**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

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| In the Matter of the Application of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company for the Issuance of an Accounting Authority Order Relating to their Electrical Operations and for a Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2). | ) ) ) ) ) | File No. EU-2014-0077 |

**REPLY BRIEF**
**OF**
**KANSAS CITY POWER & LIGHT COMPANY AND**
**KCP&L GREATER MISSOURI OPERATIONS COMPANY**

Come now Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO") (collectively "Companies"), and hereby file their Reply Brief in response to the brief filed by the Missouri Public Service Commission ("Commission") Staff ("Staff"), and the joint brief filed by Midwest Energy Consumers Group ("MECG"), Missouri Industrial Energy Consumers ("MIEC") and the Office of the Public Counsel ("OPC") (collectively "Consumers") in this proceeding.

## I. THE COMMISSION HAS THE AUTHORITY TO ISSUE AN ORDER SPECIFICALLY AUTHORIZING THE COMPANIES TO DEFER TRANSMISSION COSTS RELATED TO SPP PROJECTS.

Rather than recognizing the extraordinary nature of the build-out of the Southwest Power Pool ("SPP") transmission system over the next decade and the negative financial consequences that are and will continue to adversely impact the Companies without the approval of an Accounting Authority Order ("AAO") or transmission tracker, the Staff and Consumers argue that the Commission should not utilize any available regulatory policy that would mitigate the financial impacts of the SPP build-out of the transmission system using traditional regulatory tools. These are the same regulatory tools that have been widely employed through the last thirty years to address situations where costs are rapidly increasing above the levels currently in rates. The Staff and Consumers also have chosen to ignore the fact that the Commission has already recognized that transmission costs are necessary and prudent costs that should be recovered on a timely basis through available regulatory mechanisms such as a Fuel Adjustment Clause ("FAC") in the case of Ameren Missouri.

Instead, Staff and Consumers would have the Commission treat KCP&L and GMO in a markedly different manner than Ameren Missouri by totally ignoring the negative financial impacts to the Companies. Rather than ignoring the extraordinary nature of the current build-out of the SPP transmission system and the negative financial impacts upon the Companies, the Commission should issue an order authorizing an AAO or transmission tracker that would allow them to account for and record on its books a regulatory asset or regulatory liability related to the rapidly increasing transmission costs associated with SPP projects.

As the Companies explained in their Initial Brief, the Commission clearly has the regulatory authority and discretion to issue an AAO or transmission tracker in this case. Such action would be consistent with previous regulatory policies to defer costs related to a wide variety of costs including: renewable energy standards costs, tornado costs, construction accounting, Kansas property taxes on gas storage, ice storms, pensions and OPEBs, cold weather rule costs, security costs, safety costs, main replacement costs, manufactured gas plant clean-up costs, FAS 106 costs, flood costs, plant rehabilitation costs, coal contract buy-out costs; and AM/FM mapping costs. (*See* KCP&L Ex. 5, Ives Surrebuttal, Schedule DRI-1 (as corrected)(Tr. 259-62). The Commission should again balance the interests of consumers and the Companies by recognizing that the extraordinary build-out of the SPP transmission system is requiring the Companies to expend substantially more funds for these prudently incurred costs than are included in rates established using historical test years. In order to ensure that the customers that receive the benefits of the newly expanded transmission system also pay for the prudently incurred costs of that system, the Commission should again exercise its regulatory authority and discretion to allow the Companies to implement a regulatory policy that would mitigate the financial impacts of increasing transmission costs upon the Companies.

An order denying the application in this case will ensure that the Companies are not given the opportunity to fully recover these transmission costs in rates, and will result in regulatory lag for transmission costs being established as a part of the regulatory policy in Missouri. The Commission should avoid this unfortunate result, and instead use its regulatory authority to promote policies that will result in a proper balancing of the interests of customers and shareholders as the nation's transmission system is being rapidly expanded for the benefit of the nation's citizens.

Before discussing the disagreements between the Companies and opposing parties, there are a few areas of agreement between the Companies and Staff that should be mentioned. First, the Companies and Staff are in agreement that "Applicants must have an order from the Commission specifically authorizing any deferral." (Staff Brief, pp. 21-22) As the Companies explained in their Initial Brief, the Commission erroneously considered the transmission tracker issue moot in the Companies' last rate cases, and stated that it believed that it could not grant any practical relief because it believed that the Companies could already track transmission cost increases under the plain language of the Uniform System of Accounts ("USOA"). (*Id. at* 29) However, the Companies and Staff agree that the Commission's interpretation in the last rate case order on this point was incorrect. A specific order authorizing the deferral of costs is required before the Companies may defer transmission costs.

This proceeding provides the Commission the opportunity to approve an AAO or a transmission tracker to ensure that all prudently incurred transmission costs will be eligible for review and possible recovery in the Companies' next rate cases. In the Companies prior rate cases, the Commission thought the Companies already had the authority to defer transmission costs. As the Companies have testified, the Companies require an Order from the Commission in order to defer transmission costs to comply with the USOA.

Second, the Companies and Staff agree that the General Assembly has granted the Commission specific authority to direct the accounting treatment of the transmission costs at issue in this proceeding. (Staff Brief, p. 4) In addition, the Companies and Staff agree that "Section 393.140(8), RSMo., [the relevant enabling statute for AAOs] does not include an explicit standard" for the approval of AAOs. (Staff Brief, p. 8)

There is no statute or Commission rule that specifically mentions utility applications for AAOs or that prescribes legal or regulatory principles governing such applications. Contrary to the argument of the Staff that suggests that there is a standard in General Instruction No. 7 that "is mandatory and must be applied" (Staff Brief, p. 10), in reality, General Instruction No. 7 of the USOA does not dictate any standard to the Commission for determining when a deferral is appropriate. The competent and substantial evidence in this proceeding clearly demonstrates General Instruction No. 7 does not provide authoritative guidance to the Companies to defer costs as a regulatory asset. (KCP&L Ex. 1, Bresette Direct, p. 5; KCP&L Ex. 4, Ives Direct, pp. 8-9) In adopting its rule that applies the USOA to state public utilities (4 CSR 240-20.030), the Commission created no limitation on its *own* regulatory authority. Once again, Staff and Consumers are over-emphasizing the importance of the USOA and attempt to use it to limit the Commission's broad discretion in deciding AAO requests. In fact, the Commission's statutory authority and discretion are independent of the USOA itself.

Nevertheless, if the Companies' outside auditors are to allow a deferral to be accounted for on the Companies' financial statements, a specific order authorizing the deferral is required. As explained by the Companies' witness Ryan A. Bresette, Accounting Standards Codifications (ASC) ASC 980-340-25-1 (paragraph 9 of Statement 71) states that the "rate action of a regulator can provide reasonable assurance of the existence of an asset." (KCP&L Ex. 1, Bresette Direct, pp. 2-5) All or part of an incurred cost that would otherwise be charged to expense should be capitalized as a regulatory asset if: (1) It is probable that future revenues in an amount approximately equal to the capitalized cost will result from inclusion of that cost in allowable costs for ratemaking purposes; and (2) The regulator intends to provide for the recovery of that specific incurred cost rather than to provide for expected levels of similar future costs. (*Id*. at 2-5)

Staff erroneously suggests that "An AAO . . . is both a deviation from normal accounting rules and deviation from normal ratemaking rules." (Staff Brief, p. 5) The very existence of ASC 980 and USOA definitions of accounts 182.3 and 254 provide overwhelming evidence that the Commission's regulatory orders approving AAOs are a common part of a utility's accounting methodology. Certainly, the Commission has often exercised its discretion over the years to defer a variety of costs under a variety of circumstances for review in future rate cases. As such, deferrals continue to be a part of normal accounting for regulated utilities and do not represent deviations from normal ratemaking practices that have been utilized by the Commission for many years.

Recognizing the Commission's discretion to grant AAOs, the Staff stated: "The ultimate issue for decision in this case is the Applicants' request for an AAO permitting them to treat a portion of their transmission expenses as a regulatory asset and thus to preserve these expenses for consideration in their next general rate case." (Staff Brief, p. 4)

For the reasons stated in the Companies' testimony and briefs, the Companies respectfully request that the Commission exercise its discretion and authorize the deferral of these transmission costs, as requested by the Companies.

## II. NO MATTER WHAT STANDARD IS APPLIED, THE COMPANIES' EXTRAORDINARY TRANSMISSION COSTS MEET THE REQUIREMENTS FOR AAO DEFERRAL OR THE IMPLEMENTATION OF A TRANSMISSION TRACKER.

Consumers erroneously argue that approval of the AAO in this proceeding "would violate: (1) three decades of Commission orders; (2) the framework of the Uniform System of Accounts; and (3) the doctrine against retroactive ratemaking." (Consumers Brief, p. 8) As explained herein, these assertions are simply incorrect and should be rejected by the Commission.

### A. Past AAOs have not been limited to Acts of God.

In their joint brief, Consumers incorrectly assert that to date, Commission deferrals have been limited to instances in which an Act of God or Government have imposed costs upon public utilities. (Consumers Brief, p. 7) In fact, the subjects that have historically been found to be appropriate by the Commission for AAO approval or deferral have been much broader than the Consumers have suggested. The costs approved for AAO treatment by the Commission in the past have included the following: renewable energy standards costs, tornado costs, construction accounting, Kansas property taxes on gas storage, ice storms, pensions and other post-employment benefits ("OPEB"), cold weather rule costs, security costs, safety costs, main replacement costs, manufactured gas plant clean-up costs, Financial Accounting Standards (FAS) 106 costs, flood costs, plant rehabilitation costs, coal contract buy-out costs, and AM/FM mapping costs. (KCP&L Ex. 5, Ives Surrebuttal, Schedule DRI-1 (as corrected) (Tr. 259-62) (*See also* Staff Brief, p. 17))

Contrary to the faulty argument of Consumers that approval of the AAO mechanism would violate three decades of Commission orders, a decision to defer transmission costs associated with the extraordinary national build-out of the transmission system would be consistent with the Commission's past practices of granting AAO deferral treatment for major construction projects and power plant rehabilitation costs which are "unusual and nonrecurring, and therefore, extraordinary."

In the *Report And Order On Remand*, In Re: Joint Application of Missouri-American Water Company, St. Louis County Water Company, d/b/a Missouri-American Water Company, and Jefferson City Water Works Company, d/b/a Missouri-American Water Company, for an Accounting Authority Order Relating to Security Costs, Case No. WO-2002-273, the Commission explained the purposes of an AAO as follows:

> Through the use of AAOs, the Commission can control the timing of the recognition of expenses and receipts, thereby balancing the interests of the ratepayers and the shareholders as best services the public interest. This balancing of interests is fundamental to the Commission's statutory duty: "a fair administration of the act is mandatory. When we say 'fair,' we mean fair to the public and fair to the investors."
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> The use of an AAO to mitigate regulatory lag, for example, insures that shareholders are fully and appropriately compensated for capital investments undertaken to improve service to ratepayers. This use of an AAO serves the public interest by encouraging appropriate capital expenditures. The use of an AAO to match the costs and benefits of long-lived utility assets relieves the burden on current ratepayers who would otherwise subsidize generations yet unborn. This use of an AAO serves the public interest by maintaining intergeneration equity and permitting large projects to go forward while keeping services affordable. (*footnote omitted*).

### B. The Companies' transmission costs are extraordinary and nonrecurring as the SPP transmission build-out is a unique, one-time event.

Given the Commission's long history of approving AAOs for a variety of costs under a variety of circumstances, the Companies suggested the Commission should utilize the standard that the costs should be "material, expected to change significantly in the near future, and are primarily outside the control of the Companies". (Companies Initial Brief, pp. 4-11) However, the Staff and the Consumers have argued that the Commission should utilize a more restrictive standard—"extraordinary, material, and non-recurring"—citing the *Sibley* case. As explained in Staff's Brief at page 12, the standard adopted in the *Sibley* decision was as follows:

> The Commission's decision to grant authority to defer the costs associated with the Sibley reconstruction and coal conversion projects by recording the costs in Account No. 186 was the result of the Commission's determination that the construction projects were unusual and nonrecurring, and therefore, extraordinary. The Commission determined the projects to be unusual because of their size and substantial cost. The Commission expressed that 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 operation expense 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. (*emphasis added*; *footnote omitted)*

Even if the Commission adopts the more restrictive standard used in *Sibley*, as suggested by Staff and the Consumers, it would be lawful and reasonable for the Commission to grant the Companies' request for an AAO or transmission tracker in this case. The competent and substantial evidence in the record demonstrates that, under the circumstances that exist today in the SPP region, the transmission costs charged to the Companies by SPP and other transmission service providers are "unusual and nonrecurring, and therefore, extraordinary". (Tr. 213-14)

These costs are generated as a direct result of SPP's construction projects to expand the transmission grid to meet the Federal Energy Regulatory Commission's ("FERC") national public policy objectives. SPP's regional transmission improvement initiatives are consistent with federal policies to encourage such efforts, particularly FERC's Order No. 1000,[1] which builds on the foundation of Order No. 890,[2] and will promote both reliability and more efficient delivery of energy from new resources to customers. They are also consistent with state policies that promote renewable energy generation.[3] These cost increases are above and will continue to increase further above the amounts for transmission expense that were provided the Companies in their previous rate cases creating a significant regulatory lag gap. As such, each incremental dollar spent above the amounts provided in rates contributes to regulatory lag, and the Companies have no ability to recover these costs except to file time consuming and resource consuming rate cases year after year. (KCP&L Ex. 4, Ives Direct, p. 10) Even if the Companies filed periodic rate cases, the Companies will still be required to pay for prudent investments in the transmission system between rate cases without the opportunity for recovery, contributing to regulatory lag impacting the Companies' ability to earn their authorized returns.

Like the Sibley rehabilitation project cited by Staff and Consumers, the transmission costs that are the subject of this proceeding are extraordinary, unusual and unique, not recurring and material. <u>The extraordinary nature of these costs lies in the event driving the costs, not in the nature of the costs themselves</u>. As the Companies have shown throughout this proceeding, the Companies have historically incurred, and will continue to incur, transmission costs. <u>However, the dramatic build-out of the SPP transmission infrastructure, and in fact the nation's transmission</u>

[1] Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities, Order No. 1000, 136 FERC ¶ 61,051 (July 21, 2011), order on reh'g and clarification, Order 1000-A, 139 FERC ¶ 61,132 (May 17, 2012), reh'g pending (codified at 18 C.F.R. § 35.28).
[2] Preventing Undue Discrimination and Preference in Transmission Service, Order 890, 72 Fed. Reg. 12266 (Mar. 15, 2007), FERC Stats. & Regs. ¶ 31,241, order on reh'g, Order No. 890-A, 73 Fed. Reg. 2984 (Jan. 16, 2008) FERC Stats. & Regs. ¶ 31,261, order on reh'g and clarification, Order No. 890-B, 123 FERC ¶ 61,299 (June 23, 2008), order on reh'g and clarification, Order No. 890-C, 126 FERC¶ 61,228 (Mar. 25, 2009), order on clarification, Order No. 890-D, 129 FERC ¶ 61,126 (2009) (codified at 18 C.F.R. pts. 35, 37).
[3] See Section 393.1030-.1050 RSMo.

infrastructure, is clearly unprecedented in scale and timing compared to historical transmission investments. As discussed in detail below, the transmission costs are expected to increase 16% annually. This national effort to build-out the transmission system is clearly causing an extraordinary increase in the cost to provide necessary transmission service to the Companies' customers. This build-out is akin to the national highway infrastructure development of the 1950's. Both the national highway build-out of the 1950s and the current transmission grid build-out in response to FERC's policy to improve the national transmission grid are unusual and unique endeavors by the nation at a very substantial cost. (KCP&L Ex. 2, Carlson Direct, pp. 9-10, Schedule JRC-1 and Schedule JRC-2) Once completed, there will not be the need to continue this extraordinary effort to expand the transmission system, and therefore the current national build-out should not be characterized as a "recurring cost." These cost levels that are being charged to the Companies related to these projects are having, and will continue to have, a very significant impact on their ability to recover prudently incurred costs. As such, these costs do in fact meet the *Sibley* test of "unusual and nonrecurring, and therefore, extraordinary."

### C. The Companies' transmission costs are material, expected to change significantly and are primarily beyond the control of the Companies.

At the end of 2013, transmission costs were forecasted to exceed the amounts established in the Companies' prior rate cases by a substantial amount. As explained by Mr. Ives, KCP&L has $19,098,983 of transmission costs included in its rates, but the 2013 forecasted transmission costs were $24,033,007 for the year. Similarly, GMO has $12,315,646 included in rates, but the 2013 forecast for transmission costs were $16,857,013. (Tr. 144-45) The actual transmission costs for KCP&L and GMO, respectively, have been $25.9 million and $16.4 million in 2013. (Tr. 29) In fact, these increases are expected to increase substantially year over year subsequent to 2013 as discussed below.

Base Plan Transmission Costs allocated to KCP&L were approximately $10.5 million for the calendar year 2012, and they are projected to increase at a very significant rate from 2013 through 2019, recede slightly from there through 2021, and then increase again in 2022. As stated above, base plan transmission costs allocated to KCP&L were approximately $10.5 million for the calendar year 2012, and they are projected to increase to $35.1 million in 2016. SPP further projects KCP&L's share of the SPP transmission costs to peak at over $45 million in 2022. This equates to an approximate 16% increase per year from 2012 – 2022. (KCP&L Ex. 2, Carlson Direct, p. 9) This is a significant problem to the Companies, and it needs a regulatory solution. (Tr. 208-09, 227-28)

Base Plan Transmission Costs allocated to GMO were $5.1 million for the calendar year 2012, and they are projected to increase to $14.9 million in 2016, and peak at over $25 million in 2022. This equates to an approximate 16% increase per year from 2012 – 2022 for GMO. These projections reflect both zonal and region-wide components of the costs of SPP-approved projects and the increases are primarily driven by the region-wide components. (*Id.* at 10)

Because the magnitude of the transmission cost increases are extraordinary and are comparable to other events for which deferrals have previously been authorized, the Companies seek an order from the Commission authorizing them to defer and record to the USOA account 182.3, Other Regulatory Assets, or USOA account 254, Other Regulatory Liabilities, transmission expenses over/under amounts included in rates. Absent the Commission's authorization of an AAO or a transmission tracker, the Companies will be deprived of an opportunity to fully recover these expenses through rates. As a result, a denial of the AAO or transmission tracker requested in this proceeding would contribute to a significant regulatory lag gap and make it more difficult for the Companies to earn their authorized rate of return. Such a policy would not promote the public interest, and would constitute a poor regulatory policy when a better approach, as suggested by the Companies, is available to the Commission.

## III. STAFF'S AND CONSUMERS' ALLEGATIONS OF OVEREARNINGS ARE NOT SUPPORTED BY THE RECORD.

While contesting the "extraordinary" nature of the national build-out of the transmission grid, Staff also erroneously suggested that the AAO should be denied for the reason that "it would be grossly unfair to ratepayers given that there is evidence that the Applicants are currently overearning despite the effect of the excess transmission costs." (Staff Brief, pp. 17-18) Similarly, Consumers have also asserted that "KCPL and GMO are both earning in excess of their authorized return on equity." (Consumers Brief, p. 4) These arguments are based upon nothing more than the incomplete and extremely limited analysis of MIEC/MECG witness Greg Meyer who reviewed raw data included in the monthly surveillance reports of GMO without adjusting for weather, previous rate case order accounting adjustments, and other typical rate case adjustments. In reality, Mr. Meyer did not even have any surveillance reports for KCP&L. In fact, he candidly testified: "Because of this, it is impossible to determine how KCPL has earned since its rate case concluded." (MECG Ex 4, Meyer Rebuttal, p. 14) As such, any assertions by Staff and Consumers should be disregarded since there is insufficient competent and substantial evidence on the whole record to support such assertions.

Even though such surveillance reports are only considered as a "starting point" for the Staff's analysis of a public utility's earnings level when considering rate complaints (Tr. 272), Staff and Consumers are leaping to the conclusion that the Companies are "overearning" in this case when there is insufficient competent and substantial evidence to reach this conclusion. This approach should be rejected by the Commission.

In summary, the Commission should follow past practices and approve the requested AAO or a transmission tracker in this proceeding and thereby appropriately provide the opportunity to balance the interests of customers and shareholders. Contrary to the suggestions of Staff and Consumers, merely filing a new set of rate cases will not ensure that all prudently incurred transmission costs will be reviewed and possibly recovered in a timely manner. The Commission should fully utilize its tools in its regulatory toolbox to mitigate the financial consequences to the Companies of the unprecedented transmission build-out.

## IV. THE COMMISSION SHOULD AUTHORIZE CARRYING COSTS TO BE INCLUDED IN THE AAO OR TRANSMISSION TRACKER TO ACCOUNT FOR THE TIME VALUE OF MONEY.

Although Staff recognized in their brief that "Carrying costs have been allowed for deferrals of costs in complying with Commission mandates" (Staff Brief, p. 20), Staff maintained that there should be no carrying costs in this case. This position is short-sighted and inconsistent with Staff witness Mark Oligschlaeger's testimony that carrying costs have sometimes been included in other AAOs approved in the past. (Staff Ex. 3NP, Oligschlaeger Surrebuttal, p. 26; Tr. 233) While Staff recognizes that "mitigation of regulatory lag is an appropriate purpose of AAO" (Staff Brief, p. 20), Staff argues that it is not appropriate to eliminate it. Apparently, Staff does not believe that the Commission should <u>fully</u> recognize the time value of money, and mitigate regulatory lag in the process to the extent the Commission can through this mechanism.

In the past, the Commission has recognized that carrying costs are appropriate for inclusion in AAOs and trackers. (Staff Ex 3NP, Oligschlaeger Surrebuttal, p. 26; Tr. 233)

Contrary to Staff's inference on pages 19-20 of its brief, the Commission has authorized carrying costs for both capital costs and expenses.[4]

The Commission should again include an appropriate level of carrying costs to recognize the time value of money and reduce regulatory lag related to the deferral of transmission costs. The Companies have requested that the Commission authorize carrying costs at their weighted cost of capital. Anything less than carrying costs based upon the Companies' weighted cost of capital will not fully compensate the Companies for the time value of money.

## V. THE COMMISSION SHOULD REJECT THE CONDITIONS SUGGESTED BY STAFF AND OTHER PARTIES TO THIS PROCEEDING.

The Companies have already addressed at length the flaws associated with the Staff's conditions. It is therefore unnecessary to re-iterate them here. However, a few comments are appropriate.

First, Staff argues that the "Applicants are proposing a mismatch of revenues and expenses." (Staff Brief, p. 26) As explained in the Companies' Initial Brief, this argument is flawed. In reality, it is Staff's position that creates a mismatch of revenues and expenses. Staff has ignored one side of the revenue requirement calculation. Staff would include transmission revenues associated with local transmission projects, but chooses to exclude the costs associated with the same projects. The Companies proposed to exclude both the revenue and ownership components in its initial AAO proposal and track only changes in transmission service charges

[4] *See e.g., Order Approving And Incorporating Stipulation And Agreement*, Re: Application of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company for the Issuance of an Accounting Authority Order Relating to Their Electric Operations, File No. EU-2012-0131 (April 30, 2012)(authorizing carrying costs on renewable energy standards compliance costs; *Report And Order*, p. 26, Re: Southern Union for the Issuance of an Accounting Authority Order Relating to its Natural Gas Operations and for a Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2), File No. GU-2011-0392 (January 25, 2012)(carrying costs authorized for operations and maintenance expense and capital costs for tornado recovery costs); *Report and Order*, pp. 12, 20, Re Laclede Gas Company, Case No. GU-2007-0138 (April 17, 2008)(authorizing interest on cold weather rule compliance costs) .

associated with Regional Transmission Projects which are included in this AAO filing. (KCP&L Ex. 5, Ives Surrebuttal, p. 23)

Staff, on the other hand, suggests that the Commission include in the AAO the revenues associated with local transmission ownership, but exclude the transmission costs associated with the local transmission system. (Tr. 280) (KCP&L Ex. 5, Ives Surrebuttal, p. 23) The Staff's suggested approach is unbalanced and violates matching principles, and it would be more appropriate and reasonable to exclude the costs and the revenues associated with the local or zonal transmission system, as suggested by the Companies.

With regard to Staff's Condition 2 (Monthly Reporting), Staff argues that it is necessary to "require the Applicants to provide ongoing reporting of transmission costs and revenues flowing through the deferral mechanism." (Staff Brief, p. 28) Such onerous reporting is unnecessary since all of the information will be available for review in the Companies' next general rate case. The Commission has authorized numerous deferrals of everything from pension costs to power plant rehabilitation costs. These deferrals have amounted to hundreds of millions of dollars, and in none of these cases has the Commission found it necessary to require reporting on these deferrals outside of a rate case. It is simply not necessary to "keep the Applicants' honest," and no more effective to require needless reporting when less onerous methods are available to audit the Companies' transactions for transmission services.

With regard to Staff's Condition 3 (SPP Cost-Benefit Analysis), Staff ignores the cost and difficulty of implementing Staff's recommendation to maintain an ongoing analysis and quantification of all benefits and savings associated with participation in SPP not otherwise passed on to retail customers between general rate proceedings. Instead, this Staff condition seems to be more in the nature of a penalty to be extracted from the Companies "if extraordinary treatment of increased costs is authorized by the Commission." (Staff Brief, p. 30)

This proceeding is not the appropriate forum in which the benefits of participation in SPP should be considered. (KCP&L Ex. 5, Ives Surrebuttal, pp. 26-27) As explained in the Companies' Initial Brief, the Companies are already committed to do such cost-benefit analyses of continued membership in SPP in 2017 when their memberships are scheduled to be re-evaluated. (Companies' Brief, pp. 18-19)

With regard to Staff's Condition 4 (Cost Minimization), Staff argues that "Staff's goal is to incentivize Applicants to make every effort to maximize the benefits that accrue to both customer and shareholders from their involvement in SPP." (Staff Brief, pp. 30-31) The Companies do not need any additional incentives to optimize the expenditures for transmission services. In every general rate case, the Companies face scrutiny of their expenditures for transmission and a host of other expenditures necessary to provide the public with safe and adequate service. It is little more than a pejorative argument for the Staff to assert without any supporting competent and substantial evidence that "[i]n the absences of such an incentive, the Applicants could not be expected to act diligently to protect ratepayers from unnecessary and avoidable cost increases." (*Id.* at 31) Staff's Condition 4 (Cost Minimization) should be rejected. The Staff and other parties have the ability to review extensive public documentation and meeting minutes produced by SPP that provide explanation of the efforts by SPP to operate in an efficient manner and optimize the benefits relative to the costs billed to its participating members. Staff's proposed Condition 4 appears to be little more than an onerous regulatory roadblock that is not necessary or even helpful to provide appropriate regulatory oversight. No further conditions or "incentives" to optimize costs should be required.

With regard to Staff's Condition 6 (Amortization), Staff argues that this condition "is intended to prevent the Applicants from 'hoarding' transmission expense recoveries over a long period of time in order to maximize their potential rate recovery of transmission costs." (Staff Brief, p. 31)

As explained in the Companies' Initial Brief, Staff's Condition 6 (Amortization) makes it impossible for the Companies to establish a regulatory asset or regulatory liability in this case since it would require the Companies to immediately amortize the regulatory asset or liability. Staff's Condition 6 begins amortization before the conclusion of the next general rate case proceedings and could impair the Companies' ability to defer transmission costs into a regulatory asset or liability and thus should be not be accepted in this proceeding. (KCP&L Ex. 5, Ives Surrebuttal, pp. 30-31) This seems to be exactly the result that Staff hopes to achieve in order to accomplish a "sharing" of these costs between shareholders and ratepayers. The proposal by Staff would not only limit the full recovery of costs from ratepayers but would also preclude any potential refund to ratepayers should transmission expenses be lower than the amount currently in base rates. This is an unfortunate position, and quite short-sighted on the part of Staff. It should be rejected by the Commission. Moreover, these costs are prudently incurred transmission costs that the Companies have incurred in order to serve customers. As such, the costs are not to be shared between shareholders and customers but rather should be recovered from customers as a cost of service.

Similarly, the adoption of Condition 7 (Earnings Test) with its "sharing mechanism" would not allow the Companies to defer the transmission costs into a regulatory asset or regulatory liability since this condition would not allow the Companies to achieve the requisite probability of future recovery necessary to establish a regulatory asset or regulatory liability.

(KCP&L Ex 1, Bresette Direct, pp. 3-4)  In other words, the Companies would not be able to establish that there would be a likelihood of future recovery of the deferred costs since Condition 7 would make recovery dependent upon the earnings levels in the future.  If Condition 7 were adopted, it would defeat the purpose of the AAO request in this case.  Therefore the Commission should decline to accept this condition.

Staff argues that deferrals resulting from the AAOs or trackers should cease depending upon KCP&L's and GMO's reported return on equity ("ROE") levels.  While Staff recognizes that surveillance reports are not detailed enough to justify changes in rates in and of themselves (Staff Brief, p. 35), the Staff nevertheless claims that they are appropriate for their use as the "braking mechanism" that would "turn-off" the deferral.  (Staff Brief, p. 34) The one sided nature of Staff's condition can readily be seen in a simple example of its operation.  For example, if a company's earnings increased due to extremely hot weather, Staff's condition would "turn off" the deferral.  However, Staff and Consumers would likely protest loudly if the condition was designed to increase the deferral should a company's earnings be reduced due to a long period of mild weather.

As discussed earlier, such surveillance reports are not adjusted for weather, or a myriad of routine adjustments that are made in rate cases.  (Tr. 230-32; 271-72)  If the Commission adopted Condition 7, it is likely that the quantification of the earned ROE would be quite controversial among the parties in future proceedings.  (Tr. 235, 275)  Mr. Ives testified that he would expect hearings and a number of differences and opinions on whether or not the Companies had truly earned in excess of the authorized returns.  (Tr. 235)  At a minimum, such surveillance reports would need to be adjusted for weather effects on the Companies and other adjustments previously adopted in rate cases.

Citing to the Southwest Bell Telephone Company and Ameren Missouri "sharing plans" of the 1990s, Staff argues that such returns on common equity were used to determine a sharing of earnings. However, Staff fails to inform the Commission that these "sharing plans" were fraught with controversy. (Tr. 234-35) There was much controversy regarding the implementation of the plans, and in determining when an ROE sharing point was reached.

In summary, surveillance reports should not be used to "turn on" or "turn off" the AAO's deferral of costs, as suggested by Staff. Such a condition is unnecessary, unworkable, and unprecedented.

## VI. THE COMMISSION SHOULD REJECT CONSUMERS' ARGUMENTS THAT AAOS AND TRANSMISSION TRACKERS ARE ILLEGAL MECHANISMS.

Consumers argue in their joint brief that "any deferral of costs for future consideration would be prohibited" citing the prohibition against retroactive ratemaking and single-issue ratemaking. (Consumers Brief, pp. 12, 15) On the other hand, Staff has not suggested that AAOs and transmission trackers are inherently illegal mechanisms, as Consumers have argued. Quite to the contrary, the Staff recognizes that AAOs have been utilized by the Commission to defer costs for review in future rate cases, including pension and OPEBs accounting, service line replacement programs, computer upgrades for Y2K, renewable energy standards, changes in the property tax in Kansas, major construction projects, security costs, and infrastructure replacement programs. (Staff Brief, p. 17)

Contrary to the arguments of Consumers, the Commission and the courts have uniformly rejected such claims that AAOs are illegal retroactive ratemaking or impermissible single issue ratemaking. As explained in the Companies' Initial Brief, this universal rejection of these arguments is because AAOs and trackers do not involve ratemaking at all. *See, e.g.,* State ex rel. Noranda Aluminum, Inc. et al. v. PSC, 356 S.W.3d 293 (Mo. App. S.D.

2011). Under the proposed AAO or transmission tracker, there will be no ratemaking at this time. Before any deferred costs can later be taken into account in setting rates *in the future*, the Commission will again consider all relevant factors. Any rate case order that permits recovery of these transmission costs will set rates for future electricity usage, not retroactively adjust rates of the past.

The Commission recently has rejected the assertions of Consumers' that AAOs constituted retroactive ratemaking. In its *Order Approving and Incorporating Stipulation And Agreement ("Order")*, File No. EU-2012-0131 (issued April 19, 2012) in Re the Application of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company for the Issuance of an Accounting Authority Order Relating to their Electrical Operations, the Commission stated:

> Missouri courts have recognized the Commission's regulatory authority to grant a form of relief to a utility in the form of an AAO "which allows the utility to defer and capitalize certain expenses until the time it files its next rate case." "The AAO technique protects the utility from earnings shortfalls and softens the blow which results from extraordinary construction programs." "However, AAOs are not a guarantee of an ultimate recovery of a certain amount by the utility." The AAO "simply allows for certain costs to be separately accounted for possible future recovery in a future ratemaking proceeding." "This is not retroactive ratemaking, because the past rates are not being changed so that more money can be collected from services that have already been provided; instead, the past costs are being considered to set rates to be charged in the future." Although the courts have recognized the Commission's authority to authorize an AAO in extraordinary and unusual circumstances, there is nothing in the Public Service Commission Law or the Commission's regulations that would limit the grant of an AAO to any particular set of circumstances. (e*mphasis added; footnotes omitted*)

The Commission's use of AAOs has also been determined to be lawful and reasonable by the courts. State ex rel. Office of the Public Counsel v. PSC, 858 S.W.2d 806, 812-13 (Mo. App. W.D. 1993). *See also* State ex rel. AG Processing v. PSC, 340 S.W.3d 146, 151 (Mo. App. W.D. 2011) (holding forward-looking rate adjustments approved by the PSC pursuant to a previously adopted fuel adjustment clause did not constitute unlawful retroactive ratemaking.); State ex rel. Office of the Public Counsel v. Public Service Commission, 301 S.W.3d 556 (Mo. App. 2010) (holding that the Commission's AAO allowing a gas utility to defer the costs of complying with the Commission's cold weather rule did not violate the prohibition against retroactive ratemaking); State ex rel. Midwest Gas Users' Association v. Public Service Commission, 976 S.W.2d 470 (Mo. App. 1998) (holding that the PGA clause did not constitute improper retroactive ratemaking).

In State ex rel. Office of the Public Counsel v. PSC, 858 S.W.2d 806, 812-13 (Mo. App. W.D. 1993), the argument was made that it constitutes impermissible single-issue ratemaking to authorize a utility to defer depreciation expenses between rate cases associated with construction projects at the utility's power plants. Specifically, OPC argued that "by granting [the utility] authority to defer certain costs . . . the Commission is permitting '[the utility] to isolate individual costs [sic] of service components for future ratemaking recovery by preserving these costs by means of deferral, without proper consideration of concurrent relevant factors.'" (*Id. at* 812) In rejecting OPC's contention, the Missouri Court of Appeals indicated that the "Commission did not grant rate relief to [the utility]." (*Id.*) Rather, the Court recognized that the Commission "stated in its Report and Order that the amount of the deferred cost to be recovered as well as other ratemaking issues would be determined in a later rate case." (*Id.*)

With either the requested AAO or a transmission tracker, there will be no retroactive changes in rates or single issue ratemaking. Rates will be changed in a future rate case, based upon the consideration of all relevant factors. Rates will apply to future service, and there will be no attempt to charge or readjust consumers' past bills to account for past losses. As a result, there is no retroactive ratemaking or single issue ratemaking under the Companies' proposal, and Consumers' arguments should therefore be rejected.

## VII. CONCLUSION

In conclusion, having fully addressed the arguments of Staff and Consumers, the Companies respectfully renew their request that the Commission issue an Accounting Authority Order or transmission tracker authorizing them to account for and record on its books a regulatory asset or regulatory liability related to the rapidly increasing transmission costs associated with SPP projects. This proceeding provides the Commission an opportunity to ensure that all prudently incurred transmission costs will be eligible for review and possible recovery in the Companies' next rate cases. These transmission costs are material, expected to change significantly in the near future, and are primarily outside the control of the Companies. In addition, under the circumstances that exist today in the SPP region, with the unique, extraordinary and non-recurring build-out of the transmission system that is currently ongoing in SPP, the Commission should find and conclude that these transmission costs are extraordinary (Tr. 213-14), non-recurring, and largely outside the control of the Companies. Under either standard proposed by the parties in this case, the Commission should exercise its regulatory discretion and grant the Companies' application in this proceeding and approve either an AAO or a transmission tracker. By doing so, the Commission will reduce regulatory lag, and treat the Companies in a manner more similar to Ameren Missouri that has been authorized to pass through such transmission costs through a FAC mechanism.

Respectfully submitted,

*/s/James M. Fischer*

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**ATTORNEYS FOR**
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**KCP&L GREATER MISSOURI OPERATIONS COMPANY**

## CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, to the certified service list in this proceeding this 11th day of March, 2014.

*/s/ James M. Fischer*

James M. Fischer