BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company for the Issuance of an Accounting Authority Order Relating to their Electrical Operations and for a Contingent Waiver of the Notice Requirement of 4 CSR 240-4.020(2).	)))))))	**Case No. EU-2014-0077**

STAFF'S REPLY BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its *Reply Brief,* states as follows:

INTRODUCTION

This case presents the separate but related questions: Can the Commission grant the relief requested by the Companies? And, if it can, *should* it grant that relief? Staff suggests that the correct answer to each of these questions is "no."

Staff asserts that the Commission cannot grant the requested relief because it does not exercise an unfettered discretion, but is instead constrained to do only that which is both lawful and reasonable to advance the public interest. Staff further asserts that the Commission should not grant the relief requested by the Companies because use of an Accounting Authority Order ("AAO") to defer ordinary, everyday operating expenses for possible later recapture in rates is not appropriate.

ARGUMENT

I.

The controlling standard must be the *Sibley Test,* which embodies General Instruction No. 7 of the Uniform System of Accounts and which has been

repeatedly approved by the courts. That standard limits deferrals to items that are unusual, unique and non-recurring, and thus "extraordinary" in an accounting sense. Under the *Sibley Test,* the deferral sought herein must be denied.

The Companies' thesis is that, first, "there is no statute or Commission rule that specifically mentions utility applications for AAOs or that prescribes legal or regulatory principles governing such applications," and, second, "[w]hile some orders have dealt with "extraordinary" and "non-recurring" costs, many orders have addressed costs that were material, expected to change significantly in the near future, and were primarily outside the control of the public utility."[1] In other words, the Companies argue that there is no standard and the Commission can simply do whatever it wants.

To reinforce this misleading argument, the Companies point to a list of AAOs granted by the Commission in the past for many different purposes, including "Renewable Energy Standards costs, tornado costs, construction accounting, Kansas property taxes on gas storage, ice storms, pensions and OPEBs, cold weather rule costs, security costs, safety costs, main replacement costs, manufactured gas plant clean-up costs, FAS 106 costs, flood costs, plant rehabilitation costs, coal contract buy-out costs, and AM/FM mapping costs."[2]

Although the Companies offer no analysis of the Commission's stated reasoning in each of these cases, they nonetheless invite the reader to draw the conclusion that "[b]ased upon the myriad of examples discussed herein, it is clear that the Commission

[1] *Initial Brief of Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company ("Companies' Brief"),* pp. 4, 6.

[2] *Companies' Brief,* p. 7.

has much broader discretion to grant an AAO or a deferral of costs than the Commission Staff ("Staff"), the Office of the Public Counsel ("OPC") and the Industrial Intervenors (Midwest Energy Consumers Group ("MECG") and Missouri Industrial Energy Consumers ("MIEC")) would have the Commission believe."[3] That conclusion in no way follows from the Companies' summary of the various subjects for which AAOs have been granted in the past. In fact, Staff witness Mark Oligschlaeger testified that, "I believe in one way or the other the Commission found that they were extraordinary in nature but I would agree that they were not all the classical acts of God type situation."[4]

As Staff pointed out in its *Initial Brief,* the Commission has by administrative rule adopted accounting standards that govern deferrals such as the Companies now seek.[5] "The rules of a state administrative agency duly promulgated pursuant to properly delegated authority have the force and effect of law and are binding upon the agency adopting them."[6] The Commission thus has no choice but to apply the so-called ***Sibley Test*** that incorporates General Instruction No. 7 of the Uniform System of Accounts ("USOA").[7] Under that test, only costs reflecting an extraordinary, unique and

[3] *Id.*

[4] Tr. 262 (Oligschlaeger).

[5] *Staff's Brief,* p. 10.

[6] ***State ex rel. Martin-Erb v. Missouri Com'n on Human Rights,*** 77 S.W.3d 600, 607 (Mo. banc 2002).

[7] *Id.*

non-recurring event may be deferred.[8] The costs at issue here are not extraordinary, unique and non-recurring, and thus cannot lawfully be deferred.[9]

Staff also pointed out in its initial brief that guidance may be drawn from the standards that appellate courts must use in judging the Commission's actions. There are two, lawfulness and reasonableness.[10] A Commission decision is lawful when it is found to be authorized by statute.[11] A Commission decision is reasonable "where the order is supported by substantial, competent evidence on the whole record; the decision is not arbitrary or capricious or where the [PSC] has not abused its discretion."[12] Given that the whole point of accounting is scrupulous regularity,[13] what legitimate state interest, exactly, is the deferral sought herein by the Companies rationally related to? How could granting extraordinary accounting treatment to ordinary operating expenses be anything other than arbitrary, capricious, and an abuse of discretion?

The record shows that the costs sought herein to be deferred are not unusual, not unique, not extraordinary, and are recurring.[14] They are, instead,

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[8] *Id.,* pp. 10-13.

[9] *Id.,* pp. 14-15.

[10] *Id.,* p. 8, quoting ***Office of Public Counsel v. Missouri Public Service Com'n,*** 409 S.W.3d 371, 375 (Mo. banc 2013).

[11] ***Public Counsel,*** *supra,* 409 S.W.3d at 375 ("The lawfulness of an order is determined 'by whether statutory authority for its issuance exists[.]'") (internal citations omitted).

[12] *Id.*

[13] This point is demonstrated by the Companies' assertion that their independent auditors will not recognize the deferral unless the Commission specifically orders it.

[14] *Oligschlaeger Rebuttal,* pp. 3, 10, 12-13.

ordinary costs of doing business, incurred everyday by the Companies, as they admit.[15] The Commission already refused to grant deferral via a tracker in an earlier case for exactly that reason.[16] Now, the Applicants are back for a second bite of the apple, seeking an AAO this time.

The relief sought herein by the Companies is not just unlawful, it is unreasonable. The Companies' witness, Darrin Ives, testified that for a deferral to be recognized, its recovery must be probable.[17] Ryan Bresette, another witness for the Applicants, testified as follows:

> All or part of an incurred cost that would otherwise be charged to expense should be capitalized as a regulatory asset if: * * * [t]he regulator intends to provide for the recovery of that specific incurred cost rather than to provide for expected levels of similar future costs.[18]

But the Missouri Supreme Court has explained that "recovery of [a] specific incurred cost" is prohibited as retroactive ratemaking:

> The commission has the authority to determine the rate to be charged, § 393.270. In so determining it may consider past excess recovery insofar as this is relevant to its determination of what rate is necessary to provide a just and reasonable return in the future, and so avoid further excess recovery . . . . It may not, however, 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.[19]

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[15] *Companies' Brief,* p. 12: "The Companies have historically incurred, and will continue to incur, transmission costs."

[16] Case Nos. ER-2012-0174 and ER-2012-0175, *Report and Order* issued January 9, 2013, p. 31: "Applicants have not proved that the transmission cost increases meet that standard. The projected transmission cost increases are not "extraordinary" within the legal definition because they are not rare or current."

[17] Tr. 174 (Ives): ACS 980 requires that recovery be probable in order to recognize the deferral at all.

[18] *Bresette Direct,* pp. 2-3.

[19] ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 58 (Mo. banc 1979) (***"UCCM"***) (internal citations omitted).

In other words, the prohibition on retroactive ratemaking prevents exactly what ACS 980 requires, that is, the future recovery in rates of the specific incurred cost that has been deferred. For that reason, future recovery of ordinary, recurring costs such as transmission expenses that have been deferred through the AAO mechanism ***cannot*** be said to be probable or likely because it is prohibited by Missouri law. Furthermore, the AAO herein requested does not meet the criteria established by the Commission and ratified by reviewing courts.[20]

The future recovery of the costs whose deferral is sought in the present case would present exactly the evil that concerned the ***UCCM*** Court. When rates are inadequate because ordinary operating expenses have increased, the Company must seek new rates through a general rate case; it cannot use the device of a deferral to simply preserve the excess operating costs for future recovery. The relief sought in this case by the Companies is thus unreasonable because their future recovery is prohibited under the rule of ***Utility Consumers' Council*** as the language quoted above demonstrates.

II.

If the Commission does determine to grant the requested deferral despite Staff's advice to the contrary, the deferral should be specifically authorized in a written order.

[20] ***State ex rel. Office of the Public Counsel v. PSC,*** 858 S.W.2d 806 (Mo. App., W.D. 1993).

The requested deferral should be denied for the reasons explained in Staff's *Initial Brief* and above. If the Commission nonetheless determines to grant the requested deferral, it should be specifically authorized by order of the Commission.

III.

Even if the requested deferral is granted, the Applicants should not be awarded carrying costs because there is no public policy reason to do so.

Carrying costs are only appropriate for deferred capital expenditures or deferred capitalized expenses.[21] What are these? Deferred capital expenditures are deferred construction costs. Deferred capitalized expenses are expenditures that do not result in an asset such as plant but that are nevertheless accorded such treatment for public policy reasons. Examples include deferred costs of vegetation management programs, cold weather heat-related service, renewable energy service, demand-side programs, and costs incurred to comply with a Commission rule, where public policy favors the most beneficial treatment possible to encourage companies to spend appropriately to attain the public interest purpose underlying the particular rule. For example, in ***Aquila,*** the Court concluded that carrying costs were appropriate where recovery was delayed for twenty years.[22] There are no such public policy implications here.

Utilities' recovery of costs is *always* delayed to some extent; this delay is referred to as "regulatory lag."[23] While the *mitigation* of regulatory lag is an appropriate purpose

[21] *See* ***In the Matter of Missouri Public Service,*** 30 Mo.P.S.C. (N.S.) 320, 341 (Oct. 5, 1990), quoted with approval by ***Aquila, Inc. v. Public Service Commission,*** 326 S.W.3d 20, 30 (Mo. App., W.D. 2010).

[22] *Id.*

[23] Tr. 263 (Oligschlaeger).

of an AAO, the *elimination* of regulatory lag is not.[24] In this way, responsibility for extraordinary items is shared by shareholders and ratepayers.[25] This policy is implemented by amortizing deferred amounts immediately without rate-base treatment and without inclusion of carrying costs in the deferral.[26] Carrying costs are appropriate *only* when important public interests are served thereby.[27]

Staff does not deny that the Applicants' federally-mandated transmission expenses are increasing;[28] and Staff does not deny that Applicants must pay these expenses. What Staff objects to is Applicants' attempt to use a deferral mechanism rather than a general rate case to address these ordinary, everyday, operating costs. Even when increasing at an accelerated rate, these are not unusual costs. They are not "extraordinary" in any way in an accounting sense. For that reason, the use of an AAO would be contrary to every prior use of an AAO that Staff is aware of, and thus arbitrary and capricious. "Because rates are set to recover continuing operating expenses plus a reasonable return on investment, only an extraordinary event should be permitted to adjust the balance to permit costs to be deferred for consideration in a later period."[29]

The Applicants' request for carrying costs is thus all-the-more shocking, as though the public should for some reason pay interest in addition to the Companies'

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[24] Tr. 264 (Oligschlaeger).

[25] Tr. 264-265 (Oligschlaeger).

[26] Tr. 266 (Oligschlaeger).

[27] Tr. 288-289 (Oligschlaeger).

[28] *Companies' Brief,* pp. 9-11.

[29] ***State ex rel. Office of the Public Counsel v. PSC,*** 858 S.W.2d 806, 811 (Mo. App., W.D. 1993).

request for extraordinary recovery of these operating expenses through use of a special accounting mechanism. Just what is the public policy supporting that request, one wonders? Should the Applicants be rewarded for their obdurate refusal to initiate a rate case, particularly when that refusal is clearly driven by their knowledge that an all-relevant-factors analysis would result in no rate increase at all?[30]

IV.

If the requested deferral is granted, despite Staff's advice to the contrary, the Commission should condition the deferral with the seven conditions proposed by Staff.

Staff has proposed seven conditions in the event that the requested deferral is granted. These conditions are set out in full in Staff's *Initial Brief* and in the Companies' *Initial Brief* and need not be set out again here. Staff strongly believes that these conditions are necessary to protect the ratepayers and the public interest, but the Companies object to all but one of them.[31]

With respect to Condition No. 1, which requires that deferred excess transmission costs be netted against transmission revenues, this is exactly the treatment accorded Ameren Missouri's transmission costs in its FAC.[32] Why should KCP&L and GMO be treated differently? The "ownership costs" referred to by the

[30] Tr. 176 (Ives): After performing an "all relevant factors" analysis, the Applicants elected to seek an AAO rather than file a rate case.

[31] The Companies have no objection to Condition No. 5, *see Companies' Brief,* p. 16: "[T]he Commission should not attach conditions impacting ultimate deferral and recovery of transmission costs to this AAO application, with the exception of Condition 5 which is a standard condition for AAOs and is otherwise reasonable."

[32] Tr. 151-152, 156 (Ives); Tr. 249 (Oligschlaeger).

Applicants are properly excluded from the deferral mechanism because they are paid by base rate revenues.[33] The Commission should not fall for the Applicants' misleading discussion of these costs.

With respect to Condition No. 2, which requires monthly reporting, the Applicants' propose *quarterly* reporting, instead, if this condition is accepted by the Commission. While Staff prefers monthly reporting of deferred transmission costs, quarterly reporting would be acceptable as an alternative.

With respect to Condition No. 3, which requires an ongoing analysis and quantification of all benefits and savings associated with participation in SPP not otherwise passed on to retail customers between general rate proceedings, the Applicants' complain that it would be "difficult, if not impossible, to comply with in an accurate, cost effective, and timely basis."[34] It is odd, is it not, how eloquent the Applicants are about the benefits of SPP participation when they are seeking permission from this Commission to continue it, and how they have nothing to say when Staff asks them to prove it. Ratepayers are spending a lot of money to pay for these purported benefits, so where are they? It is only reasonable that the Companies quantify and track them so that deferred excess transmission expenses can be netted against them.

With respect to Condition No. 4, which requires the Companies to document their efforts to minimize transmission costs, the Applicants assert that it is "simply

[33] Tr. 280-281 (Oligschlaeger); *Oligschlaeger Rebuttal,* pp. 8-9.

[34] *Companies' Brief,* p. 18.

unnecessary for the Commission to instruct them to operate in as an efficient manner as possible."[35] If utilities could be trusted to act always in their customers' best interest, this Commission and its Staff would be unnecessary. It is noteworthy that the Companies admit in their *Initial Brief* that they *do not* act to minimize transmission expenses because that might "result in underdevelopment of the regional transmission system[.]"[36] This admission serves to highlight the need for Condition No. 4.

As to Condition No. 6, which would require that amortization of the amounts deferred over sixty months begin immediately, the Companies state that they "strongly oppose" it.[37] They don't like it because, they assert, it would prevent full recovery of the deferred amounts and would make it less likely that their outside auditors would accept the deferral.[38] Yet this is a common treatment of deferred assets, as Mr. Oligschlaeger testified.[39] The Companies have presented no evidence of any kind in this proceeding that the treatment of immediately amortizing deferred assets that has been ordered or agreed to in numerous past AAO dockets has ever led the involved utilities' external auditors to reject the deferrals. The Companies ought not be permitted to hoard deferred expenses for future use at a moment of their choosing that guarantees recovery in rates.

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[35] *Id.,* at p. 20.

[36] *Id.*

[37] *Id.,* at p. 21.

[38] *Id.,* at pp. 21-23.

[39] *Oligschlaeger Rebuttal,* p. 31; Tr. 266-267, 289 (Oligschlaeger).

As for Condition No. 7, which requires that deferrals automatically cease whenever surveillance reports show that the Applicants are earning more than their Commission-approved return on equity, they hate this one most of all.[40] Now, contrary to Mr. Ives' testimony at hearing,[41] the Companies assert that "KCP&L's annual surveillance report takes a considerable amount of effort to put together and would be very problematic for KCP&L to complete on a quarterly basis."[42] The Companies go on to say, however, "[t]he Companies would be willing to work with Staff to create surveillance reporting for both KCP&L and GMO that contains the appropriate amount of analysis on a quarterly basis and be consistent and reflective of the requirements for the FAC in advance of the Companies' next rate case proceedings."[43] Staff responds that it would constitute outrageous mistreatment of the ratepayers, indeed, to allow a deferral of excess unrecovered transmission costs at the same time that the Companies were over-earning.[44] Fairness requires that deferrals cease at such times.

CONCLUSION

The Commission should deny the application before it. The circumstances do not justify a deferral. Should the Applicants decide that they absolutely must recover the increasing excess transmission costs, they can file a rate case. That's how cost-of-service regulation works.

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[40] *Companies' Brief,* pp. 23-25.

[41] Tr. 170-171 (Ives).

[42] *Companies' Brief,* at p. 23.

[43] *Id.,* at p. 24.

[44] Tr. 274 (Oligschlaeger).

Respectfully submitted,

s/ Kevin A. Thompson
KEVIN A. THOMPSON
Missouri Bar Number 36288
Chief Staff Counsel

WHITNEY M. HAMPTON
Missouri Bar Number 64886
Assistant Staff Counsel

Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
573-751-6514 (Voice)
573-526-6969 (Fax)
kevin.thompson@psc.mo.gov

Attorneys for the Staff of the
Missouri Public Service Commission

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served, either electronically or by hand delivery or by First Class United States Mail, postage prepaid, on this **11th day of March, 2014,** to the parties of record as set out on the official Service List maintained by the Data Center of the Missouri Public Service Commission for this case.

/s/ Kevin A. Thompson