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Witness: Matthew R. Young
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MISSOURI PUBLIC SERVICE COMMISSION

COMMISSION STAFF DIVISION

AUDITING

SURREBUTTAL TESTIMONY

OF

MATTHEW R. YOUNG

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2016-0285

Jefferson City, Missouri
January, 2017

**** Denotes Highly Confidential Information ****

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MATTHEW R. YOUNG
KANSAS CITY POWER & LIGHT COMPANY
CASE NO. ER-2016-0285**

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1 **EXECUTIVE SUMMARY**

2 Q. Can you please summarize your surrebuttal testimony?

3 A. Yes. I respond to KCPL witness Klote's rebuttal testimony on incentive
4 compensation expense relating to the executive incentive plan and the non-executive,
5 non-union incentive plan. KCPL is recommending an expense that is calculated using
6 assumptions, which are not known and measurable at this time. Not only is KCPL's total
7 incentive compensation projection not known and measurable, it inappropriately calculates an
8 amount for incentive compensation that, on a per-employee basis, is at the upper end of the
9 range of historical incentive payouts. Lastly, KCPL's assertion that by using an assumption
10 of 100% achievement of the incentive compensation metrics the need for averaging this cost
11 for rate purposes is eliminated is flawed and its argument should be disregarded. However, if
12 the Commission orders that KCPL's method for incentive compensation expense used to
13 calculate the going-forward cost, then Staff recommends the assumed achievements should be
14 based on the midpoint of possible achievements, which is 100% for the executive plan, but
15 75% for the ValueLink incentive compensation plan.

16 I respond to KCPL's request to recover projected bad debt expense in excess of the
17 annualized level of bad debt expense calculated in this case, as described in KCPL witness
18 Klote's rebuttal testimony. KCPL's request to include an adjustment for bad debt expense
19 associated with a revenue requirement increase (or decrease) is commonly referred to as bad
20 debt "factor up" or "gross up." While KCPL's argument appears logical, it is faulty for two
21 reasons: 1) revenue levels are not the primary driver of bad debt expense, and 2) Staff has
22 performed an analysis showing that there is not a correlation of any sort between revenues and
23 bad debt expense. Additionally, if KCPL's argument is assumed to be true, KCPL will not

1 realize a full twelve months of bad debt expense on the level of revenues set in this case until
2 23 months after the true-up date, making this an out-of-period adjustment. Staff recommends
3 that this projected expense not be included in KCPL's cost of service.

4 By the same token, KCPL's request to factor up late payment revenue should
5 be denied. No direct correlation exists between retail revenues and late payment revenue to
6 justify including additional late payment revenue based on the amount of the requested
7 rate increase. However, if the Commission authorizes KCPL to use the bad debt factor up,
8 then the late payment revenue should be used as an offset (reduction) to bad debt factor up.

9 I respond to KCPL witnesses Klote and Rush on payroll expense related to
10 the Demand Side Investment Mechanism ("DSIM"). Staff is in agreement with KCPL's
11 position and will revise its payroll, payroll taxes, and payroll benefits adjustments for the
12 true-up accordingly.

13 I respond to KCPL witness Klote on depreciation study expense. KCPL believes
14 that depreciation study costs should be treated in the same manner as rate case expense, in that
15 submission of depreciation studies is associated with rate case filings. However, examination
16 of KCPL's recent filings shows that this is not necessarily the case. For example, KCPL did
17 not submit a comprehensive depreciation study for this case or for GMO's recent rate increase
18 request in Case No. ER-2016-0156. Under the Commission's rules, utility companies are
19 required to file a depreciation study every five years and this requirement is unrelated to rate
20 case activity. Even if utilities did not file a rate case, they still would have to perform
21 depreciation study every five years. Staff has included the total cost for KCPL's most recent
22 depreciation study by normalizing the expense based on a five year useful life of the
23 depreciation study. Staff is also opposed to KCPL's suggestion to defer and amortize the

1 cost for depreciation studies as the cost does not qualify for deferral accounting. Staff
2 witnesses Mark L. Oligschlaeger and Karen Lyons discuss the appropriate use of deferral
3 accounting in their rebuttal and surrebuttal testimony in this case.

4 Finally, I respond to KCPL witness Rush on rate case expense. KCPL characterizes
5 assignment of a portion of rate case expense to shareholders as an “arbitrary disallowance” of
6 prudently incurred expenses, but this argument misses the point. Ratepayers should not bear
7 the entire burden of KCPL’s rate case because ratepayers are not the only beneficiary of a rate
8 case filing. Similar to other discretionary expenditures (e.g. lobbying, donations, advertising),
9 costs are assigned to shareholders when the shareholders enjoy at least some of the benefits of
10 the expenditures.

11 KCPL also recommends in its rebuttal filing that rate case expense should not be
12 treated as a normalized expense in the cost of service, but instead should be deferred into a
13 regulatory asset with a corresponding amortization expense. This is a new recommendation
14 that was not presented in KCPL’s direct case. Staff is opposed to deferral treatment of rate
15 case expense for the same reasons discussed above for KCPL’s depreciation study.

16 **INCENTIVE COMPENSATION**

17 Q. In response to KCPL’s rebuttal testimony, has Staff changed its position on
18 KCPL’s incentive compensation expense?

19 A. No, Staff continues to recommend calculating incentive compensation
20 expense by averaging the historical payouts made for plan years 2012, 2014, and 2015.
21 The average of these three plan years represents a going-forward expense that is based on
22 known-and-measurable payouts that are not specifically tied to earnings per share (“EPS”).

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1 Q. Is this how you presented Staff's position in your rebuttal testimony?

2 A. No. While composing my rebuttal testimony, I made erroneous references to
3 the incentive compensation plan years included in my calculation. Throughout the incentive
4 compensation section in my rebuttal testimony, I inadvertently transposed the years 2013
5 and 2014. However, Staff's revenue requirement reflects the correct calculation and the
6 error in my rebuttal testimony does not change the fundamental concepts I presented in
7 that testimony.

8 Q. What position did KPCL present in its rebuttal testimony?

9 A. KCPL is supporting an incentive compensation expense calculated by
10 assuming all individuals on its current payroll achieve 100% of the metrics defined in both of
11 the 2016 incentive compensation plans for executives and management. After this amount is
12 calculated, KCPL recommends reducing the expense for the executive incentive plan,
13 (titled Annual Incentive Plan or "AIP") by 70% to recognize incentive metrics tied to EPS.
14 In its rebuttal testimony, KCPL also recommends reducing its incentive plan payout level for
15 non-executive, non-union employees (titled ValueLink) by 5% to recognize incentive metrics
16 tied to non-utility investments. Furthermore, KCPL asserts that assuming 100% achievement
17 of plan metrics effectively "utilizes an averaging component",¹ thus rendering
18 "Staff's averaging technique" unnecessary. KCPL supports this assertion by explaining
19 incentive compensation results can be above, or below, 100% achievement.

20 Q. How do you respond to the assertion that assuming 100% achievement is a
21 substitute for averaging historical incentive compensation expense?

¹ Klote rebuttal testimony, Page 15, line 22.

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1 A. The expense calculated by KCPL, based on 100% achievement, does not
2 produce a value that represents a “middle ground” when it is compared with historical
3 payouts. For the ValueLink plan, Staff analyzed KCPL’s projected incentive compensation
4 expense by comparing its projected payout per-employee to the actual per-employee payouts
5 during the previous eleven years. The per-employee cost, as shown in the following table, is
6 total-company expense (before any allocation is made to jurisdictions) and does not attempt to
7 remove payouts tied to EPS or other non-recoverable metrics:

8 **

9 **

1 Q. What conclusion should be drawn from the above table?

2 A. KCPL's assumption of 100% achievement of the ValueLink plan is not a
3 substitute for averaging prior plan years because KCPL's calculation produces a projected
4 expense that is higher than average. In fact, KCPL calculates an expense that is near the
5 upper limit of the range of historical payments.

6 Additionally, if KCPL wishes to assume a level of achievement as a substitute for
7 relying on historical payouts, it should assume the midpoint of possible achievements.
8 As illustrated in the 2016 ValueLink Plan,² each management employee may receive from
9 0% to 150% of the target amount and the mathematical midpoint of this range is 75%.
10 By assuming 100% achievement as the "average" payout, KCPL has embedded another
11 assumption in its calculation, that the achievement will never be 0%. However, 0%
12 achievement of plan metrics is a real possibility, as can be derived from the payouts in 2007,
13 2008, and 2014. If KCPL were to project incentive compensation expense based on 75%
14 achievement, its annualization would be more in line with actual historical payouts
15 per-employee.

16 Q. Earlier in this testimony, you stated KCPL is recommending an expense that is
17 calculated using assumptions and is not known and measurable. Would you please explain?

18 A. KCPL pays incentive compensation on or about March 15 of the year
19 following the plan year in which the compensation was earned. In this case, the payout for
20 plan year 2016 is projected to be paid on March 15, 2017, which is two and one-half months
21 after the true-up date of December 31, 2016. Consequently, the payout for the plan year lies
22 outside the true-up date in this case and is an out-of-period expense.

² Attached to Klote Rebuttal as Schedule RAK-10.

1 KCPL's projected expense does not account for employee transfers and employee
2 turnover. Staff performed a cross-reference of KCPL's employee roster at December 31,
3 2015 and December 31, 2016. Staff found ** _____
4 _____ . ** According to the 2016 ValueLink plan
5 document, employees that are not employed on the date of the payout (approximately
6 March 15, 2017) will not receive incentive compensation. The number of employees
7 that leave KCPL between December 31, 2016 and the date of the payout is not known
8 and measurable, but it is a realistic expectation that additional employees will depart in
9 that timeframe.

10 Staff also noted that during 2016, ** _____
11 _____ . ** According to the 2016 ValueLink plan
12 document, employees that are not employed for the entire plan year are only eligible for a
13 prorated incentive payout. KCPL's projection included in its proposal calculates incentive
14 compensation for these employees as if they were entitled to a full (un-prorated) amount.

15 Employee turnover, more specifically employee departures and employee additions,
16 are two events that will reduce incentive compensation expense. KCPL does not account for
17 turnover in its projected incentive compensation expense although employee turnover is a
18 normal and recurring event. On the contrary, Staff's recommendation is based on a
19 normalized level of known and measurable incentive compensation payouts that were
20 calculated for actual headcounts, including prorated employees, as of the date of the payout.

21 Q. What should the Commission include as short term annual incentive
22 compensation in this rate case proceeding?

1 A. The Commission should include Staff’s normalized expense as a true reflection
2 of the level of ongoing incentive compensation expense. Staff’s calculation is based on
3 known and measurable incentive payouts made in 2012, 2014, and 2015 and does not attempt
4 to speculate on the level of achievement of future incentive compensation plans. KCPL’s
5 proposed level for incentive compensation is an out of period calculation that overstates what
6 the expected level of payouts will likely be.

7 **BAD DEBT EXPENSE**

8 Q. What is Staff’s recommendation regarding a bad debt factor-up?

9 A. KCPL’s request to include an adjustment for bad debt expense proportionate
10 to a revenue requirement increase is commonly referred to as a bad debt “factor-up” or
11 “gross-up”. This adjustment is identified in the direct and rebuttal testimonies of KCPL
12 witness Klote. Staff recommends that this projected expense not be included in KCPL’s cost
13 of service. No direct correlation exists between a change in rates and a change in bad debt
14 expense to justify the use of a bad debt factor up.

15 KCPL’s rationale for making this request is based on an assumption that lacks any
16 factual evidence to support its conclusion. I would note that KCPL has not identified any
17 study or evidence that bad debts have a correlation to revenues that would justify inclusion of
18 a bad debt factor up. Instead, KCPL’s argument is based solely on theory and, what it
19 believes, is “logical” conclusions. On the other hand, Staff has analyzed KCPL’s historical
20 retail revenues and net write-offs over several years to determine if a direct and proportional
21 relationship exists between retail revenues and bad debt expense. Staff’s analysis of the
22 actual net write-offs as compared to related revenues shows no correlation, and in many cases

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1 bad debts and revenues move in opposite directions. Staff recommends that the Commission
2 deny KCPL's request to adopt the proposed bad debt factor up.

3 However, in the event that the Commission does grant KCPL's request to factor up
4 bad debt expense proportionate with an increase in revenue requirement, I would agree with
5 witness Klote's recommendation to also reflect a factor-up for additional forfeited discounts
6 (late payment fees), in the interest of consistency. KCPL included the late payment fee factor
7 up in its direct filed case.

8 Q. What analysis did Staff perform comparing bad debts to revenues?

9 A. In my rebuttal testimony, I provided several tables and graphical analyses
10 to demonstrate the fallacy of KCPL's assumption that increased revenues lead to increased
11 bad debt.

12 Staff performed the following comparative analyses of bad debt and revenues:

- 13 • An analysis of the monthly change in retail revenues and bad
14 debts
- 15 • An analysis of the percent monthly change in retail revenues
16 and bad debts
- 17 • An analysis comparing a 12 month period of bad debt to the
18 corresponding retail revenues, on a quarterly rolling basis
- 19 • Graphical analysis of the items above

20 I have attached the third analysis, which compares 12 month periods of bad debt to the
21 corresponding revenues³ on a quarterly basis from January 2007 through December 2015,
22 along with the graphical representation of the data, as Highly Confidential Schedule MRY-s1.

23 All of the data analyzed by Staff in regard to this issue is Missouri jurisdictional only.

³ The approximate time to "write-off" bad debts is six months. Therefore, bad debts in a given month relate to revenues six months prior. Staff's analysis through December 31, 2015 updates through June 2016 bad debts that relate to December 2015 revenues.

1 Q. Please explain this data and accompanying graph.

2 A. This analysis is the clearest way to depict how bad debt and revenue have no
3 positive correlation. I have listed on the graph all KCPL rate increases during the time period.

4 This data is a comparison of bad debt as a percentage of revenues from 2007 through
5 2015. This comparison is the methodology Staff and KCPL both use to annualize bad debts
6 on current annualized and normalized revenues. The graph shows KCPL's six most recent
7 rate increases, beginning with Case No. ER-2006-0314, and that each of these rate increases
8 did not result in a proportional change in bad debts. More specifically, the graph shows that
9 bad debts, as a percentage of revenues, decreased from 2007 through December 2009, during
10 a period in which KCPL was receiving rate increases in this jurisdiction. Beginning in 2010,
11 the bad debt to revenue ratio increased before peaking in June 2011, after which the bad debt
12 percentage has steadily decreased.

13 The data shows that beginning with the quarter ended June 2013 and going through
14 the quarter ended December 2015, not only has bad debt as a percentage of revenue
15 decreased, KCPL's dollar amount of net write-offs have trended downward while revenues
16 have trended in the opposite direction. The following highly confidential table shows the
17 trends in revenue and bad debt dollars:

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23 *continued on next page*

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4 Q. Does the past movement of revenue and bad debt dollars support KCPL's
5 argument for a bad debt factor up?

6 A. No. KCPL believes that it is logical that bad debt expense will increase each
7 time the Commission approves an increase in its revenue requirement. During the time period
8 presented in the table above, KCPL increased its rates on two separate occasions. The first
9 increase was effective February 2013 (Case No. ER-2012-0174) and the second increase was
10 effective September 2015 (Case No. ER-2014-0370). The actual change in bad debt expense
11 following these rate increases does not support KCPL's argument. While the rate increase
12 caused revenues to increase, bad debts declined in this period.

13 Q. Is bad debt expense tied to revenue in any way?

14 A. Yes. In order to have bad debts, a company must have a source of revenue.
15 However, the level of revenue is not the primary driver of bad-debt expense. Other factors,
16 which are beyond the control of the utility, also drive levels of bad debt. One important

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1 driver of bad debt expense is the condition of the economy. The graph presented in
2 Schedule MRY-s1 shows a spike in the percentage of bad debt to revenue between the
3 quarters ended December 2009 to June 2011. During the same time, KCPL's customers were
4 recovering from the recession of the US economy. According to data posted on the United
5 States Department of Labor – Bureau of Labor Statistics website,⁴ the unemployment rate for
6 the Kansas City, Missouri and Kansas City, Kansas metropolitan area was between 9.1% and
7 8.1% during this period. Since June 2011, the decrease in the bad debt percentage correlates
8 with the decrease in the unemployment rate in the KCPL service territory.

9 Q. Does KCPL acknowledge that other factors, besides an increase in revenues,
10 contribute to bad debt expense?

11 A. Yes. The following quote can be found on page four, lines 18 - 20 of the
12 surrebuttal testimony of Ronald A. Klote in KCPL's prior rate case, Case No. ER-2014-0370:

13 Staff has presented a number of charts attempting to show the
14 relationship of bad debts to revenue increases and decreases.
15 These relationships are the result of numerous factors impacting
16 the revenue stream of a utility.

17 While witness Klote attempts to dismiss Staff's analysis because there are numerous factors
18 that impact revenues, KCPL still has not provided factual support for its assertion that the
19 change in bad debt expense primarily correlates with changes in revenues.

20 Q. Would Staff require evidence of a perfect correlation between bad debt and
21 revenues to recommend the inclusion of a bad debt factor-up?

22 A. No. However, Staff's evidence shows not only lack of a *perfect* correlation,
23 but also lack of a general correlation. In fact, there are instances when revenues went up

⁴ As referenced on January 9, 2017.

1 while bad debts declined indicating an opposite or inverted relationship. Again, KCPL has
2 not presented an analysis of the correlation of bad debts and revenues. KCPL's contention is
3 that when revenues increase as a result of a rate case, bad debts will increase proportionately.
4 If that were true, I would expect the line representing the ratio of bad debts and revenues to be
5 relatively the same throughout the analysis, perhaps being a somewhat straight line across the
6 graph presented in Schedule MRY-s1. For example, if bad debts to revenues were .75% at
7 one time period, one would expect the ratio to fluctuate around that percentage, but not have
8 any material trends up or down. This graph does not examine the change in bad debts or
9 revenues dollars; it measures the change of the ratio between the two. Even if bad debts were
10 somewhat correlated to changes in revenue levels, KCPL's factor-up for bad debt (and late
11 payment factor-up) is not a known and measurable expense.

12 Q. How is use of a bad debt factor not consistent with the "known and
13 measurable" concept?

14 A. The anticipated effective date of rates in this case is May 28, 2017.
15 The revenue requirement authorized by the Commission, if any, will be collected in the
16 following 12 months. 12 months of bad debt expense related to the increase in revenues will
17 not be fully realized until six months after this date, which is November 2018, 18 months
18 beyond the operation of law date, and 23 months beyond the true-up date in this case.
19 KCPL's adjustment attempts to collect in rates expenses that may or may not be realized in
20 whole or in part 18 months past the effective date of rates. The level of projected bad debt
21 expense 18 months past the effective date of rates is certainly not known and measurable.

22 Q. How is Staff's normalization of bad debts in its direct filed case known
23 and measurable?

1 A. Staff's direct filed bad debt annualization captured the latest bad debt levels
2 as of the 12 months ending June 2016 that correspond with the actual revenues as of
3 December 2015. The ratio between the two is applied to the annualized, normalized revenues
4 as of June 2016. Bad debts and revenues are routinely included in the true-up process and
5 will be in this case also. This method will capture the most up to date information as of
6 December 2016.

7 Q. What is the current bad debt percentage when compared to the data in the 2014
8 rate case, Case No. ER-2014-0370?

9 A. The bad debt write-off in the 2014 rate case was 0.7033% of revenues for
10 KCPL using bad debts as of the 12 months ending December 31, 2014.⁵ In the current case,
11 the percentage is ** _____ ** for the 12 months ending June 30, 2016. Actual historical
12 data shows that after Case No. ER-2014-0370, where KCPL was awarded an increase in
13 revenues of \$89.6 million (effective September 29, 2015), bad debts as a percentage of
14 revenues has *decreased* since rates were *increased*. This evidence refutes the assumption that
15 bad debts should be increased in proportion to any rate increase granted by the Commission.

16 Q. Witness Klote quotes the Commission *Report and Order* in KCPL's 2006 rate
17 case, Case No. ER-2006-0314, in which the Commission authorized KCPL's request in that
18 case for a bad debt factor-up. Why is that case not relevant to this current case?

19 A. The 2006 KCPL rate case was its first in 20 years. There was no recent data
20 available that would confirm or deny whether or not KCPL bad debts would increase
21 proportionately with a general rate increase. However, in examining the data for KCPL since
22 the time of that rate case, the information available to Staff shows that there is no correlation

⁵ Surrebuttal Testimony of Ronald A. Klote, Case No. ER-2014-0370.

1 between rate increases and bad debts. The data Staff reviewed does not support KCPL's
2 assumptions and does not support its adjustment to factor up bad debt expense.

3 **PAYROLL**

4 Q. Have there been any changes to Staff's payroll adjustment since the
5 COS Report was filed?

6 A. Yes. KCPL witness Ronald A. Klote's rebuttal testimony discusses payroll
7 costs that relate to the DSIM rider. Staff is now in agreement with KCPL's position on this
8 matter, and will update its payroll, payroll taxes, and payroll benefits adjustment accordingly.

9 **DEPRECIATION STUDY EXPENSE**

10 Q. Can you summarize Staff's position, in its direct filing, on depreciation
11 study expense?

12 A. Yes. Staff recommends including a normalized amount of this cost in rates.
13 The normalized amount is calculated by adding the total costs of obtaining and defending
14 KCPL's most recent depreciation study, and including one-fifth of the total cost in the
15 revenue requirement. Staff did not apply any sharing mechanism to the cost for a
16 depreciation study, unlike other expenses incurred directly in relation to a rate filing.
17 Including a normalized amount in rates ensures that a company receives funds for a new
18 depreciation study after five years of collection in base rates. A five-year normalization
19 period is appropriate because pursuant to Commission rule 4 CSR 240-3.160(1)(A), public
20 utilities must submit a depreciation study every five years. In the prior KCPL rate case, Case
21 No. ER-2014-0370, the Commission found a five-year period appropriate for rate recovery of

1 this item. The following is from page 72 of the Commission's *Report and Order* in Case No.
2 ER-2014-0370:

3 The Commission also finds that it is appropriate to require a
4 full allocation to ratepayers of the expenses for KCPL's
5 depreciation study, recovered over five years, because this
6 study is required under Commission rules to be conducted every
7 five years.

8 Q. Has anything changed involving this issue since the *Report and Order* in Case
9 No. ER-2014-0370?

10 A. After Case No. ER-2014-0370, KCPL entered into an agreement with Gannett
11 Fleming Valuation and Rate Consultants to update its last depreciation study regarding its
12 generation assets. However, KCPL's most recent depreciation study on KCPL's transmission,
13 distribution, and general assets was not updated. In other words, KCPL is still using a
14 depreciation study, dated June 20, 2014, to support its current recommendations concerning
15 the depreciation rates on its transmission, distribution, and general assets in this rate case.

16 Q. In Mr. Klote's rebuttal testimony, he states KCPL is required to file a rate case
17 at a minimum of every four years.⁶ Do you believe that leads to the logical conclusion that a
18 five-year normalization of rate case expense is unreasonable?

19 A. No. KCPL is attempting to tie the purchase of a new depreciation study to
20 each and every rate case filing. However, as evidenced by the lack of purchase of an update
21 for the transmission, distribution, and general plant depreciation study for this rate case, a
22 depreciation study does not need to be submitted for every rate increase request to stay in
23 compliance with the Commission's rules. In this rate case, KCPL maintained compliance
24 with the Commission's rules for the submission of a depreciation study even though the

⁶ Klote rebuttal testimony, Page 55, lines 4-5.

1 depreciation study on its transmission, distribution, and general assets was purchased
2 approximately 24 months prior to the filing of this rate case and prior to the filing of KCPL's
3 most recent case, Case No. ER-2014-0370.

4 Q. Is there any other part of KCPL's rebuttal on depreciation study expense that
5 you wish to address?

6 A. Yes. In Mr. Klote's rebuttal testimony, he suggests that, if the costs for
7 depreciation studies are separated from rate case expense, then a regulatory asset should be
8 established so that actual costs can be deferred and amortized.⁷ KCPL goes on to point out
9 that the establishment of a regulatory asset will enable the depreciation study costs to be
10 tracked for over- or under-recovery. A tracker is a deferral mechanism that should be
11 employed only for unusual or unique circumstances, such as for costs that are highly volatile,
12 for costs for which there is no prior historical data, or for costs imposed on utilities by a
13 Commission rule that imposes an uncertain level of new costs. Depreciation study expense
14 does not meet these criteria and, as such, KCPL's newly presented recommendation should
15 be rejected.

16 **RATE CASE EXPENSE**

17 Q. Please summarize KCPL's position on rate case expense.

18 A. KCPL is requesting what it calls the "traditional" treatment of rate case costs,
19 which is full rate recovery of all costs it incurred to process this rate case filing. Also, KCPL
20 proposed in rebuttal testimony to defer rate case expense into a regulatory asset and amortize
21 the deferral over a three-year period. KCPL's recommended rate case expense recovery is in

⁷ Klote rebuttal testimony, Page 55, lines 13-21.

1 contrast to Staff's and The Office of the Public Counsel's recommendations to share rate case
2 expense between ratepayers and shareholders, as was ordered in the KCPL's most recent rate
3 case, Case No. ER-2014-0370 ("2014 Case"), and approved in other recent rate cases, with no
4 consideration of over- or under-recovery.

5 Q. Was the 2014 KCPL Case the first time the Commission has considered a
6 departure from the traditional rate treatment of rate case expense?

7 A. No. While the treatment given to rate case expense in the 2014 Case may have
8 been a departure from how KCPL's rate case expenses have been treated in the past, the
9 Commission has considered alternative rate case expense treatment in cases with other
10 utilities prior to the 2014 Case due to concern with increasing rate case costs. Evidence of the
11 Commission's past concern is found in the *Report and Order*⁸ cited on page 62 of Mr. Rush's
12 rebuttal testimony. While Mr. Rush quotes the first two sentences of a paragraph in the Order
13 from that case, I will quote the paragraph in its entirety:

14 The Commission is hesitant to disallow expenses incurred by
15 MGE in prosecuting its rate case. The company is entitled to
16 present its case as it sees fit and the Commission will not
17 lightly intrude into the company's decisions about how best to
18 present its case. However, the Commission has a
19 responsibility to ensure that the expenses that the company
20 submits to its ratepayers are reasonably and prudently
21 incurred. Otherwise, the company could take a cost-is-no-
22 object approach to its rate case presentation, secure in the
23 knowledge that the ratepayers would be required to pay for
24 any cost that the company might incur.

25 Clearly, the Commission was concerned about cost control in Missouri Gas Energy's
26 ("MGE") 2004 case. The Order goes on to order prudence disallowances of \$489,509 from
27 MGE's \$1,383,333 claimed rate case expense.

⁸ Report and Order, Re *Missouri Gas Energy*, Case No. GR-2004-0209, page 75.

1 Despite the Commission’s finding of imprudence and the Order’s language
2 discouraging “cost-is-no-object” approach to rate case expense, the Commission found itself
3 deciding another rate case expense issue in MGE’s Rate Case No. GR-2009-0355. From
4 pages 78 and 79 of the Commission’s *Report and Order* in that case:

5 OPC’s assertion that both the company and the ratepayers
6 benefit from rate case expense has merit in that shareholders do
7 receive a portion of the benefits and should be willing to pay for
8 a portion of the company’s rate case expense...

9 Unfortunately, in this case, the parties have not fully developed
10 the record on this point. More detailed cost study, comparisons
11 to other jurisdictions, and other testimony on the nature and
12 propriety of certain rate case expenses may be helpful in
13 determining how to apportion rate case expense...

14 In conclusion, this Commission wants to make clear to MGE
15 and other utilities that rate case expense is not simply a blank
16 check and if certain rate case duties can be performed “in-
17 house” by existing personnel more cheaply, we expect the
18 utility to do so. **On the issue of rate case expense, we urge**
19 **MGE and other utilities to recognize that rate case expense**
20 **may not be reflexively and automatically passed on to the**
21 **ratepayers in the future...**

22 [emphasis added]

23 Q. Did the Commission later take steps to comprehensively explore the issue of
24 rate case expense?

25 A. Yes. The Commission created an investigative working docket on April 27,
26 2011, to consider possible alternatives to the traditional approach for rate case expenses.
27 In its *Order Directing Staff to Investigate and Opening a Repository File* in Case No.
28 AW-2011-0330, one of the areas the Commission directed Staff to examine was whether
29 it was appropriate for utilities to presumptively recover 100% of rate case expenses.
30 The following is the opening paragraph from the Order in Case No. AW-2011-0330:

Surrebuttal Testimony of
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1 Testimony presented in recent rate cases and escalating rate
2 case expense requests have led the Commission to consider
3 whether changes should be made to its current rules and
4 practices whereby regulated utilities generally recover all costs
5 they incur in presenting a rate case before the Commission. The
6 Commission wants to consider whether it is appropriate for
7 shareholders to bear responsibility for a portion of rate case
8 expense . . .

9 On September 4, 2013, Staff submitted a report that recommended consideration of several
10 alternatives to the traditional approach of rate case expense treatment. It is noteworthy that
11 KCPL's and GMO's 2010 rate proceedings are mentioned in Staff's report as among the
12 "recent rate cases" that led to the Commission's request for an investigation of this topic. The
13 2014 Case was the Commission's first opportunity to consider an alternative solution for the
14 rate case expense issue in a litigated case following issuance of the Staff's report in Case No.
15 AW-2011-0330.

16 Q. How did the Commission treat rate case costs in the 2014 Case?

17 A. The Commission decided the rate case expense issue by using a proportional
18 assignment of cost based on the recognized benefit of customers and shareholders of KCPL.
19 The Commission stated at page 72 of its 2014 KCPL Order:

20 The Commission finds that in order to set just and reasonable
21 rates under the facts in this case, the Commission will require
22 KCPL shareholders to cover a portion of KCPL's rate case
23 expense. One method to encourage KCPL to limit its rate case
24 expenditures would be to link KCPL's percentage recovery of
25 rate case expense to the percentage of its rate increase request
26 the Commission finds just and reasonable. The Commission
27 determines that this approach would directly link KCPL's
28 recovery of rate case expense to both the reasonableness of its
29 issue positions and the dollar value sought from customers in
30 the rate case.

31 The Commission concludes that KCPL should receive rate
32 recovery of its rate case expenses in proportion to the amount of
33 revenue requirement it is granted as a result of the Report and

1 Order, compared to the amount of its revenue requirement rate
2 increase originally requested. This amount should be
3 normalized over three years.

4 Q. Did KCPL subsequently appeal the Commission's decision in a Missouri Court
5 of Appeals?

6 A. Yes. The Missouri Court of Appeals – Western District heard appeals from
7 KCPL on rate case expense sharing, among other issues. Attached to this testimony as
8 Schedule MRY-s2 is the Court's Opinion, as filed on September 6, 2016 in Case No.
9 WD79125. The Opinion upholds the Commission's decision on how it set just and
10 reasonable expenses to be borne by ratepayers.

11 Q. Is it fair to customers to have to pay all costs associated with a rate case filing
12 made by a utility?

13 A. No. Under the traditional rate case expense normalization, in most situations,
14 all costs had to be absorbed by customers, and under KCPL's proposal, this would continue.
15 Assigning all of the utility's rate case expense to ratepayers makes the utility the only party
16 involved in the rate case process that is not constrained to some extent by budgetary and
17 other financial restrictions, and for which the rate case costs are potentially fully fundable by
18 a third party. The costs of Staff and Public Counsel are funded through the Commission's
19 assessment to regulated utilities, and in turn charged to ratepayers through the rate case
20 process. Other parties that wish to intervene must pay for all of its costs for legal
21 representation and consultants that have expertise with complex ratemaking principles and
22 rate design concepts. It is fair to charge some rate case costs to ratepayers because of the
23 benefit received by ratepayers in the form of safe and reliable service, and to support the
24 financial condition of the utility. However, the shareholders also enjoy benefits from rate

1 increases in potential increases in profits, dividends, and stock price. The recognition of the
2 different benefits potentially received by rate case participants was one reason, among many,
3 stated in the Commission's opinion in the 2014 Case supporting its finding that assigning
4 some rate case expense to the shareholders was appropriate.

5 Q. How does Mr. Rush characterize the departure from the traditional approach to
6 rate case expense treatment?

7 A. In his rebuttal testimony, Mr. Rush refers to the Commission's ordered
8 apportionment of rate case expense between utility owners and customers as an "arbitrary
9 disallowance of prudently incurred rate case costs" and states that rate case expense sharing is
10 a substitute for prudency reviews.

11 Q. Do you agree that assigning some rate case costs to shareholders is a substitute
12 for prudency reviews?

13 A. No. Even with the utilization of a sharing mechanism, it is certainly possible a
14 utility may still incur imprudent rate case expense. If Staff found certain rate case costs
15 imprudent, it would recommend that the Commission not include those costs while setting
16 just and reasonable rates. Staff's position is that ratepayers should not bear the burden of any
17 amount of imprudent costs, even if the total amount is reduced by rate case expense sharing.

18 Although KCPL is attempting to tie how rate case expenses were allocated in the 2014
19 rate case with the issue of prudency of rate case expenses, the Commission's proportional
20 approach is not intended or designed to focus on prudency or lack thereof. Rather than
21 focusing on prudency, the focus of the Commission's methodology in the 2014 Case was to
22 assign rate case expense to the beneficiaries of a rate increase. When the Commission linked

1 rate case costs to shareholder's benefits, the desired outcome in the 2014 Case was to set rates
2 that were just and reasonable for recovery from ratepayers.

3 Q. Staff has recommended a normalization of rate case expenses, and KCPL has
4 recommended an amortization of rate case expenses. What is the difference between these
5 two methods?

6 A. A normalization adjustment includes a "normal" level of an expense in the cost
7 of service. Payroll overtime and non-wage maintenance are examples of expenses for which
8 normalization adjustments are typically applied. The cost of service is based on an ongoing
9 level of an expense for these items, and there is no "tracking" of future amounts less than or
10 greater than the amount in the cost of service for future recovery. The majority of the
11 expenses in the cost of service are not subject to any tracking. See the surrebuttal testimony
12 of Karen Lyons for a discussion of KCPL's current and requested tracked expenses as they
13 relate to the entire expense portion of KCPL's income statement.

14 An amortization adjustment identifies a certain expense and includes recovery of that
15 expense over a fixed period of time. An amortization adjustment with a fixed time period
16 explicitly (or implicitly) dictates that the expense will be amortized until it is fully recovered.
17 "Construction accounting" costs related to KCPL's Iatan 1 and Iatan 2 projects and the
18 amortization of 2011 Missouri River flood expenses are examples of amortization
19 adjustments. Because amortizations are a departure from traditional ratemaking, they can be
20 subject to recognition of over- or under-collections. Tracker mechanisms, such as KCPL's
21 pension and OPEB trackers, are similar to amortizations; tracker mechanisms are an ongoing
22 amortization and tracking of expenses with the ultimate goal of perfectly matching an expense
23 with the amount in rates for that expense.

1 Q. What are the problems with KCPL's "defer and amortize" approach of
2 recovery of rate case expense?

3 A. Under the "defer and amortize" method, the utility defers (to a Missouri-only
4 rate case expense account) all expenses related to prosecuting a rate case. The Company
5 defers expenses such as legal fees, consulting fees, copying and binding expenses, temporary
6 labor expenses, and other administrative expenses that would otherwise be charged to
7 expense. This method is problematic because there is virtually no incentive to contain costs if
8 rate recovery is certain.

9 Q. How do you respond to Mr. Rush's suggestion to establish a regulatory asset to
10 defer and amortize rate case expense?

11 A. Staff is unclear if Mr. Rush actually proposed to track rate case expense, due to
12 contradictory statements he made in his testimony. On page 58 of Mr. Rush's rebuttal
13 testimony, he discusses the "traditional" treatment of rate case expense and states,
14 "The Company believes that this approach to rate case expense should be utilized in this
15 case." However, under the "traditional" treatment, no examination of under- or over-recovery
16 of rate case expense is considered in future cases.

17 In contrast, on page 64 of his rebuttal testimony, Mr. Rush states, "I recommend that
18 rate case expenses from this case be treated as a deferral and amortized over a three year
19 period." Mr. Rush points out that if rate case expense recovery is tracked, the Company will
20 be protected by full recovery of costs. Staff assumes that despite the contradictory
21 recommendations, KCPL is supporting a tracker for rate case expense.

22 A tracker is a deferral mechanism that should be used on a very limited basis for costs
23 incurred under unique or unusual circumstances. However, rate case expense does not

Surrebuttal Testimony of
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1 warrant the use of a tracker, because methods to include rate case expense in the revenue
2 requirement have been thoroughly deliberated, and the nature of rate case expense in this case
3 does not meet the criteria for deferral accounting discussed above. As such, KCPL's newly
4 presented recommendation should be rejected.

5 Q. Does that conclude your surrebuttal testimony?

6 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light)
Company's Request for Authority to)
Implement A General Rate Increase for)
Electric Service)
Case No. ER-2016-0285

AFFIDAVIT OF MATTHEW R. YOUNG

STATE OF MISSOURI)
) ss.
COUNTY OF JACKSON)

COMES NOW MATTHEW R. YOUNG and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing Surrebuttal Testimony; and that the same is true and correct according to his best knowledge and belief.

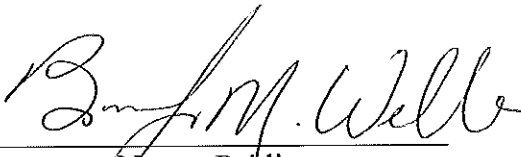
Further the Affiant sayeth not.



MATTHEW R. YOUNG

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Jackson, State of Missouri, at my office in Kansas City, on this 26th day of January, 2017.



Notary Public



BEVERLY M. WEBB
My Commission Expires
April 14, 2020
Clay County
Commission #12464070

SCHEDULE MRY-s1

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

CORRECTED
September 13, 2016



**In the
Missouri Court of Appeals
Western District**

IN THE MATTER OF KANSAS CITY)	
POWER & LIGHT COMPANY'S)	
REQUEST FOR AUTHORITY TO)	WD79125 Consolidated with
IMPLEMENT A GENERAL RATE)	WD79143 and WD79189
INCREASE FOR ELECTRIC)	
SERVICE,)	OPINION FILED: September 6,
)	2016
Appellant,)	
and)	
)	
MIDWEST ENERGY CONSUMERS')	
GROUP,)	
)	
Appellant,)	
)	
v.)	
)	
MISSOURI PUBLIC SERVICE)	
COMMISSION,)	
)	
Respondent.)	

Appeal from the Public Service Commission

Before Division Two: Karen King Mitchell, Presiding Judge, Cynthia L. Martin, Judge
and Gary D. Witt, Judge

This case consolidates two appeals from a rate case involving Kansas City Power & Light Company's ("KCPL") request for a rate increase from the Public Service Commission ("PSC"). KCPL appeals from the Report and Order ("Report and Order") of the PSC in its most recent general rate case, pursuant to Section 386.510.¹ KCPL raises five points on appeal, challenging the return on equity granted by the PSC, the methods used to calculate that rate of return, the rejection of a "tracker" accounting mechanism, the PSC's refusal to include certain transmission costs in a fuel adjustment clause, and the denial of certain rate case expenses. We affirm the PSC's Report and Order.

Midwest Energy Consumers' Group ("MECG") is an unincorporated association that is comprised of large consumers of energy, which was permitted to intervene in KCPL's rate case. MECG appeals from the Compliance Tariff Order, which implemented the Report and Order. MECG raises seven points of error, each challenging the September 16 Compliance Tariff Order that concluded the Final Compliance Tariff sheets filed by KCPL complied with the PSC's September 2 Report and Order. Each point of error challenges the process and procedure by which the PSC issued its Compliance Tariff Order. MECG's appeal is dismissed as moot.

Factual Background

KCPL is a regulated public utility under the jurisdiction of the PSC of the State of Missouri under Chapters 386 and 393. The PSC is charged with the authority to set the rates that KCPL is allowed to charge consumers pursuant to section 393.150. On

¹ All statutory references are to the Revised Statutes of Missouri 2000 as currently supplemented, unless otherwise indicated.

October 30, 2014, KCPL filed tariff sheets that would implement a general rate increase for its retail electric utility service. KCPL requested an increase on its return on equity from 9.7% to 10.3%. In addition, KCPL asked the PSC to adopt a fuel adjustment clause under section 386.266 and to use an accounting deferral mechanism for certain items of expenditure.

The implementation of the new tariffs was suspended until September 29, 2015 to allow for full rate case proceedings. A number of parties intervened and participated in the proceedings, including MCEG. A test year of twelve months, ending on March 31, 2014 and extended to December 31, 2014, was agreed to by the parties and adopted by the PSC. The PSC also established a "true-up" period to run through May 31, 2015. Public hearings were conducted and evidentiary hearings were held over a number of days. The parties filed post-hearing briefs and the case was submitted to the PSC on August 3, 2015.

In its Report and Order, the PSC set KCPL's return on equity to 9.5%. The PSC denied KCPL's request for an accounting deferral mechanism known as a "tracker" for certain expenses. The PSC permitted KCPL to implement a fuel adjustment clause, but only for "true" purchased power, approximately 7.3% of the costs charged to KCPL by the Southwest Power Pool. Finally, the PSC allowed KCPL to recover approximately 74.26% of its expenses on the rate case. Timely applications for rehearing were filed and denied.

This appeal follows. Further details regarding the relevant disputed issues are outlined as applicable in the analysis sections of each point below.

Standard of Review

An order from the PSC is presumed to be valid, and the burden of proof is on the party challenging the order, by clear and satisfactory evidence, to show that the order is either unlawful or unreasonable. *See In re Laclede Gas Co.*, 417 S.W.3d 815, 819 (Mo. App. W.D. 2014); Section 386.430.

Judicial review of the PSC's Report and Order is two-fold. *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 397 S.W.3d 441, 446 (Mo. App. W.D. 2013). First, we must determine whether the PSC's order was lawful. *Id.*

An order's lawfulness depends on whether the [PSC's] order and decision was statutorily authorized. When determining whether the order is lawful, we exercise independent judgment and must correct erroneous interpretations of the law. Because the [PSC] is purely a creature of statute, its powers are limited to those conferred by statute either expressly, or by clear implication as necessary to carry out the powers specifically granted.

Id. at 446-47 (internal quotations and citations omitted). "Second, we must determine whether the [PSC's] order was reasonable." *Id.* at 447. "In determining whether the Commission's order is reasonable, we consider (1) whether it was support[ed] by substantial and competent evidence on the whole record, (2) whether the decision was arbitrary, capricious, or unreasonable, and (3) whether the [PSC] abused its discretion." *Id.* (internal quotations and footnote omitted).

"We consider the evidence, along with all reasonable supporting inferences, in the light most favorable to the Commission's order. [*State ex rel. Mo. Gas Energy v. Pub. Serv. Comm'n*, 186 S.W.3d 376, 382 (Mo. App. W.D. 2005).] "[I]f substantial evidence supports either of two conflicting factual conclusions, '[we are] bound by the findings of the administrative tribunal.'" *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 120 S.W.3d 732, 735 (Mo. banc 2003) (quoting *Amway Corp. v. Dir. of Revenue*, 794 S.W.2d 666, 668 (Mo. banc 1990)). The determination of witness credibility is left to the Commission, "which is free to believe none, part, or all of the testimony." *Mo. Gas Energy*, 186 S.W.3d at 382 (quoting

Commerce Bank, N.A. v. Blasdel, 141 S.W.3d 434, 456–57 n.19 (Mo. App. W.D. 2004)). "It is only where a Commission order is clearly contrary to the overwhelming weight of the evidence that we may set it aside." *Id.* Additionally, with regard to issues within the Commission's expertise, "we will not substitute our judgment for that of the Commission." [*Union Elec. Co. v. Pub. Serv. Comm'n*, 136 S.W.3d 146, 151 (Mo. App. W.D. 2004)].

State ex rel. Pub. Counsel v. Mo. Pub. Serv. Comm'n, 289 S.W.3d 240, 246-47 (Mo. App. W.D. 2009).

Appeal by Kansas City Power & Light Company

Analysis

Point One - Return on Equity

In KCPL's Point One on appeal, KCPL argues the PSC erred in choosing a return on equity ("ROE") of 9.5% and in refusing regulatory treatment that recognizes certain known future cost increases because the impact of these determinations is unreasonable and unlawful as it is confiscatory.

The Supreme Court has decided that a public utility, as a matter of constitutional right,

is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding[] risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 692-93 (1923). "A rate of return is generally considered to be fair if it covers utility operating expenses, debt service, and dividends, if it compensates investors for the risks of investment, and if it is sufficient to attract capital and assure confidence in the enterprise's financial integrity." *State ex rel. Mo. Gas Energy*, 186 S.W.3d at 383 (internal quotation omitted); *see also Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944).

In Missouri, section 393.270.4 governs, in part, the PSC's authority to fix utility rates, and states the following:

In determining the price to be charged for gas, electricity, or water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

"The rate of return is, essentially, the amount that a utility must pay to secure financing from debt and equity investors." *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 274 S.W.3d 569, 573 (Mo. App. W.D. 2009). "To determine the proper rate of return, the commission should factor '(i) the ratio of debt and equity to total capital, and (ii) the cost and (iii) weighted cost for each of these capital components.'" *Id.* at 573-74 (quoting *State ex rel. Mo. Gas Energy*, 186 S.W.3d at 383).

"Determining a rate of return on equity, however, is imprecise and involves balancing a utility's need to compensate investors against its need to keep prices low for consumers." *Id.* at 574. Missouri courts have consistently held that the PSC is not required to utilize any specific methodology to calculate a just and reasonable return in setting rates.

State ex rel. Praxair, Inc. v. Pub. Serv. Comm'n, 328 S.W.3d 329, 339 (Mo. App. W.D. 2010). This Court has outlined the following principles governing review of the PSC's determination of an ROE.

The Commission has considerable discretion in rate setting due to the inherent complexities involved in the rate setting process. *State ex rel. Associated Natural Gas Co. v. Public Serv. Comm'n*, 706 S.W.2d 870 (Mo.App.1985). It is not the theory or methodology, but the impact of the rate order which counts. *State ex rel. Missouri Water Co. v. Public Serv. Comm'n*, 308 S.W.2d 704, 714 (Mo.1957). Missouri courts do not set utility rates. *State ex rel. GTE North, Inc. v. Missouri Pub. Serv. Comm'n*, 835 S.W.2d 356, 361 (Mo.App.1992). "If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." *Associated Natural Gas, 706 S.W.2d at 873* (quoting *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 602–03, 64 S.Ct. 281, 287–88, 88 L.Ed. 333 (1944)). Where ratemaking is at issue, determinations by the Commission are favored by a presumption of validity.

State ex rel. Office of the Pub. Counsel v. Pub. Serv. Comm'n, 938 S.W.2d 339, 344 (Mo. App. W.D. 1997).

The PSC set KCPL's ROE at 9.5%, down from the previous return on equity of 9.7%. KCPL had requested a new return on equity rate at somewhere between 9.7% and 10.3%. There is not a single way to determine a proper ROE. Therefore, analysts utilize three generally accepted methods to estimate a fair ROE: the Discount Cash Flow Method ("DCF"), the Risk Premium Method, and the Capital Asset Pricing Method ("CAPM").²

² The DCF method assumes that a stock's current price accurately represents the present value of all expected future cash flows for the utility. The Risk Premium method assumes that investors require a higher return to assume a greater risk. Generally, common equity investments have greater risk than bonds because bonds have more security for payment in bankruptcy proceedings than common equity. The CAPM assumes that the investor's required ROE is equal to a risk-free rate of interest plus the product of a company-specific risk factor and the expected risk premium on the market portfolio.

Analysts generally balance their use of all three methods to determine a recommended ROE.

Four expert witnesses testified as to their opinions regarding the ROE. One witness, Robert Hevert ("Hevert"), offered testimony on behalf of KCPL. He recommended an ROE of 10.3%, within a range of 10.0% to 10.6%. The PSC determined that Hevert's estimate was too high. The PSC found Hevert's (1) constant growth DCF results were based on excessive and unsustainable long-term growth rates, (2) multi-stage DCF was based on a flawed accelerating dividend cash flow timing and an inflated gross domestic product growth estimate as a proxy for long-term sustainable growth, (3) CAPM was based on inflated market risk premiums, and (4) bond yield plus risk premium was based on inflated equity risk premiums.

Michael Gorman ("Gorman") testified on behalf of the Missouri Industrial Energy Consumers and MECG. He testified that based on returns on equity awarded by other commissions, a reasonable ROE for KCPL would be 9.5% or less. He recommended an ROE of 9.1% within a range of 8.8% and 9.4%. Maureen Reno ("Reno") offered testimony on behalf of the U.S. Department of Energy and the Federal Executive Agencies and recommended an ROE of 9.0% within a recommended range of 8.2% and 9.6%. Finally, Zephania Marevangepo ("Marevangepo") offered testimony on behalf of the technical staff of the PSC. She recommended an ROE of 9.25% within range of 9.0% and 9.5%.

The PSC found the estimates from Gorman, Reno, and Marevangepo were reasonable and accurate estimates of the current market cost of capital for KCPL. The upper ends of the recommendations from these three analysts were 9.4% to 9.6%. The

PSC concluded that these recommendations relied on verifiable and independent market data and accepted market-based rate of return models. The PSC also considered a number of additional factors, including recent indicators of growth and the reduction of risk to KCPL by the PSC's approval of a fuel adjustment clause, which would support a reduced return. KCPL found that an ROE of 9.5% would allow KCPL to compete in the capital market for funds needed to maintain its financial health.

To further justify its chosen ROE of 9.5%, the PSC found that, in general, state public utility commissions are reducing authorized returns on equity to follow declines in capital market costs. The PSC looked at industry authorized returns on equity for fully litigated cases, which in 2014 was 9.63% and in the first quarter of 2015 was 9.57%. The PSC uses these comparisons because KCPL must compete with other utilities in the country for the same capital. Since the last established ROE of 9.70%, the PSC found that market capital costs for Missouri electric utilities are lower as a result of increases in stock prices and decreases in bond yields and utility dividend yields. In addition, since April of 2015, capital markets and general economic indicators have indicated expanding macroeconomic growth and increasing returns.

KCPL, on the other hand, argues that the PSC made its decision contrary to evidence of a consistent pattern of KCPL earning below its authorized ROE. KCPL presented evidence that U.S. regulatory commissions were approving ROEs that averaged 9.83% during the second quarter of 2015. KCPL also argued that it has a riskier profile than most other U.S. utilities that would justify a higher ROE. KCPL takes issue with the approach taken by the PSC to determine the ROE by relying on historical costs to set rates. KCPL

argues that the PSC's reliance on historical data will fail to reflect KCPL's current expenses when the new rates take effect, which KCPL claims will be higher than historical costs indicate due to a number of factors, a phenomenon called "regulatory lag."

The PSC counters that its approach to calculating the ROE strikes the appropriate balance between considering historical costs in setting the ROE and looking at future variables. The test year is the primary mechanism through which the PSC determines appropriate rates. The PSC focuses on four factors during the test year: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. These factors are considered to determine the utility's revenue requirement, which is the amount of revenue taxpayers must generate to pay the costs of producing the utility's services they receive while yielding a reasonable rate of return. The PSC's use of a true-up audit and hearing is designed to balance the historical data with known and measureable subsequent and future changes; these are generally limited only to accounts affected by a significant known and measurable change, such as a new labor contract, new tax rate, or the completion of a new capital asset. This procedure is designed to reduce regulatory lag.

This Court's role is not to determine what a reasonable ROE is but rather to review the record to see if the PSC's decision is lawful and supported by competent and substantial evidence. *State ex rel. Pub. Counsel*, 397 S.W.3d at 447. We must defer to the Commission's decisions regarding the credibility of witnesses and not second-guess issues

that are within the PSC's area of expertise. *See State ex rel. Pub. Counsel*, 289 S.W.3d at 247.

Evaluation of expert testimony is left to the Commission which "may adopt or reject any or all of any witnesses' testimony." *State ex rel. Associated Natural Gas Co. v. Public Service Comm'n*, 706 S.W.2d 870, 880 (Mo. App. W.D. 1985). Since the testimony of both experts was properly presented to the Commission, it was up to the Commission to choose between the conflicting evidence presented as to the propriety of including the cost of the storage gas in the new rate calculations.

State ex rel. Associated Nat. Gas Co. v. Pub. Serv. Comm'n, 37 S.W.3d 287, 294 (Mo. App. W.D. 2000).

We find that the decision of the PSC was lawful and supported by competent and substantial evidence. First, three experts each testified credibly, as found by the PSC, as to an appropriate ROE. The chosen ROE of 9.5% was within the ranges of the recommendations of these three experts. The PSC found the testimony of expert Gorman credible that an ROE as low as 9.1% would maintain KCPL's financial integrity and ability to attract capital. Gorman's analysis included an evaluation of the risks and uncertainties faced by utilities comparable to KCPL, thus complying with the Supreme Court's guidance in *Bluefield*. *See Bluefield Waterworks*, 262 U.S. at 692. Further, the PSC determined that an ROE of 9.5% was close to the average of comparable utilities, which in 2014 was 9.63% and in the first quarter of 2015 was 9.57%. This Court has previously approved a "zone of reasonableness" established by the PSC that considered a return on equity within 100 basis points (i.e. 1.0% above or below) the national average as presumptively reasonable. *See State ex rel. Pub. Counsel*, 274 S.W.3d at 574; *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968)("courts are without authority to set aside any rate selected by the

Commission [that] is within a 'zone of reasonableness"). Here, the zone of reasonableness within the national average, as found by the PSC, is 8.63% to 10.63%. An ROE of 9.5% falls squarely within the zone of reasonableness. Also, we have held that where the ROE falls within the range recommended by the expert witnesses and is in keeping with the average for other similarly situated entities, in the absence of any other significant showing that the figure established is unreasonable, this Court must defer to the PSC. *See State ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n*, 356 S.W.3d 293, 311 (Mo. App. S.D. 2011).

Although KCPL complains that the PSC only looked to "fully-litigated" cases rather than to all other rate cases to determine comparable returns on equity, KCPL has cited no authority that would suggest the PSC's reliance on fully-litigated cases is improper. Our role is not to second-guess issues that are within the PSC's area of expertise and we will not do so here. *See State ex rel. Pub. Counsel*, 289 S.W.3d at 246-47. KCPL relies extensively on past actual returns on equity to argue reducing its ROE here is unreasonable, but such comparisons are only of limited value as the PSC cannot compensate KCPL for previous unearned equity but may only use that information in its calculations of a reasonable return going forward. *See State ex rel. Mo. Gas Energy*, 186 S.W.3d at 383 (the law does not require that rates yield any particular return and past losses are not considered in deciding whether a new rate is confiscatory).

Second, although KCPL complains that the historical test-year model with a true-up period does not adequately take into account regulatory lag, the PSC has adapted its methodology to attempt to account for regulatory lag. The true-up period established by

the PSC was designed to remediate some of the negative effects of regulatory lag by taking into account known and measurable subsequent or future changes to KCPL's expenses. Again, the PSC is not obligated to use any set methodology in making its ROE determinations but must exercise its considerable discretion and expertise in finding an ROE that is just and reasonable. *See State ex rel. Praxair, Inc.*, 328 S.W.3d at 339. Determinations of the PSC have the presumption of validity that will not be upended for the sole reasons that KCPL believes it has a better way to calculate an ROE. *Id.* ("Where ratemaking is at issue, determinations by the [PSC] are favored by a presumption of validity.") The best way to account for regulatory lag is a question of methodology and is best addressed by the expertise of the PSC, which this Court will not second-guess. *See State ex rel. Pub. Counsel*, 289 S.W.3d at 246-47.

We find that KCPL's chosen return on equity was lawful and supported by substantial and competent evidence. Point One is denied.

Points Two and Three - Tracking Mechanisms and Forecasts

KCPL's claims in Points Two and Three on appeal are largely intertwined and, therefore, will be considered together. In its case in chief and in direct testimony, KCPL requested that the PSC grant it the use of tracking mechanisms³ for expenses related to certain transmission fee expenses, property tax expenses, and CIP/cyber-security expenses. In sur-rebuttal testimony, KCPL suggested, in the alternative to the requested tracking

³ For the purposes of this discussion, the "tracking mechanism" we refer to is an accounting deferral mechanism that re-characterizes an income statement item ("revenues, expenses, gains, or losses") in a current period as a balance sheet item ("regulatory assets" or "regulatory liabilities") that would be addressed in a future rate proceeding.

mechanisms for these expenses, in the event those mechanisms were denied by the PSC, that its estimates of future expenses regarding the above categories be added to the figures from which the PSC calculates KCPL's revenue requirements.

The PSC denied KCPL's request to use tracking mechanisms as to each of these categories of expenses. This is the subject of KCPL's Point Three on appeal, considered first, in which KCPL claims the PSC erred in denying its request for a "tracker" accounting deferral mechanism because the legal conclusion by the PSC that only "extraordinary" items could be deferred as regulatory assets is unlawful and unreasonable because it is contrary to the Uniform System of Accounts ("USOA"), adopted by the PSC, because the USOA does not require that revenues, expenses, gains or losses be "extraordinary" in order to be deferred as a regulatory asset or liability.

The PSC has the power, pursuant to section 393.140(4), to prescribe uniform methods of keeping accounts. The PSC has adopted a rule that requires utilities to use the USOA to maintain their books and records. *See* 4 CSR 240-20.030. KCPL's arguments regarding the USOA and its alleged right to use a tracking accounting deferral mechanism completely ignore that the PSC's decision that only extraordinary expenses should be allowed such treatment is a policy decision that has been made by the PSC and is not dictated by whether, in the abstract, the USOA provides a mechanism to defer costs, whatever the type. The PSC has decided that the "use of trackers should be limited because they violate the matching principle, tend to unreasonably skew ratemaking results, and dull the incentives a utility has to operate efficiently and productively under the rate regulation approach employed in Missouri." The manager of the PSC's auditing unit testified that the

PSC will issue accounting authority orders ("AAOs"), which serve to allow a utility to deviate the normal method of accounting for certain expenses, most often associated with "extraordinary" events. The request by KCPL for the "tracking" accounting mechanism is the same as a request for an AAO, as it seeks to book a particular cost, normally charged as an expense on a utility's income statement in the current period, to the utility's balance sheet as a regulatory asset or regulatory liability. The manager testified that the PSC

in prior cases has stated that the standards for granting the authority to a utility to defer costs incurred outside of a test year as a regulatory asset are: 1) that the costs pertain to an event that is extraordinary, unusual and unique, and not recurring; and 2) that the costs associated with the event are material.

In deciding that only extraordinary costs qualify for deferral, the PSC has followed the USOA's guidance that "it is the intent that net income shall reflect all items of profit and loss during the period." 18 CFR Part 101, General Instruction 7. An exception to this general rule is for "extraordinary items" as defined by the USOA.

KCPL makes an exceedingly perplexing argument that because USOA's Definition 31, which defines "Regulatory Assets and Liabilities," includes no requirement that items so categorized must qualify as "extraordinary," then KCPL must be allowed deferral treatment for certain of its expenses. Definition 31 states in full:

Regulatory Assets and Liabilities are assets and liabilities that result from rate actions of regulatory agencies. Regulatory assets and liabilities arise from specific revenues, expenses, gains, or losses that would have been included in net income determination in one period under the general requirements of the Uniform System of Accounts but for it being probable:

A. that such items will be included in a different period(s) for purposes of developing the rates the utility is authorized to charge for its utility services;
or

B. in the case of regulatory liabilities, that refunds to customers, not provided for in other accounts, will be required.

18 CFR Part 10. This definition, relied upon by KCPL, provides no support for KCPL's argument that it *must* be allowed to defer any expense of its choosing. The definition recognizes that certain expenses that would normally be included in net income for one period may become a regulatory asset or liability if it is probable that the item would be included in a different period for purposes of developing the rates the utility is authorized to charge for its services. The PSC, however, remains the authority that determines when an item may be included in a different accounting period for the purpose of developing authorized rates. The PSC has followed the guidance in 18 CFR Part 101, General Instruction 7, that costs should not be deferred to another accounting period except for "extraordinary items."

The PSC is granted wide discretion in determining the methodology it chooses to determine an ROE. *State ex rel. Office of the Pub. Counsel*, 938 S.W.2d at 344; *State ex rel. Praxair, Inc.*, 328 S.W.3d at 339. The PSC has historically utilized the test year and true-up procedure to determine appropriate future rates because the historical test year's expenses can be used to determine reasonable future rates. *See e.g., State ex rel. Noranda Aluminum, Inc.*, 356 S.W.3d at 318 ("Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses [. . . .]") The PSC also utilizes a true-up audit and hearing, which adjusts the historical test year figures for known and measurable subsequent or future changes. *See State ex rel. Mo. Pub. Serv. Co. v. Fraas*, 627 S.W.2d 882, 888 (Mo. App. W.D. 1981)

(discussing the PSC's use of "a modified version of the projected year model by utilizing a test year which was adjusted to take into account known and measurable future changes. That concept was implemented by the holding of what the Commission denominates as 'a true-up hearing.'") Whether a cost should be afforded different treatment and merits a deferral directly impacts the PSC's chosen methodology for setting rates and is necessarily a discretionary judgment that is within the expertise of the PSC and not this Court. Which costs a utility is able to defer would impact the PSC's chosen method to determine rates and is a matter properly confined to the PSC's expertise. As such, we will not second-guess the PSC's reasoned decision that only extraordinary items may qualify for deferral treatment.⁴ *See State ex rel. Pub. Counsel*, 289 S.W.3d at 246-47 (this Court must defer to the PSC on issues within its expertise).

Accordingly, Point Three is denied.

In Point Two on appeal, KCPL argues the PSC erred in rejecting KCPL's request that trending principles and forecasts be considered in setting future rates because Missouri law prohibits the PSC from relying exclusively on historical expenses and ignoring relevant substantial and competent evidence that for the period covered by the new rates there will be new and significant mandatory cost increases for critical infrastructure protection ("CIP"), cyber-security, Southwest Power Pool transmission costs, and property taxes.

KCPL sought the approval to use a tracking mechanism for transmission expenses for the Southwest Power Pool ("SPP"), CIP and cybersecurity, and property taxes in its

⁴ It is unnecessary for this Court to decide whether, as argued by MCEG, the use of a tracker accounting mechanism would constitute retroactive ratemaking.

case-in-chief. In sur-rebuttal testimony, KCPL suggested, in the alternative to the requested tracking mechanism for these expenses, in the event this mechanism was denied by the PSC, that its estimates of future expenses regarding the above categories be added to the figures from which the PSC calculates KCPL's revenue requirements.

Regarding SPP transmission expenses, the PSC found that KCPL incurs fees as it sends and receives power through the SPP, a Regional Transmission Organization. The PSC found that these costs for KCPL have increased over the past several years, but that the projected fees would decrease in the future and constitute ordinary and recurring operating costs. Regarding cybersecurity and CIP costs, the PSC found that KCPL's cybersecurity and CIP costs were projected to increase primarily in 2015 and decrease for the following two years. Compliance costs would then be an ongoing cost for the foreseeable future. Finally, regarding the property tax expenses, KCPL found that even though these costs had been and may continue to rise, those rates were included in normal operating costs and could be reasonably calculated on an annualized basis.

The PSC in its Report and Order, as explained *supra*, denied the use of a tracking mechanism for these expenses. In its Report and Order, the PSC also denied KCPL's request to add specific estimated future costs in the calculation of KCPL's revenue requirement. The PSC found the following with regard to each requested expense. First, the requests to add the projected future costs to KCPL's revenue requirement did not come until surrebuttal testimony and as such violated PSC Rule 4 CSR 240-2.130(7)(A), which requires that direct testimony "shall include all testimony and exhibits asserting and explaining that party's entire case-in-chief." The PSC found that KCPL's failure to include

its estimates and requests in its case-in-chief prevented other parties from having a sufficient opportunity to conduct discovery or provide testimony on the matters. Second, the PSC found that KCPL failed to adequately explain how it arrived at its estimates and how the Commission has the legal authority to grant KCPL's requested relief.

In determining rates, the PSC may consider all facts that in its judgment have a bearing on the proper determination of rates. *See* Section 393.270.4; *State ex rel. Pub. Counsel*, 397 S.W.3d at 447-48. Relevant facts, of course, include forecasts of future costs. *See Fraas*, 627 S.W.2d at 886 ("the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; rate making is by necessity a predictive science").

The PSC was within its authority to reject the inclusion of the specific amounts requested by KCPL for these projected costs in calculating KCPL's revenue requirement, as the requests were made for the first time in surrebuttal. Section 386.410 grants to the PSC the power to adopt and prescribe the rules governing its hearing procedures. The PSC has adopted numerous rules and regulations governing its procedures, including 4 CSR 240-2.130. 4 CSR 240-2.130(7)(A) provides that party's direct testimony shall include "all testimony and exhibits asserting and explaining that party's entire case-in-chief." Most direct testimony is pre-filed with the PSC in advance of the hearing. *See* 4 CSR 240-2.130(7)-(9). These procedures are important due to the highly technical nature of the issues presented at the hearing, in that it affords other parties a reasonable opportunity to provide evidence in response. Therefore, supplementing direct testimony is generally not allowed. *See* 4 CSR 240-2.130(10). It is not disputed that KCPL, for the first time in

surrebuttal, requested that its specific forecasted SPP transmission expenses, CIP/cyber-security costs, and property taxes be included in its revenue requirements. As found by the PSC, allowing KCPL to make this request for the first time in surrebuttal precluded other parties from conducting discovery on the issue and from presenting evidence to refute KCPL's allegations. The PSC had the authority to reject the projected costs in its calculations on this basis.

However, we reject KCPL's suggestion that, in refusing to include KCPL's specific forecasts of future costs into KCPL's revenue requirement, the PSC has abandoned its duty to take into account projections of KCPL's future costs when it set its ROE. Regarding the SPP transmission fees, the PSC adopted as credible the expenses and revenues forecasted by expert Karen Lyons ("Lyons"), Utility Regulatory Auditor for the PSC. Lyons's testimony took into account that although KCPL's transmission costs have increased, the amount charged by SPP is projected to *decrease in the future*. Similarly, the PSC considered evidence regarding the projected costs of CIP/cyber-security through the testimony of PSC staff that the PSC found credible. Staff testified that although costs related to CIP and cyber-security would increase primarily in 2015, thereafter the costs would *decrease for the next two years*. Finally, with regard to property taxes, the PSC accepted testimony that although those taxes were projected to increase, the costs could be reasonably calculated and an annualized level included in expenses. The PSC did consider projected costs in its calculations when it set KCPL's rates, contrary to KCPL's allegation on appeal that the PSC relied *solely* on historical data.

Point Two is denied.

Point Four - Transmission Expenses in Fuel Adjustment Clause

In Point Four on appeal, KCPL argues the PSC erred in denying KCPL the authority to use a fuel adjustment clause to recover certain transmission costs because it is unreasonable and unlawful as contrary to the Filed Rate Doctrine and the United States Constitution's Supremacy Clause in that the PSC's decision ignores that KCPL's transmission costs are set by a federal tariff approved by the Federal Energy Regulatory Commission ("FERC") and the PSC's order improperly causes its FERC-approved costs to be trapped and unrecoverable.

KCPL requested, and was granted, the implementation of a fuel adjustment clause ("FAC") in its new rates. An FAC is a statutory mechanism that allows for periodic rate adjustments, outside of a general rate case, to reflect decreases and increases in a utility's incurred fuel and purchased power costs. *See State ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 399 S.W.3d 467, 482-83 (Mo. App. W.D. 2013). KCPL is a member of SPP, which is a regional transmission organization. KCPL sells all of the power it generates into the SPP market and purchases back from SPP 100% of the electricity it sells to customers. KCPL requested the authority to include all of its wholesale transmission expenses and revenues into its FAC. The PSC allowed only transmission expenses for "true" purchased power to be recovered through the FAC and those related only to off-system sales. KCPL was denied the inclusion in the FAC of costs related to: (a) scheduling the external and internal movement of power over the transmission system; (b) upgrading and maintaining the transmission systems; and (c) fees charged by SPP and FERC to support their operations.

Section 386.266 provides the PSC with the authority to approve an FAC. That section provides that

any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings *to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation*. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

Section 386.266.1 (emphasis added); *see also* 4 C.S.R. 240–20.090(1)(C).

The regulation defines "fuel and purchased power costs" which must be considered in calculating a fuel adjustment. 4 CSR 240–20.090(1)(B). The definition varies depending upon whether off-system sales revenues and associated costs are "reflected" in the fuel adjustment clause. If off-system sales revenues and associated costs are not reflected in the fuel adjustment clause, then "fuel and purchased power costs only reflect the prudently incurred fuel and purchased power costs necessary to serve the electric utility's Missouri retail customers." 4 CSR 240–20.090(1)(B)1. If off-system sales revenues and associated costs are reflected in the fuel adjustment mechanism, then "fuel and purchased power costs reflect both: (A) The prudently incurred fuel and purchased power costs necessary to serve the electric utility's Missouri retail customers; and (B) The prudently incurred fuel and purchased power costs associated with the electric utility's off-system sales." 4 CSR 240–20.090(1)(B)2.

State ex rel. Union Elec. Co., 399 S.W.3d at 485.

The PSC found that the statute only allows the utility to use an FAC to recover transportation costs of "true" purchased power, which would not include power generated by KCPL, sold to SPP and then bought back from SPP, but only power purchased by KCPL that was not generated by KCPL. "True" purchased power, as defined by the PSC, amounts to approximately 7.3% of KCPL's wholesale transmission expenses. The PSC determined that the expenses incurred by KCPL to transmit its power from its own generation resources

to its own load (approximately the remaining 92.7% of wholesale transmission expenses) are not for "purchased power" within the meaning of the statute.

KCPL *does not* challenge on appeal the PSC's interpretation of the statute. Rather, KCPL only argues that the PSC's refusal to allow KCPL to recover all of its transmission expenses and other costs associated with the SPP through the FAC runs afoul of the "Filed Rate Doctrine" and is contrary to the principles of federal preemption. In support of its argument, KCPL cites *State ex rel. Associated National Gas Company v. Public Service Commission*, which explains that the Supremacy Clause "holds that interstate power rates fixed by the FERC must be given binding effect by state utility commissions determining intrastate rates." 954 S.W.2d 520, 530-32 (Mo. App. W.D. 1997). KCPL also cites *Nantahala Power and Light Company v. Thornburg*, which explains that a "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." 476 U.S. 953, 965 (1986).

This Court has explained the filed rate doctrine as follows:

The federal preemption and filed rate doctrine invoked by KCP & L-GMO involves the relationship between the federal and state rate-setting authorities. FERC regulates the transmission and sale of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce; however, such regulation extends only to those matters that are not subject to regulation by the states. 16 USC § 824(a). "Because of the potential conflict between the federal and state rate-setting agencies, the 'filed rate doctrine' was developed as an outgrowth of straightforward principles of [f]ederal preemption and the Supremacy [C]lause." *Associated Natural Gas Co.*, 954 S.W.2d at 530 (citing *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 963, 106 S.Ct. 2349, 90 L.Ed.2d 943 (1986); *Ark. La. Gas Co. v. Hall*, 453 U.S. 571, 577, 101 S.Ct. 2925, 69 L.Ed.2d 856 (1981)). The filed rate doctrine requires "that interstate power rates filed with FERC or

fixed by FERC must be given binding effect by state utility commissions determining intrastate rates." *Nantahala*, 476 U.S. at 962, 106 S.Ct. 2349. The filed rate doctrine prohibits a state regulatory commission from "trapping" FERC-approved costs by preventing a distributor from fully recovering those costs from its retail customers. *Id.* at 970, 106 S.Ct. 2349.

State ex rel. KCP&L Greater Mo. Operations Co. v. Mo. Pub. Serv. Comm'n, 408 S.W.3d 153, 164 (Mo. App. W.D. 2013). "Trapping" of rates occurs where "costs under a FERC tariff are categorically excluded from consideration in retail rates" and the regulated entity "cannot fully recover its costs of purchasing at the FERC-approved rate." *Entergy La., Inc. v. La. Pub. Serv. Comm'n*, 539 U.S. 39, 48 (2003).

KCPL's reliance on this case law to argue that the PSC is required to allow KCPL to include all of its wholesale transmission expenses in an FAC is misplaced. The issue before this Court is not whether the PSC is required to permit KCPL to recover the full costs of FERC-approved tariff and rate schedules. It is clear that it is. Rather, the issue is whether KCPL is *entitled* to recover these costs *through an FAC* or whether the PSC has the discretion to allow some of the costs related to SPP be recovered through an FAC while including the remaining SPP costs in its decision determining general rates. KCPL has cited no authority whatsoever that it is entitled to use an FAC in the first instance. The FAC is merely a mechanism available, pursuant to Missouri statute, that helps address the volatility of transmission costs for the utility.

KCPL asserts that the PSC's "determination that 92.7% of future increases in [KCPL's] SPP transmission expenses can only be recovered in a general rate case amounts to a disallowance of the transmission expenses that it pays under the SPP tariff." Of course, this allegation is not a fact but rather another assertion by KCPL that the methods used by

the PSC to determine appropriate rates are unsatisfactory. KCPL provides no support that it will be *foreclosed* from recovering its SPP fees through its general rates. The PSC had before it testimony to the contrary that

[a]llowing KCPL to flow increases of [all of its] wholesale transmission expenses through an FAC would allow KCPL to recover the Missouri jurisdictional portion of these increases between base rate proceedings without considering whether KCPL has any offsetting changes in its non-transmission and non-fuel revenues and expenses. This could allow KCPL to over-recover its total costs.

The FAC is a creation of Missouri statute and not mandated by *Nantahala* or the Filed Rate Doctrine. Those cases and subsequent cases stand for the proposition that state utility commissions in setting retail rates "must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price" and may not "conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable." *Nantahala*, 476 U.S. at 965-66. The PSC's conclusion that, pursuant to Missouri law, an FAC may only include transmission expenses for "true" purchased power and the remaining costs must be considered as other costs in setting the general rates does not run afoul of these principles. The *Nantahala* decision itself explains that there need not be a direct correlation between wholesale power prices and retail rates. *Id.* at 967-68. The *Nantahala* court agreed with the proposition that a state commission "may treat the proposed rate increase as it treats other filings ... and investigate the overall financial structure of [the power company] to determine whether the company has experienced savings in other areas which might offset the increased price." *Id.* (quoting *Narragansett Elec. Co. v. Burke*, 381 A.2d 1358, 1363 (R.I. 1977)).

Accordingly, we find that the PSC's decision to include only "true" purchased power transmission costs in the FAC does not run afoul of the Filed Rate Doctrine or the Supremacy Clause.

Point Four is denied.

Point Five - Rate Case Expenses

In Point Five on appeal, KCPL argues the PSC erred in implementing a formula that disallowed over \$270,000 in rate case expenses because this formula was unreasonable and unlawful because the formula was an improperly adopted rule under section 536.021 and the PSC failed to find that any of these expenses were imprudent, but instead simply used a ratio of requested-to-award revenues as part of a new formula ostensibly developed for all Missouri utilities.

KCPL sought the recovery of rate case expenses from the PSC, which are the incremental costs incurred by the utility directly related to its application to change its general rate levels. KCPL's total rate case expense as of August 12, 2015 was \$1,024,304. Staff of the PSC and the OPC alleged that certain expenses regarding expert witnesses and the costs of outside attorneys should be disallowed as they were imprudent. The PSC did not find any of the specific costs as imprudent because it determined that there is no "accessible appropriate standard for determining whether one consultant's analysis was truly unnecessary or if one attorney's expertise is worth more than another's." However, the PSC found that a significant portion of the expenses in this case were "driven primarily by issues raised by KCPL, which has complete control over the content and methodologies proposed in its rate cases." The PSC also found that KCPL has incurred rate case expenses

"substantially higher than historical levels and higher than other utilities in Missouri." According to the PSC, this was because KCPL pursued issues in its case for the benefit of only shareholders, which are highly discretionary and "typically allocated entirely to shareholders." Therefore, the PSC decided that it was reasonable that KCPL shareholders cover a portion of KCPL's rate case expense. According to the PSC, it has the legal authority to apportion rate case expenses between ratepayers and shareholders and it is appropriate to do so here where the inclusion of all the rate case expenses for payment by ratepayers would not be just and reasonable.

The PSC chose to use a formula in this case that would "directly link KCPL's recovery of rate expense to both the reasonableness of its issue positions and the dollar value sought from customers in this rate case." The PSC decided to link KCPL's percentage recovery of rate case expenses to the percentage of its rate increase request that the PSC found just and reasonable. The formula is expressed as follows: $(\text{Revenue Requirement Approved} / \text{Original Revenue Requirement Requested}) \times 100 = \text{allowable percentage of rate case expense}$. Minus the costs of the depreciation study conducted by KCPL, which the PSC found should be fully allocated to ratepayers, the net rate case expense was \$961,417. The PSC authorized the recovery of \$713,907, representing a recovery of 74.26% of the rate case expenses.

KCPL raises two primary objections to the PSC's determination regarding rate case expenses. First, KCPL argues that in using this formula the PSC has participated in unlawful rulemaking. KCPL argues that the formula used by the PSC is a new policy of

general applicability because it did not rely upon factual findings and a judgment on imprudence.

"Whether an agency decision should be promulgated as a rule is a determination that is guided by section 536.010(6)...." *Dep't of Soc. Services, Div. of Med. Services v. Little Hills Healthcare, L.L.C.*, 236 S.W.3d 637, 641 (Mo. banc 2007). Section 536.010(6) of the act provides that the term "rule" means "each agency statement of general applicability that implements, interprets, or prescribes law or policy, or that describes the organization, procedure, or practice requirements of any agency [subject to certain exceptions]."

Mo. Ass'n of Nurse Anesthetists, Inc. v. State Bd. of Registration for Healing Arts, 343 S.W.3d 348, 356 (Mo. App. W.D. 2011). The PSC argues that it did not engage in improper rulemaking because the method devised to determine a just and reasonable inclusion of rate case expenses was tied to the facts of this case and was not a statement of general applicability.

The PSC found that this formula was appropriate for this case based on a number of factors. The PSC found the following:

The evidence shows that the expenses in this case are driven primarily by issues raised by KCPL, which has complete control over the content and methodologies proposed when it files its rate cases. In this case, KCPL has requested three new trackers, two of which have never been requested before in Missouri. KCPL has also requested recovery in rates of the expenses from the Clean Charge Network, which is a type of expense that has never been raised in a rate case before this Commission. Each of these issues are unique to KCPL, and while KCPL always has the opportunity to pursue new and unique issues in a rate case, the decision to do so is entirely with[in] KCPL's power. In addition, KCPL has pursued some issues that only directly benefit shareholders, such as the La Cygne accounting authority and, of course, a higher ROE. In recent rate cases, KCPL has incurred rate case expenses substantially higher than historical levels and higher than other utilities in Missouri.

Further, the PSC explicitly recognized that the approach taken in this case is not applicable to all cases but is fact specific. The PSC explained

It is understood that some of the issues litigated in this case do not directly affect the overall revenue requirement granted by the Commission; but it is also clear that the vast majority of the litigated issues do have a direct or indirect impact on the revenue requirement. Accordingly, percentage sharing is a reasonable approach to correlating recovery of rate case expense to the relationship between the amount of litigation that benefited both ratepayers and shareholders and that which benefitted only shareholders.

Contrary to KCPL's argument, the PSC clearly established that the formula was proper *in this case* due to the unique circumstances of this rate case and it was not announcing a new policy of general applicability to all utilities. Accordingly, we find that the PSC did not engage in improper rulemaking due to their specific findings, supported by the record, that KCPL's litigation strategy, which in large part inured to the benefit of shareholders rather than ratepayers, necessitates the use of this formula in this specific case to justly and reasonably allocate rate case expenses between KCPL's ratepayers and shareholders.

Second, KCPL argues the use of the formula is unlawful because it denied the recovery of rate case expenses without a specific finding that any of the expenditures were imprudent.

Section 393.130.1 provides that all charges demanded by a utility must be just and reasonable. The Missouri Supreme Court has found that within this power "necessarily includes the power and authority to determine what items are properly includable in a utility's operating expenses and to determine and decide what treatment should be accorded such expense items." *State ex rel. City of West Plains v. Pub. Serv. Comm'n*, 310 S.W.2d 925, 928 (Mo. banc 1958); *see also State ex rel. KCP&L Greater Mo. Operations Co.*, 408

S.W.3d at 162-66. "The PSC employs a 'prudence' standard to determine whether a utility's costs meet this statutory requirement." *State ex rel. KCP&L Greater Mo. Operations Co.*, 408 S.W.3d at 163 (citing *State ex rel. Associated Nat. Gas Co.*, 954 S.W.2d at 528).

The PSC has defined its prudence standard as follows:

[A] utility's costs are presumed to be prudently incurred.... However, the presumption does not survive "a showing of inefficiency or improvidence."

... [W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).

State ex rel. Associated Nat. Gas, 954 S.W.2d at 528. The utility still has the burden of proof to show its expenses are just and reasonable. *Office of Pub. Counsel v. Mo. Pub. Serv. Comm'n*, 409 S.W.3d 371, 376 (Mo. banc 2013).

In *State ex rel. KCP&L Greater Missouri Operations Company*, this Court considered the decision by the PSC that it would be unjust and unreasonable to require ratepayers to pay for the added transmission costs of electricity transmitted from a location in Mississippi, where KCPL could transport the electricity from Missouri for a lower price. 408 S.W.3d at 162. Even though the PSC found that the decision to include the Mississippi generation fleet in the utility's operations was prudent, the added transportation costs associated with transporting the electricity to Missouri were not. *Id.* at 162-63. We found that so long as the PSC determined that the expenditure was imprudent and that the imprudence would harm ratepayers, the denial of the recovery of that expenditure from ratepayers was lawful and reasonable. *Id.* at 163.

Regarding rate case expenses, the PSC recognized that rate cases are both beneficial to shareholders of a utility and also utility customers, but in different ways. Shareholders benefit from the rate case expenses as the costs are incurred to increase the utility's revenues and profitability. Customers benefit by having a healthy utility. In this case, the PSC found that a standard prudence review of each expenditure in the rate case would not be possible and, even if conducted, would not provide a strong incentive for KCPL to impose cost controls because the utility holds all the information needed to identify imprudence. Therefore, the PSC did not identify any line item expense as explicitly imprudent, but rather found that the costs incurred by KCPL, as a whole, in pursuing its litigation strategy that in large part inured to the sole benefit of shareholders, were imprudent. An expert testified for the Staff of the PSC that, in similar contexts, highly discretionary costs that do not benefit customers, such as charitable donations, political lobbying expenses, and incentive compensation tied to earnings per share are typically allocated entirely to shareholders.

We will not say the PSC did not have the authority to determine that expenses incurred by KCPL for the sole benefit of its shareholders were imprudent such that it would be unjust and unreasonable to require ratepayers to bear the burden of those expenses. Here, where the PSC has found a certain category of expenditures imprudent, it would not make sense to require the PSC to do a line item review of the costs associated with the expenditure to determine whether each cost associated with KCPL's litigation strategy was imprudent. The majority of costs, for example, those related to infrastructure and transmission costs, are transparent and verifiable by the PSC. Rate case expenses are

opaque, shielded from effective oversight by privilege and confidentiality. It would be an abdication of the PSC's responsibility to set just and reasonable rates to allow a utility to benefit from imprudently incurred litigation expenses. Serious doubt as to the prudence of KCPL's litigation strategy was raised by the parties, and it was KCPL's burden to prove that its expenses (i.e. the expenses related to the litigation strategy found by the PSC to have been solely for the benefit of shareholders) were just and reasonable. KCPL does not argue on appeal that its litigation strategy was prudent but only that the remedy crafted by the PSC was not within its power. We find that the remedy crafted by the PSC was a reasonable exercise of the PSC's discretion and expertise in determining just and reasonable expenses to be borne by ratepayers.

Point Five is denied.

Conclusion of KCPL Appeal

The Report and Order of the Public Service Commission is affirmed.

Appeal by Midwest Energy Consumers' Group

KCPL initiated its rate case in October of 2014 by filing its proposed tariff sheets with the PSC. The proposed tariff sheets were scheduled to become effective thirty days after the filing on November 29, 2014. The PSC, however, suspended the effective dates for the proposed tariffs on November 5, 2015 for a period of 11 months to provide time to study the proposed rate increase, to hold hearings, and to determine if the proposed tariffs were just and reasonable.

MECG is an unincorporated association that is comprised of large consumers of energy, which was permitted to intervene in KCPL's rate case at a pre-hearing conference

on November 24, 2014. At this same pre-hearing conference, it was established that the PSC would need to issue its Report and Order no later than September 2, 2015 in order to meet the September 29, 2015 effective date of the proposed tariffs. Evidentiary hearings were held June 15-19, 29-30, and July 1 of 2015. MECG participated throughout the rate case. On August 3, 2015, after the submission of final briefs by the parties, the case was submitted for deliberation and decision to the PSC.

The PSC issued its Report and Order on September 2, 2015. The PSC rejected KCPL's proposed tariff sheets from October of 2014 and authorized KCPL to file tariff sheets that complied with the Report and Order no later than September 8, 2015. The PSC ordered its staff to file its recommendation regarding the approval of the compliance tariff sheets no later than September 14, 2015. The PSC also ordered any other parties to respond to the compliance tariff sheets no later than September 14, 2015. MECG *did not and is not* appealing the September 2, 2015 Report and Order. MECG appeals the September 16 Compliance Tariff Order, discussed *infra*.

KCPL filed its compliance tariff sheets on September 8, 2015. KCPL also filed a motion that requested expedited approval of the compliance tariff sheets in light of the thirty-days' notice and publication period required by section 393.140(11).⁵ On September

⁵ Section 393.140(11) states, in relevant part, the following:

Unless the commission otherwise orders, *no change shall be made in any rate or charge*, or in any form of contract or agreement, or any rule or regulation relating to any rate, charge or service, or in any general privilege or facility, which shall have been filed and published by a gas corporation, electrical corporation, water corporation, or sewer corporation in compliance with an order or decision of the commission, *except after thirty days' notice to the commission and publication for thirty days as required by order of the commission*, which shall plainly state the changes proposed to be made in the schedule then in force and the time when the change will go into effect. *The*

14, the staff of the PSC filed its recommendation, supported by affidavits, to reject or suspend KCPL's compliance tariff sheets due to issues regarding language in the fuel adjustment clause tariff sheets. The following day, September 15, 2015, KCPL withdrew the contested fuel adjustment clause tariff sheets and filed new ones that addressed the PSC's concerns ("Final Compliance Tariffs"). Contemporaneously on September 15, the staff of the PSC and KCPL filed a joint motion for approval of all the compliance tariff sheets supported by affidavits of three staff members of the PSC.

Also on September 15, MECG filed its Objection to Tariffs, Objection to Affidavits and Request for Hearing. MECG objected to the Final Compliance Tariffs and the staff's pleading and affidavits that were used as evidentiary support for the PSC's decision to approve the Final Compliance Tariffs. MECG also requested a hearing to cross-examine the staff regarding the contents of their affidavits and to determine whether there was substantial and competent evidence to support the PSC's finding that the Final Compliance Tariffs complied with the Report and Order. On September 16, 2015, the PSC issued its Order Regarding Compliance Tariff Sheets ("Compliance Tariff Order") that concluded that the Final Compliance Tariffs were consistent with the Report and Order and were effective on September 29, 2015.

commission for good cause shown may allow changes without requiring the thirty days' notice under such conditions as it may prescribe.

(emphasis added).

On September 29, 2015, the PSC issued its order denying MECG's Objections and Request for Hearing, finding that the matter was no longer a contested case. MECG filed its Application for Rehearing, which was denied.

On appeal, MECG raises seven points of error, each challenging the September 16 Compliance Tariff Order that concluded the Final Compliance Tariff sheets filed by KCPL complied with the PSC's September 2 Report and Order. Each point of error challenges the process and procedure by which the PSC issued its Compliance Tariff Order. MECG argues the PSC erred in issuing its Compliance Tariff Order because: (1) the PSC unlawfully expedited the 30-day notice period in section 393.140(11) to an unreasonable fifteen hours (Point One); (2) there was not good cause to expedite the notice period (Point Two); (3) section 393.140(11) does not authorize the PSC to expedite the thirty-day statutory publication period (Point Three); (4) there were not adequate findings of fact to support the PSC's Compliance Tariff Order (Point Four); (5) the PSC's Compliance Tariff Order was not supported by substantial and competent evidence (Point Five); (6) the PSC denied MECG the opportunity to cross-examine the PSC's staff witnesses regarding the contents of their affidavits in support of the Compliance Tariff Order (Point Six); and (7) the PSC denied MECG the opportunity to present evidence to show that KCPL's compliance tariffs did not comply with the September 2 Report and Order (Point Seven).

Analysis

Before we can address the merits of MECG's appeal, we must first consider the PSC's argument that MECG's appeal is moot. "A threshold question in any appellate review of a controversy is the mootness of the controversy." *Kansas City Power & Light*

Co. v. Midwest Energy Consumers Grp., 425 S.W.3d 142, 144 (Mo. App. W.D. 2014). "A moot issue is one upon which, if we resolved it in the appellant's favor, our holding would have no practical effect." *Id.* (quoting *T.C.T. v. Shafinia*, 351 S.W.3d 34, 36 (Mo. App. W.D. 2011)). "When an event occurs that makes a decision on appeal unnecessary or makes it impossible for the appellate court to grant effectual relief, the appeal is moot and generally should be dismissed." *Id.* (quoting *State ex rel. Chastain v. City of Kansas City*, 968 S.W.2d 232, 237 (Mo. App. W.D. 1998)).

MECG appeals from the PSC's Compliance Tariff Order, which approved the Final Compliance Tariffs filed by KCPL on September 15, 2015. Should this Court vacate the Compliance Tariff Order, it would be as if that order had never been made. *See State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm'n*, 266 S.W.3d 842, 843 (Mo. banc 2008) ("The general rule is that when an order or judgment is vacated, the previously existing status is restored and the situation is the same as though the order or judgment had never been made.") In such a scenario, by operation of section 393.140(11), the Final Compliance Tariffs filed by KCPL on September 15, 2015 would have gone into effect by the non-action of the PSC. *See* Section 393.140(11); *see also State ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n*, 535 S.W.2d 561, 566 (Mo. App. 1976)⁶. Further, section 393.140(11) provides that after the tariffs are filed and take effect, no corporation is able to "demand, collect or receive a greater or less or different compensation for any service

⁶ "The 'file and suspend' provisions of the statutory sections quoted above lead inexorably to the conclusion that the Commission does have discretionary power to allow new rates to go into effect immediately or on a date sooner than that required for a full hearing as to what will constitute a fair and reasonable permanent rate. This indeed is the intended purpose of the file and suspend procedure. Simply by non-action, the Commission can permit a requested rate to go into effect."

rendered or to be rendered than the rates and charges applicable" at that time. This is called the "filed rate doctrine" and constitutes a general rule against "retroactive ratemaking." *See e.g., State ex rel. AG Processing v. Pub. Serv. Comm'n*, 340 S.W.3d 146, 150 (Mo. App. W.D. 2011). Therefore, even if this Court were to find some error by the PSC regarding the Compliance Tariff Order, by virtue of section 393.140(11), the Final Compliance Tariffs became effective and now, because of the filed rate doctrine, this Court can provide no meaningful relief to MECG.

MECG concedes in briefing before this Court that it agrees with the above analysis that prior to 2011 this case would have been moot absent an exception to the mootness doctrine. MECG argues, however, that section 386.520, enacted in 2011, makes the case no longer moot. Section 386.520.2 provides, in relevant part:

2. With respect to orders or decisions issued on and after July 1, 2011, that involve the establishment of new rates or charges for public utilities that are not classified as price-cap or competitive companies, there shall be no stay or suspension of the commission's order or decision, however:

(1) In the event a final and unappealable judicial decision determines that a commission order or decision unlawfully or unreasonably decided an issue or issues in a manner affecting rates, then the court shall instruct the commission to provide temporary rate adjustments and, if new rates and charges have not been approved by the commission before the judicial decision becomes final and unappealable, prospective rate adjustments.

It appears that the application of this particular statute is a matter of first impression. The parties have not identified any cases actually interpreting this section or discussing how this section could impact the previously discussed general rule against retroactive ratemaking. To interpret a statute, we begin with the language chosen by the legislature. "If the intent of the legislature is clear and unambiguous, by giving the language used in

the statute its plain and ordinary meaning, then we are bound by that intent and cannot resort to any statutory construction in interpreting the statute." *State ex rel. Union Elec. Co.*, 399 S.W.3d at 479-80 (quoting *Goerlitz v. City of Maryville*, 333 S.W.3d 450, 455 (Mo. banc 2011)).

When determining the meaning of statutory language, the whole act must be taken into consideration, and the words of one section or statute must be read in the context of other statutes on the same subject as well as with cognate sections. We presume that the legislature intended that each word, clause, sentence, and provision of a statute have effect and should be given meaning.

In re KCP&L Greater Mo. Operations Co., 408 S.W.3d 175, 186 (Mo. App. W.D. 2013) (internal citations and quotations omitted).

Section 386.520.2 and its subparts only apply to orders and decisions of the PSC "that involve the establishment of new rates or charges for public utilities" MECG's sole argument that its appeal is not moot relies upon the operation of section 386.520.2 in the event that this Court finds error regarding the process and procedure followed by the PSC with respect to the PSC's Compliance Tariff Order. Therefore, the first question that must be answered is whether section 386.520.2 is even applicable to the PSC's action with respect to the Compliance Tariff Order.

This Court has recently explained the process and procedures used to establish new rates for a utility as follows:

The PSC was created and established to regulate public utilities that operate in Missouri. § 386.040; *State ex rel. Office of Pub. Counsel v. Mo. Pub. Serv. Comm'n*, 331 S.W.3d 677, 681 (Mo. App. W.D. 2011). "The PSC is authorized to approve rate schedules for electrical corporations, typically during a general rate case, as long as the rate is just and reasonable both to the utility and to its customers." *Office of Pub. Counsel*, 331 S.W.3d at 681 (citing § 393.150).

Usually, a rate case begins when a utility files a schedule with the PSC, stating a new rate. § 393.150.1. The new rate schedule becomes effective automatically unless the PSC suspends it under section 393.150.1. When a proposed rate schedule is suspended pursuant to section 393.150.1, the PSC must provide notice to the affected parties, hold a full hearing, and consider all relevant factors before approving any new rate. *Office of Pub. Counsel*, 331 S.W.3d at 681.

After a new rate is approved, the utility publishes a proposed tariff sheet. *See State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 276 S.W.3d 303, 305 (Mo. App. W.D. 2008). "A tariff is a document which lists a public utility[']s services and the rates for those services." *State ex rel. Mo. Gas Energy v. Pub. Serv. Comm'n*, 210 S.W.3d 330, 337 (Mo. App. W.D. 2006) (quoting *Bauer v. Sw. Bell Tele. Co.*, 958 S.W.2d 568, 570 (Mo. App. E.D. 1997)). The PSC reviews the proposed tariff sheets to determine whether the proposed tariffs comply with the order approving the new rate. *See Mo. Gas Energy*, 210 S.W.3d at 337. Only after the PSC's review and approval do the proposed tariffs take effect. *See* 4 CSR 240–3.010(28).

"In the context of cases before the [PSC], the terms 'tariff' and 'rate schedule' are synonymous." *State ex rel. AG Processing, Inc. v. Pub. Serv. Comm'n*, 311 S.W.3d 361, 364 n.3 (Mo. App. W.D. 2010). In practice, it is common in a rate case for the PSC to approve a new rate in an initial report and order with findings of fact and conclusions of law, and then to issue one or more subsequent orders approving the proposed tariff sheets that implement the previously approved rate change. *See, e.g., State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm'n*, 236 S.W.3d 632, 634–35 (Mo. banc 2007); *AG Processing, Inc.*, 276 S.W.3d at 305.

In re KCP & L Greater Mo. Operations Co., 408 S.W.3d at 178.

When are the new rates and charges "established"? We think it is clear that "new rates and charges" are established for a public utility in the contested case, after a formal hearing, and set by the PSC's Report and Order. The PSC is charged with adopting rules to govern its own hearing procedures. Section 386.410. The record in a formal hearing stands as submitted for consideration by the PSC after the recording of all the evidence or, if applicable, the filing of briefs and oral argument. *See* 4 CSR 240.2.150(1). The Report

and Order is the culmination of the PSC's formal hearing wherein interested parties are provided the opportunity to conduct discovery, submit and question evidence, and present their case before the PSC. The Report and Order then establishes the new rates and charges that the utility then implements by filing new tariffs. Subsequent orders from the PSC, such as the Compliance Tariff Order, merely assure that the subsequent tariffs submitted by a utility comply with the substantive findings in the PSC's Report and Order. *See e.g., State ex rel. Aquila, Inc. v. Pub. Serv. Comm'n*, 326 S.W.3d 20, 25 (Mo. App. W.D. 2010) (orders issued subsequent to the Report and Order merely determined whether the utility complied with the mandates and substantive standards adopted by the PSC in its Report and Order).

After the PSC issues its Report and Order, there is no longer a contested case. Chapter 386 governs the procedures before the PSC. The Missouri Administrative Practices Act ("MAPA"), Chapter 536, applies to proceedings before the PSC where there is a procedural gap in Chapter 386. *See State ex rel. Noranda Aluminum, Inc.*, 24 S.W.3d at 244-45; *State ex rel. Coffman v. Pub. Serv. Comm'n*, 121 S.W.3d 534, 539 (Mo. App. W.D. 2003) (*overruled on other grounds*)⁷. Chapter 386 does not discuss the distinction between a contested and noncontested case, so instead we turn to MAPA. *State ex rel. Coffman*, 121 S.W.3d at 539. "Normally, determining whether a case is contested or noncontested is of crucial importance because it determines not only the procedural

⁷ *State ex rel. Coffman* repeatedly refers to Chapter 368, which is a chapter pertaining to loan and investment companies. However, *Coffman* repeatedly refers to *Noranda*, which in fact discusses the application of MAPA to the PSC and Chapter 386. It appears that the references to Chapter 368 in *Coffman* are a mistake and were intended to refer to Chapter 386.

requirements that the administrative proceeding must satisfy but also the type and extent of review which the circuit and appellate courts may employ." *Id.*

The answer to whether a matter before the PSC is contested or noncontested depends on the answer to a single question: Is the PSC required by law to hold a hearing? If the answer is yes, then the matter is a contested case. *Id.*; *see also* Section 536.010(4). The requirement to hold a hearing can be imposed expressly by statute or ordinance. *State ex rel. Coffman*, 121 S.W.3d at 539. The requirement to hold a hearing may also be imposed by due process principles where, for example, the agency decision "concerns a protected property interest." *Id.*; *see also State ex rel. Yarber v. McHenry*, 915 S.W.2d 325, 328 (Mo. banc 1995). A "hearing" under MAPA has been interpreted to mean a proceeding in which "a measure of procedural formality is followed." *City of Valley Park v. Armstrong*, 273 S.W.3d 504, 507 (Mo. banc 2009). Such formalities in a contested case generally include notice of the issues, oral evidence taken upon oath or affirmation and cross-examination of witnesses, the making of a record, adherence to evidentiary rules, and written decisions including findings of fact and conclusions of law. *Id.* (citing *Hagely v. Bd. of Educ. of Webster Groves Sch. Dist.*, 841 S.W.2d 663, 668 (Mo. banc 1992)).

Pursuant to statute and the PSC's adopted rules, the PSC may suspend filed tariffs to conduct full rate case proceedings. *See* Section 393.150.1. The rules of procedure for those hearings are set forth in Chapter 386 and also in rules adopted by the PSC pursuant to section 386.410. Those rules include provisions regarding service upon parties, 4 CSR 240-2.080, rules regarding discovery, 4 CSR 240-2.090, and rules regarding the presentation of evidence, 4 CSR 240-2.130. Pursuant to 4 CSR 240-2.150(1), "[t]he record

of a case shall stand submitted for consideration by the commission after the recording of all evidence or, if applicable, after the filing of briefs or the presentation of oral argument." Thereafter, the PSC's order must be in writing and issued as soon as practicable after the record has been submitted, stating its conclusions. 4 CSR 240-2.150.2. Since the case at this point is a contested case and Chapter 386 does not specify what would constitute adequate findings of fact, Missouri courts have applied MAPA, which requires that

[e]very decision and order in a contested case shall be in writing, and except in default cases or cases disposed of by stipulation, consent order or agreed settlement, the decision, including orders refusing licenses, shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

State ex rel. Pub. Counsel, 274 S.W.3d at 576 (quoting Section 536.090).

After the record of the case is submitted and the PSC issues its final report and order, the procedural protections afforded rate case proceedings expire. After the PSC issues its final report and order, the only right afforded the parties is the right to seek rehearing. *See* Section 386.500; 4 CSR 240-2.160. The PSC need only grant a rehearing "if in its judgment" there is a "sufficient reason therefor [. . .]" Section 386.500. MECG has identified no requirement by statute or rule that after the close of evidence and after the PSC issues its final Report and Order, that each subsequent order issued by the PSC to ensure compliance with its substantive findings in the Report and Order must be preceded by a hearing. The contested case at that point is closed. In this case, MECG requested a hearing when it filed its objections to the proposed compliance tariffs and affidavits in support thereof, which was denied by the PSC. We see no statute or rule that would require

new contested proceedings to consider a challenge to new tariffs filed pursuant to the PSC's Report and Order.

This result aligns with the "file and suspend" procedure adopted by the PSC and utilized in this case, in which the PSC is granted the discretion, in the first instance, to decide whether to approve a filed tariff without a formal hearing. *See* Sections 393.150.1 and 393.140(11); *State ex rel. Coffman*, 121 S.W.3d at 541 (review of PSC's decision to approve a tariff under a file and suspend case is for abuse of discretion). Here, the initial tariffs filed by KCPL were suspended so that a formal hearing on the issues could be conducted. The hearing was conducted, which resulted in the final Report and Order, at which point the contested case closed. The PSC in its Report and Order rejected KCPL's tariffs and ordered KCPL to file new tariffs complying with the Report and Order. The Report and Order provided the other parties an opportunity to comment upon the compliance tariff sheets for the benefit of the PSC's deliberations, but, at that point, no party had a *right* to a hearing before the PSC decided whether the compliance tariffs actually complied with the Report and Order.

Having established that no rule or statute required a hearing prior to the Compliance Tariff Order, the next issue is whether due process requires a hearing. *State ex rel. Coffman*, 121 S.W.3d at 539. This issue has been settled that "there is no protected property interest in a particular utility rate." *Id.*; *State ex rel. Jackson Cty. v. Pub. Serv. Comm'n* 532 S.W.2d 20, 31 (Mo. banc 1975). As there is no protected property interest in utility rate, due process does not require a hearing. *State ex rel. Coffman*, 121 S.W.3d at 539. Therefore, we find that the PSC is not required to hold a hearing prior to issuing subsequent

orders implementing compliance tariffs to ensure they conform to the substantive findings and conclusions reached in the Report and Order.⁸

Accordingly, pursuant to MAPA, subsequent orders issued by the PSC to ensure compliance with its Report and Order are orders issued in a noncontested case. Orders in a noncontested case are not subject to reasonableness review as the PSC is not required to issue findings of fact. *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n*, 210 S.W.3d 344, 354-55 (Mo. App. W.D. 2006); *see also In re KCP & L Greater Mo. Operations Co.*, 408 S.W.3d at 190 n.19 ("an order approving tariffs is not the type of PSC order that contains findings of fact, an element essential to a review of reasonableness; therefore, generally, reasonableness is not a proper basis to challenge an order approving tariffs.") As there are extensive procedural protections in place in Chapter 386 to govern the establishment of rates, we think it is reasonable to conclude that subsequent orders issued in an uncontested case to implement the findings of the contested case cannot be said to "establish" rates.

Further, by its very terms, section 386.520.2 only applies in instances where there is an unappealable judicial decision that has determined that the PSC's order "unlawfully or unreasonably decided an issue or issues *in a manner affecting rates*" (emphasis added). As explained above, MECG did not challenge the September 2 Report and Order establishing KCPL's rates. MECG only argues on appeal that the PSC erred in the process

⁸ The parties have not identified any cases directly addressing the specific issue of whether orders issued to implement the findings of the Report and Order are orders in a contested case or a noncontested case. This Court in the past has treated such orders as noncontested. In *State Public Service Commission v. Missouri Gas Energy*, this Court treated such an order as being entered in a noncontested case, as that was the PSC's finding and that finding was not challenged on appeal. 395 S.W.3d 540, 544 (Mo. App. W.D. 2013). Other cases have also suggested, although not directly addressed, that these orders arise out of a noncontested case. *See In re KCP&L Greater Mo. Operations Co.*, 408 S.W.3d at 190 n.19 (compliance tariff orders are generally not orders that require findings of fact and not subject to reasonableness review).

and procedure afforded to MECG to review and challenge the compliance tariff orders. MECG has not even challenged on appeal the substantive finding by the PSC that the Compliance Tariff Order does comply with the Report and Order. Even if we were to find that the process and procedure followed by the PSC was deficient, there would not be a finding by this Court that the PSC had decided an issue unlawfully or unreasonably in a manner affecting rates.

The Report and Order of the PSC is the culmination of the hearing required by law and is the order of the PSC establishing new rates or charges for public utilities. Subsequent orders by the PSC ensuring compliance with the Report and Order are orders issued in a non-contested case merely implementing the previous decision of the PSC. As such, we find that Section 386.520.2 is inapplicable to MECG's challenge to the Compliance Tariff Order. Pursuant to the filed rate doctrine, this Court cannot provide any meaningful relief even if MECG's appeal were meritorious.

Even if an appeal is moot, we may exercise our discretion to consider an appeal if one of two narrow exceptions are met. *State ex rel. Mo. Energy Dev. Ass'n v. Pub. Serv. Comm'n*, 386 S.W.3d 165, 176 (Mo. App. W.D. 2012).

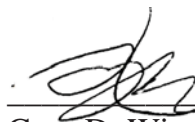
First, the issue may be considered if the case becomes moot after it has been argued and submitted. Additionally, the issue may be considered if it is one of general public interest and importance, recurring in nature and will otherwise evade appellate review unless the court exercises its discretionary jurisdiction.

Id. (internal citations omitted). The first exception is not applicable here as the case became moot prior to argument and submission.

The question, therefore, is whether the issues presented by MECG are ones of general public interest and importance, recurring in nature and would otherwise evade appellate review. We find that that MECG's appeal and the issues presented therein are not the type that are likely to evade appellate review. This Court has in fact considered other cases in which parties have challenged the process and procedure used by the PSC to approve compliance tariffs. *See e.g., State ex rel. Office of the Pub. Counsel v. Pub. Serv. Comm'n*, 409 S.W.3d 522 (Mo. App. W.D. 2013) (granting writ of mandamus upon finding that PSC order approving compliance tariffs did not provide a reasonable time for review under Section 386.490.1). We find that the issues raised by MECG are not likely to evade appellate review and we decline to exercise our discretion to consider MECG's moot appeal.

Conclusion

The decision of the PSC is affirmed and MECG's appeal is dismissed as moot.



Gary D. Witt, Judge

All concur