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# BEFORE THE PUBLIC SERVICE COMMISSION

# OF THE STATE OF MISSOURI

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| 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** |

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# REPORT AND ORDER

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**Issue Date:** **December 21, 2006**

**Effective Date:** **December 31, 2006**

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## REPORT AND ORDER

## APPEARANCES

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**SENIOR REGULATORY LAW JUDGE:** **Ronald D. Pridgin**

## LIST OF ISSUES

On October 6, 2006, Staff submitted a list of issues for determination by the Commission. Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to pleadings. No party timely objected to Staff's list. Therefore, the Commission will articulate the list of issues as Staff has. The issues that the parties present to the Commission are as follows:

Incentive Compensation

*What amount, if any, of incentive compensation should be included in rates?*

Pensions

*How should the expense and contributions relating to pension benefits for (1) Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?*

*Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?*

Hawthorn 5

*Should the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion in 1999 have been accounted for differently?*

*Is the AFUDC amount overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?*

*Is the gross plant value of Hawthorn 5 overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?*

*Should an adjustment be made to KCPL's books and records regarding the amount for AFUDC to fund the Hawthorn 5 reconstruction?*

Ice Storm Costs

*What amount of the amortization of the costs associated with the 2002 ice storm should be included in rates?*

EEI Dues

*What amount of EEI dues should be included in rates?*

Severance Costs

*What amount, if any, of severance costs should be included in rates?*

Bad Debts

*Should the bad debt percentage be applied to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?*

Fuel & Purchased Power Expense

*What is the appropriate level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?*

*What level of natural gas fuel price should be used in the production cost modeling that is used, along with appropriate fuel adders, to quantify the level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?*

<u>Surface Transportation Board Litigation</u>

*Should the deferred expenses associated with the Surface Transportation Board rail rate complaint case that were incurred through June 30, 2006, be included in rate base?*

<u>SO2 Premiums</u>

*How should SO2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?*

*What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO2 premiums in this case?*

<u>Injuries and Damages</u>

*What is the appropriate amount of injuries and damages expense to include in rates?*

<u>Rate Case Expense</u>

*What amount of rate case expense should be included in rates?*

*Should rate case expense be normalized or deferred and amortized? If the latter, then what is the appropriate amortization period for the deferred rate case expense?*

*Should the costs deferred for future amortization be included in rate base?*

Corporate Projects and Strategic Initiatives

*Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?*

Payroll, Including A&G Salaries

*How should annualized payroll costs of Great Plains Energy Services (GPES) employees be allocated to KCPL?*

*What is the proper method to be used in determining the allocation or assignment of A&G salaries to be capitalized or expensed?*

Other Benefits

*What amount of other benefits should be included in rates?*

Maintenance Expense

*Should an adjustment be made to normalize test year maintenance for production and distribution expenses? If so, how?*

Property Taxes

*Should property taxes be adjusted to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions, and other factors during the test period, including both the update period and true-up period?*

Decommissioning Expense

*Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?*

True-Up

*What elements of Cost of Service and Rate Base should be updated in the September True Up?*

Regulatory Plan Additional Amortizations

*What amount of Regulatory Plan additional amortizations should be allowed to maintain KCPL's credit rating?*

*Should a "gross up" for taxes be added to this amount? If so, what amount is appropriate?*

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

*Over what period of time should the Regulatory Plan additional amortizations be treated as an offset to rate base?*

*Should the capital structure be synchronized with the investment in Missouri jurisdictional electric operations? How should that be accomplished?*

*Should an amount be added to Missouri jurisdictional rate base to reflect additional investments related to Missouri jurisdictional electric operations?*

Weather Normalization/Customer Growth

*What methodology should be used to compute Large Power class kWh sales and revenues?*

Jurisdictional Allocations

*What is the appropriate method (4 CP vs. 12 CP) to use for allocating generation and transmission costs among jurisdictions?*

*How should A&G expenses be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?*

Off-system Sales

*What level of off-system sales margin should be included in determining KCPL's cost of service?*

*How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?*

*What parameters do the Commission-approved Stipulation and Agreement in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?*

*Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders? Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?*

Depreciation

*What are the appropriate depreciation rates to be used in establishing rates in this proceeding?*

Cost of Capital

*What is the appropriate capital structure?*

*What is the appropriate return on common equity (ROE)?*

*Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?*

Class Cost-of-Service

*On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?*

*On what basis should production capacity and transmission costs be allocated to classes?*

*What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes?*

*Do KCPL's computation of coincident peak demands and class peak demands properly recognize line losses?*

*To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?*

*What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 933, 923, 930.2 and 931 among Missouri retail customer classes?*

*Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?*

*Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?*

*Should revenue adjustments be phased in over multiple years?*

*Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?*

*How should any increase in the revenue requirement be implemented?*

Rate Design

*Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2? Should the cost-basis of general service all-electric rates be included in this analysis?*

*Should KCPL's proposed changes to the General Service customer charge be implemented?*

Availability of General Service Space-Heating Rate Discounts

*In this case, should the qualification provision of the existing general service all-electric rate schedules be expanded as proposed by KCPL, and the all-electric winter* *energy rate increased an additional 5%, to make rate discounts available to existing and future customers who are not all-electric customers?*

*Should the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs be eliminated or restricted to existing customers only until there is a comprehensive class cost of service study and/or cost-effectiveness study which analyzes and supports such tariffs and provisions as well as KCPL's Affordability, Energy Efficiency and Demand Response programs?*

Weatherization

*Should the weatherization program be modified so that KCPL's Call Center will refer customers to the program?*

*Should LIHEAP recipients be directed to the weatherization program and be required to participate in it?*

*Should KCPL participate in an "Energy Conservation Program" that will provide consultation, weatherization materials and installation? If so, should the cost of the program to be underwritten by KCPL and charged to the customer?*[1]

## FINDINGS OF FACT

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of

[1] The Missouri Department of Natural Resources and The City of Kansas City, Missouri object to this issue.

the parties. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises."[2] Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420.[3] Section 536.090 provides, in pertinent part:

> Every decision and order in a contested case shall be in writing, and . . . the decision . . . shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

Missouri courts have not adopted a bright-line standard for determining the adequacy of findings of fact.[4] Nonetheless, the following formulation is often cited:

> The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence.[5]

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2 Section 386.420.2, RSMo 2000. All further statutory references, unless otherwise specified, are to the Revised Statutes of Missouri (RSMo), revision of 2000.

3 St. ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n of Mo., 103 S.W.3d 813, 816 (Mo. App., W.D. 2003); St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n, 24 S.W.3d 243, 245 (Mo. App., W.D. 2000).

4 Glasnapp v. State Banking Bd., 545 S.W.2d 382, 387 (Mo. App. 1976).

5 Id. (quoting 2 Am.Jur.2d Administrative Law § 455, at 268).

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected."[6] Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely conclusory."[7]

With these points in mind, the Commission renders the following Findings of Fact.

## Procedural History

On February 1, 2006, Kansas City Power & Light Company submitted to the Commission proposed tariff sheets, effective for service on and after January 1, 2007, that are intended to implement a general rate increase for electrical service provided in its Missouri service area. KCPL's proposed tariffs would increase its Missouri jurisdictional revenues by approximately $57 million, or by 11.5%. The Commission issued an Order and Notice on February 3, in which it gave interested parties until February 23 to request intervention.

The Commission received timely intervention requests from: the United States Department of Energy, acting on behalf of the National Nuclear Security Administration; the City of Kansas City, Missouri; Missouri Gas Energy, a Division of Southern Union Company; The Empire District Electric Company; Aquila, Inc.; Trigen-Kansas City Energy Corporation; Jackson County, Missouri; AARP; and Missouri Industrial Energy Consumers.

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[6] St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n, 806 S.W.2d 680, 684 (Mo. App., W.D. 1991) (quoting St. ex rel. Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n, 701 S.W.2d 745, 754 (Mo. App., W.D. 1985)).

[7] St. ex rel. Monsanto Co. v. Pub. Serv. Comm'n, 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on St. ex rel. Rice v. Pub. Serv. Comm'n, 359 Mo. 109, 220 S.W.2d 61 (1949)).

In addition, the Commission received untimely intervention requests from Wal-Mart Stores East, L.P. and W. Bill Dias. The Commission granted these requests as well.

Furthermore, in Commission Case No. EO-2005-0329, KCPL had entered into a Stipulation and Agreement regarding an Experimental Regulatory Plan, which was the genesis for this rate case. A portion of that agreement provided that the non-KCPL signatories would automatically become intervenors in this rate case. The non-KCPL signatories to the Stipulation and Agreement in Case No. EO-2005-0329 that are intervenors in this case are: the Staff of the Commission; the Office of the Public Counsel; the Missouri Department of Natural Resources; Praxair, Inc.; Missouri Industrial Energy Consumers; Ford Motor Co.; Aquila, Inc.; The Empire District Electric Company; Missouri Joint Municipal Electric Utility Commission; and the City of Kansas City, Missouri.[8]

In addition, part of the Commission's February 3 notice stated that in Case No. EO-2005-0329, the signatories to the stipulation in that case agreed that the test year for this case would be the historic test year period ending December 31, 2005, updated for known and measurable changes through June 30, 2006, with a true-up period through September 30, 2006, and KCPL filing a reconciliation in the true-up proceeding on or about October 21, 2006. No parties objected to the afore-mentioned true-up dates, and the Commission will adopt them. The Commission held local public hearings in Kansas City on August 24, an evidentiary hearing on October 16-17, 19-20, 23-24, 26-27, and a true-up hearing on November 16.

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[8] On April 17, 2006, the Commission granted the Missouri Joint Municipal Electric Utility Commission's motion to withdraw.

## Discussion

KCPL is an electric utility and a public utility subject to Commission jurisdiction. The Staff of the Commission is represented by the Commission's General Counsel, an employee of the Commission authorized by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]"[9] The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"[10] The remaining parties consist of political subdivisions served by and located within KCPL's service territory, industrial and commercial consumers, a competitor, labor union locals, and a pro se intervenor.

### Revenue Requirement

Ratemaking involves two successive processes:[11] first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.[12] The second process is rate design, that is, the construction of tariffs that will

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[9] Section 386.071.

[10] Sections 386.700 and 386.710.

[11] It is worth noting here that Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. See Utility Consumers Council, supra, 585 S.W.2d at 48-49; St. ex rel. Jackson County v. Pub. Serv. Comm'n, 532 S.W.2d 20, 28-29 (Mo. banc 1975), cert. denied, 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

[12] St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).

collect the necessary revenue requirement from the ratepayers. Some of the parties have filed a non-unanimous stipulation on class cost of service and rate design, to which no party has objected.

Revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.[13] These four issues will be discussed separately below.

The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D)\,R$$

where:
- RR = Revenue Requirement;
- C = Prudent Operating Costs, including Depreciation Expense and Taxes;
- V = Gross Value of Utility Plant in Service;
- D = Accumulated Depreciation; and
- R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.[14] The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8)

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[13] Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 Hastings L.J. 1133, 1134 & 1149-50 (1983).

[14] See St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.[15] Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

To begin deciding KCPL's revenue requirement, the Commission will first discuss rate of return.

### ***Rate of Return:***

*What is the appropriate capital structure?*

*What is the appropriate return on common equity (ROE)?*

*Should ROE be adjusted either upwards or downwards to reflect increased or decreased risk or company performance? If so, what adjustment should be made?*

The equation set out above shows that the Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital.

The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure.

[15] Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

**1. Capital Structure and Embedded Cost of Capital:**

The composition of the capital structure and the embedded cost of the components other than common equity are not difficult to ascertain. It is simply a "snapshot" as of a given moment in time. The parties agree that a proper capital structure for this case is: Debt – 44.79%; Preferred Stock – 1.53%; Common Equity – 53.69%.[16]

**2. Cost of Common Equity:**

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, determining a return on equity requires speculation about the desires and requirements of investors when they choose to invest their money in KCPL rather than elsewhere. As a result, the Commission cannot simply find a rate of return on equity that is "correct"; a "correct" rate does not exist.

However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. In Missouri Gas Energy, the Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the

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[16] See Post-Hearing Brief of Kansas City Power & Light Company, p. 5 (filed November 17, 2006); Staff's Post-Hearing Brief, pp. 69-70 (filed November 17, 2006); Initial Post-Hearing Brief of The Office of The Public Counsel, p. 22 (filed November 17, 2006).

national average."[17] Nevertheless, the national average is an indicator of the capital market in which KCPL will have to compete for necessary capital.

In a survey of regulatory decisions from around the country, as reported by Regulatory Research Associates, the average allowed return in the electric utility industry for the third quarter of 2006 was 10.06%.[18] That same study revealed that for the first quarter of 2006, the average ROE for electric utilities was 10.38%; for the second quarter, 10.69%.[19] The average of those three ROEs is approximately 10.37%; thus, the Commission finds that it should set return on equity somewhere in a range from 9.37% to 11.37%.

For additional guidance on exactly where in that "zone of reasonableness" the Commission should set KCPL's return on equity, the Commission must turn to the expert advice offered by financial analysts. This "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."[20]

KCPL, Staff, OPC, and the U.S. Department of Energy (DOE) sponsored financial analysts who recommended a return on equity in this case. Their recommended ROEs are: KCPL – 11%, plus a 50 basis point adder; OPC – 9.9%; Staff – 9.32-9.42%; DOE – 9%. Because the return on equity recommended by DOE falls outside of the "zone of reasonableness", the Commission will discard it and find that it merits no further

[17] In re Missouri Gas Energy, 12 Mo.P.S.C.3d 581, 593 (Report and Order issued September 21, 2004).

[18] Tr. Vol. 12, p. 1241.

[19] Ex. 34, p. 4.

[20] L.S. Goodman, 1 The Process of Ratemaking, 606 (1998).

discussion.[21] KCPL's recommended ROE of 11.5% is actually a recommendation of 11%, with a 50 basis point adder; thus, the Commission finds KCPL's recommendation of 11%, plus any potential adder to make the ultimate ROE 11.37%, within the "zone of reasonableness." The Commission must now analyze the remaining suggested ROEs.

KCPL

Although KCPL offered witnesses Cline, Giles, and Bassham to support its requested ROE, KCPL's main witness on this issue, in the Commission's opinion, was Dr. Hadaway. Dr. Hadaway's credentials are impeccable; he earned his Doctor of Philosophy in Finance from The University of Texas – Austin in 1975, and has also been an adjunct professor there.[22] He has also been either an Assistant or Associate Professor of Finance at The University of Alabama, Texas Tech University and Texas State University – San Marcos. Furthermore, Dr. Hadaway was Director of the Economic Research Division at the Public Utility Commission of Texas. His job duties consisted of supervising the Texas Commission's economic, finance and accounting staffs, as well as serving as the Texas Commission's chief financial witness in telecommunications and electric cases. Finally, he has taught numerous courses at utility conferences concerning, among other issues, cost of capital. In conclusion, Dr. Hadaway has testified between two and three hundred times before public utility commissions concerning cost of capital.[23]

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[21] The Commission notes that DOE's witness, Dr. Woolridge, has impressive credentials, being a professor of finance at Penn State University. However, in contrast to Dr. Hadaway, Dr. Woolridge has never worked for, or even testified for, a public utility.

[22] Ex. 33, Sch. SCH-8.

[23] Tr. Vol. 12, p. 1301.

Dr. Hadaway's analysis began with the entire 60 company group of electric utilities followed by Value Line, which is an investment survey that is published for approximately 1,700 companies, both regulated and unregulated.[24] He then narrowed that group to 24, including only companies that have: at least a triple-B (investment grade) bond rating; at least 70 percent of revenues from regulated utility sales; consistent financial records not affected by recent mergers or restructuring; and a consistent dividend record with no dividend cuts within the past two years.[25] Those 24 companies included companies mostly from the Midwestern United States, but also included companies from other regions to make the sample more representative of the entire country. Even DOE's witness, Dr. Woolridge, found Dr. Hadaway's proxy groups acceptable.[26]

Once he obtained his proxy group, Dr. Hadaway then used a traditional discounted cash flow (DCF) model to arrive at his ROE estimate of 9.3 to 9.4%, virtually identical to the same ROE estimate that Staff witness Barnes used. However, finding those results unreasonably low, Dr. Hadaway then used recalculated constant growth results with the growth rate based on long-term forecasted growth in GDP, yielding an ROE range of 11.2% to 11.3%. Finally, using a multistage DCF model, Dr. Hadaway arrived at an ROE range of 10.6% to 10.8%.

In short, Dr. Hadaway used a risk premium model as a check of reasonableness on his DCF results, and his results were between 10.6% and 11.3%. His ultimate ROE recommendation is an approximate mid-point of that range at 11%, with a 50 basis point

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[24] Ex. 34, p. 11; Ex. 201, p. 17.

[25] Ex. 33, pp. 3-4.

[26] Tr. Vol. 12, p. 1343.

"adder" to account for the high construction risk KCPL will have during its Experimental Regulatory Plan, for a total of 11.5% recommended ROE. His "adder" came from risk adders he studied in FERC cases that ranged from 50 to 200 basis points, as well as a recent case from this Commission in which the Commission added 30 basis points to The Empire District Electric Company's ROE.[27]

Staff

Staff witness Matthew Barnes earned a Bachelor of Science degree in Business Administration in Accounting from Columbia College in December 2002, and an MBA with an emphasis in Accounting from William Woods University in May 2005. He has been an auditor for Staff since 2003.[28]

This case is the first case in which Staff witness Barnes has been a chief cost-of-capital witness.[29] In contrast to the other cost of capital witnesses, who used 21-24 companies in their proxy group, Mr. Barnes used only five.[30] He chose those companies because they met the following criteria: vertically integrated electric utility; publicly traded stock; information printed in ValueLine;[31] ten years of available data; at least investment grade credit rating; two sources for projected growth available with one from ValueLine;

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[27] Id. at 1248.

[28] Ex. 101, p. 1.

[29] Tr. Vol. 9, p. 994.

[30] Tr. Vol. 9, p. 984, p. 1001.

[31] An investment survey published for approximately 1,700 companies, both regulated and unregulated. It is updated quarterly and probably represents the most comprehensive and widely used of all investment information services. It provides both historical and forecasted information on a number of important data elements. Ex. 201, p. 17.

and no Missouri operations.[32] In selecting companies for a proxy group, Mr. Barnes did not consider the amount of non-regulated business, the location of the company, or the company's fuel mix. As Dr. Hadaway noted, besides being too small from a statistical standpoint, Mr. Barnes ends up with a flawed sample because it is dominated by companies that are not similar to KCPL. Four of the five companies are in Value Line's West Region: Hawaiian Electric (based in Honolulu, Hawaii); IDACORP (based in Boise, Idaho); Pinnacle West (based in Phoenix, Arizona); and Puget Energy (based in Bellevue, Washington). The other company, Southern Company (based in Atlanta, Georgia), is in Value Line's East Region. Staff's sample does not assist the Commission in determining whether KCPL would have the opportunity to earn a rate of return 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."[33]

As a consequence of the small sample of companies used in its sample group, the fact that those companies are outside the Midwest, and Mr. Barnes' decision not to allow for construction risk when calculating return on equity, the Commission will reject Staff's recommended return on equity.

OPC

OPC's cost of capital witness, Mr. Baudino received a Bachelor of Arts Degree with majors in Economics and English in 1979, and a Master of Arts degree in Economics in

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[32] Tr. Vol. 9, p. 979; Ex. 101, Sch. 12.

[33] Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 692-93; 43 S.Ct. 675, 679; 67 L.Ed. 1176 , 1182-83 (1923) (emphasis supplied).

1982, both from New Mexico State University.[34] Afterwards, he worked for the New Mexico Public Service Commission Staff before taking his current position as a consultant with Kennedy and Associates.[35]

Before Mr. Baudino applied a DCF analysis to determine his recommended ROE, he, like Dr. Hadaway and Mr. Barnes, had to construct a proxy group. First, using the July 2006 issue of the AUS Utility Reports, he picked electric companies that were rated either Baa/BBB or A/A by Moody's and Standard and Poor's. He used this criterion because KCPL currently has a split bond rating, BBB from S&P and A2 from Moody's. From that group, he selected companies that had at least 50 percent of their revenues from electric operations and that had long-term earnings growth forecasts from either Zack's or First Call/Thomson.

Then, Mr. Baudino eliminated companies that had cut or eliminated dividends since 2003, were recently or currently involved in merger activities, and had recent experience with significant earnings fluctuations. He found those criteria important because utilities that are undergoing those types of changes are not good candidates for the DCF model.[36]

Some of the companies he used were Midwestern, and some not; when asked why he excluded a company that both Staff and KCPL included in their proxy groups, Mr. Baudino could not remember.[37] This is troubling, considering that he claims that his analysis relies on a proper sample of companies.[38]

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[34] Ex. 201, p. 1.

[35] Id.

[36] Id. at 15.

[37] Tr. Vol. 11, p. 1107.

[38] Id. at 1117.

The Commission notes that Mr. Baudino criticizes Dr. Hadaway's use of ValueLine betas (a company or industry risk versus the risk of the market as a whole) instead of First Call/Thomas betas. However, Mr. Baudino testified, "I'll admit that I don't know how they were calculated" and that, compared to ValueLine, he "can't really tell you which is more accurate."[39] When asked about his analysis about how much risk KCPL is exposed to for non-firm off-system sales versus other Missouri utilities, Mr. Baudino testified that he had not really looked at it.[40]

The Commission finds Mr. Baudino's analysis less credible than Dr. Hadaway's analysis because Dr. Hadaway has more education and experience than does Mr. Baudino in evaluating cost of capital for regulated utilities. Further, Mr. Baudino could not recollect why he rejected a certain company for his proxy group, and did not know the accuracy of the very information he was using in his analysis. Moreover, in direct conflict with this Commission's "zone of reasonableness" decisions in MGE and Empire, he would have the Commission <u>ignore</u> other jurisdictions' findings on ROE.[41] Again, while the Commission will not "unthinkingly mirror the national average" in this case, the Commission finds that it is simply common sense to use national average ROEs as a reference point because that gives the Commission insight about the capital market in which KCPL must compete for equity dollars.

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[39] <u>Id.</u> at 1096-97.

[40] <u>Id.</u> at 1112.

[41] Ex. 203, p. 3.

As stated above, the Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.[42] The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task.[43] In the earlier of these cases, Bluefield Water Works, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[44]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> 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.[45]

The Court restated these principles in Hope Natural Gas Company, the later of the two cases:

> '[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.

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[42] C.F. Phillips, Jr., The Regulation of Public Utilities, 390 (1993); Goodman, 1 The Process of Ratemaking, supra, at 606.

[43] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[44] Bluefield, supra, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

[45] Id., 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

> 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.[46]

In the final analysis, it is not the method employed, but the result reached, that is important.[47] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[48]

After considering all of the evidence and the arguments of the parties, the Commission determines that the appropriate ROE is 11%. This ROE is within the "zone of reasonableness" and based upon the Commission's finding that Dr. Hadaway's credentials are superior to those of the other ROE expert witnesses, thus making his evidence more credible. Additionally, the Commission finds Dr. Hadaway's comparative group, and his analysis of that group, the most credible.

Also, the Commission finds that the Experimental Regulatory Plan, while allowing KCPL's credit metrics to stay at investment grade, thus pleasing the **bond** community, does not necessarily make KCPL more attractive to **equity** investors.[49] As KCPL invests in

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[46] Hope Nat. Gas Co., supra, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

[47] Within a wide range of discretion the Commission may select the methodology. Missouri Gas Energy v. Public Service Comm'n, 978 S.W.2d 434 (Mo. App., W.D. 1998), rehearing and/or transfer denied; State ex rel. Associated Natural Gas Co. v. Public Service Commission, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. State ex rel. City of Lake Lotawana v. Public Service Comm'n of State, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

[48] Fed. Power Comm'n v. Nat. Gas Pipeline Co., 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

[49] Tr. Vol. 9, pp. 949-50; see also Tr. Vol. 13, pp. 1306-07, 1310.

Iatan 2 and other ERP assets, thereby almost doubling its rate base,[50] KCPL may need additional amortization of some $70 to $80 million even at an 11.5% return on equity.[51] Moreover, out of the roughly $563.6 million in common equity KCPL's parent, GPE, plans to issue during the ERP, some $213.6 million, or 37.9% of the total stock issuance, is planned for issuance in 2007.[52] The extraordinary budgeted cost and magnitude of the construction contemplated in the Experimental Regulatory Plan, coupled with KCPL's compelling cost of capital evidence, dictates that the Commission should find this issue in favor of KCPL.

The final issue in return on equity is KCPL's requested "adder" of 50 basis point, or 0.5% additional ROE, requested due to the company's construction risk.[53] The level of risk that KCPL, and therefore KCPL investors, will endure during its Experimental Regulatory Plan is somewhat, although not completely, ameliorated by the additional amortizations KCPL may book. As Dr. Hadaway himself acknowledged, although the Experimental Regulatory Plan benefits primarily bondholders, it also has some lesser benefit to shareholders as well.[54] What is more, the Commission will remove considerable risk from KCPL's volatile off-system sales as discussed below. For these reasons, the Commission is of the opinion that KCPL's evidence does not warrant an upward adjustment of 50 basis points. Instead, the Commission will reduce the upward adjustment to only 25 basis points, resulting in a Cost of Common Equity of 11.25%.

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[50] Ex. 33, Sch. SCH-1; Tr. Vol. 12, p. 1305.

[51] Id. at 938.

[52] In re Kansas City Power & Light Company, Case No. EO-2005-0329, Stipulation and Agreement, Appendix B (filed March 28, 2005).

[53] Ex. 33, pp. 3-5; Tr. Vol. 12, p. 1248-49, 1297, 1304-05.

[54] Tr. Vol. 12, p. 1307-10.

Off-System Sales

*What level of off-system sales margin should be included in determining KCPL's cost of service?*

Inextricably linked to return on equity are off-system sales. KCPL witness Cline explains the link between off-system sales in this manner:

> "Each million dollars (of non-firm off-system sales) is worth 9.57 basis points on return on equity. So, yes, every million dollars above the X value or the 25 percentile would result in a 9.57 base (sic) point increase in return on equity, all things equal."[55]

In Case No. EO-2005-0329, the Commission approved a Stipulation among KCPL and the other signatory parties that contemplated an Experimental Regulatory Plan. Under the terms of the Stipulation, KCPL agreed that off-system energy and capacity sales revenues and related costs will continue to be treated "above the line" for ratemaking purposes. KCPL also agreed that it would not propose any adjustment that would remove any portion of its off-system sales from its revenue requirement determination in any rate case during the life of the Experimental Regulatory Plan.

Despite this language in the Stipulation, the parties have wildly differing views of what amount of off-system sales should be included in KCPL's revenue requirement. KCPL points out that it derives almost 50% of its earnings from off-system sales, which are far riskier than regulated sales. KCPL sponsored the testimony of Michael Schnitzer, Director of the NorthBridge Group, Inc., a consulting firm for the electric and natural gas industry. Mr. Schnitzer's testimony focused on the risk KCPL faces in the off-system sales market, and offered a probabilistic analysis of what KCPL's non-firm off-system sales would

[55] Tr. Vol. 9, p. 746.

be in 2007. In summary, Mr. Schnitzer opined that the Commission should set the non-firm off-system margin at the 25th percentile, meaning that KCPL would have a 75% chance of achieving or exceeding the predicted level of those sales.

Alternatively, KCPL recommends that if the Commission eschews the 25-75 analysis, then the Commission could set rates at the 50th percentile. But, in return, as mentioned by KCPL witness Giles, KCPL states that the Commission should award KCPL 9.57 basis points (or 0.0957%) extra in return on equity (ROE) for each $1 million of non-firm off-system sales margin between the 25th and 50th percentile.[56] So, for example, although this is not the evidence in this case, if the difference between the 25th and 50th percentiles were $10 million in sales, and the Commission sets off-system sales at the 50th percentile, then KCPL argues that the Commission should award KCPL an additional 95.7 basis points (9.57 basis points times 10), or 0.957% ROE, on top of whatever ROE it independently determined KCPL should earn.

Another alternative KCPL proposed was that KCPL would accept a mechanism whereby the Commission would set rates by using the 25th percentile of non-firm off-system sales in the revenue requirement. In addition, the Commission would order KCPL to book as a regulatory liability any amount exceeding the 25th percentile, with said liability to flow back to ratepayers in the next rate case.

Staff recommends that the Commission set the non-firm off-system sales level at the same level of sales KCPL made in 2005, believing that those sales are representative of what KCPL will experience in 2007. The off-system sales that Staff includes in revenue requirement is roughly $9 million less than other parties' recommended non-firm off-system

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[56] Id.

sales net margin level of the 50th percentile. In addition, KCPL's recommended 25th percentile is some $28 million less company-wide, and $15 million less Missouri jurisdictional portion, than Staff's recommendation.

OPC lobbies for a 50th percentile point on Schnitzer's curve, arguing that this is the only point where the Commission has an equal opportunity of estimating KCPL's non-firm off-system sales for 2007 too high or too low. This, argues OPC, is equally fair to shareholders and to ratepayers. DOE largely concurs with OPC's recommendation.

Praxair alleges that the most appropriate level of off-system sales to be put into KCPL's revenue requirement is the 2006 budgeted amount. This level is some $12 million higher than recommended by Staff. This level of off-system sales margins: (1) reflects KCPL's best estimate of its 2006 level of off-system sales; (2) is comparable to the amount budgeted for the year that rates will be in effect; (3) is consistent with the most likely level of off-system sales margins as reflected in KCPL's statistical modeling; and (4) reflects KCPL's commitment to include all off-system sales margins above the line and for the benefit of ratepayers.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case, with a corresponding regulatory asset account for KCPL to book any amount below the 25th percentile to be recovered in the next rate case. Not unlike KCPL's witness Dr. Hadaway, Michael Schnitzer possess impressive qualifications: after receiving degrees from Harvard and Massachusetts Institute of Technology, Mr. Schnitzer has been in private industry, consulting electrical and gas companies on strategic and economic issues since 1979.[57] No parties disagreed with his analysis or offered counter-analysis.[58] The disagreement among the parties seems not to be with Mr. Schnitzer's analysis, but KCPL witness Giles' choice to pick the 25th percentile from among the probabilities.[59] Staff, OPC and Praxair recommend the Commission set off-system sales at a higher level; those recommendations, if adopted, would place more into revenue requirement from off-system sales, thereby lessening the revenue to be collected from Missouri retail customers.

Mr. Giles chose the 25th percentile from Mr. Schnitzer's analysis due to the large portion of riskier, non-firm off-system sales KCPL makes in comparison to less risky regulated sales.[60] This is true especially in light of KCPL beginning its Experimental Regulatory Plan, which includes, among other things, constructing latan 2, and which was budgeted at some $1.3 billion.[61] But, as Mr. Giles admits, given the fairly substantial chance that KCPL will meet or exceed that 25th percentile, there are a number of ways to account for KCPL's relatively low risk for non-firm off-system sales, including adjustments to risk sharing and potential refunds.[62]

When discussing risk, one should keep in mind not only the *probability* of an event coming true (or not coming true) but also the *importance* of the event. For example, the probability of a coin landing on "heads" to decide which team receives the ball at the

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[57] Ex. 30, pp. 1-2.

[58] Tr. Vol. 7, pp. 459-61; Vol. 8, pp. 885, 917-18.

[59] See Staff's Post-Hearing and True-Up Brief, p. 32.

[60] Ex. 3, p. 24.

[61] Id.

[62] Id. at 28.

beginning of a football game is 50%. Likewise, a revolver with six cartridge chambers, three of which have bullets, after the chamber is spun, has a 50% chance of firing a bullet on the first pull of the trigger. Yet, the importance of the result of the coin flip versus the importance of the revolver firing the bullet on the first pull of the trigger hardly needs to be explained.

In this case, the importance of the event of KCPL meeting a certain level of off-system sales is neither as trivial as who gets the ball first, nor as important as whether the gun fires. What is at stake here is the importance to KCPL of a certain level of non-firm, off-system sales put into revenue requirement versus the importance of that same level of non-firm, off-system sales to Missouri ratepayers.

Once the Commission decides return on equity, as well as all other issues outside of additional amortization, those decisions will give KCPL its revenue requirement. Then, in accordance with the additional amortizations allowed in Case No. EO-2005-0329, KCPL will be allowed to book those amortizations to keep itself investment grade. In other words, *in the short term*, regardless of the Commission's decision on return on equity, the revenue requirement, and, therefore, the rates Missouri retail ratepayers must pay, will not change.

Under the Experimental Regulatory Plan, KCPL has the option to file a rate case again on February 1, 2007; all indications are, it will.[63] That means that any rates decided in this case likely will be in effect for only one year. Consequently, although Missouri ratepayers would not receive the benefit of corresponding rate base reduction from a higher amortization, *in the short term*, Missouri ratepayers are not harmed by the 25th percentile scenario presented by KCPL, especially in light of the fact that the Commission will order

[63] Tr. Vol. 9, p. 828.

KCPL to account for any sales over that 25th percentile and to flow them back to ratepayers, as KCPL witness Giles suggested. In contrast, the potential importance of not achieving that level during a time when KCPL will be issuing equity and investing hundreds of millions of dollars in infrastructure construction and upgrades could be disastrous to KCPL. In short, in balancing the interests of shareholders and ratepayers, straying from KCPL's recommended 25th percentile might benefit ratepayers some, but might also damage KCPL much, much more than any benefit that might accrue to ratepayers.

Finally, the Commission finds that there is competent and substantial evidence in the record to support KCPL's position that the amount that should go into KCPL's revenue requirement is the 25th percentile "trued-up" number found in a schedule attached to the true-up testimony of KCPL witness Tim Rush.[64] OPC objects to using this number on the grounds that the Commission excluded the true-up testimony of KCPL witness Schnitzer, who was the sponsor of the study that found that number. But even though the Commission excluded Schnitzer's true-up testimony, the Commission received the testimony of KCPL witness Rush, including the disputed true-up number, without objection.[65] This is significant because "in fact, all probative evidence received without objection in a contested case must be considered in administrative hearings."[66] In other words, once Rush's testimony was admitted without objection, which was before Schnitzer's testimony was even offered[67], the disputed trued-up number for the 25th

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[64] Ex. 54, p. 3; Sch. 2, p. 4 of 51.

[65] Tr. Vol. 15, p. 1644.

[66] *See* Dorman v. State Bd. of Registration of Healing Arts, 64 S.W.3d 446, 454 (Mo.App. 2001); *see also* Section 536.070(8)("Any evidence received without objection which has probative value shall be considered by the agency along with the other evidence in the case.")

[67] Tr. Vol. 15, p. 1653.

percentile of off-system sales was in the record, and all parties waived objection to that evidence, even if they made a "specific and laborious objection" to that same evidence later in the hearing.[68] Furthermore, this evidence is probative, because, again no party objected to KCPL witness Schnitzer's direct, rebuttal or surrebuttal testimony that laid out his probabilistic analysis[69], and because no party questioned his methodology,[70] but rather, attacked only KCPL witness Giles' choice to use a certain number on Schnitzer's curve.

*How should the off-system sales margin be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?*

*What parameters do the Commission-approved Stipulation and Agreement in Case No. EO-2005-0329 impose on the treatment of off-system sales revenue in this case?*

*Should KCPL's customers receive the benefit of all margins of off-system sales or should it be shared between customers and shareholders? Should a mechanism be adopted to ensure that the benefit is received by the appropriate party or parties? If so, what mechanism?*

As explained by KCPL witnesses Chris Giles and Don Frerking, KCPL proposes to allocate its margins, or profits, from off-system sales among its Missouri retail, Kansas retail and FERC wholesale jurisdictions using an unused energy allocation methodology. KCPL has never before sought to allocate separately its off-system sales margins among its jurisdictions.[71]

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68 See Canania v. Director of Revenue, 918 S.W.2d 310, 313 (Mo. App. 1996).

69 Tr. Vol. 12, p. 1375.

70 Tr. Vol. 7, pp. 459-61; Vol. 8, pp. 885, 917-18.

71 Ex. 5, p. 5.

KCPL's unused energy allocation methodology "is calculated by subtracting the actual energy usage from the 'available energy.' The available energy is defined as the average of the 12 coincident peak demands multiplied by the total hours in the test period."[72] The rationale behind the unused energy allocation methodology was to develop "an allocation methodology that correlates with the unused capacity that enables the Company to make the off-system sales" that result in the margins at issue.[73]

Staff recommends that the Commission continue to use the energy allocator for revenues from non-firm off-system sales of energy, including the margin component thereof. This is the time-tested and widely accepted method for allocating such revenues in this state because it is appropriate for allocating revenues and associated costs that are purely variable with the amount of energy sold.[74]

The Staff opposes the Company's proposal, which would shift some $4.4 million in revenues from KCPL's Missouri jurisdiction to its Kansas jurisdiction.[75] Other parties, such as OPC, Praxair, MIEC, and DOE, support the traditional energy allocation mechanism proposed by the Staff.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the unused energy allocator rewards the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that

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[72] Ex. 9, pp. 7-8.

[73] Ex. 4, p. 10.

[74] Ex. 115, p. 6; Tr. Vol. 8, p. 702.

[75] Ex. 115, p. 5.

jurisdiction.[76] Load Factor is average energy usage divided by peak demand. The higher the load factor, the closer the average load is to peak demand.[77] The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales.

In KCPL's recent Regulatory Plan case (Case No. EO-2005-0329), some $14 million in expenditures was authorized for demand response programs that should result in increasing KCPL's load factor, and hence, reducing KCPL's need to acquire higher energy cost combustion turbines.[78] Yet, KCPL proposes to allocate a greater proportion of the off-system sales margin to the lower load factor Kansas jurisdiction. Thus, use of the unused energy allocator creates a possible disincentive to implement projects aimed at increasing load factor.[79] Furthermore, application of the unused energy allocator ignores the fact that, thanks to Missouri's higher load factor, Kansas is already benefiting to a greater extent than Missouri from a lower overall cost of energy.

The only costs assigned to non-firm off-system sales is the fuel and purchased power costs – the variable costs – hence the appropriateness of using the energy allocator. This is consistent with the way KCPL itself allocates the costs relating to the energy portion of firm capacity contracts – using the energy allocator. The reason is simple – the energy allocator is used to allocate variable costs of fuel and purchased power costs relating to retail sales. Using the same rationale, the energy allocator is equally appropriate to use as the allocation factor for both energy of firm (as KCPL does) and non-firm off-system sales.

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[76] Ex. 125, p. 4.

[77] Ex. 125, p. 3.

[78] Tr. Vol. 8, pp. 700-01.

[79] Tr. Vol. 8, p. 701.

The demand based unused energy allocator should not be used to allocate off-system sales – either energy from firm capacity sale contracts or non-firm off-system sales. Because plant is not dedicated to support non-firm off-system sales, there is no associated demand charge.[80]

KCPL's settlement of its Kansas case, recently approved by the Kansas Corporation Commission, is a "black box" settlement, meaning that the Commission cannot tell what level of off-system sales are built into KCPL's Kansas rates.[81] This means that any off-system margins that this Report and Order would ostensibly assign to Kansas would not go to Kansas ratepayers, but instead would go to KCPL shareholders. This Report and Order sets KCPL's Missouri rates at a just and reasonable level; any assignment of off-system sales margin away from Missouri using KCPL's proposed allocator would result in a windfall for KCPL shareholders. Thus, the Commission will reject KCPL's novel unused energy allocator, and will use the energy allocator proposed by Staff and other parties.

### *Rate Base:*

Rate base is the second step in determining revenue requirement. To repeat, revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses the calculation of revenue requirement is expressed in the following formula:

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[80] Id. at 588-89, 702.

[81] See In re Kansas City Power & Light Company, Order Approving Stipulation and Agreement, pp. 7-8, Docket No. 06-KCPE-828-RTS (Order issued December 4, 2006).

$$RR = C + (V - D) R$$

where:

| | | | |
|---|---|---|---|
| where: | RR | = | Revenue Requirement; |
| | C | = | Prudent Operating Costs, including Depreciation Expense and Taxes; |
| | V | = | Gross Value of Utility Plant in Service; |
| | D | = | Accumulated Depreciation; and |
| | R | = | Overall Rate of Return or Weighted Cost of Capital. |

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation. According to the parties' reconciliation, the following are contested rate base issues: regulatory asset – AFUDC on Hawthorn 5; eliminate depreciation related to AFUDC adjustment; regulatory expense; January, 2002 ice storm; STB litigation; LED-LDI project; CORPDP-KCPL.

Hawthorn 5

*Should the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion in 1999 have been accounted for differently?*

This issue concerns the accounting treatment of moneys recovered from insurance and lawsuits with respect to the destruction of KCPL's Hawthorn Station Unit 5, and the rebuild of that unit.

KCPL's Hawthorn 5 generating unit was originally commissioned into service in 1969. On February 17, 1999 an explosion at Hawthorn 5 destroyed the steam generator. KCPL decided to rebuild Hawthorn 5 after examining alternatives. KCPL needed the unit back in service as soon as possible so demolition of the plant took place in the spring and early summer of 1999 and construction began on the "new" unit in mid-summer 1999.

Hawthorn 5 was substantially rebuilt to a new, state of the art, coal-fired base load generating unit with a completely new steam generator (boiler), feed water system and pumps, air quality control system including the installation of a Selective Catalytic Reduction (SCR) system, scrubber and bag-house, control room, transformer, fuel-handling equipment, and water intakes. The steam turbine generator was substantially rehabilitated and updated.[82]

KCPL received insurance recoveries and lawsuit settlements amounting to $247.9 million. (Of this total, insurance recoveries amounted to $209.75 million and lawsuit settlements amounted to $38.178 million.). KCPL accounted for the insurance proceeds as salvage and recorded the proceeds to FERC Account 108, Accumulated Provision for Depreciation; KCPL claims it was merely following Uniform System of Accounts' (USOA) protocol in booking the insurance proceeds as it did.

Staff proposes the following adjustment:

> One, KCPL booked the insurance recoveries and lawsuit settlements as an increase to depreciation reserve as salvage instead of a reduction of plant in service, results in the plant in service balance being overstated. As a consequence of KCPL's methodology, manual adjustment is required for both financial and regulatory purposes to remove the amount of depreciation relating to the amounts of plant construction received from insurance and lawsuit settlement.[83]

Staff believes that KCPL should have booked the insurance recoveries and lawsuit settlements received before and during the reconstruction to plant in service as a direct offset to the cost of reconstruction.[84]

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[82] Ex. 139, pp. 31-32.

[83] Id. at 34, 36.

[84] Id. at 35.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The plain language of Account 108-B of the USOA states:

> At the time of retirement of depreciable electric utility pant, this account shall be charged with the book cost of the property retired and the cost of removal and shall be credited with the salvage value and any other amounts recovered, such as insurance.[85]

USOA property retired, as applied to electric plant, is property that has been removed, sold, abandoned, **destroyed**, or which for any cause has been withdrawn from service.[86] The evidence is abundantly clear that Hawthorn 5 was destroyed. The Commission sees nothing unambiguous; there is no exception for property destroyed "but later rebuilt." Staff's hearsay evidence of FERC employees commenting during a phone conversation that maybe KCPL could have treated the proceeds differently is hardly enough to overcome the plain language found in the USOA.

*Is the AFUDC amount overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?*

*Is the gross plant value of Hawthorne 5 overstated as a result of the way that KCPL accounted for the insurance recoveries and lawsuit settlements related to the Hawthorn 5 explosion?*

*Should an adjustment be made to KCPL's books and records regarding the amount for AFUDC to fund the Hawthorn 5 reconstruction?*

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[85] Ex. 139, p. 39.

[86] 18 C.F.R. Pt. 101, Definitions 28; see also Tr. Vol. 5, p. 208 (emphasis added).

KCPL witness Wright asserts that KCPL did not have excess cash from insurance proceeds to fund the Hawthorn 5 rebuild, and therefore did not need to use as much debt or equity to pay for the project. She states that the Staff's analysis omits that KCPL spent approximately $162 million in unreimbursed purchased power from the time of the explosion until the rebuild in service date of June 2001 and approximately $10.0 million on cost of removal, and KCPL incurred approximately $296 million in cash expenditures related to Hawthorn 5 in excess of insurance proceeds.[87]

Staff frames the issue as follows:

> KCPL has overstated the plant in service as a result of calculating AFDC on the entire cost of the reconstruction of Hawthorn 5 instead of treating the funds received from insurance recoveries before and during the reconstruction as an offset to the cost of reconstruction. The total insurance proceeds were reduced by $5.0 million associated with replacement power and an additional $2.219 million relating to administrative and general cost offsets. These two amounts were not considered by the Staff as capital expenditures like the reconstruction of Hawthorn 5 costs. The net amount of insurance recoveries after the aforementioned deductions was the amount used as an offset to the cost of reconstruction which is used to calculate the AFDC.[88]

Staff reduced the amount of AFDC for Hawthorn 5 to $7.63 million from the $20.64 million calculated by KCPL to eliminate a return on proceeds that was calculated by KCPL on the insurance received. The $7.63 million recalculates AFDC considering the insurance recoveries that relate to the capital costs, excluding from the insurance recoveries amounts for insurance received of $5 million for replacement power and $2.19 million of cost described by KCPL as administrative and general cost offsets.[89]

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[87] Ex. 8, pp. 3-4

[88] Ex. 139, p. 35; 140, p. 16.

[89] Ex. 140, pp. 5, 16.

According to Staff, the books and records of KCPL should be corrected to reflect no allowance of AFDC on the insurance proceeds received by KCPL.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. Staff's subtraction of insurance proceeds from cumulative construction costs to recalculate AFUDC is counter to the AFUDC formula from the USOA, which uses the average balance in construction work in progress.[90] KCPL's following the USOA does not result in overstating the rate base calculation of Hawthorn 5. Furthermore, KCPL's deposit of the insurance cash into its general corporate account, rather than earmarking the funds for a specific use, was perfectly proper,[91] and earmarking those funds as Staff would have had KCPL do could have resulted in an earlier rate increase.[92] Because KCPL calculated AFUDC properly, no adjustment is required.

<u>*Surface Transportation Board Litigation*</u>

*Should the deferred expenses associated with the Surface Transportation Board rail rate complaint case that were incurred through June 30, 2006, be included in rate base?*

On October 12, 2005, KCPL filed a rate complaint case with the Surface Transportation Board ("STB") against Union Pacific Railroad ("UP"). KCPL's complaint alleges that UP's charges to transport coal from Wyoming's Powder River Basin to KCPL's Montrose plant in Missouri are excessive. As explained by Public Counsel witness Smith:

> In the STB rate complaint case identified above, KCPL charged that UP's rates for the movement of coal from the Powder River Basin (PRB) to KCPL's Montrose Generating Station were unreasonably high. KCPL believes that

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[90] 18 C.F.R. Pt. 101, Electric Plant Instructions (17).

[91] Tr. Vol. 5, p. 201

[92] <u>Id.</u> at 196.

> the rates charged by UP exceeded 180% of the variable cost and was greater than the "stand-alone cost" to provide such service.[93]

KCPL and Staff wish to treat the actual Surface Transportation Board (STB) litigation costs as a regulatory asset, with costs to be amortized to expense over five years beginning in January, 2007. Any refund KCPL receives would first offset any existing balance of STB case costs in the regulatory asset, with the remainder of the refund offsetting fuel costs as determined in a future proceeding.

OPC objects, stating that the Commission should disallow this expense because ratepayers receive no benefit from these estimated costs in this rate case. In the alternative, OPC says that if the Commission includes the costs, then the costs should be spread over a five-year period.

The Commission finds that the competent and substantial evidence supports the position of KCPL and Staff, and finds this issue in their favor. Even OPC, who opposes KCPL on this issue, applauds KCPL for pursuing this litigation, believing it is to the ratepayers' benefit that KCPL tries to recover what it believes to be excessive freight cost for moving coal from Wyoming. The treatment that KCPL and Staff request would first allow KCPL to recover the cost of the STB litigation, with any balance being applied to fuel costs as determined in a future proceeding.[94] This solution appears just and reasonable, as KCPL, Staff, and OPC could all voice their views in that future proceeding on exactly what STB litigation costs were prudent, and on how much money should flow back to ratepayers.

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[93] Exhibit 210, Smith Direct, p. 18.

[94] Ex. 118, pp. 22-23; Ex. 13, pp. 3-4.

Corporate Projects and Strategic Initiatives

*Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?*

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, along with a Motion for Leave to Late-File said stipulation. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix A, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, grants the motion to late-file it, and approves the stipulation.

The Signatories have agreed that certain costs incurred by KCPL will have a benefit relating to more than one period and that related non-labor costs should be deferred as a regulatory asset and amortized over the periods to which the benefits will apply. Costs identified to be deferred include all costs incurred after January 1, 2005 related to project LED-LDI, Leadership Development, and CORPDP-KCPL, Corporate Development-KCPL. These non-labor costs were determined to be $1,781,451 (total Company) and $1,542,115 (total Company), respectively, for the period January 1, 2005 through September 30, 2006. The LED-LDI projects captured costs to develop an enhanced leadership development program for supervisors and managers and to conduct associated training for eligible employees. The CORP-KCPL project captured costs related to KCPL for corporate-level resource planning, business analysis, strategic planning, development of short and long-term business plans and assessment and adjustment of such plans and business decisions in response to changes in the marketplace.

The Missouri jurisdictional amount of such costs as well as the Missouri jurisdictional amount of additional non-labor costs incurred for these projects through the end of 2006 will be deferred. As agreed upon by the Signatories, the Commission authorizes KCPL to amortize the deferred costs to expense over a five (5) year period beginning January 1, 2007.

Although the Signatories have agreed that these costs should be deferred and amortized over a five (5) year period, the Signatories have not reached an agreement concerning either the rate base treatment of these costs or what percentage of these costs constitute the Missouri jurisdictional amount. Those issues are to be decided by the Commission within the "Corporate Projects and Strategic Initiatives" and the "Jurisdictional Allocations" issues now before the Commission for decision in this proceeding.

For the rate base treatment of these expenses, the Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. In rebuttal testimony, KCPL witness Lori Wright stated that KCPL was supportive of Staff's treatment of these costs, yet, without explaining why these projects would be an asset, maintained that these costs should be included in rate base.

As explained by Staff witness Hyneman, "In order for an item to be added to rate base, it must be an asset. Assets are defined by the Financial Accounting Standards Board (FASB) as 'probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events' (FASB Concept Statement No. 6, Elements of Financial Statements). Once an item meets the test of being an asset, it must also meet the ratemaking principle of being 'used and useful' in the provision of utility service. Used and useful means that the asset is actually being used to provide service and that it is actually needed to provide utility service. This is the standard adopted by many regulatory jurisdictions, including the Missouri Public Service Commission."[95]

The Commission finds that the competent and substantial evidence supports the position of Staff, and finds this issue in Staff's favor. While KCPL's projects appear to be prudent, KCPL produced insufficient evidence for the Commission to find that these projects rise to the level of an asset, on which the company could earn a rate of return. What is at issue is not whether a project[96] is a "probable future economic benefit", as KCPL asserts in its brief; what is at issue is the remainder of the FASB definition Mr. Hyneman quoted, which is "obtained or controlled by an particular entity as a result of past transactions or events." In other words, an asset is some sort of possession or belonging worth something. KCPL obtains or controls assets, such as generation facilities and transmission lines. To attempt to turn an otherwise legitimate management expense, such as a training expense, into an asset by dubbing it a "project" makes a mockery of what an asset really is, which is some type of property.[97] Using KCPL's argument, <u>any</u> expense is potentially an asset by simply calling it a "project", and thus could be included in rate base. KCPL's projects do not rise to the level of rate base.

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[95] Ex. 119, p. 13.

[96] <u>Project</u> – a plan or proposal; scheme; an undertaking requiring concerted effort. The American Heritage Dictionary, Second College Edition, p. 990 (1985).

[97] Black's Law Dictionary, Sixth Edition, p. 116.

***Depreciation:***

*What are the appropriate depreciation rates to be used in establishing rates in this proceeding?*

Depreciation is an accounting convention under which the value of an asset is reduced proportionately over the course of its useful life. At the end of its life, the asset is considered to have lost all value except residual salvage value. If the accounting convention were perfect, an asset would be fully depreciated at the time it is actually retired, that is, removed from service.[98] In ratemaking, depreciation is an operating expense, the purpose of which is to return to the investors their original investment in an asset as it is consumed in the public service. "The purpose of the annual allowance for depreciation and the resulting accumulation of a depreciation reserve is . . . to enable the utility to recover the cost of such property to it."[99] Depreciation expense is booked to the depreciation reserve, which amount is deducted in ratemaking from the original cost basis of the utility's plant-in-service or rate base. The resulting net rate base is the present value of the investors' capital assets devoted to public service.

The Constitution requires that the investors' original capital outlay be returned to them in rates as the utility's assets are expended in the public service:

> A water plant, with all its additions, begins to depreciate in value from the moment of its use. Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs but for making good the depreciation and replacing the parts of the property when they come to the end of their life. . . . [The Company] is entitled to see that from earnings the value of the property invested is kept

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[98] See In the Matter of St. Louis County Water Company, 4 Mo.P.S.C.3d 94, 102-3 (1995); In the Matter of Depreciation, 25 Mo.P.S.C. (N.S.) 331.

[99] St. ex rel. Martigney Creek Sewer Co. v. Pub. Serv. Comm'n, 537 S.W.2d 388, 396-397 (Mo. banc 1976).

> unimpaired, so that at the end of any given term of years the original investment remains as it was at the beginning.[100]

KCPL, relying on the depreciation rates set out in the Experimental Regulatory Plan, did not submit a depreciation study. Staff, on the other hand, relying on language in that same stipulation that said that parties may propose changes to KCPL's depreciation rates, did just that by submitting a depreciation study.

In its current depreciation study, Staff performed a broad-group, average-life depreciation study utilizing the straight-line method, broad-group procedure and whole life technique.[101] Staff's current deprecation rates are based on Staff's estimate of average service life and net salvage value for each capital account. Based upon its depreciation study, Staff recommends that the Commission adopt the depreciation rates for the various accounts as set out in Schedule 2 to the Direct Testimony of Staff witness Rosella L. Schad. The depreciation rates determined by the Staff's study would decrease the currently ordered depreciation accrual by approximately $10 million annually.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission, in Case No. EO-2005-0329, recently approved depreciation rates for KCPL. In contrast to those rates, the Commission has serious concerns about Staff's recent depreciation study. For example, it is unclear what Staff did in its lifespan analysis, and Staff seems to inaccurately presume that certain generation-related assets have an indefinite life.[102] Also, it appears that Staff's average service lives for certain transmission, distribution and general plant

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[100] Knoxville v. Knoxville Water Co., 212 U.S. 1, 13-14, 29 S.Ct. 148, 152, 53 L. Ed. 371, 381 (1909).

[101] Ex. 131, p. 3

[102] Ex. 10, pp. 16-17.

assets are some 10-20 years too long. Furthermore, Staff's calculation of net salvage rates may be inaccurate, with its attempts to eliminate outliers by excluding the highest and lowest net salvage amounts actually exacerbating, rather than solving, the problem.[103]

What is more, any decrease in depreciation likely would not affect rates in this case, because KCPL would be allowed additional amortization to meet the credit metrics agreed to in Case No. EO-2005-0329.[104]

Regulatory Plan Additional Amortizations

*What amount of Regulatory Plan additional amortizations should be allowed to maintain KCPL's credit rating?*

The Commission discusses this issue in this section of the Report and Order because, as explained by KCPL witness Frerking, amortization is, in fact, the same as depreciation expense.[105] And, this issue, although tied in with return on equity and off-system sales, is actually independent of those, and all other issues.[106] As aptly explained by Staff witness Traxler:

> "Once the Commission makes a decision in every rate case (during KCPL's Experimental Regulatory Plan) on the issues, at that point in time, we'll take that scenario and determine whether or not an additional amortization is required. The amortization will result specifically from the Commission's decisions on all the other issues."[107]

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[103] Id. at 19-20.

[104] Tr. Vol. 7, p. 503, 515.

[105] Id. at 504.

[106] The Commission notes that, despite the Experimental Regulatory Plan's statement that KCPL would need approximately $17 million in amortizations in this rate case (Ex. 143, p. 37), the parties present this issue for the Commission to resolve.

[107] Tr. Vol. 11, p. 1179 (parenthetical phrase added); see also Tr. Vol. 9, pp. 858-859.

In addition to Staff, KCPL's counsel and the Public Counsel largely concurred with Mr. Traxler's statement; namely, that once the Commission decides the revenue requirement, that the parties can agree on how to calculate how much, if any, Additional Amortization is required under the Experimental Regulatory Plan approved in Case No. ER-2005-0329.[108] As such, there appears to be no issue for the Commission to explicitly resolve with this Report and Order; the Commission's decision on all other issues will dictate to KCPL and the other parties exactly what additional amortization is needed.

*Should a "gross up" for taxes be added to this amount? If so, what amount is appropriate?*

On December 4, 2006, KCPL, Staff, OPC and Praxair submitted a Nonunanimous Stipulation and Agreement Regarding Regulatory Plan Amortizations. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix B, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

According to the signatories, this stipulation has the following key points:

> 1. The entire amount of the Regulatory Plan amortization allowed in rates is to be treated as additional book depreciation for rate and financial statement purposes by KCPL;
>
> 2. An additional tax straight-line depreciation deduction in the entire amount of the Regulatory Plan amortization allowed in rates will be assumed for rate purposes and financial reporting purposes; and
>
> 3. The accumulated book depreciation reserve resulting from the recognition of the Regulatory Plan amortization as book depreciation will be recognized as an offset

[108] Tr. Vol. 5, p. 59; Vol. 8, p. 620; see also Ex. 214, p.1, 8.

(reduction) to rate base in subsequent rate cases. The accumulated reduction in deferred income tax expense resulting from including the Regulatory Plan amortization in the straight line tax depreciation deduction will be reflected on KCPL's tax records and included in subsequent rate cases, as appropriate, along with all other factors included in the determination of deferred income tax expense. The net effect of these changes related to the Regulatory Plan amortizations to the accumulated depreciation reserve and the accumulated deferred tax reserve is an overall reduction to KCPL's rate base. The reduction in deferred taxes will be reflected in the deferred income tax balance in rate base in future rate cases, as well as all other changes affecting the deferred tax balance, including additional deferred taxes resulting from KCPL's plant additions.

The Regulatory Plan amortization is intended to provide KCPL the necessary cash flow to meet the two particular debt coverage ratios identified in the Regulatory Plan based upon KCPL's Missouri jurisdictional cost of service.[109] The entire amount of the Regulatory Plan amortization will be treated as additional book depreciation, and the entire amount of the amortization will be reflected in KCPL's tax calculation as additional tax straight-line depreciation deduction.

The Commission finds the stipulation to be a reasonable resolution of the "gross-up" issue among the parties, and will approve it.

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

KCPL and Staff agree that the risk factor that should be used to calculate Regulatory Plan additional amortizations for off-balance sheet purchased power agreements should be 50%, which is the same risk factor that Standard & Poor's used to analyze KCPL's debt. In

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[109] Adjusted Funds From Operations Interest Coverage and Adjusted Funds From Operations as a Percent of Average Total Debt. See Paragraph III.B.1.i and Appendix E and Appendix F of the Regulatory Plan.

contrast, OPC believes that risk factor does not realistically reflect KCPL's chance of defaulting on those obligations, and instead, opts for a 10% risk factor.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission is mindful that this rate case, as well as others KCPL likely will file in the next few years, is somewhat dependent upon the Stipulation and Agreement in the Experimental Regulatory Plan case. That stipulation provides that the parties agree that KCPL should remain at investment grade.[110] The amount of amortization needed to keep KCPL at investment grade, in turn, is driven largely by Standard & Poor's credit metrics.[111] Standard & Poor's uses a 50% risk factor to rate KCPL's off-balance sheet obligations, so it seems sensible for the Commission to use that same factor. In contrast, a lower risk factor would result in the additional amortization being determined using a lower level of debt than used by Standard & Poor's. "This, in turn, would result in (KCPL) failing to meet the thresholds that S&P has established. . . . S&P's position must be accepted as a given in light of what the amortization mechanism is designed to accomplish."[112] Although OPC's argument for a 10% risk factor has some merit, OPC's "belief"[113] that the lowest risk factor should be utilized is less convincing than the argument that S&P actually uses a 50% risk factor.

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[110] See In re Kansas City Power & Light Company, Case No. EO-2005-0329, Stipulation and Agreement, p. 18 (filed March 28, 2005).

[111] Tr. Vol. 12, p. 1276, p. 1328.

[112] Ex. 25, p. 6.

[113] Ex. 213, pp. 4-5.

*Over what period of time should the Regulatory Plan additional amortizations be treated as an offset to rate base?*

In the stipulation labeled Appendix B, the signatories agreed that pursuant to and in compliance with the provisions of the Stipulation and Agreement that the Commission approved in Case No. EO-2005-0329, any Regulatory Plan additional amortization that is provided to KCPL pursuant to that Stipulation and Agreement shall be used as a reduction to rate base for the longer of (a) at least ten (10) years following the effective date of the July 28, 2005 Report And Order in Case No. EO-2005-0329 or (b) until the investment in the plant in service accounts to which the Regulatory Plan additional amortizations are ultimately assigned by the Commission is retired. The Commission finds this reasonable, and approves of the stipulation's resolution of this issue.

*Should the capital structure be synchronized with the investment in Missouri jurisdictional electric operations? How should that be accomplished?*

*Should an amount be added to Missouri jurisdictional rate base to reflect additional investments related to Missouri jurisdictional electric operations?*

Again, as mentioned in the stipulation labeled Appendix B, the signatories agree that the additional amortization calculation based upon the revenue requirement resulting from the true-up in this case will reflect an allocation of Great Plain Energy, Inc.'s (GPE's)/KCPL's capital structure to Missouri electric operations. This allocation will exclude the impact of the operations of GPE/KCPL not related to KCPL's Missouri electric operations. The Commission finds this reasonable, and approves of the stipulation's resolution of this issue.

***Allowable Operating Expenses***

The final variable in the revenue requirement equation that the Commission must resolve is what expenses are prudent, and therefore should be included in KCPL's cost of service.

Capitalization of Certain Costs

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, already described above as Appendix A. Again, the Commission approves the stipulation and, as requested by KCPL in the stipulation, and not opposed by Staff, the Commission further makes the following findings:

As agreed to by KCPL and Staff, the Commission authorizes KCPL to capitalize all costs incurred after January 1, 2005 related to project MSC0140, KCPL Strategic Initiatives, and certain advertising costs all incurred by KCPL in the development of various components and informing customers of the features of KCPL's Regulatory Plan Capital Investments, which will be transferred and capitalized to the Iatan 2 construction project. These costs were determined to be $2,137,705 (total Company) during the 2005 test year.

Furthermore, the Commission approves the agreement between KCPL and Staff to allow KCPL to capitalize certain costs incurred subsequent to the test year, as well as related costs, to the Regulatory Plan Capital Investment project to which they apply. The Commission notes that the parties do not agree on what percentage of those costs constitutes the Missouri jurisdictional amount, and the Commission will address that issue within the "Jurisdictional Allocations" issue pending in this case.

Incentive Compensation

*What amount, if any, of incentive compensation should be included in rates?*

KCPL requests that all of its incentive compensation be included in cost of service. Staff objects, stating that roughly 35% of the cost should be disallowed on the grounds that it is either tied to earnings per share (EPS), and thus has negligible, if any, benefit to ratepayers, or is awarded for vague reasons.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As far as compensation tied to EPS, the Commission notes that KCPL management has the right to set such goals. However, because maximizing EPS could compromise service to ratepayers, such as by reducing customer service or tree-trimming costs, the ratepayers should not have to bear that expense. What is more, because KCPL is owned by Great Plains Energy, Inc., and because GPE has an unregulated asset, Strategic Energy L.L.C., it follows that KCPL could achieve a high EPS by ignoring its Missouri ratepayers in favor of devoting its resources to Strategic Energy.

KCPL's attempt to state that Staff has no evidence to support its theory that maximizing EPS might not benefit KCPL shareholders misses the point; KCPL has the burden to prove that the Commission should approve the tariffs. Further, KCPL's argument that disallowing any of its incentive compensation costs would put it at a competitive disadvantage fails. KCPL management is free to offer whatever compensation packages it wants. Nevertheless, if the method KCPL chooses to compensate employees shows no tangible benefit to Missouri ratepayers, then those costs should be borne by shareholders, and not included in cost of service.

Pensions

*How should the expense and contributions relating to pension benefits for (1)Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?*

*Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?*

On December 4, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Pension Issues. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix C, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

According to the signatories, this stipulation has the following key points:

a. Clarify the pension provisions in KCPL's Regulatory Plan with regard to KCPL's joint partners in the latan and LaCygne generating stations.

b. Identify, for purposes of calculating the tracking mechanism provided for in the method agreed to in the Regulatory Plan, the Regulatory Assets, including the Prepaid Pension Asset and annual Pension Cost resulting from rates established in this rate case, Case No . ER-2006-0314. The tracking mechanism requires that all Regulatory Assets and /or Liabilities, including the Prepaid Pension Asset, and annual Pension Cost be identified as of the established true-up date for each KCPL rate case during the period covered of the Regulatory Plan.

c. Set out the agreement of the Staff and KCPL regarding the treatment of pension costs which result under Financial Accounting Standard (FAS) 88 for financial reporting and ratemaking purposes during the period of the Regulatory Plan.

Ice Storm Costs

*What amount of the amortization of the costs associated with the 2002 ice storm should be included in rates?*

On January 30 and 31, 2002, a severe ice storm struck the Kansas City area. As a result, some 305,000 KCPL customers lost electrical service. KCPL used hundreds of outside workers to get service restored and, due to the unusual expenses related to that storm, KCPL applied for an accounting authority order, which the Commission granted.[114] That order allowed KCPL to defer the ice storm costs ratably over the period from September, 2002 until January, 2007. One condition in that order stated:

> e. That in granting the requested AAO, the Commission makes no findings as to whether deferred expenses are reasonable, whether other factors contributed to the damage to the system and the resulting repair/replacement costs incurred, or whether KCPL would have suffered financial harm (*i.e.* earnings during the period were inadequate to compensate KCPL for the costs incurred) absent deferral. The Commission reserves the right to consider in a future rate case the ratemaking treatment of the costs deferred, as well as any assertions, including the appropriate amortization period, made by parties thereto.

Because the amortization allowed by the AAO case was in effect during the test year and true-up period, KCPL asserts that it should be able to recover those costs.

The United States Department of Energy (DOE) argues that KCPL has already recovered those costs in rates, and that, therefore, the Commission should disallow this expense. According to DOE witness Dittmer, KCPL has recovered those costs due to its robust, if not excessive return on equity during the ice storm amortization period.[115]

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[114] See In re Kansas City Power & Light Company, Order Granting Accounting Authority Order, Case No. EU-2002-1048 (July 30, 2002).

[115] See Ex. 803, pp. 22-24.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. DOE complains that KCPL has already recovered those costs in rates. However, DOE witness Dittmer testified that he was unaware of any Staff or Commission action to reduce rates from 2002 to now because of overearnings, which would include the recovery of ice storm costs from ratepayers.[116] Regardless of KCPL's prior earnings, the Commission gave KCPL an accounting authority order to defer and amortize its ice storm costs through January 31, 2007, which includes the test year in this case. Because Staff has no position on this issue[117], the Commission finds that competent and substantial evidence exists to show that KCPL's ice storm costs were prudent.

EEI Dues

*What amount of EEI dues should be included in rates?*

According to KCPL and Staff briefs, this issue has been settled. As such, the Commission has no dispute to resolve on this issue.

Severance Costs

*What amount, if any, of severance costs should be included in rates?*

KCPL wishes to recover severance that it pays to former employees in its cost of service on the grounds that those costs extinguish any possible liability those former

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[116] Tr. Vol. 9, pp. 898-99.

[117] KCPL asserts that Staff believes KCPL should be allowed seven months of amortization from June 30, 2006 until January 31, 2007. DOE alleges that Staff believes that four months of amortization, from September 30, 2006 to January 31, 2007, be allowed. However, Staff states in both of its post-hearing briefs that it has no position on the ice storm costs issue. The Commission finds that Staff has waived any position it might have had on this issue.

employees may have against the company. It also claims that these severance costs are recurring. In contrast, Staff asserts that only KCPL shareholders, and not its ratepayers, receive the benefit of these costs.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. Staff's witness on this issue, Charles Hyneman, testified that KCPL answered one of his data requests by admitting that severance costs protect KCPL against such issues as sexual harassment or age discrimination, and that such costs are not recoverable in rates.[118] He contrasted those severance payments, made only to protect shareholders, with severance payments made to decrease payroll, which could be included in cost of service because of the benefit to ratepayers. Moreover, Staff points out that KCPL excluded its 2005 severance costs from its earnings per share calculation that determines its management's incentive compensation payment.[119] The Commission sees no equity in allowing KCPL to recover these costs from ratepayers when its own management excludes those same costs from its EPS calculation, to the enrichment of its executives via the incentive compensation plan.

Bad Debts

*Should the bad debt percentage be applied to reflect the total revenues, including any rate increase in Missouri jurisdictional retail revenues awarded in this proceeding?*

[118] Tr. Vol. 5, p. 251.

[119] Id. at 239.

KCPL and Staff agree that KCPL should apply a 0.61% bad-debt write-off factor to KCPL's Missouri jurisdictional revenue. The contested issue between these parties is what that Missouri jurisdictional revenue should be.

KCPL asserts that the Commission should apply that factor to the actual Missouri jurisdictional revenue that the Commission finds appropriate for this case. In contrast, Staff objects, maintaining that such treatment harms ratepayers because there is no demonstrable correlation between the level of retail sales and the percentage of bad debts. Instead, Staff appears to argue that the Commission should apply the bad debt percentage write-off to its pro forma revenue requirement in its case, rather than the actual revenue requirement the Commission decides.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission understands Staff's argument that there is not a perfect positive correlation between retail sales and the percentage of bad debts. While it's possible that KCPL's bad debt expense could decrease, the Commission finds it more probable, and therefore just and reasonable, that an increase in the amount of revenue that KCPL is allowed to collect from its Missouri retail ratepayers will result in a corresponding increase in bad debt expense.

Fuel & Purchased Power Expense

*What is the appropriate level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?*

*What level of natural gas fuel price should be used in the production cost modeling that is used, along with appropriate fuel adders, to quantify the level of on-system fuel and purchased power expense that KCPL should be allowed to recover in its rates?*

KCPL has accepted Staff's fuel and purchased power numbers.[120] According to KCPL's and Staff's post-hearing briefs, there is no issue for the Commission to resolve.

<u>SO2 Premiums</u>

*How should SO2 premiums related to lower-sulfur coal be recorded for book and ratemaking purposes?*

*What parameters does the Commission-approved Stipulation & Agreement in Case No. EO-2005-0329 impose on the treatment of SO2 premiums in this case?*

To understand this issue, it is best that the Commission quote from a Stipulation and Agreement that KCPL, Staff and OPC (among other parties) signed in the Experimental Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329. The disputed language is:

> "To the extent that KCPL pays premiums for lower sulfur coal up until January 1, 2007, it will determine the portion of such premiums that apply to retail sales and will record the proportionate cost of such premiums in Account 254. But in no event will the charges to the Missouri jurisdictional portion of Account 254 for these premiums exceed $400,000 annually."[121]

As read by KCPL and Staff, any limitation on the amount of Account 254 premiums KCPL can book will expire on December 31, 2006. OPC asserts that the second sentence of the above quote, beginning, "But in no event", prevents KCPL from **ever** charging more

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[120] Tr. Vol. 6, p. 361.

[121] Ex. 143, p 10.

than $400,000 annually to Account 254 for the Missouri jurisdictional portion of SO2 premiums. As framed by Staff, another way to look at this issue is whether the word 'but' " . . . is tantamount to 'however', or whether it should be construed as the equivalent of 'and' and thus be subordinate to the prior sentence.[122]

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. To analyze these sentences, the Commission will read the disputed language in its entirety, in hopes of gleaning the content of the disputed phrase "But in no event." The sentence that contains the disputed phrase "But in no event" also contains the clause "for these premiums." To know what "these premiums" are requires looking back to the preceding sentence. That sentence says "these premiums" are for "lower sulfur coal up until January 1, 2007."[123]

Also, It is instructive that these two adjoining sentences both mention Account 254, thus showing some sort of relationship between the two sentences, whereas Account 254 is not only not mentioned anywhere else in that paragraph of the stipulation, but it is also not mentioned in the preceding two paragraphs, either.[124] The Commission finds that the more reasonable interpretation of the disputed language is to read the two sentences together to mean that any limitation on the amount of Account 254 premiums KCPL can book will expire on December 31, 2006.

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[122] Staff's Post-Hearing Brief, p. 14.

[123] Although the Commission notes that the first sentence of the disputed sentences uses the phrase "such premiums" and the second sentence uses "these premiums", the premiums discussed appear to be the same.

[124] Ex. 143, pp. 9-10.

Injuries and Damages

*What is the appropriate amount of injuries and damages expense to include in rates?*

KCPL calculates its test year costs using the accrual method of accounting; that is, KCPL books probable and expenses before actually outlaying the cash to pay those expenses.[125] Staff states that although KCPL is following generally accepted accounting principles in using the accrual method of accounting to book these expenses, it prefers that the Commission order KCPL to use a three-year average of cash payments via a cash method of accounting for the purpose of setting rates.[126]

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission finds Staff's position on the cash method of accounting inconsistent with its cash working capital analysis; Staff itself acknowledges that KCPL does not pay its casualty claims until 185 days after they occur.[127] Due to this lag of paying casualty expenses, ratepayers have provided the cash working capital for those 185 days, and ratepayers receive credit for that money through a reduction in rate base.[128] Finding this issue in KCPL's favor therefore allows accounting consistency for injuries and damages expense and cash working capital, and provides adequate protection for ratepayers via a reduction in rate base on which KCPL may earn a return on investment.

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[125] Tr. Vol. 6, pp. 290-91.

[126] Id. at 304-05.

[127] Id. at 297.

[128] Ex. 139, p. 30.

Rate Case Expense

*What amount of rate case expense should be included in rates?*

*Should rate case expense be normalized or deferred and amortized? If the latter, then what is the appropriate amortization period for the deferred rate case expense?*

*Should the costs deferred for future amortization be included in rate base?*

KCPL argues that the Commission should amortize rate case expenses over two years. In contrast, Staff and OPC ask the Commission to normalize those expenses over a three-year period.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. To normalize an expense is to account for an expense that is not expected to regularly occur by spreading out the cost of the expense over a number of years.[129] Staff chose the three year number for normalizing because the Experimental Regulatory Plan doesn't require another rate filing for three years.[130]

In contrast, KCPL's choosing of a two-year amortization period more accurately reflects the reality of the Experimental Regulatory Plan. While Staff and OPC point out that the Commission usually normalizes these expenses, the Experimental Regulatory Plan itself, including the construction of Iatan 2, installation of wind generation, and environmental upgrades of other facilities, is hardly normal. KCPL also acknowledged that the plan anticipates that KCPL could be back for a rate case as early as next year, or as late as 2009, and that a two year amortization was chosen as a reasonable mid-point.[131]

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[129] Tr. Vol. 6, p. 312.

[130] Id.

[131] Ex. 7, p. 12.

KCPL is embarking upon an extraordinary process, and will no doubt need access to several million dollars of capital to accomplish its goals. Further, costs of construction of a coal-based generating unit, as well as the other projects enumerated in the Experimental Regulatory Plan are not easily estimable, and the Commission fully expects KCPL to file rate cases each year during this plan to keep up with its costs.[132]

Property Taxes

*Should property taxes be adjusted to reflect changes in tax jurisdiction assessment values, levy rates, in plant additions, and other factors during the test period, including both the update period and true-up period?*

Staff recommends that the Commission calculate property tax expense by multiplying the January 1, 2006 plant-in-service balance by the ratio of the January 1, 2005 plant-in-service balance to the amount of property taxes paid in 2005. KCPL wants the property tax cost of service updated to include 2006 assessments and levies.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As with all issues, KCPL bears the burden of proof. According to KCPL's True-up brief, its September 30 true-up filing had latest available actual 2006 tax levy rates for 96% of Missouri tax liability. As the Commission deciphers KCPL's true-up filing – entitled KCPL's Summary of Adjustments, September Update – line 152 shows a *decrease* in property taxes. To the extent this issue was in play, it was not listed in the Commission-ordered List of Issues for the True-up Proceeding, filed by Staff on November 8, and KCPL did not object to that list, or put on any evidence

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[132] Tr. Vol. 9, p. 828.

concerning property taxes at the true-up hearing. As such, the Commission does not find adequate evidence to support KCPL's position on this issue.

Decommissioning Expense

*Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?*

On December 5, 2006, KCPL and Staff submitted a Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives, along with a Motion for Leave to Late-File said stipulation. The Commission allowed parties until December 11 to object. No parties objected and, therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, attached as Appendix A, as if it were unanimous.

The Commission finds the above-referenced stipulation reasonable, and therefore, grants the motion to late-file it, and approves the stipulation. As requested by KCPL in the stipulation, and not opposed by Staff, the Commission further makes the following findings:

1) KCPL's annual Missouri retail jurisdictional decommissioning cost accrual shall be $1,281,264, commencing January 2007 and KCPL's decommissioning trust fund payments shall be at that annual level;

2) Decommissioning cost accruals, as a consequence of "1)," will continue to be included in KCPL's cost of service and will continue to be included in KCPL's rates for ratemaking purposes;

3) The decommissioning cost accrual schedule identified in the direct testimony of Don A. Frerking in this proceeding, Schedule DAF-5, shows an annual Missouri

jurisdictional decommissioning cost accrual of $1,281,264, commencing January 2007, and;

4) The earnings rate assumed by KCPL for the decommissioning trust, as shown in Schedule DAF-5 of the direct testimony of Don A. Frerking, takes into consideration the tax rate change and the removal of the investment restrictions resulting from the federal Energy Policy Act of 1992.

True-Up

*What elements of Cost of Service and Rate Base should be updated in the September True Up?*

At the November 16 true-up hearing, a contested issue was whether 113 employees to be added after the September 30 true-up date should be included in cost of service.

KCPL states that a typical employee payroll annualization would look at an employee count at the end of the test period to determine payroll expense. However, KCPL claims that method is not appropriate here because of circumstances surrounding the last several months of the periods. Specifically, KCPL experienced significant workforce reductions in April, 2006, and again in August and September, 2006, so that KCPL's employee numbers on September 30, 2006 are artificially low.[133] That artificially low number comes from KCPL's workforce realignment, occurring in March, 2005, and from the annual exodus of employees from KCPL due to retirement. KCPL announces interest rate changes every August, giving KCPL employees information and time to decide if they

[133] Ex. 54, p. 9

want to retire with a lump-sum payment from the company.[134] In 2006, some 50 employees decided to retire.

Staff counters that the driver for the September 30 true-up date was the project in-service date of KCPL's $85 million, 100 MW wind generation facility at Spearville, Kansas.[135] Staff says that it gave fair warning to KCPL that only employees actually employed and on the KCPL payroll as of September 30, 2006 would be placed into cost of service.[136] Further, Staff states that including these 113 employees, who were not actually working for KCPL as of September 30, 2006, would violate the "matching principle". That principle is an attempt to match cost of capital, rate base, revenues and expenses as of a certain date; setting rates when these variables are not matched could result in a company either over-earning or under-earning, and thereby the Commission would not be setting just and reasonable rates if it did not use the matching principle. OPC concurs in Staff's proposal.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. The Commission agrees with Staff that it is important to match revenues and expenses as of a date certain. As Staff points out, should the Commission accept KCPL's 113 employees in cost of service, then the Commission would also need to insert additional revenue from customer growth occurring after the known and measurable date of June 30.

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[134] Ex. 56, pp. 4-5.

[135] Ex, 163, pp. 10, 17.

[136] Ex. 163, pp. 9-10.

While KCPL's employee numbers as of September 30, 2006 may be deceivingly low, those numbers are, in fact, accurate as of that date. KCPL is on the cusp of a comprehensive construction plan, and needs capital and employees to meet the commitments embodied in the Experimental Regulatory Plan. But KCPL management signed off on the stipulation that called for the true-up date in this case to be September 30. And KCPL management set up its retirement plan such that employees may leave in droves in August and September of each year, with replacements not being hired until after September 30. KCPL management largely created this problem, and must live with the consequences of those 113 employees being excluded from cost of service. If the Commission does not take a snapshot of a company's revenues and expenses as of the known and measurable date, the true-up date, or any date, for that matter, then what? KCPL's employee count, as well as a host of other revenues and expenses, has no doubt changed since the true-up hearing; the Commission will get yet another snapshot of those changes when KCPL files its next rate case. To set just and reasonable rates, the Commission simply must match revenues and expenses as of a certain date.

Weather Normalization

*What methodology should be used to compute Large Power class kWh sales and revenues?*

KCPL maintains that its Large Power (LP) class of customers is weather-sensitive due to those customers' having substantial air-conditioning loads that vary with temperature, with typical weekday loads of about 250 MWs up to about 55 degrees, rising steadily with temperature, reaching about 300 MW at 80 degrees. On the other hand, Staff dismisses the argument, saying, among other things, that the LP class is more influenced by seasonal rather than day-to-day fluctuations.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. The LP class consists of a fairly small number of large businesses engaged in wildly different enterprises; hotels, office buildings, manufacturing, and hospitals are examples.[137] These businesses' electricity needs vary more due to the type of commerce they are in than due to day-to-day temperature changes. Furthermore, if the Commission were to weather normalize this class, it would also need to weather normalize their revenues that this class produces, a process that, because of the complexities of the class, is extremely difficult to do; in fact, the Commission's Staff does not weather normalize the LP class for any Missouri electric utility.[138]

Finally, the Commission considers Dr. McCollister's statistical regression analysis. He used that analysis to estimate the effect of cooling degree days with a base temperature of 55 degrees. The statistical significance of the coefficient for this variable as measured by the t-statistic was 17.7. According to Dr. McCollister, any value above 2.0 is *usually* considered significant, so 17.7 is extremely significant.

In response to Dr. McCollister's claim that any t-statistic of 2 or more is indicative of weather sensitivity, Staff witness Lange responded that he used random numbers to arrive at a t-statistic of over 2, thus calling into question the reasonableness of Dr. McCollister's analysis; in fact, the Commission reconciles this evidence by finding that while Dr. McCollister's analysis *usually* would mean that a t-statistic of 2.0 or more is significant, it

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[137] Ex. 121, p. 3

[138] Id. at 4

is not significant in this case due to Staff witness Lange's evidence that random numbers would also produce a t-statistic of over 2.0.[139]

Jurisdictional Allocations

*What is the appropriate method (4 CP v. 12 CP) to use for allocating generation and transmission costs among jurisdictions?*

*How should A&G expenses be allocated to the Missouri retail, Kansas retail and FERC wholesale jurisdictions?*

KCPL operates in both Kansas and Missouri. Instead of maintaining separate systems, KCPL's sole system serves both jurisdictions. To set just and reasonable rates for each jurisdiction requires allocating various generation and transmission capital costs property between these states. KCPL and other parties disagree over which coincident peak method to use to allocate those costs.

Coincident peak refers to the load of each jurisdiction that coincides with the hour of a utility's overall system peak. KCPL asserts that its operating and capacity planning realities, which take into account all hours of the year, and not just peak hour or seasonal peak needs, dictate use of the 12 CP demand allocator. Staff and other parties assert that KCPL has historically used the 4 CP method, that the 12 CP method would allocate more plant investment and costs to Missouri and less to Kansas, and that KCPL's high peak demand from June until September is more akin to a 4 CP than a 12 CP system.

The Commission finds that the competent and substantial evidence supports Staff's position, and finds this issue in favor of Staff. As on all issues, KCPL bears the burden of

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139 Id. at 4-5.

proof. KCPL's witness on this issue, Don Frerking: (1) had never conducted a jurisdictional allocation analysis prior to this proceeding; (2) had never taken any classes or attended any conferences related to jurisdictional allocations; (3) had never had any training regarding jurisdictional allocations; (4) had not consulted any textbooks or treatises related to jurisdictional allocations; (5) had not reviewed any testimony filed in other jurisdictions related to jurisdictional allocations; and (6) had not reviewed any FERC decisions on the issue of jurisdictional allocations. KCPL's witness readily admits that the 12 CP methodology was not the result of any "independent analysis", but rather was a decision made elsewhere.

In contrast, not only Staff, but Praxair, Ford, and Missouri Industrial Energy Consumers support the 4 CP methodology. Their evidence showed that a 4 CP methodology for a utility such as KCPL is appropriate because its non-summer peak demands are significantly lower than the summer peak demands. Moreover, Praxair witness, Maurice Brubaker, has testified hundreds of times on cost allocation issues, and his testimony was that the Commission should use the 4 CP method. In addition, Staff witness Maloney convincingly disputed KCPL's claim that its system is similar to The Empire District Electric Company's system, for which Staff recommended a 12 CP method. Maloney testified that Empire's winter peaks are higher in relation to its summer peaks than are KCPL's peaks. The less developed gas distribution system in Empire's more rural service area results in more electric space-heating use in Empire's area, accounting for a higher winter load for Empire than for KCPL. KCPL's lower winter load suggests that a 4 CP allocation is more appropriate than a 12 CP method.

Weatherization

*Should the weatherization program be modified so that KCPL's Call Center will refer customers to the program?*

*Should LIHEAP recipients be directed to the weatherization program and be required to participate in it?*

As addressed by the parties' post-hearing briefs, any issues between the City of Kansas City, Missouri, the Missouri Department of Natural Resources, and KCPL have been resolved, and an order from the Commission on these issues will not be required. Accordingly, at the behest of the parties, the Commission will not address these issues.

*Should KCPL participate in an "Energy Conservation Program" that will provide consultation, weatherization materials and installation? If so, should the cost of the program to be underwritten by KCPL and charged to the customer? (DNR and KC object to this issue.)*

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. W. Bill Dias[140] brings up several issues outside of the List of Issues the parties filed on October 6, to which he failed to object, and to which parties object as being not only properly before the Commission, but outside the Commission's jurisdiction regardless of whether they were timely presented.

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140 Mr. Dias' pleadings list him as such sundry entities as, "W. Bill Dias"; "W. Bill Dias and W. Bill Dias D/B/A 1.Paystation .com"; and "Dias Capital Growth Corporation, Inc." For simplification's sake, the Commission will refer to these entities as Mr. Dias.

Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to any pleading. Mr. Dias failed to timely respond. As a consequence, the Commission will not address any issues outside the October 6 List of Issues.

Furthermore, Mr. Dias' attempts to represent Dias Capital Growth Corporation, Inc., as well as such groups as The Baptist Minister's Union[141], "the community", "the urban community", etc., are tantamount to the unauthorized practice of law, as some parties have pointed out.[142] To the extent that Mr. Dias purports to represent any entity other than himself, including Dias Capital Growth Corporation, Inc., such representation appears to be the unauthorized practice of law; therefore, the Commission finds that any evidence or argument that Mr. Dias makes on anyone's behalf other than his very own should not be considered.

Moreover, KCPL objects to the concerns that W. Bill Dias brings up to the extent that they are on the List of Issues, saying it is patently unfair for the Commission to order KCPL to contract with him and to order shareholders to simply hand him $5 million for the programs that he wants.[143] For example, his surrebuttal asks for the Commission to force KCPL into a contractual relationship, and asks for compensation for confidential information he's shared with KCPL. Mr. Dias does not cite, and the Commission cannot find, any legal authority to give him the various forms of relied that he requests. What is more, Mr. Dias' evidence, which included hearsay evidence such as newspaper articles from the

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[141] KCPL witness John Marshall testified that the Baptist Ministers Union separated its interest from Mr. Dias (Tr. Vol. 6, p. 401)

[142] Despite being a *pro se* litigant, in his post-hearing briefs, remarks and testimony before the Commission , Mr. Dias' purports to speak on behalf of such entities as "the Urban Community of Greater Kansas City"; "the Urban Community"; the Baptist Ministers' Union of Kansas City; Dias, the company; and churches that will partner with Mr. Dias and/or his company.

[143] Tr. Vol. 14, p. 1535.

Kansas City Call and USA Today, hardly rises to the level of competent and substantial evidence. As a result, to the extent that Mr. Dias' concerns are within the October 6 List of Issues, the Commission will deny those requests.

**<u>Class Cost-of-Service and Rate Design</u>**

<u>Class Cost-of-Service</u>

*On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?*

*On what basis should production capacity and transmission costs be allocated to classes?*

*What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes?*

*Do KCPL's computation of coincident peak demands and class peak demands properly recognize line losses?*

*To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?*

*What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 933, 923, 930.2 and 931 among Missouri retail customer classes?*

*Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?*

*Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?*

*Should revenue adjustments be phased in over multiple years?*

*Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?*

*How should any increase in the revenue requirement be implemented?*

Rate Design

*Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of latan 2? Should the cost-basis of general service all-electric rates be included in this analysis?*

*Should KCPL's proposed changes to the General Service customer charge be implemented?*

By way of reminder, the rates that KCPL will be allowed to charge its customers are based on a determination of the company's revenue requirement. KCPL's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can be expressed as the following formula:

Revenue Requirement = E + D + T + R(V-AD+A)
Where: E = Operating expense requirement
D = Depreciation on plant in rate base
T = Taxes including income tax related to return
R = Return requirement
(V-AD+A) = Rate base
For the rate base calculation:
V = Gross Plant
AD = Accumulated depreciation
A = Other rate base items

The Commission has resolved issues regarding revenue requirement; now, what remains is what class of customers must pay what share of that revenue requirement.

On November 9, KCPL, Staff, OPC, Explorer Pipeline, Praxair, DOE, Ford, MIEC and Wal-Mart filed a Stipulation and Agreement Regarding Class Cost of Service and Rate Design Issues. No party objected; Trigen responded timely, and specifically stated that it did not object because the stipulation carved out contested issues that Trigen and KCPL present to the Commission for resolution.

Therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation, affixed to this Report and Order as Appendix D, as if it were unanimous. The Commission finds the above-referenced stipulation reasonable, and therefore, approves the stipulation.

The Signatories agree to overall company rate revenue neutral interclass changes in class revenue responsibilities that have the effect of increasing current residential customer class rates by about 2.00%; decreasing current small, medium and large general service class rates by about 0.45%; decreasing current large power service class rates by about 2.54%; and making no change to current lighting class rates as more particularly described Appendix A attached to the stipulation. Further, the Signatories agree new rates will be developed based on the "Post-Shifted Class Rate Revenues," and then each rate element of those rates will be factored up by multiplying them by the sum of one plus the result of dividing any overall increase in company revenue requirement the Commission orders in this case by total KCPL Missouri revenue at present rates as trued-up to generate final rates from this case.

Availability of General Service Space-Heating Rate Discounts

*In this case, should the qualification provision of the existing general service all-electric rate schedules be expanded as proposed by KCPL, and the all-electric winter energy rate increased an additional 5%, to make rate discounts available to existing and future customers who are not all-electric customers?*

As stated above, several parties filed a Stipulation and Agreement Regarding Class Cost of Service and Rate Design on November 9. Trigen responded, stating that it did not object to the stipulation because it did not address the two above-listed issues, leaving them instead to be litigated and resolved by the Commission.

KCPL and the other signatories to the November 9 class cost of service stipulation want to increase the general service space heating and all-electric winter energy rate by five percentage points more than each class' general applications rates.[144] In addition, KCPL wishes to expand the qualifications provision to establish electric heating as the primary heating sources, rather than the requirement that the customer qualifications is all-electric. Trigen objects, stating that KCPL has failed to produce any cost of service study to support its proposal.

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[144] Ex. 21, pp. 4-5;

The Commission finds that the competent and substantial evidence supports Trigen's position, and finds this issue in favor of Trigen. KCPL has not provided adequate proof that its proposal is supported by any cost of service, incremental or marginal cost analysis, or any other underlying study.[145] Instead, KCPL's evidence rolled together standard tariff customers within each general service category, so that the cost of service study results are inconclusive as to the all-electric and separately metered space heating customers.[146]

*Should the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs be eliminated or restricted to existing customers only until there is a comprehensive class cost of service study and/or cost-effectiveness study which analyzes and supports such tariffs and provisions as well as KCPL's Affordability, Energy Efficiency and Demand Response programs?*

KCPL asserts that its general service rate design has been in place for years, and that the Commission should reject Trigen's request to dismantle such a design, especially in light of the fact that Trigen is a competitor of KCPL, and has not done its own analysis to study the impact such a proposal would have on KCPL customers in the downtown Kansas City, Missouri area. Trigen states, again, that KCPL has inadequate cost support for either its existing general service all-electric rate discount or its existing separately metered space heating discount.

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[145] Tr. Vol. 11, p. 1028.

[146] Ex. 701, pp. 28-29.

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of KCPL. The Commission is concerned that during KCPL's winter season, commercial and industrial customers under the all-electric general service tariffs pay about 23% less for the entire electricity usage than they would otherwise pay under the standard general service tariff, and that commercial and industrial customers under the separately metered space heating provision would pay about 54% less for such usage than they would pay under the standard general service tariff.[147]

However, the Commission recognizes that KCPL participated in an extensive class cost of service study in 1996, and that KCPL has reached an agreement for class cost of service and rate design in the present case. The Commission will adopt Staff's suggestion, and Trigen's alternative suggestion, that the Commission restrict the existing general service all-electric rate schedules and the separately metered space heating provisions of KCPL's standard general service tariffs to existing customers until there is a comprehensive class cost of service study. This appears to be a reasonable solution, since no one has performed a cost study of the impacts of eliminating the current rates.[148]

## CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law.

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[147] Ex. 701, pp. 8-9; 14-15.

[148] KCPL Final Post-Hearing Brief, p. 56; Staff Final Post-Hearing Brief, pp. 75-76.

## Jurisdiction, Burden of Proof, and Duty of Commission

KCPL is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(42) and (15), RSMo 2000. As such, KCPL is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

Section 393.140(11), RSMo 2000, gives the Commission the authority to regulate the rates that KCPL may charge its customers for electricity. In determining the rates that MGE may charge its customers, the Commission is required to determine that the proposed rate is just and reasonable.[149] KCPL has the burden of proving that its proposed increase is just and reasonable.[150]

In determining whether rates are just and reasonable, the Commission must balance the interests of the investor and the consumer.[151] The Commission's failure to establish just and reasonable rates would, in fact, violate the United States Constitution. In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[152]

In the same case, the Supreme Court provided the following 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. A public utility is

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[149] Section 393.150.2, RSMo 2000.

[150] Section 393.150.2, RSMo 2000.

[151] Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1943).

[152] Bluefield, 262 U.S. at 690 (1923).

> 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.[153]

In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

> Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.[154]

As stated above, the Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.[155] The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must guide the Commission in its task.[156] In the earlier of these cases, Bluefield Water Works, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust,

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[153] Id. at 692-93.

[154] Federal Power Commission v. Natural Gas Pipeline Co. 315 U.S. 575, 586 (1942).

[155] Phillips, The Regulation of Public Utilities, *supra,* 394; Goodman, 1 The Process of Ratemaking, supra, 606.

[156] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176.

> unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[157]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> 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.[158]

The Court restated these principles in Hope Natural Gas Company, the latter of the two cases:

> '[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.[159]

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[157] Bluefield, supra, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

[158] Id., 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

[159] Hope Nat. Gas Co., supra, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

In the final analysis, it is not the method employed, but the result reached, that is important.[160] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[161]

**Applicable Statutes and Legal Standards:**

The Missouri Public Service Commission was created by the General Assembly in 1913.[162] The General Assembly delegated to the Commission the police power to establish utility rates, subject to judicial review of the question of reasonableness.[163] The Commission's purpose is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.[164] While "the dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental,"[165] the Commission must also permit the utility to recover a "just and reasonable" return on the assets it has devoted to the public service.[166]

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160 Again, within a wide range of discretion, the Commission may select the methodology. Missouri Gas Energy, 978 S.W.2d at 434; State ex rel. Associated Natural Gas Co., 706 S.W.2d at 880, 882); Fraas, 627 S.W.2d at 888; Lake Lotawana, 732 S.W.2d at 194.

161 Nat. Gas Pipeline Co., 315 U.S. at 586; 62 S.Ct. at 743; 86 L.Ed. at 1049-50.

162 State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 47 (Mo. banc 1979).

163 State ex rel. City of Harrisonville v. Public Service Commission of Missouri, 291 Mo. 432, 236 S.W. 852 (1922); City of Fulton v. Public Service Commission, 275 Mo. 67, 204 S.W. 386 (1918), error dis'd 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; City of St. Louis v. Public Service Commission of Missouri, 276 Mo. 509, 207 S.W. 799 (1919); Kansas City v. Public Service Commission of Missouri, 276 Mo. 539, 210 S.W. 381 (1919), error dis'd 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; Lightfoot v. City of Springfield, 361 Mo. 659, 236 S.W.2d 348 (1951).

164 Id.; May Dep't Stores Co. v. Union Electric Light & Power Co., 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

165 State ex rel. Crown Coach Co. v. Public Service Commission, 179 S.W.2d 123, 126 (1944)

166 Utility Consumers' Council, 585 S.W.2d at 49.

"There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."[167]

In 1925, the Missouri Supreme Court stated:

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.[168]

The Public Service Commission has exclusive jurisdiction to establish public utility rates.[169] A public utility has no right to fix its own rates and cannot charge or collect rates that have not been established by the Public Service Commission[170]; neither can a public utility change its rates without first seeking authority from the Commission.[171] A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable.[172]

Section 393.130, in pertinent part, requires a utility company's charges to be just and reasonable and not in excess of charges allowed by law or by order of the commission. It also prohibits electrical corporations from discriminating against customers by charging different prices for the same or similar services.

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167 State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

168 State ex rel. Washington University et al. v. Public Service Commission et al., 308 Mo. 328, 344-45, 272 S.W. 971, 973 (en banc).

169 May Department Stores Co. v. Union Electric Light & Power Co.,107 S.W.2d 41, 57 (1937).

170 Id.

171 Deaconess Manor Ass'n v. Public Service Com'n, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

172 May Department Stores, supra, 107 S.W.2d at 50.

Section 393.140 authorizes the Commission to determine just and reasonable rates. Section 393.150, in pertinent part, authorizes the Commission to suspend for a period of time any schedule stating new rates, charges, rules, regulations, or practices, and to hold "a hearing concerning the propriety of such rate, charge, . . . rule, regulation or practice." Section 393.270 provides in paragraph 4 that in determining the price to be charged, "the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . ." The courts have held that this statute means that the Commission's determination of the proper rate must be based on consideration of all relevant factors.[173] Section 393.230.1 authorizes the Commission to value the property of water and sewer utilities in Missouri.

Finally, Section 393.270 provides:

* * *

> 2. After a hearing and after such investigation as shall have been made by the commission or its officers, agents, examiners or inspectors, the commission within lawful limits may, by order, fix the maximum price of . . . electricity . . . not exceeding that fixed by statute to be charged by such corporation or person, for the service to be furnished; and may order such improvement . . . in the manufacture, transmission or supply of electricity . . ., or in the methods employed by such persons or corporation as will in its judgment be adequate, just and reasonable.
>
> 3. The price fixed by the commission under sections 393.110 to 393.285 shall be the maximum price to be charged by such corporation or person for . . . electricity for the service to be furnished within the territory and for a period to be fixed by the commission in the order, not exceeding three years, except in the case of a sliding scale, and thereafter until the commission shall, upon its own motion or upon the complaint of any corporation or person interested, fix a higher or lower maximum price of . . . electricity . . . service to be thereafter charged.

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[173] State ex rel. Missouri Water Co. v. Public Service Comm'n, 308 S.W.2d 704, 719 (Mo. 1957); State ex rel. Midwest Gas Users' Ass'n v. Public Service Commission, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); State ex rel. Office of Public Counsel v. Public Service Com'n of Missouri, 858 S.W.2d 806 (Mo. App., W.D. 1993).

4. In determining the price to be charged for . . . electricity . . . the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

The dominant purpose in creation of the Commission is public welfare.[174] Section 386.610 reads, in relevant part, that "[t]he provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and substantial justice between patrons and public utilities." The Commission must weigh the benefits and detriments to all the groups affected by its decision.

Section 386.250, jurisdiction of Commission, reads, in relevant part, as follows:

The jurisdiction, supervision, powers and duties of the public service commission herein created and established shall extend under this chapter: (1) To the manufacture, sale or distribution of gas, natural and artificial, and electricity for light, heat and power, within the state, and to persons or corporations owning, leasing, operating or controlling the same; and to gas and electric plants, and to persons or corporations owning, leasing, operating or controlling the same . . .

Section 393.140, general powers of Commission in respect to gas, water, electricity and sewer services, reads, in relevant part, as follows:

The commission shall:

(1) Have general supervision of all gas corporations, electrical corporations, water corporations and sewer corporations having authority under any special or general law or under any charter or franchise to lay down, erect or maintain wires, pipes, conduits, ducts or other fixtures in, over or under the streets, highways and public places of any municipality, for the purpose of furnishing or distributing water or gas or of furnishing or transmitting electricity for light, heat or power, or maintaining underground conduits or ducts for electrical conductors, or for the purpose of collecting, carrying, treating, or disposing of sewage, and all gas plants, electric plants, water systems and sewer systems owned, leased or operated by any gas corporation, electrical corporation, water corporation, or sewer corporation.

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[174] Alton R. Co. v. Public Service Commission, 110 S.W.2d 1121, 1125 (Mo. App. 1937).

(2) Investigate and ascertain, from time to time, the quality of gas or water supplied and sewer service furnished by persons and corporations, examine or investigate the methods employed by such persons and corporations in manufacturing, distributing and supplying gas or electricity for light, heat or power and in transmitting the same, and in supplying and distributing water for any purpose whatsoever, and in furnishing a sewer system, and have power to order such reasonable improvements as will best promote the public interest, preserve the public health and protect those using such gas, electricity, water, or sewer system, and those employed in the manufacture and distribution thereof, and have power to order reasonable improvements and extensions of the works, wires, poles, pipes, lines, conduits, ducts and other reasonable devices, apparatus and property of gas corporations, electrical corporations, water corporations, and sewer corporations.

Section 393.140 conveys upon the Commission broad supervisory powers and provides that the Commission shall have general supervision over all electric utilities operating in Missouri.[175]

**IT IS ORDERED THAT:**

1. All pending motions and requests for relief not otherwise granted are denied.

2. The proposed tariff sheets filed by Kansas City Power & Light Company on February 1, 2006, Tariff No. YE-2006-0594, are rejected.

3. The Stipulation and Agreement Regarding Class Cost-of-Service and Rate Design Issues filed on November 9, 2006 is approved.

4. The Nonunanimous Stipulation and Agreement Regarding Pension Issues filed on December 4, 2006 is approved.

5. The Nonunanimous Stipulation and Agreement Regarding Regulatory Plan Additional Amortizations filed on December 4, 2006 is approved.

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[175] State ex rel. Atmos Energy Corp. v. Public Service Commission, 103 S.W.3d 753 (Mo. banc 2003).

6. The Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives is approved, and Staff's Motion for Leave to Late-File Nonunanimous Stipulation and Agreement Regarding Capitalization of Certain Costs, Decommissioning Expense Accrual, and Corporate Projects and Strategic Initiatives is granted.

7. Kansas City Power & Light Company may file tariffs that comport with this Report and Order.

8. This Report and Order shall become effective on December 31, 2006.

9. This case may be closed on January 1, 2007.

**BY THE COMMISSION**

Colleen M. Dale
Secretary

( S E A L )

Davis, Chm., Murray, and Appling, CC., concur;
Gaw and Clayton, CC., dissent, with separate
dissenting opinion(s) to follow;
and certify compliance with the provisions of
Section 536.080, RSMo.

Dated at Jefferson City, Missouri,
on this 21st day of December, 2006.

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | |
|---|---|
| In the Matter of the Application of Kansas City Power and 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 |

# NONUNANIMOUS STIPULATION AND AGREEMENT REGARDING CAPITALIZATION OF CERTAIN COSTS, DECOMMISSIONING EXPENSE ACCRUAL, AND CORPORATE PROJECTS AND STRATEGIC INITIATIVES

Come now the Staff of the Missouri Public Service Commission ("Staff") and Kansas City Power & Light Company ("KCPL" or "Company"), the undersigned parties ("Signatories"), and respectfully state to the Missouri Public Service Commission ("Commission") that various agreements have been reached, and request that the Commission's Report And Order in this case approve those agreements which are contained in this Stipulation And Agreement ("Agreement"):

1. The Signatories have reached an agreement on the capitalization of certain costs associated with the development and implementation of the capital investments associated with KCPL's Regulatory Plan, as approved by the Commission in Case No. EO-2005-0329 ("Regulatory Plan Capital Investments"), including costs associated with the construction of the Iatan 2 project. These costs have never been indicated as an issue in the pending KCPL rate increase, so, for example, they do not appear as an issue in the LIST OF ISSUES filed with the Commission in this case on October 6, 2006. The Signatories have also reached an agreement that resolves among them the issue listed under the heading "Decommissioning Expense" in the LIST OF ISSUES. Additionally, regarding the "Corporate Projects and Strategic Initiatives"

Exhibit 4

issue in the LIST OF ISSUES, the Signatories have never disagreed as to the accounting treatment and the amortization period of expenses for the purpose of establishing rates, but have not agreed to the associated rate base treatment of those costs. These issues as they appear in the LIST OF ISSUES are:

**Decommissioning Expense:**

> Should decommissioning expense be reduced to reflect the amount of annual accruals expected under a 60-year license?

**Corporate Projects and Strategic Initiatives:**

> Should the costs of the LED-LDI and CORPDP-KCPL projects, which are being deferred and amortized over 5 years, be included in rate base?

**<u>Capitalization of Certain Costs</u>**

2. The Signatories have agreed that certain costs incurred by KCPL relate to its development and implementation of the Regulatory Plan Capital Investments and that such costs should be capitalized to the construction projects or Company programs to which they apply. The Signatories agree that the Commission's Report and Order in this case should authorize KCPL to capitalize all costs incurred after January 1, 2005 related to project MSC0140, KCPL Strategic Initiatives, and certain advertising costs all incurred by KCPL in the development of various components and informing customers of the features of KCPL's Regulatory Plan Capital Investments, which will be transferred and capitalized to the Iatan 2 construction project. These costs were determined to be $2,137,705 (total Company) during the 2005 test year. The Signatories also have agreed that certain costs incurred subsequent to the test year, as well as related costs should be capitalized to the Regulatory Plan Capital Investment project to which they apply. Although the Signatories agree that the Missouri jurisdictional amount incurred for these projects should be capitalized, the Signatories have not reached an agreement concerning what percentage of those costs constitute the Missouri jurisdictional amount. That issue is to be

decided by the Commission within the "Jurisdictional Allocations" issue now before the Commission for decision in this proceeding.

**Decommissioning Expense Accrual and Wolf Creek Life**

3. As a result of the Commission's approval in Case No. EO-2005-0329 (KCPL's Regulatory Plan case) of the depreciation life of the Wolf Creek nuclear generating station increasing from 40 years to 60 years, the decommissioning cost accrual for Wolf Creek changes. KCPL is proposing to effectuate that change, a decrease in the annual funding level, in this case. KCPL submitted testimony stating that in order to ensure the continued tax qualification of the decommissioning trust fund, the change in funding levels must be approved by the Internal Revenue Service ("IRS") and the IRS requires certain statements in an Order of the Commission. Thus, KCPL has requested in the instant case, and the Staff does not oppose, that the Commission include in its Report and Order the following language that KCPL states is required by the IRS for the continued tax qualification of the decommissioning trust fund: The Commission finds 1) KCPL's annual Missouri retail jurisdictional decommissioning cost accrual shall be $1,281,264, commencing January 2007 and KCPL's decommissioning trust fund payments shall be at that annual level, 2) decommissioning cost accruals, as a consequence of "1)," will continue to be included in KCPL's cost of service and will continue to be included in KCPL's rates for ratemaking purposes, 3) the decommissioning cost accrual schedule identified in the direct testimony of Don A. Frerking in this proceeding, Schedule DAF-5, shows an annual Missouri jurisdictional decommissioning cost accrual of $1,281,264, commencing January 2007, and 4) the earnings rate assumed by KCPL for the decommissioning trust, as shown in Schedule DAF-5 of the direct testimony of Don A. Frerking, takes into consideration the tax rate change and the removal of the investment restrictions resulting from the federal Energy Policy Act of

1992. The Company also states it will continue to address Statement of Accounting Financial Standards No. 143, Accounting for Asset Retirement Obligations, as it relates to nuclear decommissioning, under the guidance provided by the Commission in its March 5, 2004 Order Concerning Application for Accounting Authority Order in Case No. EU-2004-0294.

**Corporate Projects and Strategic Initiatives**

4. The Signatories have agreed that certain costs incurred by KCPL will have a benefit relating to more than one period and that related non-labor costs should be deferred as a regulatory asset and amortized over the periods to which the benefits will apply. Costs identified to be deferred include all costs incurred after January 1, 2005 related to project LED-LDI, Leadership Development, and CORPDP-KCPL, Corporate Development-KCPL. These non-labor costs were determined to be $1,781,451 (total Company) and $1,542,115 (total Company), respectively, for the period January 1, 2005 through September 30, 2006. The LED-LDI projects captured costs to develop an enhanced leadership development program for supervisors and managers and to conduct associated training for eligible employees. The CORP-KCPL project captured costs related to KCPL for corporate-level resource planning, business analysis, strategic planning, development of short and long-term business plans and assessment and adjustment of such plans and business decisions in response to changes in the marketplace. The Missouri jurisdictional amount of such costs as well as the Missouri jurisdictional amount of additional non-labor costs incurred for these projects through the end of 2006 will be deferred. The Signatories agree that the Commission's Report and Order in this case should authorize KCPL to amortize the deferred costs to expense over a five (5) year period beginning January 1, 2007. Although the Signatories have agreed that these costs should be deferred and amortized over a five (5) year period, the Signatories have not reached an agreement concerning either the rate

base treatment of these costs or what percentage of these costs constitute the Missouri jurisdictional amount. Those issues are to be decided by the Commission within the "Corporate Projects and Strategic Initiatives" and the "Jurisdictional Allocations" issues now before the Commission for decision in this proceeding.

5. This Agreement is being entered into for the purpose of disposing of the issues that are specifically addressed in this Agreement. In presenting this Agreement, none of the Signatories to this Agreement shall be deemed to have approved, accepted, agreed, consented or acquiesced to any ratemaking principle or procedural principle, including, without limitation, any method of cost or revenue determination or cost allocation or revenue related methodology, and none of the Signatories shall be prejudiced or bound in any manner by the terms of this Agreement (whether this Agreement is approved or not) in this or any other proceeding, other than a proceeding limited to enforce the terms of this Agreement, except as otherwise expressly specified herein.

6. This Agreement has resulted from extensive negotiations and the terms hereof are interdependent. If the Commission does not approve this Agreement without modification, then the Agreement shall be void and no Signatory shall be bound by any of the agreements or provisions herein, except as specifically provided herein.

7. If the Commission does not unconditionally approve this Agreement without modification, and notwithstanding its provision that it shall become void, neither this Agreement, nor any matters associated with its consideration by the Commission, shall be considered or argued to be a waiver of the rights that any Signatory has for a decision in accordance with Section 536.080 RSMo 2000 or Article V, Section 18 of the Missouri Constitution, and the Signatories shall retain all procedural and due process rights as fully as though this Agreement

had not been presented for approval, and any suggestions or memoranda, testimony or exhibits that have been offered or received in support of this Agreement shall become privileged as reflecting the substantive content of settlement discussions and shall be stricken from and not be considered as part of the administrative or evidentiary record before the Commission for any further purpose whatsoever.

8. If the Commission unconditionally accepts the specific terms of this Agreement without modification, the Signatories waive, with respect to the issues resolved herein: their respective rights (1) to call, examine and cross-examine witnesses pursuant to Section 536.070(2), RSMo 2000; (2) their respective rights to present oral argument and/or written briefs pursuant to Section 536.080.1, RSMo 2000; (3) their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2, RSMo 2000; (4) their respective rights to seek rehearing pursuant to Section 386.500, RSMo 2000 and (5) their respective rights to judicial review pursuant to Section 386.510, RSMo 2000. These waivers apply only to a Commission order respecting this Agreement issued in this above-captioned proceeding, and do not apply to any matters raised in any prior or subsequent Commission proceeding, or any matters not explicitly addressed by this Agreement. This Agreement contains the entire agreement of the Signatories concerning the issues addressed herein.

9. If the Commission has questions for the Signatories' witnesses or Signatories, the Signatories will make available, at any on-the-record session, their witnesses and attorneys on the issues resolved by this Agreement, so long as all Signatories have had adequate notice of that session. The Signatories agree to cooperate in presenting this Agreement to the Commission for approval, and will take no action, direct or indirect, in opposition to the request for approval of this Agreement.

**WHEREFORE**, the undersigned Signatories respectfully request the Commission to issue an order in this case approving the Agreement subject to the specific terms and conditions contained therein.

Respectfully submitted,

**/s/ Steven Dottheim**
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ATTORNEYS FOR
KANSAS CITY POWER & LIGHT
COMPANY

## Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 5th day of December 2006.

**/s/ Steven Dottheim**

**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 for Electric Service to Begin the Implementation of Its Regulatory Plan ) | Case No. ER-2006-0314 |

# NONUNANIMOUS STIPULATION AND AGREEMENT REGARDING REGULATORY PLAN ADDITIONAL AMORTIZATIONS

Come now the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("Public Counsel"), Praxair, Inc. ("Praxair") and Kansas City Power & Light Company (KCPL), collectively "Signatories," and respectfully state to the Missouri Public Service Commission ("Commission"):

1. The Signatories have reached a Stipulation And Agreement Regarding Regulatory Plan Additional Amortizations ("Agreement") that resolves among them the "gross-up" for taxes issue of the calculation of the quantification of the Regulatory Plan Additional Amortizations issue and sub-issues listed under the heading "Regulatory Plan Additional Amortizations," in the List Of Issues filed with the Commission in this case on October 6, 2006. The sub-issue concerning how KCPL's off-balance sheet obligations should be valued for purposes of the additional amortizations has been fully contested and still must be decided by the Commission in this proceeding.

2. The Signatories hereby agree that the methodology discussed in the attachment ("Appendix 1") hereto shall be the methodology used to calculate the quantification of any income tax impacts associated with the Regulatory Plan additional amortizations in KCPL rate

**Exhibit B**

increase or rate decrease cases.

3. The Signatories agree that the additional amortization calculation based upon the revenue requirement resulting from the true-up in this case will reflect an allocation of Great Plain Energy, Inc.'s (GPE's)/KCPL's capital structure to Missouri electric operations. This allocation will exclude the impact of the operations of GPE/KCPL not related to KCPL's Missouri electric operations.

4. This Agreement is subject to various provisions of the Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329, such as Paragraph III.B.1.i and Paragraph III.B.1.p. Paragraph III.B.1.i of the Regulatory Plan, as amended by the Commission's August 23, 2005 Order Approving Amendments To Experimental Regulatory Plan, states, in part, that (i) the amortization amounts in the aggregate shall not exceed the expected cost savings from the amortization mechanism and the lower costs of capital resulting from investment grade ratings and (ii) "[t]he accumulated 'Additional Amortizations To Maintain Financial Ratios' amounts will be treated as increases to the depreciation reserve and be deducted from rate base in any future KCPL rate proceedings, beginning with the first rate case after the 2006 Rate Case." Paragraph III.B.1.p of the Regulatory Plan states that in order to ensure that the benefits of offsetting the rate base related to the amortizations in the Regulatory Plan accrue to KCPL's customers in future rate proceedings, these benefits shall be reflected in rates, notwithstanding any future changes in the statutory provisions contained in Chapters 386 and 393 RSMo, for at least ten (10) years following the effective date of the Order Approving Stipulation And Agreement in Case No. EO-2005-0329.[1]

5. Further, KCPL acknowledges that this Agreement is a resolution and is an

[1] The effective date of the Commission's July 28, 2005 Report And Order in Case No. EO-2005-0329 was August 7, 2005.

implementation of the resolution of the gross-up issue that was intentionally left unresolved by the Regulatory Plan Stipulation And Agreement in Case No. EO-2005-0329. This resolution is implemented pursuant to and in compliance with the provisions of that Stipulation And Agreement, and that as a result thereof, any Regulatory Plan additional amortization that is provided to KCPL pursuant to that Stipulation And Agreement shall be used as a reduction to rate base for the longer of (a) at least ten (10) years following the effective date of the July 28, 2005 Report And Order in Case No. EO-2005-0329 or (b) until the investment in the plant in service accounts to which the Regulatory Plan additional amortizations are ultimately assigned by the Commission is retired. Such reduction to rate base is understood and accepted by KCPL without reservation.

6. This is a legally binding agreement and creates binding contractual and legal relationships for its duration. By signing or authorizing execution by its representatives on its behalf, KCPL represents and acknowledges that it has sought and obtained such counsel, legal or otherwise as it desires and fully understands and acknowledges that termination or modification of any of the terms hereof requires the consent and signature of all signatories to this agreement or explicit authorization of the Commission. KCPL agrees that it may not unilaterally seek Commission termination of this Agreement unless it can show that there is a significant and imminent risk that its ability to provide safe and adequate service will be substantially impaired. KCPL acknowledges that the inability to provide safe and adequate service is the appropriate standard for the Commission to apply to any request to unilaterally terminate this Agreement. KCPL also agrees that this Agreement is complete in itself, that in entering into it KCPL is not relying upon any assumptions, impressions or understandings that are not reflected in this Agreement, and that nothing in this Agreement changes the terms of the Case No. EO-2005-0329

KCPL Experimental Regulatory Plan Stipulation And Agreement. KCPL further agrees that the rate base offset that is agreed upon herein is not dependent upon the inclusion of the Iatan 2 plant in KCPL's rate base or whether that plant becomes fully operational and used for service by any particular date or time or ever becomes fully operational and used for service.

7. The Signatories agree that the calculated amount of any Regulatory Plan additional amortizations during KCPL's Regulatory Plan will reflect an allocation of GPE's/KCPL's total company capital structure to its Missouri jurisdictional retail electric operations. GPE's/KCPL's Missouri jurisdictional allocated capital structure will be calculated by synchronizing the capital structure component ratios with the amount of its Missouri jurisdictional electric rate base plus any net balance sheet investment in electric operations it incurs in serving Missouri retail electric customers that is not reflected in its rate base. This synchronization will be effectuated by applying the debt and equity capital ratio percentages from GPE's/KCPL's total company capital structure to the sum of Missouri jurisdictional rate base plus the additional net balance sheet investment incurred to serve Missouri jurisdictional electric operations.

8. The Signatories agree that the additional net balance sheet investment for purposes of calculating the Regulatory Plan additional amortizations solely in this proceeding shall be ($14,209,674).

9. This Agreement is being entered into for the purpose of disposing of the issues that are specifically addressed in this Agreement. In presenting this Agreement, none of the Signatories to this Agreement shall be deemed to have approved, accepted, agreed, consented or acquiesced to any ratemaking principle or procedural principle, including, without limitation, any method of cost or revenue determination or cost allocation or revenue related methodology, and

none of the Signatories shall be prejudiced or bound in any manner by the terms of this Agreement (whether this Agreement is approved or not) in this or any other proceeding, other than a proceeding limited to enforce the terms of this Agreement, except as otherwise expressly specified herein.

10. This Agreement has resulted from extensive negotiations and the terms hereof are interdependent. If the Commission does not approve this Agreement without modification, then the Agreement shall be void and no Signatory shall be bound by any of the agreements or provisions herein, except as specifically provided herein.

11. If the Commission does not unconditionally approve this Agreement without modification, and notwithstanding its provision that it shall become void, neither this Agreement, nor any matters associated with its consideration by the Commission, shall be considered or argued to be a waiver of the rights that any Signatory has for a decision in accordance with Section 536.080 RSMo 2000 or Article V, Section 18 of the Missouri Constitution, and the Signatories shall retain all procedural and due process rights as fully as though this Agreement had not been presented for approval, and any suggestions or memoranda, testimony or exhibits that have been offered or received in support of this Agreement shall become privileged as reflecting the substantive content of settlement discussions and shall be stricken from and not be considered as part of the administrative or evidentiary record before the Commission for any further purpose whatsoever.

12. If the Commission unconditionally accepts the specific terms of this Agreement without modification, the Signatories waive, with respect to the issues resolved herein: their respective rights to call, examine and cross-examine witnesses pursuant to Section 536.070(2), RSMo 2000; their respective rights to present oral argument and/or written briefs pursuant to

Section 536.080.1 RSMo 2000; their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2 RSMo 2000; their respective rights to seek rehearing pursuant to Section 386.500 RSMo 2000; and their respective rights to judicial review pursuant to Section 386.510 RSMo 2000. These waivers apply only to a Commission order respecting this Agreement issued in this above-captioned proceeding, and do not apply to any matters raised in any prior or subsequent Commission proceeding, or any matters not explicitly addressed by this Agreement.

13. This Agreement, including all exhibits, schedules, appendices and attachments, contains the entire agreement of the Signatories concerning the issues addressed herein. Except as explicitly stated herein, there are no oral promises, agreements, warranties, obligations, assurances, unstated understandings, or conditions precedent that affect, limit or expand it.

14. Should the Commission have questions about this Agreement, the Signatories will make available their witnesses and attorneys on the issues resolved by this Agreement. If the Commission has questions for the Signatories' witnesses or Signatories, the Signatories will make available, at any on-the-record session, their witnesses and attorneys on the issues resolved by this Agreement, so long as all parties have had adequate notice of that session. The Signatories agree to cooperate in presenting this Agreement to the Commission for approval, and will take no action, direct or indirect, in opposition to the request for approval of this Agreement.

**WHEREFORE**, the undersigned Signatories respectfully request the Commission to issue an order in this case approving the Nonunanimous Stipulation And Agreement Regarding Regulatory Plan Additional Amortizations subject to the specific terms and conditions contained therein.

Respectfully submitted,

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ATTORNEYS FOR PRAXAIR, INC.

## REGULATORY PLAN AMORTIZATIONS RESOLUTION EXPLANATION

A resolution of the Regulatory Plan Additional Amortization "gross-up" for taxes issue has been reached in the Kansas City Power & Light Company (KCPL) rate increase case, Case No. ER-2006-0314, involving the following key points:

1. The entire amount of the Regulatory Plan amortization allowed in rates is to be treated as additional book depreciation for rate and financial statement purposes by KCPL;

2. An additional tax straight-line depreciation deduction in the entire amount of the Regulatory Plan amortization allowed in rates will be assumed for rate purposes and financial reporting purposes; and

3. The accumulated book depreciation reserve resulting from the recognition of the Regulatory Plan amortization as book depreciation will be recognized as an offset (reduction) to rate base in subsequent rate cases. The accumulated reduction in deferred income tax expense resulting from including the Regulatory Plan amortization in the straight line tax depreciation deduction will be reflected on KCPL's tax records and included in subsequent rate cases, as appropriate, along with all other factors included in the determination of deferred income tax expense. The net effect of these changes related to the Regulatory Plan amortizations to the accumulated depreciation reserve and the accumulated deferred tax reserve is an overall reduction to KCPL's rate base. The reduction in deferred taxes will be reflected in the deferred income tax balance in rate base in future rate cases, as well as all other changes affecting the deferred tax balance, including additional deferred taxes resulting from KCPL's plant additions.

The Regulatory Plan amortization is intended to provide KCPL the necessary cash flow to meet the two particular debt coverage ratios identified in the Regulatory Plan based upon KCPL's Missouri jurisdictional cost of service.[1] The entire amount of the Regulatory Plan amortization will be treated as additional book depreciation, and the entire amount of the amortization will be reflected in KCPL's tax calculation as additional tax straight-line depreciation deduction.

[1] Adjusted Funds From Operations Interest Coverage and Adjusted Funds From Operations as a Percent of Average Total Debt. *See* Paragraph III.B.1.i and Appendix E and Appendix F of the Regulatory Plan.

## CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed by pre-paid first class postage, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 4th day of December 2006.

/s/ Steven Dottheim

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Application of Kansas City Power and 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 |

# NONUNANIMOUS STIPULATION AND AGREEMENT REGARDING PENSION ISSUES

Come now the undersigned parties in this case ("Signatories"), and respectfully state to the Missouri Public Service Commission ("Commission"):

1. The Signatories have reached an agreement ("Agreement") that resolves among them all of the Pensions issues listed under the heading "Pensions" in the LIST OF ISSUES filed with the Commission in this case on October 6, 2006.

2. Those issues, as stated in the LIST OF ISSUES, are:

Pensions:

> How should the expense and contributions relating to pension benefits for (1) Joint Partners and (2) the Supplemental Executive Retirement Plan (SERP) be accounted for in the tracking of the regulatory asset required by the Stipulation and Agreement in Case No. EO-2005-0329?
>
> Should FAS 88 pension expenses be treated consistently with the KCPL application in this proceeding and its application for an AAO in Case No. EU-2006-0560?

3. The Stipulation and Agreement approved by the Commission in its Report and Order in Case No. EO-2005-0329 that embodies KCPL's Experimental Regulatory Plan ("Regulatory Plan") includes an agreement between the signatory parties regarding the calculation of pension cost for financial reporting and ratemaking purposes during the period of the Regulatory Plan.

4. This Stipulation and Agreement is intended to accomplish the following:

**Exhibit C**

a. Clarify the pension provisions in KCPL's Regulatory Plan with regard to KCPL's joint partners in the Iatan and LaCygne generating stations.

b. Identify, for purposes of calculating the tracking mechanism provided for in the method agreed to in the Regulatory Plan, the Regulatory Assets, including the Prepaid Pension Asset and annual Pension Cost resulting from rates established in this rate case, Case No. ER-2006-0314. The tracking mechanism requires that all Regulatory Assets and /or Liabilities, including the Prepaid Pension Asset, and annual Pension Cost be identified as of the established true-up date for each KCPL rate case during the period covered of the Regulatory Plan.

c. Set out the agreement of the Staff and KCPL regarding the treatment of pension costs which result under Financial Accounting Standard (FAS) 88 for financial reporting and ratemaking purposes during the period of the Regulatory Plan.

**Treatment of Pension Cost for Joint Partners**

5. KCPL, Aquila Inc. (Aquila) and The Empire District Electric Company (Empire) jointly own the Iatan 1 generating station. KCPL and Westar Energy (Westar) jointly own the LaCygne generating station. As the majority owner and operator of both generating stations, KCPL allocates the operating costs, including pension costs, to the other joint partners, Aquila, Empire and Westar.

6. KCPL and the Staff agree KCPL employee pension costs related to KCPL employees directly assigned to or who allocate part of their time to work for the Iatan and LaCygne generating stations will be calculated consistently with the methodology identified in the Regulatory Plan. Any regulatory asset, including the prepaid pension asset, and/or liability,

generated under paragraphs 2, 3, 4, 5, 6 and 7 of the pension agreement embodied in the Stipulation and Agreement the Commission approved in its final Report and Order in Case No. EO-2005-0329 will be calculated separately for the amounts related to KCPL's joint partners. KCPL employee pension costs for KCPL employees at the Iatan and LaCygne generating stations will be allocated among the joint owners of the stations in proportion to their ownership interests. None of the regulatory assets and/or liabilities, including the prepaid pension asset, or annual pension cost related to KCPL's joint partners will be reflected in rate base or cost of service in any KCPL rate case during the period covered by the Stipulation and Agreement in Case No. EO-2005-0329.

**Treatment of Pension Cost for the Supplemental Executive Retirement Plan (SERP)**

7. KCPL maintains a Supplemental Executive Retirement Plan (SERP) for key employees. The plan, administered by KCPL, does not utilize a trust fund. KCPL and the Staff agree that the SERP plan will not be included in the tracking mechanism for Regulatory Assets and/or Liabilities, including the Prepaid Pension Asset. SERP will be included in cost of service separately for rate making purposes.

**Annual Pension Cost and Regulatory Assets - Case No. ER 2006-0314**

8. KCPL's Missouri jurisdictional rates established in this case, ER-2006-0314, are based on $ 31,010,736 (total Company) for annual pension cost expense under FAS 87, after capitalized amounts and the portion of KCPL's annual pension cost which is allocated to KCPL's joint partners in the Iatan and LaCygne generating stations, but before inclusion of allowable SERP pension costs.

9. KCPL's Prepaid Pension Asset balance included in rate base, exclusive of the joint partners' share, is $ 29,707,323 (total Company) at September 30, 2006.

10. KCPL's Regulatory Asset for the difference between pension cost recognized in

its prior rates and its actual pension costs under FAS 87 since January of 2005 is $28,232,355 (total Company) at September 30, 2006, exclusive of any amount allocated to KCPL's joint partners.

11. KCPL's rates reflect the 5-year amortization of the $28,232,355 Regulatory Asset identified in the prior paragraph. KCPL will amortize $ 4,423,445 (total Company), after capitalization, annually beginning with the effective date of rates established in this case, ER-2006-0314.

**FAS 88 Pension Cost treatment for Financial Reporting and Ratemaking Purposes**

12. Unlike FAS 87, which allows for delayed recognition in net periodic pension cost of certain unrecognized amounts, FAS 88 requires immediate recognition of certain costs arising from settlements and curtailments of defined benefit plans. Without deferred accounting treatment approved by the Commission, KCPL is required to recognize a significant FAS 88 pension cost prior to year-end 2006 as a result of a significant number of pension settlements occurring during 2006. FAS 88 costs are legitimate pension costs which should be recovered in rates.

13. KCPL has requested deferred accounting treatment in Case No. EU-2006-0560 for FAS 88 pension costs consistent with the deferred accounting treatment allowed for FAS 87 pension costs in Case No. EO-2005-0329. KCPL and the Staff have reached an agreement in this case, Case No. ER-2006-0314, to adopt deferred accounting treatment for FAS 88 pension costs consistent with FAS 87 deferred accounting treatment which, if accepted, resolves this issue and eliminates the need to address the issue in Case No. EU-2006-0560. Therefore, KCPL shall dismiss its application in Case No. EU-2006-0560 within ten (10) days after an order issued by the Commission approving this Stipulation and Agreement becomes both final and not subject to court review under Section 386,510, RSMo. 2000.

a. Any FAS 88 costs deferred and subject to recovery in a future KCPL rate case should (a) include only the costs related to KCPL's Missouri jurisdictional electric operations and (b) exclude all amounts assignable to Aquila, Empire and Westar Energy as joint owners of the Iatan and LaCygne generating stations;

b. KCPL and the Staff agree that all of KCPL's FAS 88 pension costs related to KCPL's Missouri jurisdictional electric operations, exclusive of amounts allocated to Aquila, Empire and Westar Energy, during the period between January 1, 2006 and KCPL's next rate case will be deferred in a regulatory asset and amortized to cost-of-service over 5 years in KCPL's next rate case. This treatment will continue to apply in all KCPL rate cases during the period of KCPL's Regulatory Plan. There were no FAS 88 pension costs included in cost of service in Case No. ER-2006-314.

c. KCPL will be required to fund all FAS 88 pension costs it collects in rates. Since KCPL will not be required to fund any FAS 88 cost prior to recovery in rates, no rate base treatment will be required for the regulatory asset representing deferred FAS 88 costs.

14. This Agreement is being entered into for the purpose of disposing of the issues that are specifically addressed in this Agreement. In presenting this Agreement, none of the Signatories to this Agreement shall be deemed to have approved, accepted, agreed, consented or acquiesced to any ratemaking principle or procedural principle, including, without limitation, any method of cost or revenue determination or cost allocation or revenue related methodology, and none of the Signatories shall be prejudiced or bound in any manner by the terms of this Agreement (whether this Agreement is approved or not) in this or any other proceeding, other

than a proceeding limited to enforce the terms of this Agreement, except as otherwise expressly specified herein.

15. This Agreement has resulted from extensive negotiations and the terms hereof are interdependent. If the Commission does not approve this Agreement without modification, then the Agreement shall be void and no Signatory shall be bound by any of the agreements or provisions herein, except as specifically provided herein.

16. If the Commission does not unconditionally approve this Agreement without modification, and notwithstanding its provision that it shall become void, neither this Agreement, nor any matters associated with its consideration by the Commission, shall be considered or argued to be a waiver of the rights that any Signatory has for a decision in accordance with Section 536.080 RSMo 2000 or Article V, Section 18 of the Missouri Constitution, and the Signatories shall retain all procedural and due process rights as fully as though this Agreement had not been presented for approval, and any suggestions or memoranda, testimony or exhibits that have been offered or received in support of this Agreement shall become privileged as reflecting the substantive content of settlement discussions and shall be stricken from and not be considered as part of the administrative or evidentiary record before the Commission for any further purpose whatsoever.

17. If the Commission unconditionally accepts the specific terms of this Agreement without modification, the Signatories waive, with respect to the issues resolved herein: their respective rights (1) to call, examine and cross-examine witnesses pursuant to Section 536.070(2), RSMo 2000; (2) their respective rights to present oral argument and/or written briefs pursuant to Section 536.080.1, RSMo 2000; (3) their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2, RSMo 2000; (4) their respective rights to seek rehearing pursuant to Section 386.500, RSMo 2000 and (5) their respective rights

to judicial review pursuant to Section 386.510, RSMo 2000. These waivers apply only to a Commission order respecting this Agreement issued in this above-captioned proceeding, and do not apply to any matters raised in any prior or subsequent Commission proceeding, or any matters not explicitly addressed by this Agreement. This Agreement contains the entire agreement of the Signatories concerning the issues addressed herein.

18. If the Commission has questions for the Signatories' witnesses or Signatories, the Signatories will make available, at any on-the-record session, their witnesses and attorneys on the issues resolved by this Agreement, so long as all parties have had adequate notice of that session. The Signatories agree to cooperate in presenting this Agreement to the Commission for approval, and will take no action, direct or indirect, in opposition to the request for approval of this Agreement.

**WHEREFORE**, the undersigned Signatories respectfully request the Commission to issue an order in this case approving the Agreement subject to the specific terms and conditions contained therein.

Respectfully submitted,

Nathan Williams

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ATTORNEYS FOR
KANSAS CITY POWER & LIGHT
COMPANY

## Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 4th day of December 2006.

Nathan Williams

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Application of Kansas City Power and 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 |

## STIPULATION AND AGREEMENT REGARDING CLASS COST-OF-SERVICE AND RATE DESIGN ISSUES

**COME NOW** the undersigned parties in this case ("Signatories"), and respectfully state to the Missouri Public Service Commission ("Commission"):

1. The Signatories have reached an agreement ("Agreement") that resolves among them, with the exception of those issues listed under the subheading "Availability of General Service Space-Heating Rate Discounts," all of the Rate Design/Cost-of-Service issues listed under the heading "**Class Cost-of-Service and Rate Design,**" in the LIST OF ISSUES filed with the Commission in this case on October 6, 2006.

2. Those issues as stated in the LIST OF ISSUES are:

**Class Cost-of-Service and Rate Design:**

**Class Cost-of-Service:**

On what basis should distribution costs be allocated to classes? Should the allocation of primary distribution costs include any customer-related component? What type of demand should be used to allocate the cost of distribution substations and distribution lines?

On what basis should production capacity and transmission costs be allocated to classes?

What is the appropriate method to use for allocating margins on off-system sales among Missouri retail customer classes? (MIEC)

Do KCP&L's computation of coincident peak demands and class peak demands properly recognize line losses?

**Exhibit D**

To what extent, if any, are current rates for each customer class generating revenues that are greater or less than the cost of service for that customer class?

What is the appropriate basis for allocating Administrative and General Expense Account Numbers 920, 922, 923, 930.2, and 931 among Missouri retail customer classes?

Should revenue adjustments among classes be implemented in order to better align class revenues to class cost-of-service? If so, what percentage increase or decrease should be assigned to each customer class?

Should class revenue adjustments be implemented even if no increase or decrease in revenue requirement is granted?

Should revenue adjustments be phased-in over multiple years?

Should revenue adjustments among the non-residential classes be applied uniformly or non-uniformly?

How should any increase in the revenue requirement be implemented?

**Rate Design:**

Should a comprehensive analysis of KCPL's class cost-of-service issues and rate design be conducted after the conclusion of the regulatory plan and the in-service date of Iatan 2? Should the cost-basis of general service all-electric rates be included in this analysis?

Should KCPL's proposed changes to the General Service customer charge be implemented?

3. The Signatories agree to overall company rate revenue neutral interclass changes in class revenue responsibilities that have the effect of increasing current residential customer class rates by about 2.00%; decreasing current small, medium and large general service class rates by about 0.45%; decreasing current large power service class rates by about 2.54% and making no change to current lighting class rates as more particularly described in attached Appendix A.

4. The Signatories agree to the provisions of Appendix A, all of which are designed

to implement overall company revenue neutral changes in class revenue responsibilities. In particular, the Signatories agree that the class rate revenue responsibilities to be used as the base for implementing any overall increase in revenues the Commission orders in this case are the dollar amounts shown in the table between items (4) and (5) on the line labeled "Post-Shifted Class Rate Revenues."

5. The Signatories agree new rates will be developed based on the "Post-Shifted Class Rate Revenues," and then each rate element of those rates will be factored up by multiplying them by the sum of one plus the result of dividing any overall increase in company revenue requirement the Commission orders in this case by total KCPL Missouri revenue at present rates as trued-up to generate final rates from this case.

6. This Agreement is being entered into for the purpose of disposing of the issues that are specifically addressed in this Agreement. In presenting this Agreement, none of the Signatories to this Agreement shall be deemed to have approved, accepted, agreed, consented or acquiesced to any ratemaking principle or procedural principle, including, without limitation, any method of cost or revenue determination or cost allocation or revenue related methodology, and none of the Signatories shall be prejudiced or bound in any manner by the terms of this Agreement (whether this Agreement is approved or not) in this or any other proceeding, other than a proceeding limited to enforce the terms of this Agreement, except as otherwise expressly specified herein.

7. This Agreement has resulted from extensive negotiations and the terms hereof are interdependent. If the Commission does not approve this Agreement without modification, then the Agreement shall be void and no Signatory shall be bound by any of the agreements or provisions herein, except as specifically provided herein.

8. This Agreement is expressly contingent on all parties in this case either signing

this Agreement or not opposing this Agreement so that it is treated by the Commission as a unanimous stipulation and agreement as set forth in Commission Rule 4 CSR 240-2.115. If anyone opposes this Agreement or if the Commission does not unconditionally approve this Agreement without modification, and notwithstanding its provision that it shall become void, neither this Agreement, nor any matters associated with its consideration by the Commission, shall be considered or argued to be a waiver of the rights that any Signatory has for a decision in accordance with Section 536.080 RSMo 2000 or Article V, Section 18 of the Missouri Constitution, and the Signatories shall retain all procedural and due process rights as fully as though this Agreement had not been presented for approval, and any suggestions or memoranda, testimony or exhibits that have been offered or received in support of this Agreement shall become privileged as reflecting the substantive content of settlement discussions and shall be stricken from and not be considered as part of the administrative or evidentiary record before the Commission for any further purpose whatsoever.

9. If the Commission unconditionally accepts the specific terms of this Agreement without modification, the Signatories waive, with respect to the issues resolved herein: their respective rights (1) to call, examine and cross-examine witnesses pursuant to Section 536.070(2), RSMo 2000; (2) their respective rights to present oral argument and/or written briefs pursuant to Section 536.080.1, RSMo 2000; (3) their respective rights to the reading of the transcript by the Commission pursuant to Section 536.080.2, RSMo 2000; (4) their respective rights to seek rehearing pursuant to Section 386.500, RSMo 2000 and (5) their respective rights to judicial review pursuant to Section 386.510, RSMo 2000. These waivers apply only to a Commission order respecting this Agreement issued in this above-captioned proceeding, and do not apply to any matters raised in any prior or subsequent Commission proceeding, or any matters not explicitly addressed by this Agreement. In particular, with respect to the issues

resolved herein, they waive their rights to call, examine and cross-examine the following witness:

Laura Becker Direct Testimony (Ex. 40) (KCPL)
Lois J. Leichti Direct Testimony (Ex. 38) and Rebuttal Testimony (Ex. 39) (KCPL)
Tim M. Rush Direct Testimony, pp. (Ex. 21) and Rebuttal Testimony, pp. (Ex. 22) (KCPL)
James Busch Direct Testimony (Ex. 108), Rebuttal Testimony (Ex. 109), Surrebuttal Testimony (Ex. 110) and Supplemental Surrebuttal Testimony (Ex. 111) (Staff)
Janice Pyatte Direct Testimony (Ex. 128), Rebuttal Testimony (Ex. 129) and Surrebuttal Testimony (Ex. 130) (Staff)
Maurice Brubaker Rate Design Direct Testimony (Ex. 602), Rate Design Rebuttal Testimony (Ex. 604), and Surrebuttal Testimony (Ex. 605). (Ford/Praxair/MIEC)
Barbara Meisenheimer Rate Design Direct Testimony (Ex. 206), Supplemental Direct Testimony (Ex. 207), Rebuttal Testimony (Ex. 208) and Surrebuttal Testimony (Ex. 209) (Public Counsel)
James T. Selecky Direct Testimony (Ex. 901), Rebuttal Testimony (Ex. 902) and Surrebuttal Testimony (Ex. 903) (Wal-Mart)
Gary C. Price Direct Testimony (Ex. 806), Rebuttal Testimony (Ex. 807) and Surrebuttal Testimony (Ex. 808) (DOE)

10. This Agreement contains the entire agreement of the Signatories concerning the issues addressed herein.

11. The issues resolved by this Agreement were scheduled to be heard on October 26, 2006. If the Commission has questions for the Signatories' witnesses or Signatories, the Signatories will make available, at any on-the-record session, their witnesses and attorneys on the issues resolved by this Agreement, so long as all parties have had adequate notice of that session. The Signatories agree to cooperate in presenting this Agreement to the Commission for approval, and will take no action, direct or indirect, in opposition to the request for approval of this Agreement.

**WHEREFORE**, the undersigned Signatories respectfully request the Commission to issue an order in this case approving the Agreement subject to the specific terms and conditions contained therein.

Respectfully submitted,

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## Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 9th day of November 2006.

**/s/ Dennis L. Frey**

## ER-2006-0314 KCPL CCOS & Rate Design Settlement

(1) No litigation of individual class cost of service issues (choice of allocators, etc.)

(2) Revenue shifts between the classes will be independent of the final outcome of KCPL's revenue requirement.

(3) Any revenue-neutral dollar decrease to the non-residential classes will be split between General Service and Large Power.

(4) Revenues associated with the three general service classes (Small GS, Medium GS, Large GS) will be increased/decreased by a uniform percentage.

| | **MO Retail** | **Residential** | **Small GS** | **Medium GS** | **Large GS** | **Large Power** | **Lighting** | **GS Combined** |
|---|---|---|---|---|---|---|---|---|
| Class Revenues @ 0% Increase | $483,655,953 | $171,390,326 | $36,585,812 | $62,431,139 | $108,727,991 | $98,463,950 | $6,056,735 | $207,744,942 |
| Revenue-Neutral $ Change | $0 | $3,427,807 | ($163,395) | ($278,823) | ($485,589) | ($2,500,000) | $0 | ($927,807) |
| Revenue-Neutral % Change | 0.0% | 2.00% | -0.45% | -0.45% | -0.45% | -2.54% | 0.0% | |
| Post-Shifted Class Rate Revenues | $483,655,953 | $174,818,133 | $36,422,417 | $62,152,316 | $108,242,402 | $95,963,950 | $6,056,735 | $206,817,135 |

(5) Any increase in the overall revenue requirement will be implemented as an equal percentage increase to post-shifted class revenues.

COMBINED EFFECT OF CLASS REVENUE SHIFTS AND EQUAL PERCENTAGE REVENUE REQUIREMENT INCREASE

| KCPL % Incr to Rate Rev | Overall KCPL Million $ Increase | Total RES % Increase | Total RES $ Increase | Total GS % Increase | Total GS $ Increase | Total PWR % Increase | Total PWR $ Increase | Lighting % Increase | Lighting $ Increase |
|---|---|---|---|---|---|---|---|---|---|
| 7.5% | $36.3 | 9.7% | $16.5 | 7.0% | $14.6 | 4.8% | $4.7 | 7.5% | $0.5 |
| 8.0% | $38.7 | 10.2% | $17.4 | 7.5% | $15.6 | 5.3% | $5.2 | 8.0% | $0.5 |
| 8.5% | $41.1 | 10.7% | $18.3 | 8.0% | $16.7 | 5.7% | $5.7 | 8.5% | $0.5 |
| 9.0% | $43.5 | 11.2% | $19.2 | 8.5% | $17.7 | 6.2% | $6.1 | 9.0% | $0.5 |
| 9.5% | $45.9 | 11.7% | $20.0 | 9.0% | $18.7 | 6.7% | $6.6 | 9.5% | $0.6 |
| 10.0% | $48.4 | 12.2% | $20.9 | 9.5% | $19.8 | 7.2% | $7.1 | 10.0% | $0.6 |
| 10.5% | $50.8 | 12.7% | $21.8 | 10.0% | $20.8 | 7.7% | $7.6 | 10.5% | $0.6 |
| 11.0% | $53.2 | 13.2% | $22.7 | 10.5% | $21.8 | 8.2% | $8.1 | 11.0% | $0.7 |
| 11.5% | $55.6 | 13.7% | $23.5 | 11.0% | $22.9 | 8.7% | $8.5 | 11.5% | $0.7 |

(6) The following features of the existing non-residential rate design will be maintained:
The value of the customer charge should remain based upon customer size (kW) and should be uniform across classes.
The value of the facilities charge ($ per kW) should remain uniform across classes on a voltage-adjusted basis.
The value of the reactive charge ($ per kVar) should remain uniform across classes.
The value of the separate (additional) meter charge ($ per meter) should remain uniform across classes.
Within each class, the various demand charges ($ per kW) and energy charges ($ per kWh) should only reflect differences in losses between voltage levels (i.e, should be the same on a loss-adjusted basis).
[NOTE: These issues only arise when non-uniform percentage changes are made to non-residential classes.]

Appendix A

(7) The level of the non-residential customer charges, facilities charges, reactive charges, and additional meter charges will not be subject to change,

on a revenue-neutral basis (i.e., these charges will ultimately increase by the system average percent).

(8) The loss adjustments to be reflected in KCPL's non-residential rates will reflect, to the extent possible, the results of the loss study KCPL performed for this case.

(9) The value of the residential separate (additional) meter charge ($ per meter) should be the same as for the non-residential classes. (i.e., will ultimately increase by the system average percent).

(10) The level of the residential, single-meter customer charge should be subject to both the revenue-neutral increase and the revenue requirement increase.

(11) No planned phase-in of class revenue shifts; consider the issue of further revenue shifts on a case-by-case basis.

(12) General service space heating and all-electric winter rates will be increased by 5 percentage points more than each class' general application rates.

(13) The remaining general service space heating and all-electric issues (broadening availability, restricting availability to existing customers or totally eliminating the rate schedules) will be litigated.

STATE OF MISSOURI

OFFICE OF THE PUBLIC SERVICE COMMISSION

**I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.**

**WITNESS my hand and seal of the Public Service Commission, at Jefferson City, Missouri, this 21st day of December 2006.**

**Colleen M. Dale**
**Secretary**

## *MISSOURI PUBLIC SERVICE COMMISSION*

### *December 21, 2006*

**Case No. ER-2006-0314**

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***Enclosed find a certified copy of an ORDER in the above-numbered case(s).***

***Sincerely,***

***Colleen M. Dale***
***Secretary***