BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City	)	
Power & Light Company's Request	)	Case No. ER-2012-0174
for Authority to Implement a General	)	
Rate Increase for Electric Service	)	

MECG RESPONSE TO KCPL OPPOSITION TO MOTION TO STRIKE AND RENEWED REQUEST FOR EXPEDITED TREATMENT

COMES NOW, the Midwest Energy Consumers' Group ("MECG"), pursuant to the Commission's June 20, 2012, *Order Setting Time for Reply*, and for its Reply to KCPL's Opposition to its Motion to Strike Pre-Filed Testimony and Reject Tariffs respectfully states as follows:

I. SUMMARY

1. On May 25, 2012, MECG and OPC filed their Motion to Strike and Reject portions of the pre-filed testimony and tariffs filed by KCPL. In that Motion, MECG and OPC conclusively demonstrate that KCPL's request to share in off-system sales violates certain commitments that it made in the Regulatory Plan Stipulation. Specifically, in that Plan, KCPL committed "not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case" for as long as Iatan 2 was in rate base.

2. On June 15, 2012, KCPL filed its *Opposition to Motion to Strike Pre-Filed Testimony and Reject Tariffs* ("Opposition"). In its Opposition, KCPL's seek to avoid the plain language of the Regulatory Plan and, instead, obfuscate this issue with: (1) misstatements regarding the extent of its commitments under the Regulatory Plan and (2) erroneous claims as to the proper application of Missouri ratemaking procedure. In order

to understand the falsity in KCPL's Opposition, it helps for one to have an understanding of the KCPL Regulatory Plan and the rationale underlying the inclusion of the various commitments in that Plan. Furthermore, given KCPL's false claims that opposing counsel has previously advocated for the implementation of a sharing mechanism, it is incumbent that the Commission understands ratemaking procedure and how KCPL's claims are not only off point, but represent a dramatic departure from traditional ratemaking procedure.

II. MISSOURI RATEMAKING PROCEDURE

A. RATE BASE

3. Prior to 1976, electric utilities in Missouri were allowed to include in rate base, and earn a return on, investment known as Construction Work in Progress ("CWIP"). In this way, ratepayers provided financial assistance with the construction of large capital projects. Against the backdrop of huge cost overruns in the construction of nuclear generating plants, and recognizing that some utilities were actually seeking to earn a return on their investment in cancelled nuclear plants, Missouri voters enacted Proposition 1. That statute, codified at Section 393.135, provides

> Any charge made or demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

Thus, Missouri ratemaking procedure provides that a utility is required to arrange all the capital required to finance the construction of a generating plant. Only when that plant is fully operational and used for service is the utility allowed to begin seeking a return on its investment.

B. REVENUES AND EXPENSES

4. Missouri ratemaking procedure also provides that the Commission set a normalized level of expenses and revenues for inclusion in rates. During the time that rates are in effect, if every expense and revenue item that is incurred exactly matches the amount included in rates, then the utility will earn its authorized rate of return. The utility is given an opportunity, however, to earn an inflated rate of return by either increasing revenues above the level that was included in rates or by decreasing expenses below the level included in rates. Once earned, various court decisions have held that it is unconstitutional to take these excessive profits from the utility.[1] Thus, until new rates are set, the utility is permitted to keep the entirety of any profits deriving from their efforts to increase revenues or decrease expenses. The *quid pro quo* for this opportunity to earn excess profits is that the utility bears all the risk that revenues will decrease or expenses will increase.

III. THE KCPL REGULATORY PLAN AND ITS SUBSEQUENT CASE CONSTITUTED A DRAMATIC DEPARTURE FROM TRADITIONAL RATEMAKING PROCEDURE

A. RATE BASE

5. In 2004, KCPL sought to build its first baseload generating station in several decades. Given the price of constructing this baseload unit, KCPL sought to engage stakeholders in a process by which ratepayers, despite the limitations of Proposition 1, would help to finance the construction of Iatan 2. Ultimately, it was agreed that ratepayers would pay regulatory amortizations to assist KCPL in financing

[1] *State ex rel. Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41, 59 (Mo. banc 1979).

this construction project.[2] In this regard, the KCPL Regulatory Plan represented a departure from traditional Missouri ratemaking procedure in that KCPL was no longer expected to provide the entirety of the capital underlying the construction of the generating unit. In fact, KCPL ultimately collected over $146 million from ratepayers in the form of Regulatory Amortizations to help finance the construction of Iatan 2.[3]

6. Ratepayers, however, required certain concessions from KCPL in order to waive their objection to the Regulatory Amortizations. Recognizing that the existence of Iatan 2 would provide KCPL more energy to sell in the wholesale market, KCPL agreed "not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case."[4] In this way, all margins from off-system sales would be used to reduce retail rates. Given that the underlying asset would be used for several decades, KCPL's commitment not to "remove any portion of its off-system sales from its revenue requirement" would last as long as the Iatan 2 "investments and expenses are considered in the determination of Missouri jurisdictional rates." Effectively, while ratepayers would suffer higher rates in the short term as a result of the Regulatory Amortizations; ratepayers would have the assurance of lower rates in the long term as a result of KCPL's commitment to include all off-system sales margins as an offset to retail rates.

B. REVENUES AND EXPENSES

7. As shown, under Section 393.135, utilities have been required to finance the cost of construction of generating plants solely on its own. In this regard, the

[2] See, *Stipulation and Agreement*, Case No. EO-2005-0329, filed March 28, 2005 (referred to herein as *Regulatory Plan*).
[3] See, *Non-Unanimous Stipulation and Agreement Regarding Depreciation and Accumulated Additional Amortizations*, Case No. ER-2010-0355, filed February 2, 2011, at page 6.
[4] *Stipulation and Agreement*, Case No. EO-2005-0329, filed March 28, 2005, at page 22.

development of Regulatory Amortizations under the KCPL Regulatory Plan represented a dramatic departure from Missouri ratemaking procedure. The departure from Missouri ratemaking procedure was not limited solely to the calculation of rate base. In fact, given the magnitude of the Iatan 2 project, KCPL also sought, and was granted, a dramatic departure in the method that the Commission calculated the level of certain revenues and expenses included in rates. Specifically, while the Commission normally included a normalized level of revenues and expenses (including off-system sales margins) in rates, KCPL asked that the Commission instead include an amount of off-system sales margins that was well below what it expected to realize.

8. In its 2006 rate case, the Commission considered the appropriate amount of off-system sales to include as an offset to retail rates. Consistent with the traditional approach of including a "normalized" level of off-system sales, several parties proposed either: (1) KCPL's budgeted level of off-system sales for the following year or (2) KCPL's predicted level at the 50th percentile of its forecasted study.[5] At KCPL's request, the Commission eschewed the use of a "normalized" level of off-system sales and, instead, adopted KCPL's proposal to include a level of off-system sales that equated to the 25th percentile of KCPL's forecasted study.[6] Along with this depressed level of off-system sales, KCPL also proposed, and the Commission adopted, the use of a tracker mechanism so that ratepayers received the benefit of any off-system sales that were realized above the 25th percentile.[7] Thus, ***at KCPL's request***, the Commission made a dramatic departure from the historical method of including a normalized level of

[5] See, *Report and Order*, Case No. ER-2006-0314, issued December 21, 2006, at pages 32-33.
[6] *Id.* at page 33.
[7] See, *Order Regarding Motions for Rehearing*, Case No. ER-2006-0314, issued January 18, 2007.

revenues and expenses, and instead included a depressed level of off-system sales in conjunction with the implementation of a tracker mechanism.

IV. KCPL'S OPPOSITION IS MISPLACED

9. The present case represents the first case following the completion of the Iatan 2 generating station. While the majority of the provisions included in the Regulatory Plan expired with the completion of Iatan 2, KCPL's commitment "not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case" survives and will remain so long as the Iatan 2 investments remain in rate base. Nevertheless, after eagerly accepting over $146 million of Regulatory Amortizations to help it construct Iatan 2, KCPL now seeks to renege on the consideration that was to be received by the ratepayers – the commitment "not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case." While its Regulatory Plan commitment clearly provides that ***<u>all</u>*** off-system sales margins will be utilized to reduce retail rates, KCPL now seeks to "share" in a portion of off-system sales.

10. In its Opposition, KCPL advances several theories designed to allow it to free itself from its Regulatory Plan commitment. ***First***, KCPL claims that certain portions of its off-system sales commitment expired with the rest of the Regulatory Plan. KCPL then claims that its sharing provision does not conflict with the off-system sales provision that is still in effect.[8] ***Second***, KCPL claims that its sharing mechanism was proposed in order to meet the expressed desires of the Commission in the last case.[9] ***Third***, KCPL improperly claims that undersigned counsel, in response to questioning by

[8] *Opposition*, pages 2-5, ¶¶6-15.
[9] *Opposition*, pages 5-6, ¶¶16-18.

Commissioner Davis in the last case, proposed and acquiesced in a sharing mechanism for off-system sales.[10] ***Fourth***, KCPL claims that the preclusion against sharing of off-system sales only applies to off-system sales generated by Iatan 2.[11] As the following discussion reveals, KCPL's arguments are misplaced and its sharing mechanism should be summarily rejected.

A. THE ENTIRETY OF THE OFF-SYSTEM SALES PROVISION REMAINS IN EFFECT.

11. At pages 2-5 (paragraphs 6-15) of its Opposition, KCPL asserts that the Regulatory Plan off-system sales commitment can be severed into 3 sentences. Under KCPL's theory, the first 2 sentences, originally contained in the Regulatory Plan, expired in 2010 with the remainder of the Regulatory Plan. Only the last sentence, submitted separately in response to a Commission order, survived the expiration of the Regulatory Plan. KCPL, then, asserts that the only relevant language is the last sentence.

12. As detailed in Movants' Motion, the Regulatory Plan initially contained a provision related to the future ratemaking treatment for off-system sales.

> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.[12]

At the evidentiary hearing, the parties revealed that they would be submitting additional language to "tighten" up the off-system sales provision.[13] Thus, on July 25, 2012, the parties submitted a new off-system sales provision that included a third sentence that

[10] *Opposition*, pages 6-7, ¶¶19-22.
[11] *Opposition*, pages 7-8, ¶¶23-25.
[12] *Stipulation and Agreement*, Case No. EO-2005-0329, filed March 28, 2005, at page 22.
[13] Tr. Volume 8, page 1004, Case No. EO-2005-0329 (July 12, 2005).

contained the term of the off-system sales provision. The new off-system sales provision states:

> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process. ***KCPL agrees that all of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates.***[14]

13. Contrary to KCPL's current claim, the relevant third sentence was not submitted as a stand-alone provision or a replacement for the previous language. Instead, as the following paragraph from a joint pleading indicates, the new language refers explicitly to those previous sentences; it provides a term for those sentences. As the pleading indicates:

> According to the Stipulation and Agreement, KCPL will not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case, and KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process. However, the length of the term of ***this*** agreement related to the ratemaking treatment of off-system sales was not formally reflected in the Stipulation and Agreement. During the hearings conducted in this matter, KCPL's counsel stipulated on-the-record that KCPL would agree to ***this*** ratemaking treatment for off-system sales will continue as long as the Iatan 2 costs are included in KCPL's rate base.[15]

Thus, as the Joint Pleading indicates, the term provision is not intended to be a separate stand-alone provision. Rather, it is part and parcel of the entire off-system sales

[14] *Signatory Parties' Response to Order Directing Filing*, Case No. EO-2005-0329, filed July 26, 2005, at pages 2-3. (emphasis added).
[15] *Id.* at pages 1-2.

provision that must be read together with the other off-system sales provisions and which preclude KCPL's current sharing proposal.

14. That aside, even if the third sentence were read as a stand-alone provision, it would still preclude KCPL's current proposal. Specifically, that provision mandates that "all" off-system revenues be reflected in Missouri rates.

> KCPL agrees that ***<u>all</u>*** of its off-system energy and capacity sales revenue will continue to be used to establish Missouri jurisdictional rates as long as the related investments and expenses are considered in the determination of Missouri jurisdictional rates. (emphasis added).

Therefore, whether read together or separately, the off-system sales provision precludes any effort by KCPL to keep a portion of the off-system sales revenues. Given that KCPL now seeks to retain a portion of these revenues under its sharing proposal, KCPL has violated its commitment under the Regulatory Plan.

B. <u>THE COMMISSION'S PREVIOUS ORDER DID NOT PROPOSE A SHARING MECHANISM OR CONSTITUTE AN INVITATION FOR KCPL TO VIOLATE THE REGULATORY PLAN.</u>

15. At pages 5-6 (paragraphs 16-18) of its Opposition, KCPL seeks to excuse its obvious violation of the Regulatory Plan by noting that the Commission had previously found that the use of the 25th percentile created a financial disincentive to earn "increased profits in the wholesale market."[16] Recognizing this disincentive, the Commission increased its expectations of KCPL and increased the level of off-system sales in rates to the 40th percentile.[17] KCPL, however, wrongly interprets the Commission's order as an open invitation to violate the off-system sales provision of the Regulatory Plan and propose the implementation of a sharing mechanism for off-system sales. The Commission's order was not so broad.

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[16] *Opposition* at page 5, paragraph 16.
[17] *Id.* at pages 5-6, paragraph 17.

16. It is important to remember that the tracker mechanism and the use of the 25th percentile were implemented solely at KCPL's request. Consumer groups immediately noted that the use of such a deflated level of off-system sales in conjunction with a tracker mechanism would set low expectations for KCPL. As its performance over the last 5 years indicates, KCPL simply met these low expectations. Now KCPL's admits that when faced with low expectations, KCPL will not use "its best efforts to increase OSS margins."[18] Given KCPL's admission that it would not use "its best efforts to increase OSS margins," the Commission has been proven right in its decision to increase expectations to the 40th percentile. By increasing such expectations, however, the Commission did not invite KCPL to violate the off-system sales commitment in the Regulatory Plan.

C. COUNSEL DID NOT ADVOCATE A SHARING MECHANISM IN THE LAST CASE

17. At pages 6-7 (paragraphs 19-22), KCPL falsely interprets a conversation between Commission Davis and counsel from the last case as support for its violation of the Regulatory Plan. In response to several questions from the bench, counsel advocated for the elimination of 25th percentile and the attendant tracker mechanism and instead return to the use of a normalized level of off-system sales. Now, KCPL wrongfully concludes that "implicit in these statements to the Commission is the concept of ***sharing risks and benefits***, and providing incentives to KCP&L."[19]

18. As indicated at paragraph 4, historical ratemaking procedure "provides that the Commission set a normalized level of expenses and revenues for inclusion in rates." "The utility is given an opportunity, however, to earn an inflated rate of return by

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[18] *Opposition* at page 6, paragraph 18.
[19] *Opposition* at page 7, paragraph 21.

either increasing revenues above the level that was included in rates or by decreasing expenses below the level included in rates." The questions and answers referenced by KCPL do not call for the implementation of a sharing plan, but instead for the return to the use of a normalized level of off-system sales. **<u>Under traditional ratemaking, there is no sharing of risks and benefits. Rather, the utility bears all of the risk, but also keeps all the potential benefits</u>**. Traditional ratemaking, as discussed on the record, is not a sharing of risks and benefits.

19. While traditional ratemaking provides the utility with all of the risk and benefits, KCPL through its proposed sharing mechanism, wants the opportunity for increased profits, but does not want to accept the associated risk. As KCPL admits in its Opposition, if off-system sales decline, KCPL wants to be allowed to book a portion of the reduced amount in a deferred account with future recovery.

20. Finally, it is important for the Commission to understand that the departure from traditional ratemaking was not done at the insistence of the consumers. Rather, the Commission adopted the use of the tracker mechanism, and the decreased incentives inherent with the tracker, at the insistence of KCPL. It is disingenuous for KCPL to now criticize the Commission and the consumers for the continued use of a tracker mechanism that does not provide it an incentive to "exert its best efforts to increase OSS margins." If KCPL wants to return to the use of traditional ratemaking, the proper method is to propose a normalized level of off-system sales, not to propose a sharing mechanism that expressly violates the terms of its Regulatory Plan and places heightened risks on the ratepayers.

D. <u>THE REGULATORY PLAN COMMITMENT IS NOT LIMITED SOLELY TO CERTAIN GENERATING STATIONS. IT DOES NOT ALLOW FOR SHARING OF ANY OFF-SYSTEM SALES.</u>

21. Finally, at paragraphs 23-25, KCPL desperately asserts that the Regulatory Plan commitment only applies to off-system sales derived solely from assets created under the Regulatory Plan. The Regulatory Plan commitment is not as narrow as KCPL now seeks to convince the Commission.

22. As previously indicated, KCPL committed "not to propose any adjustment ***<u>that would remove any portion</u>*** of its off-system sales from its revenue requirement in any rate case." Clearly, this commitment does not limit itself solely to off-system sales generated by particular units. Rather, the commitment precludes KCPL from proposing an adjustment "that would remove ***<u>any</u>*** portion" of off-system sales.

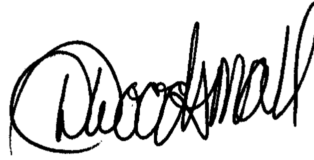
23. The reason that the commitment does not attempt to apply to specific generating stations is that off-system sales cannot be credited solely to a single unit. Because of economic dispatch, generating stations are placed in-service based upon their relative operating costs. Baseload units, such as Wolf Creek and Iatan, which have lower operating costs, are always generating to meet native load. The opportunity for off-system sales then comes from the opportunity for other units, because they have been displaced in the economic dispatch order by lower cost units, to now make off-system sales instead of being dispatched for native load. Under KCPL's misplaced theory, Iatan 2, because it is being dispatched entirely to meet native load, would never have off-system sales. Rather, units with a higher operating costs, that have been displaced in the economic dispatch order by the presence of Iatan 2, would now be available to make off-systems sales. Clearly then, the presence of Iatan 2 and other baseload units makes off-

system sales possible. It is therefore not possible to assign credit for the off-system sales to the higher cost generating asset as its freedom to make such sales was entirely dependent on the presence of the lower cost generating assets like Iatan 2. Given this, the Regulatory Plan commitment was not limited to off-system sales from a particular unit, but instead precludes KCPL from attempting to keep "any portion" of off-system sales.

V. CONCLUSION

24. As can be seen, KCPL's opposition is misplaced. In exchange for receiving over $146 million of financing from ratepayers for the construction of Iatan 2, KCPL committed never to "propose any adjustment that would remove any portion of its off-system sales from its revenue requirement in any rate case." This commitment did not expire with the remainder of the Regulatory Plan. Rather, the commitment lasts as long as the generating station that was constructed with the ratepayer provided financing. Given this commitment, KCPL's pending sharing proposal violates the express provisions of the Regulatory Plan and should be stricken. MECG renews its request that the Commission move expeditiously to strike KCPL's sharing proposal from its tariffs and testimony so that parties are not burdened with the costs of litigating this misplaced issue.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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

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David L. Woodsmall

Dated: July 3, 2012