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-2012-0174

and

In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service	))))	Case No. ER-2012-0175

POST-HEARING BRIEF OF THE MISSOURI INDUSTRIAL ENERGY CONSUMERS

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THE MISSOURI INDUSTRIAL ENERGY CONSUMERS'
INITIAL POST-HEARING BRIEF

Comes now the Missouri Industrial Energy Consumers ("MIEC") and for its initial post-hearing brief, states as follows:

I. The Commission should deny the Company's proposed Transmission Tracker

Kansas City Power & Light Company ("KCPL") and KCPL Greater Missouri Operations Company ("GMO") referred to collectively as ("the Company") propose to establish a transmission cost tracking mechanism ("Transmission Tracker") which would track certain transmissions costs[1] on an actual basis versus the level set in this proceeding. If the Transmission Tracker is accepted, any actual transmission cost amount in excess of the level set in this case would be treated as a regulatory asset and any actual shortfall from the level set in this case would be treated as a

[1] *E.g.,* Dauphinais Direct, Ex. 404, p. 7, ll. 4 – 9 discussing how the Company proposes to establish a Transmission Tracker to track the actual level of the following three expenses from the values for these expenses that were included in the base rates: Southwest Power Pool ("SPP") Schedule 1-A Administration Charge; SPP Transmission Costs; and SPP Schedule 12 FERC Assessment Fees. Actual amounts for these expenses that are in excess of the base rate level would be treated as a regulatory asset (Account 182) and actual shortfalls for these expenses from the base rate level would be treated as a regulatory liability (Account 254).

regulatory liability.[2] Then, during the next base rate proceeding, the Company would seek a true-up of these expenses.

The Company's proposed Transmission Tracker should be denied for three reasons: (1) the Company has not demonstrated that it needs to track these expenses; (2) the Transmission Tracker would enable the Company to engage in single-issue ratemaking, a practice which the Missouri Supreme Court has held to be unlawful; and (3) the Transmission Tracker eliminates the Company's inherent to minimize expenses and maximize revenues between rate proceedings.

A. The Commission should reject the Transmission Tracker because it is unnecessary.

To show the Transmission Tracker is necessary, the Company must show that the tracked expenses are: (1) substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases; (2) beyond the control of management, where utility management has little influence over experienced revenue or cost levels; and (3) "volatile in amount, causing significant swings in income and cash flows if not tracked".[3] As the evidence demonstrates, the Company has not met any of these three criteria.

With respect to the first criteria, the SPP Schedule 1-A rate is relatively small at $0.255 per MWh.[4] GMO's total SPP Transmission Costs are projected to increase from just under $7 million to just under $17 million by 2016.[5] KCPL's total SPP Transmission Costs are projected to increase from just under $20 million to just under $45 million by 2016.[6] The SPP Schedule 12 FERC Assessment Fees are also relatively small in magnitude.[7] These costs are not substantial enough to

[2] *E.g.,* Dauphinais Direct, Ex. 404, p. 2, ll. 7-12.

[3] Report and Order, Case No. ER-2007-002, pp. 20-21 (discussing how, among other things, the three criteria are "well accepted" in the regulatory community).

[4] Dauphinais Direct, Ex. 404, p. 9, ll. 6-12.

[5] *Id.* at p. 9, ll. 15-16; *see also* October 26, 2012 Transcript, p. 641, ll. 8-11.

[6] *E.g.,* Dauphinais Direct, Ex 404, p. 8, ll. 13-14.

[7] *Id.* at p. 9, ln. 4.

potentially jeopardize the Company's financial integrity. Moreover, as the Company's witnesses attest, the regional transmission projects driving these costs are expected to provide the Company with significant offsetting benefits, but the Transmission Tracker will not reflect these offsetting benefits.[8]

With respect to the second criteria, the Company maintains control over the expenses. The Company can actively manage the SPP stakeholder process to help to ensure that the SPP's costs are maintained within reasonable levels.[9] Moreover, the Company can work with Federal Energy Regulatory Commission ("FERC") to the extent that the Company is unsuccessful in the SPP stakeholder process.[10] During this proceeding, the Company has failed to show that it cannot manage these costs.

With respect to the third criteria, the expenses are not volatile. The Commission defined volatility regarding fuel and purchased power costs and the need for a fuel adjustment clause as follows:

> 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, the fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriate low or high rates.[11]

The increase in total SPP Transmission Costs are not volatile because the increase is well forecasted by SPP and occurs in stair steps much like the rate base of a utility increases as new major capital projects are brought into service.[12] The costs at issue are steadily increasing and will continue to increase. It is not sufficient for utility to simply assert that since the expenses are increasing, the

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[8] *Id.* at p. 8, lns. 23 – 25; p. 9, ll. 1-2.
[9] *Id.* at p. 8, ll. 10 – 12 and 18 - 20.
[10] *Id.*
[11] ER-2007-0002 Report and Order, at p. 23.
[12] Dauphinais Direct, Ex. 404, p. 9, ll. 18-20.

expenses must be volatile.[13] Rather, the Company must actually show that the expense is unpredictable. A reasonable determination must be made that the expense can go rapidly up and down in an unpredictable manner. The Company has failed to make this demonstration.[14]

In summary, the evidence shows that Transmission Tracker is bad policy because the costs at issue are not large enough to impact the Company's financial health, the Company maintains an ability control over the costs, and the costs are not volatile. Additionally, the Transmission Tracker is bad policy because it would harm ratepayers because it would track an increasing expense without tracking offsetting benefits.

B. The Transmission Tracker should be denied because it constitutes unlawful single-issue ratemaking.

The Missouri Supreme Court has held that single-issue ratemaking is unlawful, stating as follows:

> The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established. <u>Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses</u>.[15]

The Transmission Tracker results in unlawful single-issue ratemaking because it allows the Company to recover tracked costs without regard to the Company's actual costs and offsets during the period in which the tracked costs were incurred, in violation of the Missouri Supreme Court's holding.[16] Specifically, the Transmission Tracker would result in rate changes due to either an

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13 ER-2007-0002 Report and Order, at p. 23.

14 Dauphinais Surrebuttal, Ex. 420, p. 3, ll. 19-21.

15 State ex rel. Utility Consumers Council of Missouri, Inc. v. Pub. Serv. Comm'n, 585 S.W.3d 41, 59 (Mo. 1979)(emphasis added)(citations omitted).

16 *E.g.,* October 26, 2012 Transcript, pp. 662-663 and pp. 671-672.

increase in a tracked expense or a decrease in a tracked revenue, without any consideration of whether the Company would simultaneously be receiving offsetting decreases in expenses or offsetting increases in revenues for those expenses and revenues that are not being tracked.[17] The evidence in this case shows that the Transmission Tracker results in unjust and unreasonable rates by breaking the fundamental connection between revenues, expenses and rate base.[18] The adoption of the Transmission Tracker fails to allow examination of the revenues and the costs required to be examined in the rate-setting process. Such trackers are illegal in that they track only certain costs between rate cases and thus do not consider all relevant factors between rate cases. The Company cannot lawfully recover costs in future rates without regard to the impact of those costs on current rates consideration of evidence regarding countervailing cost decreases or offsets that benefit the Company. Single-issue ratemaking is outside the scope of Missouri's statutory process for setting just and reasonable rates.

C. The Transmission Tracker should be denied because it undermines the the Company's incentive to minimize expenses and maximize revenues.

The Transmission Tracker eliminates the Company's otherwise inherent incentive has to minimize expenses and maximize revenues between rate proceedings. Over time, the Transmission Tracker would undermine the Company's incentive to be vigilant in controlling costs..[19] For example, if the Company is permitted allowed to track an expense, then it can become indifferent to minimizing that expense because it will not have a pressing need to file a new rate case in order to recover any increases resulting from that expense.[20] Also, when KCPL is allowed to track a revenue,

[17] Dauphinais Direct, Ex. 404, p. 8, ll. 5-9.
[18] *Id.* at ll. 9-11.
[19] Dauphinais Direct, Ex. 404, p. 8, ll. 12-14.
[20] *Id.* at p. 8, ll. 14-17.

KCPL can become indifferent with regard to maximizing the revenue because KCPL knows that it will not need to file a base rate case in order to recover any shortfall in that revenue.[21]

II. The Commission should adopt a rate of return on common equity within a range of 9.1% - 9.5%

The MIEC strongly supports the testimony of Michael P. Gorman, the Office of Public Counsel's ("OPC") witness, regarding the Company's cost of common equity, or the return that investors require on an investment in the Company ("Return on Equity" or "ROE"). The OPC has provided persuasive testimony that estimates the Company's current market cost of Return on Equity is in the range of 9.10% to 9.50%.[22]

As discussed in depth in both the testimony and the hearings, the OPC used numerous models based on financial theory to estimate the Company's Return on Equity. These five models include: (1) a constant growth Discounted Cash Flow ("DCF") model using consensus analysts' growth rate projections; (2) a constant growth DCF using sustainable growth rate estimates; (3) multi-stage growth DCF model; (4) a Risk Premium model; and (5) a Capital Asset Pricing Model ("CAPM").[23] As the evidence indicates, some of these models more accurately capture the market risk premium.[24] Notably, OPC relied upon the same proxy group used by Company witness Dr. Samuel Hadaway to estimate KCPL's Return on Equity, except that only one company (i.e., Ameren Corporation) was excluded because its consensus analysts growth rate was negative.[25] Therefore, OPC's proxy group reasonably approximates the Company's investment risk and can be used to estimate the Return on Equity.[26]

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[21] *Id.* at p. 8, ll. 17-20.

[22] *E.g.,* Gorman Direct, Ex. 300, p. 3, ll. 7-11 and p. 39, ll. 9-11; *see also* October 23, 2012 Transcript, p. 536, ll. 5-9.

[23] Gorman Direct, Ex. 300, p. 14, ll. 20-23; p. 15, ll. 1-3.

[24] October 23, 2012 Transcript, pp. 539-540 (discussing how the CAPM model should not be given considerable weight because of the relatively low level of treasury bond securities relative to corporate and utility bond yields).

[25] *Id.* at p. 15, ll. 6-9; *see also* October 23, 2012 Transcript, pp. 517-521.

[26] Gorman Direct, Ex. 300, p. 16, ll. 4-6.

Instead of repeating arguments that were already discussed at length during the hearings, the MIEC would like to emphasize three key points that support the Commission adopting OPC's Return on Equity. First, the models advanced by the OPC have solid support from the academic community.[27] Second, OPC has relied upon a recommended range for the Company's Return on Equity that utilizes results from different models. The DCF model produced a ROE of 9.50%, and the Risk Premium model produced a ROE of 9.10%.[28] Unlike some other parties in this proceeding, OPC has relied upon a reasonable ROE range that is based on the results of reliable models. Finally, OPC effectively challenges and refutes Dr. Hadaway's testimony.[29] The evidence demonstrates that even if Dr. Hadaway had made his adjustments to Mr. Gorman's ROE calculations, the results would not have created a material change in Mr. Gorman's recommended Return on Equity range.[30][31]

III. The Commission should adopt the *Non-Unanimous Stipulation Regarding Class Cost of Service and Rate Design*.

A *Non-Unanimous Stipulation Regarding Class Cost of Service and Rate Design* ("Non-Unanimous Stipulation") was filed on October 29, 2012 by the Company, the Commission Staff, Midwest Energy Consumer's Group and the MIEC. No party objected to this Non-Unanimous Stipulation regarding the appropriate non-residential rate design for GMO. Accordingly, pursuant to the Commission's Rule 4 CSR 240-2.115, the Commission may treat the Non-Unanimous Stipulation as

[27] *E.g.,* Gorman Direct, Ex. 300, p. 24, ll. 3-13 and p. 25, ll. 1-5 (discussing support for the multi-stage DCF model).

[28] *Id.* at p. 39, ll. 9-11.

[29] Gorman Direct, Ex. 300, pp. 43-53; *see also* Gorman Surrebuttal, Ex. 301, pp. 6 – 14.

[30] "In my surrebuttal testimony, I found certain flaws and errors in Dr. Hadaway's comments on my direct testimony analysis. In my surrebuttal testimony, I responded to his method of revising my return on equity recommendations and showed where he skewed the results upward, in my opinion, and had he implemented the same type of procedure on that analysis in a more symmetrical and balanced way, that his adjustments would not have created a material change in my recommended return on equity. Indeed, revising Dr. Hadaway's revisions to my direct case return on equity studies would support a return on equity in the range of 9.3 percent to 9.5 percent, which is within my recommended return on equity of 9.1 percent to 9.5 percent." *See* October 23, 2012 Transcript, M. Gorman testimony, p. 536, ll. 10 – 24.

[31] October 23, 2012 Transcript, p. 536.

unanimous with respect to GMO's rate design, and the Commission should therefore adopt the Non-Unanimous Stipulation as supported by the evidence with respect to GMO's rate design.

With respect the rate design for KCPL, an objection to the Non-Unanimous Stipulation was filed by the OPC, AARP and the Consumers Council of Missouri on November 2, 2012. Pursuant to Commission Rule 4 CSR 240-2.115, the Commission must therefore treat the Non-Unanimous Stipulation as a mere position of the signatory parties with respect to KCPL. However, no party opposed the provisions of the Non-Unanimous Stipulation regarding the appropriate LGS/LP rate design for KCPL. Accordingly, the MIEC respectfully requests that the Commission adopt the Non-Unanimous Stipulation with respect to LPS/LP rate design for KCPL.

The MIEC supports adoption of the Non-Unanimous Stipulation in its entirety as a reasonable resolution of contested issues based on the recommendations contained in the Direct, Rebuttal and Surrebuttal Testimony of Maurice Brubaker in this case.[32]

Respectfully submitted,

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[32] Brubaker Direct, Ex. 406; Brubaker Rebuttal, Ex. 407, and Brubaker Surrebuttal, Ex. 408.

CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been emailed this 28th day of November, 2012, to all parties on the Commission's service list in this case.

/s/ Diana Vuylsteke