BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of Its Regulatory Plan	)))))	Case No. ER-2006-0314

REPLY AND TRUE-UP BRIEF OF UNITED STATES DEPARTMENT OF ENERGY/NATIONAL NUCLEAR SECURITY ADMINISTRATION (DOE/NNSA)

NP VERSION

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****[redacted]** Designates "Proprietary" and "Highly Confidential" (HC) Information.**
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Pursuant to the Standard Protective Order.

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DOE/NNSA'S REPLY AND TRUE-UP BRIEF

INTRODUCTION

DOE/NNSA intervened in this proceeding on behalf of the DOE/NNSA plant in Kansas City, a large customer of Kansas City Power and Light Company (KCPL), as well as on behalf of other affected Federal Executive Agencies. On November 17, 2006, it filed its Post Hearing Brief in this case in both an HC and a NP version. We made recommendations to the Commission for its findings and conclusions relating to these issues in that Brief. In this Reply and True-Up Brief, we make additional argument only insofar as the issues were affected by the True-Up Hearing and by other parties Post Hearing Briefs.

In this Brief we will generally follow the format of our earlier Brief and address the same issues as deemed necessary.

OFF-SYSTEM SALES

The filed issues list sets out the Off-system Sales Issues to be determined as follows:

1. **What level of off-system sales margin should be included in determining KCPL's cost of service?**
2. **How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?**
3. **What parameters do the Commission-approved Stipulation & Agreement (Experimental Regulatory Plan) in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?**

4. **Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders?**

5. **Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?**

1. What Level Of Off-System Sales Margin Should Be Included In Determining KCPL's Cost Of Service?

DOE/NNSA recommended a level of off-system sales margin be included in KCPL's cost of service in the "all company" amount of **[redacted]** **(HC)**[1] allocated among jurisdictions using the energy allocator recommended in its Brief, at pp. 7-8. KCPL offered no new arguments in support of its position.

2. How Should The Off-System Sales Margin Be Allocated To The Missouri Retail, Kansas Retail And FERC Wholesale Jurisdictions?

DOE/NNSA requested that the Commission reject KCPL's never-before-utilized "unused energy allocator" to assign non-firm energy sales margins to the Missouri jurisdiction in its Post Hearing Brief at pp. 8-12. KCPL raised no new arguments in support of the "unused energy allocator" in its Post Hearing Brief.

3. What Parameters Do The Commission-Approved Stipulation & Agreement (Experimental Regulatory Plan) In Case No. ER-2005-0329 Impose On The Treatment Of Off-System Sales Revenue In This Case?

DOE/NNSA submitted that KCPL has contractually bound itself by its execution of the Stipulation and Agreement (hereinafter the "Experimental Regulatory Plan" or "Plan") approved by the Commission in Case No. ER-2005-0329 (Exhibit 143), by an amendment to the Experimental Regulatory Plan and by statements of its officers, to allocate all margins from off-system sales to its ratepayers. See our Post Hearing Brief at pp.12-13.

4. Should KCPL's Customers Receive The Benefit Of All Margins Of Off-System Sales Or Should It Be Shared Between Customers And Shareholders?

This issue was fully addressed in our Post Hearing Brief at pp.14-16. KCPL raised no new arguments in its Post Hearing Brief in support of its position.

5. Should A Mechanism Be Adopted To Ensure That The Benefit Is Received By The Appropriate Party Or Parties? If So, What Mechanism?

This issue was fully addressed in our Post Hearing Brief at pp.16-17. KCPL raised no new arguments in its Post Hearing Brief in support of its position.

ICE STORM COSTS

No amount of the amortization of the costs associated with the 2002 ice storm should be included in rates, as KCPL has already recouped such costs.

DOE/NNSA opposes KCPL's proposal to include within the Missouri jurisdictional cost of service amortization of ice storm costs incurred in 2002 and that issue was discussed in our Post Hearing Brief. In Staff's Post Hearing Brief, Staff expressly stated at p. 8 that: "Staff has no position on this issue." But, of course, KCPL does have a position and it wants to enjoy continued recovery for the test year and beyond even though DOE/NNSA Witness Dittmer pointed out in his testimony that KCPL has already recovered this cost. See Dittmer, Direct Testimony, Exhibit 803 and 803 HC at pp. 19-27.[2]

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[1] All references to HC numbers in this brief are set between asterisks thus **[redacted]** followed by an **(HC)** notation.

[2] Although KCPL in its Post Hearing Brief at p. 35 characterizes Witness Dittmer's proposed disallowance as "cherry picking", it ignores the Commission's own Accounting Authority Order, (AAO) where the Commission explicitly states that "… it reserved the right to consider in a future case the ratemaking treatment of this expense" and even quotes the Commission language in the Brief but KCPL then **ignores the Commission's plain language in the AAO**.

ADDITIONAL AMORTIZATION

No Regulatory Plan additional amortizations have been shown by the evidence in this case to be necessary, as there is no competent and substantial evidence in this record which shows that KCPL's credit rating is or will be downgraded.

In our Post Hearing Brief we demonstrated that in order for this Commission to find that "additional amortizations" should be allowed in this case, competent and substantial evidence is required to support such a finding, not merely the "knee-jerk" application of the Regulatory Plan and its Stipulation.[3] *State ex rel. Dyer* v. *Public Service Commission,* 341 S. W. 2nd 795, (Sup. 1961), certiorari denied 81 S. Ct. 1351, 366 U.S. 924, 6 L. Ed. 2d 384. We do not mean to belabor the point here. We further demonstrated that there was no competent and substantial evidence to support such a finding. DOE/NNSA submits that is still the case. KCPL has failed to provide evidence that Standard & Poor's (S&P) is about to downgrade KCPL's credit rating and that a downgrading of KCPL's debt will be more unreasonable and costly to KCPL ratepayers than requiring ratepayers to fund the additional amortization expense.[4]

Staff pointed out in its Post Hearing Brief at p. 28, that DOE/NNSA Witness Woolridge explained rating agencies method of ratings in the following exchange between Staff Counsel Dottheim and Dr. Woolridge at Tr. Vol.12, pp. 1328-1329:

> **(By Staff Counsel Dottheim) "Dr. Woolridge, at page 52 of your Direct**
> **Testimony, Exhibit 801, lines 5 and 6 you make reference to**
> **the amortization to maintain S&P's financial ratio benchmarks.**
> **And on page -- well, in Exhibit 802, your Surrebuttal**
> **Testimony on page 4, lines 13 and 14, you make reference to**

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[3] In addition to Intervenor DOE/NNSA, Jackson County, AARP, Trigen and Wal-Mart are not signatories to the Regulatory Plan Stipulation.

[4] The Commission should be cognizant that requiring present ratepayers to assist in financing KCPL's construction program through added amortization expense which will be paid back to future ratepayers results in an intergenerational subsidy. What the parties to this case would have accomplished in the Rate Design Stipulation filed in this case, i.e. beginning to eliminate interclass subsidies will thus be negated if the Commission in allowing added amortization expense at the recommendation of the Signatory Parties to the Experimental Regulatory Plan will simply create a new intergenerational subsidy. This is not we submit, prudent nor sound ratemaking as we pointed out in our earlier Brief at pp.19 et seq.

the amortization to maintain S&P financial ratio benchmarks that are in the Kansas City Power & Light regulatory plan Stipulation and Agreement, do you not?

A. Yes.

Q. Kansas City Power & Light is presently triple B rated by Standard and Poor's?

A. Yes.

Q. And triple B rating is investment grade?

A. Yes.

Q. Dr. Woolridge, is it a certainty that Standard and Poor's would downgrade Kansas City Power & Light if it did

(p.1329)

not meet the triple B metrics?

A. No.

Q. Well, could you please explain that?

A. I mean, companies on an ongoing basis don't meet the metrics for the ratings they achieve. And, in fact, if you read any of the S&P documentation or those of Moody's, they'll say these are not strict guidelines. These are simply metrics they look at. And they're very insistent to indicate that these are not the strict guidelines that some people think they are. I've been involved in several cases where commissions have set things based off of the S&P metrics. And the thing is, first of all, these metrics are broad ranges. Second of all, if you look at Moody's, their range -- their metrics tend to be much more lenient in terms of what their ranges they look at to achieve a certain bond rating. But they are not strict guidelines. And, I mean, that's kind of my observation from looking at these things over the years. But all you have to do is read the S&P documentation on their ratios and that's the first thing they tell you, they're not strict guidelines.

As we stated in our Initial Post Hearing Brief: one of the major financial weaknesses impacting KCPL's credit according to S&P has nothing to do with the building of IATAN 2 or costs associated with that plant but instead, according to S&P relates to the risk profile of Strategic Energy, a separate ***unregulated*** subsidiary of Great Plains Energy. See Staff Exhibit No. 145.

Office of Public Counsel (OPC) Witness Trippensee in his Rebuttal True-Up Testimony stated the following in response to the following question by Public Counsel

Mills:

"Q. Are the parties to this case or the Commission obligated to defer to Standard & Poor's in the calculation of the Regulatory Plan Amortization?

A. No. …the ***Stipulation and Agreement and the Commission's Report & Order clearly do not anticipate that this Commission defer its regulatory authority to S&P to set just and reasonable rates.*** (Emphasis supplied.)

In a further question by OPC Counsel Mills at p. 3, Trippensee Rebuttal Ex. 220:

> Q. While the Staff proposes to defer to S&P regarding the risk factor, are the other components of the regulatory plan amortization proposed by Staff consistent with Standard & Poor's methods?
>
> A. No. There are **numerous examples** where the Regulatory Plan Amortization **recommended by Staff is inconsistent with S&P methods**. The entire calculation is based upon findings by this Commission on the cost to serve Missouri retail operations while **S&P looks at total Company operations**, including non-regulated operations such as Strategic Energy. The RPA also **allocates the capital structure to Missouri retail operations**. That Missouri jurisdictional allocation excludes debt that supports non-Missouri retail operations and the resulting interest expense on that debt coverage. This lowers cash flow requirements by **lowering the interest coverage requirement** (Emphasis supplied).

Further in answer to another question by OPC Counsel Mills, Witness Trippensee responded in his Rebuttal True-Up Testimony at p. 3, Ex. 220:

> Public Counsel believes ***this Commission should <u>not blindly follow S&P procedures</u> in setting rates for Missourians nor does Public Counsel believe the Stipulation and agreement in ER-2005-0329 contemplated such an adherence to an organization whose mission has absolutely nothing to do with ensuring Missourians have just and reasonable utility rates*** (Emphasis supplied).

We fully concur in this well reasoned statement by OPC Witness Trippensee who has no pecuniary interest at all in the outcome of this proceeding and instead is following the legal mandate of the OPC.

DOE/NNSA emphasizes again that since the Commission was not a party to the Stipulation and Agreement reached in Case No. EO-2005-0329, it is not bound by the Experimental Plan to provide ***any*** additional amortization expense to KCPL. The Commission should recognize the Experimental Plan for what it is, in part an imposed loan from ratepayers to KCPL at an interest rate (if one is granted) that the lender is being required to accept. The Commission should ask itself if it believes that ratepayers would voluntarily make such a loan, if asked. The Commission should grant this extraordinary relief to KCPL only if the necessity for the relief is supported by the most compelling evidence. Finally, if the Commission is going to be a party to protecting KCPL from a potential financial problem it should at least wait until KCPL is able to prove to the Commission that there actually is a problem. There is neither proof that KCPL would or will be downgraded by S&P nor is there any proof in this record that it is not more costly to ratepayers to prevent KCPL from a downgrade than the cost to ratepayers of such a downgrade. KCPL offered no such proof.

If a "gross up" for taxes is to be added to any additional amortizations, it should be allowed only if it is included as a future off-set to rate base.

As we stated in our initial Post Hearing Brief, if the Commission allows any additional amortization, then DOE/NNSA supports Staff's calculations in this case. See Draft Nonunanimous Stipulation dated October 31, 2006[5].

What risk factor should be used in calculating the Regulatory Plan additional amortizations for off-balance sheet purchased power agreements?

We fully addressed this in our Post Hearing Brief and KCPL raised no new argument in its Post Hearing Brief in support of its position.

If Regulatory Plan additional amortizations are granted in this case then they should be treated as an offset to rate base in the next case.

We fully addressed this in our Post Hearing Brief and KCPL raised no new argument in its Post Hearing Brief in support of its position.

[5] At the time of the preparation of this Brief a Draft Stipulation was circulating among the parties.

JURISDICTIONAL ALLOCATION

What Is The Appropriate Method (4 CP Vs. 12 CP) To Use For Allocating Generation And Transmission Costs Among Jurisdictions?

Jurisdictional demand allocation refers to the process by which demand-related costs are allocated to the applicable jurisdictions, that is Missouri, Kansas and FERC. DOE/NNSA recommends that the appropriate jurisdictional allocator for allocation of generation and transmission costs to the Missouri jurisdiction is the 4 CP allocator. See our Post Hearing Brief at pp. 21-25. KCPL has offered nothing new in support of its position in its Brief.

COST OF CAPITAL

Appropriate Capital Structure

In our Post Hearing Brief we demonstrated the appropriate Capital Structure. See Post Hearing Brief at p.25. Staff Witness Barnes in his True-Up Testimony updated such capital structure and we do not object to such update. See Barnes True-Up Testimony at p.2., Ex. 153.

Appropriate Return on Common Equity (ROE)

In our Post Hearing Brief we demonstrated why the Commission in this case should find an appropriate return on equity to be 9% based on a traditional Discounted Cash Flow (DCF) methodology as advocated by DOE/NNSA Witness Woolridge, which methodology this Commission has endorsed on numerous occasions and which has been upheld by Missouri Courts. See our Post Hearing Brief at pp.25-30.

Return On Equity (ROE) Should Not Be Adjusted Either Upwards Or Downwards To Reflect Increased Or Decreased Risk Or Company Performance.

As we said earlier in our Post Hearing Brief at pp 29-30, no evidence was offered in testimony by any party which would indicate any need for an upward adjustment in ROE[6]. KCPL raised nothing new in its Post Hearing Brief that requires response or comment herein.

Although DOE/NNSA Witness Woolridge agreed that the Stipulation and Regulatory Plan has "not eliminated" the Company's financing, construction and regulatory risks he indicated in his Direct Testimony that there are elements of the Agreement which significantly reduce the riskiness of KCPL. See Woolridge Direct Testimony, Ex.801 at pp. 51-52.

We submit that after the Commission reviews all of the proposed recommendations for rate of return and ROE in this case it will find that an ROE of 9% and an overall rate of return of 7.66%[7] is just and reasonable for KCPL based on the evidentiary record in this case.[8]

<u>CLASS COST-OF-SERVICE AND RATE DESIGN:</u>

Most of the parties in this case including, KCPL, Staff, Office of Public Counsel, Praxair, DOE-NNSA and other industrial intervenors have filed a Stipulation relating to Cost of Service and Rate design which was filed with the Commission on November 9, 2006.

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[6] As we pointed out in our Post Hearing Brief at p.29, DOE/NNSA Witness Woolridge did not make an adjustment to his equity return specifically for the impact of the Regulatory Plan but did observe in his Rebuttal Testimony that the impact of the Regulatory Plan certainly had an impact of lowering the risk by at least 30 basis points due to the agreement by the Signatory Parties to maintain the current credit rating of KCPL. See Woolridge Surrebuttal at p.5, Exhibit No. 808.

[7] As we observed earlier if the Commission accepts Staff Witness Barnes adjusted capital structure then the overall ROR would be 7.68%.

[8] Although KCPL Witness Hadaway used in part the RRA for his Risk Premium check as to what constitutes a reasonable return on equity, he admitted on cross examination that the most recent RRA was 10.06%, well below his recommendation. See Tr. Vol. 12 at p.1241 and as set out in Staff's Post Hearing Brief at p.70. We do not endorse the use of such a number in making a finding by the Commission of a reasonable return on equity as it fails both the ***<u>Hope</u>*** and ***<u>Bluefield</u>*** tests. Nor do we think it appropriate as a Risk Premium check.

CONCLUSION

Intervenor, DOE/NNSA submits that as it argued in its Post Hearing Brief filed in this case, that after careful consideration of the competent and substantial evidence in this record that such evidence supports a reduction in current rates for KCPL as also recommended by the Commission Staff and by the Public Counsel.[9] If the Commission determines that extraordinary relief is to be granted to KCPL through additional amortization based on competent and substantial evidence in this record, then we submit all of the rate payers are entitled to a reasonable return on those amortizations (certainly not less than KCPL's allowed ROE in this case) and an offset to rate base should be made in the next KCPL rate case.[10] The Commission should also be cognizant of the fact that as we said earlier[11] additional amortization provided by today's ratepayers involves an intergenerational subsidy through a misalignment of cost of service. Finally, we also recommend the Commission's approval of the Rate Design Stipulation filed in this case.

Respectfully Submitted

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[9] Staff Witness Traxler made a True-Up recommendation regarding its rate reduction to $29 million. See True-Up Ex. 163, p.5.

[10] At the time of this submission Staff was projecting a rate reduction for KCPL of approximately $29 million, Public Counsel at approximately $30 million and DOE/NNSA at approximately $41 million. See KCPL Exhibit No. 46 as adjusted for the estimate of the impact of the True-Up Testimony filed by Staff Witness Traxler. Exhibit 163 on November 7, 2006. The primary differences between Staff and DOE/NNSA are due to the differences in Cost of Equity, Ice Storm Damage recovery and Off-System Sales recommendations.

[11] See our comments in Footnote 4 herein.