BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

KCP&L GREATER MISSOURI OPERATIONS COMPANY'S
RESPONSE TO ORDER DIRECTING FILING

KCP&L Greater Missouri Operations Company ("GMO" or "Company"), pursuant to 4 CSR 240-2.080, files its response to the *Order Suspending Tariff Sheets and Directing Filing* issued on June 2, 2011 ("*June 2 Order Directing Filing*") which directed that the parties file by June 8, 2011 a pleading identifying GMO's short term debt costs, and explaining the reasons that the carrying costs in the Commission-mandated phase-in plan should not equal the Company's short-term debt costs.

In response to the *June 2 Order Directing Filing*, the Company states as follows:

A. Short-term Debt Costs

1. First, it should be noted that short-term debt costs vary widely over the course of time. In fact, short-term interest costs can differ on a daily basis. However, over the most recent twelve-month period, June 2010 through May 2011, the Company's short term debt costs as reflected on its monthly AFUDC calculations, which encompass an all-in cost for short term borrowings, have averaged 4.473%.

B. The Commission Should Not Utilize Short Term Debt Costs in the Phase-In Plan, But Instead Should Adopt the Commission's Approach To Carrying Costs When It Approved the Wolf Creek Phase-In Plan—(i.e. Overall Return On Investment)

2. If the Commission believes that a phase-in plan for the L&P division is necessary, then it is important that the Commission approve a phase-in plan that uses the appropriate level of carrying costs to meet the following statutory mandate of Section

393.155.1: "Any such phase-in shall allow the electrical corporation to recover the revenue which would have been allowed in the absence of a phase-in and shall make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years." In other words, the phase-in plan statute requires that the phase-in plan keep the Company whole so that it will "recover the revenue which [it] would have been allowed in the absence of a phase-in" plan. The use of a very low short term debt cost will not accomplish this statutory requirement. This may be the reason that such low carrying costs were not utilized in any phase-in plans adopted in the Wolf Creek[1], Callaway[2], and Grand Gulf[3] cases. However, the use of the Company's overall rate of return on investment, or weighted cost of capital, accomplishes this requirement.

3. The Commission's *Report And Order* in the Wolf Creek rate case approved KCP&L's only previously approved phase-in plan, stating: "The carrying costs on the deferred revenues under the phase-in plan shall be calculated at the overall rate of return." (Re Kansas City Power & Light Company, 28 Mo.P.S.C. (N.S.) at 418)(*emphasis added*).

4. In the Wolf Creek case, the phase-in was over a period of seven years. The first year increase was for 7% followed by an increase of 5% in year two. The increases in years 3-7

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[1] As explained herein, the phase-in plan for the Wolf Creek case authorized carrying costs at a level equal to the overall rate of return on investment. Re Kansas City Power & Light Company, 28 Mo.P.S.C. (N.S.) 228, 418 (1986). The Wolf Creek phase-in plan was shortened by the passage of the Tax Reform Act of 1986. *See* 29 Mo.P.S.C. (N.S.) 51-52 (1987).

[2] In Re Union Electric Co, 27 Mo.P.S.C. (N.S.) 183, 270-73 (1985), the phase-in plan for the Callaway nuclear unit rate case was accomplished by deferring the equity return on Callaway-related rate base, and recovery of the deferred equity in years 5-8. The phase-in plan included increases of 14% (Year One), followed by an increase of 10% (Year Two), and increases of 7.29% for Years 3-6. The deferred equity recovery would have been fully recovered by the end of the eighth year requiring a 12.49% decrease in rates. However, the phase-in was shortened by the passage of the Tax Reform Act of 1986. *See* 29 Mo.P.S.C. (N.S.) 51-52 (1987).

[3] In Re Arkansas Power & Light Co., 28 Mo.P.S.C. (N.S.) 425, 482-83 (1986), the phase-in plan for the Grand Gulf Nuclear Unit was accomplished by allowing recovery of carrying costs of 11.71% which was the overall rate of return found to be reasonable in the case. The five-year phase-in plan included a 6.64% increase in Year One, followed by equal percentage increases in years two through five, with a rate reduction in the year following the completion of the phase-in plan. The phase-in tariff sheets were ordered to be filed within thirty (30) days of the effective date of the Report And Order.

were 3.49%. But what is important for this case is that the Commission authorized the carrying costs on the deferred revenues at the level equal to the Company's overall rate of return. All deferrals and carrying costs were expensed over the phase-in period, and the tariff sheets implementing the phase-in were authorized to become effective automatically in the succeeding years unless suspended by the Commission for good cause shown. (*Id.* at 417-18)

5. In this case, the Company utilized the same method for determining the carrying costs that was last approved by the Commission in the Wolf Creek rate case—its overall rate of return on investment, or the same weighted cost of capital (i.e. 8.414%) that was authorized by the Commission in its *Report And Order* in this case. This method will accomplish the statutory requirement of Section 393.155.1 "to recover the revenue which would have been allowed in the absence of a phase-in." However, the use of the short term debt cost in the phase-in tariffs will not recover the same revenues which would have been allowed in the absence of a phase-in plan.

6. To illustrate this point, it should be noted that the Commission's *Report And Order* authorized a revenue increase for the L&P division of $29,772,796. However, the Commission's *Order of Clarification and Modification* issued on May 27, 2011 restricted the first year increase to the L&P division to the amount GMO originally requested of $22,101,088 (Year One), and ordered a two year phase-in, pursuant to Section 393.155.1. As a result, the first year rate increase of $22,101,088 is $7,671,708 less than what GMO would have received absent the phase-in order for the first year following the effective date of the *Report And Order*. By ordering the phase-in, the Commission has effectively denied the Company the right to earn a return on investment during the first year on a substantial amount of invested capital, unless appropriate carrying costs are allowed to be recovered during the phase-in plan to offset the full

amount of this lost revenue. Merely by allowing GMO to recover during the phase-in period the difference between what GMO would have recovered if the full increase was immediately implemented and the first year rate increase, does not make GMO whole, as Staff suggested in its Response filed on June 7, 2011.[4] The fact that the rates will eventually increase over the phase-in period reaching the $29,772,796 level at the conclusion of the phase-in period does not mean that GMO's revenues and earnings will increase by the same amount as if the Commission had allowed the full authorized rate increase of $29,772,796 to go into effect immediately. GMO will not be "financing" its earnings using short term debt, as implied by Staff's analysis. In reality, GMO will forego those earnings, unless the Commission utilizes the overall return on investment as its carrying cost.

7. GMO has three (3) sources of funds to operate its public utility business: 1) revenue, 2) additional equity and 3) additional debt (primarily long-term). By decreasing one of the sources of funds, (i.e. first year revenue authorized in this case), the Company has to rely on the other two sources for funds (i.e. equity and long-term debt, or the weighted cost of capital). For GMO, the opportunity cost of not having available during the first year of the rate increase the $7,671,708 ($29,772,796 minus $22,101,088) is the utility's allowed overall rate of return on investment. In other words, the overall rate of return on investment is the opportunity cost that GMO loses by not having the funds available to invest in its business. In the case of the L&P division phase-in plan, the deferred revenue represents funds not available to invest in its business, and as a result, the Company loses the opportunity to earn its overall rate of return on investment of 8.414%. Until the Company finally recovers the full amount of its authorized rate increase of $29,772,796, the Company loses the opportunity to earn 8.414% on this money.

[4] Staff Response To Order Suspending Tariff Sheets And Directing Filing, pp. 2-3. (June 7, 2011).

This is the reason that the overall rate of return, as recognized by the Wolf Creek decision, is the appropriate carrying cost to be utilized in the phase-in plan.

8. As explained in the Company's May 31, 2011 cover letter accompanying the tariffs, L&P division's First Year tariffs would produce $22,101,088 of additional revenues during the first year following the rate increase. In order to effectuate the Year Two phase-in ordered by the Commission, the L&P division's second year rate increase is a $12,153,060 increase above the first year tariffs. This $12,153,060 second year increase reflects: (1) the phase-in rate increase of one half of the difference between $29,772,796 and $22,101,088 ($3,835,854), (2) the deferred revenue (i.e. $7,671,708) during the first year of the phase-in plan, and (3) the carrying costs equal to GMO's authorized rate of return (8.414%) on the deferred revenue of $7,671,708 (i.e. $645,498). The total revenue during Year Two from these tariffs would be $34,254,148 ($22,101,088 + $12,153,060 = $34,254,148). If the Commission utilized the Company's short-term debt rate of 4.473%% instead of the 8.414% overall rate of return, the Company's revenues would be reduced by approximately $302,000.

9. In order to effectuate Year Three of the phase-in plan, the L&P's division's third year phase-in tariffs reflect a rate decrease of $322,749 below the Year Two tariffs. The Year Three tariffs reflect: (1) the remaining phase-in rate increase of one half of the difference between $29,772,796 and $22,101,088 ($3,835,854), (2) the deferred revenue (i.e. $3,835,854) during the second year of the phase-in period, and (3) the carrying cost equal to GMO's authorized rate of return (8.414%) on the deferred revenue of $3,835,854 ($322,749). This increase is offset by the reversal of the prior year's deferred revenues and the prior

year's carrying costs.[5] If the Commission utilized a carrying cost equal to the short-term debt cost of 4.473%, then the Company's revenues would be reduced by approximately $151,000.

10. In order to complete the Commission's ordered phase-in plan, the amount of rate decrease reflected by the final year of the tariffs is $4,158,603. These tariffs complete the phase-in and establish the L&P division's rates at $29,772,796 (the amount of the L&P rate increase as ordered prior to any phase-in). By recovering the deferred revenue over the first two years as ordered by the Commission, and including a carrying cost on those deferred revenues at the Company's overall return on investment, as was authorized in the Wolf Creek Phase-In Plan, the Commission will fulfill the statutory requirement of Section 393.155.1 "to recover the revenue which would have been allowed in the absence of a phase-in.." If the Commission authorized carrying costs of less than the overall authorized return on investment, then the phase-in plan will not fulfill the statutory requirement of Section 393.155.1.

11. As explained in the Company's *Application For Rehearing and Motion For Clarification* filed on June 3, 2011, the Commission Staff has recognized that the first year tariffs that authorize a $22,101,088 rate increase for the L&P division need to be processed more quickly than the remaining years of the phase-in plan. In addition, Staff indicated that it was continuing to review the tariffs that implemented the remaining years of the phase-in plan. (*See Staff Recommendation To Approve Tariff Sheets*, para. 6) The Commission should approve the first year phase-in tariffs of $22,101,088 without further delay while the Commission considers the carrying cost issue. It is absolutely critical that the first year increase for the L&P division, and the authorized increase for the MPS division be approved immediately.

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[5] A worksheet explaining the Phase-In Plan calculations was included in the May 31, 2011 tariff filing package made by the Company.

WHEREFORE, KCP&L Greater Missouri Operations Company respectfully responds to the Commission's *June 2 Order Directing Filing*, and renews its request that the tariffs for the first year of the phase-in plan for the L&P division be allowed to go into effect as soon as practicable, and that the suspension of the MPS tariffs be lifted immediately.

Respectfully submitted,

/s/ James M. Fischer

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the above and foregoing was served upon counsel of record on this 8th day of June, 2011.

/s/ James M. Fischer
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