BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service	))))	**Case No. ER-2014-0370_** Tariff Nos. YE-2015-0194 & YE-2015-0195

STAFF'S INITIAL BRIEF

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TABLE OF CONTENTS

INTRODUCTION 1

I. Cost of Capital 3

A. Capital Structure and Cost of Debt 4

B. The Cost of Common Equity ("ROE:) 6

II. Fuel Adjustment Clause 37

A. Does KCPL's fuel adjustment clause request violate the Stipulation and Agreement from Case No. EO-2005-0329? If so, should it be rejected? 37

B. Has KCPL met the criteria for the Commission to authorize it t o have a fuel adjustment clause? 42

C. Should the Commission authorize KCPL to have a fuel adjustment clause? 46

D. If the Commission authorizes KCPL to have a fuel adjustment clause, how should it be structured? 46

E. If the Commission authorizes KCPL to have a a fuel adjustment clause, what FAC-related reporting requirements should it order KCPL to comply with? 58

F. If the Commission authorizes KCPL to have a FAC, Should KCPL be allowed to add cost and revenue types To its FAC between rate cases? 59

G. If the Commission authorizes KCPL to have a FAC, Should KCPL be required to clearly differentiate itself from GMO on customer bills? 60

III. Transmission Fees Expense 60

A. What level of transmission fees expense should the Commission recognize in KCPL's revenue requirement? 60

B. Should a tracker be implemented for KCPL's future transmission fees expense that varies from the level of transmission fees expense the Commission recognizes in KCPL's revenue requirement and that KCPL will not recover through a fuel adjustment clause? 60

Single-Issue Rate Making Mechanisms 67

IV. Property Tax Expense 90

A. What amount of property tax should be recognized in KCPL's Revenue requirement? 91

B. Should the Commission grant KCPL a Property Tax Tracker? ... 92

C. If the Commission grants KCPL a Property Tax Tracker, should KCPL get a return on as well as return of the tracked amounts? 95

D. If the Commission grants KCPL a Property Tax Tracker, should KCPL get carrying costs on the tracked amounts? 96

V. CIP/Cyber-Security Expense 97

A. What level of CIP/cyber-security expense should the Commission recognize in KCPL's revenue requirement? 97

B. Should a tracker be implemented for KCPL's CIP/cyber-security expense that varies from the level of CIP/cyber-security expense the Commission recognizes in KCPL's revenue requirement? 98

C. If the Commission grants KCPL a CIP/cybersecurity tracker, should KCPL get a return on as well as return of the tracked amounts and get carrying costs on the tracked amounts? 101

VII. LaCygne Environmental Retrofit project – what level of KCPL's investment in the LaCygne Environmental Retrofit project should be included in KCPL's Missouri rate base? 102

VIII. Rate Case Expense 102

A. Was any of the rate case expense incurred by KCPL imprudent? 103

B. Should KCPL's shareholders share any part of KCPL's rate case expense? 105

C. What level of rate case expense for this proceeding should the Commission recognize in KCPL's revenue requirement? 114

XVII. Management Audit – Should the Commission order a management audit of KCPL? 115

XVIII. Clean Charge Network 115

XIX. Income-tax related issues (including accumulated deferred income taxes or "ADIT" – what adjustments, if any, are necessary to ensure that KCPL's income tax allowance, include ADIT matters, is calculated appropriately?..124

XXIV. Revenues – what is the appropriate level of revenues for the large General service and large power classes to account for Customers switching from one rate class to another? 128

XXV. Class Cost of Service, Rate Design, Tariff Rules and Regulations 128

XXVI. Low-Income Weatherization 133

A. Should the unexpended low-income weatherization program funds collected through KCPL's base rates be used to offset any expenditures relating to the low-income weatherization program the costs of which KCPL is otherwise to recover through its MEEIA recovery mechanism? 133

B. Should the low-income weatherization program costs be collected In base rates on a going forward basis or should those program costs be collected as part of KCPL's MEEIA recovery mechanism? 135

XVII. Economic Relief Pilot Program – should the program be expanded to serve additional customers as proposed by KCPL? 135

XXVIII. Decoupling: Should the Commission consider, in File No. AW-2015-0282 or similar proceeding, decoupling of KCPL's revenues from customer usage? 137

CONCLUSION... 138

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STAFF'S INITIAL BRIEF

COMES NOW the Staff of the Missouri Public Service Commission, by and through counsel, and for its initial brief, states:

INTRODUCTION

Kansas City Power & Light Company ("KCPL") and its affiliate KCP&L Greater Missouri Operations Company ("GMO") provide retail electric service to the public in parts of Kansas and Missouri as "KCP&L," their brand and service mark. Following is a map of their service areas, with KCPL's Missouri service area is shown in blue.[1]

[1] http://kcpl.com/about-kcpl/company-overview/service-area (Accessed April 27, 2015).

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Approximately 275,000[2] of KCPL's 519,000[3] retail customers are in Missouri. Currently KCPL gets about $770 million from them each year[4]. In this case KCPL is requesting to increase that $770 million by $121 million (to $891 million), a nearly 16 percent increase.

Of KCPL's 519,000 Missouri retail customers, 459,000 (88%) are residential customers and 60,000 (12%) are commercial customers[5]; therefore, KCPL's residential customers will bear the brunt of the rate increase. To serve these customers, KCPL owns 4.492 gigawatts of generation—549 megawatts of nuclear, 2.75 GW of coal, 148 MW of wind, 772 MW of natural gas-fired combustion turbines and 375 MW of oil-fired combustion turbines.[6] This is KCPL's sixth general rate increase case in Missouri since 2006. The prior case numbers follow with the approximate overall percentage increases granted[7] and the residential customer percentage increases:

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[2] Ex. 202, *Staff rate design class cost of service report*, Sch. MSS-D2 (p. 63of 69).

[3] Ex. 200, *Staff revenue requirement cost of service report*, p. 2, l. 2. .

[4] Ex. 118, KCPL witness Ives direct, p. 12, l.20; Ex. 201, Staff Accounting Schedules, Rate Revenue Summary (for 2014 per Staff: $762 million (unadjusted), and $758 million (normalized and annualized) .

[5] Ex. 200, *Staff revenue requirement cost of service report*, p. 2, l. 2.

[6] *Id.*, p. 2, ll. 7-11.

[7] *Id.*, p. 11, l. 3, Table 1.

Case No.	ER-2006-0314	ER-2007-0291	ER-2009-0089	ER-2010-0355	ER-2012-0174
Increase	10.46%[8]	8.4%[9]	16.1%[10]	5.23%[11]	9.64%[12]
Residential Increase	12.46%	8.4%	16.1%	5.23%	9.64%

As the above table shows, collectively, overall KCPL's Missouri retail customers and residential customers have seen their rates increase by 60.39% and 63.29%, respectively, over six years (January 1, 2007 to January 26, 2013).[13] However, during that same period of time—2007 to 2013—average weekly wages in the Missouri counties where KCPL provides electric service increased collectively only 11.47%, slightly less than the 11.56% they increased throughout Missouri during that same time frame and about 1% below the CPI increase.[14]

This brief follows the order of the issues as listed in the list of issues.

I. Cost of Capital

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

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[8] MoPSC press release FY-07-153; http://psc.mo.gov/CMSInternetData/PressReleases/Archive/pr-07-153.pdf

[9] MoPSC press release PR-08-86; http://psc.mo.gov/Electric/PR-08-86_--_PSC_Grants_Rate_Increase_To_Kansas_City_Power__Light (Accessed April 27, 2015).

[10] MoPSC press release PR-09-210; http://psc.mo.gov/Electric/PR-09-210_--_PSC_Approves_Agreement_Reached_In_KCPL_Electric_Rate_Case (Accessed April 27, 2015).

[11] MoPSC press release PR-11-166; http://psc.mo.gov/Electric/PR-11-166_--_PSC_Issues_Decision_in_KCPL_Rate_Case (Accessed April 27, 2015).

[12] MoPSC press release PR-13-77; http://psc.mo.gov/Electric/PSC_Issues_Decision_In_KCPL_Rate_Case (Accessed April 27, 2015).

[13] Based on the Edison Electric Institute's winter 2014 *Typical Bill and Average Rates Report*, KCPL's Missouri retail customers overall have experienced an effective increase in their KCPL electric bills of 59.7% (10.99 ¢/kWh / 6.88 ¢/kWh. Staff witness Cary F. Featherstone surrebuttal testimony, Sch. CGF-s1, p. 2 of 4.

[14] Ex. 200, *Staff revenue requirement cost of service report*, p. 10, ll. 6-9.

B. Capital structure – what capital structure should be used for determining rate of return?

C. Cost of debt – what cost of debt should be used for determining rate of return?

Introduction:

The Commission must determine three issues in the Cost of Capital area in this case: (1) What should the return on common equity ("ROE") be? (2) What capital structure should be used? And, (3) what cost of debt should be used?

A. Capital Structure and Cost of Debt:

Two of the three issues may be disposed of quickly. Of the four expert financial analysts that testified in this case, all but one agreed to use the consolidated capital structure of Great Plains Energy as of December 31, 2014, and Great Plains' embedded cost of long-term debt as of the same date, discarding short-term debt from the consideration.

Only Maureen Reno, expert witness for the United States Department of Energy ("DOE"), opposed the use of the capital structure of Great Plains Energy, KCPL's parent company, choosing to use KCPL's actual capital structure as of December 31, 2014, instead.[15] All the other expert witnesses in this case propose to use the parent company's capital structure, including Mr. Gorman, Mr. Marevangepo, and Mr. Hevert.[16] Great Plains Energy's capital structure has been used for both KCPL and for its sister utility, GMO, at least since the acquisition of GMO's predecessor, Aquila.[17] In the most

[15] Tr. 9:234; Ex. 700, Reno direct, p. 10.

[16] Tr. 9:234-35.

[17] Tr. 9:235.

recent KCPL-GMO rate cases, the Commission adopted the parent company's structure.[18] The Kansas Corporation Commission has also used Great Plain's capital structure for KCPL in past rate cases.[19] Ms. Reno's only explanation for her preference was that "applying the capital structure of the parent company is akin to applying a hypothetical capital structure"; however, she never explained why she believed this would be inappropriate in this case.[20] The Commission should ignore Ms. Reno's preference as to capital structure.

Likewise, Maureen Reno is also the only witness that proposes to include short-term debt in the cost-of-capital determination; the others consider only long-term debt and the two classes of equity.[21] Ms. Reno's explanation for her position is as follows:

> Since short-term debt is used to fund the operations and investments of the firm, credit-rating analysts incorporate such interest-bearing debt in their ratings. For example, S&P considers ratios, such as Funds from Operations/Total Debt and Total Debt/Capitalization when rating a company. These ratings, in turn, are used by investors to gauge the risks associated with valuing a utility's assets. Finally, excluding short-term debt from the capital structure makes the capital structure more equity-rich, which is more expensive, thereby shifting the cost to ratepayers.[22]

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[18] Tr. 9:235.

[19] Tr. 9:235.

[20] Ex. 701, Reno surrebuttal, pp. 13-14.

[21] Tr. 9:235-36.

[22] Ex. 701, Reno surrebuttal, p. 15. Ms. Reno also testified, "The short-term debt in the cost of capital is the debt used to fund the operations and investments of the firm. Credit rating analysts, therefore, incorporate all interest-bearing debt in their ratings. Although some analysts may assume that short-term debt will be refinanced with long-term debt, any trend in the balance of short-term debt should be reflected in the company's capital structure. Since KCP&L held a positive short-term debt balance throughout the period December 31, 2013 through December 31, 2014, I include it in the Company's capital structure." Ex. 700, Reno direct, pp. 10-11.

Ms. Reno's explanation is not sufficient for the Commission to discard its long-established practice and the Commission should ignore it.

B. The Cost of Common Equity ("ROE"):

Staff recommends that the Commission allow KCPL a return on common equity ("ROE") in the range 9.00% to 9.50%, midpoint 9.25%, based upon its expert analysis of market-driven data using traditional analytical tools.[23] This ROE should be combined with Great Plains' consolidated capital structure, cost of debt and cost of preferred stock as of the true-up date, May 31, 2015, to arrive at the allowed rate of return ("ROR") in this case of 7.276% to 7.527%, midpoint 7.401%.[24]

Party & Expert	Recommendation
KCP&L (Robert Hevert)[25]	10.00%-10.60%, **10.30%**
MIEC (Michael Gorman)[26]	8.80%-9.40%, **9.10%**
Staff (Zephaniah Marevangepo)[27]	9.00%-9.50%, **9.25%**
DOE (Maureen Reno)[28]	8.20%-9.60%, **9.00%**
TABLE 1 – EXPERT RECOMMENDATIONS.	

The recommendations before the Commission in this case range between 8.20% and 10.60%. Two of the expert witnesses testified that an authorized ROE anywhere within their recommended ranges would be appropriate.[29]

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[23] Ex. 200, *Staff revenue requirement cost of service report,* p. 19.

[24] Featherstone true-up direct, p. 5. Great Plains' true-up consolidated capital structure as of May, 31, 2015, consisted of 50.09% common stock equity, 0.55% preferred stock and 49.36% long-term debt. Its cost of long-term debt was 5.56% and its cost of preferred stock was 4.29%.

[25] Ex. 228, Marevangepo surrebuttal, p. 4; Tr. 9:169 (Hevert).

[26] Tr. 9:258 (Gorman).

[27] Ex. 200, *Staff revenue requirement cost of service report,* p. 19.

[28] Ex. 700, Reno direct, p. 32.

[29] Tr. 9:253 (Reno); 9:258 (Gorman).

What is the Significance of This Issue?

Cost of capital is the largest single issue in this case – the difference between Staff's position and KCPL's is worth over $18 million.[30] Cost of capital is always a large issue in terms of the amount of revenue requirement and also a contentious issue in a general rate case; this case is no exception. The term "cost of capital" refers to the cost of each component of the capital structure, typically long-term debt, preferred equity and common equity.[31] The cost of both long-term debt and preferred equity is historic or "embedded" and can be readily determined from the controlling instruments.[32] The cost of common equity, on the other hand, is driven by the market and must be estimated through expert analysis and judgment.

The Experts

Four expert financial analysts testified before the Commission in this case and offered estimates to the Commission for the cost of common equity. All four of the experts are well-qualified by education and experience to participate in this case. No party has challenged the qualifications of any of these expert witnesses.

Mr. Hevert and Mr. Gorman are independent consultants. They both have MBAs and hold the Chartered Financial Analyst ("CFA") designation.[33] Each of them has testified before this and other utility regulatory commissions concerning ROE many

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[30] Ex. 203, *Staff's Reconciliation.*

[31] Short-term debt, that is, debt payable in less than one year, is generally excluded.

[32] For example, the interest rate on a corporate bond can be determined by examining the indenture. Ms. Reno testified, "Long-term debt costs are computed using the Company's actual 9 embedded costs as reported in the Company's 2014 SEC 10-k Report." Ex. 700, Reno direct, p. 10.

[33] Ex. 115, Hevert direct, p. 1; Ex. 550, Gorman direct, App. A, pp. 1 and 4.

times.[34] Mr. Hevert provides ROE testimony solely on behalf of utilities.[35] He charges $350 per hour.[36] His estimate for this case was $99,600, excluding surrebuttal testimony and the hearing.[37] Mr. Gorman provides ROE testimony primarily on behalf of industrial consumers and federal executive agencies, but he has also represented utilities and consumer advocates.[38] He charges $235 per hour and anticipates a total fee of about $30,000 for this case.[39]

Mr. Marevangepo is a member of the Commission's Financial Analysis Staff. He has an MBA and is also a Certified Rate of Return Analyst ("CRRA").[40] He has sponsored written and oral testimony in several cases before this Commission regarding cost of capital and financing issues, in addition to the present case.[41]

Ms. Reno, DOE's expert witness, is a consultant from New Hampshire.[42] She has a MA in Economics and is completing a Ph.D. in Economics at the University of

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[34] The case participation experience of these witnesses is detailed at Ex. 115, Hevert direct, Attachment A, and Ex. 550, Gorman direct, App. A, p. 3.

[35] Tr. 9:165-66, 167 (Hevert).

[36] Tr. 9:167 (Hevert).

[37] *Id.*

[38] Michael Gorman, Tr. 9:288-89.

[39] *Id.,* at 289.

[40] Ex. 200, *Staff revenue requirement cost of service report,* App. 1, at p. 75.

[41] *Id.,* at App. 1, pp. 76-77.

[42] Ex. 700, Reno direct, pp. 1-2.

New Hampshire.[43] She was a staff member of the New Hampshire Public Utilities Commission for ten years and has testified as a cost-of-capital expert a number of times.[44]

What is the Rate of Return?

In addition to KCPL's prudent operating and maintenance expenses, revenue requirement includes both a return "of" and a return "on" the net current value of the shareholders' investment.[45] The former is provided by depreciation expense; the latter by the rate of return. The rate of return is a multiplier which, applied to the net current rate base, results in the return or "profit" allowed to the investors in return for the use of their private property in serving the public. The Due Process Clause of the 14th Amendment to the United States Constitution requires that the shareholders be allowed an opportunity to earn a reasonable return on their investment.[46] Pursuant to financial theory, a fair rate of return is an amount sufficient to meet the utility's capital costs.[47] For this reason, the rate of return is considered to be equivalent to the Weighted Average Cost of Capital ("WACC").[48] The WACC is computed by multiplying a ratio reflecting the proportion that each capital component constitutes of the whole by

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[43] *Id.*

[44] *Id.*

[45] Edison Electric Institute (EEI), ***Rate Shock Mitigation*** (June, 2007; available on the Internet) p. 5 ("In simple terms, a utility's cost of service or revenue requirement consists of three primary elements: (1) operating costs, such as fuel costs, purchased power costs, operations and maintenance (O&M) costs and customer service costs; (2) a return of capital cost, otherwise known as depreciation expense; and (3) a return on capital cost, including applicable income taxes.").

[46] ***St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n,*** 585 S.W.2d 41, 49 (Mo. banc 1979) ("***UCCM***").

[47] Ex. 200, *Staff revenue requirement cost of service report,* p. 22.

[48] *Id.,* p. 18.

its cost and summing the results.[49] The Commission does not set the rate of return directly, but sets the ROE which is a component of the rate of return. In this way, the Commission indirectly sets the rate of return.

The cost of common equity capital must be estimated.[50] This is a difficult task, as academic commentators have recognized.[51] It is said that this "is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony."[52] The evaluation of expert testimony is left to the Commission, which “may adopt or reject any or all of any witness’s [sic] testimony.”[53]

Constitutional Parameters

The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must be met in setting the allowed return on common equity.[54] Each of the experts has affirmed that he or she conducted studies and made recommendations with these parameters in mind.[55] In the earlier of these

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[49] *Id.*

[50] Ex. 115, Hevert direct, p. 5.

[51] C.F. Phillips, Jr., ***The Regulation of Public Utilities: Theory & Practice*** 394 (PUR: Arlington, VA, 1993); L.S. Goodman, 1 ***The Process of Ratemaking***, 606 (PUR: Vienna, VA, 1998).

[52] Goodman, *supra,* 606.

[53] ***State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission of Missouri,*** 116 S.W.3d 680, 690 (Mo. App., W.D. 2003); ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 37 S.W.3d 287, 294 (Mo. App., W.D. 2000) (quoting ***State ex rel. Associated Natural Gas Company v. Public Service Commission,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985)).

[54] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[55] Ex. 115, Hevert direct, pp. 6-7; Ex. 200, *Staff revenue requirement cost of service report,* pp. 19-21; Ex. 550, Gorman direct, p. 11; Ex. 700, Reno direct, p. 2.

two 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.[56]

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.[57]

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. 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.[58]

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

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

[58] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

From these two decisions, three guiding principles can be discerned:

(1) An adequate return is commensurate to the returns realized from other businesses with similar risks. This is the principle of the commensurate return.

(2) An adequate return is sufficient to assure confidence in the financial integrity of the utility and to maintain the utility's credit rating. This is the principle of financial integrity.

(3) An adequate return is sufficient to enable the utility to obtain necessary capital. This is the principle of capital attraction.

The first of these principles is based on risk and unmistakably requires a comparative process. The return on common equity set by the PSC must be about as much as investors would realize from other investments with similar risks.[59] What entities are those? Other public utilities. Financial analysts and investors recognize that every line of business is, by its very nature, subject to a set of unique risks. Consequently, the business entities that face corresponding risks and uncertainties to the utility under consideration are necessarily other utilities engaged in delivering the same service under similar conditions. Therefore, the Commission must look to the returns required from a proxy group of comparable companies in setting the utility's return on common equity.[60]

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[59] ***Hope***, *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted): "By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."

[60] Ex. 115, Hevert direct, p. 9: "Since the ROE is a market-based concept, and KCP&L is not a publicly traded entity, it is necessary to establish a group of comparable publicly-traded companies to serve as its "proxy". Even if the Company were a publicly traded entity, short-term events could bias its market value during a given period of time. A significant benefit of using a proxy group is that it serves to

The second principle, simply stated, refers to the effect of the PSC's decision on the utility's credit rating. If the Commission's decision will not cause it to drop, then the utility's credit is maintained and confidence that the utility will continue in business in the future, meeting its obligations as they come due, providing safe and adequate service to its customers, and yielding a fair return to its shareholders is unimpaired.

The third principle refers to the utility's ability to compete in the marketplace for necessary capital. KCPL competes for capital with other utilities and utilities likewise compete with unregulated businesses.[61]

<u>Proxy Groups</u>

Because the constitution requires a comparative analysis, each of the experts applied well-established financial analytical methods to one or more proxy groups. The goal in constructing these proxy groups is to approximate the profile of KCPL as closely as possible.[62] This is achieved by using comparable companies that are in the same line of business as KCPL and which are perceived by investors as having the same

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moderate the effects of anomalous, temporary events associated with any one company." *Staff Revenue Requirement Cost-of-Service Report,* p. 21*:* "Financial theory holds that the company-specific Discounted Cash Flow ("DCF") method satisfies the constitutional principles inherent in estimating a return consistent with those of companies of comparable risk; however, Staff recognizes that there is also merit in analyzing a comparable group of companies as this approach allows for consideration of industry-wide data. Because Staff believes the cost of equity can be reliably estimated using a comparable group of companies and the Commission has expressed a preference for this approach, Staff relies primarily on its analysis of a comparable group of companies to estimate the cost of equity for KCPL."

[61] Tr. 9:251-52 (Reno).

[62] *Staff revenue requirement cost of service report,* p. 38: "Although Staff has changed its proxy group selection process as compared to the 2012 rate cases, the ultimate goal is the same, which is to select companies whose operations are confined as much as possible to regulated utility operations ("pure-play regulated utilities"/ "pure-play") with a majority of the regulated utility operations being that of the electric utility sector." Ex. 115, Hevert direct, p. 9: "care taken to ensure risk comparability[.]"

degree of risk. The analysts used similar proxy groups and no significant issues emerged concerning the composition of the proxy groups.

Analytical Methods:

> As the Commission has pointed out, because no one financial model is any more “correct” than any other in all circumstances, it is important to consider the results of a variety of methods. * * * The Commission also has found that because ratemaking is an inexact science, and given that there is no statutorily prescribed method to estimate the Cost of Equity, different approaches may be used in different cases. * * * Although doing so requires the use of financial models, determining the Cost of Equity does not always lend itself to a strictly mathematical solution. Rather, it requires the application of reasoned judgment in vetting the models and assumptions used by various analysts, and in assessing the reasonableness of their recommendations.[63]

Two principal methods have emerged for determining the cost of common equity, the "market-determined" approach and the "comparable earnings" approach.[64] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[65] Examples of market-determined methods are the Discounted Cash Flow method ("DCF"), the Capital Asset Pricing Model ("CAPM") and the Risk Premium method.[66] The comparative earnings approach is a comparative method and relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[67] None of the analysts in this case used the comparative earnings approach.

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[63] Ex. 116, Hevert rebuttal, p. 3.

[64] Phillips, *supra,* 394.

[65] *Id.*

[66] *Id.*

[67] *Id.,* at 397.

In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.[68] "If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end."[69] "It is the impact of the rate order which counts; the methodology is not significant."[70] Within a wide range of discretion, the Commission may select the methodology used in ratemaking, including fixing the ROE.[71] The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.[72] It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.[73] "No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use

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[68] ***State ex rel. Arkansas Power & Light Company v. Missouri Public Service Commission,*** 736 S.W.2d 457, 462 (Mo. App., W.D. 1987); ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[69] ***Hope***, *supra,* 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at ___ .

[70] ***State ex rel. GTE North, Inc. v. Public Serv. Commission,*** 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

[71] ***Missouri Gas Energy v. Public Service Commission***, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; ***State ex rel. Associated Natural Gas Company v. Public Service Commission***, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); ***State ex rel. Missouri Public Service Company v. Fraas***, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

[72] ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[73] ***State ex rel. City of Lake Lotawana v. Public Service Commission***, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

different approaches in different cases."[74] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[75]

All of the experts in this case used more-or-less similar models, but their inputs, interpretations and "looking at results in the context of other observable quantifiable measures" differed.[76] Each analyst used variations of the DCF method and the CAPM. Only Ms. Reno did not also use a version of the Risk Premium method.

- **Discounted Cash Flow ("DCF") method:** The DCF method is based on the theory that a stock's current price reflects the present value of all expected future cash flows.[77] In its simplest, "constant growth" form, the DCF is simply the sum of the dividend yield (current dividend/current stock price) and a growth rate.[78] The dividend yield is calculated by dividing the annualized dividend by the current stock price.[79] The selection of a growth rate is critical. The Constant Growth DCF assumes stable growth into perpetuity.[80] Because of the limitations inherent in that assumption,[81]

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[74] ***Arkansas Power & Light,*** *supra,* 736 S.W.2d at 462.

[75] ***Federal Power Commission v. Natural Gas Pipeline Company***, 315 U.S. 575, 586, *62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50* (1942); *see* ***State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,*** 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

[76] Tr. 9:166 (Hevert).

[77] Ex. 115, Hevert direct, p. 15.

[78] Ex. 200, *Staff revenue requirement cost of service report,* p. 42.

[79] *Id.*

[80] Ex. 115, Hevert direct, p. 17; *Staff revenue requirement cost of service report,* p. 43.

[81] Ex. 200*, Staff revenue requirement cost of service report,* p. 44: "The constant-growth DCF model may not yield reliable results if industry and/or economic circumstances cause expected near-term growth rates to be inconsistent with sustainable perpetual growth rates." Gorman Direct, p. 20: "The limitation on the constant growth DCF model is that it cannot reflect a rational expectation that a period of high/low

each analyst also performed a Multi-Stage DCF, in which a different growth rate is specified for each of several stages.[82] "The ability of a multi-stage DCF analysis to reliably estimate the cost of common equity is primarily driven by the analyst using a reasonable growth rate for the final stage because this rate is assumed to last into perpetuity."[83] The terminal stage growth rate is typically not higher than projected GDP[84] and may be as low as the inflation rate.[85] The choice of the terminal stage growth rate is critical.[86]

- **Capital Asset Pricing Model ("CAPM"): "**The CAPM method of analysis is based upon the theory that the market-required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific security."[87] It is a type of risk premium analysis.[88] The CAPM's inputs are the risk-free rate, the market-risk premium, and beta, a coefficient unique to each company that expresses its risk compared to

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short-term growth can be followed by a change in growth to a rate that is more reflective of long-term sustainable growth."

[82] Ex. 550, Gorman direct, p. 21; Ex. 200, *Staff revenue requirement cost of service report,* p. 45.

[83] Ex. 200, *Staff revenue requirement cost of service report,* p. 45.

[84] Ex. 550, Gorman direct, p. 18 "A long-term sustainable growth rate for a utility stock cannot exceed the growth rate of the economy in which it sells its goods and services. Hence, a reasonable proxy for the long-term maximum sustainable growth rate for a utility investment is best proxied by the projected long-term Gross Domestic Product ("GDP")."

[85] Ex. 200, *Staff revenue requirement cost of service report,* p. 45: "[I] in Staff's experience, most DCF analyses do not assume a growth rate much higher than the expected rate of inflation, currently 2.0% to 2.5%."

[86] Ex. 200, *Staff revenue requirement cost of service report,* p. 46.

[87] Ex. 550, Gorman direct, p. 33.

[88] Ex. 115, Hevert direct, p. 25; Reno direct, p. 28.

that of the market as a whole.[89] Because utilities are less risky than the market as a whole, the beta values used by the analysts are less than 1.00.[90]

- **Risk Premium method:** "This approach is based on the basic financial tenet that equity investors bear the residual risk associated with ownership and therefore require a premium over the return they would have earned as a bondholder."[91] The inputs are a debt yield and the equity risk premium.[92]

Analytical Results

The experts' results, and the recommendations based upon those results, are presented graphically in Table Two, below.

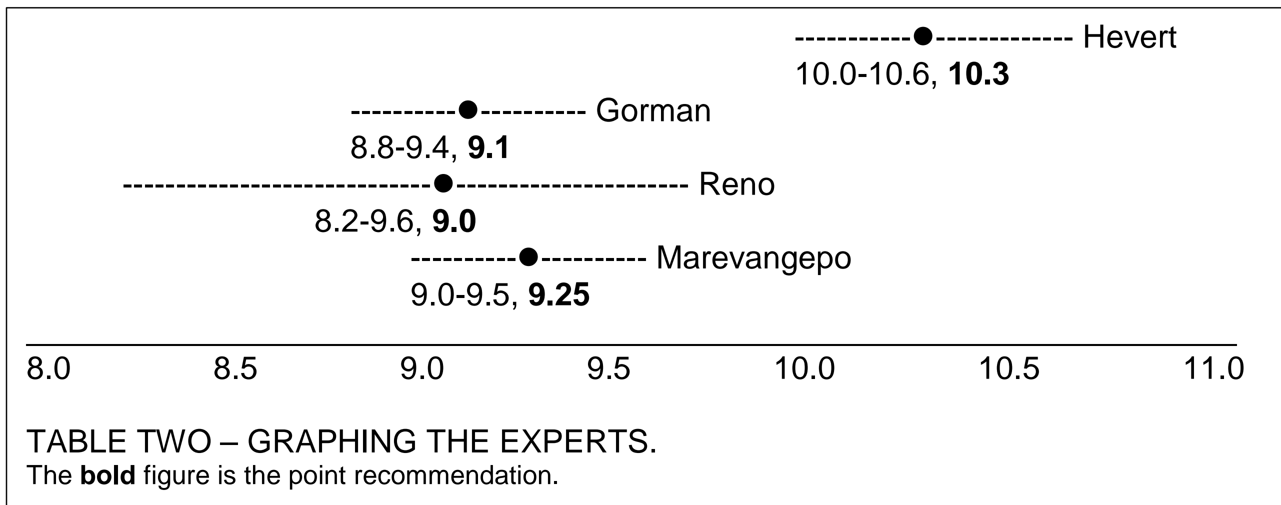

TABLE TWO – GRAPHING THE EXPERTS.
The **bold** figure is the point recommendation.

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[89] Ex. 550, Gorman direct, p. 34; Ex. 115, Hevert direct, pp. 25-26; Ex. 116, Hevert rebuttal, p. 41.

[90] Ex. 116, Hevert rebuttal, p. 89.

[91] Ex. 115, Hevert direct, p. 29.

[92] *Id.*

A glance at Table Two shows that the recommendations of Mr. Marevangepo, Mr. Gorman and Ms. Reno are clustered together at the lower end of the scale; the area of overlap extends from 9.0% to 9.4%. One immediate and obvious conclusion is that the weight of expert opinion favors an allowed ROE at or below 9.4%.

Several of the experts criticized the methods, inputs and results of the others. Mr. Hevert criticized the results obtained by the other experts as too low; Ms. Reno, Mr. Marevangepo and Mr. Gorman criticized Mr. Hevert's results as too high. The specific criticisms made by Ms. Reno, Mr. Marevangepo and Mr. Gorman imply that Mr. Hevert purposely manipulated his analyses to obtain higher results. Mr. Marevangepo stated:

> Constant DCF: While Staff respectfully understands that the equity analysts' projected 5-year compound annual growth rate ("CAGR") in Earnings per Share ("EPS") are meant to provide investors information on companies' near-term growth prospects, Staff opposes Mr. Hevert's assumption that such growth rates represent investors' assumed perpetual growth of utilities' Dividends Per Share ("DPS") in context of a constant-growth DCF analysis. Mr. Hevert's constant-growth DCF method assumes that the initial cash flow (dividend) component will continue to grow at the rate of the equity analysts' projected 5-year CAGR in EPS into perpetuity *–i.e. exceeding the period (5-year timeframe) to which the estimates rightfully apply.* Consequently, the use of equity analysts' projected 5-year CAGR in EPS estimates (5.64% average), *which are usually higher than long run actual earnings (approximately 93%) and also higher than projected nominal Gross Domestic Product ("GDP") projections for the U.S economy (approximately 4.32%)*, **as perpetual growth rates of cash flows for his proxy companies inflated Mr. Hevert's constant-growth DCF results.**[93]
>
> Multi-stage DCF: Mr. Hevert's multi-stage DCF method assumes a perpetual nominal GDP growth rate of 5.65%, which he conveniently based on a historical (1929-2013) real GDP growth rate input of 3.27% and a forward inflation rate input of 2.31%. In his direct testimony,

[93] Ex. 227, Marevangepo rebuttal, pp. 10-11.

Mr. Hevert delicately expressed ignorance of the existence of publicly available long-term forward real GDP projection values. Thus, Mr. Hevert justified the use of historical data for the real rate portion of his inflated projected nominal GDP growth rate. To set the record straight, analyst projections for long-term real GDP rate data exist and are publicly available. The consensus long-term nominal GDP projection, based on projected real GDP and inflation, is approximately 4.32%; and not greater than 5% by any means. Even Mr. Gorman's multi-stage perpetual growth rate of 4.60% acknowledges that the U.S. projected nominal GDP is not greater than 5%. Staff opposes the convenient application of such a mix-and-match approach *(of using historical data and forward projections)* to estimate a forward perpetual nominal GDP especially from a witness who ceaselessly touted throughout his direct testimony the superiority of analysts' earnings growth rate forecasts in predicting stock prices. **Staff, therefore, notes that Mr. Hevert's multi-stage results were conveniently inflated to justify a higher allowed ROE for KCPL.**[94]

CAPM: **Mr. Hevert's CAPM cost of equity results (10.64%-12.09% range) were primarily driven by his unreasonably high and flawed ex-ante *(forward-looking)* market risk premiums (approximately 10.35% on average).** As one may wonder – *How on earth did Mr. Hevert produce such extremely high market risk premiums?* The answer lies in his use of expected returns for the S&P 500 that cannot be corroborated by any reputable investment source. Mr. Hevert's computation of the S&P estimated required market return (i.e., the estimated cost of equity of the entire U.S equity market –as measured by the S&P 500 index companies) was based on Mr. Hevert's irrational assumption that the S&P 500 will achieve capital gains in perpetuity at the same rate as equity analysts' projected 5-year CAGR in EPS. Staff knows of no third-party investment source that estimates market returns in this fashion.[95]

Bond Yield Risk Premium: Mr. Hevert's results were largely driven by his assumption that long-term authorized ROEs represent the market's required returns from the RRA list of regulated electric utilities. As Staff explained earlier, authorized ROEs should not be viewed as synonymous with the market's required returns. **Authorized ROEs are usually higher than the cost of equity mostly due to policy decisions that various commissions in different jurisdictions may choose to adopt. Thus,**

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[94] *Id.,* pp. 11-12.

[95] *Id.,* p. 12.

one may review authorized ROEs for purposes of determining what investors may use to model cash flows, but not for purposes of estimating the market's required returns.[96]

Similarly, Mr. Gorman stated:

> Mr. Hevert's recommended return on equity of 10.30% is overstated and should be rejected. Mr. Hevert's analyses produce excessive results for various reasons, including the following: (1) his constant growth DCF results are based on excessive and unsustainable long-term growth rates; (2) his multi-stage DCF is based on a flawed accelerated dividend cash flow timing, and an inflated Gross Domestic Product ("GDP") growth estimate as a proxy for long-term sustainable growth; (3) his CAPM is based on inflated market risk premiums; and (4) his Bond Yield Plus Risk Premium is based on inflated utility equity risk premiums.[97]

One area where Mr. Hevert's selection of inputs resulting in higher results may be seen is the growth rates used in the various DCF analyses.

	Constant Growth DCF	**Terminal Stage, Multi-Stage DCF**
HEVERT	4.72%-5.32%, 4.35%-5.64%[98]	5.65%[99]
MAREVANGEPO	3.5%-4.5%[100]	3.0%, 4.0%, 4.4%[101]
GORMAN	4.72%, 4.80%, 4.89%[102]	4.60%[103]
RENO	4.50%, 4.61%, 5.27%[104]	4.80%, 5.50%[105]

TABLE THREE – COMPARISON OF ANALYSTS' GROWTH RATES.

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96 *Id.,* pp. 12-13.

97 Ex. 551, Gorman rebuttal, pp. 6-7.

98 Ex. 116, Hevert rebuttal, Sch. RBH-12.

99 Ex. 115, Hevert direct, p. 24.

100 Ex. 200, *Staff revenue requirement cost of service report,* p. 44.

101 *Id.,* pp. 45, 53.

102 Ex. 550, Gorman direct, pp. 17,19-20.

103 *Id.,* p. 26.

104 Ex. 700, Reno Direct, pp. 20, 22.

105 *Id.,* p. 25.

Table Three demonstrates that the analysts' criticisms of Mr. Hevert are correct – the highest values on the table are the growth rates Mr. Hevert used.

For his Constant Growth DCF, Mr. Hevert used eight growth rates with each of two proxy groups, for a total of sixteen growth rates.[106] With the Combined Proxy Group, Mr. Hevert used eight growth rates ranging from 4.72% to 5.32%.[107] With the Revised Proxy Group, Mr. Hevert used eight growth rates ranging from 4.35% to 5.64%.[108] Mr. Hevert's highest growth rates, 5.32% and 5.64%, are *higher* than any of the growth rates used by the other analysts.[109] And, in an exercise of his professional judgment, Mr. Hevert *discarded* the results produced by his low growth rates.[110] Because the result of the Constant Growth DCF is produced by simple addition, the use of a high input *necessarily* results in a high output.

Similarly, Mr. Hevert used 5.65% as the terminal value for his Multi-Stage DCF, which is *higher* than any of the terminal values used by the other analysts. It is 15 basis points higher than Ms. Reno's highest terminal growth rate, 5.50%; it is 125 basis points *higher* than Mr. Marevangepo's highest terminal growth rate, 4.40%; and it is 105 basis points *higher* than Mr. Gorman's terminal growth rate, 4.60%. Again, in both versions of the DCF, high inputs will *always* result in high outputs.

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[106] *See* Sch. RBH-12.

[107] *Id.* Four mean growth rates and four median growth rates.

[108] *Id.*

[109] Ms. Reno used 5.64% as her highest growth rate.

[110] Ex. 700, Reno Direct, p. 3.

The choice of growth rate is critical since the DCF result is simply the sum of the growth rate and the dividend yield. The dividend yield factor, which is calculated by dividing a projected dividend by the stock price, cannot readily be manipulated by analysts. The choice of growth rate, on the other hand, is a matter of expert judgment. As Mr. Gorman testified, "Most of [Mr. Hevert's] DCF return estimates are based on growth rates that are too high to be reasonable estimates of long-term sustainable growth. Therefore, many of his constant growth DCF analyses reflecting analysts' growth are not producing reasonable DCF return estimates."[111]

In the Multi-Stage DCF, the terminal growth rate is the most significant of those used because it projects to perpetuity, that is, forever. Mr. Marevangepo testified, "[I]t is extremely important to select a reasonable growth rate for this stage to arrive at a reliable cost of equity estimate. Cost of equity estimates using multi-stage DCF methodologies are **extremely sensitive** to the assumed perpetual growth rate."[112] The weight of expert opinion suggests that this growth rate should not be higher than the growth expected in the Gross Domestic Product ("GDP"), which is "[t]he value of all finished goods and services produced within a country during a given period of time (usually measured annually) . . . [, including] public and private consumption, government expenditures, investments, and exports less imports."[113] Mr. Hevert

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[111] Ex. 551, Gorman rebuttal, p. 9.

[112] Ex. 200, *Staff revenue requirement cost of service report,* p. 46 (emphasis in the original).

[113] Hevert Direct, p. ii. *See* Gorman Direct, p. 18: "A long-term sustainable growth rate for a utility stock cannot exceed the growth rate of the economy in which it sells its goods and services. Hence, a reasonable proxy for the long-term maximum sustainable growth rate for a utility investment is best proxied by the projected long-term Gross Domestic Product ("GDP"). *Blue Chip Economic Indicators* projects that over the next 5 and 10 years, the U.S. nominal GDP will grow in the range of 4.7% to 4.4%. As such, the average growth rate over the next 10 years is around 4.6%, which I believe is a reasonable

updated his analyses in his rebuttal testimony; although he changed the low end of his range from 10.2 to 10.0, he did not change his point recommendation.[114] He explained his original terminal growth rate as follows:

> The long-term growth rate of 5.65 percent is based on the real GDP growth rate of 3.27 percent from 1929 through 2013, and an inflation rate of 2.31 percent. The GDP growth rate is calculated as the compound growth rate in the chain-weighted GDP for the period from 1929 through 2013. The rate of inflation of 2.31 percent is a compound annual forward rate starting in ten years (i.e., 2024, which is the beginning of the terminal period) and is based on the 30-day average projected inflation based on the spread between yields on long-term nominal Treasury Securities and long-term Treasury Inflation Protected Securities, known as the "TIPS spread."[115]

However impressive Mr. Hevert's explanation appears to be, the fact remains that his terminal growth rate is, in Ms. Reno's words, "a little high."[116] As Mr. Gorman testified, "Because Mr. Hevert's use of a historical real GDP growth rate does not reflect independent consensus economists' outlook for future real GDP growth, his nominal GDP growth rate used as his growth rate in his multi-stage DCF model overstates a reasonable multi-growth DCF return for his proxy group."[117]

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proxy of long-term sustainable growth." Reno Direct, p. 25: "For the final stage including the 11th year to infinity, I apply two growth rates of 19 4.8 percent and 5.50 percent, which represent the long-run growth rate of the 20 economy, adjusted for inflation."

[114] Ex. 116, Hevert rebuttal, p. 2: "In my Direct Testimony I recommended an ROE of 10.30 percent within a range of 10.20 percent to 10.60 percent. Although the range of results for certain models has changed since I filed my Direct Testimony, the capital markets recently have been quite volatile, with quickly increasing interest rates, and rapidly decreasing utility stock prices. On balance, such instability would suggest heightened uncertainty and increasing capital costs. At the same time, I believe that it is appropriate to reflect the revised and updated results in my recommendation and as such, I have reduced the lower bound of my recommended range to 10.00 percent. Accordingly, my revised recommended range is 10.00 percent to 10.60 percent, with a point estimate of 10.30 percent."

[115] Ex. 115, Hevert direct, p. 24.

[116] Tr. 9:247 (Reno).

[117] Ex. 551, Gorman rebuttal, p. 13.

	HEVERT	MAREVANGEPO	GORMAN	RENO
CAPM				
Equity Market Premium	10.24, 10.38	6.20, 4.64	6.20, 7.60, 6.90	8.99, 7.73
RISK PREMIUM METHOD[118]				
Risk Premium	5.64, 6.89, 7.51	3.00, 4.00	4.25, 6.40	N/A
TABLE FOUR – COMPARISON OF CAPM AND RISK PREMIUM INPUTS.[119]				

In addition to the DCF analyses, each of the experts also used the CAPM and all of them except Ms. Reno used the Risk Premium method as well. The CAPM and the Risk Premium methods are similar in that, in each case, an equity market premium or risk premium is added to a bond yield in order to determine the additional return necessary for investors to choose the stock over the bond. Here, the opportunity for manipulation is in the calculation of the equity market premium or risk premium. As was the case with the DCF analyses, Mr. Hevert again selected inputs intended to produce higher results.

Comparing the equity market risk premia used by the experts as depicted in Table Four, Mr. Hevert's are unmistakably the highest values. Mr. Hevert used two equity market risk premia in his updated CAPM analysis, 10.24% and 10.38%.[120] The *lower* of these values is 125 basis points *higher* than the next highest equity market risk premium used by any expert, 8.99% used by Ms. Reno. The average of the equity

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[118] Including Staff's "Rule of Thumb."

[119] Sources: Ex. 116, Hevert rebuttal, Sch's RBH-14, RBH-16, RBH-17; Ex. 200, *Staff revenue requirement cost of service report,* pp. 55, 56; Ex. 550, Gorman direct, pp. 29, 31, 36; Ex. 700, Reno direct, p. 30.

[120] Ex. 116, Hevert rebuttal, Sch's RBH-14, RBH-16.

market risk premia used by the other analysts, as shown in Table Four, is 6.89%; which is 342 basis points *lower* than the average of Mr. Hevert's equity market risk premia, 10.31%. Mr. Gorman observed, "My major concern with Mr. Hevert's CAPM analysis is his inflated market risk premium estimates."[121]

The same observation applies to Mr. Hevert's Risk Premium analyses. He used three risk premia: 5.64%, 6.89% and 7.51%.[122] Again, simple inspection of Table Four reveals that these are the highest values used by any of the experts. The *lowest* risk premium used by Mr. Hevert, 5.64, is 123 basis points *higher* than the average of the risk premia used by Mr. Marevangepo and Mr. Gorman, 4.41%. However, it is *lower* than Mr. Gorman's highest risk premium at 6.40%. However, the average of Mr. Hevert's three risk premia – 6.68% -- is 227 basis points *higher* than the average of the other analysts' risk premia. Mr. Gorman criticized Mr. Hevert's Risk Premium analyses as inaccurate and unreliable.[123]

A fair summary of these observations is that Mr. Hevert consistently used *higher* values for those inputs requiring professional judgment. In other words, where he had a choice, he chose higher rather than lower.[124] The inevitable result is higher outcomes and a higher return recommendation. Mr. Gorman provided an eloquent summary of the results of the experts' analyses in this case: "Indeed, all return on equity witnesses'

[121] Ex. 551, Gorman rebuttal, p. 17.

[122] Table Four..

[123] Ex. 551, Gorman rebuttal, p. 20.

[124] Ex. 552, Gorman surrebuttal, p. 2: "Mr. Hevert's analyses and recommendations are simply based on inflated data and artificially adjusted models – his results are not reliable."

Methodologies in this case, including Mr. Hevert's when corrected, prove that KCPL's current market cost of equity is 9.5% or less."[125]

Benchmarking

One way to look at the experts' recommendations is to compare them to what other utility regulatory commissions are doing around the country.

The first and most important benchmark for consideration, one which was noticeably on the minds of witnesses and counsel at the hearing of this case, is this Commission's recent ROE award to Ameren Missouri: 9.53%.[126] While each case necessarily must be decided on its particular merits and on the evidence presented to the Commission, nonetheless, it would be highly unusual for the Commission to treat KCPL markedly differently from how it treated Ameren Missouri a few months previously. Mr. Gorman testified that while 9.53% was a reasonable result for Ameren Missouri, it would be unreasonably high for KCPL.[127]

Excluding the effect of certain outlier decisions in Virginia, the average allowed electric ROEs were 9.76% in 2014, 9.80% in 2013, and 10.17% in 2012.[128] Mr. Gorman testified that, in calendar year 2014, the industry authorized return on equity for fully litigated cases was 9.63% and, in the first quarter in 2015, it was 9.57%.[129] Mr. Gorman testified that the Commission should consider the ROEs granted by other regulatory

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[125] *Id.*, p. 2.

[126] ***In the Matter of Union Electric Company d/b/a Ameren Missouri,*** Case No. ER-2014-0258 (*Report and Order,* issued April 29, 2015) p. 68; Ex. 227 Marevangepo rebuttal, p. 4..

[127] Tr. 9:293 (Gorman).

[128] Ex. 200, *Staff revenue requirement cost of service report,* pp. 56-57.

[129] Ex. 551, Gorman rebuttal, p. 3; and Sch. MPG-SR-1.

commissions because they provide some information as to what the market generally expects in terms of a balanced regulatory decision.[130] Ms. Reno, similarly, testified that what other commissions across the country do in awarding ROEs is important because it creates expectations.[131] However, she noted that there is a danger of circularity when a commission looks at the ROEs granted by other commissions.[132] All of the experts except Mr. Hevert agreed that awarded ROEs are trending downwards across the country.[133] Since the Federal Reserve, and economists in general, have been cautious about the staying power of the current economic recovery, and consequently a continuation of a low long-term interest rate environment, state public utility commissions have incorporated such cautious expectations and the low opportunity cost of utility stocks in allowed ROEs. As a result, there has been a decreasing trend in the allowed ROEs in recent rate cases, particularly in 2014.[134]

Mr. Gorman provided a good summary of the benchmarking results in this case:

> While commissions have not adjusted authorized returns on equity down to the levels indicated fair and reasonable by market-based models, they clearly are reducing authorized returns on equity to follow the significant decline in capital market costs. Hence, Mr. Hevert's suggestion that the opposing witnesses' return on equity recommendations are deficient is a meritless argument. While commissions generally do adjust authorized returns on equity in a conservative manner, a reasonable finding for a return on equity in this case is conservatively at 9.5% or less.

[130] Tr. 9:296 (Gorman).

[131] Tr. 9:252-53 (Reno).

[132] Tr. 9:253 (Reno).

[133] Tr. 9:189 (Marevangepo); Tr. 9:233 (Reno); Tr. 9:297, 298-99 (Gorman); Ex. 552, Gorman surrebuttal, p. 3.

[134] Ex. 700, Reno direct, p. 31.

In contrast, Mr. Hevert's proposed return on equity of 10.30% is inflated and based on flawed data and models.[135]

Significant Capital Market Changes

Among the things which the Commission must consider in the all-relevant-factor analysis required by statute are economic and capital market conditions as they apply to KCPL.

Staff compared its cost of equity analysis in 2012 to its cost of equity analysis for the 2014 rate case. Staff did so based on two different sets of proxy groups. Staff's analysis in the Staff *Revenue Requirement Cost-of-Service Report* showed that the cost of equity had declined by approximately 90 to 100 basis points since 2012.[136] Due to a contraction in stock prices subsequent to the period Staff analyzed for the Staff Cost of Service Report, Staff updated this analysis and still concluded that the cost of equity had declined by 80 to 90 basis points since 2012.[137] Staff noted that a comparison of Mr. Hevert's multi-stage DCF analyses for the same companies he used in the 2012 Ameren Missouri rate case, Case No. ER-2012-0166, and in the KCPL rate case showed a decline in the cost of equity of 45 to 62 basis points.[138] In fact, due to the significant changes in the capital market data Mr. Hevert reviewed for this case as compared to the most recent Ameren Missouri rate case, Case No. ER-2014-0258 (which was filed only four months earlier than KCPL's rate case), Mr. Hevert has

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[135] Ex. 52, Gorman surrebuttal, pp. 3-4.

[136] *Staff revenue requirement cost of service report,* p. 51

[137] Marevangepo rebuttal, p. 4.

[138] *Id,* p.5.

lowered his ROE recommendation by 10 basis points.[139] Therefore, the capital market data Mr. Hevert reviewed for purposes of the KCPL case actually supports a lower cost of capital than the capital market data he just reviewed for purposes of the Ameren Missouri rate case just four months ago. Additionally, Mr. Hevert's cost of equity estimate for his proxy group of electric utilities in the 2012 Ameren Missouri rate case was 10.50%. For purposes of this case, Mr. Hevert's cost of equity estimate for electric utilities was 10.30%.[140] This supports a reduction of KCPL's allowed ROE of at least 20 basis points based on Mr. Hevert's opinion alone.

Staff witness Marevangepo provided financial data in Table 1 on page 9 of his rebuttal testimony to help explain why an objective application of cost of equity models would imply a significant decline in the cost of equity for electric utilities.[141] The lower dividend yields and higher price-to-earnings ratios are simply due to a decline in long-term interest rates. Mr. Marevangepo provided information that showed that the cost of debt to utilities declined by 83 basis points between 2012 and the most recent six months at the time of his rebuttal.[142]

Additionally, Mr. Gorman testified that there is strong evidence that capital costs are lower now than at the time of KCPL's last rate case.[143] Mr. Gorman explained that his recommendations have trended steadily downwards over the last four years because of changes in capital market costs, including declining bond yields, declining

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[139] *Id,* p. 6.

[140] *Id,* p. 6.

[141] *Id,* p. 9.

[142] *Id,* p. 7.

[143] Tr. 9:258, 265, 300-301 (Gorman).

utility dividend yields, and rising utility stock prices, all of which indicate that the market cost of equity for Missouri utilities has declined significantly since 2011.[144]

More recently, there have been contractions in P/E ratios since January 2015, which means that share prices are declining.[145] In the last six to four weeks, both treasury and corporate bond yields have increased.[146] Janet Yellen, Chair of the Federal Reserve Board, stated, "It will be appropriate at some point this year to take the initial step to raise the federal funds rate target and begin the process of normalizing monetary policy."[147] However, Ms. Reno pointed out that these are not signs that the economy is improving; they are merely market corrections.[148] She stated, "And so we still haven't moved from that low interest rate environment where there are low costs of capital."[149] Ms. Reno testified:

> But what we're seeing here is the Federal Reserve is stepping away from expansionary policy. These are – these are changes to short-term rates. And investors also consider -- in addition to what's going on in the short-term rates, they're also looking at what's going on in long-term rates, and they're making their assessments. And so the short-term variations are different than what investors expect in the long run. As you see in our results, that is my results in the CAPM and the DCF results, which are also in line with other witnesses before you today.[150]

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[144] Tr. 9:279-80 (Gorman).

[145] Tr. 9:211-12 (Marevangepo).

[146] Tr. 9:212 (Marevangepo).

[147] Tr. 9:214 (Marevangepo).

[148] Tr. 9:238 (Reno).

[149] Tr. 9:238 (Reno).

[150] Tr. 9:239 (Reno).

Other Considerations

In this case, KCPL seeks an increase in its retail rates of $120.9 million, an increase of 15.75%.[151] KCPL has 519,000 retail customers, about 275,000 of which are in Missouri. Currently, KCPL collects about $770 million a year from its Missouri customers.

This case is KCPL's sixth general rate case in Missouri since 2006.[152] In 2006, KCPL got a rate increase of 10.46%; in 2007, an increase of 8.4%; in 2009, an increase of 16.1%; in 2010, an increase of 5.23%; and in 2012, an increase of 9.64%.[153] KCPL's cumulative rate increases since 2006 total 60.39%. Adding the present requested increase of 15.75% brings the cumulative total to 85.65%.

88% of KCPL's customers are residential customers and they will bear the brunt of any rate increase that is granted. Residential customers have seen a 60% increase since 2006.[154] Among the factors that the Commission must consider is the economic impact of the proposed rate increase on KCPL's residential customers. The counties that compose KCPL's service area continue to experience challenges in the wake of the Great Recession, 2008 and following.[155] Real gross domestic product growth has been smaller in Missouri than in the United States as a whole since the recession ended.[156]

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[151] Ex. 200, *Staff revenue requirement cost of service report,* pp. 4, 6.

[152] *Id.,* p. 12.

[153] *Id.*

[154] Featherstone surrebuttal, p. 8.

[155] *Id.,* p. 7.

[156] *Id.*

In fact, GDP growth was negative in Missouri in the year 2011.[157] Annual unemployment levels in Missouri are still higher than the pre-recession unemployment levels.[158] The unemployment rates for 2014 show that Missouri unemployment is leveling off near 4.6%, while nationally a downward trajectory is continuing.[159] Missouri is not resolving unemployment as well as the nation as a whole.

The number of jobs in KCPL's service territory peaked in 2008, and it is still below 2004 levels.[160] The current economic outlook suggests that employment, household income, and GDP will improve over the short term.[161] From 2007 to 2013, the counties in the KCPL service area collectively experienced an 11.47% increase in average weekly wages, but this was somewhat lower than the overall Missouri compounded increase in average weekly wages of 11.56%, and it's also about 9.1% below the increase in the Consumer Price Index ("CPI").[162] Thus, wage growth has been less than the increase in the cost of living.

While KCPL's overall rates are below the national average, its cumulative rate increase of 60.39% compares to the national average rate increase of 30% from 2005 to 2014.[163] KCPL's current rates are higher than the regional and state averages.[164] Since 2006, electric rates for residential customers have already increased

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[157] *Id.*

[158] *Id.,* p. 8.

[159] *Id.*

[160] *Id.*

[161] *Id.,* p. 9.

[162] *Id.,* p. 10.

[163] Featherstone surrebuttal, p. 8.

[164] *Id.*

by 60%.[165] From 2007 to 2013, the increase in average weekly wages for the counties in the KCPL service area was less than one-fifth of the increase in electric rates.[166] KCPL has also experienced inflationary pressure illustrated by a 17.84% increase in the Producer Price Index ("PPI") for industrial commodities between 2007 and 2013.[167] However, an increase of 17.84% is obviously much smaller than an increase of 57.69%.

A Comprehensive Suite of Cost-Recovery Mechanisms

KCPL contends that it is substantially under-earning its authorized return on equity.[168] As a cure for what ails it, KCPL seeks a "comprehensive suite of cost-recovery mechanisms" including a Fuel Adjustment Clause ("FAC") and several trackers.[169] These regulatory mechanisms would act to reduce KCPL's investment risk by shifting it to the ratepayers.[170] Consequently, if some or all of these regulatory mechanisms are adopted, the Commission should make a corresponding downward adjustment to KCPL's ROE.[171] Mr. Gorman testified:

> Implementing regulatory mechanisms in this case that reduce the Company's risk going forward will result in a different assessment of the Company's risk than what I used in my study. So my return on equity recommendation reflects the Company's risk -- investment risk as it exists right now. If regulatory mechanisms reduce that risk going forward, then

[165] *Id.*

[166] *Id.*

[167] *Id.*

[168] Tr. 9:209-10 (Marevangepo).

[169] A Moody's Investment Report introduced during the hearing (Ex. 141) explains that investors should not be troubled in the near term by declining awarded ROEs because of "persistently low interest rates and a comprehensive suite of cost recovery mechanisms."

[170] Tr. 9:258-59, 261 (Gorman).

[171] Ex. 551, Gorman rebuttal, p. 5; Tr. 9:195, 225-26, 228, 229-30 (Marevangepo).

> an adjustment to my recommended rate of return would be appropriate, because my recommended rate of return reflects the risk that exists today. If the regulatory mechanisms, again, lower those risks, then a reduced return on equity would be appropriate to recognize the risk reduction created by the implementation of new regulatory mechanisms.[172]

What sort of adjustment should the Commission make? Mr. Gorman testified that the best the Commission can do is to use its independent discretion to determine where within his recommended range a fair return on equity would be in view of the risk reduction.[173] He testified that, if the Commission were to implement an FAC for KCPL, it would be appropriate for the Commission to move towards the lower end of his proposed range; below the mid-point.[174] He pointed out that, in the rate case in which Ameren Missouri implemented the fuel adjustment mechanism, Ameren's own witness, Dr. Roger Morin, stated that implementing a fuel adjustment mechanism at that time would have justified a 25-basis-point reduction to the return on equity.[175] Mr. Gorman stated that he agreed with him on that.[176] Mr. Gorman testified:

> My recommended point estimate of 9.10% is the midpoint of my estimated range of 8.80% to 9.40%. If new rider mechanisms are implemented, the Commission should award a return on equity below 9.10%, but above my low-end estimate of 8.80%. The actual point estimate below the midpoint cannot be precisely measured, however going below the midpoint of the estimated range would be reasonable.[177]

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[172] Tr. 9:259-60, *cf.* 261 (Gorman).

[173] Tr. 9:261-62 (Gorman).

[174] Tr. 9:264 (Gorman).

[175] Tr. 9:292 (Gorman).

[176] *Id.*

[177] Ex. 551, Gorman rebuttal, p. 5.

Conclusion:

Based on all of the foregoing, Staff recommends that the Commission authorize an ROE for KCPL somewhere in the range of 9.0% to 9.5%, midpoint 9.25%, as recommended by Staff expert witness Zephania Marevangepo. Mr. Marevangepo's recommendation is based on direct evidence from the capital markets that clearly shows the cost of capital has declined since KCPL's last rate case. The Commission need not get lost in the weeds of theory and subjective inputs to conclude that the cost of capital for KCPL has declined since 2012. It is no coincidence that the price-to-earnings ratios of electric utilities have been trading at all-time highs at the same time. It isn't even disputed by any of the witnesses that as interest rates decline and utility stock prices increase, this means the cost of equity has declined.

The weight of expert opinion adduced in this case favors an authorized ROE no higher than 9.5%, but the decline in the cost of equity since 2012 is more consistent with authorizing an ROE of 9.25%. This is strongly supported by economic data showing that KCPL's cost of capital has dropped quite significantly, reducing its costs and raising its shareholders' wealth, while its customers continue to struggle in the wake of the Great Recession. Frankly, the people of Missouri deserve better.

The analyses performed by KCPL's expert witness, Robert Hevert, do not pass close scrutiny. In those areas where professional judgment was required, he chose to skew the data in his client's favor. Consistently, Mr. Hevert selected higher inputs rather than lower inputs. His growth rates are too high; his market equity risk premia are too high. Where the results obtained by the other analysts are closely clustered and corroborate one another, Mr. Hevert's are isolated and suspiciously high.

Perhaps these facts are not surprising in view of Mr. Hevert's lucrative practice of providing expert testimony for utility companies across the land.[178]

The Commission must balance the investors' interests against the ratepayers' interests. This issue is the largest single issue in this case and it is the issue where the Commission has the most discretion. That is not an unfettered discretion, however, because the Commission's decision must be supported by substantial evidence of record. As demonstrated by the foregoing, the substantial evidence in this record supports an allowed ROE no higher than 9.5%.

Kevin A. Thompson.

II. Fuel Adjustment Clause

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

Yes, KCPL's fuel adjustment clause request violates the Stipulation and Agreement from Case No. EO-2005-0329, and yes, KCPL's request should be rejected.

On March 28, 2005, KCPL, Staff, the Office of the Public Counsel, and numerous other parties filed a Stipulation and Agreement ("Stipulation") in Case No. EO-2005-0329, which included what was referred to as an "Experimental Regulatory Plan" (the "Regulatory Plan") for KCPL.[179] On July 28, 2005, the Commission issued a Report and Order approving the Regulatory Plan and ordering the signatories (including KCPL) to abide by all of the terms and requirements in the

[178] Robert Hevert, Tr. 9:163 (Hevert).

[179] Ex. 200, p. 189, Staff revenue requirement cost of service report.

Stipulation.[180] As relevant to the issue before the Commission in this case, the Stipulation provides as follows:

> KCPL agrees that, prior to June 1, 2015, it will not seek to utilize any mechanism authorized in current legislation known as "SB 179" or other change in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors. In exchange for this commitment, the Signatory Parties agree that if KCPL proposes an Interim Energy Charge ("IEC") in a general rate case filed before June 1, 2015 in accordance with the following parameters, they will not assert that such proposal constitutes retroactive ratemaking or fails to consider all relevant factors.[181]

As the Commission is aware, this issue involves the interpretation of the sentences of the Stipulation set out above; specifically, whether the first sentence quoted above precludes KCPL from requesting a fuel adjustment clause ("FAC") in a rate case filed before June 1, 2015, as this case was. Staff and almost all other parties to this case believe that the Stipulation precludes KCPL from requesting a FAC in a rate case filed prior to June 1, 2015; KCPL's position in this case is that it could request a FAC in a rate case filed prior to June 1, 2015, as long as the FAC was not made effective until after June 1, 2015.

As the Missouri Supreme Court, en banc, has stated in another case involving a stipulation approved by the Commission:

> A stipulation, like any other settlement agreement, must be construed using ordinary rules of contract construction. A contract must be construed as a whole so as to not render any terms meaningless, and a construction that gives a reasonable meaning to each phrase and clause and

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[180] *In the Matter of a Proposed Regulatory Plan of Kansas City Power & Light Company*, Case No. EO-2005-0329, *Report and Order* issued July 28, 2005.

[181] Ex. 200, p. 190, Staff revenue requirement cost of service report.

> harmonizes all provisions is preferred over a construction that leaves some of the provisions without function or sense.[182]

Applying the rules of construction as set forth by the Supreme Court, to provide meaning to the applicability of the June 1, 2015 date in the Stipulation, both the first and the second sentences of the Stipulation must be read together. One of the "mechanisms" authorized in SB 179 (which is now Section 386.266 RSMo) is an interim energy charge, or IEC. It is significant that the date in both sentences – June 1, 2015 – is the same. The second sentence qualifies the first sentence by allowing KCPL to do something it could not do under the first sentence. If the first sentence meant that KCPL could request a SB 179 mechanism (such as an IEC or a FAC) in a rate case filed before June 1, 2015, as long as that mechanism did not become effective until after June 1, 2015, as now contended by KCPL, then the date in the second sentence would be meaningless. Under KCPL's interpretation, KCPL could have filed for an IEC or a FAC eleven months prior to June 1, 2015, thereby rendering the date in the second sentence meaningless, in violation of the rules of construction as stated by the Supreme Court. Therefore, the first sentence must mean that KCPL is not permitted to request an IEC, a FAC, or any other SB 179 mechanism in a rate case filed before June 1, 2015, while the second sentence creates an exception to that broad prohibition by allowing KCPL to request an IEC (but not a FAC) in a rate case filed before June 1, 2015.[183]

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[182] *State ex rel. Riverside Pipeline Company v. Public Service Commission*, 215 S.W.3d 76, at 84 (Mo. Banc 2007).

[183] Ex. 200, p. 192, Staff revenue requirement cost of service report.

Mr. Featherstone of Staff, who participated in the "countless meetings" which resulted in the Stipulation, testified at the hearing regarding his recollection of the negotiations which led to the Stipulation and his understanding of what the provision in the Stipulation which is at issue in this case meant.[184] He testified that in 2005, when the Stipulation was executed, a FAC was not particularly attractive to KCPL because KCPL had a "great deal of off-system sales" and the fuel clauses which were being structured at the time for other companies flowed-through off-system sales,[185] which benefited ratepayers by serving to reduce the cost of fuel and purchased power. He further testified that it was his interpretation at that time, and that it remains his interpretation today, that the paragraph of the Stipulation in question precluded KCPL from seeking a FAC in a rate case filed prior to June 1, 2015.[186] He explained – consistently with the rules of construction set forth by the Missouri Supreme Court discussed above – that "the two sentences [of the Stipulation paragraph at issue] have to be read in totality."[187] Specifically, he stated the following concerning his understanding of the meaning of the Stipulation paragraph:

> That it was the two sentences have to be read in totality. You have to – the first sentences have to be read in totality. The first sentence tells KCP&L what it cannot get and the second sentence is what it can get. And it's all linked to the June 1, 2015, date. And it was in my view that what we negotiated in this agreement, this contract was that they [KCPL] could not seek or request a fuel clause prior to June 1 of 2015.[188]

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[184] Tr. 16:1388-1392, 1396-1401.

[185] Tr. 16:1400-1401.

[186] Tr. 16:1401.

[187] Tr. 16:1391.

[188] Tr. 16:1391-1392.

Even KCPL has previously recognized, under oath, that the Stipulation precludes KCPL from requesting a FAC prior to June 1, 2015.[189] In Case No. ER-2012-0174, which involved a request by KCPL for an IEC, KCPL witness Mr. Rush stated in his written Direct Testimony (with an affidavit attached) as follows:

> Q: Does the Company have a Fuel Adjustment Clause ("FAC")?
>
> A: No, it does not. Per the Stipulation and Agreement ("Stipulation") approved in 2005 by the Commission in KCP&L's Experimental Regulatory Plan ("Regulatory Plan") docket, Case No. EO-2005-0329, **the Company agreed that it will not seek a FAC prior to June 1, 2015**. However, the Company is not prohibited from requesting an IEC.[190] (emphasis added)

Mr. Rush, as well as counsel for KCPL, made similar statements regarding the Stipulation at the evidentiary hearing in Case No. ER-2012-0174.[191] The Commission should notice that Mr. Rush's testimony from Case No. ER-2012-0174 quoted above did not say that KCPL agreed that it will not **use** a FAC prior to June 1, 2015, or that it could seek a FAC prior to June 1, 2015, **as long as** the FAC was not made effective until after June 1, 2015. He simply testified that "the Company agreed that it will not **seek** a FAC prior to June 1, 2015." (emphasis added) In other words, even KCPL has previously recognized that **seeking** a FAC prior to June 1, 2015, as it has done in this case, is prohibited by the terms of the Stipulation. Mr. Rush's position in this case regarding the Stipulation directly contradicts his testimony in Case No. ER-2012-0174. Although in his rebuttal testimony in this case he unsuccessfully attempts to explain away this

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[189] Ex. 200, p. 192, Staff revenue requirement cost of service report.

[190] Ex. 207, Schedule ND-S2-11 (Surrebuttal Testimony of Natelle Dietrich, Schedule ND-S2, page 11); Ex. 200, pp. 192-193, Staff Report Revenue Requirement Cost of Service.

[191] Ex. 200, p. 193, Staff revenue requirement cost of service report.

contradiction, this direct contradiction should not be surprising, considering that he has previously testified before the Commission that an opinion from the Court of Appeals addressing the FAC of KCPL's sister company GMO did not mean what it clearly said.[192]

Finally, the Commission itself appears to have previously recognized that the Stipulation precludes KCPL from proposing a FAC in a rate case filed prior to June 1, 2015. In its Report and Order approving the Regulatory Plan and ordering the signatories (including KCPL) to abide by all of the terms and requirements in the Stipulation, the Commission stated that "KCPL has agreed that before June 1, 2015*,* it will not seek to use any mechanism authorized in SB 179, enacted this year, or other change in state law that would allow riders or surcharges or changes in rates outside of a general rate case based upon a consideration of less than all relevant factors;" the Commission then went on to recognize that KCPL could "***propose*** **an Interim Energy Charge ("IEC") in a general rate case filed before June 1, 2015**" within certain parameters.[193] (emphasis added)

Simply put, KCPL's fuel adjustment clause request violates the Stipulation and Agreement from Case No. EO-2005-0329 and should be rejected.

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

No, KCPL has not met the criteria previously adopted by the Commission for a fuel adjustment clause ("FAC").

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[192] Ex. 207, p. 2 and Schedule ND-S1.

[193] *In the Matter of a Proposed Regulatory Plan of Kansas City Power & Light Company*, Case No. EO-2005-0329, *Report and Order* issued July 28, 2005, p. 15.

The Commission should first recognize that electrical corporations have no absolute "right" to a FAC. The statute which authorizes fuel adjustment clauses for electrical corporations, § 386.266 RSMo, provides in subsection 4 that:

> The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission ***may*** approve such rate schedules [*i.e.*, fuel adjustment clauses] after considering all relevant factors which may affect the costs or overall rates and charges of the corporation. . . .

(emphasis added). While the Commission is authorized to approve a corporation's request for a FAC it is clearly not required to do so.[194]

While the statute does not provide "specific guidance on when a fuel adjustment clause should be approved,"[195] the Commission has adopted certain criteria for determining when a FAC is appropriate. As stated in the Commission's 2008 *Empire* order:

> The Commission concluded that a cost or revenue change should be tracked and recovered through a fuel adjustment clause ***only if*** that cost or revenue change is:
>
> 1. Substantial enough to have a material impact upon revenue requirements and the financial performance of the business between rate cases;
>
> 2. beyond the control of management, where utility management has ***little influence*** over experienced revenue or cost levels; and

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[194] The Commission has previously recognized that it is not required to approve a FAC; see *In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks – MPS and Aquila Networks – L&P Service Areas,* Case No. ER-2007-0004, *Report and Order* issued May 17, 2007, p. 30.

[195] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company,* Case No. ER-2008-0093, *Report and Order* issued July 30, 2008, p. 35.

3. volatile in amount, causing ***significant swings*** in income and cash flows if not tracked.[196] (emphasis added)

The foregoing criteria are consistent with 4 CSR 23 240.20.090(2)(C) which states:

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

Staff applied the foregoing criteria in its evaluation of KCPL's FAC request and determined that it does not meet at least two of the three criteria set forth in the *Empire* order. KCPL has not shown that the fuel and purchased power costs KCPL is experiencing are beyond KCPL's control, or that they are volatile[197] in amount.[198] The evidence shows that KCPL has highly effective mechanisms in place that optimize its ability to acquire fuel at the best cost possible and for long terms; KCPL employs a staff of experts that administers its purchasing and hedging strategies.[199] In fact, KCPL's own evidence shows that KCPL exercises considerable control over coal price and that coal price volatility is mitigated as a result of that control – coal being KCPL's major fuel

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[196] *In the Matter of The Empire District Electric Company's Tariffs to Increase Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company,* Case No. ER-2008-0093, *Report and Order* issued July 30, 2008, p. 37.

[197] Merriam-Webster Dictionary defines volatile as "likely to change in a very sudden or extreme way." Ex. 209, p. 2.

[198] Ex. 208, p. 2.

[199] Ex. 200, p. 197, Staff revenue requirement cost of service report.

expense.[200] ** ____ . ** [201] KCPL's reliance on natural gas and oil is minimal, which in itself reduces the magnitude of volatility of those fuels.[202]

Another cost KCPL is seeking to include in its proposed FAC is its Southwest Power Pool ("SPP") transmission costs. Although transmission costs may have increased, or be projected to increase, KCPL has failed to provide any evidence showing any sudden or extreme change[203] in costs, whether forecasted or actual, related to transmission costs.[204] In fact, KCPL's own chart shows that the transmission costs which KCPL is seeking to include in its proposed FAC, while rising, are clearly not volatile.[205] Since these costs may be increasing, but are not volatile, there are traditional ratemaking treatments that can be used to address them – such as allowing for an annualization of the costs, recognizing that the costs are increasing and making necessary adjustments to reflect an accurate level of costs going forward – rather than including them in a FAC or other type of tracker mechanism.[206]

In the Commission's most recent electric rate case Report and Order, issued on June 24, 2015, the Commission addressed the FAC of The Empire District Electric Company ("Empire") (which had previously been authorized to use a FAC) and whether

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[200] Ex. 208, pp. 2-4.

[201] Ex. 208, p. 6.

[202] *Id.*

[203] Merriam-Webster Dictionary defines volatile as "likely to change in a very sudden or extreme way." Ex. 209, p. 2.

[204] Ex. 209, p. 3.

[205] Transmission chart on page 11 of the direct testimony of KCPL witness Tim Rush, reproduced in the *Errata to Staff revenue requirement cost of service report*, Ex. 200; see also Ex. 200 p. 199.

[206] Ex. 209, p. 3.

SPP transmission costs and revenues should be included in Empire's FAC.[207] Like KCPL, Empire is a member of the SPP. The Commission's findings regarding the FAC issue begin on page 23 of the Report and Order, and, directly relevant to this case, include the following findings regarding SPP transmission expense on page 25:

> 37. The projected five year SPP related transmission expansion costs are expected to increase, but do not demonstrate volatility.
>
> 38. Empire's Missouri jurisdictional RTO transmission costs are reasonably projected and thus not volatile.[208]

The same is true of KCPL's SPP transmission costs – they "are expected to increase, but do not demonstrate volatility" and "are reasonably projected [*i.e.,* annualized] and thus not volatile."

KCPL has not met the criteria for the Commission to authorize it to have a FAC, and the Commission should not grant KCPL's request for a FAC.

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

No. See discussion under A and B above under the **Fuel Adjustment Clause** heading.

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

If the Commission does *not* authorize KCPL to have a fuel adjustment clause, the Commission does not need to decide any of the remaining "issues" listed under the

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[207] *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Case No. ER-2014-0351, *Report and Order* issued June 24, 2015, p. 23.

[208] *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Case No. ER-2014-0351, *Report and Order* issued June 24, 2015, p. 25.

Fuel Adjustment Clause heading. Otherwise, the following "issues" will need to be decided by the Commission.

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

As discussed above, electrical corporations have no absolute "right" to a FAC. The statute which authorizes fuel adjustment clauses for electrical corporations, § 386.266 RSMo, provides in subsection 4 that:

> The commission shall have the power to approve, modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission ***may*** approve such rate schedules [*i.e.*, fuel adjustment clauses] after considering all relevant factors which may affect the costs or overall rates and charges of the corporation. . . .

(emphasis added). While the Commission is authorized to approve a corporation's request for a FAC it is clearly not required to do so.[209]

Furthermore, subsection 1 of § 386.266 RSMo specifically states in pertinent part that "The commission may, in accordance with existing law, include in such rate schedules [*i.e.*, fuel adjustment clauses] *features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities*." (emphasis added). Indeed, in its *Report and Order* issued on May 17, 2007, in Case No. ER-2007-0004 – where the

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[209] The Commission has previously recognized that it is not required to approve a FAC; see *In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks – MPS and Aquila Networks – L&P Service Areas,* Case No. ER-2007-0004, *Report and Order* issued May 17, 2007, p. 30.

Commission first established the current 95%/5% sharing mechanism for KCPL's sister company GMO (formerly known as Aquila) – the Commission stated on page 54 that:

> The Commission also finds after-the-fact prudence reviews alone are insufficient to assure Aquila [now GMO] will continue to take reasonable steps to keep its fuel and purchased power costs down, and the easiest way to ensure a utility retains the incentive to keep fuel and purchased power costs down is to not allow a 100% pass through of those costs.[210]

If the Commission does authorizes KCPL to have a FAC it should order a 95/5 percent incentive sharing mechanism for KCPL like the other electric utilities in Missouri with FACs have in their FAC.[211] More specifically, the Commission should order a 95/5 percent sharing mechanism, where customers would be responsible for, or receive the benefit of, 95 percent of any deviation in costs and revenues the Commission allows to flow through the FAC as defined in the FAC tariff from the base level set in this case, and KCPL shareholders would have the responsibility for, or receive the benefit of, the remaining 5 percent.[212] As stated earlier, the Commission has previously found the 95/5 percent sharing mechanism to be appropriate for other Missouri electric utilities. For example, in the Commission's Report and Order in Case No. ER-2008-0318, on page 76, the Commission stated:

> AmerenUE's fuel adjustment charge shall include an incentive clause providing that 95 percent of any deviation in fuel and purchased power costs from the base level shall be passed to customers and 5 percent shall be retained by AmerenUE. This incentive clause will give AmerenUE a sufficient opportunity to earn a fair return on equity as required by Section 386.266 and the Hope and Bluefield decisions. At the same time, it will protect AmerenUE's customers by giving the company an incentive

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[210] *Id.* at 54.

[211] Ex. 208, p. 8.

[212] Ex. 200, p. 195; Ex. 202, p. 38; Ex. 208, p. 8.

to be prudent in its decisions by not allowing all costs to simply be passed through to customers.[213]

Allowing KCPL to pass along fuel and purchased power expenses to its customers without having some "skin in the game" might act as a disincentive for KCPL to manage its fuel expense properly.[214] As the Commission previously found in adopting the 95/5 percent sharing mechanism for KCPL's sister company GMO (formerly known as Aquila), "the easiest way to ensure a utility retains the incentive to keep fuel and purchased power costs down is to not allow a 100% pass through of those costs" and "after-the-fact prudence reviews alone are insufficient."[215]

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

The costs and revenues that are to be included in the FAC should obviously be approved by the Commission. Staff would support identifying the costs and revenues to be included by FERC account and subaccount; for example, see Schedule DEE-1 to Ex. 202 and Erratum. However, the costs and revenues to be included in the actual FAC tariff will depend upon the Commission's decision in this case, which will likely

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[213] *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service,* Case No. ER-2008-0318, *Report and Order* issued January 27, 2009, p. 76.

[214] Ex. 208, p. 8.

[215] *In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks – MPS and Aquila Networks – L&P Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks – MPS and Aquila Networks – L&P Service Areas,* Case No. ER-2007-0004, *Report and Order* issued May 17, 2007, p. 54.

cause the need for some revisions to the accounts and subaccounts set forth in Schedule DEE-1.

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

See (ii) above.

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

Based on the Commission's orders in the recent *Ameren Missouri*[216] rate case (ER-2014-0258) and *Empire*[217] rate case (ER-2014-0351), if the Commission authorizes KCPL to have a FAC Staff recommends including a level of transmission expense which represent KCPL's (1) costs to transmit electric power KCPL did not generate to its own load and (2) costs to transmit excess electric power KCPL is selling to third parties to locations outside of SPP.[218] Mr. Dauphinais, who testified on behalf of Missouri Industrial Energy Consumers, calculated the associated level to be 7.3% of relevant transmission expense.[219]

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

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[216] *In the Matter of Union Electric Company, d/b/a Ameren Missouri's Tariff to Increase Its Revenues for Electric Service,* Case No. ER-2014-0258, *Report and Order* issued April 29, 2015, p. 115.

[217] *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Case No. ER-2014-0351, *Report and Order* issued June 24, 2015, p. 28.

[218] Ex. 209, pp. 4-5 and 9-10.

[219] Ex. 557 (Dauphinais rebuttal), pp. 10-14.

No. These costs are of such a nature they should not flow through a FAC.[220] As the Commission recently found in its *Empire* rate case order:

> 36. SPP's Schedule 1A transmission rate is designed to recover costs associated with administration of SPP's Open Access Transmission Tariff and is used by SPP for tariff administration. Schedule 12 transmission costs are those costs allocated by SPP on behalf of FERC to recover FERC administration costs for transmission services. SPP Schedule 1-A (Tariff Administration Service) and SPP Schedule 12 (FERC Assessment Charge) are not fluctuating fuel and purchased power costs, but rather, administrative costs.[221]

Accordingly, these fees should not be included in the FAC if the Commission authorizes KCPL to have a FAC.

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

Staff has not objected to including recognized gains and losses associated with *hedging* in the FAC.[222] However, Staff recommends removing all recognized gains and losses associated with *cross-hedging* activities from the proposed FAC tariff.[223] In KCPL's response to Staff's data request Number 434, KCPL stated[224]:

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[220] Ex. 202, Staff rate design and class cost-of-service report, pp. 40-41.

[221] *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Case No. ER-2014-0351, *Report and Order* issued June 24, 2015, p. 25.

[222] Tr. 18:1612; see also pp. 1599-1601 for discussion of the difference between hedging and cross-hedging.

[223] Ex. 209, pp. 13-14 and Tr. 18:1612.

[224] Ex. 209, pp. 13-14.

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____ ____ ____ ____ ____ ____ ____ ____ ____ ____ ____ ____ ____ ____ . **[225]

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

No, at least not as proposed by KCPL. Accessorial charges, broker commissions, fees and margins are generic terms and should be more specifically defined within the tariff if they are to be included at all.[226] It is Staff's understanding that KCPL no longer uses bio-fuels and if KCPL was to resume the practice of burning bio-fuel, the costs should be recorded to the renewable energy standard so the reference to bio-fuel should be excluded from the tariff and not recovered in a FAC.[227] Staff recommends removing propane as Staff is not aware that KCPL utilizes propane either as a start-up fuel, burn stabilization or environmental control.[228] As for SO_2 amortizations, as stated by Ms. Mantle, "In past rate cases and in the Regulatory Plan, the parties agreed to amortize certain revenues from the sale

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[225] *Id.*

[226] *Id.* at p. 8.

[227] *Id.* In addition, 4 CSR 240-20.100(6)(A)16 provides that "RES [Renewable Energy Standard] compliance costs shall only be recovered through an RESRAM or as part of a general rate proceeding and shall not be considered for cost recovery through an environmental cost recovery mechanism or fuel adjustment clause or interim energy charge."

[228] Ex. 209, p. 8.

of SO_2 allowances over a set number of years resulting in a fixed revenue amount to offset costs. Because it is a fixed amount and it is included in permanent rates, it should not be included in the FAC."[229]

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

Staff takes no position on this issue.

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

Yes. This language[230] is needed to ensure that these specific costs are not sought for recovery through KCPL's FAC if the Commission authorizes KCPL to have a FAC.[231]

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

No. Staff disagrees with the inclusion of "miscellaneous charges" as the term is vague and should be specifically defined with the tariff.[232]

xi. How should OSSR be defined?

OSSR (Off-System Sales Revenues) should be defined as set forth in Schedule DEE-1-3 to Exhibit 202 (Staff's Rate Design & Class Cost-of-Service Report):

OSSR = Revenues from Off-System Sales:
The following revenues or costs reflected in FERC Account Number 447: all revenues from off-system sales. This includes charges and credits

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[229] Ex. 309 (Mantle direct), p. 35.

[230] Ex. 202, p. 37 and erratum, Sch. DEE-1-1.

[231] Ex. 209, p. 8.

[232] *Id.* at p. 9.

> related to the SPP Integrated Marketplace including, energy, ancillary services, revenue sufficiency and neutrality payments and distributions, Over collected losses payments and distributions, TCR and ARR settlements, demand reductions, virtual energy costs, revenues and related fees where the virtual energy transaction is a hedge in support of physical operations related to a generating resource or load, generation/export charges, ancillary services including non- performance and distribution payments and SPP uplift revenues or credits. Off-system sales revenues from full and partial requirements sales to municipalities that are served through bilateral contracts in excess of one year shall be excluded from OSSR component.[233]

Staff contends this terminology more accurately describes the type of revenue that should be included in the FAC than KCPL's proposed language.[234]

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

Although KCPL's recommendation might be appropriate if line losses are proportional to the kWh sales, Staff's witness Mr. Eaves testified that he does not believe line losses between Missouri and Kansas are proportional based on the customer mix (residential v. commercial/industrial).[235] KCPL's Kansas customers are primarily residential, whereas its Missouri customers are more of a mix of residential, commercial and industrial.[236] Typically, a service area comprised of residential customers (Kansas) will experience a higher line loss percentage than a service area with a greater mixture of residential, commercial and industrial customers (Missouri).[237] Therefore, the proposed definition of the "J" component included in Schedule DEE-1-4

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[233] Ex. 202 and erratum, Sch. DEE-1-3.

[234] Ex. 209, p. 10.

[235] *Id.*

[236] *Id.* at 11.

[237] *Id.*

to Exhibit 202 (Staff's Rate Design & Class Cost-of-Service Report) is correct when NSI (Net System Input) is defined as: [Retail Sales (KS+MO) + Sales for Resale + Border Customers + Firm Wholesale + Losses].[238] This definition of NSI should also be included in the FAC tariff if the Commission authorizes KCPL to have a FAC.

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

The rate schedules implementing the FAC should have an amount for the Base Factor when the Commission initially approves them.[239] At the hearing, Mr. Rush of KCPL agreed that a FAC Base Factor must be set in this case, assuming the Commission authorizes KCPL to have a FAC, and that the Base Factor needs to be set forth in the FAC tariff.[240] His only dispute was with including the Base Factor on the FAC "formula" sheet (see Schedule DEE-1-6 to Ex. 202 and Erratum) in addition to including it in the "body" of the FAC tariff, but admitted that KCPL was "not going to make a huge argument about whether it's there [on the formula sheet] or not" and "if you want it there, we would probably do that."[241] The Base Factor should be both in the body of the FAC tariff and on the "formula" sheet, as reflected in Schedule DEE-1-6 to Ex. 202 and Erratum. However, the actual calculation of the Base Factor will need to be modified to reflect the Commission's final decision in this case.[242]

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[238] *Id.*

[239] *Id.*

[240] Tr. 18:1630-1631.

[241] *Id.*

[242] Ex. 209, p. 11.

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

Staff supports two voltage level adjustment factors (primary and secondary) in this case in the event that KCPL is authorized to implement a FAC tariff.[243] Staff also recommends that the Commission order KCPL to include in its line loss study for its next general rate case the information necessary to allow the parties to consider and evaluate if any additional voltage level adjustment factors should be incorporated into the FAC tariff in KCPL's next rate case.[244]

Rule 4 CSR 240-20.090(9) requires an electric utility that desires to implement a Rate Adjustment Mechanism ("RAM"), such as the current request of KCPL to initiate a FAC, to complete a Missouri jurisdictional system loss study. According to the Rule, this study must be conducted within twenty-four months prior to the general rate case in which it requests its initial RAM and thereafter "on a schedule that permits the study to be used in the general rate proceeding necessary for the electric utility to continue to utilize a RAM." KCPL's loss study was provided in KCPL's response to Staff Data Request No. 0172; the study is dated October 29, 2014, and contains system loss calculations/determinations based on data collected during calendar year 2013.[245] Staff used the information in this loss study in developing its recommended primary and

[243] Ex. 200, pp. 200-201.

[244] Ex. 204, p. 3.

[245] Ex. 200, p. 200.

secondary voltage level adjustment factors reflected in Staff's Revenue Requirement Cost of Service Report.[246]

In his rate design direct testimony Mr. Brubaker, testifying on behalf of the Missouri Industrial Energy Consumers (MIEC) and Midwest Energy Consumers' Group (MECG), recommends four voltage level distinctions in the FAC, in the event that KCPL is authorized to implement a FAC tariff. However, KCPL's loss study does not contain applicable data for losses experienced at the substation level, which is one of the voltage level distinctions recommended by Mr. Brubaker; in other words, his analysis is not based on the loss study required by 4 CSR 240-20.090(9) for this very purpose, nor is it based on the same data.[247]

Therefore, for purposes of this case, in the event that KCPL is authorized to implement a FAC tariff, such tariff should contain only two voltage level adjustment factors (primary and secondary). However, the Commission should also order KCPL to include in its line loss study for its next general rate case the information necessary to allow the parties to consider and evaluate if any additional voltage level adjustment factors should be incorporated into the FAC tariff in KCPL's next rate case.[248]

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

Staff has recommended two six-month Accumulation Periods: October through March and April through September, and a twelve-month Recovery Period to

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[246] *Id.* at pp. 200-201.

[247] Ex. 204, pp. 2-3 and Sch. AJB-1.

[248] Ex. 204, p. 3.

commence three months after the close of each Accumulation Period.[249] The details regarding Accumulation Periods, Filing Dates and Recovery Periods are set forth on Schedule DEE-1-1 to Exhibit Number 202, Staff's Rate Design & Class Cost-of-Service Report and Erratum.

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

Staff would support the use of consistent energy allocators.

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

Due to the accelerated Staff review process necessary with FAC adjustment filings, Staff recommends the Commission order KCPL to provide the information listed below to aid the Staff in performing FAC tariff, prudence and true-up reviews;[250] it is Staff's understanding that KCPL has agreed to provide this information[251]:

- As part of the information KCPL submits when it files a tariff modification to change its Fuel and Purchased Power Adjustment rate, include KCPL's calculation of the interest included in the proposed rate;
- Maintain at KCPL's corporate headquarters or at some other mutually-agreed-upon place and make available within a mutually-agreed-upon time for review, a copy of each and every coal and coal transportation, natural gas, fuel oil and nuclear fuel contract KCPL has that is in or was in effect for the previous four years;
- Within 30 days of the effective date of each and every coal and coal transportation, natural gas, fuel oil and nuclear fuel contract KCPL enters into, provide both notice to the Staff of the contract and opportunity to review the contract at KCPL's corporate headquarters or at some other mutually-agreed-upon place;

[249] Ex. 200, p. 195.

[250] Ex. 202, Staff Rate Design and Class Cost-of-Service Report, p. 42.

[251] Ex. 135 p. 17; Tr. 18:1700-1701.

- Provide a copy of each and every KCPL hedging policy that is in effect at the time the tariff changes ordered by the Commission in this rate case go into effect for Staff to retain;
- Within 30 days of any change in a KCPL hedging policy, provide a copy of the changed hedging policy for Staff to retain;
- Provide a copy of KCPL's internal policy for participating in the Southwest Power Pool's Integrated Market;
- Maintain at KCPL's corporate headquarters or at some other mutually-agreed-upon place and make available within a mutually-agreed-upon time for review, a copy of each and every bilateral energy or demand sales/purchase contract;
- If KCPL revises any internal policy for participating in the Southwest Power Pool, within 30 days of that revision, provide a copy of the revised policy with the revisions identified for Staff to retain; and
- The monthly as-burned fuel report supplied by KCPL required by 4 CSR 3.190(1)(B) shall explicitly designate fixed and variable components of the average cost per unit burned including commodity, transportation, emission, tax, fuel blend, and any additional fixed or variable costs associated with the average cost per unit reported (Staff is willing to work with KCPL on the electronic format of this report).[252]

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

KCPL should be allowed to do this only to the extent that the Commission-approved FAC tariff provides for KCPL to do so. In this regard Staff would refer the Commission to Schedule DEE-1 to Staff's Rate Design and Class Cost-of-Service Report[253] which contains redline exemplar tariff sheets with proposed changes to KCPL's proposed FAC tariff sheets, which provides on DEE-1-4 as follows:

> Should FERC require any item covered by components[254] FC, E, PP, TC, OSSR or R to be recorded in an account different than the FERC accounts listed in such components, such items shall nevertheless be included in component FC, E, PP, TC, OSSR or R. In the month that the Company begins to record items in a different account, the Company will

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[252] Ex. 202, Staff rate design and class cost-of-service report, pp. 42-43.

[253] Ex. 202, p. 37 and erratum, Sch. DEE-1.

[254] These components are defined in Sch. DEE-1 to Ex. 202 and erratum.

file with the Commission the previous account number, the new account number and what costs or revenues that flow through the Rider FAC are to be recorded in the account.[255]

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

Staff takes no position on this issue.

Jeffrey A. Keevil.

III. Transmission Fees Expense

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

The appropriate level of transmission expense included in KCPL's cost of service will be determined in the true-up portion of this rate case. The true-up period ending date approved and ordered by the Commission in its *Order Setting Procedural Schedule and Establishing Test Year and Other Procedural Requirements* issued on December 12, 2014, is May 31, 2015. In that same Order, the Commission set August 3, 2015, as the date for filing "Reply *and true-up briefs*." (emphasis added) Accordingly, Staff will address this issue in its Reply and True-up Brief.

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

No; KCPL's transmission fees tracker request should be denied for several reasons, many of which are also applicable to KCPL's other tracker requests in this

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[255] Ex. 202, p. 37 and erratum, Sch. DEE-1-4.

case. Staff addresses the general issue of Tracker Policy elsewhere in this brief and will not repeat that discussion here.

In regard to KCPL's transmission fees tracker request specifically, the Commission should first recognize that KCPL raised this issue for the first time in its rebuttal testimony,[256] in violation of 4 CSR 240-2.130(7) which requires *direct* testimony to include "all testimony and exhibits asserting and explaining that party's entire case-in-chief" and, in a case in which all parties file direct testimony, limits *rebuttal* testimony to "testimony which is responsive to the testimony and exhibits contained in any other party's direct case." Under this Commission rule, a proposal such as a tracker should have been included in KCPL's direct testimony, as were KCPL's proposals for a property tax tracker, a vegetation management tracker, and a cyber-security tracker.[257] This proposal should therefore be rejected.

The Commission has previously considered and denied – not that long ago – a KCPL request for a transmission tracker. In KCPL's last rate case, Case No. ER-2012-0174, both KCPL and its sister company GMO requested a transmission tracker.[258] In its *Report and Order* issued on January 9, 2013, in that case, the Commission stated:

> "Extraordinary" describes matters subject to deferral, and does not apply to transmission cost increases, as discussed below.
>
> * * *
>
> Applicants [KCPL and GMO] have not proved that the transmission cost increases meet [the] standard. The projected transmission cost increases

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[256] See Ex. 223, p. 2.

[257] *Id.*

[258] The GMO case was Case No. ER-2012-0175, and the Commission heard the cases together and issued one Report and Order covering both Case Nos. ER-2012-0174 and ER-2012-0175.

> are not "extraordinary" within the legal definition because they are not rare or current.
>
> "Rare" does not describe cost increases in the utility business generally. Specifically, Applicants' evidence shows the following as to transmission. Transmission is an ordinary and typical, not an abnormal and significantly different, part of Applicants' activities. Also, Applicants showed that paying more for transmission than in the previous year is a foreseeably recurring event, not an unusual and infrequent event. Thus, "items related to the effects of" transmission cost increases are not rare and, therefore, are not extraordinary.[259]

The foregoing is still true, and KCPL's transmission tracker request should again be denied.

A tracker is a deferral mechanism which should only be used as a last resort when other techniques fail to capture an appropriate level of costs in rates for a particular cost of service item. [260] Trackers should only be used for costs which are volatile; for which it is difficult to predict an appropriate level of ongoing costs; and for costs for which there is no historical data on which to base such a prediction.[261] KCPL's transmission costs are ordinary operating costs – normal and recurring costs that are not "extraordinary"[262] and as such should be annualized according to traditional ratemaking principles.[263] The Commission has previously found KCPL's transmission

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[259] *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service,* Case No. ER-2012-0174, *Report and Order* issued January 9, 2013, pp. 30-31.

[260] Ex. 222, p. 3.

[261] *Id.*

[262] Ex. 223, p. 9.

[263] See Ex. 222, p. 3.

cost increases are not extraordinary.[264] The Commission has also recently found that SPP transmission costs "are expected to increase, but do not demonstrate volatility" and "are reasonably projected [*i.e.,* annualized] and thus not volatile."[265] KCPL's transmission tracker request should be denied, as it was in KCPL's last rate case.

Furthermore, trackers should only be used in rare circumstances, since they isolate a specific expense without consideration of other fluctuations in a utility's cost of service; they do not account for any changes in investment, expense, or revenue which could offset the expense being tracked.[266] With its transmission tracker request KCPL is once again attempting to isolate one expense without taking into consideration any change in expense or revenue that may offset future increases in transmission expense.[267] There is evidence that the administrative fees charged to KCPL by SPP will actually decrease in the future, as opposed to increase as suggested by KCPL.[268] Again, KCPL's transmission tracker request should be denied.

In its surrebuttal testimony, KCPL added another request for the first time – in violation of 4 CSR 240-2.130(7) as discussed earlier in regard to its tracker request which was raised for the first time in rebuttal testimony – which appears to be some sort of "subject to refund" rate proposal based solely on forecasted transmission expense,

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[264] *In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service,* Case No. ER-2012-0174, *Report and Order* issued January 9, 2013, pp. 30-31.

[265] *In the Matter of The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area,* Case No. ER-2014-0351, *Report and Order* issued June 24, 2015, p. 25.

[266] Ex. 223, p. 2.

[267] *Id.* at p. 6.

[268] *Id.* at pp. 6-9.

which would increase the cost of service[269] by $5 million subject to refund in the next rate case if the increased costs were less than projected. KCPL provided extremely limited detail regarding this proposal. Since KCPL raised this issue for the first time in surrebuttal testimony, Staff and the other parties were denied the opportunity to respond to it in testimony, or to conduct meaningful discovery regarding the proposal. In any event, this request by KCPL should be denied for a number of reasons, including the same reasons the tracker request should be denied.

In addition, the Commission should be aware that a "subject to refund" rate, without specific statutory authority such as that contained in § 386.266 RSMo which authorized fuel adjustment clauses, is at best of questionable legality – especially one that is "baked into" the base rates, as KCPL's proposal appears to propose. In the *UCCM* case, in which the Missouri Supreme Court found the Commission did not have the statutory authority (at that time, before the enactment of § 386.266 RSMo) to authorize a fuel adjustment clause for recovery of utilities' fuel costs, even though it found the fuel clause to be unlawful the Supreme Court refused to order a refund of the excess amounts collected by the utilities under the FAC.[270] Therefore, recovering any "refund" under KCPL's proposal could prove problematic.

KCPL's request constitutes improper surrebuttal; suffers from the same infirmities from which its tracker request suffers; lacks sufficient detail to even be implemented; and is legally questionable at best. Accordingly, it should be denied.

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[269] Apparently, KCPL would have the Commission determine a "just and reasonable" revenue requirement and then add another $5 million on top of the amount found to be "just and reasonable."

[270] *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission,* 585 S.W.2d 41 (Mo. en banc 1979).

i. Should KCPL get a return on as well as return of the tracked amounts?

Although it is not clear that KCPL has even requested a "return on" amounts tracked pursuant to its requested transmission tracker in its testimony, since it did not even raise the transmission tracker issue until it filed rebuttal testimony and does not appear to address the issue in that testimony, KCPL will undoubtedly want a return on the tracked amounts if it is granted a transmission tracker. This would effectively grant KCPL rate base treatment of these amounts. If the Commission grants KCPL's request for a transmission tracker it should *not* allow a "return on" the tracked amounts; *i.e.,* it should not allow rate base treatment for any portion of these amounts.

Rate base treatment for regulatory assets and liabilities generally applies to costs related to an asset, *i.e.,* a capital addition.[271] For example, in this case, Staff included in rate base the unamortized balances as of December 31, 2014, for the regulatory assets related to Iatan 1 and Iatan 2 Construction Accounting which was authorized in prior cases.[272] KCPL's transmission costs, on the other hand, are ordinary operating costs/expenses and are *not* capital in nature.[273] KCPL should not get a "return on" any of the tracked amounts.

ii. Should KCPL get carrying costs on the tracked amounts?

Although it is not clear that KCPL has even requested carrying costs on the amounts tracked pursuant to its requested transmission tracker in its testimony, since it did not even raise the transmission tracker issue until it filed rebuttal testimony and does

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[271] Ex. 222, p. 14.

[272] *Id.*

[273] Ex. 223, p. 9.

not appear to address the issue in that testimony, KCPL will undoubtedly want carrying costs on the tracked amounts if it is granted a transmission tracker. If the Commission grants KCPL's request for a transmission tracker it should *not* allow carrying costs on the tracked amounts.

In addition to an overall opposition to KCPL's requested transmission tracker, Staff is also opposed to the inclusion of carrying costs in any tracker that might be authorized. Carrying costs are comparable to a return on an investment which is added to a deferred cost to recognize the delay in recovering the cost in rates.[274] In other words, if the Commission granted KCPL's transmission tracker request and allowed KCPL to get carrying costs on the tracked amounts, KCPL customers would ultimately pay more in rates for an expense item that can be determined using normal ratemaking principles.[275] Under such a scenario, all risks relating to the expense would fall on KCPL's customers.[276]

Allowing KCPL to get either a return on and/or carrying costs on amounts tracked pursuant to its requested transmission tracker would result in KCPL's customers paying more than they otherwise would for an expense that can be determined using normal ratemaking principles. The Commission should not allow KCPL to get either.

Jeffrey A. Keevil.

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[274] Ex. 222, p. 13.

[275] *Id.*

[276] *Id.*

IV. Single-Issue Rate Making Mechanisms

KCPL requests several single-issue rate making mechanisms in the current case. Single-issue rate making, in brief, is the process of singling out one item that impacts the revenue requirement such as an expense from a utility's cost of service and allowing it to separately recover those expenses from ratepayers without considering any other items. Missouri's variety of single-issue ratemaking includes customer surcharges or riders that include fuel adjustment mechanisms, expense trackers and accounting authority orders. KCPL requests three expense trackers for cip/cyber security, property taxes, and certain transmission expenses. KCPL also seeks a customer surcharge in the form of a fuel adjustment clause. The particulars of each tracker and the FAC, along with the issue-specific reasons why Staff recommends the Commission not change KCPL's current recovery method for each of these expenses will be addressed later.

Single-issue rate making has been continually found by Missouri courts to be a "radical departure from the usual practice" in which the Commission must consider all relevant factors to make a proper determination for rates. *See* *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (1979).[277] The Supreme Court regards it as retro-active ratemaking:

> to permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established. [*Id.*]

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[277] See also *State ex rel. Public Counsel v. Public Service Com'n of State*, 397 S.W.3d 441 (Mo. Ct. App. 2013), *State ex rel Midwest Gas Users' Ass'n v. Public Service Commission*, 976 S.W.2d 470 (Mo. Ct. App. 1998).

Deviations from Missouri's ratemaking model occur only under limited circumstances, usually promulgated in regulations such as SB 179. However, even under those exceptions to the prohibitions against single-issue rate making, certain criteria must be met to be eligible, and no utility is obligated to include a FAC as part of its tariff, implying these exceptions are neither a right nor a requirement. *See State ex rel Union Elec Co v. Public Service Com'n of State*, 399 S.W.3d 467 (Mo. Ct. App. 2013).

KCPL's proposals for deferral accounting are not justifiable under Commission and Missouri Court precedent and policy. KCPL tries to muddy the water by focusing on the specter of an earnings shortfall, rather than examination of the actual costs proposed to be given tracker treatment. In this regard, KCPL makes two arguments throughout its prefiled testimony, 1) that the Missouri regulatory environment is backwards and broken, and 2) that KCPL is experiencing a "dramatic" earnings shortfall, completely out of the company's control.

KCPL laments the poor regulatory environment as part of its case. KCPL even commissioned a policy paper to persuade the Commission to believe its structure and policies were outdated and illogical. This is simply not true. The Commission's policies and ratemaking practices protect and balance both the interests of ratepayers and utilities, by listening to all parties in rate proceedings, deliberating of the merits of the issues proposed, considering all relevant factors and addressing legitimate needs of the parties. This results in promulgated policies and practices that are fair to all parties.

KCPL's proposed radical departure from these well-developed and well-reasoned Commission policies and practices should be rejected.

One such policy found appropriate by the Commission to reduce the impact of regulatory lag is the use of Missouri's historical test year, which sets rates based on a relationship established between revenues, expenses, rate base and rate of return levels for a utility at a set point in time. Although called a historical test year, historical costs and revenues are used as only a starting point, undergoing normalization, annualization and true up proceedings to grant the utility and ratepayers the most accurate information for establishing the relationship and setting rates. After all adjustment mechanisms are accounted for, the "lag" time between when rates are set and when rates take effect is a mere four months, much shorter than the 27 months KCPL witness Mr. Darrin Ives claims. Mr. Ives also seems to have failed to mention KCPL's concerns with Missouri's model to its own Ms. Melissa Hardesty. Ms. Hardesty seems to undermine not only her request for a property tax tracker, but much of KCPL's argument by stating on page 23 of her rebuttal testimony that the "Commission looks a *[sic]* historical costs to determine the appropriate amount of costs to include in cost of service. It is inappropriate to single out one expense item…"

Both KCPL and Staff annualize and normalize revenues and expenses in developing rate increase recommendations. Through this annualization process, costs like payroll and fuel are included in the cost of service at levels unrelated to actual incurred costs in the test year or for any current 12 month period. As an example, payroll costs are included in the case at the most current point in time through the true-up period – in this case the May 31, 2015 true-up—using the most recent pay

increases and employee levels.[278] Using the most recent information available to develop costs included in the revenue requirement calculation substantially reduces the regulatory lag experienced by KCPL. In the case of the last two rate cases, KCPL reduced its regulatory lag for payroll by reducing the work force after the rate case concluded.

A simple example will illustrate how the annualization process works to ensure the most complete costs are included in the rate case and that those costs have no bearing on the test year levels or even the most recent 12 months of actual costs:

(See table on next page.)

[278] Ex 211, p. 7.

Month No.	Month	Test Year	Update Period	True-Up Period	True-Up Period
1	January	$100,000			
2	February	100,000			
3	March	100,000			
4	April	100,000	$100,000		
5	May	100,000	100,000		
6	June	100,000	100,000		
7	July 10% increase	110,000	110,000	$110,000	$110,000
8	August	110,000	110,000	110,000	110,000
9	September	110,000	220,000 add 10 employees	220,000	220,000
10	October	110,000	220,000	220,000	220,000
11	November	110,000	220,000	220,000	220,000
12	December	110,000	220,000	220,000	220,000
1	January		220,000	220,000	220,000
2	February		220,000	220,000	220,000
3	March		220,000	220,000	
4	April			220,000	220,000
5	May			220,000	220,000
6	June			330,000 add 10 employees	330,000
	Total Actual	$1,260,000	$2,060,000	$2,530,000	$2,530,000
	Total Annualized	$1,320,000	$2,640,000	$3,960,000	$3,960,000
	Adjustment	$60,000	$580,000	$1,430,000	
7	July				275,000 - 5 employees reduction
	After True-up annualized				$3,300,000
	Savings Retained				$660,000

Assumptions: Test Year -- 10 employees at $10,000 each per month- 10% increase month 7 which increase per employee payroll costs to $11,000 each per month

Update period – add 10 employees September of update

True-up period – add 10 employees June (last month of true-up)

After true-up – lose 5 employees- $55,000 per month times 12 months or $660,000 payroll savings after employee reductions which the company keeps until rates change

The above table shows that the annualization using the latest information that occurs in a true-up provides the company with payroll costs representative of those

costs during the time rates are in effect. If a company like KCPL reduces its payroll through a reduction in the work force like that occurred in 2011 and 2013, the company will experience reduced costs compared to those included in rates. When employee levels are reduced, the savings are retained by the company until rates are changed.

Another such policy is the Commission's traditional acceptance of regulatory lag as the best available mechanism to mimic competitive pressures in otherwise monopolistic environment. Regulatory lag is to regulated utilities as competition is to non-regulated competitive enterprises. Regulatory lag, as described by noted economist and utility regulatory expert Dr. Alfred Kahn, rewards utilities for superior performances and penalizes inefficiencies. In competitive markets, buyers and rival industries ensure efficiency and cost control, but in a monopoly that lacks competition and has a captive buyer base, some mechanisms are required to imitate this effect. Regulatory lag is that mechanism. Regulatory lag incentivizes utilities to aggressively control costs, and discourages waste and inefficiencies. KCPL's witness, Dr. Edwin Overcast, argues at first against this view of regulatory lag, claiming "regulatory lag providing incentives is not sound for the reasons discussed"[279] and cites a law review article written in 1980 that concludes regulatory lag is a clumsy, crude tool that functions poorly to promote utility efficiency.[280] Dr. Overcast then proceeds to contradict himself in surrebuttal by claiming "regulatory lag continues to be an effective incentive for a significant portion of costs in rates…".[281]

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[279] Ex. 129, p. 26.

[280] *Id.* at 26.

[281] Ex. 130, , p. 7.

Additionally, considering all relevant factors in determining rates is a tried and true method, endorsed again in the Commission's recent *Report and Order* in Case No. ER-2014-0258. This ensures the matching principle is followed, and that the entire cost and expense booking of the utility is viewed, not just a distorted glimpse of a singled cost.

By tracking one expense, ratepayers' burden increases, without the benefit of even a review for decreasing expenses or increases in revenues elsewhere that will compensate for an increase in one single utility expense. For instance, tracking property taxes as KCPL suggests, would only focused on increases in property taxes, ignoring concurrent reductions in areas such as workforce, where KCPL reduced levels by 140 to 160 employees since the last rate case (a savings of approximately $18.6 million on Missouri basis[282], or the elimination of the nuclear storage fees assessed by the DOE (a savings of $3.5 million on a Missouri basis[283]). KCPL also benefits from the use of the 2012 Great Plains Energy ("GPE") capital structure, which was a more costly higher equity and lower debt ratio in its rate, while the current capital structure is a lower cost ratio of lower equity and higher debt.[284] These reductions in expenses can offset concurrent increases in other expenses, leaving the ratepayer to burden only, if any, the amount KCPL actually experienced as shortfall, instead of the entire tracked amount.

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[282] Ex 211, p. 23.

[283] *Id.* p. 25.

[284] *Id.* p. 21.

Finally, the Commission and Staff do support trackers and other deferral mechanisms in limited circumstances, showing a willingness to address legitimate utility concerns. Automatic expense recovery mechanisms such as trackers and FACs are appropriate only for short periods of time and only when the facts and circumstances surrounding the utility's operating environment support their use, such as extreme expense volatility for a FAC. The Commission has upheld deferral mechanisms outlined in law, such as the MEEIA surcharges or surcharges authorized under SB 179. The Commission also grants exceptions to the prohibition on single-issue rate making, when the criteria outlined in the ER-2012-0174 *Report and Order are met*. There, the Commission found the only authority for a tracker was in General Instruction 7 in the *Uniform System of Accounts*. The Commission evaluates trackers by examining time, effect and rarity. All trackers requested by KCPL do not have a significant impact on revenue, nor are they significantly volatile to make them appropriate for tracker treatment. Increases alone do not make a cost volatile. *See Report and Order* ER-2014-0351. Rarity is another factor examined, and KCPL's proposals fail this prong. Rarity, as the Commission found in ER-2012-0174 *Report and Order* is "unusual, infrequent, not foreseeably recurring, activities abnormal and significantly different from the ordinary and typical", but does not describe cost increases in business usually. Property taxes, transmission expenses and cybersecurity are normal, reoccurring costs of doing business for KCPL.

Policies such as described above contribute to a positively regarded regulatory environment in Missouri. KCPL may claim in this case that Missouri's regulatory methods are ineffective; however, Mr. Bryant, one of KCPL's vice presidents, cited a

constructive regulatory environment in Missouri that allows for supportive cost recovery for the credit rating upgrades for KCPL by Standard & Poor's Rating Services and Moody's.[285] Our current methodology of using all relevant factors and prohibition against single-issue rate making, as well as use of historical test year lead to an environment where Missouri's Regulatory Research Associates ("RRA") ranking is an A/2[286], the same ranking as New York, Oklahoma, and Utah, three states Dr. Overcast, KCPL's hired witness, makes numerous mention to as enlightened models. Kansas, the other state KCPL operates in, also ranks the same as Missouri.[287] Dr. Overcast further testified that almost all utilities today have credit ratings of BBB.[288] If all utilities are giving the same credit rating, then adding a fuel adjustment clause or any of the requested tracker mechanisms are not proven to help make the utility more financial sound, nor grant it easier access to capital. Furthermore, if all state environments, including ones with FACs and trackers or forecasted test years, produced similar credit ratings for their utilities, why is Missouri singled out as an example of outmoded ratemaking? Mechanisms seemed not to matter to Dr. Overcast in the end, as he stated "if you can't earn your allowed return, then that can't be a constructive environment."[289] This simplistic statement fails to consider the myriad other reasons why a company

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[285] Ex. 211, p. 13.

[286] Ex. 212 Sch. CGF-s3 pp. 1-2.

[287] Ex. 129- Modernizing Utility Ratemaking Practices in a Changing Industry, Black and Veatch Project No. 187810, attached as Schedule HEO-2

[288] Tr. 16:1379.

[289] Tr. 16:1357.

cannot earn its authorized ROE, including a depressed economy, abnormal weather, acts of god, or the utility's own ability to manage and control costs.

Although many comparisons were made between Missouri's environment and that of other states, the author of these comparisons who testifies 99%[290] of the time on behalf of utilities, Dr. Overcast, admitted to a startling lack of familiarity with Missouri's legal and Commission driven framework regarding single-issue ratemaking. In fact, he admitted to not examining the underlying statutes, rules or case law for his purported thorough review of ratemaking practices in his expert testimony or "policy" paper.[291] There are several examples were his misunderstanding or ignorance of the Commission's recent prior decisions call into question his designation as an expert on this subject. The most egregious example involves the Commission's *Report and Order* in Case No. ER-2012-0174. In hearing, Dr. Overcast was challenged when he claimed the standard in Missouri was not extraordinary.[292] Dr. Overcast claimed he had consulted Commissions decisions related to AAOs and trackers.[293] He further explained that his understanding of the last KCPL request for a transmission tracker was actually for an AAO, so the extraordinary standard would apply.[294] How he came to this conclusion is unknown, since Dr. Overcast did not read the pleadings, testimony or Order in the case.[295] Another glaring failure to familiarize himself with Commission

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[290] Tr. 16:1350.

[291] Tr. 16:1341.

[292] Tr. 16:1360.

[293] Tr. 16:1360.

[294] Tr. 16:1361.

[295] Tr. 16:1361.

rulings came to light during questions by Commissioner Hall and MECG attorney David Woodsmall. Dr. Overcast tried to downplay KCPL's own admissions by Mr. Bryant that the constructive Missouri environment in Missouri led to upgrades in Moody's rating[296] by first citing gas tracking mechanisms.[297] When Commissioner Hall had to point out the obvious, that KCPL would not be speaking in regards to gas companies, Dr. Overcast then claimed this was in reference to EO-2005-0329, also referred to as the "Regulatory Plan."[298] When later questioned by MECG attorney Mr. Woodsmall, Dr. Overcast admitted he had not read the regulatory plan,[299] could not explain the details of the plan nor what costs were being deferred or recovered today.[300] In fact, Dr. Overcast confused amortizations generally with those that were referred to as Additional Amortizations used to meet certain financial metrics during the construction of Iatan 2 prescribed in the Regulatory Plan.

The Commission should take note that KCPL paid Dr. Overcast ** ___ ** **an hour for his testimony and work on this case. Dr. Overcast on the stand said his rate was ** ___ _ **[301], however, invoices received from KCPL and the Black and Veatch Consulting Contract[302] list his hourly rate as ** ___ . ****

[296] Ex. 211p. 13.

[297] Tr. 16:1356.

[298] Tr. 16:1357.

[299] Tr. 16:1359.

[300] Tr. 16:1359.

[301] Tr. 17:1348.

[302] Ex 226Schedule KM-s8, p. 5.

In surveying the US for policies regarding trackers, KCPL never mentions that no other Missouri utilities are afforded the tracker treatment KCPL requests. KCPL witness Tim Rush in the hearing stated that to his knowledge, no Missouri utility had a property tax tracker, a cybersecurity cost tracker, or standalone trackers for SPP transmission expenses.[303] Mr. Rush also acknowledge that on the effective dates of Ameren and Empire's new tariff sheets, no Missouri utility will have a vegetation management tracker.[304]

The second driving factor in KCPL's proposals of single-issue rate making mechanisms is what they claim is lower than authorized ROEs. Numerous KCPL witnesses mentioned stagnant growth.[305] However, Mr. Jim Shay, Senior Vice President-Finance, and Chief Financial Officer for Great Plains Energy ("GPE") spoke positively about KCPL's growth during a recent earnings call. He cited an increase in actual demand by 0.4%, an increase in industrial segments by 2.3%, and residential segment increase of 0.2%.[306] He noted an increase in numbers of residential and commercial groups, and that declines in use per customer are captured in the throughput disincentive and MEEIA customer bill surcharge.[307] The Missouri environment, and KCPL's returns in generally, where sufficient enough to grant a 21% total shareholder return for shareholders in 2014, as testified by KCPL witness

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[303] Tr. 16:1384-1385

[304] Tr. 16:1384

[305] Ex. 118, p. 8.

[306] Ex 215,p. 20.

[307] *Id.*

and Executive Vice President Scott Heidtbrink.[308] KCPL's Missouri operations, along with GMO, make up 71% of Great Plains retail revenues.[309] In 2013, total shareholder return of 24% placed KCPL in Tier 1 of investor owned utilities, compared to a 13% return for the Edison Electric Institute Index.[310] Mr. Shay communicated an expected growth of four to six percent in dividends and earnings due to a growing service territory and solid cash flows during a November 4th, 2014 GPE Board of Directors meeting.[311] KCPL's earned ROE in Missouri has been sufficient to attract capital and make KCPL a safe investment choice. Although making claims about a riskier environment in Missouri, Dr. Overcast admitted that KCPL is not having trouble accessing capital.[312] In fact, KCPL accessed capital markets to finance the construction of Iatan 2 and the environmental upgrades at Iatan 1 and La Cygne 1 and 2. Furthermore, since 2011 KCPL reduced its debt cost significantly.[313] The table below, reproduced from Mr. Featherstone's rebuttal testimony and created from data requested completed by KCPL, show refinancing that resulted in $11.8 million in savings on a total company basis, an amount through regulatory lag that KCPL benefits from, since the higher original interest rates are included in existing rates.[314]

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[308] Tr. 16:1311

[309] Ex. 211, p. 15.

[310] *Id.* at 21.

[311] *Id.* at 16.

[312] Tr. 16:1389

[313] Ex. 211p. 16.

[314] *Id.* at 17.

Type of Debt	Amount of Debt- original interest rate	Maturing	Refinanced/ Remarketed & interest rate	Annual Interest Savings	Savings since 2013 to Sept 2015—assume two full years	KCPL Missouri Share-
Series 1992 EIRR bonds	$31 million at 5.25%	2017	2013- remarketed at 1.25%	$1,240,000		
Series 1993A bonds	$40 million at 5.25%	2023	2013- remarketed at 2.95%	920,000		
Series 1993B bonds	$39.5 million at 5.00%	2023	2013- remarketed at 2.95%	809,750		
Series 2007B bonds	$73.25 million at 5.375%	2035	2013- remarketed at 0.753%	3,385,615		
Series 2007A bonds	$73.25 million at 5% and 5.125%	2035	2013- remarketed at 0.753%	3,189,990		
Series 2008 State EIERA	$23.4 million at 4.90%	2038	2013- remarketed at 2.875%	473,850		
Interest Costs Savings				**$10,019,205**	**$20,038,410**	**$10,620,357**
Senior Note	$150 million at 6.50%		2011- refinanced at 5.30%	$1,800,000		
TOTAL				**$11,819,205**		

Source: Ex Staff-211, Rebuttal Testimony of Cary G. Featherstone, pg. 17

The Commission granted a ROE of 9.7% in ER-2012-0174. KCPL may not have earned 9.7%, but there is evidence the earning shortage is not as large as KCPL claims. Four different Missouri equity returns have been reported to Staff as of this date. KCPL reported a 5.50% in the 2014 KCPL Cost of Service Model, a 5.69% in their Missouri Energy Efficiency Investment Act Reporting, a 5.9% in Mr. Rush's rebuttal[315]

[315] Ex 212 p. 52.

(later in hearings, KCPL corrected this return to the 5.69%) and a 6.1% in the annual surveillance report.[316] This is an increase of 60 basis points. Staff witness Cary Featherstone noted attempts at distortion in his filed testimony. KCPL operates in two states, Kansas and Missouri. Mr. Featherstone notes that incorrect allocations in the jurisdiction distort actual earned returns based on KCPL's Missouri operations, artificially decreasing them.[317] KCPL used a 2013 demand allocation factor for ROE calculation to artificially reduce Missouri's 2014 results, when the 2014 demand factor is the appropriate choice.[318] This overstates costs allocated to Missouri, which in turns causes the ROE to be understated, which Mr. Featherstone notes makes for a more favorable presentation supporting the position it cannot earn authorized returns.[319] Mr. Featherstone uses a prior manipulation attempted by KCPL in 2005 to demonstrate how small changes in demand allocation factors can cause significant ROE impacts. In ER-2006-0314, a difference of 0.4714% in demand factor caused a 1.007% change in ROE.[320] KCPL also failed to remove an abnormal June 2013 result in the ROE calculation for 2013, although it was so abnormal that it was removed from the rate case and replaced with June 2014.[321]

KCPL does seem to be experiencing some difficulties earning its authorized ROE, even if the gap is smaller than KCPL claims. The Commission should note that

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[316] Tr. 16:1389

[317] Ex. 212, p. 40.

[318] *Id.* at 50.

[319] *Id.*

[320] *Id.* at 53.

[321] *Id.* at 51.

earned ROE is profit for shareholders and KCPL, above their cost of doing business. Despite implications otherwise, KCPL is well able to cover all expenses. Staff witness Charles Hyneman gave a detailed examination of KCPL's past earnings as a result of shareholder beneficial regulatory lag, and came to the conclusion that in light of the extremely high ROEs earned; the slighter lower than authorized ROEs are reasonable in the context of the poor performance of the national economy since 2008. In this analysis, Mr. Hyneman analyzed the nearly twenty year period, from 1986 to 2005, where KCPL did not pursue a rate increase. Due to a declining rate base, customer growth, and strong off system sales, among other factors, KCPL earned above the national authorized ROE for this twenty year period.[322] Below is a table reproduced from Mr. Hyneman's rebuttal testimony, showing KCPL ROEs and the nationally authorized ROE as reported by RRA.

(See table on next page.)

[322] Ex. 215, p. 21.

YEAR	KCPL ROE Form 10-K	RRA Electric Utility Authorized ROE
1993	12.0%	11.4%
1994	11.7%	11.3%
1995	13.6%	11.6%
1996	11.6%	11.4%
1997	8.0%	11.4%
1998	13.3%	11.7%
1999	8.8%	10.8%
2000	18.2%	11.4%
2001	12.9%	11.1%
2002	12.9%	11.2%
2003	15.7%	11.0%
2004	17.0%	10.8%
2005	12.9%	10.5%
2006	13.0%	10.4%
2007	11.3%	10.4%
2008	8.5%	10.5%
2009	7.9%	10.5%
2010	8.4%	10.3%
2011	6.8%	10.3%
2012	6.9%	10.2%
2013	8.1%	10.0%
2014	7.5%	10.0%
Avg	11.2%	10.8%

Source: Ex Staff-215, Rebuttal Testimony of Charles Hyneman, pg. 11

This table shows that until the economic crash in 2008, KCPL earned over the national average ROE for nearly 15 years straight.[323] Mr. Hyneman notes that KCPL must have found its over-average earnings reasonable, because it did not seek rate relief.[324] Mr. Hyneman compares the average KCPL's earnings exceeded the averaged authorized ROE, by 339 basis points ("bps"), to the current negative deviations from

[323] Ex. 215, p. 12.

[324] *Id.* at 15.

average authorized ROE of 253 bps.[325] Mr. Hyneman draws the conclusion that if KCPL's acceptance of high positive deviations in ROE that benefited shareholders for twenty years showed a belief in the reasonableness of those returns, that a lower negative deviation for a significantly shorter time period must also be accepted as reasonable.[326] It should be noted that KCPL did not request any tracking mechanisms in the period from 1986 to 2006, when it experienced beneficial regulatory lag, to protect ratepayers. It only requested such mechanisms when experienced slightly lower ROEs to protect shareholders, circumventing the symmetrical nature of regulatory lag.

KCPL tried to undermine Mr. Hyneman's data in two ways. First they tried to undermine the source of his data, the Form 10-K, filed by KCPL with the Securities and Exchange Commission ("SEC") every year. SEC Form 10-K are significant to KCPL, these are the primary numbers investors look at[327], which if KCPL is concerned about attracting capital working in Missouri's environment, it seems sensible to look at the numbers investors look to in forming their opinions. Mr. Hyneman testified he tried to request ROEs for the period of 1986 to 2005 in a data request, however, KCPL claimed they did not calculate them for that period.[328] KCPL instead proposed using surveillance reports, and continued criticizing Mr. Hyneman's refusal to use them during hearing.[329] Mr. Hyneman testified to several reasons why annual surveillance reports are not a reliable source of information. Surveillance reports do not go through the mechanisms

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[325] *Id.*

[326] *Id.*

[327] Tr. 16:1456

[328] Tr. 16:1456

[329] Tr. 16:1456

usually seen in a rate case, such as normalization, annualization or adjustments for any reoccurring events. [330] Mr. Hyneman also noted that a $7 million dollar stock compensation charge was included in their 2014 surveillance report, a number that artificially decreases ROE, as this $7 million is not considered in cost of service expenses.[331] Mr. Hyneman is also following Commission example by giving surveillance reports limited value. In *Noranda Aluminum, Inc., et al. v. Union Electric Company,* File No. EC-2014-0223, the Commission found that:

> It is important to understand that the earnings levels reported in the surveillance reports are actual per book earnings of the utility and cannot be compared directly to an authorized return on equity to determine whether a utility is overearning. Actual per book earnings are often computed differently than earnings used for the purpose of establishing rates. When setting rates, the Commission looks at "normal" levels of ongoing revenues and expenses, while book earnings can be affected by abnormal, non-recurring and extraordinary events. A good example of this is the weather.

The Commission found that unadjusted per-book surveillance reports are not sufficient to establish a utility was over-earning in ER-2014-0358, reason dictates that unadjusted per-book surveillance reports are not sufficient to establish under-earnings or justify use of extraordinary rate mechanisms either.

Mr. Ives also tries to undermine Mr. Hyneman by stating KCPL never earned its authorized return on equity in any year from 1993 to 2006.[332] KCPL had an authorized ROE of 15% set in a case prior to 1993 in Case No. EO-85-185—the Wolf Creek rate case, but Mr. Hyneman testified that in his expert opinion and experience, that the Commission would not have found a 15% return to be a reasonable one during that

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[330] Tr. 16:1457

[331] Tr. 16:1457

[332] Tr. 16:1325

period.[333] Mr. Ives testified that KCPL did not file for rate relief in this period[334], which is the procedural step a company takes when it feels it is under-earning. Mr. Ives also admitted that KCPL had five rate reductions during this period[335], shown below in a table reproduced from Mr. Hyneman's rebuttal testimony.

KCPL MO Percentage Rate Decrease	Effective Date
2.67	January 1994
2.00	July 1996
2.5	January 1997
3.2	March 1999

Source: Ex Staff-215, Rebuttal Testimony of Charles Hyneman

In fact, a review of orders issued by the Commission in four rate cases for four separate electric utilities show the levels of ROEs authorized during the period KCPL did not file rate cases:

(See table on next page.)

[333] Tr. 16:1460

[334] Tr. 16:1325

[335] Tr. 16:1325

Utility	Case No.	Equity Rate of Return	Reference
UtiliCorp United Inc. Missouri Public Service	ER-90-101	12.84%	1990 General Rate Case[336]
St. Joseph Light & Power Company	ER-93-41 & EC-93-252	11.67%	1993 General Rate Case[337]
Union Electric (Ameren Missouri)	ER-87-114	12.01%	1987 General Rate Case [338]
Empire District Electric	ER-2001-299	10%	2001 General Rate Case[339]

Clearly, KCPL would not have received a 15% ROE after the 1986 Wolf Creek rate case. Compared to the above ROEs authorized by the Commission, KCPL earned in excess of the above equity returns during much of the 1990s up through the time it started filing rate cases as part of the Regulatory Plan.

KCPL blames Missouri policies for its inability to earn its rate of return, but does no introspection into internal causes. The Commission should take notice that KCPL has the highest administrative and general costs ("A&G") of any Missouri utility.[340] KCPL incurs A&G costs at $302.53 a customer, the highest per customer cost of any Missouri electric utility.[341] Staff witness Keith Majors noted that for every dollar in revenue KCPL receives, a large portion of that dollar goes to A&G costs than the other

[336] UtiliCorp United 1990 rate case decided by the Commission October 5, 1990 30 Mo. P.S.C. (N.S.) 357.

[337] St. Joseph Light & Power rate case decided by the Commission June 25, 1993, 2 Mo. P.S.C. 3d 255.

[338] Union Electric 1987 rate case decided by the Commission December 21, 1987, 29 Mo. P.S.C. (N.S.) 339.

[339] The Empire District Electric Company rate case decided by the Commission September 20, 2001, 10 Mo. P.S.C. 3d 474.

[340] Ex 200, p. 234.

[341] *Id.* at p. 238.

comparable utilities in the study.[342] KCPL blames transmission costs, fuel costs, property taxes and every other cost, except A&G for their inability to earn their authorized ROE. However, KCPL has a larger A&G expense compared to all other operating expenses, including fuel and maintenance.[343]

In conclusion, Staff recommends the Commission heed its findings in the *Report and Order* recently filed in the Ameren rate case.[344]

> The Commission sets rates in a forward looking process using a test year to evaluate the amount of revenue the utility needs to earn to recover its costs and to have a reasonable opportunity to earn a profit. **The utility is not guaranteed a profit, just an opportunity to earn that profit**. Sometimes, circumstances make it difficult for the utility to earn that profit. Perhaps the summer is cooler than normal and people do not use their air conditioners so the utility does not sell as much electricity as anticipated. Or, perhaps, a generating plant goes down, resulting in unanticipated capital expenditures for the utility. Sometimes, circumstances favor the utility and it is able to earn more revenue than was anticipated when its rates were set. Whether the utility earns more or less revenue than was anticipated when the Commission set its rates does not necessarily indicate over- or under-earnings such that the utility's rate are no longer just and reasonable, though that can be one relevant factor of many to consider when setting new rates. Thus, in most cases, mention of over- or under-earnings is just a shorthand way of discussing whether the Commission should examine a utility's existing rates to determine if they are still just and reasonable.[345] [emphasis added]
>
> The Commission only sets the rates that Ameren Missouri, or any other utility, may charge its customers. It does not determine a maximum or minimum return the utility may earn from those rates. Sometimes, the established rate will allow the utility to more than was anticipated when the rate was established. Sometimes, the utility will earn less than anticipated. But the rate remains in effect until it is changed by the Commission, and so long as the utility has

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[342] *Id.*

[343] *Id.* at 239.

[344] In the Matter of Union Electric Company d/b/a Ameren's Missouri's Tariff to Increase Its Revenue for Electric Service, Case No. ER-2014-0238.

[345] *Id.* at 32.

> charged the authorized rate, it cannot be made to refund any "over-earnings," nor can it be allowed to collect any "under-earnings" from its customers.
>
> **The practice of setting future rates to adjust for past earning levels is condemned as retroactive ratemaking that would deprive either the utility or its customers of their property without due process**.[346] [emphasis added]

KCPL is not guaranteed a profit, just an opportunity to earn that profit. Extraordinary rate making mechanisms like KCPL is requesting in this case, should not be driven by a utility's fear of inadequate shareholder returns or even past lower than authorized ROEs, but only by substantive analysis of the issues themselves.

Staff recommends that KCPL's proposals for a FAC and the various trackers be denied for the general policy reasons outlined above, and for individual reasons described in detail below. If KCPL looks at its earnings and finds it is not earning what it believes it should, it can begin the rate review process.[347] The Commission should note granting trackers has no bearing on the frequency of rate cases, as KCPL suggests. Ameren has a fuel clause and in the past had many different trackers but files frequent rate cases as the Commission is all too familiar. Furthermore, if an expense is so significant that it impacts revenues as KCPL claimed in their opening statement[348], then KCPL would need to file rate cases to recover the tracked amounts, since just tracking an amount alone would not solve any revenue short falls. If KCPL is granted any of these items,

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[346] *Id.* at 30-34.

[347] *Id.* at 32.

[348] Tr. 16:1247

then Staff recommends a reduction in the authorized ROE, to balance the reduction in corporate risk KCPL faces.

Nicole Mers.

IV. Property Tax Expense

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

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

i. Should KCPL get a return on as well as return of the tracked amounts?

ii. Should KCPL get carrying costs on the tracked amounts?

Introduction:

The issue of property tax expense is twofold: first, as in many cases, the question is what level of property tax expense the Commission should recognize in KCPL's revenue requirement. The second part of the issue involves whether a tracker should be utilized for KCPL's property tax expense. Staff has never recommended the use of a tracker for property tax expense and continues to recommend in this case the denial of a property tax tracker. However, in the event that the Commission does choose to implement a property tax tracker, two more issues arise. Should KCPL get a return *on* the tracked amounts in rate base? Should KCPL get carrying costs on the tracked amounts? Staff's position is "no" to both. KCPL should not be able to get a return on a normal operating expense, as though these were invested funds, and customers should not be required to pay more for an expense that can be determined using normal ratemaking principles.

A. What amount of property tax should be recognized in KCPL's revenue requirement?

Staff's recommended treatment of property tax expense in this case is to annualize property tax expenses based upon property in-service on January 1, 2015,[349] multiplying this amount by a ratio derived from historical tax payments.[350] Staff applied a property tax ratio based on actual 2014 property tax payments divided by January 1, 2014, taxable plant.[351] Both Staff and KCPL calculate property tax expense by applying the tax rate paid for the previous year to the property owned at the start of the current year.[352] KCPL's expert witness, Melissa Hardesty, admitted that she calculated the annualized level of property tax using the same method as Staff.[353]

Tax bills for each year are assessed on the property KCPL owns on January 1 of that calendar year.[354] The taxes are typically not due to the taxing authorities until December 31 of the same year.[355] Staff recommends using the annualized property tax method of calculation as providing the best available information, since it relies on the actual January 1, 2015, balance of KCPL's property and uses the most recent, known tax rate (2014), without attempting to estimate or project any change in the rate of taxation that is not known as of the update period or the true up date in this case.[356]

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[349] *Staff revenue requirement cost of service report,* p. 128.

[350] *Staff revenue requirement cost of service report,* p. 128; Tr. 18:1818-19.

[351] *Staff revenue requirement cost of service report,* p. 128; Ex. 222, Lyons rebuttal, p. 7.

[352] *Staff revenue requirement cost of service report,* p. 129; Tr. 18:1818.

[353] Tr. 18:1817.

[354] *Staff revenue requirement cost of service report,* p. 128.

[355] *Id.*

[356] *Id. at* p. 129.

In surrebuttal, for the first time, KCPL recommends an increase to Staff's annualized property expense based on an arbitrary forecast of property tax expense. First, Staff notes that this was improper surrebuttal because it should have been included in KCPL's direct case.[357] Second, Staff contends that KCPL's forecasted property tax expense is significantly overstated and, therefore, should not be used to annualize KCPL's property taxes.[358] Additionally, it improperly includes capitalized property tax associated with utility plant that is still under construction and not yet used for service.[359]

Staff's approach is consistent with that taken previously[360] and it has received several favorable rulings from the Commission in prior rate cases. Property tax costs, like transmission, vegetation management and cyber security costs, are known and measurable, normal day-to-day operating costs for which Staff can determine a level of ongoing expense to be included in KCPL's cost of service using historical costs and ratemaking principles, such as normalizations and annualizations.

B. Should the Commission grant KCPL a Property Tax Tracker?

No, the Commission should not grant KCPL a Property Tax Tracker. Trackers should only be used for costs that are volatile, difficult to predict, and for which there is no historical data on which to base a prediction.[361] Trackers should be rarely used,

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[357] Commission Rule 4 CSR 240-2.130(7)(D),"Surrebuttal testimony shall be limited to material which is responsive to matters raised in another party's rebuttal testimony."

[358] Ex. 223, Lyons surrebuttal, pp. 26-27 (HC); Tr. 18:1820.

[359] Tr. 18:1816, 1819-20.

[360] Tr. 18:1819.

[361] Ex. 222, Lyons rebuttal, pp. 7-8; Ex. 236, Oligschlaeger surrebuttal, p. 2.

limited to circumstances in which it is extremely difficult to identify an appropriate level of costs to be included in rates.[362] Property taxes are normal operating costs that will continue to occur every year and an annualized level to include in rates can be easily calculated.[363] A tracker is an appropriate regulatory device for some situations, which do not include property taxes due to their predictable and recurring nature.[364] Additionally, trackers by their nature reduce KCPL's incentive to operate efficiently.[365]

Staff recognizes that property taxes have increased; however, the use of a tracker is not justified simply because a specific cost has increased.[366] A variety of factors can impact property tax expenses. Among other things, many plant additions over the past several years have led to an increase in property taxes.[367] Staff has reflected the increase in property taxes in rates in previous KCPL rate cases, as well as in this rate case.[368] KCPL predicts that property taxes will continue to rise, but it provides no analysis to justify this assertion.[369] Historical increases in property taxes do not necessarily lead to increased property taxes in the future.[370]

By requesting a tracker, KCPL is requesting to recover a specific expense that can be reasonably calculated, without taking into consideration all increases or

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[362] Ex. 222, Lyons rebuttal, pp. 7-8; Ex. 223, Lyons surrebuttal, pp. 23, 24; Ex. 236, Oligschlaeger surrebuttal, p. 2.

[363] Ex. 223, Lyons surrebuttal, p. 24.

[364] Ex. 223, Lyons surrebuttal, p. 24.

[365] Tr. 18:1827-8.

[366] Ex. 222, Lyons rebuttal, p. 6; Ex. 223, Lyons surrebuttal, p. 23.

[367] Ex. 222, Lyons rebuttal, pp. 8, 9.

[368] *Id.* at p. 9.

[369] *Id.* at p. 11.

[370] *Id.*

decreases of KCPL's other expenses and revenues.[371] KCPL is quick to point out when costs are increasing and the effect that the cost increases have on their earnings but does not address any cost decreases.[372] For example, KCPL has reduced its employee workforce and has discontinued incentive compensation for union employees, both of which actions resulted in significant cost reductions that would offset a portion of the increase in property taxes.[373]

Staff's method of calculating an annualized level of property taxes accounts for actual property tax rates and for plant additions that have contributed to the increase in KCPL's property tax expense. The use of a tracker does not take into consideration any cost reductions that can offset increased property tax costs.[374] A property tax tracker would cause an inconsistency with the investment, revenue, and expense relationship.[375] The amounts determined through traditional ratemaking principles are intended to match the relationship with KCPL's investment, revenue, and expense and anticipate that the same relationship will continue in the foreseeable future.[376]

No utilities, including KCPL, currently have a property tax tracker in Missouri.[377] Circumstances for KCPL do not make it so difficult to identify an appropriate level of property tax costs that a tracker would be necessary. In the event KCPL determines it

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[371] *Id.* at p. 8.

[372] Ex. 223, Lyons surrebuttal, p. 24.

[373] Ex. 223, Lyons surrebuttal, p. 25.

[374] Ex. 222, Lyons rebuttal, p. 12.

[375] *Id.* at p. 8.

[376] *Id.* at p. 8.

[377] Tr. 18:1836 (Addo).

is not recovering expenses, it can file a rate case.[378]

Therefore, Staff urges the Commission to use Staff's method to calculate property taxes, which does not include the use of a tracker or forecasted levels.

C. If the Commission grants KCPL a Property Tax Tracker, should KCPL get a return on as well as return of the tracked amounts?

If the Commission grants KCPL's request for a property tax tracker, the Commission should not allow rate base treatment for any unamortized balance related to property taxes.[379] Rate base treatment for regulatory assets and liabilities generally applies to costs related to an asset.[380] For example, in this case, Staff included in rate base the unamortized balances as of December 31, 2014, for the regulatory assets related to Iatan 1 and Iatan 2 Construction Accounting which was authorized in prior rate cases.[381] The Commission has also approved rate base treatment for other reasons.[382] For example, the Commission granted rate base treatment to incentivize KCPL to continue to invest in Demand Side Management programs ("DSM"), again as part of other rate cases.[383] In Case No. ER-2010-0355, beginning on page 93 of its Report and Order, the Commission stated the following:

> The Commission has determined that it is important to reduce the disincentives to the Companies to having robust DSM programs. The Companies have clearly indicated that delayed recovery is one of those disincentives. By adding the unamortized balances to rate base the

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[378] Tr. 18:1826-28.

[379] Ex. 222, Lyons Rebuttal, p. 14.

[380] *Id.*

[381] *Id.*

[382] *Id.*

[383] *Id.*

> Commission will encourage DSM programs and promote the policy of this state as stated in MEEIA. Thus the Commission determines that the unamortized balances of the regulatory asset accounts shall be included in rate base for determining rates in this case.[384]

Property taxes are a normal operating expense and not capital in nature.[385] KCPL's request for carrying costs and rate base treatment would result in KCPL customers paying more for an expense that can readily be determined using normal ratemaking principles.[386] Consequently, KCPL should not be allowed to earn a return on these expenses.

D. If the Commission grants KCPL a Property Tax Tracker, should KCPL get carrying costs on the tracked amounts?

KCPL is requesting carrying costs based on KCPL's short-term interest rate on property tax amounts.[387] Staff adamantly opposes this request. Carrying costs are comparable to a return on an investment that may be added to a deferred cost to recognize the delay in recovering the cost in rates.[388] In other words, the accrual of carrying costs is intended to make KCPL whole for the time value of money associated with rate recovery of deferred property tax expense.[389] If the Commission granted KCPL's proposed property tax tracker that includes carrying costs, KCPL customers would ultimately pay more in rates for an expense item that is known and measureable

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[384] *Id.*

[385] Ex. 222, Lyons rebuttal, p. 14.

[386] *Id.*

[387] Ex. 222, Lyons rebuttal, p. 13; Ex. 1134, Rush direct, p. 29.

[388] Ex. 222, Lyons rebuttal, p. 13.

[389] *Id.*

according to normal ratemaking principles.[390] The increased expenses are ultimately paid by KCPL's customers.[391] Under KCPL's proposal, all risks relating to property taxes would fall on the KCPL's customers.[392] In Staff's view, this treatment would be inequitable and thus unjust and unreasonable.

Conclusion:

Staff urges the Commission adopt its customary method for determining property tax expense and to reject KCPL's attempt to inflate this amount by using overstated estimates. Staff also urges the Commission to reject KCPL's request for a property tax tracker. KCPL's tracker proposal in this case would allow it to collect from customers in the future any increases it may incur in the area of property taxes while keeping for itself any offsetting declines in its cost of service.[393] This would not result in equitable or balanced ratemaking.[394] Finally, if the Commission does establish a property tax tracker, KCPL should not get either carrying costs or a return "on" the amount deferred.

Marcella Mueth and Kevin A. Thompson.

V. CIP/Cyber-Security Expense

A. What level of CIP/cyber-security expense should the Commission recognize in KCPL's revenue requirement?

The Commission should recognize ** ———— ** (total company) or ** ———— ** (Missouri jurisdictional) amount of CIP and cybersecurity costs in

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[390] *Id.*

[391] *Id.*

[392] *Id.*

[393] Ex. 236, Oligschlaeger surrebuttal, p. 3.

[394] *Id.*

KCPL's final revenue requirement calculation.[395] This is an appropriate amount of costs based on KCPL's history of costs relating to CIP and cybersecurity and its projections of future costs. Amounts have been trued-up to May 31, 2015, to provide the most accurate calculations possible.[396]

B. Should a tracker be implemented for KCPL's CIP/cyber-security expense that varies from the level of CIP/cyber-security expense the Commission recognizes in KCPL's revenue requirement?

i. Should KCPL get a return on as well as return of the tracked amounts?

ii. Should KCPL get carrying costs on the tracked amounts?

In Case No. ER-2012-0174, the Commission found:

> Applicants [KCPL and GMO] have not carried their burden of proving that the Commission should order deferred recording ("a tracker") for transmission costs. The issue is moot because Applicants can already determine how to record that cost by themselves, as they do with almost every cost every day, under the *Uniform Systems of Accounts ("USoA").*[397]

KCPL's request in this case for a tracker for CIP and cybersecurity costs should not be granted. KCPL is free to record its costs as it sees fit, to the extent that the records are sufficiently detailed for the Staff to determine in an audit that the costs associated with CIP and cybersecurity were reasonably and prudently incurred. The creation of a tracker, by its very nature, presumes that the costs recorded in that tracker are recoverable. Such a presumption runs contrary to the prohibition against single-issue ratemaking.

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[395] Ex. 256, true-up rebuttal testimony of Karen Lyons, p. 16.

[396] Ex. 256, true-up rebuttal testimony of Karen Lyons, p. 15.

[397] *In the matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate increase for Electric Service*, Case No. ER-2012-0174, *Report and Order,* at 28.

The Commission should closely examine whether trackers are truly essential to proper fiscal management. Staff Witness Mark Oligschlaeger, on page 6 of his rebuttal testimony,[398] addresses the difference between an accounting authority order (AAO) and a tracker, specifically, the nature of the costs that apply to both.

When a utility requests a cost tracker certain criteria are applied to Staff's consideration: 1) whether the applicable costs demonstrate a significant fluctuation as well as up and down volatility over time and whether accurate estimation is difficult; 2) whether these are new costs for which there is little or no historical experience and accurate estimation is difficult; 3) whether the costs are imposed upon a utility by Commission rule; and, 4) if the costs are material in nature.[399] CIP and cybersecurity costs have been occurring since the beginning of KCPL's dealings with the internet and technology. The costs are not new, and the historical costs incurred by KCPL were used by both KCPL and Staff to make their projections of future costs.[400] The costs of CIP and cybersecurity are not volatile nor do they fluctuate severely. These costs have steadily increased as KCPL's reliance on the internet and technology has increased.

Costs that simply increase are not considered "volatile." Most categories of costs increase over time. Estimation is clearly not difficult, as both KCPL and Staff provided projections of future costs in their testimony.[401] CIP and cybersecurity standards have been updated based on standards set down by the North America Electric Reliability

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[398] Ex. 235.

[399] Ex. 235, rebuttal testimony of Mark Oligschlaeger, p. 3.

[400] *Id.* at p. 12.

[401] Ex. 132, rebuttal testimony of Joshua Phelps-Roper, p. 9; Ex. 223, surrebuttal testimony of Karen Lyons, p. 36.

Corporation ("NERC"), but no Commission rules relate to these standards.[402] Finally, CIP and cybersecurity costs can be recovered in a general rate case; KCPL's cost recovery will not be substantially different if there is a Commission-approved tracker (except to the extent that a tracker may serve as a disincentive to tightly control costs)[403]. The costs do not meet the Staff's criteria necessary to justify a tracker.[404]

In addition, Staff considers whether the costs incurred are beyond the utility's control when contemplating tracking them. KCPL witness Roper states that KCPL will have control over all programs relating to CIP and cybersecurity,[405] contrasted with KCPL's lack of control over property taxes, which it notes as a justification for a property tax tracker.[406]

In surrebuttal, for the first time, KCPL recommends an increase to Staff's annualized level of CIP expense based on an arbitrary forecast of CIP expense.[407] Since KCPL raised this issue for the first time in surrebuttal testimony, Staff and other parties were denied the opportunity to respond to it in testimony. KCPL request to include forecasted expense for CIP/cyber security should be denied for reasons that a tracker should be denied and for legal standards set forth in transmission tracker section of Staff's brief.

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[402] Ex. 213, rebuttal testimony of Randy Gross, p. 3.

[403] Ex. 235, rebuttal testimony of Mark Oligschlaeger, pp. 7-9.

[404] Ex. 223, surrebuttal testimony of Karen Lyons, p. 34.

[405] Ex. 132, rebuttal testimony of Joshua Phelps-Roper, p. 10.

[406] Ex. 134, direct testimony of Timothy M. Rush, p. 7.

[407] Ex. 136, surrebuttal testimony of Timothy M. Rush, pp. 15-16.

C. If the Commission grants KCPL a CIP/cybersecurity tracker, should KCPL get a return on as well as return of the tracked amounts and get carrying costs on the tracked amounts?

If the Commission grants KCPL a CIP/cyber-security tracker, the Commission should not allow rate base treatment on any unamortized balance and carrying costs on deferred amounts. KCPL customers would ultimately pay more in rates for an expense item that is a normal operating expense, which Staff opposes.[408] Trackers are put in place to permit a utility to recover a specific set of fluctuating costs.[409] The purpose of a tracker is not for utility profit; KCPL should not be permitted to collect the return on or include carrying costs on its tracked costs if a tracker is granted.

When the NERC created the CIP V5 requirements, it conducted a study in which six industry participants implemented elements of those new requirements. [410] Study participants recognized that spreadsheets alone would be insufficient. Automated workflow systems provided single-source data entry and consistency and easier mechanisms to support asset protection and demonstrative compliance. Study participants emphasized the need to automate."[411] If a tracker is granted in this case for the same type of expenses allowed by the Kansas Corporation Commission tracker,[412]

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[408] Ex. 222, rebuttal testimony of Karen Lyons, p. 28.

[409] Ex. 235, rebuttal testimony of Mark Oligschlaeger, p. 3.

[410] Ex. 213, rebuttal testimony of Randy Gross, p. 6.

[411] *Id*. at p.8.

[412] The tracker in the proposed Stipulation and Agreement presented to the KCC is limited to only costs supported by an outside vendor invoices that fall into the categories of: Contractors Labor; Consulting Fees; IT Consulting Services; Data Processing Software and Support; Data Processing Maintenance (Direct testimony of KCC witness Justin T. Grady, page 21, lines 1-6, Docket No. 15-KCPE-116-RTS.) The KCC staff recommended that internal labor be excluded because of the inherent risk of inappropriate cost shifting, double recovery in rates, and lack of an easily verifiable audit trail (Direct testimony of KCC

KCPL should be required to have in place such an automated workflow system. Staff opposes a tracker for CIP and cybersecurity costs altogether. However, if the Commission does approve a tracker for these costs, then Staff encourages the Commission to limit the tracked amounts in several ways, as in the KCC Stipulation and Agreement.[413] The CIP/cyber-security tracker in that matter is limited to non-labor operations and maintenance (O&M) costs and has a definite termination date.

Colleen M. Dale and Whitney Payne.

VII. La Cygne Environmental Retrofit Project – *What level of KCPL's investment in the La Cygne Environmental Retrofit project should be included in KCPL's Missouri rate base?*

The amounts shown on KCPL's regulatory books in FERC USOA accounts 211, 312, 315, 316, 353, 355 and 356 for the La Cygne Environmental Retrofit project as of May 31, 205, which, as shown on page five of the true-up direct testimony of Staff witness Charles R. Hyneman (Exhibit 252), is $292,620,121.

Nathan Williams.

VIII. Rate Case Expense

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

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

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

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witness Justin T. Grady, page 21, lines 19-20 and page 22, lines 1-12, Docket No. 15-KCPE-116-RTS.). Midwest Energy Consumer's Group witness Michael L. Brosch also has expressed these same concerns in his revenue requirement direct testimony (Ex. 502) on page 35, lines 4-26 and page 36, lines1-4.

[413] Kansas Corporation Commission, Docket No. 15-KCPE-116-RTS.

Introduction:

Rate case expense encompasses the additional or incremental costs incurred by a utility in prosecuting a general rate case. Rate case expense includes the fees and expenses of outside counsel and expert consultants, as well as other litigation costs. Because the amount of rate case expense can be significant, it is often a contentious issue in rate cases. In the present case, Staff urges the Commission to treat rate case expense like other utility expenses that are shared by ratepayers and shareholders because, like them, rate case expense is not incurred solely to benefit the utility's customers. Instead, it is incurred partly – perhaps largely -- to benefit shareholders by reducing the effect of regulatory lag on utility profits.

The issue of rate case expense can be broken down into three major areas of contention. The first is whether any of KCPL's claimed rate case expenses were imprudently incurred. The second is whether the Commission should require KCPL shareholders to cover any portion of KCPL's rate case expense. The third is what level of rate case expense for this proceeding the Commission should recognize in KCPL's revenue requirement.

A. Was any of the rate case expense incurred by KCPL imprudent?

Staff is seeking disallowance of all of the expenses of one KCPL consultant, Dr. Overcast, because his testimony is partly inapplicable to Missouri and partly duplicative of the testimony of other KCPL witnesses.[414] Witness Overcast's testimony

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[414] Ex. 226, Majors surrebuttal, p. 62; Tr. 13:920-21; 1031; 1050. The amount in question is approximately $36,000. Tr. 13:1032.

addresses the several tracking mechanisms requested by KCPL, including the FAC.[415] His testimony is largely duplicative of several KCPL witnesses, including Ives, Hardesty, Blunk, Carlson, Crawford, and Roper.[416] This witness' expenses are unnecessary incremental rate case expenses.[417] KCPL has incurred several thousands of dollars related to witness Overcast through March 31, 2015.[418]

While Staff does not recommend any disallowance of the cost of the depreciation study performed by KCPL witness Spanos, Staff does recommend that it be amortized over five years, with no sharing.[419] Commission Rule 4 CSR 240-3.160 requires a depreciation study every five years.[420]

The Commission has adopted a standard of reasonable care requiring due diligence as the standard for evaluating the prudence of a utility's conduct.[421] "The Commission will assess management decisions at the time they are made and ask the question, 'Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?'"[422] Although the burden of proof in this rate case is on KCPL,[423] utility operating expenses are presumed to have been prudently incurred

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415 Ex. 226, Majors surrebuttal, p. 62.

416 Ex. 226, Majors surrebuttal, p. 62; Tr. 13:1035.

417 Ex. 226, Majors surrebuttal, p. 62.

418 *Id.*

419 *Id.* at p. 63; Tr. 13:1028-29.

420 Ex. 226, Majors surrebuttal, p. 63; Tr. 13:1027-28.

421 ***In the Matter of Union Electric,*** 27 Mo.P.S.C. (N.S.) 183, 194 (1985).

422 *Id.*

423 § 393.150.2, RSMo.

unless some challenger makes a "showing of inefficiency or improvidence" that "creates serious doubt" as to the prudence of a particular expenditure.[424] In that case, the burden is on the utility to show that the questioned expenditure was, in fact, prudent.[425]

Staff challenges the expenses incurred by KCPL with respect to the testimony of Dr. Overcast, asserting that his testimony is, in part, inapplicable to Missouri and otherwise duplicative of the testimony offered by other KCPL witnesses. Those other witnesses, furthermore, are employees of KCPL and so their testimony did not result in any incremental rate case expenses. Although KCPL attempted to show that Dr. Overcast brought a national perspective not reflected by the other witnesses, this effort was unconvincing. Nothing in the purported national perspective added anything useful to the testimony before the Commission. At the time KCPL engaged Dr. Overcast, its management knew (or should have known) that it had ample employee witnesses available to address the issues concerned.

Staff has shown that the engagement of Dr. Overcast was imprudent and KCPL has not shown that it was. Therefore, the challenged expenses, amounting to some $36,000, should be disallowed.

B. Should KCPL's shareholders share any part of KCPL's rate case expense?

Staff recommends a 50/50 sharing of the actual reasonable and prudent rate case expenses incurred in relation to this case between shareholders and

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[424] ***Office of Public Counsel v. Missouri Public Service Com'n,*** 409 S.W.3d 371, 376 (Mo. banc 2013); *quoting* ***Matter of Union Electric,*** 27 Mo.P.S.C. (N.S.) 183, 193 (1985); in turn quoting ***Anaheim, Riverside, etc. v. FERC,*** 669 F.2d 799, 809 (D.C. Cir. 1981).

[425] *Id.*

ratepayers.[426] This amount should be normalized over three years, therefore, 1/3 of the amount determined should be included in revenue requirement.[427] Because rate case expense is typically "end-loaded" or "back-loaded" (i.e. a material amount of cost is incurred near the end of the case, i.e. evidentiary hearings), Staff's examination of rate case expense resulting from this case is not complete.[428] Staff recommends updating actual rate case expense through the filing of briefs.[429] Staff further recommends that rate case expense not be tracked for under or over recovery.[430]

Why is Staff changing its policy on rate case expense? Because, in the course of an investigation ordered by the Commission on April 27, 2011, Staff determined that the current practice of allowing a utility to recover all, or almost all, of its rate case expense from its customers creates a disincentive for utility management to control rate case expense.[431] Indeed, KCPL allowed rate case expense for a single case to reach almost $12 million.[432] Staff's proposed sharing mechanism, on the other hand, incentivizes a company to limit its rate case expenses.[433] Another consideration is simple fairness. Fair cost apportionment, also called rate equity, is a traditional goal of

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[426] Ex. 200, *Staff revenue requirement cost of service report,* p. 131; Ex. 226, Majors surrebuttal, p. 55; Ex. 236, Oligschlaeger surrebuttal, p. 9.

[427] Ex. 226, Majors surrebuttal, p. 55. However, Staff recommends a five-year recovery period for the cost of KCPL's depreciation study offered in this case.

[428] Ex. 200, *Staff revenue requirement cost of service report,* p. 131; Ex. 241, Young rebuttal, p. 5; Tr. 13:1020.

[429] Ex. 226, Majors surrebuttal, p. 55.

[430] Ex. 200, *Staff revenue requirement cost of service report,* p. 130.

[431] Ex. 200, *Staff revenue requirement cost of service report,* pp. 133-134; Ex. 226, Majors surrebuttal, p. 57.

[432] Ex. 226, Majors surrebuttal, pp. 58-59.

[433] Ex. 226, Majors surrebuttal, p. 134; Ex. 236, Oligschlaeger surrebuttal, p. 11.

regulation.[434] Given this utility's insistence that regulatory lag is preventing it from earning its authorized rate of return, it follows that KCPL's customers receive little or no benefit (in the short run) from a rate case intended to *increase* the price of the service they receive. Why, then, should the customers pay 100% of the cost KCPL incurs in raising their rates?[435]

Staff believes that 50/50 sharing of rate case expenses is both equitable and likely to result in cost containment. Staff witness Keith Majors testified:

> And then you've got the expenses that the Company incurs to prosecute its -- prosecute its rate case. And I think if you were to objectively look at those expenses, you would see that there is some benefit for ratepayers in that they -- in the future, they will -- it's -- part of that cost is for safe and adequate service, but also the shareholders have a direct benefit in that -- in that they have the opportunity to receive a reasonable return on their investment. And so that was Staff's rationale for the 50/50 sharing.[436]

Rate case expense is different from most other types of utility operational expenses.[437] After all, the rate case process is adversarial in nature, with the utility and ratepayers on opposing sides.[438] Many ratepayers would certainly argue that rate case expense does not benefit them at all. Accordingly, the utility's shareholders, who are

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[434] *See, e.g.,* Lowell E. Alt, Jr., ***Energy Utility Rate Setting,*** pp. 59-60 (2006; Lulu).

[435] Tr. 13:996, ll. 15-21:

> Q. (Mr. Opitz): And so is it your testimony that the ratepayers should have to pay for the Company to try and remove their benefit of regulatory lag?
>
> A. (Mr. Ives): If it's moving us toward a chance to earn our return, I believe that's appropriate.
>
> Q. So that's a yes?
>
> A. Yes.

[436] Tr. 13:1033 (Majors).

[437] Tr. 13:1062 (Addo).

[438] Tr. 13:1022 (Ives).

the primary beneficiaries of the rate case, should shoulder a fair share of the costs incurred in litigating the rate case. Staff witness Mark Oligschlaeger testified:

> Prudency is obviously one aspect you want to look at in allowing a particular cost recovery or not. It is not the only aspect. Among the other aspects are benefit to customers. That would be the -- largely the other rationale that needs to be looked at. And we don't believe that rate case expense in entirety can be or should be thought of as all -- as 100 percent being beneficial to customers because of, again, the unique factors we discussed earlier.[439]

This is not an unprecedented recommendation. There are several other costs that KCPL incurs on an ongoing basis that, although prudent, are typically not borne in part or at all by ratepayers.[440] The shareholders bear the costs of such items as incentive compensation tied to earnings per share and other financial measures, charitable donations, some dues, political lobbying expenses, board of directors retreat expenses, certain executive expenses, and half of the funds dedicated to the Economic Relief Program.[441] These incurred costs, while undisputedly prudent from the company's perspective, are nonetheless assigned to the shareholders because, by their very nature, they do not directly benefit the utility's customers.[442]

The Commission is required to parse the utility's expenses in this way because its statutory mandate is to determine "just and reasonable rates," in consideration of all relevant factors.[443] The law requires that "[a]ll charges made or demanded by any . . . electrical corporation . . . for . . . electricity . . . or any service rendered or to be rendered

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[439] Tr. 13:1050.

[440] Ex. 226, Majors surrebuttal, p. 58.

[441] Ex 226, Majors Surrebuttal, p. 58.

[442] *Id.*

[443] § 393.140(5), RSMo.

shall be just and reasonable and not more than allowed by law or by order or decision of the commission."[444] The law further provides that "[e]very unjust or unreasonable charge made or demanded for . . . electricity . . . or any such service, or in connection therewith, or in excess of that allowed by law or by order or decision of the commission is prohibited."[445] Finally, the law specifies what the Commission must do if, after investigation and hearing, it determines that the rates of the subject utility are not "just and reasonable":

> Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished, notwithstanding that a higher rate or charge has heretofore been authorized by statute, and the just and reasonable acts and regulations to be done and observed[.][446]

What is a "just and reasonable" rate? It is a rate that balances the interests of the various stakeholders in the light of the public interest.[447] A just and reasonable rate is fair to both the utility and to its customers[448] and is no more than is necessary to "keep public utility plants in proper repair for effective public service, [and] . . . to insure

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[444] § 393.130.1, RSMo.

[445] *Id.*

[446] § 393.140(5), RSMo.

[447] *See* ***State ex rel. Union Electric Co. v. Public Service Commission,*** 765 S.W.2d 618, 622 (Mo. App., W.D. 1988) ("Ratemaking is a balancing process").

[448] ***St. ex rel. Valley Sewage Co. v. Public Service Commission,*** 515 S.W.2d 845 (Mo. App., K.C.D. 1974).

to the investors a reasonable return upon funds invested."[449] The fixing of just and reasonable rates involves a balancing of the investor and the consumer interests, and the making of pragmatic adjustments; in determining rates, a regulatory body is not bound to the use of any single formula or combination of formulae.[450] In the final analysis, it is not the methodology or theory used but the impact of a rate order of the Commission which counts in determining whether rates are just, reasonable, lawful and nondiscriminating.[451] There is no question that the Commission is authorized to require KCPL's shareholders to pay a portion of its rate case expense.

Additionally, requiring ratepayers to pay 100% of rate case expenses ratepayers would provide KCPL with an inequitable financial advantage over other participants in the rate case process. Staff and OPC operate within tight annual budgets and interveners pay their own legal expenses.[452] In contrast, if KCPL expects to be able to recover 100% of its rate case expenses in rates, it has no real incentive to constrain its budget. In recent cases, KCPL has incurred rate case expenses substantially higher than historical levels, and higher than other large utilities in Missouri.[453]

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[449] ***St. ex rel. Washington University et al. v. Public Service Commission,*** 308 Mo. 328, 344-45, 272 S.W. 971, 973 (banc 1925).

[450] ***State ex rel. Office of Public Counsel v. Public Service Com'n,*** 367 S.W.3d 91, 108 (Mo. App., S.D. 2012), *quoting* **Fed. Power Comm'n v. Hope Nat. Gas Co.,** 320 U.S. 591, 602-3, 64 S.Ct. 281, ___, 88 L.Ed. 333, ___ (1944).

[451] ***State ex rel. Associated Natural Gas Co. v. Public Service Com'n of Missouri,*** 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

[452] Ex. 200, *Staff revenue requirement cost of service report,* p. 133.

[453] Ex. 200, *Staff revenue requirement cost of service report,* pp. 134-135. KCPL incurred $11.9 million in rate case expense for Case Nos. ER-2010-0355 and ER-2010-0356, the largest amount in Missouri history. Ex. 226, Majors surrebuttal, pp. 58-59.

A 50/50 sharing of rate case expenses, if applied now and potentially in the future, would encourage KCPL to reasonably contain the costs incurred as part of future rate cases.[454] This acts more directly as a financial incentive than would a full prudency review alone. The Commission opened a working docket on this issue in Case No. AW-2011-0330. Staff Witness Mark Oligschlaeger primarily authored the rate case expense report that was filed in that working case.[455] In his testimony, Mr. Oligschlaeger addressed other sharing alternatives, noting two approaches that may be of particular interest to the Commission as possible alternatives to Staff's recommended 50/50 sharing proposal:[456]

(1) starting the sharing point for this expense at a higher dollar value;[457] and

(2) splitting rate case expense based upon a comparison of the ordered rate increase to the original amount requested by the utility.[458]

In the first of these alternatives, Instead of commencing the sharing at the first dollar of rate case expense incurred by KCPL, KCPL would be allowed to fully recover all prudently incurred rate case expenses up to, say, the first $500,000, with all prudently incurred amounts above that level shared on an equal basis between KCPL and its customers.[459] Another approach would be to allow KCPL to recover all prudent rate case expenses up to a level of $2.50 of expense per customer, with all prudently

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[454] Tr. 1058-59.

[455] Ex. 243 HC; Tr. 13:1046.

[456] Ex. 236, Oligschlaeger surrebuttal, pp. 10-12.

[457] *Id.* at p. 10.

[458] *Id.*

[459] *Id.*

incurred amounts above that level shared on an equal basis between KCPL and its customers.[460] This approach recognizes that some amount of rate case expense must be incurred by a utility in support of a general rate application, but that the utility also has more discretion over the amount spent in total as that amount increases.[461]

Under the second alternative, KCPL would receive rate recovery of rate case expenses in proportion to the amount of rate relief it is granted compared to the amount of its rate increase request.[462] For example, if the Commission ultimately decided that the utility should be awarded only half of what it sought, KCPL's allowed rate case expense recovery would be capped at half of its actual rate case related expenditures.[463] In the event the utility was awarded all – or even more than all -- of its rate increase request, rate case expense recovery would be capped at 100% of actual prudent expenses.[464] Use of this approach would directly tie a utility's recovery of rate case expense to the reasonableness of its issue positions and the dollar value sought from customers.[465] However, Staff’s position continues to be that the 50/50 sharing proposal would be most effective in creating an incentive for the utility to control rate case expenses and would be most equitable:[466]

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[460] *Id.* This approach would allow KCPL recovery of approximately $685,000 of rate case expense before sharing would begin.

[461] *Id.*

[462] *Id.*

[463] *Id.* at p. 11.

[464] Ex. 236, Oligschlaeger Surrebuttal, p. 11.

[465] *Id.*

[466] Ex. 200, *Staff revenue requirement cost of service report,* p. 134; Tr. 13:1047 (Oligschlaeger)..

> Q. (Mr. Opitz): Why that option compared to the other possibilities you discussed?
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> A. (Mr. Oligschlaeger): We believe -- partly our goal is a -- what we consider a more appropriate allocation of rate case expenses between the Company's customers and its shareholders. But also our goal is to perhaps obtain treatment that provides a company, a utility, with stronger incentives to make reasonable and economical decisions in terms of the amount of rate case expense it incurs.[467]

Is it necessary for the Commission to engage in a rulemaking in order to treat rate case expense differently than it has been treated before? In Staff's opinion, it is not. After all, none of the Commission's policies with respect to other types of operating expenses are embodied in rules. Thus, the Commission does not permit full recovery of advertising expense, incentive compensation, charitable donations, and certain other categories of operating expense. None of these policies are embodied in rules. And, none of these disallowances are based on considerations of prudence.

The change that Staff proposes in this case in the treatment of rate case expense is simply the result of a closer scrutiny of such expenses under the long-standing principles applicable to ratemaking -- the principles of reasonableness, necessity, and customer benefit.[468] A consideration of all of these principles and their application to rate case expenses suggests that the shareholders ought, in all fairness, to be required to pay a significant proportion of them. In Staff's view, that fair proportion is half.

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[467] Tr. 13:1048.

[468] The principle of reasonableness is embodied in the familiar concept of the least-cost alternative. The principle of necessity is reflected in the traditional concept of "used-and-useful." The principle of customer benefit is reflected by the familiar segregation of expenses into those "above the line" and those "below the line." None of these notions is either new or revolutionary.

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

Staff recommends a 50/50 sharing of reasonable and prudent rate case expense between shareholders and ratepayers.[469] This amount should be normalized over three years, therefore, only 1/3 of the amount determined to be recoverable from the ratepayers should be included in the revenue requirement.[470]

Conclusion:

The Commission is required, under the law, to set just and reasonable rates in consideration of all relevant factors. In performing its statutory duties, the Commission examines the company's expenses to determine whether each expenditure was prudent, necessary, reasonable, and beneficial to its customers. One very relevant factor for consideration is that expenses incurred in a rate case cannot be said to be entirely for the customers' benefit. Indeed, these expenses may benefit utility customers very little. Therefore, it is unfair, unjust and unreasonable to require the ratepayers to absorb 100% of these expenses. Staff's position of a 50/50 sharing of prudently incurred rate case expenses between shareholders and ratepayers is an equitable and easily administered solution. It has the added benefit of creating a strong incentive for the company to manage and contain its rate case expenses. Staff urges the Commission to adopt its position on this issue, disallowing the expenses associated

[469] Ex. 226, Majors surrebuttal, p. 55.

[470] *Id.*

with the engagement of Dr. Overcast as imprudent and recognizing in revenue requirement one-third of KCPL's remaining rate case expenses.

Marcella Mueth and Kevin A. Thompson.

XVII. Management Audit—*Should the Commission order a management audit of KCPL?*

Staff has no position on this issue.

XVIII. Clean Charge Network

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

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

C. If so, who pays for it?

Introduction:

The Clean Charge Network is KCPL and GMO's plan to install over 1,000 electric vehicle charging stations (including about 15 fast charging stations) throughout Kansas City and the region surrounding it in KCPL's and GMO's service areas in Missouri and Kansas.[471] For two years vehicles may be charged for free, Nissan Motor Company will pay for electricity delivered at fast charging stations and KCPL's customers where the other stations are sited will pay for the electricity delivered at them.[472] The rate for electricity will be based on the rate schedule of the KCPL or GMO customer where the station is sited.[473] Approximately one-third of the stations will be located in KCPL's

[471] Ex. 119, KCPL witness Ives supplemental direct, p. 1, l. 8 to p. 2, l. 7.

[472] Ex. 119, KCPL witness Ives supplemental direct, p. 2, ll. 8-16; Sch. DRI-2, p. 1.

[473] Ex. 119, KCPL witness Ives supplemental direct, p. 2, ll. 12-16.

service area in Missouri, one-third in KCPL's service area in Kansas and one-third in GMO's service area.[474]

The above issues regarding the Clean Charge Network are interrelated and all stem from what KCPL must show for the Commission to decide whether KCPL has demonstrated that the portion of the Clean Charge Network it is starting to build out in its Missouri service area is a public utility service, the costs of which KCPL may recover from its Missouri retail customers through the rates they pay KCPL.

As of May 31, 2015, KCPL has invested $732,559 in its Clean Charge Network in Missouri, but plans to invest a total of $7 to $8 million.[475] KCPL estimates the bill impact of its current investment to be 43 cents per year (corrected from 32 cents per year) for the average residential customer[476] and, when fully deployed, about $2 per year.[477]

Although KCPL repeatedly asserts its Clean Charge Network is a pilot project, it developed the project without obtaining any input from any of the parties in this rate case, including those representing consumers who will bear the costs of the project if the Commission allows them into KCPL's revenue requirement,[478] it has not established any criteria by which it proposes to measure the success of the Clean Charge Network,[479] and it has not conducted any studies for the five areas of public benefit

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[474] Ex. 200, Staff revenue requirement cost of service report, p. 205, n. 106.

[475] Tr. 11:567-568; Tr. 11:593; Tr. 11:600.

[476] Tr. 11:567, ll. 9-19.

[477] Tr. 11:600-601; Tr. 11:606- 607.

[478] Tr. 11:626-627.

[479] Tr. 11:584, ll. 6-13.

KCPL believes the Clean Charge Network can provide—beneficial electrification, environmental benefits, economic development, customer programs, and cost and efficiency benefits.[480]

Argument:

The theme underlying KCPL's Clean Charge Network is, like the theme in the 1989 movie *Field of Dreams*, "build it and they will come."[481] As Staff stated in testimony, "The Clean Charge Network is a joint initiative with GMO that is designed to 'serve as a catalyst for electric vehicle adoption in the Kansas City region.'"[482] However, KCPL has not shown that if it builds the Clean Charge Network in Missouri it will have any impact on the adoption of the use of electric vehicles in its Missouri service area, adoption which it argues would lead to cleaner air and more efficient use of its generating plants by increasing demand for electricity during the mornings and at night.[483] Instead, KCPL relies on information from California which has set a target of reducing greenhouse gases to 80% below 1990 levels by 2050 and whose Governor Brown has issued Executive Order B-16-2012 which establishes a goal of 1.5 million zero emissions vehicles on California's roads by 2025 and a 2050 target of an 80%

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[480] Tr. 11:577-582.

[481] While not evidence, in a recent E&E ClimateWire news article published July 15, 2015, titled, *Will Calif.'s ambitious policies to promote electric vehicles sell in other states?*, reporter Brittany Patterson quotes Edward Kjaer, director of transportation electrification for Southern California Edison in the following passage, "'Build it and they will come does not work, and we know that,' he said, referring to the sometimes-disconnected charging station infrastructure the state [of California' currently has." http://www.eenews.net/climatewire/stories/1060021800/ accessed July 15, 2015.

[482] Ex. 200, Staff revenue requirement cost of service report, p. 204, ll. 23-25.

[483] Ex. 119, KCPL witness Ives supplemental direct, Sch. DRI-1, p. 3 of 10; Tr. 11:570-571

reduction of transportation emissions from 1990 levels.[484] Since KCPL and GMO's collective generation mix is currently 81% coal,[485] increasing the demand for electricity to charge electric vehicles on the Clean Charge Network will increase the emissions of harmful greenhouse gases as the number of electric vehicles increases.[486]

A similar build-it-and-they-will-come situation occurs with residential subdivisions, where a developer typically puts in the infrastructure for new housing, *i.e.*, builds the infrastructure to sell the subdivision lots. In KCPL's tariff (Tariff Sheets P.S.C. Mo. No. 2, First Sheet No. 1.33B through 1.33L for rate areas No. 1 & No. 3), in such situations KCPL's tariff requires (or at least required until December 31, 1984[487]) that electric service be undergrounded and that the developer "at his own cost and expense furnish, install, own, operate and maintain to [KCPL's] specifications, proper service entrance conductors and equipment, meter sockets and meter socket risers and conduit for feeder and service lines under all public streets and rights of way, and areas to be paved or landscaped," with the potential for reimbursement of his cost and expense. (Tariff Sheets P.S.C. Mo. No. 2, First Sheet No. 1.33E and First Sheet No. 1.33J). In other words, with regard to the cost of underground facilities, the risk that the subdivision will not build out is primarily borne by the developer, not KCPL or its retail customers.

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[484] Ex. 119, KCPL witness Ives supplemental direct, Sch. DRI-3, p. 13.

[485] Ex. 216. Staff witness Hyneman surrebuttal, Sch. CRH-s4, p. 8 of 44 (KCPL and GMO June 2015 Investor Presentation, p. 4).

[486] KCPL witness Ives surrebuttal, Sch. DRI-11, p. 1 of 6: "A caveat to consider is that when coal plants supply the majority of the power in a given area, electric vehicles may emit more CO_2 and SO_2 pollution than hybrid vehicles."

[487] See Tariff Sheet P.S.C. Mo. No. 2, First Sheet No. 1.33L.

By asking this Commission to allow KCPL to recover the costs of the charging stations in the Clean Charge Network from its retail customers by including the stations in its rate base then allocating them out to its customer classes through the results of a class cost of service study,[488] KCPL is asking this Commission to guarantee that KCPL's Missouri retail customers reimburse it for its investment in that network in Missouri, plus give it a return on that investment, regardless of whether anyone, or even any of KCPL's Missouri retail customers, uses the Clean Charge Network to charge electric vehicles.

While Staff is not arguing that as a matter of law publicly available electric vehicle charging stations located in Missouri do not require Commission-issued certificates of convenience and necessity, Staff is recommending the Commission find that KCPL has not shown that charging electric vehicles at its Clean Charge Network charging stations in Missouri is a public utility service and, therefore, KCPL is not entitled to recover any of its capital investment in those stations from its Missouri retail customers. If the Commission disagrees and finds that charging electric vehicles at those stations is a public utility service, then Staff recommends that only those who use or request the charging stations pay for the costs associated with them. In other words, those charging their electric vehicles or those who request an electric vehicle charging station should pay not only for the costs of the electricity KCPL delivers, but also the cost of the stations themselves and any other additional costs KCPL incurs to deliver that electricity at the charging stations.

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[488] Tr. 11:590-591.

With regard to when someone is providing electric service as a public utility, in 1918, after the Commission ordered him to restore electric service to persons to whom he had cut that service off, the Missouri Supreme Court held, on facts which included that those receiving electrical service had to supply their own lines to the brewery where the generator was located and that electricity was provided only when more electricity was generated than needed to run the brewery for which the generator was obtained, Mr. Danciger was not operating as a public utility. In its opinion the Court stated, "It is certainly fundamental that the business done by respondent either constitutes him a 'public utility,' or it does not. If he is a public utility, he is such within the whole purview, and for all inquisitorial and regulatory purposes of the Public Service Commission Act."[489] The Court also quoted Mr. Wyman on public service corporations, with approval, as follows[490]:

> The rule by which profession of public employment is to be tested, where, as here, such profession arises if at all implicitly, is thus laid down by Mr. Wyman:
>
> "The fundamental characteristic of a public calling is indiscriminate dealing with the general public. As Baron Alderson said in the leading case: 'Everybody who undertakes to carry for any one who asks him is a common carrier. The criterion is whether he carries for particular persons only, or whether he carries for every one. If a man holds himself out to do it for every one who asks him, he is a common carrier; but if he does not do it for every one, but carries for you and me only, that is a matter of special contract.' This regular course of public service without respect of persons makes out a plain case of public profession by reason of the inevitable inference which the general public will put upon it. 'One transporting goods from place to place for hire, for such as see fit to employ him, whether usually or occasionally, whether as a principal or an

[489] *State ex rel. M. O. Danciger & Co. v. Public Service Commission of Missouri*, 275 Mo. 483; 205 S.W. 36, 40; 18 A.L.R. 754 (Mo. 1918).

[490] 205 S.W. at 42.

incidental occupation, is a common carrier.' " 1 Wyman on Pub. Service Corps. 227.

The Supreme Court's 1918 view of the law in Missouri on when an entity is a public utility is unchanged.[491] The original and primary purposes of the Commission are to protect the public from both discriminatory and predatory actions by utilities.

Absent the Clean Charge Network stations, in March of this year there were at least 151 electric vehicle charging stations in the Kansas City, Missouri, region, of which no more than 44 belonged to KCPL or GMO.[492] Based on KCPL's own testimony, through July 2014 675 electric vehicles were registered with Chargepoint in KCPL's Missouri and Kansas and GMO's service areas of which approximately 280 (139+73+31+16+11+11) were registered KCPL's and GMO's service areas in Missouri, but when asked on June 16, 2015, during the hearing, KCPL witness Ives was unable to provide more current numbers.[493] Since membership in Chargepoint is required to access the stations, the inescapable conclusion is that unless more electric vehicles register with Chargepoint in the Kansas City area, then only about 675 electric vehicles will be using the more than 1,000 Clean Charge Network electric vehicle charging stations.[494]

In the analogous circumstance where natural gas is compressed and sold for use as vehicle fuel, the Commission has not asserted jurisdiction, although it has set rates

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[491] See *e.g. Hurricane Deck Holding Company v. Public Service Commission*, 289 S.W.3d 260 (Mo. App. 2009).

[492] Ex. 200, Staff revenue requirement cost of service report, p. 205, l. 17 to p. 206, l. 8.

[493] Ex. 119, KCPL witness Ives supplemental direct, Sch. DRI-6, 11th page; Tr. 11:584-586.

[494] Ex. 119, KCPL witness Ives supplemental direct, p. 1, ll. 8-19; Sch. DRI-1.

for Laclede Gas Company delivering natural gas that its customer compresses, but Laclede d/b/a MGE sell compressed natural gas as a vehicle fuel in or around St. Joseph, Missouri.[495]

At three of the local public hearings held in this case—the local public hearings held on April 23 and May 5, 2015, in Kansas City, Missouri and the local public hearing held May, 6, 2015, in Gladstone, Missouri, members of the public addressed electric vehicles or electric vehicle charging stations, most questioning why they should pay for the charging stations.

At the first local public hearing held on April 23, 2015, Ms. Karilynn Meyers who resides in Kansas City, Missouri, testified:

> We don't drive electric cars. Why should we pay for the stations, the charging stations? Let the people that can go out and buy the new cars pay for their charging stations. Yes, I know it would help the air, but we don't have that option where we live. So that does not help us.

At the May 5, 2015 local public hearing Ms. Amrita Burdick and Ms. Jamekia Kendrix, both of whom reside in Kansas City, Missouri, testified. Ms. Burdick testified:

> I am here, I'm a retired librarian and I wanted to sort the information and see what it looks like. I'm also a person on a fixed income myself as a retired person and I have a stake in the case. And as I looked at this, probably most of you here got this mailer, charge here, charge there, charge everywhere. Well, originally that was about only electric cars, which is not a bad idea, but unfortunately I feel like it probably also applies to this rate increase.[496]

Ms. Jamekia Kendrix testified,

> Because what you're doing right now is causing us, the taxpayers, to pay on the back end, because the people who cannot afford to pay

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[495] Ex. 200, Staff revenue requirement cost of service report, p. 208, ll. 1-22.

[496] Tr. 7:18.

> these bills are going to non-profit organizations, and those organizations to figure out, "How do I get the money to meet the X," and that's taxpayer money. And KCP&L does not come to taxpayers and ask us if we approve the improvements at those rates.
>
> They didn't ask us if we wanted electric vehicle charging stations. They didn't ask us about the Wolf Creek Nuclear Generation Station. But we're paying for it with our tax dollars by subsidizing the electric bills for these folks who can't afford to pay.[497]

At the May 6, 2015, local public hearing Mr. Andrew Inzerillo, who resides in Gladstone, Missouri testified,

> Then, I want to talk about this electric vehicle parking station. I got livid at that. I go by Antioch Shopping Center and Walgreen's has got an electric charging station there, and in all the years, I've been heading up there at least three or four years, never has anybody parked and been there, never once, and then they want to charge the retail customers for these charging stations.
>
> Tell you a little story about a drunken sailor went into a beer joint and he says, "When I drink, everybody drinks." The day he says, "When I pay, everybody pays." So the whole thing is, if you use it, you pay for it; if we don't use it, why should we pay for it?[498]

The Commission should note the insights and concerns expressed by members of the public it is charged with protecting.

If a certificate of convenience were required for electric vehicle charging stations, then they would need to be "necessary and convenient," which the Missouri Supreme Court has said means they must be an improvement that justifies their cost. KCPL attempts to justify its retail customers paying the costs of its Clean Charge Network charging stations by theorizing the charging stations will encourage more people to buy electric vehicles which will, in turn, reduce emissions and improve KCPL's load profile;

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[497] Tr. 7:60.

[498] Tr. 8:17.

however, KCPL relies almost exclusively on results from California to support its theory.[499] As to its existing electric vehicle charging stations that are not part of the Clean Charge Network KCPL shows a wide variation in usage at those 32 stations, with only its Clean Cities and some of its Smart Grid stations getting any real usage.[500]

Conclusion:

On the evidence adduced in this case, the Commission should reject KCPL's request to have its retail customers undergird its speculative venture into providing electric vehicle charging stations on the basis that KCPL has not shown that electric vehicle charging stations are an electric service the Commission should regulate. Instead, at this point in time, the Commission should leave the risk of this venture with KCPL and treat it as a non-regulated activity or, at a minimum, if the Commission decides the Clean Charge Network is a public utility service, then the Commission should require KCPL to file tariff rate schedules that put the cost of the charging stations on those who charge their vehicles at them or who request their installation.

Regardless of how it decides in this case who should pay for the Clean Charge Network, Staff recommends that all issues associated with the Clean Charge Network should be examined in a working docket case after resolution of this case with a primary objective of providing all interested and affected stakeholders the opportunity to comment on how the Clean Charge Network should be treated in the future.

XIX. Income Tax Related Issues (including accumulated deferred income taxes or "ADIT") – *what adjustments, if any, are necessary to ensure that KCPL's income tax allowance, including ADIT matters, is calculated appropriately?*

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[499] Ex. 119, KCPL witness Ives supplemental direct, Sch. DRI-2 through Sch. DRI-5.

[500] Ex. 119, KCPL witness Ives supplemental direct, Sch. DRI-7, pp. 8-10; Tr. 11:586-589.

There are four (4) income tax issues, three (3) of which are being pursued by Midwest Energy Consumers Group ("MECG") and one of which is being pursued by Staff and MECG. The issue addressed below is that which is being pursued by both Staff and MECG: ADIT associated with construction work in progress ("CWIP"). Staff has not taken a position on the three other issues. (Tr. Vol. 20, p. 1942, ll. 15-21).

KCPL's deferred income tax reserve represents in effect a prepayment of income taxes by KCPL's customers. The book-tax timing difference creates deferral or future liability of income taxes. KCPL's rate base is reduced by the deferred tax reserve balance to avoid having customers pay a return on funds that are provided cost-free to KCPL.[501]

KCPL noted in rebuttal testimony that it generated a net operating loss (NOL), and receives no cash tax benefit related to ADIT.[502] However, KCPL fails to mention that KCPL is receiving from ratepayers fully normalized cash income taxes in cost of service. The significant tax benefits are realized by KCPL through accelerated tax depreciation because the benefits are not immediately flowed through to ratepayers. Normalization treatment means that KCPL ratepayers do receive the benefit of accelerated depreciation through ADIT, a cost free source of capital which reduces rate base.[503]

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[501] Ex. 224, Majors direct, p. 176, ll. 19-27.

[502] Ex. 112, Hardesty rebuttal, p. 4, ll. 3-6; p. 5, ll. 8-12, 18-20.

[503] Ex. 226, Majors surrebuttal, p. 64, ll. 6-11.

KCPL records ADIT that is associated with the CWIP on its books and records. Although CWIP is not included in rate base due to Proposition 1 (Section 393.135 RSMo.), KCPL is allowed to earn an allowance for funds used during construction ("AFUDC") before the property under construction is added to rate base. AFUDC is accrued during the construction of the asset and included in rate base when the plant is "fully operational and used for service,"[504] i.e., placed in service. AFUDC is included in depreciation and rate base over the life of the plant. For the calculation of AFUDC, there is no consideration for ADIT as a reduction to the base on which it is calculated; the AFUDC is calculated on the "gross" amount, with no consideration of ADIT.[505]

AFUDC follows a formula and is calculated based on the utility's actual cost of debt and equity in a given time period. It is an accounting entry that increases non-cash income during the construction period of an asset, but it does not entail actual cash payments. AFUDC does not account for the income tax impact of ADIT. KCPL records an ADIT liability based on the AFUDC recorded in a given period. Because ADIT is not considered in the calculation of AFUDC the benefit must be accounted for elsewhere; i.e., rate base should be offset for ADIT associated with CWIP balances.[506]

The Commission in a recent Ameren Missouri rate case, *Re Union Electric Co., d/b/a/ Ameren Missouri*, Case No. ER-2012-00166, 2012 WL 6643105 (2012) held that it was appropriate to reduce rate base for ADIT associated with CWIP balances, when

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[504] Language from § 393.135 RSMo.

[505] Ex. 224, Majors direct, p. 178, ll. 2-12.

[506] Ex. 226, Majors surrebuttal, p. 64, ll. 12-18.

the CWIP amounts are not included in rate base. The Commission stated in part in its *Report and Order* at page 30:

> In other words, failure to recognize the CWIP-related ADIT balance in the company's rate base will overstate the companies AFUDC costs and future rate base, essentially allowing the company to earn AFUDC and a return on capital supplied by ratepayers.
>
> *   *   *   *
>
> As fully explained in the findings of fact, Ameren Missouri must include CWIP-related ADIT balances as an offset to rate base to avoid overstating AFUDC and future rate base, to the detriment of both current and future ratepayers.

KCPL contends that the fact that KCPL is in an NOL position is the basis to distinguish the Commission's decision in the recent Ameren Missouri rate case. However, similarly to Ameren Missouri ratepayers, KCPL ratepayers provide fully normalized income taxes in the cost of service regardless of the actual amount KCPL pays to the IRS. KCPL seems to argue that it is not realizing all the benefits of accelerated depreciation, that a NOL position invalidates the fact that KCPL ratepayers are providing cash income taxes. The Commission correctly decided this issue in Case No ER-2012-0166, recognizing income taxes ratepayers provide in the cost of service.[507]

The Commission should decide that the amount of ADIT on CWIP as of December 31, 2014, trued-up for amounts through May 31, 2014, is an additional reduction to KCPL's rate base, just as are the other amounts of ADIT.

Steven Dottheim.

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[507] Ex. 226, Majors surrebuttal, p. 64, l. 21 – p. 65, l. 3.

XXIV. Revenues—What is the appropriate level of revenues for the large general service and large power classes to account for customers switching from one rate class to another?

This is a true-up issue for which Staff has reached a settlement in principle.

XXV. Class Cost of Service, Rate Design, Tariff Rules and Regulations

Staff believes that the *Non-Unanimous Stipulation and Agreement* filed on June 16, 2015 is a fair and equitable resolution for all classes and customers. No settlement is perfect. It represents the work and trade-offs of the numerous parties involved. The *Non-Unanimous Stipulation and Agreement* is reasonable. It does not award any party all they sought, but a fair and equitable recommendation was reached and found acceptable to all the parties except KCPL.

Staff recommends the Commission make no factual findings regarding the general suitability of any class cost-of-service study method over any other. Staff believes that a CCOS study is not precise and should be used only as a guide in designing rates along with other considerations. Staff performed three CCOS studies.[508] The *Non-unanimous Stipulation and Agreement* does not recommend that the Commission use any particular methodology, but instead that it relied upon one or more of the submitted CCOS studies as achieving a reasonable allocation of production capacity costs and allocating net cost of service among the customer classes.

Based on CCOS results, Staff is not recommending any revenue-neutral adjustments to any class as each class would be close to Staff's CCOS study results

[508] Ex. 202, *Staff rate design class cost of service report,* p. 9.

within a realm of reasonableness range.[509] The *Non-unanimous Stipulation and Agreement* supports Staff's recommendation.

Staff requests the Commission support the *Non-Unanimous Stipulation and Agreement,* including no increase to the residential customer charge, based on considerations taken into account when reaching the agreement. First, the *Non-Unanimous Stipulation and Agreement* provides for no revenue neutral adjustments for any class especially the residential class. This would alleviate any potential positive revenue-neutral adjustments for the residential class as previously proposed by MIEC/MECG and the United States Department of Energy. Secondly, another consideration evaluated by Staff was the support for the residential rate structure change for the residential general use and space heating (ResB) to agree with rate structure for residential general use (ResA) and ResC. Finally, support for increasing the first energy block rate of the frozen All-Electric service rate schedules for the SGS, MGS, and LGS rate classes increasing by an additional 5%.

The *Non-Unanimous Stipulation and Agreement* also continues the prior practice of rate schedule elimination and consolidation. There are approximately 68 rate schedules with many frozen (grandfathered). The number of rate schedules has caused concerns for KCPL, Staff, and other parties. Staff believes there could be discrimination concerns. The Commission has recognized some of these concerns in prior decisions. The *Non-Unanimous Stipulation and Agreement* continues to remedy some of these

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[509] *Id.*, p. 2.

concerns and moves toward remedying these concerns with potential elimination of rate schedules in future case.

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

Staff recommends the Commission maintain the current residential customer charge at $9.00 per the *Non-Unanimous Stipulation and Agreement*. KCPL, on the other hand, proposes to increase the monthly customer charge to $25.00 per month which represents a 177% increase.[510] This requested increase is substantially above the system average increase in this or any other prior KCPL electric rate case.[511] Staff recommended that, based on CCOS results and policy considerations, the residential customer charge increase by the average increase for the class. In this case, KCPL current residential customer charge is $9.00. In the *Non-unanimous Stipulation and Agreement*, Staff supports a residential customer charge of $9.00 (current rate) for other considerations relating to priority of *Non-Unanimous Stipulation and Agreement*. It should be noted that a common theme expressed during each of the public hearings held in this rate case, was the overall impact of the increased residential customer charge on fixed income homes and low income individuals. Most of the customers testified that any increase to the fixed customer charge would have a detrimental impact to those living on fixed incomes or who were low income.[512]

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[510] Tr. 11:369, ll. 3-7.

[511] Ex. 217, R. Kliethermes rebuttal, p. 4, ll. 5-6.

[512] Tr. 3:7-8, 16-19, and 31-33.

The revenue KCPL requests to collect through the residential customer charge in this case is approximately $72.5 million annually compared to approximately $26.1[513] million that KCPL currently collects through its residential customer charge. This is an increase of $46.4 million annually, from the increase in the customer charge only. To put this into perspective KCPL's overall requested increase in rates is approximately 120.9 million[514], with the residential class being responsible for approximately 37% of the increase or approximately $44.9 million.

Staff's recommendation on the residential customer charge is consistent with the Commission's guidance issued in the Commission's *Report and Order* in ER-2012-0166, where the Commission stated, "[s]hifting customer costs from variable volumetric rates, which a customer can reduce through energy efficiency efforts, to fixed customer charges, that cannot be reduced through energy efficiency efforts, will tend to reduce a customer's incentive to save electricity."[515] The Commission also noted that increasing the customer charge would send the wrong message to customers.[516] All of these concerns remain valid in this present rate case and counsel against an increase in the monthly residential customer charge.

It is intuitive that moving costs from the variable portion of the rate to the fixed residential customer charge would work again the public policy of encouraging energy efficiency. No matter what efforts or practices customers utilized to conserve electricity,

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[513] Ex. 217, R. Kliethermes rebuttal, p. 3, l. 4.

[514] *Id.* at line 7.

[515] *Report and Order*, Case No. ER-2012-0166, p. 110, ¶ 12.

[516] *Id.,* at p. 111, ¶ 13.

the fixed charge would loom as an ever present, immovable cost working against energy efficient efforts and conduct.[517] This also disincentives the consumer from making proactive energy efficiency changes because they have lost control over a portion of their bill which will now remain unchanged no matter what the consumer may do to reduce energy usage.

KCPL has provided no link to the proposed $25 fixed residential customer charge and the cost to actually provide fixed cost services to residential customers. In evaluating the fixed residential customer charge the following items are taken into consideration in calculating the cost: monthly meter reading, billing, postage, customer accounting service expense, as well as a portion of the costs associated with required investment in the meter, the service line ("drop"), and other billing related costs.[518] Based on Staff's Class Cost of Service study results and rate design principals' regarding rate simplicity, stability, and customer understandability, Staff is recommending that the fixed residential customer charge remain at the current level of $9.00 as set forward in the *Non-Unanimous Stipulation and Agreement*. As set forth in the corrected testimony of Staff witness Robin Kliethermes[519], Staff's Class Cost of Service study and calculation of the residential customer charges results in a cost to serve customers of approximately $11.88.

KCPL's proposal to raise the residential customer charge to $25.00 results in a 177% increase in this monthly fixed charge and again, is not supported by any evidence

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[517] Tr. 3:9-12.

[518] Ex. 202, *Staff rate design class cost of service report*, p. 34.

[519] See Affidavit of Robin Kliethermes, Ex. 247.

in the record. In fact, KCPL's own Class Cost of Service study found the fixed cost to serve residential customers to be $13.54[520]. However KCPL is asking this Commission to include local facility equipment[521], or demand distribution secondary components and demand distribution transformation components, in order to calculate a residential customer charge of $22.67 which falls below KCPL's requested customer charge of $25[522]. Staff and other parties have urged this Commission to reject including local facility equipment in the fixed residential customer charge[523].

Because KCPL has failed to show that the residential customer charge should increase to its recommended $25.00, and because an increase to the residential customer charge would impede the public policy of encouraging energy efficiency, Staff recommends the residential customer charge remain at $9.00 consistent with the *Non-Unanimous Stipulation and Agreement.*

Cydney Mayfield.

XXVI. Low-Income Weatherization

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

The surplus Income Eligible Weatherization Program funds collected through base rates should be applied to the present costs of the program until they are depleted.

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[520] Ex. 135, Tim Rush rebuttal testimony, p. 55, ll. 22-23. The cost categories included in KCPL's calculation of the customer cost is the same cost categories that Staff includes in its calculation of the residential customer charge.

[521] Ex. 136, Tim Rush surebuttal testimony, p. 20, ll. 5-9.

[522] Ex. 217, R. Kliethermes rebuttal, p. 4, ll. 11-15.

[523] Ex. 218, R. Kliethermes surrebuttal, pp. 2-4.

Once the funds are depleted, KCPL should collect funding for the program either through base rates or recover through MEEIA; it should not be permitted to continue obtaining funding through both avenues.

Income-eligible weatherization was established by stipulation in the 2012 rate case. The tariff provisions became effective February 13, 2013. [524] The language in the original stipulation stated that,

> "[T]his low-income weatherization program should not be funded in rates at the same time KCPL's retail customers are funding a low-income weatherization program the Commission approves under the MEEIA … (Both programs are not funded at the same time and they are mutually exclusive.)"[525]

Staff recommends that the Commission order a single funding mechanism for income-eligible weatherization.

The tariff states, "program funds cannot be used for administrative costs except those incurred by the Social Service Agency that is directly related to qualifying and assisting Customers under this Program."[526] The Stipulation states, "Any low-income weatherization funds which KCPL collects through its rates during a year which are not distributed to the low-income weatherization agencies during that year will be available for distribution in subsequent years." [527]

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[524] Stipulation and Agreement, Case Nos. ER-2012-0174 and ER-2012-0175.

[525] *Id.*

[526] Tariff Sheet 1.96, Schedule KHW-3, Page 26.

[527] Stipulation and Agreement, Case Nos. ER-2012-0174 and ER-2012-0175.

Funds collected for the program are intended to be applied solely to the program work. Unexpended funds are to be rolled over to the next year. [528] Staff recommends that any funds presently in the program should be applied to program costs before KCPL obtains any recovery through MEEIA.

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

Staff is neutral on the matter of whether funds are collected through base rates or MEEIA, but it wants assurance that the funds will not be collected through both simultaneously. Should the Commission choose to order KCPL to collect income-eligible weatherization funds through its MEEIA program, base rates must be adjusted accordingly.

Colleen M. Dale and Whitney Payne

XVII. Economic Relief Pilot Program—*Should the program be expanded to serve additional customers as proposed by KCPL?*

KCPL's request to expand its limits on customer participation in its Economic Relief Pilot Program should be granted, but its request for increased funding should be denied. An additional important measure is to amend the tariff to reflect an eligibility requirement of 200% of the federal poverty level, which has changed since 2009.[529]

The Economic Relief Pilot Program was established in the 2009 rate case and the amendments to the tariff became effective September 1, 2009. The relevant portions of the tariff set out that "the ERPP program has been designed so that the

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[528] Ex. 200, Staff revenue requirement cost of service report, p. 138.

[529] Ex. 200, Staff revenue requirement cost of service report, p. 137.

Company neither profits from nor incurs losses as a result of offering this experimental program."[530] The funds collected for the economic relief program are intended for a specific use. To that end, the tariff goes on to state that, "if any program funds in excess of actual program expenses remain at the end of the ERPP program, the Company shall redirect the excess funds to tariffed demand-side management programs." [531]

Presently KCPL's program contains $51,230 in excess, undistributed ratepayer funds.[532] The tariff requirement that shareholder funding match ratepayer funding results in over $100,000 in surplus. KCPL proposes to apply these funds to its Dollar-Aide program, but Dollar-Aide is not a demand-side management program.[533]

Staff does not dispute that the economic relief program benefits nearly 1000 low income KCPL customers each month. However, Staff understands that the program costs are borne by all KCPL customers, including low-income ratepayers. Increasing funding will result in a higher customer charge, and risk an even greater surplus. Considering the existing surplus, Staff believes that the economic relief program already has the ability to increase participation without increasing funding. It recommends the Commission grant the request for an increase in participation and deny the request for an increase in funding.

The tariff requires eligibility for the economic relief program to be based on the poverty guidelines in the Federal Register maintained by the United States Department of

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[530] Tariff Sheet No. 43Z.3

[531] *Id.*

[532] Ex. 135, rebuttal testimony of Timothy M. Rush, p. 4.

[533] Ex. 200, Staff revenue requirement cost of service report , p. 137.

Health and Human Services.[534] In 2009, when the program was established, eligibility for similar programs in Missouri was set at 185% of the federal poverty level. Shortly after the program went into effect, the rate for most other, similar programs was changed to 200% of the federal poverty level. [535] Staff requests that the tariff and the program operation be updated to apply the 200% of the federal poverty level as the eligibility criteria. KCPL does not oppose this change.[536]

Colleen M. Dale and Whitney Payne.

XVI. Decoupling: *Should the Commission consider, in File No. AW-2015-0282 or a similar proceeding, decoupling of KCPL's revenues from customer usage?*

At the hearing, Staff did not take a position on the issue of decoupling as it has chosen to address those matters in the working docket established by the Commission in AW-2015-0282. Staff believes that the issue warrants further review and evaluation, but that doing so in isolation in the context of an individual rate case is not the proper place for such a policy to be established and evaluated given the already time constrained environment of a general rate case. Furthermore, there are various stakeholders who may be impacted by such a policy and that a working docket is a better venue for ensuring that all parties impacted are heard and their concerns evaluated. Therefore, Staff recommends that the Commission allow all interested parties to proceed forward with the issue of revenue decoupling in File No. AW-2015-

[534] 42 U.S.C. § 9902(2).

[535] Ex. 200, Staff revenue requirement cost of service report , p. 137.

[536] Ex. 134, rebuttal testimony of Timothy M. Rush, p. 6.

0282 and reject any proposal for revenue decoupling as advanced by any of the parties in the instant case.

Cydney Mayfield.

CONCLUSION

WHEREFORE, for the reasons set forth above, the Staff requests the Commission to adopt the Staff's position on each and every issue that was presented in this case.

Respectfully submitted,

/s/ Nathan Williams

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronic mail to all counsel of record this 22nd day of July, 2015.

/s/ Nathan Williams