BEFORE THE PUBLIC SERVICE COMMISSION
<u>OF THE STATE OF MISSOURI</u>

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan	)))))	Case No. ER-2010-0355

and

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

INITIAL POSTHEARING BRIEF OF

INDUSTRIAL INTERVENORS

<u>AS TO KCPL AND JOINT ISSUES</u>

David L. Woodsmall (MBE #40747)
Jeremiah D. Finnegan (MBE #18416)
Stuart W. Conrad (MBE #23966)
428 E. Capitol Ave., Suite 300
Jefferson City, MO 64111
(573) 635-2700 voice
(573) 635-6998 facsimile
E-mail: dwoodsmall@fcplaw.com

ATTORNEYS FOR THE
INDUSTRIAL INTERVENORS

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COME NOW Praxair, Inc., the Midwest Energy Users' Association, Ag Processing, Inc. a cooperative, and the Sedalia Industrial Energy Users' Association (collectively referred to herein as "MEUA" or "Industrial Intervenors") by and through the undersigned counsel, pursuant to the Commission's August 18, 2010 Order Setting Procedural Schedule, and submit their Initial Posthearing Brief on the issues set forth below.

I. INTRODUCTION

Throughout the course of this hearing it has become apparent that it is time for a change in the mindset in the approach that the Commission takes towards KCPL. In recent years, during the implementation of the Regulatory Plan, the Commission has continually given KCPL the benefit of the doubt. For instance:

- In order to minimize the risk, during the Regulatory Plan, associated with KCPL's dependence on the wholesale market, the Commission used the 25th percentile of off-system sales margins in its calculation of retail rates. This change from traditional ratemaking shifted the risk of such sales, or that KCPL would not engage in these sales, entirely to the ratepayers. Ultimately, this risk proved expensive. As will be explained, with these lower expectations, KCPL took an apathetic approach to the wholesale market. As a result, with less off-system sales to offset retail rates, KCPL's rates have increased dramatically.

- In order to help finance the construction programs under the Regulatory Plan, the Commission unnecessarily gave KCPL inflated returns on equity. In fact, in 2006, the Commission awarded KCPL the highest return on equity in the nation.

- During a period of time when KCPL management should have had single-minded focus on the construction of Iatan 2 and the other Regulatory Plan projects, the Commission allowed the Company to divert its attention to the acquisition of another utility. As a result, Company management, that should have been overseeing much of the management work on Iatan 2, instead abdicated much of that responsibility to contractors and consultants like Schiff, Harden. The obvious result of this lack of management attention is that the costs of Iatan 2 quickly increased and the rate case expense associated with this case has skyrocketed.

- Throughout this entire 5 year period, ratepayers were ordered to pay KCPL over $180 million in the form of regulatory amortizations.

Now with the completion of the Regulatory Plan, it is time for the Commission's mindset to change from protecting KCPL to protecting their ratepayers. It is time to think of the customers again!

With this in mind, the Commission needs to start setting appropriate expectations again for KCPL's management. First, the Commission needs to acknowledge that KCPL's Administrative and General ("A&G") costs need to be brought under control. Without fail, among the Missouri electric utilities and Westar (the largest Kansas electric utility), KCPL and GMO's A&G costs are significantly higher than any other utility. The following chart is indicative of this ongoing problem.

A&G Expenses per Megawatt Hour Sold (MWH)						
	Empire	GMO	KCPL	Combined KCPL / GMO	AmerenUE	Westar
A&G Expenses	$28,579,310	$66,976,333	$142,093,271	$209,069,604	$243,925,979	$82,212,174
MWH Sold	5,409,839	8,112,391	20,062,162	28,174,553	47,078,720	17,273,374
A&G / MWH	**$5.28**	**$8.26**	**$7.08**	**$7.42**	**$5.18**	**$4.76**

Source: Ex. 231, Majors Surrebuttal, page 16.

Therefore, the ***first*** necessary expectation is that KCPL / GMO bring its A&G costs in line with the other Missouri electric utilities. To place in perspective, if KCPL / GMO were required to reduce A&G costs to a level comparable to AmerenUE and Empire, then approximately $63 million of costs will have been driven out of rates.[1]

Second, as an outgrowth of KCPL's spiraling A&G costs, the Commission should set an expectation for lower rate case expense. In a 1993 decision, the Commission disallowed approximately 33% of Missouri-American's rate case expense. There, the Commission noted:

[1] ($7.42 - $5.18) * 28,174,553 = $63.1 million.

> But the Commission must continue to look to the record for evidence in support of rate case expense and in this case that evidence is lacking. Disallowing all expense, or perhaps even disallowing any prudently incurred rate case expense could be viewed as violating the Company's procedural rights. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. ***The operative words here, however, are necessary and prudently incurred. The record does not reflect efforts at cost containment and consequently it does not support that these expenses have been prudently incurred.***[2]

The Commission should set similar expectations in this case. In the case at hand, KCPL has made no efforts at cost containment. Unlike its last litigated case, in which in-house counsel litigated a significant number of issues,[3] KCPL completely handed over responsibility for litigating this case to outside counsel. Even on issues in which KCPL completely waived cross-examination of witnesses on an issue, that waiver was provided by outside counsel.

Third, the Commission should set higher expectations for KCPL's performance in the wholesale market. In 2006, the Commission set rates using the 25th percentile of off-system sales margins. At that time, the Commission expected additional margins to be forthcoming because KCPL had a "fairly substantial chance" of exceeding this level. As such, the Commission implemented a tracker so that the additional profits could be returned to ratepayers. As section IV of this brief describes, however, through its implementation of the unused energy allocator in Kansas, KCPL had created a disincentive for it to participate in the wholesale market. As a result, KCPL is now required to return $1.05 for every $1.00 it made in the wholesale market. Therefore, despite the Commission's hopes for greater off-system sales, KCPL only achieved up to

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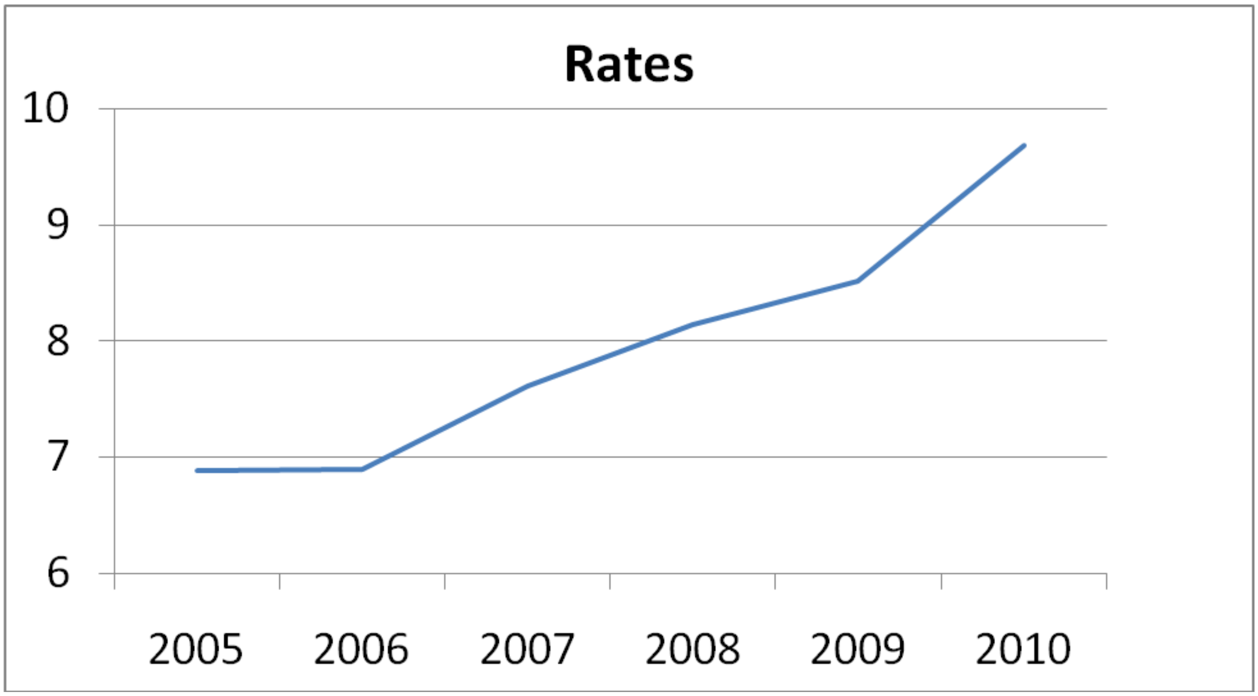
[2] *Report and Order*, Case No. Case No. WR-93-212, 2 Mo.P.S.C. 3d 446 (issued November 18, 1993) (emphasis added).
[3] Exhibit 1217.

the level of the Commission's lowered expectations. In this case, the Commission should set higher expectations in order to get KCPL to overcome its self imposed disincentives. As such, MEUA recommends that the Commission require KCPL to achieve at the 40th percentile.

Ultimately, by turning its focus back to the ratepayers and by setting proper expectations for this underperforming utility, the Commission can provide some long awaited relief to ratepayers that have seen rates increase by 41% in the last 6 years.



Source: Ex. 215, Featherstone Direct, page 46.

II. OVERVIEW OF POSITIONS

- Return on Equity: For the reasons advanced in Section IV of this Brief and the testimony of Michael Gorman, MEUA recommends a return on equity of 9.4 – 9.9%, with a midpoint of 9.65%.

- Off-System Sales Margins: For the reasons advanced in Section V of this Brief and the testimony of Greg Meyer, MEUA recommends that the Commission set off-system sales margins at **___________**.

- Off-System Sales Adjustments: For the reasons advanced in Section VI of this Brief and the testimony of Greg Meyer, MEUA recommends that the Commission reject each of the specific off-system sales adjustments offered by KCPL.

- Merger Transition Costs: For the reasons advanced in Section VII of this Brief and the testimony of Staff Witness Majors, MEUA recommends that the Commission reject any further recovery of merger transitions costs as requested by KCPL.

- Rate Case Expense: For the reasons advanced in Section VIII of this Brief, MEUA recommends that the Commission disallow 33% of the projected ***$13.8 million*** of rate case expenses associated with presenting this case. In addition, MEUA asks that the Commission, consistent with the recent decision of the Kansas Commission, normalize the recoverable costs over a 4 year period.

- <u>Advanced Coal Credit Arbitration Costs</u>: For the reasons advanced in Section IX of this Brief, MEUA recommends that the Commission disallow the entirety of the legal fees and other costs associated with the Advanced Coal Credit Arbitration.

- <u>Unsupported Rate Increases Claimed By KCPL</u>: Recognizing that the $9.78 million now requested by KCPL is not supported by competent and substantial evidence in the record and for the reasons advanced in Section X of this Brief, MEUA recommends that the Commission deny KCPL recovery for this unsupported rate increase.

III. BURDEN OF PROOF

Section 393.150(2) provides that, in any rate increase proceeding, the burden of proof is on the party seeking the increased rate. In considering the appropriate schedule for this proceeding, the Commission adopted KCPL's based upon its acknowledged burden of proof.

> Furthermore, the Commission will adopt the order of issues proposed by KCP&L. While the Commission understands the positions argued by Staff and MEUA, the Commission concludes that KCP&L has the burden to put on its case, and should be granted considerable leeway in the order in which it would like to present its evidence.[4]

Burden of proof, however, does not only mean that the utility gets the advantages when it comes to presenting its evidence. Burden of proof also means that the utility must accept the "burden" of proving its case.

In this regard, the Supreme Court has provided a great deal of insight regarding burden of proof. Specifically, as it applies to Commission proceedings, the Supreme Court has told us: (1) that burden of proof is a "substantial right" of the customers and (2) that burden of proof should be "rigidly enforced" by the Commission.

> The rules as to burden of proof are important and indispensable in the administration of justice, and constitutes a substantial right of the party of whose adversary the burden rests; they should be jealously guarded and rigidly enforced by the courts.[5]

The Supreme Court has also provided definition for the burden of proof.

> The burden of proof meaning the obligation to establish the truth of the claim by a preponderance of the evidence, rests throughout upon the party asserting the affirmative of the issue. The burden of proof never shifts during the course of the trial.[6]

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[4] *Order Setting Blocks of Exhibit Numbers*, Case No. ER-2010-0355, page 2 (issued January 12, 2011).
[5] *Highfill v. Brown*, 320 S.W.2d 493 (Mo. 1959).
[6] *Clapper v. Lakin*, 123 S.W.2d 27 (Mo. 1938).

As such, the burden of proof means that the proponent of higher rates in a Commission proceeding has the "obligation to establish the truth" of its need for the higher rates. In this regard, customers are given the benefit of the doubt that the utility only needs the lower rate and that the utility must "prove" that the higher rate is necessary. Therefore, if there is any question regarding the legitimacy of a cost or expense; if the Commission does not adequately understand an issue; or if the Company fails to adequately explain its need for the higher rate, then the utility has failed to meet its burden of proof.

Finally, the Supreme Court has provided insight as to the implications to a party that fails to meet its burden of proof: "the failure of the plaintiff to sustain such burden ***is fatal*** to his or her relief or recovery."[7]

[7] *Id.*

IV. RETURN ON EQUITY

A. INTRODUCTION AND OVERVIEW

It is well established that public utility commissions have several basic objectives. Foremost among these objectives is to ensure adequate earnings for the utility while preventing excessive (monopoly) profits.[8] Absent regulatory controls, the utility will inevitably seek to extract monopoly profits from the many (the ratepayers of Missouri) for the benefit of the few (the shareholders scattered across the nation).

The attempt to extract monopoly profits in this case is best seen in the Company's request for an inflated return on equity. Rather than seeking that level of return that is "sufficient to ensure confidence in the financial soundness of the utility,"[9] KCPL / GMO seek to bolster their corporate profits. The Supreme Court has pointed out, however, that the utility has no "right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."[10]

In this case, KCPL / GMO request a profit (the return on equity) of 10.75%.[11] In support of this request, KCPL / GMO present the testimony of Dr. Hadaway. As this brief demonstrates, Dr. Hadaway's analysis is fundamentally flawed and has been routinely rejected by other state utility commissions. Ultimately, the same flaws referenced by those state utility commissions are contained in Dr. Hadaway's analysis presented in this case.

In contrast, the Industrial Intervenors present the testimony of Michael Gorman. In its recent decision in the recent AmerenUE rate case, the Commission expressly relied

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[8] Phillips, Charles F. Jr., *The Economics of Regulation*, Rev. ed. (1969) at page 124.
[9] *Bluefield Water Works and Improvement Co. v. Public Service Comm'n*, 262 U.S. 679, 692-693 (1923).
[10] *Id.*
[11] Ex. 28, Hadaway Rebuttal, page 23.

upon the recommendations and conclusions espoused by Mr. Gorman. Consistent with his analysis in that case, Mr. Gorman has prepared a return on equity analysis in this case which ensures sufficient and comparable earnings while avoiding concerns of monopoly profits. Specifically, Mr. Gorman has utilized: (1) a discounted cash flow; (2) a risk premium; and (3) a capital asset pricing model analysis in his determination of a just and reasonable return on equity. The ultimate result of each of these models leads to a recommended range of 9.40% - 9.90% with a recommended midpoint return on equity of 9.65%.[12]

MODEL	RESULT
DCF	9.88% (Ex. 1203, page 27)
Risk Premium	9.68% (Ex. 1203, page 32)
CAPM	9.40% (Ex. 1203, page 37)
Average	9.65% (Ex. 1203, page 37)

In an effort to show the reasonableness of his methodology, Mr. Gorman also replicated Dr. Hadaway's DCF analyses after accounting for and correcting the obvious flaws in Hadaway's methodology. The results of Hadaway's corrected analysis (9.75%) buttress the reasonableness of Gorman's return on equity recommendation (9.65%).[13]

MODEL	HADAWAY UPDATED RESULT	ADJUSTED HADAWAY RESULT
CONSTANT GROWTH DCF (Analysts' Growth Rates)	10.2 – 10.4%	10.2 – 10.4%
CONSTANT GROWTH DCF (Long-Term GDP Growth Rate)	10.7 – 10.8%	9.5 – 9.6%
TWO-STAGE GROWTH DCF	10.5%	9.4%
AVERAGE	10.5%	9.75%

[12] Ex. 1203, Gorman Direct, page 37.
[13] Ex. 1204, Gorman Surrebuttal, pages 11-12.

As can be seen, when based upon more reliable assumptions (i.e., consensus economist projections), Dr. Hadaway's analysis provides results that are virtually identical to Mr. Gorman's recommendation.

B. GORMAN CREDIBILITY AND OBJECTIVE ANALYSIS

In May of 2010, the Commission issued its decision in the last AmerenUE rate proceeding. In that case, the Commission was confronted with the conflicting testimony of several return on equity witnesses. In its decision, the Commission expressly relied upon Mr. Gorman's conclusions and recommendations in reaching its conclusion that AmerenUE's return on equity recommendation was faulty.

For instance, in its analysis, AmerenUE relied solely upon a constant growth DCF methodology that resulted in a return on equity of 11.2%. Based upon Mr. Gorman's conclusions, the Commission held that the AmerenUE DCF result is "overstated because it is based on a unsustainably high dividend yield and median growth rate."[14] As the Commission recognized, Gorman took these "deficiencies into account and based [his] recommendation on additional sustainable growth DCF and multi-stage DCF models."[15]

The Commission then noted that, while Ameren failed to perform these other DCF analyses, Gorman "reworked [Ameren's] constant growth DCF analysis as a multi-stage growth analysis."[16] Relying upon this "reworked" analysis prepared by Gorman, the Commission found that "it is reasonable to believe that if [Ameren] had performed a multi-stage DCF analysis, as [it] should have, [its] recommendation might be in the low 10 percent area along with Gorman and Lawton."[17] Clearly, then, the recommendations

[14] *Report and Order*, Case No. ER-2010-0036, issued May 28, 2010 ("AmerenUE") at page 21.
[15] *Id.* at page 22.
[16] *Id.*
[17] *Id.*

and conclusions provided by Mr. Gorman were critical to the decisions reached by the Commission in the Ameren case.

In this case, Mr. Gorman presents the same objective analysis relied upon by the Commission in its Ameren decision. Here, noticing the Commission's apparent interest in considering the results of multiple return on equity analyses,[18] Mr. Gorman provided five different analysis: (1) a constant growth DCF analysis using analysts' 3-5 year growth rates; (2) a sustainable growth DCF analysis which considers the comparable companies' retained earnings; (3) a multi-stage growth DCF analysis which relies on a long-term growth rate equal to the consensus analysts' projection of gross domestic product; (4) a risk premium analysis; and (5) a Capital Asset Pricing Model analysis. The average of all of these analyses result in a recommendation of 9.65%.[19]

Unique to his analysis, and consistent with the directives of the *Hope* and *Bluefield* decisions, Mr. Gorman then checks to ensure that his recommended return on equity will support an investment grade credit rating. Specifically, Mr. Gorman undertook certain financial analyses for KCPL / GMO based upon his recommended return on equity.[20] Mr. Gorman then compared the financial results to the benchmarks for the three critical S&P financial ratios: (1) debt to EBITDA (Earnings Before Income Taxes, Depreciation and Amortizations); (2) funds from operations to total debt; and (3)

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[18] Tr. 2874-2876.

[19] Demonstrating his objectivity, Mr. Gorman always considered the most recent information no matter the impact on his recommendation. Specifically, Mr. Gorman updated his analysis twice during the processing of this case. While Mr. Gorman initially recommended a return on equity of 9.65% in his KCPL testimony, the passage of time before the filing of the GMO testimony caused a reduction in Mr. Gorman's recommendation to 9.50%. As Mr. Gorman noted, "My return on equity recommendation for KCPL-GMO reflects updated information. The updated information reflects a continued decline in capital market costs. . . Specifically, DCF return estimates have declined, and projected Treasury bond yields are about 20 basis points lower." (Ex. 1403, Gorman Direct, page 3). By the time the evidentiary hearing took place, Mr. Gorman again modified his analysis to account for changing market conditions. (Tr. 2852-2853). Therefore, Mr. Gorman now recommends a return of 9.65% for both KCPL and GMO. (Tr. 2853).

[20] Ex. 1203, Gorman Direct, at pages 38-42 and Schedule MPG-17.

total debt to total capital.[21] These were the same financial metrics utilized in the context of the KCPL Regulatory Plan.[22] As Mr. Gorman's analysis reveals, his recommended return on equity will allow both KCPL and GMO to meet the investment grade credit metrics for each of these financial ratios. As Mr. Gorman concludes, therefore, "an authorized return on equity of 9.65% will support internal cash flows that will be adequate to maintain KCPL's current investment grade bond rating."[23]

C. HADAWAY ANALYSIS

In contrast to Mr. Gorman's objective analysis, KCPL / GMO rely upon a return on equity analysis that is most notable for the widespread rejection it has received from other public utility commissions. That analysis has not only seen negative response from these other state commissions, it also runs contrary to recent expectations established by this Commission in its AmerenUE rate decision.

Specifically, KCPL / GMO present that testimony of Samuel Hadaway. Based solely on his DCF analyses, Dr. Hadaway claims that a reasonable return on equity for KCPL / GMO is in the range of 10.2 to 10.8%.[24] Relying upon its own perception of customer satisfaction and reliability, KCPL / GMO request that the Commission grant a return on equity at the top of Hadaway's recommended range.[25] As such, KCPL / GMO request a return on equity of 10.75%. This brief will not only show that Dr. Hadaway's analysis is flawed and has been universally criticized by state utility commissions, it will also show (in the following section) that KCPL / GMO's perception of their customer satisfaction and reliability is misstated.

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[21] *Id.* page 39.
[22] *Id.* page 40.
[23] *Id.* at page 42.
[24] Ex. 28, Hadaway Rebuttal, page 22.
[25] *Id.* at page 24; Ex. 7, Blanc Direct, page 10.

Since leaving his role at the Texas Public Utility Commission, Dr. Hadaway has appeared hundreds of times in state ratemaking proceedings. Interestingly, in the past 25 years, Hadaway has always appeared on behalf of the utility.[26] While the expectations may not be expressly stated, it is clear that, so long as he wants to keep receiving utilities' business, Dr. Hadaway must be able to justify high returns for his clients.

In this case, Hadaway justifies his high return recommendation in part by subjectively excluding or discounting various methodologies. For instance, in his Direct Testimony, Hadaway conducted a risk premium analysis which resulted in a return on equity of 10.61% - 10.82%.[27] Realizing that his analysis was dated, Hadaway then updated his analysis in his rebuttal testimony. Faced with the sudden realization that his risk premium analysis now only justified a return on equity of 10.05% - 10.24%,[28] Hadaway simply insisted that such results should be "discounted."[29] Similarly, while Gorman and Staff Witness Murray provided results from the CAPM analysis,[30] Hadaway found that the CAPM "understates the cost of equity capital."[31] As such, Hadaway refused to undertake such an analysis.[32] Therefore, unlike Gorman's testimony which included the results of all three of the widely accepted return on equity methodologies, Hadaway's analysis is based **solely** upon his various DCF analyses. As will be seen, the results of each of Hadaway's DCF analyses are, nevertheless, fraught with problems and have been widely criticized and rejected by state utility commissions.

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[26] Ex. 27, Appendix A, pages 2-6.
[27] Ex. 27, Hadaway Direct, page 44.
[28] Ex. 28, Hadaway Rebuttal, page 23.
[29] *Id.*
[30] Ex. 1203, Gorman Direct, pages 32-37; Ex. 210, Staff Cost of Service Report, pages 34-36.
[31] Ex. 28, Hadaway Rebuttal, page 23.
[32] *Id.*

First, Hadaway undertakes a constant growth DCF analysis which relies on analyst growth rates. It is well established that constant growth DCF analyses have a tendency to be overstated in the current economy. While the constant growth DCF analyses is intended to be perpetual in nature, the underlying analyst growth estimates are usually only focused on the short-term (the next 3-5 years).[33] Ultimately, because of their short-term focus, these analysts' growth projections are not sustainable.[34] Therefore, as the Commission has recently held, the constant growth DCF will collapse under the weight of these unsustainable growth projections.

> [T]he constant growth DCF result is overstated because it is based on a unsustainably high dividend yield and median growth rate. Morin's constant growth DCF suffers from the same deficiencies as Gorman described for his own constant growth analysis. . . . Gorman and Lawton took those deficiencies into account and based their recommendations on additional sustainable growth DCF and multi-stage DCF models. . . . In contrast, despite his belief that it is important to "use a whole bunch of techniques", Morin relied on his constant growth DCF analysis and did not analyze any other form of DCF. . . . It is reasonable to believe that if Dr. Morin had performed a multi-stage DCF analysis, as he should have, his recommendation might be in the low 10 percent area along with Gorman and Lawton.[35]

The same problems previously noted by the Commission in the constant growth DCF model are found within Hadaway's analysis.[36] Despite the clarity of the Commission's recent decision, Hadaway continues to give inappropriate weight to his constant growth DCF analysis. Interestingly, Hadaway appears to recognize the obvious

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[33] Ex. 1203, Gorman Direct, page 19 ("Analyst growth rate projections are intended to represent a period of three to five years. These growth rates reflect the analysts' assessments of the growth outlooks for these companies during this time period. This is significant, because the constant growth DCF model requires a growth rate that can be sustained over a long-term indefinite period.").

[34] Current growth rates are based upon the expectation of increased earnings resulting from the large construction cycle currently seen in the electric industry. Such growth rates are not reflective of more normalized levels of constructions and are therefore not sustainable. *Id.* at page 22.

[35] *Report and Order*, Case No. ER-2010-0036, pages 21-22.

[36] Ex. 1204, Gorman Rebuttal, page 7 ("These growth rates are <u>not</u> sustainable in the long run.").

faults in his analysis.[37] Nonetheless, likely as a result of the high return produced by this flawed analysis, he included those results in his recommendation.

Second, Hadaway undertakes a constant growth (GDP) DCF analysis that is not dependent on analyst growth estimates. In light of the obvious shortcomings of his initial constant growth analysis, Hadaway attempts to provide a long-term growth rate that is consistent with the perpetual nature of the constant growth DCF analysis. While Hadaway replaces the analysts' growth rate with a gross domestic product ("GDP") surrogate, he rejects all recognized measures of GDP growth and, instead, provides his own "estimate" of GDP growth.[38] In this regard, Hadaway's "estimate" of GDP growth is based entirely on historical measures and ignores all forward-looking estimates of GDP growth. Hadaway's analysis has been widely criticized by state utility commissions. The following excerpt from a Washington Utilities and Transportation Commission decision is reflective of this widespread criticism.

> The principal disagreement between the Company and its expert critics centers on Dr. Hadaway's use of nominal historical GDP growth rates in the DCF formula. We do not take issue with Dr. Hadaway's opinion that the DCF formula requires a long-term growth rate or that growth in GDP may serve as a better measure of long-term growth than analysts' forecasts in the short-term. ***However, in this case, we find persuasive Mr. Gorman's argument, that if growth in GDP is used for this critical input to the DCF formula, it should be a forward-looking, not an historical average.***[39]

[37] Hadaway Direct, Ex. 27, page 39 ("While I continue to endorse a longer-term growth estimation approach . . . I show the traditional DCF results because this is the approach that has traditionally been used by most regulators).

[38] Ex. 27, Hadaway Direct, page 41.

[39] *Washington Utilities and Transportation Commission v. Pacificorp*, 2006 Wash. UTC Lexis 156, 170 (Washington Utilities and Transportation Commission, April 17, 2006) (emphasis added). See also, *In re: Centerpoint Energy*, 245 P.U.R.4th 384 (Arkansas Public Service Commission, September 19, 2005); *In re: Commonwealth Edison Company*, 250 P.U.R.4th 161 (Illinois Commerce Commission, July 26, 2006); *In re: Fitchburg Gas and Electric Light Company*, 2008 Mass.P.U.C. Lexis 13 (Massachusetts Department of Telecommunications and Energy, February 29, 2008; and *In re: Public Service Company of New Mexico*, 2008 New Mexico P.U.C. Lexis 14 (New Mexico Public Regulatory Commission, April 24, 2008)

Thus, Dr. Hadaway's reliance on a historical quantification of GDP growth, to the exclusion of forward-looking estimations has been commonly rejected in the ratemaking community.

Moreover, Dr. Hadaway's reliance on his own <u>subjective</u> estimation of the GDP growth rate is also problematic. In its decision in the recent AmerenUE case, this Commission expressly stated a preference for the use of publicly available assumptions. The Commission rationale's being that only such publicly available assumptions could be actually relied upon by the investment community in making its market decisions.

> Murray's reliance on analyst reports to support his recommendation is misplaced. <u>***Most investors do not have access to the specific analyst reports that Murray examined and thus they cannot rely on them in deciding where to invest their money.***</u>[40]

As Dr. Hadaway readily acknowledges, his estimation of the GDP growth rate is only published in his testimony.[41] As such, "most investors do not have access" to this specific estimate. Furthermore, these investors "cannot rely on [Hadaway's estimate] in deciding where to invest their money."

The practical effect of Hadaway's subjective, historically-derived GDP growth estimate is not surprising – it significantly increases his recommended return on equity. As Mr. Gorman points out, Dr. Hadaway's estimation of GDP growth rate is 6.0%.[42] In contrast, the "consensus economists' projections" of GDP growth is 4.75%.[43] When Dr. Hadaway's estimation of GDP growth is replaced with a more reliable measure, the

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[40] *AmerenUE* at page 20, paragraph 18 (emphasis added).
[41] Tr. 2479-2480.
[42] Ex. 1205, Gorman Surrebuttal, page 12.
[43] *Id.* at page 9-10.

results of his constant growth (GDP) DCF analysis drop from approximately 10.7% to 9.6%.[44]

Finally, it should be noted that the use of any measure of GDP growth as an input to the constant growth DCF model is of questionable applicability to the electric industry. Specifically, the GDP growth reflects the overall growth in the U.S. economy and includes both high growth industries (biotech, healthcare, etc.) and industries expected to experience lower growth. Typically, given the maturity of the electric industry, it is not expected that the electric industry will actually experience the same level of growth experienced in the economy as a whole. As such, the use of any GDP growth rate estimate will likely result in an overstated return on equity. As the Arkansas Commission has pointed out:

> With regard to Mr. Hadaway's use of the Gross Domestic Product (GDP) growth rate, he is correct that investor-expected dividend growth rates overall are likely correlated with GDP growth rate. However, he has failed to demonstrate that industry-specific DCF investor-expected growth rates are also equal to the nominal GDP growth rate. This is a crucial distinction. For example, a mature industry may have a rich dividend yield and a small expected growth rate, while a young industry may, conversely, have a small dividend yield and a large expected growth rate. It would be reasonable to expect the mature industry's expected dividend growth rate to be less than nominal GDP growth, while the young industry's expected growth is greater than GDP growth.[45]

<u>Third</u>, Hadaway combines his two previous DCF analyses and undertakes a multi-stage DCF analysis which relies upon the problematic analyst growth rates for the first stage and his overstated historical estimation of GDP growth for the final stage. As demonstrated previously, and as the Commission has recently acknowledged, "the constant growth DCF result is overstated because it is based on an unsustainably high

[44] *Id.* at page 10.

[45] *In the Matter of Centerpoint Energy Arkla*, 245 P.U.R. 4th 384 (Arkansas Public Service Commission, September 19, 2005).

dividend yield and median growth rate." Furthermore, as demonstrated previously, Hadaway's historical estimation of GDP growth rate is significantly overstated when compared against consensus economists' projections of GDP growth rate. Therefore, it is not surprising that, when he combines these two overstated assumptions into a multi-stage analysis; Hadaway's results are grossly overstated. As Mr. Gorman demonstrates, by simply replacing the GDP estimate, Hadaway's multi-stage DCF analysis would decrease from 10.5% to 9.4%.[46]

Ultimately, when consensus analysts' projections are used as assumptions in his models, Hadaway's analysis is virtually identical to the 9.65% recommendation forwarded by Mr. Gorman.

MODEL	HADAWAY UPDATED RESULT	ADJUSTED HADAWAY RESULT
CONSTANT GROWTH DCF (Analysts' Growth Rates)	10.2 – 10.4%	10.2 – 10.4%
CONSTANT GROWTH DCF (Long-Term GDP Growth Rate)	10.7 – 10.8%	9.5 – 9.6%
TWO-STAGE GROWTH DCF	10.5%	9.4%
AVERAGE	10.5%	9.75%

Source: Ex. 1205, Gorman Surrebuttal, page 12.

D. KCPL REQUEST FOR HIGH END RETURN ON EQUITY

While Dr. Hadaway recommends a return on equity range of 10.2 to 10.8%,[47] KCPL / GMO contend that the Commission should grant a return on equity at the high end of this range (10.75%) based upon their alleged "reliability and customer satisfaction achievements."[48] As this brief demonstrates, much like Hadaway's assessment of return on equity, KCPL / GMO's assessment of their customer satisfaction performance is

46 Ex. 1205, Gorman Surrebuttal, page 12.
47 Ex. 28, Hadaway Rebuttal, page 22.
48 Ex. 7, Blanc Direct, page 10.

vastly overstated. The unrefuted evidence in this case conclusively demonstrates that KCPL / GMO customer satisfaction is the lowest of all electric utilities in Missouri. Furthermore, since 2006, when the Commission awarded KCPL the highest return on equity in the nation, KCPL has seen a rapid decline in its customer satisfaction. Therefore, not only should the Commission reject KCPL / GMO's request for a return at the high end of the recommended range, the Commission should acknowledge the unacceptable nature of KCPL / GMO's performance and consider a return on equity at the low end of Gorman's recommended range.

In support of its claim of "customer satisfaction achievements," KCPL directs the Commission's attention to the rankings of customer satisfaction provided by JD Power and Associates rankings.[49] Contrary to KCPL's hopes and assertions, however, those rankings cover up a larger problem. While KCPL asks the Commission to focus on its Number 2 ranking in residential satisfaction among Midwest large utilities, Staff's evidence indicates that KCPL's performance has been slipping dramatically. As Staff Witness Kremer pointed out, while KCPL's current rating is 655, this represents a dramatic decrease from the 697 score received in just 2007.[50] Therefore, since the time when the Commission authorized KCPL the highest return in the nation,[51] KCPL's performance has steadily, and dramatically, slipped. Certainly, this is not the performance that should have been expected of a utility that was awarded the highest return on equity in the nation for 2006.

Furthermore, while the data utilized by JD Power is of unknown accuracy and of questionable application to the immediate issue, Staff presented evidence which is

[49] *Id.*
[50] Tr. 2960-2961.
[51] *Report and Order*, Case No. ER-2006-0314, at page 30 (issued December 22, 2006) ("2006 Order").

directly relevant to the Commission and its duties. As Staff Witness Kremer indicated during cross-examination, KCPL's customer satisfaction, as measured by Commission complaints is the worst in the state.

> And KCPL from 2008, 2009, 2010, if I calculated this correctly, they are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase. ***<u>But KCPL dramatic increase in customer complaints</u>***.[52]

Certainly this unrefuted evidence is not reflective of a utility with high customer satisfaction. Given the "dramatic increase in customer complaints," KCPL has not justified its request for a return on equity at the high end of the recommended range. In fact, given the Commission's previous willingness to give KCPL a 25 basis point increase in return on equity,[53] the Commission should now consider whether it should acknowledge KCPL's poor performance and set its expectations by granting KCPL a return on equity at the lower end of Mr. Gorman's recommended range.

E. OTHER RECENT DECISIONS AND OTHER JURISDICTIONS

As the Commission has previously recognized, *Hope* and *Bluefield* require the Commission to consider the return earned by other businesses "which are attended by corresponding risks and uncertainties" in the "same general part of the country."[54] In general, the Commission fulfills this charge through the expert witness' reliance on comparable companies. Nevertheless, in previous decisions, the Commission has expressed interest in other state return on equity decisions.

[52] Tr. 2962.
[53] *2006 Order* at page 30.
[54] *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679, 692-693 (1923).

Inevitably, KCPL / GMO will direct the Commission's attention to national average return on equity decisions as reported by Regulatory Research Associates. Such comparisons are obviously misplaced. As the Arkansas Commission has noted:

> This Commission gives no weight to such data for three reasons. First, there is an element of circularity involved if this Commission, as well as other state Commissions, rely upon rate of return determinations in other states for determining the appropriate allowed return for utilities in their states. Second, neither this Commission nor the parties have had an opportunity to probe the factors that made up the allowed return determinations in the other states. This Commission must make determinations based upon the evidence presented in testimony and hearings before this Commission, pursuant to the laws of the State of Arkansas. Third, this sort of comparison is akin to piecemeal ratemaking and is unacceptable. For example, we do not know the other state commissions' policies regarding rate base, expenses, depreciation, etc. As noted by CEUG witness Staley: "Every natural gas utility has different needs, different risks, different load profiles, and different performance levels. Consequently, every natural gas utility should have a uniquely determined ROE."[55]

Given the logic of this argument, then, the only other state commission decisions which would hold any relevance would be: (1) other electric decisions in the State of Missouri – because they involve the same "state commission policies regarding rate base, expenses, depreciation, etc." and (2) other state commission decisions involving KCPL – because they involve the same utility with the same risks, load profiles and performance levels. Along this line, the Commission should be solely mindful of its recent decision in the AmerenUE rate case <u>and</u> the Kansas Corporation Commission's recent decision involving KCPL.

In May of 2011, the Commission issued its decision in the most recent AmerenUE rate increase. While decisions involving other companies must be approached with a fair amount of question, this case, since it is recent and involves the same state commission

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[55] *In the Matter of Centerpoint Energy Arkla*, 245 P.U.R. 4^{th} 384 (Arkansas Public Service Commission, September 19, 2005).

policies involving rate base, expenses, depreciation, etc., is of certain value to the Commission's immediate inquiry. In that case, the Commission authorized AmerenUE an increase of 10.1%. It is important to recognize, however, that the capital markets have changed in the intervening time period. Specifically, bond yields in the intervening months declined significantly, hit a trough, and then experienced a slight rebound.[56] What is important to realize, however, is that bond yields are still lower than at the time the Commission issued the Ameren decision. As Mr. Gorman explains, "capital market costs have decreased in the range of 20 to 30 basis points since that time."[57] Thus, all else being equal, a 10.1% return on equity in May should equate to a 9.8 to 9.9% return on equity today. Such a result would be safely within Mr. Gorman's recommended return on equity of 9.4 to 9.9%.[58] Of course, KCPL's recent poor customer satisfaction performance, see *supra*, could dictate a return lower in Mr. Gorman's range.

Additionally, the Kansas Corporation Commission recently issued its decision regarding KCPL's request to increase its rates in Kansas. In that decision, issued November 22, 2010, the KCC authorized KCPL a return on equity of 10.0%. Much of the analysis in that decision addressed the Commission's criticism of Dr. Hadaway for deciding to forego any consideration of the CAPM analysis. Ultimately, the Commission ruled that consideration of the CAPM was necessary.

> Using both CAPM and DCF generates an analysis that encompasses the current economic climate. While that blended approach generates lower ROE's than what has been reported in recent years, and below the average 10.48% authorized by state utility commissions in the first and second quarters of 2010, the Commission cannot ignore the downward trend

[56] Ex. 100.
[57] Tr. 2853 and 2879.
[58] Ex. 1203, Gorman Direct, page 37.

> which was documented at hearing. . . . Recognizing that we must also set the ROE, we order it to be set at 10.0%[59]

Clearly, then, there are two types of decisions which would be relevant to the Commission's consideration of return on equity. First are those recent decisions involving the same "state commission policies regarding rate base, expenses, depreciation, etc." In this regard, the Commission's recent decision, in which it authorized AmerenUE a return on equity of 10.1% is enlightening. Second are those decisions of other state utility commissions which involve a utility with the same risks, load profiles and performance levels. Given that the recent Kansas decision involved KCPL and necessarily involves a utility with the same risk, load profile and performance, that Commission's decision to authorize a 10.0% return on equity is also especially relevant. Of course, in order to properly reflect the different market conditions currently being experienced, the Commission should also attempt to recognize the recent drop in bond yields since the time of those decisions.

F. CONCLUSION

The Industrial Intervenors ask that the Commission set a return on equity for KCPL at 9.65%. This return on equity is justified for several reasons:

1. A 9.65% return on equity is supported by the objective analysis provided by Mr. Gorman. Mr. Gorman's analysis relies upon DCF, risk premium and CAPM analyses. In its recent AmerenUE decision, the Commission expressly relied upon many of the conclusions and recommendations offered by Mr. Gorman.

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[59] *Order Addressing Prudence, Approving Application, in part, and Ruling on Pending Requests*, Docket No. 10-KCPE-415-RTS, 2010 Kan. PUC Lexis 1132 (Kansas Corporation Commission, issued November 22, 2010).

2. The analysis offered by Mr. Gorman avoids many of the shortcomings contained in KCPL's recommendation. First, Mr. Gorman performs and considers the results of the DCF, risk premium and CAPM analysis. In contrast, KCPL's analysis only relies upon its DCF analysis. Second, Mr. Gorman does not give undue weight to the constant growth DCF based upon analysts' growth estimates. As has been demonstrated, and the Commission has previously found, these short-term growth estimates are not sustainable in the long-term. Therefore, a constant growth DCF based upon these analysts' growth estimates is overstated. Third, Mr. Gorman relies upon consensus analysts' estimates for his use of the GDP growth rate in his multi-stage DCF analysis. This growth rate is published and likely is utilized by investors as the basis for actual investment decisions. In contrast, Dr. Hadaway relies upon his subjective estimation of GDP growth that is based entirely on historical figures and fails to consider any of the widely considered future estimates of GDP growth. Dr. Hadaway's estimation has been widely criticized among state utility commission.

3. Mr. Gorman's analysis shows that the cash flows generated from a 9.65% return on equity are sufficient to support KCPL / GMO's current investment grade credit rating. Through this fact, the Commission is assured that it is meeting the guidelines established by the *Hope* and *Bluefield* opinions.

4. Mr. Gorman's 9.65% recommendation is consistent with both this Commission recent decision granting a 10.1% return on equity to AmerenUE, a utility subjected to the same state policies concerning rate base, expenses, and depreciation, and the Kansas Corporation Commission decision granting a 10.0% return on equity to KCPL. When the lower bond yields, that are now prevalent as compared to the time of

those decisions, are considered, a return on equity lower than either of those decisions is appropriate.

For all these reasons, the Commission should grant KCPL a return on equity of 9.65%.

V. OFF-SYSTEM SALES MARGINS

A. INTRODUCTION AND OVERVIEW

This issue concerns the appropriate level of off-system sales margins to be included in retail rates. While KCPL's generating stations are devoted primarily to the service of its native load customers, KCPL is also able to sell any excess energy from these units in the wholesale market. These profits made in the wholesale market are referred to as off-system sales margins.

This brief will demonstrate that, in recent years, KCPL's performance in the wholesale market has slipped dramatically. While KCPL will inevitably claim that its decreasing wholesale performance is a result of declining energy prices, the evidence shows that KCPL's performance has also coincided with its short-sighted recommendation to implement the unused energy allocator in Kansas. As a result of the differing allocation methodologies in Missouri and Kansas, KCPL is now required to return $1.05 for every $1.00 that it makes in off-system sales margins. The practical effect, as KCPL has admitted, is that it has a disincentive to participate in the wholesale market. For customers, on the other hand, the practical effect is that retail rates have been skyrocketing while KCPL's performance in the wholesale market has slipped.

Recognizing that the Commission cannot fix the allocation difference which exists between the two states, MEUA asks that the Commission instead increase its expectations of KCPL to participate in the wholesale market. In both KCPL's 2006 and 2007 cases, the Commission set low expectations by setting rates at the 25th percentile. The reasons, however, for setting rates at the 25th percentile are no longer in existence. As such, the Commission is free to set higher expectations.

The evidence also shows that when higher expectations are set for KCPL, it is able to achieve these expectations. For instance, as part of a Stipulation in the last case, KCPL agreed to set off-system sales margins at the 44.5 percentile. In the year following that Agreement, KCPL was able to reach these expectations. As such, MEUA suggests that KCPL's request to again set rates at the 25th percentile would represent a significant step backwards for ratepayers. Instead, MEUA asks that the Commission set rates using the 40th percentile. Such a level of off-system sales margins is consistent with that set in the last case, is conservative, and should be easily achievable.

In considering this issue it is important for the Commission to realize that it is **not** making a disallowance for KCPL. Specifically, KCPL has not incurred an expense for which it is now seeking recovery in rates. Rather, with this issue, the Commission is merely setting an expectation for KCPL to participate in the wholesale market. KCPL will only incur a loss to the extent that it continues to refuse to continue to participate in the wholesale market and fails to reach the Commission's expected level of off-system sales.

B. THE RAPID INCREASE IN KCPL RATES HAS COINCIDED WITH KCPL'S DECREASED PERFORMANCE IN WHOLESALE MARKET

In at the beginning of this brief, the Industrial Intervenors pointed out that KCPL's retail rates have increased dramatically over the past five years. KCPL would undoubtedly claim that the increase in rates has been a result of the construction projects built under the Regulatory Plan. The evidence in this case shows, however, that this rapid increase in rates also coincides with KCPL's failure to fully participate in the wholesale market.

It is undisputed that the margins associated with off-system sales should inure to the benefit of the ratepayers. Recognizing that ratepayers compensate the utility for all costs associated with participating in the wholesale market, any margins realized as a result of those off-system sales should naturally go towards reducing retail rates. For example, retail rates provide the utility a return on their investment in the power plants used to generate off-system energy and the transmission lines used to transmit that energy.[60] Rates also include the depreciation on those generation and transmission investments;[61] the fuel used to generate the off-system energy;[62] the salaries of the dispatchers who make the off-system sales;[63] as well as the computers and telephones used by those dispatchers.[64] In fact, given that ratepayers compensate KCPL for <u>all</u> of the costs underlying the wholesale transactions, KCPL has expressly agreed that it would return all off-system sales margins to the ratepayers.

> KCPL agrees that off-system energy and capacity sales revenues and related costs will continue to be treated above the line for ratemaking purposes. ***<u>KCPL specifically agrees not to propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case</u>***. And KCPL agrees that it will not argue that these revenues and associated expenses should be excluded from the ratemaking process.[65]

Recognizing that these off-system sales margins are a critical offset to retail rates, it is interesting to realize that the sudden increase in retail rates not only coincided with the construction projects in the Regulatory Plan, but also with KCPL's sudden poor performance in the wholesale market.

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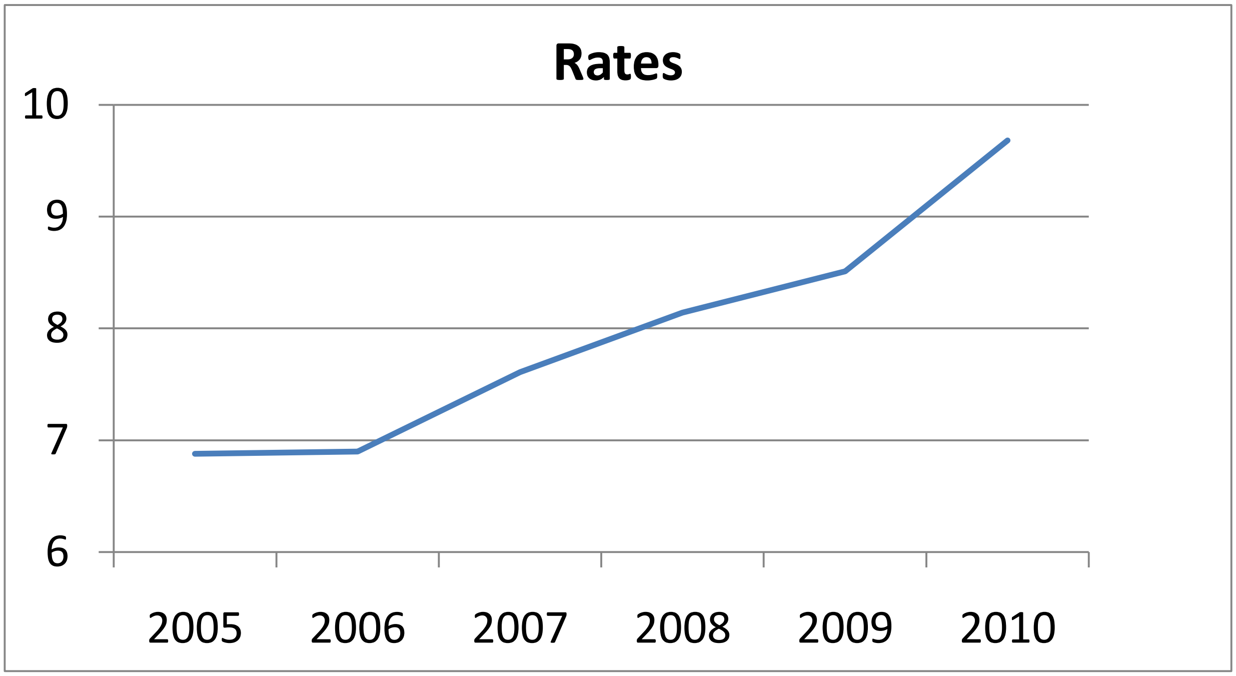
[60] Tr. 3373-3374.
[61] Tr. 3374.
[62] Tr. 3375.
[63] *Id.*
[64] *Id.*
[65] Tr. 3376 (emphasis added).

Since the commencement of the Regulatory Plan in 2005, KCPL rates have increased rapidly. In fact, with the rate increase sought in this case, KCPL rates will have increased by 41% in six years.



Source: Ex. 215, Featherstone Direct, page 46.

This rapid increase in KCPL's retail rates has coincided with the significant deterioration recently seen in KCPL's performance in the wholesale market.

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Source: Ex. 1210**

KCPL will likely blame its poor performance in the wholesale market on the decline in gas prices, and the attendant decrease in wholesale market rates, that occurred during this period. While these are certainly factors in KCPL's recent dismal performance, it is not coincidental that KCPL's performance also occurred when regulatory disincentives were created. As the following section indicates, KCPL's poor wholesale performance coincides with: (1) the establishment of the unused energy allocator in Kansas and (2) the low expectations set by Missouri in using the 25th percentile of off-system sales margins to set retail rates.

C. KCPL'S DECREASED WHOLESALE PERFORMANCE IS LARGELY A RESULT OF: (1) KCPL'S MISGUIDED DECISION TO IMPLEMENT THE UNUSED ENERGY ALLOCATOR IN KANSAS AND (2) MISSOURI SETTING LOW EXPECTATIONS AT THE 25TH PERCENTILE

1. KANSAS' USE OF THE UNUSED ENERGY ALLOCATOR

In 2006, KCPL filed its first rates cases in Missouri and Kansas under the newly approved Regulatory Plan. Realizing the critical function that off-system sales margins play in setting local rates, the issue of the allocation of these margins between Missouri and Kansas, and the appropriate level to include in rates, was hotly contested.

Until 2006, off-system sales were allocated between Missouri and Kansas using the energy allocator. By utilizing the same allocation methodology in both states, it was assured that each dollar of off-system margins was perfectly divided between the jurisdictions. In an effort that many believe was designed to equalize rates between the jurisdictions, KCPL suddenly proposed the use of the unused energy allocator in both jurisdictions.[66]

Realizing that this new method would allocate a greater share of off-system margins to its jurisdiction, the Kansas Commission quickly accepted KCPL's newly-created allocation methodology.[67] The Missouri Commission, however, called KCPL's proposal "novel," and rejected its implementation.[68]

> A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the unused energy allocator rewards the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that jurisdiction. Load Factor is average energy usage divided by peak demand. The higher the load factor, the closer the average load is to peak

[66] Tr. 3365.
[67] Tr. 3365.
[68] *2006 Order* at page 40.

> demand. The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales.[69]

Thus, where the allocation of off-system sales was once perfectly allocated between the jurisdictions, KCPL's decision to recommend the unused energy allocator now caused a disconnection in the way these dollars are allocated between Missouri and Kansas.

Interestingly, KCPL has since recognized the flawed nature of the unused energy allocator and has asked the Kansas Commission to reject its continued usage. In its recently completed Kansas case, the KCPL witness found that KCPL proposed the allocator "without sufficient study." As such, it is "not an appropriate method for allocating off-system sales margins."

> I believe that KCP&L proposed the unused energy allocator without sufficient study of its implications and reasonableness. Since the unused energy allocator allocates more off-system sales margins (and hence, lower overall costs) to the Kansas jurisdiction, the other parties may not have devoted the resources to study its reasonableness. Based on the analysis that I present here, I believe that the unused energy allocator is not an appropriate method for allocating off-system sales margins.[70]

While KCPL did ask the Kansas Commission to remedy this problem, the KCC nevertheless clings to the beneficial nature of this allocator[71] and rejected KCPL's request to eliminate the unused energy allocator.[72]

The practical effect of KCPL's development of an allocator "without sufficient study" is that Missouri and Kansas now allocate off-system sales margins in different

[69] *Id.* at pages 38-39. The Missouri Commission also found that the unused energy allocator creates a disincentive for demand side management programs which are "aimed at increasing load factor" and ignores the fact that fuel costs, the primary component of off-system sales, are allocated via the energy allocator. (*Id.*).
[70] Tr. 3367-3368.
[71] Elimination of the unused energy allocator would reduce the allocation of off-system sales margins from 47.70% to 45.64%. *Order: 1) Addressing Prudence; 2) Approving Application, In Part; and 3) Ruling on Pending Requests*, Case No. 10-KCPL-415-RTS, page 126 (Kansas Corporation Commission, issued November 22, 2010).
[72] *Id.* at page 127.

manners. This is not an insignificant problem. As KCPL witnesses testified, this difference, caused by KCPL undertaking actions "without sufficient study," has now created a disincentive for KCPL to engage in off-system sales.

> By that, I mean that for every dollar of off-system sales margin that the Company makes from selling off-system sales, it costs the Company one dollar and five cents, or a loss of five cents on the dollar. This does not make any sense, and serves as an economic disincentive for the Company to pursue off-system sales.[73]

Therefore, as a result of proposing the unused-energy allocator in Kansas, and KCPL's inability to subsequently convince the KCC that its continued use is inappropriate, KCPL must now return $1.05 for every dollar that it makes in the wholesale market. This has created a disincentive to participate in the wholesale market. Not surprisingly, as a result of this disincentive, KCPL's performance in the wholesale market has slipped dramatically in the last five years.

Furthermore, it is important to realize that nothing this Commission does in this case can remedy KCPL's misguided actions in Kansas. As indicated, the Kansas Commission has recently adopted the unused energy allocator again. Recognizing the flawed nature of that allocator, KCPL has agreed to the continued use of the energy allocator in Missouri.[74] Therefore, for the indefinite future, there will continue to exist a difference in allocation methodologies between Missouri and Kansas. Given the disincentive caused by KCPL's own misguided actions in Kansas, the Missouri

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[73] Tr. 3367. See also, Exhibit 7, Blanc Rebuttal, page 46 ("Because Missouri and Kansas adopt different allocation methodologies to derive what portion of the margins KCP&L's Kansas and Missouri customers should receive, KCP&L presently gives to its customers about 105% of its off-system sales margins. That is punitive and should stop, but requires this Commission and the KCC to adopt the same allocation methodology, which to date they have chosen not to do.").

[74] See, *Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues*, filed February 3, 2011, at page 5 ("Staffs energy allocator of 56.94% shall be used for allocating off-system sales margins to the Missouri jurisdiction.").

Commission will have to find an alternative method to force KCPL to participate in the wholesale market.

2. MISSOURI SETTING LOW EXPECTATIONS AT 25TH PERCENTILE

In the same case in which it rejected KCPL's request to use the unused energy allocator, the Missouri Commission adopted its own novel method for establishing the appropriate level of off-system sales margins to include in retail rates. It is well established that normal ratemaking dictates that a normalized level of expenses and revenues be included in rates. As such, using KCPL's method for forecasting off-system sales margins, the Commission should have included the 50th percentile of off-system margins for inclusion in rates.[75] Instead, in recognition of KCPL's Regulatory Plan, the Commission deviated radically from traditional ratemaking and only set rates using the 25th percentile.

> The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case.[76]

Ultimately, the Commission's use of the 25th percentile signaled to KCPL that the Commission did not expect KCPL to perform in the wholesale market at levels consistent with history.

The Commission mistakenly believed that the use of the 25th percentile would result in "a fairly substantial chance that KCPL will meet or exceed that 25th percentile."[77] The Commission, however, failed to account for the disincentives caused

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[75] Tr. 3428.
[76] *2006 Order* at page 33, as modified by *Order Regarding Motions for Rehearing*, issued January 18, 2007, at pages 2-3.
[77] *Id.* at page 34.

by KCPL proposing the unused energy allocator in Kansas "without sufficient study." Thus, while KCPL would ordinarily be expected to exceed the 25th percentile 3 out of every 4 years, and exceed the 50th percentile every other year, the following section indicates that KCPL has not acted consistent with the "fairly substantial chance" relied upon by the Commission. Instead, KCPL has only been achieving the low levels (25th percentile) actually used by the Commission for ratemaking.

D. AS A RESULT OF DISINCENTIVES, KCPL ONLY ACHIEVES THE LEVEL OF OFF-SYSTEM SALES THAT IS REQUIRED. BUT, WHEN EXPECTATIONS ARE INCREASED, KCPL HAS DEMONSTRATED THAT IT CAN STILL MEET THESE EXPECTATIONS

Given the disincentives caused by the differing methods for allocating off-system sales between Missouri and Kansas, KCPL is faced with a situation in which it is required to return $1.05 for every $1.00 that it makes in the wholesale market. Rather than suffer this loss, KCPL instead seeks to limit the amount that the Missouri Commission expects it to participate in the off-system sales market. For this reason, KCPL continues to seek implementation of the 25th percentile.

Not surprisingly, given its financial disincentive and the low expectations set by the Missouri Commission, KCPL has only participated in the wholesale market to the minimal levels expected by this Commission. For instance, in the 2006 case, the Missouri Commission first set rates at the 25th percentile. This equated to expected off-system sales margins of **___________**. Given the probabilities of the Schnitzer model, KCPL would have a 3:1 chance of exceeding the 25th percentile and should have a 50/50 chance of exceeding the 50th percentile level of **___________**.[78] Recognizing that it would have to return $1.05 for every dollar by which it exceeded the 25th

[78] Ex. 7, Blanc Direct, page 12 (lines 10-12).

percentile, KCPL never approached the median level expected by the Schnitzer model and instead barely achieved the 25th percentile actually expected by the Commission. Ultimately, KCPL earned off-system sales margins in 2007 of **__________**.[79]

In 2007, the Commission was asked again to establish an appropriate level of off-system sales margins for inclusion in rates. Once again, despite the fact that it had a 50/50 chance of achieving **__________**, KCPL asked the Commission to set off-system sales margins at the 25th percentile.[80] Again, the Commission agreed and set its expectations at only **___________**.[81] Not surprisingly, given the continuing financial disincentive, KCPL only achieved off-system sales margins in 2008 of **___________**.[82]

In 2009, KCPL again filed its case asking the Commission to utilize the 25th percentile. As KCPL acknowledges, this 25th percentile would equate to a level of off-system sales margins of **__________**.[83] As a result of a Stipulation and Agreement in that case, however, KCPL agreed to include a level of off-system sales of **___________**. In 2010, KCPL achieved off-system sales margins of **__________**.[84]

As can be seen then, KCPL's performance in the wholesale market has been influenced greatly by the financial disincentive caused by the different allocation methodologies utilized by Missouri and Kansas. While the Commission recognized a "fairly substantial chance" that KCPL would outperform the 25th percentile, KCPL only achieved that level of off-system sales included in rates by the Commission. Sadly,

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[79] *Id.* at page 12 (line 12).
[80] *Id.* at page 12 (line 21).
[81] *Id.* at page 12 (line 20).
[82] *Id.* at page 12 (line 22).
[83] *Id.* at page 13 (line 7).
[84] Ex. 1209.

KCPL never reached the levels of wholesale profits that it had realized prior to the newly created financial disincentive.

KCPL'S RECENT OFF-SYSTEM SALES PERFORMANCE	
Case No. ER-2006-0314	Set at 25th percentile: **__________**
	Achieved: **__________**
Case No. ER-2007-0291	Set at 25th percentile: **__________**
	Achieved: **__________**
Case No. ER-2009-0089	Set by Stipulation at: **__________**
	Achieved: **__________**

Source: Ex. 7, Blanc Direct, pages 12-13 and Exhibit 1209.

While KCPL's performance in 2010 simply achieved the expectations set by the KCPL in the 2009 case, this achievement showed that KCPL was capable of much more than the 25th percentile. In that case, the Commission did not set the expected level of performance. Instead, the parties executed a Stipulation and Agreement that settled the entirety of the case. As provided in that Stipulation, the parties did not utilize the 25th percentile level of **___________**.[85] Instead, KCPL agreed to utilize off-system sales margins of **____________**,[86] or the level equivalent to the 44.5 percentile.[87] Interestingly, despite what it would probably now claim to be lofty expectations; KCPL was able to achieve this level. In fact, KCPL was ultimately able to slightly exceed this expectation and made **___________**.[88]

[85] Ex. 7, Blanc Direct, page 13.
[86] *Id.*
[87] Ex. 121, page 3.
[88] Ex. 1209.

Thus, KCPL's recent performance has proven two things. First, as a result of financial disincentives, KCPL will only achieve that level necessary to meet the Commission's expectations. Second, when the Commission sets higher expectations, even at the 44.5 percentile, KCPL is capable of meeting those expectations. Nevertheless, KCPL now asks the Commission to take a step backward. KCPL asks that the Commission ignore the fact that the initial basis for setting rates at the 25th percentile no longer exists. KCPL asks that the Commission ignore the fact that it is capable of achieving more in the wholesale market. KCPL asks that the Commission ignore the fact that retail rates are increasing rapidly. KCPL asks that the Commission continue to break with traditional ratemaking. Instead, KCPL asks that the Commission again lower its expectations and set rates using the 25th percentile.

As the following sections shows, however, the reasons for setting rates at the 25th percentile are no longer applicable. As such, MEUA suggests that the Commission must continue to push KCPL to overcome the financial disincentive it caused when it recommended the unused energy allocator in Kansas. MEUA will show that, while still conservative, rates should be set at the 40th percentile. This will finally give ratepayers some relief from the ever increasing KCPL retail rates.

E. THE REASONS FOR SETTING OFF-SYSTEM SALES MARGINS AT THE 25TH PERCENTILE ARE NO LONGER APPLICABLE

In its 2006 Report and Order, the Commission gave two reasons for initially setting rates using the 25th percentile. First, the Commission recognized that KCPL "derives almost 50% of its earnings from off-system sales, which are far riskier than regulated sales."[89] Second, the Commission noted that KCPL was commencing the

[89] *2006 Order* at page 31.

Regulatory Plan which called for large construction projects "budgeted at some $1.3 billion."[90] This large construction program made the implications of KCPL not achieving the 50th percentile level of off-system sales dictated by traditional ratemaking more risky. As the following analysis shows, however, neither of the reasons previously relied upon by the Commission is still applicable today. In fact, given the completion of the Regulatory Plan and the elimination of these reasons for setting lower expectations, the Commission is free to set the higher expectations necessary to force KCPL to act against the financial disincentives that KCPL created.

1. OFF-SYSTEM SALES ARE NO LONGER 50% OF KCPL'S EARNINGS

Prior to 2006, KCPL had gone approximately 20 years without a rate increase. Recognizing the beneficial nature of regulatory lag, KCPL shareholders were able to reap all the benefits from KCPL's efforts to decrease costs or increase revenues. Given this opportunity, KCPL achieved windfall profits. While rates were reduced a couple times during that period, KCPL continually sold its excess coal-fired generation in the wholesale market. As a result, in an effort to continually satisfy the shareholders demand for profits, these off-system sales margins became an increasingly large part of KCPL's earnings portfolio.

As the following chart indicates, in 2005, off-system sales margins represented over **____** of KCPL's earnings. Once KCPL entered the Regulatory Plan, however, it was subjected to annual rate cases. Realizing that it would no longer be permitted to keep any benefits realized from exceeding expectations in the wholesale market, and in light of the disincentives existing between the Missouri and Kansas allocation

[90] *Id.* at page 34.

methodologies, KCPL stopped relying on off-system sales margins. Today, off-system sales margins barely make up **____** of KCPL's earnings.

OFF-SYSTEM SALES AS A PERCENTAGE OF KCPL EARNINGS			
	Earnings	Off-System Sales Margins	Percentage
2005	$144 million	**____________**	60.31%
2006	$149 million	**____________**	52.55%
2007	$157 million	**____________**	47.75%
2008	$125 million	**____________**	44.84%
2009	$129 million	**____________**	25.14%
2010	$163 million	**____________**	20.41%

Source: Earnings: Ex. 1212 (years 2005-2009) and Ex. 1213 (year 2010)
Off-System Margins: Ex. 1210 (years 2005-2009) and Ex. 1209 (year 2010)

As can be seen, the Commission's previous concern that KCPL's reliance on off-system sales caused an increased risk is no longer applicable.

2. CAPITAL EXPENDITURES HAVE RETURNED TO NORMAL LEVELS

The second reason provided by the Commission for deviating from traditional ratemaking treatment for KCPL's off-system sales margins is that KCPL was embarking on a large construction project under the Regulatory Plan that made KCPL more risk adverse. As can be seen from the following chart, at various points during the Regulatory Plan, KCPL's five year capital expenditures were expected to more than double KCPL's existing plant in-service.

KCPL CAPITAL EXPENDITURES			
	Plant Balance	5 Year Capital Expenditures	Percentage
2005	$2.63 Billion	**__________**	82.55%
2006	$2.81 Billion	**__________**	95.02%
2007	$2.84 Billion	**__________**	129.71%
2008	$2.92 Billion	**__________**	117.90%
2009	$3.34 Billion	**__________**	71.12%

Source: Plant Balances: Exhibit 1215
Capital Expenditures: Exhibit 1211

As can be seen, capital expenditures going forward have returned to normal levels. With the completion of Iatan 2 and the other projects completed under the Regulatory Plan, KCPL is no longer exposed to the risks associated with a significant ongoing capital undertaking. As such, the reasons for setting rates at the 25th percentile are no longer applicable. Interestingly, however, KCPL never even considered these factors or the completion of the Regulatory Plan when it filed its case.[91] Instead, KCPL simply asked the Commission to continue to use the 25th percentile because that was "consistent with the Commission's orders in the KCP&L's last three cases."[92] As we have seen, however, the real reason for the use of the 25th percentile is that KCPL wants to minimize the Commission's expectations and the implications of its use of the unused energy allocator in Kansas.

[91] Tr. 3371.
[92] Ex. 7, Blanc Direct, page 10.

F. MEUA'S RECOMMENDATION ESTABLISHES THE NECESSARY EXPECTATIONS TO GET KCPL PAST THE DISINCENTIVES, BUT STILL SHOULD BE EASILY ACHIEVEABLE

As this brief has shown, the Commission's decision to set off-system sales at the 25th percentile has resulted in underachievement by KCPL. Recognizing that KCPL would have a 50/50 probability of meeting or exceeding the 50th percentile, the Commission rightfully believed that KCPL would have "a fairly substantial chance" of exceeding the 25th percentile. As such, the Commission implemented, at KCPL's request, a tracker to return all margins above the 25th percentile. The Commission, however, failed to account for the strong financial disincentive caused by KCPL's recommendation that the Kansas Commission implement the unused energy allocator. As such, the margins, over and above the 25th percentile that the Missouri Commission expected, never materialized. Instead, because KCPL was required to return $1.05 for every $1.00 it earned in the wholesale market, KCPL simply aimed for the 25th percentile and then stopped. The victim of this undertaking was not the Commission or KCPL. Rather, ratepayers have been victimized through skyrocketing retail rates by KCPL's refusal to participate in the wholesale market.

The Commission cannot fix the disincentives caused by the varying allocation methodology that exists between Missouri and Kansas. The Kansas Commission has again approved the continued use of the flawed unused energy allocator, and the parties to this case have agreed to the continued use of the energy allocator in Missouri. Therefore, the Commission must find another way to protect the ratepayers from KCPL's continued apathy and require KCPL to participate in the wholesale market. For this reason, MEUA recommends that the Commission set rates at the 40th percentile.

The evidence indicates that the 40th percentile recommendation: (1) will cause KCPL to participate more fully in the wholesale market and (2) is still conservative in that it is readily achievable. In fact, the evidence shows that the use of the 40th percentile is actually a slight step backwards from the expectations agreed to by KCPL in the Stipulation from the last case.

As previously indicated, in the Stipulation and Agreement in the last case, KCPL expressly agreed to setting rates based upon **___________** of off-system sales margins.[93] As Mr. Schnitzer has testified, this equated to the 44.5 percentile.[94] Ultimately, KCPL was able to meet these heightened expectations and earned **___________** in the wholesale market in 2010.[95] As such, KCPL has demonstrated that it is able to achieve more in the wholesale market when more is expected and required. It is important to recognize, therefore, that KCPL has already voluntarily agreed to the use of the 44.5 percentile in a previous case and was able to meet such expectations. While the use of the 40th percentile constitutes a small step backwards, it is nothing close to the massive retreat reflected in KCPL's request to the use the 25th percentile. For this reason, the 40th percentile is conservative and easily achievable.

The 40th percentile is also conservative and easily achievable in that it represents a point where KCPL has a better than equal probability of meeting or exceeding expectations. While the median point (50th percentile) provides an equal opportunity to exceed or fall short, the 40th percentile provides KCPL a 60% probability of exceeding.[96]

[93] Ex. 7, Blanc Direct, page 13.
[94] Ex. 121, page 3.
[95] Ex. 1209.
[96] Ex. 1216, Meyer True-Up Rebuttal, page 9.

Therefore, by pure statistics, MEUA's recommendation is conservative and easily achievable.

In addition, the 40th percentile is the appropriate amount of off-system sales margins to include in rates because it represents the single most likely outcome of the Schnitzer analysis. As shown in Schnitzer's testimony, the possible outcomes of his analysis form a bell curve.[97] In this case, the "single most likely outcome" is the result represented by the 40th percentile.[98]

Furthermore, the 40th percentile recommendation is conservative in that it only represents a small increase in the amount of off-system sales volumes expected from KCPL. As Mr. Meyer explained, with the addition of Iatan 2, more wind generation, increased capacity at Wolf Creek, and the expiration of the MJMEUC firm power contract, the 5.6% increase in MWh's reflected in the MEUA recommendation is "very conservative."[99]

Finally, it is important to note that, unlike in previous years, the Commission will not have an immediate opportunity to correct its low expectations. As a result of the Regulatory Plan, KCPL was scheduled to file annual rate cases.[100] Given this, the Commission was assured that it would have an opportunity within a year, to fix the level of off-system sales margins. With the completion of the Regulatory Plan, KCPL has stated that it has no definite plans for its next rate case.[101] As such, it is critical that the Commission use <u>this</u> opportunity to provide relief to the ratepayers that have been suffering from KCPL's apathy towards the wholesale market.

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[97] Ex. 58, Schnitzer Direct, Schedule MMS2010-3.
[98] Ex. 121, page 2.
[99] Ex. 1216, Meyer True-Up Rebuttal, page 9.
[100] Tr. 3372.
[101] Tr. 3373.

G. KCPL'S TRUE-UP ANALYSIS IS FLAWED

Likely as a result of the overwhelming evidence against its use of the 25^{th} percentile, KCPL took an alternative approach and unilaterally lowered its expectations from the wholesale market by filing a true-up recommendation that reflected lower off-system sales margins at the 25^{th} percentile. As the evidence shows, however, KCPL's true-up analysis is flawed. Specifically, MEUA has shown that the underlying KCPL assumptions related to Baseload Planned Outages and Firm Load Obligations are both significantly overstated. The effect of overstating these two assumptions is to lower the expected level of off-system sales. The evidence deduced at the true-up hearing shows conclusively that, while KCPL argues with a certain amount of the impacts quantified by MEUA associated with these two flawed assumptions, it still admits that there is some merit to MEUA's assertions.

First, in order to limit the expected amount of off-system sales margins from its model, KCPL assumed a higher than expected amount of planned outages. Effectively, by having the model assume that its baseload units are unavailable due to a planned outage, the model will be unable to model any off-system sales from that unit. In its true-up testimony, MEUA compared the level of planned outages in the KCPL model against KCPL's actual planned outage schedule.[102] By comparing to the actual KCPL planned outage schedule, it became apparent that KCPL had assumed an inflated level of planned outages and thus artificially reduced the expected level of off-system sales margins.

Second, KCPL also assumed an inflated level of Firm Load Obligations. In making this determination, MEUA compared KCPL's Firm Load Obligation in its off-system sales model against the actual firm load obligation contained in the KCPL fuel

[102] Ex. 1216, Meyer True-Up Rebuttal, Schedule GRM-TU-2 (pages 1 and 2).

model. Again, KCPL's assumption in its wholesale model is unnecessarily high. As Mr. Meyer explains, "by causing the off-system sales model to believe that these units are needed to provide energy for native load that does not truly exist, KCPL has artificially lowered the projected off-system sales margins."[103]

H. CONCLUSION

As this brief has shown, the recent rapid increase in KCPL rates is not only a result of KCPL's recent construction program; it is also largely a direct result of KCPL's disinterest in participating in the wholesale market. This disinterest is easily explained by KCPL's decision to propose the unused energy allocator in Kansas "without sufficient study." The effect of that decision, once adopted by the Kansas Commission, was to have different methodologies in Missouri and Kansas for the allocation of off-system sales margins. As KCPL has recognized, it is required, as a result of that misguided decision, to return $1.05 for every $1.00 it receives in off-system sales. KCPL bemoans, "[t]his does not make any sense, and serves as an economic disincentive for the Company to pursue off-system sales."[104] But the decision to utilize that methodology was solely the responsibility of KCPL and cannot be fixed in this case. As a result, this Commission must look to alternative methods to require KCPL to participate in the wholesale market.

In 2006, the Commission, fearful of the increasing risk associated with the Regulatory Plan construction program, set off-system sales margins at the 25th percentile. The Commission was hopeful that, through the tracker mechanism, ratepayers would still

[103] Ex. 1216, Meyer True-Up Rebuttal, page 7.
[104] Tr. 3367. See also, Exhibit 7, Blanc Rebuttal, page 46 ("Because Missouri and Kansas adopt different allocation methodologies to derive what portion of the margins KCP&L's Kansas and Missouri customers should receive, KCP&L presently gives to its customers about 105% of its off-system sales margins. That is punitive and should stop, but requires this Commission and the KCC to adopt the same allocation methodology, which to date they have chosen not to do.").

receive a large amount of the off-system sales margins over that 25th percentile. The Commission, however, failed to adequately account for the financial disincentives caused by KCPL's decision to utilize the unused energy allocator in Kansas. As a result, KCPL continually only reached that level of off-system sales dictated by the Commission and no more. Fortunately, the reasons for setting rates based upon the 25th percentile are no longer applicable and the Commission is free to set higher expectations.

This brief has demonstrated that, when higher expectations are set, KCPL is capable of achieving greater wholesale profits. In the last case, KCPL voluntarily agreed to set rates based on the 44.5 percentile level of off-system sales. Despite these higher expectations, KCPL was able to achieve the necessary wholesale performance. It would represent a significant step backward to now set rates at the 25th percentile. Instead, MEUA recommends that the Commission set rates at the 40th percentile of the analysis contained in KCPL's Direct Testimony. As has been demonstrated, this level of off-system sales is readily achievable and is conservative. For all these reasons, the Commission should set rates which include a level of off-system sales margins of **________________**.

VI. OFF-SYSTEM SALES ADUSTMENTS

In a further effort to reduce the level of off-system sales margins expected by the Commission, KCPL makes several unjustified adjustments to the level of off-system sales resulting from Schnitzer's model. As Mr. Meyer's testimony reveals, the KCPL's adjustments to the Schnitzer results are not justified. For this reason, MEUA recommends that the Commission reject all three adjustments.

A. SPP LINE LOSS CHARGES

In its testimony, KCPL asks that the Commission reduce the level of off-system sales resulting from the Schnitzer model to account for line loss charges that KCPL incurs when it makes off-system sales outside the SPP market footprint. As KCPL notes, SPP assesses a line loss charge whenever KCPL undertakes a wholesale transaction outside the SPP footprint. For this reason, KCPL proposes to reduce the expected level of off-system sales resulting from the Schnitzer model. KCPL, however, fails to account for the increased revenues that also must occur with any of these transactions. For this reason, KCPL's rationale is flawed and must be rejected.

While Mr. Schnitzer models off-system sales which occur in the SPP region, it is undisputed that KCPL also undertakes certain wholesale transactions which occur outside of this region. "In reality, however, KCPL makes OSS in markets other than SPP-North and at prices other than the SPP-North price."[105] As such, the Schnitzer model fails to account for any of the increased costs ***and revenues*** that occur as a result of transactions which occur outside of SPP.

In its one-sided adjustment, KCPL proposes to only recognize the cost side of any transactions which occur outside of the SPP region. KCPL fails to account for the fact

[105] Ex. 1201, Meyer Direct, page 8.

that, in addition to the cost, there are increased revenues associated with these transactions as well.[106] As Mr. Meyer explains:

> To the extent that KCPL makes an OSS outside of the SPP footprint, KCPL should receive a premium above the SPP-North market prices to offset the additional transmission charge that will be charged to KCPL. If KCPL didn't receive such a premium, then it would not make the sale and would avoid the associated loss charge.[107]

KCPL has not disputed that these additional revenues are a fact. Rather, KCPL simply fails to account for these revenues. These revenues, however, are a fact that must be accounted for in conjunction with the associated cost.

> If the sale outside the SPP footprint did not cover the additional SPP line loss charges, KCPL would be better to forego these sales and instead sell their excess power within the SPP footprint. In such a situation, the OSS margin generated from a sale inside the SPP footprint would generate greater margins. Therefore, before KCPL makes an OSS outside the SPP footprint, it should verify that the price (revenues) received for the sale will recover the SPP line loss charges which will be assess to that sale. If KCPL cannot meet that threshold, then KCPL should sell its power inside the SPP footprint as modeled by Mr. Schnitzer.[108]

As MEUA notes, "it is inappropriate to simply reflect the cost associated with these sales without also reflecting the increased price that KCPL will receive from these sales."[109] For this reason, the KCPL adjustment should be rejected.

B. PURCHASES FOR RESALE

In addition, KCPL also seeks to reduce the level of off-system sales recommended by Mr. Schnitzer to reflect losses that KCPL claims it experiences on Purchases for Resale transactions. Again, KCPL's proposed adjustment is flawed in that it fails to consider both the losses and gains as a unified whole. Instead, KCPL proposes

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[106] *Id.*
[107] *Id.* at pages 7-8.
[108] Ex. 1202, Meyer Surrebuttal, page 4.
[109] *Id.*

to ignore the gains, thus allowing those revenues to flow to shareholders while expressly saddling ratepayers with the attendant losses. For this reason, KCPL's adjustment should be rejected.

The issue in question concerns bilateral purchases that KCPL makes for which it subsequently sells a portion back into the SPP market. By its adjustment, KCPL seeks to keep any gains associated with the purchase side of the transaction, but then asks the ratepayers to compensate it for the subsequent smaller loss associated with the sale.

As Mr. Meyer points out, the following example clearly demonstrates the problem.[110] KCPL needs to purchase 100 MWs of power to meet its peak load requirements from 2:00 p.m. to 6:00 p.m. KCPL can fulfill that power need by purchasing 4 hours of 100 MWs at $90 per MW. Thus the total cost would be $36,000.[111] A cheaper alternative exists by which KCPL can purchase 100 MWs for 8 hours (from 2:00 p.m. until 10:00 p.m.) for $40 per MW. Recognizing that this alternative only costs $32,000,[112] KCPL makes the 8 hour transaction.

Since KCPL does not need this power during the other four hours (6:00 p.m. until 10:00 p.m.), KCPL sells the extra power into the SPP market at $35 / MW. Ultimately, the KCPL fuel model does not include the $40 / MW actual cost, but instead reflects the $90 market price for the 4 hours that power was needed. As such, the practical effect of this transaction is that there is a $50 gain for every MW of power purchased during the peak 4 hour period. Therefore, the total gain is $20,000.[113]

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[110] Ex. 1201, Meyer Direct, page 10.
[111] $90 / MW * 100 MWs * 4 hours = $36,000.
[112] $40 / MW * 100 MWs * 8 hours = $32,000.
[113] $50 / MW savings * 100 MWs * 4 hours = $20,000

On the other hand, there is a small loss associated with the sale of the extra power during the non-peak hours at a price that was less than the purchase price. This loss of $5 / MW for every MW of power sold is a result of purchasing the power at $40 and selling it at $35. Therefore, the attendant loss is $2,000.[114]

By its adjustment, KCPL asks ratepayers to compensate it, through a reduction in off-system sales, for the $2,000 of loss. KCPL forgets to consider, however, that there is an offsetting $20,000 gain to the same transaction. MEUA does not dispute that KCPL should be compensated for such loss, but asserts that KCPL is compensated by keeping the entirety of the gain. As Mr. Meyer explains:

> Through its adjustment, KCPL is attempting to separate the loss from the gain. KCPL effectively proposes that the gain remain with the shareholders, but that it be allowed to recover the loss (in this example, $2,000) from ratepayers by reducing Mr. Schnitzer's OSS margin levels. This adjustment should not be recognized because there is no consideration given to the savings generated by the purchase during the peak hours. Since KCPL does not operate under a fuel adjustment clause, any savings that it recognizes in fuel and purchase power expense, relative to the cost built into rates, will inure directly to the benefit of its shareholders. Historically, KCPL shareholders would receive the net benefit (i.e., the gain portion less the loss portion). By this adjustment, however, KCPL wants to separate the gain portion of the transaction from the loss portion of the transaction.

The KCPL adjustment is decidedly one-sided. Specifically, the adjustment seeks to allocate the gain and assign it to the shareholders while subsequently saddling the ratepayers with the loss. For this reason, the adjustment should be rejected.

C. REVENUE NEUTRALITY UPLIFT CHARGES

Finally, KCPL seeks to reduce its projected level of off-system sales to account for revenue neutrality uplift charges assessed by SPP. As Mr. Meyer describes:

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[114] $5 / MW * 100 hours * 4 hours = $2000.

> When SPP settles the energy imbalance market, SPP does not always collect the exact amount of revenues needed to disburse back to market participants. If SPP is short, then a charge is imposed on market participants. If SPP has collected too much, a credit is given to market participants. KCPL records any charge as purchased power expense and any credit as OSS revenue.[115]

As MEUA points out, however, these costs and revenues are incurred whether KCPL makes off-system sales. As Mr. Meyer explains, "the settlement of the Energy Imbalance Service market is more related to native load circumstances and not driven by OSS. Energy to serve native load is clearly greater than energy needed to make OSS, and it is that energy that creates the Energy Imbalance Service market."[116] Given this, these revenue neutrality uplift charges should not be considered as an adjustment to off-system sales margins, but rather as a cost of KCPL's annualized fuel expense.[117]

The reason underlying KCPL's adjustment is its desire to continually expand the scope of its various tracker mechanisms to include new costs. In this case, KCPL does not have a fuel adjustment clause. Therefore, KCPL seeks to include these costs that are more properly associated with fuel and purchased power and include them in the off-system sales tracker.

> By reducing OSS margins for [revenue neutrality uplift] charges, KCPL is seeking to have a component of fuel expense tracked and its fluctuations captured in between rate cases. This is not a proper expense item to offset OSS margins. I continue to support placing this level of expense in base rates and not reduce OSS margins.[118]

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[115] Ex. 1201, Meyer Direct, page 12.
[116] Exhibit 1202, Meyer Surrebuttal, page 8.
[117] Ex. 1201, Meyer Direct, page 12. ("I am proposing that these net costs be included in annualized fuel expense and not reflected as a reduction to KCPL's OSS margins). See also, Exhibit 1202, Meyer Surrebuttal, page 7.
[118] Exhibit 1202, Meyer Surrebuttal, pages 8-9.

VII. MERGER TRANSITION COSTS

A. INTRODUCTION

At its core, this issue concerns KCPL's request to recover costs which it admits have already been recovered. Specifically, KCPL seeks recovery of transition costs associated with its acquisition of Aquila in 2008. As Staff has recognized, however, KCPL has recovered the entirety of the transition costs through the application of regulatory lag to merger synergy savings. Despite three rounds of testimony, as well as the opportunity for cross-examination, KCPL has never disputed that these synergy savings materialized or that, during the lag between rate cases, KCPL retained the entirety of these synergy savings. Given that KCPL has already recovered the entirety of these costs, it would be fundamentally inequitable to specifically grant KCPL recovery of any additional costs. For this reason, the Commission should reject KCPL's request.

B. BACKGROUND, DEFINITION OF TRANSITION COSTS AND PRIOR COMMISSION DECISION

In July of 2008, the Commission approved the acquisition of Aquila by Great Plains Energy. In consummating that acquisition, Great Plains Energy incurred certain costs. These costs have been labeled as either transaction costs or transition costs. As described by KCPL, "transaction costs include investment bankers' fees, as well as consulting and legal fees associated with the evaluation, bid, negotiation and structure of the transaction."[119] Transition costs, on the other hand, are "costs incurred to successfully coordinate and integrate the utility operations of KCP&L and GMO. . . These costs include non-executive severance costs for employees terminated as a result of

[119] Ives Direct, Ex. 35, page 6.

the merger, facilities integration costs, and incremental third-party and other non-labor expenses incurred to support the integration of the companies."[120]

In its Report and Order in the acquisition case, the Commission expressly precluded any recovery of transaction costs.[121] Pertaining to transition costs, however, the Commission left open the possibility of future recovery of these costs.

> The Commission will give consideration to their [transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCPL and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.[122]
>
> Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.[123]
>
> The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.[124]

C. TRANSITION COSTS SHOULD BE DISALLOWED IN THAT KCPL HAS ALREADY RECOVERED THESE COSTS.

In the case at hand, KCPL / GMO quantified significant merger synergies as a result of the consolidation of various functions in the two utilities. Specifically, KCPL / GMO quantify approximately $121 million in regulated synergies that they have realized as of June 30, 2010.[125] Furthermore, KCPL / GMO project an additional $259 million in such synergies that will occur through the end of 2013.[126]

While those synergies eventually inure to the benefit of ratepayers, it is undisputed that these benefits are initially kept entirely by shareholders. Given the

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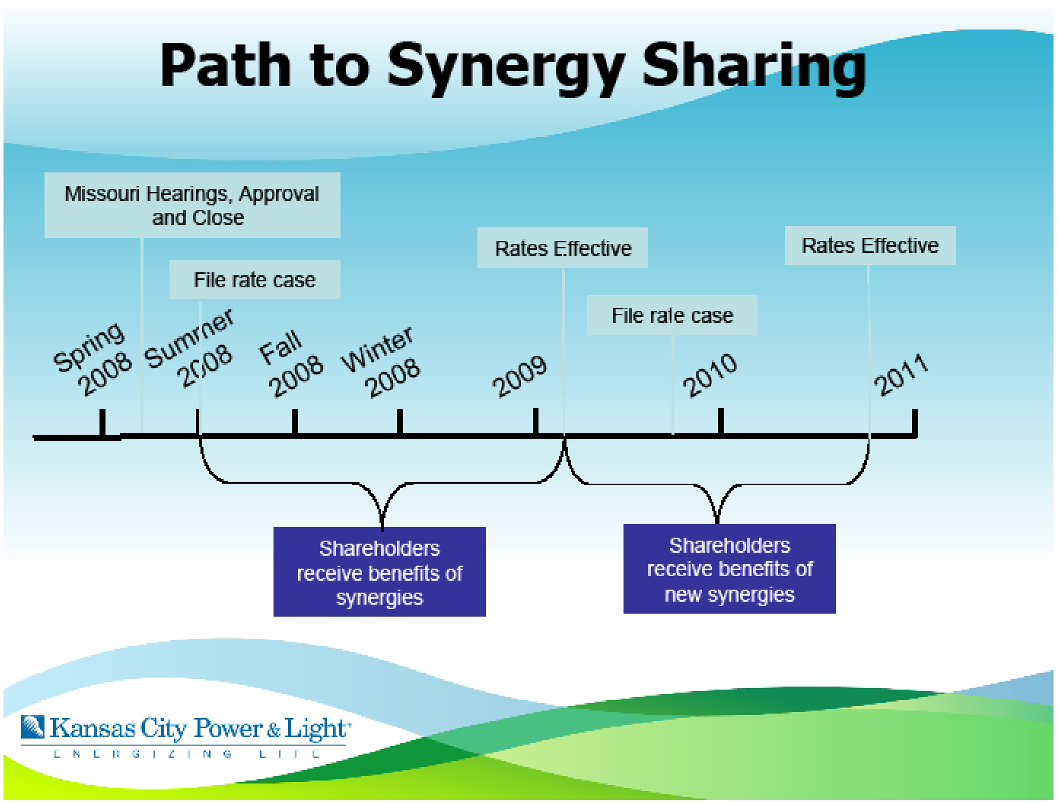
[120] *Id.* at page 4.
[121] *Report and Order*, Case No. EM-2007-0374, pages 239-240.
[122] *Id.* at page 241, footnote 930.
[123] *Id.* at page 284.
[124] *Id.*
[125] Ex. 230, Majors Rebuttal, page 9.
[126] *Id* at page 10.

statutory scheme in place in Missouri, it is well established that there is a lag between when a cost or revenue is incurred and when that cost or revenue is reflected in rates. This is known as regulatory lag.[127] As a result of regulatory lag, if the Companies experience a cost decrease, there is a lag in time until that reduced cost is reflected in rates. During that lag, the Company shareholders reap, in the form of increased earnings, the entirety of any benefit associated with reduced costs.

Theoretically then, if KCPL and GMO realized savings as the result of merging various aspects of the companies, those savings accrue <u>entirely</u> to the shareholders until such time as another rate case is completed. As an example then, to the extent that KCPL and GMO realized savings associated with economies of scale pertaining to the purchase of computers, paper, and office supplies, KCPL and GMO shareholders keep the entirety of these savings until such time as the Commission sets new rates reflecting the Companies' new cost structure.[128] Thus, while the acquisition closed on July 14, 2008,[129] KCPL / GMO shareholders kept the entirety of all synergies realized for the following 13.5 months until rates were changed on September 1, 2009.[130]

The retention of merger synergies by the KCPL / GMO shareholders is more than just a theory; it is real and admitted by the Company. As the following KCPL slide clearly indicates, KCPL / GMO management recognizes that until a rate case is completed, regulatory lag dictates that the benefits of merger synergies vest **<u>solely</u>** with the shareholders.

[127] Ex. 210, Staff Cost of Service Report, page 190.
[128] Staff provides an excellent example of the benefits associated with regulatory lag. In the example, KCPL / GMO realize a savings of $129,452 associated with the elimination of one $50,000 position on October 1, 2008. See, Ex. 230, Majors Rebuttal, pages 4-5.
[129] Closing date of KCPL / Aquila acquisition. Ex. 230, Majors Rebuttal, page 6.
[130] Effective date of tariffs in first rate case following acquisition. Ex. 230, Majors Rebuttal, pages 4-5.



SCHEDULE 1-3

Source: Ex. 230, Majors Rebuttal, Schedule 1-3.

Company discovery responses indicate that through September 1, 2009 KCPL / GMO shareholders had already retained over $59.3 million in merger synergies.[131] Despite these retained merger synergies, KCPL / GMO still ask that it be allowed to recover approximately $51.8 million of transition costs from ratepayers. Recognizing that the Company shareholders have already retained over $59.3 million in merger synergies, Staff rightfully points out that the Company *"**has realized $7.5 million [in merger synergy savings] over the transition costs**."*[132]

Additional evidence indicates that KCPL / GMO will, over the next 4 years, continue to recover additional merger synergies over and above what they have already

[131] *Id.* at page 12.
[132] *Id.*

recovered. For instance, KCPL / GMO project a total of $344 million in merger synergies through 2013. Of that amount, KCPL / GMO project that ratepayers will only realize $150 million of those synergy savings.[133] As such, the remainder, over $194 million of synergy savings will be retained solely by KCPL / GMO shareholders.[134]

The best evidence that KCPL's management understands the benefits of regulatory lag is the timing of its announcement that it is reducing the management work force by 150 employees.[135] Undoubtedly, KCPL knew of this coming event and could have made this announcement during the true-up period and had those cost savings reflected in rates. Instead, by waiting until a week after the true-up hearing, KCPL seeks to keep the entirety of these savings for shareholders. Therefore, given estimated savings of $20 million per year,[136] and in the event that KCPL waits three years until its next rate case, shareholders will have retained an $60 million as a result of regulatory lag.

Ultimately it has been shown that KCPL "has not made any attempt to dispute the fact that KCPL has recovered through retained synergies, an amount greater than transition costs."[137] While KCPL acknowledges that it would be "unreasonable"[138] for the Company to recover costs that have already been recovered, KCPL nonetheless seeks further recovery of transition costs. Given that the Company shareholders have already recovered these transition costs in the form of retained merger synergies, and will continue to reap the benefits of these synergy savings, it is fundamentally inequitable to expect ratepayers to again compensate the Company for these costs.

[133] *Id.* at page 14.
[134] *Id.*
[135] See, 8K filing with Securities Exchange Commission (filed March 10, 2011). As reflected in that Filing, "The organizational realignment process is expected to eliminate approximately 150 non-union positions."
[136] Given an average salary of $100,000 with benefits of 33%, this amounts to total company savings of approximately $20 million per year.
[137] Ex. 231, Majors Surrebuttal, page 4.
[138] Tr. 3469.

VIII. RATE CASE EXPENSE

By its decision on this issue, the Commission will be given the opportunity to provide long-awaited clarification as to the amount that utilities can charge its ratepayers for rate case expense. Specifically, MEUA asks that the Commission reinstate a previous Commission standard by which the recovery of rate case expenses is based in large part on the utility showing cost containment. Absent this long-awaited clarification, rate case expense for utilities will continue to skyrocket.

In its case, KCPL / GMO ask that ratepayers compensate the Company for over ***$7.7 million***[139] of rate case expense. Recognizing that this is the amount paid through December 31, 2010, it does not reflect all the legal and consultant costs associated with litigating and briefing these cases during the months of January through March. KCPL estimates that it will incur an additional ***$6.1 million*** in rate case expense[140] for a total of ***$13.8 million***. By any standard, it is unquestioned that a large portion of this expense is incurred so that shareholders can argue for the inclusion of imprudent amounts in rate base; a higher return on equity; recovery of arbitration costs when KCPL was found to have acted with **__________________**; and lower wholesale expectations necessary to avoid the implications of an off-system sales allocator recommended by KCPL "without sufficient study".

Despite this obvious shareholder benefit, KCPL / GMO ask that ratepayers be required to pay the entirety of this amount. By this case, the Commission can finally send a clear message as to the reasonable amount that the utility can expect to include in rates.

[139] Ex. 309, Majors True-Up Direct, page 3.
[140] Tr. 3634.

The Commission has previously recognized that "the general rule governing rate case expense provides that those expenses which are known and measurable, reasonable, necessary and prudently incurred in the preparation and presentation of the Company's case may be included in the expenses of the Company."[141] Based upon this vague standard, Staff has conducted an extensive audit of the rate case expenses, primarily legal fees, incurred by KCPL. Based upon this audit, Staff has proposed specific disallowances in the amount of $1.2 million.[142] This represents a trifling 15% of the total amount of rate case expense incurred by KCPL through December 31, 2010.[143] As the expenses for January through March are paid, the percentage disallowed by Staff will shrink further. If KCPL's final projection of $13.8 million is correct, Staff's disallowance will amount to less than 9% of the final amount of rate case expense.[144]

In contrast, recognizing KCPL's failure to implement any cost containment associated with the presentation of this rate case, MEUA asks that the Commission disallow 33% of the KCPL / GMO rate case expenses. MEUA asserts that, given the issues presented in this case, shareholders benefit significantly from the presentation of these issues and should be assigned a proportional portion of these costs. The incurrence of significant legal fees so that KCPL can seek to recover imprudent expenses, inflated return on equity or decreased level of off-system sales are incurred solely for the shareholders. By assigning 33% of these costs to be incurred by the shareholders, the Commission will recognize this fact.

[141] *Report and Order*, Case No. WR-93-212 (issued November 18, 1993).
[142] Ex. 309, Majors True-Up Direct, page 9.
[143] *Id.*
[144] $1.2 million / $13.8 million = 8.7%.

In a 1993 Missouri-American decision, the Commission attempted to provide some definition by which to measure whether rate case expense is necessary and prudently incurred. In that case the Commission based its decision on whether actual evidence exists of cost containment.

> The Commission must continue to look to the record for evidence in support of rate case expense and in this case that evidence is lacking. Disallowing all expense, or perhaps even disallowing any prudently incurred rate case expense could be viewed as violating the Company's procedural rights. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. ***The operative words here, however, are necessary and prudently incurred. The record does not reflect efforts at cost containment and consequently it does not support that these expenses have been prudently incurred.***[145]

Absent evidence of cost containment, the Commission in that case disallowed approximately one-third of Missouri American's rate case expense. Evidence of cost containment is equally lacking in this case.

In its last rate litigated rate case, KCPL in-house attorneys shared in a great deal of the work associated with litigating that case. Those attorneys, whose salary and benefits are already recovered through rates, litigated issues associated with policy, off-system sales margins, Hawthorn 5 settlement costs and uranium enrichment overcharges.[146] Unlike that case, however, KCPL attorneys in this case did not present a single opening statement or cross-examine a single witness. Rather, while present in the hearing room, KCPL in-house attorneys watched numerous outside attorneys do the work that should be expected of these in-house attorneys. All told, ***eight*** outside attorneys (Glenda Cafer, Susan Cunningham, Lisa Gilbreath, Jim Fischer, Larry Dority, Daniel Gibb, Karl Zobrist, and Charles Hatfield) entered an appearance for KCPL / GMO in this

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[145] *Id.*
[146] Ex. 1217

case. Those attorneys conducted 100% of the trial work which occurred in this case. Even on matters as simple as offering extraneous exhibits at the end of the hearing, KCPL had at least two outside attorneys simply sitting in the hearing room and compiling additional rate case expense. More disconcerting, even in those instances in which KCPL chose not to engage in any cross-examination,[147] the waiver of cross-examination was done by an outside attorney billing at **____** per hour.[148]

As KCPL admits, through December 31, 2010, and therefore not counting any of the litigation and briefing time that will be incurred, KCPL has paid the following amounts to law firms:

Firm	KCPL Case[149]	MPS Case[150]	L&P Case[151]
Schiff Harden	$988,000	$275,000	$89,000
Stinson Morrison	$92,000	$18,000	$28,000
SNR Denton	$423,000	$131,000	$123,000
Fischer & Dority	$310,000	$170,000	$123,000

Thus, before a single word is uttered in the hearing room or a single character typed into the brief, Fischer & Dority has billed at least $603,000 with SNR Denton billing an additional $677,000.

The extravagance of rate case expense is not only seen in the number of outside counsel appearing in this case, and the number of hours and travel expenses incurred by

[147] See, off-system sales margins in which KCPL refused to conduct any cross-examination of Staff or Industrial witnesses. Tr. 4910 (waiver of cross examination on Staff witness Harris); Tr. 4911 (waiver of cross examination on Staff witness Featherstone); and Tr. 4920 (waiver of cross examination of MEUA witness Meyer).
[148] Ex. 231, Majors True-Up Direct, page 4.
[149] Tr. 3636-3637. It is important to remember that these are the expenses from Schiff, Harden associated with presentation of this rate case and do not reflect the millions of dollars of other expenses that have been capitalized into the cost of Iatan 1 and Iatan 2.
[150] Tr. 3639
[151] Tr. 3639

those counsel, but also in the matters for which KCPL sought expert witnesses. For instance, in the 2006 rate case, KCPL handled the issue of jurisdictional allocations through the use of in-house personnel.[152] While such expertise certainly exists within the Company, KCPL in this case hired an outside consultant.[153] The extravagance of that decision is best realized when one understands that this witness was hired to help mitigate the differing allocation methodologies between Missouri and Kansas. As KCPL has previously admitted, the difference in jurisdictional allocations between the two states is solely a result of KCPL's decision to propose the unused energy allocator "without sufficient study."[154] Certainly, Missouri ratepayers should not be expected to reimburse KCPL for the costs of a consultant retained to fix a problem caused by KCPL making decisions "without sufficient study." Ultimately, despite the extravagance of hiring this outside consultant, KCPL simply settled the matter by agreeing to continue to use the energy allocator in Missouri.

The final tally indicates that KCPL retained the following outside consultants[155] in this case: Chris Giles;[156] Gary Goble;[157] Samuel Hadaway;[158] Steven Jones;[159] Larry

[152] *2006 Order* at page 75.
[153] Exhibits 39 and 40; Tr. 3366.
[154] Tr. 3367-3368.
[155] These are only the consultants that filed testimony. Of course, there are other consultants that provided rate case services that did not file testimony.
[156] Ex. 24 and 25.
[157] Ex. 26.
[158] Ex. 27-29.
[159] Ex. 38.

Loos;[160] Daniel Meyer;[161] Kris Nielsen;[162] Paul Normand;[163] Kenneth Roberts;[164] Michael Schnitzer;[165] John Spanos;[166] and Ken Vogl.[167]

By this brief, MEUA has demonstrated that KCPL has failed to engage in any degree of cost containment associated with rate case expense. Despite the availability of legal counsel and technical experts at the Company, KCPL personnel continually rested on the sideline and allowed such work to be done by outside consultants. Certainly the implications for such decisions should be borne, at least in part, by shareholders. For this reason, and consistent with a previous case in which it made similar findings, MEUA asks that the Commission disallow 33% of KCPL and GMO's rate case expense.

Finally, MEUA asks that the Commission extend the period over which it normalizes that portion of rate case expenses which it deems recoverable from ratepayers. In recent years, the Commission has amortized rate case expense over two years. The length of that period at that time was appropriate because KCPL had a set schedule, under the Regulatory Plan, for the filing of annual rate cases.[168]

With the completion of the Regulatory Plan, however, KCPL no longer has a set schedule for the filing of its next rate case. In fact, KCPL readily acknowledges that it has no plans to file its next rate case.[169] Nevertheless, KCPL asks that the Commission allow recovery of rate case expense over an abbreviated two year period. In its recent Kansas rate decision, the Kansas Staff sought and the Commission agreed that rate case

[160] Ex. 39-41.
[161] Ex. 43-45.
[162] Ex. 46.
[163] Ex. 47-49.
[164] Ex. 50-53.
[165] Ex. 58.
[166] Ex. 59-61.
[167] Ex. 62.
[168] See, *Order Approving Stipulation and Agreement*, Case No. EO-2005-0329.
[169] Tr. 3373.

expense should be amortized over four years.[170] Given the lack of definitive plans to file its next rate case, the Commission should normalize the adjusted rate case expense over a four year period.

[170] Ex. 231, Majors Surrebuttal, Schedule 5-2.

IX. ADVANCED COAL CREDIT ARBITRATION COSTS

In 2008, KCPL applied for and received a $125 million qualifying advanced coal tax credit from the IRS associated with the construction of Iatan 2.[171] Although KCPL had several other partners in the project, including Empire, GMO and MJMEUC, KCPL sought to keep the entirety of the tax credit for itself.[172] Upon realizing that KCPL intended to keep the entirety of this credit, Empire filed a notice of arbitration in 2009 seeking its proportionate share of the tax credit (or the monetary equivalent).[173] On December 30, 2009, the Arbitration Panel issued its Final Arbitration Award. In its decision, the Panel found that KCPL's actions constituted **________________**.[174]

> **____
> ____
> ____
> ____
> ____
> ____
> ____
> ____**[175]

Despite this finding, KCPL charges ratepayers for the costs of defending itself in this arbitration. As of October 31, 2010, KCPL had paid the SNR Denton firm over $617,000 for "both the arbitration proceedings and its appeal of the arbitration panel's decision."[176]

As Staff notes, ratepayers have been provided no benefit associated with this expense.[177] By granting KCPL recovery of these legal fees, the Commission is encouraging this utility to engage in activity which constitutes "willful misconduct." Certainly, the Commission should expect more from its utilities.

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[171] Ex. 223, Harrison Surrebuttal, page 4.
[172] *Id.*
[173] *Id.* at pages 4-5.
[174] *Id.* at Schedule 1-3.
[175] *Id.* at Schedule 1-4.
[176] Ex. 231, Majors Surrebuttal, page 19.
[177] *Id.*

X. UNSUPPORTED RATE INCREASES CLAIMED BY KCPL

In its True-Up Direct Testimony, KCPL readily acknowledges that, despite originally asking for $92.1 million, it can now only justify an increase of $55.8 million. "KCP&L's true-up reflects a revenue deficiency of $55.8 million."[178] Suddenly, at the time it made its opening statement at the true-up hearing, and without making any corrections to its true-up testimony, KCPL was inexplicably asking for an increase of $66.1 million.[179] KCPL's request for $66.1 million is not supported by the testimony.

It is MEUA's understanding that after filing its true-up direct testimony, KCPL selectively sought to adopt those aspects of Staff's case which would lead to higher rates. A review of the true-up reconciliation[180] indicates that through this selective process, KCPL has sought to artificially increase its revenue requirement by $9,783,534. The primary component is made up of $7,913,431 of additional fuel expense that Staff modeled, but KCPL never claimed to need.

Because KCPL never raised this issue in the context of its true-up testimony, the consumer parties were never aware of KCPL's sleight of hand attempt to claim greater rate increases. The bottom line, however, is that there is no evidentiary justification for this higher increase. KCPL's acknowledged revenue deficiency is $55.8 million. Staff on the other hand acknowledges a maximum revenue deficiency of $10.9 million.[181] It is improper for KCPL to attempt to selectively choose, especially without notifying the parties of the rationale, various aspects of Staff's case.

[178] Ex. 114, Rush True-Up Direct, page 1.
[179] See, Exhibit 119, page 2.
[180] Ex. 328.
[181] Ex. 302.

Ultimately, this issue is easily decided through the application of burden of proof. As detailed in Section III, “the burden of proof means the obligation to establish the truth of the claim by preponderance of the evidence.”[182] In the case at hand, there is no evidence to support KCPL’s belated request for anything greater than $55.8 million. Therefore, every decision made by the Commission which deviates from the position recommended by KCPL ultimately represents a reduction from this claimed $55.8 million revenue deficiency.

Interestingly, in a previous Empire case, the Commission had to choose between the expense level recommended by Staff and that offered by Empire. Unable to decide on the basis of any evidence, the Commission simply chose the higher fuel expense offered by Empire based solely upon its alleged “greater familiarity with the intricacies of its system and facilities.”[183] Certainly, if the Commission used such alleged “familiarity” to adopt a higher level of fuel expense in that case, it should apply the same logic to adopt the lower level now conceded within KCPL’s true-up testimony.

In the event KCPL believed that its true-up testimony was erroneous, it was incumbent upon them to make the necessary corrections prior to that evidence being placed into the record. It was completely improper to file its testimony for $55.8 million and without: (1) informing any of the parties or Commission at the hearing or (2) making any corrections to its testimony, for KCPL to suddenly claim that it could selectively adopt aspects of Staff’s case to accept. It has been stated that the burden of proof “constitutes a substantial right” of the customers in Commission cases. The Commission has been charged with “jealously guarding” this right. At the end of the day, the

[182] *Clapper v. Lakin*, 123 S.W.2d 27 (Mo. 1938).
[183] *Report and Order*, Case No. ER-2006-0315, page 37 (issued December 21, 2006).

Commission, not KCPL, is the entity that is responsible for deciding the appropriate level of each expense. In this case, there is no basis <u>in the record</u> for the Commission to decide the appropriate level for each of the expenses encompassed by $9.783 million that KCPL now seeks.

X. CONCLUSION

For all the reasons expressed in this brief, and based upon the substantial and competent evidence in the record, MEUA recommends that the Commission adopt the following positions:

1. Award KCPL / GMO a return on equity in the range of 9.4 – 9.9%, with a midpoint of 9.65%;
2. Set rates based upon a level of off-system sales margins of **___________**;
3. Reject all of KCPL's proposed off-system sales adjustments;
4. Deny any additional recovery of merger transition costs;
5. Disallow 33% ($4.6 million) of the $13.8 million of rate case expenses and annualize the remaining amount over four years for a normalized level of $2.3 million to be included in rates;
6. Disallow any recovery of expenses associated with arbitrating the advanced coal credit issue with Empire; and
7. Reject KCPL's unsupported request to increase its true-up case by $9.78 million.

Respectfully submitted,

____

David L. Woodsmall (MBE #40747)
Jeremiah D. Finnegan (MBE #18416)
Stuart W. Conrad (MBE #23966)
428 E. Capitol Ave., Suite 300
Jefferson City, MO 64111
(573) 635-2700 voice
(573) 635-6998 facsimile
E-mail: dwoodsmall@fcplaw.com

ATTORNEYS FOR THE INDUSTRIAL INTERVENORS

CERTIFICATE OF SERVICE

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

____

David L. Woodsmall

Dated: March 10, 2011