56.

[325] Tr. 11, p. 872, line 25, through p. 873, line 6.

[326] Tr. 11, p. 976, line 10, through p. 977, line 3.

indicates a higher level of expense and a lower level of revenue than Staff's revenue requirement calculation.[327] This difference explains in large part why the other CCOS studies differ from Staff's.

A. What interclass shifts in revenue responsibility, if any should the Commission order in this case?

B. How should any increase ordered in this case be applied to each class?

It is appropriate in this matter to apply any revenue increases equally across the board; as based on Staff's investigation and CCOS no interclass shifts in revenue responsibility are necessary. Staff's recommended rate design ensures that each class pays its approximate cost of service within the reasonable range of precision for a CCOS study. Staff determined in this matter that no rate class was subsidizing another class, proving that each class is contributing to the rate of return. Staff's study further establishes that each class's contribution to the rate of return is reasonably consistent with the overall rate of return.

In considering the reasonableness of the studies submitted in this case, the concepts that are important to consider are the precision of the CCOS study and the consistency of rates of return across classes.[328] CCOS studies are used as a guide to designing rates and are not an exact science. Many of the inputs to a CCOS study, such as class load data, class revenues, and expenses are all dependent on the point in time the CCOS study was conducted. In this case the parties submitted the results of their CCOS studies with their direct testimony, and each of the studies, except Staff's,

[327] Ex. 212, *Sarah Kliethermes Rebuttal,* p.5, lines 3-8.

[328] Ex. 202, *Staff RD Report,* p.27, lines 6-14.

was based on KCPL's entire revenue requirement request.[329] By the time true-up is completed in this case these inputs will have changed and class responsibility will have shifted.

Given Staff's starting revenues and starting revenue requirement in comparison to Staff's ending revenues and revenue requirement, if Staff were to conduct and submit the results of a new CCOS study today it would not anticipate significant changes to the results. This is based on the analysis Staff describes in its CCOS Report regarding the precision of CCOS studies in general.[330] However, as discussed in Staff's rebuttal and surrebuttal testimonies in this case, there have been significant changes or errors included in KCPL's starting revenues and revenue requirement, which are the basis of all other CCOS studies submitted in this case.

C. Should KCPL be permitted to increase the fixed customer charge on residential customers?

All rate elements should be increased at an equal percentage so the residential customer charge should be increased at the same percentage as the residential class's overall rate increase, but only up to $12.62. Any potential increase beyond that point should be applied evenly to the blocked energy charges. KCPL witness Ms. Miller stated on the stand that were it not for the Company's inclusion of the MEEIA Cycle 1 and RESRAM charges, it would be proposing the same $12.62 charge that Staff proposes.[331]

D. Should KCPL be required to implement the block rate structure proposed by the Division of Energy for residential customers?

[329] Ex. 212, *Sarah Kliethermes Rebuttal,* p. 5, lines 3-8.

[330] Ex. 202, *Staff RD Report,* p. 27, lines 6-14.

[331] Tr. 11, p. 942, lines 9-12.

DE's proposal would shift revenue recovery from the first block to the second and third blocks. As Robin Kliethermes stated in her rebuttal testimony, "Moving revenue recovery to the second and third block will result in a greater level of volatility in revenue recovery and customer bills than is currently experienced due to weather."[332] Additionally, the shift could allow KCPL to over-recover revenues at times when usage increases drastically as a result of changing weather.[333]

Staff cannot recommend an inclining block structure as proposed by DE for KCPL at this time. As Mr. Schmidt stated on the stand at the evidentiary hearing, any radical change to rate structure is going to affect a large portion of KCPL customers, especially on the residential side.[334] Furthermore, the benefits of implementing an inclining block structure in this case are vague at best and would be complicated for customers to understand and utilize to their fullest extent. While parties produced testimony stating that inclining block rates would encourage energy efficiency, history has shown that extreme swings in weather will cause customers to use their air conditioning or furnaces regardless of the rate structure. Therefore, volatile weather patterns coupled with an inclining block rate structure could actually cost customers a good deal more if they were to use enough energy to reach the third block. At present, customers have no notice of a potential change in their rate structures and their bills would not explain the change. Staff is also concerned about the lack of time for customers to adjust to a new rate structure. In the discussions concerning the importance of elasticity with Chairman Hall, Mr. Jester stated that the more time

[332] Ex. 210, *Robin Kliethermes Rebuttal,* p. 5, lines 9-11.

[333] Ex. 210, *Robin Kliethermes Rebuttal,* p. 6, lines 4-18.

[334] Tr. 12, p. 1104, lines 7-25.

customers have to adapt, the more a rate change would be elastic.[335] Based on the effective date of rates in this case, June 1, 2017, customers would not only be immediately subjected to the new rate structure but would experience it just as summer temperatures kick in and begin to raise electricity usage. Despite Mr. Jester's statement that this Commission's practice is to "ignore elasticities,"[336] Chairman Hall made clear in his questioning that the Commission intends to consider this detail in its decision for its final report and order in this matter.

Should the Commission determine that inclining block rates are appropriate; a modified approach to DE's proposal would be a better solution for KCPL. As Chairman Hall pointed out when questioning Mr. Hyman, a three block structure for both summer and winter is appropriate.[337] By keeping the first two blocks of the structure static and increasing only the third, customers would be more encouraged to conserve energy by remaining within the first two blocks. Both OPC witness Dr. Geoff Marke[338] and DE witness Martin Hyman[339] were presented with this theory in cross-examination and accepted it as a plausible theory. KCPL witness Ms. Miller in her discussion with Chairman Hall further supported Staff's proposal, but only if the Commission implements inclining block rates as part of its report and order.[340] Staff also agrees with Dr. Marke and Mr. Hyman that the customer charge should not be raised as a result of any new rate structure.[341] Another modification would be for KCPL to move towards

[335] Tr. 12, p. 1141, lines 2-5.
[336] Tr. 12, p. 1142, lines 21-23.
[337] Tr. 12, p. 1256, line 21, through p. 1257, line 25.
[338] Tr. 12, p. 1162, line 13, through p. 1164, line 1.
[339] Tr. 12, p. 1233, line 23, through p. 1234, line 17.
[340] Tr. 11, p. 946, line 22, through p. 947, line 3.
[341] Ex. 210, *Robin Kliethermes Rebuttal,* p.2, lines 10-14.

shoulder and non-shoulder months instead of summer and non-summer months in light of customer usage during summer and winter months being more similar to each other and usage during fall and spring being more similar.[342] Currently KCPL defines the summer months as June, July, August, and September. If KCPL defined the winter months as December, January, February, and March and created a third group, designating the months of October, November, April, and May as shoulder months; KCPL could have inclining rates for summer and winter and flat or inclining rates for the shoulder months.[343] Staff would suggest that the Commission delay the implementation of the new rate structure to allow KCPL time to send out customer notices regarding the change in structure and the potential effect it would have on customers' bills. On the stand, OPC did not oppose such a proposition.[344]

In response to party concerns that KCPL might over recover revenues as a result of a move to inclining block rates, Chairman Hall suggested the proposal of a tracker for revenues. In general, Staff suggests the use of trackers be limited to unique or unusual circumstances. As any changeover to inclining block rates for KCPL would presumably be intended as an ongoing change, Staff does not recommend that the Commission order the use of a tracker mechanism to address concerns regarding possible occasional over recovery of revenues in the future.

E. Should KCPL be required to propose time-varying rate offerings for residential customers in future cases?

[342] Ex. 201, *Staff RD Report,* p. 25, lines 19-22.

[343] Ex. 210, *Robin Kliethermes Rebuttal,* p. 7, lines 11-12 and 19-23.

[344] Tr. 12, p. 1160, line 24, through p. 1162, line 9.

Time-varying rates have the potential to provide several benefits to KCPL customers. Staff supports working towards a well-designed pilot program for TOU rates and is supportive of Commission guidance directing KCPL to work towards general use time-varying rate options for KCPL's residential customers. Staff witness Robin Kliethermes stated at the hearing that, "So it [time of use rates] could reduce that peak demand more so than what an inclining block would."[345] KCPL agrees that time-varying rates may be more beneficial than inclining block rates as Ms. Miller states in her testimony.[346]

F. How should any increase to Rates LGS and LPS be distributed?

As stated above, Staff has determined that all rate components should be increased by an equal percentage. This, consistent with the CCOS study's results on cost causation, would avoid sending a price signal encouraging consumption of energy as a result of the hours use rate design, and would reduce the likelihood of causing some customers' rates to decrease while other customers' to dramatically increase. Shifting the revenue-setting responsibility to individual customer natural coincident peaks ("NCPs") improperly signals that this determinant, which is not related to production capacity requirements, is somehow relevant to the cost of energy.

G. Should KCPL's line extension tariff be modified?

In GMO's last rate case, Case No. ER-2016-0156, the company expressed a desire for consistency in facility extension tariff provisions across the KCPL and GMO certificated areas. Staff recognizes the desire for consistency between the utilities and supports modifying KCPL's tariff to match GMO's. GMO's tariff sends accurate price

[345] Tr. 11, p. 1044, lines 21-23.

[346] Ex.138 *Marisol Miller Surrebuttal* p.9:20-22.

signals, which encourages the use and renovation of existing facilities without inappropriately charging customers for new facilities.

- *Whitney Payne*

XX. Clean Charge Network:

A. Is the Clean Charge Network a regulated public utility service?

B. Should capital and O&M expenses associated with the Clean Charge Network be recovered from ratepayers?

C. Should KCPL develop a PEV-TOU rate to be considered in its next general rate case?

D. Should the session charge be removed from the tariff?

Staff anticipates that the Commission will resolve these issues in the same manner as it resolved the similar issues presented in Case No. ET-2016-0246, Ameren Missouri's Electric Vehicle Charging Station Tariff case. Staff continues to have serious concerns with the legality of the Commission's resolution. While it may well reflect the most desirable policy, the Commission is not empowered to make policy. Policy is made by the Missouri General Assembly and is expressed in statutes. Like all administrative tribunals, the Commission is authorized only to find the facts and to apply existing law to those facts. Characterizing the provision of electric power to an electric vehicle via a charging station as a "battery-charging service" is a legal fiction, not a finding of fact.

- *Kevin A. Thompson*

XXV. Customer Experience

Is KCPL's strategy with respect to customer service, customer experience and community involvement in the interest of its customers?

While Staff does not take a stance on KCPL continuing or discontinuing the political questions on its surveys, Staff supports Chairman Hall's suggestion that the

costs for the portion of the survey questions that are inherently political in nature be booked below the line.[347] These political questions are not related to providing better programs or services to customers, and in fact, KCPL shares these results with their political action group,[348] which influences its donations to political candidates. As seen by the wide range of response in OPC's Exhibits 330 and 331, there is not a cohesive candidate or proposition supported by all ratepayers, and some ratepayers may find, in fact, that donations to political candidates is detrimental to their interest. Therefore, Staff argues the appropriate balance between KCPL's right to political speech and the customer's right to just and reasonable rates that only include costs incurred for their benefit, is to take a ratio of political questions over total questions and book a corresponding percentage of total survey cost below the line. KCPL witness Mr. Caisley stated at trial: "I think we would say, Okay, let's figure out a way to make an adjustment…I think that's perfectly reasonable."[349] This statement suggests KCPL agrees that customers should not be paying for these politically-oriented questions.

The Commission should direct KCPL to make a filing providing the total number of surveys and their costs booked during the test year and true up period, the total number of questions on those surveys that are political in nature, and the percentage of political oriented questions to total survey questions. Using this information will allow the Commission to determine an appropriate cost to book below the line.

- *Nicole Mers*

[347] Tr. 12, p. 1504, lines 12-15.
[348] Tr. 12, p. 1496, lines 10-15.
[349] Tr. 12, p. 1505, lines 3-6.

CONCLUSION

In conclusion, Staff recommends that the Commission grant KCPL a general rate increase amounting to approximately $13,724,239 and set its ROE at 8.65%, resolving each contested issue as Staff has recommended. In this way, just and reasonable rates will be set and all relevant factors will be considered, with due regard to the interests of the various parties and to the public interest.

WHEREFORE, on account of all the foregoing, Staff prays that the Commission will issue its findings of fact and conclusions of law, determining just and reasonable rates and charges for KCPL as recommended by the Staff herein; and granting such other and further relief as is just in the circumstances.

Respectfully submitted,

/s/ NICOLE MERS
Nicole Mers
Missouri Bar # 66766
Assistant Staff Counsel

KEVIN A. THOMPSON
Missouri Bar # 36288
Chief Staff Counsel

ROBERT S. BERLIN
Missouri Bar # 51709
Deputy Staff Counsel

JAMIE MYERS
Missouri Bar # 68291
Assistant Staff Counsel

WHITNEY PAYNE
Missouri Bar # 64078
Assistant Staff Counsel

Missouri Public Service Commission
P.O Box 360
Jefferson City, MO 65102
573-751-6651 (Voice)
Nicole.mers@psc.mo.gov

Attorneys for the Staff of the
Missouri Public Service Commission

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 22nd day of March 2017, to all counsel of record.

/s/ Nicole Mers