BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

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

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

I. INTRODUCTION.

1. The Companies have thoroughly discussed the issues in their Initial Post-Hearing Brief ("Initial Brief"), and it is unnecessary to re-iterate those arguments herein. However, a few of the parties have raised points in their Initial Post-Hearing Briefs that require a response at this time.

2. As explained in the Companies' Initial Brief, the issues remaining to be resolved by the Commission will have a large impact upon the Companies and their customers. In particular, cost of capital and the transmission tracker issues are two common issues that will have a substantial impact upon the financial health of the Companies. The Crossroads issue and the Fuel Adjustment Clause ("FAC") Sharing Percentage issue relate only to GMO and are

significant. Finally, the residential all-electric and space heating rate issue raised by Southern Union Company d/b/a Missouri Gas Energy ("MGE") in both cases needs to be resolved in a fair and equitable manner so that the Companies can continue to maintain their off-peak winter heating load. This issue may have a significant impact on specific customers served under the residential all-electric and space heating rate.

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

II. KCP&L ONLY ISSUES.

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

1. Rate Design.

4. As explained in KCP&L's Initial Brief, the Signatories to the October 29, 2012 Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service/Rate Design Issues ("KCP&L CCOS Stipulation") agreed that the Commission should increase residential true-up revenues by 1.00% in addition to any other increase implemented by the Commission, with a corresponding equal-percentage revenue neutral decrease in the true-up revenues for all other non-lighting rate classes. This shift is consistent with the CCOS studies, which demonstrated that the residential class was not paying its appropriate share of the Company's costs of service. See KCPL-38, Normand Direct, Sch. PMN-2; Staff-211 Staff Rate Design and Class Cost of Service Report at 3; Staff-233, Scheperle Rebuttal at 3; USDOE-501, Goins Direct, Sch. DWG-1. KCP&L believes that the Signatories' agreements in the KCP&L CCOS Stipulation are supported by the results of the cost of service studies.

5. The Office of the Public Counsel ("OPC"), AARP, and Consumers Council of Missouri ("CCM") filed briefs in opposition to the proposed resolution of the issues suggested by the Signatories to the KCP&L CCOS Stipulation, and instead argued in favor of an across-the-board increase to all classes. See OPC Initial Brief at 3-6; AARP Initial Brief at 12-13, CCM Initial Brief at 1. Clearly, the evidence contained in the summary of the CCOS studies included in Staff witness Scheperle's Rebuttal Testimony at page 3 supports a modest shift to the residential class, as suggested by the Signatories to the KCP&L CCOS Stipulation. See Staff-233, Scheperle Rebuttal at 3.

6. No party has challenged the proposed resolution of the Large Power rate design issues recommended in the KCP&L CCOS Stipulation in this case, and it should be adopted by the Commission. Similarly, no party has challenged the resolution of the Large General Service ("LGS") rate design issues recommended in the KCP&L CCOS Stipulation in this case, and it should be adopted by the Commission. See KCP&L CCOS Stipulation at 2.

7. In summary, the overall increase granted by the Commission should be applied as an equal percentage to the base rate revenues of each class, after adjusting for the inter-class adjustments described in paragraph 1 of the KCP&L CCOS Stipulation. The rate design changes included in the KCP&L CCOS Stipulation for the Large Power and LGS classes should also be adopted.

2. Residential Space Heat Services.

8. In its Initial Brief, Staff continues to recommend the Commission reject MGE's proposal to eliminate or freeze KCP&L's residential all-electric and space-heating rates. See Staff Initial Brief at 100-02. The Companies agree with Staff that MGE's proposal is not cost-justified, would be an abrupt change, and cause rate shock to the Companies' all-electric and space-heating customers.

9. MGE is suggesting that Commission order the elimination of the residential all-electric and space heating rates that have existed for more than thirty years. See MGE Initial Brief at 4-5. The Commission should reject MGE's position for the reasons stated by the Companies and Staff.

10. As explained in the Companies' Initial Brief, MGE's argument for eliminating residential space heating rates appears to be nothing more than an attempt to prevent KCP&L from providing cost-based rates for customers who choose to use electricity to heat their homes. See Tr. 1030. If the Commission adopted MGE's unjustified position, it would likely result in a loss of winter electric load (and resulting loss of margin), and the eventual need to increase the rates to the Company's other customers.

11. In its Initial Brief, MGE argued that "Seventy-Nine percent (79%) of KCPL's Residential customers are subsidizing specially-priced, discounted rates that encourage the increased use of electricity." See MGE Initial Brief at 3. This argument is incorrect. Contrary to MGE's assertion, KCP&L's all-electric and space-heating rates are not subsidized, and they are neither discounted nor designed to encourage use of electricity. The competent and substantial evidence demonstrates that KCP&L's residential all-electric and space heating rates recover more than the incremental or variable costs of providing the service and make a contribution to the fixed costs of the Company. See Tr. 1027-28. As a result, MGE is wrong that residential all-electric and space-heating rates are subsidized. See KCPL-42, Rush Rebuttal at 6.

12. The results of the Company's CCOS study show that each class of customer recovers the cost of service to that class and provides a positive return on investment. Within each class in the study, the seasonal rates show the same thing. The summer and winter rates for each class provide recovery of the cost of service and earn a positive return on investment. Id.

The all-electric and space-heating customers pay the tariffed rates without a discount from the tariff, and these rates are not promotional rates, but recover the incremental costs and provide a contribution the fixed costs of the Company.

13. The fact that these rates earn a slightly lower return on investment than the system average return does not suggest that the all-electric and space-heating rates are less than cost or otherwise "subsidized." Since all-electric and space-heating services compete with alternative fuels (e.g. natural gas), such pricing is appropriate and necessary to ensure that other customers receive a contribution to fixed costs from these services. In the event that the space heating rates were priced so high that space heating customers dropped their all-electric or space heating service, then KCP&L's remaining customers would be adversely affected, and their rates would have to eventually increase. See Tr. 1028-29.

14. MGE disregards the competent and substantial evidence that there is no subsidy for the residential all-electric and space-heating services. Instead MGE focuses on the level of the return earned by these services. See MGE Initial Brief at 3. Given that winter space heating is clearly an off-peak service that must compete with alternative fuels, it is not appropriate or reasonable to expect that this competitive service would necessarily earn a rate of return comparable to the Company's on-peak summer rates. Residential space-heating and all-electric rates, which are largely provided during off-peak periods, have different costs than summer electric rates, which are provided during on-peak periods. MGE's position does not take into consideration the differing load characteristics of a home heated with electricity versus a home heated with natural gas. See KCPL-42, Rush Rebuttal at 7.

15. There is also no competent and substantial evidence to support MGE's claim that there is a "subsidization of Residential Space Heat customers by all other Residential customers in the winter." See MGE Initial Brief at 3. As explained in the Companies' Initial Brief, several

parties, including the Company, Staff, United States Department of Energy ("USDOE"), and Industrial Intervenors, sponsored CCOS studies that largely supported the conclusion that residential all-electric rates are providing a higher return than the general residential rates, as Staff witness Michael Scheperle testified during cross-examination. See Tr. 1064-67.

16. In fact, Staff's cost of service study shows that for KCP&L, the index of return for all-electric rates was 0.57 percent compared to the overall residential rates which had an index of return of only 0.53 percent. See Tr. 1066. Similarly, the USDOE cost of service study had a similar result showing that the residential all-electric rate had an index of return of 0.55 percent compared to the overall residential rates which had an index of return of only 0.49 percent. Id. See also KCPL-38, Normand Direct, Sch. PMN-2; Staff-211 Staff Rate Design and Class Cost of Service Report at 3; USDOE-501, Goins Direct, Sch. DWG-1. This CCOS study evidence refutes MGE's claim that other residential customers are "subsidizing" residential space heating services.

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

18. It is also important to note that with the exception of MGE, a natural gas company that provides service within the Companies' service territory, there were no builders, developers, or HVAC dealers that intervened in this rate case pursuing rate design changes, in particular the elimination or freezing of these rates. If there was a large public outcry to eliminate certain

rates, then it would be expected that there would have been more interest in this case other than the Companies' competitor with an obvious self-interest. Id.

19. MGE ignores in its Initial Brief the primary issue of "customer choice." MGE fails to consider that residential customers and builders are apparently satisfied with the performance of their electric heating choices, primarily heat pumps, and choose to install them in their residences. Heat pumps are also installed with gas heat back-ups. The Companies believe that the dual fuel aspect is well received by the marketplace. Id.

20. MGE also asserts that the Kansas Corporation Commission designed Residential rates based on a shift in revenue collection away from General Use customers toward Space Heat customers in the Kansas 2010 rate case, Docket No. 10-KCPE-415-RTS. See MGE Initial Brief at 14. As explained by Mr. Rush, MGE does not properly discuss the context of the Kansas rate case. In Kansas, multiple parties took the extreme position of eliminating rates and deploying inverted block pricing for some rates. Many of these proposals would have resulted in extreme increases for significant numbers of the Company's customers. The proposal offered by KCP&L was made to provide some movement to the rates but avoid the extreme outcomes proposed by the parties. See KCPL-42, Rush Rebuttal at 10. The Company does not believe that the record in this case justifies any similar adjustments.

21. Contrary to the assertions of MGE (see MGE Initial Brief at 21-23), there would be a severe rate impact upon KCP&L's space heating customers if MGE's recommendations were adopted. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13. In fact, as explained in the Companies' Initial Brief, it was the rate impact upon customers that caused Staff witness Michael Scheperle to oppose MGE's proposals in this case. See Tr. 1068-69.

22. Company witness Tim Rush also presented evidence of the severe impact upon customers from the elimination of space heating and all-electric rates. For a typical KCP&L

customer, the impact of the elimination of all-electric and space heating rates could be 24.83%, before any increase in this proceeding is granted. See KCPL-43, Rush Surrebuttal, Sch. TMR-8 at 4. Assuming a 10% overall rate increase in this case, then the total impact upon KCP&L's typical space heating customers could be approximately 34%. See Tr. 1024-25. Schedule TMR-8 also included analysis for space heating customers at other usage levels. See KCPL-43, Rush Surrebuttal, Sch. TMR-8 at 4.

23. Based upon this analysis, some space heating customers would have increases of 6.06% to 39.59% if the space heating rate was eliminated—before any overall increase was granted in this case. Such increases would be "too much for the customers to bear" merely to promote the competitive interests of MGE. See Tr. 1074-75.

3. Staff's Proposal to Increase by 5% the First Block of the Residential Space Heating Rates.

24. The Company believes that the record does not justify increasing the first block of the residential space heating rate by 5%, as suggested by Staff. Any increase in rates should be spread equally to all classes and rate components. See KCPL-40, Rush Direct at 7-10; KCPL-42, Rush Rebuttal at 1-13; KCPL-43, Rush Surrebuttal at 4-10. As explained in the Company's Initial Brief, there is no cost justification for increasing the first block of the residential space heating rates by more than the system average increase. The Commission should therefore decline to adopt Staff's recommendation on this issue.

B. Resource Planning.

1. Sierra Club's La Cygne and Montrose Investment Recommendations.

25. The Company has already addressed Sierra Club's witness' recommendations, and nothing new was presented in Sierra Club's Initial Brief. It is therefore unnecessary to re-iterate information contained in the Companies' Initial Brief at 11-13. However, it might be worth noting that Sierra Club's primary recommendation related to the La Cygne retrofit

project is as follows: "Given the developments of the last one to two years in natural gas and energy markets, the results of KCP&L's analysis of the economics of the La Cygne retrofits should be updated now to determine whether it is prudent to proceed with the retrofit project. (Biewald Direct at p. 13, lines 7-9)" See Sierra Club Initial Brief at 9. Such analysis is periodically done by KCP&L, and will be updated and included in the 2013 update to its Integrated Resource Plan ("IRP").

26. In OPC's Initial Brief, the Public Counsel asserted that the Commission should open "a new case to identify the type of information that should be collected to document project management and ongoing planning decisions." See OPC Initial Brief at 11. The Company believes that this recommendation is also unnecessary. As explained by Mr. Rush and Mr. Crawford during the hearings, KCP&L and GMO are already heavily involved in the integrated resource planning which is mandated by 4 CSR 240-22. See Tr. 589-90, 601-11. This IRP process involves a rigorous review of the Companies' planning process that is transparent with extensive participation by Staff, OPC, Missouri Department of Natural Resources ("MDNR"), Sierra Club, and other participants. In addition, KCP&L is already providing monthly LaCygne project management reports to Staff. KCP&L will provide these reports to OPC at OPC's request.

27. On April 9, 2012, KCP&L and GMO filed with the Commission its 2012 IRP process, which is required by the Commission's Electric Utility Resource Planning rule, 4 CSR 240-22. On September 6, 2012, Staff, OPC, MDNR, Sierra Club, and the Natural Resources

Defense Council ("NRDC") submitted reports identifying concerns and deficiencies regarding the IRP.[1]

28. The Companies have been actively engaged with the parties to the IRP dockets to resolve identified issues. See Tr. 593, 637. On November 19, 2012, the parties to Case Nos. EO-2012-0323 and EO-2012-0324 filed a joint filing which resolved a large number of the alleged deficiencies raised by the parties. In addition, the Companies are scheduled to provide annual updates to their IRPs in 2013. See Tr. 638. It is unnecessary to duplicate this process, or otherwise open another proceeding to review the Companies' planning processes related to La Cygne and Montrose.

29. In addition to the IRP process, in any future rate case proceeding in which the Company is seeking the recovery of investments related to La Cygne and/or Montrose, the Company will be required to dispel any serious doubts raised by other parties related to the prudence of its investments in La Cygne and Montrose. See Report and Order at 74-77, In re Kansas City Power & Light Co., Case No. ER-2010-0355 (Apr. 12, 2011); State ex rel. Associated Natural Gas v. Public Service Commission, 954 S.W.2d 520, 528-29 (Mo. App. W.D. 1997). OPC will have the opportunity to present its concerns, if any, related to the Company's planning in that proceeding. It is unnecessary for the Commission to open a new docket at this juncture just to anticipate a future rate case.

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

III. KCP&L – GMO COMMON ISSUES.

A. Cost of Capital.

1. Return on Common Equity.

(a) Legal Standard.

30. In an unorthodox approach to setting a Missouri public utility's return on equity ("ROE"), the Staff urges the Commission to adopt a new philosophy and set ROE at the lowest possible constitutional rate that is not confiscatory. See Staff Initial Brief at 38-39. This argument is based upon a misreading of both federal electricity law, as well as Missouri appellate authorities which uniformly require that a return be fair, just, and reasonable. See Bluefield Waterworks & Improvmt. Co. v. Public Service Comm'n of West Virginia, 262 U.S. 679, 692 (1923) ("Bluefield"); Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) ("Hope"); State ex rel. Public Counsel v. PSC, 274 S.W. 3d 569, 576 (Mo. App. W.D. 2009).

31. Staff relies upon cases that interpret the federal Natural Gas Act and its unique language, which is different from federal electricity laws and Missouri law. Section 5(a) of the Natural Gas Act, 15 U.S.C. Section 717d(a), provides that in a complaint case the Federal Energy Regulatory Commission ("FERC") "may order a decrease where existing rates are unjust, unduly discriminatory, preferential, otherwise unlawful, or are not the lowest reasonable rates." See Federal Power Comm'n v. Natural Gas Pipeline Co., 315 U.S. 575, 584 (1942) (emphasis added).[2] This language is contained in a provision relating only to "decreases in rates," where complaint cases are brought by third parties or where FERC convenes an investigation of a utility's gas rates on its own motion. See 15 U.S.C. § 717d.

[2] Staff Initial Brief at 38-39 & nn. 165-66.

32. In contrast, the Federal Power Act requires that rates for electric energy shall be simply "just and reasonable." See § 205, 16 U.S.C. § 824(d)(1) [rates/charges filed by public utilities], § 824e(a) [complaints]. This is also the case with the Public Utility Regulatory Policies Act of 1978. See 16 U.S.C. § 824a(3)(b)(1)-(2).

33. More importantly, if the Commission were to order an ROE that was simply the lowest non-confiscatory return, it would be contrary to Missouri law. A rate that is non-confiscatory but not just and reasonable falls short of the mandate of Section 393.130.1[3] which explicitly requires "just and reasonable" rates. See State ex rel. Mo. Gas Energy v. PSC, 186 S.W.3d 376, 383-84 (Mo. App. W.D. 2005).

34. Nonetheless, several parties have urged the Commission to set a rate that is all but confiscatory. See OPC Initial Brief at 19;[4] MECG Initial Brief at 31-33; AARP Initial Brief at 11. While the Companies understand that the economy is recovering from a severe recession, setting the ROE at the lowest possible non-confiscatory rate would have definite implications on the credit ratings of KCP&L and GMO, leading inevitably to higher rates because of the higher cost of debt. See Bluefield, 262 U.S. at 694 ("Low, uncertain, or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors."); See also Hope, 320 U.S. at 603 ("That return [on equity], moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.").

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[3] Unless otherwise indicated, all statutory references are to the Missouri Revised Statutes (2000), as amended.

[4] OPC's Initial Brief at 16 refers to KCP&L's proposal for an interim energy charge. That issue has been settled and is no longer before the Commission. See §§ 4(G), 5(D), Second Non-Unanimous Stipulation and Agreement as to Certain Issues (filed Nov. 8, 2012). It should also be recognized that the Regulatory Plan approved by the Commission in 2005, Case No. EO-2005-0329, preserved KCP&L's credit rating during a period of significant construction and economic upheaval.

35. Moreover, there has been no suggestion that the Companies have had poor or declining operations. Although the adequacy of a utility's service can be a factor in setting rates, there is no evidence in this case that either KCP&L or GMO deserve a lower rate of return because of inferior performance. Cf. State ex rel. Public Counsel v. PSC, 374 S.W.3d at 575-76. Particularly in light of evidence that the economy is beginning to improve,[5] there is no reason for a substantial slash in setting the Companies' ROE because of the recent recession.

(b) The ROE Experts.

36. While each of the ROE witnesses presented to the Commission are experts in the legal sense, there are significant differences in their backgrounds. While the Companies' expert Dr. Samuel Hadaway has testified in recent years for investor-owned public utilities, he brings a unique perspective to his studies and analysis. He is the only expert who holds a Ph.D., having received that degree from the University of Texas in Finance and Econometrics. He is the only expert witness who has taught on the college level, served as the chief economist at a major state public utility commission, and has presented expert opinions on behalf of utility customers, municipal and rural electric utilities, as well as investor-owned utilities. See KCPL-19, Hadaway Direct at 1-2 and App. A; GMO-114, Hadaway Direct at 1-2 and App. A.

37. Neither Mr. Gorman for OPC nor Mr. Kahal for USDOE have ever represented investor-owned utilities in their rate proceedings. See OPC-300, Gorman Direct, App. A at 2-3; USDOE-550, Kahal Direct at 2-3 & Ex. A at 9-35. Their consulting is limited to governmental agencies and industrial customers of utilities whose chief objective is to lower utility rates and their ROE. Staff's Mr. Murray has only testified on behalf of Commission Staff.

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[5] Productivity increased at an annual rate of 2.9% during the third quarter of 2012, a 100 basis points upward adjustment from the preliminary November 1 estimate of 1.9%. See News Release, Bureau of Labor Statistics, U.S. Department of Labor (Dec. 5, 2012), attached as Ex. A. Total nonfarm payroll employment rose by 146,000 in November, and the unemployment rate dropped to 7.7%. See id. (Dec. 7, 2012), attached as Ex. B.

38. The judgment exercised by these experts in offering their ROE recommendations is also important to assess. While regulatory agencies "welcome expert testimony," they "must often make difficult choices between conflicting testimony."[6] In this regard, it is significant that Mr. Murray relied heavily upon old and inaccurate data to support his ROE range of 8.0% to 9.0%. As discussed in the Companies' Initial Brief in Paragraph 65, the Mergent Manual data and the 10-company Value Line data used by him is over ten years old and stale. The most recent year that these sources analyzed was 1999. See Staff-200, Staff Cost of Service Report at 40-41; Staff-202, App. 2, Sch. 14 (Value-Line Data for ten companies, 1968-99), Sch. 15 (Mergent Data, 1947-1999); Staff-258, Staff Cost of Service Report at 43-44.

39. Staff's admissions about "key weakness in the data" and replication "problems" call much of Mr. Murray's analysis into question. See Staff-200, Staff Cost of Service Report at 45, 51; Staff-258, Staff Cost of Service Report at 48, 54. It is therefore not surprising that Staff now states that the "top of the zone of reasonableness is the 3rd quarter national average of awarded ROEs of 9.78." See Staff Initial Brief at 41. This is a significant concession.

40. Moreover, Staff's figure of 9.78% reflects all investor-owned utilities for the third quarter of 2012, including less risky T&D (transmission and distribution) utilities, as well as higher earning generation rider cases. See GMO-116, Hadaway Surrebuttal, Sch. SCH-14 at 5. If only comparable vertically-integrated utilities like KCP&L and GMO are considered, the third quarter ROE 2012 average for the U.S. is 9.90%. Id.

41. As a result, Staff's new ROE range of 9.0% to 9.78% (which, in reality, should be 9.9%) reaches the beginning point of Dr. Hadaway's ROE range of 9.8% to 10.3%. See KCPL-

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[6] Leonard S. Goodman, The Process of Ratemaking 606 (1998).

20, Hadaway Rebuttal at 31; GMO-115, Hadaway Rebuttal at 31. Staff's new range is also closer to the average of ROE's approved by Midwestern utility commissions which is 10.15%.[7]

42. Finally, Dr. Hadaway is the only ROE expert witness to explicitly consider the unprecedented intervention in the economy by the U.S. Treasury and the Federal Reserve Board. The other experts proceeded with their traditional Discounted Cash Flow ("DCF") and Risk Premium analyses or relied upon outdated data to lower the results of the traditional models. Their conclusions were either improperly depressed or, in Staff's case, entirely out of the mainstream. Dr. Hadaway provided balance in his long-term and multi-stage DCF models in Direct Testimony, as well as his Terminal Value model that he provided in Rebuttal. This latter model was not provided to supplant the traditional DCF models, but to address today's economic conditions where the government has kept interest rates abnormally low. See KCPL-20, Hadaway Rebuttal at 30-31; GMO-115, Hadaway Rebuttal at 30-31.

43. In response to Staff and the other experts' commentary, Dr. Hadaway explained that the Terminal Value model uses current utility price/earnings ("P/E") ratios to estimate future prices, which tends to balance the low dividend yield aspects of the traditional models. Id. The usefulness of this approach is understood to eliminate the "distorting influences" of short-term inferences or other effects.[8]

44. Such a balanced approach is consistent with the view that other commissions in the Midwest have followed, given that ROE's have not plummeted in the last few months. It is

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[7] As noted in the Companies' Initial Brief, if the 9.20% ROE awarded by the South Dakota Commission is disregarded as an outlier, the average Midwestern ROE for 2012 is 10.28%. See Companies' Initial Brief at 37-38; GMO-116, Hadaway Surrebuttal, Sch. SCH-14 at 5.

[8] Leonard S. Goodman, The Process of Ratemaking 615-16 (1998). It is clear that such distortions are occurring today. See Tr. 531; KCPL-58 (FDIC Vice Chairman and former Kansas City Fed President Hoenig's observation that low interest rates "distort the market" and "distort the allocation of capital").

also consistent with the approach taken by regulatory commissions in prior years when interest rates fell dramatically. As the Virginia Commission observed:

> This commission has no control over a rapidly changing economy or volatile interest rates. We do, however, have the power to regulate authorized returns on equity. The commission feels that stability in the cost of equity is in the interest of utilities, ratepayers and the economic environment of the commonwealth.
>
> When interest rates soared and the prime rate exceeded 20%, we did not allow exorbitant authorized returns which would have exacerbated the situation. We allowed returns to gradually increase, recognizing the trends of the day but avoiding extreme reaction.
>
> Recently interest rates have plummeted. Our appropriate reaction should not be to cut authorized equity returns drastically, but to once again gradually move in the direction of the trend. Our goal is a fair and stable environment which will allow Virginia's utilities to better plan for the future and continue to provide economical, reliable service.

In re Potomac Elec. Co., 74 P.U.R.4th 428, 432 (Va. Corp. Comm'n 1986). Accord, In re Pacific Gas & Elec. Co., 1992 WL 675767 * 51, 137 P.U.R.4th 449, 495 (Calif. Pub. Util. Comm'n 1992) ("Just as we have used caution in not setting utilities' returns on common equity too high in inflationary times, we must balance this by refraining from setting them too low in today's recessionary economy.").

(c) Growth Rates.

45. Several of the parties continue to attack Dr. Hadaway's long-term growth rate of 5.7%. See Staff Initial Brief at 32-33; OPC Initial Brief at 13. However, they mischaracterize the analysis that he employed to arrive at the 5.7%, except to say that he is not in line with forecasters. Id. The basis of Dr. Hadaway's analysis is clear. It is a historical look at growth in the U.S. economy over the past 60 years, which gives weight to more recent trends. As he testified, the most recent period of low inflation and low growth is given six times the weight of the growth rate in the earliest decade in the 60-year period. See KCPL-19, Hadaway Direct at 38; GMO-114, Hadaway Direct at 36; KCPL-20, Hadaway Rebuttal, Sch. SCH-11; GMO-115,

Hadaway Rebuttal, Sch. SCH-11. Reliance upon historical data is a logical way to develop a growth rate since, as Mr. Murray testified, investors rely on historical data "without a doubt." See Tr. 484. Given the wide divergence in predictions,[9] the use of a historical model weighted toward recent trends is a far more useful and accurate tool than whatever the forecasters are saying today.

46. The Midwest Energy Consumers' Group ("MECG"), which did not sponsor a witness, makes several assertions that are not based on the Companies' current recommendations and analysis, or are simply wrong. MECG states that Dr Hadaway rejected a Risk Premium analysis because it produced an ROE of 9.87%. See MECG Initial Brief at 19. In reality, Dr. Hadaway's Risk Premium analysis yielded an ROE of 10.14%. See KCPL-20, Hadaway Rebuttal at 31, Sch. SCH-13; GMO-115, Hadaway Rebuttal at 31, Sch. SCH-13. Moreover, Dr. Hadaway did not reject the Risk Premium analysis at all. It was set forth as an alternative to his DCF analysis. See KCPL-19, Hadaway Direct at 39-41; GMO-114, Hadaway Direct at 39-41, Sch. SCH-6; KCPL-20, Hadaway Rebuttal at 31, Sch. SCH-13. As noted above, Dr. Hadaway's final long-term growth rate was 5.7%, which superseded the initial recommendation in his Direct Testimony, and was accompanied by his analysts' growth rate projection average of 5.48%. See KCPL-20, Hadaway Rebuttal, Sch. SCH-12 at 1-3; GMO-115, Hadaway Rebuttal, Sch. SCH-12 at 1-3.

47. MECG also quotes the Staff Cost of Service Report regarding KCP&L's administrative and general costs, without advising the Commission that this data was from 2011. See MECG Initial Brief at 26-27. These statistics in isolation fail to take into consideration the cost-cutting measures that KCP&L has implemented, including the Organizational

[9] Dr. Hadaway noted that in 1979 the U.S. Energy Information Administration predicted a long-term inflation rate of 6.3%, but today predicts 2%. As he testified, the EIA was wrong in 1979 and is likely wrong today. See Tr. 444.

Realignment/Voluntary Separation ("ORVS") Program, which Staff acknowledged has realized a net savings of approximately $13 million. See Staff-200, Staff Cost of Service Report at 254. Finally, MECG asserts that KCP&L's debt is rated "A" by Standard and Poor's ("S&P"). See MECG Initial Brief at 29. As the Commission, Staff and other parties are aware, KCP&L's debt is rated BBB by S&P and Baa3 by Moody's. See Tr. 364 (testimony of KCP&L Vice President of Investor Relations and Treasurer Kevin Bryant).

48. It is also important to recognize OPC's abandonment of its expert Mr. Gorman, who recommended an ROE range of 9.1% to 9.5%. See OPC-300, Gorman Direct at 39; OPC-307, Gorman Direct at 39. As the Companies pointed out in their Initial Brief, had Mr. Gorman used more accurate growth rates, and accounted for the inverse relationship between risk premiums and interest rates in his Risk Premium analysis, his DCF analysis would have been in the range of 9.9% to 10.1%, and his Risk Premium analysis in the range of 9.85% to 9.95%. See Companies' Initial Brief at 23-24.

49. Apparently OPC has recognized the validity of these criticisms, and instead now recommends that Staff's clearly unreasonable initial low ROE of 8.0% be seriously considered. See OPC Initial Brief at 19. Even Staff no longer endorses an 8.0% ROE. See Staff Initial Brief at 40 (recommending range of 9.0% to 9.78%).

50. Given Staff's new recommendation of a high ROE of 9.78%, it is clear that Dr. Hadaway's range of 9.8% to 10.3% is the most reasonable recommendation for the Commission's consideration.

2. Capital Structure.

51. The Companies have proposed that their capital structure be set on a consolidated basis, reflecting Great Plains Energy Incorporated's ("GPE") capital structure, exclusive of short-term debt, as of August 31, 2012. Staff has concurred with this proposal. See Staff Initial

Brief at 41-42. The only party sponsoring a witness that opposes this recommendation is OPC, which endorses a hypothetical capital structure. See OPC Initial Brief at 19.[10]

52. Under the Companies' proposal, the capital structure would be:

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

See KCPL-10, Bryant Rebuttal at 5; GMO-106, Bryant Rebuttal at 5-6; KCPL-60, Rush True-Up Rebuttal at 2.

53. OPC's Michael Gorman commented on the increase in the common equity, claiming that it had not been justified by the Companies. In response to Mr. Gorman's concerns, which were only raised at the last minute in Surrebuttal,[11] KCP&L's Treasurer Kevin Bryant explained at the hearing that the Companies were relying upon low cost (5.292%) short-term debt on an interim basis to refinance high costs (11.875%) long-term Aquila, Inc. ("Aquila") debt that had finally matured. See Tr 360-62, 368-69. He stated that the Companies' plan is to refinance GPE and GMO short-term debt in 2013 after a GPE $250 million debt issuance matures, and to combine all of the short-term debt in a longer term issuance at a lower interest rate. Id. at 360-61.

54. In response to Mr. Bryant's explanation, OPC has essentially repeated the proposed True-Up Direct Testimony of Mr. Gorman that was struck by the Commission on November 16, 2012. There is no evidence in the record that the Companies are attempting to increase equity simply in order to inflate their cost of capital. See OPC Initial Brief at 20-22. None of the reasons cited by OPC require a hypothetical capital structure.

[10] The USDOE states that it neither supports nor opposes the Companies' proposal. See USDOE Initial Brief at 14.

[11] See OPC-301 and OPC-308.

55. The Commission has preferred to use a utility's actual capital structure, and not a hypothetical one, unless the debt/equity ration is "inefficient and unreasonable," or if there is a holding company system. See State ex rel. Associated Nat. Gas No. v. PSC, 706 S.W.2d 870, 878-79 (Mo. App. W.D. 1985). Here, the Companies have agreed with Staff to use the coordinated operations of KCP&L and GMO. See KCPL-10, Bryant Rebuttal at 13; GMO-106, Bryant Rebuttal at 14.

56. There is no basis for finding that the GPE capital structure is either inefficient or unreasonable. The Commission should use the actual capital structure of GPE for the capital structures of KCP&L and GMO, as has been the Commission's historic preference. See State ex rel. Missouri Office of the Public Counsel v. PSC, 293 S.W.3d 63, 83-84 (Mo. App. S.D. 2009); Report and Order at 17-20, In re Missouri Gas Energy, Case No. GR-2009-0355 (Feb. 10, 2010); Report and Order at 31-32, In re Kansas City Power & Light Co., Case No. ER-2007-0291 (Dec. 6, 2007); Report and Order at 33-36, In re Union Elec. Co., Case No. ER-2007-0002 (May 22, 2007).

57. Similarly, there is no reason to include short-term debt in the capital structure of the Companies. As Staff witness David Murray stated: "I've evaluated monthly construction work in progress ("CWIP") and short-term balances for the 12-months ended through August 31, 2012 and short-term debt balances do not exceed CWIP balances on a consistent basis." See Staff-251, Murray Surrebuttal at 4; Tr. 470 ("I evaluated the balances of short-term debt, but I did not include them [in the capital structure]." As a result, he did not recommend the inclusion of short-term debt in the capital structure.

58. USDOE raises an issue regarding Other Comprehensive Income ("OCI") and its exclusion from the capital structure. In response to his concerns, Mr. Bryant testified that the current OCI balance is primarily the unamortized net-of-tax income or loss on interest rate

derivatives that have been settled. See KCPL-10, Bryant Rebuttal at 13-14. Because of the temporary nature of the OCI balance resulting from general accepted accounting principles, the exclusion of the OCI balance from the equity component of the capital structure of the Companies is both proper and consistent with the capital structure that was approved by the Commission in the Companies' recent rate cases. Id.

59. Finally, MECG offers certain endorsements of OPC's witness Gorman, even though it did not sponsor a witness on its own. MECG mimics the positions of OPC, and its arguments are flawed in the same way. However, MECG's most glaring failure is its reliance on a St. Joseph Light & Power Company rate case decided 20 years ago, where the equity proposed by the company was almost 58%. See MECG Brief at 34-35. That is a far cry from the proposal recommended by the Companies and Staff where the common equity would account for 52.56% of the capital structure, and was fully supported by prefiled and hearing testimony by Mr. Bryant. It is obvious that MECG failed to study Mr. Bryant's evidence with regard to the increase in the equity ratio, as well as the further explanation provided by Staff's Mr. Murray.

3. Cost of Debt.

60. No party other than Staff proposes an adjustment in the Companies' actual cost of debt. The Companies propose that the consolidated cost of debt be 6.425% on a consolidated basis. See KCPL-10 Bryant Rebuttal at 13; GMO-106 Bryant Rebuttal at 14. Staff agrees that a consolidated cost of debt should be used, but proposes an adjustment from the 6.425% actual consolidated cost of debt to an arbitrary and hypothetical 6.187%. See Staff Initial Brief at 42.

61. Staff's entire argument relates back to the difficulties encountered by GMO's predecessor Aquila, yet Staff cites no firm evidence that today's far lower debt costs being carried by GMO could be even lower had history taken a different course.

62. The evidence is to the contrary. GPE has taken aggressive steps to reduce debt costs at GMO, including the final retirement of the expensive 11.875% Aquila Senior Notes that Staff acknowledges were retired on July 2, 2012. See Staff Initial Brief 43; KCPL-10 Bryant Rebuttal at 5-6; GMO-106 Bryant Rebuttal at 6.

63. As Mr. Bryant explained in detail in his Rebuttal and Surrebuttal Testimony, the three issues that Staff seeks to adjust were issued at competitive rates that reflected the actual marketplace, and not the hypothetical adjustments proposed by Staff. Staff's three different set of adjustments (set forth in the Staff Cost of Service Report and Mr. Murray's Rebuttal and Surrebuttal Testimony) simply reflect his personal opinion of what GMO might have been able to obtain if certain events occurring almost ten years ago had taken a different course. There is simply no rational basis to reject the market-based interest rates of the three issuances in favor of Staff's proposed adjustments, particularly since Staff has not alleged any imprudence or impropriety in the actions taken by the Companies and GPE in the marketplace when negotiating these rates.

64. Mr. Murray did not offer any complaints about GPE's behavior in the marketplace or its failure to achieve a better rate. He simply argued that GMO should be rated BBB, instead of its current rating of BBB-. See Tr. 477. Just as the Commission rejected Mr. Murray's recommended adjustment in GPE's Equity-Linked Units in the Companies' last rate cases, it should reject his arbitrary adjustments in this case and accept the actual interest rates of the three debt issues in question. See Report and Order at 126-29, In re Kansas City Power & Light Co., Case No. ER-2010-0355 (Apr. 12, 2011); Report and Order at 153-56, In re KCP&L Greater Mo. Operations Co., Case No ER-2010-0356 (May 4, 2011).

B. **<u>Transmission Tracker.</u>**

65. In its Initial Brief, Staff asserted that the transmission tracker "would provide shareholders with double recoveries and windfall revenues . . ." <u>See</u> Staff Initial Brief at 88. This argument first surfaced during the Staff's mini-opening statement on the transmission tracker issue. <u>See</u> Tr. 650-59. Otherwise, there was no mention of this issue in the Staff's Direct, Rebuttal, or Surrebuttal Testimony in this case. As a result, the Companies' do not believe that there is any competent and substantial evidence in the record to support this Staff concern or argument. However, the Companies will briefly address this concern below.

66. Apparently, Staff is concerned that as "grandfathered" transmission agreements expire, continued transmission service to customers would be provided under the Southwest Power Pool ("SPP") tariff, and somehow this could result in a "double recovery" by the Companies. This concern on the part of Staff is unfounded, however, as it is based on factually incorrect assumptions. There would be no "double recovery" or "windfall" under the transmission tracker. Staff appears to base this line of reasoning on statements by Mr. Ives during the hearing that were taken out of context. Contrary to the Staff's interpretation, Mr. Ives stated his uncertainty as to the inclusion of grandfathered service costs in Account 565, and referred to his Direct Testimony as the source of definitive information regarding costs to be included in the tracker. <u>See</u> Tr. 681-83.

67. As explained in the Direct Testimony of Mr. Ives, the Company proposes to include in the transmission tracker the FERC Account 565 costs, SPP Schedule 1-A fees charged to Accounts 561 and 575, and FERC Schedule 12 fees charged to Account 928. <u>See</u> KCPL-29, Ives Direct at 15. This is further confirmed by Schedule DRI-1, which is attached to Mr. Ives' Direct Testimony and which shows, inter alia, the Company's total annual expense amount for account 565. The total amount in this account is to be included in the transmission tracker, as

noted in Mr. Ives' testimony. The Company records all transmission service expense in this account, regardless of whether it is provided through SPP, through other open access transmission tariffs, or through grandfathered agreements.

68. As a result of this accounting treatment, any change in the amount of transmission service cost related to grandfathered agreements will be reflected in the tracker. If a grandfathered agreement were to be terminated and replaced by SPP service, the tracker would reflect only the difference, whether positive or negative, between the amount charged to the Company under the new SPP service and the amount previously charged to the Company under the grandfathered agreement. As such, there would be no double recovery of these costs through the transmission tracker mechanism. However, if Staff has a concern about the accounting of grandfathered transmission agreements, then those concerns should be raised in the Companies' next rate proceedings in which the tracked transmission costs would be reviewed. Certainly, the Company is willing to work with Staff to ensure the appropriate accounting of such costs. See Tr. 697. It is not appropriate to reject the transmission tracker based upon Staff's inaccurate understanding regarding the accounting treatment of expired grandfathered transmission agreements.

69. Unlike other electric companies that recover transmission costs through the FAC mechanism, KCP&L and GMO do not recover increases in network transmission service charges through the FAC mechanism. As the Commission knows, KCP&L does not have a FAC at this time, and GMO's FAC does not include the recovery of increasing SPP network transmission service expenses in the manner that Ameren's FAC mechanism has provided in the past. GMO's FAC does include a relatively small portion of transmission expenses that result from off-system power sales activity. Therefore, these expenses would be excluded from the GMO tracker. However, the GMO FAC does not include the rapidly expanding set of costs related to network

transmission service. It is therefore important that the Commission consider the appropriateness of a transmission tracker for KCP&L and GMO in this proceeding. Unless the Commission acts to establish the transmission tracker, there will be no regulatory mechanism to ensure that increasing SPP transmission expenses between rate cases are appropriately deferred for possible recovery in a future rate proceeding.

70. The Companies have already discussed Staff's proposed conditions for the transmission tracker. See Companies' Initial Brief at 49-56. The Companies believe that the Commission should adopt the transmission tracker as proposed by the Company and without conditions. Again, the details of the accounting of the proposed tracker are found in the Direct Testimony of Company witness Darrin Ives. See KCPL-29, Ives Direct at 13-17, GMO-123, Ives Direct, at 11-15. However, as explained in the Companies' Initial Brief at 49-56, the Companies could implement the transmission tracker with the following conditions:[12]

(a) That the tracker reflect both transmission revenues and expenses, with the revenues limited to those related to the Companies' own cost responsibility. The amount related to the Companies' cost responsibility is the portion of the Companies' revenues that is derived from transmission charges the Companies paid to SPP as transmission customers. See Tr. 695-96, 687-88. This excludes revenues derived from other utilities, which neither match nor correspond to the expenses included in the tracker. The Companies receive financial data from SPP that identifies the different sources of revenue. See Tr. 695. An illustrative example of the portion of KCP&L's and GMO's revenues that would be included in the tracker is provided in the columns labeled,

[12] Condition (a) is a revised version of Staff's Condition 1. Conditions (b), (c), and (d) are the same as Staff's proposed conditions 2, 3, and 5. Staff's condition 1 (as originally proposed), 4, and 6 are unacceptable to the Companies, for the reasons stated in the Companies' Initial Brief at 52-56.

"KCP&L as Customer" and "GMO as Customer" in the table below, for a recent 12-month period:

Transmission Revenue Received from SPP
Identified with Transmission Customer Source

Revenue Recipient	**KCP&L as Customer**	**GMO as Customer**	**Others as Customer**	**Total**
KCP&L	$3,605,026	$39,345	$5,217,571	$8,861,941
GMO	$1,157,207	$661,093	$3,305,174	$5,123,473
Total	$4,762,232	$700,438	$8,522,744	$13,985,415

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

(c) That all ratemaking considerations regarding transmission revenue and expense amounts deferred by the Companies pursuant to a tracker be reserved to the next KCPL/GMO rate proceedings, including examination of the prudence of the revenues and expenses.

(d) That nothing in any order authorizing Companies' use of a transmission tracker is intended to amend, modify, alter, or supersede any previous Commission order or agreement approved by the Commission concerning KCP&L's or GMO's involvement in SPP or treatment of SPP transmission revenues and expenses.

71. In their Initial Briefs, the Missouri Industrial Energy Consumers ("MIEC") and MECG raised several arguments to support their positions that the Company's proposed transmission tracker should be denied. Under the Industrial Intervenors' shotgun approach to this issue, these Industrial representatives suggest that the Commission should ignore the rapidly increasing transmission costs for the following reasons: (1) the Company has not demonstrated that it needs to track these expenses; (2) the transmission tracker would enable the Company to engage in single-issue ratemaking; (3) the transmission tracker would violate the doctrine against retroactive ratemaking; (4) the transmission tracker eliminates the Company's inherent [incentive] to minimize the expenses and maximize revenues between rate proceedings; (5) the transmission tracker seeks to replace the "opportunity for recovery with a "guarantee" of recovery; and (6) the Transmission Costs do not meet the criteria for extraordinary ratemaking mechanisms. <u>See</u> MIEC Initial Brief at 2-6; Initial MECG Brief at 39-50. The Companies have already thoroughly addressed most of these arguments, but a few additional points need to be made to address their unjustified criticisms of the Companies' transmission tracker proposal.

72. As explained in the Companies' Initial Brief, the actual charges from transmission providers are appropriate candidates for a tracker mechanism because they are material, expected to change significantly in the near future, and are primarily outside the control of KCP&L and GMO. There is clearly a need for a transmission tracker, as recognized by Staff in the Companies' last rate cases, if increasing transmission costs are going to be appropriately recovered during the next rate cases.

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

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

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

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

77. For KCP&L, the *total* charges related to transmission service were $17.3 million in 2008, and grew to $27.1 million in 2011. By the end of this year, they are projected to be $39 million, and in three years, they are projected to be nearly $59 million. See KCPL-29, Ives Direct, Sch. DRI-1. He also includes similar projections for GMO which show total charges for

transmission service increasing for the MPS district from $12.1 million in 2011 to $17.2 million projected for 2012, and increases to $21.2 million projected for 2015. See GMO-123, Ives Direct, Sch. DRI-1.

78. As explained in the Companies' Initial Brief, the courts have uniformly rejected claims that trackers are illegal as "single issue ratemaking" or "illegal retroactive ratemaking". See Companies' Initial Brief at 56-59. Trackers are established in a general rate proceeding at which time "all relevant factors" are considered. Before any changes tracked in the tracker can later be taken into account in setting rates *in the future*, the Commission will again consider all relevant factors. All relevant factors will be considered when the deferred transmission expenses are reviewed in the Companies' next rate case.

79. Under the transmission tracker, the difference between the base level of charges and the actual level of transmission charges would be tracked. The Companies can ask that the difference be considered for later recovery in future rates, but that will only occur in the context of a general rate proceeding where all relevant factors are considered. Any rate would be applied to the future sales only. The bottom line is that the Commission has full authority to authorize the Company to defer changes in these net charges via a tracker.

80. Contrary to the assertions of MECG, there is no "guarantee" of recovery under the Companies' transmission tracker proposal. As already stated, the transmission expenses will be reviewed in the context of the next rate case. The transmission tracker merely preserves the "opportunity" for possible recovery if and when the Commission determines these expenses to be prudent and appropriate in a future rate proceeding.

81. In conclusion, the Companies would respectfully request the Commission implement a transmission tracker as proposed by the Company, including appropriate conditions if deemed necessary.

IV. GMO ONLY ISSUES

A. Crossroads.

82. Staff, MECG, Dogwood Energy, LLC ("Dogwood"), and Midwest Energy Users' Association ("MEUA") address issues related to the Crossroads Energy Center ("Crossroads"). These parties primarily argue that the Commission should simply make the same findings as it did in the Company's last rate case, Case No. ER-2010-0356. The Commission's Crossroads determinations in that case are currently on appeal in Case No. WD75038. More importantly, as conceded in Staff's Initial Brief (at least as it relates to deferred taxes), the evidence in this case is different and requires a different result.

83. The Commission is not bound by its prior decisions and should decide this case on the merits of the current evidence. The evidence in this case plainly shows (i) that the value of Crossroads that should be included in rate base is $82.7 million (adjusted for depreciation through the August 31, 2012 true-up date in this case)[13] (see GMO-111, Crawford Rebuttal at 1); (ii) that the amount of accumulated deferred taxes included in this rate base value should correspond with the level of net plant included in rate base, and thus should be updated through August 31, 2012 as well (see GMO-118, Hardesty Rebuttal at 3-4; Staff-271, Featherstone Rebuttal at 47); (iii) that depreciation expense should be based upon the authorized gross plant value for Crossroads (id.); and (iv) that the cost of transmission should be included in revenue requirement (see GMO-102, Blunk Direct at 29-30; GMO-110, Crawford GMO Direct at 13; Tr. 316-18, 321, 956-57).

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[13] Rate base equals plant in service, less reserve for depreciation, less accumulated deferred income taxes, and will be updated through the true-up period of August 31, 2012.

1. Crossroads Valuation.

(a) Legal Standard.

84. In its Initial Brief, Staff recites a detailed account of history and testimony, but includes no discussion of the legal standards for determining the fair value of Crossroads. While MECG does rely on an 1898 U.S. Supreme Court case for the proposition that only the "fair value" of the property may be recovered from ratepayers, MECG also does not elaborate on the legal standards for actually determining fair value.

85. As discussed in the Company's Initial Brief, recent Missouri case law specifically addresses the proper valuation for investments such as Crossroads. The fair value of the investment, as a matter of law, lies somewhere between the original costs paid and the *current* replacement costs. State ex rel. Missouri Water Co. v. PSC, 308 S.W.2d 704, 719 (Mo. 1958) (holding that original cost should be used as a *floor* when valuing an asset).[14] "Fair market value is the price at which the property could be sold by a *willing* seller to a buyer who is under no compulsion to buy." Shirley's Realty, Inc. v. Hunt, 160 S.W.3d 804, 808 (Mo. App. W.D. 2005) (emphasis added). The Missouri Water case thus is consistent with a "fair market value" analysis because what a willing seller would pay a willing buyer (either the costs actually paid or the costs to replace the asset) is the fair market value. Peterson v. Continental Boiler Works, 783 S.W.2d 896, 900 (Mo. en banc 1990).

86. The non-Company parties engage in much discussion about the history of Crossroads, as well as of GMO's predecessor Aquila. Such background is wholly irrelevant to a decision on the value of Crossroads because the legal standard is clear. It doesn't matter who owned the asset before, why they built it, what the market was at the time they built it, or even

[14] The only evidence of current replacement cost was provided by Company witness Burton L. Crawford.

whether it was a good idea to build the asset. The legal question on valuation is simple: what would a willing buyer pay a willing seller. Staff witness Featherstone acknowledged that the history of Crossroads is simply history, and that Staff has moved past whether it is prudent to place Crossroads into rate base. See Tr. 933:24-934:19. This Commission should do likewise.

87. Moreover, Staff repeats throughout its Initial Brief that factors, such as the location of Crossroads and the conjectural negotiations that occurred around its purchase, should affect the Commission's valuation determination. These factors are irrelevant, as the evidence shows that Crossroads is the least cost option in the Company's 20-year preferred resource plan analysis and meets the Staff's in-service criteria. See GMO-111, Crawford Rebuttal at 3, 7, Sch. BLC-9(HC); Tr. 913-14. The cost of the resources was bid at Crossroads net book value (original cost). The evaluation of Crossroads as a potential GMO resource also included projected transmission costs of $11 million. See Tr. 913-14. Even with the $11 million in transmission costs, which is more than double the actual transmission costs (id.), Crossroads was the lowest cost of several options considered. See GMO-111, Crawford Rebuttal at 3; Sch. BLC2010-9(HC); Tr. 913.

88. The following is a brief history of the fair value placed on Crossroads when willing sellers sold the plant to willing buyers:

- 2007 – $117.9 Million. This is the price at which the non-regulated Aquila Merchant offered Crossroads to Aquila's regulated business as part of a Request for Proposals ("RFP") process. Crossroads was the lowest cost alternative of all options analyzed, even when additional transmission costs are added in. See GMO-111, Crawford Rebuttal at 3-5, Sch. BLC2010-9(HC); GMO-125, Ives Surrebuttal at 29.

- 2008 – $117 Million. This is the net book value that GMO recorded on its books as a result of the Aquila acquisition. See GMO-111, Crawford Rebuttal at 2. This is also the value at which GMO sought to include Crossroads in its 2008 rate case.
- 2008 – $121 Million. This is the value determined by the independent, third party PricewaterhouseCoopers "solely to assist in the matter of determining fair value." See GMO-125, Ives Surrebuttal at 37.
- 2012 – $82.7 Million. This is the depreciated value submitted by the Company in the case presently before the Commission. See GMO-111, Crawford Rebuttal at 1.

89. The original cost and the RFP response are the only evidence of what a willing buyer would pay a willing seller for the Crossroads facility.

(b) The Affiliate Transaction Rule.

90. To the extent Staff and MECG argue for some application of the Affiliate Transactions Rule ("Rule"), 4 CSR 240-20.015, they provide no analysis. However, it is clear from the record in this case that the $82.7 million value that GMO places on Crossroads meets the spirit and the letter of the Rule.

91. The Affiliate Transactions Rule prohibits a regulated electrical corporation from providing a "financial advantage" to an affiliated entity, defined as compensating that affiliate above the lesser of fair market value or fully distributed cost. See 4 CSR 240-20.015(2)(A). There can be no argument that Crossroads was transferred from Aquila Merchant to Aquila, Inc. in March 2007, prior to GPE's acquisition of Aquila, at the net book value of Crossroads at that time. See Staff-271, Featherstone Rebuttal at 22, Sch. CGF-REB-4 at 1; GMO-125, Ives Surrebuttal at 29. After GPE's acquisition of Aquila, Crossroads was moved from GMO's

business unit NREG to MOPUB's[15] books and records. See Staff-271, Featherstone Rebuttal at 22, Sch. CGF-REB-4 at 2; GMO-125, Ives Surrebuttal at 30. In September, 2008 GMO's regulated jurisdictions filed a rate case that included Crossroads in MPS's rate base at net book value of $117 million. Id.; GMO-111, Crawford Rebuttal at 2.

92. As described above, GMO transferred Crossroads to its regulated books at the fair market value of $117 million, as the fair market value of Crossroads was less than the fully distributed cost described in the Rebuttal Testimony of Mr. Crawford,[16] and GMO has routinely sought to include Crossroads in its rate cases at this fair market value (less depreciation in the present case). See GMO-111, Crawford Rebuttal at 1-5, 7, Sch. BLC2010-9(HC); GMO-125, Ives Surrebuttal at 29-30. GMO even transferred this asset well below the $121 million fair value determined by the independent, third party PricewaterhouseCoopers. See GMO-125, Ives Surrebuttal at 37.

93. To the extent Staff and MECG argue that Aquila's regulated operations paid too much for Crossroads when it purchased Crossroads from Aquila Merchant (which occurred before the GPE acquisition), Staff and MECG ignore the fact that this purchase was done using an RFP process as specifically allowed and envisioned by the rule. See 4 CSR 240-20.015(3). Indeed, that subsection of the Rule provides an evidentiary standard for the establishment of fair market value that relies not upon comparable or proxy sales, but rather upon an RFP process for the asset being sold.

94. There is no dispute in this case that Aquila's regulated operations acquired Crossroads from Aquila Merchant using an RFP process. See Tr. 913-914; Staff-271,

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[15] MOPUB is the regulated business unit which previously served the territory known as Missouri Public Service. See Featherstone Rebuttal, Sch. CGF-REB-4 at 2.

[16] See GMO-111, Crawford Rebuttal at 5, 7.

Featherstone Rebuttal at 22; GMO-125, Ives Surrebuttal at 29. Crossroads was offered at the net book value for the plant. When considering all costs (including $11 million for the cost of transmission service, which turned out to be much higher than actual transmission costs), Crossroads was the "winner" in the RFP process as the cost of all other options was greater. Therefore, the Rule dictates that the fair value of Crossroads at the time was the net book value. This is exactly the basis for the value the Company requests in this rate case (less depreciation since that time).

95. Staff and MECG's arguments concerning the Rule are nothing more than a distraction from the issue at hand—what constitutes the fair value of Crossroads. The fair value of Crossroads is what a willing seller would pay a willing buyer. Peterson v. Continental Boiler Works, 783 S.W.2d 896, 900 (Mo. en banc 1990). The fact that GPE had a preliminary estimate of the value of Crossroads is irrelevant. The opinion of a buyer is not legally significant to fair market value. Rather, the fair value is the price the buyer and the seller agree upon in the marketplace. Similarly, references from Staff and MECG about the lack of other bidders in 2005 is irrelevant to the valuation analysis. See MECG Initial Brief at 67. Staff argues that "AmerenUE had no interest in acquiring Crossroads." See Staff Initial Brief at 56. Ameren's position on the value of Crossroads is no more relevant than the position of the thousands of other entities that did not bid on or attempt to acquire Crossroads. Finally, what buyers and sellers were willing to agree upon for other assets could be some indication of value if such assets are truly comparable, but such analysis is no substitute for what was paid for the asset in question.

(c) GPE's Joint Proxy Statement.

96. Staff and MECG both emphasize GPE's preliminary, unilateral, valuation filed in its S-4 Joint Proxy Statement[17] with the Securities and Exchange Commission ("SEC"). Interestingly, although Staff discusses the Joint Proxy Statement, Staff recommends a higher value be placed on Crossroads. As Staff seemingly acknowledges, the Joint Proxy Statement is not relevant to the analysis. The testimony is undisputed that the Joint Proxy Statement value is preliminary and is not an agreement between a buyer and seller about the value. See GMO-125, Ives Surrebuttal at 31-38. The text of the Joint Proxy Statement itself also discloses the preliminary and unilateral nature of the value stated. The Joint Proxy Statement clearly refers to GPE's "estimates" and discloses that the value is "preliminary internal analysis" that is "significantly affected by assumptions regarding the current market." See Staff-258, Cost of Service Report at 78-79. Internal analysis by a buyer is not evidence of fair market value.

(d) Staff and MECG's Comparison With "Forced" Sales.

97. Staff and MECG also propose that the Commission analyze what they consider to be comparable or "proxy" sales. Such proposals, however, do not address the proper legal standard. In this case, we know exactly what a willing buyer would pay a willing seller, not for some other asset, but for Crossroads itself. GPE was a willing buyer and Aquila was a willing seller at the time Aquila's assets were acquired. Undoubtedly, like any buyer, GPE would have preferred to pay less for the assets and, like any seller, Aquila would have preferred to receive more. But in the course of negotiations, they arrived at a price. PricewaterhouseCoopers analyzed the transaction and found that the value of Crossroads was actually *higher* than the net

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[17] Form S-4, referred to as a joint proxy statement/prospectus, must be submitted to the SEC in the event of a merger or an acquisition between two companies. GPE and Aquila filed their Form S-4 with the SEC on May 8, 2007. It will be referred to as the "Joint Proxy Statement" herein.

book value used by the Company in its filing in this case. See Tr. 937; GMO-111, Crawford Rebuttal at 2. This valuation is further supported by the fact that Crossroads had previously been sold for net book value in response to the RFP process discussed above. The evidence is very clear that on two separate occasions, a willing seller was willing to pay net book value or higher for Crossroads. Net book value is the value the Company has assigned to the property in this case and it is the appropriate value to be recovered because it is, as a matter of law, fair market value.

98. Instead, Staff and MECG wish to discuss hypothetical transactions.[18] First they discuss the fact that Ameren passed on Crossroads at one point in time. Of course, there is no evidence before the Commission about exactly why Ameren passed. Regardless, it is clear that Ameren was not a willing buyer and Ameren's opinion is of no value to the analysis.

99. Next, Staff and MECG discuss purchase of facilities other than Crossroads—the Raccoon Creek and Goose Creek facilities in Illinois. It is not proper to rely on these transactions when the Commission has a value for Crossroads itself. Moreover, although Staff and MECG represent that the turbines are exactly the same, it is clear that Raccoon and Goose Creek are not comparable facilities because the costs to operate the facilities in the provision of retail electric service to GMO customers would be markedly different.[19] For example, while Staff's primary witness agreed that the value of the comparison facilities might be affected by transmission costs (see Tr. 946), and while Staff acknowledges that Ameren had no transmission

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[18] The vast majority of Staff's argument on comparable sales relies on Staff-395(HC). GMO had no opportunity to cross examine a witness on the exhibit because the witness could not testify about its contents or the circumstances surrounding the exhibit. GMO properly objected to the introduction of the evidence, which objection was overruled. See Tr. 896-902.

[19] Staff concedes that "there is a material difference in the comparison of GMO's acquisition of Crossroads with AmerenUE's acquisition of Goose Creek and Raccoon Creek." See Staff Initial Brief at 54. Yet Staff appears to advocate that the transactions are relevant to each other.

costs to bring Raccoon Creek and Goose Creek into native load (see Staff Initial Brief at 52), Staff did not consider transmission costs in reaching a recommendation to the Commission concerning valuation. See Tr. 947-948.

100. Staff did not consider that GMO, unlike Ameren, would need annual revenue of $9.7 million to transmit the energy if it were to purchase those facilities, which is nearly double the $5.2 million revenue requirement to transmit energy from Crossroads. See GMO-111, Crawford Rebuttal at 7. Similarly, gas transportation is significantly higher for those facilities. See GMO-103, Blunk Rebuttal at 3; GMO-111, Crawford Rebuttal at 7. This analysis makes clear that, *for GMO*, Crossroads was the lowest cost option. See GMO-111, Crawford Rebuttal at 7. Mr. Crawford acknowledges that the costs to buy the Raccoon Creek and Goose Creek facilities were less than the costs to buy Crossroads, but that the costs to provide service would be remarkably different. As a result, the revenue requirement for Crossroads is considerably less even when transmission costs are included. Just as one might be willing to pay a little more for a car that gets good gas mileage and thereby saves money in the long run, GMO paid more for the facility, but spends considerably less to produce the energy and deliver it to its customers. The result is fair value for the customers.

101. Furthermore, as described in the Company's Initial Brief, the purchase of the Goose Creek and Raccoon Creek units was "essentially a forced sale." State ex rel. Public Counsel v. PSC, 274 S.W.3d 569, 579 (Mo. App. W.D. 2009). The Missouri Court of Appeals thus found that, because of the circumstances surrounding their sale, "their purchase price is not a good measure of the market price" for other units. Id., quoting In re Union Elec. Co., Case No. ER-2007-0002, Report and Order at 62 (May 22, 2007). Because we have a judicial finding that the Goose Creek and Raccoon Creek units do not indicate fair market value, use of these units in

the Commission's analysis of the value of Crossroads, as suggested by Staff and MECG, would be error.

(e) Evidence of Fair Value on the Record.

102. The Commission has before it the evidence it needs to determine fair value. GPE (a willing buyer) was willing to pay Aquila (a willing seller) net book value for the assets. PricewaterhouseCoopers determined that GPE actually paid slightly less than fair value in the transaction. See GMO-125, Ives Surrebuttal at 37. Using an RFP process, Aquila regulated found that net book value plus $11 million in annual transmission costs (which is more than double what the actual transmission costs turned out to be (see Tr. 913-14)) was its lowest cost option for capacity. Consequently, Aquila regulated was willing to pay Aquila Merchant net book value for Crossroads. Finally, replacing Crossroads with a similar facility in the GMO service area would require an annual revenue requirement of $33.1 to $38.7 million, compared with $20.5 million for Crossroads. See GMO-111, Crawford Rebuttal at 6-7. There is no evidence at all to rebut these replacement costs. The revenue requested by the company in this case is significantly less than what the company would be seeking to recover in a replacement scenario. Id. The Company's request clearly falls within the values established by the Courts in the Missouri Water case. Net book value thus is the proper valuation.

(f) Arguments Concerning Ownership.

103. In a unique twist, Dogwood and MEUA raise the issue of ownership, and, with scant analysis, suggest that Crossroads should not be included in rate base "at all" See Dogwood Initial Brief at 5; MEUA Initial Brief at 1. Nevertheless, the entirety of the evidence before the Commission is that Crossroads should be included in rate base. Staff's Cost of Service Report for GMO indicates that "GMO owns four natural gas-fired combustion turbines at its Crossroads generating station located in Clarksdale, Mississippi." See Staff-258, Staff Cost of Service

Report at 74. A GPE memorandum attached to Staff witness Cary Featherstone's Rebuttal Testimony describes in detail the reason for and the timing of the property accounting move of Crossroads to the books and records of GMO's MOPUB business unit. See Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 2-3. This memorandum documents the placement of Crossroads on the books and records of Aquila, and the transfer of the facility to MOPUB's books and records after the merger. Id. Furthermore, Mr. Featherstone summarizes the timeline of transfer of Crossroads in his Rebuttal testimony. See Staff-271, Featherstone Rebuttal at 22.

104. The premise of Dogwood and MEUA's ownership issue appears to be a mistaken belief a public utility cannot include in rate base property owned and operated by someone else, who sells capacity and energy to the utility. In fact, the South Harper facility, located in Cass County, Missouri near the City of Peculiar is financed, owned, and operated under circumstances nearly identical to those surrounding Crossroads, and is properly included in rate base as a capital lease. See StopAquila.org v. City of Peculiar, 208 S.W.3d 895, 897-98 (Mo. en banc 2006). South Harper is included in MPS' rate base. See Staff-271, Featherstone Rebuttal at 34.

105. The financial, ownership, and operation arrangement for Crossroads is analogous to that for South Harper and is well-documented in the record, contrary to the assertions of Dogwood. See Dogwood Initial Brief at 7. The City of Clarksdale, Mississippi financed the Crossroads plant under an arrangement similar to Chapter 100 financing in Missouri, Sections 100.010-100.200. See Tr. 884. As is the case for the South Harper facility, Crossroads is owned by a third party and leased back to the Company. See Tr. 910-11; Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 1-3. Furthermore, similar to South Harper, Crossroads is controlled by GMO through a long-term tolling agreement. See Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 1. Also the case for South Harper, GMO holds a purchase option that

provides the opportunity for GMO to purchase the plant from the City of Clarksdale for a nominal amount. Id.

106. Crossroads is recorded in GMO's books and records as a capital lease. See Tr. 910-11; Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 1-3. Per the Code of Federal Regulations Title 18, Part 101, capital leases are recorded to property account 101.1 and then classified in functional plant accounts 301-399 prescribed for electric plant in service. See Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 3. Both Crossroads and South Harper are long-term agreements for capacity and energy properly classified as capital leases in property assets account 101.1 on the Company's books and includable in rate base like any other generating facility. See Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 1-3.

107. Dogwood appears to concede that it is proper to include a capital lease arrangement in rate base. See Dogwood Initial Brief at 7. Furthermore, Dogwood does not address or attempt to contradict Mr. Crawford's testimony that there are contractual arrangements for purchase of power from Crossroads that are "structured similar to a capital lease." See Tr. 910.

108. Nevertheless, Dogwood alleges that "[t]here is no investment or corresponding risk and no asset to include in rate base and generate a return." See Dogwood Initial Brief at 6. The cases that Dogwood cite for this assertion are inapposite. State ex rel. Public Counsel v. PSC, 274 S.W.3d 569 (Mo. App. W.D. 2009), involved the construction of a power plant to generate electricity to sell to the federal government by Electric Energy, Inc., a company formed by Union Electric Company ("UE") and four independent utilities. In State ex rel. Public Counsel, UE purchased plant stock using shareholder funds and never included the plant in its rate base. This case is wholly irrelevant to the arrangement at Crossroads, whereby Crossroads is financed in an arrangement similar to Chapter 100 financing in Missouri, is controlled by

GMO through a long-term tolling agreement, and is properly recorded as a capital lease to property account 101.1, per the Code of Federal Regulations Title 18, Part 101. See Staff-271, Featherstone Rebuttal Sch. CGF-REB-4 at 1-3. GMO has included Crossroads in its rate base, as it is a long-term lease for capacity properly classified as a capital lease in property assets account 101.1 on GMO's books and includable in rate base. So too is State ex rel. Associated Natural Gas Co. v. PSC, 706 S.W.2d 870 (Mo. App. W.D. 1985) irrelevant to the Crossroads analysis. That case involved the authority of the Commission to employ the concept of "double leveraging," in which the Commission considers the financial structure of a corporate parent in determining the service rates of the subsidiary. Nothing in this case supports Dogwood's proposition that Crossroads should not be part of rate base.

2. Incurred Transmission Costs Are Recoverable.

109. Staff acknowledges that GMO has actually incurred transmission costs to transmit energy from Crossroads. See Staff Initial Brief at 68. Company testimony establishes that when these transmission costs are netted against the savings for gas transportation as a result of Crossroads being located near natural gas, customers recognize a substantial cost savings. Company witness Wm. Edward Blunk explained his calculations in pre-filed testimony and at hearing. See Tr. 319-321. He summarized his findings as follows:

> Q: So based on the calculations you've done in your testimony, does it save the ratepayers money on transportation costs to use the Crossroads facility in Mississippi?
> A: Yes.
> Q: And is that savings sufficient to justify the transmission costs?
> A: Yes. You save more off the – you save more off the natural gas transportation than what the electric transmission is going to cost. [See Tr. 321:13-22.]

110. There is no testimony to contradict the Company's witness. Staff did not object to the introduction of the testimony outlined above, but in its Initial Brief claims the costs associated with gas transportation are speculative. Staff has provided no alternative analysis and

no witnesses rebutted the gas transportation costs to which Mr. Blunk testified. As a result, it is undisputed that transmission costs have been incurred and it is undisputed that these are more than offset by the gas transportation cost savings. The Company is entitled to recover the costs of transmission because it was prudent and appropriate to incur those transmission costs. No party points to any testimony contradicting the natural gas transportation figures presented. Indeed, MECG simply argues that if it made sense to put natural gas fired facilities in Mississippi, GMO should do it for all of its facilities. See MECG Initial Brief at 89. This is not evidence, but simply speculation.

111. Similarly, MECG argues that transmission costs have something to do with valuation. See MECG Initial Brief at 90. MECG ignores the competent and substantial evidence on the record. As discussed above, the Company is allowed to recover the costs of the plant. The cost of the plant is fair market value, which in this case is the amount that GPE paid Aquila for the facility – the net book value. The transmission costs may be analyzed independently of that value or they may be analyzed together. MECG, and to a certain extent Staff, value the plant without transmission costs for purposes of plant value, but then attempt to take away transmission costs that are actually incurred. Such argument must be put aside in favor of the evidence.

112. The *evidence* in this case is that with full recovery of transmission costs, the revenue requirement for Crossroads is significantly lower than it would be to replace the facility or to purchase facilities identified by Staff and transmit electricity from their locations. See GMO-111, Crawford Rebuttal at 7.[20] Crossroads has an annual revenue requirement of $20.5

[20] Mr. Crawford's chart of revenue requirement points out the fallacy of Staff's case. Staff includes a much lower revenue requirement for plant due to Staff's position on the value of the plant. Yet staff allows no revenue for electrical transmission. Staff essentially presents a hypothetical facility that simply cannot exist – a facility with gas transportation to Mississippi but no electric transmission costs from Mississippi to Western Missouri.

million. The Goose Creek option would have a revenue requirement of $5 million more and a replacement plant option would have a revenue requirement $13 million to $18 million higher. Crossroads is the best option for customers under any scenario, including the cost of the transmission service. It is transmission service that makes access to Crossroads possible. See Crawford Rebuttal at 8. Without it, the plant cannot provide the services required for serving GMO retail customers.

113. It would be illogical to disallow one cost component of what is already the overall lowest cost option. Furthermore, as discussed in the Company's Initial Brief, excluding from rates the cost of transmission required to bring energy from Crossroads to GMO's service territory, results in the elimination of the tariff rate approved by FERC, thus "trapping" such costs in violation of the Filed Rate Doctrine and the Supremacy Clause of the U.S. Constitution, Article VI, Clause 2.

3. Deferred Taxes.

114. Although they disagree on the value of the plant, Staff witnesses and Company witnesses agree that deferred taxes should be calculated based on the value the Commission places on the Crossroads plant. As the Staff points out, the evidence in this case is different than in the last case on this point. See Staff Initial Brief at 68.

115. Nevertheless, MECG disagrees with both the Staff and the Company and asks the Commission to instead rely on the evidence in the last rate case and to adopt the exact same position it took there, albeit on a different record. MECG correctly states the position of Staff and the Company that "deferred taxes should flow from the Commission's valuation instead of being part of that valuation." See MECG Initial Brief at 81. MECG goes on to a rather complex analysis of tax rules and factual allegations without a single citation to evidence in the record. See MECG Initial Brief 81-82. MECG's arguments are simply not supported by any witness in

this case. Rather MECG argues that the Commission "got it right" last time on a record that is different than the one at issue here, yet MECG offers no explanation of why the evidence in this case supports the determination MECG supports.

B. GMO Off-System Sales Margins.

116. As noted in its Initial Brief, Staff does not propose any monetary adjustment regarding its concerns about GMO's level of off-system sales ("OSS") margins. See Companies' Initial Brief at 68-71; Staff Initial Brief at 104-05. No other parties address this issue.

117. Staff urges GMO "to pursue a higher level of off-system sales margin." Id. at 105. GMO understands Staff's sentiments and will continue to use its best efforts to promote OSS. With the improvement in the economy and the recent increases in the price of natural gas, such increases may well come to pass (particularly if transmission constraints are relieved).

118. However, GMO notes that continued reference to Aquila's record of OSS margins is not appropriate, as are comparisons with Empire, which is a much different company that operates with different resources in a different part of the region. See Companies' Initial Brief at ¶¶ 180-85; GMO-111, Crawford Rebuttal at 8-9.

C. Rate Design/CCOS Study.

1. Residential Space Heating Services.

119. In its Initial Brief, Staff continues to recommend the Commission reject MGE's proposal to eliminate or freeze KCP&L's residential all-electric and space-heating rates. See Staff Initial Brief at 100-02. The Companies agree with Staff that MGE's proposal would be an abrupt change, and cause rate shock to the Company's all-electric and space-heating customers.

120. As explained in the Companies' Initial Brief, MGE has taken the unusual step of intervening to promote its own competitive interests at the expense of Companies' customers. In fact, MGE is suggesting that the Commission order the elimination of the residential all-electric

and space heating rates which have existed for more than thirty years. See MGE Initial Brief at 4-5. The Commission should reject MGE's position for the reasons stated by the Companies and Staff.

121. As explained in the Companies' Initial Brief, MGE's argument for eliminating residential space heating rates appears to be nothing more than an attempt to prevent GMO from providing cost-based rates for customers who choose to use electricity to heat their homes. See Tr. 1030. If the Commission adopted MGE's position, it would likely result in a loss of winter electric load, and the eventual need to increase the rates to the Company's other customers.

122. In its Initial Brief, MGE argued that "Seventy-Nine percent (79%) of KCPL's [apparently including GMO's] Residential customers are subsidizing specially-priced, discounted rates that encourage the increased use of electricity." See MGE Initial Brief at 3. Contrary to MGE's assertion, GMO's all-electric and space-heating rates are not subsidized, and they are not discounted nor designed to encourage use of electricity. The competent and substantial evidence also demonstrates that GMO's residential all-electric and space heating rates recover more than the incremental or variable costs and make a contribution to the fixed costs of the Company. See Tr. 1027-28. As a result, MGE is wrong that residential all-electric and space-heating rates are "subsidized." See GMO-42, Rush Rebuttal at 7. The results of the Company's CCOS study show that each class of customer recovers the cost of service to that class and provides a return on investment. Within each class in the study, the seasonal rates show the same thing. The summer and winter rates for each class provide recovery of the cost of service and a positive return on investment. Id. at 7-8.

123. The fact that the winter rates earn a slightly lower return on investment than the system average return does not suggest that the all-electric and space-heating rates are less than cost or otherwise "subsidized." Since all-electric and space-heating services compete with

alternative fuels (e.g. natural gas), such pricing is appropriate and necessary to ensure that other customers receive a contribution to fixed costs from these services. In the event that the space heating rates were priced so high that space heating customers dropped their all-electric or space heating service, then GMO's remaining customers would be adversely affected, and their rates would have to increase. See Tr. 1028-29.

124. MGE disregards this evidence that there is no subsidy, and instead argues that the "KCPL winter Residential rate of return is lower than the summer Residential rate of return." See MGE Initial Brief at 3. Given that winter space heating is clearly an off-peak service that must compete with alternative fuels, it is not appropriate or reasonable to expect that this competitive service would necessarily earn a rate of return comparable to the Company's on-peak summer rates. Residential space-heating and all-electric rates, which are largely provided during off-peak periods, have different costs than summer electric rates, which are provided during on-peak periods. MGE's position does not take into consideration the differing load characteristics of a home heated with electricity versus a home heated with natural gas. See GMO-135, Rush Rebuttal at 8.

125. There is also no evidence to support MGE's claim that there is a "subsidization of Residential Space Heat customers by all other Residential customers in the winter." See MGE Initial Brief at 3. As explained in the Companies' Initial Brief, several parties, including the Company, Staff, USDOE, and Industrial Intervenors, sponsored CCOS studies that largely supported the conclusion that residential all-electric rates are providing a higher return than the general residential rates, as Staff witness Michael Scheperle testified during cross-examination. See Tr. 1064-67. In fact, Staff's cost of service study shows that for GMO, the index of return for all-electric rates was 0.96 percent compared to the overall residential rates which had an

index of return of only 0.91 percent. See Tr. 1065. This CCOS study evidence refutes MGE's claim that other residential customers are "subsidizing" residential space heating services.

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

127. It is also important to note that outside of MGE, a natural gas company that provides service within the Company's service territory, there were no builders, developers or HVAC dealers that intervened in this rate case pursuing rate design changes, especially eliminating or freezing rates. If there was a large public outcry to eliminate certain rates, then it would be expected that there would have been more interest in this case other than those with an obvious self-interest. Id.

128. MGE avoids discussion in its Initial Brief and testimony the primary issue of "customer choice." MGE fails to consider that residential customers and builders are apparently satisfied with the performance of their electric heating choices, primarily heat pumps, and choose to install them in their residences. Heat pumps are also installed with gas heat back-ups. The Company believes that the dual fuel aspect is well received by the marketplace. Id.

129. MGE also asserts that the Kansas Corporation Commission designed Residential rates based on a shift in revenue collection away from General Use customers toward Space Heat customers in the Kansas 2010 rate case, Docket No. 10-KCPE-415-RTS. See MGE Initial Brief at 14. As explained by Mr. Rush, MGE does not properly establish the context of the Kansas case. Multiple parties took the extreme position of eliminating rates and deploying inverted

block pricing for some rates. Many of these proposals (like MGE's in this case) would have resulted in extreme increases for significant numbers of the Company's customers. The proposal offered by KCP&L was made to provide some movement to the rates but avoid the extreme outcomes proposed by the parties. See GMO-135, Rush Rebuttal at 11-12.

130. Contrary to the assertions of MGE (see MGE Initial Brief at 21-23), there would be a severe rate impact upon GMO's space heating customers if MGE's recommendations were adopted. See GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14. In fact, as explained in the Company's Initial Brief, it was the rate impact upon customers that caused Staff witness Scheperle to oppose MGE's proposals in this case: "The main reason I disagreed with MGE is the amount of increases that KCPL has experienced . . . since the beginning of January 2007 . . . KCP&L has had about a 43.8 percent increase in rates, and to eliminate an all-electric rate is—it's too much for the customers to bear . . . ." See Tr. 1068-69.

131. Company witness Tim Rush also presented evidence of the severe impact upon customers from the elimination of space heating and all-electric rates. See Tr. 1024-25. He included an analysis for space heating customers in the MPS and L&P areas at various usage levels. See GMO-136, Rush Surrebuttal, Sch. TMR-12.

132. Based upon this analysis, some space heating customers would have substantial increases if the space heating rate was eliminated—before any overall increase was granted in this case. Such increases, in the words of Michael Scheperle, would be "too much for the customers to bear" merely to promote the competitive interests of MGE.

2. Staff's Proposal to Increase by 5% the First Block of the Residential Space Heating Rates.

133. The Company believes that the record does not justify increasing the first block of the residential space heating rate by 5%, as suggested by Staff. Any increase in rates should be

spread equally to all classes and rate components. See GMO-134, Rush Direct at 10-13; GMO-135, Rush Rebuttal at 2-14. As explained in the Companies' Initial Brief, there is no cost justification for increasing the first block of the residential space heating rates by more than the system average increase.

D. GMO's MEEIA Application.

134. No additional comments are necessary regarding the Missouri Energy Efficiency Investment Act ("MEEIA") Application.

E. GMO Fuel Adjustment Clause.

1. The FAC Should be Approved as Requested by GMO.

135. No party presented a witness who opposed the continuation of GMO's FAC. The only parties who opposed some form of the FAC were AARP and the Consumers Council of Missouri, of whom only AARP submitted a brief.[21]

136. AARP opposed the passage of Senate Bill 179 and continues to oppose any utility that seeks to implement an FAC or other rate adjustment mechanism under Section 386.266. AARP objects to the FAC as an "anti-consumer piecemeal mechanism," but fails to recognize the continuous scrutiny that the prudence reviews provide under Section 386.266.4(4), as well as the annual true-up process that remedies any over-collections under Section 386.266.4(2).

137. AARP also fails to note that while fuel and purchased power costs have increased during the majority of the accumulation periods of the FAC, the most recent period saw a lowering of costs to consumers as a result of price decreases. See Staff-258, Staff GMO Cost of Service Report at 267. The Commission approved this cost adjustment in tariffs that lowered the FAC by $1.91 per month in the MPS service territory and by $1.47 in the L&P territory. See

[21] Consumers Council of Missouri submitted a filing that merely adopted AARP's Initial Brief.

Order Approving Tariff to Change FAC Rates, In re KCP&L Greater Mo. Operations Co., Case No. ER-2012-0478 (Aug. 15, 2012).

138. The FAC and its statutory framework provide a balanced approach to dealing with fuel costs, and AARP has provided no persuasive reason why GMO's FAC should not be continued.

2. Fuel Adjustment Clause: Sharing Mechanism.

139. GMO has proposed that the FAC continue as it currently exists, where 95% of the prudently incurred fuel and purchased power costs are paid by customers, with 5% of those costs being absorbed by the utility. Staff has proposed to continue the FAC, but change the sharing mechanism to an 85%-15% ratio. See Staff Initial Brief at 70-71. Staff's arguments to change the sharing mechanism continue to rely upon an unfair and inaccurate characterization of the testimony of GMO witness Wm. Edward Blunk, a flawed analysis of KCP&L versus GMO third-party energy purchases, and a failure to recognize GMO's history of prudent fuel and purchased power practices.

140. Staff continues to misinterpret Mr. Blunk's testimony regarding GMO's hedging program. As Mr. Blunk stated both in his testimony in this case, as well as in the Third Prudence Review case (Case No. EO-2011-0390), hedging is done for the benefit of customers to protect them from sudden fluctuations in price. See GMO-103, Blunk Rebuttal at 6-7. Moreover, with the 5% share assessed to GMO, it is definitely not indifferent about the 5% which has amounted over the history of the FAC to $8.3 million. See Staff-258, Staff Cost of Service Report at 270-71.

141. Staff's Initial Brief fails to note anywhere in its argument that each dollar that GMO is allowed to recover under the FAC is thoroughly scrutinized for prudence. GMO has had an incentive from the first day that the FAC went into effect to do its best to assure the

Commission and its customers that all of its fuel and purchased power costs are prudently incurred. As part of that program, GMO implemented a hedging program that the Commission did find prudent in the Third Prudence Review, contrary to the claims of Staff. See Report and Order at 65-66, In re Third Prudence Review of Costs subject to the Fuel Adjustment Clause of KCP&L Greater Mo. Operations Co., Case No. EO-2011-0390, (Sept. 4, 2012). While the FAC is a sensible mechanism that allows public utilities, upon the approval of the Commission, to recover such costs on a more timely basis under Section 386.266, it does nothing to relieve GMO or any other public utility from its obligation to conduct itself prudently.

142. Staff's second point in its Initial Brief continues to misinterpret Section 3.190 data supplied to the commission. As Company witness Ryan Bresette testified, during 2011 the power that KCP&L bought for GMO was at an average price of $38.15 MWh, and the average price of the power KCP&L bought to serve its own load obligations was $38.95 MWh. See KCPL-9, Bresette Surrebuttal 6-7. Because Section 3.190 does not distinguish between inter-company transactions and off-system sales with other companies, Staff's analysis is not accurate. When the information used from the Companies' FERC Form 1 is analyzed, as Mr. Bresette explained, a full and accurate picture is provided. See KCPL-8, Bresette Rebuttal at 13-14. There were no practices implemented by either GMO or KCP&L that operated to GMO's detriment. See KCPL-9, Bresette Surrebuttal at 2-7.

143. Staff also criticizes GMO for relying upon short-term purchased power agreements, even though Staff witness Mr. Barnes admitted that at today's low prices, this strategy has worked to the benefit of customers. See Tr. 828-29. If Staff prefers GMO to consider building a new generating unit, as opposed to relying upon purchased power agreements, this is a matter for Chapter 22 resource planning and should be pursued accordingly. Moreover, Staff's reference to GMO's position on rebasing in earlier rate cases is not relevant to

this proceeding. From the beginning, GMO has made it clear in this case that it will rebase energy costs. See GMO-134, Rush Direct at 4:13-15.

144. Finally, Staff fails to appreciate that its proposal will triple the costs that GMO will be required to absorb when fuel and related costs increase. During the past ten accumulation periods the cost of fuel has risen in each period, except the most recent one. See Staff-258, Staff Cost of Service Report at 265. The anomaly that occurred in the tenth accumulation period resulted from the unprecedented decline in the price of natural gas, which was reflected in whole sale electricity prices. Id. at 267. However, since that time, natural gas prices have increased, and it is likely that fuel prices will once again be on the rise, as they have since the FAC was approved in 2007. Id. at 265-67. See also Report and Order at 29-32, In re Third Prudence Review of Costs Subject to Fuel Adjustment Clause of KCP&L Greater Mo. Operations Co., No. EO-2011-0390 (Sept. 4, 2012).

145. In light of the current expectations that fuel prices will continue to rise, there is no reason to accept Staff's recommendation to triple the costs that GMO will be required to absorb even if every penny is prudently incurred on behalf of customers. When the Commission approved GMO's FAC in 2007, it established the 95%-5% formula as "a significant incentive" for GMO to take "all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment." See Report and Order at 54, In re Aquila, Inc., Case No. ER-2007-2004 (May 17, 2007). Since that time, the Company has prudently administered its fuel and purchase power procurement operations, thus fulfilling the objectives of the Commission. The 95/5 formula has worked well, and Staff has provided no good cause for the Commission to change it.

V. CONCLUSION.

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

147. The Companies believe that competent and substantial evidence on the record as a whole supports their position on the issues as described above. Resolution of these issues as the Companies propose will lead to just and reasonable rates that properly balance the interests of shareholders and customers, and that give the Companies an opportunity to earn a reasonable rate of return following the conclusion of the case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 11th day of December, 2012, to all counsel of record.

/s/ Lisa A. Gilbreath
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