BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City	**)**	
Power & Light Company's Request	**)**	**<u>Case No. ER-2014-0370</u>**
for Authority to Implement a General	**)**	
Rate Increase for Electric Service	**)**	

REPLY BRIEF OF MISSOURI INDUSTRIAL ENERGY CONSUMERS

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Come now, the Missouri Industrial Energy Consumers ("MIEC"), and for their reply brief state as follows:

I. RETURN ON EQUITY

A. Introduction.

In support of its argument that its authorized return on equity ("ROE") should be increased by the Commission in this case, KCPL notes that the effects of the Great Recession have started to abate, and major economic trends show substantial improvement over the last time the Commission set KCPL's rate of return. KCPL also states that the ROE set in this case should permit it to continue to attract investors while reflecting the concerns and interests of its customers. It concludes that the Commission must strike the appropriate balance among the recommendations presented to it by four experts in the context of economic data and capital cost trends.[1]

MIEC agrees with KCPL's conclusion that the Commission should balance the interests of shareholders and customers by reflecting current capital market costs, and economic trends in determining the appropriate ROE in this case. However, the Commission should carefully consider the accuracy of the representations of market and economic data, and make an informed

[1] KCPL Initial Brief 1-3.

determination based on these factors. KCPL's assessment of these factors is not accurate, but instead, generally reflects a biased view of market and economic data, as explained below.

The competent and verifiable evidence of market and economic data presented by all four witnesses in this proceeding clearly demonstrates that KCPL's current cost of equity falls in the range of 9.0% to 9.5%.

B. KCPL's Estimate of the Cost of Equity is Not Supported by Competent and Substantial Evidence.

At the outset of its brief,[2] KCPL focuses on the spread of the parties' ROE recommendations in its last rate case, and compares these recommendations to the ROE authorized in that case. KCPL then notes that when the low end of KCPL witness Hevert's recommended range is averaged with the combined average of the high end of the non-KCPL experts' recommended ranges the result is an ROE of 9.75%. But no expert in this case arrived at an ROE recommendation using this approach, so this theory was not tested by experts in this case or subject to cross-examination. If KCPL had offered this methodology in the record, MIEC could have illustrated why the methodology set out in KCPL's brief does not produce a reliable estimate of the company's cost of capital. Under this "average spread" approach, the Company's recommendation is given the same weight as the combined high-end average of all other witnesses, without any consideration of whether the Company's recommendation is unreasonably inflated. Instead, the Commission's finding of a reasonable and balanced ROE in all rate cases should be based on the facts in that case, and assessment by experts.

Citing Exhibit 139,[3] KCPL asserts that 9.75% is very close to the average ROE authorized in the second quarter of 2015 and the average of all ROEs during 2014 of 9.88%.

[2] KCPL Initial Brief 2.
[3] Id.

KCPL's argument is misleading. KCPL filed Exhibit 139 in June of 2015, when second quarter 2015 data was not yet available. Hence, the only accurate information included in KCPL's Exhibit 139 is the first quarter of 2015, which shows integrated utility companies' average authorized ROEs of 9.64%, and which is approximately 14 basis points lower than the average ROE from the first quarter of 2014 (9.86%) for vertically integrated utilities.

The average authorized ROEs in 2014 are also lower than the average ROEs awarded over the last several years.[4] MIEC's recommended range of 8.8% to 9.4% provides the Commission with a recommended ROE that is squarely in line with authorized ROEs for electric utilities around the country, albeit slightly lower than that average, which is consistent with the downward trend in authorized ROEs.

KCPL makes some unsupported arguments concerning the studies performed by the non-Company ROE witnesses in this proceeding, including some erroneous conclusions related to certain low-end estimates which did not find their way into the witnesses' recommended ROE range for KCPL.[5] For example, KCPL cites MIEC witness Gorman's low-end estimates in the range of 8.34% to 8.48% for his DCF studies, 7.39% for risk premium, and 8.27% for his capital asset pricing model ("CAPM"). However, what KCPL fails to mention is that the ROE estimates it has highlighted were not used by Mr. Gorman to form his recommended ROE range. Mr. Gorman's recommended range was 8.8% to 9.4%.[6] The low-end of his recommended range is considerably higher than all these low-end estimates that are criticized by KCPL. Similarly,

[4] Gorman Schedule MPG-12, Ex. 550.

[5] KCPL Initial Brief 2-3.

[6] Gorman Direct at 2, Ex. 550.

KCPL criticizes certain low-end estimates made by Staff that ultimately were not reflected by Staff in forming its recommended range of 9.0% to 9.5%.[7]

It would have been equally disingenuous for other parties to have highlighted Mr. Hevert's high-end estimates that are unreasonable and unlawful to the extent they result in excess and unjust prices to retail customers. Specifically, Mr. Hevert made findings of ROEs of 12.09% and 11.84%.[8] These estimates are clearly excessive and would result in unlawful monopolistic pricing if adopted. Unlike KCPL, however, MIEC recognizes that Mr. Hevert did not expand his recommended range to include these extraordinarily high ROE estimates. This demonstrates the unreasonableness of KCPL's arguments.

KCPL outlines the recommendations of its witness Mr. Hevert in Paragraphs 17-27 of its brief. Curiously, the Company's arguments seem to suggest that a fair ROE would be something closer to 9.75%, rather than the 10.0% to 10.6% with a recommended point estimate of 10.3% made by its witness Mr. Hevert. This indicates that even KCPL does not find Mr. Hevert's recommended range to be credible.

For the reasons outlined in MIEC's Initial Brief,[9] Mr. Hevert's analysis is biased and skewed to inflate a fair ROE for KCPL. His constant growth DCF analysis was biased because he relied on only the highest growth rates from several data sources in order to find a way to produce a high constant growth DCF study. A more balanced assessment of his constant growth DCF analysis showed that an ROE in the area of 9.05% is more reasonable.[10] His multi-stage DCF model was inflated because he did not rely on independent market participants' projections of future GDP growth as a long-term sustainable growth rate. Instead, Mr. Hevert produced his

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[7] Staff Initial Brief 6.
[8] Schedule RBH-5, page 1, Ex. 115.
[9] MIEC Initial Brief 1-12.
[10] Gorman Rebuttal, Ex. 551, p. 10, l. 13 – p. 11, l. 13.

own GDP growth rate forecast, which cannot be found anywhere except in his rate of return testimony, and therefore is not reflective of investor outlooks. Indeed, Mr. Hevert's GDP growth forecast is substantially higher than independent consensus market participants, and almost certainly overstates investor outlooks, which are highly relevant in the determination of the cost of capital.

Mr. Hevert's multi-stage growth DCF analysis is also biased because he made assumptions concerning payout ratios, which had the effect of inflating dividend growth during the transitional stage of his model. Correcting Mr. Hevert's multi-stage growth DCF analysis would produce a return in the range of 8.74% to 8.82%.[11]

Mr. Hevert's CAPM return estimate is also inflated because he projected a return on the market that is far too high to be a rational outlook for investments in the U.S. stock market. Correcting the overstatement of the projected market return, and the resulting market risk premium, lowers his CAPM return to around 8.8%.[12]

Finally, Mr. Hevert also produced a risk premium study that increases an equity risk premium based on reductions only in nominal interest rates. This is incorrect. Equity risk premiums will increase or decrease based on relative differences in the investment risk of equity versus bond securities. Changes in nominal interest rates constitute one risk factor, but it is not the only risk factor that changes this relationship. Correcting Mr. Hevert's inexact and flawed inverse relationship based equity risk premium model would reduce his ROE estimate to 8.14%.[13] In sum, correct applications with reasonable input, rational outlook and correct market

[11] *Id.*, p. 16, ll. 1-11.
[12] *Id.*, p. 19, ll. 1-7.
[13] *Id.*, p. 21, ll. 13-16.

relationships would change Mr. Hevert's ROE analyses to suggest that a fair ROE for KCPL in this proceeding is in the range of 8.7% to 9.1%.[14]

C. <u>KCPL's Criticism of MIEC Witness Gorman's Recommendation is Not Well-Founded.</u>

KCPL relies on an erroneous argument raised by its witness Mr. Hevert concerning the methodology used by Mr. Gorman in developing his ROE recommendation.[15] In his testimony, Mr. Hevert alleged that Mr. Gorman applied specific weights to his DCF, risk premium and CAPM studies to arrive at his recommended midpoint estimate for the ROE. Mr. Gorman explained that that was not correct. Instead, Mr. Gorman completed his analyses in an unbiased manner, reviewed industry data concerning the utility access to equity capital and debt capital and credit analysts' comments on the utility industry related to the risk and access to capital, and also made an assessment of KCPL's specific risk factors in interpreting the results of his studies.[16].

All of this information, along with Mr. Gorman's extensive experience in measuring utilities' rates of return are the basis for his conclusions for each of his model results, which he then used to form a recommended ROE range. Mr. Hevert's attempt to create some sort of simplistic mathematical relationship diminishes the significant information, analysis and detailed work that went into Mr. Gorman's study and recommended return.

KCPL argues that MIEC's recommended ROE of 9.1%, which is the midpoint of Mr. Gorman's recommended range of 8.80% to 9.40%, is below the returns authorized by the least supportive regulatory commissions. Moreover, it asserts that a recognition of the recent growth in the economy and increasing utility bond yields and declining utility stock prices would

[14] *Id*., p. 8, Table 1.
[15] KCPL Initial Brief 14.
[16] Tr. p. 302, l. 13 – p. 303, l. 8.

produce a higher ROE than the recommendation reached by Mr. Gorman when he originally did his study.[17] In support of this assertion, KCPL points to Mr. Gorman's recommendation for Ameren Illinois of 9.25%.

MIEC does not dispute that stock prices have come down and utility dividend yields have gone up slightly. However, the impact of those changes on Mr. Gorman's recommended ROE is only around 15 basis points. That is, Mr. Gorman's recommended ROE for Ameren Illinois was 9.25%, versus his recommendation of 9.1% in this case. And, contrary to KCPL's statements, Ameren Illinois is a combination electric and gas utility similar to Ameren Missouri. While the case cited by KCPL is a natural gas rate case, Ameren Illinois is not a gas-only utility as KCPL incorrectly implies.

KCPL notes that MIEC witness Gorman used standard methods in DCF and CAPM analyses, but incorrectly alleges that those methods contradict each other.[18] In support of this assertion, KCPL states that Gorman produced a CAPM study that adjusted abnormal expansion in price-to-earnings ("P/E") ratios in determining an appropriate market risk premium. According to KCPL, this resulted in a reduction to the CAPM estimate. On the other hand, KCPL asserts that Gorman's DCF estimates reflect unusually high P/E ratios and low growth rates that he accepted without question, which resulted in low DCF return estimates. This, KCPL concludes, results in a contradiction between his CAPM and DCF studies. However, KCPL's arguments do not accurately describe Mr. Gorman's CAPM study.

Mr. Gorman did reference Morningstar's market risk premium of 6.1%[19] that was reduced because of a temporary expansion of the P/E ratio. However, contrary to KCPL's

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[17] *Id*.
[18] *Id*. at 15.
[19] Gorman Direct, Ex. 550 at 38.

assertions, Mr. Gorman did not rely on this market risk premium. Instead, Mr. Gorman relied on Morningstar's[20] high-end of the market risk premium of 7.6% in forming his high-end market risk premium estimate. This market risk premium was not adjusted by the temporary P/E expansion. For his low-end CAPM return estimate, Mr. Gorman used a market risk premium estimate of 6.2%, which was based on the difference between the total return of the market less the total return in Treasury bonds.[21] Again, this market risk premium was not adjusted by the temporary P/E expansion.

The market risk premium cited by KCPL that was reduced by the temporary P/E ratio expansion fell below the range of market risk premiums used by Mr. Gorman in his recommended CAPM range. Further, Mr. Gorman also applied judgment and gave more weight to the high-end market risk CAPM return estimate based on his high-end market risk premium, again refuting the legitimacy of KCPL's false arguments that Mr. Gorman relied on a market risk premium that was reduced because of a temporary expansion of the market P/E ratio. KCPL's arguments are simply erroneous, and ignore the fact that Mr. Gorman took a conservative approach in applying his expertise in this case by excluding unreasonably low ROE estimates.

KCPL's focus on the supposed temporary expansion in the P/E ratio for the utility industry is also misleading. The P/E ratios of utility stocks have increased more recently, in conjunction with the decline in the utility bond yields. This buildup of utility stock prices is precisely why utility capital costs are very low today. The value of utility bond securities is also enhanced by investors' recognition of a significant decline in utility bond yields currently, which has existed for at least the last five years.[22]

[20] *Id*. at 36, ll. 7-13.
[21] *Id*., ll. 14-20.
[22] Gorman Direct, Ex. 550, Schedule MPG-13.

KCPL's argument that the increase in the utility industry P/E ratio is a temporary phenomenon has no basis in fact. The P/E ratio is high relative to historical levels, but so are stock yields, and observable and verifiable utility bond yields are very low. This observable market evidence proves that utility capital costs are very low in this market. The Company's P/E ratio arguments are simply erroneous and an attempt to convince the Commission to ignore observable market evidence that shows that utility capital costs are currently very low.

KCPL argues that while ROE calculations require the exercise of judgment and discretion, Mr. Gorman has used his judgment to continuously lower his ROE recommendations.[23] The Company cites no evidence to support this assertion. A review of the record in this case shows that this assertion is erroneous. Mr. Gorman's recommended ROE in this case is a range of 8.8% to 9.4%. The low-end of that range is his *highest* DCF return estimate. If Mr. Gorman exercised judgment to lower the ROE, he would not have reduced the low-end of his recommended range. Further, in interpreting his risk premium studies, Mr. Gorman provided the greatest consideration to the high-end risk premium estimates. Again, this is not consistent with KCPL's false claim that Mr. Gorman used his judgment to reduce his ROE recommendation. A fair ROE should be based on competent assessments of market conditions, capital market costs and investor expectations – not unwarranted personal attacks on the expert witnesses in this case. KCPL's argument here is simply factually deficient and based on a false assertion.

KCPL's comparison of Mr. Gorman's recommendation to that of Staff does not support its contention that Mr. Gorman's ROE recommendation has been driven downward.[24] Indeed, Staff's ROE recommendation in this case is much higher than its recommendation in the last

[23] KCPL Initial Brief 16.
[24] *Id*.

case.[25] Staff's ROE recommendations have now increased to the level that is more in line with Mr. Gorman's recommendations. Mr. Gorman's recommendations have consistently been relied on by this Commission in past cases, and have successfully supported Missouri utilities' ability to attract capital to fund large capital programs. Thus it appears Staff is exercising good judgment in modifying its ROE recommendation to a point estimate that has proven to meet the standards of fair compensation and support the financial integrity of the utility and provide the utility access to capital under reasonable terms and conditions. On the other hand, as in past cases, the Company's position reflects an inflated ROE, which is imbalanced and would not result in just and reasonable rates.

D. Conclusion.

As explained above, the competent and verifiable evidence of market and economic data presented by all four witnesses in this proceeding clearly demonstrates that KCPL's current cost of equity falls in the range of 9.0% to 9.5%. This Commission should adopt the recommendation of MIEC witness Gorman, and authorize an ROE of 9.1% for KCPL in this case.

II. FUEL ADJUSTMENT CLAUSE

A. KCPL's Fuel Adjustment Clause Request Violates the Stipulation and Agreement form Case No. EO-2005-0329, and Should Be Rejected.

On June 10, 2015, the MIEC filed its Motion to Strike Pleadings, Reject Tariff Sheets and Strike Testimony, all relating to KCPL's request, made prior to June 1, 2015 to implement an FAC. Therein, MIEC made the same arguments that it made in its initial brief. Those arguments are:

> (1) that paragraph III.B.1.c. of the Agreement evidences that, "**in exchange for**" KCPL's agreement that prior to June 1, 2015, it would "not to seek to utilize" any mechanism authorized by section 386.266, RSMo, including an

[25] Staff Initial Brief 2.

> FAC, the Signatory Parties would not to object to any IEC sought ***prior to*** June 1, 2015, if the IEC complied with the six requirements listed in the Agreement;
>
> (2) that if the Agreement is read to allow KCPL to seek an FAC prior to June 1, 2015 so long as the FAC is not effective until after June 1, 2015 (as advocated by KCPL), then there is no mutuality of consideration with respect to these two provisions, and this construction would be inconsistent with any reasonable intent of the parties;
>
> (3) that clearly the intent expressed in the plain language of the Agreement is that in any rate case filed prior to June 1, 2015, KCPL would be prohibited from seeking an FAC but permitted to seek an IEC;
>
> (4) that under KCPL's incorrect reading of the Agreement, KCPL could request ***both*** an IEC and an FAC in any rate case filed before June 1, 2015, so long as the effective date of the FAC were on or after June 1, 2015.

KCPL's Initial Brief fails to address most of these arguments. Rather, KCPL reads the word "seek" from "seek to utilize" out of the Stipulation. The most apt definition of seek is "to ask for: REQUEST <--s advice>."[26] This same definition appears in the dictionary cited by KCPL, the Merriam-Webster online dictionary. MIEC is unable to find the online definition offered by KCPL in its brief, namely "to try to get or achieve." In fact, the online dictionary definitions from the dictionary that KCPL cites are:

> 1. to resort to **:** go to
> 2 a**:** to go in search of **:** look for
> b**:** to try to discover
> 3 **:** to ask for **:** request <*seeks* advice>
> 4 **:** to try to acquire or gain **:** aim at <*seek* fame>
> 5 **:** to make an attempt **:** try **—**used with *to* and an infinitive <governments…*seek* to keep the bulk of their people contented — D. M. Potter>[27]

Therefore, "prior to June 1, 2015, [KCPL] will not seek to utilize [an FAC]" means that "prior to June 1, 2015, [KCPL] will not [request] to utilize [an FAC]." Here, well prior to June 1, 2015, KCPL did in fact request to use an FAC. That violates the clear intent evidenced by the

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[26] Merriam Webster's Collegiate Dictionary 1057 (10th ed. 1997).

[27] www.merriam-webster.com/dictionary/seek.

words of the Stipulation. KCPL's interpretation also nullifies the "in exchange for" language and destroys the mutuality of consideration reasonably assumed in any agreement. That is because under KCPL's interpretation it could seek both an FAC and an IEC at the same time and have both in effect at the same time so long as it asked for both prior to June 1, 2015 and did not use the FAC until on or after June 1, 2015. KCPL should have sought an IEC in its rate case filed before June 1, 2015 as that was clearly what the Stipulation allowed.

KCPL argues that MIEC's construction reads the words "to utilize" out of the Stipulation. But that is not the case.[28] The action sought here is the utilization, or use, of an FAC. Listing the action sought is not inconsistent with the MIEC's plain reading of the Stipulation. The Stipulation provides that "prior to June 1, 2015, [KCPL] will not seek to utilize [an FAC.]" Under MIEC's construction, KCPL may not seek, prior to June 1, 2015, to use an FAC. The law is clear that KCPL may not use an FAC until after the Commission approves such use. The law is equally clear that the Commission may not approve the use of an FAC unless the utility first "make[s] an application" for an FAC.[29] The triggering event under section 386.266 is the application, or "seek[ing]," of an FAC. The plain language of the Stipulation is consistent with section 386.266.1. The Stipulation does not provide that KCPL shall not seek to use, prior to June 1, 2015, an FAC. The sentence structure of the Stipulation supports the MIEC's plain meaning construction of the words of the Stipulation.

[28] KCPL Initial Brief 38.

[29] Section 386.266.1 ("Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge").

C. <u>In the Event that KCPL is Granted an FAC Surcharge Tariff, the Cost to Transmit Self-Generated Power to Its Customers Should Not Be Included in that Surcharge Mechanism.</u>

As indicated in MIEC's Initial Brief, this issue is simple and straightforward. KCPL, however, whether by intention or not, confuses this issue. The issue is not whether KCPL should be allowed to recover SPP transmission costs. It can, just not between, or outside of, rate cases. The issue is also not whether participation in the SPP is prudent. And the question is not whether transmission costs are increasing. The question is whether the legislature has allowed this Commission to focus on this single issue, transmission costs, for ratemaking rather than considering "all relevant factors." The legislature has allowed this Commission to focus on the single issue of costs for fuel and purchased power or the transportation of the same. Section 386.266.1. But as this Commission has repeatedly found, the cost to transmit power that KCPL produces with its power-generation equipment to serve its load is not the cost to transport "purchased power." Because they are not costs of transporting purchased power, these costs must be recovered as most of KCPL's costs are recovered, namely by building them into base rates in a rate case. Even if the subject charges were "purchased power transportation" charges within the meaning of section 386.266, which they are not, this Commission still would have discretion to deny recovery of the charges through an FAC surcharge and it should rightly deny that discretion.

The record is clear that no investor-owned electric utility in Missouri is allowed to surcharge through an FAC its transmission costs for self-generated power.[30] To expert witness

[30] Testimony of Natelle Dietrich, Tr. 1648-1650.

Dauphinais' knowledge, no other state allows that treatment either.[31] Nor is any investor-owned electric utility in Missouri allowed a tracker for such costs.[32]

As the MIEC noted in its opening statement and in its Initial Brief, three times now this Commission has ruled that self-generated power is not "purchased power" for purposes of section 386.266. *See In re Kansas City Power & Light, Greater Missouri Operation*,[33] In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service,[34] and *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*.[35] Although KCPL knew that the MIEC and other parties rely on these cases, its Initial Brief fails to discuss them.

A plain reading of section 386.266.1 supports this Commission's above three decisions. If all power provided to ratepayers is "purchased power," as KCPL now claims, then why would section 386.266 even allow a surcharge for fuel costs since ratepayers would be served solely by purchased power? KCPL's current construction of the statute makes no sense. If KCPL's current construction were correct, the statute would have simply allowed a surcharge of all increases in purchased power costs and the costs to transmit purchased power. KCPL's Initial Brief fails to address these shortcomings in its analysis.

Rather than address section 386.266 head on, KCPL argues that its SPP transmission costs are significant and volatile. In doing so, it incorrectly argues that its SPP transmission costs are more significant and change faster than the same costs incurred by Ameren Missouri

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[31] Tr. 1776, ll. 8-16.
[32] Testimony of Natelle Dietrich, Tr. 1648-1650.
[33] Case No. ER-2010-0356, p. 218-219.
[34] Case No. ER-2014-0258 (Issued on April 29, 2015 and Effective on May 12, 2015) pp. 115-116.
[35] Case No. ER-2014-0351 (Issued on June 24, 2015 and Effective on July 24, 2015) pp. 25-28.

from MISO.[36] First, whether the charges are significant and volatile is not relevant if the charges are not authorized for single-issue ratemaking under section 386.266. They are not and this Commission has repeatedly so concluded. Second, the future transmission charges for KCPL, the ones governed by rates in this case, are not more, but rather less, significant and change at a slower rate than those for Ameren Missouri. Mr. Dauphinais noted that in his live testimony to this Commission. The graph shown on page 7 of Carlson Surrebuttal, Exhibit 108, conveniently includes periods 2006 through 2014 in an effort to demonstrate larger changes in transmission costs for KCPL compared to Ameren Missouri. In fact, however, for periods when new rates will be in effect, Ameren Missouri's transmission expenses will change more because KCPL is already past its biggest point of growth while Ameren Missouri is still facing its biggest point of growth. That KCPL is past its biggest point of growth is shown in Schedule TMR5 attached to the Direct testimony of Tim Rush, Ex. 134. From 2012 through 2014, that graph shows that KCPL's SPP transmission costs grew from approximately $13 million to approximately $35 million. By contrast, from 2015 through 2017, those costs are expected to increase a total of $7 million from approximately $48 million to approximately $55 million. Mr. Dauphinais explained during his cross examination that KCPL's testimony and charts on the topic were misleading because of the time frames covered by the charts:

> **Q. Now, Mr. Carlson at page 7 of his surrebuttal prepared a graph that compared KCPL's account 565 expenses to those of Ameren Missouri's. And I've got a copy of that. Do you remember reviewing that in your preparation?**
>
> A. Yes.
>
> **Q. Okay. And would you agree that based upon that chart, that KCPL's incurred expenses under Schedule 11 that are charged to account 565 are much more variable and indeed volatile compared to Ameren Missouri?**

[36] KCPL Initial Brief 50-51.

A. Well, there's a problem with this chart, and that is that it ends in 2014. If this -- if we took this chart and compared it to Mr. Rush's Schedule TMR-5 from his direct testimony, we'll see that the charges in account 565 are projected to grow less aggressively and actually generally level off over time. And then the other thing that's not shown by stopping at 2014 is what happens to Ameren Missouri's 565 charges after 2014. Those are going to significantly grow. What we have is a difference on when regional transmission projects, the concept of regional transmission projects was implemented by the RTOs. SPP had a head start over MISO and the introduction of regional transmission projects opened up new opportunities and that new opportunity caused a boom in new construction. So SPP, we see this boom in new construction and we see the quick rise in the transmission rate for SPP under Schedule 11. MISO got a later start and so Ameren's 565 charges are lagging. They're increased. So that is the issue with this table.

Q. Well, but you confirmed what Mr. Rush has said, which is that for the next three or four years, these costs are going to go up for KCPL until they flat; correct?

A. But less aggressively as we can see from Schedule TMR-5.

Q. And that goes through schedule -- that goes through the year 2019; correct? Those increases?

A. Those increase, yes, level off in 2019 and 2020.

Q. So we're here in June, July of 2015 and those are projected to increase at least for four more years?

A. Yes, but nowhere near as aggressively as they did between 2010 and 2015. Actually, I'll even say 2014.[37]

On redirect, Mr. Dauphinais explained this point further:

Q. Do you have an opinion, then, with regard to the graph that was included in Mr. Carlson's testimony, the graph that ends at 2014?

A. Yes. As I indicated earlier, it doesn't tell the complete story, and so I would refer the Commission to Mr. Rush's direct testimony as Schedule TMR-5. And this is a multi-color graph running from 2010 to 2025 with the -- with the actual charges shown from 2010 to 2013 and projected charges after that. And if you look at this chart after 2014 while there is growth through 2019, it levels off after 2019. And in addition, the level that will grow from 2014 to 2019 on a percentage

[37] Dauphinais cross, Tr. 1777-1779.

basis is much smaller than what occurs on 2010 through 2015. So the key is KCPL is past the biggest point of growth in these costs. There will be growth in the future, but they will not be as severe as what they've already gone through and they will level off. And this differs from, for example, Ameren Missouri's situation. Ameren Missouri's situation is such that the charges from 2015 to 2021 are going to increase by 185 percent. So much larger increase on a percentage basis.

Q. Now, you had indicated to Mr. Zobrist that SPP had a head start over MISO. Do you recall that discussion?

A. Yes.

Q. Is that head start reflected either in Mr. Rush's Schedule 5 or in the graph in Mr. Carlson's testimony?

A. The graph in Mr. Carlson's testimony is useful in that it shows the SPP charges are [ramping] up through 2014 very aggressively while the MISO ones haven't -- for Ameren Missouri [they] have not increased that much through 2014. But again, when we go from 2015 to 2021, MISO's forecast of which is sort of their version of Schedule 11 for SPP, those are projected to increase by 185 percent from $.58 per megawatt hour to $1.65 per megawatt hour.

Not only were KCPL's graphs misleading, the facts show that the transmission costs are not volatile. During Mr. Dauphinais' redirect, he was crystal clear on that point:

Q. Do you think that the transmission costs that we've been discussing this afternoon are volatile?

A. No, I do not believe they're volatile.

Q. And why not?

A. Because they're really not likely to change in a really extreme sudden. What we're seeing is sustained increases, very -- somewhat rapid increases in the early years but we're past those in the case of KCPL. But nevertheless, they are predicted and those forecasts of those future costs are updated on a periodic bases by SPP so we know they're coming. There's some variation, but that variation isn't large enough to be called volatile and that's what my coefficient of variance analysis showed, too.

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Q. Now, you, and I believe it was Mr. Carlson, had a disagreement or should I say you disagreed with the way Mr. Carlson calculated his COV?

A. Yes.

Q. Remember that?

A. Yes.

Q. And you had discussion of that in your surrebuttal?

A. Yes.

Q. Would you explain to the Commission why you believe his calculation was incorrect?

A. Yes. He essentially was looking at historical actual transmission costs without giving any consideration to the fact that it was already forecasted, that those transmission charges were going to increase over time. So instead of looking at how good the forecast was or how the forecast is moving around as we converged onto an actual value, he just simply looked at how the [values] were chang[ing] over time. That variance. And that's assuming there's never going to be a change in transmission costs and that's simply not the case because we knew these projects were coming.

Q**. And on page 5 of your surrebuttal testimony, you provide your recalculation of the coefficient of variance?**

A. Yes.

Q. Refer you to page line 16 through 19.

A. Yes.

Q. Would you tell the Commission what your calculation shows?

A. My calculation shows that the estimates for any given year, but just looking at the forecast and how they change, that the coefficient [of] variance numbers were much smaller than were calculated by Mr. Carlson. I had the highest number was 20 percent on the coefficient of variance and one was as low as 5 percent.

Q. How does that calculation of coefficient of variance relate to any kind of finding the Commission would make as to volatility?

A. That's a relative measure of volatility, so those numbers are much larger. For example, with the levels that say Mr. Carlson had, you can make a[n] argument that these costs are volatile. But again he didn't make the calculation correctly and these are much smaller numbers.

Were the Commission to grant KCPL an FAC, Mr. Dauphinais calculated which transmission costs were for the transportation of purchased power allowed by section 386.266:

> **Q. Okay. On Schedule 11, I mean, of these schedules, as far as Kansas City Power & Light is concerned, where is the real money at issue?**
>
> A. Oh, Schedule 11, it's the base plan operations which are recovered through Schedule 11.
>
> **Q. And did you recommend allowance if there is an FAC allowance of any of the Schedule 11 charges?**
>
> A. Yes. Actually, Schedule 11 is most of their account 565 expense, and so what I'm recommending is that -- that all but 92.7 percent of it, or 7.3 percent of it, would be recoverable in the FAC, if the Commission chooses to grant Kansas City Power & Light Company an FAC in this proceeding.

In summary, the facts, prior decisions of this Commission, and KCPL's own FERC filings demonstrate that it should not be allowed to surcharge transmission costs for power generated by its own generators and provided to its load. Mr. Dauphinais calculated the portion of transmission charges that should be excluded from surcharge (92.7%) and which portion should be allowed (7.3%).[38] The Commission should adopt those calculations in setting KCPL's Base Factor for the FAC and the terms and conditions of the FAC itself should this Commission conclude that an FAC is allowed at this time.[39]

D. <u>If the Commission Authorizes KCPL to Have a Fuel Adjustment Clause, How Many Different Voltage Levels of Service Should Be Recognized For Purposes of Applying Loss Factors?</u>

The requirement to recognize voltage level differences represents proper cost of service ratemaking. As Mr. Brubaker graphically demonstrated, there are cost differences between

[38] *Id.*, p. 11, l. 20 – p. 14, l. 11.

[39] Dauphinais Rebuttal, Ex. 557, p. 3, l. 19 – p. 48, l. 3.

customers taking service at transmission, substation, primary distribution and secondary distribution voltage levels. Exhibit 554, Brubaker Direct (Rate Design), page 7. "Additional investment and expenses are required to serve customers at secondary voltages, compared to the cost of serving customers at higher voltages." *Id.* at page 8. Customers that require service at lower voltage levels impose costs on the utility. For instance, customers that take service at substation voltage impose substation costs that are not required for customers taking service at transmission voltage. Similarly, customers taking service at distribution level voltage impose costs associated with varying degrees of line transformers. As Mr. Brubaker then recognizes, customers that need to take service at lower voltage levels impose more than just additional investment; each level of voltage transformation also increases the level of electric line losses. "Each additional transformation, thus, requires additional investment, additional expenses and ***results in some additional electrical losses.***" *Id.* at page 9 (emphasis added). These additional line losses are unquestioned and must be reflected in the voltage level line loss adjustment multipliers. As Mr. Brubaker demonstrates, line losses increase dramatically as voltage transformations occur:

Voltage Level Line Loss Adjustment Multipliers

Transmission 1.015651%
Substation 1.024828%
Primary 1.037072%
Secondary 1.061288%[40]

This fact, that voltage transformation results in line losses, should be recognized in proper ratemaking. For this reason, Commission Rule 4 CSR 240-3.161 requires a utility to provide "calculations supporting the voltage differentiation of the FAC collection rates, if any, to account for differences in line losses by voltage level of service." 4 CSR 240-3/161(7)(A)(3).

[40] Ex. 554, Brubaker Direct (Rate Design), Schedule MEB-COS-9.

While KCPL recognizes four different voltage levels for calculating base rates (secondary voltage; primary voltage; substation voltage and transmission level voltage), KCPL only proposes to recognize two (primary level and secondary level) voltage levels and line loss values for use in its fuel adjustment clause. Specifically, while transmission level and substation voltage customers impose significantly less line losses, KCPL inexplicably proposes to lump these customers in with the primary voltage customers for purposes of calculating the fuel adjustment charge.

The impact on the substation and voltage levels customers is obvious. "[C]harging substation customers the primary voltage level line loss factor would essentially overcharge them by 50% for losses (3.7072% versus the correct 2.4828%); and would overcharge transmission level customers by 140% for losses compared to what they should be charged (3.7072% instead of the correct 1.5651%)."[41] Given that proper ratemaking dictates that varying line losses be recognized, and the ready availability of such line loss data, Mr. Brubaker recommends that, in any case in which the Commission authorizes KCPL to utilize a fuel adjustment clause, KCPL should be required to "charge customers according to the four separate voltage levels at which delivery takes place, and not the two levels it has proposed in this case."

In the face of this evidence and common sense arguments, KCPL in its Initial Brief, merely devotes three and one half lines of "argument" to this issue, asserting that "the two voltage levels identified in KCPL's proposed FAC are sufficient to appropriately distinguish cost recovery" and that "[t]he proposal of MIEC witness Brubaker on page 35 of his rate design Direct Testimony (Ex. 554) should be rejected." KCPL Initial Brief, p. 58, citing Rush Rebuttal, Exhibit 135. The cited Rush Rebuttal is woefully short on analysis in support of his "close enough for government work" position:

[41] Brubaker Direct, Ex. 554, p 35.

> **Q: Does the company agree with MIEC witness Maurice Brubaker on page 35 of his rate design testimony that if a[n] FAC is approved for KCPL that the rates should be set at four voltage levels instead of two?**
>
> A: No. The Company believes that the two voltage levels identified in its proposed FAC are sufficient to appropriately distinguish the cost recovery.

To summarize, in the face of Mr. Brubaker's significant common sense testimony and supporting calculations of differing cost causation, KCPL's only response in both testimony and its brief is that two voltage levels are sufficient to appropriately distinguish the cost recovery. It offers no explanation or calculations to support that bald assertion and offers no explanation or calculations discrediting in any way Mr. Brubaker's calculations and analysis. This Commission should accept Mr. Brubaker's recommendation and set rates at four different voltage levels for purposes of an FAC should this Commission allow the same in spite of the Stipulation.

III. THERE IS NO AUTHORITY FOR THE TRACKERS THAT KCPL PROPOSES

During the evidentiary hearing in this case, MECG noted that, absent "extraordinary" costs, the Commission lacked statutory authority to implement KCPL's proposed trackers. In its Initial Brief, MECG noted that, in a review proceeding, the appellate court will seek <u>specific</u> statutory authority in order to determine if the Commission's decision is lawful.

> Since it is purely a creature of statute, ***<u>the Public Service Commission's powers are limited to those conferred by the above statutes, either expressly, or by clear implication as necessary to carry out the powers specifically granted</u>***. Thus, while these statutes are remedial in nature, and should be liberally construed in order to effectuate the purpose for which they were enacted, "neither convenience, expediency or necessity are proper matters for consideration in the determination of" whether or not an act of the commission is authorized by the statute.[42]

In its Initial Brief, KCPL attempts to rebut MECG's claims. Relying on the <u>general</u> powers conferred under Sections 393.140(4) and 393.140(8), KCPL argues that the Commission

[42] *Id.* at page 49 (citations omitted, emphasis added).

"has statutory authority to grant each of the trackers proposed by KCPL."[43] Noticeably, however, KCPL fails to provide any case law extending this general power to the specific relief now requested by KCPL.

KCPL's failure to provide any <u>specific</u> authority, statutory or otherwise, is not surprising given the fact that such authority does not exist. Specifically, while KCPL references Sections 393.140(4) and 393.140(8) as statutory authority, the limited case law interpreting these provisions indicate either: (1) that the general authority conveyed in these statutes does not provide for any specific statutory powers[44] or (2) that this statutory authority provides the power to defer costs, but only for an "extraordinary" event.[45]

In 1979, the Missouri Supreme Court considered the Commission's utilization of deferral accounting through the implementation of a fuel adjustment clause. In fulfilling its review of the Commission's decision, the Court sought to determine if the Commission had specific statutory authority for approving the deferral accounting represented by the fuel adjustment clause. In response to the Court's inquiry, the Commission, like KCPL today, pointed to Section 393.140 as authority for the fuel adjustment clause. Dealing a crushing blow to the Commission's argument there, and to KCPL's current argument, the Supreme Court found that Section 393.140 only provides general authority and does not provide any specific authority.

> Respondents, however, state that the statutes as a whole do support their power to utilize a fuel adjustment clause. *Section 393.130* generally sets out basic rules governing the giving of safe and adequate service by the utility, and prevents preferential rates being given one customer. <u>***Section 393.140 sets out the general powers of the commission***</u>. While this statute gives the PSC general supervisory power over electric utilities, as discussed *supra*, it gives the PSC broad discretion

[43] KCPL Initial Brief 24.

[44] *State ex rel. Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979) ("*UCCM*").

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

> only *within* the circumference of the powers conferred on it by the legislature; ***the provision cannot in itself give the PSC authority to change the rate making scheme set up by the legislature***.[46]

Thus, the Missouri Supreme Court has found that, contrary to KCPL's current claims, Section 393.140 fails to provide any specific statutory authority.

In 1993, the Missouri Court of Appeals considered the Commission's decision to allow for the limited use of deferral accounting for "extraordinary" events. There, the Commission held that the deferral of depreciation and carrying cost did not constitute retroactive ratemaking, as defined by UCCM court, because the costs were associated with an extraordinary event and were outside the current "match of revenues and expenses." As such, the Commission opined that deferral accounting for this "extraordinary" event was appropriate.

> The Commission does not consider the granting of the deferrals of extraordinary items either single-issue or retroactive ratemaking as argued by Public Counsel. Retroactive ratemaking occurs when rates are set to recover for past deficiencies or to refund past excesses. . . ***The deferrals approved in Case No. EO-91-358 do not constitute retroactive ratemaking since they involve items which have been found to be extraordinary and therefore outside the current period match of revenues and expenses***.[47]

On appeal, the Court of Appeals, interpreting both Sections 393.140(4) and 393.140(8), agreed that deferral accounting was appropriate, but only for an "extraordinary event."

> The Commission's decision to grant authority to defer the costs associated with the Sibley reconstruction and coal conversion projects by recording the costs in Account No. 186 was the result of the Commission's determination that the construction projects were unusual and nonrecurring, and therefore, extraordinary. . . . Because rates are set to recover continuing operating expenses plus a reasonable return on investment, only ***an extraordinary event*** should be permitted to adjust the balance to permit costs to be deferred for consideration in a later period.[48]

[46] *UCCM* at pp. 55-56.

[47] Case No. EO-91-358, *Report and Order*, issued December 20, 1991, 1 Mo.PSC 3d 200, 212-213.

[48] *Sibley* at p. 811.

As such, contrary to KCPL's claims that the Commission has broad authority to implement its requested trackers, such authority is either non-existent (Supreme Court's *UCCM* decision), or only exists for an "extraordinary event" (Missouri Court of Appeals' *Sibley* decision). Certainly, such limited authority cannot be stretched to include ordinary costs such as property taxes, transmission costs and cyber-security costs. Indeed, less than 12 months ago, the Commission held that transmission costs, since they are an ordinary expense, do not meet the Court's "extraordinary" standard.

> In Missouri, rates are normally established based off of a historic test year. The courts have stated than an AAO allows the deferral of a final decision on current *extraordinary* costs until a rate case and therefore is not retroactive ratemaking. Consistent with the language in General Instruction No. 7, the Commission has evaluated the transmission costs for which Companies seek an AAO to determine if they are an unusual and infrequent occurrence. The Commission concludes they are not.
>
> Companies began incurring transmission expenses when they began providing retail electric service. Transmission costs are part of the ordinary and normal costs of providing electric service and are expected to continue in the foreseeable future. Furthermore, while the transmission costs at issue may have a significant effect on Companies, they are not "abnormal and significantly different from the ordinary and typical activities" of the Companies. The increase in transmission costs was anticipated and is indeed the norm for all electric utility members of SPP. ***<u>Therefore, the transmission costs are not extraordinary</u>***.[49]

The Commission should make a similar determination regarding KCPL's proposed trackers in this case.

IV. THE CLASS COST OF SERVICE AND RATE DESIGN DETERMINATIONS SHOULD BE RESOLVED BY THE STIPULATION DATED JUNE 16, 2015

Although MIEC and Staff witnesses had disagreement over the approach to determining class cost of service, both Staff and MIEC agreed in a Non-Unanimous Stipulation and Agreement ("Stipulation") filed June 16, 2015, to an equal percentage allocation among classes of any rate increase ordered in this case, thus mooting their disagreement on class cost of service.

[49] Case No. EU-2014-0077, *Report and Order*, issued July 30, 2014, at page 10.

The only party to object to the Stipulation was KCPL and its objection did not reach the issues of the method for determining class cost of service. Moreover, the equal percent allocation is what KCPL proposed in its, filing, and what it continues to support. MIEC believes that the Non-Unanimous Stipulation and Agreement filed on June 16, 2015 is a fair and equitable resolution for all classes and customers. It represents the work and trade-offs of the numerous parties involved. The Non-Unanimous Stipulation and Agreement is reasonable. It does not award any party all they sought, but is a fair and equitable recommendation acceptable to all the parties except KCPL.

MIEC recommends that the Commission make no factual findings regarding the general suitability of any class cost-of-service study method over any other. The Non-Unanimous Stipulation and Agreement does not recommend that the Commission use any particular methodology, but instead that the Stipulation relied upon one or more of the submitted CCOS studies as achieving a reasonable allocation of production capacity costs and allocating net cost of service among the customer classes.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 3rd day of August, 2015, to all counsel of record.

*/s/ Edward F. Downey*______