BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company For Approval to Make Certain Changes In its Electric Service to Begin the Implementation of Its Regulatory Plan	)))))	**Case No. ER-2006-0314**

POSTHEARING REPLY BRIEF

OF

PRAXAIR, INC.

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COMES NOW Praxair, Inc. ("Praxair") and submits its Posthearing Reply Brief on the issues set forth below.

I. INTRODUCTION

Following the initial briefing, most parties submitted a Stipulation and Agreement regarding the class cost of service and rate design issues. It is Praxair's understanding that non-signatory parties have either indicated that they do not oppose that Stipulation or the pertinent time limit for objections to be submitted has expired. With resolution of these potentially contentious issues, and subject to the Commission's acceptance of that Stipulation and Agreement, Praxair submits this Reply Brief addressing the issues and subissues of Jurisdictional Allocations and Off-System Sales. Praxair generally supports the revenue requirement positions advanced by the Staff of the Missouri Public Service Commission. While we do not intend to repeat arguments previously made, brief reference to earlier positions and arguments may be necessary to establish context.

II. JURISDICTIONAL ALLOCATIONS

A. What Is The Appropriate Method (4 CP vs. 12 CP) To Use For Allocating Generation And Transmission Costs Among Jurisdictions?

As indicated in Praxair's Initial Brief, the determination of the proper demand allocator (4 CP v. 12 CP) is based upon both quantitative and qualitative factors as set forth in a FERC case involving Carolina Power & Light Co.[1] In its Brief, KCPL readily acknowledges that the *Carolina Power & Light* standard is the appropriate test for determining the demand allocator in this proceeding.[2] KCPL's willingness to utilize the *Carolina Power & Light* standard is interesting because its witness readily admits that he

[1] *Carolina Power & Light Co.*, 4 FERC ¶ 61,107 (1978).
[2] KCPL Initial Brief at page 60.

had not reviewed the decision prior to filing his testimony,[3] that he was unaware that the standard even existed until he reviewed Staff's testimony,[4] and that he did not know whether the standard was still utilized by the FERC today.[5] Nevertheless, KCPL now concedes that the quantitative factors found in the *Carolina Power & Light* standard "support use of the 4 CP Demand allocation methodology."[6] In fact, as reflected in Staff's testimony, for each of the seven years of data, the quantitative factors fall within "the range established and applied by the FERC when adopting a 4 CP methodology."[7]

KCPL's concession ought to make the Commission's decision on this issue easy. Having conceded, however, that the quantitative factors dictate the use of the 4 CP Demand allocation methodology advanced by Staff and Praxair, KCPL nevertheless attempts to shift the focus to ***general*** qualitative factors which it believes support its position.

> The Company's capacity planning process takes into account all the hours of the year, not just the peak hour or any seasonal peaks. In addition, the Company utilizes periods of the year, typically in the spring or fall, with lower retail and FERC jurisdictional wholesale peak loads to perform necessary maintenance on its generating facilities and to pursue off-system sales while still maintaining adequate reserve margins.[8]

In fact, based upon its recitation of these ***general*** operating realities, KCPL asserts that "[n]o party presented evidence refuting the operating realities of KCPL's system as described by Mr. Frerking."[9] In actuality, KCPL's argument refutes itself because it listed "general" characteristics that are so "general" that they are applicable to every electric utility. KCPL's argument demonstrates a fallacy of composition. That is to say,

[3] Tr. 575.
[4] Tr. 576.
[5] *Id.*
[6] KCPL Initial Brief at page 60.
[7] Exhibit 123, page 3.
[8] KCPL Initial Brief at page 60.
[9] *Id.*

every electric utility: (1) plans based upon all the hours of the year; (2) performs maintenance during off-peak periods; and (3) engages in off-system sales. KCPL's witness conceded that these operating realities were applicable to every electric utility regardless of whether it demonstrates load characteristics of a 4 CP or 12 CP electric utility.[10]

Recognizing that both the quantitative and general qualitative factors do not justify its 12 CP methodology, KCPL still struggles to justify its recommended use of the 12 CP methodology by bootstrapping itself to Staff's recommendation to use the 12 CP methodology in a recent Empire District Electric proceeding. In its Brief, KCPL wrongly claims that "KCPL experiences the same operating realities as those experienced by Empire, which Ms. Maloney cited in support of adopting a 12 CP allocation methodology for Empire."[11] KCPL's claim is misplaced, both factually and legally.

Unlike KCPL, Empire's operational realities dictate use of a 12 CP methodology. Unlike KCPL, Empire faces a significant winter peak.[12] Empire's service territory includes large rural areas. As Staff notes, "Empire experiences significant winter peaking because the saturation of electric heating among Empire's customers is high due to the fact that Empire serves a more rural territory in which the gas distribution system for winter heating is not as developed as in KCP&L's territory."[13] Staff continues on to discuss how this significant winter peak affects Empire's operating realities. "[B]ecause of the existence of a winter peak, Empire has a much shorter window of opportunity to do

[10] Tr. 581-582.
[11] KCPL Initial Brief at page 61.
[12] Tr. 585.
[13] Exhibit 124, page 4.

scheduled maintenance."[14] KCPL's attempt to bootstrap itself to the 12 CP methodology utilized for Empire lacks merit. Comparisons are not legitimate.

Finally, in its Brief, KCPL gets to the real substance of its desire to utilize the 12 CP methodology.

> Both of KCPL's other jurisdictions, *i.e.*, Kansas and the Federal Energy Regulatory Commission, use the 12 CP demand allocation methodology for KCPL. As explained by Mr. Frerking, "if consistent allocation methodologies are not utilized in the Company's various jurisdictions, the result will be over- or under-recovery of the Company's prudently incurred costs."[15]

Unfortunately for KCPL, any risk of inconsistency among the various jurisdictions is self-inflicted and is not the result of any independent decisions or analyses conducted by those jurisdictions. In an effort to reach an agreement with the Kansas Staff regarding KCPL's recent regulatory plan, KCPL agreed to utilize the 12 CP methodology in future rate proceedings.[16] KCPL's agreement to utilize the 12 CP methodology in Kansas was made without regard to whether the 12 CP methodology was actually appropriate. In fact, KCPL did not even conduct a jurisdictional allocation analysis, prior to entering that agreement, to determine which demand allocator was most appropriate.[17] As a result of this agreement, KCPL's witness recognized that even if his analysis showed that the 4 CP methodology was the most appropriate, he was precluded from making such a recommendation for the Kansas jurisdiction.[18]

KCPL's Initial Brief as well as the underlying record provides no basis for the Commission to adopt KCPL's 12 CP demand allocation methodology. Rather, the record

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[14] *Id.*
[15] KCPL Initial Brief at page 62.
[16] Tr. 578.
[17] Tr. 579.
[18] Tr. 580.

demonstrates that the quantitative and qualitative factors from the *Carolina Power & Light* standard mandate the adoption of a 4 CP methodology. Furthermore, KCPL's attempt to undermine Staff's proposal to use the 4 CP methodology by drawing comparisons to the recent Empire proceeding is unfounded. KCPL's jurisdictional consistency argument falls flat. The record reflects that KCPL blindly entered into an agreement in Kansas to use the 12 CP methodology without any independent analysis to determine if that methodology is appropriate. Errors in other jurisdictions do not justify Missouri ratepayers facing inappropriately increased rates.

B. How Should A&G Expenses Be Allocated To The Missouri Retail, Kansas Retail and FERC Wholesale Jurisdictions?

KCPL's Initial Brief is noteworthy for its failure to even address the substance of this issue. KCPL asserts that it used a "number of methods depending on the cause of the [A&G] costs."[19] KCPL devotes several sentences to discussing the methods used for allocating these A&G costs. KCPL then summarily concludes that the "remainder of the A&G expenses" should be allocated using the Energy allocator.[20] KCPL's Brief, as well as its witness, fails to provide any rational basis for its conclusion that the "remainder of the A&G expenses" should be allocated using the Energy allocator. This failure to support its position is noticeable when one recognizes that the use of the Energy allocator to allocate the remainder of the A&G costs is the crux of this entire issue.

As reflected in Praxair's testimony and its Initial Brief, KCPL's Energy allocator bears no relationship to the cause of the costs in these accounts. The costs captured in these accounts are not related to the generation of ***energy***.[21] Instead, because these costs

[19] KCPL Initial Brief at page 62.
[20] *Id.*
[21] Exhibit 602, page 28.

are related to corporate administrative and general costs, it is more appropriate to allocate these accounts on salaries and wages.[22]

III. OFF-SYSTEM SALES

A. What Level Of Off-System Sales Margin Should Be Included In Determining KCPL's Cost Of Service?

In its Initial Brief, OPC points out that:

> The off-system sales margin issue is one of the areas in which KCPL is seeking to change the rules of the regulatory regime in its favor. It is doing so in two different ways. First, it wants the Commission to include a very low level of total company off-system sales margins in the ratemaking calculation. Second, it wants to assign an unreasonably large amount of those margins to Kansas. These two changes each have the effect of under-recognizing revenues that KCPL will receive in the period in which the rates established in this case will be in effect, and thus inflate the amount of revenues that will be needed from Missouri retail ratepayers. The Commission should recognize these changes for what they are: attempts to undermine the Regulatory Plan and to achieve additional returns for shareholders at the expense of ratepayers.[23]

OPC is referring to KCPL's proposal to set rates based upon that level of off-system margins which corresponds with the 25th percentile of KCPL's probabilistic analysis of the 2007 off-system market. KCPL acknowledges that, contrary to the Stipulation and Agreement in Case No. EO-2005-0329, "any profit from such sales exceeding the 25% point would be retained by the Company as a means of increasing the Company's opportunity to earn the ROE set in this case."[24]

In light of the repeated criticisms of the parties as well as the seemingly obvious violation of the Stipulation and Agreement, KCPL finally appears to recognize that its proposal would "unfairly benefit the Company."[25] In fact, instead of supporting its

[22] Exhibit 601, page 3.
[23] OPC Initial Brief at pages 13-14.
[24] KCPL Initial Brief at page 12.
[25] *Id.* at page 12.

prefiled position, KCPL now devotes a large portion of its Initial Brief on this issue to the presentation of unsupported "alternatives" that it believes reflect "a more symmetrical proposition."[26] KCPL is creative, but creativity does not equal competent and substantial evidence.

First, KCPL suggests that the Commission could include a normalized level of off-system margins at the 50th percentile of its analysis and instead increase KCPL's authorized ROE. As the record indicates, however, this position was not properly presented by KCPL and was advanced by a witness who has no background in the establishment of an appropriate return on equity.[27] There is no competent evidence to support a specific off-system sales risk adjustment to the authorized ROE.

Second, KCPL suggests that the Commission could implement a mechanism that allows KCPL to book a regulatory liability / asset to reflect the actual amount of off-system margins experienced. As KCPL admits, however, this position was not properly advanced on the record by KCPL.[28] As such, neither the parties at the hearing nor the Commission could properly consider such a proposal. Specifically, recognizing that KCPL new proposal constitutes a request for an Accounting Authority Order, such a position would be properly presented to the Commission through an Application.[29]

The Commission should recognize KCPL's prefiled position as designed to "unfairly benefit the Company." Rather than utilize KCPL recommended 25th percentile

[26] *Id.*
[27] Tr. 812-813.
[28] Tr. 771 and 816-817.
[29] Section 536.063(2) and 4 CSR 240-2.060.

level of off-system margin, the Commission should instead include a normalized level of off-system margins in the ratemaking process as reflected in Praxair's Initial Brief.[30]

B. How Should The Off-System Sales Margin Be Allocated To The Missouri Retail, Kansas Retail And FERC Wholesale Jurisdictions?

In its Initial Brief, KCPL acknowledges that off-system sales margins have been historically allocated to the various jurisdictions based upon the Energy allocator. Nevertheless, KCPL now proposes a unique, and new methodology – the KCPL christened "unused energy allocator."[31] KCPL provides very little rationale for its newly crafted "unused energy allocator." Rather, KCPL merely notes that its methodology "correlates with the unused capacity that enables the Company to make the off-system sales that result in the margins at issue."[32]

The remaining parties have raised numerous criticisms of KCPL's methodology. To date, in both its Initial Brief as well as its prefiled testimony, KCPL has failed to respond to these criticisms. As Praxair's Witness pointed out in prefiled testimony:

> The [unused energy] methodology does not give any consideration at all to sales made from the reserve capacity that is paid for by all customers and carried for the benefit of all customers in proportion to customer loads, rather than in proportion to some ill-defined notion of "unused energy." It also does not recognize scheduled maintenance requirements of forced outage events, nor does it recognize specific class load patterns. It is a rather simplistic, broad brush and unique allocation formula.[33]

These criticisms were amplified by Mr. Brubaker during the evidentiary hearing on this issue. Specifically, Mr. Brubaker pointed out that KCPL's unused energy allocator: (1) fails to account for when off-system sales are being made or from what

[30] Praxair Initial Brief at pages 8-12.
[31] KCPL Initial Brief at page 15.
[32] *Id.*
[33] Exhibit 603, page 5.

capacity;[34] (2) does not consider jurisdictional load shapes;[35] (3) does not consider the lower energy costs and higher off-system margins that should be utilized in a high load factor jurisdiction like Missouri; [36] and (4) ignores the fact that some off-system sales come from buying and reselling of capacity.[37] Furthermore, KCPL's allocation methodology would undermine the fundamental purpose of the recently enacted 2005 Energy Policy Act.[38]

KCPL's "unused energy allocator" is fundamentally flawed and is without merit. As such, the Commission should adopt the historically recognized Energy allocator for the allocation of off-system sales margins.

<u>C.</u> <u>What Parameters Does The Commission-Approved Stipulation & Agreement In Case No. EO-2005-0329 Impose On The Treatment Of Off-System Sales Revenue In This Case?</u>

KCPL undisputedly agreed in the Stipulation and Agreement in Case No. EO-2005-0329 to treat all off-system sales revenues "above the line" for ratemaking purposes. Despite this explicit agreement, KCPL nonetheless seeks to make an adjustment that would take a large portion of those revenues "below the line" for the benefit of its shareholders. This is a direct violation of the provisions of the Stipulation and Agreement.

KCPL vainly argues that, while the Stipulation and Agreement requires that all sales be considered above the line, "there is nothing in the Stipulation which requires that off-system sales revenue be included in rates on a normalized or historical basis."[39]

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[34] Tr. 738.
[35] *Id.*
[36] *Id.*
[37] *Id.*
[38] Praxair Initial Brief at page 13.
[39] KCPL Initial Brief at page 14.

Certainly the Stipulation does not require inclusion of a "normalized or historical" level of off-system revenues in rates, nor does it explicitly require compliance with Commission rules, but settlements are not negotiated in a vacuum. Such a requirement is founded in the basic rules of ratemaking historically utilized by this Commission. None of the parties believed it to be necessary to require KCPL to adhere to fundamental notions of the ratemaking methodology. This is just another example of an electric utility seeking to have the Commission sanction their creative attempts to escape an approved Stipulation and Agreement that it now finds onerous. However those same "onerous" terms are of benefit to ratepayers and form part of the consideration underlying the agreed to Regulatory Plan.

As indicated, the need to utilize a "normalized" level of off-system sales is founded in basic notions of ratemaking followed by this Commission for several decades.

> Allowable operating expenses are those which recur in the normal operations of a company, and ***<u>a company's rates are set for the future based upon its past experience for a test year with adjustments for annualizations, normalizations and known and measureable changes</u>***.[40]

This process of using normalization adjustments has been approved by Missouri courts.

> The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection. A test year is a tool used to find the relationship between investment, revenues, and expenses. Certain adjustments are made to the test year figures; "normalization" adjustments used to eliminate non-recurring items of expenses or revenues and

[40] *In re: Missouri Public Service*, 1 MoPSC 3d 200, 205 (1991) (emphasis added). See also, *In re: Missouri Public Service*, 2 MoPSC 3d 230, (1994); *In re: Southwestern Bell Telephone Company*, 2 Mo. PSC 3d 479 (1993); *In re: Southwestern Bell Telephone Company*, 29 MoPSC (N.S.) 607 (1989) ("As a result of its audit Staff made adjustments to the test year data. These adjustments fall into four categories, as discussed by Staff witness Schallenberg. These categories are: normalization adjustment, annualization adjustment, disallowances and pro forma adjustments. By adjusting the test year data Staff proposes what it considers the appropriate revenue requirement for SWB for setting rates on a going-forward basis.").

"annualization" adjustments used to reflect the end-of-period level of investment, expenses and revenues.[41]

The Commission should not sanction KCPL's attempt to evade the express negotiated provisions of the Stipulation and Agreement as well as basic notions of ratemaking.

D. Should KCPL's Customers Receive The Benefit Of All Margins Of Off-System Sales Or Should It Be Shared Between Customers And Shareholders? Should A Mechanism Be Adopted To Ensure That The Benefit Is Received By The Appropriate Party Or Parties? If So, What Mechanism?

In its Initial Brief, Praxair noted that KCPL never provided any substance to a proposal to share off-system sales between customers and shareholders.[42] KCPL's witness readily admits that "[w]e have not made a specific proposal in terms of testimony, anything direct in this case. I had anticipated making those proposals in settlement discussions."[43] Given the lack of definitive proposal on this matter by KCPL, it would be inappropriate to implement such a mechanism in this proceeding. Obviously a secret proposal cannot be supported by competent and substantial evidence as required by the Missouri Constitution.

In its Brief, KCPL appears to agree that such a mechanism would be inappropriate. "KCPL does not propose sharing OSS margins with customers, which would be contrary to the intent and spirit of the Stipulation."[44] As such, the Commission should include a normalized level of off-system sales margins in the ratemaking process.

[41] *State ex rel. GTE North, Inc. v. Missouri Public Service Commission*, 835 S.W.2d 356, 368 (Mo.App. W.D. 1992) (citing to *State ex rel Southwestern Bell Telephone Co. v. Public Service Commission*, 645 S.W.2d 44, 53 (Mo.App. 1982).
[42] Praxair Initial Brief at pages 15-16.
[43] Tr. 771.
[44] KCPL Initial Brief at page 17.

IV. CONCLUSION

For all of the foregoing reasons, Praxair respectfully requests that the Commission adopt its position as set forth in its Initial Brief on each of the issues set forth herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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

David L. Woodsmall

Dated: November 27, 2006