

Staff Response to Senator Eric S. Schmitt
April 5, 2013

On March 15, 2013, Senator Eric S. Schmitt sent a letter to Missouri Public Service Commission (Commission) Chairman Robert Kenney seeking PSC analysis and information on the following topics:

- The safety, adequacy and reliability of Missouri's current electric infrastructure;
- Identification of electric infrastructure problems, costs and needs;
- Rate impact of the implementation of Senate Bill 207;
- Electric utilities' financial need for legislation;
- Due process and appropriate procedure in respect to the new rate mechanisms proposed by Senate Bill 207;
- Other information which the PSC finds relevant to this legislation.

On March 20, 2013, the Commission opened Working Case No. EW-2013-0425 as a repository for interested utilities, organizations, and other stakeholders to file written comments, which were due no later than April 1, 2013.

In this response, the Commission Staff (Staff) provides analysis and information to Senator Schmitt and includes a summary of the comments submitted by interested entities in the working case.

Nothing in this response shall be construed or portrayed as Staff or the Commission, taking a position on any provisions of Senate Bill 207 or its substitutes or amendments.

I. The safety, adequacy and reliability of Missouri's current electric infrastructure

Missouri Statutes require electric utilities to "furnish and provide such service instrumentalities and facilities as shall be safe and adequate and in all respects just and reasonable."¹ This principle guides the Commission in all aspects of utility regulation. As outlined further below, the Commission has implemented several rules to help ensure the safety, adequacy and reliability of Missouri's electric infrastructure. Some of the rules were implemented in direct response to reliability issues such as outages resulting from significant storm events in 2007 and 2008.

The electric utility industry is often referred to in terms of distribution, transmission, and production facilities. Missouri's investor-owned electric utilities are considered vertically integrated, that is the electric utilities include distribution, transmission, and production facilities.

Electric distribution facilities are the focus of Commission's Electric Utility Operational Standards, which are contained in 4 CSR 240-23. Chapter 23 contains three rules, which became effective in June 2008:

¹ Section 393.130. 1., RSMO Supp. 2012

- a. 4 CSR 240-23.010 Electric Utility System Reliability Monitoring and Reporting Submission Requirements – establishes reliability monitoring and reporting requirements for electric corporations.
- b. 4 CSR 240-23.020 Electrical Corporation Infrastructure Standards - establishes the minimum requirements for the transmission and distribution facilities of electric corporations regarding inspection, condition rating, corrective actions, record keeping and reporting, in order to provide safe and adequate electrical service.
- c. 4 CSR 240-23.030 Electrical Corporation Vegetation Management Standards and Reporting Requirements – sets forth requirements that electrical corporations shall follow in managing vegetation in proximity to an energized distribution facility and sets reporting requirements for transmission line vegetation management in order to promote a safe, efficient and reliable supply of electric power.

Electric transmission facilities are regulated by both the Commission and the Federal Energy Regulatory Commission (FERC). In addition, each of the investor-owned electric utilities is a member of a regional transmission organization (RTO), either the Midwest Independent System Operator (MISO) or the Southwest Power Pool (SPP).

Generation additions are part of the integrated resource planning process long before construction is complete. The long-term planning of production (generation) facilities is one of the primary focuses of the Commission's Electric Utility Resource Planning process, 4 CSR 240-22. The Commission's Chapter 22 policy objective states, "The [C]ommission's policy goal...is to set minimum standards to govern the scope and objectives of the resource planning process that is required of electric utilities subject to its jurisdiction in order to ensure that the public interest is adequately served." The electric utilities Chapter 22 policy objective states, "The fundamental objective of the resource planning process at electric utilities shall be to provide the public with energy services that are safe, reliable, and efficient, at just and reasonable rates, in compliance with all legal mandates, and in a manner that serves the public interest and is consistent with state energy and environmental policies."

Large capital investments that are required to add generation and the associated, significant risks that impact generation decisions result in analysis that focuses on the electric utility's generation resources. Chapter 22 also has rules that cover topics such as Transmission and Distribution Analysis, 4 CSR 240-22.045, and Demand-Side Resource Analysis, 4 CSR 240-22.050.

Generally speaking, the electric infrastructure in Missouri is safe and reliable. On occasion, the Commission receives complaints from customers regarding electric utility infrastructure reliability. Staff reviews and the Commission decides these complaints from the perspective of determining whether any Commission rules or statutes have been violated. Similarly, reliability concerns and issues are occasionally raised in the context of electric utility rate cases. In the 100 years that the Commission has been in existence, the level of service that meets the "safe and adequate" standard has changed over time, and it is not unreasonable to assume that the definition of "safe and adequate" will continue to evolve.

The following excerpts from testimony filed with the Commission by the investor-owned utilities in each of those utilities' most recent rate cases may also provide some guidance as to the safety, adequacy and reliability of Missouri's current electric infrastructure.

Direct Testimony in Case No. ER-2012-0166 of Warner L. Baxter, President and Chief Executive Officer of Ameren Missouri (Page 9, Lines 16-21)

"... our steady investment in infrastructure has resulted in measurable reliability improvements since 2006 as reflected in the chart below, which shows the average outages per customer per year. As you can see, our reliability has improved nearly 27% since 2006. Further, we expect our 2011 average outages per customer per year to be in the top quartile in the electric industry and it reflects the lowest level we have achieved in recent history." (chart omitted)

Direct Testimony in Case No. ER-2012-0174 of Terry Bassham, President and Chief Operating Officer of Kansas City Power & Light Company (Page 7, Lines 12-14)

"KCP&L provides some of the most reliable electrical service in the country. The Company has been named the most reliable electric utility in the region for four years in a row."

Direct Testimony in Case No. ER-2012-0175 of Terry Bassham, President and Chief Operating Officer of KCP&L Greater Missouri Operations Company (GMO) (Page 5, Lines 5-6)

"GMO provides some of the most reliable electric service in the country."

Direct Testimony in Case No. ER-2012-0345 of Kelly S. Walters, Vice President-Chief Operating Officer-Electric of The Empire District Electric Company (Page 16, Lines 10-11 and Lines 14-15)

"The number of outages related to vegetation issues has declined by over 63 percent since 2006."
"Empire has fully implemented a system inspection and remediation program designed to meet the Commission's standards in this area."

II. Identification of electric infrastructure problems, costs and needs

The Commission has regulations in place that set minimum standards for the various components of the utilities' infrastructure. Consistent with Commission rules, a daily function of electric utilities is to address problems, costs and needs associated with their electric infrastructure. For distribution facilities, Chapter 23 sets out minimum standards for the frequency and scope of infrastructure inspections and vegetation management. The investor-owned electric utilities are required to report on their ability to meet these requirements. If a utility is not in compliance with aspects of the rules, it must submit a plan for how it will meet the requirements in the near future. In addition, the utilities must report the problems discovered during the inspection process and document all repairs that were performed to correct these problems. 4 CSR 240-23.010 also requires that the utility identifies its top five percent (5%) worst performing circuits and submit a plan for corrective action to fix problems with the worst performing circuits.

For transmission infrastructure, the regional transmission organization (RTO) planning processes identify problems and needs that strengthen a utility's transmission grid as well as the electric grid in the respective regions. Missouri investor-owned electric utilities work with the RTOs and

the other member electric utilities to identify and address problems and needs. In addition, the electric utilities also evaluate their transmission system on a stand-alone basis to identify any problems that need corrected.

The integrated resource planning process (4 CSR 240-22) identifies problems, needs, and risks related to generation infrastructure over a planning horizon, which is a minimum of 20 years. This process also lays out the strategies (contingencies) that the utility plans to employ to address various risks.

III. Rate impact of the implementation of Senate Bill 207

Ratemaking Process Overview

The Commission sets rates based on comprehensive analyses of historical costs incurred by the electric utility to provide service. Except as otherwise allowed by statute, rates are not based on single issues or single items of cost. Rather, the total cost of service is considered through the process of a general rate case.

The Western District Court of Appeals stated, “[W]hen a utility’s rate is adjusted on the basis of a single factor, without consideration of all relevant factors, it is known as single-issue ratemaking. Single-issue ratemaking is generally prohibited in Missouri ‘because it [will] cause the [Commission] to allow [a] company to raise rates to cover increased costs in one area without realizing that there were counterbalancing savings in another area.’” *State ex rel. Pub. Counsel v. Pub. Serv. Comm’n of State*, 2013 WL 151002, 5 (Mo.App. W.D., 2013), *quoting State ex rel. Midwest Gas Users’ Ass’n v. Public Service Comm’n*, 976 S.W.2d 470, 479 (Mo. App. W.D., 1998.).

The general ratemaking process ensures the Commission sets rates that are just and reasonable using an analysis of all relevant factors. Legislation has allowed consideration of single issues or single items of cost for consideration by the Commission outside of the general rate case. For example, in 2005, legislation authorized the Commission to set rates include a Rate Adjustment Mechanism, such as the Fuel Adjustment Clause and the Environmental Cost Recovery Mechanism. These Rate Adjustment Mechanisms allow the utilities to adjust a volumetric rate to collect fuel or other defined costs from customers outside of a general rate case proceeding, and are subject to a post-implementation prudence review. Similarly, the proposed electric utility ISRS will allow costs associated with certain infrastructure replacements and additions to be passed on to consumers more quickly, outside of a general rate case, without comprehensive analysis of all costs and expenses. Section 393.1215 of the proposed legislation authorizes the implementation of a mechanism to track selected utility expenses for subsequent recovery in rates, which depending on the manner of implementation, could also result in single-issue ratemaking.

The time between when the electric utility incurs costs and recovers those costs through new rates is referred to as regulatory lag. In an environment where costs are increasing, regulatory lag is referred to as negative regulatory lag, and could cost the utility some amount of money. In an environment where costs are decreasing, regulatory lag is referred to as positive regulatory lag, and could result in utility over-earning. The ultimate financial effect of regulatory lag is

greatly debated. SB 207 would remove some of the negative regulatory lag from the ratemaking process.

Staff Analysis of Rate Impact of Senate Bill 207

Two different parts of the legislation would have a likely impact on customer rates: (1) the “ISRS” provisions of the bill (Sections 393.1200, 393.1205 and 393.1210), which will allow rate increases outside of general rate proceedings; and (2) the expense “tracker” provisions of the bill (Section 393.1215), which mandates inclusion in rates of an expense amortization in future general rate proceedings.

Attachment A represents Staff’s analysis of the potential annual rate impact of those portions of Senate Bill 207 that allow for periodic infrastructure system replacement surcharge (ISRS) rate adjustments for Missouri investor-owned electric utilities. This information was provided in response to previous legislative inquiries. As discussed more fully below, this information has been updated with this inquiry. Attachment B represents the updated rate impact associated with the electric ISRS provisions of the bill. Attachment C represents Staff’s analysis of the potential rate impact of that portion of Senate Bill 207 which mandates implementation of a tracker.

For its analysis of the rate impact of the bill, Staff used SCS SB 207 as the applicable language governing the operation of the electric utility ISRS and the tracker. Separate rate impact analyses have been prepared for Ameren Missouri (Ameren), The Empire District Electric Company (Empire), Kansas City Power & Light Company (KCPL), KCPL – Greater Missouri Operations/MPS District (GMO – MPS), and KCPL – Greater Missouri Operations/SJLP District (GMO – SJLP). The latter three entities are all subsidiaries of Great Plains Energy (GPE) offering electric service to Missouri customers using different approved rate schedules.

All of the potential rate impacts discussed below should be viewed as estimates, and do not constitute a prediction of the actual rate impact for any given year, or even the first year of implementation of the legislation. Attachment D provides a more detailed explanation of the various calculations for each Missouri investor-owned electric utility.

Infrastructure System Replacement and Addition Surcharge

Sections 393.1200, 393.1205 and 393.1210 provide that an electric utility may file for an ISRS rate change for its qualifying plant expenditures under certain conditions. For purposes of the ISRS filing, the gross value of the qualifying plant additions is to be offset by any growth in the utility’s accumulated deferred tax reserve and accumulated deferred income tax reserves that have occurred since the utility’s last general rate proceeding.

Pursuant to earlier requests for information from legislators, Staff provided estimates of the annual rate impact of the ISRS provisions of SB 207, using information obtained in part from the electric utilities. The annual revenue requirement impact of the ISRS legislation calculated by Staff at that time was approximately \$40 million for Ameren, approximately \$5 million for Empire, approximately \$12.5 million for KCPL, approximately \$7.5 million for GMO/MPS division, and approximately \$2.5 million for GMO/SJLP division. Staff has a correction to these prior estimates, and a clarification.

When Staff prepared its earlier ISRS rate impact estimations, it did not attempt to directly model the rate impact of the bill provisions in Section 393.1200 that allow electric utilities to “defer” (not recognize in current income) carrying charges and depreciation expense calculated on plant additions for the period of time between when the addition is placed “in-service” and when the plant addition is reflected in ISRS rates. Under traditional ratemaking, a utility is not allowed to defer, for future recovery in rates, carrying charges and depreciation expense on new plant additions between the in-service date and the date such additions are reflected in permanent rates. Therefore, the provisions of SB 207 which allow deferral and subsequent recovery of such costs within ISRS rate filings on all qualifying plant additions allow electric utilities to recover costs in customer rates that have not generally been allowed recovery under current Missouri ratemaking practices. These costs have been recovered in certain instances where stakeholders have reached an agreement approved by the Commission, or where the Commission has authorized such recovery. These prior instances usually involved the addition of large generating unit additions to the electric utilities’ systems.

In retrospect, the rate impact of the deferral provision should have been incorporated into Staff’s earlier ISRS rate projections. Based upon the text of SB 207, as well as discussions with utility officials, Staff believes the intent of the legislation is to include the carrying cost and depreciation deferrals within the costs eligible for recovery within the ISRS rate mechanism. Staff’s estimate is that appropriately reflecting the deferral provision of the electric ISRS legislation will result in an approximate \$42.0 million annual total ISRS rate impact for Ameren, an annual \$5.5 million rate impact for Empire, an annual \$13.5 million ISRS rate impact for KCPL, an annual \$8.0 million rate impact for GMO/MPS division, and an annual 2.5 million rate impact for GMO/SJLP division.

It should be noted that these annual rate increase projections will be multiplied over time through the impact of the possibility of multiple ISRS rate increases between the filing of general rate proceedings. For example, if Ameren waits for the full three-year, eleven-month period between general rate filings it is allowed if it takes advantage of the ISRS rate process, Ameren would be expected to implement approximately \$168 million in ISRS rate increases before its general rate level is adjusted in a general rate proceeding. For all electric utilities combined, the amount of total ISRS increases over a four-year period would be approximately \$275 million, according to the Staff’s updated estimates.

The plant additions that qualify for ISRS rate treatment will also, absent successful prudence challenges, be reflected in a utility’s customer rates in a general rate proceeding. Therefore, the ISRS rate mechanism has the primary impact of changing the timing of when plant additions are reflected in customer rates. Based on Staff’s analysis, the ISRS rate process would almost always accelerate charging of costs associated with plant additions to customers in comparison to when such costs might be included in their rates under traditional rate regulation. Further, any utility cost of service trends that may serve to mitigate or even totally offset the rate impact of qualifying plant additions (for example, increasing revenues from customers or decreasing expenses) that would enter into the ratemaking equation in a general rate proceeding will not be taken into account as part of the ISRS rate process. For these reasons, Staff is of the opinion that use of the ISRS rate mechanism included in SB 207 will have the impact of charging electric customers in Missouri higher rate levels at any point between general rate proceedings than

would be charged to them under traditional rate regulation. This has also been the impact on the affected natural gas and water customers of the more limited ISRS rate mechanism currently allowed to gas and water utilities under state law.

If an electric utility chooses to add plant to its system after implementation of SB 207 that it would not have added in the absence of that legislation, then treatment of plant additions under SB 207 will mean higher rates in total to customers in addition to acceleration of charging plant related costs to customers. It is not entirely clear what the intentions of the electric utilities are in regard to making incremental plant investments if SB 207 becomes law. It is Staff's understanding that the annual ISRS plant addition information provided to it by Ameren reflects an assumption of an additional \$100 million in annual incremental additions tied to passage of SB 207. It is Staff's understanding that the annual ISRS plant information provided to it by Empire, KCPL and GMO did not include an assumption for any incremental plant additions tied to passage of SB 207.

Because the amount of annual ISRS investments by utility will be affected by many variables over time, in any given year it can be expected that the actual amount of ISRS eligible plant rate increases may be significantly greater or less than the amount of the estimated annual rate increase calculated by Staff for each electric utility.

Tracker Section

Section 393.1215 states that any electrical corporation that has had a general rate proceeding within the past three years shall implement a mechanism to track the differences between various costs. In other words, this Section allows an electric utility to defer (not recognize in current income) any differential between its actual incurred costs and the amount of rate recovery it receives for the following cost of service items, calculated in total: noncapitalized labor charges, training expenses, employee benefits, payroll taxes, transmission charges or expenses, property taxes, property insurance and costs associated with use of external contractors to operate or maintain the utility's electric system. The Section further mandates that the electric utility recover the amount of this differential in customer rates in its next general rate proceeding through a three-year amortization of the total differential. (This provision would require that the Commission divide the amount of the differential by three for purposes of inclusion in rates, with the utility consequently receiving recovery of the full amount after three years.)

Under most circumstances, utilities are not currently allowed to recover in rates any differential between the amount of their past incurred costs and their past recovery of those costs, either regarding an isolated cost or taking into account their entire cost of service. Instead, rates are set "prospectively" in order to allow the utility an opportunity to recover costs on a going-forward basis. Rates are not set "retroactively" to allow the utility to recoup in rates any past loss in incurring higher costs than the level for which it received rate recovery, or conversely to allow customers to recoup any past gain by the utility in reducing the amount of its incurred costs below the level recovered in rates. While the Commission does authorize "trackers" in certain limited circumstances, none of the items listed in Section 393.2015 as mandated for tracker treatment have been authorized for such treatment by the Commission to date.²

² Ameren is currently allowed to include certain MISO related transmission expenses, net of

As a whole, the items listed in Section 393.2015 as qualifying for the “tracker” have tended to result in increases in a utility’s revenue requirement over time. No significant cost of service items that tend to decrease a utility’s revenue requirement over time (i.e., increased customer revenues) are included in this section of SB 207. For this reason, as well as the fact that rate recovery associated with tracker treatment of these costs has never been incorporated into Missouri ratemaking in the past, it is almost a certainty that implementation of this provision will mean higher customer rates in the future than would be authorized under traditional ratemaking regulation.

It is difficult to estimate the potential rate impact of the tracker provision of SB 207, as that is dependent upon future cost escalation trends applicable to each of the listed expenses. For some categories of expense included within the tracker provision, prior information regarding each utilities’ actual annual expenses are not readily available. For this reason, Staff chose to focus its analysis on some of the larger expense items for which annual cost information was readily obtainable. For noncapitalized labor costs and property taxes, Staff examined the escalation trend in those expenses over the last six years (2006 to 2011) in each utility’s filed annual reports to develop its estimate of the likely rate impact of the tracker. For transmission expenses, Staff used Empire’s, KCPL’s, and GMO’s estimates of the annual increase in Southwest Power Pool (SPP) related transmission expenses that they would experience in the future, as set forth in their most recent Missouri general rate filing, to develop its estimate of the tracker’s rate impact.³ Assuming that these recent cost trends for labor and property taxes continue in the future, and that the utilities’ recent estimate of escalation of their SPP transmission expenses are accurate, Staff determined the following amounts as a reasonable and conservative estimate of the annual rate impact due to the tracking of transmission expenses, labor, and property taxes (assuming the maximum period between general rate cases allowed under SB 207, and the required three-year amortization of the “tracked” amount):

Empire - \$9.7 million

KCPL - \$20.0 million

GMO/MPS Division - \$10.0 million

GMO/SJLP Division - \$3.3 million

For Ameren, Staff determined the following amount as a reasonable and conservative estimate of the annual rate impact due to the tracking of labor and property taxes:

MISO transmission revenues, in its Fuel Adjustment Clause (FAC) mechanism, and obtain subsequent recovery of 95% of the net differential in transmission costs from customers through operation of the FAC. The provisions of the electric ISRS language do not allow inclusion of transmission revenues in the “tracker”.

³ Utilities also incur non-labor transmission expenses not associated with SPP operations. Though such costs would be eligible for inclusion in the tracker, Staff has not attempted to estimate future levels of these costs.

Ameren - \$38.7 million⁴

Because Staff's analysis of the tracker rate impact did not incorporate a specific examination of all cost of service elements listed in Section 393.1215 of SB 207, the actual rate impact of the tracker provision of SB 207 is likely to be larger than the amounts shown above.⁵ Accordingly, Staff views the tracker rate impacts presented above as representing a lower bound of a reasonable estimate of the annual rate impact of the tracker in the first general rate proceeding for the electric utilities following SB 207 becoming law.

IV. Electric utilities' financial need for legislation

Ameren, Empire, KCPL, and GMO currently have the ability to attract capital at investment-grade costs. Attachment E includes a comparison of long-term and short-term rating categories of the three major rating agencies, which will provide a legend to the following discussion. Staff's response will address the first two companies separately and the last two companies together because they are sister companies owned by Great Plains Energy Company.

Ameren Missouri

Ameren Missouri's creditworthiness is rated by the three major rating agencies, Standard & Poor's (S&P), Moody's and Fitch. Its ratings are as follows:

	<u>S&P</u>	<u>Moody's</u>	<u>Fitch</u>
Outlook	CreditWatch-Positive	Stable	NA
Corporate	BBB	Baa2	BBB+
Unsecured	NA	Baa2	NA
Secured	A-	A3	A
Commercial Paper	A-2	P-3	F-2

Sources: Ameren 2012 SEC 10-K Filing; August 10, 2012 Moody's Investor Service Credit Opinion on Union Electric Company; March 14, 2013 S&P Research Report on Union Electric Company; Fitch Ratings

NA – not available or not applicable

S&P's CreditWatch-Positive Outlook for Ameren Missouri is due to the positive implications associated with the "high probability of a further upgrade following the completion of the merchant sale to Dynegy Inc." This sale is expected to have a positive impact on both the business risk profile of Ameren Missouri's parent company, Ameren, as well as on certain key financial ratios that weigh heavily into S&P's credit rating assignments.

⁴ Again, This amount does not include transmission expenses for Ameren, as they are currently included in Ameren's FAC.

⁵ Under the existing trackers authorized by the Commission, utilities are generally allowed to accrue a carrying cost on "tracked" amounts until the time costs are included in rates, or to include the unrecovered portion of the tracked cost in utility rate base, or both. Inclusion of tracked costs in rate base and accrual of carrying charges on the tracked expenses are neither mandated or prohibited by SB 207. If the Commission authorizes either of these actions in relation to the SB 207 tracker, then the rate impact estimates for each utility shown above would be larger.

The above credit ratings are premised on Ameren Missouri's projected capital expenditures of \$3.8 billion for the period 2013 through 2017.

On March 28, 2013, S&P stated the following about the potential impact of SB 207 on Ameren Missouri's credit quality: "Recently, legislators introduced a bill that would allow the Missouri electric utilities to implement an infrastructure system replacement surcharge. We view this rider as potentially credit supportive, assuming it passes and is implemented as intended."

On September 11, 2012, Ameren Missouri issued \$485 million of 30-year secured debt at an annual interest rate of 3.90%.

Ameren Missouri currently has a credit facility in the amount of \$1 billion, of which it has direct access to \$800 million. This credit facility mainly supports its ability to issue commercial paper. Ameren Missouri did not have any short-term debt outstanding as of December 31, 2012.

It is important to note that Ameren Missouri's S&P credit rating is based on S&P's evaluation of Ameren's overall creditworthiness, which had consistently been lower due to Ameren's riskier merchant generation operations. However, with Ameren's recent divestiture of these operations, S&P increased Ameren Missouri's credit rating from 'BBB-' to 'BBB' and it appears that S&P may increase it further in the near future.

Empire

Empire's creditworthiness is rated by the three major rating agencies. Its ratings are as follows:

	<u>S&P</u>	<u>Moody's</u>	<u>Fitch</u>
Outlook	Stable	Stable	Stable
Corporate	BBB	Baa2	BBB-
Unsecured	BBB	Baa2	BBB
Secured	A-	A3	BBB+
Commercial Paper	A-2	P-2	F3

Sources: Empire's 2012 SEC 10-K Filing; Fitch Ratings

S&P's Stable Outlook for Empire is based on the expectation that management will maintain cash flow protection and debt leverage measures in line with the 'BBB' corporate credit rating.

The above credit ratings are premised on Empire's projected capital expenditures of \$163.4 million in 2013, \$165.5 million in 2014 and \$178.1 million in 2015.

As it relates to the analysis of Empire's credit ratings, Staff is not aware of any specific commentary from the rating agencies regarding the potential impact of the ISRS legislation.

On October 30, 2012, Empire issued \$30 million of 20-year secured debt at an annual interest rate of 3.73% as well as \$120 million of 30-year secured debt at an annual interest rate of 4.32%.

Empire currently has a credit facility in the amount of \$150 million. This credit facility mainly supports its ability to issue commercial paper. Empire had \$24 million of commercial paper outstanding balance as of December 31, 2012 at a weighted-average interest rate of 1.05%.

KCPL AND GMO

KCPL's and GMO's credit quality are rated by two major rating agencies. Their ratings are as follows:

	<u>Standard & Poor's</u>	<u>Moody's</u>
<u>KCPL</u>		
Outlook	Stable	Stable
Corporate	BBB	NA
Unsecured	BBB	Baa2
Secured	A-	A3
Commercial Paper	A-2	P-2
<u>GMO</u>		
Outlook	Stable	Stable
Corporate	BBB	NA
Unsecured	BBB	Baa3
Secured	NA	NA
Commercial Paper	A-2	P-3

Sources: Great Plains Energy's 2012 SEC 10-K Filing; March 29, 2012 Moody's Investor Service Credit Opinions on Kansas City Power & Light and Great Plains Energy Incorporated; October 10, 2013 S&P Research Reports on Kansas City Power & Light Company and KCP&L Greater Missouri Operations
NA – not available or not applicable

S&P's Stable Outlook for KCPL and GMO is premised on S&P's forecast that Great Plains Energy's financial measures will improve due to increased operating cash flow and a strengthened balance sheet.

The above credit ratings are premised on Great Plains Energy's total annual projected capital expenditures for 2013 through 2015 of \$724.9 million, \$710.6 million, and \$715.5 million, respectively.

As it relates to the analysis of KCPL's and GMO's credit ratings, Staff is not aware of any specific commentary from the rating agencies regarding the potential impact of the ISRS legislation.

On March 14, 2013, KCPL issued \$300 million of 10-year unsecured notes at an annual interest rate of 3.15%.

KCPL currently has a \$600 million revolving credit facility and GMO currently has a \$450 million revolving credit facility. These credit facilities expire in December 2016. The companies mainly support each company's ability to issue commercial paper. As of December 31, 2012, KCPL had \$361 million of commercial paper outstanding at a weighted-average interest rate of 0.48% and GMO had \$169.1 million of commercial paper outstanding at a weighted-average interest rate of 0.94%. It is Staff's understanding that GMO's higher costs are due to GMO's higher financial risk profile caused by debt incurred by Aquila for non-regulated operations. The higher risk profile is reflected in Moody's lower unsecured and commercial paper rating for GMO.

V. Due process and appropriate procedure in respect to the new rate mechanisms proposed by Senate Bill 207

It is difficult to provide an analysis of due process and the appropriate procedures related to the implementation and calculation of the proposed ISRS rate mechanism. Much is dependent upon the amount of information that is readily available prior to the filing of a petition and associated rate schedules requesting the recovery of costs for those replacements and additions. For instance, if there is a construction project monitoring process for eligible infrastructure replacement and additions there may be less need for a comprehensive review once a petition is filed. However, as proposed, the ISRS process would remove a large component of cost analysis in the determination of just and reasonable rates. This is not to suggest the Commission would be unable to review these costs at all; however, the analysis would not be part of the broader “just and reasonable” analysis of a traditional general rate proceeding. Instead, the ISRS-related costs would largely be subject to a mathematical review for accuracy, as well as a review to verify the eligibility of those costs for inclusion in an electric ISRS. The costs included in the proposed ISRS would still be subject to thorough analysis in the company’s next general rate case.

In contrast, due process for the tracker portion of SB 207 (Section 393.1215) is largely diminished since the proposed statutory language mandates implementation of the tracker and mandates recovery of the tracker-related cost differential.

VI. Other information which the PSC finds relevant to this legislation

At this time, Staff does not have any additional information relevant to the legislation, but provides the following summary of comments submitted to the Commission’s Working Case No. EW-2013-0425. The summaries are provided as a brief overview of the comments. Inclusion or omission of any statements should not be viewed as a representation of Staff’s views on the comments or their content. The summaries are provided in the order received in the Commission’s Electronic Filing and Information System (EFIS) and the comments in their entirety, with supporting documentation, can be viewed in EFIS.

Empire

- A. Empire’s current infrastructure is safe, adequate and reliable. Empire’s ability to continue to provide that level of service will be enhanced by the legislation as facilities approaching the end of their useful life are replaced.
- B. Empire is facing significant infrastructure needs, and will continue to be replaced with no accompanying incremental revenue to offset cost. Removing regulatory disincentives will insure investments are made in a systematic, orderly and timely manner to benefit customers.
- C. Empire worked with Commission Staff to assess the impact of cost recovery on a more timely basis.
- D. Financial need is directly related to financial disincentives built into the regulatory framework.
- E. The proposed electric ISRS and all of the costs associated with it are subject to full Commission review.

- F. There is a relatively short list of expenses to be tracked and they are generally related to infrastructure investment. These expenses can vary. Tracking of uncontrollable RTO costs are directly related to infrastructure investment. Similar cost trackers have been used by the Commission on a case-by-case basis without significant problems.

Steven Carver and Michael Brosch on behalf of Consumers Council of Missouri and the Missouri Retailers Association

- A. The electric utilities have presented no evidence demonstrating any quantifiable economic or service quality benefits for electric consumers.
- B. The current regulatory framework is not broken, serves to achieve a reasonable balance between the interests of utilities and their customers, and should not be liberalized in the manner proposed by SB 207 and HB 398.
- C. The Commission has provided unique cost recovery methods and has approved non-traditional regulatory mechanisms such as granting deferral accounting authority and subsequent amortization of extraordinary costs; implementing issue-specific tracking mechanisms; establishing a process that allows a true-up of components to more closely match recent costs with the effective date of any rate change authorized in a pending rate proceeding; authorizing non-traditional post-in service construction accounting for major projects; and authorizing a multi-year earnings sharing mechanism for Ameren and an experimental regulatory plan for Kansas City Power & Light.
- D. SB 207 and HB 398 would allow electric utilities to defer as a regulatory asset or liability, which coupled with the ISRS would virtually guarantee electric utilities will at least earn their authorized return at ratepayer expense. Current incentives for management to contain and control expenses will be terminated.
- E. The tracker will shift the burden from the utility proving expenses are just and reasonable to Staff, the Office of the Public Counsel, and other intervenors in the next rate proceeding demonstrating some portion of deferred expenses were unreasonable or imprudent.
- F. Absent other electric utilities offering service in the same area, there is no competitive market pressure to restrain the prices a utility can charge for services. It is imperative costs be subject to regulatory scrutiny.
- G. SB 207 and HB 398 represent “piecemeal” ratemaking and distort the proper balance of the components of the ratemaking equation allowed in a general rate case. Both bills prohibit the Commission from considering offsetting factors, but would account for increasing expenses in isolation.
- H. The ISRS provisions represent single-issue ratemaking. Utility rates should be revised based upon an assessment of changes in the overall costs incurred to provide service and changes in revenues, expenses, rate base and costs of capital at a common point in time.
- I. The policies of the Commission moderate any negative impacts of regulatory lag, while preserving important incentives.
- J. Internally generated cash flows arise from recovery of depreciation on existing plant investment, recovery of income tax expense that is deferred and collection of return allowances on existing investment balances.
- K. There could be some delay in formal cost recovery for assets added between rate cases, but the delay only affects the months prior to completion of the next rate case and may be offset by other cost savings or revenue growth.

- L. An electric ISRS for routine plant additions is much broader than the special ratemaking treatment previously approved by the Commission.
- M. The Commission recently considered a request for an extraordinary cost recovery mechanism for additions between rate cases and found, among other things: the mechanism would violate the “test-year principle”; there is reason to believe that while the mechanism would encourage capital projects that, while helpful, are not necessary to provide safe and adequate service; utility ratemaking is forward-looking, what the company has earned in the past is not necessarily indicative of what it will earn in the future; the mechanism would be bad public policy and should not be authorized.
- N. Missouri’s electric utilities are large and mature businesses with stable net income and strong internal cash flows that provide funding for the majority if not all infrastructure construction costs incurred in recent years.

Dogwood Energy, LLC (The only independent electric power producer in Missouri and a customer of an electric utility regulated by the Commission.)

- A. Reliability is undeniably a critical component of electric generation, transmission and distribution infrastructure and an ISRS can be an effective means of expediting system replacements for reliability purposes; however, SB 207 and HB 398 not only allow recover of eligible infrastructure system replacements, but also electrical plant additions, including but not limited to capacity additions and environment compliance additions.
- B. Assuming prudence ultimately can be reviewed, the Commission, would only be able to protect ratepayers from imprudent costs by denying recovery to shareholders of monies already expended.
- C. Section 393.170 requires advance approval from the Commission for construction of additional electric plan, but the proposed bills would not allow for advanced review. (Includes references to court decisions.)
- D. Section 386.266.2 only authorizes a surcharge for “prudently incurred” environmental compliance costs. The proposed bills do not allow for prudence consideration of environmental compliance before recovery by surcharge.
- E. Once funds are expended on an imprudent choice, they are no longer available to support a better option. For instance, a plant that should be retired should not undergo environmental compliance upgrades instead.
- F. Includes much discussion about the ambiguity of SB 207 and HB 398 due to cross-referencing with the gas IRSR statutes.
- G. If HB 473 is enacted, the problems identified for SB 207 and HB 398 would be exacerbated since the amount of surcharge (and size of project) would be increased to 15% of base revenue levels, and an after-the-fact review could be 5 years instead of 3 years.
- H. The proposed bills would be greatly enhanced by either not allowing surcharges for capacity, environmental compliance and other types of additions, or by expressly requiring advance approval of additions pursuant to Section 393.170 as a condition of eligibility for the ISRS.

Missouri Electric Alliance (Alliance of Ameren, KCPL, GMO, and Empire)

- A. Proposed legislation modernizes current energy policies to support and encourage incremental investment in Missouri's energy infrastructure rather than discouraging investment.
- B. Provides electric utilities with more timely cash flows that can be re-invested.
- C. Legislation will help support an incremental \$100-\$150 million in infrastructure investment each year and create and sustain 1000 new jobs, including approximately 300-350 new direct jobs.
- D. Customers will pay no more than the actual cost of investment in facilities that are currently being used to serve them. The costs of new revenue generating investments and investments in new electric generating facilities and office buildings are excluded.
- E. The legislation contains robust consumer protections – The Commission has 150 days (or 195 days under HB 398) for a full review of information related to the ISRS filings to ensure compliance with the law. The Commission also has a full opportunity to review the prudence of investments in the next general rate proceeding, and if imprudent, customer bills will be credited for all amounts paid with interest for the imprudent costs.
- F. ISRS filings are limited to 2 per year and the ISRS cannot increase rates more than 8% between rate cases, which can be up to 4 years.
- G. There is a 2% rate cap on the tracker expense for a period of up to four years.
- H. The bills contain a sunset provision – 20 years for SB 207 and 12 years for HB 398.
- I. The MEA utilities' current infrastructure is safe, adequate and reliable – even exceeding minimum standards, but proactive steps are needed today to address the needs and challenges of the future.
- J. The MEA utilities face significant infrastructure needs in order to continue the high level of performance. A 2013 report by the American Society of Civil Engineers attests that electric infrastructure across the nation is nearing the end of its useful life and at increasing risk for significant outages.
- K. The legislation would allow electric utilities to more timely recover costs actually spent on infrastructure.
- L. Electric utilities do not fully recover their costs when they make incremental investments in infrastructure, which provides a disincentive to invest. Legislation provides for a more timely reimbursement of dollars so that more of these funds can be more quickly reinvested.
- M. Missouri's less favorable regulatory environment impacts electric utilities' credit quality, which imposes a hidden cost in the form of higher costs of capital. Although MEA utilities have access to capital markets today, they may not in the future.
- N. A healthy electric infrastructure attracts businesses to the state.

Missouri Industrial Energy Consumers (MIEC) – Joint efforts of the Bryan Cave LLP law firm, the Analysis Group, Inc., Professor Gilbert Metcalf and Brubaker & Associates, Inc.

- A. MIEC has been requesting that the utilities identify safety, reliability or other problems and shortcomings with their systems, but only has received limited anecdotal examples.
- B. The claims the utilities are making at the legislature and in the media are at odds with what they have told regulators and the investment community.
- C. Missouri utilities are strong financially, have a stable or positive outlook, and have access to needed capital at reasonable costs. Provides analysis of the financial standing of each of the electric utilities.

- D. Estimates the four-year costs to customers for the ISRS and the tracker would be \$1.2 billion.
- E. If a utility moved (accelerated) \$100 million of annual infrastructure investments from 2019-2024 to 2014-2018, the utility would invest an additional \$100 million. In 8 years, Missouri customers would pay an additional \$280 million for electric service per \$100 million of accelerated investment.
- F. Since 2007, Missouri electric utilities have been granted over \$1 billion of rate increases and have been allowed to collect nearly \$500 million in additional revenues through the Fuel Adjust Clause. The impact on consumers for the rate increases has ranged from about 40% to 70%.
- G. Electric utilities have the right to file a rate case at any time. In addition, mechanisms have been developed to accommodate changing circumstances: Accounting Authority Orders; Fuel Adjustment Clause; Trackers for vegetation management, infrastructure inspections, pensions, other post employment benefits (OPEB), storms, environmental cost recovery mechanism, renewable energy standard rate adjustment mechanism, Missouri Energy Efficiency Investment Act, true-up for rate cases, construction accounting, regulatory plans, performance-based regulation, emergency rate relief.
- H. A 10% increase in electricity prices is likely to result in over 61,000 lost jobs in Missouri, which is approximately 1.8% of the workforce.

Craig Eichelman on behalf of AARP

- A. Supports the comments of Consumers Council of Missouri and Missouri Retail Association.
- B. The legislation will make it easier and faster for utilities to increase rates, costing consumers hundreds of millions of dollars.
- C. The proposed ISRS is not limited to essential or emergency repairs, but covers all types of investments from smart meters to utility poles to power plants.
- D. The Commission's limited review would consist of checking the utilities math instead of ensure customers are not overcharged.
- E. The utilities would have less incentive to control costs.
- F. The Office of Public Counsel and other interveners will have an uphill battle to show whether an investment was "worth the money".
- G. The tracker mechanism allows virtually all non-capital expenditures to be deferred with limited review.
- H. AARP released a report "Increasing Use of Surcharges on Consumer Utility Bills," which discusses increased use of fee and surcharge "schemes". The surcharges discussed in the report are more limited than what is proposed in SB 207.

American Society of Civil Engineers (ASCE)

- A. ASCE's most recent report card on America's unmet infrastructure needs shows that the nation's infrastructure is at a critical moment with a tremendous gap between needed investment and planned funding.
- B. The study shows the gap between needed investment in roads, bridges, electric grids and available funding is more than \$1 trillion.
- C. Investments to modernize aging electric infrastructure will have a high benefit-to-cost ratio over time.

- D. Failing to act will cost money in lost productivity, economic development and overall quality of life.

David Mason (Mason and Associates)

- A. ISRS legislation does not remove Commission oversight; it merely streamlines the process by allowing utilities to recoup the costs of maintenance they have already expended prior to the next rate case.
- B. The law protects ratepayers. They can rest assured the charges on the electric bill are both prudently-incurred and financed more responsibly.
- C. The legislation is critically important to job creation in Missouri.

Sally Nance (CEO of Excelsior Springs Hospital)

- A. In Missouri, where we get the majority of our power from aging coal plants, we are behind other states in reforming the electric regulatory model. We need to do more to make sure we have reliable infrastructure and regulations are not a barrier.
- B. The ISRS legislation includes continued full oversight from the Commission.
- C. We are going to regulate smarter with regulation that will benefit the consumer.
- D. The ISRS is vital for reliability, cost predictability and a growing Missouri economy.

Kurt Schulz (Past Chairman of the Electrical Board of Missouri and Illinois on Behalf of Westinghouse)

- A. Missouri's energy infrastructure is falling behind other states.
- B. Regulations delay necessary upgrades needed to provide reliable and efficient power.
- C. The need for updates not only includes utility poles and transformers, but substations, distribution systems and power generation facilities.
- D. Advancements in technology and modern regulations will create a stronger electric grid and create an incentive for new technologies like Small Modular Reactors.
- E. This means more quality jobs, a better energy future, and a stronger, competitive Missouri economy.

Susan Stuart (Chief Brand Officer for Centrex)

- A. Centrex depends on the state's ability to attract new employers. HB 398 would better position our state to compete for commercial and manufacturing development.
- B. HB 398 is a jobs bill for now and the future and it is reliable affordable power for all.

Westinghouse

- A. It is imperative to maintain and expand the transmission grid infrastructure based upon reasonable projections of increased demand and the need to maintain the nation's energy security.
- B. As a strategic partner of Ameren Missouri and the Missouri Electric Alliance and its customers, Westinghouse Electric Company is committed to the sustained success of Missouri's electric providers.
- C. Westinghouse considers itself fortunate to have found a business partner in Ameren Missouri. Together they are committed to bringing five Westinghouse Small Modular Reactors to Missouri.

- D. With its unique assets with exceptional science and engineering programs, Missouri offers an exceedingly strong research and workforce development system to feed the development of a new industry supply chain.
- E. To maintain and expand Missouri's competitive positioning and for Missouri electric users to save potentially tens of millions of dollars in permitting fees, Missouri needs to be competitive on all fronts.
- F. It is especially important to signal the financial markets and energy sectors that Missouri is investing in next generation technology infrastructure that will provide a secure, durable and low-cost electricity delivery system.

Pangea Group

- A. Pangea Group is a small business so the immediate jobs created by the ISRS legislation are important.
- B. The legislation is the type of change Missouri needs to compete for new commercial and industrial development. It streamlines regulations that are standing in the way of Missouri's ability to attract new industry.

The Commission also received 13 public comments indicating the commenter opposes additional electric rate increases. One supporting comment was a duplicate of comments summarized above and, therefore, was not included again.