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

and

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

REPLY POSTHEARING BRIEF OF

MIDWEST ENERGY CONSUMERS' GROUP

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COMES NOW the Midwest Energy Consumers' Group (collectively referred to herein as "MECG") by and through the undersigned counsel, pursuant to the Commission's April 26, 2012, *Order Consolidating Cases for Hearing and Setting Procedural Schedule, and Amended Notice of Hearing*, and provides its post-hearing reply brief. Specifically, this brief will address the combined KCPL / GMO issues of: (1) capital structure; (2) return on equity; and (3) transmission tracker. This brief will also address the KCPL specific issue regarding class cost of service / rate design and the GMO specific issue regarding Crossroads valuation, deferred taxes and transmission expense.

I. <u>CAPITAL STRUCTURE</u>

- MECG Initial Brief at pages 34-38.
- KCPL / GMO Initial Brief at pages 38-40.
- OPC Initial Brief at pages 19-22.

In its Initial Brief, MECG demonstrated that KCPL's proposed true-up capital structure is unreasonable. Specifically, MECG showed that KCPL's capital structure relies heavily on common equity – the most expensive form of capitalization. In fact, while KCPL's comparable company group has an average equity ratio of 49.6%; KCPL's true-up capital structure contains 52.56% common equity. In fact, KCPL's capital structure contains more of the expensive equity than 17 of the 21 companies included in its comparable company group.[1] Importantly, as MECG demonstrated, there are no benefits to ratepayers associated with this higher equity ratio. While KCPL's equity ratio is higher, it is not enough higher to reduce debt costs.[2] Therefore, the only practical effect of the equity rich capital structure is to inflate KCPL's revenue requirement.[3] Finally, MECG showed that KCPL's equity rich capital structure is not reflective of ongoing operations. Instead, this capital structure only exists momentarily while KCPL intentionally waits to refinance its current short-term debt, that was used to refinance maturing long-term debt, with new long-term debt issuances planned after the true-up period. This refinancing activity is inevitable and, when complete, will significantly reduce the equity ratio in KCPL / GMO's capital structure.[4]

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[1] MECG Initial Brief at pages 35-36.
[2] *Id.* at page 36.
[3] *Id.* at pages 37-38.
[4] *Id.* at page 37.

For these reasons, MECG proposed a capital structure that is consistent with the capital structure exhibited by the comparable company group. This KCPL capital structure would include 50% equity and 50% debt. In the past, the Commission has expressly authorized the use of such a capital structure as part of "its duty to protect the ratepayers" from rates that are based upon an equity-rich capital structure.[5]

In its Initial Brief, KCPL argues that the Commission should utilize its equity-rich capital structure simply because it is the "capital structure of their holding company Great Plains Energy Incorporated as of August 31, 2012." In making this recommendation, however, KCPL does not refute the notion that its capital structure is: (1) overly reliant on expensive common equity; (2) differs significantly from the capital structure of its comparable company group; (3) results in an inflated revenue requirement; or (4) provides no benefit to KCPL ratepayers. Instead, KCPL simply glosses over all of these criticisms of its capital structure.

Interestingly, however, KCPL actually acknowledges that its capital structure is not reflective of ongoing operations. In its Initial Brief, MECG pointed out that KCPL has used short-term debt to refinance a significant amount of long-term debt that is usually included in its capital structure.[6] Since KCPL has excluded this short-term debt, KCPL's equity ratio is artificially inflated. As KCPL admits, once this short-term debt reaches a balance of $300 million, it will be refinanced with long-term debt and the common equity ratio will then immediately fall back to approximately 50%.[7] In other words, KCPL's equity ratio is illusionary. KCPL acknowledges that it plans to refinance

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[5] *Report and Order*, ER-93-41 and EC-93-252, issued June 25, 1993, at page 252.
[6] MECG Initial Brief at page 37 (citing to KCPL Exhibit 10, Bryant Rebuttal, pages 6-11).
[7] *Id.* citing to Tr. 360-363.

this short-term debt balance shortly after the conclusion of the true-up.[8] As such, the equity-rich capital structure is not reflective of ongoing operations.

In its Initial Brief, KCPL admits many of these basic points. Specifically, KCPL admits it KCPL was "relying upon low-cost short-term debt on an interim basis to refinance high-cost long-term debt."[9] Further, the Company acknowledges that it has excluded this short-term debt from its capital structure.[10] The practical effect of this reliance on short-term debt and subsequent exclusion of this same debt is to artificially inflate the equity ratio in the capital structure. Finally, KCPL admits that it will "refinance this short-term debt next year."[11] As such, the equity-rich capital structure existing as of the true-up date is illusionary and not reflective of ongoing operations.

Given that KCPL's capital structure is not reflective of ongoing operations, reflects significantly more equity than that of the comparable company group, provides no benefit to ratepayers and serves to artificially inflate KCPL's revenue requirement, MECG urges the Commission to implement a capital structure consisting of 50% equity and 50% debt. Such a capital structure is reflective of ongoing operations, is consistent with the comparable company group and reflects KCPL's intentions to refinance the short-term debt in its capital structure immediately following the implementation of new rates.

[8] *Id.* (citing to KCPL Exhibit 10, Bryant Rebuttal, pages 6-11).
[9] KCPL Initial Brief at page 39.
[10] *Id.* at page 40.
[11] *Id.* at page 39.

II. RETURN ON EQUITY

- MECG Initial Brief at pages 12-33.
- KCPL / GMO Initial Brief at pages 13-38.
- OPC Initial Brief at pages 11-19.
- Staff Initial Brief at pages 9-41.
- FEA / DOE Initial Brief at pages 1-12.
- MIEC Initial Brief at pages 6-7.
- AARP / CCM Initial Brief at pages 10-12.

In reading KCPL's Initial Brief, one is immediately struck by contradictions as well as Dr. Hadaway's continuing refusal to correct the problems that have consistently plagued his analysis. These problems have been repeatedly referenced by other state utility commissions in rejecting Dr. Hadaway's inflated recommendations. Undoubtedly, for these reasons, this Commission and many other state commissions have repeatedly found Mr. Gorman's testimony to be more credible than Dr. Hadaway's "transparent efforts to inflate the company's proposed return on equity."[12] Recognizing the continually changing composition of the Commission, however, MECG will not simply rely on this Commission's previous rejections of Dr. Hadaway's analysis. Instead, MECG will address in detail each of the contradictions in KCPL's brief as well as the problems plaguing its witness' analysis. Ultimately, the Commission should once again see that Michael Gorman "did the best job of presenting the balanced analysis the Commission seeks."[13]

[12] *Report and Order*, Case No. ER-2007-0004, issued May 17, 2007, at page 59 (emphasis added).
[13] *Id.* at page 60.

A. KCPL'S RELIANCE ON OTHER STATE UTILITY DECISIONS

On at least 8 different occasions,[14] KCPL urges the Commission to consider the return on equity decisions authorized by other public utility commissions. The problem with reliance on the decisions of other public utility commissions is that they become circular and return on equity would never change despite changing economic conditions.

> The Commission does not believe it would necessarily be appropriate for its return on equity finding to simply mirror the national average. That average, of course, could be appropriate for KCPL, or for any other utility. But, if all commissions just approved average ROEs, then returns on equity would not change, and commission approved ROEs would merely cluster around each other despite changing economic conditions and different companies' management styles. The circularity of such behavior should be apparent.[15]

The Missouri Court of Appeals has also criticized Missouri utilities' arguments to impose an average return on equity requirement on the Commission. "The average rate, although an important factor, is far from a precise indicator of a proper rate. Averages do not factor unusual circumstances and other significant situations."[16]

KCPL's continued reliance on these other return on equity decisions is not surprising. Given the changing economic conditions that the Commission has previously referenced, KCPL wants the Commission to rely on stale commission decisions that have not considered the fact that the cost of capital has declined significantly. In other words, by relying on stale decisions, KCPL hopes to leverage a return on equity that is inflated for today's economic conditions.

Noticeably, when interest rates and required equity returns are dropping, utilities are constantly lagging behind. Instead, given their nostalgic feelings for the higher

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[14] KCPL Initial Brief at paragraphs 26, 27, 29, 38, 93, 94, 95 and 96).

[15] *Report and Order*, Case No. ER-2007-0291, issued December 6, 2007, at page 13 (emphasis in original).

[16] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 574 (Mo.App. 2009).

returns that were authorized last month or last year, utilities like KCPL continually reference these dated state utility commissions. The problems with such decisions are obvious. For instance, in its brief, KCPL references a North Dakota decision from February 29, 2012 authorizing a return on equity of 10.4%.[17] In addition to being 10 months old, that North Dakota decision undoubtedly relied upon economic conditions that were already 4-6 months old. Therefore, the economic conditions underlying the decision now referenced by KCPL are already 14-16 months old. Essentially, instead of relying upon the lower capital costs existing today, KCPL wants the Commission to base its return on equity on the economic conditions underlying that decision; economic conditions that are now 14-16 months old. The practical effect of KCPL's reliance on dated state utility decisions and the stale economic conditions reflected in those decisions is that its recommendations are inflated for today's economic conditions.

B. KCPL'S RECOMMENDATION IS ADMITTEDLY INFLATED

By its own evidence, KCPL acknowledges that it is requesting a return on equity that is inflated. Twice in its brief, KCPL acknowledges that its witness believed that a 9.80% return on equity is reasonable.[18] Nevertheless, KCPL inexplicably requests a return on equity of 10.30%.[19] KCPL provides no basis for this inflated request – no reference to increase risk, inability to access capital or problems providing safe and adequate service. Rather, KCPL simply makes a passing reference to the "current state of the economy."[20] KCPL fails to recognize, however, that the 9.80% return on equity found to be reasonable by its own witness is based upon the "current state of the

[17] KCPL Initial Brief at page 38.
[18] KCPL Initial Brief at paragraphs 28 and 50.
[19] KCPL Initial Brief at paragraph 96.
[20] KCPL Initial Brief at paragraph 96.

economy." Therefore, such considerations are already factored into and considered in the 9.80% return on equity. Ultimately, the Commission should recognize KCPL's request as nothing more than another attempt to inflate its revenue requirement at a time when ratepayers are suffering under the unaffordability of KCPL's rates. KCPL's inflated request is completely contrary to the Commission's own description of its role. "The Commission is trying to find the lowest reasonable rate that protects the interests of ratepayers and shareholders. That is what it has always done."[21]

C. THE ACTUAL ZONE OF REASONABLENESS (8.0% - 10.3%)

KCPL actually gives some valuable direction to the Commission. As KCPL points out, the zone of reasonable range in any case, is "the zone between the lowest rate not confiscatory and the highest rate fair to the public."[22] As such, this better defined zone should replace the arbitrary 100 basis point zone previously relied upon by the Commission. The Commission's previous zone, since it relies solely on the stale national average return on equity, does not provide a good estimation of either the higher or lower end of this zone.

In this case, evidence and admissions provide a good and up to date estimation of the true zone of reasonableness. Specifically, even though not actually supported by the analysis of its return witness, the higher end of the zone would equate to the 10.3% return on equity requested by KCPL. On the other hand, the bottom limit of the zone is somewhere below 8.0%. As KCPL admits, Staff's Witness presents a range of return of 8.0% to 9.0%.[23] While KCPL dislikes the 8.0% return, it acknowledges that such a return

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[21] *Report and Order*, Case No. ER-2011-0028, issued July 13, 2011, at pages 73-74.
[22] KCPL Initial Brief at paragraph 37 (citing to *In re New Jersey Power & Light Co. v. State*, 89 A.2d 26, 44 (N.J. 1952).
[23] KCPL Initial Brief at paragraph 64.

would not be confiscatory. Instead, KCPL characterizes such a return as "the lowest rate of return that [the Commission] can constitutionally determine without being unlawfully confiscatory."[24] Therefore, the zone of reasonableness as defined by the evidence, and admitted by KCPL, would extend somewhere below 8.0% to 10.3%.

D. KCPL REFUSAL TO CONSIDER AFFORDABILITY

As mentioned, despite its acknowledgment that a reasonable return on equity would be 9.80%, KCPL inexplicably requests a return on equity of 10.30%.[25] While KCPL has paid lip-service to the notion of affordability and the "difficult economic times" currently being experienced in its service area,[26] it is apparent that such consideration did not extend to its return on equity recommendation.

KCPL's refusal to acknowledge the real world conditions being experienced by its ratepayers is reminiscent of the same lackadaisical attitude taken by Rocky Mountain Power. In its decision in a Rocky Mountain Power rate case, the Idaho Commission criticized Rocky Mount Power and its return on equity witness (Hadaway) for their "failure to consider the economic conditions faced by ratepayers.

> ***We find that RMP has, in this case, downplayed the poor economic conditions that exist in its Idaho service territory where many are on fixed incomes, unemployed and underemployed***. This Commission cannot discount as simply anecdotal the testimony and comments of RMP customers. While we cannot say "No" to a requested increase in rates because customers are uniform in their opposition, together their testimony serves as the real-life context and backdrop of our decision. Their testimonies and comments remind us that we are not engaged in simply an academic exercise dealing in regulatory principles, generalities and industry averages. Our decision has real consequences. ***RMP is not immune or shielded from the state of the local economies in its service***

[24] KCPL Initial Brief at paragraph 28.
[25] KCPL Initial Brief at paragraph 96.
[26] KCPL Exhibit 2, Bassham Direct, at pages 8-10.

> ***area. They are a factor in our decision as to what is fair, just and reasonable. RMP is part of the economy, not separate from it.***[27]

In this case, the best demonstration that KCPL continues to downplay "the poor economic conditions that exist in its service territory" is not only in its inflated and unsupported return on equity recommendation, but also in its refusal or inability to bring its A&G costs in line with other utilities. As pointed out in MECG's Initial Brief, KCPL's A&G costs are highest among all Missouri and Kansas electric utilities.[28] MECG demonstrated that, if KCPL reduced its A&G costs to the level incurred by the next worst electric utility, this rate case would have been largely unnecessary.[29]

In light of the excessive A&G costs included in rates, it is reasonable for the Commission to not only reject KCPL's inflated return on equity recommendation, but to also set a return that is at the low end of the range of reasonableness. As Missouri and federal courts have recognized, the Commission is free to set a lower return on equity to account for deficiencies in the utilities' service.[30] Recognizing, then, that 50 basis points are worth approximately $9.0 million in rates,[31] the Commission could reduce rates by $9.0 million simply by reducing its authorized return on equity from 9.50% to 9.0%. KCPL could then easily make up this difference by reducing its A&G costs by $9.0 million. It is important to remember that profit not only comes from the Commission's authorized return on equity, but also by the utility's ability to control costs. In this case,

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[27] PacificCorp d/b/a Rocky Mountain Power, Order No. 32196, Case No. PAC-E-10-07, issued February 28, 2011 (Idaho PUC) at page 11 (emphasis added).
[28] MECG Initial Brief at page 26.
[29] *Id.* at page 27.
[30] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 576 (Mo.App. 2009); D.C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 466 F.2d 394, 419-20 (D.C.Cir.1972).
[31] OPC Exhibit 316 (Difference between KCPL return on equity of 10.40% and Staff return on equity of 9.00% (140 basis points) is worth $24,561,635. Therefore, 50 basis points are worth $8.77 million).

the Commission should set a reduced return on equity and push KCPL to generate more profits through the reduction of these excessive A&G costs.

E. CREDIBILITY OF THE WITNESSES

In an obvious attempt to bolster the diminished credibility of its witness, who has been repeatedly rejected in favor of the objective analysis of Mr. Gorman, KCPL claims that Dr. Hadaway has testified on behalf of "industrial customers." Referencing Dr. Hadaway's experience contained in an appendix to his testimony, one immediately recognizes that such a claim is laughable. Since he left the Texas Public Utility Commission in August of 1983, Dr. Hadaway has testified on return on equity / cost of money in at least 143 cases. The only case in which Dr. Hadaway testified on behalf of an industrial customer was his first case immediately after leaving the Texas Commission. Therefore, despite KCPL's claims, Dr. Hadaway has not testified on behalf of industrial customers in over 27 years and over 143 cases. Similarly, Dr. Hadaway has not testified on behalf of state utility commissions, residential advocates or any other customer group. Instead, Dr. Hadaway has devoted his career entirely to testifying on behalf of regulated utilities. In contrast, Mr. Gorman has testified for numerous consumer groups and residential advocates. Furthermore, demonstrating the objective nature of his testimony, Mr. Gorman has testified on behalf of several public utility commissions.

This Commission has had several opportunities to consider the merits of Mr. Gorman's objective testimony as compared to Dr. Hadaway. Repeatedly, the Commission has rejected Dr. Hadaway's "transparent efforts to inflate the company's proposed return on equity." In its 2007 Aquila decision, the Commission expressly

considered the opinions and recommendations of both Gorman and Hadaway. In that case, the Commission made several findings regarding Hadaway's analysis. "When the Commission steps back, the first pattern that emerges is the realization that ***the rate of return advocated by the expert who testified for Aquila [Hadaway] is too high.***"[32] Still again, the Commission noted, "the construction risk upward adjustment proposed by Dr. Hadaway appears to be a ***transparent effort to inflate the company's proposed return on equity.***"[33]

In contrast, the Commission obviously preferred Mr. Gorman's analysis. "In particular, the Commission accepts as credible the testimony of SIEUA, AG-P, and FEA's witness, Michael Gorman."[34] "Of the witnesses who testified in this case Michael Gorman**,** the witness for SIEUA, AG-P and FEA, did the best job of presenting the balanced analysis the Commission seeks."[35] Similarly, in the last KCPL rate case, the Commission stated that it "finds Mr. Gorman's testimony to be more credible than the testimony of Mr. Murray and Dr. Hadaway."[36] Other commissions have been virtually unanimous in their preference for the objective analysis of Mr. Gorman versus the flawed analysis of Dr. Hadaway.[37]

Similar sentiments have been recently expressed by numerous individual Commissioners in the deliberations of the pending Ameren rate case. Clearly, once again, Mr. Gorman's testimony is more credible than Dr. Hadaway.

[32] *Report and Order*, Case No. ER-2007-0004, issued May 17, 2007 (emphasis added).
[33] *Id.* (emphasis added).
[34] *Id.*
[35] *Id.*
[36] *Report and Order*, Case No. ER-2010-0355, issued April 12, 2011, at page 117.
[37] See, *Washington Utilities and Transportation Commission v. PacifiCorp*, 2006 Wash. UTC Lexis 156, 170 (Washington Utilities and Transportation Commission, April 17, 2006).

F. DR. HADAWAY RELIANCE ON NON-PUBLISHED DATA

In its Initial Brief, KCPL criticizes Staff's witness for reliance on "articles, reports and data from investment bankers which are not part of the public process to set public utility rates."[38] KCPL's criticism represents the epitome of hypocrisy.

KCPL's witness has been repeatedly criticized for his reliance on data that was created by him and, therefore, "not part of any public process." Recognizing the obvious flaws of using short-term growth rates in a DCF methodology that is focused on a perpetual income stream,[39] Dr. Hadaway utilizes a multi-stage growth DCF that relies on a long-term forecast of gross domestic product ("GDP"). Seeking a high GDP growth rate to drive his inflated return on equity recommendations, Dr. Hadaway rejects all of the accepted and publicly available forecasts of GDP. Instead, Dr. Hadaway formulates his own estimate of long-term GDP growth which, by his own admission, is not published or available as part of any public process.

Recognizing that the DCF analysis is designed to determine the cost that investors require for an equity investment in a particular company, the Commission has routinely insisted that any DCF assumptions be published and available to the very investors for which the DCF attempts to quantify a return on equity.

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

[38] KCPL Initial Brief at paragraph 84. See also, KCPL Initial Brief at paragraph 68.
[39] As KCPL admits, "a basic assumption of the DCF model is that the dividend growth rate is constant in ***every year to infinity***." KCPL Initial Brief at paragraph 86, footnote 13.
[40] *Report and Order*, Case No. ER-2010-0036, issued May 28, 2010, at page 20, paragraph 18 (emphasis added).

Given that Dr. Hadaway's GDP projections are not published, investors do not have access to this data and "cannot rely on [Hadaway's estimate] in deciding where to invest their money."

G. DR. HADAWAY'S OVER-RELIANCE ON HISTORICAL DATA IN HIS PROJECTION OF GDP GROWTH RATE

In its Initial Brief, KCPL justifies its inflated return on equity by specific reliance on Dr. Hadaway's multi-stage DCF analysis.[41] As mentioned, that model relies primarily on Dr. Hadaway's subjective estimation of the GDP growth rate. Putting aside issues with the fact that Dr. Hadaway's GDP estimate is not published and is unavailable for any market investors, his GDP growth estimate is also inflated because of his over-reliance on historical data. Specifically, as KCPL notes, "Dr. Hadaway used a 5.7% growth rate." "Notably, this 5.7% growth rate is lower than the 6.6% average nominal GDP growth rate in the United States over the past 60 years."[42]

Again, Dr. Hadaway's reliance on historical data, instead of publicly available, well scrutinized forecasted data is problematic. The problem associated with relying on historical data as it applies to a mature industry, like the electric industry, is well recognized. The use of any measure of GDP growth as an input to the constant growth DCF model is of questionable applicability to the electric industry. Specifically, the GDP growth reflects the overall growth in the U.S. economy and includes both high growth industries (biotech, healthcare, etc.) and industries expected to experience lower growth. Typically, given the maturity of the electric industry, it is not expected that the electric industry will actually experience the same level of growth experienced in the economy as

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[41] KCPL Initial Brief at paragraphs 85-86.
[42] KCPL Initial Brief at paragraphs 85-86.

a whole. As such, the use of any GDP growth rate estimate will likely result in an overstated return on equity. As the Arkansas Commission has pointed out:

> With regard to Mr. Hadaway's use of the Gross Domestic Product (GDP) growth rate, he is correct that investor-expected dividend growth rates overall are likely correlated with GDP growth rate. However, he has failed to demonstrate that industry-specific DCF investor-expected growth rates are also equal to the nominal GDP growth rate. This is a crucial distinction. For example, a mature industry may have a rich dividend yield and a small expected growth rate, while a young industry may, conversely, have a small dividend yield and a large expected growth rate. It would be reasonable to expect the mature industry's expected dividend growth rate to be less than nominal GDP growth, while the young industry's expected growth is greater than GDP growth.[43]

Similarly, the Washington Commission held:

> The principal disagreement between the Company and its expert critics centers on Dr. Hadaway's use of nominal historical GDP growth rates in the DCF formula. We do not take issue with Dr. Hadaway's opinion that the DCF formula requires a long-term growth rate or that growth in GDP may serve as a better measure of long-term growth than analysts' forecasts in the short-term. ***However, in this case, we find persuasive Mr. Gorman's argument, that if growth in GDP is used for this critical input to the DCF formula, it should be a forward-looking, not an historical average.***[44]

Interestingly, in its own brief, KCPL itself contradicts and criticizes Dr. Hadaway's reliance on historical data in the development of his GDP growth rate. Specifically, referencing text books on the subject, KCPL admits that historical growth rates are problematic in that they can be "biased by non-recurring events or by structural shifts in the fundamentals of the industry and / or the company."[45] Still again, while Dr.

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

[44] *Washington Utilities and Transportation Commission v. PacifiCorp*, 2006 Wash. UTC Lexis 156, 170 (Washington Utilities and Transportation Commission, April 17, 2006) (emphasis added).

[45] KCPL Initial Brief at paragraph 92 (citing to Roger A. Morin, New Regulatory Finance (2006) at page 293.

Hadaway utilizes an inflated GDP estimate of 5.80%, KCPL claims a "slow but steady outlook for growth" of only 2.0%.[46]

In an attempt to divert attention from the short-comings of Dr. Hadaway's self-serving quantification of GDP growth (5.7%), KCPL criticizes Mr. Gorman's GDP growth assumption of 4.9%.[47] As Mr. Gorman explains, however, the 4.9% GDP estimate provided by *Blue Chip Financial Forecasts* suffers from neither of the problems with Dr. Hadaway's estimate. Specifically, instead of being self-serving like Dr. Hadaway's estimate, the *Blue Chip* estimate is published and publicly available. Furthermore, instead of being overly dependent on historical data that is not relevant to a mature industry, it reflects actual consensus economist estimates of forecasted GDP growth.

> *The Blue Chip Financial Forecasts* publishes consensus economists' GDP growth projections twice a year. These consensus analysts' GDP growth outlooks are the best available measure of the market's assessment of long-term GDP growth. These analyst projections reflect all current outlooks for GDP, as reflected in analyst projections, and are likely the most influential on investors' expectations of future growth outlooks. The consensus economists' published GDP growth rate outlook is 5.1% to 4.7% over the next 10 years.[48]

The practical effect of Dr. Hadaway's subjective, historically-derived GDP growth estimate is not surprising – it significantly increases his recommended return on equity. As Mr. Gorman points out, Dr. Hadaway's estimation of GDP growth rate is 5.8%.[49] In contrast, the "consensus economists' projections" of GDP growth is 4.80%.[50] When Dr. Hadaway's estimation of GDP growth is replaced with a more reliable

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[46] KCPL Initial Brief at paragraph 26.
[47] KCPL Initial Brief at paragraph 87.
[48] OPC Exhibit 300, Gorman Direct, pages 26-27.
[49] OPC Exhibit 300, Gorman Direct, page 47.
[50] *Id.*

measure, the results of his constant growth (GDP) DCF analysis drop from approximately 10.1% to 9.3%.[51]

Again, the Commission should not only reject Dr. Hadaway's inflated analysis, but also must question the credibility of any witness that repeatedly relies upon such self-serving and irrelevant assumptions in light of the myriad of publicly available and well scrutinized estimates.

H. KCPL'S CRITICISMS OF MR. GORMAN'S RISK PREMIUM ANALYSIS ARE MISPLACED.

In classic fashion, while its own witness summarily rejected his risk premium analysis because it results in a return on equity estimate that is lower than his recommendation,[52] KCPL nonetheless criticizes the results (9.10%) of Mr. Gorman's risk premium analysis. Specifically, KCPL claims that "Mr. Gorman fails to recognize the inverse relationship between equity risk premiums and interest rates."[53] Again, KCPL's criticisms are misplaced.

As Mr. Gorman explains, the relationship between equity risk premium and interest rates is not based on "a simple inverse relationship between risk premiums and interest rates, but rather is tied to perceived risk differentials between the two competing investments."[54] As all of the academic literature on the subject notes, any inverse relationship is not simply tied to changes in nominal interest rates, but rather is based upon "perceived risk differentials between debt and equity investments."[55]

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[51] *Id.* at page 48.
[52] KCPL Exhibit 19, Hadaway Direct, page 33.
[53] KCPL Initial Brief at paragraph 55.
[54] OPC Exhibit 301, Gorman Surrebuttal, page 11.
[55] *Id.*

These "perceived risk differentials," primarily as a result of inflation, did cause an inverse relationship to exist in the 1980s. That said, however, no inverse relationship has been recognized since the very early 1990s.[56] As Mr. Gorman notes, "the academic literature does not support a simplistic inverse relationship between interest rates and equity risk premiums. Rather, the authors of these studies recognize that equity risk premiums change with perceived changes in investment risk. Dr. Hadaway's simplistic analysis takes no account of changes to perceived risk, and inappropriately increases equity risk premiums for no other reason than a reduction in nominal interest rates."[57]

I. MR. GORMAN'S RECOMMENDATION ENSURES THE FINANCIAL HEALTH OF THE UTILITY.

At pages 15-19, KCPL recites a litany of holdings from various court decisions including portions of the two seminal United States Supreme Court cases on the issue of return on equity. At paragraph 32, KCPL notes that "a key concern in setting the appropriate return on equity is that the return be reasonably sufficient to maintain the financial health of the utility." In support of this notion, KCPL references both the Hope and Bluefield cases.

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[58]
>
> By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in

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[56] *Id.* at page 11.
[57] *Id.* at page 13.
[58] KCPL Initial Brief at paragraph 32 (citing to *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 693 (1923)).

> the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[59]

While KCPL makes reference to these legal directives, those directives were never actually considered within the return on equity recommendation of Dr. Hadaway.

In its decision, the Supreme Court stated that the return on equity recommendation should only be that amount necessary to preserve the "financial integrity" of the Company.[60] Based upon this requirement, Mr. Gorman undertook a "financial integrity" analysis designed to determine if his recommended 9.10% - 9.50% return on equity would allow the Company to preserve its current investment grade credit rating. The results of Mr. Gorman's financial integrity analysis conclusively show that "at my low-end recommended return on equity of 9.10% and the Company's actual capital structure, KCPL's financial credit metrics are supportive of an investment grade bond rating.[61]

While KCPL references the fact that any return on equity must support its credit rating, Dr. Hadaway completely fails to consider this requirement. Undoubtedly, this omission was due to the fact that, if a 9.10% return on equity is sufficient to maintain "financial integrity," KCPL's recommended return on equity of 10.30% is clearly excessive. Not wanting to demonstrate the excessiveness of its recommendation, KCPL simply omits any consideration of the "financial integrity" requirement.

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[59] KCPL Initial Brief at paragraph 32 (citing to *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591, 603 (1944)).
[60] *Id.*
[61] OPC Exhibit 300, Gorman Direct, at page 42.

III. **TRANSMISSION TRACKER**

- MECG Initial Brief at pages 39-50.
- KCPL / GMO Initial Brief at pages 44-59.
- Staff Initial Brief at pages 86-95.
- MIEC Initial Brief at pages 1-6.
- FEA Initial Brief at pages 1-7.

A. INTRODUCTION

It is abundantly clear, given the Initial Briefs filed in this matter, that virtually all parties believe that KCPL's proposed transmission tracker is bad regulatory policy. Specifically, Staff, MIEC, Federal Executive Agencies and MECG all urge the Commission to reject KCPL's proposed tracker mechanism. In fact, MIEC, MECG and FEA all argue that the KCPL proposal also runs afoul of the doctrine against retroactive ratemaking and is therefore unlawful.

In its Initial Brief, MECG pointed out that the KCPL proposal is **bad regulatory policy** because: (1) it seeks to replace the "opportunity" for recovery with a "guarantee" of recovery; (2) it significantly shifts the balancing of interests set forth by the Missouri Supreme Court and (3) it fails to meet the strict criteria set forth by the Commission for implementation of such an extraordinary mechanism. In addition, MECG claimed that KCPL's proposal is **unlawful** and contrary to the doctrine against retroactive ratemaking in that it seeks to provide for the recovery of past losses in future rates.

Despite the fact that MECG raised these points in its opening statement and its statement of positions, KCPL continues to ignore most of these arguments in its Initial Brief. Specifically, KCPL fails to address any of the points supporting the notion that its

proposal constitutes bad regulatory policy. Instead, KCPL simply wants the Commission to focus on the expected growth in this cost item[62] and the unreasonableness of Staff's conditions for the implementation of any tracker.[63]

In this reply brief, MECG will attempt to address the points raised by KCPL in its Initial Brief.[64] Without repeating the entirety of the arguments from its Initial Brief, MECG will again show that KCPL's proposed tracker constitutes bad regulatory policy and violates the doctrine against retroactive ratemaking.

B. TRACKER MECHANISMS DISTURB THE BALANCING OF RISK AND INCREASE THE PROBABILITY THAT RATES WILL BE EXCESSIVE.

In its Initial Brief, MECG pointed out that tracker mechanisms "disturb the balancing of risk and increase the probability that rates will be excessive."[65] KCPL again fails to address this allegation, but makes several statements in its brief that nevertheless support MECG's assertion. While MECG believes that any tracker is bad regulatory policy and does not believe that it should be implemented even with Staff's conditions, it is noticeable that KCPL has steadfastly held to the notion that any transmission tracker should only allow for recovery of past costs while ignoring any associated recovery of past revenues. Repeatedly in its brief, KCPL seeks to limit its tracker to only those transmission expenses and charges incurred as a result of its actions as a transmission

[62] KCPL Initial Brief at pages 44-47.
[63] KCPL Initial Brief at pages 47-56.
[64] Given its position that any transmission tracker is unlawful and constitutes bad regulatory policy, MECG will not directly address the reasonableness of any conditions to be attached to any tracker mechanism. Rather, if the Commission does seek to step on to this slippery slope and allow for the tracking of routine expenses, it should attached significant conditions, similar to those outlined by Staff, prior to granting such a tracker.
[65] MECG Initial Brief at pages 43-46.

customer.[66] KCPL, however, refuses to consider any offsetting revenues realized as a result of KCPL's actions as a transmission owner.[67]

KCPL's proposal violates one of the fundamental notions of ratemaking – that expenses and revenues be matched. "The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection. A test year is a tool used to find the relationship [matching] between investment, revenues, and expenses."[68] KCPL's proposal, and refusal to implement Staff's condition, violates the proper matching of expenses and revenues. Instead, KCPL seeks to track only those expenses / revenues associated with its role as a transmission customer. Not surprisingly, these expenses are expected to result in an increased revenue requirement in the future. On the other hand, KCPL seeks to ignore the expenses / revenues associated with its role as a transmission owner. These expenses / revenues would lead to a decreased revenue requirement, but as a result of KCPL's selective, one-sided proposal, KCPL seeks to ignore them.

KCPL's attempt to game the scope of tracking mechanisms is not new. In fact, the attempt to set the scope of the tracker to the detriment of its ratepayers has become routine for KCPL. KCPL has routinely sought to use tracker mechanisms to recover past expenses while leaving all revenues untracked; thereby allowing the utility to keep excess profits. For instance, in 2007, the Commission approved a fuel adjustment clause for

[66] KCPL Initial Brief at page 47, paragraph 122.
[67] KCPL Initial Brief at page 47, paragraph 123. The one-sided nature of KCPL's proposal is also reflected in its assertions against Staff's conditions. Specifically, Staff proposes that any tracker include all revenues and expenses. KCPL agrees to this proposal so long as it only includes expenses / revenues associated with KCPL acting as a transmission customer. KCPL objects to Staff's proposal to the extent that it includes revenues associated with its actions as a transmission owner. As KCPL urges, "the tracker would not include revenues related to other utilities' use of the Companies' transmission facilities."
[68] *State ex rel. GTE North v. Public Service Commission*, 835 S.W.2d 356, 368 (Mo.App. 1992) (citations omitted).

GMO. In the context of its first true-up docket following the implementation of that fuel adjustment clause, GMO refused to recognize the increase in off-system sales that would otherwise offset the increase in GMO's fuel expenses. By limiting the scope of the fuel adjustment clause to only expenses, GMO was able to exactly recover all expenses while realizing windfall profits associated with increased off-system revenues of over $5.3 million.[69]

Still again, in this case, GMO sought to implement a tracker mechanism to recover any depreciation and carrying costs associated with distribution plant replacement in St. Joseph.[70] Once again, in the context of this tracker, GMO resolutely refused to track any associated increases in revenues or decreases in other expenses.[71] As Mr. Meyer described GMO's one-sided tracker mechanism:

> It is quite interesting that GMO proposes to defer for future rate recovery the depreciation expense and return on plant investment, yet asserts that the increased revenues and decreased maintenance costs associated with those projects should wait to be reflected in customer rates until GMO's next rate case. GMO's proposal is a win / win for GMO.[72]

In its Initial Brief, MECG pointed out that there are factors that constantly work to cause rates to be excessive.[73] Similarly, there are factors that tend to cause rates to be inadequate.[74] By limiting its transmission tracker to only those items that tend to cause rates to be inadequate (e.g., transmission costs) without any consideration of related items that tend to cause rates to be excessive (e.g., transmission revenues), KCPL has intentionally sought to disturb the careful balancing of risks envisioned by the Supreme

[69] See, *Response of KCP&L Greater Missouri Operations Company to Staff Recommendation*, Case No. EO-2009-0431, filed July 6, 2009, at page 1.
[70] See, GMO Exhibit 140, Weisensee Direct, pages 51-52.
[71] See, MECG Exhibit 425, Meyer Direct, pages 22-23; MECG Exhibit 426, Meyer Surrebuttal, pages 20-23.
[72] MECG Exhibit 425, Meyer Surrebuttal, page 23.
[73] MECG Initial Brief at page 43 (e.g., transmission costs, fuel expenses and increased plant).
[74] *Id.* (e.g., increasing transmission revenues, depreciating rate base and increasing usage).

Court. Clearly, the Commission should realize by now that KCPL's transmission tracker is not simply about "ensuring the appropriate recovery of transmission costs."[75] If this were true, KCPL would willingly include transmission revenues as well as expenses in its tracker. In actuality, KCPL's transmission tracker is about increasing the possibility that rates will generate excessive profits.

C. KCPL'S TRANSMISSION COSTS DO NOT MEET THE CRITERIA FOR EXTRAORDINARY RATEMAKING MECHANISMS.

At pages 46-50 of its Initial Brief, MECG demonstrated that KCPL's transmission costs do not meet the Commission's strict criteria for implementation of an extraordinary ratemaking mechanism like a tracker. Specifically, the Commission has previously required a showing that a cost is: (1) volatile; (2) substantially large and (3) beyond management control. As MECG pointed out, KCPL never alleged, in all of its direct testimony, that its transmission costs are volatile.[76]

Interestingly, KCPL's inability to categorize its transmission costs as volatile extended to its Initial Brief. In over 15 pages of brief on this subject, KCPL never once argued that its transmission costs were "volatile." Instead, KCPL simply attempts to gloss over this deficiency by noting that these costs are "increasing."[77] But the fact that a cost is increasing does not mean that the cost is volatile. As the Commission has noted,

> Markets in which prices are volatile tend to go up and down in an unpredictable manner. When a utility's fuel and purchased power costs are swinging in that way, the time consuming ratemaking process cannot possibly keep up with the swings. As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates.[78]

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[75] GMO Exhibit 123, Ives Direct, page 11.
[76] *Id.* at page 49.
[77] KCPL Initial Brief at pages 44-47 (paragraphs 117-122).
[78] *Report and Order*, Case No. ER-2007-0002, issued May 22, 2007, at page 23.

In addition to its failure to meet the Commission's volatility criteria, KCPL also failed to make any showing that its transmission costs are substantially large or beyond management control. Instead, without any showing, KCPL simply makes the unsupported claim that these costs are "material" and "primarily outside the control of KCP&L and GMO."[79]

KCPL is unable to make a showing that these costs are material because there is no evidence to support such a finding. As shown at pages 46-47 of the MECG Initial Brief, the growth in transmission costs is only projected to be 4.2% of KCPL's total expenses. Certainly, this is not material and can be offset by increases in revenues or decreases in other costs, especially A&G costs.

The fact that KCPL fails to meet the criteria for an extraordinary ratemaking mechanism is also reflected in its decision not to conduct any cross-examination of MECG's witness on this issue. Interestingly, in its Initial Brief, KCPL criticized and implied weakness in Staff's position because of Staff's refusal to conduct cross-examination of KCPL's witnesses.

> Mr. Crawford was brought to the hearing room and tended for cross-examination to respond to questions that Staff had raised regarding his Rebuttal Testimony. Curiously, Staff declined to ask Mr. Crawford even one question. Similarly, Staff asked Mr. Blunk no questions regarding his GMO Surrebuttal Testimony when he was presented to the Commission at hearing.[80]

In hypocritical fashion, however, KCPL's criticism is equally applicable to its position on this issue. In his testimony, MECG witness Dauphinais repeatedly noted that KCPL failed to meet the criteria for the implementation of an extraordinary ratemaking

[79] KCPL Initial Brief at page 44.
[80] GMO Initial Brief at pages 69-70.

mechanism. Given the opportunity to cross-examine Mr. Dauphinais and challenge his opinion, KCPL simply waived cross-examination and left his opinion unrebutted.[81]

D. TRACKER MECHANISMS VIOLATE THE DOCTRINE AGAINST RETROACTIVE RATEMAKING.

At pages 41-42 of its Initial Brief, MECG proved, through citation to Missouri Supreme Court decisions, that KCPL's requested transmission tracker is unlawful. At pages 56-59, KCPL ineffectively argues that a tracker is lawful.

First, KCPL argues that, since Accounting Authority Orders ("AAOs") are lawful, then its proposed tracker must also be lawful. KCPL's argument is misplaced. While the Missouri Court of Appeals has found that AAOs are lawful, the Court has also held that such extraordinary treatment is limited solely to expenses that are "unusual or extraordinary."[82] As the Court noted, "extraordinary items" are:

> Those items related to the effects of events and transactions which have occurred during the current period and which are ***not typical or customary business activities*** of the company. Accordingly, they will be events and transactions of significant effect which ***would not be expected to recur frequently*** and which ***would not be considered as recurring factors*** in any evaluation of the ordinary operating processes of business.[83]

Using this definition of extraordinary, the Commission has allowed deferral and recovery of power plant build costs, as well as ice storm and tornado damage costs. Each of these costs could be considered not typical and not recurring. On the other hand, transmission costs are typical, customary and recurring. As KCPL admits, these costs have been incurred every year and are expected to be incurred every year. As such, it is misplaced

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[81] Tr. 741.

[82] *State ex rel. Office of the Public Counsel v. Public Service Commission*, 858 S.W.2d 806, 810 (Mo.App. 1993).

[83] *Id.* (emphasis added).

for KCPL to assert that, since an extraordinary cost may be deferred and recovered, its recurring transmission costs may also be deferred and recovered.

The reason for treating extraordinary costs differently than those costs that are typical, customary and recurring is made abundantly clear by the Court of Appeals.

> Deferral of costs just to support the current financial status distorts the balancing process utilized by the Commission to establish just and reasonable rates. Because rates are set to recover continuing operating expenses plus a reasonable return on investment, ***only an extraordinary event should be permitted to adjust the balance to permit costs to be deferred for consideration in a later period.***[84]

Clearly, since KCPL's transmission costs are not "extraordinary," they should not "be permitted to adjust the balance" that rates will be excessive or inadequate.

Second, KCPL attempts to argue the lawfulness of its proposed transmission tracker by bootstrapping it to the legislatively approved fuel adjustment clause. Again, KCPL's argument fails. As the Court held in its consideration of the fuel adjustment clause, the FAC has been expressly authorized by the General Assembly.[85] "By specifically stating that the legislature could authorize fuel adjustment clauses like the one adopted by KCP&L here, the Supreme Court in UCCM presumably contemplated that such clauses would not themselves violate the retroactive ratemaking doctrine."[86] In contrast, KCPL's proposed tracker mechanism and the deferral and recovery of past losses associated with transmission costs have not been authorized by the General Assembly. As such, any analogy to the Commission's fuel adjustment clause is necessarily misplaced.

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[84] *Id.* at page 811 (emphasis added).

[85] See, Section 386.266.

[86] *State ex rel. AG Processing, Inc. v. Public Service Commission*, 340 S.W.3d 146, 151 (Mo.App. 2011).

Finally, KCPL attempts to put aside any concerns with retroactive ratemaking by claiming that the "amount of the deferred cost to be recovered as well as other ratemaking issues would be determined in a later rate case."[87] KCPL's argument is a desperate attempt to preserve its proposed tracker and fails to reflect even an elementary understanding of KCPL's actual tracker proposal.

As reflected in its testimony and its Initial Brief, KCPL expects that any ratemaking issues associated with its proposed tracker would be made in this case and not in a later proceeding. As KCPL admits:

> The Companies propose that transmission costs (i.e., charges), as defined in the transmission tracker, be set in the true-up process in this rate proceeding. The Companies would then track actual charges on an annual basis against this amount, with the jurisdictional portion of any excess treated as a regulatory asset (Account 182) and the jurisdictional portion of any shortfall treated as a regulatory liability (Account 254). ***The regulatory asset or liability would be included in rate base.***[88] ***The regulatory asset or liability be amortized to cost of service in the Company's next rate proceeding, over the same length of period as costs are accumulated with the unamortized balance included in rate base.***[89]

The KCPL proposed tracker, therefore, does conflict with the doctrine against retroactive ratemaking because it would allow current losses to be recovered in future rates.

E. KCPL'S PROPOSED TRACKER IS PROHIBITED BY THE TERMS OF THE KCPL REGULATORY PLAN

In 2005, KCPL executed its Regulatory Plan. That regulatory plan provided the regulatory support necessary for KCPL to implement its Comprehensive Energy Plan.

[87] KCPL Initial Brief at page 57.
[88] *Id.* at page 47.
[89] KCPL Exhibit 29, Ives Direct, page 16.

One critical aspect of that Regulatory Plan was a commitment not to seek a fuel adjustment clause prior to June 1, 2015.[90]

In the context of the pending Ameren rate case, the Commission has verbally indicated that it is appropriate for transmission costs to be considered within the context of Ameren's fuel adjustment clause.[91] Such a position represents a radical shift from the Commission's previous position that transmission costs should not be included in the fuel adjustment clause.

> The Commission concludes that all transmission costs should not be included in GMO's adjustment clause because they are not included in section 386.266, RSMo. Supp. 2010, as a type of cost to be recovered through a fuel adjustment clause, they are inconsistent with the definitions of fuel and purchased power cost in 4 CSR 240-20.090(1)(B), and elsewhere, and they do not vary in a direct relationship with fuel or purchased power.[92]

MECG agrees with the Commission's previous decision to exclude transmission costs from the fuel adjustment clause. If the Commission reverses course and now decides that these transmission costs should be included in the fuel adjustment clause, then there are necessarily implications to that decision. Specifically, if transmission costs are now considered within the fuel adjustment clause, then they necessarily fall within the scope of KCPL's commitment not to seek a fuel adjustment clause. As such, KCPL's proposed transmission tracker would be a backdoor attempt to implement its forbidden fuel adjustment clause. This prohibition was astutely raised by Chairman Gunn and agreed to by KCPL.

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[90] *Stipulation and Agreement*, Case No. EO-2005-0329, filed March 28, 2005, at page 7, approved by the Commission on July 28, 2005.
[91] See, Commission deliberations at November 28, 2012 public meeting.
[92] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2011, at page 218.

Q. Since you signed the stipulation and agreement that said that you wouldn't ask for a fuel adjustment clause, wasn't the signing of that stipulation and agreement an acceptance of some risk from the company that conditions could occur that would be alleviated by a fuel adjustment clause?

A. Oh, absolutely.

Q. And the company is saying, we're willing – in order to get -- in order to get this agreement, we're willing to take that risk of those conditions changing upon us rather than -- rather than somewhere else?

A. That's correct. And one of the provisions in there accepting that risk was the ability to -- in -- rather than a fuel adjustment clause to ask for an IEC.[93]

In the case at hand, KCPL agreed not to seek a fuel adjustment clause until June 1, 2015. As KCPL acknowledged in response to questions from the Chairman, with this commitment, KCPL accepted the risk that conditions would change regarding the costs (including transmission costs) that would flow through that fuel adjustment clause. As such, KCPL's request for a transmission tracker is prohibited by its commitment in the Regulatory Plan. While KCPL was allowed to seek an interim energy charge, and may have been able to develop an interim energy charge that included such costs, it has voluntarily withdrawn its request for an IEC.[94] As such, the Commission should find that KCPL's transmission tracker is prohibited by its commitment not to seek a fuel adjustment clause until June 1, 2015.

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[93] Tr. 241-242.

[94] *Second Non-Unanimous Stipulation and Agreement as to Certain Issues*, Case No. ER-2012-0174, filed on November 8, 2012, at page 4.

IV. RATE DESIGN / CLASS COST OF SERVICE

- MECG Initial Brief at pages 51-61.
- KCPL / GMO Initial Brief at pages 2-6.
- OPC Initial Brief at pages 3-6.
- MIEC Initial Brief at pages 7-8.
- AARP / CCM Initial Brief at pages 12-13.

On October 29, 2012, a Non-Unanimous Stipulation and Agreement was executed and filed by Kansas City Power & Light Company, the Staff of the Public Service Commission, Midwest Energy Consumer's Group and the Missouri Industrial Energy Consumers. As provided by that settlement, the Signatories agree 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.

Given the objections of Public Counsel as well as AARP / Consumers Council of Missouri, the Stipulation must be treated as non-unanimous and the Commission is required, by rule and case law, to decide these issues. As Commission Rule 4 CSR 240-2.115(2)(D) provides, the opposed non-unanimous stipulation "shall be considered to be merely a position of the signatory parties to the stipulated position." Consistent with *State ex rel. Fischer v. Public Service Commission*,[95] all of the opposed issues "shall remain for determination after hearing."

Interestingly, despite their objections, OPC and AARP / CCM provide the Commission very little in their briefs to justify their opposition. Nevertheless, in this Reply Brief, MECG will address the points raised by OPC and AARP / CCM.

[95] 645 S.W.2d 39 (Mo.App. 1983).

Furthermore, since OPC and AARP / CCM rely entirely on the KCPL class cost of service study to justify their opposition to the interclass shifts, MECG will also address the limited discussion contained in the KCPL Brief.

In their Initial Briefs, OPC[96] and AARP / CCM[97] both expressly rely on the KCPL class cost of service study to support their belief that no cost shifts should be made from the commercial / industrial classes to the residential classes. As the results of the various class cost of service studies demonstrate, however, KCPL's class cost of service study is remarkably different than any other study and constitutes an outlier.[98]

INDEX OF RETURN

	Staff	**DOE**	**Industrials (A&E 4NCP)**	**Industrials (A&E 2NCP)**	**Industrials (4CP)**	**KCPL**
Residential	0.53	0.49	0.42	0.42	0.49	**0.98**
Small General	2.13	1.84	2.02	1.99	1.84	**1.98**
Medium General	1.55	1.31	1.42	1.41	1.31	**1.28**
Large General	1.29	1.34	1.42	1.45	1.34	**1.05**
Large Power	1.16	1.28	1.33	1.33	1.28	**0.54**

As Staff indicates:

> An Index of Return above 1.0 indicates revenue from the customer class exceeds KCPL's cost of providing service to that class; therefore, to equalize revenues and cost of service, rate revenues should be reduced, i.e., the class has overpaid. An Index of Return below 1.0 indicates revenue from the class is less than KCPL's cost of providing service to

[96] OPC Initial Brief at pages 3-5.
[97] AARP / CCM Initial Brief at pages 12-13.
[98] Staff Exhibit 233, Scheperle Rebuttal, page 3 (referring to KCPL Study contained in Normand Direct; Staff Study contained in Staff Class Cost of Service Report; DOE Study contained in Goins Direct; and Industrials Study contained in Brubaker Direct).

> that class; therefore, to equalize revenues, and cost of service, rate revenues should be increased, i.e., the class has underpaid.[99]

Therefore, while 5 class cost of service studies, including Staff's study, shows that residential rates are significantly below cost, KCPL's flawed study concludes that residential rates are virtually equal to cost. Similarly, while 5 studies show that industrial rates are well above cost, the flawed KCPL study shows that industrial rates are below cost.

The reason for the significant difference in the KCPL study is readily apparent. As OPC notes, "one of the most contested aspects of any CCOSS [Class Cost of Service Study] is the allocation of production plant."[100] While the Industrials, Staff and DOE all rely on production plant allocators that are readily accepted in the industry, the KCPL study relied upon by OPC and AARP / CCM, is based upon the BIP allocator – an "obscure and arcane method that has not found support in the industry."[101] In fact, despite being proposed for over 30 years, KCPL's witness can only identify a single instance in which his production plant allocator has been accepted by a state utility commission.[102]

Not only has the BIP production plant allocator fallen on deaf ears in other states, it is entirely at odds with the recent decisions of this Commission. Specifically, contrary to prior decisions, the BIP methodology over-emphasizes the importance of class energy usage in its allocation of production plant. By doing this, the BIP methodology minimizes the importance of class peak demand. In a recent Ameren decision, the

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[99] *Id.* at page 4.
[100] OPC Initial Brief at page 3.
[101] MECG Exhibit 408, Brubaker Surrebuttal, page 3.
[102] *Id.*

Commission expressly criticized production plant allocators that rely heavily on class energy usage and recognized the logic of the Average & Excess methodology.

> Some customer classes, such as large industrials may run factories at a constant rate, 24 hours a day, 7 days a week. Therefore, their usage of electricity does not vary significantly by hour or by season. Thus, while they use a lot of electricity, that usage does not cause demand on the system to hit peaks for which the utility must build or acquire additional capacity. Another customer class, for example, the residential class, will contribute to the average amount of electricity used on the system, but it will also contribute a great deal to the peaks on system usage, as residential usage will tend to vary a great deal from season to season, day to day, hour to hour. To recognize that pattern of usage, the Average and Excess method separately allocates energy cost based on the average usage of the system by the various customer classes. It then allocates the excess of the system peaks to the various customer classes by a measure of that class' contribution to the peak. In other words, the average and excess costs are each allocated to the customer classes once.[103]

As such, the Commission found that production plant allocators need to rely primarily on the relative class relative peak demand.[104]

In this case, KCPL's reliance on the class energy usage is even more predominant than it was when the Commission cautioned against its use. In the Ameren case, approximately 55% of production plant was allocated on the basis of class energy usage.[105] In contrast, the KCPL BIP methodology, now relied upon by OPC and CCM, allocates approximately 80% of production plant based upon class energy.[106] Certainly, the BIP methodology and its over-reliance on energy usage is faulty and should again be rejected.

Finally, in addition to its faulty allocation of production plant, the BIP study is also contrary to the Commission's stated method for allocating off-system sales between

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[103] *Report and Order*, Case No. ER-2010-0036, issued May 28, 2010, at pages 84-85.
[104] *Id.* at page 85.
[105] MECG Exhibit 407, Brubaker Rebuttal, page 6.
[106] *Id.*

the classes. In both a recent KCPL and Ameren case, the Commission stated that off-system sales should be allocated based upon energy usage. As the Commission stated in that KCPL decision:

> The only costs assigned to non-firm off-system sales is the fuel and purchased power costs – the variable costs – hence the appropriateness of using the energy allocator. This is consistent with the way KCPL itself allocates the costs relating to the energy portion of firm capacity contracts – using the energy allocator. The reason is simple – the energy allocator is used to allocate variable costs of fuel and purchased power costs relating to retail sales. ***Using the same rationale, the energy allocator is equally appropriate to use as the allocation factor for both energy of firm and non-firm off-system sales.***[107]

Despite the clarity of the Commission order in that KCPL case, KCPL has again neglected to allocate off-system sales on the basis of class energy usage.[108] As such, the KCPL BIP methodology is inherently unreliable and should be rejected by the Commission.

Noticeably, despite their reliance on the KCPL BIP study, neither OPC nor AARP / CCM attempt to resuscitate this "obscure and arcane method." In fact, while relying on the results of the KCPL study, OPC disavows any agreement with the specific allocators used within the study. "Public Counsel accepted the results of KCPL's CCOS for use in this case, but does not endorse any of KCPL's allocators."[109]

Similarly, KCPL has provided no support for its flawed BIP methodology. Instead, KCPL readily accepts that the BIP method provides results vastly different than all of the other studies.[110] Nevertheless, KCPL, as the sponsor of the study relied upon

[107] *Report and Order*, Case No. ER-2006-0314, issued December 21, 2006, at page 39.
[108] MECG Exhibit 407, Brubaker Rebuttal, page 6.
[109] *Public Counsel's Statement of Positions*, filed October 12, 2012, at page 3
[110] See, KCPL Brief at page 4.

by OPC and AARP / CCM and while citing specifically to this evidence[111], clearly points out that the revenue neutral shift envisioned by the stipulation "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."

Ultimately, as reflected in its proposed findings of fact, MECG asks that the Commission simply reaffirm its previous findings regarding the appropriate allocation of production plant as well as off-system sales. Specifically, MECG requests that the Commission again find that the Average and Excess production plant allocator appropriately considers both class energy and peak demand in its allocation of production plant. In contrast, the BIP methodology relied upon by OPC and AARP / CCM is faulty in that it is overly dependent on class energy usage in its allocation of production plant. Also, MECG requests that the Commission again find that off-system sales should be allocated among the classes on the basis of relative class energy usage.

Once the Commission has made these findings, MECG suggests that the Commission finds that the 1.0% revenue neutral shift of costs to the residential class, and the corresponding decrease to the non-lighting classes, appropriately considers gradualism and represents an appropriate step towards cost of service for all classes.

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[111] *Id.* at page 3.

V. CROSSROADS

Undoubtedly reflecting the clarity of the Commission's previous decision regarding the appropriate valuation of Crossroads, as well as the overwhelming strength and quantity of Staff's evidence on the subject, GMO's brief included six short pages on the issue of the appropriate valuation of Crossroads. By contrast, Staff's brief included 12 pages and the MECG brief contained 25 pages on this same subject. Despite its brevity, the GMO brief is fraught with: (1) outright falsehoods; (2) a fundamental misunderstanding of the notion of "original cost" as contained in the Uniform System of Accounts; and (3) a misstatement of the evidentiary requirements imposed upon the Commission. In this brief, MECG will demonstrate the flawed nature of GMO's brief. Once shown, given these shortcomings in GMO's arguments, the Commission must reject GMO's inflated valuation of the Crossroads unit.

A. STAFF PROVIDED COMPETENT AND SUBSTANTIAL EVIDENCE TO SUPPORT THE COMMISSION'S VALUATION METHODOLOGY AS WELL AS A LOWER VALUATION.

In its Initial Brief, GMO makes several allegations regarding the submitted evidence that are patently untrue. Specifically, GMO wrongfully claims that there is only evidence to support the use of its alleged "original cost" valuation. GMO claims:

> Although the Commission has substantial and competent evidence to support the Company's request to include Crossroads in rates based on its original value, ***there is no evidence to support any other valuation***.[112]
>
> But Staff never offers an opinion as to the value of Crossroads and ***never offers evidence in this case that would support the same finding previously entered by the Commission***.[113]
>
> Here, Staff has failed to include any testimony about the data upon which it bases its opinion. Without evidence of the data underlying Staff's

[112] GMO Initial Brief at paragraph 160 (emphasis added).
[113] *Id.* (emphasis added).

> suggestion, the Commission simply has no evidence upon which to find in favor of Staff's position.[114]
>
> Instead, Staff's position is to simply adopt the value the Commission placed on Crossroads in the last case. ***But Staff did not incorporate the evidence from the last case into this case and did not present evidence on which the Commission could decide in this case that the value of Crossroads is something other than original cost***.[115]

GMO's assertions are blatant falsehoods. The Commission should expect more from its utilities, especially when those utilities are expecting to access ratepayer pockets for expenses associated with its multitude of attorneys. Instead of devoting its time to considering viable arguments, the Commission is now expected to consider such non-issues. In the past, the Commission has criticized GMO for its failure to provide a "balanced analysis."[116] Certainly, falsehoods regarding the nature of the evidence do not fulfill the Commission's expectation of a "balanced analysis."

As the Commission can obviously deduce by now, MECG believes that there is a large amount of "competent and substantial evidence" to support the valuation methodology utilized in the last case. Indeed, contrary to GMO's assertion that there is only evidence to support its "original cost" valuation, Staff presents evidence to support the Commission's valuation methodology as well as a valuation that is significantly lower.

Specifically, Staff filed direct, rebuttal and surrebuttal evidence regarding the appropriate value for Crossroads. In its direct testimony, Staff provided 8 pages of testimony regarding the Crossroads valuation.[117] Included in that testimony is a section

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[114] *Id.* at paragraph 161.
[115] *Id.* at paragraph 165 (emphasis added).
[116] *Report and Order*, Case No. ER-2007-0004, issued May 17, 2007, at page 60.
[117] Staff Exhibit 258, Staff Cost of Service Report, at pages 73-80.

entitled Support For Crossroads Energy Valuations.[118] With references to Data Request responses and Aquila SEC filings, Staff details the fact that Aquila sold several combustion turbines to Ameren, identical to the Crossroads facility, at a cost of $205.88 / kW.[119] This is the value utilized by the Commission in its last decision. In addition, Staff provided evidence, in the form of Aquila admissions contained in SEC filings, that the actual fair market value of Crossroads is $172.00 / kW.[120] Furthermore, Staff provided evidence that Aquila had sold combustion turbines in Colorado and Nebraska for even lower prices.[121]

In rebuttal testimony, Staff presented an additional 15 pages of testimony on the valuation of Crossroads.[122] Again, with reference to SEC filings, data request responses and Uniform System of Accounts citations, Staff documents all the evidence underlying the Commission's previous valuation methodology – a methodology now supported by Staff.

In surrebuttal testimony, Staff presented an additional 58 pages of testimony[123] and 121 pages of Schedules consisting of Aquila data request responses, PowerPoint presentations, emails, requests for proposals, meeting minutes and letters, all supporting the Commission valuation methodology now adopted and supported by the Staff.[124] Finally, during the hearing, Staff submitted 3 exhibits, consisting of 70 pages,

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118 *Id.* at page 76.
119 *Id.* at pages 77-78.
120 *Id.* at pages 78-79 ($51.6 million ÷ 300,000 kW = $172.00 / kW).
121 *Id.* at pages 79-80.
122 Staff Exhibit 271, Featherstone Rebuttal, at pages 20-34.
123 Staff Exhibit 292, Featherstone Surrebuttal, at pages 60-117.
124 *Id.* at Schedules CGF-SUR-19 through 24.

documenting Aquila's efforts to sell Crossroads and its failure to even entice a single bidder.[125]

While GMO undoubtedly does not like the evidence provided by the Staff, such dislike should not be equated to a lack of evidence. Staff has provided competent and substantial evidence, in this case, to support the valuation methodology utilized by the Commission in the last case as well as evidence to support an even lower valuation. GMO's assertions must be rejected and the Commission should question GMO's credibility and candor.

B. COMMISSION PROCEEDINGS ARE NOT BOUND BY TECHNICAL RULES OF EVIDENCE, MISSOURI APPROVED INSTRUCTIONS OR OTHER REQUIREMENTS IMPOSED ON JURIES.

Recognizing the overwhelming nature of the Staff's evidence, GMO desperately seeks to have the Commission dismiss Staff's evidence through misplaced legal arguments. In an effort to force the Commission to adopt its erroneous definition of original cost,[126] GMO attempts to discredit the entirety of Staff's evidence. Specifically, GMO argues that Staff failed to meet the necessary standard for admission of expert valuation testimony. "The standards for admission of expert testimony are fundamental rules of evidence and opinions on value may not be relied upon unless they comply with these standards."[127] GMO's argument is misplaced.

Contrary to GMO's implication, Commission proceedings are not bound by the same rules of evidence that apply to jury trials. Section 386.410 expressly provides that GMO's "standard for admission of expert testimony" is not applicable to Commission

[125] Staff Exhibits 393, 394 and 395.
[126] See, Section V(B)
[127] GMO Initial Brief at page 61 (citing to *Board of Healing Arts v. McDonagh*, 123 S.W.3d 146 (Mo. banc 2003).

proceedings. "In all investigations, inquiries or hearings the commission or commissioner shall not be bound by the technical rules of evidence." That statute continues to note that "no formality in any proceeding nor in the manner of taking testimony before the commission or any commissioner shall invalidate any order, decision, rule or regulation made, approved or confirmed by the commission." As such, GMO's claimed standard for admission of expert valuation testimony is not applicable to the Commission and would not invalidate "any order approved by the Commission."

The reason for this broad exception for Commission proceedings is obvious. Unlike a jury trial which is heard before lay jurors and must include specific guidelines on the nature of valuation testimony that those jurors are allowed to hear, Commissioners are presumably appointed and confirmed for their ability to screen expert testimony to arrive at an appropriate valuation. Indeed, the Commission's valuation statute provides broad discretion on the considerations that would impact the Commission's decision regarding the value of utility property. "The Commission shall have the power to ascertain the value of the property of every . . . electrical corporation . . . and ***every fact which in its judgment may or does have any bearing on such value***."[128] Indeed, the Commission is not limited solely to expert valuation testimony, but may consider anything in its valuation decision. "The commission is empowered to resort to any other source of information available."[129]

Interestingly, in other parts of its brief, GMO recognizes that the Commission is not bound to a single methodology. As GMO acknowledges, "[u]nder the statutory standard of 'just and reasonable' it is the result reached not the method employed which

[128] Section 393.230.1 RSMo
[129] Section 393.230.2 RSMo.

is controlling. It is not the theory but the impact of the rate order which counts."[130] Missouri courts have reached similar conclusions. "[T]he Commission is not bound to any set methodology in ensuring a just and reasonable return in setting rates."[131]

Clearly, contrary to GMO's assertions, the Commission is not bound to a particular standard in its receipt of expert valuation testimony. Indeed, the Commission is not even bound to consider only valuations provided by expert witnesses. Rather, reflecting its expertise, the Commission wields broad discretion regarding valuation and may consider anything which may have a "bearing on such value." GMO's argument and its attempt to paint the Commission into a legal corner is misplaced.

C. GMO'S APPLICATION OF "ORIGINAL COST" AS CONTAINED IN THE UNIFORM SYSTEM OF ACCOUNTS (USOA) IS MISPLACED.

In its Initial Brief, GMO claims that the Commission is required to use its inflated Crossroads valuation because the GMO valuation is allegedly based upon "net original cost." As this brief demonstrates, however, GMO's assertion is based upon a misunderstanding of the definition of "original cost" as contained in the FERC Uniform System of Accounts ("USOA") and adopted by the Missouri Commission.

In 1975, the Commission first adopted the FERC Uniform System of Accounts.[132] Specifically, Commission rule provides that all electrical corporations "shall keep all accounts in conformity with the Uniform System of Accounts Prescribed for Public

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[130] GMO Initial Brief at page 17 (citing to *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

[131] GMO Initial Brief at page 17 (citing to *State ex rel. Praxair v. Public Service Commission*, 328 S.W.3d 329, 339 (Mo.App. 2010).

[132] See, 4 CSR 240-20.030. Revisions to the FERC USOA were subsequently adopted by the Commission in 1976, 1993, 1996 and 2002.

Utilities and Licensees subject to the provisions of the Federal Power Act, as prescribed by the Federal Energy Regulatory Commission (FERC)."[133]

Relevant to the immediate inquiry, the FERC USOA provides the following definition for original cost. "*Original cost,* as applied to electric plant, means the ***cost of such property to the person first devoting it to public service.***"[134] The instructions to the FERC regulations specifically recognize a distinction between property constructed by the utility and property acquired by the utility. "The detailed electric plant accounts (301 to 399, inclusive) shall be stated on the basis of cost to the utility of plant constructed by it and the original cost, estimated if not known, of plant acquired."[135]

In this case, contrary to the very definition provided by USOA, GMO essentially argues that the Crossroads value should be based upon Aquila Merchant's cost of construction.[136] Contrary to GMO's assertions, however, the cost of construction for Aquila Merchant is **NOT** original cost. The cost of construction is not the original cost because as the FERC definition requires, Aquila Merchant did not devote Crossroads to the "public service." Instead, while GMO's IRP mandated a capacity addition in 2005 and a prudent utility would have fulfilled such a need at that time, Crossroads was not devoted to the "public interest" until it was actually transferred to GMO's regulated books.[137] In fact, demonstrating the flaw in GMO's assertions, Ameren utilized the correct definition of "original cost" - the price that it paid for the Raccoon Creek / Goose Creek and not the original construction cost – when it included these units in rate base.[138]

[133] 4 CSR 240-20.030(1).
[134] 18 CFR Part 101 §23 (emphasis added).
[135] 18 CFR Part 101, Electric Plant Instructions.
[136] Staff Exhibit 271, Featherstone Rebuttal, page 27.
[137] *Id.* at page 22.
[138] *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 577 (Mo.App. 2009).

Given the requirements of the USOA definition of original cost, the best quantification of GMO's cost for Crossroads is contained in the numerous SEC filings made by Great Plains in May through August 2007. In at least three SEC filings, Great Plains / Aquila indicated that the "fair market value" of Crossroads was $51.6 million.[139] "The preliminary internal analysis indicates a fair value estimate of Aquila's non-regulated Crossroads power generating facility of approximately $51.6 million."[140] Given its proximity in time, as well as the mandatory affirmation attached to these SEC filings, MECG maintains that $51.6 million represents the cost of Crossroads at the time that it was devoted to "public service." As such, pursuant to the definitions contained in the Uniform System of Accounts, the original cost of Crossroads for ratemaking purposes should be $51.6 million.

In the last case, the Commission rejected the value contained in the SEC filings. Instead, as a benefit to GMO, the Commission ignored the ongoing need for capacity reflected in its 2005 IRP and utilized a proxy sale valuation based upon the sale of identical combustion turbines by Aquila to Ameren in 2006. Specifically, the Commission found that a surrogate value for the cost that GMO paid for Crossroads is based upon Aquila's sale of the Raccoon Creek and Goose Creek combustion turbines to Ameren.[141] Using the $205.88 / kW cost of Raccoon Creek and Goose Creek,[142] the Commission found that the Crossroads "original cost" was $61.8 million.[143] While MECG continues to believe that the Great Plains admission ($51.6 million), contained in

[139] *Id.* at page 22.
[140] Staff Exhibit 271, Featherstone Rebuttal, page 30 (citing to Great Plains Energy & Aquila Joint Proxy Statement / Prospectus, filed May 8, 2007, at page 175).
[141] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2011, at page 99.
[142] *Id.* at page 80.
[143] *Id.* at page 95.

its SEC filings, represent the best estimation of the "original cost" of Crossroads, MECG would acknowledge that the Commission's valuation methodology used in GMO's 2010 case is reasonable. Specifically, unlike any other evidence in the record, this valuation methodology reflects: (1) an actual sale of identical combustion turbines and (2) the identical seller with the same mindset.

In contrast, GMO argues that its original cost should be based upon the cost of construction ($132.7 million) for Aquila Merchant. As indicated, GMO's valuation is not only inflated, it is also directly contrary to the definition of original cost contained in the Uniform System of Accounts. Clearly, GMO's claim that its valuation is based upon original cost is erroneous.

D. GMO MISTAKENLY BELIEVES THAT THERE IS A DISTINCTION BETWEEN "ORIGINAL COST" AND "FAIR MARKET VALUE." NEVERTHELESS, UNDER GMO'S DEFINITION OF FAIR MARKET VALUE, THE COMMISSION SHOULD <u>LOWER</u> ITS VALUE FOR CROSSROADS.

Reflecting its failure to apply the definition of "original cost" as reflected in the Uniform System of Accounts, GMO's brief believes that there is a distinction between original cost and fair market value.[144] GMO's perceived distinction is misplaced. Given that: (1) "<u>original cost</u>" is dependent upon the cost of Crossroads at the time that Great Plains bought it and devoted it to public service and (2) "<u>fair market value</u>" seeks to uncover this cost paid by Great Plains, these inquiries are actually one in the same.

Given that these inquiries are the same, Staff's effort to uncover fair market value is not only appropriate, it is mandatory. In this case, consistent with the Commission's determination in the last case, Staff quantified fair market value, and therefore GMO's

[144] GMO Initial Brief at paragraph 162 ("To the extent this Commission considers evidence [fair market value] other than the original cost of Crossroads as recorded by the Company.)

original cost, based upon the surrogate sale of identical combustion turbines by Aquila to Ameren. Based upon this arms-length transaction value ($205.88 / kW), Crossroads necessarily has a value of $61.8 million. These arms-length transactions are based upon two actual transactions made by a willing buyer and seller that are not affiliated.

GMO, however, criticizes Staff's use of this proxy transaction, and therefore the Commission's last decision, on the basis that the sale of the Raccoon Creek / Goose Creek turbines was "essentially a forced sale."[145] GMO bases this claim entirely on the fact that "Aquila was anxious to sell off assets to improve its financial situation."[146]

The fact Aquila "was anxious to sell" Raccoon Creek and Goose Creek is, however, irrelevant to a determination of "fair market value" and therefore to GMO's "original cost." As GMO recognizes "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."[147] The mindset of the seller is irrelevant. So long, as the buyer (Ameren) was "under no compulsion to buy," fair market value has been established.

Moreover, it is hypocritical for GMO to claim that the Commission should consider the mindset of the seller (Aquila) as it applies to the sale of Raccoon Creek and Goose Creek, but shouldn't also consider the mindset of the same seller when determining the "fair market value" / "original cost" of Crossroads. Clearly, Aquila was motivated, as a result of its financial condition, to sell both Raccoon Creek and Goose Creek. Similarly, Aquila was just as motivated to sell Crossroads. Given the commonality of the seller as well as that seller's motivation, the Raccoon Creek / Goose

[145] GMO Initial Brief at paragraph 166.
[146] GMO Initial Brief at paragraph 166 (citing to *State ex rel. Public Counsel v. Public Service Commission*, 274 S.W.3d 569, 579 (Mo.App. 2009).
[147] GMO Initial Brief at paragraph 163 (citing to *Shirley's Realty, Inc. v. Hunt*, 160 S.W.3d 804, 808 (Mo.App. 2005).

Creek valuation is all the more relevant. This fact has previously been recognized by the Commission.

> It is incomprehensible that GPE would pay book value for generating facilities in Mississippi to serve retail customers in and about Kansas City, Missouri. And, it is a virtual certainty that GPE management was able to negotiate a price for Aquila that considered the distressed nature of Crossroads as a merchant plant which Aquila Merchant was unable to sell despite trying for several years. Further, ***it is equally likely that GPE was in as good a position to negotiate a price for Crossroads as AmerenUE was when it negotiated the purchases of Raccoon Creek and Goose Creek, both located in Illinois, from Aquila Merchant in 2006***.[148]

While the GMO definition of "fair market value" supports the Commission's continued use of the Raccoon Creek / Goose Creek proxy valuation, it undermines GMO's own valuation. Specifically, GMO asserts that fair market value "is the price at which the property could be sold by a willing buyer to a buyer who is under no compulsion to buy." Given its reliance on this definition, it is interesting that GMO claims that its valuation is supported by a PriceWaterhouseCoopers analysis.[149] This appraisal does not signify the price of any willing buyer. As Staff points out, this "analysis provides no guidance as to the question of what value to place on Crossroads."[150]

If the Commission were to reject the proxy sale valuation utilized in the last case, it is apparent that, under GMO's own definition, the fair market value for Crossroads should actually decrease. Specifically, much like its SEC filing, the fair market value based upon GMO's definition must actually be significantly less. In 2005, at the same time that it was selling Raccoon Creek and Goose Creek, Aquila hired Lehman Brothers to solicit buyers for Crossroads. While Lehman Brothers initially valued Crossroads at

[148] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2011, at page 94.
[149] GMO Initial Brief at paragraph 163.
[150] Staff Exhibit 292, Featherstone Surrebuttal, page 74.

______________ or a total value of **________________**.[151] Within 6 months, Lehman Brothers had reduced its valuation to as low as **______** or a total value of **___________**.[152] Ultimately, despite this decreased valuation, and after contacting 79 bidders, Aquila did not receive a single bid for Crossroads.[153] Given that Aquila / Great Plains had no "willing buyers," it is impossible to place any fair market value on Crossroads other than $0.

E. GIVEN THE NUMEROUS FLAWS IN ITS TESTIMONY AND ARGUMENT, GMO HAS NOT MET ITS SUBSTANTIAL BURDEN OF PROOF. IN CONTRAST, RELYING ON COMPANY ADMISSIONS, MECG HAS MET ITS BURDEN FOR A LOWER VALUATION.

As the Commission can undoubtedly see, given GMO's misplaced attempts to paint the Commission into a legal corner, its misapplication of the Uniform System of Accounts and the litany of falsehoods contained in its Brief, GMO has not met its burden of proof regarding its requested inflated valuation for Crossroads.

Section 393.150(2) provides that, in any rate increase proceeding, the burden of proof is on the party seeking the increased rate. "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation." Furthermore, given that GMO is taking a position that is contrary to the Commission's previous determination, Section 386.430 also places the burden on GMO.

> In all trials, actions, suits and proceedings arising under the provisions of this chapter or growing out of the exercise of the authority and powers granted herein to the commission, ***the burden of proof shall be upon the party adverse to such commission*** or seeking to set aside any determination, requirement, direction or order of said commission, to show by clear and satisfactory evidence that the determination,

[151] Staff Exhibit 395.
[152] *Id.*
[153] *Id.*

> requirement, direction or order of the commission complained of is unreasonable or unlawful as the case may be.

Here, given the state of its evidence, GMO has attempted to meet its significant burden through legal machinations and misstatements regarding the nature of the evidence. As this brief has demonstrated, GMO's assertions are misplaced.

Perhaps, however, the best demonstration that GMO has failed to meet its burden of proof is its paucity of evidence. Coincidentally, after claiming that Staff did not provide sufficient evidence, GMO did not present a single piece of evidence on this issue in its direct testimony. As contained in the Commission's rules, direct testimony "shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief."[154] Despite this direction, GMO did not provide a single piece of evidence "explaining its case-in-chief." Instead, GMO simply indicated that it included Crossroads as its full book value.[155] In fact, while GMO's Senior Director of Regulatory Affairs states that the valuation of Crossroads will be "discussed later in my testimony,"[156] he never even mentions Crossroads again in his testimony. Still again, in its Initial Brief, despite its obligation to contain its "entire case-in-chief" in its direct testimony, GMO never even references its direct testimony relevant to Crossroads. Clearly, GMO recognizes the pitiful state of its record on the issue of valuation and, instead, seeks to extract its preferred result through false legal assertions.

Further demonstrating its failure to meet its burden of proof, GMO did not even provide a valuation for Crossroads that is consistent with the August 31, 2012 true-up date in this case. A careful review of the GMO testimony in this case indicates that GMO

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[154] 4 CSR 240-2.130(7)(A).
[155] GMO Exhibit 134, Rush Direct, page 8.
[156] GMO Exhibit 123, Ives Direct, page 5.

simply included its net book value calculation for Crossroads in its direct testimony. GMO failed to provide a more recent number for valuation, deferred taxes or Crossroads depreciation that complies with the updated test year period or the true-up period. GMO has simply fumbled this issue.

Ultimately, the Commission should utilize a valuation that is either consistent with its decision in the last case ($61.8 million) or, as Aquila's admissions in SEC filings reveal, a lower fair market value ($51.6 million).

F. THE INCLUSION OF CROSSROADS IN RATE BASE AT AN INFLATED VALUATION, OR WITH THE ELIMINATION OF ACCUMULATED DEFERRED TAXES OR THE INCLUSION OF ANY TRANSMISSION COSTS WOULD BE IMPRUDENT.

In its Initial Brief, GMO wrongly claims that "no other party provided testimony suggesting that utilizing Crossroads was imprudent."[157] Contrary to GMO's assertion, MECG has continually asserted, and the Commission has previously recognized, that the inclusion of Crossroads could indeed by imprudent. Specifically, the Commission held that Crossroads would only be prudent ***if***: (1) Crossroads reflected a rate base consistent with its proxy sale valuation ($61.8 million less all accumulated deferred taxes) and (2) all transmission costs were disallowed.

> The decision to include Crossroads in the generation fleet at an appropriate value was prudent with the exception of the additional transmission expense, when other low-cost options were available. Paying the additional transmission costs required to bring energy all the way from Crossroads and including Crossroads at net book value with no disallowances, is not just and reasonable and is discussed in detail below.[158]

[157] GMO Initial Brief at paragraph 157.
[158] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2001, at page 91.

Similarly, the Commission held that GMO's actions were prudent only if this entire valuation package was maintained. Otherwise, GMO's actions and Crossroads addition to rate base would be imprudent.

> The Commission concludes that ***if*** included in rate base at a fair market value, rather than the higher net book value paid to its affiliate, ***and*** except for the additional cost of transmission from Mississippi to Missouri, the Company's 2004 decision to pursue the construction of three 105 MW combustion turbines at South Harper and pursue a 200 MW system-participation based purchased power agreement, and the Company's decision to add the Crossroads generating facility to the MPS generation fleet were prudent and reasonable decisions.[159]

Given the interdependent nature of the Commission's valuation methodology, the Staff's evidence clearly questions the prudency of Crossroads should any portion of the Commission's valuation package be modified.

> If the Commission were to include any transmission costs for Crossroads in the revenue requirement for MPS and rely on the values that AmerenUE placed on Raccoon Creek and Goose Creek for valuing Crossroads, it should discount the $61.8 million valuation for Crossroads.[160]

MECG agrees with the logic of the Commission's previous decision and Staff's current evidence. The only way to maintain the prudency of GMO's decision to include Crossroads in rate base is to maintain the previous, interdependent valuation package. Only by including Crossroads in rate base at a value of $61.8 million or less, reflecting all accumulated deferred taxes and disallowing all transmission costs will the decision to include Crossroads be prudent.

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[159] *Id.* at page 99.
[160] Staff Exhibit 271, Featherstone Rebuttal, pages 38-39. See also, Tr. 931. (I've stated that in my surrebuttal, that if the Commission wanted to reconsider some amount for transmission costs, there would be a direct relationship to the total valuation of the plant itself, the asset value of the plant itself. The more transmission costs that you would put into rates, then the less valuable or the less -- the lesser amount that would be reflective or should be reflective in rate base.).

G. THE PRUDENCY OF CROSSROADS IS DEPENDENT ON THE COMMISSION MAINTAINING ITS PREVIOUS VALUATION PACKAGE INCLUDING REFLECTING OF ALL ACCUMULATED DEFERRED TAXES.

As reflected in the previous section, the Commission found that the inclusion of Crossroads in rate base was prudent so long as it was valued at the Raccoon Creek / Goose Creek valuation including a reduction for all accumulated deferred taxes and the disallowance of all transmission costs. As the Commission noted in its order addressing GMO's application for rehearing in the previous case, the reflection of all accumulated deferred taxes was part of the "relevant factors" deemed necessary to be considered as part of its valuation package.[161] In this case, GMO attempts to chip away at all three parts of the Commission's valuation package. In the previous section, MECG has shown that GMO's attempts to discredit the Commission's Raccoon Creek / Goose Creek valuation are misplaced. In this section, MECG will address problems with GMO's attempt to modify the deferred tax portion of the valuation. In the next section, MECG will address GMO's erroneous arguments regarding transmission costs associated with Crossroads.

In its Initial Brief, GMO argues that the amount of deferred taxes to include "must be based on the value assigned to Crossroads."[162] Again, GMO is wrong. As MECG notes in its Initial Brief, contrary to GMO's assertions, accumulated deferred taxes do not simply flow from the Commission's valuation. Rather, those deferred taxes are part and parcel of the Commission's overall valuation.[163] There are 3 reasons supporting the Commission's decision to include these deferred taxes as part of its valuation. ***First***, the

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[161] *Order of Clarification and Modification*, Case No. ER-2010-0356, issued May 27, 2011, at page 3.
[162] GMO Initial Brief at page 65.
[163] MECG Initial Brief at page 81.

accumulated deferred taxes in question arose out of the accelerated tax deduction provided by the income tax code and only made possible by the profits provided by regulated operations. ***Second***, the accumulated deferred tax balance was undoubtedly considered by Great Plains when it purchased Aquila. ***Third***, accumulated deferred taxes are always included as an offset to rate base.[164]

The inconsistences in GMO's position on Crossroads are again demonstrated with regard to the Crossroads accumulated deferred taxes. As mentioned previous, GMO argues that the Crossroads valuation should be based upon the Aquila Merchant original cost of construction in 2003. As indicated, since Crossroads was not devoted to public service at this time, this cost is not consistent with the "original cost" for GMO. Nevertheless, despite GMO's argument that the plant valuation ought to be based upon the 2003 value, GMO claims that the calculation of deferred taxes should not start until 2007.[165] Again, GMO's insistence that it be allowed to pick an earlier date for purposes of valuation and a later date for purposes of calculating deferred taxes is contradictory.

In the last case, the Commission utilized a consistent valuation package. In that case, the Commission considered as part of its Crossroads valuation the value of Crossroads when it was first devoted to public service in 2008 as well as the accumulated deferred tax balance as of that date. MECG urges the Commission to maintain this consistent approach.

Finally, in its brief, GMO resorts to *ad hominem* attacks on MECG's witness. Specifically, without any reference to the evidence, GMO claims that Mr. Meyer's "thoughts on deferred taxes lack any foundation" and "offers no value to this

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[164] *Id.* at pages 81-82.
[165] GMO Exhibit 119, Hardesty Surrebuttal, pages 8-9.

Commission, and is nothing more than the comments of a lay person."[166] Again, GMO offers no support for such an attack. Nonetheless, GMO's attack is almost comical given its inconsistent remarks elsewhere in its brief.

When responding to an attack regarding its negative off-system sales, GMO decides to attack Staff for its refusal to conduct any cross-examination of the GMO witnesses. Despite its eagerness to access the pockets of ratepayers for rate case expense, GMO complains:

> Mr. Crawford was brought to the hearing room and tended for cross-examination to respond to questions that Staff had raised regarding his Rebuttal Testimony. Curiously, Staff declined to ask Mr. Crawford even one question. Similarly, Staff asked Mr. Blunk no questions regarding his GMO Surrebuttal Testimony when he was presented to the Commission at hearing.[167]

Clearly, GMO's attacks on Staff's strategy reflect the actions of a utility unwilling to address the merits of an issue.

At expense to its constituents, MECG brought Mr. Meyer to the hearing room for cross-examination by GMO.[168] Despite having at least three attorneys participating on the issue of Crossroads valuation and deferred taxes,[169] GMO did not ask Mr. Meyer a single question.[170] Despite claims that Mr. Meyer's "thoughts on deferred taxes lack any foundation," GMO did not argue a lack of foundation, but simply allowed his testimony

[166] GMO Initial Brief at page 66.
[167] GMO Initial Brief at pages 69-70.
[168] Remember, MECG is not permitted to charge others for rate case expenses. Instead, its members are expected to pay for the rate case expense of GMO in its electric rates as well as the rate case expense of Staff and Public Counsel through its PSC assessments also included in electric rates. Any costs for its own witnesses are entirely over and above these other costs.
[169] See, Mr. Hatfield waiving cross-examination at Tr. 975; Mr. Fischer making objections regarding other aspects of the Crossroads issue at Tr. 896-897 and Mr. Steiner's continual presence in hearing room (Tr. 774).
[170] Tr. 975.

to be accepted into the record.[171] Similarly, despite claims that his opinions "offer no value to the Commission," GMO did not ask him a single question.[172] Finally, despite its claim that Mr. Meyer's opinions are nothing more than the "comments of a lay person," GMO never challenged Mr. Meyer's designation as an expert or his ability to provide expert testimony. Again, MECG suggests that such ramblings are simply those of a utility unable or unwilling to engage in discussion on the merits of an issue.

As stated in its Initial Brief, MECG urges the Commission to maintain its valuation package including the reflection of all accumulated deferred taxes and the disallowance of all transmission costs.

H. THE CONTINUED DISALLOWANCE OF CROSSROADS TRANSMISSION IS NECESSARY TO MAINTAIN THE PRUDENCE OF GMO'S CROSSROADS DECISION.

In its last decision, the Commission made numerous findings supporting its decision to disallow Crossroads transmission costs. Recognizing that, unlike the proxy sale valuation, Crossroads is located in a different RTO from its customers, the Commission found that GMO's decision to include Crossroads in rate base would be imprudent unless it disallowed all transmission costs.

> ***It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location***. Thus, the Commission will exclude the excessive transmission costs from recovery in rates.[173]
>
> ***The decision to include Crossroads in the generation fleet at an appropriate value was prudent with the exception of the additional transmission expense***, when other low-cost options were available. Paying the additional transmission costs required to bring energy all the way from

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[171] Tr. 974.
[172] Tr. 975.
[173] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2001, at page 87 (emphasis added).

> Crossroads and including Crossroads at net book value with no disallowances, is not just and reasonable.[174]
>
> ***In addition to the valuation, the Commission concludes that but for the location of Crossroads customers would not have to pay the excessive cost of transmission.*** Therefore, transmission costs from the Crossroads facility, including any related to OSS shall be disallowed from expenses in rates and therefore also not recoverable through GMO's fuel adjustment clause.[175]
>
> The Commission further determines that it is ***not just and reasonable for GMO customers to pay the excessive cost of transmission from Mississippi*** and it shall be excluded.[176]

Despite the clarity of the Commission's previous findings and the overwhelming nature of Staff's evidence on this issue, GMO nonetheless urges the Commission to dismiss its previous decision and now allow these Crossroads transmission costs. Despite the importance of this issue and the tremendous burden that it carries with regard to this issue, GMO devotes only two pages of its brief[177] towards changing the Commission's mind. Again, like the entirety of its argument on Crossroads, GMO's assertions with regard to transmission costs are based upon inaccurate claims regarding the evidentiary record and the Commission's legal authority.

1. Plant Location Should be Within the Same RTO

As the primary support for its argument that it be allowed to recover transmission costs associated with Crossroads, GMO claims that "Staff's sole rationale" is that "utilities simply don't put power plants where their customers are not located."[178] GMO's characterization is not only overly simplistic, it is woefully incorrect.

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[174] *Id.* at page 91 (emphasis added).
[175] *Id.* (emphasis added).
[176] *Id.* at page 100 (emphasis added).
[177] GMO Initial Brief at pages 66-68.
[178] GMO Initial Brief at paragraph 173.

Staff has presented voluminous testimony regarding the need to disallow Crossroads transmission costs. In that testimony, Staff does not simply reject the inclusion of such costs on the basis that Crossroads is not where the GMO customers are located. This is analogous to saying that a person died from a cut after having his leg cut off. It is a grossly simplistic characterization of the issue and fails to address the true problem.

The problem is not simply that Crossroads is not where the utilities' customers are located. Rather, Crossroads is located in a transmission constrained area located entirely within the Entergy service area.[179] With Entergy now becoming a member of MISO, and GMO continuing to be a member of SPP, Crossroads is geographically located in a different RTO.[180] Given that Crossroads is located in a different RTO, GMO incurs significant transmission costs associated with transmitting energy through MISO and out to the SPP service area. In 2011, these costs were over **__________** Looking forward, these costs are significantly understated. Now, instead of paying the Entergy transmission rate, GMO will be required to pay the MISO transmission rate.[181] The evidence demonstrates that the MISO rate is "double" the Entergy rate.[182] As such, absent other changes, GMO should expect the transmission costs associated with Crossroads to double.

GMO attempts to excuse this problem by claiming that it is accepted for a utility to build a power plant outside of its service area.[183] Again, GMO's assertions are not entirely accurate. While it is common for a utility to build a generating facility outside of

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[179] Tr. 702-703.
[180] *Id.*
[181] Tr. 932.
[182] *Id.*
[183] GMO Initial Brief at paragraph 173.

its service area, it is unprecedented for a utility to build such a facility outside of its RTO.[184] The reason underlying such a limitation is that a utility does not incur transmission costs associated with transmitting energy within its RTO. Therefore, while Wolf Creek is not located within KCPL's service area, it is located within the geographic footprint of SPP. Similarly, the wind turbines used by KCPL and GMO are also located in SPP. Other than Crossroads, none of the KCPL and GMO generating facilities is located outside of SPP.

In the last case, the Commission recognized the imprudent nature of GMO's decision to include Crossroads in its generation portfolio despite its location in a different RTO.

> GMO does not incur any transmission costs for its other production facilities that are located in its MPS district that are used to serve its native load customers in that district. . . . It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location. Thus, the Commission will exclude the excessive transmission costs from recovery in rates.[185]

2. Natural Gas Costs Are Not Cheaper for Crossroads

Next, GMO attempts to minimalize the transmission costs associated with Crossroads. GMO falsely claims that, as a result of Crossroads proximity to the Gulf gas fields, the natural gas costs for Crossroads are cheaper than for its other units.[186] GMO then mistakenly concludes that this savings in natural gas costs more than offsets the cost of transmitting electricity from Mississippi to Missouri.[187] GMO's allegations are not

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[184] GMO Exhibit 110, Crawford Direct, Schedule BLC-7; Staff Exhibit 258, Staff Cost of Service Report, page 71.
[185] *Report and Order*, Case No. ER-2010-0356, issued May 4, 2001, at page 87.
[186] GMO Initial Brief at paragraph 174.
[187] *Id.*

only contradicted by Staff's abundant testimony, but also by GMO's own internal documents.

<u>First</u>, in his testimony, Staff witness Featherstone points out that the reason for cheaper gas costs to GMO's Kansas City area facilities is the difference in cost between Midcontinent region gas and Henry Hub area gas.

> Historically, the Mississippi based Crossroads has experienced higher natural gas costs when compared to natural gas prices and costs in Kansas City, Missouri. GMO gets its natural gas in the area known as Midcontinent region of the United States – a location where natural gas prices tend to be lower than most of the other parts of the country and in the Gulf region, Mississippi in particular. The Midcontinent region includes portions of Texas, Oklahoma and Kansas. Historically, natural gas prices in the Midcontinent region have been significantly lower than at the Henry Hub area in Louisiana.[188]

<u>Second</u>, Staff demonstrates through actual natural gas costs and transportation costs that GMO's Kansas City area facilities have cheaper costs. The following table shows the delivered natural gas price ($$/MMBtu) with the relevant variable transportation rate for the GMO South Harper, Greenwood and Crossroads units.[189]

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<u>Third</u>, GMO's internal documents demonstrate that the Kansas City area gas plants are much cheaper than Crossroads. Given GMO's argument that Crossroads natural gas costs make it cheaper to run, one would expect that Crossroads would be dispatched earlier than any other natural gas facility. GMO admits, however, that

[188] Staff Exhibit 293, Featherstone Surrebuttal, page 117.
[189] *Id.* at page 119.

Crossroads is dispatched after South Harper, Ralph Green and the Greenwood units.[190] In addition, the heat rate for the Crossroads unit is worse than for these other natural gas units.[191]

Finally, anecdotal evidence conclusively demonstrates that Crossroads natural gas costs cannot offset the high cost of transmitting energy from Mississippi to the Missouri service area. This is proven by the fact that KCPL and GMO have many natural gas units, but every other generating facility is located within the SPP footprint. More specifically, all twenty-one (21) natural gas generating units[192] are located within the KCPL and GMO service area.[193] According to GMO's logic, these other units should have been located in Mississippi to take advantage of the alleged low cost natural gas. Yet, KCPL and GMO never even studied a Mississippi location for these other natural gas facilities.

3. Commission is not Required to Allow Recovery of Transmission Costs

In a single paragraph, GMO incorrectly argues that the Commission is mandated, as a result of federal preemption regarding the rates for interstate transmission costs, to allow recovery of the transmission costs associated with Crossroads.[194] Making reference to previous federal and Commission decisions, GMO falsely asserts that, by disallowing these costs, the Commission has displaced FERC's authority to establish appropriate transmission rates.

> At its most obvious, the filed rate doctrine means that a state commission cannot decide that the FERC-approved interstate transportation rate that

[190] Staff Exhibit 394.
[191] Staff Exhibit 393.
[192] Staff Exhibit 258, Staff Cost of Service Report, pages 70-71.
[193] Tr. 894-895.
[194] GMO Initial Brief at paragraph 176.

> the local distribution company (LDC), such as MGE, is paying is too high and refuse to allow the LDC to include those costs in its rates.[195]

GMO, however, fails to distinguish between ratemaking for interstate transmission rates, which is governed by FERC under the supremacy clause, and the authority to consider whether it was prudent for GMO to ever incur such costs, which is exclusively within this Commission's authority.

In Nantahala Power and Light Company v. Thornburg,[196] the United States Supreme Court held that the North Carolina Utility Commission unlawfully interfered with authority granted to FERC. Specifically, the North Carolina Commission acted unlawfully when it found that a power allocation agreement previously approved by FERC was unreasonable and instead calculated a new allocation methodology. Relying on the supremacy clause, the Court found that "under the filed rate doctrine, the [FERC] alone is empowered to make that judgment [of reasonableness], and until it has done so, no rate other than the one on file may be charged."[197] Given this, the Court held that, "***once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable***."[198]

In the case at hand, the Commission did not and would not violate the supremacy clause by finding that GMO imprudently incurred the cost of transmitting power from Mississippi to Missouri. The Commission has not found that the FERC approved rate was "unreasonable." Rather, as it held in its previous decision, the Commission is finding that it was imprudent for GMO to include Crossroads, located in Mississippi, in

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[195] GMO Initial Brief at paragraph 176 (citing to *Order Consolidating Cases*, Case No. GR-2001-382, issued September 10, 2002.
[196] 476 U.S. 953 (1986).
[197] *Id.* at 964.
[198] *Id.* at 966.

its rate base for Missouri customers. Only by disallowing these costs could this decision be made prudent.

> ***The decision to include Crossroads in the generation fleet at an appropriate value was prudent with the exception of the additional transmission expense***, when other low-cost options were available. Paying the additional transmission costs required to bring energy all the way from Crossroads and including Crossroads at net book value with no disallowances, is not just and reasonable.[199]

Clearly, there is a distinction between finding that a FERC rate is unreasonable and finding that it was imprudent for a utility to ever incur those FERC approved costs. GMO fails to understand this distinction.

Moreover, the Supreme Court made it clear that it was limiting its decision solely to the strict holding previously expressed. By finding that state commission could not redetermine a FERC approved rate, the Supreme Court did not imply that the state commission was forced to implement an adjustment clause to allow automatic pass through, on a dollar for dollar basis, of any changes in the FERC rate. In fact, a change in FERC approved rates "need not lead to an increase in retail rates."[200]

> The commission . . . may treat the proposed rate increase as it treats other filings . . . and investigate the overall financial structure of [the power company] to determine whether the company has experienced savings *in other areas which might* offset the increased price.[201]

As such, the Supreme Court was careful to limit its holding solely to the supremacy clause and made efforts to maintain the jurisdiction of the state utility commissions. As such, it is reasonable to believe that the *Nantahala* doctrine would not be extended to

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[199] *Id.* at page 91 (emphasis added).
[200] *Id.* at page 967.
[201] *Id.* (citing to *Narragansett Electric Co. v. Burke*, 381 A.2d 1358, 1363 (1977). See also, *Public Service Co. of Colorado v. Public Utilities Commission*, 644 P.2d 933, 941 (Col. 1982) ("The commission may treat the [increase] as it treats other filings for proposed rate increases . . . and investigate whether [either of the gas companies] has experienced *savings in other areas which might offset the increased price* for natural gas to consumers.") (emphasis in original).

limit the state utility commission’s ability to determine whether the utility prudently incurred the FERC approved charges.

VII. CONCLUSION

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

1. Reject KCPL's true-up capital structure as unreasonable and not reflective of ongoing operations. Instead, the Commission should adopt a capital structure consisting of 50% equity and 50% debt.

2. MECG urges the Commission to authorize a return on equity at the low end of Gorman's range of reasonable return on equity (9.10% - 9.50%). Specifically, MECG urges the Commission to award a return on equity of 9.10% to account for the unaffordability of GMO's rates and GMO's continued failure to control its escalating A&G costs. In the event that the Commission implements GMO's transmission tracker, MECG urges the Commission to make an explicit 10 basis point reduction in return on equity to account for the significant shift in risk caused by the implementation of the transmission tracker.

3. Reject KCPL's proposal to implement a transmission tracker. Such a tracker violates the doctrine against retroactive ratemaking in that it allows for the recovery of past losses through future rates. Furthermore, tracker mechanisms represent bad regulatory policy because they result in a significant shift in the balancing of risk envisioned by the Missouri Supreme Court. Additionally, KCPL has failed to show that transmission costs meet the criteria set forth by the Commission for the implementation of an adjustment / tracker mechanism. Finally, KCPL has committed not to seek a fuel adjustment clause. To the extent that the Commission finds that such costs should flow

through the fuel adjustment clause, KCPL has assumed the risk that such costs will change. In the event, however, that the Commission implements a transmission tracker, MECG urges the Commission to make an explicit 10 basis point reduction in GMO's authorized return on equity to account for this shift in risk from shareholders to ratepayers.

4. Adopt the interclass shifts reflected in the October 29, 2012 Non-Unanimous Stipulation and Agreement. MECG urges the Commission to reaffirm: (1) its previous adoption of the Average and Excess methodology for allocation of production plant and (2) the previous finding that off-system sales margins should be allocated on the basis of class energy usage. After the affirmation of these previous Commission decisions, the Commission should find that the interclass shift contained in the Non-Unanimous Stipulation represents a reasonable movement towards each class' true class cost of service. Finally, as an unopposed portion of the October 29, 2012 Non-Unanimous Stipulation, MECG urges the Commission to expressly adopt the LGS / LP rate design set forth in that stipulation.

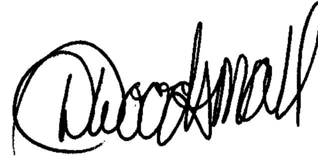
5. MECG urges the Commission to maintain its valuation methodology from the last case including a $61.8 million valuation, recognition of all accumulated deferred taxes and disallowance of all Crossroads transmission costs. In the event that the Commission reconsiders its previous decision, MECG urges the Commission to adopt the admitted fair market value of $51.6 million as contained in the Great Plains / Aquila SEC filings from the time of the acquisition.

Furthermore, given the recognition of deferred taxes with all other facilities, MECG asserts that the Commission should continue to reflect the entirety of the

accumulated deferred tax balance. This recognition further considers the fact that the accelerated depreciation deduction that forms the basis for the accumulated deferred tax balance was only possible because of the profits provided by the regulated customers.

Finally, the Commission should continue to disallow the transmission costs associated with transmitting energy from Crossroads (in MISO) to the customers (in SPP). These costs are escalating and should not be borne by customers.

Respectfully submitted,



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CERTIFICATE OF SERVICE

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

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David L. Woodsmall

Dated: December 11, 2012