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-2014-0370

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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The Office of the Public Counsel ("OPC" or "Public Counsel") offers the following brief on the contested issues caused by Kansas City Power & Light Company's ("KCPL" or "Company") October 30, 2014, rate case filing.

1. INTRODUCTION

A. Rate-Setting Standards

All rates charged by public utilities must be just and reasonable, authorized by law, and supported by competent and substantial evidence. § 393.150 RSMo; *Utility Consumers Council of Missouri v. P.S.C.,* 585 S.W.2d 41 (Mo. 1979). Accordingly, each issue resolved by the Commission must be reasonable, lawful and supported by the evidence. *Id.* When employing the reasonableness standard, the Commission must do so with the understanding that the primary purpose of the commission is to serve and protect ratepayers, while the protection given to the utility is merely incidental to the Commission's primary purpose. *Straube v. Bowling Green Gas Co.,* 227 S.W.2d 666, 669 (Mo. 1950). Stated another way, the company's rights "are subservient to the rights of the public." *Gulf Transport Co. v. P.S.C.,* 658 S.W.2d 448 (Mo. App. 1983). Moreover, protecting ratepayers requires the Commission to consider the *impact* that its rate decisions has upon ratepayers. *Office of the Public Counsel v. P.S.C*, 938 S.W.2d 339 (Mo.

Ct. App. 1997). Accordingly, the most critical considerations a commission makes when approving rate increases is the impact the increase will have upon ratepayers.

B. Public Policy Considerations Regarding Low-Income and Fixed-Income Ratepayers

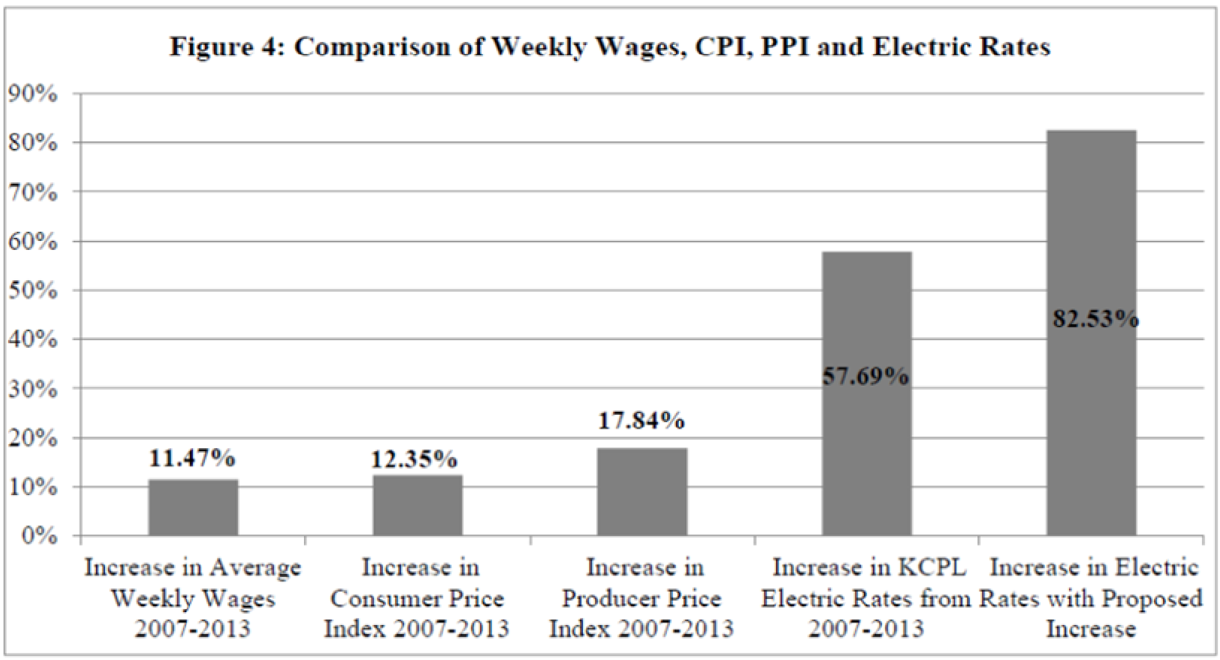
The financial struggles of a significant portion of KCPL's residential and small commercial customers, and the potential impacts resulting from this case, are public policy considerations the Commission must weigh when deciding this case. Protecting Missouri families and businesses from harm is unquestionably in the public interest.

According to the U.S. Census Bureau, nine (9) of the thirteen (13) counties in KCPL's service territory have a poverty rate that is higher than the Missouri average (Exhibit ("Ex") 301, p.18). Jackson County, the most populated county in KCPL's service territory, has a 17.2% poverty rate compared to the 15.8% Missouri average (*Id.*). Randolph and Pettis Counties, also in KCPL's service territory, have over twenty percent (20%) of residents living in poverty (*Id.*). These high poverty levels may be due in part to the 2007 recession, a conclusion supported by data from the National Association of Counties, which shows slow or non-existent recovery in KCPL's territory since the recession for the following indicators:

- Jobs Recovered: 2 out of 13 counties (7.05%)
- Unemployment Rate Recovered: 0 out of 13 counties (0.00%)
- GDP Recovered: 2 out of 13 counties (7.05%)
- Home Prices Recovered: 1 out of 13 counties (0.77%)

(Ex. 301, p.21). The long-lasting impacts of the recession are also shown by comparing the 2007-2013 weekly wage increase, Consumers Price Index (CPI) increase, and the Producer Price Index (PPI) increases, to the rate increases experienced by KCPL's customers in that same timeframe. As the table below shows, wage increases are already behind increases to the CPI or PPI, but the most drastic comparison is between the 11.47% increase in wage increases compared to the 57.69% increase in KCPL's rates since 2007, and the 82.53% increase in KCPL rates if KCPL's request is granted in full.

A large portion of KCPL's customers are not able to keep up with KCPL's rate increases – one out of every five KCPL residential customers have past due balances (Ex.301, p.23). The decisions the Commission makes in this case will determine, not if, but *how many* customers will be forced off the system, forced to go deeper into debt, or forced to forego important necessities such as medicine and proper nutrition.



(Ex.301, p.22). This evidence provides the Commission with unrefuted facts that a large portion of customers in KCPL's residential class would be harmed financially by any increase in their bills. Given these facts and the hardship rate increases cause ratepayers, any unnecessary rate increase should be denied, and likewise, any proposal that unnecessarily shifts financial risk from shareholders to ratepayers should also be denied as being contrary to the public interest.

C. Ratepayer Comments Help Determine the Public Interest

Comments made by ratepayers during the Commission's local public hearings provide the Commission with essential feedback from those that will ultimately pay for any rate increase approved by the Commission. To highlight a few comments on the issue of rate affordability, Ms. Atkins, a Kansas City area resident and Emergency Assistance Director at her church, testified that she sees firsthand the struggles of KCPL's low-income customers (Transcript (Tr.), p.19). Ms. Atkins provided an example of a disabled woman that receives only $887 per month of disability benefits, and to this customer, KCPL's rate increases are "a mountain to overcome" (*Id.*). Likewise, Ms. Norman in Kansas City testified that "when people are not making as much money net as they were ten years ago, and the utility companies are making considerably more money than they were. That's not fair…" (*Id.*, p. 30). Ms. Lee testified that rate increases create problems with the ability for senior citizens to afford much-needed medicines, and lead ratepayers to payday lenders and pawn shops to help pay their electric bill (*Id.,* pp.36-38). These outcomes are undeniably not in the public interest.

Many other KCPL customers, far more than typical for a rate case, offered comments complaining about KCPL's customer service. One KCPL customer raised issue with KCPL's insensitive policy of forcing widows off of budget billing for a year for no other reason than the passing of their husband (Tr., pp. 21-22). Another KCPL customer complained that KCPL installed substantial facilities in front of the customer's home despite there being locations that were far less intrusive upon which to locate the facilities (Tr., pp. 7-8). A number of other KCPL ratepayers complained of service disruption issues caused by a large user's demand – an issue that has plagued these customers with outages and damaging electrical surges for years (*Id.,* pp. 11, 16, 27 and 38). These complaints are indicative of a company that appears to have lost its focus on providing good customer service. Public Counsel asks the Commission to be mindful of these concerns and complaints as it decides the issues in this case.

C. KCPL has the Burden of Proof on All Issues

KCPL has the burden of proving, with competent and substantial evidence, that each and every cost included in rates, each and every rate design change, and each and every rate mechanism, and every other change requested by KCPL in this case is just and reasonable, lawful, and in the public interest. Section 393.150.2, RSMo; *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371 (Mo. 2013). There are two components to KCPL's burden of proof: "the burden of producing (or going forward with) evidence and the burden of persuasion." *Kinzenbaw v. Dir. of Revenue*, 62 S.W.3d 49, 53-54 (Mo. 2001). The burden of production is KCPL's "duty to introduce enough evidence on an issue to have the issue decided by" the Commission, and the burden of persuasion is KCPL's duty to convince the Commission to view the facts in a way that favors KCPL. *Id.* For each issue before the Commission, KCPL has the burden of *producing evidence* to support a finding that KCPL's proposed changes are just and reasonable, lawful and in the public interest; and likewise, KCPL has the burden of *persuading* the Commission of the same. *Id.* To satisfy its burden, KCPL's proposed changes must be "supported by competent and substantial evidence upon the whole record and [be] reasonable, or, as is sometimes conversely stated," KCPL's proposed changes cannot be supported by evidence that is "arbitrary or capricious or…against the overwhelming weight of the evidence." *State ex rel. State Highway Com. v. P.S.C.*, 471 S.W.2d 249 (Mo. 1971).

2. THE ISSUES

I. <u>Cost of Capital</u>

A. Return on Common Equity – What return on common equity should be used for determining rate of return?

The weight of the evidence before the Commission supports a return on common equity (ROE) for KCPL of 9.0% to 9.25%. Four experts offered evidence on ROE: Ms. Reno (9.0%), Mr. Gorman (9.1%), Mr. Marevangepo (9.25%), and Mr. Hevert (10.3%). As explained below, Mr. Hevert's recommendation consistently uses inflated estimates and growth rates to manipulate the outcome of his analysis to reach a desired result, and, therefore, is not reliable. Of the remaining recommendations, with a range of 9.0% to 9.25%, Public Counsel urges the Commission to authorize KCPL to earn no more than a 9.0% return on equity.

Quoting the U.S. Supreme Court in *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985), the Missouri Court of Appeals said:

> [T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' … Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which counts. [emphasis added]

It is clear that the Commission is not bound to apply any particular formula in the determination of a just and reasonable rate. The U.S. Supreme Court in *Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692 (1923), has provided guidance on what is a just and reasonable rate:

> What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts.

Similarly, the Missouri Supreme Court in *State ex rel. Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979), has determined that the appropriate level of rates must be determined based upon a consideration of all relevant factors. Section 393.270, RSMo., states that in determining the price to be charged for utility service, the Commission may consider all facts which in its judgment have any bearing upon a proper determination with regard to, among other things, a reasonable average return upon capital actually expended. The U.S. Supreme Court has provided guidance in *Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679, 692 (1923), on what is a just and reasonable rate of return for a regulated utility:

> A public utility 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. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.

The U.S. Supreme Court in Federal Power Commission v. Hope Natural Gas Company, 320 U.S. 591, 603 (1944), has further stated:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return

> to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital. [citations omitted]

On the issue of setting a return on equity, the Commission previously stated on page 15 of the Report & Order in Ameren Missouri's rate case, Case No. ER-2008-0318:

> Determining an appropriate return on equity is without a doubt the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, in determining a return on equity, the Commission must consider the expectations and requirements of investors when they choose to invest their money in AmerenUE rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate of return on equity that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive rate of return on equity that would drive up rates for AmerenUE's ratepayers. In order to obtain guidance about the appropriate rate of return on equity, the Commission considers the testimony of expert witnesses. [emphasis added]

With these statements, the Commission acknowledged the requirement that, in determining whether the rates proposed by KCPL are just and reasonable, the Commission must equally balance the interests of the investor and the consumer.

As stated above, four separate witnesses provided evidence on ROE. MIEC and MECG witness Mr. Michael P. Gorman's direct testimony includes a thorough analysis of ROE (Ex. 550). His analysis relied upon three models: the Discounted Cash Flow (DCF), the Risk Premium model, and the Capital Asset Pricing Model (CAPM). These models estimated KCPL's current market cost of equity to be 9.10%, based upon a DCF result of 8.60%, a Risk Premium result of 9.4%, and a CAPM result of 9.05% (Ex. 550, p. 39). Based upon these analyses, Mr. Gorman determined that the estimated ROE range to be 8.80% to 9.40%, with 9.10% as his midpoint and his recommendation (*Id.*). Mr. Gorman's range "reflects current market capital costs, increased interest rate risk in the current market due to Federal Reserve policies and other factors, and represents fair compensation to KCPL's investors for the total investment risk of it regulated utility" (*Id.*).

KCPL's cost of capital witness Mr. Robert Hevert recommends an ROE for KCPL of 10.3%, more than 100 basis points above the next highest ROE recommendation of 9.25% (Ex. 115). Mr. Hevert's testimony states that he determined his ROE recommendation based on his use of a Constant Growth DCF model, a Multi-Stage DCF model, a CAPM, and a Bond Yield Plus Risk Premium Approach (Ex. 115, pp. 15-29). However, when Mr. Hevert's estimates are corrected, his studies actually support an ROE of 9.05% (Ex. 551, p.8).

a. KCPL's Corrected Constant Growth DCF = 9.05%

ROE witness Mr. Gorman testified that Mr. Hevert's "constant growth DCF results are based on excessive and unsustainable long-term growth rates" (Ex. 551, p.6). Mr. Hevert uses an average growth rate of 6.81% for his 30, 90 and 180-day DCF results, whereas "the proxy group averages for First Call, *Value Line*, and Zacks are 5.29%, 5.35% and 5.89%, respectively" (Ex. 551, p.9). Mr. Hevert also uses 3-year to 5-year long-term growth rates that are "substantially higher than the consensus economists' long-term growth outlooks for the U.S. economy," evidenced by the fact that his 5.64% to 6.81% proxy group growth rates are considerably higher than the 4.4% to 4.47% growth rate for GDP growth in the U.S. general economy (Ex. 551, p.10). It is entirely unreasonable to expect the proxy companies to grow considerably faster than the economies in which they serve (*Id.*). "Hence, Mr. Hevert's high-end DCF return estimates simply are not reflective of any market participant's growth rate outlooks, even over the next three to five years" (*Id.*). This unreasonably increases Mr. Hevert's return estimates (*Id.*). When his estimates are corrected to reflect reasonable estimates of long-term sustainable growth, his DCF studies support a DCF return for KCPL in the range of 8.46% to 9.65% with a midpoint of 9.05% (*Id.,* p.10).

b. KCPL's Corrected Multi-Stage DCF = 8.78%

Mr. Hevert's ROE recommendation is also overstated because his multi-stage DCF is: 1) based upon inflated GDP growth estimates; and 2) based upon flawed accelerated dividend cash flow timing (Ex. 551, p.6). Mr. Hevert's GDP growth estimates are inflated because he uses "historical real GDP that is out of line with the consensus economists' forward-looking real GDP growth outlooks" (Ex. 551, p.12). By using overstated GDP growth rates, Mr. Hevert's multi-stage DCF "overstates a reasonable multi-growth return for his proxy group" (Ex. 551, p.13).

ROE witness Mr. Marevangepo testified that Mr. Hevert, in order to justify his overstated GDP growth rates, "delicately expressed ignorance of the existence of publicly available long-term forward real GDP projection values" as justification for his use of historical data for long-term real GDP growth rate, despite the public availability of analyst projections for long-term real GDP data (Ex.227, p.11). "Mr. Hevert's multi-stage results were conveniently inflated to justify a higher allowed ROE for KCPL" (Ex. 227, p.12).

Mr. Hevert's multi-stage growth DCF analysis also accelerates dividend payments, which "manipulates the timing of the dividend cash flows" by assuming that investors will receive four quarters of dividend payments after only owning the stock for two quarters (Ex. 551, p. 13). "By adjusting the inputs to cause dividends to grow faster than earnings over this time period, his cash flows increase, which increases his DCF return estimate" (Ex. 551, p. 14). This was done without a legitimate basis because *Value Line's* 3-year to 5-year payout ratio projections are in line with the industry average, and his adjustment inflates growth rates, and increases his DCF return estimate (Ex. 551, p.15).

When these two errors are corrected in Mr. Hevert's analysis, by reflecting economists' projections of future long-term GDP growth, and by correcting the timing of dividends to a more reasonable cash flow, the result is a multi-stage growth DCF analysis of 8.78% (Ex. 551, p.16).

c. KCPL's Corrected CAPM = 8.80%

The third reason why Mr. Hevert's ROE recommendation of 10.3% is overstated is because his CAPM is based on inflated market risk premiums (Ex. 551, p.7). His market risk premiums are inflated because he uses market growth rates of 11.31% and 11.89% that "are more than two times the growth rate of the U.S. GDP long-term growth outlook of 4.6%" (Ex. 551, p.17). Mr. Gorman testified that Mr. Hevert's results are, therefore, inflated and unreliable (Ex. 551, p.18). Mr. Marevangepo confirmed this when he testified that Mr. Hevert used "expected returns for the S&P 500 [that] cannot be corroborated by any reputable investment source" (Ex. 227, p.12).

A revision to Mr. Hevert's calculations that uses a 6.96% market risk premium, which is the highest Morningstar estimate of the market risk premium, results in a CAPM in the range of 8.28% to 9.29% with a midpoint of approximately 8.80% (Ex. 551, p.19).

d. KCPL's Corrected Bond Yield Plus Risk Premium = 8.14%

The last reason why Mr. Hevert's ROE recommendation is overstated is because his Bond Yield Plus Risk Premium is based on inflated utility equity risk premiums (Ex. 551, p.7). "Mr. Hevert's contention that there is a simplistic inverse relationship between equity risk premiums and interest rates is not supported by academic research" (Ex. 551, p.19). Corrected for this error, Mr. Hevert's study produces a risk premium estimate of 8.14% (Ex. 551, p.21).

Corrected to remove Mr. Hevert's inflated estimates, his analysis produces a Constant Growth DCF of 9.05%; a Multi-Stage DCF of 8.78%; a CAPM of 8.8%; and a Bond Yield Plus Risk Premium of 8.14% (Ex. 551, pp. 10-21). The average of these four produces an estimate of 8.69%, and supports an ROE for KCPL of no more than 9.0%. A 9.0% ROE is also well within the range of what constitutes a reasonable ROE as determined by Ms. Reno (8.2%-9.6%), Mr. Gorman (8.8%-9.4%), and Mr. Marevangepo (9.0%-9.5%).

II. Fuel Adjustment Clause

"Section 386.266 allows the Commission to approve a fuel adjustment clause. The statute does not require that the Commission approve a fuel adjustment clause. Instead, it specifically gives the Commission authority to accept, reject or modify a proposed fuel adjustment clause after giving an opportunity for a full hearing in a general rate case" (Report and Order, Case No. ER-2007-0004, p.63, May 17, 2007).

A. Does KCPL's fuel adjustment clause request violate the Stipulation and Agreement from Case No. EO-2005-0329? If so, should it be rejected?

KCPL's request to implement an FAC violates the Stipulation and Agreement from Case No. EO-2005-0329 and the order approving the agreement because KCPL is prohibited from requesting an FAC before June 1, 2015. In KCPL's October 30, 2014, rate case filing, filed seven months before June 1, 2015, KCPL seeks to utilize an FAC. Accordingly, KCPL's request violates the Stipulation and Agreement and should be denied. This interpretation is consistent with the plain and ordinary language used in the agreement, and it is also the interpretation given by high-level KCPL employees.

Plain and Ordinary Meaning

"By its very nature, a settlement agreement is a compromise by each party to the agreement of certain rights in order to gain what it did not have an established right to claim." *Missouri Cable Telecommunications Assoc. v. P.S.C.,* 929 S.W.2d 768 (Mo. Ct. App. 1996). "Missouri courts generally treat settlement agreements as contracts." *Id.* "If, giving the language used its plain and ordinary meaning, the intent of the parties is clear and unambiguous, we cannot resort to rules of construction to interpret the contract. Mere disagreement over the interpretation of the terms of a contract does not create an ambiguity." *Mendota Ins. Co. v. Lawson,* 456 S.W.3d 898, 903 (Mo. Ct. App. 2015).

The relevant language from the Stipulation and Agreement states:

> "KCPL agrees that, <u>prior to June 1, 2015</u>, <u>it will not seek to utilize</u> any mechanism in current legislation known as 'SB 179' or other change in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors. <u>In exchange for this commitment</u>, the Signatory Parties agree that if KCPL proposes an Interim Energy Charge ("IEC") in a <u>general rate case filed before June 1, 2015</u> in accordance with the following parameters, they will not assert that such proposal constitutes retroactive ratemaking or fails to consider all relevant factors…" [emphasis added].

Here the agreement establishes the compromise – KCPL agreed that before June 1, 2015, it would not *seek* to use a rate adjustment mechanism, and in exchange for this, the other parties agreed that if KCPL sought to use an Interim Energy Charge (IEC) before June 1, 2015, the other parties would not assert retroactive ratemaking or that the IEC fails to consider all relevant factors. June 1, 2015 was the "demarcation point" whereby KCPL was free to propose an IEC in any rate case filed before June 1, 2015, but was precluded from requesting a rate adjustment mechanism before that date. If KCPL had proposed an IEC in this rate case, which was filed before June 1, 2015, the other parties would have been precluded from arguing that the charge constituted retroactive ratemaking or did not consider all relevant factors. This is the plain and ordinary meaning of the words used, which provides the clear and unambiguous intent of the parties. It is, therefore, unnecessary to resort to rules of construction to interpret the contract. *Mendota*, 456 S.W.3d 898, 903.

To the extent the Commission determines that the language is ambiguous, it would be necessary to resort to the rules of construction to interpret the agreement. *Id.* When construing contract language, all contract provisions should be harmonized if possible. *Dunn Indus. Group, Inc. v. City of Sugar Creek*, 112 S.W.3d 421, 429 (Mo. 2003). Here it is possible to harmonize the agreement because the language of the first sentence can be harmonized with the language of the second sentence to provide the intention of the parties, as discussed in the preceding paragraph, that the type of mechanism that KCPL could <u>seek</u> changed on June 1, 2015. Prior to June 1, 2015, KCPL could <u>propose</u> an IEC, after June 1, 2015, KCPL could <u>seek</u> to utilize a rate adjustment mechanism like the FAC.

KCPL wants the Commission to read the first sentence of the relevant language as follows: "KCPL agrees that prior to June 1, 2015, it will not ~~seek to~~ utilize any mechanism…" The words "seek to" have meaning, and KCPL's strained interpretation would render this language meaningless. Missouri courts construe contracts as a whole so as not to render any terms meaningless. S*tate ex rel. Riverside Pipeline Co., L.P. v. P.S.C.* 215 S.W.3d 76, 84 (Mo. banc 2007). "A construction that gives a reasonable meaning to each term and harmonizes all provisions is preferred over a construction that renders some provisions without function or sense." *Chochorowski v. Home Depot U.S.A.*, 404 S.W.3d 220, 229 (Mo. 2013).

During the evidentiary hearing, commissioners questioned the parties over the agreement language, and in particular, the purpose of the word "utilize" and whether the interpretation provided by the parties to the agreement (other than KCPL) would render that word meaningless (Tr. 78). The answer is no - the word "utilize" was a necessary part of the phrase "prior to June 1, 2015, it will not seek to utilize any mechanism" because companies do not seek a mechanism, they use a mechanism. And to use a mechanism was understood to require an action on the part of the company where in some way they sought approval from the Commission to use the mechanism – most likely through the filing of an application or tariff. This is what KCPL agreed not to do prior to June 1, 2015 – make whatever filing was necessary to use an SB 179 mechanism.

KCPL Changed its Interpretation

KCPL has not always interpreted the agreement as it now claims it should be interpreted. On at least two occasions KCPL interpreted the agreement consistent with the interpretation understood by all other parties. Both interpretations occurred closer in time to when the agreement was executed. In KCPL's last rate case Mr. Tim Rush, KCPL's Director of Regulatory Affairs, testified:

> Q. Does the Company have a Fuel Adjustment Clause ("FAC")?
>
> A. No, it does not. Per the Stipulation and Agreement ("Stipulation") approved in 2005 by the Commission in KCP&L's Experimental Regulatory Plan ("Regulatory Plan") docket, Case No. EO-2005-0329, <u>the Company agreed that it will not seek a FAC prior to June 1, 2015</u>. However, the Company is not prohibited from requesting an IEC. [emphasis added].

This interpretation is clear. KCPL also provided a different interpretation of the agreement in a March 29, 2005, Form 8-K filing that KCPL made with the Securities and Exchange

Commission (SEC) the day after the Stipulation and Agreement was filed with the Commission in Case No. EO-2005-0329 (Ex. 507). The Form 8-K, signed by Ms. Jeanie Sell Latz, KCPL's Executive Vice President, states:

> (c) An interim energy charge may be proposed by KCP&L in any rate case filed before June 1, 2015 to recover projected fuel and purchased power costs, subject to refund. The duration of each interim energy charge will not exceed two years. KCP&L will not seek prior to June 1, 2015, to utilize any mechanism authorized in pending legislation or other change in state law that would allow riders, surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors.

(Ex. 507, emphasis added). This example and the example provided above, showing high-level KCPL employees providing an interpretation that is consistent with all other interpretations provided by other parties to the case, is indicative of how the language should be interpreted.

The Commission also has interpreted the agreement in a manner consistent with that proposed by the Commission's Staff and the consumer groups in this case when the Commission held, "As part of a general rate case, KCP&L may seek an FAC to include transmission costs in June of 2015" (Report and Order, Case No. EU-2014-0077, p.11, July 30, 2014). Although the Commission clarified in a later order that it was not directing KCPL as to when it may file for an FAC, the language used in the Commission's order is a clear and correct interpretation of the agreement.

Because KCPL's interpretation of the agreement is not supported by the plain reading of the language, is not supported by the rules of construction, and is not supported by prior statements made by KCPL's own employees, KCPL's request of an FAC in this case is premature and in violation of a Commission order, and should, therefore, be denied.

B. Has KCPL met the criteria for the Commission to authorize it to have a fuel adjustment clause?

If the Commission concurs with Public Counsel that KCPL was prohibited from seeking an FAC prior to June 1, 2015, the remaining twenty-one (21) FAC issues and sub-issues become moot and do not require a Commission decision. However, should the Commission consider KCPL's request for an FAC in this case, the Commission should deny KCPL's request to implement an FAC because the costs that KCPL seeks to include have not met the necessary criteria. Requiring electric companies to meet certain criteria is necessary to protect customers against unnecessary FACs. FACs should be the exception, rather than the norm, because, according to the Supreme Court of Missouri, FACs create the potential for harm to the public on two fronts: 1) they create a disincentive for company management to control costs; and 2) they greatly increase the chance that the company is over-earning because they allow rate increases without considering all relevant factors. *Utility Consumers Council of Missouri, Inc. v. P.S.C.*, 585 S.W.2d 41 (Mo. 1979)("*UCCM*"). The Court characterized FACs as "a radical departure from the usual practice of approval and disapproval in the context of a general rate case" where "the commission must of course consider all relevant factors." *Id.* According to the Court, "a preference exists for the rate case method." *Id.* The Supreme Court also quoted a prior Commission order rejecting an FAC due to the disincentives it would create for management to bargain for the lowest coal rates possible:

> Furthermore, under such a proposal, management would not be encouraged to bargain for the lowest coal rates possible when it would know any increase would be immediately "flowed through" to customers. Also, many other factors, other than cost of fuel, affect this company's rate of return. We do not feel it is good regulation to set aside this one element of expenses for special treatment while ignoring the total overall picture of expenses and resultant rate of return.

(*UCCM*, 585 S.W.2d at 50).

These concerns still hold true today – FACs reduce management's incentives to bargain for more inexpensive fuel (Ex. 309, p.7), and they allow special treatment for one cost (fuel and purchased power) while ignoring the overall picture of expenses and resultant rate of return, which increases the chances of over-earning (Ex. 308, p.5). The Supreme Court's concerns raise serious public policy considerations that should be factored into the criteria employed by the Commission in determining whether an FAC is justified for KCPL. The Supreme Court's concerns were shared by the General Assembly when it included in § 386.266.1 a provision allowing "features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities," the requirement that the Commission can only approve an FAC "after considering all relevant factors which may affect the costs or overall rates and charges," and the requirement for prudence audits. Section 386.266.4(4), RSMo.

The Commission was certainly mindful of the Supreme Court's opinion when it adopted its rate adjustment mechanism (RAM) rules, and in particular, 4 CSR 240-20.090(2)(C), which provides the Commission's *minimum* criteria for determining whether a cost component should be recovered through an FAC:

> (C) In determining which cost components to include in a RAM, the commission <u>will consider</u>, but is not limited to only considering, <u>the magnitude of the costs</u>, <u>the ability of the utility to manage the costs</u>, <u>the volatility of the cost component and the incentive provided to the utility as a result of the inclusion or exclusion of the cost component</u>. The commission may, in its discretion, determine what portion of prudently incurred fuel and purchased power costs may be recovered in a RAM and what portion shall be recovered in base rates.

4 CSR 240-20.090 [emphasis added]. To meet the requirements of the Commission's own rule, in this case, KCPL must establish that each cost component satisfies the criteria on: (1)

magnitude; (2) manageability; (3) volatility; and (4) incentives. Public Counsel witness Ms. Lena Mantle's testimony provides the Commission with a practical approach for determining whether each of the above criteria have been met, as well as additional criteria that ensure the public interest is being protected.

Ms. Mantle testified, "An FAC should be granted to an electric utility only if it is *necessary* to provide a utility with a sufficient opportunity to earn a fair return on equity" (Ex. 309, p.3). KCPL has not provided the Commission with evidence that an FAC is *necessary* to enable it to earn a fair return, and during the evidentiary hearing, KCPL appeared to take exception to having necessity as a criteria, which could lead one to believe KCPL does not believe an FAC is necessary for it to earn a fair return, and this implicit concession is important when considering magnitude and volatility (Ex. 309, p. 18; Tr. 1515).

Magnitude and Volatility of the Costs

The magnitude of a cost component and the volatility of a cost component are two of the minimum criteria to be considered. 4 CSR 240-20.090(2)(C). The American Heritage Dictionary defines *magnitude* as, "greatness in size or extent" and as "greatness in significance or influence," and it defines *volatility* as "tending to vary often or widely, as in price."[1] An FAC cost component is of sufficient magnitude or "greatness" if the weight of the evidence establishes that "past and expected changes in the costs and revenues proposed to be included in the FAC are substantial enough to have a material impact upon revenue requirement and the financial performance of the electric utility between rate cases" (Ex. 309, p.3). Volatility, on the other hand, can be measured by determining whether KCPL has established that "costs and revenues included are volatile in amount, causing significant swings in income and cash flows if not

[1] www.ahdictionary.com

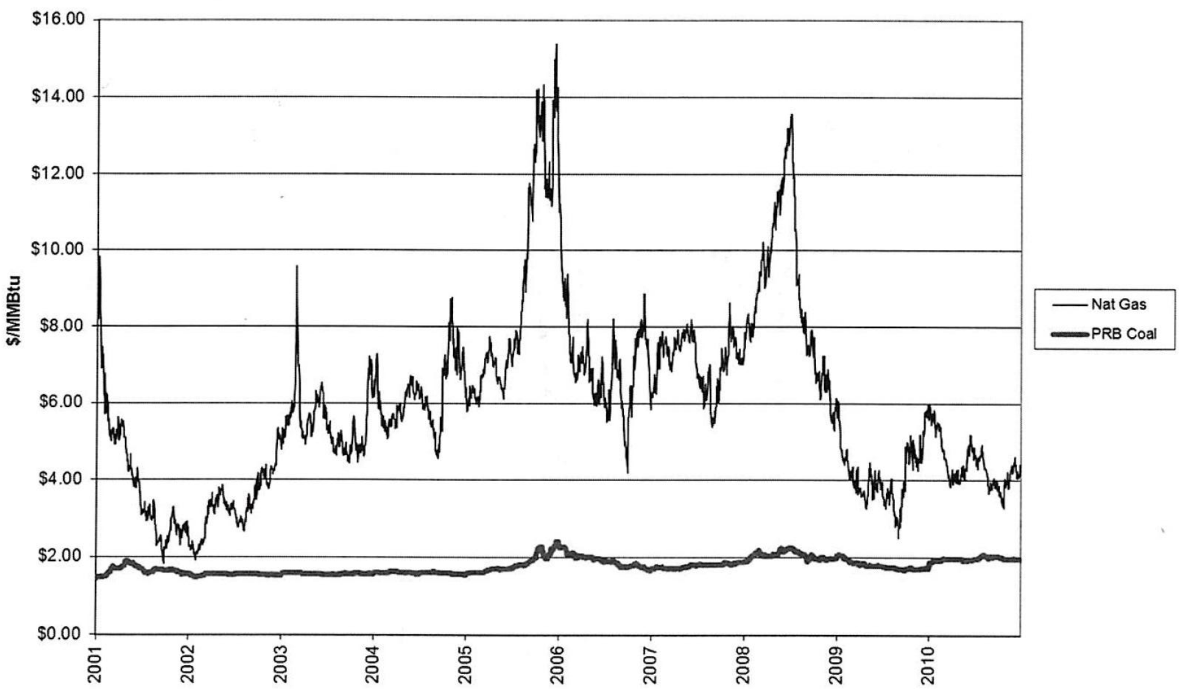
tracked" (*Id.*). These two criteria were used by the Commission when it considered an FAC for Empire District Electric Company in Case No. ER-2008-0093, and again when it considered an FAC for Union Electric in Case No. ER-2008-0318 (Ex. 309, p.15). These criteria are linked in that the prices must be volatile in amount, and that amount must be of a substantial magnitude to have a material impact on the company. It is the magnitude of *changes* in the costs and revenues that impact the earnings of the electric utility (Ex. 309, p.18). If there is no volatility, there would be no changes of any material magnitude.

Energy costs make up approximately 28% of KCPL's gross revenue requirement (Ex. 202, p.13). However, the magnitude and volatility criteria must be applied to the <u>cost components</u> of the fuel sources KCPL actually uses and seeks to recover through an FAC. 4 CSR 240-20.090(2)(C). KCPL's evidence has not established that changes in fuel and purchased power cost components are substantial enough to have a material impact on the company's revenue requirement and financial performance, or that such costs are volatile. The percent of energy generated by KCPL's fuel mix for 2013 and 2014 was as follows:

Fuel Source	**2013**	**2014**
Coal	85%	81%
Nuclear	12%	16%
Wind	2%	2%
Natural gas and oil	1%	1%

(Ex. 200, p.2). Starting with coal, KCPL witness Mr. Blunk's testimony included the below chart comparing delivered coal prices to natural gas prices.

Natural Gas vs Delivered Coal Price



(Ex. 103, Sch. WEB-5). This chart shows that changes in coal prices, the steady line at the bottom, are neither volatile nor have they changed by a sufficient magnitude to justify an FAC. Coal makes up 81% to 85% of KCPL's generation, whereas natural gas, represented by the more erratic line, represents less than 1% of KCPL's generation (Ex. 200, p.2). On a forward looking basis, according to KCPL's 2014 SEC Form 10K, KCPL currently has approximately 95% of its coal requirements for 2015 under contract and a ten percent increase in the market price of coal would result in only a $2.1 million increase in fuel expense for KCPL (Ex. 503, p.17). This $2.1 million increase is not significant enough to justify an FAC (*Id.*).

Nuclear fuel, the second largest fuel in KCPL's mix at 16% in 2014, also lacks volatility. Mr. Eaves analyzed KCPL's nuclear fuel cost and its future contracted uranium prices, and the results from his highly confidential tables clearly show that KCPL's nuclear fuel costs are not volatile (Ex. 208, p.6). Public Counsel witness Mr. Lena Mantle also testified that data on KCPL's nuclear fuel costs dating back to 2005 show little variability (Ex. 309, p.23). KCPL has provided no evidence to the contrary that shows volatility in nuclear fuel costs. In fact, KCPL states that it has under contract ***

*** (Ex.103HC, p. 32).

The remaining KCPL fuel sources are not a large enough part of KCPL's generation mix to establish a need for an FAC. Staff witness Mr. Eaves testified that "KCPL's reliance on natural gas and oil for the generation of electricity is minimal, which in itself reduces the magnitude of volatility" (Ex.208, p.6). The evidence shows that natural gas and oil make up only 1% of KCPL's generation mix (Ex.200, p.2). Ms. Mantle also testified that KCPL has historically had little variability in natural gas and oil costs (Ex. 309, p.23).

In addition, KCPL did not show volatility in its purchased power expense. Ms. Mantle shows how KCPL's purchased power costs have been fairly stable since 2009 (Ex. 309, p.23).

Recognizing the lack of volatility in KCPL's fuel and purchased power costs, KCPL witness Mr. Tim Rush's testimony asserts that KCPL should be granted an FAC because of volatility in KCPL's *off-system sales* revenues (Ex.134, p.7). This assertion should be rejected by the Commission because, § 386.266, the statutory authority for an FAC, is clear that the basis for grating an FAC is "to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation". Off-system sales revenues are not a cost of fuel and purchased power, or transportation. Changes in off-system sales revenues are not contemplated by the statute and, therefore, cannot be a lawful basis for granting an FAC enacted to address fuel and purchased power *cost* increases and decreases. § 386.266.1, RSMo. While this Commission has in the past provided for off-system sales revenues to flow through FACs to offset increases in fuel costs with additional revenues, those offsets cannot now be used to establish an evidentiary justification for the establishment of an FAC in the first place. Even if off-system sales were a lawful basis upon which to grant an FAC, the magnitude of off-system sales quoted by KCPL witness Mr. Rush greatly exaggerates the true magnitude of the off-set to fuel costs to provide service to KCPL's customers. The true off-set to fuel costs to provide service to KCPL customers is the off-system sales margin, which is only a fraction of what Mr. Rush claims because he failed to factor in the cost of making off-system sales (Ex. 309, p.22).

The relevant volatility must be volatility in the increases and decreases in fuel and purchased power costs (Ex. 309, p.21). As explained above, KCPL has not met its burden of proving to the Commission that the cost components associated with coal, nuclear, natural gas, oil and wind are volatile, or that the volatility is of such a magnitude that it is substantial enough to have a material impact upon the revenue requirement and the financial performance of KCPL.

The other large cost that KCPL is proposing be included in the FAC is transmission. The Commission recently addressed transmission costs in Empire District Electric Company's recent rate case and concluded that "[t]he projected five year SPP related transmission expansion costs are expected to increase, but do not demonstrate volatility" (Report and Order, Case No. ER-2014-0351, p.25). The Commission also found that "Missouri jurisdictional RTO transmission costs are reasonably projected and thus not volatile" (*Id.*). That order was issued last month and will become effective on July 24, 2015 (*Id.*).

The Commission's conclusions for Empire are also supported by the evidence in the present case. Mr. Eaves testified that "because SPP's Transmission Schedule 11 costs are known and measurable, traditional ratemaking practices would be more than sufficient to allow KCPL a reasonable opportunity to recover these costs from customers on a going forward basis; thus, KCPL would not need special regulatory treatment afforded this individual cost item" (Ex. 200, p.199). This testimony is consistent with the Commission's order in Case No. ER-2007-0002 where the Commission concluded that "rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause" (Report and Order, Case No. ER-2007-0002, p.23). The Commission explained:

> Markets in which prices are volatile tend to go up and down in an unpredictable manner. When a utility's fuel and purchased power costs are swinging in that way, the time consuming ratemaking process cannot possibly keep up with the swings. As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriately low or high rates. Because AmerenUE's costs are simply rising, that sort of protection is not needed. As Brosch explains, rising, but known, fuel costs are the worst reason to implement a fuel adjustment clause because such a fuel adjustment clause allows the utility to recover a single known rising cost while avoiding a rate case in which all its other expenses and revenue, which are changing in the background, will be examined and perhaps used to offset all or part of the rising fuel cost to avoid an unnecessary rate increase.

Beyond the Control of Management

All cost components KCPL seeks to include in its FAC must also be found to be beyond the control of management. 4 CSR 240-20.090(2)(C). This can be shown if KCPL's evidence establishes that "changes in the costs and revenues included are beyond the control of management, where utility management has little influence over experienced revenue or cost levels" (Ex. 309, p.3). This criteria was also used by the Commission when it considered an FAC for Empire District Electric Company in Case No. ER-2008-0093, and again when it considered an FAC for Union Electric in Case No. ER-2008-0318 (Ex. 309, p.15).

KCPL's Generation Planning Manager, Mr. Blunk, testified as to the control KCPL's management has over coal costs through KCPL's coal hedging strategy:

> Q. How did this strategy perform for KCP&L?
>
> A: Since its implementation some years ago, this strategy has helped us avoid much of the coal market volatility. It has also helped us avoid locking in to the market highs. Using this strategy we have achieved weighted average prices that are below what we would have had to pay if all of our coal had been purchased in the calendar year before use.

(Ex. 103, p. 25). This testimony shows that coal costs are not beyond the control of management and that KCPL prides itself on its ability to implement cost saving strategies.

FAC Must be in the Public Interest

An FAC should be granted for KCPL only if the proposed FAC is in the public interest. *Straube v. Bowling Green Gas Co.,* 227 S.W.2d 666, 669 (Mo. 1950). KCPL seeks to impose a new surcharge on all customer bills – a charge KCPL's customers have never seen. A relevant public interest question is whether KCPL's proposed surcharge unreasonably shifts an inappropriate amount of risk regarding the electric utility's fuel and purchased power costs to its customers (Ex. 309, p.3). Under the current rate structure, KCPL's costs of fuel and purchased power are recovered through base rates set on a test year period of costs. The actual costs incurred are determined by the market and by KCPL's management decisions. Through its FAC request, KCPL seeks to abandon that process, which is not broken, and replace it with a completely different ratemaking methodology that imposes more risks onto KCPL's customers, which should not be found to be in the public interest unless absolutely necessary.

Another relevant public interest question is whether KCPL's proposed FAC would unreasonably cause volatility in the bills of KCPL's customers (*Id.*). Since KCPL's FAC request that does not meet the Commission's criteria, it is inherently against the public interest because it would unreasonably and unnecessarily shift all risk regarding fuel and purchased power onto the public, and would unreasonably and unnecessarily cause volatility in customer’s bills. For these reasons, KCPL’s request for an FAC is contrary to the public interest.

FACs Change the Company's Incentives

The last criterion for determining whether an FAC is justified is a consideration of the incentives that an FAC provides. Specifically, the rule states that "the incentive provided to the utility as a result of the inclusion or exclusion of the cost component" should be a criteria of whether or not to allow a cost component in an FAC. 4 CSR 240-20.090(2)(C). The Supreme Court of Missouri in *UCCM* also recognized that an FAC creates disincentives for the company's management to control costs. 585 S.W.2d 41.

According to KCPL's Generation Planning Manager, Mr. Blunk, KCPL currently has a financial incentive to control its fuel and purchased power costs under its present rate structure where such costs are recovered through base rates (Tr.1594). Mr. Blunk has over 30 years of experience, and testified that KCPL is successful in minimizing fuel and purchased power costs through strategies implemented by the Company, including strategies which KCPL has classified as highly confidential (Ex. 103, p.25). These positive outcomes are the result of KCPL having an incentive to maintain low fuel and purchased power costs (Tr.1594).

An example of how an incentive can enhance performance is KCPL's incentive compensation plan. Mr. Blunk testified that under KCPL's incentive compensation plan, benchmarks are set for each department that are based upon financial metrics of earnings per share, with cash payouts to departments that achieve such earnings per share metrics (Tr. 1596). He further testified that these financial incentives encourage good job performance, but if the incentive were removed, employees would no longer have an incentive to achieve their benchmarks (Tr. 1596-1597). In the context of KCPL's fuel and purchased power costs, Mr.

Blunk testified that KCPL's purchasing strategies have proven to be successful and have helped KCPL's financial performance (Tr. 1597-1598). If KCPL were to be granted an FAC, thereby removing the financial incentives to continue implementing cost-saving strategies, KCPL would not need to continue seeking to achieve those savings just as employees without an incentive compensation plan will not continue working to achieve their benchmarks.

Public Counsel encourages the Commission to issue an order finding that the disincentive that an FAC will create for KCPL to achieve fuel and purchased power cost savings is reason alone to deny KCPL an FAC because there can be no stronger incentive to KCPL to stay focused on minimizing these costs than a financial incentive.

C. Should the Commission authorize KCPL to have a fuel adjustment clause?

The Commission should not authorize KCPL to establish an FAC for any one or all of the following reasons:

a. KCPL's request violates the Commission's order in Case No. EO-2005-0329, as addressed above in issue II.A (Ex. 309, pp. 9-10).

b. KCPL has not provided complete descriptions of the costs and revenues it proposes to flow through the FAC as required by 4 CSR 240-3.161 (Ex. 309, pp.11-13).

c. KCPL has not met the criteria identified above in issue II.B in that:

(1) KCPL has not shown that an FAC is necessary to earn the company's authorized return;

(2) KCPL has not provided necessary detail regarding the costs and revenues proposed to flow through the FAC;

(3) KCPL has not shown that fuel and purchased power costs, including transportation costs, are volatile;

(4) KCPL has not shown that changes in costs and revenues are beyond the control of management;

(5) KCPL has not shown that an FAC would not shift an unreasonable amount of risk to ratepayers; and

(6) KCPL has not shown that causing volatility in the bills of the thousands of residential and business customers is in the public interest (Ex. 309, pp. 18-29).

Each of these is addressed in greater detail above, except the question as to whether KCPL has not provided a "complete explanation" of the costs and revenues in proposes to flow through the FAC as required by 4 CSR 240-3.161(2)(H) and (I) (Ex. 309, pp. 11-13). To comply with this filing requirement, KCPL witness Mr. Tim Rush includes Schedule TMR-2 to his direct testimony that lists costs and revenues that KCPL is requesting be included in an FAC. KCPL's descriptions, however, "are short and sometimes cryptic (e.g., Account 565027 Trans OP Trans by Other Demand)" (Ex. 309, p.27). These descriptions fall short of the rule requiring *complete* explanations of the costs and revenues to be included.

A "complete explanation" suggests something far different than a cryptic and abbreviated list of accounts. It suggests that the costs will be "explained", and to explain something is to make that thing "plain or comprehensible"[2] And its explanations are to be *complete*, meaning, all necessary components are to be explained.

KCPL’s failure to provide complete explanations of what it would include in an FAC if an FAC is approved for KCPL is contrary to an important public policy criteria the Commission should require, that is, that an FAC must be: (1) “Straightforward to administer and readily audited and verified through periodic regulatory reviews”; and (2) “Balanced such that any known factors that mitigate costs impacts are accounted for in a manner that preserves test year

[2] www.ahdictionary.com

matching provisions" (Ex. 503, p.15; Ex. 310, p.7). KCPL's cryptic descriptions do not satisfy this criteria and this alone is reason enough to deny KCPL an FAC.

Public Counsel encourages the Commission to read Ms. Mantle's Schedule LMM-2, which contains KCPL's descriptions of the costs and revenues KCPL is requesting be included in it FAC, and try to decipher whether the explanations are complete enough to enable the Commission to understand with confidence the types of costs and revenues that would be included in an FAC. If the Commission cannot understand the costs based on KCPL's list, the Commission should conclude that KCPL has not satisfied its filing requirements for proposing an FAC because it has not provided "complete explanations" of the costs and revenues KCPL proposes be included. 4 CSR 240-3.161(2)(H) and (I).

D. If the Commission authorizes KCPL to have a fuel adjustment clause, how should it be structured?

i. What percentage (customers/company) of changes in costs and revenues should the Commission find appropriate to flow through the fuel adjustment clause?

If the Commission authorizes KCPL to implement an FAC, KCPL should be authorized to flow no more than 50% of changes to costs and revenues to ratepayers through the FAC (Ex.309, pp. 30-32). There are two primary reasons to require a 50/50 sharing mechanism. First, KCPL's proposal to place 100% of the risk of fluctuating costs and revenues on the customers ignores the fact that customers have virtually no way to manage this risk (Ex. 309, p.31). "Customers do not purchase fuel for the generating plants. Customers do not maintain the power plants. Customers do not manage emission allowances. The customer's only way to manage their risk is to use less electricity" (*Id.*). KCPL, on the other hand, makes all decisions regarding fuel purchasing, the maintenance of its power plants, and the management of its emission allowances (*Id.*). Recognizing this, it is only reasonable to place *at least* as much risk on KCPL as the customers by requiring a 50/50 sharing mechanism whereby the risk of fluctuating costs and revenues is shared equally.

The second reason why a 50/50 sharing mechanism is reasonable is because it maintains incentives for KCPL to achieve cost savings that otherwise would be lost. Ms. Mantle testified that under an FAC there is no incentive for KCPL to achieve cost savings in the following ways:

- KCPL would have no incentive to search for the lowest price fuel.
- KCPL would have no incentive to achieve higher off-system sales margins.
- KCPL would have no incentive to work within SPP to keep transmission costs low.
- KCPL would have no incentive to manage its emission allowances.
- KCPL would have no incentive to keep its generating plants running efficiently.

(Ex. 309, p.31). These important incentives are lost with the FAC proposed by KCPL, but a 50/50 sharing mechanism helps maintain these incentives.

A 50/50 sharing mechanism should not be misconstrued to imply that KCPL would only get to recover 50% of its fuel and purchased power costs. Instead, the vast majority of KCPL's fuel costs would still be recovered through base rates set at a level meant to recover *all* fuel and purchased power costs, including transportation (Ex. 309, p.31). The FAC would only address the increases and decreases in such costs between rate cases by sharing those increases or decreases equally between the company that makes all the decisions regarding fuel and purchased power, and the customers that use the electricity but have no say in fuel decisions.

ii. Should the costs and revenues that are to be included in the FAC be approved by the Commission and explicitly identified along with the FERC account, subaccount and the resource code in which KCPL will record the actual cost/revenue? If so, what costs and revenues should be included and

what are their corresponding FERC accounts, subaccounts and resource codes?

If the Commission approves an FAC for KCPL, the costs and revenues to be included should be explicitly identified by FERC account, subaccount and resource code (Ex. 309, p. 30). The costs and revenues to be included should be limited to only those costs and revenues specifically identified by KCPL and supported with detailed descriptions that enable the Commission to understand clearly the costs and revenues that KCPL seeks to recover through an FAC. Commission rule 4 CSR 240-3.161 requires KCPL to file "complete explanations" of the costs it seeks to include in an FAC, and Commission rule 4 CSR 240-20.090(2)(C) requires each cost to satisfy certain criteria. By requiring explicit approval of each cost component by account and subaccount, the Commission will be ensured that each cost to be included in an FAC satisfies the necessary criteria found in 4 CSR 240-20.090(2)(C). Ms. Mantle testified as to her concerns with allowing an FAC to be approved generally by FERC account:

> [I]t is the Commission's role to determine what cost components should be in an FAC. If it approves a generic "everything in FERC account 555," any cost component (or type) that KCPL records in that account can then be included in the FAC. New cost types that may or may not be fuel and purchased power costs and have not been reviewed and approved by the Commission can flow through the FAC just because KCPL recorded the cost in FERC account 555. This clouds the transparency of the FAC and severely limits prudence audits.

(Ex. 309, p.33). Requiring KCPL to provide complete explanations of its cost components helps ensure that an FAC is not being abused, and it helps improve the Staff's ability to audit the prudency of FAC charges.

iii. Should the FAC tariff sheets reflect the accounts, subaccounts, resource codes, and the cost/revenue description?

The tariff sheets should include FERC accounts, subaccounts, resource codes and cost/revenue descriptions (Ex.309, pp. 34-35). This is important for the same reasons identified above as to why it is important for the Commission to approve each cost component to ensure it satisfies the criteria required by 4 CSR 240-20.090(2)(C). Requiring a company to be more specific in its tariff about the allowed cost components helps ensure that no new cost components that may or may not satisfy the Commission's criteria will be added between rate cases.

iv. Should Southwest Power Pool ("SPP") and other regional transmission organization/independent system operator transmission fees be included in the FAC, and at what level?

KCPL's wholesale transmission expenses and revenues not associated with the transportation of fuel or purchased power should not be recovered through the FAC (Ex.557, pp. 5-16). Section 386.266.1, RSMo, allows an electric utility to make periodic rate adjustments only to "reflect increases and decreases in its prudently incurred fuel and purchased power costs, including transportation." The only transportation costs that can be included in an FAC are transportation costs for fuel and or purchased power, and according to witness Mr. Jim Dauphinais, "since fuel cannot be physically transported using the electric transmission system, the only wholesale transmission expenses and revenues that can be included in the FAC are wholesale transmission expenses incurred to transport purchased power" (Ex. 557, p.7).

If the Commission approves an FAC for KCPL, the Commission should exclude wholesale transmission expenses incurred to transmit power from KCPL's own generation resources to its own load because these expenses are not incurred for transportation of fuel or purchased power (Ex. 557, p.7). Likewise, the Commission should also exclude "KCPL's wholesale transmission expenses incurred to transmit the electric power it is selling to third-parties (i.e., Off-System Sales) to locations outside of SPP along with all of KCPL's wholesale transmission revenues" because these are also not incurred for transportation of fuel or purchased power (*Id.*).

In Case No. ER-2014-0258, the Commission denied Ameren Missouri's request to include transmission expenses that were not a cost of fuel and purchased power. The order stated:

> The evidence demonstrated that for purposes of operation of the MISO tariff, Ameren Missouri sells all the power it generates into the MISO market and buys back whatever power it needs to serve its native load. From that fact, Ameren Missouri leaps to its conclusion that since it sells all its power to MISO and buys all that power back, all such transactions are off-system sales and purchased power within the meaning of the FAC statute. The Commission does not accept this point of view.
>
> The drafters of the FAC statute likely did not envision a situation where a utility would consider all its generation purchased power or off-system sales. In fact, the policy underlying the FAC statute is clear on its face. The statute is meant to insulate the utility from unexpected and uncontrollable fluctuations in transportation costs of purchased power. At the time the statute was drafted, and even in our more complex present-day system, the costs of transporting energy in addition to the energy generated by the utility or energy in excess of what the utility needs to serve its load are the costs that are unexpected and out of the utility’s control to such an extent that a deviation from traditional rate making is justified.
>
> Therefore, of the three reasons Ameren Missouri incurs transmission costs cited earlier, the costs that should be included in the FAC are 1) costs to transmit electric power it did not generate to its own load (true purchased power) and 2) costs to transmit excess electric power it is selling to third parties to locations outside of MISO (off-system sales). Any other interpretation would expand the reach of the FAC beyond its intent.

(Report and Order, Case No. ER-2014-0258, p. 115). For the reasons explained in the testimony of Mr. Jim Dauphinais, and for the reasons explained by the Commission in the above cases, only lawful transmission fees should be recovered through an FAC.

v. **Should SPP and FERC Administrative fees (SPP Schedule 1-A and 12) be included in the FAC?**

None of KCPL's SPP administration charges or the NERC and FERC fees (Accounts 561, 565, 575 and 928) should be recovered through an FAC, as Mr. Jim Dauphinais testified, because these are neither fuel and purchased power expenses nor transportation expenses incurred to deliver fuel or purchased power (Ex. 557, pp. 16-17). RTO administrative fees are not included in FAC's of the other electric utilities in Missouri (Ex. 208, p.10). Including such fees would be an unlawful expansion of the authority granted the Commission in § 386.266.1, RSMo. These fees are appropriate, however, for recovery through base rates.

vi. **Should all realized gains and losses from KCPL's cross hedging practices be included in the FAC?**

Realized gains and losses from cross hedging practices should be excluded (Ex. 209, pp. 13-14). According to a data request response from KCPL, ***

*** (Ex. 209, pp.13-14). Accordingly, if the Commission grants KCPL an FAC, cross hedging should be excluded.

vii. **Should SO_2 amortizations, bio fuels, propane, accessorial charges, broker commissions, fees and margins, be included in the FAC?**

SO_2 amortizations should not be included in the FAC because they are a fixed amount that is already included in permanent rates. Ms. Mantle testified, "In past rate cases and in the Regulatory Plan, the parties agreed to amortize certain revenues from the sale of SO_2 allowances over a set number of years resulting in a fixed revenue amount to offset costs. Because it is a fixed amount and it is included in permanent rates, it should not be included in the FAC" (Ex. 309, p. 35). Fixed costs that have zero volatility fluctuations will not impact ROE and have no basis in a surcharge meant to provide for recovery of costs that fluctuate between rate cases.

In regard to bio-fuels, propane, accessorial charges, broker commission fees and margins, KCPL has not met its burden of proof to allow the Commission to determine whether KCPL incurred such expenses during the test year, whether KCPL will incur such expenses in the future, or whether such expenses are appropriate for an FAC. Section 393.150.2, RSMo. Staff witness Mr. Eaves testified:

> Staff believes "accessorial charges" is a generic term and should be more specifically defined within the tariff. Staff understands KCPL no longer uses bio-fuels and if it was to resume the practice of burning bio-fuel, the costs should be recorded to renewable energy standard so the reference to bio-fuel should be excluded from the tariff and not recovered in a FAC. Broker commissions, fees and margins were struck as they are generic terms and should be defined within the tariff. Staff removed propane as it is not aware that KCPL utilizes propane either as a start-up fuel, burn stabilization or environmental controls.

(Ex. 209, p.8). Accordingly, these expenses should not be included in an FAC.

viii. Should the FAC include costs and revenues that KCPL is not currently incurring or receiving other than insurance recoveries, subrogation recoveries and settlement proceeds related to costs and revenues included in the FAC?

Costs that a company is not currently incurring should be excluded from an FAC until approved by the Commission in a subsequent rate case because they would cause rate increases due to costs that do not withstand Commission review to determine whether including such costs are lawful or reasonable under § 386.266, RSMo, and that the cost satisfies the criteria for eligibility under 4 CSR 240-20.090(2)(C) (Ex.311, p.28).

A similar argument can be made for excluding additional revenues that a company is not currently receiving (Ex. 309, p.34). Exceptions to this would be revenues for insurance recoveries, subrogation recoveries and settlement proceeds related to costs and revenues included in the FAC because such revenue increases are likely the result of circumstances that caused additional costs or reduced revenues in the FAC. Ms. Mantle explained:

> These would be revenues typically related to an unexpected incident or accident. If circumstance occurs where there are insurance recoveries, subrogation recoveries or settlement proceeds related to costs and revenues included in the FAC, it is very likely that at some point in time, prior to the receipt of the recovery or settlement, that there were increased costs or reduced revenues due to that circumstance that have been included in the fuel adjustment rates (FARs) paid by the customers. Therefore, it is important to include FAC-related insurance recoveries, subrogation recoveries and settlement proceeds related to costs and revenues in the FAC.

(Ex.309, p.34).

ix. Does the FAC need to have exclusionary language added to insure that NERC and FERC penalties are not included?

If the Commission approves an FAC for KCPL, it should be made clear in the tariff that NERC and FERC penalties are not to be included (Ex. 209, p.8). Staff witness Mr. Dana Eaves proposed the following language to be added to Tariff Sheet 50.1, "All penalties accessed associated with The North American Electric Reliability Corporation and other regional entities compliance and reliability standards shall be excluded from the FAC" (*Id.*). This language will provide assurances that such costs, which are not fuel and purchased power costs under § 386.266, RSMo, are not sought to be included in an FAC.

x. Should the phrase "miscellaneous SPP IM charges, including but not limited to," be included in KCPL's FAC tariff?

The FAC tariff sheets should define clearly what charges are to be included, and no charges other than what the Commission approves should be included in the FAC (Ex. 309, p. 35). Including a vague and open-ended term regarding "miscellaneous charges" would open the door for the inclusion of cost components that have not been approved by the Commission and that do not meet the Commission's 4 CSR 240-20.090(2)(C) criteria for cost components that can lawfully be included in an FAC (Ex. 209, p.8).

xi. How should OSSR be defined?

Public Counsel supports the tariff modifications proposed by the Staff's exemplar tariff sheets appearing as Schedule DEE-1-3 to the Staff Rate Design and Class Cost of Service Report and Erratum to Staff's Rate Design and Class Cost of Service Report, which states on Staff's proposed Tariff Sheet No. 50.2:

> Revenues from Off-System Sales: The following revenues or costs reflected in FERC Account Number 447: all revenues from off-system sales. This includes charges and credits related to the SPP Integrated Marketplace including, energy, ancillary services, revenue sufficiency and neutrality payments and distributions, Over collected losses payments and distributions, TCR and ARR settlements, demand reductions, virtual energy costs, revenues and related fees where the virtual energy transaction is a hedge in support of physical operations related to a generating resource or load, generation/export charges, ancillary services including non- performance and distribution payments and SPP uplift revenues or credits. Off-system sales revenues from full and partial requirements sales to municipalities that are served through bilateral contracts in excess of one year shall be excluded from OSSR component.

Staff's proposal also removes the vague and open-ended language of “Market charges including, but not limited to” that KCPL proposes be included in the definition of Off-System Sales in the FAC tariff sheets.

xii. How should the "J" component be defined, i.e., how should “Net System Input” be defined for KCPL’s operations?

Public Counsel supports the definition proposed by Staff witness Mr. Dana Eaves (Ex. 209, pp. 10-11). Mr. Eaves explains that this jurisdictional allocation component, which helps calculate jurisdictional calculations between Missouri and Kansas, should recognize that line loss is not the same between the two jurisdictions because Kansas customers are mostly residential whereas Missouri has a greater portion of commercial and industrial customers (Ex.209, pp.10-11). Mr. Eaves explained, "It is typically the case that a service area comprised of residential customers will experience higher line loss percentage than that of a system with a mixture of residential, commercial and industrial customers as Missouri service territory reflects. I believe that my proposed definition of the “J” component that is included in the redline version of the FAC [tariff] is correct when NSI is defined as [Retail Sales (KS+MO) + Sales for Resale + Border Customers + Firm Wholesale + Losses]" (*Id.*).

xiii. Should the rate schedules implementing the FAC have an amount for the Base Factor when the Commission initially approves them, or not until after the end of the first FAC accumulation period?

The costs and revenues used to determine the base factor should be the same as the costs and revenues included in the revenue requirement used to set permanent rates. Because this factor will be known at the time the tariff sheets are filed and will be included in the FAC tariff sheets that describe the FAC, the base factor should be shown in the FAC rate schedule tariff sheet the Commission approves (Ex.209, p.11). During the hearing KCPL witness, Mr. Rush, agreed to include the base factor if requested (Tr.1630).

xiv. How many different voltage levels of service should be recognized for purposes of applying loss factors?

The FAC should include only rates at primary and secondary voltage levels as Staff proposes (Ex. 200, pp.200-201). KCPL's Loss Study does not contain all of the data which would be necessary to calculate additional voltage level factors (Ex. 204, p.3). The Commission should order KPCL to include a line loss study in its next general rate case that includes information necessary to allow parties to consider and evaluate if any additional voltage level adjustment factors should be incorporated into KCPL's FAC rates (Ex. 204, p.2-3).

xv. What are the appropriate recovery periods and corresponding accumulation periods for the FAC?

The FAC recovery periods should be October through September and April through March with the corresponding accumulation periods changed to January through June and July through December respectively. This change is in the public interest because it would reduce the number of times customers see a change in their rates to three times a year (Ex.309, pp. 37-38).

KCPL's customers already see changes to permanent rates twice per year because KCPL's rates go up in June to reflect the higher usage period and they go down in October for the non-cooling months. KCPL's proposal would add two additional rate changes for the Fuel Adjustment Rate (FAR) in January and July, for a total of four annual rate changes. Public Counsel proposes that the FAR changes occur in April and October, instead of January and July, so that the change in permanent rates that currently occurs in October would be combined with the FAR rate change. This change would reduce the number of annual rate changes realized by KCPL's customers to three per year (Ex. 309, pp. 37-38). In KCPL's Position Statement, KCPL took the position that this change was acceptable (EFIS No. 269).

xvi. Should FAC costs and revenues be allocated in the accumulation period's actual net energy cost in a manner consistent with the allocation methodology utilized to set permanent rates in this case?

Public Counsel concurs with the positions taken by KCPL and the Commission's Staff that FAC costs and revenues should be allocated in the accumulation period's actual net energy cost in a manner consistent with the allocation method used to set permanent rates.

E. If the Commission authorizes KCPL to have a fuel adjustment clause, what FAC-related reporting requirements should it order KCPL to comply with?

The reporting requirements requested by Staff will increase the transparency of the FAC. Therefore, the Commission should require KCPL to supply the additional information requested by Staff.

F. If the Commission authorizes KCPL to have an FAC, should KCPL be allowed to add cost and revenue types to its FAC between rate cases?

KCPL should not be able to add costs and revenues types to its FAC between rate cases. Such decisions should be made during a rate case where ratepayers have input and where the Commission determines what should be included (Ex. 309, p. 34). These reasons were previously addressed above regarding the need for the Commission to specifically approve each cost component to be included in an FAC to ensure compliance with § 386.266, RSMo, and 4 CSR 240-20.090. If a cost component increase occurs between rate cases and it is of sufficient magnitude to have a material negative impact on a company's earnings, the company always has the option of filing a rate case.

G. If the Commission authorizes KCPL to have an FAC, should KCPL be required to clearly differentiate itself from GMO on customer bills?

KCPL should be required to identify which rate schedules, including a designation that clearly differentiates itself from KCP&L – Greater Missouri Operations Company to reduce (Ex. 210, p. 7). While KCPL may be able to identify which rates a customer is billed on when a customer calls in, (Tr. 1636), customers have to search the KCP&L web site to find a map to determine whether they are served by KCPL or GMO and then use the rate code on their bill to determine the applicable rates (Ex. 554, p.53). Whatever weak branding rationale KCPL may have for not clearly differentiating between these two distinct legal entities, must fail in the face of ratepayer confusion.

III. <u>Transmission Fees Expense</u>

A. What level of transmission fees expense should the Commission recognize in KCPL's revenue requirement?

Public Counsel did not file testimony on a particular level of transmission fees. However, Mr. Jim Dauphinais testified that the Commission should deny KCPL's proposed pro forma adjustment to remove 100% of its net plant, transmission revenues and transmission O&M expenses associated with its SPP Regional Transmission Projects from its retail rates in Missouri (KCPL Adjustments RB-81, R-81 and CS-81) (Ex. 557, p. 24). Mr. Dauphinais explained that KCPL's proposal would allow "KCPL to charge its Missouri retail customers for their share of these projects constructed and owned by KCPL based on FERC's authorized revenue requirement for the projects rather than a revenue requirement set by this Commission" (*Id.*). Although the dollar value associated with this issue is small ($2,000), Mr. Dauphinais characterized this as "an issue of great important precedent with respect to the Commission potentially allowing jurisdictional electric utilities to earn a FERC-authorized return from their Missouri retail customers" (*Id*.). Mr. Dauphinais recommends that the Commission "only allow KCPL to make pro forma rate base, revenue and O&M expense adjustments to remove the 92.4% of these projects that is not allocated to KCPL under the SPP Open Access Transmission Tariff" (*Id*.).

Trackers

The next five issues address expenses that KCPL wishes to track during the period in which they are incurred and then defer recognition of those costs in rates until a future period. KCPL initially proposed to use four different cost tracking mechanisms in this case: (1) the FAC; (2) a property tax tracker; (3) a cyber-security tracker; and (4) a vegetation management tracker. The vegetation management tracker was resolved through a stipulation in which KCPL agreed to drop its request (EFIS No. 450). However, there are still four tracker proposals before the Commission because KCPL proposed a transmission expense tracker in the rebuttal testimony of KCPL witness Mr. Tim Rush that was not proposed in KCPL's direct testimony (Ex. 135, p.11). Before any tracker can be approved by the Commission, however, it must be both lawful and reasonable.

Of the four trackers still at issue, only the FAC is statutorily authorized. § 386.266 RSMo. Since the Commission's powers must be statutorily authorized, the Commission must find the statutory authority for approving KCPL's remaining tracker requests. *UCCM*, 585 S.W.2d 41. Arguing for such authority is KCPL's burden, and to the extent KCPL's initial brief cites to Missouri statutes that KCPL believes gives the Commission such authority, Public Counsel will respond to those arguments in Public Counsel's reply brief.

Without the statutory authority to implement, trackers constitute unlawful retroactive ratemaking because they allow costs to be deferred to a future period for the sole purpose of retroactively charging future customers for losses incurred in a prior period. *UCCM*, 585 S.W.2d at 47. In *UCCM*, the Supreme Court held that it was unlawful for the Commission to "redetermine rates already established and paid without depriving the utility (or the consumer if the rates were originally too low) of his property without due process." *UCCM*, 585 S.W.2d 41,

58. "Past expenses...cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses." *UCCM*, 585 S.W.2d 41, 55, citing, §§ 393.270(3) and 393.140(5) RSMo. This is exactly what trackers seek to do - recover past losses through future rates due to an *unproven* mismatch of rates with expenses. The "losses" are unproven because when deferred costs are considered for ratemaking treatment, all relevant factors are not considered for the period that the costs were tracked. It is not known whether the company realized decreases in other costs or increases in revenues that offset the claimed cost increases, and therefore, eliminated any justification for the deferrals.

Retroactive ratemaking violates an accounting concept called the matching principle. Public Counsel witness and accountant Mr. Ted Robertson explained:

> The matching principal is a fundamental concept of accrual basis accounting that revenues should be offset against expenses on the basis of their cause-and-effect relationship. It states that, in measuring net income for an accounting period, the costs incurred in that period should be matched against the revenue generated in the same period. One of the basic accounting principles; it is followed to create a consistency in the income statements, balance sheets, etc. That is, financial statements may be greatly distorted if expenses are recognized earlier rather than later and vice versa; jeopardizing the quality of the statements and providing an unfair representation of the financial position of the business.

(Ex. 312, p. 5). Deferrals, on the other hand, seek to match expenses from a prior period with rates to be charged in a future period, resulting in a mismatch of expenses and revenues, and a purposeful and misleading distortion of the company's financial statements.

"KCP&L's tracker requests presuppose that there will be a significant earnings shortfall without considering all relevant factors. A hot summer could cause a significant revenue increase that could offset any cost increase or even surpass the cost increase" (Ex. 308, p. 5).

Deferring a single cost from a prior period to a future period also constitutes single-issue ratemaking. Single-issue ratemaking occurs when rates are determined based upon a single issue or factor without considering all relevant factors. *Midwest Gas Users' Ass'n v. P.S.C.*, 976 S.W.2d 470 (Mo. Ct. App. 1998). In the case of a deferral that is allowed to be recovered in future rates, a single cost is deferred for future rate recovery without considering all relevant factors that occurred during the same period the cost was incurred. All relevant factors would include, among other things, all revenues and expenses that occurred during the same period, including all cost decreases or revenue increases that offset the tracked cost increases. By not considering all relevant factors, allowing deferred costs to be included in rates constitutes single-issue ratemaking (*Id.*).

If the Commission concludes that KCPL's trackers are lawful, the next question to ask is whether such requests are reasonable and in the public interest. *Straube v. Bowling Green Gas Co.*, 227 S.W.2d 666, 669 (Mo. 1950). A primary reason trackers are not reasonable or in the public reason is they reduce the utility's incentive to control costs. In the Commission's recent Report and Order resolving Ameren Missouri's rate case, Case No. ER-2014-0258, the Commission explained why trackers are not in the public interest when it rejected Ameren's tracker request and stated, "By their nature, cost trackers tend to reduce a utility’s incentive to aggressively control costs by ensuring that all costs will be recovered" (Report and Order, Case No. ER-2014-0258, p.45). Because of this, the Commission concluded, trackers should be used only "sparingly" (*Id.* p. 50). The Commission also concluded, "Under a tracker, such costs would be subject to a prudence review, but a prudence review cannot control costs as efficiently as a strong economic incentive" (*Id.* p.45). The Commission found this to be sufficient reason to deny Ameren's tracker requests (*Id.*). KCPL's proposed trackers are no different - if approved, any one of them would reduce the company's incentives to implement strategies that control the tracked costs.

Any deviation from the matching principle creates a false or skewed picture of a company's overall costs (Case No. SR-2013-0016, *In the Matter of the Request for an Increase in Sewer Operating Revenues of Emerald Pointe Utility Company*, Report and Order, pp. 32-33 (July 20, 2013)). A tracker mechanism causes costs incurred in one time period to be collected from ratepayers in a later period – indeed, from ratepayers that may not have even been taking utility service when the cost was incurred - and so, generally, should be avoided. It should also be noted that while KCPL has now requested five (5) different cost tracking mechanisms in this case, KCPL does not propose the same standard to track changes in *revenue* levels that will likely occur in the future in order to prevent over-earnings.

Providing KCPL with a disincentive to control costs is the exact opposite direction from which Commission policies should be headed with regard to KCPL cost containment given KCPL's recent struggles in that regard. As testified by Dr. Geoff Marke, "Trackers and other single-issue ratemaking mechanisms work as a strong disincentive for utility management to control costs and they run counter to cost of service regulation. Given the 57.75% compounded increase in rates from the past five rate cases as well as the 15.75% rate increase sought in this case, controlling costs must be a priority" (Ex. 302, p. 27).

With the exception of the legality of an FAC, the issues identified above apply to all trackers requested by KCPL. One additional characteristic that KCPL's tracker requests all have in common, including the FAC, is that KCPL has not shown that including a test-year level of expense in rates will be insufficient to provide KCPL with an opportunity to recover its costs and earn a reasonable return.

B. Should a tracker be implemented for KCPL’s future transmission fees expense that varies from the level of transmission fees expense the Commission recognizes in KCPL’s revenue requirement and that KCPL will not recover through a fuel adjustment clause?

KCPL's transmission tracker request should be rejected. KCPL's request for a transmission expense tracker is unreasonable for the public policy reasons against trackers discussed above, and because KCPL has not demonstrated that SPP transmission costs are volatile. KCPL's cost estimates do not have high levels of unexpected variance and the cost estimates for the charges are routinely updated and disseminated by SPP (Ex. 558, p.5). In addition, the stakeholder and regulatory process for approval of transmission projects combined with these cost estimates provide KCPL more than enough time to analyze the costs in conjunction with the costs of all of its other operations and, if necessary, react by filing a rate case (Ex. 558, pp. 5-6, 9, 12).

A transmission expense tracker as proposed by KCPL is also not authorized by statute, and would constitute retroactive ratemaking and single-issue ratemaking as discussed above. Further, KCPL's proposal also violates the Commission's rules because it was not raised in KCPL's case-in-chief presented in its October 30, 2014, rate case filing as required by 4 CSR 240-2.130(7), which states, " Direct testimony shall include all testimony and exhibits asserting and explaining that party’s entire case-in-chief." KCPL's transmission tracker proposal was not raised until rebuttal testimony, in violation of 4 CSR 240-2.130(7), and should be denied because it harms the ability of other parties to this case, consumer parties in particular, to adequately respond to the new proposal.

IV. Property Tax Expense

B. Should a tracker be implemented for KCPL’s property tax expense that varies from the level of property tax expense the Commission recognizes in

KCPL's revenue requirement? i. Should KCPL get a return on as well as return of the tracked amounts? ii. Should KCPL get carrying costs on the tracked amounts?

KCPL's property tax tracker request should be rejected and KCPL should recover revenues for property tax expense through base rates, and no more, as do all other utilities in Missouri. KCPL's property tax expense is predictable and Staff's annualized property tax amount accurately captures the known and measurable ongoing level of property tax expense (Ex. 307, p.14). Simply put, a property tax tracker is unnecessary. The Commission's Staff has consistently used its method for calculating property tax expense, and the Staff's methodology has been upheld by the Commission (Ex. 307, p. 15). The evidence shows that there is "a predictive direct relationship between KCP&L's Plant-in-Service and the actual property tax amount paid by the Company" (Ex. 307, p.15). The Company's property tax liability increases from 2009 through 2014 are primarily and predictably due to plant additions (Ex. 307, p.15). The "Staff's methodology utilized to calculate the Company's annualized property tax amount provides the best available information regarding KCP&L's actual January 1, 2015 Plant in-Service and the most recent 2014 tax rates" (*Id.*).

The Commission should also deny KCPL's request for a tracker because KCPL's assertions that property tax expense will increase are speculative at best (*Id.*). "The use of tracking mechanisms should not be authorized based on speculative events" (*Id.*).

In addition, a property tax tracker as proposed by KCPL is not authorized by statute, would violate the matching principle, and would constitute retroactive ratemaking and single-issue ratemaking as discussed above.

V. <u>CIP/cyber-security Expense</u>

B. Should a tracker be implemented for KCPL's CIP/cyber-security expense that varies from the level of CIP/cyber-security expense the Commission recognizes in KCPL's revenue requirement? i. Should KCPL get a return on as well as return of the tracked amounts? ii. Should KCPL get carrying costs on the tracked amounts?

The Commission should deny KCPL's request for a CIP/cyber-security tracker for a number of reasons. First, costs associated with security standards, even new standards, are a normal on-going business expense (Ex. 307, p.20). KCPL currently incurs CIP and cyber-security costs and recovers those costs through rates as a normal cost of doing business (*Id.*). This includes costs associated with government-mandated expenses, and changes to government-mandated expenses, which are normal costs of doing business for KCPL in that KCPL has incurred similar cyber-security costs in the past for earlier versions of security standards and changes to those standards (*Id.*). Recovering costs through base rates in this manner is always the preferred method of recovering expenses. *UCCM*, 585 S.W.2d 41.

Public Counsel urges the Commission not to be mislead into believing that rejecting KCPL's request for a CIP/cyber-security tracker will have any impact whatsoever upon the level of protection KCPL provides for its system. "To be clear, appropriate measures to secure NERC CIP/Cyber standard compliance will take place regardless of whether or not KCPL has a tracker. It is inappropriate for the Company to frame this tracker as an either/or dilemma for the Commission" (Ex. 302, p.28). The point here is that KCPL will make whatever changes are mandated by the federal government regardless of whether or not KCPL has a tracker in place, and, therefore, rejecting this tracker request will have absolutely no impact on security. The new standards cited by KCPL are the fifth version of these standards required by NERC, all prior versions were addressed by KCPL without the need for a tracker (*Id.*).

Public Counsel was unable to find a single example of a CIP/Cyber Tracker or other related adjustment clause mechanism being approved by any Commission in the United States (Ex. 302, p.29). Most recently, West Virginia's Public Service Commission rejected a single-issue rate mechanism proposal for CIP/Cyber compliance by American Electric Power in 14-1152-E-42 (*Id.*). KCPL's own list of trackers approved in other jurisdictions fails to include a single example of a similar tracker being approved anywhere in the U.S. (*Id.*).

Other reasons to reject KCPL's request for a CIP/cyber-security tracker is that KCPL has not properly defined the type of costs that would be included in such a tracker, essentially amounting to a blank check for KCPL to defer and track costs (Ex. 307. p.21). Granting KCPL's request would also encourage similar tracker requests by other public utilities (*Id.*).

"Cyber-security and infrastructure risk mitigation is not a novel concept that somehow necessitates special ratemaking treatment. KCPL has every incentive it already needs in traditional ratemaking to be fully compliant with all cyber-security and infrastructure protection requirements placed on it and there should be no doubt that the existence or non-existence of a cost tracker will do nothing to change that" (Ex. 302 p.30).

Lastly, a CIP/cyber-security tracker as proposed by KCPL is not authorized by statute, would violate the matching principle, and would constitute retroactive ratemaking and single-issue ratemaking as discussed above.

XIV. Rate case expense

A. Were any rate case expenses claimed by KCPL imprudently incurred?

Rate case expenses should first be evaluated by the Commission to determine if they have been prudently and/or reasonably incurred (Ex. 307, p.46). Any rate case expense found to be imprudently incurred and/or unreasonably incurred must be disallowed (*Id.*). Customers cannot be made to pay for costs the Commission finds were imprudently incurred. § 393.150, RSMo. The facts of this case demonstrate that KCPL incurred certain rate case expenses that are unreasonable and should, therefore, be disallowed as imprudent. The first such imprudent expenses are the excessive attorney fees incurred by KCPL to present its case to the Commission. In addition to KCPL's two experienced in-house counsel, KCPL also retained three separate law firms that employed a number of additional attorneys and firm employees providing services related to this case (Ex. 307, p.27). The additional attorneys charged KCPL hourly rates of $495 per hour and $350 per hour, which the evidence demonstrates is unreasonable and imprudent (*Id*.).

Comparing the outside attorney rates incurred by KCPL to the outside attorney rate by Ameren Missouri in its recently concluded rate case demonstrates that a comparable hourly rate is $200 per hour, which was the rate charged by Ameren's experienced outside counsel to represent Ameren Missouri in its rate case (*Id.*). Ameren's outside counsel comes from "the oldest law firm in Columbia, Missouri, and one of the largest firms based in central Missouri" and provides the Commission with a good proxy for determining the prudence of the hourly rates charged by KCPL's outside counsel (Ex. 308, pp.27-29). A rate of $200 per hour is also in line with rates charged by attorneys in Missouri pursuant to a survey conducted by the Missouri Bar which is attached to the surrebuttal testimony of Public Counsel witness Mr. Addo (Ex. 308, Schedule WA-5). The median hourly rate charged by Missouri's sole practitioners is $151 to $200 per hour, while the median hourly rate charged by Missouri's attorneys in law firms with more than one attorney is between $200 and $250 (*Id.*). An hourly rate of $350 per hour is charged by only 6% to 9% of Missouri's attorneys, while an hourly rate of $495 per hour is charged by approximately 1% of Missouri's attorneys (*Id*.). It is imprudent for a public utility such as KCPL to pay attorney rates that are at the high end of fees charged by attorneys in Missouri. This is especially true when the company retains two very experienced in-house attorneys, Mr. Hack and Mr. Steiner, that are fully capable of presenting KCPL's case to the Commission. KCPL's customers, who already pay for KCPL's in-house attorney salaries, should not be forced also to pay for the highest priced attorneys around to perform duties that can be performed by KCPL's experienced in-house attorneys. While KCPL repeatedly relied upon the high-priced attorneys to make opening statements and conduct cross-examination of witnesses, KCPL's in-house attorneys sat nearby and watched.

Despite the imprudence of duplicating services that KCPL's in-house attorneys are able to provide, Public Counsel is not recommending a complete disallowance of the high attorney fees. Rather, Public Counsel is proposing only that the hourly rates be adjusted to $200 per hour to keep the hourly rates to a reasonable and prudent level (Ex. 308, p. 27). According to Public Counsel witness Mr. Addo, the imprudent costs to be disallowed if the high attorney fees were adjusted to $200 per hour is $91,767, a number that is still subject to further true-up (William Addo True-Up Direct Testimony, pp. 10-11). This includes a recalculation of the attorney fees charged by Dentons US, LLP, Fischer & Dority, P.C., and Cafer Pemberton, LLC (*Id.*).

In addition, Public Counsel also recommends a disallowance of expenses incurred retaining the services of Mr. Overcast of Black & Veatch because Mr. Overcast's testimony is duplicative of testimony from KCPL's in-house employees (Ex. 308, p.28). Mr. Overcast testified on the topics of fuel and purchased power costs and trackers, testimony on which other KCPL in-house personnel also testified, including KCPL witnesses Heidtbrink, Ives, Blunk, Bresette, Carlson, Crawford, Rush, Hardesty, Roper and Kiely. Mr. Overcast's testimony was unnecessary and excessive, and should be disallowed as imprudent (*Id.*).

If the Commission were to reduce the hourly rate allowed to $200 for outside attorneys, as proposed by Public Counsel, this would not be a first. The Commission did exactly that in Case No. GR-2004-0209 when Missouri Gas Energy (MGE) employed a law firm that charged $690 per hour to represent MGE in a rate case (Report and Order, Case No. GR-2004-0209, p.119). The Commission recalculated the law firm's bill by applying a $200 per hour rate instead of a $690 per hour rate, and allowed only the recalculated amount in rates (*Id*.). The Commission in that case also rejected the entire bill of another law firm used by MGE because its work was duplicative of work done by the other law firm retained by MGE (*Id.*). Public Counsel's recommendations in the present case are not new approaches used by the Commission to allow only prudently incurred expenses. Recalculating the bill and eliminating duplicative work are reasonable and proven solutions to address KCPL's excessive rate case expenses.

KCPL's rate case expenses are indicative of a company that appears to take for granted that 100% of its rate case expenses will be recoverable through rates, a mindset that has lead to a "cost is no object" approach towards presenting its case to the Commission. Disallowing imprudent costs will prevent ratepayers from paying excessively for costs that KCPL should not have incurred to present its case. The cumulative disallowance for imprudence that the Commission should order (subject to additional true-up) is $127,112, which is the sum of $91,767 for KCPL's outside attorneys and $35,345 for Black & Veatch (Addo True-Up Direct Testimony, pp. 10-11).

B. Should the Commission require KCPL shareholders to cover a portion of KCPL's rate case expense?

KCPL shareholders should be required to cover at least half of KCPL's prudently incurred rate case expense, which is calculated *after* the disallowances for imprudence identified above (Ex. 307, pp. 30-35). Good public policy dictates that "it is just and reasonable to share rate case expense equally between shareholders and ratepayers because the outcome of a rate case proceeding benefits both shareholders and ratepayers—shareholders in the form of allowed return on equity, and ratepayers in the form of safe, adequate, and reliable service" (Ex. 306, p.31). The allowed return on equity is a substantial portion of the present rate case, as it is in any typical rate case, whereby the company expends considerable rate case resources attempting to convince the Commission as to a higher rate of return than what ratepayers and the Commission's Staff recommend as reasonable. This issue is always adversarial in nature with the company pitted against its customers each and every time, and it is indicative of the fact that shareholders benefit significantly from rate cases and, therefore, it is entirely reasonable that shareholders pay for those benefits. KCPL chose when to file its rate case, KCPL chose which issues to bring to the Commission, and KCPL chose to hire attorneys, advocates and consultants to present and argue its case to the Commission at a cost KCPL decided to incur in its sole discretion, not the ratepayers (Ex. 306, p.31).

The Commission Staff's Cost of Service Report stated that "the rate case process in Missouri is, at least in part, premised upon an assumption that the utility is not likely in all circumstances to act in the best interests of its customers. This assumption points out the inequity of having customers finance a utility’s efforts to increase rates that may be ultimately found by the Commission to be excessive or unreasonable in amount" (Ex. 200, p. 133). It is unreasonable and simply unfair to require ratepayers to pay 100% of the expenses incurred by KCPL to advocate for issues that are contrary to the interest of KCPL’s customers and often contrary to the public interest generally.

Similar to how tracking mechanisms provide a disincentive to companies to control the costs that are tracked for future recovery, allowing KCPL to recover 100% of its rate case expenses has the negative effect of providing the company with a disincentive to control costs (Ex. 306, p.32; Ex. 200, p. 133). If KCPL is limited to recovering only half of its prudently incurred rate case expense, KCPL will, in future cases, be forced to question each rate case expense incurred, which will have the positive effect of reducing overall rate case expenses.

A 50/50 sharing is reasonable, as opposed to a different sharing percentage, because KCPL's ratepayers and KCPL's shareholders benefit from the rate case expense process (Ex. 200, p. 133). KCPL's shareholders benefit through an authorized return on their investment, and KCPL's customers benefit with improvements in service (*Id.*). A 50/50 split recognizes the mutual benefits both receive from rate cases. In addition, the facts of this case show that KCPL is incurring rate case expenses with little incentives to keep those costs in check, and a substantial stake in rate case expenses have shown to be necessary to keep KCPL's expenses in check in future proceedings.

A 50/50 sharing is also reasonable because the vast majority of the litigated issues were raised by KCPL to benefit shareholders by shifting risk onto ratepayers. These include KCPL's requests for: (1) an inflated 10.3% ROE; (2) an FAC (that KCPL agreed not to seek); (3) a $25 residential customer charge; (4) a transmission expense tracker; (5) a property tax expense tracker; (6) a CIP/cyber-security expense tracker; (7) a vegetation management expense tracker; and (8) a late-filed request for a $20 million "pilot" program to install 1,000 electric vehicle charging stations. These issues comprised virtually all of the unsettled issues that the ratepayers have been forced to litigate, and they compromise the vast majority of the time spent in the hearing room and in this brief. Ratepayers are forced to try and protect against an unreasonable shifting of risk onto ratepayers, and it seems only reasonable that shareholders contribute at least half towards their *own* rate case expenses. These facts suggest that a 50/50 sharing is actually too generous and ratepayers should carry a far smaller burden that KCPL, but ratepayers seek only a 50/50 sharing in this case.

Other reasons that support a 50/50 sharing include: (1) KCPL used three outside law firms in addition to their in-house counsel, including one high-priced law firm that only prepared witnesses for the hearing (Addo True-Up Direct, p. 9); (2) KCPL paid excessive attorney hourly rates of $495 and $350 per hour to provide services that could be provided in house, and in fact, on many occasions KCPL's in-house attorneys sat idle while the high-priced attorneys made opening statements and conducted cross-examination; (3) KCPL duplicated the testimony of in-house employees with testimony provided by expenses consultants; and (4) Rate case expenses KCPL has incurred in recent cases is "substantially higher than historical levels, and higher than other large utilities in Missouri" (Ex. 200, p.135). These types of gross excess will continue unless KCPL's portion is substantial enough to put pressures on KCPL to contain costs, and a 50% stake should be the *minimum* portion allocated to KCPL's shareholders to provide this downward pressure on expenses (Ex. 200, p.134).

The Commission addressed the issue of rate case expenses in a 2010 decision wherein the Commission recognized that shareholders benefit from rate cases and should be willing to pay a portion of rate case expense:

> OPC's assertion that both the company and the ratepayers benefit from rate case expense has merit in that shareholders do receive a portion of the benefits and should be willing to pay for a portion of the company's rate case expense. The record is not developed on the issue, but there is a strong public policy argument that requiring the company to bear some portion of the rate case expense would incentivize the company to more aggressively manage its rate case expenses.

(Report and Order, Case No. GR-2009-0355, p. 78). While the record in the MGE case above was not developed on the issue, such is not the case here for KCPL as multiple expert witnesses have testified on rate case expense. Moreover, the "strong public policy argument" in favor of rate case expense sharing has not changed. The Commission also stated:

> The ratemaking process necessarily and appropriately requires the regulator to make decisions as to expenses that are appropriately borne by the utility's shareholders and those that are appropriately borne by the ratepayer. Rate case expense is no exception.
>
> ...
>
> ...this Commission wants to make clear to MGE and other utilities that rate case expense is not simply a blank check and if certain rate case duties can be performed "in-house" by existing personnel more cheaply, we expect the utility to do so. On the issue of rate case expense, we urge MGE and other utilities to recognize that rate case expense may not be reflexively and automatically passed on to the ratepayers in the future. This Commission disallowed certain rate case expenses (attorney fees) in the 2006 MGE rate case and the Commission will not hesitate to do so again should the evidence support such a decision.

(Report and Order, Case No. GR-2009-0355, p.79).

Requiring the utility's shareholders to assume a portion of prudently incurred expenses is not a novel concept and has been used for other expenses where it was determined that shareholders benefited from the expense and should, therefore, be responsible for the expense. The Staff's Cost of Service Report identified charitable donations and lobbying expenses as discretionary expenses that have historically not been included in cost of service (Ex. 200, pp.133-134). Rate case expenses, to a great extent, are very similar to lobbying in that much of the expenses are incurred to benefit shareholders through increased profits.

Across the country, the 50/50 sharing of rate case expense is not unusual. The New Jersey Public Utilities Commission adopted a 50/50 sharing on multiple occasions and concluded that "a rate case benefits both ratepayers and shareholders and, absent any special circumstances, sharing of these expenses is appropriate." 2006 N.J. PUC LEXIS 165 (N.J. PUC 2006). *See also* 2001 N.J. PUC LEXIS 146 (N.J. PUC 2001).

In Rhode Island, the Supreme Court of Rhode Island upheld a sharing order and concluded, "As a matter of policy, its sharing of rate-case costs between shareholders and ratepayers is sound" and " sharing costs of deferred rate-case expense with stockholders may provide an incentive to the company to minimalize rate case costs." *Providence Gas Co. v. Malachowski*, 656 A.2d 949, 953 (R.I. 1995).

In Minnesota, the Minnesota Public Utilities Commission concluded that it "has often granted partial recovery of economic development costs, recognizing that these costs generally benefit shareholders as much as ratepayers. The Commission finds that here, too, a 50/50 sharing represents the most equitable distribution of these costs, since both Company and ratepayers benefit from them." 2010 Minn. PUC LEXIS 444, 81-82 (Minn. PUC 2010).

The last case to be mentioned occurred in Pennsylvania, where the Pennsylvania Public Utilities Commission provided a detailed explanation as to why it ordered a 50/50 sharing:

> Our conclusion is that a 50/50 sharing, between the stockholders and ratepayers, of the prudently incurred current rate case expense is an appropriate balancing of the respective interests.
>
> First, while it has been argued that ratepayers benefit from a rate case and any resulting increase in rates through the increased financial integrity of the utility, through the utility's maintenance of the ability to raise external capital, through the raising of such capital on reasonable or more reasonable terms, it cannot be overlooked that stockholders are the most immediate beneficiaries of increased rates. We perceive no reason why rate cases should be a cost-plus operation. Second, proper incentives must be formed so that utilities are discouraged from:
>
> (1) filing repeated and excessive rate filings which include exaggerated claims of little merit, but which nevertheless require rebuttal and absorb significant amounts of regulatory resources;

> (2) attempting to overcome their opponents and regulators by a massive assault of legal and technical experts; and
>
> (3) operating their business inefficiently.
>
> Were regulators to establish an inflexible rule, which allowed recovery of all rate case expenditures, the effect would be to encourage all of the above: repeated and excessive filing, litigational overkill, and inefficiency. Third, in recent cases we have seen the relitigation of matters which have been decided numerous times before, such as the accumulated debt interest and preferred dividend issue relitigated again in this proceeding. Additionally, we have observed large expenditures for outside services. Accordingly, we find that an appropriate balancing of the respect [sic] interests of the ratepayers and stockholders requires the assignment of the current rate case expense on a 50/50 sharing basis." 1982 Pa. PUC LEXIS 154 (Pa. PUC 1982)

A 50/50 sharing of rate case expense is good public policy because it recognizes that rate cases, like lobbying and charitable donations, are done for the benefit of shareholders, while also recognizing that ratepayers see some benefit from rate cases when rate increases are used to enhance or maintain a good quality of service.

C. What level of rate case expense for this rate case should the Commission recognize in KCPL's revenue requirement?

As of the date of true-up direct testimony, the Commission should include $63,743 in rates for KCPL's normalized rate case expense (Addo True-Up Direct, p.8). Mr. Addo reached his normalized rate case expense amount incurred by KCPL to date of $63,743 by first subtracting the imprudent amount of $127,112 from the total rate case expense amount of $534,180 to reach $407,068 in prudently incurred expenses (*Id*.). This $407,068 was then divided between ***$ *** incurred for the depreciation study and the remaining ***$ *** for all other rate case expenses. These amounts were split 50/50 between shareholders and ratepayers, with the depreciation study amount of ***$ *** normalized over a 5-year period, and the remaining rate case amount of ***$ *** normalized over a 3-year period. This results in a total normalized amount to include in rates of $63,743 (*Id.*). This amount is subject to additional true-up through August 12, 2015.

XVII. <u>Management Audit</u>

Should the Commission order a management audit of KCPL?

The evidence in this case demonstrates that it is reasonable and in the public interest to order KCPL to undergo a management audit by an independent auditor, which is necessary to identify cost savings and efficiencies (Ex. 500, p.13). This audit should encompass all functional operation and maintenance activities as well as administrative and general expenses (*Id*.). "KCP&L's expenses are excessive and this problem must be addressed by KCP&L with Commission oversight; the Commission cannot resolve this structural problem through ratemaking adjustments alone" (*Id.*).

Mr. Lane Kollen, a consultant retained by MECG and Public Counsel, testified that KCPL's administrative and general (A&G) expenses are excessive compared to other utilities operating in the region (*Id.,* p.14). Mr. Kollen characterizes the issue as a structural problem within KCPL, and testified that such an audit should also audit KCPL's operations and management (O&M) expenses because A&G and O&M are closely related (Id.). "The Commission should oversee the management audit scope and KCP&L's implementation of the recommendations to ensure that KCP&L's costs are reduced to reasonable levels" (*Id.,* p.15).

The evidence shows that Mr. Kollen has testified in approximately 200 rate cases around the country, and of those 200, he recommended a management audit in only five or six of those cases, which suggests that this is not a routine recommendation for Mr. Kollen (Tr. 1224). The evidence also shows that KCPL itself has retained outside consultants to review its processes, and according to KCPL's witness Mr. Bresette, those reviews resulted in beneficial recommendations for KCPL (Tr. 1168-1169). An order from this Commission directing KCPL to undergo a management audit would not be a novel approach to find savings and efficiencies. *In the Matter of a Management Audit of Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P*, Case No. EO-2006-0356; *In the matter of The Raytown Water Company's tariffs to provide for a permanent increase in rates for water service,* Case No. WR-92-85.

During the evidentiary hearing, KCPL's witness on this issue, Mr. Bresette, testified that KCPL was resistant to a management audit "because management clearly understands the inner workings of KCP&L and continuously reviews processes and procedures" (Tr. 1170). This response assumes that KCPL's management is flawless and that all possible savings and efficiencies have already been identified and implemented. Herein lies one of the problems that KCPL faces currently – KCPL's management assumes that it cannot find additional savings and efficiencies and that an outside auditor would not approach a management audit with a different perspective with new ideas. On the contrary, an independent auditor would bring to a management audit the knowledge gained from auditing and finding savings and efficiencies in numerous instances across the country –knowledge and experience not possessed by KCPL management (Tr. 1214). "[T]he expectation would be that there would be savings resulting from the audit, and savings of a magnitude much greater than the cost of the audit" (Tr. 1216).

Assuming KCPL is granted some level of rate increase in this case, KCPL's captive customers will have undergone six (6) general rate increases in just the last eight (8) years (Ex. 301, p.22). If KCPL's total request in this case were added to the past five (5) increases, the cumulative total would be $404,033,644, or approximately $50 million per year (Id.). A management audit will identify savings and efficiencies and help contain KCPL's current pattern of substantial and constant cost increases, and is in the public interest. Mr. Kollen explained that "we have a series of rate increases that are very substantial over the last five or six years, and we also have indicative information that the administrative and general expenses are high compared to other utilities operating in the region" (Tr. 1228-1229). Mr. Kollen also testified that he has "never seen a situation where a management audit has not paid for itself" (Tr. 1229).

XVIII. Clean Charge Network

KCPL filed its rate case application and direct testimony on October 30, 2014. Commission rule 4 CSR 240-2.130(7) required KCPL to raise its entire case-in-chief in direct testimony. But nowhere in KCPL's direct testimony is any mention of KCPL's $20 million plan to install 1,000 electric vehicle (EV) charging stations around the Kansas City area. The parties met in a prehearing conference on November 24, 2014, where they discussed a procedural schedule for the case (Tr. Vol. 1). Thereafter, interested parties intervened, the parties retained the consultants necessary to present their case, and certain parties proposed a procedural schedule to the Commission (EFIS Nos. 1-90). KCPL made no mention of its EV proposal throughout this time. When the parties disagreed over the procedural schedule, numerous pleadings were filed with the Commission, and throughout this time, KCPL continued to keep the other parties in the dark about their plan to introduce a new issue into the case at a later date. Then, on February 2, 2015, ninety-nine (99) days after KCPL initiated the case and presented its case-in-chief to the Commission, KCPL filed the supplemental testimony of KCPL witness Mr. Darren Ives regarding KCPL's new EV charging station proposal (EFIS No. 92).

Public Counsel maintains its position expressed in prior motions opposing the consideration of this issue in this case (EFIS No. 95). Consumer parties and the Commission's Staff have been cut short on 99 days, over three months, of opportunity to engage in discovery, to seek consultants on the issue, and to conduct research on what could amount to a substantial change in Missouri regulation. There is absolutely no excuse for KCPL to have maintained its silence on their plan to introduce this new issue into the case. To the extent KCPL claims it was an issue of confidentiality, there are rules in place regarding the disclosure of confidential information, and the other parties could have been alerted to the new issue and maintained the level of confidentiality KCPL applied to the new plan. But KCPL did not do that, and instead, purposely kept its customers in the dark about its proposal to invest in a $20 million *pilot* program and to have customers that will not use the proposed new service to pay for it.

The supplemental direct testimony of Mr. Ives should have been rejected. By not rejecting it, KCPL's customer's rights to due process and their ability to present a case to the Commission on this issue have been compromised. *State ex rel. Praxair, Inc. v. Mo. PSC*, 344 S.W.3d 178 (Mo. 2011).

A. Should all issues associated with KCPL's Clean Charge Network be considered in a separate case, and not considered in this case?

Public Counsel urges the Commission to deny KCPL's request to allow any amount of the EV charging station in rates of existing customers, and instead, open a working docket as proposed by KCPL to consider the long list of unanswered questions raised by KCPL's plan. These include unanswered questions regarding ratepayer subsidies, program goals, income distribution, public participation, tariffs, program design, scope of the investment, risk shifting, cost-benefit analyses, participating organizations, host sites, free electricity offerings, anti-competitive subsidies, and proper performance-based measures to determine effectiveness, among others (Ex. 304, pp. 11-39). These and other program details are missing from KCPL's proposal and would be best addressed in a separate docket (*Id.*). KCPL witnesses confirmed that the many questions not answered by KCPL's proposal could be addressed in a working docket, which suggests that even KCPL recognizes that its request to include the service costs in rates is premature (Tr.577).

B. Is the Clean Charge Network a public utility service?

The "well known purpose of [monopoly regulation] is to avoid the inevitable economic loss and waste that follows duplication or paralleling of the lines and facilities of competing companies." (1951 Mo. PSC LEXIS 17 (Mo. PSC 1951).

In 1918, the Supreme Court of Missouri explained the policy further:

> [T]he act establishing the Public Service Commission, defining its powers and prescribing its duties is indicative of a policy designed, in every proper case, to substitute regulated monopoly for destructive competition. The spirit of this policy is the protection of the public. The protection given the utility is incidental. The policy covers a particular case when competition would impair or destroy a utility and, as a consequence, eventually entail an increase of rates charged the public.

State ex rel. Electric Co. v. Atkinson, 275 Mo. 325, 337 (Mo. 1918). The purpose of monopoly regulation is to protect customers against the possibility that competition would require the duplication of a vast and expensive distribution systems, and would result in the destruction of the utility if competition whittled away at a customer base necessary to provide the revenues necessary to maintain the system. *Id.*

The above quote and policy involved raises the question, does a service where competition would *not* destroy the utility require Commission regulation? Certainly monopoly regulation would be warranted if each provider of EV charging stations were required to duplicate KCPL's entire distribution system. But the evidence in the case shows that there are already other providers of EV charging stations in the Kansas City area without the need to completely duplicate KCPL's electric distribution system (Ex. 200, p.206). However, that could quickly change if KCPL is authorized to subsidize its EV charging station service through rates paid by existing residential and business customers, an advantage not afforded competitive providers of the service (Ex. 304, p.15).

There are many unanswered questions about this “pilot” service to make the decision in this case as to how this service will be treated going forward. The consequences of getting it wrong, which is quite possible given the truncated process KCPL forced upon the Commission, are far too great to decide whether the service is regulated, non-regulated, or somewhere in between. The best outcome is to make that determination - a determination that could establish the success or failure of the service in the future - in a working docket where the Commission and parties can devote the time and stakeholder involvement that this very important issue deserves.

C. If the Clean Charge Network is a public utility service, who pays for it?

There is not enough supporting detail to substantiate any ratepayer burden. All costs of KCPL’s new service should be rejected and borne by shareholders and the users of that service. If/when it is appropriate for ratepayers to bear the costs of the CCN - after policyholders have weighed-in during an appropriate proceeding – only the cost causers/end users should pay for the costs.

XXV. <u>Class cost of service, rate design, tariff rules and regulations</u>

On June 16, 2015, the Commission's Staff, Public Counsel, Missouri Industrial Energy Consumers (“MIEC”), Midwest Energy Consumers’ Group (“MECG”), Consumers Council of Missouri, Missouri Division of Energy, and the United States Department of Energy, (collectively, the “Signatories”) filed a Non-Unanimous Stipulation and Agreement on Certain

Issues wherein the Signatories reached agreement as to the issues listed in section XXV, Class Cost of Service and Rate Design, subsections A and B, as set forth in the List of Issues filed by Staff on June 9, 2015. This agreement covers all class cost of service and rate design issues. For those issues, Public Counsel supports the terms of the agreement, as explained below.

A. <u>Class cost of service</u>

a) Production Plant

1) What methodology should the Commission use to allocate fixed production plant costs among customer classes?

B. <u>Rate design</u>

a) What methodology is most reasonable for allocating net cost of service among the customer classes in this case?

b) How should any revenue increase be allocated among rate schedules?

c) What, if any, interclass shift in revenue responsibilities should the Commission make?

The Non-Unanimous Stipulation and Agreement resolves the above four (4) issues as follows:

> **Class Cost of Service, Production Plant**: The Signatories agree that the Commission should allocate any increase to revenue requirement resulting from this case as an equal percentage increase to all the classes. Given that an equal percent revenue allocation is consistent with some party recommendations contained on the record, the Signatories do not believe that the Commission needs to make specific findings as to the appropriate methodology for allocating production plant costs among the customer classes.

(EFIS No. 293). Public Counsel supports this outcome and recommends approval of this portion of the Non-Unanimous Stipulation. While KCPL objected to the Non-Unanimous Stipulation, KCPL appears to be in agreement that any revenue requirement increase should be allocated on an equal percentage basis to all rate classes (Tr. 333-334).

d) <u>Residential</u>

1) Customer charge – at what level should the Commission set KCPL's residential customer charge?

Public Counsel urges the Commission to reject KCPL's proposed $25 residential customer charge, which would constitute a $16 per month, or 177% increase to the current $9.00 charge. The Non-Unanimous Stipulation entered into by the Staff, the Division of Energy, and consumer parties states:

> With regard to the residential customer charge, the Signatories agree that the current customer charge of $9.00 should remain the same for a residential general use customer, and the residential customer charges for the other remaining residential customer rate schedules remain the same as currently charged.

(EFIS No. 293). This outcome is consistent with good public policy and is supported by the weight of the evidence before the Commission in this case. Public policy is defined by the Supreme Court of Missouri as "the principle which declares that no one can lawfully do that which has a tendency to be injurious to the public welfare." *State ex rel. St. Louis v. Public Service Com.*, 335 Mo. 448, 458 (Mo. 1934). If the Commission makes a change to KCPL's residential rate design, the Commission's decision will have an immediate impact on 241,619 residential customers in apartments and houses across thirteen counties (Ex. 301, p.6). But the 241,947 represents the number of apartments and houses, it does not represent the number of people impacted by this case. Any rate design change will impact approximately 565,388 people.[3] Because of these impacts, it is important to understand the current state of the population that will be impacted most.

[3] *See* 2010 Decennial Census (indicating the average occupancy per housing unit in Kansas City is 2.34 people).

KCPL is not concerned with the number of customers that would be negatively impacted by an increase to the customer charge, or they would have provided a better analysis of the issue. KCPL has provided no meaningful analysis of the demographics of their customers. KCPL's entire focus in its residential rate design is the importance of its impact to shareholders.

Fortunately, unlike KCPL, the Commission's purpose is to promote the public interest through the establishment of public policies that protect the public welfare. *State ex rel. St. Louis v. Public Service Com.*, 335 Mo. 448, 458 (Mo. 1934). An increase to the customer charge would not promote the public interest and would constitute poor public policy.

KCPL's residential customers, a substantial number of which are in poverty and struggling to meet their daily needs, should have as much control over their utility bills as possible so that they can reduce their monthly expenses by using less power. In fact, these were the Commission's exact words three months ago when it rejected Ameren Missouri's request to increase its customer charge from $8.00 to $8.50:

> Residential customers should have as much control over the amount of their bills as possible so that they can reduce their monthly expenses by using less power, either for economic reasons or because of a general desire to conserve energy. Leaving the monthly charge where it is gives the customer more control.

(Report and Order, Case No. ER-2014-0258, pp. 76-77). The needs of Ameren Missouri's customers are no different than the needs of KCPL's customers, and there is no reasonable justification for reaching an opposite conclusion in the present case. In this instance, good public policy in the St. Louis region is also good public policy in the Kansas City region, and Kansas City area residents deserve no less. Customers on either side of the state benefit from having control over their bill.

Bill control is especially important for elderly and low-income KCPL customers that cannot afford another rate increase, and that have already been forced to turn off their air conditioning in 100º heat (Public Comment No. P201502042).[4] This should be a significant concern to this Commission due to the potential life-threatening implications. A utility's desire to shift risk onto the backs of its most needy of customers, for no other reason than to guarantee greater profits, should never be a public policy endorsed by this Commission.

As the Commission determined for Ameren Missouri, "residential customers should have as much control over their bills as possible" and raising the fixed charge takes away the customer's ability to control their bills. The Commission's Ameren Missouri rate case order also concluded that economic reasons are not the only reasons why customers should have as much control over their bills as possible – control also promotes energy efficiency and conservation. Again, the incentives for customers in St. Louis to conserve energy should be no less than the incentives for customers in Kansas City. Good public policy favors rate designs that promote energy efficiency and conservation – and increases to the fixed customer charge reduce a customer's incentive to employ energy efficiency measures in their home, including measures as simple as turning off lights to reduce consumption (Ex. 303, p.35).

Increasing the customer charge also reduces the gains customers thought they would see for customers that have already invested in energy efficiency measures (*Id.*). A rate design that promotes energy *consumption* by increasing the residential customer charge to the highest amount in the region would run counter to the Commission's policy directions and ratepayer investments in energy efficiency and conservation efforts to date (Ex. 302, pp. 24-25).

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[4] This public comment and all other public comments filed in EFIS are attached to this brief for ease of reference.

KCPL witness Mr. Rush cited to Bonbright's Principles of Public Utility Rates[5] for the factors which should be considered when designing rates, and those principles include the impacts that rate design has upon energy efficiency and demand response programs (Ex. 134, p.60). A high customer charge would impact the assumptions included in KCPL's current energy efficiency program adopted under the Missouri Energy Efficiency Investment Act (MEEIA) (Ex 301, p.7). Public Counsel witness Dr. Geoff Marke explained:

> …increasing the customer charge at this level would diminish the payback period for all customers' energy efficiency efforts promoted by the Company to date. The cost effective calculations would be reduced across the board for residential ratepayers, which will impact financial decisions and prolong future payback assumptions. In short, the Company would be promoting inefficiency and consumption indirectly by denying residential customers the conservation and efficiency savings they expect from their energy efficiency investments.

(*Id.*). A change to the residential customer charge would necessitate an evaluation of KCPL's MEEIA program to determine what changes need to be made to that program to reflect the impact of an increase to the customer charge and a decrease in the customer's ability to realize gains from their energy efficiency efforts (*Id.*).

The evidence before the Commission from the Staff and Public Counsel show that the approximate cost to serve a residential customer is $11.88 (Ex. 247, 316 and 317). This $11.88 is also consistent with KCPL's own cost figures since Public Counsel's witness Dr. David Dismukes concurred with KCPL's class cost of service study and used it to calculate costs (Ex 303, p.3). A $9.00 customer charge already recovers over seventy-five percent (75%) of the costs to serve a customer through a flat customer charge, with the remaining twenty-five percent

[5] Bonbright, J.C., Principles of Public Utility Rates. New York, NY: Columbia University Press. 1961. pp. 290-294.

(25%) recovered through a variable rate to enable the customer to have better control over their bill as discussed above. KCPL's proposed $25.00 customer charge, according to KCPL, would recover almost all residential customer and local distribution costs through a flat charge (Ex. 134, p.65). The Company's residential customer charge proposal presumes that local distribution facilities are customer-related despite the fact that it does not identify these costs as customer-related in its class cost of service study (Ex.305, p.8). The Commission should reject the Company's proposal to include the demand-related local facilities charges in the customer charges of residential customers, since it is inconsistent with traditional cost of service and ratemaking practice (*Id.*).

The Company's evidence focuses exclusively on its desire to recover more costs up front. Even if KCPL's cost arguments were accurate, which they are not, cost is only one consideration among many other discussed in this brief when designing rates. Even KCPL witness Mr. Rush recognizes that cost is but one consideration among many considerations when he cited to Bonbright's Principles of Public Utility Rates and identified a number of considerations to be made when designing rates, including: (1) Minimize Customer Dissatisfaction; (2) Continue Practice of Gradualism (rate increases should be gradual to protect against rate shock); (3) Simplify Rate Structures; (4) Construct Consistent Rate Structures; and (5) Consider impact to Energy Efficiency and Demand Response Programs (Ex. 134, p. 60).

Another consideration not mentioned by Mr. Rush is that low customer charges also act as an incentive to KCPL management to continuously seek cost-saving measures, whereas guaranteed recovery through an increased customer charge lessens those incentives. Given the problems the evidence has shown regarding KCPL's unreasonably high expenses and the need for a management audit, every reasonable incentive available to the Commission to encourage

KCPL management to continue seeking cost-saving measure should employed by the Commission, including the incentive included in a low customer charge.

A survey of current customer charges in the Midwest shows that over half of the utilities surveyed have customer charges at the same rate or lower than KCP&L's current residential customer charge (Ex. 303, p.15). The average residential customer charge is $8.87 for Midwest region utilities (*Id*.). According to Dr. Dismukes, "Of the 58 utilities surveyed, one utility has a customer charge equal to the Company's residential customer charge, 36 electric utilities have customer charges lower than the Company does and 20 have a customer charge higher than the Company's current charge" (*Id.*).

Public Counsel strongly encourages the Commission to leave KCPL's customer charge at $9.00 per month. Customers have endured far too many rate increases in the recent past, and will face another increase as a result of this case, and increasing the customer charge is bad public policy for all the reasons discussed above and should be rejected.

2) Energy charge – at what level should the Commission set KCPL's residential energy charges?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> With regard to the residential energy charge, the Signatories agree that after accounting for the continuation of the existing customer charges, the residential energy charges will be increased by the same percentages to achieve required revenues.

(EFIS No. 293). This position is consistent with the testimony of Public Counsel witness Dr. David Dismukes that any increase to the residential class be applied to each of the volumetric rate blocks on an equal percentage basis (Ex. 303, p. 41).

3) Time of day – should the time of day rate be frozen from the addition of future customers (KCPL proposal) or should KCPL be required to file modified time of day tariff provisions in its next rate case (DE proposal)?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> Regarding time of day rates, the Signatories agree that current residential and other special two part time of day or real time pricing tariffs remain available, and the Signatories would request that the Commission order Kansas City Power & Light Company to complete a study regarding these issues within 2 years in which no party is obligated to support the findings of that study or any proposed tariff design as a result of that study.

(EFIS No. 293). This outcome is consistent with Public Counsel's recommendation that the Commission reject the Company's TOU rate proposal and require the Company to re-file a modified and improved TOU tariff in its next rate case (Ex. 303, p. 33).

4) Should the ResB rate structure be changed to make it consistent with ResA and ResC rate structures?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> The Signatories agree to allow modification to the structure of the ResB rate to add an intermediate block rate which will be set equal to the first block rate to make it consistent with the ResA and ResC rate structures.

(EFIS No. 293).

e) Commercial and industrial

1) SG, MG, LP and LGS energy charges – at what level should the Commission set KCPL's SG, MG, LP and LGS energy charges?

2) SG, MG, LP and LGS separate meter space heating energy charges and the first energy block rate for the winter rates – at what level should these energy charges be set?

3) Should the Commission adopt MIEC/MECG's rate design proposal for the LGS and LP rate classes, or some a variant of it?

f) Special rates

1) Two-part time of use – Should the two-part time of use rate be eliminated from the addition of future customers (KCPL proposal) or should KCPL be required to file a modified two-part time of use tariff provisions in its next rate case?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> Except as provided in the following paragraph, as rate design relates to Commercial and Industrial classes the Signatories agree with the following as it relates to section B(e)(1)-(3) and section (B)(f)(1) and (3) in the Issues List: the following rate components of each class be increased across-the-board for each class on an equal percentage basis after:
>
> • Increasing the first winter energy block rate of the frozen All-Electric Service rate schedules for the SGS, MGS, and LGS rate classes increasing by an additional 5%;
>
> • Changing the winter second and third SGS all electric block rates to match the winter second and third general service SGS block rates;
>
> As explained in the pre-filed Direct Cost of Service and Rate Design testimony of Maurice Brubaker, at pages 32-33, the general service LGS and LP second block energy rates shall receive 75% of the applicable class percentage increases and there shall be no increase to the tail blocks of the general service LGS and LP energy rates. Any remaining increase in revenue requirement for these classes shall be collected through an equal percentage increase in the customer, demand and first energy blocks.

2) Special interruptible – Should the special interruptible rate be frozen from the addition of future customers?

Consistent with the Non-Unanimous Stipulation and Agreement, Public Counsel does not oppose KCPL's request to eliminate the special interruptible rate (EFIS No. 293).

3) Real time pricing – Should the real time pricing rate be frozen from the addition of future customers (KCPL proposal) or should KCPL be required to file modified real time pricing tariff provisions in its next rate case?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> Regarding time of day rates, the Signatories agree that current residential and other special two part time of day or real time pricing tariffs remain available, and the Signatories would request that the Commission order Kansas City Power & Light Company to complete a study regarding these issues within 2 years in which no party is obligated to support the findings of that study or any proposed tariff design as a result of that study.

(EFIS No. 293).

4) Standby pricing – Should the real time pricing rate be frozen from the addition of future customers?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

> Signatories agree that a working group should be formed to review KCP&L's Standby Service Tariff for the purposes of 1) ensuring that the design of standby rates and the terms and conditions of service are consistent with best practices and 2) to develop recommendations on cost-based rate levels. Signatories request that the Commission order KCP&L to file a new Standby Service Tariff in its next general rate case.

(EFIS No. 293).

C. Tariff rules and regulations

4. Standby service – Should KCPL be required to establish a working group to review its Standby Service Tariff to ensure that rates are cost-based and reflect best practices?

Public Counsel recommends that the Commission adopt the position of the parties to the Non-Unanimous Stipulation and Agreement as follows:

Signatories agree that a working group should be formed to review KCP&L's Standby Service Tariff for the purposes of 1) ensuring that the design of standby rates and the terms and conditions of service are consistent with best practices and 2) to develop recommendations on cost-based rate levels. Signatories request that the Commission order KCP&L to file a new Standby Service Tariff in its next general rate case.

(EFIS No. 293).

XXVI. Low-income Weatherization

A. Should the unexpended low-income weatherization program funds collected through KCPL's base rates be used to offset any expenditures relating to the low-income weatherization program the costs of which KCPL is otherwise to recover through its MEEIA recovery mechanism?

The Commission should order the unexpended low-income weatherization program funds collected through KCPL's base rates to offset any expenditures relating to the low-income weatherization program. Staff witness Ms. Kory Boustead explained:

> KCPL's MEEIA rider became effective on July 6, 2014 and KCPL 1 still continues to collect for the program in base rates. Since all Program expenditures are eligible for recovery through the MEEIA rider, funds collected in base rates will not be applied to program expenditures. Also, KCPL has experienced barriers that prevented the Company from spending Program funds prior to the effective date of the MEEIA environment. The largest intended recipient of KCPL Program funding, City of Kansas City, discontinued its Weatherization Program in 2013. During the period after which the Kansas City stopped taking funding and prior to the time a new vendor, United Services Community Action Agency was selected, Program funds collected by KCPL were not distributed. Due to KCPL's inability to use these Program funds (both pre and post MEEIA), there will be a surplus of $1,105,850 as of the effective date of rates in this case. Staff proposes the surplus of Program funds be used to offset any expenditures relating to the Program through KCPL's MEEIA recovery mechanism.

(Ex. 200, p.139). In KCPL's Position Statement, KCPL agreed with the Staff's recommendation (EFIS No. 269).

B. Should the low-income weatherization program be part of KCPL's MEEIA recovery mechanism on a going forward basis, or should it continue to be collected in base rates outside of KCPL's MEEIA recovery mechanism?

KCPL should resume recovery of low-income weatherization program (LIWAP) costs in base rates following the conclusion of KCPL's MEEIA Cycle 1 and cease recovery of these costs in future MEEIA applications, as proposed by the Division of Energy (DE) (Ex.301, p.27). Currently, "all gas and electric investor-owned utilities in Missouri have some amount of weatherization funding in their base rates except KCPL and Greater Missouri Operations KCPL. The latter two utilities recover their LIWAP costs through their Commission approved MEEIA" (Ex. 301, p.25).

The basis for this change is that electric utilities are not mandated to have a MEEIA and there are no guarantees that KCPL's MEEIA will continue. Moving LIWAP into base rates will "assures program consistency and continuity and allows the recovery of annual weatherization funding as costs occur" (Ex. 350, p.11).

During the evidentiary hearing, Public Counsel witness Dr. Geoff Marke was questioned as to his opinion of DE's proposal to recover LIWAP through MEEIA versus recovery through base rates (Tr. 1970). Dr. Marke testified to a number of reasons to approve DE's proposal. One very important reason involves the need to address weatherization in multi-family housing (Tr. 1971). Ninety-nine percent (99%) of MEEIA weatherization funds go to single-family homes (Tr. 1970). Funding the LIWAP through KCPL's MEEIA would allow LIWAP funds to be made available to multi-family homes (Tr. 1971).

Accordingly, to ensure that LIWAP funding stability and to allow LIWAP funds to apply to multi-family homes, Public Counsel supports DE's proposal and asks the Commission approve the proposal and more LIWAP funding from the MEEIA and into base rates.

Conclusion

Public Counsel urges the Commission to keep in mind the 57% increases that KCPL's customers have already endured over the last 8 years. The primary reason why KCPL seeks this rate increase is to recover the costs of additional plant, including the large plant investments at La Cygne. To the extent the Commission allows those investments in rates, and a 9.0% ROE, KCPL will be well-compensated in the following years, and all other requests by KCPL, such as: an FAC; tracker mechanisms; rate designs that shift costs and risk from the company to small users; excessive rate case expenses; an unstudied electric vehicle charging station proposal; and more, should be rejected in the interest of protecting the public.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all counsel of record this 22nd day of July 2015.

/s/ Marc Poston