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-2012-0174
In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service.	))))	Case No. ER-2012-0175

INITIAL POST-HEARING BRIEF OF KANSAS CITY POWER & LIGHT COMPANY AND KCP&L GREATER MISSOURI OPERATIONS COMPANY

Karl Zobrist MBN 28325
Lisa A. Gilbreath MBN 62271
SNR Denton US LLP
4520 Main Street, Suite 1100
Kansas City, MO 64111
(816) 460.2400 (Phone)
(816) 531.7545 (Fax)
karl.zobrist@snrdenton.com
lisa.gilbreath@snrdenton.com

James M. Fischer MBN 27543
Fischer & Dority, P.C.
101 Madison Street, Suite 400
Jefferson City, MO 65101
(573) 636-6758 (Phone)
(573) 636-0383 (Fax)
jfischerpc@aol.com

Charles W. Hatfield MBN 40363
Stinson Morrison Hecker LLP
230 W. McCarty Street
Jefferson City, MO 65101
(573) 636-6263 (Phone)
(573) 636-6231 (Fax)
chatfield@stinson.com

21505558

Roger W. Steiner MBN 39586
Corporate Counsel
Kansas City Power & Light Company
1200 Main
Kansas City, MO 64105
816.556.2314 (Phone)
816.556.2787 (Fax)
roger.steiner@kcpl.com

Attorneys for Kansas City Power & Light Company
and KCP&L Greater Missouri Operations Company

Table of Contents

I. INTRODUCTION 1

II. KCP&L ONLY ISSUES. 2

A. Rate Design/Class Cost of Service Study ("CCOS"). 2

1. How should the class cost of service studies be relied on for determining shifts in customer class revenue responsibilities that are revenue neutral on an overall company basis? 2

(a) What methodology should be used to allocate demand-related (fixed) production costs in KCP&L's class cost-of-service study? 2

(b) What methodology should be used in the CCOS to allocate OSS margins? 2

2. How should any rate increase be allocated among the various customer classes? 2

3. How should rates be designed? 2

4. Should the Commission adopt Staff's proposal to increase by 5% the first energy block rate of the winter All-Electric General Services rates? 2

5. Should the Commission adopt Mr. Brubaker's LGS / LP rate design methodology? 2

6. Residential rate adjustments: 2

(a) Should current residential rates be adjusted to reflect a revenue-neutral shift seasonally and among residential rate schedules in the winter based on KCP&L's class cost of service study? 2

(b) How should any residential rate increase be assigned to rate elements? 3

7. Residential Space Heat services: 6

(a) Should KCP&L's Residential Space Heat services be eliminated? 6

(b) In the alternative, should KCP&L's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case? 7

(c) Should the Commission adopt Staff's proposal to increase by 5% the first block of the residential space heating rates? 7

(i) The Cost Of Service Studies Support the Continuation of the Residential Space Heating And All-Electric Rates. 7

(ii) MGE's Proposals Would Severely And Adversely Impact KCP&L's Space-Heating and All-Electric Customers Merely To Promote the Competitive Interests of MGE. 9

(iii) MGE's Proposal to Freeze Rate Schedules Will Cause Customer Confusion, Complaints, and Substantially Complicate the Administration of the Company's Rate Schedules. 10

B. Resource Planning. 11

1. Should the Sierra Club's recommendations regarding the La Cygne and Montrose investments be adopted? 11

III. KCP&L – GMO COMMON ISSUES. 13

A. Cost of Capital. 13

1. Return on Common Equity: What return on common equity should be used for determining rate of return? 13

(i) Governing Legal Principles. 15

(ii) The Companies' Recommendation: Dr. Hadaway. 19

(iii) OPC's Recommendation: Mr. Gorman. 21

(iv) Department of Energy & Federal Executive Agencies' Recommendation: Mr. Kahal. 24

(v) Staff's Recommendation: Mr. Murray. 26

(vi) Proxy Group Issues. 28

(vii) Growth Rates. 33

(viii) ROEs Authorized by Other Public Utility Commissions. 37

2. Capital Structure: What capital structure should be used for determining rate of return? 38

3. **Cost of Debt:** 40

(a) **Should GPE's consolidated cost of debt be assigned to KCP&L and GMO or should the cost of debt be subsidiary specific?** 40

(b) **In either case, should adjustments be made to holding company debt issued subsequent to GPE's acquisition of GMO?** 41

B. **Transmission Tracker.** 44

1. **Should the Commission authorize KCP&L and GMO to compare their actual transmission expenses with the levels used for setting permanent rates in these cases, and to accrue and defer the difference into a regulatory asset?** 44

(i) **Staff Supported a Transmission Tracker in the Last KCP&L and GMO Rate Cases.** 47

(ii) **Staff Conditions For a Transmission Tracker in This Case.** 49

(iii) **Lawfulness of Transmission Trackers.** 56

IV. **GMO ONLY ISSUES** 59

A. **Crossroads.** 59

1. **What should be the value of Crossroads included in rate base?** 59

(i) **Original Cost is the Proper Value of Crossroads** 60

(ii) **There is no evidence to support a different valuation** 61

(iii) **The Weight of the Evidence Establishes That the Original Cost is the Correct Value of Crossroads.** 62

2. **What amount of accumulated deferred taxes associated with Crossroads should offset the value of Crossroads in rate base?** 65

3. **Should depreciation expense be based upon the authorized gross plant value for Crossroads?** 66

4. **What transmission costs for energy from Crossroads should be included in revenue requirement?** 66

B. GMO Off-System Sales Margins. 68

1. How should Purchases for Resale (including issues related to negative margins) be treated? 68

C. Rate Design/Class Cost of Service Study. 71

1. Residential rate adjustments: 71

(a) Should current Residential rates be adjusted to reflect a revenue-neutral shift seasonally and among Residential rate schedules in the winter based on GMO's class cost of service study? 71

(b) How should any Residential revenue increase be assigned to rate elements? 71

2. Residential Space Heating services: 72

(a) Should GMO's Residential Space Heating services be eliminated? 72

(b) In the alternative, should KCP&L's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case? 72

(c) Should the Commission adopt Staff's proposal to increase the residential space heating rates? 72

(i) The Cost Of Service Studies Support the Continuation of the Residential Space Heating And All-Electric Rates. 72

(ii) MGE's Proposals Would Severely And Adversely Impact GMO's Space-Heating and All-Electric Customers Merely To Promote the Competitive Interests of MGE. 74

(iii) MGE's Proposal to Freeze Rate Schedules Will Cause Customer Confusion, Complaints, and Substantially Complicate the Administration of the Company's Rate Schedules. 75

3. Should the Commission adopt Staff's proposal to increase the non-residential space heating rates? 76

21505558

D. GMO's MEEIA Application. 77

1. Should the costs of any programs, shared benefits or lost revenues under MEEIA be recovered from retail customers? If so, what is the amount, and the associated per kWh rate? 77

E. GMO Fuel Adjustment Clause. 77

1. Should the Commission approve, modify, or reject GMO's request for a Fuel Adjustment Clause? 77

2. What should GMO's FAC sharing be? 78

(i) 2007 Commission Order. 78

(ii) KCP&L's Off-System Sales Margin Proposal. 80

(iii) GMO's Alleged "Indifference" to its Net Energy Costs. 80

(iv) GMO Reluctance to Rebase Energy Costs. 82

(v) GMO's Energy Purchases from KCP&L During 2011 82

(vi) Shifting From 95/5 to 85/15 Would Triple GMO's Share of Under-Collection. 83

(vii) Purchased Power Agreements. 86

3. Should both the revenues and the costs associated with Renewable Energy Certificates flow through GMO's FAC? 86

4. Should GMO's FAC tariff be clarified to specify that the only transmission costs included in it are those that GMO incurs for purchased power and off-system sales, excluding the transmission costs related to the Crossroads Energy Center? 87

5. Should GMO be ordered to provide or make available the additional information and documents requested by Staff to aid Staff in performing FAC tariff, prudence, and true-up reviews? 87

V. CONCLUSION. 88

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-2012-0174
In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service.	))))	Case No. ER-2012-0175

INITIAL POST-HEARING BRIEF OF
KANSAS CITY POWER & LIGHT COMPANY AND
KCP&L GREATER MISSOURI OPERATIONS COMPANY

Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO") ("Company" or, collectively, "Companies") submit this Initial Post-Hearing Brief ("Brief") in accord with the Missouri Public Service Commission's ("Commission" or "PSC") Order Consolidating Cases for Hearing and Setting Procedural Schedule issued April 26, 2012.

I. INTRODUCTION.

1. Throughout the course of this case, the parties have worked diligently to resolve many issues. However, the issues remaining to be resolved by the Commission will have a large impact upon the Companies and their customers. In particular, cost of capital and the transmission tracker issues are two common issues that will have a substantial impact upon the financial health of the Companies. The Crossroads issue and the Fuel Adjustment Clause ("FAC") Sharing Percentage issue relate only to GMO and are significant. Finally, the residential all-electric and space heating rate issue raised by Southern Union Company d/b/a Missouri Gas Energy ("MGE") in both cases needs to be resolved in a fair and equitable manner

21505558

so that the Companies can continue to maintain their off-peak winter heating load. The impact of this issue may have a significant impact on specific customers served under the residential all-electric and space heating rate.

2. Proper consideration of these matters (as well as the other issues discussed below) will lead to a decision that sets just and reasonable rates that properly balance the interests of shareholders and customers, and will give the Companies an opportunity to earn a reasonable rate of return following the conclusion of the case.

II. KCP&L ONLY ISSUES.

A. Rate Design/Class Cost of Service Study ("CCOS").

1. How should the class cost of service studies be relied on for determining shifts in customer class revenue responsibilities that are revenue neutral on an overall company basis?

(a) What methodology should be used to allocate demand-related (fixed) production costs in KCP&L's class cost-of-service study?

(b) What methodology should be used in the CCOS to allocate OSS margins?

2. How should any rate increase be allocated among the various customer classes?

3. How should rates be designed?

4. Should the Commission adopt Staff's proposal to increase by 5% the first energy block rate of the winter All-Electric General Services rates?

5. Should the Commission adopt Mr. Brubaker's LGS / LP rate design methodology?

6. Residential rate adjustments:

(a) Should current residential rates be adjusted to reflect a revenue-neutral shift seasonally and among residential rate schedules in the winter based on KCP&L's class cost of service study?

(b) How should any residential rate increase be assigned to rate elements?

3. On October 29, 2012, KCP&L, the Midwest Energy Consumer's Group ("MECG"), Missouri Industrial Energy Consumers ("MIEC"), and the Missouri Public Service Commission Staff ("Staff") filed a Non-Unanimous Stipulation And Agreement Regarding Class Cost of Service/Rate Design Issues ("KCP&L CCOS Stipulation"). However, on November 2, 2012, the Office of the Public Counsel ("OPC"), AARP, and Consumers Council of Missouri filed objections to the KCP&L CCOS Stipulation. As a result, the Commission should consider the competent and substantial evidence in the record and render its decision based upon the evidence. See 4 CSR 240-2.115(2)(D). The Company supports the terms of the KCP&L CCOS Stipulation, and urges the Commission to resolve the above-referenced CCOS and rate design issues consistent with the terms of the KCP&L CCOS Stipulation, and based upon the competent and substantial evidence in the whole record.

4. The signatories to the KCP&L CCOS Stipulation agreed that the Commission should increase residential true-up revenues by 1.00% in addition to any other increase implemented by the Commission with a corresponding equal-percentage revenue neutral decrease in the true-up revenues for all other non-lighting rate classes. This shift is consistent with the CCOS studies which demonstrated that the residential class was not paying its appropriate share of the Company's costs of service. See KCPL-38, Normand Direct, Sch. PMN-2; Staff-211 Staff Rate Design and Class Cost of Service Report at 3; USDOE-501, Goins Direct, Sch. DWG-1. Staff summarized the results of the class of service studies as follows:

TABLE 1

Summary Results of Class Cost of Service Results INDEX OF RETURN						
Customer Class	KCP&L	Staff	USDOE	Industrials A&E 4NCP	A&E 2NCP	4CP
RESIDENTIAL (RES)	0.98	0.53	0.49	0.42	0.42	0.49
Regular	1.08	0.54	0.48			
All Electric	0.75	0.57	0.50			
Separately Metered	0.53	0.24	0.52			
Time of Day	0.91	0.90	0.38			
SMALL GENERAL	1.98	2.13	1.84	2.02	1.99	1.84
Primary & Secondary	2.01	2.16	1.84			
Other	1.82	2.59	2.28			
All Electric	1.50	1.49	1.70			
Separately Metered	1.70	1.54	1.87			
MEDIUM GENERAL	1.28	1.55	1.31	1.42	1.41	1.31
Primary	1.65	1.43	1.99			
Secondary	1.32	1.63	1.32			
All Electric	0.96	1.06	1.20			
Separately Metered	1.31	1.15	1.32			
LARGE GENERAL	1.05	1.29	1.34	1.42	1.45	1.34
Primary	1.26	1.81	1.55			
Secondary	1.17	1.37	1.35			
All Electric	0.81	1.03	1.25			
Separately Metered	1.32	1.44	1.52			
LARGE POWER	0.54	1.16	1.28	1.38	1.33	1.28
Primary	0.65	1.22	1.37			
Secondary	0.62	1.24	1.26			
Substation	0.34	1.00	1.20			
Transmission	0.17	0.89	0.96			
LIGHTING	1.12	1.38	5.64	2.31	2.31	5.64

21505558

See Staff-233, Scheperle Rebuttal at 3. The Company believes that the signatories' agreements in the KCP&L CCOS Stipulation are supported by the results of the cost of service studies.

5. For the Large Power ("LP") rate schedule, the signatories to the KCP&L CCOS Stipulation recommend that any increase to that rate class shall be implemented as follows:

> (i) No increase to the current energy charge tail block rate elements – the seasonal rate elements applicable to energy charge that exceeds 360 hours use per month;
>
> (ii) 75% of the class average percentage increase shall be assigned to the middle block seasonal rate elements applicable to energy usage between 180 hours and 360 hours use per month; and
>
> (iii) The remaining amount of the increase shall be assigned to all remaining rate elements on an equal percentage basis.

See KCP&L CCOS Stipulation at 1-2.

This recommendation is consistent with the evidence filed by KCP&L and the Industrial Intervenors. See KCPL-43, Rush Surrebuttal at 13; MIEC-830 and MECG-406, Brubaker Direct at 3-35.

6. For the Large General Service ("LGS") rate schedule, any increase to that rate class should be implemented as follows:

> (i) No increase to the over 360 hours use per month energy block;
>
> (ii) The separately metered energy charges shall receive the LGS class average;
>
> (iii) The second 180 hours use energy charge increase adjusted as needed to yield target class revenue increase, but not less than zero increase; and
>
> (iv) Remaining charges increase by Class average increase plus 4 percent, unless the second hours use block increase reaches zero, then the adder is reduced as needed to produce target class increase.

See KCP&L CCOS Stipulation at 2.

This recommendation is consistent with the evidence filed by KCP&L and the Industrial Intervenors. See KCPL-43, Rush Surrebuttal at 13; MIEC-830 and MECG-406, Brubaker Direct at 3-35.

7. The overall increase granted by the Commission should be applied as an equal percentage to the base rate revenues of each class, after adjusting for the inter-class adjustments described in paragraph 1 of the KCP&L CCOS Stipulation. The revenue neutral shift to the residential class as proposed by MGE should be denied. Competent evidence was presented in the testimony of Mr. Rush that the current rate design be maintained for many reasons that are discussed throughout this brief. See KCPL-38, Normand Direct, Sch. PMN-2; Staff-211 Staff Rate Design and Class Cost of Service Report at 3; USDOE-501, Goins Direct, Sch. DWG-1.

7. Residential Space Heat services:

(a) Should KCP&L's Residential Space Heat services be eliminated?

8. In this proceeding, MGE has taken the unusual step of intervening to promote its own competitive interests at the expense of KCP&L's customers. In fact, MGE is suggesting that Commission order the elimination of the residential all-electric and space heating rates which have existed for more than thirty years. See MGE Position Statement at 3-5.

9. As explained below, MGE's argument for eliminating residential space heating rates appears to be nothing more than an anti-competitive attempt to prevent KCP&L from providing cost-based rates for customers who choose to use electricity to heat their homes. See Tr. 1030. The Commission should not encourage such behavior by competitors, and it should reject the arguments and positions of MGE that would severely impact KCP&L's space heating and all-electric customers.

(b) In the alternative, should KCP&L's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?

10. No. KCP&L's residential space heating services should not be scheduled for elimination in a subsequent rate case by freezing their availability. As explained below, the "freezing" of rate schedules will cause customer confusion, complaints, and substantially complicate the administration of the Company's rate schedules.

(c) Should the Commission adopt Staff's proposal to increase by 5% the first block of the residential space heating rates?

11. No. The Company recommends that the existing rate design be maintained. Any increase in rates should be spread equally to all classes and rate components. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13; GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14; KCPL-43, Rush Surrebuttal at 4-10. As explained below, there is no cost justification for increasing the first block of the residential space heating rates by more than the system average increase.

(i) The Cost Of Service Studies Support the Continuation of the Residential Space Heating And All-Electric Rates.

12. In this proceeding, several parties, including the Company, Staff, United States Department of Energy ("USDOE"), and Industrial Intervenors, sponsored CCOS studies. See KCPL-38, Normand Direct, Sch. PMN-2; Staff-211 Staff Rate Design and Class Cost of Service Report at 3; USDOE-501, Goins Direct, Sch. DWG-1. The cost of service studies largely supported the conclusion that residential all-electric rates are providing a higher return than the general residential rates, as Staff witness Michael Scheperle testified during cross-examination. See Tr. 1064-67. In fact, Staff's cost of service study shows that for KCP&L, the index of return for all-electric rates was 0.57% compared to the overall residential rates which had an index of return of only 0.53%. See Tr. 1066. Similarly, the USDOE cost of service study had a similar

result showing that the residential all-electric rate had an index of return of 0.55% compared to the overall residential rates which had an index of return of only 0.49%. Id. While KCP&L's cost of service study had a slightly lower index of return for residential all-electric rates than the overall residential rates, such a small differential does not justify the radical step of eliminating residential all-electric and space heating rates, as suggested by KCP&L's primary competitor for residential space heating service. MGE presented no study that would justify the proposed changes in rate design suggested by MGE. Based upon the totality of the cost of service study evidence, it would be inappropriate to eliminate or freeze the residential all-electric and space heating rates, or raise the residential all-electric rates and space heating rates by a greater percentage than the residential general class.

13. The competent and substantial evidence also demonstrates that KCP&L's residential all-electric and space heating rates recover more than the incremental or variable costs and make a contribution to the fixed costs of the Company. See Tr. 1027-28. In the event that the space heating rates were priced so high that space heating customers dropped their all-electric space heating service, then KCP&L's remaining customers would be adversely affected, as described by Mr. Rush during the hearing:

> **Q. Mr. Rush, if the Commission adopted a proposal that would cause space heating customers to drop the service, would you lose that margin?**
>
> * * *
>
> A. I believe that we would have a large fallout if you increase customers' rates to where essentially they were priced out of their product line and they said, you know, that it doesn't make sense to keep electric heat here. That, quite frankly, is not the way rates are designed. We -- the space heating class is a class of customer that has distinct usage characteristics much different than all other customers that are general use, particularly because they have electric heat and how the characteristics of the load profile that's used.
>
> **Q. If you lost space heating customers, would that affect general use residential customers or other customers?**

A. It would result in increasing their rates to recover the lost margins of the space heating customers.

Q. Would that be a good thing?

A. I don't believe so.

See Tr. 1028-29.

14. Based upon the competent and substantial evidence in the record, the Commission should find and conclude that the cost of service studies in the record support the continuation of the Company's residential all-electric and space heating rates. If the Commission priced the space heating service rates so high that the service was not competitive with natural gas or other fuels, then it would have an adverse effect on the Company's remaining residential and other customers. See Tr. 1029.

(ii) MGE's Proposals Would Severely And Adversely Impact KCP&L's Space-Heating and All-Electric Customers Merely To Promote the Competitive Interests of MGE.

15. Most importantly, there would be a severe rate impact upon KCP&L's space heating customers if MGE's recommendations were adopted. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13; GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14. In fact, it was the rate impact upon customers that caused Staff witness Scheperle to oppose MGE's proposals in this case: "The main reason I disagreed with MGE is the amount of increases that KCPL has experienced . . . since the beginning of January 2007." See Tr. 1074. "Since 2007, KCP&L has had about a 43.8 percent increase in rates, and to eliminate an all-electric rate is—it's too much for the customers to bear . . . ." See Tr. 1074-75.

16. Company witness Tim Rush also presented evidence of the severe impact upon customers from the elimination of space heating and all-electric rates. For a typical KCP&L customer, the impact of the elimination of all-electric and space heating rates could be 24.83%, before any increase in this proceeding is granted. See Ex. KCPL-43, Rush Surrebuttal, Sch.

TMR-8 at 4. Assuming a 10% overall rate increase in this case, then the total impact upon KCP&L's typical space heating customers could be approximately 34%. See Tr. 1024-25.[1] Schedule TMR-8 also included analysis for space heating customers at other usage levels. See KCPL-43, Rush Surrebuttal, Sch. TMR-8 at 4. Based upon this analysis, some space heating customers would have increases of 6.06% to 39.59% if the space heating rate was eliminated—before any overall increase was granted in this case. Such increases, in the words of Michael Scheperle, would be "too much for the customers to bear" merely to promote the competitive interests of MGE.

17. The Company recommends that the existing rate design be maintained. Any increase in rates should be spread equally to all classes and rate components. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13; GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14; KCPL-43, Rush Surrebuttal at 4-10.

(iii) MGE's Proposal to Freeze Rate Schedules Will Cause Customer Confusion, Complaints, and Substantially Complicate the Administration of the Company's Rate Schedules.

18. The "freezing" of rate schedules is fraught with complications and difficulties. In a recent case, the Company's large general all-electric rate schedules were "frozen." See Re: Kansas City Power & Light Company, Case No. ER-2007-0291, Report and Order at 82 (Dec. 6, 2007) ("2007 Rate Case"). Unfortunately, as Mr. Rush explained, this "freezing" of rate schedules resulted in numerous customer complaints:

> A. We've had a lot of complaints with regard to our commercial side or our, we call it general service side, which is small, medium, large general service.

[1] During cross-examination, counsel for MGE attempted to suggest that Mr. Rush did not understand MGE's proposal, and if he understood that MGE would shift some of the cost recovery to the summer months, it would change Mr. Rush's analysis. See Tr. 997-1003. However, as Mr. Rush pointed out, if he modified his analysis, as suggested by MGE, to conform to MGE's counsel's representations about the MGE proposal, it would appear to make the percentage increases for a typical space heating customer greater than presented in Mr. Rush's schedules. See Tr. 1003.

> We've had quite a few complaints because of the freezing, because we had construction in progress and you're trying to figure out, okay, this customer was building a home and planning to put electric heat in and now all of a sudden they're exempted from it after the fact, and they had a plan to do so all up to that time, and they base their decision on that electric heat rate or the heating rate.

See Tr. 1027.

19. In one recent case, a formal complaint was filed with the Commission related to the "freezing" of rate schedules. The Company followed what it understood to be the directive of the Commission to "freeze" the rate schedule, and not permit a new or different customer to have all-electric service at the same premises. After hearing, the Commission ruled that the complainant should be entitled to receive large general all-electric service even though the account had previously been in the name of a management company. See Briarcliff Developments v. Kansas City Power & Light Company, Case No. EC-2011-0383, Report and Order (Mar. 7, 2012). This customer complaint is an example of the complications and difficulties that can result from an order to freeze a rate schedule without language describing exactly how the order is to be implemented by the Company.

20. For all of the reasons discussed herein, the Commission should reject MGE's recommendation to eliminate or freeze the residential all-electric and space heating rates of the Companies. Instead, the Commission should authorize an across-the-board increase in rates with the residential class, including the residential all-electric and space heating rates.

B. Resource Planning.

1. Should the Sierra Club's recommendations regarding the La Cygne and Montrose investments be adopted?

21. In this proceeding, the Sierra Club filed the Direct Testimony of Bruce E. Biewald which recommended the following:

> I recommend that the Missouri Commission articulate, in its order in this rate case, that prudent planning includes an obligation for KCP&L to actively seek out relevant information, to conduct rigorous planning analysis, to continue

> to monitor and re-evaluate the decision as construction proceeds, and to thoroughly document and communicate the inputs, methodologies, and results of those planning analyses with the stakeholders and the Missouri Commission. The planning should not be done in a piecemeal fashion, but rather should look forward in order to include appropriate consideration of all reasonably anticipated regulatory requirements. Any eventual rate recovery of the investment should be contingent upon KCP&L conducting and demonstrating prudent planning with regard to spending at these existing coal plants.

See Sierra Club-925, Biewald Direct at 4-5.

22. The Company believes that this recommendation is unnecessary and largely irrelevant to this rate case proceeding. As explained by Mr. Rush and Mr. Crawford during the hearings, KCP&L and GMO are already heavily involved in the integrated resource planning which is mandated by 4 CSR 240-22. See Tr. 589-90, 601-11. This Integrated Resource Plan ("IRP") process involves a rigorous review of the Companies' planning process that is transparent with extensive participation by Staff, OPC, Missouri Department of Natural Resources ("MDNR"), the Sierra Club, and other participants.

23. On April 9, 2012, KCP&L and GMO filed with the Commission its 2012 IRP process, which is required by the Commission's Electric Utility Resource Planning rule, 4 CSR 240-22. On September 6, 2012, Staff, OPC, the MDNR, Sierra Club, and the Natural Resources Defense Council ("NRDC") submitted reports identifying concerns and deficiencies regarding the IRP.[2]

24. The Companies have been actively engaged with the parties to the IRP dockets to resolve identified issues. See Tr. 593, 637. On November 19, 2012, the parties to Case Nos. EO-2012-0323 and EO-2012-0324 submitted a joint filing which resolved a large number of the alleged deficiencies raised by the parties. In addition, the Companies are scheduled to provide

[2] See various comments and reports filed by Staff, OPC, MDNR, Sierra Club, NRDC on Sept. 6, 2012 in Case Nos. EO-2012-0323 and EO-2012-0324.

annual updates to their IRPs in early 2013. See Tr. 638. They will also be addressing Special Contemporary Issues as a part of the IRP processes.[3] It is unnecessary to duplicate this process, or otherwise open another proceeding to review the Companies' planning processes.

25. Sierra Club's recommendation is of questionable relevance to this rate case proceeding. KCP&L has not requested recovery of costs related to the La Cygne project in this rate case. Any discussions of project prudence and the associated documentation and review will be addressed in a rate proceeding after the environmentally-upgraded La Cygne assets are determined by Staff to be in-service and a formal request for cost recovery is filed with the Commission. This is also true with the Montrose plant. While a recently completed capital project at Montrose is included in this case, it is not a major addition comparable to the La Cygne retrofit project. See KCPL-42, Rush Rebuttal at 16-18. The Companies therefore respectfully request that the Commission decline to accept Sierra Club's recommendation to open another proceeding to review the Companies' planning processes related to La Cygne and Montrose. This effort is already going forward, with Sierra Club's participation, in the context of the Commission's IRP rules and ongoing proceedings.

III. KCP&L – GMO COMMON ISSUES.

A. Cost of Capital.

1. Return on Common Equity: What return on common equity should be used for determining rate of return?

26. In the wake of the Great Recession, with a slow but steady outlook for growth,[4] the Commission must determine what return on equity ("ROE") will permit the Companies to

---

[3] See Order Establishing Special Contemporary Resource Planning Issues, Case Nos. EO-2013-0106 and EO-2013-0107 (issued Nov. 1, 2012).

[4] Third quarter growth increased to 2.0% from second quarter growth of 1.3%. See News Release, "Gross Domestic Product: Third Quarter 2012 (Advance Estimate)" issued by the Bureau of Economic Analysis, U.S. Dep't of Commerce (Oct. 26, 2012).

continue to attract investors while reflecting the concerns and interests of customers. The Commission must strike the appropriate balance with reference to a broad set of economic data and choose, as it has in the past, a point within the zone of reasonableness that reflects the risks faced by the Companies. Such a point should also be consistent with ROEs determined by other regulatory utility commissions for comparable companies.

27. In the 2010 rate cases (Case Nos. ER-2010-0355 and ER-2010-0356) the Commission set the Companies' ROE at 10.0%, an approximate mid-point between the recommendations of experts Samuel Hadaway (10.5%) and Michael Gorman (9.65%).[5] As Dr. Hadaway testified, 10.0% "was well below ROEs allowed for other similarly situated utilities at the time." See KCPL-20, Hadaway Rebuttal at 25:11-12; GMO-115, Hadaway Rebuttal at 25:11-12; Tr. 410. The average ROE for integrated utilities in 2010 was 10.38%. See Tr. 410-11. The average authorized equity returns for such utilities in 2011 was 10.24%. See KCPL-20, Hadaway Rebuttal at 5; GMO-115, Hadaway Rebuttal at 5.

28. In this case the Commission faces arguments by several parties to set the lowest rate of return that it can constitutionally determine without being unlawfully confiscatory. See Tr. 339, 334-45. However, as discussed in more detail below, the Commission must reject such a drastic outcome and rely instead upon the recommendations of the experts with the most reasonable ROE ranges that are based upon generally accepted and reliable estimates of the returns that investors expect. Most prominent among those expert opinions is that of Dr. Hadaway who has testified before this Commission on several occasions. He recommends that the Commission consider a range of 9.8% to 10.3%, noting that the unprecedented intervention

[5] See Report and Order ¶ 321, 331, In re Kansas City Power & Light Co., Case No. ER-2010-0355 (Apr. 12, 2011).

of the Federal Reserve Board in the nation's money supply indicates that an ROE of 10.3% is reasonable.

29. The recommendations of Mr. Gorman on behalf of OPC (mid-point of 9.3%) and Matthew Kahal on behalf of the USDOE (9.5%) fall well below Dr. Hadaway's range, and significantly below recent ROEs authorized by Midwestern and other regulatory utility commissions. At the far bottom is Staff's recommendation of 9.0%, based upon a range of 8.0% to 9.0%, as advocated by David Murray. The Commission should reject Mr. Murray's analysis and recommendations, as it has in the past.

(i) Governing Legal Principles.

30. The Supreme Court of the United States established requirements for determining the reasonable rate of return in Bluefield Waterworks & Improvement Co. v. Public Serv. Comm'n of West Virginia, 262 U.S. 679, 692 (1923) ("Bluefield") and Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) ("Hope"). In short, the fixing of "just and reasonable" rates involves a balancing of investor and consumer interests. Hope, 320 U.S. at 603. "What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts." Bluefield, 262 U.S. at 692.

31. A reasonable rate of return is one that closely approximates the profits upon capital invested in other undertakings where the risk involved and other conditions are similar. Bluefield, 262 U.S. at 689-90. "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 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 . . . ." Bluefield, 262 U.S. at 692.

32. A key concern in setting the appropriate return on common equity is that the return be reasonably sufficient to maintain the financial health of the utility. Bluefield, 262 U.S. at 693; Hope, 320 U.S. at 603. "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." Bluefield, 262 U.S. at 693. As the Hope Court explained:

> [T]he 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.

Hope, 320 U.S. at 603.

33. The Bluefield Court stressed this point, declaring:

> Investors take into account the result of past operations, especially in recent years, when determining the terms upon which they will invest in such an undertaking. Low, uncertain, or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors.

Bluefield, 262 U.S. at 694.

34. In Bluefield, the West Virginia Commission ordered a rate of return of 6%. The Supreme Court found that while a 6% rate of return had been reasonable in the recent past, the record in that case showed that the utility's rate of return had been suffering long before that rate case was brought. 262 U.S. at 695. With investors in mind, the Court held that a 6% rate of return "is substantially too low to constitute just compensation for the use of the property employed to render the service." Id. The Supreme Court, therefore, reversed the state appellate court that had affirmed the decision of the West Virginia Commission.

35. While the Hope and Bluefield Courts require that investor and customer interests be balanced in setting a *reasonable* rate of return, which depends upon many factors to be considered by the Commission, neither Court enunciated a particular methodology to arrive at a reasonable rate of return. Conversely, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts." Hope, 320 U.S. at 602 (citations omitted).

36. Following Bluefield and Hope, Missouri appellate courts agree that "the Commission is not bound to any set methodology in ensuring a just and reasonable return in setting rates." State ex rel. Praxair, Inc. v. PSC, 328 S.W.3d 329, 339 (Mo. App. W.D. 2010). See State ex rel. Noranda Aluminum, Inc. v. PSC, 356 S.W.3d 293, 311 (Mo. App. S.D. 2011).

37. In performing its duty, the Commission is bound to set a rate of return that falls within a zone of reasonableness: "Statutory reasonableness is an abstract quality represented by an area rather than a pinpoint. It allows substantial spread between what is unreasonable because too low and what is unreasonable because too high." Federal Power Comm'n v. Conway Corp., 426 U.S. 271, 278 (1976), quoting Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co., 341 U.S. 246, 251 (1951). Stated differently, the zone of reasonableness is "the zone between the lowest rate not confiscatory and the highest rate fair to the public." In re New Jersey Power & Light Co. v. State, 89 A.2d 26, 44 (N.J. 1952).

38. The Commission generally sets the zone of reasonableness at 100 basis points above and below the national average ROE authorized for similarly-situated utilities. See State ex rel. Public Counsel v. PSC, 274 S.W.3d 569, 574 (Mo. App. W.D. 2009). This methodology for setting the zone of reasonableness was upheld by the Missouri Court of Appeals as recently as this year, holding as reasonable an ROE that "falls within the zone of reasonableness for

returns on equity based on the national average authorized return on equity for gas utilities." State ex rel. Office of the Public Counsel v. PSC, 367 S.W.3d 91, 110-11 (Mo. App. S.D. 2012).

39. Moreover, a utility is entitled to something more than a minimum or merely non-confiscatory return. Northern Illinois Light & Traction Co. v. Illinois Commerce Comm'n, 134 N.E. 142, 147 (Ill. 1922) ("A public utility is entitled to have a rate of return which will yield a fair return . . . and not a rate which is confiscatory, or which is merely non-confiscatory"). "[T]here is a difference between a rate which is merely nonconfiscatory and one which is just and reasonable, and it is the just and reasonable rate which the commission is called upon to fix." State Pub. Utils. Comm'n v. Springfield Gas & Elec. Co., 125 N.E. 891, 895 (Ill. 1919).

40. In other words, the Commission's duty is to set a just and reasonable rate, not merely setting a rate that passes constitutional muster. "A rate order may be unjust and unreasonable without being confiscatory . . . . If a rate order merely fails to yield a fair profit or return, it is unreasonable and unjust, but not confiscatory. If it will not only not yield a fair profit or return, but calls on the utility to operate at a loss, it is confiscatory." Lone Star Gas Co. v. State, 153 S.W.2d 681, 696 (Tex. 1941). "Manifestly, the just and reasonable rate is not necessarily the minimum rate which will stand the constitutional test. If that were true, the Commission could not give weight to any other factor or factors in rate-making, either in the interest of the public or the utility, and would be bound by the naked legal rights of the parties." Waukesha Gas & Elec. Co. v. Railroad Comm'n of Wisconsin, 194 N.W. 846, 850 (Wis. 1923).

41. Given Sections 393.130.1 and 393.150.2 and other passages of the Public Service Commission Law that authorize "just and reasonable" rates, it is perfectly reasonable for the Commission to adopt a rate of return at the upper end of the zone of reasonableness. "A commission or other legislative body, in its discretion, may determine to be reasonable and just a rate that is substantially higher than one merely sufficient to justify a judicial finding in a

confiscation case . . . . It is well known that rates substantially higher than the line between validity and unconstitutionality properly may be deemed to be just and reasonable, and not excessive or extortionate." Banton v. Belt Line Ry. Corp., 268 U.S. 413, 422-23 (1925).

42. For example, the Missouri Court of Appeals has upheld the Commission's conclusion that the appropriate ROE is higher than the national average when there are perceived risks associated with investment in the utility. State ex rel. Praxair, Inc. v. PSC, 328 S.W.3d 329, 339 (Mo. App. W.D. 2010).

(ii) The Companies' Recommendation: Dr. Hadaway.

43. The Companies' ROE recommendation was presented by Dr. Hadaway who holds a bachelor's degree in economics from Southern Methodist University, and a master's of business administration degree in finance and a Ph.D. in finance and econometrics from the University of Texas at Austin. He was the Chief Economist and Director of the Economic Research Division at the Public Utility Commission of Texas in the early 1980s, and has taught finance at the University of Alabama, Texas Tech University, Texas State University at San Marcos, and at the University of Texas at Austin. Over the course of his career, Dr. Hadaway has sponsored testimony on behalf of investor-owned utilities, electric cooperatives, municipal utilities, and industrial customers. His expert testimony has been accepted by state regulatory commissions around the country, from California to Massachusetts, and from Minnesota to Louisiana. See KCPL-19, Hadaway Direct at Appendix A; GMO-114, Hadaway Direct at Appendix A.

44. Dr. Hadaway's recommendation is based on four Discounted Cash Flow ("DCF") models which he compared with a Risk Premium analysis. See KCPL-19, Hadaway Direct at 35; GMO-114, Hadaway Direct at 35; KCPL-20, Hadaway Rebuttal at 30-31; GMO-115, Hadaway Rebuttal at 30. Importantly, his opinions rely not only upon data from the markets, but

also reflect the unusual state of the credit markets, which have been marked by the unprecedented intervention of the Federal Reserve Board. The DCF analysis requires a proxy group of a sufficient number of utilities with a risk profile similar to that of the Companies. Dr. Hadaway's initial proxy group consisted of 22 electric utilities whose profiles, as reported in Value Line, indicated they met certain criteria. These requirements, which none of the other experts disputed, required (a) at least a BBB corporate bond rating, (b) at least 70% of revenues derived from regulated utility sales, (c) no recent merger activity, and (d) a consistent dividend record. See KCPL-19, Hadaway Direct at 4; GMO-114, Hadaway Direct at 4.

45. In his updated ROE recommendations presented in Rebuttal, Dr. Hadaway adjusted the utilities in his group of comparable companies so that they all met his criteria. See KCPL-20, Hadaway Rebuttal at 29; GMO-115, Hadaway Rebuttal at 29. Although Mr. Gorman and Mr. Kahal criticized the new proxy group, as discussed in detail below, the changes made by Dr. Hadaway were both necessary and reasonable.

46. Dr. Hadaway's DCF analysis utilized four models: two versions of the traditional Constant Growth model, a Multi-Stage model, and a Terminal Value model. See KCPL-19, Hadaway Direct at 35; GMO-114, Hadaway Direct at 35; KCPL-20, Hadaway Rebuttal at 30; GMO-115, Hadaway Rebuttal at 30. In the Constant Growth models Dr. Hadaway utilized an analyst's growth rate projection and an estimated long-term gross domestic product ("GDP") growth rate, respectively. In the Multi-Stage model, he used Value Line's near-term projected dividends, as well as a long-term GDP growth rate of 5.70%. The results of these first three DCF models produced a range of 9.8% to 10.1%. See KCPL-20, Hadaway Rebuttal, Sch. SCH-12 at 1-3; GMO-115, Hadaway Rebuttal, Sch. SCH-12 at 1-3.

47. Recognizing that recent economic events and current market conditions have called into question the validity of the traditional Constant Growth assumptions of the DCF

model, Dr. Hadaway added the Terminal Value model in his Rebuttal. See KCPL-20, Hadaway Rebuttal at 30-31; GMO-115, Hadaway Rebuttal at 30-31. This model was presented to the Commission for comparison purposes and, as Dr. Hadaway emphasized at the hearing, "was used to balance the extremely low dividend yields in the other models." See Tr. 384-85, 446-47. See also KCPL-20, Hadaway Rebuttal at 30-31; GMO-115, Hadaway Rebuttal at 30-31. The Terminal Growth model uses current utility price-to-earnings ratios to estimate future prices, thus bringing a necessary counter-balance to the low dividend yield results of the traditional DCF models. Id.

48. The ROE range determined by Dr. Hadaway's application of all four models was 9.8% to 10.3%.

49. Dr. Hadaway also performed a Risk Premium Analysis based on ROEs allowed by utility regulatory commissions and projected BBB utility interest rates. That analysis indicated an ROE of 10.14%. See KCPL-20, Hadaway Rebuttal at 31; GMO-115, Hadaway Rebuttal at 31.

50. The results from these models led Dr. Hadaway to conclude that the current cost of equity capital is in the range of 9.8% to 10.3%, and that the Companies' requested 10.3% ROE is reasonable. Id.

(iii) OPC's Recommendation: Mr. Gorman.

51. Michael Gorman, a managing principal with Brubaker & Associates, Inc. (Chesterfield, Missouri), testified on behalf of OPC. He holds a bachelor of science degree in electrical engineering from Southern Illinois University and a master's degree in business administration from the University of Illinois at Springfield. He worked at the Illinois Commerce Commission as a financial analyst (1983-89). After a short tenure with Merrill Lynch as a financial consultant, he has worked at Brubaker & Associates since 1990. He mainly

testifies on behalf of large industrial and other customer groups before state regulatory commissions. See OPC-300, Gorman Direct at Appendix A; OPC-307, Gorman Direct at Appendix A.

52. Mr. Gorman presented three DCF models, a risk premium model and a capital asset pricing model (CAPM). The three DCF models consisted of a Constant Growth, a Sustainable Growth and a Multi-Stage Growth model. For the Constant Growth model he used an annual growth rate of 5.14%, which yielded an ROE range of 9.46% to 9.54%. See OPC-300, Gorman Direct at 19; OPC-307, Gorman Direct at 20 (average/median). For his Sustainable Growth model he used a growth rate of 4.85%, producing an ROE range of 9.15% (average) and 8.57% (medium). See OPC-300, Gorman Direct at 21; OPC-307, Gorman Direct at 21. In his Multi-Stage Growth DCF model, Mr. Gorman relied on three growth rates: a short-term rate of 5.14%; a transition period of five years (rates from 4.94% to 5.10%); and a long-term growth period where he used only a 4.9% growth rate. See OPC-300, Gorman Direct at 25 and Sch. MPG-9; OPC-307, Gorman Direct at 26 at 25 and Sch. MPG-9. This yielded a range of ROEs of 9.3% (average) and 9.47% (median).

53. Unlike Dr. Hadaway, Mr. Gorman made no effort to adjust his analysis for the federal government's significant intervention in the credit markets, which he does not even mention in his discussion of the electric utility industry or of current investment risks. See OPC-300, Gorman Direct at 5-10; OPC-307, Gorman Direct at 5-10. Mr. Gorman also ignores the recent historically low inflation rates, which are almost a full percentage point below longer-term historical averages. See KCPL-20, Hadaway Rebuttal at 17-18; GMO-115, Hadaway Rebuttal at 17-18. Mr. Gorman's use of analysts' growth rates for his multi-stage DCF model are unreasonably low because they are dominated by recent, virtually zero growth in the economy, and are based on assumed long-term inflation rates of only about 2.0%. Id. at 18. Mr. Gorman's

response to Dr. Hadaway's criticism is to reject any reliance upon historical data (OPC-301, Gorman Surrebuttal at 9-10; OPC-308, Gorman Surrebuttal at 9-10), and make no explicit adjustment for the policies of the federal government. See Tr. 531. Such a failure is significant, even though Mr. Gorman acknowledged the validity of the views of Thomas Hoenig, former president of the Kansas City Federal Reserve Bank, that low interest rates "distort the market" and "distort the allocation of capital." See Tr. 531; KCPL-58.[6]

54. Had Mr. Gorman used a more appropriate growth rate, his high ROE recommendation of 9.50%, based on his DCF models (OPC-300, Gorman Direct at 39; OPC-307, Gorman Direct at 39), would have been in the range of 9.9% to 10.1%. See KCPL-20, Hadaway Rebuttal at 19; GMO-115, Hadaway Rebuttal at 19. Mr. Gorman implicitly acknowledged that his DCF models are flawed, given that he rejected the 9.15% ROE estimate of his Sustainable Growth model and the 9.30% estimate of his Multi-Stage model. Relying only on the Constant Growth (analysts' growth) model at 9.46%, he rounded it up to 9.5% to arrive at what he termed a "conservative" conclusion. See OPC-300, Gorman Direct at 29; OPC-307, Gorman Direct at 29; Tr. 531:25.

55. Mr. Gorman's Risk Premium analysis, like Dr. Hadaway's, estimates the difference between authorized ROEs and the yields on U.S. Treasury bonds and utility bonds. However, Mr. Gorman fails to recognize the inverse relationship between equity risk premiums and interest rates. This well recognized relationship over the past 30 years demonstrates that equity risk premiums increase as interest rates decline (such as exists today), and that such premiums were lower when interest rates in the past were high. See KCPL-19, Hadaway Direct at 40-41; GMO-114, Hadaway Direct at 40-41. This relationship has been well documented in

[6] Mr. Hoenig is now Vice Chairman and a Director of the Federal Deposit Insurance Corporation.

the literature, including the respected treatise New Regulatory Finance by Dr. Roger A. Morin, which Mr. Gorman himself relies upon in other portions of his testimony.[7] See OPC-300, Gorman Direct at 24-25; OPC-307, Gorman Direct at 25.

56. By conducting a standard regression analysis to account for this inverse relationship between risk premiums and interest rates, Dr. Hadaway demonstrated that Mr. Gorman's risk premium data supports an ROE of 9.95% for the Treasury bond analysis and a 9.85% ROE for a utility bond analysis.[8]

57. Although Mr. Gorman did conduct a CAPM analysis, it yielded an ROE of 8.35%, which he rounded to 8.4%. See OPC-300, Gorman Direct at 39; OPC-307, Gorman Direct at 39. However, he did not base his ROE recommendation on that analysis. See Tr. 522, 532. The range of Mr. Gorman's recommendation is 9.1% to 9.5%, with a mid-point of 9.3%. Id.

(iv) Department of Energy & Federal Executive Agencies' Recommendation: Mr. Kahal.

58. Matthew I. Kahal is a consultant with Exeter Associates, Inc. (Columbia, Maryland). He holds bachelor's (1971) and master's degrees in economics (1974) from the University of Maryland. He testifies mainly on behalf of government energy users and state consumer advocates, and has appeared before numerous state regulatory commissions as well as the Federal Energy Regulatory Commission ("FERC"). See USDOE-550, Kahal Direct at Appendix A.

---

[7] "Published studies by Brigham, Shome, and Vincent (1985), Harris (1986), Harris and Marston (1992, 1993), Carleton, Chambers and Lakonishok (1983), Morin (2005), and McShane (2005), and others demonstrate that, beginning in 1980, risks premiums vary inversely with the level of interest rates-rising when interest rates fell and declining when interest rose." Roger A. Morin, New Regulatory Finance 129 (2006).

[8] Dr. Hadaway corrected his Rebuttal Testimony at 20, which had indicated the utility bond risk premium analysis was 9.95%. It is 9.85%. See Tr. 372:3-6.

59. Mr. Kahal, on behalf of the USDOE and Federal Executive Agencies, utilized both the DCF model and a CAPM study, although he found the latter "approach to be much less useful than the DCF method." See USDOE-550, Kahal Direct at 7. Because the CAPM analysis produced a low range of 6.7% to 8.8%, Mr. Kahal stated that he placed no reliance on that analysis in formulating his ROE recommendation. Id. at 26.

60. Using a growth rate range from 4.5% to 5.5%, Mr. Kahal produced an ROE range of 8.8% to 9.8%. Id. at 23-24. His "final recommendation" was a 9.5% ROE. Id. at 24.

61. This recommendation is based only on the Constant Growth DCF model which Mr. Kahal conducted without explicit consideration for the current capital market anomalies that he discusses. See USDOE-550, Kahal Direct at 9-10. He observed that "extraordinarily low rates" of interest reflected in both Treasury and non-Treasury debt instruments "are the result of an intentional policy of the Federal Reserve Board of Governors . . . to make liquidity available to the U.S. economy and to promote economic activity." Id. 9:7-10. He acknowledged that the Federal Reserve Board's Quantitative Easing programs additionally "exert downward pressure on long-term interest rates," as well as the program known as Operation Twist.[9]

62. Dr. Hadaway noted that if consideration of these economic facts, and adjustments to the proxy group were made to eliminate companies that no longer met the criteria, Mr. Kahal's mean ROE analysis (using his high growth rate of 5.5%) would increase his ROE recommendation to 9.88%. See KCPL-20, Hadaway Rebuttal at 27-28; GMO-115, Hadaway Rebuttal at 27-28.

---

[9] Quantitative Easing is the Federal Reserve Board's program of purchasing mortgage-backed securities at a rate of $40 billion per month. Tr. 451-52. The Federal Reserve Board recently announced that this program would continue through the end of 2012. See Federal Reserve Press Release (Oct. 24, 2012), attached as Exhibit A.

Operation Twist is the Fed's program of selling $267 billion shorter-securities and buying the same amount of longer-term debt in an effort to keep long-term interest rates down. See Tr. 452; KCPL-20, Hadaway Rebuttal at 3, n. 1; GMO-115, Hadaway Rebuttal at 3, n. 1.

(v) Staff's Recommendation: Mr. Murray.

63. David Murray is the Utility Regulatory Manager of the Financial Analysis Unit of the Staff. He holds a bachelor of science degree in business administration from the University of Missouri (Columbia) and a master's in business administration from Lincoln University. Since October 2010 he has been a Chartered Financial Analyst ("CFS"). He has worked on the Commission Staff since 2000. He has only presented testimony before the Commission. See Staff-202, Staff Cost of Service Report at Appendix 1 at 63-69; Staff-260, Staff Cost of Service Report at Appendix 1 at 74-80.

64. In contrast to all the other ROE witnesses, Staff's Mr. Murray presents an ROE range of 8.0% to 9.0%, substantially below the returns allowed for other similarly situated utilities by this Commission, as well as other public utility commissions. See Staff-200, Staff Cost of Service Report at 65; Staff-258, Staff Cost of Service Report at 69. He recommends that the Commission set the Companies' ROE at 9.0%, but promptly disparages this figure as "well-above what Staff believes the true cost of equity to be in the current capital market environment." Id.

65. Although Staff acknowledges that an estimate of a utility's cost of equity should pass the "common sense" test (see Staff-200, Staff Cost of Service Report at 24; Staff-258, Staff Cost of Service Report at 28), Mr. Murray utilizes extremely low DCF growth rates based on outdated and discontinued Mergent Manual data from 1947 through 1999. See Staff-200, Staff Cost of Service Report at 45; Staff-258, Staff Cost of Service Report at 484 ; Staff-203, Staff Cost of Service Report, Appendix 2, Sch. 15; Staff-261, Staff Cost of Service Report, Appendix 2, Sch. 15. Mr. Murray then attempts to bolster that analysis, which was rejected by the Commission in the Companies' last rate cases, with a group of only ten companies, several of which are no longer in business, with data from Value Line only for the period 1968-99. See

Staff-200, Staff Cost of Service Report at 40-42; Staff-258, Staff Cost of Service Report at 43-45; Staff-203, Staff Cost of Service Report, Appendix 2, Sch. 14; Staff-261, Staff Cost of Service Report, Appendix 2, Sch. 14. Indeed, Staff admitted that "a key weakness in the data Staff analyzed is that it does not extend past 1998." See Staff-200, Staff Cost of Service Report at 51:24-25; Staff-258, Staff Cost of Service Report at 54:27-28; Tr. 495. Mr. Murray additionally admitted that he had problems replicating the Mergent data that he utilized in his study. See Staff-200, Staff Cost of Service Report at 45:12-13; Staff-258, Staff Cost of Service Report at 48:16-17. He apparently came to this conclusion after conducting the investigation he promised in his 2010 Surrebuttal with regard to "the discrepancy between the growth rates." See Murray Surrebuttal at 8, at 12:11-12, Case No. ER-2010-0355 (Exhibit 235).

66. Mr. Murray also sought to rely upon an article in the Public Utilities Fortnightly by a former member of the Wisconsin Commission Staff. See Staff-200, Staff Cost of Service Report at 53-54; Staff-258, Staff Cost of Service Report at 56-57. Although Mr. Murray quotes the author as believing that the cost of equity for utilities is in the 7% to 8% range (Staff-200, Staff Cost of Service Report at 64:24-25; Staff-258, Staff Cost of Service Report at 67:24-25), he acknowledges that this is not the author's recommendation. Indeed, the author endorsed "a more reasonable standard," which "regulators have adopted implicitly," and set ROE above any estimated cost of equity. See KCPL-57 at 5; Tr. 496-97.

67. As Dr. Hadaway pointed out, the Wisconsin Commission's actions in recent rate cases filed by Wisconsin Power and Light Co. and by Northern States Power (Wisconsin) set the ROEs of those companies at 10.4%. See KCPL-20, Hadaway Rebuttal at 14-15; GMO-115, Hadaway Rebuttal at 14-15; GMO-116, Hadaway Surrebuttal, Sch. SCH-14 at 4-5 (decisions in 2011 and 2012).

68. Finally, Mr. Murray relies upon investment banker reports and valuations performed by financial analysts that were not prepared for purposes of establishing rates or ROE in a public utility's rate case before a regulatory commission. The ISI Report, attached to Mr. Murray's Surrebuttal as Exhibit 4, reveals that the authors are speculators and stock pickers, giving advice to "buy" or to "hold" on utility securities. Mr. Murray admitted that they were simply investment advisors (see Tr. 499) and that the model that ISI uses, to which he did not have access, was not intended to recommend ROEs to public utility commissions. See Tr. 499-500.

(vi) Proxy Group Issues.

69. Regardless of the method used to estimate ROE, an expert must decide what group of comparable companies or proxy group should be utilized. The Hope and the Bluefield cases hold that the basic premise in determining a fair return is that the ROE should be commensurate with returns on investments in other firms with comparable risks. Hope, 320 U.S. at 603; Bluefield, 263 U.S. at 692.

70. As Dr. Roger Morin has stated:

> Confidence in the reliability of the estimate of equity cost can be enhanced by estimating the cost of equity capital for a variety of risk-equivalent companies. Such group comparisons not only act as a useful check on the magnitude of the cost of equity estimate obtained from a single company, but also mitigate any distortion introduced by measurement errors in the model inputs, for example, beta estimates, dividend yield, and growth.

Roger A. Morin, New Regulatory Finance 397 (2006).

71. The task of selecting a proxy group of companies strictly engaged in regulated utility business "has become increasingly difficult for electric and gas utilities in recent years." Id. at 399. Electric utilities have been involved in takeovers, restructuring, deregulation and other similar activities over the past decade, and have also found themselves in volatile capital markets. Id. "There is often considerable uncertainty in capital markets, as evidenced by interest

rate gyrations and widely divergent forecasts of the economy and interest rates." Id. The results obtained from the standard methodologies "is wider today than in the past, and the application of professional judgment to the results obtained is greater now than in the past." Id.

72. Despite these difficulties, Morin and other experts state that "it is important to select relatively large sample sizes as opposed to small sample sizes consisting of a handful of companies in applying the CAPM, Risk Premium and DCF methods." Id.

73. In the pending cases, Dr. Hadaway used a proxy group of 22 companies in his Direct Testimony, which was accepted by both Mr. Gorman and Mr. Kahal. See KCPL-19, Hadaway Direct at 4 and Sch. SCH-1; GMO-114, Hadaway Direct at 4 and Sch. SCH-1. He later modified this proxy group, dropping four companies that no longer met the relevant criteria, and adding three others that did, for a revised group of 21 companies. See KCPL-20, Hadaway Rebuttal at 16-17, 29; GMO-115, Hadaway Rebuttal at 16-17, 29. While those adjustments were proper, as discussed further below, the Hadaway proxy group of 21 stands in stark contrast to Staff's proxy group of only ten companies. See Staff-203, Staff Cost of Service Report, Appendix 2, Sch. 8; Staff-61, Staff Cost of Service Report, Appendix 2, Sch. 8. While Mr. Gorman and Mr. Kahal further revised the adjusted Hadaway proxy group, it is significant that neither of them endorsed Mr. Murray's narrow group of ten companies. See Tr. 522 (Gorman), 552 (Kahal).

74. Dr. Hadaway's initial proxy group of 22 companies was compiled and proposed in February 2012. When he filed his Rebuttal in September, significant changes had occurred in four of the companies in his group. Edison International ("Edison") is facing "erratic earnings prospects due to nonrecurring charges for its non-regulated coal plants." See KCPL-20, Hadaway Rebuttal at 16; GMO-115, Hadaway Rebuttal at 16. He noted that Value Line reported that currently low power prices made it "unappealing" for Edison "to spend large sums on

environmental upgrades that would be needed to keep its coal units operating." Id. As a result, Edison's projected growth rates were so low that "its DCF estimates are not significantly above the cost of debt." Id. at 16-17. Because of these dire projections of low growth, Edison was removed from the proxy group. Id. at 29.

75. Similarly, Cleco Corporation ("Cleco") (the holding company of Cleco Power, formerly Central Louisiana Electric Company) was experiencing unusually higher stock prices which Value Line stated was the result of "takeover speculation." Id. at 17. Dr. Hadaway observed that a high stock price influenced by takeover speculation explains Cleco's abnormally low dividend yield at just over 3.0%, and he dropped it from the group. Id.

76. Dr. Hadaway and Mr. Gorman removed Ameren Corporation ("Ameren") from the proxy group because the growth rates estimated by Value Line, Zacks, and Thomson all projected negative near-term earnings growth. Id. at 29; OPC-300, Gorman Direct at 15;[10] OPC-307, Gorman Direct at 15.

77. Finally, Dr. Hadaway eliminated Vectren Corporation ("Vectren"), the parent company of Southern Indiana Gas & Electric Company, because its percentage of regulated revenue had fallen below the 70% threshold. See KCPL-20, Hadaway Rebuttal at 29; GMO-115, Hadaway Rebuttal at 29. Because Vectren did not fit the criteria that Dr. Hadaway established at the beginning of the case, it needed to be removed.

78. To make certain that the proxy group was sufficiently large, Dr. Hadaway added three other companies who met the criteria: CMS Energy (the owner of Consumers Energy), Integrys Corporation (the owner of several regulated utilities in Wisconsin, Minnesota, and

[10] "I relied on the same utility proxy group used by KCPL witness Hadaway . . . . However, I excluded Ameren Corp. because its consensus analysts growth rate was negative, likely due to concern at the merchant generation units."

Michigan), and UNS Energy (the owner of Tucson Electric Power). He testified that Integrys Corporation was added because its regulated revenue percentage is now above 70%, and that the financial conditions of CMS Energy and UNS Energy have normalized so that their equity ratios now exceed 30%. Id. at 29.

79. Mr. Gorman and Mr. Kahal complain that these adjustments were made to eliminate companies with lower projected earnings and growth, and not to achieve a qualified proxy group. However, of the four companies removed, only two had earnings growth estimates that were low (Edison and Cleco), while Vectren and Ameren had relatively high earnings growth potential. See KCPL-19, Hadaway Direct, Sch. SCH-5 at 1; GMO-114, Hadaway Direct, Sch. SCH-5 at 1. As the chart below explains, other low-ranking utilities like IDACORP (parent of Idaho Power Company) and Xcel (the parent of Minnesota and Wisconsin utilities) were not removed by Dr. Hadaway.

Hadaway DCF Proxy Group

Initial DCF ROEs (Hadaway Direct, Schd. SCH-5 at 1) of Companies Removed in Rebuttal

	Analysts Growth	LT GDP Growth	Low Near-Term 2-Stage Growth	Average
Ameren	9.10	10.90	10.50	10.166
Cleco	8.80	9.30	9.50	9.20
Edison Int'l	7.40	9.10	8.80	8.433
Vectren	10.10	10.80	10.60	10.50
Average	8.85	10.025	9.85	
Group Average	10.0	10.2	10.0	
Group Median	10.0	10.4	10.1	
Companies not Removed:				
IDACORP	7.4	8.8	8.9	8.366
Xcel	9.2	9.9	9.6	9.566

80. Neither Mr. Gorman nor Mr. Kahal claimed that the companies that were eliminated from the original proxy group still met the criteria or that the new companies added to the proxy group did not meet the criteria. See Tr. 518 (Gorman), Tr. 551 (Kahal). Mr. Gorman did not specifically challenge any of the companies that were added or deleted on the basis of the Hadaway four-point criteria (Tr. 518), and he acknowledged that even with these changes, Dr. Hadaway's ROE range decreased. See Tr. 522. Although Mr. Gorman professed during the hearing to have his own proxy group criteria (see Tr. 520:12-13), he never actually set forth any criteria. He did conclude that the proxy group that Dr. Hadaway used was appropriate because the companies' credit rating, common equity ratio and business risk profile were comparable. See OPC-300, Gorman Direct at 15-16; OPC-307, Gorman Direct at 16. Despite this lack of analysis, Mr. Gorman, seeing that two of the companies eliminated by Dr. Hadaway had low DCF return estimates, arbitrarily eliminated two companies with the highest return estimates. See OPC-301, Gorman Surrebuttal at 7; OPC-308, Gorman Surrebuttal at 7. He failed to recognize that Dr. Hadaway also eliminated Vectren which had above-average growth and ROE estimates. See OPC-301, Gorman Surrebuttal, Sch. MPG-SR-1 at 2-3; OPC-308, Gorman Surrebuttal, Sch. MPG-SR-1 at 2-3.

81. Mr. Kahal objected to the removal of Cleco and Edison, as well as Ameren which Mr. Gorman agreed was proper to remove. See USDOE-551, Kahal Surrebuttal at 6-8. Like Mr. Gorman, he failed to note in his Surrebuttal Testimony that Dr. Hadaway had removed Vectren from the proxy group. He only acknowledged this at the hearing, where he also admitted, contrary to his Surrebuttal, that he "had a problem with Ameren as well." See Tr. 550.

82. Responding to Dr. Hadaway's removal of Ameren, Cleco and Edison, Mr. Kahal, in effect, retaliated by eliminating Alliant, Great Plains and Hawaiian Electric simply because they were the companies with the highest growth rates. See USDOE-551, Kahal Surrebuttal at 8.

Mr. Kahal, like Mr. Gorman, kept two of the lowest growth companies, IDACORP and Xcel. Although he objected to Dr. Hadaway's three new companies, Mr. Kahal did not determine whether they met Dr. Hadaway's criteria. See Tr. 551.

83. Although Mr. Kahal's reductions reduced the proxy group to 16 or 17, he added no new companies. See USDOE-551, Kahal Surrebuttal at 7-8. This omission is telling since he testified that "use of an appropriate and robust proxy group" is preferred because it "helps to allow . . . 'data anomalies' to cancel out in the averaging process." See USDOE-550, Kahal Direct at 17. Given Mr. Kahal's testimony that "more is better than less" (Tr. 552:11), his criticism of Dr. Hadaway who eliminated companies that didn't meet the criteria and added companies that did is not valid.

(vii) Growth Rates.

84. The debate over the appropriate growth rates used in this case takes two forms. Dr. Hadaway, Mr. Gorman and Mr. Kahal disagree on how inflation and growth in the economy should be assessed historically and then projected into the future. They also debate the extent to which analysts' projections should be considered. The second issue relates to Staff's reliance upon articles, reports and data from investment bankers which are not part of a public process to set public utility rates. Use of these non-traditional sources, as well as incomplete and outdated historical data shows why Staff's recommendations are so far below those of the other parties.

85. A key component of the long-term GDP growth Constant Growth DCF model and the two-stage growth DCF model is the projected long-run Nominal GDP growth rate. The Nominal GDP growth rate consists of the rate of inflation plus real GDP growth. See KCPL-19, Hadaway Direct at 36-37 and Sch. SCH-4; GMO-114 Direct at 36-37 and Sch. SCH-4; OPC-300, Gorman Direct at 27; OPC-307, Gorman Direct at 27. Dr. Hadaway used a 5.7% growth

rate, giving more weight to recent low-growth trends as a basis for predicting the future. See KCPL-20, Hadaway Rebuttal, Sch. SCH-11; GMO-115, Hadaway Rebuttal, Sch. SCH-11.[11]

86. Notably, this projected 5.7% growth rate is lower than the 6.6% average nominal GDP growth rate in the United States over the past 60 years. Id., Sch. SCH-11. Given that the long-term inflation rate (known as the GDP price deflator) has been 3.7%,[12] estimates using the current low inflation rates in the DCF model, which requires a long-term analysis, is improper. "The long-term growth rate in the DCF model (in either the constant growth or multi-stage growth version) is an estimate of what investors should expect for nominal dividend growth (real growth plus inflation) over the very long term (technically in perpetuity)." See KCPL-20, Hadaway Rebuttal at 13; GMO-115, Hadaway Rebuttal at 13.[13] As Dr. Hadaway noted at the hearing, the U.S. Energy Information Administration ("EIA") predicted in 1979 a long-term inflation rate of 6.3%. See Tr. 444:5. However, today the EIA is predicting a long-term or permanent inflation rate of 2%. As Dr. Hadaway observed: "They were wrong then and I think they're wrong now. Something between those numbers is a more realistic reflection of what long-term inflation in our country is going to be, and it's not 1.9 or 2% as much as some of us wish that it might be." Id.

87. By contrast, Mr. Gorman uses for his Multi-Stage DCF analysis a long-term growth rate for Year 11 into perpetuity of 4.9%. See OPC-300, Gorman Direct at 25-27; OPC-307, Gorman Direct at 25-27. This rate is itself lower than the nominal GDP growth in most of the 10-year periods of the past 60 years, except for the most recent period, which had rates of -

---

[11] This was a reduction of the 5.8% long-term expected growth rate that he proposed in his Direct Testimony at 36 and Sch. SCH-4.

[12] KCPL-20, Hadaway Rebuttal, Sch. SCH-11; GMO-115, Hadaway Rebuttal, Sch. SCH-11.

[13] A basic assumption of the DCF model is that the "dividend growth rate is constant in every year to infinity." Morin, New Regulatory Finance at 256.

1.2% and 0.0% for 2008 and 2009, respectively. See KCPL-20, Hadaway Rebuttal at 18-19; GMO-115, Hadaway Rebuttal at 18-19. The use of such recent, short-term depressed data creates an unrealistically low estimate of ROE.

88. Both Dr. Hadaway and Mr. Gorman relied on the well-recognized Brigham & Houston treatise, Fundamentals of Financial Management regarding growth rates, quoting a passage on expected growth rates. See KCPL-19, Hadaway Direct at 37:7-12; GMO-114, Hadaway Direct at 37:12-18; OPC-300, Gorman Direct at 26:15-20; OPC-307, Gorman Direct at 26:23-27:4. However, it is revealing that Dr. Hadaway quoted, but Mr. Gorman failed to cite an important estimate of specific rates. The sentence omitted by Mr. Gorman states: "On this basis, one might expect the dividend of an average, or 'normal,' company to grow at a rate of 5 to 8 percent a year."[14] In light of the complete citation, Dr. Hadaway's long-term growth of 5.7% is not only reasonable, but perhaps a bit conservative.

89. Mr. Kahal recommends an expected growth rate range of 4.5% to 5.5%. See USDOE-550, Kahal Direct at 23. He, too, ignores the current capital market anomalies which lead to unreasonably low ROE estimates. Had he used the upper end of his growth rate range, and properly adjusted the proxy group which he initially accepted from Dr. Hadaway, his ROE estimates would have increased to 9.75% to 9.88%. See KCPL-20, Hadaway Rebuttal at 27; GMO-115, Hadaway Rebuttal at 27.

90. Staff's growth rates are far below those of Mr. Gorman and Mr. Kahal, and should be dismissed as unreasonable. Mr. Murray's recommends a 3.5% growth rate for the Multi-Stage DCF, as he recommended in the last case and which was rejected by the Commission. See Staff-200, Staff Cost of Service Report at 45, 55; Staff-258, Staff Cost of

[14] Eugene F. Brigham and Joel F. Houston, Fundamentals of Financial Management 298 (11th ed. 2007) (emphasis added).

Service Report at 48, 58. In an acknowledgement that he is well out of the mainstream, he later advises the Commission that if it uses a GDP growth rate, based on the data relied on by the other experts, he recommends a 4.3% figure. See Staff-200, Staff Cost of Service Report at 57; Staff-258, Staff Cost of Service Report at 60.

91. A growth rate of 3.5% fails the "common sense" test that Staff endorses. Because that rate is below the 3.7% average rate of inflation in the U.S. economy over the past 60 years, his recommendation must be rejected. See KCPL-20, Hadaway Rebuttal at 13; GMO-115, Hadaway Rebuttal at 13.

92. While the other experts criticized Dr. Hadaway's reliance on historical growth rates to determine the long-term GDP growth rate, it is consistent with the accepted literature on the topic. Dr. Morin states that if historical growth rates are to be representative of long-term future growth rates, "they must not be biased by non-recurring events or by structural shifts in the fundamentals of the industry and/or the company." See Morin, New Regulatory Finance at 293. He observed that low historical growth rates in the 1970s "were not representative of future growth rates and could not be extrapolated into the future." Id. Therefore, Dr. Hadaway's adjustments are appropriate, particularly with respect to long-term projections. Given Dr. Morin's observation that estimating the growth component "is the most difficult and controversial step in implementing DCF,"[15] the use of sound professional judgment is critical. Given that Dr. Hadaway is the only expert testifying on cost of capital issues who explicitly considered the abnormally depressed economic data of the last four or five years, his analysis should be relied upon by the Commission.

[15] See Morin at 283.

(viii) ROEs Authorized by Other Public Utility Commissions.

93. This Commission has always compared its ROE analysis with those of other commissions to make certain that it was not out of the mainstream. Although it does not "slavishly follow the national average in awarding a return on equity"[16] or "unthinkingly mirror the national average,"[17] the Commission has concluded that "the national average is an indicator of the capital market" in which a utility "will have to compete for necessary capital." See Report and Order at 122, In re Kansas City Power & Light Co., Case No. ER-2010-0355 (Apr. 12, 2011); Report and Order at 148, In re KCP&L Greater Mo. Operations Co., Case No. ER-2010-0356 (May 4, 2011).

94. The Supreme Court has advised commissions to examine the returns being earned by companies "at the same time and in the same general part of the country" as the utility appearing before it. Bluefield, 262 U.S. at 692. During 2012 the average of the returns allowed by commissions for vertically integrated companies is 10.05%. See GMO-116, Hadaway Surrebuttal, Sch. SCH-14 at 5, Tr. 373. The average ROE authorized in the Midwest, as depicted below, is 10.15%.

[16] Report and Order at 67, In re Union Elec. Co., Case No. ER-2011-0028 (July 13, 2011).

[17] Report and Order at 19, In re Missouri Gas Energy, Case No. GR-2004-0209 (Sept. 21, 2004).

__2012 Returns on Equity: Midwestern States__

2/15	Indiana Michigan Power Co.	Michigan PSC	10.20%
2/29	Northern States Power Co. (Minn.)	North Dakota PSC	10.40%
3/29	Northern States Power (Minn.)	Minnesota PUC	10.37%
6/7	Consumers Energy	Michigan PSC	10.30%
6/15	Wisconsin Power & Light	Wisconsin PSC	10.40%
6/19	Northern States Power (Minn.)	South Dakota PUC	9.25%
6/26	Wisconsin Electric Power	Michigan PSC	10.10%
7/9	Oklahoma Gas & Electric	Oklahoma CC	10.20%
	Average ROE: 10.15%		

See GMO-116, Hadaway Surrebuttal, Sch. SCH-14 at 5.

95. If the South Dakota Commission's decision of 9.25% in the Northern States Power case is eliminated as an outlier, the average Midwestern ROE for vertically-integrated utilities in 2012 (through the third quarter) is 10.28%. This is essentially equal to the top of Dr. Hadaway's upper range and the Companies' request for an ROE of 10.30%.

96. Based on the evidence, the Commission should find that 10.30% is a just and reasonable rate, reflective of the current state of the economy, and one that will permit KCP&L and GMO to continue to attract investors as they serve the public interest.

2. Capital Structure: What capital structure should be used for determining rate of return?

97. The Companies recommend the following capital structure, based upon the actual capital structure of their holding company Great Plains Energy Incorporated ("GPE"), as of August 31, 2012:

Proposed Capital Structure for the Companies

Debt	46.84%
Preferred Stock	0.60%
Common Equity	52.56%
Total	100%

See KCPL-10, Bryant Rebuttal at 5; KCPL-60, Rush True-Up Rebuttal at 2.

98. Staff offered a similar recommendation, initially based upon GPE's capital structure as of June 30, 2012. See Staff-200, Staff Cost of Service Report at 33-34; GMO-258, Staff Cost of Service Report at 36-37. Staff's final recommendation presented during the True-Up is consistent with the Companies' position. See Staff-383 and Staff-384, Capital Structure Schedules (Acct. Sched. 12), Staff True-Up Direct Accounting Schedules for KCP&L, GMO-MPS and GMO-L&P as of Aug. 31, 2012 (filed Nov. 8, 2012). This capital structure reflects the $287.5 million of new equity that resulted from the conversion of the GPE Equity Units on June 15, 2012 and the maturity of the GMO $500 million 11.875% Senior Notes. See KCPL-10, Bryant Rebuttal at 5-6; GMO-106, Bryant Rebuttal at 6.

99. In response to criticism offered by OPC witness Mr. Gorman, Vice President of Investor Relations and Treasurer Kevin Bryant testified that the Companies were relying upon low-cost (5.292%) short-term debt on an interim basis to refinance high-cost (11.875%) long-term Aquila, Inc. ("Aquila") debt. See Tr. 360-62, 368-69. Mr. Bryant explained that the Companies' plan was to refinance their short-term debt next year. Because a GPE $250 million debt issuance matures in 2013, he stated that the plan is to combine all of the short-term debt and to refinance it with a longer-term issue that would attract a bigger market, likely resulting in a lower interest rate and, therefore, lower utility debt costs. Id. at 360-61.

100. Both Staff's Mr. Murray and DOE's Mr. Kahal understand and accept the Companies' debt practices, and have excluded short-term debt from the capital structure of the

Companies. See Staff-250, Murray Surrebuttal at 4; Staff-3006, Murray Surrebuttal at 4; Tr. 470 (Murray); USDOE-550, Kahal Direct at 5-6.

101. The Companies' proposed capital structure (which excludes short-term debt) is proper and should be accepted.

3. Cost of Debt:

(a) Should GPE's consolidated cost of debt be assigned to KCP&L and GMO or should the cost of debt be subsidiary specific?

102. Staff has proposed that a consolidated cost of debt be used for both KCP&L and GMO. See Staff-200, Staff Cost of Service Report at 34; Staff-258, Staff Cost of Service Report at 37.

103. The Companies do not agree with Staff's reasons to move to a consolidated cost of debt figure because Staff continues to place undue emphasis on GMO's pre-acquisition finances when it was operating as Aquila. See Staff-200, Staff Cost of Service Report at 34-37; Staff-258, Staff Cost of Service Report at 37-41. However, the Companies do not oppose using the 6.425% actual consolidated cost of debt for each of them. See KCPL-10, Bryant Rebuttal at 13; GMO-106, Bryant Rebuttal at 13-14.

104. While using a consolidated cost of debt for ratemaking purposes would provide less revenue to KCP&L and more to GMO, and could affect KCP&L's credit ratings, the Companies believe adopting a consistent cost of debt method is in the long-term best interest of the utilities, as well as their customers. Id. Therefore, the Companies do not oppose using the actual 6.425% consolidated cost of debt for both KCP&L and GMO. See KCPL-10, Bryant Rebuttal at 13; GMO-106, Bryant Rebuttal at 14.

(b) In either case, should adjustments be made to holding company debt issued subsequent to GPE's acquisition of GMO?

105. Staff proposes that downward adjustments be made to the actual negotiated coupon rates of three debt issuances that GPE made after acquiring Aquila, now doing business as GMO. See Staff-200, Staff Cost of Service Report at 34-37; Staff-258, Staff Cost of Service Report at 37-40.

106. Staff proposes to adjust the following:

i. $250 million in unsecured Senior Notes, issued August 13, 2010 for a three-year term with a 2.75% interest rate ("August 2010 Issue").

ii. $350 million in unsecured Senior Notes, issued May 16, 2011 for a ten-year term with a 4.85% interest rate ("May 2011 Issue").

iii. $287.5 million in unsecured Senior Notes, issued March 19, 2012 for a ten-year term with a 5.29% interest rate ("March 2012 Issue").

107. Based on a series of arbitrary and subjective reductions, Mr. Murray proposed in the Staff Report, as well as in his Rebuttal and Surrebuttal Testimony, that various and different reductions be made to the interest rates actually negotiated in the debt market for each of these issuances. Over the course of the case, Mr. Murray has recommended three costs of debt. The Staff Cost of Service Reports recommended a consolidated cost of debt of 6.247%. See Staff-200, Staff Cost of Service Report at 37; Staff-258, Staff Cost of Service Report at 40. Mr. Murray readjusted this to 6.142% in his Rebuttal, but then changed his mind once again and made more adjustments in his Surrebuttal when he raised his hypothetical consolidated debt cost to 6.187%. See Staff-227, Murray Rebuttal at 28; Staff-283, Murray Rebuttal at 30; Staff-250, Murray Surrebuttal at 4; Staff-3006, Murray Surrebuttal at 4.

108. As explained by Vice President of Investor Relations and Treasurer Kevin Bryant, Staff ignored the fact that GMO as a stand-alone company could not have independently issued the August 2010 and May 2011 issues because it did not have the requisite three years of

continuous financial statements required for public or private offerings. See KCPL-10, Bryant Rebuttal at 7-9; GMO-106, Bryant Rebuttal at 7-9. Therefore, investors would have required a GPE guarantee which would have resulted in the same interest rates that were actually received in the U.S. Securities and Exchange Commission registered GPE public offering. Id.

109. The Commission previously supported inclusion of the $250 million August 2010 Issue without any adjustment in the cost of debt approved in GMO's last rate case. See Report and Order, ¶¶ 415, 419, In re KCP&L Greater Mo. Operations Co., Case No. ER-2010-0356 (May 4, 2011); KCPL-10, Bryant Rebuttal at 7; KCPL-11, Bryant Surrebuttal at 4.

110. Staff also ignored the fact that GMO currently has a split credit rating, where its Standard & Poor's rating of BBB is the same as KCP&L, but GMO's rating from Moody's of Baa3 is one notch lower. Staff also failed to incorporate the full "new issue concession" cost that can reach 20-25 basis points. See KCPL-10, Bryant Rebuttal at 8-9; GMO-106, Bryant Rebuttal at 8-9.

111. In Rebuttal Mr. Murray expanded on his arbitrary adjustments. For example, he reported that in July 2011 a third-party had submitted "indicative" bids to KCP&L on a 30-year debt offering at 5.95% and a 10-year offering at 4.45% that were not consummated. Because KCP&L was able to issue debt two months later in September 2011 at 5.30%, Mr. Murray concluded that the 65-point difference represented an "overestimated" amount that should be used "to assume" that the GPE 10-year May 2011 (4.85%) and March 2012 (5.292%) offerings were over-priced. However, he failed to consider the different rate decrease that had occurred in the 30-year Treasure bond (a drop of 95.7 points) compared with the much smaller decrease in the 10-year Treasury note (a drop of 62 points) between July and September 2011. See KCPL-11, Bryant Surrebuttal at 5-6.

112. He then made two additional assumptions: (1) if KCP&L had issued the 10-year debt, "it would have been at a coupon close to 4.00%" and (2) if "these two GPE debt issues [May 2011 and March 2012] could have been issued by an entity with a credit rating proper for GMO's low business risk," they would have borne a 4.00% coupon rate. See Staff-227, Murray Rebuttal at 27-28; Staff-283, Murray Rebuttal at 29-30.

113. All told, Staff makes *three* assumptions about debt never issued by any company to adjust reality-based debt and to come to a consolidated embedded cost of debt worthy of a fable.

114. Finally, the Staff Cost of Service Report and Mr. Murray's Rebuttal ignored the fact that GPE's March 2012 5.292% senior notes were not a new debt issue, but were a remarketing of the previously outstanding 10.0% subordinated notes that were components of the GPE Equity Units. See Staff-200, Staff Cost of Service Report at 37; Staff-258, Staff Cost of Service Report at 40; Staff-227, Murray Rebuttal at 26-28; Staff-283, Murray Rebuttal at 26; KCPL-10, Bryant Rebuttal at 9; GMO-106, Bryant Rebuttal at 9. While the Equity Units were more costly than debt, they were cheaper than issuing equity, as the Commission recognized when it found that their "cost . . . was reasonable and was incurred in the best interest of the ratepayers" in GMO's last rate case. See KCPL-10, Bryant Rebuttal at 9; GMO-106, Bryant Rebuttal at 9. As Mr. Murray did recognize in Surrebuttal, the actual cost of this offering to ratepayers is not 5.292%, but 5.112%. See Staff-250, Murray Surrebuttal at 37-38; Staff-3006, Murray Surrebuttal at 38-39. More importantly, Staff's apparent premise that GMO could have issued this debt is erroneous because the Equity Units were linked to the issuance of common stock. Since GMO has no public common stock, the units were issued by GPE and, consequently, the remarketing of the GPE subordinated notes was required to remain at the holding company level. See KCPL-10, Bryant Rebuttal at 9; GMO-106, Bryant Rebuttal at 9.

115. For all of these reasons, Staff's unreasonable and arbitrary adjustments to the actual cost of debt should be rejected.

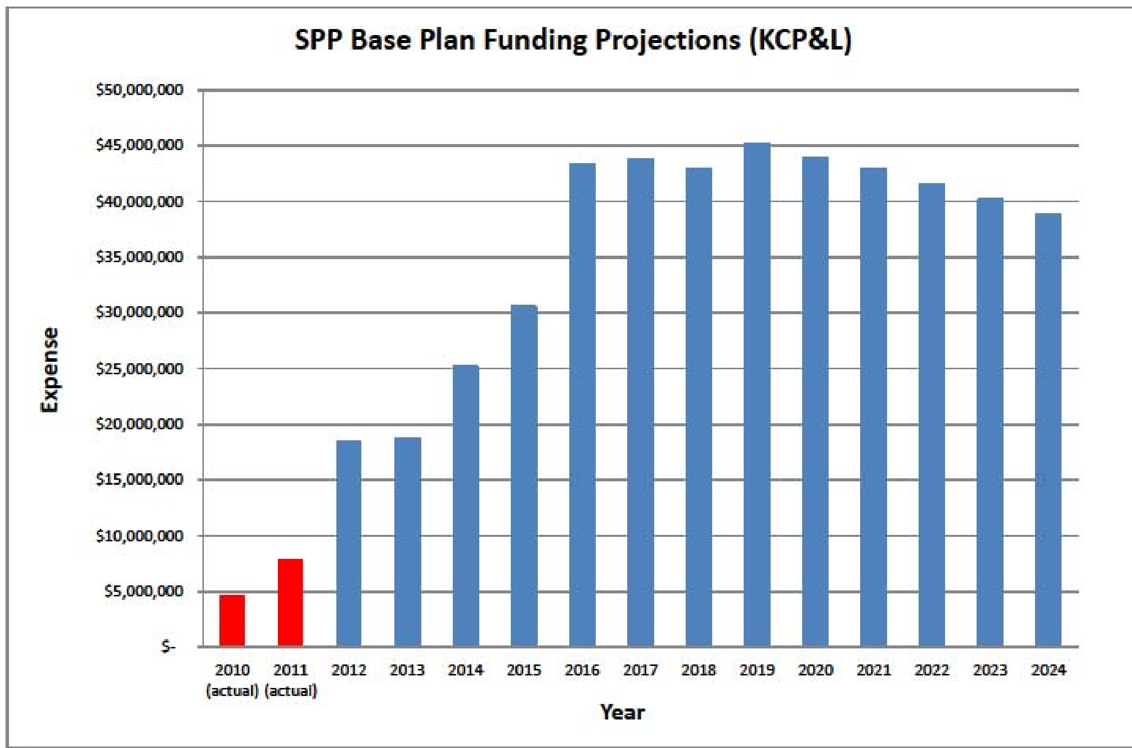
B. Transmission Tracker.

1. Should the Commission authorize KCP&L and GMO to compare their actual transmission expenses with the levels used for setting permanent rates in these cases, and to accrue and defer the difference into a regulatory asset?

116. The Companies request that the Commission authorize the use of a transmission tracker mechanism to ensure appropriate recovery of transmission costs as a result of charges from Southwest Power Pool ("SPP") and other providers of transmission service. The Companies believe that these actual charges from transmission providers are appropriate candidates for a tracker mechanism because they are material, expected to change significantly in the near future, and are primarily outside the control of KCP&L and GMO.

117. Transmission costs can change significantly from year-to-year, and such costs are a material cost of service component. Historically, transmission costs have fluctuated due to load variations, both native and off-system. However, the Companies are currently experiencing increasing costs for SPP's regional transmission upgrade projects and increasing SPP administrative fees. The Companies expect these costs to continue to increase. See KCPL-29, Ives Direct at 13-17; GMO-123, Ives Direct at 11-15.

118. The Direct Testimony of John Carlson includes tables that show rather dramatically how SPP transmission costs allocated to KCP&L and GMO have been rising and projections from SPP show that these expenses will continue to increase through 2017, recede slightly in 2018, and then increase again in 2019. See KCPL-12, Carlson Direct, Sch. JRC-1; GMO-108, Carlson Direct, Sch. JRC-1.



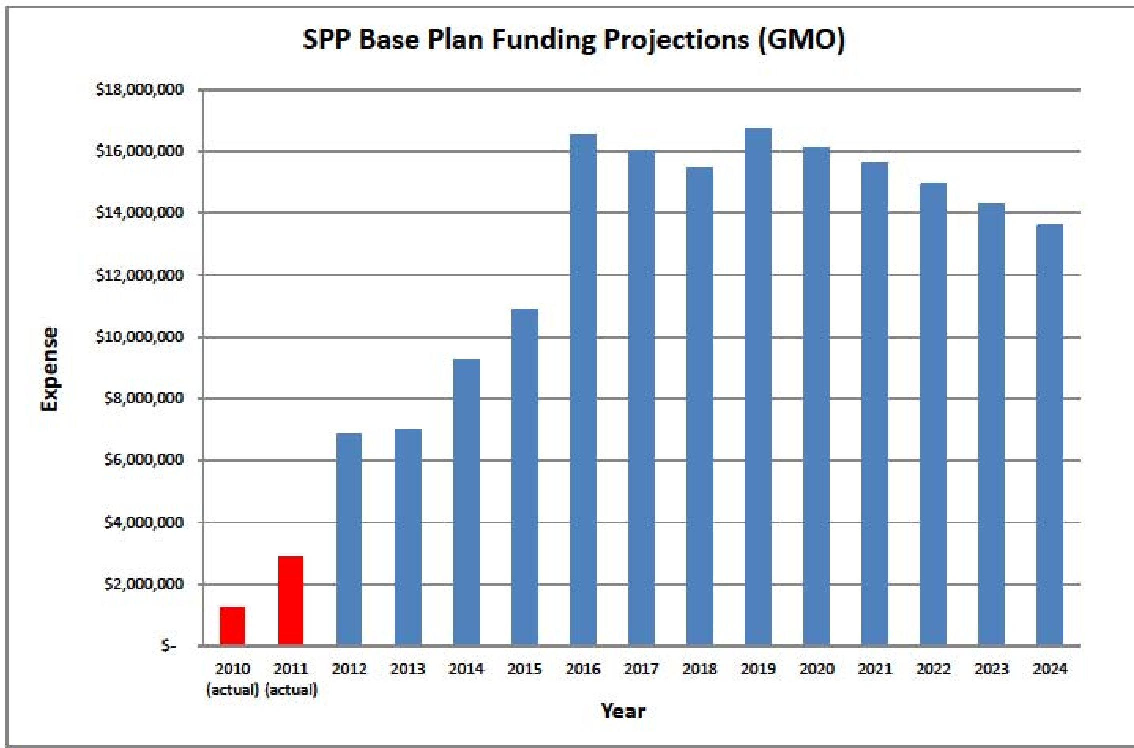
[1]

[1] Projections for 2012 – 2024 taken from: FINAL SPP 10 Year ATRR Forecast Jan 25 2012 for Posting to RTWG REV 5.xlsx, Maintained by SPP Engineering, Posted January 25, 2012, http://www.spp.org/publications/2012%20January%20ATRR%20Forecast.zip

Schedule JRC-1

119. SPP forecasts that transmission costs allocated to KCP&L will be $18.4 million for the calendar year 2012, and they will increase in subsequent years and peak at over $45.2 million in 2019. This equates to an approximate 14% increase per year over that timeframe.

120. For GMO, SPP forecasts that transmission costs allocated to GMO will be $6.8 million for the calendar year 2012, and will increase to $9.2 million in 2014, and peak at over $16.7 million in 2019. This also equates to an approximate 14% increase per year over that timeframe. These projections reflect both zonal and region-wide components of the costs of SPP-approved projects. The increases are primarily driven by the region-wide components.



[1]

[1] Projections for 2012 – 2024 taken from: FINAL SPP 10 Year ATRR Forecast Jan 25 2012 for Posting to RTWG REV 5.xlsx, Maintained by SPP Engineering, Posted January 25, 2012, http://www.spp.org/publications/2012%20January%20ATRR%20Forecast.zip

Schedule JRC-1

121. Mr. Ives's Direct Testimony includes a schedule that shows how transmission charges have increased significantly in recent years and are projected to grow at an even faster pace in the future. For KCP&L, the total charges related to transmission service were $17.3 million in 2008, and grew to $27.1 million in 2011. By the end of this year, they are projected to be $39 million, and in three years, they are projected to be nearly $59 million. See KCPL-29, Ives Direct, Sch. DRI-1. He also includes similar projections for GMO which show total charges related to transmission service increasing for the MPS district from $12.1 million in 2011 to $17.2 million projected for 2012, and increases to $21.2 million projected for 2015. See GMO-123, Ives Direct, Sch. DRI-1.

122. The escalation in transmission expenses discussed above is a result of charges by SPP to the Companies due to their role as transmission-using members of the Regional Transmission Organization ("RTO") and transmission customers under the SPP tariff. It is the expenses resulting from such charges that the Companies propose to include in the tracker.

123. Under the SPP tariff, the Companies also are a "Transmission Owner," in which capacity they incur costs associated with owning, maintaining, and operating transmission facilities. As compensation for costs incurred as Transmission Owners under the SPP tariff, the Companies receive revenue from SPP. The Companies are not proposing to include in the transmission tracker the expenses or other costs associated with service as Transmission Owners. Correspondingly, the Companies are not proposing to include in the transmission tracker the revenues associated with service as Transmission Owners.

124. The Companies propose that transmission costs (i.e., charges), as defined in the transmission tracker, be set in the true-up process in this rate proceeding. The Companies would then track actual charges on an annual basis against this amount, with the jurisdictional portion of any excess treated as a regulatory asset (Account 182) and the jurisdictional portion of any shortfall treated as a regulatory liability (Account 254). The regulatory asset or liability would be included in rate base. See KCPL-29, Ives Direct at 13-17; KCPL-12, Carlson Direct at 2-11; KCPL-30, Ives Rebuttal at 23-25; KCPL-13, Carlson Rebuttal at 2-4; GMO-123, Ives Direct at 11-15; GMO-108, Carlson Direct at 2-11; GMO-124, Ives Rebuttal at 24-26; GMO-13, Carlson Rebuttal at 2-3; KCPL-49, Weisensee Direct at 33-35; GMO-140, Weisensee Direct at 34-36.

(i) Staff Supported a Transmission Tracker in the Last KCP&L and GMO Rate Cases.

125. In the last KCP&L and GMO rate cases, Case Nos. ER-2010-0355 and ER-2010-0356, the Companies recommended a transmission tracker mechanism, and Staff supported, with

modifications, the Companies' proposed tracker mechanism. However, this issue was withdrawn and not pursued by the Companies or Staff.

126. In the last KCP&L and GMO rate cases, Staff supported the transmission tracker mechanism in the Staff Report—Revenue Requirement Cost of Service for the following reasons:

> Staff has completed its review of the Company's transmission expenses and recommends the Commission authorize the Company to use a transmission expense and revenue tracker. Staff recommends the Company be authorized to use a transmission expense tracker due to the historical growth in and current high level of the Company's transmission expenses, the uncertainty in the levels of its future transmission expenses, and because the Company has less control over the level of transmission expenses the SPP assigns to it than the Company has over most of its other expenses.

See Exhibit KCPL-59 at 150; Exhibit GMO-145 at 161; Tr. 705-07.

127. During cross-examination, Staff witness Dan Beck agreed that transmission expense has grown, and all projections indicate that transmission expenses will be growing in the future. See Tr. 707. In fact, the Staff Cost of Service Report demonstrates that transmission charges grew from $3.1 million in 2005 to a projected level of $25 million in 2010. See Tr. 707-08. He also candidly admitted that "there's issues out in the horizon that would create uncertainty" with regard to both KCP&L and GMO transmission expenses. Id. In fact, in April 2010, SPP approved $1.4 billion of transmission investment related to its Priority Projects. See KCPL-59 at 151; GMO-145 at 162; Tr. 708. The Staff Report went on to explain the uncertainties associated with such increasing transmission expenses:

> Staff does expect additional transmission valued at over $1billion to be planned by SPP in its new Integrated Transmission Planning Year 20 ("ITP20"), consisting of transmission at, or possibly about, 345 kV, which is most likely to be voted on for approval by the SPP Board in January 2011. Approval of ITP20 would lead to an increase in expected future transmission expenses for the Company, although the exact amount of those expenses are unknown at this time. Transmission project cost estimates may also differ significantly from the final

> cost of these projects built, increasing the uncertainty of the future level of the Company's transmission expenses.

See KCPL-59 at 151; GMO-145 at 162; Tr. 707-10.

128. Mr. Beck also testified that SPP is going forward with its plans to have substantial investment made in transmission facilities as Staff expected in the last rate case. See Tr. 709-10. In addition, he also testified that there is uncertainty associated with these projects. See Tr. 710.

(ii) Staff Conditions For a Transmission Tracker in This Case.

129. In this case, Staff opposed the use of a transmission tracker. Staff witness Beck noted several changes that have occurred since the last rate cases, including the FERC's issuance of Order 1000, and GPE's announcement that GPE and American Electric Power had formed Transource Energy, LLC, a transmission company, with GPE owning 13.5% of Transource Energy. See Staff-291, Beck Surrebuttal at 3-4. However, from the Companies' perspective, these developments do not mitigate the need for a transmission tracker since transmission expenses are projected to be increasing and uncertain, notwithstanding the fact that transmission-only companies, which are regulated by FERC, may be building the new transmission facilities under FERC Order 1000. In other words, KCP&L and GMO are going to be experiencing increasing transmission costs no matter what entity builds the regional transmission facilities. A transmission tracker is needed to ensure that Missouri retail customers pay the appropriate transmission costs.

130. In Staff's Surrebuttal Testimony in this proceeding, Staff witness Mark Oligschlaeger has suggested the following conditions if the Commission decided to approve a Transmission Tracker:

1. That the tracker reflect both transmission revenues and expenses, and thereby operate as a two-way mechanism (i.e., tracking both under and over collections of net transmission costs).

2. That KCPL will provide to all parties in this case on a monthly basis copies of billings from SPP for all SPP rate schedules that contain charges and revenues that will be included in the tracker and will report, per its general ledger, all expenses and revenues included in the tracker by month by Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) account and KCPL subaccount or minor account. KCPL shall also provide, on no less than a quarterly basis, the internally generated reports it relies upon for management of its ongoing levels of transmission expenses and revenues. KCPL should also commit to notify the parties to this case of any changes to its existing reporting or additional internal reporting instituted to manage its transmission revenues and expenses.

3. That all ratemaking considerations regarding transmission revenue and expense amounts deferred by the Company pursuant to a tracker be reserved to the next KCPL rate proceeding, including examination of the prudence of the revenues and expenses.

4. That KCPL must impute into its tracker mechanism, the level of transmission revenues earned by any transmission company affiliate related to facilities in KCPL's Missouri jurisdictional service territory into its tracker mechanism to the extent necessary to ensure that no additional revenue requirement resulting from any decision by Great Plains Energy, Inc. (GPE) to transfer responsibility for transmission construction activity from KCPL's regulated business is passed on to KCPL's Missouri retail customers through the tracker.

5. That nothing in any order authorizing KCPL's use of a transmission tracker is intended to amend, modify, alter, or supersede any previous Commission order or agreement approved by the Commission concerning KCPL's involvement in SPP or treatment of SPP transmission revenues and expenses.

6. That deferrals resulting from the transmission tracker mechanism cease under certain circumstances, identified in the sixth condition specified below, depending upon KCPL's reported return on equity (ROE) level.

See Staff-230, Oligschlaeger Surrebuttal at 7-8. [18]

131. Several of these conditions are acceptable to the Companies with certain modifications. Staff's first condition is that the tracker reflect both transmission revenues and expenses, and thereby operate as a two-way mechanism, tracking both under and over collections

[18] Similar conditions were also proposed for GMO. See Staff-3008, Oligschlaeger Surrebuttal at 3-4.

of net transmission costs. See Tr. 642-47; 695-98. If it were appropriately limited to revenue related to the Companies' own cost responsibility, this condition could be acceptable to the Companies. Id. The Companies' own cost responsibility would be defined as the portion of the Companies' revenues that is derived from the transmission charges the Companies paid to SPP for the use of zonal and regional transmission facilities. The tracker would not include revenues related to other utilities' use of the Companies' transmission facilities. Id.; see also Tr. 696. The Companies do not fully agree with Staff's condition, but for purposes of this case, the Companies could accept this condition if it were limited as described herein.

132. As explained in the Direct Testimony of John Carlson, in recent years, SPP launched an initiative to develop a group of transmission upgrades that would benefit the entire SPP region and to allocate those project costs regionally based on load ratio share (the ratio of a transmission customer's network load to the total SPP load). See KCPL-12, Carlson Direct at 6-7. KCP&L currently has approximately an 8% (4% in both Missouri and Kansas) load share responsibility for those projects as well as other transmission upgrade costs in the SPP region that are allocated on a region-wide basis. GMO has a separate and additional share of approximately 4% of those regionally allocated costs. See Tr. 697. Therefore, the Companies together have approximately a 12% responsibility for regionally allocated costs. This is in addition to the zonally allocated costs of SPP-approved projects.

133. In 2010, SPP implemented a Highway/Byway cost allocation methodology which was a hybrid zonal ("Byway") and regional ("Highway") allocation model, dependent on the voltage level of the transmission facility. Concurrently, SPP approved the Priority Projects, a group of projects that would help reduce congestion, better integrate SPP's east and west regions, improve SPP members' ability to deliver power to customers, and further the addition of new generation to the electric grid. Id.

134. The Highway/Byway methodology effectively regionalizes transmission costs associated with regionally-focused transmission facilities. More specifically, the Highway/Byway cost allocation methodology was structured in the following manner:

Voltage	Regional	Zonal
300 kV and above	**100%**	**0%**
Above 100 kV and below 300 kV	**33%**	**67%**
100 kV and below	**0%**	**100%**

135. SPP's cost allocation methodology has changed over time as the needs of the SPP region and its members have changed and as both national and state policies and goals have developed. The methodology used prior to SPP becoming an RTO was based on local, reliability-based transmission solutions and zonally-allocated costs. This mirrored an operating environment where utilities were responsible for maintaining and operating systems within their own operating zone. Once SPP received RTO status, that environment changed and SPP began planning regionally to meet the needs of its transmission customers which now include retail load in eight states. The regional focus of the RTO created the need for regional allocation of the resulting costs, in order to effectively meet the needs of the SPP region as a whole, instead of utility by utility. Id.

136. It is unacceptable to the Companies to include in the transmission tracker revenues received from other companies related to facilities constructed to meet SPP's regional needs. See Tr. 696-97. Such regional facilities are paid for by all SPP members, through SPP's cost allocation formulas, and not primarily by KCP&L or GMO customers. KCP&L-Missouri and GMO only pay 4% each for such regional transmission projects, and it would be

inappropriate to include the full increase in revenues that the Companies would receive from other SPP members for such projects, since they only paid for 8% of the costs. See KCPL-12, Carlson Direct at 6-7; GMO-108, Carlson Direct at 6-7. To include the full increase in revenues in the tracker when only a fraction of the corresponding costs are being included would result in mismatch of revenues and costs.

137. Staff's second condition is that KCP&L provide all parties certain information and reports related to transmission expenses and revenues. This condition is acceptable to the Companies. See Tr. 643.

138. Staff's third condition is that all ratemaking considerations regarding transmission revenue and expense amounts deferred by the Company pursuant to the tracker be reserved to the next rate proceeding, including the examination of the prudence of the revenue and expenses. The third condition is also acceptable to the Companies. See Tr. 643-44.

139. The fourth condition is unclear to the Companies. According to Mr. Oligschlaeger's testimony, "the purpose of this [fourth] condition is to require KCPL to pass through SPP transmission revenue requirements to Missouri retail customers calculated on an equivalent basis with Missouri Commission ratemaking practices." See Staff-308, Oligschlaeger Surrebuttal at 10. This is a condition that is apparently intended by Staff to have KCP&L impute into its tracker mechanism a level of transmission revenues earned by any transmission company affiliate related to facilities in KCP&L's Missouri jurisdictional service territory.

140. Under Staff's fourth condition, Staff seemingly wants to lower the federally-approved transmission charges included in KCP&L's transmission expenses to a level that would be consistent with the ROE and capital structure established by the PSC in KCP&L rate cases, which has been lower than the ROE typically used by FERC to establish transmission rates. See Tr. 733 (Oligschlaeger). FERC also allows for the inclusion of CWIP, and Staff would make an

adjustment to eliminate CWIP from the federally-approved transmission charges paid by KCP&L. This condition was not included in Staff's testimony in the last case, and the Companies believe it is inappropriate and unnecessary. In fact, it may also be unlawful, depending upon how it was implemented.

141. If the Commission adopted such an approach, any condition should be limited to only transmission facilities that are constructed by a KCP&L affiliate in KCP&L and GMO's certificated service territory, and only to the extent that the revenues received for such a project do not result from regional cost allocation by SPP. See Tr. 646; 695-98. It is important to remember that whether KCP&L, GMO, Transource, or any other entity builds regional facilities in KCP&L's or GMO's service areas, the Companies' Missouri rate payers only pay for approximately 8% of the costs.

142. The application of this suggested condition could be unlawful. For instance, it would be unlawful for the Commission to order that profits from an affiliated transmission company be imputed to the regulated public utility's ratepayers. The proposed condition is unlawful if it takes away the profit a transmission-only affiliate makes by taking dollars away from the regulated utility. Recently, the Missouri Court of Appeals made clear that the Commission has no power to impute profits from an unregulated affiliate by taking adverse action against the utility that it regulates.[19] In that case involving Atmos Energy Corporation's ("Atmos") Actual Cost Adjustment, Staff sought to disallow approximately $300,000 of purchased gas costs. Staff calculated the $300,000 by determining the profit Atmos' marketing affiliate, AEM, made on a gas supply contract with Atmos. The Commission properly recognized that the presumption of prudence applied even though Atmos had bought gas from its

---

[19] See Office of Public Counsel v. PSC, Case No. WD 74714, Slip. Op. (Sept. 18, 2012).

marketing affiliate through a competitive bidding process, and since neither Staff nor OPC (which pursued the appeal) presented any evidence that created a serious doubt about the prudence of the affiliated purchase. As a result, the Commission properly ruled in Atmos' favor.

143. The Missouri Court of Appeals rejected the attempt to impute the profit from the unregulated affiliate, and affirmed the Commission's rejection of this attempt, stating: "[T]he OPC cites no cases holding that a utility acts imprudently in transacting business with its affiliate simply because the affiliate earns a profit on the transaction."[20]

144. Staff's fifth condition indicates that "nothing in any order authorizing the Companies' use of a transmission tracker is intended to amend, modify, alter, or supersede any previous Commission order or agreement by the Commission concerning KCP&L's involvement in SPP or treatment of SPP transmission revenues and expenses. Staff's fifth condition is also acceptable to the Companies. See Tr. 644.

145. Staff's sixth condition indicates that the transmission tracker mechanism would cease if the Company reports that its earnings are at or in excess of its authorized ROE on a twelve-month rolling forward average basis, as stated in quarterly earnings surveillance reports to the Commission. The Company is unfamiliar with any other tracker mechanism that has this type of condition. Staff witness Oligschlaeger also testified that he knew of no similar condition in any existing tracker mechanism, although it is being proposed in the pending Ameren rate case. See Tr. 735.

146. The Companies believe this sixth condition is unnecessary and unworkable. The very nature of the transmission expense tracker will be to keep track of transmission expenses and the Companies will credit or debit to customers through a regulatory asset or regulatory

---

[20] Id. at. 13.

liability any incremental amount above or below the level of transmission costs included in rates. See Tr. 644-45. For many years, KCP&L has filed a more detailed annual surveillance report, rather than a monthly surveillance report. This annual surveillance report takes about a month to prepare, as it involves the jurisdictional allocations between Missouri and Kansas. Id.

147. The Companies believe that it would be unworkable to "turn on" and "turn off" the tracker mechanism based upon the ROE shown on a quarterly surveillance report. Such surveillance reports show varying ROEs that are not weather-normalized, and are not adequate for determining whether a public utility is "overearning" its authorized ROE. These surveillance reports only show "trends" in earnings, and do not precisely identify that a public utility's rates are too high or too low. To utilize the quarterly surveillance reports for determining when to turn off a transmission tracker would be unworkable, unreasonable, and inappropriate.

(iii) Lawfulness of Transmission Trackers.

148. During the mini-opening statements on this issue, counsel for MIEC and MECG challenged the lawfulness of the transmission tracker as "single issue ratemaking" and "retroactive ratemaking." See Tr. 662-65, 667-74. For the reasons stated herein, these legal challenges should be rejected.

149. The courts have uniformly rejected such claims that trackers are illegal. This is because trackers, like Accounting Authority Orders ("AAO"), do not involve ratemaking at all. See, e.g., State ex rel. Noranda Aluminum, Inc. et al. v. PSC, 356 S.W.3d 293 (Mo. App. S.D. 2011). Trackers are established in a general rate proceeding at which time all relevant factors are considered. Before any changes tracked can later be taken into account in setting rates *in the future*, the Commission will again consider all relevant factors. Prohibited single-issue ratemaking occurs only if a "public utility [is allowed] to *change* an existing rate without

consideration of all relevant factors . . . ." State ex rel. Sprint Spectrum L.P. v. PSC, 112 S.W.3d 20, 28 (Mo. App. W.D. 2003) (emphasis added).

150. In State ex rel. Office of the Public Counsel v. PSC, 858 S.W.2d 806, 812-13 (Mo. App. W.D. 1993), the argument was made that it constitutes impermissible single-issue ratemaking to authorize a utility to defer depreciation expenses between rate cases associated with construction projects at the utility's power plants. Specifically, OPC argued that "by granting [the utility] authority to defer certain costs . . . the Commission is permitting '[the utility] to isolate individual costs [sic] of service components for future ratemaking recovery by preserving these costs by means of deferral, without proper consideration of concurrent relevant factors.'" Id. at 812. This argument is similar to the arguments of MIEC and MEUC in their respective mini-opening statements on this issue. In rejecting OPC's contention, the Missouri Court of Appeals indicated that the "Commission did not grant rate relief to [the utility]." Id. Rather, the Court recognized that the Commission "stated in its Report and Order that the amount of the deferred cost to be recovered as well as other ratemaking issues would be determined in a later rate case." Id.

> The Commission's order did not presume to determine a new rate [using the deferred costs] but effectively permitted [the utility] . . . to file a rate case . . . and then to present evidence and argue that the deferred costs . . . should be considered by the Commission in approving a [future] rate change. The Commission's order does not preclude consideration of other relevant factors when the Commission considers the appropriate rate to be charged the utility's customers. The Commission's order . . . does not constitute single-issue ratemaking.

Id. at 813.

151. Similarly, under the transmission tracker, the difference between the base level of charges and the actual level of transmission charges would be tracked. The Companies may ask that the difference be considered for later recovery in future rates, but that will only occur in the

context of a general rate proceeding where all relevant factors are considered. Any rate would be applied to the future sales only. The bottom line is that the Commission has full authority to authorize the Company to defer changes in these net charges via a tracker.

152. In some ways, the transmission tracker is similar to an AAO. Under AAOs, the Commission authorizes the public utility to defer costs for review and possible recovery in the next general rate case. The Commission's use of AAOs has also been determined to be lawful and reasonable. State ex rel. Office of the Public Counsel v. PSC, 858 S.W.2d 806, 812-13 (Mo. App. W.D. 1993).

153. Nor does the transmission tracker constitute "retroactive ratemaking." Counsel for MECG has made similar arguments, challenging the lawfulness of the FAC on the ground that the FAC constituted retroactive ratemaking. However, the Court in State ex rel. AG Processing v. PSC, 340 S.W.3d 146, 151 (Mo. App. W.D. 2011) has rejected this argument, stating:

> By specifically stating that the legislature could authorize fuel adjustment clauses like the one adopted by KCP&L here, the Supreme Court in *UCCM* presumably contemplated that such clauses would not themselves violate the retroactive ratemaking doctrine. The Court's description of the retroactive ratemaking doctrine in *UCCM* also suggests that a properly authorized fuel adjustment clause would not be unlawful. *UCCM* state that, under the retroactive ratemaking doctrine, the PSC "may not . . . redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process."

See 585 S.W.2d at 58 (footnote omitted).

154. Similarly, the Courts have rejected arguments that AAOs and the Purchased Gas Adjustment Clause constitute retroactive ratemaking. See State ex rel. Office of the Public Counsel v. Public Service Commission, 301 S.W.3d 556 (Mo. App. 2010) (holding that the PSC's AAO allowing a gas utility to defer the costs of complying with the Commission's cold weather rule did not violate the prohibition against retroactive ratemaking); State ex rel. Midwest

Gas Users' Association v. Public Service Commission, 976 S.W.2d 470 (Mo. App. 1998) (holding that the PGA clause did not constitute improper retroactive ratemaking).

155. With the transmission tracker, there will be no retroactive changes in rates. Rates will be changed in a future rate case, based upon the consideration of all relevant factors. Rates will apply to future service, and there will be no attempt to charge or readjust consumers' past bills to account for past losses. As a result, there is no retroactive ratemaking under the Company's proposal, and MECG's argument should therefore be rejected.

156. In conclusion, the Companies respectfully request the Commission implement a transmission tracker as proposed by the Company, including appropriate conditions.

IV. GMO ONLY ISSUES

A. Crossroads.

1. What should be the value of Crossroads included in rate base?

157. The Company included the costs of the Crossroads generating station in its filing in this case. Crossroads uses four gas-fired combustion turbines in Clarksdale, Mississippi, to generate electricity which is then transmitted into the GMO service area. See Staff-258, Staff Cost of Service Report at 74. The Company included Crossroads at its "net original cost" as defined by the FERC's Uniform System of Accounts. See GMO-125, Ives Surrebuttal at 26. As of March 31, 2012, GMO valued Crossroads at approximately $82.7 million. See GMO-111, Crawford Rebuttal at 1. Staff agrees that Crossroads should be included in rate base. See Tr. 933:24-934:19. No other party provided testimony suggesting that utilizing Crossroads was imprudent. Therefore, the issue is not whether to include Crossroads in rate base, but what value to assign to the plant.

(i) Original Cost is the Proper Value of Crossroads.

158. As a matter of law, the Company is entitled to a reasonable return upon the investment it has made in Crossroads. State ex rel. Missouri Pub. Serv. Co. v. Fraas, 627 S.W.2d 882, 866 (Mo. App. W.D. 1981). The Company claimed Crossroads at its "original cost." See GMO-125, Ives Surrebuttal at 26. In the past, the Commission has argued that original cost is the proper cost to be used in determining the fair value of an asset. State ex rel. Missouri Water Co. v. PSC, 308 S.W.2d 704, 719 (Mo. 1958) ("the Commission frankly states that in its determination of the rate of return to which the company was entitled. . . it adopted the formula of original costs. . . ."). In the Missouri Water case, the company argued for a valuation *above* original costs, because the present value was *higher* than the original costs (due to many factors, including inflation). The Supreme Court agreed that the Commission should have considered evidence establishing a higher cost. In so doing, the Court engaged in a lengthy discussion of the way to value a utility asset. Critical to the analysis here, the Court held that original cost should be used as a *floor* when valuing an asset. The value of an asset "falls as a matter of judgment somewhere between these two brackets" of original costs less depreciation as the floor and the current costs to replace the asset as the ceiling. Id. at 718, quoting Railroad Comm'n v. Houston Natural Gas Corp., 289 S.W.2d 559, 572 (Tex. 1956). In this case, the Company is not asking for a value above original cost, but instead included Crossroads at the "floor" level or original costs.

159. The evidence of original cost is totally undisputed. There is no testimony to rebut the Company's testimony that original cost has been calculated using generally accepted accounting principles. See GMO-125, Ives Surrebuttal at 26. There is no dispute that the accounting firm of PricewaterhouseCoopers reached an opinion that the fair market value paid for Crossroads was actually *higher* than the net book value used by the Company in its filing in

this case. See Tr. 937; GMO-111, Crawford Rebuttal at 2. As a matter of evidence, the original cost is not disputed.

(ii) There is no evidence to support a different valuation.

160. Although the Commission has substantial and competent evidence to support the Company's request to include Crossroads in rates based on its original value, there is no evidence to support any other valuation. Staff was the only party to provide testimony suggesting valuations. Staff's position was succinctly stated at the hearing as "we should stay with the Commission's ordered value" from the last case. See Tr. 944. But Staff *never* offers an opinion as to the value of Crossroads and never offers evidence in *this case* that would support the same finding previously entered by the Commission. The Commission is not bound by *stare decisis*. State ex rel. GTE North, Inc. v. PSC, 835 S.W.2d 356, 271 (Mo. App. W.D. 1992); State ex rel. Churchill Truck Lines, Inc. v. PSC, 734 S.W.2d 586, 592-93 (Mo. App. W.D. 1987). Any finding in this case must be based on substantial and competent evidence presented in this case alone. The only evidence before the Commission is the original cost.

161. To the extent the Commission construes Staff's suggestions about valuation as an opinion on the value of Crossroads and therefore some evidence of value, these suggestions lack a sufficient foundation to be considered as evidence in this case. Board of Healing Arts v. McDonagh, 123 S.W.3d 146, 154-55 (Mo. en banc 2003). The standards for admission of expert testimony are fundamental rules of evidence and opinions on value may not be relied upon unless they comply with these standards. Id. The company timely objected to any testimony by Staff concerning valuation. See Tr. 920-21, 971. To the extent Staff is offering opinions on value, there is nothing in the testimony that explains the basis for the valuations offered. Although foundational shortcomings normally go to weight, when the "sources relied upon by the expert are so slight as to be fundamentally unsupported," it is error to rely on the expert's

testimony in reaching a conclusion. Glaize Creek Sewer Dist. v. Gorham, 335 S.W.3d 590, 594 (Mo. App. E.D. 2011). "An expert opinion on the value of real property must not be based on speculation. To have probative value expert opinion must be founded upon substantial data, not mere conjecture, speculation or unwarranted assumption. It must have a rational foundation." Id. Here, Staff has failed to include any testimony about the data upon which it bases its opinion. Instead, Staff simply argues that because the Commission reached a value in the last case, it should reach the same value in this case. Without evidence of the data underlying Staff's suggestion, the Commission simply has no evidence upon which to find in favor of Staff's position.

(iii) The Weight of the Evidence Establishes That the Original Cost is the Correct Value of Crossroads.

162. To the extent this Commission considers evidence other than the original cost of Crossroads as recorded by the Company and/or looks past the evidentiary shortcomings in Staff's case, the weight of the evidence clearly establishes that the original cost is the correct amount to be recorded for Crossroads.

163. Staff's position appears to be that the Commission should determine the fair market value of Crossroads. See Tr. 945. "Fair market value is the price at which the property could be sold by a willing seller to a buyer who is under no compulsion to buy." Shirley's Realty, Inc. v. Hunt, 160 S.W.3d 804, 808 (Mo. App. W.D. 2005). Neither party can be obligated to engage in the transaction. Peterson v. Continental Boiler Works, 783 S.W.2d 896, 900 (Mo. en banc 1990). Applying the fair market value standard establishes that the original cost was itself the fair market value because PricewaterhouseCoopers made such a determination. Furthermore, there was an additional time that Crossroads was essentially offered for sale. In March 2007, GMO put out a Request For Proposals ("RFP") for supply resources.

See GMO-111, Crawford Rebuttal at 3. Crossroads was offered in response to the RFP. The cost of the resources was bid at Crossroads book value (original cost) but also included projected transmission costs of $11 million. See Tr. at 913-14. Even with the $11 million in transmission costs, which is more than double the actual transmission costs (id.), Crossroads was the lowest cost of several options considered. See GMO-111, Crawford Rebuttal at 3; Sch. BLC2010-9(HC); Tr. 913. The original cost and the RFP response are the only evidence of what a willing buyer would pay a willing seller for the Crossroads facility.

164. Staff provides no competent evidence to the contrary. Staff provided a good deal of testimony about a preliminary estimate included in proxy statements filed during GPE's acquisition of Aquila. These proxy statements contained statements from GPE as to the preliminary estimate of the value of Crossroads. Importantly, Staff *does not assert that the preliminary proxy value is the correct value.* See Tr. 943. Staff is correct that the preliminary proxy valuation is not the fair market value or the proper value to be included in rate base. The proxy statement valuation was not even an attempt at a fair market valuation and it was extremely preliminary. See GMO-125, Ives Surrebuttal at 31-38.

165. Instead, Staff's position is to simply adopt the value the Commission placed on Crossroads in the last case. See Staff-271, Featherstone Rebuttal at 20-21. But Staff did not incorporate the evidence from the last case into this case and did not present evidence on which the Commission could decide *in this case* that the value of Crossroads is something other than original cost. Staff makes a feint attempt at presenting such evidence, by asserting that the Commission's prior order was "based on the average of two non-affiliate sales transactions of generating facilities identical to Crossroads." See Id. at 21. The facilities referred to are the Raccoon Creek and Goose Creek units in Illinois, but Staff never presents testimony such that

the Commission could find that the facilities were identical, nor do they present evidence to arrive at a true value for those facilities with all costs included.

166. First and foremost, the purchase of the Goose Creek and Raccoon Creek units was "essentially a forced sale." State ex rel. Public Counsel v. PSC, 274 S.W.3d 569, 579 (Mo. App. W.D. 2009). Because of the circumstances surrounding their sale, "their purchase price is not a good measure of the market price" for other units. Id., quoting In re Union Elec. Co., Case No. ER-2007-0002, Report and Order at 62 (May 22, 2007).

167. Furthermore, at the hearing, Staff's primary witness agreed that the value of the comparison facilities might be affected by transmission costs. See Tr. 946. He also agreed that transmission costs should be included when considering the value of a plant. Yet, the witness admitted that he did not consider transmission costs in reaching a recommendation to the Commission concerning valuation. See Tr. 947-948. Nor did Staff consider gas transmission costs when it made the comparisons, even though Staff agrees that all costs should be considered. Id.

168. Company witnesses addressed these deficiencies in Staff's analysis and provided an apples-to-apples comparison of the facilities and options discussed in the testimony. See GMO-111, Crawford Rebuttal at 7. The analysis considered all costs for Crossroads, all costs for Raccoon/Goose Creek, and all costs for building a plant in the GMO territory. The costs for transmission and fuel at Raccoon/Goose Creek would be significantly higher than Crossroads, yet Staff did not include those figures in its valuation. See GMO-103, Blunk Rebuttal at 3. The analysis clearly establishes that Crossroads is the lowest cost option of all of those discussed. See GMO-111, Crawford Rebuttal at 7. Therefore, it is appropriate to include Crossroads in rate base at original cost because, of all the options presented, Crossroads is what a willing buyer would pay a willing seller for the service – it is the lowest cost option of those presented and

considered in this case. Staff's witness does not directly dispute the evidence presented by the Company as to the "all in" costs of the various options considered. See Tr. 954-55. Without evidence to the contrary, the only evidence that the Commission may consider is contained in Mr. Crawford's testimony about the "apples to apples" comparison values.

169. The Commission must decide this case based upon competent and substantial evidence regardless of what it may have ruled in the last case. The evidence in *this case* leaves only one conclusion – the Company's inclusion of Crossroads at its original cost is also the fair market value for Crossroads and it is the appropriate value to assign the plant.

2. What amount of accumulated deferred taxes associated with Crossroads should offset the value of Crossroads in rate base?

170. GMO agrees that deferred income taxes should be a reduction to rate base. Staff and GMO agree that those deferred income taxes must be based on the value assigned to Crossroads. See GMO-118, Hardesty Rebuttal at 3; Staff-271, Featherstone Rebuttal at 47. GMO's amount of deferred taxes is based on its original cost value for Crossroads as included in its direct case filings and discussed at length above. Staff has suggested a lower amount for the cost of Crossroads and, although GMO disagrees with Staff's suggested value, GMO agrees with Staff that the amount of deferred taxes (an offset to rate base) should be reduced if the Commission adopts Staff's valuation. Id. Staff and GMO, therefore, agree on the method to be used for determining deferred taxes once the Commission reaches a decision on the value to be assigned to Crossroads. This method is consistent with generally accepted accounting principles. See GMO-118, Hardesty Rebuttal at 4.

171. MECG presented testimony of Greg Meyer commenting on deferred taxes. See MECG-401, Meyer Surrebuttal at 17-20. Similar to the defects discussed above concerning staff's thoughts on the value of Crossroads, Mr. Meyer's thoughts on deferred taxes lack any

foundation at all and never offer an opinion of any sort. Instead, Mr. Meyer simply discusses the Commission's prior decision and then disagrees with Ms. Hardesty's testimony. Mr. Meyer offers no opinion that deferred taxes have been calculated incorrectly. Nor does Mr. Meyer point the Commission to any standard, rule, or other guidance indicating that the Company's treatment of deferred taxes is improper. Mr. Meyer's opinion offers no value to this Commission, and is nothing more than the comments of a lay witness.

3. Should depreciation expense be based upon the authorized gross plant value for Crossroads?

172. Like the accumulated deferred tax issue above, the level of depreciation expense should be consistent with the value that the Commission authorizes for Crossroads.

4. What transmission costs for energy from Crossroads should be included in revenue requirement?

173. The Company's case includes the actual cost of transmitting power from the Crossroads plant to the GMO service territory. There is no dispute that these are actual costs incurred by GMO. See Tr. 956. Staff disputes these charges and asks that no transmission costs be included in rate base. In testimony, Staff asserted that "utilities simply don't put power plants where their customers are not located." See Staff-271, Featherstone Rebuttal at 41. This appears to be the sole rationale for Staff's recommendation of a disallowance. But at hearing, Staff's witness acknowledged that a utility would be prudent to utilize a power plant outside of its service area if this presented the lowest cost to ratepayers. See Tr. 956-57. That is exactly the case for Crossroads.

174. The evidence is undisputed that producing power through the use of natural gas is significantly less expensive in Mississippi because of its proximity to natural gas fields. See Tr. 316. As a result of this close proximity, the fuel transportation costs are much lower than they would be for a facility located in Missouri. See Tr. 318. By using a plant in Mississippi, GMO

captures significant savings versus costs to produce the same electricity within its territory, for example at the South Harper facility. See GMO-102, Blunk Direct at 29-30. The trade off, of course, is that the electricity produced in Mississippi must be transmitted to Missouri. The evidence is undisputed that by having the Crossroads facility in Mississippi and transmitting it to Missouri "you save more off the natural gas transportation than what the electrical transmission is going to cost." See Tr. 321. GMO is prudently incurring transmission costs because the transmission costs result in significant savings to the ratepayers. Id.

175. No other party has offered competent and substantial evidence to support a finding that the actual transmission costs for transmitting electricity from Crossroads are imprudent or not in the best interest of GMO retail customers. The only attempt is made by Staff's mere speculation that a utility should not place a power plant outside of its territory. Such speculation is insufficient to support any Commission finding on the issue. Glaize Creek Sewer Dist. v. Gorham, 335 S.W.3d 590, 594 (Mo. App. 2011). Nor do the facts support Staff's recommendation. When all costs are properly considered, ratepayers save money by having the Crossroads facility located in Mississippi.

176. Furthermore, "a state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." Nantahala Power and Light Co. v. Thornburg, 476 U.S. 953, 965 (1986). In other words, FERC-approved transmission costs must be included in revenue requirements, lest the Commission run afoul of the filed rate doctrine. The Commission has previously recognized that it cannot refuse to include FERC-approved costs in rates, stating:

> The filed rate doctrine precludes the various state public utility commissions from treading on the authority of the Federal Energy Regulatory Commission (FERC) by second-guessing the rates for interstate transport of natural gas that are established by FERC. The filed rate doctrine recognizes that under the supremacy

> clause of the U.S. Constitution, the states must defer to the regulatory authority of the federal government.
>
> At its most obvious, the filed rate doctrine means that a state commission cannot decide that the FERC-approved interstate transportation rate that the local distribution company (LDC), such as MGE, is paying is too high and refuse to allow the LDC to include those costs in its rates.

See Order Consolidating Cases, In re Mo. Gas Energy's Purchased Gas Adjustment Tariff Revisions, Case No. GR-2001-382, 2002 WL 31492304 *2 (Sept. 10, 2002).

B. GMO Off-System Sales Margins.

1. How should Purchases for Resale (including issues related to negative margins) be treated?

177. The Staff Cost of Service Report raises questions regarding the decline in GMO's off-system sales ("OSS") levels and margins since the Company was acquired by GPE in 2008. In its case-in-chief Staff only expresses concerns and does not propose any dollar adjustment for such negative sales margins, which it admits it "cannot explain." See Staff-258, Staff Cost of Service Report at 108:12. Mr. Harris, Staff's witness, confirmed this at the hearing. See Tr. 752:3-7.

178. More importantly, Mr. Harris conceded that Staff has not investigated GMO's wholesale energy purchasing practices before being acquired and compared them to its post-acquisition practices. See Tr. 752-53. He was unable to describe in any detail Aquila's practices regarding its use of network transmission service (also known as "network integrated transmission service") with how GMO uses such service today. Id. at 753. Indeed, on redirect examination, Mr. Harris was only able to say that to the best of his knowledge all Missouri utilities are currently complying with their FERC-approved Open-Access Transmission Tariff ("OATT"). See Tr. 758.

179. The inability of Staff to express an opinion on the pre-acquisition practices of Aquila with GMO's post-acquisition practices is critical for two reasons. First, it demonstrates

why neither Staff nor any other party effectively countered the Rebuttal Testimony of GMO witness Burton Crawford where he explained how GMO's Purchases for Resale and its limited excess energy available to make OSS resulted in negative OSS margins. See GMO-111, Crawford Rebuttal at 8-9. Secondly, it explains why Mr. Harris did not account for post-acquisition changes in GMO's use of network service to pursue OSS margins under their OATTs. See GMO-104, Blunk Surrebuttal at 8.

180. Regarding the first point, Mr. Crawford explained that in order to reliably serve its native load customers, GMO purchases energy in the wholesale market. See GMO-111, Crawford Rebuttal at 8:18-19. During actual operations, GMO periodically does not need all of the energy that it has purchased, which it re-sells back into the wholesale market. Mr. Crawford noted that on average the price of purchased power is greater than the revenue received from the power that is re-sold. See GMO-111, Crawford Rebuttal at 8-9. Because GMO has little excess energy to sell itself, the losses on these Purchases for Resale exceed the OSS margins resulting from power sales made from GMO's own resources. Id. at 9:3-4.

181. KCP&L also experiences losses related to Purchases for Resale. See KCPL-16, Crawford Rebuttal at 9:6. However, because KCP&L is long on capacity and "has the ability to make significantly more off-system sales than GMO," the losses on such resale transactions for KCP&L are not as apparent as they are for GMO. See GMO-111, Crawford Rebuttal at 9:6-9.

182. Mr. Crawford was brought to the hearing room and tendered for cross-examination to respond to questions that Staff had raised regarding his Rebuttal Testimony.[21] Curiously, Staff declined to ask Mr. Crawford even one question. See Tr. 749. Similarly, Staff

---

[21] See Staff-295, Harris Surrebuttal at 3-4.

asked Mr. Blunk no questions regarding his GMO Surrebuttal Testimony when he was presented to the Commission at hearing. See Tr. 314.[22]

183. On the second point, Mr. Blunk had explained that Staff's concerns regarding the "collapse"[23] of GMO's OSS margins post-acquisition was also related to Aquila's practices regarding network integrated transmission service under its OATT and changes that were made post-acquisition. See GMO-104, Blunk Surrebuttal at 8.

184. As the Commission is well aware, wholesale traders may not use network transmission service to purchase energy with the intent to support OSS. Utilities are allowed to use network transmission service to take energy from designated network resources and to deliver such energy to serve their network native load. However, using such transmission service to serve a wholesale merchant function is not consistent with the purpose and provisions of a FERC-approved OATT. See MidAmerican Energy Co., 112 FERC ¶ 61,346, 2005 WL 2430182 (2005).

185. In MidAmerican Energy, a FERC audit by the Office of Market Oversight and Investigations concluded that the utility's use of network transmission service to make short-term purchases and concurrent OSS was "inconsistent with MidAmerican's OATT." Id. at 6. FERC concurred with the findings of the audit, which were resolved by MidAmerican's agreement to construct $9.2 million of previously unplanned transmission upgrades, to forego recovery of all costs associated with those upgrades for six years after they were placed in service, and to implement certain corrective actions recommended by the FERC auditors. Id. at 3.

---

[22] As agreed to by the parties, Mr. Blunk was presented on all of the issues that he testified to, including all GMO issues. Tr. 284.

[23] See Harris GMO Rebuttal at 6.

186. Given these explanations offered by Mr. Crawford and Mr. Blunk, there is no basis for Staff's concerns.

C. Rate Design/Class Cost of Service Study.

1. Residential rate adjustments:

(a) Should current Residential rates be adjusted to reflect a revenue-neutral shift seasonally and among Residential rate schedules in the winter based on GMO's class cost of service study?

(b) How should any Residential revenue increase be assigned to rate elements?

187. The Company recommends that the Commission adopt the Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service/Rate Design ("GMO CCOS Stipulation") which was filed on October 29, 2012. No party has filed an objection to this GMO CCOS Stipulation, and as a result, the Commission should treat it as a Unanimous Stipulation and Agreement, pursuant to 4 CSR 240-2.115(2)(C).

188. In the GMO CCOS Stipulation, the signatories agree that any rate increase for either the GMO – MPS or GMO – L&P rate districts should be implemented by: (1) allocating the portion of the increase not related to Missouri Energy Efficiency Investment Act ("MEEIA") on an equal percentage across-the-board basis to the current base revenues of all rate classes, and (2) assigning the portion of the increase related to MEEIA to customer classes in the manner outlined in the Non-Unanimous Stipulation and Agreement Resolving KCP&L Greater Missouri Operations Company's MEEIA Filing in Case No. EO-2012-0009.

189. The signatories further agreed that, for the LGS, LP Service and Lighting classes of the MPS and L&P rate districts, any non-MEEIA portion of the rate increase to the rate class should be implemented on an equal percentage, across-the-board basis to each rate element for that rate class, and that the MEEIA portion of the increase shall be in the form of a separate

energy charge in each applicable rate schedule. The signatories further agreed that the customer charge for the residential and Small General Service ("SGS") classes will remain unchanged. See GMO CCOS Stipulation, pp. 2-3.

2. Residential Space Heating services:

(a) Should GMO's Residential Space Heating services be eliminated?

(b) In the alternative, should KCP&L's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?

(c) Should the Commission adopt Staff's proposal to increase the residential space heating rates?

(i) The Cost Of Service Studies Support the Continuation of the Residential Space Heating And All-Electric Rates.

190. In this proceeding, several parties, including the Company, Staff, and Industrial Intervenors sponsored CCOS studies. See GMO-132, Normand Direct, Sch. PMN-2; Staff Rate Design and Class Cost of Service Report at 3-7; MIEC-831, Brubaker Direct at 3-29. The cost of service studies largely supported the conclusion that residential all-electric rates are providing a higher return than the general residential rates, as Staff witness Michael Scheperle testified during cross-examination. See Tr. 1064-67. In fact, Staff's cost of service study shows that for GMO, the index of return for all-electric rates was 0.96% compared to the overall residential rates which had an index of return of only 0.91%. See Tr. 1065. While GMO's cost of service study had a slightly lower index of return for residential all-electric rates than the overall residential rates, such a small differential does not justify the radical step of eliminating residential all-electric and space heating rates, as suggested by GMO's competitor for residential space heating service. MGE presented no study that would justify the proposed changes in rate design suggested by MGE. Based upon the totality of the cost of service study evidence, it

would be inappropriate to raise the residential all-electric rates and space heating rates by a greater percentage than the residential general class.

191. The competent and substantial evidence also demonstrates that GMO's residential all-electric and space heating rates recover more than the incremental or variable costs and make a contribution to the fixed costs of the Company. See Tr. 1027-28. In the event that the space heating rates were priced so high that space heating customers dropped their all-electric space heating service, then GMO's remaining customers would be adversely affected, as described by Mr. Rush during the hearing:

> **Q. Mr. Rush, if the Commission adopted a proposal that would cause space heating customers to drop the service, would you lose that margin?**
>
> * * *
>
> A. I believe that we would have a large fallout if you increase customers' rates to where essentially they were priced out of their product line and they said, you know, that it doesn't make sense to keep electric heat here. That, quite frankly, is not the way rates are designed. We -- the space heating class is a class of customer that has distinct usage characteristics much different than all other customers that are general use, particularly because they have electric heat and how the characteristics of the load profile that's used.
>
> **Q. If you lost space heating customers, would that affect general use residential customers or other customers?**
>
> A. It would result in increasing their rates to recover the lost margins of the space heating customers.
>
> **Q. Would that be a good thing?**
>
> A. I don't believe so.

See Tr. 1028-29.

192. Based upon the competent and substantial evidence in the record, the Commission should find and conclude that the cost of service studies in the record support the continuation of the Company's residential all-electric and space heating rates. If the Commission priced the

space heating service rates so high that the service was not competitive with natural gas or other fuels, then it would have an adverse effect on the Company's remaining residential and other customers.

(ii) MGE's Proposals Would Severely And Adversely Impact GMO's Space-Heating and All-Electric Customers Merely To Promote the Competitive Interests of MGE.

193. Most importantly, there would be a severe rate impact upon the Company's space heating customers if MGE's recommendations were adopted. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13; GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14. In fact, it was the rate impact upon customers that caused Staff witness Scheperle to oppose MGE's proposals in this case. See Tr. 1068. If the Commission adopted MGE's proposal to eliminate residential all-electric and space heating rates, there would be a substantial, adverse rate impact upon GMO's space heating customers. Staff witness Scheperle testified the annual bills for such customers would increase from $50.88 per year for lower use customers to $674.88 for customers that used the 4,000 kilowatt hours per month. At the higher usage level, this would amount to a 17.53 percent increase before any rate increase in the GMO rate case is approved. See Tr. 1069.

194. Company witness Tim Rush also presented evidence of the severe impact upon customers from the elimination of space heating and all-electric rates. For a typical GMO customer in the L&P district, the impact of the elimination of all-electric and space heating rates could be 12.58%, before any increase in this proceeding is granted. See GMO-136, Rush Surrebuttal, Sch. TMR-12 at 6. Assuming a 10% increase in this case, then the total impact upon KCP&L's typical space heating customers could be approximately 22.58%. See Tr. 1025-26.[24]

[24] During cross-examination, counsel for MGE attempted to suggest that Mr. Rush did not understand MGE's proposal, and if he understood that MGE would shift some of the cost recovery to the summer months, that it would

195. Schedule TMR-12, page 6 of 9 also included analysis for space heating customers at other usage levels. Based upon this analysis, some space heating customers would have increases of 3.40% to 17.71% increases if the space heating rate was eliminated in the L&P district — before any overall increase was granted in this case. Similarly, for the MPS district, the rate increases that would result from the elimination of space heating and all-electric rates would range from -2.44% to 17.01%.

196. Such increases, in the words of Michael Scheperle, would be "too much for the customers to bear" merely to promote the competitive interests of MGE. The Company recommends that the existing rate design be maintained. Any increase in rates should be spread equally to all classes and rate components. See GMO-134, Rush Direct at 10-13; GMO-135 Rush Rebuttal at 2-14; GMO-136, Rush Surrebuttal at 12.

(iii) MGE's Proposal to Freeze Rate Schedules Will Cause Customer Confusion, Complaints, and Substantially Complicate the Administration of the Company's Rate Schedules.

197. The "freezing" of rate schedules is fraught with complications and difficulties. In a recent case, large general all-electric rate schedules were "frozen."[25] Unfortunately, as Mr. Rush explained, this "freezing" of rate schedules resulted in numerous customer complaints:

> A. We've had a lot of complaints with regard to our commercial side or our, we call it general service side, which is small, medium, large general service. We've had quite a few complaints because of the freezing, because we had construction in progress and you're trying to figure out, okay, this customer was building a home and planning to put electric heat in and now all of a sudden they're exempted from it after the fact, and they had a plan to do so all up to that time, and they base their decision on that electric heat rate or the heating rate.

See Tr. 1021.

---

change Mr. Rush's analysis. See Tr. 997-1003. However, as Mr. Rush pointed out, if he corrected his analysis to conform to MGE's counsel's representations about the MGE proposal, it would appear to make the percentage increases for a typical space heating customer greater than presented in Mr. Rush's schedules. See Tr. 1003.

[25] Re Kansas City Power & Light Company, Case No. ER-2007-0291, Report and Order at 82.

198. In one recent case, a formal complaint was filed with the Commission related to the "freezing" of rate schedules. The Company followed what it understood to be the directive of the Commission to "freeze" the rate schedule, and not permit another customer to have all-electric service at the same premises. After hearing, the Commission ruled that the complainant should be entitled to receive large general all-electric service even though the account had previously been in the name of a management company. See Briarcliff Developments v. Kansas City Power & Light Company, Case No. EC-2011-0383, Report and Order (Mar. 7, 2012). This customer complaint is an example of the complications and difficulties that can result from an order to freeze a rate schedule without language describing exactly how the order is to be implemented by the Company.

3. Should the Commission adopt Staff's proposal to increase the non-residential space heating rates?

199. No. For the same reasons that the Commission should not adopt MGE's proposals, the Commission should also decline to adopt Staff's suggestion to increase the non-residential space heating rates.

200. As a part of the GMO rate case, the Company has committed to conduct a CCOS/rate design study to review the possible consolidation of the MPS and L&P districts. More specifically, GMO has agreed as follows:

> GMO will perform, prepare and file in its general electric rate case the results of a comprehensive study on the impacts on its retail customers of eliminating the MPS and L&P rate districts and implementing company-wide uniform rate classes, and rates and rate elements for each rate class, taking into account the potential future consolidation of GMO rates with those of KCPL. In this study, GMO will provide a distribution of rate impact on each of its customers of moving from MPS to L&P rate structures, and rate elements, and likewise, from L&P to MPS rate structures, and rate elements. If GMO would prefer a class rate structure that is different from a current MPS or L&P class rate structure, then individual customer impacts should be provided for the rate structure that GMO proposes.

GMO will conduct a class cost of service study to determine the differences in its costs to serve each of the customer classes in both the MPS and the L&P rate districts. Staff and GMO will develop the study schedule.[26]

201. The Company believes that any change in the GMO rate structure should await the completion of this comprehensive CCOS/rate design study which will be included in GMO's next rate case.

D. GMO's MEEIA Application.

1. Should the costs of any programs, shared benefits or lost revenues under MEEIA be recovered from retail customers? If so, what is the amount, and the associated per kWh rate?

202. On November 7, 2012, the Commission issued its *Order Incorporating Unopposed Non-Unanimous Stipulations and Agreement.* This order effectively resolves the MEEIA issue in this case, and the revenue requirement associated with GMO's MEEIA program will be incorporated into this case.

E. GMO Fuel Adjustment Clause.

1. Should the Commission approve, modify, or reject GMO's request for a Fuel Adjustment Clause?

203. GMO requests that the Commission continue the FAC as it currently exists. The FAC was first approved by the Commission in the last rate case submitted by GMO's predecessor, Aquila, Case No. ER-2007-0004 in 2007. As GMO witness Tim Rush noted, several modifications and clarifications have been made to the FAC in subsequent rate cases. See GMO-134, Rush Direct at 4-5.

204. No party sponsored a witness that opposed the continuation of the FAC.[27] Staff did sponsor testimony proposing certain adjustments, which are discussed below.

---

[26] See Unanimous Stipulation And Agreement Regarding Certain Issues at 10-11 (filed Oct. 19, 2012).

[27] OPC supports Staff's positions. AARP and Consumers Council of Missouri oppose all FACs, but recommend a 50/50 sharing ratio if the Commission continues the GMO FAC.

205. Rate adjustment mechanisms like an FAC were specifically authorized by state law with the passage of Senate Bill 179, now codified at Section 386.266. As the Commission stated in approving GMO's FAC, "a fuel adjustment clause . . . and prudence reviews, including some type of incentive mechanism to encourage Aquila to behave prudently, best allow this Commission to set rates that are both just and reasonable for consumers." See Report and Order at 41, In re Aquila, Inc., Case No. ER-2007-0004 (May 17, 2007).

206. The Commission has not deviated from that decision in the past five years, and no party has offered a persuasive reason why the FAC should not be continued.

2. What should GMO's FAC sharing be?

207. GMO's current sharing mechanism calls for 95% of its prudently incurred fuel and purchased power costs be paid by customers, with 5% to be absorbed by the utility. See Staff-258, Staff Cost of Service Report at 260-61; GMO-135, Rush Rebuttal at 16. The Staff Report and testimony sponsored by Staff witness Matthew Barnes propose that the mechanism be changed so that GMO's share of such prudently incurred costs is tripled and customers in the future only bear 85% of such costs. See Staff-258, Staff Cost of Service Report at 269; Staff-269, Barnes Rebuttal at 5; Staff-290, Barnes Surrebuttal at 8.

208. Staff provides a handful of reasons that it contends support a further erosion of GMO's ability to recover these costs. However, these reasons are either based upon an erroneous interpretation of earlier Commission statements or GMO testimony, or simply fail to set forth a rational and persuasive argument why any change in the sharing ratio should occur.

(i) 2007 Commission Order.

209. When the Commission first approved GMO's FAC in 2007, it concluded that after-the-fact prudence reviews, as well as a sharing mechanism of 95%-5% was "appropriate." Id. at 54.

210. The Staff Cost of Service Report (Case No. ER-2012-0175) at page 269 notes the Commission's comment that any incentive mechanism must be designed "to keep its fuel and purchased power costs down." Id. However, the final finding of fact by the Commission stated:

> With a 95% pass-through, the Commission finds Aquila will be protected from extreme fluctuations in fuel and purchased power costs, yet retain a significant incentive to take all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment.

Id. (emphasis added).

211. It is important to remember that when the Commission approved GMO's FAC, it found that having the utility absorb 5% was "a significant incentive," not a modest or token incentive. The Commission was also concerned about GMO's ability to achieve adequate earnings, concluding that the 95/5 ratio provided it with "an opportunity to earn a fair return on its investment."

212. Clearly pertinent is Mr. Rush's testimony that if the ratio had been set at 85/15, GMO's earnings would have been reduced by $16.5 million. See GMO-135, Rush Rebuttal at 18. Staff does not question the math, given that its report shows the figure would be closer to $16.6 million. See Staff-258, Staff Cost of Service Report at 270-71 (each 5% of sharing is worth $8.3 million).

213. Yet, without any particular reason, and in the wake of the Commission's recent finding that GMO's fuel and purchased power expenses, including hedging expenses, were prudent,[28] Staff now seeks to triple the amount of costs that GMO would be required to absorb.

---

[28] In re Third Prudence Review of Costs Subject to the Fuel Adjustment Clause of KCP&L Greater Mo. Operations Co., Case No. EO-2011-0390, Report and Order at 65-66 (Sept. 4, 2012).

(ii) KCP&L's Off-System Sales Margin Proposal.

214. Staff cites KCP&L's OSS margins proposal in its rate case as demonstrating "a willingness on the part of GPE to accept a 25% share of risk related to the uncertainty of KCP&L's cost of fuel and purchased power net of off-system sales revenue." See Staff-258, Staff Cost of Service Report at 269-70.

215. KCP&L's proposal is irrelevant for a number of reasons. First, under its 2005 Regulatory Plan, KCP&L cannot implement an FAC or other rate adjustment mechanism until June 1, 2015. See GMO-135, Rush Rebuttal at 23; Report and Order at 15, In re Proposed Regulatory Plan of Kansas City Power & Light Co., No. EO-2005-0329 (July 28, 2005).

216. Most importantly, Staff fails to point out that the current OSS margin mechanism applied to KCP&L is completely asymmetrical, in that KCP&L absorbs all OSS margins up to the 40% of expected margins, and then is required to return to customers any OSS margin above that level. See GMO-135, Rush Rebuttal at 22; KCPL-40 Rush Direct at 14. There is no incentive provided to KCP&L under its current OSS mechanism because there is no sharing whatsoever.

217. KCP&L's OSS margin proposal has no relevance to the GMO FAC sharing mechanism, and provides no support for a change in the current 95%-5% sharing mechanism.

(iii) GMO's Alleged "Indifference" to its Net Energy Costs.

218. Based upon an incomplete citation to testimony by GMO witness W. Edward Blunk in another case, Staff concludes that GMO has shown "total indifference" to the net energy costs that it incurs because the 5% share of risk is insufficient to motivate the utility to control its fuel and purchased power costs.

219. As Mr. Blunk explained in great detail, Staff has taken out of context his oral testimony in In re Third Prudence Review of Costs Subject to the Fuel Adjustment Clause of

KCP&L Greater Mo. Operations Co., Case No. EO-2011-0390 ("Third Prudence Review"). See GMO-103, Blunk Rebuttal at 4-8. The point that Mr. Blunk made in his testimony in that case was that because GMO had properly hedged and insured against a spike in the price of natural gas, such as was triggered by Hurricane Katrina in 2005, "then you are indifferent." See GMO-103, Blunk Rebuttal at 6:23. "It was only with a hedging program such as the one used by GMO to protect its ratepayers" that GMO could "say there is indifference to skyrocketing prices." Id. at 7:1-2.

220. As Mr. Blunk advised the Commission in the Third Prudence Review, if a natural disaster caused electricity prices to "skyrocket," the "significant gain" in the natural gas futures contracts would provide "money to offset what's happened on the cash or the physical market for electricity." Id. at 7:8-15. He concluded that as a result of the hedging "I've got . . . insurance proceeds to help pay for this now higher price electricity." Id. at 7:15-16.

221. It was only in this context that Mr. Blunk stated GMO would be "indifferent" because it had protected its customers from a sudden increase in the cost of electricity which, even if found prudent, would still require GMO to absorb 5% of such higher electricity costs. As Mr. Blunk noted, "GMO is not indifferent about the 5%." Id. at 7:23-24.

222. However, the most important point is that during the Third Prudence Review, Staff found no evidence of GMO imprudence except for the practice of using natural gas futures contracts to hedge purchased power risks. See GMO-103, Blunk Rebuttal at 4-5, citing Staff's Third Prudence Review Report and Recommendation, In re Third Prudence Review of Costs Subject to the Fuel Adjustment Clause of KCP&L Greater Mo. Operations Co., Case No. EO-2011-0390 (Nov. 28, 2011).

223. In the Commission's Report and Order issued earlier this year, it found no imprudence with regard to any of these allegations, and dismissed the Staff complaint, denying

all of the relief sought by Staff. See Report and Order at 65-66, In re Third Prudence Review of Costs Subject to the Fuel Adjustment Clause of KCP&L Greater Mo. Operations Co., Case No. EO-2011-0390 (Sept. 4, 2012).

(iv) GMO Reluctance to Rebase Energy Costs.

224. GMO's opposition to rebasing FAC energy costs in its 2009 and 2010 rate cases is irrelevant since GMO has specifically agreed to rebase costs in this case. See GMO-134, Rush Direct at 4:13-15.

225. The reason GMO had proposed to keep the base amounts for both the MPS and L&P divisions at their existing levels in earlier cases was so the overall rate increase would be "as low an amount as reasonable, yet still provide a fair return to the Company." See Report and Order at 206, Case No. ER-2010-0356 (May 4, 2011). Given the Commission's preference in the last case to reflect changes in fuel and purchased power costs, GMO proposed that such rebasing occur in this case. Consequently, there are no issues regarding rebasing in this proceeding and Staff's point misses the mark.

(v) GMO's Energy Purchases from KCP&L During 2011.

226. Based upon an erroneous interpretation by Staff of data that KCP&L and GMO submitted to the Commission regarding net hourly generation for each generating unit, Staff improperly concluded that KCP&L was buying higher cost energy on behalf of GMO, but cheaper energy for itself. See Staff-258, Staff Cost of Service Report at 275-77.

227. The data cited by Staff relates to filings made pursuant to 4 CSR 240-3.190, which contains reporting requirements for electric utilities. However, what Staff fails to note is that Section 3.190 data does not distinguish between inter-company transactions and other OSS transactions with unrelated companies. See KCPL-8, Bresette Rebuttal at 13-14. As a result, once the sales are removed that reflect KCP&L's purchases to serve native load in the midst of

the 2011 Missouri River flood, as a result of reduced operations at its coal-fired plant and other coal conservation measures, the power purchased by KCP&L on behalf of GMO customers was actually cheaper than that which KCP&L bought for its own customers. Id.

(vi) Shifting From 95/5 to 85/15 Would Triple GMO's Share of Under-Collection.

228. Staff's final point is that increasing GMO's 5% share of the total under-collection to 15% "would provide a stronger incentive to keep GMO's fuel and purchase power costs down." See Staff-258, Staff Cost of Service Report at 270. However, what the Staff Cost of Service Report actually illustrates in dramatic fashion is the massive financial burden that would be placed upon GMO if such a shift occurred.

229. Staff observed that the cumulative under-collected amounts related to fuel and purchased power expenses over the past four and a half years was $165 million, which it properly concluded was "significant to GMO." Id. at 269:4-6. Staff found that if an FAC had not been approved by the Commission, "GMO would have lost approximately 36.4% of its test year net income before taxes (NIBT)." Id. at 269:8-10.

230. During each of the past ten accumulation periods, except the most recent tenth one (December 2011-May 2012), the Company had always under-collected its expenses. Id. 265. A decrease occurred in this most recent period only because of a substantial decline in natural gas prices and a resulting decrease in purchased power prices. Id. at 267. Yet, despite this significant track record of under-collections, where only one accumulation period in ten resulted in a decrease in expenses, Staff proposes to triple the average costs that the Company would be required to absorb. Based on the historical data, this would increase GMO's costs per accumulation period from $919,000 to $2.8 million. See Staff-258, Staff Cost of Service Report at 272.

231. If 15% had been used instead of 5% during the last nine full accumulation periods, GMO would have absorbed not $8.3 million, but rather almost $25 million. See Tr. 832 (Staff witness Barnes). Put another way, if Staff's statement is correct that the average accumulation period under-collection was $2.8 million, under the 85/15 ratio GMO would have been forced to absorb nearly $25.2 million. See Staff-258, Staff Cost of Service Report at 272.

232. As the following illustration shows, changing the 95/5 ratio to 85/15 would impose more risks on GMO without any countervailing benefit, except in the unusual situation of deflationary energy markets (which have only occurred once in the last ten accumulation periods):

Fuel Adjustment Clause Sharing Mechanism

	Current FAC Sharing Mechanism 95%/5%	Staff FAC Sharing Proposal 85%/15%	Difference
Year 1			
$10,000,000			
Customer	$9,500,000	$8,500,000	$(1,000,000)
GMO	$500,000	$1,500,000	$1,000,000
Year 2			
$9,000,000			
Customer	$8,550,000	$7,650,000	$(900,000)
GMO	$450,000	$1,350,000	$900,000

GMO absorbs $1 million more in year 1 and $900,000 more in year 2.

233. The only solace that Staff offers the Company is that in the rare event when prices decrease, such as only happened in the tenth accumulation period, GMO would be able to share in 15% of such cost reductions, instead of 5%. Given the history of under-collections, and the

general trend of rising fuel and associated production costs, shifting to an 85/15 sharing ratio poses greater risks and uncertainties for GMO.

234. As GMO witness Tim Rush indicated, Missouri is one of the few states where a sharing mechanism is employed. The survey conducted at Mr. Rush's request for the last rate case indicated that the only sharing mechanisms employed by other Midwestern regulatory jurisdictions related to OSS, not to FACs, and that nothing had changed since that 2011 survey. See Tr. 802-04 (Rush); GMO-146 and GMO-147.[29] Those conclusions are consistent with the conditions that existed when the Commission approved GMO's FAC in 2007. The Commission then noted that "all but two of the 29 non-restructured states without retail competition allow their electric utilities to recover fuel and purchased power costs through some type of fuel adjustment clause."[30] The Commission additionally noted that "other states' experience with fuel adjustment clauses can be instructive for this commission" in weighing decisions regarding FACs.[31]

235. The survey of Midwestern states and Mr. Rush's observations regarding the current 95/5 sharing mechanism make clear that tripling the amount of under-collected fuel and purchased power costs to GMO would be harmful to its earnings and likely to cause a decrease of 0.5% on its authorized ROE. See GMO-135, Rush Rebuttal at 26:10-13; Tr. 808.

236. Staff's idea of an additional incentive is nothing more than an additional penalty that would require GMO to absorb three times the amount of prudently incurred fuel and

---

[29] See In re KCP&L Greater Mo. Operations Co., Case No. ER-2010-0356, Report and Order at ¶ 571 & n. 799 (May 4, 2011).

[30] In re Aquila, Inc., Case No. ER-2007-0004, Report and Order at 31 (May 17, 2007).

[31] Id.

purchased power costs without, as Mr. Barnes admitted, any finding of mismanagement or imprudence by GMO. See Tr. 832-33.

(vii) Purchased Power Agreements.

237. Finally, Staff criticizes GMO's alleged reliance on short-term purchased power agreements, instead of putting unspecified "steel in the ground." See Staff-269, Barnes Rebuttal at 4. How this relates to Staff's proposal to triple GMO's cost risks under the FAC sharing mechanism is unclear and, in light of the current fall in market prices, illogical.

238. Mr. Barnes acknowledged on cross-examination that GMO customers have benefited in the past year because of the decrease in the price of wholesale electricity, GMO's ability to take advantage of those decreases in its purchased power arrangements, and the resulting decrease in fuel adjustment rates. See Tr. 828-29.

239. Although Staff recommends that GMO build power plants (which would trigger new rate cases and, undoubtedly, issues of rate case expense), Staff is reluctant to recommend even what type of plant should be built, let alone what its size should be. See Tr. 830. Mr. Barnes acknowledged that "typically" such issues and decisions are addressed in the Commission's integrated resource planning process. GMO's current plans are being evaluated in Case No. EO-2012-0324.

3. Should both the revenues and the costs associated with Renewable Energy Certificates flow through GMO's FAC?

240. Staff recommended that the Commission require any future revenues from the sale of Renewable Energy Certificates ("RECs") flow through the FAC as an off-set to costs in the calculation of GMO's fuel adjustment rate. See Staff-258, Staff Cost of Service Report at 278:4-12.

241. Assuming that Staff's recommendation is that REC revenue be used to off-set REC costs, GMO agrees to this recommendation. See GMO-135, Rush Rebuttal at 27:3-5.

4. Should GMO's FAC tariff be clarified to specify that the only transmission costs included in it are those that GMO incurs for purchased power and off-system sales, excluding the transmission costs related to the Crossroads Energy Center?

242. Staff recommends that GMO's FAC include only transmission costs that are necessary for it to receive purchased power to serve native load and for it to make OSS. It requests that any transmissions costs related to the Crossroads Energy Center be excluded from the FAC.

243. GMO agrees that transmission costs that are incurred to serve native load and to make OSS that benefit native load are appropriate to include in the FAC.

244. GMO also believes that the transmission costs that it incurs to bring power from Crossroads Energy Center in Clarksdale, Mississippi to Missouri are prudent, given the low cost of natural gas in that part of the country, which more than off-set transmission and other related costs. The full amount of such costs should be recovered by GMO, whether included in the FAC or otherwise included in GMO's revenue requirement. However, GMO does not contend that such costs must be recovered in the FAC. See KCPL-42, Rush Rebuttal at 30, GMO-104, Blunk Surrebuttal at 2-6; GMO-111, Crawford Rebuttal at 1-8; GMO-112, Crawford Surrebuttal at 1-7.

5. Should GMO be ordered to provide or make available the additional information and documents requested by Staff to aid Staff in performing FAC tariff, prudence, and true-up reviews?

245. Staff requests that the Commission order GMO to comply with nine filing requirements that Staff asserts will aid it in performing FAC tariff, prudence, and true-up reviews. See Staff-258, Staff Cost of Service Report at 280-81. Staff does not claim that it has encountered any problems in conducting these reviews since the FAC was implemented in 2007.

246. Contrary to Staff's implication, GMO has supplied such information to Staff for the past three years. The Non-Unanimous Stipulation and Agreement approved by the Commission in GMO's 2009 rate case required it to provide virtually all of the information requested here. See In re KCP&L Greater Mo. Operations Co., Case No. ER-2009-0090, Non-Unanimous Stipulation and Agreement, § 18 at 10-11 (May 22, 2009). Section 18 concerned the FAC and set forth a variety of submissions that GMO agreed to make and has made since the Non-Unanimous Stipulation was approved by the Commission. See In re KCP&L Greater Mo. Operations Co., Case No. ER-2009-0090, Order Approving Non-Unanimous Stipulations and Agreements and Authorizing Tariff Filing at 12-15 (June 10, 2009).

247. GMO is unaware of any problems that have been encountered by Staff with regard to these requests. GMO is perplexed by Staff's request in this pending case where it requests to be advised of any purchases by GMO for "nuclear fuel." See Staff-258, Staff Cost of Service Report at 280:12-14. GMO owns no nuclear generating units and does not purchase nuclear fuel.

248. Therefore, the Commission need not impose any such requirements because they are already being fulfilled pursuant to the Stipulation in Case No. ER-2009-0090.

V. CONCLUSION.

249. The issues that remain in these cases to be resolved by the Commission will have a large impact upon the Companies and their customers. As discussed above, cost of capital and the transmission tracker issues are two common issues that will have a substantial impact upon the financial health of the Companies. The Crossroads issue and the FAC sharing percentage issue also will have a significant impact upon GMO.

250. The Companies believe that competent and substantial evidence on the record as a whole supports their position on the issues as described above. Resolution of these issues as the

Companies propose will lead to just and reasonable rates that properly balance the interests of shareholders and customers, and that give the Companies an opportunity to earn a reasonable rate of return following the conclusion of the case.

Respectfully submitted,

/s/ Karl Zobrist
Karl Zobrist MBN 28325
Lisa A. Gilbreath MBN 62271
SNR Denton US LLP
4520 Main Street, Suite 1100
Kansas City, MO 64111
(816) 460-2400 (Phone)
(816) 531-7545 (Fax)
karl.zobrist@snrdenton.com
lisa.gilbreath@snrdenton.com

James M. Fischer MBN 27543
Fischer & Dority, P.C.
101 Madison Street, Suite 400
Jefferson City, MO 65101
(573) 636-6758 (Phone)
(573) 636-0383 (Fax)
jfischerpc@aol.com

Charles W. Hatfield MBN 40363
Stinson Morrison Hecker LLP
230 W. McCarty Street
Jefferson City, MO 65101
(573) 636-6263 (Phone)
(573) 636-6231 (Fax)
chatfield@stinson.com

Roger W. Steiner MBN 39586
Corporate Counsel
Kansas City Power & Light Company
1200 Main Street
Kansas City, MO 64105
(816) 556-2314 (Phone)
(816) 556-2787 (Fax)
roger.steiner@kcpl.com

Attorneys for Kansas City Power & Light Co. and
KCP&L Greater Missouri Operations Co.

CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 28th day of November, 2012, to all counsel of record.

/s/ Lisa A. Gilbreath
Lisa A. Gilbreath