BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan.	)))))	**<u>Case No. ER-2012-0174</u>** Tariff No YE-2012-0404
In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.	))))	**<u>Case No. ER-2012-0175</u>** Tariff No. YE-2012-0405

STAFF'S INITIAL BRIEF

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In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement its Regulatory Plan.	)))))	**Case No. ER-2012-0174** Tariff No YE-2012-0404
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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

KCP&L is the brand and service mark by which Kansas City Power & Light Company ("KCPL") and KCP&L Greater Missouri Operations Company ("GMO") operate and present themselves to the public.[1] They have three areas with differing rate structures in west-central and northwestern Missouri, approximated by the red, grey and green areas shown in the map on the following page, which is reproduced from Staff's KCPL Cost of Service Report.[2] Rates in the grey area are governed by KCPL's

[1] Ex. Staff-201, Staff KCPL Cost of Service Report, p. 1; Ex. Staff-259, Staff GMO Cost of Service Report, p. 1.

[2] Ex. Staff-201, Staff KCPL Cost of Service Report, p. 5 and the map following p. 257; Ex. Staff-259, Staff GMO Cost of Service Report, pp. 5-6.

tariff, rates shown in the red area are governed by GMO's tariff for its MPS rate district and rates in the green area are governed by GMO's tariff for its L&P rate district. GMO has no employees of its own; instead, KCPL employees perform GMO's work.[3]

KCPL serves approximately 511,000 customers, of which about 451,000 are residential customers, about 58,000 are commercial customers and the remaining about 2,100 are industrial, municipal and other utility customers. To serve these customers, KCPL owns and operates 547 MW of nuclear generating capacity, about 2,760 MW of coal capacity, 148 MW of wind capacity (accredited at 12 MW), 771 MW of natural gas-fired combustion turbine capacity, and 410 MW of oil-fired combustion turbine capacity. It also purchases power.[4] However, it has sufficient generating capacity to meet its load.

Until it filed a rate case on February 1, 2006, to initiate its experimental alterative regulatory plan (Case No. ER-2006-00314), KPCL had not filed a general rate increase case for about twenty years, that last case being Case No. EO-85-185. KCPL's rate

[3] Ex. GMO-101, GMO witness Bassham Direct, p. 4; Ex. Staff-201, Staff KCPL Cost of Service Report, pp. 104, 201; and 213; Ex. Staff-259, Staff GMO Cost of Service Report, p. 1.

[4] Ex. Staff-201, Staff KCPL Cost of Service Report, p. 2.

case activity, starting with Case No. EO-85-185, follows:[5]

Order Date	Case Number	Original Rate Reques	Commission Decision
April 23, 1986	EO-85-185	$194.7 million	$78.3 million
April 1, 1987	EO-85-185	Not Applicable	$7.7 million
May 5, 1988	EO-85-185	Not Applicable	$8.5 million
December 29, 1993	ER-94-197	Not Applicable	($12.5 million)
July 3, 1996	EO-94-199	Not Applicable	($9.0 million)
October 7, 1997	EO-94-199	Not Applicable	($11.0 million)
April 13, 1999	ER-99-313	Not Applicable	($15.0 million)

Case No.	Date Filed	Amount Requested	Amount Authorized	Effective Date of Rates
ER-2006-0314	February 1, 2006	$57 million 11.5% increase	$50.6 million	January 1, 2007
ER-2007-0291	February 1, 2007	$45 million 8.3% increase	$35.3 million	January 1, 2008
ER-2009-0089	September 5, 2008	$101 million 17.5% increase	$95 million 16.2% increase	September 1, 2009
ER-2010-0355	June 4, 2010	$92.1 million 13.8% increase	$34.8 million 5.23% increase	May 4, 2011
ER-2012-0174	February 27, 2012	$105.7 million 15.1% increase	Pending	January 2013 expected

As the above table shows, collectively, KCPL's retail customers have seen their rates increase by 43.80% over just under four and one-half years (January 1, 2007 to May 4, 2011). However, during that same period of time—2007 to 2011—average weekly wages in the Missouri counties where KCPL provides electric service increased

[5] Ex. Staff-201, Staff KCPL Cost of Service Report, p. 16.

collectively only 11.45%, slightly less than the 11.63% they increased throughout Missouri during that same time frame and slightly less than the 11.58% CPI increase. [6]

GMO has approximately 312,000 customers, of which about 274,000 are residential customers, about 38,000 are commercial customers and the remaining about 500 customers are industrial, municipal and other utility customers. To serve these customers, GMO owns, 2,139 MW of generating capacity, of which 1,042 MW is coal capacity, 1,036 MW is natural gas-fired combustion turbine capacity, and 61 MW is oil-fired combustion turbine capacity. Like KCPL, it also purchases power.[7] However, unlike KCPL, GMO relies significantly on power it purchases, including short-term power purchases, to serve its load.[8]

GMO filed numerous rate cases since 2000. Its rate case history from July 3, 2006, follows:[9]

Case No.	Date Filed	MPS Amount Requested	MPS Amount Authorized	L&P Amount Requested	L&P Amount Authorized	Effective Date of Rates
ER-2007-0004	July 3, 2006	$94.5 million (22% increase)	$ 45.3 million (11.64% increase)	$22.4 million (22.1% increase)	$13.6 million (12.79% increase)	June 3, 2007
ER-2009-0090	September 5, 2008	$ 66 million (14.4 % increase excluding any impact of the fuel clause)	$48 million (10.46% increase)	$ 17.1 million (14.4 % increase excluding any impact of the fuel clause)	$15 million (11.85% increase)	September 1, 2009
ER-2010-0356	June 4, 2010	$75.8 million (14.4% increase excluding impact of the fuel clause)	$35.7 million (7.2%)	$22.1 million (13.9% increase excluding impact of the fuel clause)	$22.1 million (15.8%) Full amount before phase-in of $29.8 million excluding deferrals	June 25, 2011

[6] Ex. Staff-201, Staff KCPL Cost of Service Report, pp. 6-7.

[7] Ex. Staff-259, Staff GMO Cost of Service Report, p. 2.

[8] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 122-124.

[9] Ex. Staff-259, GMO Staff Cost of Service Report, p. 7.

As the above table shows, collectively, GMO's retail customers in its MPS rate district have seen their rates increase by 32.13% and its retail customers in its L&P rate district have seen their rates increase by 46.14% over four years (June 3, 2007 to June 25, 2011). However, during that same period of time—2007 to 2011—average weekly wages in the Missouri counties within the MPS rate district increased collectively by 11.80% and those in the L&P rate district increased collectively by 14.72%, slightly more than the 11.63% they increased throughout Missouri during that same time frame and slightly more than the 11.58% CPI increase.[10]

These rate cases started on February 27, 2012, when KCPL and GMO filed applications and proposed tariff changes to implement general electric rate increases which the Commission docketed as Case Nos. ER-2012-0174 and ER-2012-0175, respectively. KCPL originally requested an annual revenue requirement increase of about $105.7 million, which it said represented a 15.1% increase in rates, or about $0.48 per day for a typical residential customer.[11] GMO originally requested an annual revenue requirement increase of about $83.5 million, which it said represented an 11.76% increase in rates, total company. For each of its two rate districts—MPS and L&P—it requested annual revenue requirement increases of about $58.3 million, or 10.9%, and $25.2 million, or 14.6%, respectively, which it said would increase typical residential customer bills in each rate district by $0.27 and $0.36 per day, respectively.[12]

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[10] Ex. Staff-259, Staff GMO Cost of Service Report, p. 13.

[11] Ex. KCPL-2, KCPL witness Bassham Direct, p. 6.

[12] Ex. GMO-101, GMO witness Bassham Direct, p. 4.

On November 7, 2012, the Commission issued in both of these cases its *Order Incorporating Unopposed Non-Unanimous Stipulations and Agreements* that took effect November 17, 2012. The agreements incorporated in that order resolve a number of issues in the KCPL case for a revenue requirement increase of $6.14 million, a number of issues in the GMO case for revenue requirement increases for the MPS rate district of $20.35 million ($6.28 million from the October 19th agreement and $14.07 from the MEEIA agreement—Ex. Staff-391) and for the L&P rate district of $6.20 million ($1.54 million from the October 19th agreement and $4.66 million from the MEEIA agreement—Ex. Staff-391).

On November 16, 2012, the Commission issued in both of these cases a second *Order Incorporating Unopposed Non-Unanimous Stipulations and Agreements* that also took effect on November 17, 2012. The agreements incorporated in that order, with the exceptions of return on common equity, capital structure and cost of debt (Issues **II**.3.a., b. and c.), resolve all revenue requirement issues in the KCPL case for $53,500,440 (about one-half of KPCL's original $105.7 million request) and all revenue requirement issues for the L&P rate district in the GMO case for $18,525,414. Therefore, subject to adjustment only for the stated rate of return issues, KCPL's revenue requirement in Case No. ER-2012-0174 is $53,500,440, and the revenue requirement for GMO's L&P rate district in Case No. ER-2012-0175 is $18,525,414 (original request of about $25.2 million). The return on common equity (Issue II.3.a.) for both KCPL and GMO may be affected by how the Commission decides the transmission tracker issue (Issue II.11.) and, for GMO only, by how it decides the FAC issues (Issues III.11.), since both trackers and FACs affect shareholder risk. Therefore, those issues, through return on common equity, affect the revenue requirements for KCPL, and GMO's L&P and MPS rate districts.

The agreements incorporated in the Commission's November 16, 2012, order leave unresolved for determining the revenue requirement for GMO's MPS rate district not only the return on common equity, capital structure and cost of debt issues (Issues **II**.3.a., b. and c.), but also the Crossroads issues (Issues **III**.1.a., b., c. and d.). Therefore, subject to adjustment only for the stated rate of return and Crossroads issues, the revenue requirement for the MPS rate district in Case No. ER-2012-0175 is $15,950,146 (original request of about $58.3 million). As stated above, both trackers and FACs affect shareholder risk. Therefore, those issues, through return on common equity, affect the revenue requirement for GMO's MPS rate district.

The other issues now pending before the Commission for decision are:

- Fuel Adjustment Clause (Issue **III**.11 (GMO)).
- Transmission Tracker (Issue **II**.11 (KCPL and GMO)); and
- Rate Design / Class Cost of Service Study (Issues **I**.6 (KCPL) and **III**.7 (GMO)) except for those rate design and class cost of service issues that are resolved in the agreements separately filed on October 29, 2012, in Case Nos. ER-2012-0174 and ER-2012-0175 that are titled, *Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service / Rate Design.*
- Off-System Sale Margins (Issue **III**.3 (GMO)); and
- Resource Planning-LaCygne and Montrose (Issue **I**.9 (KCPL)).

Staff presents its position and argument on each of these issues in this brief.

REVENUE REQUIREMENT ISSUES

COST OF CAPITAL

Because it has the greatest impact on rates—for both KCPL and GMO—and is applicable not only to KCPL and GMO, but also to both of GMO's rate districts—MPS and L&P, Staff is starting its brief with the rate of return issues: return on common equity, capital structure and cost of debt (Issues **II**.3.a., b. and c.). These issues are described in the list of issues as follows:

II.3. Cost of Capital (KCPL and GMO—both rate districts):

a. Return on Common Equity: What return on common equity should be used for determining rate of return?

b. Capital Structure: What capital structure should be used for determining rate of return?

c. Cost of Debt:

i. Should GPE's consolidated cost of debt be assigned to KCPL and GMO or should the cost of debt be subsidiary specific?
ii. In either case, should adjustments be made to holding company debt issued subsequent to GPE's acquisition of GMO?
iii. Should any adjustments be made to certain debt issuances? Should the cost of debt be a consolidated cost of debt of 6.425%?

In determining the amount of revenue requirement to allow for each of the GPE operating companies, the Commission must include an opportunity for the shareholders to earn a reasonable return on their investment.[13] That return is calculated as the product of a rate of return and the value of the shareholders'

[13] ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*****,** 585 S.W.2d 41, 49 (Mo. banc, 1979) ("***UCCM***").

investment, at original cost basis, less accumulated depreciation.[14] The rate of return is the sum of the cost of each type of capital in the utility's capital structure, weighted by the percentage each type forms of the whole. In the present case, the cost-of-capital issue contains three sub-issues. These concern (1) the return on common equity; (2) the proportion of each type of capital in the capital structure; and (3) the cost of debt.

Economic Considerations:

The determination of just and reasonable rates requires consideration of all relevant factors, including prevailing economic and capital market conditions.

Economic Conditions in the Companies' Service Areas:

The 44 counties served by the GPE operating companies have endured a difficult economic situation since 2007 due to the Great Recession of 2008 and subsequent slow recovery.[15] Indeed, Missouri's economic recovery has been slower than that of the nation as a whole.[16] Missouri was at 94.4% of its pre-recession level in June 2012, while the nation, at 101.2%, had surpassed its pre-recession level.[17] The recession hit Missouri particularly hard, as well; the state dropped to 91.9% of its pre-recession level, while the nation as a whole fell only to 95.3%.[18] Missouri has also lagged behind the

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[14] State ex rel. Union Electric Co. v. Public Service Commission, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

[15] KCP&L serves 13 counties; GMO serves 31 counties. *KCPL RR Report,* p. 6; *GMO RR Report,* p. 11.

[16] KCPL RR Report, p. 8; GMO RR Report, p. 14.

[17] *KCPL RR Report,* p. 9; *GMO RR Report,* p. 15. The Federal Reserve Bank of Philadelphia's coincident index is a combination of payroll employment, wages, unemployment and hours of work to give a single measure of economic performance.

[18] KCPL RR Report, supra; GMO RR Report, supra.

rest of the nation in growth of Gross Domestic Product ("GDP").[19] Missouri's real GDP grew by 0.04% in 2011, while the national real GDP grew by 1.5%.[20] All of the counties served by the GPE operating companies have higher unemployment rates now than they did in 2007.[21]

KCPL's Missouri ratepayers have experienced a 43.80% increase in electric rates since 2007, while experiencing an increase in average weekly wages of 11.45%.[22] GMO's MPS rate district experienced an 11.80% increase in average weekly wages and the L&P rate district had a 14.72% increase in average weekly wages; meanwhile, electric rates increased 32.13% in the MPS rate district and 46.14% in the L&P rate district.[23] During the same time period, the Consumer Price Index ("CPI") increased 11.58%, while the Producer Price Index ("PPI") for Industrial Commodities increased by 19.66%.[24] The cost of living utility index for Missouri was 103.1 in the first quarter of 2012, indicating that utility expenses constitute a higher percentage of a Missouri resident's living expenses than the average U.S. resident.[25] Electric rates are thus increasing at a much more rapid pace than either average weekly wages or inflation and electric utility service is becoming increasingly difficult for many Missourians to afford.

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[19] KCPL RR Report, supra; GMO RR Report, supra.

[20] *KCPL RR Report,* p. 9; *GMO RR Report,* p. 16. "Real" GDP is adjusted to remove the effects of inflation, while "nominal" GDP is not.

[21] KCPL RR Report, p. 11; GMO RR Report, p. 18.

[22] KCPL RR Report, supra.

[23] GMO RR Report, p. 13.

[24] KCPL RR Report, p. 7; GMO RR Report, supra.

[25] KCPL RR Report, p. 7; GMO RR Report, p. 14.

The National Economy and Financial Markets:

The nation's economy is recovering at a slow pace from the Great Recession of 2008, unlike the rapid pace of previous economic recoveries.[26] Observers consequently remain concerned about the long-term outlook for the U.S. and global economies.[27] Most economists expect that ongoing domestic economic growth will be lower than those achieved between the end of World War II and the collapse of 2008.[28] Many economists expect the long-term nominal GDP growth rate to be in the range of 4% to 5%, based on an expected annual inflation rate of 2%.[29]

In an ongoing effort to stimulate further economic recovery, the Federal Reserve Bank has maintained the Federal Funds Rate at historic low levels between 0.00% and 0.25% and has extended its bond buy-back program in an effort to maintain, or even further reduce, low long-term interest rates.[30] Nonetheless, the Federal Reserve Bank has also lowered its projections of near-term economic growth to between 1.9% and 2.4% this year and under 3% next year.[31] Market expectations of inflation are low; the 2012 monthly spread between 30-year Treasury Inflation Protected Securities ("TIPS") and non-inflation-protected Treasury bonds indicates that investors are requiring only an

[26] KCPL RR Report, p. 24; GMO RR Report, p. 28.
[27] KCPL RR Report, supra; GMO RR Report, supra.
[28] KCPL RR Report, supra; GMO RR Report, supra.
[29] KCPL RR Report, supra; GMO RR Report, supra.
[30] KCPL RR Report, p. 25; GMO RR Report, p. 29.
[31] KCPL RR Report, supra; GMO RR Report, supra.

additional 2.25% to 2.40% return for potential inflation.[32] In summary, the price of money has never been lower.

Utilities have been reaping the benefit of the present low cost of capital. It is now common for utilities to issue 10-year to 15-year bonds at coupons in the 3% range.[33] The Empire District Electric Company issued $88 million worth of 15-year secured debt at a coupon of 3.58% in April 2012.[34] Ameren Missouri issued 30-year secured debt at a coupon of 3.9% on September 11, 2012.[35] Long-term interest rates, as measured by 30-year Treasury bonds ("T-bonds"), decreased to the high 2% to 3% range for the period August 2011 through May 2012.[36] Long-term utility bond yields have closely tracked the changes in 30-year T-bond yields; the current spread between utility bond yields and 30-year Treasury yields at 1.91% is slightly above the average of 1.55% since 1980, while the absolute yield on utility bonds recently fell below 5% for the first time.[37]

The low cost of debt reflected by bond yields has produced a "spectacular couple of years for electric utility stock returns."[38] "Regulated" utilities' total returns in 2010 and 2011 were 38.05% over the two years, a far superior performance to the markets in

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[32] KCPL RR Report, supra; GMO RR Report, supra.

[33] KCPL RR Report, p. 26; GMO RR Report, p. 30.

[34] KCPL RR Report, supra; GMO RR Report, supra.

[35] Murray KCPL Surr., p. 9.

[36] KCPL RR Report, supra; GMO RR Report, supra.

[37] KCPL RR Report, supra; GMO RR Report, supra.

[38] KCPL RR Report, p. 27; GMO RR Report, p. 31.

general.[39] For the twelve months ending December 31, 2011, the total return on the Dow Jones Industrial Average was 8.38%, the total return on the Standard & Poor's 500 ("S&P 500") was 2.11%, and the total return on the Edison Electric Institute ("EEI") Index of electric utilities was 19.99%.[40] More specifically, on a non-market-capitalization-weighted basis, the total return for the twelve months ending December 31, 2011, was 22.30% for EEI "Regulated" electric utilities, 19.52% for EEI "Mostly Regulated" electric utilities and 21.36% for "Diversified" electric utilities.[41] This strong performance in the regulated utility equity sector has evidently been driven by the continued decline in bond yields because there is no evidence that investors expect high growth in that projected 5-year earnings-per-share ("EPS") forecasted growth rates have actually declined.[42] This clear indication that investors are willing to pay more for regulated utility shares is unmistakable evidence that the cost of equity for regulated electric utilities has declined.[43] As Staff's expert financial analyst David Murray testified:[44]

> The current macroeconomic environment is clearly favorable to utilities in terms of a lower cost of capital for debt and equity instruments. Staff believes these lower capital costs should be shared with ratepayers through lower authorized returns on common equity ("ROEs").

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[39] KCPL RR Report, supra; GMO RR Report, supra. 2010: 15.75%; 2011: 22.30%.

[40] KCPL RR Report, p. 26; GMO RR Report, p. 30.

[41] KCPL RR Report, p. 27; GMO RR Report, p. 31.

[42] KCPL RR Report, supra; GMO RR Report, supra.

[43] KCPL RR Report, pp. 27-28; GMO RR Report, pp. 31-32.

[44] KCPL RR Report, supra; GMO RR Report, supra.

The GPE Operating Companies:

KCP&L and GMO are vertically-integrated, regulated electric utilities that are both owned by GPE, an integrated electric utility holding company.[45] GPE's sole reportable business segment is electric utility.[46] Its business risk profile is "excellent" and its financial risk profile is "aggressive."[47] GPE's senior unsecured debt credit rating is "Baa3," as is GMO's; KCP&L's is one notch higher at "Baa2."[48] The outlook for both companies is "stable."[49] GMO's debt is supported by a guarantee from GPE, a necessity for an investment-grade rating for GMO.[50] KCP&L, GPE's only other asset, thus indirectly supports GMO and its credit standing has been negatively impacted.[51] GPE has treated KCP&L -- and thus its ratepayers -- unfairly in the course of its post-acquisition financing activities; the average coupon rate for GMO has been 4.402%, while that of KCP&L has been 6.23%.[52]

A.

Return on Common Equity

What return on common equity should be used for determining rate of return?

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[45] Gorman KCPL Dir., p. 9.

[46] KCPL RR Report, p. 29.

[47] KCPL RR Report, p. 30.

[48] *KCPL RR Report,* p. 30. Rating by Moody's. Gorman reports "BBB+" and "A3" for KCP&L and "BBB" and "Baa3" for GMO. *Gorman KCPL Dir.,* p. 9; *Gorman GMO Dir.,* p. 9.

[49] Gorman KCPL Dir., p. 9; Gorman GMO Dir., p.11.

[50] Id.

[51] *Id.,* at 30, 32.

[52] *Id.,* at 33.

Staff has determined, based upon its expert analysis of market-driven data using traditional analytical tools, that the cost of common equity ("COE") for both KCPL and GMO is within the range of 8.00% to 9.00%, mid-point 8.50%, which should be combined with each company's capital structure, cost of debt and cost of preferred stock as of August 31, 2012, to arrive at the allowed rate of return ("ROR") in this case.[53] Staff recommends that, based on a consideration of all relevant factors, the Commission authorize a return on common equity ("ROE") in the range of 9.0, Mr. Murray's recommendation, and the national average of awarded ROEs of 9.92 for the first three quarters of 2012,[54] mid-point 9.46, rounded up to 9.5, which is Mr. Kahal's recommendation[55] and which is within Mr. Gorman's recommended range of 9.1 to 9.5 and almost identical to his recommended ROE of 9.4.[56]

What is the significance of this Issue?

As usual, cost of capital is among the largest issues in each of these cases. The difference between Staff's position and KCPL's is worth almost $30 million; the difference between Staff's position and GMO's is worth approximately $20 million.[57] 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

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[53] *KCPL RR Report,* p. 21; *GMO RR Report,* p. 25. Both companies' capital structure consists of 51.82% common equity, 0.61% preferred stock, and 47.57% debt; the embedded cost of preferred stock is 4.291 and the embedded cost of debt is 6.247. *KCPL RR Report, supra; GMO RR Report, supra.*

[54] Tr. 17:423.

[55] Tr. 17:543.

[56] Tr. 17:536.

[57] Staff's Reformatted Reconciliations, Exs 316 (KCPL) and 317 (GMO).

long-term debt, preferred equity and common equity.[58] Unusually, in this case, there is a dispute about the cost of long-term debt. The cost of both long-term debt and preferred equity is historic or "embedded" and can generally be readily determined from the controlling instruments.[59] The cost of common equity, on the other hand, is driven by the market and must be estimated through expert analysis and judgment. Four expert financial analysts testified before the Commission in this case and offered recommendations to the Commission for the cost of common equity as set out below.[60] Three of the four expert witnesses testified that an authorized ROE anywhere within his recommended range would be appropriate.[61] Dr. Hadaway insisted that only the top of his range would be an appropriate ROE award, but admitted that he made this recommendation at his clients' specific direction.[62]

SUMMARY OF ROE RECOMMENDATIONS:[63]		
Hadaway	Company	9.80 to 10.30, **10.30**
Kahal	FEA	8.80 to 9.80, **9.50**
Gorman	MIEC	9.10 to 9.50, **9.40**
Murray	Staff	8.00 to 9.00, **9.00**

Table 1.

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

[59] For example, the interest rate on a corporate bond can be determined by examining the indenture.

[60] Mr. Gorman and Mr. Murray have MBAs and hold the Chartered Financial Analyst ("CFA") designation. *Gorman Dir.,* App. A, pp. 1-4; *KCPL RR Report,* App. 1, p. 63; *GMO RR Report,* App.; 1, p. 74. Mr. Murray is also a Certified Rate of Return Analyst ("CRRA"). *KCPL RR Report, supra; GMO RR Report, supra.* Matthew Kahal has an M.A. in Economics, he is "A.B.D." (all but dissertation) in Economics at the University of Maryland for 38 years. *Kahal Dir.,* pp. 1-2 and App. A. Dr. Hadaway has a Ph.D. in Finance and Economics. *Hadaway Dir.,* App. A., p. 1. His most recent publication is dated 1989. *Id.*

[61] Tr. 17:523 (Gorman); 17:463-464 (Murray); 17:544 (Kahal).

[62] Tr. 17:432-434; *but see*:17:420.

[63] Tr. 17:420, 432-433 (Hadaway); Tr. 17:543-544 (Kahal); *Gorman Dir.,* p. 2; Tr. 17:536 (Gorman); *KCPL RR Report,* p. 21; *GMO RR Report,* p. 25 (Murray).

Determination of the Cost of Common Equity:

The cost of common equity ("COE") is the return necessary to induce investors to invest in the utility's common stock, or, put slightly differently, "[a] utility's cost of common equity is the return investors require on an investment in the utility."[64]

> The cost of equity is the rate of return that common stockholders expect, just as interest on bonds and dividends on preferred stock are the returns that investors in those securities expect. Equity investors expect a return on their capital commensurate with the risks they take, consistent with returns that are available from other similar investments. Unlike returns from debt and preferred stocks, however, the equity return is not directly observable in advance and, therefore, it must be estimated or inferred from capital market data and trading activity.[65]

The COE must be estimated; it cannot be directly observed.[66] This is a difficult task, as academic commentators have recognized.[67] 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."[68] The evaluation of expert testimony is left to the Commission, which "may adopt or reject any or all of any witness's [sic] testimony."[69]

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[64] Gorman KCPL Dir., p. 14.

[65] Hadaway KCPL Dir., p. 21.

[66] *Id.,* at 33.

[67] 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).

[68] Goodman, *supra,* 606.

[69] ***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)).

A matter of terminology arises at the outset. Staff maintains that the cost of equity ("COE") is distinct from the return on equity ("ROE").[70] The truth of Staff's position is readily apparent. The COE is the return necessary to induce investors to invest in the utility's common stock; it is a market-driven value that must be discerned by the experts through analysis and judgment. The ROE is the figure set by the Commission. The COE and ROE may be the same number, but they don't have to be. The Commission, in its discretion, can set the ROE at or above the COE, with various consequences.[71] As Staff expert witness David Murray testified, "investment analysts do not equate allowed ROEs to the COE. In fact, investment analysts actually expect commissions to authorize ROEs higher than the COE."[72]

Constitutional Parameters:

The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must be met in setting the cost of common equity.[73] Each of the experts has affirmed that he conducted his studies and made his recommendations with these parameters in mind. In the earlier of these 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

[70] KCPL RR Report, p. 24; GMO RR Report, p. 28.

[71] *See* Ex. 57, Steven Kihm, "Rethinking ROE," ***Public Utilities Fortnightly,*** 149:8 (August 1, 2011).

[72] Murray KCPL Surr., pp. 8-9.

[73] 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).

> public utility company of its property in violation of the Fourteenth Amendment.[74]

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.[75]

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.[76]

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

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

[76] ***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 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. 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 realized by a proxy group of comparable companies in setting the utility's return on common equity.

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 market place for necessary capital. The GPE operating companies compete for capital with other utilities on a global basis and utilities likewise compete with unregulated businesses.[77]

Methodology for Determining the Cost of Equity:

Two principal methods have emerged for determining the cost of common equity: these are the "market-determined" approach and the "comparable earnings" approach.[78] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[79] Examples of market-determined methods are the Discounted Cash Flow method ("DCF") and the Capital Asset Pricing Model ("CAPM").[80] 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.[81] The comparative earnings approach requires a comparative study of earnings on common equity in both regulated and unregulated enterprises of similar risk.[82] Another frequently-encountered method that does not fall within the boundaries of either of the principal approaches referred to above is the Risk Premium method ("RP"). This method is "relatively straightforward" and requires that the analyst "(1) determine the historic spread between the return on debt and the return

[77] Tr. 17:481-482.

[78] Phillips, *supra,* 394.

[79] *Id.*

[80] Id.

[81] *Id.,* at 397.

[82] *Id.,* at 397-98.

on common equity, and (2) add this risk premium to the current debt yield to derive an approximation of current equity return requirements."[83]

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.[84] "If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end."[85] "It is the impact of the rate order which counts; the methodology is not significant."[86] Within a wide range of discretion, the PSC may select the methodology.[87] The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.[88] It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.[89] "No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use different approaches in different cases."[90]

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[83] *Id.,* at 399.

[84] 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).

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

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

[87] **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).

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

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

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

The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[91] "Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[92]

<u>The Proxy Groups</u>:

Guided by the principle of the commensurate return, and because the stock of the GPE operating companies is not publicly traded, each analyst employed a proxy group of publicly-traded companies selected to reflect the investment risk characteristics of KCP&L and GMO.[93]

Company witness Samuel Hadaway assembled a "large reference group of investment grade electric utilities selected from the *Value Line Investment Survey ("Value Line")*."[94] Each company included in Dr. Hadaway's proxy group met these criteria:[95]

- At least a triple-B (investment grade) bond rating;
- At least 70 percent of revenues from regulated utility sales;
- Consistent financial records not affected by recent mergers or restructuring;

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[91] ***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).

[92] *Id.*

[93] Hadaway KCPL Dir., pp. 3-4; Kahal KCPL Dir., pp. 16-17.

[94] *Id.,* at 4. Hadaway's original proxy group consisted of ALLETE, Alliant Energy Co., Ameren, AEP, Avista Corp., Black Hills Corp., Cleco Corp., DTE Energy Co., Edison International, GPE, Hawaiian Electric, IDACORP, Pinnacle West, Portland General, SCANA Corp., Sempra Energy, Southern Co., Teco Energy, Vectren, Westar Energy, Wisconsin Energy, and Xcel Energy. *See* Sch. SCH-1, p. 1.

[95] Id.

- Consistent dividend record with no dividend cuts within the past two years.

Staff witness David Murray selected a proxy group of ten companies from an initial group of 55 market-traded electric utilities by applying certain criteria.[96] Murray's criteria were:

- Classified as an electric utility by Value Line (55 companies);
- Publicly-traded stock;
- Followed by EEI and classified by EEI as a regulated electric utility (19 companies eliminated, 36 remaining);
- Followed by AUS and reporting at least 70% of revenues from electric operations (11 companies eliminated, 25 remaining);
- Ten years of Value Line historical growth data available (3 companies eliminated, 22 remaining);
- No reduced dividend since 2009 (2 companies eliminated, 20 remaining);
- Projected growth available from Value Line and Reuters (1 company eliminated, 19 remaining);
- At least investment grade credit rating (3 companies eliminated, 16 remaining);
- Company-owned generating assets (0 companies eliminated, 16 remaining);

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[96] *KCPL RR Report,* p. 37 & App. 2, Sch. 7. Murray's proxy group included Alliant Energy Co., AEP, Cleco Corp., GPE, IDACORP, Pinnacle West, Southern Co., Westar Energy, Wisconsin Energy, and Xcel Energy. *KCPL RR Report,* App. 2, Sch. 8.

- Rated an ‘Excellent’ Business Risk Profile by S&P (4 companies eliminated, 12 remaining);
- No significant merger or acquisition announced in last 3 years (2 companies eliminated, 10 remaining).[97]

Interestingly, all of Murray's proxy companies also appeared in Hadaway's original proxy group.

OPC's expert witness, Michael Gorman, analyzed "a group of publicly traded utilities that I have determined share investment risk similar to [the GPE operating companies]."[98] Gorman used Hadaway's proxy group, but excluded Ameren "because its consensus analyst growth rate was negative, likely due to concern at the merchant generation units."[99] Mr. Gorman noted that the proxy group had similar investment risk as the GPE operating companies, as indicated by similar investment-grade credit ratings; a similar common-equity ratio in the capital structure; and a similar business-risk ranking.[100] Mr. Gorman concluded, " Based on these proxy group selection criteria, I believe that my proxy group reasonably approximates the investment risk of [the GPE operating companies], and can be used to estimate a fair return on equity for [them]."

Matthew Kahal analyzed "a proxy group of vertically integrated electric utility

[97] KCPL RR Report, p. 38; GMO RR Report, p. 41.

[98] Gorman KCPL Dir., p. 15; Gorman GMO Dir., p. 15.

[99] *Gorman KCPL Dir.,* p. 15; Sch. MPG-2.

[100] *Gorman KCPL Dir.,* pp. 15-16; *Gorman GMO Dir.,* p. 16. The proxy group's average senior credit rating of BBB+ is identical to KCP&L and one notch higher than GMO; the proxy group's average common-equity ratio of 49.6% is comparable to that of the GPE operating companies at 45.5% (excluding short-term debt; as of March 31, 2012); and both the proxy group and the GPE operating companies have a business risk profile of "Excellent."

companies."[101] In his opinion, a proxy-group study is more reliable because "noise" is thereby cancelled out; additionally, the use of current market data, averaged over six months, adds stability to the results.[102] Mr. Kahal used Dr. Hadaway's original proxy group of 22 electric utilities because he concluded that it was "acceptable" and that Hadaway's selection criteria were "reasonable."[103]

Dr. Hadaway updated his analyses in his rebuttal testimony. In particular, he adjusted his proxy group by removing four companies and adding three others.[104] Dr. Hadaway's final proxy group of 21 companies included all but one (Cleco) of the ten companies studied by Murray; Gorman and Kahal did not update their analyses.

<u>The Experts' Analytical Methods</u>:

The analysts all used variants of the same analytical methods, relying on market-based data to quantify investor expectations regarding required equity returns.[105] Dr. Hadaway applied four alternative versions of the constant growth, multistage growth and terminal value DCF models and a bond-yield-plus-equity RP analysis to an investment grade company reference group of other electric utilities "generally similar" to KCP&L and GMO.[106]

Staff expert witness David Murray determined the Companies' cost of common equity through a comparable company cost-of-equity analysis of a proxy group of

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[101] Kahal KCPL Dir., p. 15.

[102] *Id.,* at 17.

[103] *Id.,* at 17-18.

[104] *Hadaway KCPL Rebuttal,* p. 29. Hadaway removed Ameren, Edison International, Cleco, and Vectren; he added CMS Energy, Integrys, and UNS Energy. *Id.*

[105] Hevert Dir., p. 18.

[106] Hadaway KCPL Dir., pp. 3-4.

ten companies using the DCF method.[107] Additionally, Mr. Murray used a CAPM analysis and a survey of other indicators as a check of the reasonableness of his recommendations.[108] Mr. Murray gave primary weight to the results of his multi-stage DCF analysis.[109]

Mr. Gorman used several models based on financial theory to estimate the Companies' cost of common equity, including a constant growth DCF model using consensus analysts' growth rate projections; a constant growth DCF using sustainable growth rate estimates; a multi-stage growth DCF model; an RP model; and a CAPM.[110] Mr. Gorman applied these models to a group of publicly-traded utilities that he determined share investment risk similar to that of KCP&L and GMO.[111]

Mr. Kahal employed "both the DCF and CAPM models, applied to a proxy group of vertically integrated electric utility companies."[112] Mr. Kahal relied on his DCF results, using the CAPM as a check on reasonableness.[113]

In its simplest, "constant growth" form, the DCF is simply the sum of the dividend yield, calculated from the current stock price and the expected dividend, and a growth rate.[114] The constant-growth DCF model is widely used by investors to evaluate

[107] KCPL RR Report, p. 37; GMO RR Report, p. 40.

[108] KCPL RR Report, supra; GMO RR Report, supra.

[109] KCPL RR Report, p. 41.

[110] Gorman KCPL Dir., pp. 14-15.

[111] *Id.,* at 15.

[112] Kahal KCPL Dir., p. 15.

[113] Id.

[114] Gorman KCPL Dir., pp. 16-17; Hadaway KCPL Dir., p. 27; KCPL RR Report, p. 39.

stable-growth investment opportunities, such as regulated utility companies.[115] The dividend yield is calculated by dividing the annualized dividend by the current stock price.[116] Three of the four analysts also conducted a multi-stage DCF, in which a different growth rate is specified for each of several stages. Staff expert witness Murray testified, “[t]he 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 in perpetuity.”[117]

The risk premium analysis is based on the principle that investors require a higher return to assume greater risk.[118] As Dr. Hadaway explained, "[t]he risk premium methods begin with currently observable market returns, such as yields on government or corporate bonds, and add an increment to account for the additional equity risk."[119] Typically, a government security is chosen as the "risk-free rate" and to this is added an "equity risk premium" intended to reflect the incremental additional return required for investors to select the more risky utility common stock over the less risky Treasury security. Dr. Hadaway calculated an equity risk premium by comparing authorized regulated electric utility ROEs to the average annual interest rate for 1980 to 2011.[120] Mr. Gorman calculated two equity risk premia by comparing authorized regulated electric utility ROEs to U.S. Treasury bond yields and "A"-rated utility bond yields for the

[115] KCPL RR Report, p. 38.

[116] KCPL RR Report, p. 39.

[117] KCPL RR Report, p. 42.

[118] Gorman KCPL Dir., p. 29.

[119] Hadaway KCPL Dir., p. 27.

[120] Hadaway KCPL Dir., p. 39.

period 1986 through 2011.[121] A variety of the RP used by Staff expert witness David Murray is the Rule of Thumb, in which "[t]he cost of equity is estimated by simply adding a risk premium to the yield-to-maturity ("YTM") of the subject company's long-term debt."[122]

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 that of the market as a whole.[123] The CAPM is a more sophisticated version of the RP.[124] Dr. Hadaway did not perform a CAPM in this case, explaining his opinion that "under current market conditions, the CAPM does not provide reliable estimates of the cost of equity . . . [due to] the government's continuing intervention in the credit markets and the resulting artificially low U.S. Treasury bond interest rates that have resulted, as well as the recent market turmoil's effects on the CAPM's other required inputs."[125]

The Expert's Analytical Results:

The results obtained by the experts, as well as certain critical inputs, are presented below in tabular form for the sake of convenience:

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[121] Gorman KCPL Dir., pp. 29-30.

[122] KCPL RR Report, p. 59.

[123] KCPL RR Report, p. 57; Hadaway KCPL Dir., p.34.

[124] Hadaway KCPL Dir., p. 27.

[125] *Id.,* p. 34.

HADAWAY	MURRAY	GORMAN	KAHAL
Constant Growth DCF Analyst Growth Rates **DY = 4.32** **GR = 5.48** **Mean ROE = 9.8** **Median ROE = 9.8**	Constant Growth DCF Analyst Growth Rates **DY = 4.10** **GR = 5.0 - 5.5** **Low ROE = 9.1** **High ROE = 9.6**	Constant Growth DCF Analyst Growth Rates **DY = 4.32** **GR = 5.14** **Mean ROE = 9.46** **Median ROE = 9.54**	Constant Growth DCF Long Term Growth Rates **DY = 4.3** **GR = 4.5 - 5.5** **Low ROE = 8.8** **High ROE = 9.8** **Midpoint = 9.3**
Constant Growth DCF Long Term GDP Growth **DY = 4.4** **GR = 5.7** **Mean ROE = 10.1** **Median ROE = 10.0**	--	Sustainable Growth DCF **DY = 4.3** **Sustainable GR = 4.85** **Mean ROE = 9.15** **Median ROE = 8.57**	--
Two-Stage DCF Low Near-Term Growth **Stage 2 GR = 5.7** **Mean ROE = 9.9** **Median ROE = 9.9**	Multi-Stage DCF Low Growth Rates **Stage 1 GR = 5.5** **Stage 3 GR = 3.0 - 4.0** **Low ROE = 7.82** **Middle ROE = 8.23** **High ROE = 8.61**	Multi-Stage DCF **Stage 1 GR = 5.14** **Stage 3 GR = 4.9** **Mean ROE = 9.30** **Median ROE = 9.47**	--
Terminal Value DCF **Mean ROE = 10.3** **Median ROE = 9.8**	Multi-Stage DCF GDP Growth Rate **Stage 1 GR = 5.5** **Stage 3 GR = 4.3** **ROE = 8.85**	--	--
Risk Premium Projected Utility Bond Yield **Adjusted ERP = 4.77** **ROE = 10.14**	Rule of Thumb **RP = 3.0 - 4.0** **Low ROE = 7.92** **High ROE = 9.52**	Risk Premium Equity Risk Premium over Treasury Yields **ERP = 4.41 - 6.13** **Low ROE = 8.01** **High ROE = 9.73** **Weighted Result=9.20**	--
Risk Premium Current Utility Bond Yield **Adjusted ERP = 4.96** **ROE = 9.87**	--	Risk Premium Equity Risk Premium over Utility Bond Yields **ERP = 3.03 - 4.62** **Low ROE = 7.98** **High ROE = 9.57** **Weighted Result=9.00**	--
--	CAPM **RFR = 3.13** **Beta = 0.69** **Arithmetic MRP = 5.7** **Geometric MRP = 4.1** **Arithmetic ROE = 7.06** **Geometric ROE = 5.96**	CAPM **Beta = 0.72** **MRP = 6.6** **ROE = 8.40**	CAPM **Beta = 0.73** **MRP = 5.0 - 8.0, 9.0** **Low ROE = 6.7** **High ROE = 8.8** **Midpoint = 7.7** **High Sensitivity = 9.6**
Sources: *Hadaway KCPL Rebuttal,* Sch's 12 & 13*;* Staff's *KCPL RR Report,* p. 59 & App. 2, Sch's 11, 13, 22*; Gorman KCPL Direct,* pp. 33, 39 & Sch's MPG-4, MPG-7, MPG-9, MPG-11, MPG-16*; Kahal KCPL Direct,* pp. 23-24, 26-27, & Sch's MIK-4 & MIK-5*.*			

Table 2.

<u>Analytical Flaws and Errors</u>:

Each of the expert witnesses criticized the work product and recommendations of the others. In particular, witnesses Murray, Gorman and Kahal criticized Dr. Hadaway's methods and results.

Staff expert witness David Murray noted, " the primary factor that causes varying COE results when applying DCF methodologies is the growth factor, whether it is the constant-growth rate in a single-stage DCF or the varying growth rates in a multi-stage DCF analysis."[126] With respect to the multi-stage DCF, Murray noted, " the most critical stage for estimating the COE is that of the final stage, in which a perpetual growth rate is assumed."[127]

A review of the experts' results and inputs, set out in Table 2, above, reveals the critical nature of the growth rates selected by the analysts in driving the DCF results. Dr. Hadaway used the highest growth rates in his constant growth DCF (5.48 and 5.7) and obtained the highest results (9.8, 10.0, 10.1). The same pattern is found with respect to the multi-stage DCFs. Murray used the lowest terminal-stage growth rates, based on his analysis of the actual long-term growth experience of electric utilities, including Missouri utilities, and examples of practical utility stock investment analysis, all of which corroborates his position that investors simply do not expect mature regulated electric utilities to grow at a rate anywhere near GDP.[128] Additionally, Mr. Murray

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[126] Murray KCPL Rebuttal, p. 3.

[127] Id.

[128] Tr. 17:507-508, 510-511.

provided a thorough -- and unrebutted -- analysis of the trends in the growth of utilities and GDP since 1947.[129] He presented data from the Bureau of Economic Analysis that shows that the utility industry's contribution to GDP has been declining since the late 1990s, which refutes the assumption made by both Dr. Hadaway and Mr. Gorman that investors expect utilities to grow at the same rate as GDP in perpetuity.[130] While Mr. Murray did find some correlation of utility growth and GDP growth, he concluded that it was diluted by 50% due to the issuance by electric utilities of additional common equity because of high dividend payout ratios.[131] Thus, if GDP growth rates are used to project perpetual growth for electric utilities, they must be halved to reflect this dilution.

Mr. Murray criticized Dr. Hadaway's proxy group, stating that it "contains companies that have significant non-regulated operations, such as merchant generation operations . . . [which] are much riskier than [the GPE operating companies'] regulated electric utility operations."[132] This criticism lies with equal validity against Mr. Gorman and Mr. Kahal, who also used Dr. Hadaway's original proxy group. Murray stated that Hadaway should have excluded DTE Energy, Edison International, Hawaiian Electric, and Vectren.[133]

With respect to Dr. Hadaway's updated analysis, presented in his rebuttal testimony, Mr. Murray stated:

> Dr. Hadaway introduced a new approach to estimate the COE that he didn't provide in his direct testimony. Incredibly, Dr. Hadaway then uses this new methodology as the primary basis to support his revised

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[129] KCPL RR Report, pp. 40-41; GMO RR Report, pp. 43-44.

[130] KCPL RR Report, pp. 47-48; GMO RR Report, pp. 50-51.

[131] *KCPL RR Report,* pp. 47, 50-52; *GMO RR Report,* pp. 50, 53-55.

[132] *Id.,* at 4.

[133] *Id.,* at 5-6.

> recommendation. Dr. Hadaway's introduction of an entirely new approach as part of Dr. Hadaway's update should be weighed by the Commission when considering Dr. Hadaway's credibility.[134]

Mr. Murray summarized his critique of Dr. Hadaway by noting that his theories are questionable to the extent that they rely on extremely high GDP growth rates.[135]

OPC's expert witness, Michael Gorman, testified that "Dr. Hadaway's recommended return on equity is excessive and should be rejected."[136] Mr. Gorman went on to say that "Dr. Hadaway's own analyses would support a return on equity in the range of 9.2% to 10.0% if it is adjusted to reflect current market data and his models are properly applied."[137] Gorman criticizes Hadaway's use of "inflated GDP growth estimates,"[138] observing that Hadaway uses a growth rate in his DCF analyses that is higher than projected nominal GDP growth.[139] In summation, Gorman states, "Dr. Hadaway's GDP growth outlook rate projections are simply out of line and out of touch with the consensus market outlooks."[140] Gorman also criticized Hadaway's RP analyses, noting that he used "inflated equity risk premiums,"[141] based on inputs that are "highly uncertain and produce inaccurate results"[142] and an adjustment developed via a regression analysis that is "unreasonable, . . . inappropriate[,] and not consistent

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[134] Murray KCPL Surr., p. 8.

[135] Tr. 17:507.

[136] Gorman KCPL Dir., p. 2.

[137] *Id.,* at 43-44.

[138] *Id.,* at 44.

[139] *Id.,* at 46-47.

[140] *Id.,* at 48.

[141] *Id.* at 49.

[142] *Id.,* at 50.

with [the] academic literature."[143] Mr. Gorman went on to say:

> Importantly, Dr. Hadaway’s analysis simply ignores investment risk differentials. He bases his adjustment to the equity risk premium exclusively on changes in nominal interest rates. This is a flawed methodology that does not produce accurate or reliable risk premium estimates. His results should be rejected by the Commission.[144]

Expert witness Matthew Kahal also criticized Dr. Hadaway. With respect to Hadaway's updated analyses, presented in his rebuttal testimony, Kahal stated "I find his revised analysis (which is not a true update) to be unpersuasive and overstated."[145] In particular, Kahal notes that "Dr. Hadaway’s Rebuttal Testimony presents what purports to be an update to his original cost of equity studies, but he makes some major changes that have the effect of increasing his cost of equity results compared to the results he would have obtained had he done a pure update."[146] Mr. Kahal criticizes Dr. Hadaway's updated study for (1) significant changes to the proxy group that have the effect of inflating the ROE and (2) the introduction of an entirely new DCF method involving a "rather speculative" projection of the 2016 stock price.[147] Mr. Kahal states, "This is an entirely new study, not an update."[148]

Mr. Kahal also criticizes Dr. Hadaway's long-term and two-stage DCF analyses. He states that they "continue to rely on the discredited assumption that investors expect

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[143] Id.

[144] *Id.,* at 53.

[145] Kahal KCPL Surr., p. 2.

[146] *Id.,* at 5.

[147] *Id.,* at 6-7; Tr. 17:403.

[148] Id., at 6.

long-term growth for the U.S. economy (nominal GDP) of 5.7 percent per year."[149] Mr. Kahal goes on to note, "If Dr. Hadaway's update had used a more realistic U.S. GDP long-term forecast, his two DCF studies that use projected GDP growth as data inputs would produce ROE estimates of well below 9.5 percent."[150] With respect to Dr. Hadaway's change of his proxy group, Mr. Kahal stated, "While I have no strong objection to the removal of observations that are highly abnormal or clear aberrations, it is biased and improper to revise the study by removing only the unusually low observations."[151] Kahal noted that, if Hadaway also removed the three companies with the highest ROEs from his proxy group (Alliant, GPE, Hawaiian Electric), his DCF result would have been 9.4, identical to Gorman's recommendation and close to Kahal's.[152]

Evaluating the Experts:

All of the experts, as has already been shown, use much the same methods and data and their varying results are driven by their varying assumptions and inputs.[153] There is not a single right answer; rather, there is a range or spectrum of answers within which the Commission is free to choose the value that meets its regulatory goals.

As a starting place, the Commission awarded an ROE of 10.00 to the GPE operating companies in their last rate case.[154] Three of the four expert witnesses testified that the cost of capital has declined significantly since that case was decided.

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[149] *Id.,* at 7.

[150] Id.

[151] Id., at 8.

[152] Id.

[153] Table 2, *supra*.

[154] Gorman Dir., p. 3.

A useful and entirely relevant benchmark for the Commission to consider is the trend manifest in the ROEs authorized by other state commissions. That trend over the past six months is downward. For 2011, the national average was 10.22.[155] For the first nine months of 2012, the national average was 9.97.[156] For the first quarter of 2012, the average spiked, to 10.84; but for the second quarter, the average was 9.92.[157] For the third quarter, it was 9.78.[158]

Another helpful approach is found in the cost-of-common-equity jurisprudence of the United States Supreme Court, whose ***Bluefield*** and ***Hope*** decisions have already been cited as the source of the controlling constitutional parameters: the principles of the commensurate return, financial integrity and capital attraction.[159] The Supreme Court's ratemaking cases describe a two-step return-setting paradigm that could be used to make the Commission's task somewhat easier. In ***Bluefield***, the Court said:

> 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.[160]

Here, the Court unmistakably described one limit on the Commission's decision: a return that is ***too low*** is tantamount to confiscation and is thus unconstitutional. In the

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[155] Ex. 313.

[156] Tr. 17:422.

[157] Tr. 17:423.

[158] *Id*.

[159] ***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).

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

same case, the Court also delineated a second limit on the Commission's rate decision: "A public utility . . . has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures."[161] This language describes the upper limit of the rate decision. A return that is **too high** is one that produces the sort of profits realized from "highly profitable enterprises or speculative ventures."[162]

Between these limits is a "zone of reasonableness" within which the Commission is free to set the rate of return. The Supreme Court has stated, "[w]e have emphasized that courts are without authority to set aside any rate adopted by the Commission which is within a 'zone of reasonableness.'"[163] This is not, however, the analytical tool of the same name that this Commission has frequently used over the past few years. That tool is an exercise in benchmarking in which the recommendations of the experts are compared to the average of recently-allowed ROEs. While useful, that analysis is flawed. First, it inevitably pulls the ROE in any case toward the average; and second, its range of 100 basis points either side of the average is entirely arbitrary. [164] The first step is to define the limits of the zone of reasonableness. At the bottom is what the Court calls the "lowest reasonable rate," that is, the ***lowest*** rate that is not

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

[162] *Id.* An ROE that is too high would likely also be unconstitutional by virtue of taking unjustifiable advantage of the captive ratepayers.

[163] ***In re Permian Basin Area Rate Cases,*** 390 U.S. 747, 797-798, 88 S.Ct. 1344, 1376, 20 L.Ed.2d 312, ___ (1968).

[164] Staff notes that the Commission's Zone of Reasonableness analysis has been upheld in the face of every challenge by zealous counsel. ***State ex rel. Praxair, Inc. v. Public Service Commission,*** 328 S.W.2d 329, 340-41 (Mo. App., W.D. 2010); ***State ex rel. Public Counsel v. Public Service Commission,*** 274 S.W.3d 569, 574 (Mo. App., W.D. 2009).

confiscatory and, consequently, is constitutionally permissible. "By long standing usage in the field of regulation the 'lowest reasonable rate' is one which is not confiscatory in the constitutional sense."[165] By keying the Commission's return-setting analysis off the ***lowest reasonable rate*** rather than the average of recently-awarded returns, the flaws noted above are avoided.

The second step is to set the ROE by reference to the lowest reasonable rate. The Commission is free to set the return on equity anywhere within the zone of reasonableness, guided by its consideration of all the evidence in the light of the public interest. As the Court has said, rate-setting agencies "are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances."[166] The Court has also said, "[t]he Commission may, within this zone [i.e., the zone of reasonableness], employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs[.]"[167]

Staff's expert witness David Murray has identified the GPE operating companies' COE and, in his ROE recommendation, identified the lowest reasonable rate. He testified that his intention was to accurately report the GPE operating companies'

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[165] ***Federal Power Commission,*** *supra,* 315 U.S. at 585, 62 S.Ct. at 742, 86 L.Ed. at ___. The Court went on to say: "Assuming that there is a zone of reasonableness within which the Commission is free to fix a rate varying in amount and higher than a confiscatory rate, the Commission is also free . . . to decrease any rate which is not the 'lowest reasonable rate.'" *Id.* (internal citations omitted).

[166] ***Federal Power Commission v. Natural Gas Pipeline of America,*** 315 U.S. 575, 585-586, 62 S.Ct. 736, 742-743, 86 L.Ed. 1037, ___ (1942).

[167] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 797-798, 88 S.Ct. at 1376, 20 L.Ed.2d at ___.

COE.[168] Above Staff's recommendation is the zone of reasonableness within which the Commission is free to set the return. As Missouri courts have stated repeatedly, "[i]t is not the theory or methodology, but the impact of the rate order which counts."[169] Nonetheless, the Commission must articulate its reasons for setting the return at a particular point within the allowable zone.[170] These reasons extend to all "relevant regulatory purposes" including a consideration of the likely impacts of the rate order.[171] Among the principles that should guide the Commission's choice of a particular point within the zone of reasonableness are those articulated in ***Hope*** and ***Bluefield,*** including the principles of the commensurate return, capital attraction and financial integrity.[172]

Conclusion:

Based on all of the foregoing, Staff recommends that the Commission authorize an ROE for the GPE operating companies in the range of 9.0, Mr. Murray's recommendation, and the third quarter national average of awarded ROEs of 9.78.[173] The mid-point of the recommended range is 9.39, which is well-within Mr. Gorman's recommended range of 9.1 to 9.5 and almost identical to his recommended ROE of 9.4. It is close to Mr. Kahal's recommendation of 9.5 and very close to his DCF midpoint

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[168] Tr. 17:461.

[169] ***Praxair,*** *supra,* 328 S.W.3d at 339, *citing* ***State ex rel. Missouri Water Co. v. Public Service Commission,*** 308 S.W.2d 704, 714 (Mo.1957).

[170] Otherwise, judicial review is frustrated.

[171] ***Permian Basin Area Rate Cases,*** *supra,* 390 U.S. at 797-798, 88 S.Ct. at 1376, 20 L.Ed.2d at ___.

[172] ***Bluefield,*** *supra,* 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183; ***Hope,*** *supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

[173] Tr. 17:423.

of 9.3. As Staff has demonstrated herein, the United States Supreme Court has held that there is a zone of reasonableness within which the Commission has discretion to set the cost of common equity in order to achieve appropriate regulatory goals. These goals include those traditional ***Hope*** and ***Bluefield*** goals of assuring the utility's financial integrity and its ability to attract capital at a reasonable cost, but also encompass and extend to broader regulatory and public policy objectives. These objectives include consideration of the likely impact of the Commission's order.

Staff urges the Commission to find that Mr. Murray's recommended ROE of 9.0 is the lowest reasonable rate and thus the bottom of the zone of reasonableness within which the Commission has discretion to set the GPE operating companies' ROE. Staff further urges the Commission to find that the top of the zone of reasonableness is the 3rd quarter national average of awarded ROEs of 9.78. The evidence presented suggests that a higher award would be contrary to the observable recent trend of ROE awards and would take unfair advantage of the Company's captive ratepayers.

B.

<u>Capital Structure</u>

What capital structure should be used for determining rate of return?

> The appropriate capital structure for determining the allowed rate of return is GPE's consolidated capital structure, exclusive of short-term debt, as of the true-up date, August 31, 2012.

Staff's expert witness testified that he would have no concerns with a ratemaking capital structure including 52.42% equity.[174]

C.

Cost of Debt

iv. Should GPE's consolidated cost of debt be assigned to KCPL and GMO or should the cost of debt be subsidiary specific?

GPE's consolidated cost of debt should be assigned to KCPL and GMO.

v. In either case, should adjustments be made to holding company debt issued subsequent to GPE's acquisition of GMO?

Yes.

vi. Should any adjustments be made to certain debt issuances? Should the cost of debt be a consolidated cost of debt of 6.425%?

Yes, adjustments should be made to certain debt issuances. The following GPE debt issuances should be adjusted downward anywhere within the ranges supported in Staff's testimony with Staff recommending point adjustments in its surrebuttal testimony:

- GPE's $250 million, 3-year, 2.75% Note: 60 to 75 basis points; point estimate of 65 basis points;
- GPE's $350 million, 10-year, 4.85% Note: 60 to 85 basis points; point estimate of 65 basis points;
- GPE's $287.5 million, 10-year, 5.292% Note: 110 to 120 basis points; point estimate 115 basis points.

No, the cost of debt should not be 6.425%. After the aforementioned adjustments are made, the appropriate consolidated cost of debt should be 6.187%.

Due to Staff's discovery of additional data from the Company, Staff now recommends different downward adjustments to the same three GPE debt issuances

[174] Tr. 17:469-470. Staff's true-up figure (Highly Confidential) is somewhat higher. *Murray KCPL Surr.*, p. 4 (HC), & Sch. DM-SUR-1 (HC).

that Staff adjusted in Staff's Report.[175] Downward adjustments are appropriate because, although GPE's financial guarantee has allowed GMO to have an investment grade credit rating, this rating is still below the level at which Aquila committed to assess hypothetical costs to Missouri ratepayers.[176] In Case No. EF-2003-0465, Aquila's management committed to charge Missouri ratepayers only such debt costs as are consistent with a "BBB" credit rating.[177] There is no good reason why this ratepayer protection should not continue. In the Aquila acquisition case, EM-2007-0374, the Commission noted the applicants' proposal "to follow the debt cost recovery procedure that the Commission used in Aquila's recent Missouri rate cases."[178]

GMO no longer has debt on its books that was issued when Aquila was non-investment grade.[179] This debt was retired on July 2, 2012.[180] However, GMO's debt costs are still not free from the effects of the creative financing techniques required to finance GMO's Missouri utility assets.[181] Such techniques would not have been required but for the previous corporate structure of Aquila and its failed non-regulated investments.[182] For this reason, Staff continues to believe that certain hypothetical costs must be assumed.

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[175] Murray KCPL Surr., p. 5.

[176] *Id.,* at 29.

[177] Id.

[178] In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Co., and Aquila, Inc., Case No. EM-2007-0374 (Report & Order, issued July1, 2008), pp. 156, 248-249.

[179] Murray KCPL Surr., p. 33.

[180] Id.

[181] Id.

[182] Id.

The cost of capital of any business segment should be based on the risk profile of the assets in that segment, not the risk profile of the consolidated entity that owns the segment.[183] GMO's assets are high-quality, low-risk assets.[184] In the absence of Aquila's high-cost legacy debt, there is no reason to believe that GMO would be rated any lower than KCPL, which is rated "BBB."[185] For that reason, Staff has proposed adjustments to the cost of debt issued by GPE on GMO's behalf that reflect the spread between KCPL debt and GMO debt.[186] These adjustments will protect Missouri ratepayers from unreasonably high debt costs that cannot in fairness be charged to them.

Kevin A. Thompson

CROSSROADS

The only other issues affecting rates in these pending cases are the Crossroads issues (Issues **III**.1.a., b., c. and d.). They impact only customer rates in GMO's MPS rate district. The Crossroads issues are:

III.1. Crossroads (GMO—MPS rate district only):

a. What should be the value of Crossroads included in rate base?

b. What amount of accumulated deferred taxes associated with Crossroads should offset the value of Crossroads in rate base?

c. Should depreciation expense be based upon the authorized gross plant value for Crossroads?

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[183] *Id.,* at 34.

[184] *Id.,* at 31.

[185] Id.

[186] *Id.,* pp. 36-38.

d. What transmission costs for energy from Crossroads should be included in revenue requirement?

These Crossroads issues result from GMO's resource planning since the 1990's (starting when it was known as UtiliCorp United, Inc., then later as Aquila, Inc., and now as GMO) when it anticipated decoupling of generation from transmission and distribution in Missouri, and through an affiliate—Aquila Merchant Services, Inc.—was aggressively expanding in the unregulated energy markets. Some of Staff's criticism of GMO's resource planning is found at pages 92-93 of Staff witness Featherstone's GMO surrebuttal testimony[187] where he testifies to a number of serious deficiencies:

- Having a corporate policy not to build regulated generation evidenced by not having built generation since 1983, except for South Harper in 2005 which effects the regulated operations to this day and Iatan 2 in August 2010. It transferred Crossroads to its regulated operations in August 2008.

- In 1997 attempted to move all generating assets to an Exempt Wholesale Generator (EWG), Case No. EM-97-395. Application was withdrawn after opposition by Staff.

- MPS Resource planning in 1992 determined need for a combined cycle unit by 2000 for MPS yet Aquila's corporate decision made to build unit as a non-regulated merchant plant (Aries) after regulated operations did most of the preliminary work for the development of the project.

- MPS purchased power agreement from 2001 to 2005 from a non-regulated Aquila affiliate (the Aries Combined Cycle Agreement).

[187] Ex. Staff-294.

- In 2004, Aquila sold its 50% share of Aries giving its partner ** ____________________________________ ___ ** to take unit over.

- Aquila attempts unsuccessfully to re-acquire Aries in December 2006.

- Despite having a known certain date to replace the Aries Agreement by June 2005, Aquila did not timely plan for the replacement of this capacity. Until January 2004, did not seriously consider building generation instead looking at another purchased power agreement from an affiliate (Aries II).

- Aquila Merchant attempts to sell at steep discounts three turbines which were to be installed at Aries as Aries II in 2002. Units were placed in storage. While units were for sale, at no time were the units ever considered or offered to MPS to meet its growing capacity needs before January 2004. In January 2004 Aquila made decision to replace Aries Capacity Agreement with three combustion turbines it had left over from its merchant business. These units had been in storage since 2002 during which the units' warranty expired. Units were eventually installed at the South Harper facility in June and July 2005.

- South Harper legal issues caused by having to move forward on project to get units in service by June 2005 to replace Aries Agreement. Since Aquila already had possession of units since 2002, appropriate planning could have taken place much earlier than it did providing ample time to get necessary community support.

- Aquila had many combustion turbines, three of which were new units, in its asset portfolio that it sold at distressed values resulting in hundreds of millions of dollars of impairment charge losses that the Company did not consider to use for its regulated operations despite MPS' need to for capacity. (Raccoon Creek (340 megawatts) and Goose Creek (510 megawatts) sold to Union Electric Company d/b/a AmerenUE, now d/b/a Ameren Missouri, in 2005 with sale completed in early 2006 and three other General Electric 7 EAs combustion turbines sold to non-investor owned utilities in Nebraska).

- In 2000 Aquila re-acquired MPS' four combustion turbines at Greenwood which it had built starting in 1975 and sold under a sale lease back which had a provision where the Company could acquire the units at the end of the lease at the existing market value. Aquila re-acquired the units at greater than the original purchase price even though the units were 25 years old. The units were reacquired by a Aquila non-regulated MPS affiliate with a corporate decision that MPS entered into a 15-year purchased power agreement. This agreement was ultimately terminated and the units were moved back in the regulated operations of MPS. The 25-year old units are now in rate base at a greater amount than what they were originally purchased for in 1975 and 1976. Customers will have in essence paid for these units twice- once through the lease payments which were included in rates and now again in rate base. If the units had been rate based from the mid-1970s the units would have been close if not fully depreciated except for additions occurring over the operating life of the assets.

- GMO’s inclusion of Crossroads in rate base in this case at full net book value, not including all related deferred income taxes and the inclusion of all annual transmission costs.

The Commission addressed these same issues in GMO’s last general electric rate case,[188] and Staff views that the Commission not only intended to, but did, finally resolve them there. However, GMO is raising them again.

As the Commission recognized in GMO’s last general electric rate case, the value of an energy center such as the Crossroads depends not only the cost of the generators and other physical facilities, but also on the location of the center, the costs of generating the electricity there (fuel, fuel transportation, operations and maintenance) and the costs of getting the electricity from the energy center to the customers who use

[188] *In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service*, Case No. ER-2010-0356.

it (transmission). That the Commission did so is apparent from paragraph 271 on page 91 of its May 4, 2011, *Report and Order* in that case:

> When conducting its due diligence review of Aquila's assets for determining its offer price for Aquila, [Great Plains Energy]would have considered the transmission constraints and other problems associated with Crossroads. (Footnote omitted). ***It is incomprehensible that [Great Plains Energy] would pay book value for generating facilities in Mississippi to serve retail customers in and about Kansas City, Missouri.*** (Emphasis added). And, it is a virtual certainty that [Great Plains Energy] management was able to negotiate a price for Aquila that considered the distressed nature of Crossroads as a merchant plant which Aquila Merchant was unable to sell despite trying for several years. Further, it is equally likely that [Great Plains Energy] was in as good a position to negotiate a price for Crossroads as AmerenUE [(Union Electric Company then d/b/a AmerenUE, now d/b/a Ameren Missouri)] was when it negotiated the purchases of Raccoon Creek and Goose Creek, both located in Illinois, from Aquila Merchant in 2006.

That the value of an energy center is dependent on these factors is important to resolution of the Crossroads issues, each of which are taken up in turn in the order listed in the list of issues filed October 11, 2012.

Issue **III**.1.a. What should be the value of Crossroads included in rate base?

Due to a number of factors, it would be unfair to GMO's customers for their rates to be based on the net book value of Crossroads. Those factors include that Crossroads is located within the Entergy electric system near Memphis and far from GMO's load; it was built to sell energy into the unregulated market as part of Aquila's corporate policy not to build new generation to serve its retail customers (native load) but, instead, to own unregulated generation;[189] although Aquila needed capacity it owned by 2005, Aquila entered into short-term purchased power contracts—including

[189] Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, p. 92.

contracts for energy from Crossroads—rather than seeking to include Crossroads in its rate base until 2008;[190] corresponding with changes in the cost of gas, the value of combustion turbines dropped from 2000 to 2005 then rose again;[191] and if Crossroads was truly attractive to Aquila for its regulated operations, the time to have acquired it was in 2002 to 2006, not in 2008 or later.

GMO acquired Crossroads from an affiliate; therefore, in GMO's last rate case the Commission applied its affiliate transaction rule and found that the fair market value of Crossroads was substantially less than the net book value of $104 million which GMO sought to include in rate base for its MPS rate district because Aquila had attempted, without success, to sell Crossroads; Great Plains Energy, in three separate SEC filings made under oath in early 2007 in connection with its acquisition of Aquila (which it renamed GMO), disclosed a "fair value" for Crossroads of $56.1 million; many deregulated generating assets, including combustion turbines identical to those in service at Crossroads, experienced a significant devaluation following the crash of the deregulated electric market and the bankruptcy of Enron; in 2002 Aquila offered to sell three of 21 combustion turbines it has purchased below cost to several entities, including KCPL, before it stored them until it installed them at South Harper in 2005 and wrote their value down to comply with the Commission's affiliate transaction rule; and Aquila sold thirteen combustion turbines below cost in 2002 and 2006 as follows:

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[190] Ex. Staff-282, Staff witness Mantle GMO Rebuttal, p. 5.

[191] Ex. GMO-102, GMO witness Blunk Direct, p. 4, Sch. MEB-1; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, p. 78.

- Goose Creek—6 General Electric turbines sold to AmerenUE in 2006;
- Raccoon Creek—4 General Electric turbines sold to AmerenUE in 2006;
- Utility in Beatrice, Nebraska – 2 General Electric turbines sold in 2002; and
- Utility in Colorado – 1 General Electric turbines sold in 2002.

The Commission found the fair market value of Crossroads to be $61.8 million as of July 14, 2008, stating the following in paragraph 275 on page 96 of its May 14, 2011, *Report and Order*:

> Considering the depressed market as exhibited by the sale of similar turbines to Ameren, and the valuation of these assets reported to the SEC by [Great Plains Energy ($51.6 million)], the Commission finds that $61.8 million is an accurate reflection of the fair market value of Crossroads as required by the affiliate transaction rule as of July 14, 2008.

The same facts upon which the Commission based its foregoing finding that the fair market value of Crossroads to include in GMO's rate base for its MPS rate district is $61.8 million as of July 14, 2008, are in the evidentiary record in this case.

- Aquila attempted, without success, to sell Crossroads;[192]
- In three separate SEC filings made under oath in early 2007 Great Plains Energy and Aquila, in connection with its acquisition of Aquila (which it renamed GMO), disclosed a "fair value" for Crossroads of $56.1 million;[193]

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[192] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 74-75, 77; Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, internal and July 2005 Lehman Brothers presentations.

[193] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 78-79.

- many deregulated generating assets, including combustion turbines identical to those in service at Crossroads, experienced a significant devaluation following the crash of the deregulated electric market and the bankruptcy of Enron;[194]
- in 2002 Aquila offered to sell three of 21 combustion turbines it had purchased below cost to several entities, including KCPL, before it stored them until it installed them at South Harper in 2005 and wrote their value down to comply with the Commission's affiliate transaction rule;[195]
- Aquila sold thirteen combustion turbines below cost in 2002 and 2006 as follows:
    - Goose Creek—6 General Electric turbines sold to AmerenUE in 2006;[196]
    - Raccoon Creek—4 General Electric turbines sold to AmerenUE in 2006;[197]
    - Utility in Beatrice, Nebraska – 2 General Electric turbines sold in 2002;[198]
    - Utility in Colorado – 1 General Electric turbines sold in 2002.[199]

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[194] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 74, 75, 77, 79 and 80; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, pp. 79-82.

[195] Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, pp. 84, 90, 92-93, Sch. CGF-SUR-21, pp. 1, 2 and 6 of 50.

[196] Ex. Staff-259HC, Staff GMO Cost of Service Report, p. 77.

[197] *Id*.

[198] *Id*. at p. 79.

[199] *Id*.

Additionally, there is evidence in both cases that the market for combustion turbines was depressed in 2003 through 2005, and at the same time Aquila needed capacity to replace the capacity it was getting from Aries purchased power agreement that ended May 31, 2005, Aquila could have purchased combustion turbines to replace that capacity at the lowest prices at which they were selling during 2000 to 2012.[200]

As in GMO's last general electric rate case, there is evidence here that Aquila Merchant sold to AmerenUE in early 2006 two energy centers located in Illinois and within the Midwest Independent Transmission System Operator (MidwestISO or MISO) footprint with installed 75 MW General Electric model 7EA combustion turbines combustion turbines identical to those Aquila Merchant installed at Crossroads—Goose Creek (six turbines near Monticello) and Raccoon Creek (four turbines near Flora)[201]—and that it publicly disclosed in SEC filings in connection with Great Plains Energy's acquisition of Aquila that it valued Crossroads at $51.6 million.[202] As a member of the MidwestISO Ameren Missouri incurs no transmission costs for taking electricity from either Goose Creek or Raccoon Creek to serve its native load.[203] The values Aquila and AmerenUE put on Goose Creek and Raccoon Creek are reasonable for the purchase of a comparable energy center. In GMO's last general electric rate case the Commission recognized that comparability and valued Crossroads based on the

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[200] Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, pp. 78-84.

[201] Ex. Staff-294, Featherstone GMO Surrebuttal, p.88, ll. 13-15 and p. 93, ll. 13-16; Ex. Staff-263 Staff GMO Cost of Service Report, Appendix 3, Sch. CGF 14, pp. 3-4; Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers March 2005 Confidential Information Memorandum to Aquila, p. 25.

[202] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 78-79.

[203] Ex. Staff 272, Featherstone GMO Rebuttal, p. 38, ll. 17-19.

average installed MW at Goose Creek and Raccoon Creek that Ameren UE paid, *i.e*., $205.88 per kilowatt.[204] 300 MW multiplied by $205.88 per kilowatt is $61.8 million.

Contrary to GMO's argument Crossroads should be included in its rate base at the higher net book value of $91.3 million ($132.7 million plant in service, including transmission plant, less $41.4 million depreciation reserve for a net of $91.3 million)[205] than the $61.8 million the Commission found, if the Commission erred at all in valuing Crossroads in GMO's last rate case, it *overvalued* Crossroads by how it relied on the 2006 sales of Goose Creek and Raccoon Creek to AmerenUE.

Because for GMO Crossroads entails ongoing transmission costs to serve GMO's native load (Crossroads is outside the Southwest Power Pool (SPP) footprint with transmission through Entergy, but GMO's service area is not[206]), and for AmerenUE Goose Creek and Raccoon Creek do not (Goose Creek, Raccoon Creek and AmerenUE's service area are all within the Midwest ISO footprint and have

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[204] *In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service*, Case No. ER-2010-0356, May 4, 2011, *Report and Order*,¶ 272, pp. 94-95; Ex. Staff-259, Staff GMO Cost of Service Report, p. 77, l. 25.

[205] Ex. Staff-272, Featherstone GMO Rebuttal, p. 23, ll. 2-8.

[206] Ex. GMO-110, GMO witness Crawford direct, p. 12; Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers March 2005 Confidential Information Memorandum to Aquila, pp. 2 and 7; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, p. 66; see *In the Matter of the Application of KCP&L Greater Missouri Operations Company for Authority to Transfer Functional Control of Certain Transmission Assets to the Southwest Power Pool, Inc.*, Case No. EO-2009-0179, June 24, 2009, *Notification that KCP&L Greater Missouri Operations Company has Exercised Authority Granted by the Commission* and *In the Matter of the Application of KCP&L Greater Missouri Operations Company for Authority to Extend the Transfer of Functional Control of Certain Transmission Assets to the Southwest Power Pool, Inc.*, Case No. EO-2012-0136, November 1, 2011, *Notice Opening File ["to consider Kansas City Power & Light Company & KCP&L Greater Missouri Operations Company's joint request for approval of continued participation in SPP beyond October 1, 2013"].*

transmission through AmerenIP and AmerenCIPS, respectively[207]), there is a material difference in the comparison of GMO's acquisition of Crossroads with AmerenUE's acquisition of Goose Creek and Raccoon Creek. That material difference is the future transmission costs to serve native load from the energy center, a difference that makes Crossroads a less attractive acquisition, *i.e*., it lowers the fair market value. That future transmission costs negatively affect the value of an energy center is supported here by the fact that when it negotiated and bought Goose Creek and Raccoon Creek from Aquila Merchant in 2005 to early 2006, neither AmerenUE, nor any of the other seventy-eight other parties contacted, expressed any interest in acquiring Crossroads, although Aquila was marketing it with Goose Creek and Raccoon Creek.[208] Lehman Brothers, the agent through which Aquila marketed Goose Creek, Raccoon Creek and Crossroads, made the following observations in July 2005:

> ** **[209]
>
> (Emphasis added).

[207] Staff-263, Staff GMO Cost of Service Report, Appendix 3, Sch. CGF 14, pp. 3-4; see *In the Matter of the Application of Union Electric Company for Authority To Continue the Transfer of Functional Control of Its Transmission System to the Midwest Independent Transmission System Operator, Inc.*, Case No. EO-2011-0128, April 19, 2012, *Report and Order*, as clarified by May 17, 2012, *Order Granting Ameren Missouri's Motion to Clarify Report and Order*; Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers March 2005 Confidential Information Memorandum to Aquila, pp. 1, 2 and 5.

[208] Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers July 2005 presentation to Aquila and Lehman Brothers March 2005 Confidential Information Memorandum to Aquila.

[209] Ex. Staff 395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers July 2005 presentation to Aquila, Slide 2.

With regard to the locations of these energy centers with respect to load centers, Flora, Illinois, (Raccoon Creek) is about 100 miles from St. Louis, Missouri, Monticello, Illinois, (Goose Creek) is about 150 miles from St. Louis, Missouri, and Clarksdale, Mississippi, (Crossroads) is about 525 miles from Kansas City, Missouri,[210] about 350 miles from St. Louis, Missouri, about 215 miles from Sikeston, Missouri, about 167 miles from Oakville, Missouri, about 75 miles from Memphis, Tennessee, about 150 miles from Little Rock, Arkansas, about 285 miles from Nashville, Tennessee, and about 250 miles from Birmingham, Alabama.[211] In fact, Aquila marketed the fact that Crossroads is close to Memphis, Tennessee, and within the Entergy electric system when it attempted to sell Crossroads:

> ** **[212]

[210] Ex. Staff-259, Staff GMO Cost of Service Report, p. 74, ll. 22-26.

[211] These are facts of which the Commission may take notice. § 536.070(6) RSMo.

[212] Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers March 2005 Confidential Information Memorandum to Aquila, p.7.

Although Crossroads is closer to AmerenUE's native load than to GMO's native load, AmerenUE would also incur transmission costs to serve its native load from Crossroads because Crossroads is in the Entergy electric system and outside the Midwest ISO footprint. That AmerenUE had no interest in acquiring Crossroads when it acquired Goose Creek and Raccoon Creek is persuasive evidence that the fair market value of Crossroads is less than the fair market values of Goose Creek and Raccoon Creek. It is also noteworthy that, although Aquila had a division for its MPS rate district that acted independently as a rate regulated entity, that division was not one of the 79 parties Lehman Brothers contacted about Goose Creek, Raccoon Creek and Crossroads when it marketed those energy centers, although Aquila needed capacity for that rate district to replace the capacity it was losing when the Aries purchased power agreement ended May 31, 2005.[213]

However, in GMO's last general electric rate case, the Commission, after rejecting Staff's argument that the Commission should impute the value of two 105 MW combustion turbines built in 2005 in GMO's rate base for its MPS rate district instead of including Crossroads, concluded GMO should not recover Crossroads transmission costs in rates, as shown by paragraphs 245 to 247 of its May 4, 2011, *Report and Order*:

> 245. The cost of transmission to move energy from Crossroads to customers served by MPS is a very significant cost that is far greater than the transmission costs for power plants located in the MPS district. The annual energy transmission cost was estimated as $406,000 per month.

[213] Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers July 2005 presentation to Aquila, slide7; Ex. Staff-259, Staff GMO Cost of Service Report, p. 80, ll. 16-29; Ex. Staff-294, Featherstone GMO Surrebuttal, p.93, ll. 9-17.

> This is also substantially higher on an annual basis than the transmission plant costs for the Aries site where the three South Harper Turbines were originally planned to be installed.
>
> 246. This higher transmission cost is an ongoing cost that will be paid every year that Crossroads is operating to provide electricity to customers located in and about Kansas City, Missouri. GMO does not incur any transmission costs for its other production facilities that are located in its MPS district that are used to serve its native load customers in that district. This ongoing transmission cost GMO incurs for Crossroads is a cost that it does not incur for South Harper, and is the cause of one of the biggest differences in the on-going operating costs between the two facilities.
>
> 247. It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location. Thus, the Commission will exclude the excessive transmission costs from recovery in rates.

Because it disallowed GMO recovery of transmission costs, it was reasonable for the Commission to value Crossroads as if GMO did not incur transmission costs to get electricity from Crossroads to serve its native load, *i.e.*, it was reasonable and appropriate for the Commission to rely on the average of the installed cost per MW AmerenUE paid for the capacity at Goose Creek and Raccoon Creek to value Crossroads for GMO (300 MW multiplied by $205.88 per kilowatt equals $61.8 million). There is no reason for the Commission to deviate from that approach in this case, *i.e.*, so long as it disallows recovery of transmission costs in rates, the Commission should still find $61.8 million is, as of July 14, 2008, an accurate reflection of the fair market value of Crossroads as required by the Commission's affiliate transaction rule.

Issue **III**.1.b. What amount of accumulated deferred taxes associated with Crossroads should offset the value of Crossroads in rate base?

In GMO's last general electric rate case the Commission determined the accumulated deferred income tax reserve associated with Crossroads was $15 million because Aquila Merchant was unprofitable and could not realize the benefit of the depreciation deduction but for its affiliation with GMO, Great Plains Energy considered the deferred tax reserve impact when valuing Aquila when acquiring it and the Commissions' $61.8 million valuation was "generous."[214] There the Commission did not have evidence before it of what the accumulated deferred income tax reserve associated with Crossroads would be based on rate base treatment of Crossroads commencing on the July 14, 2008, date the Commission used for determining that the fair market value of Crossroads was $61.8 million. Instead, it had GMO's argument there should be no accumulated deferred income tax reserve offset to rate base and evidence from Staff that deferred income taxes of $15 million had accumulated since Crossroads was built in 2002.

Consistent with how the Commission found accumulated deferred income taxes associated with Crossroads in GMO's last general electric rate case, there is evidence in this case that the deferred income taxes that have accumulated since Crossroads was built in 2002 total $14.8 million as of August 31, 2012.[215] However, unlike the prior case, here there is evidence that, based on a value for Crossroads of $61.8 million as of July 14, 2008, the deferred income taxes associated with Crossroads that have accumulated through August 31, 2012, is $4,333,301.[216]

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[214] *In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service*, Case No. ER-2010-0356, May 4, 2011, *Report and Order*,¶ 272, p. 99; May 27, 2011, *Order of Clarification and Modification*, pp. 2-3.

[215] Ex. GMO-118, GMO witness Hardesty Rebuttal, p. 2; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, p. 122.

[216] Ex. Staff-384, GMO True-up Accounting Sch. 2, p. 1 of 2, l. 37; Ex. GMO-149, GMO witness Rush True-up Rebuttal, pp. 1-2.

GMO disagrees that the rate base value of Crossroads as of July 14, 2008, should be $61.8 million, but does agree that, if the value of Crossroads as of July 14, 2008, is $61.8 million, then $4,333,301 is the correct amount for the accumulated deferred income taxes as of August 31, 2012.[217] Unlike in its last case, here GMO is not arguing accumulated deferred income taxes should not be an offset to the rate base value of Crossroads.[218] Instead, it argues that, as of August 31, 2012, Crossroads should be valued at a net book value of $91.3 million, based on its transfer to rate base on July 14, 2008, and, therefore, the deferred income taxes that have accumulated since then and offset that rate base value are $8,355,048.[219]

If the Commission includes the fair market value of Crossroads in GMO's rate base as of July 14, 2008—which it previously found to be $61.8 million—then it should start accumulating deferred income tax from that same date on based on the fair market value of Crossroads.[220] However, if the Commission includes the net book value of Crossroads in GMO's rate base, as GMO advocates, then the associated deferred income tax offset should be the deferred income taxes that have accumulated from the date Crossroads was completed in 2002—$14.8 million as of August 31, 2012.[221] This is because, if the Commission grants GMO a variance from the Commission's affiliate

[217] Ex. GMO-119, GMO witness Hardesty Surrebuttal, p. 9; Ex. Staff-384, GMO True-up Accting Sch. 2, p. 1 of 2, l. 37; Ex. GMO-149, GMO witness Rush True-up Rebuttal, pp. 1-2.

[218] See GMO-117, GMO witness Hardesty Direct, p. 4; Ex. GMO-118, GMO witness Hardesty Rebuttal, pp. 2-5; Ex. GMO-119, GMO witness Hardesty Surrebuttal, p.8.

[219] Ex. GMO-117, GMO witness Hardesty Direct, p. 4; Ex. GMO-119, GMO witness Hardesty Surrebuttal, p.8.

[220] Ex. Staff-272, Staff witness Featherstone GMO Rebuttal, pp. 46-47; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, pp. 122-123.

[221] Ex. Staff-272, Staff witness Featherstone GMO Rebuttal, p. 49; Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, p. 122.

transaction rule—4 CSR 240-20.015—and requires GMO's retail customers in its MPS rate district to pay rates that are based on the costs Aquila's merchant operations incurred for Crossroads, those customers should get the benefit of all the timing differences between tax depreciation accounting and ratemaking depreciation accounting from the date Aquila Merchant built Crossroads in 2002.

Issue **III**.1.c. Should depreciation expense be based upon the authorized gross plant value for Crossroads?

As both Staff witness Featherstone and GMO witness Hardesty explain in their testimony accrued deferred income taxes are the result of the differences in when a utility gets depreciation for income tax purposes and when it gets depreciation for rate making purposes. For rate making purposes depreciation is recognized in the same amount per year over a number of years—straight-line depreciation; however, for income tax purposes, a utility may be able to recognize depreciation at an accelerated rate, i.e., it may be able to recognizes a greater annual level of depreciation in earlier years and a lesser annual level in later than with straight-line depreciation; however, over the full depreciation period, it will recognize the same total amount of depreciation. Because of the resulting mismatch between when the utility realizes the tax depreciation benefit (earlier) and when it realizes depreciation in its retail customer rates (later), the accumulated difference is applied as an offset to rate base since retail customers pay in rates for income taxes based on straight-line depreciation.[222] As a result, depreciation expense, like accumulated deferred income tax with which it is interdependent, should

[222] Ex. Staff-272, Staff witness Featherstone GMO Rebuttal, p. 48; Ex. GMO-118, GMO witness Hardesty Rebuttal, pp. 3-5.

be based on the value the Commission determines for Crossroads in GMO's rate base for its MPS district.

Issue **III**.1.d. What transmission costs for energy from Crossroads should be included in revenue requirement?

GMO's revenue requirement should not include transmission costs for energy from Crossroads. As the Commission stated in paragraph 247 of its May 4, 2011, *Report and Order* in Case No. ER-2010-0356, "It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location." This conclusion is supported by Lehman Brothers report to Aquila in July 2005 on its efforts to market Goose Creek, Raccoon Creek and Crossroads where in addition to stating it has contacted 79 parties it stated:

** ____

____ **[223]

Aquila Merchant built Crossroads in 2002 near Memphis as part of Aquila's aggressive expansion into the unregulated energy markets in anticipation of decoupling of generation from transmission and distribution in Missouri and elsewhere. Aquila intentionally designed and built Crossroads as a merchant plant located to take advantage of a point of transmission constraint to maximize revenues from selling power into the market during periods of peak demand when that transmission constraint point became congested, not to serve GMO's native load over 500 miles away.[224] When reporting to Aquila on its marketing of Goose Creek, Raccoon Creek and

[223] Ex. Staff 395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers July 2005 presentation to Aquila, slide 2.

[224] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 74 and 83.

Crossroads, Lehman Brothers described part of the marketability of Crossroads, none of which is applicable to serving GMO's native load, as follows:

> ** [redacted] s
> **[225]

Notably, GMO has combustion turbines at Nevada, Ralph Green, Lake Road, Greenwood and South Harper, which are all within Missouri, and KCPL has gas-fired generation at Hawthorn, West Gardner and Osawatomie, all within its service area.[226]

As stated at the beginning of this Crossroads section of this brief, the value of an energy center is interdependent with the location of the center, the costs of generating the electricity there (fuel, fuel transportation, operations and maintenance) and the costs of getting the electricity from the energy center to the customers who use it (transmission). As Staff explained above when it addressed the rate base valuation of Crossroads (Issue **III**.1.a.), the Commission recognized this interdependence in GMO's last general electric rate case and based its valuation of Crossroads, in part, on having

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[225] Ex. Staff-395HC, GMO response to Staff Data Request 0180 in Case No. ER-2009-0090, November 1, 2001, Lehman Brothers March 2005 Confidential Information Memorandum to Aquila, p.7.

[226] Vol. 19, Tr. 894-95, GMO witness Crawford; Ex. GMO-102, GMO witness Blunk Direct, p. 26 (South Harper); Ex. Staff 294, Staff witness Featherstone GMO Surrebuttal, pp. 119-20.

excluded from GMO's rate base for its MPS rate district GMO's cost to transmit electricity over 500 miles from Crossroads to its retail customers. Therefore, if the Commission includes transmission costs for Crossroads in determining the revenue requirement for GMO's MPS rate district in this case, then it should lower its rate base valuation of Crossroads, to take into account that unlike AmerenUE when it bought Goose Creek and Raccoon Creek, an entity acquiring Crossroads at fair market value would have priced the cost of ongoing transmission into that value. Like Goose Creek and Raccoon Creek are for AmerenUE, GMO concedes that if Crossroads was in or near its service area, it would not incur transmission costs for Crossroads.[227]

GMO argues that the Commission should allow it energy transmission costs from Crossroads because natural gas transportation costs to Crossroads are comparatively low and when viewed collectively transmission and transportation costs at Crossroads are less than what they would be if Crossroads was located at South Harper.[228] Not only has GMO provided a high estimate of firm natural gas transportation cost for Crossroads located at the South Harper site, GMO has not shown the South Harper site is the most reasonable site for evaluating the cost of sufficiently firm gas transportation cost for Crossroads within GMO's service area.[229] Further, GMO witness Blunk did not know whether the estimate upon which he was relying for natural gas transportation cost estimates were based on building new pipeline and right-of-way or expanding

[227] Ex. GMO-111, GMO witness Crawford Rebuttal, p. 5.

[228] Ex. GMO-102HC, GMO witness Blunk Direct, pp. 25-30; Ex. GMO-110, GMO witness Crawford Direct, pp. 11-14.

[229] Ex. Staff-272, Staff witness Featherstone Rebuttal, pp. 45-46.

existing pipeline capacity,[230] and it appears GMO's analysis is based on 2011 information, not on information current in 2004-2005 (when Aquila needed to replace the electricity it was obtaining from Aries through a purchased power agreement that ended May 31, 2005), 2005-2006 (when AmerenUE negotiated and purchased Goose Creek and Raccoon Creek which the Commission relied on to value Crossroads) or even 2008 (the Commission valued Crossroads as of July 14, 2008).[231]

GMO has never used Crossroads to serve load in the winter, only in the summer months of June to September during peak demand, and it has never run it even half the time then.[232] GMO does need Crossroads' capacity during the summer—June to September, and to meet SPP's capacity requirements during those months it needs both firm natural gas transportation[233] and firm energy transmission from Crossroads to its load,[234] but there is no evidence in the record that SPP requires GMO to have them year round. However, there is evidence SPP does not. During cross-examination GMO witness Blunk testified that GMO has two firm natural gas transportation contracts for Crossroads in Clarksdale, Mississippi, one with the pipeline Texas Gas Transmission Corporation for November to March of each year 2009 to 2022 and one with the marketer ProLiance Energy for the months of May to September each year.[235] He further testified that GMO has firm gas transportation to Crossroads during the

[230] Vol. 17, Tr. 307.

[231] See, e.g., Ex. GMO-104HC, GMO witness Blunk Direct, Sch. WEB-3HC

[232] Vol. 17, Tr. 298-299, GMO witness Blunk.

[233] Ex. GMO-104HC, GMO witness Blunk Surrebuttal, p. 2.

[234] Ex. GMO-112HC, GMO witness Crawford Surrebuttal, p. 2.

[235] Vol. 17, Tr. 300-302, GMO witness Blunk.

winter to compensate Texas Gas Transmission for facilities the pipeline constructed to serve Crossroads.[236] Additionally, on cross-examination GMO witness Crawford testified that SPP has a separate requirement for meeting capacity needs during the four summer months and that GMO only uses Crossroads to meet that requirement, not an annual capacity requirement.[237] There is reason to doubt that GMO even needs year round natural gas transportation, given its summer peaking needs and the ability to acquire release capacity on the gas pipelines.[238]

GMO witness Blunk relies on estimates for the gas transportation costs to South Harper he presents, which are based on the assumption Crossroads is located at South Harper.[239] When doing so, he relies on informal inquiries about current pipeline capacity and tariff rates,[240] which set a maximum cost, he does not rely on the actual alternatives of evaluating responses to requests for proposals or firm gas transportation quotes from natural gas marketers such as ProLiance Energy to ascertain a market cost of the firm gas transportation capacity. Similarly, GMO witness Crawford relies on MISO tariff rates for GMO's estimate of energy transmission costs from Goose Creek and Raccoon Creek to GMO's service area.[241] However, those estimates are irrelevant. No one has proposed that GMO should be treated as having acquired Goose Creek or Raccoon Creek.

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[236] Vol. 17, Tr. 303, GMO witness Blunk.

[237] Vol. 19, Tr. 889-890.

[238] Vol. 17, Tr 306; Ex. 272, Staff witness Featherstone Rebuttal, pp. 44-45.

[239] Ex GMO 104HC, GMO witness Blunk Surrebuttal, p. 6, lines 17-18; Ex. Staff-272, Staff witness Featherstone Rebuttal Staff, pp. 44-45.

[240] Ex. GMO-104HC, GMO witness Blunk Surrebuttal, pp. 3-4.

[241] Ex. GMO-111, GMO witness Crawford Rebuttal, p. 7.

As Staff explained above where it addressed the valuation of Crossroads, the sales of Goose Creek and Raccoon Creek are relevant as comparable sales; however, the relevant energy transmission and gas transportation costs are those the buyer, AmerenUE, pays, not those GMO would pay had it acquired those energy centers. Therefore, the tariff rates GMO witness Blunk relies on for firm gas transportation to Goose Creek and Raccoon[242] are almost certainly a high estimate. Further, as GMO witnesses Blunk and Crawford both acknowledged during the evidentiary hearing, Staff is not suggesting GMO should have built an energy center in Illinois.[243]

GMO's evidence of firm natural gas transportation costs almost certainly overestimates what GMO would pay, and is not persuasive; therefore, as it did in GMO's last rate case, the Commission should again disallow transmission costs from Crossroads. In addition to overstating firm natural gas costs for an additional 300 MW at South Harper by relying on FERC approved tariff rates, assuming year-round firm transportation rather than for the summer months and using current 2010 information rather than information for 2004-2005, 2005-2006 or even 2008, GMO has not demonstrated that there is not a better location in its service area for installing 300 MW of natural gas-fired combustion turbines. Its sole stated basis for using its South Harper as a proxy for evaluating the costs of transporting gas into an energy center such as Crossroads located within its service area is the proximity of South Harper to two existing natural gas pipelines.[244] It appears from Ex. GMO-144 that there are a number

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[242] Ex. GMO-104HC, GMO witness Blunk Surrebuttal, p. 5.

[243] Vol. 17, Tr. 313-14, GMO witness Blunk; Vol. .19, Tr. 893, GMO witness Crawford.

[244] Ex. GMO-102, GMO witness Blunk Direct, pp. 26-27.

of locations within or near GMO's service area like South Harper where it could locate natural gas-fired combustion turbines near to more than one pipeline. Further, as the Commission is aware from prior litigation involving the lawfulness of South Harper, South Harper may not be a viable site for other reasons. Staff witness Featherstone testified in rebuttal that GMO has a number of other sites where it potentially could install combustion turbines, including a site in Sedalia and an expansion at GMO's Greenwood site. He also suggests that GMO's affiliate KCPL has two existing sites at Osawatomie and West Gardner where combustion turbines might be installed through a joint ownership agreement.[245]

GMO ignores the commodity cost of natural gas focusing on firm natural gas transportation costs. Natural gas costs less in the Kansas City area than it does in Clarksdale, Mississippi, as shown by Staff's comparison of the commodity costs of natural gas Crossroads in Mississippi with the commodity costs of natural gas for South Harper near Peculiar, Missouri and Greenwood in Kansas City, which shows the commodity price of natural gas has been and is less for both South Harper and Greenwood than Crossroads. Even when incremental delivery costs are added, natural gas delivered in Kansas City, Missouri, is historically cheaper than natural gas delivered to Crossroads. Because GMO incurs no pipeline reservation payments for Greenwood the all-in gas costs for Greenwood are less than they are for Crossroads.[246] Both Greenwood and South Harper have lower heat rates than Crossroads which means that

[245] Ex. Staff-272, Staff witness Featherstone GMO Rebuttal, p. 46.

[246] Ex. Staff-294, Staff witness Featherstone GMO Surrebuttal, pp. 118-19.

both are more efficient than Crossroads in generating electricity, and both are dispatched (used to generate electricity) before Crossroads.[247]

According to GMO witness Crawford GMO incurs about $5.2 million of transmission cost for Crossroads annually, or about $434,000 per month.[248] Based on GMO's response to a Staff data request in this case, annually it has incurred the transmission costs for Crossroads from 2007 to 2011 that follow:[249]

Year	Annual cost
2011	** _______ **
2010	** _______ **
2009	** _______ **
2008	** _______ **
2007	** _______ **

Those costs increased significantly from 2007 to 2008 to 2009. Other than that transmission costs have increased, and it is likely they will continue to increase substantially in the near future due to FERC policies expressed in FERC Orders 1000, 1000-A and 1000-B,[250] the circumstances surrounding GMO's transmission costs for Crossroads are materially unchanged from when the Commission disallowed them in

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[247] Ex. Staff-393HC, GMO response to Staff Data Request 147, and Ex. Staff-394HC, GMO response to Staff Data Request 52.

[248] Ex. GMO-110, GMO witness Crawford Direct, pp. 12-13.

[249] Ex. Staff-259, Staff GMO Cost of Service Report, p. 83.

[250] FERC orders amending 18 C.F.R. Part 35 addressing *Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities*, FERC Docket No. RM10-23-000; Order No. 1000, issued July 21, 2011; FERC Docket No. RM10-23-001; Order No. 1000-A, issued May 17, 2012 and FERC Docket No. RM10-23-002; Order No. 1000-B, issued October 18, 2012.

GMO's last general electric rate case, and GMO has not shown otherwise. The Commission should continue to disallow GMO recovery of transmission costs for Crossroads when setting rates for GMO's MPS rate district.

Nathan Williams

OTHER ISSUES

The remaining issues impact future charges or have implications for revenue requirements in future rate cases.

FUEL ADJUSTMENT CLAUSE

Staff will first address the issues pertaining to GMO's fuel adjustment clause because one or more of them may impact GMO's future fuel adjustment charges to its customers and may affect the return on common equity the Commission determines (Issue **II**.3.a.). Those issues are:

III.11. **FAC** (GMO only):

a. Should the Commission approve, modify, or reject GMO's request for a Fuel Adjustment Clause?

b. What should GMO's FAC sharing be?

c. Should both the revenues and the costs associated with Renewable Energy Certificates flow through GMO's FAC?

d. Should GMO's FAC tariff be clarified to specify that the only transmission costs included in it are those that GMO incurs for purchased power and off-system sales, excluding the transmission costs related to the Crossroads Energy Center?

e. Should GMO be ordered to provide or make available the additional information and documents requested by Staff to aid Staff in performing FAC tariff, prudence, true-up reviews?

a. Should the Commission approve, modify, or reject GMO's request for a Fuel Adjustment Clause?

The Commission should modify GMO's Fuel Adjustment Clause ("FAC") as set forth below. Since GMO is requesting it be allowed to continue operating with a FAC, the Commission should also order GMO to provide or make available to Staff certain information and documents which it has previously been providing to aid Staff in performing FAC tariff, prudence, and true-up reviews, which will also be addressed below.

b. What should GMO's FAC sharing be?

At the risk of oversimplification, under GMO's current FAC tariff, the difference between GMO's actual, prudently incurred fuel and purchased power costs net of off-system sales revenues ("total energy costs") and the billed base fuel and purchased power costs net of off-system sales revenues based on GMO's base energy rates per kWh ("base energy costs") will result in either an under-collection or over-collection of total energy costs during an accumulation period. If it under-collects (*i.e.*, total energy costs exceed base energy costs) GMO is allowed to recover from its customers 95% of the under-collection amount and must absorb the remaining 5%. If it over-collects (*i.e.*, base energy costs exceed total energy costs), GMO must return 95% of the over-collection amount to its customers and is allowed to retain the remaining 5%. Staff recommends the Commission order that GMO's FAC "sharing mechanism" be changed from 95% recovered from/returned to customers and 5% absorbed/retained by GMO to 85% recovered from/returned to customers and 15% absorbed/retained by GMO to provide GMO with a more appropriate incentive to reduce its fuel and purchased power costs, or at least to keep them down.[251]

It should first be recognized that electrical corporations such as GMO 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.[252]

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 Commission first established the current 95%/5% sharing mechanism for GMO (formerly known as Aquila)—the Commission stated on page 54 that:

[251] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 260, 269-278; Ex. Staff-270, GMO Rebuttal Testimony of Matthew J. Barnes, pp. 1-5.

[252] The Commission has previously recognized that it is not required to approve a FAC; see *Report and Order* issued on May 17, 2007, in Case No. ER-2007-0004, p. 30.

> 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.

Although the Commission originally established the 95%/5% sharing mechanism as an incentive for GMO to keep its fuel and purchased power costs down, with the passage of time the evidence[253] has continued to mount that the 95%/5% mechanism—which places only 5% of the risk of increases in the cost of fuel and purchased power on GMO—is an insufficient incentive for GMO to keep those costs down. Therefore, Staff recommends changing the FAC sharing mechanism from 95%/5% to 85%/15% to provide GMO with greater incentive.

That the current sharing mechanism provides insufficient incentive for GMO to keep its fuel and purchased power costs down is reflected in the testimony of GMO witness Wm. Edward Blunk in Case No. EO-2011-0390 *and* in the present case. In Case No. EO-2011-0390[254] Mr. Blunk, the Supply Planning Manager for both KCPL and GMO, testified during redirect questioning by the company's attorney as follows:

> Q. Does any of this discussion that you have here on page 17 or 18 suggest that the company isn't hedging to protect customers?
>
> A. The purpose of our hedging program really is to protect customers. *The fuel clause, the customer is the one that bears the energy market risk.* So all the hedging is for the benefit of the customer. There is no benefit to the company of any of this hedging. There is no benefit to the company.

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[253] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 269-278; Ex. Staff-270, GMO Rebuttal Testimony of Matthew J. Barnes, pp. 1-5; Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, pp. 2-10.

[254] As shown by Ex. Staff-397, the hearing in Case No. EO-2011-0390, the testimony referred to herein was long after GMO's last rate case. Therefore, this evidence has come to light since the last rate case.

> Q. So you're indifferent whether you – if the Commission says don't cross hedge anymore, what would be the company's response?
>
> A. We would probably stop hedging, hedging altogether. There's no – the company has no benefit from employing this hedging program. It is strictly for the benefit of the customer.
>
> Q. Does the company – does Kansas City Power & Light Company, to your knowledge, hedge in Kansas?
>
> A. No. We do not hedge in Kansas because in Kansas KCPL has a fuel clause. Again, *when there's a fuel clause in place, the hedging is for the benefit of the customer*. *There is no benefit to the company for a hedge program. There's no motive, no benefit, no reason to do it*.[255] (Emphasis added).

During the same redirect questioning, Mr. Blunk further testified:

> Q. From the shareholder perspective, assuming that you have an FAC in place, do you care if a Katrina hits?
>
> A. As a share—well, *from the company's perspective, its risk goes through the fuel clause*, *so no*. As a ratepayer, I'm a GMO ratepayer, I do care.[256] (Emphasis added).

The testimony of Mr. Blunk quoted above from Case No. EO-2011-0390 shows GMO's indifference to its actual amount of fuel cost and purchased power costs net of off-system sales revenues under the current 95%/5% sharing mechanism. In the present case GMO, of course, claims Staff has taken Mr. Blunk's testimony out of context because he was talking about hedging. To demonstrate that Mr. Blunk's testimony has not been taken out of context, Staff submitted the transcript of the entirety of the redirect questioning of Mr. Blunk in Case No. EO-2011-0390 as Exhibit No. 397. Further, while it is true that Mr. Blunk was talking about hedging, it is important to

[255] Ex. Staff-397 pp. 124-125; Ex. Staff-259, Staff GMO Cost of Service Report, pp. 273-274.

[256] Ex. Staff-397 p. 130; Ex. Staff-259, Staff GMO Cost of Service Report, p. 274.

remember what hedging is—according to Mr. Blunk's testimony in this case, "Hedging is the process of protecting oneself against [price] risk."[257] In explaining his testimony in Case No. EO-2011-0390, Mr. Blunk testified in this case that "the Company's exposure to market price risk is managed by having a fuel adjustment clause ("FAC") in place, but without a hedge program, the ratepayer's risk would not be managed."[258] In other words, by merely having a FAC with a 95%/5% sharing mechanism in place, GMO considers itself protected from the risk of higher prices and is indifferent about whether or not it hedges its fuel price risk—unlike ratepayers, who are not protected without a hedging program.

Staff fails to see in what "context" GMO's position—that it doesn't need to even attempt to protect itself from the risk of rising fuel and purchased power costs, because it has a fuel adjustment clause—could be viewed as showing anything other than that the current sharing mechanism is *not* providing GMO with sufficient incentive. By showing such indifference to the risk of higher prices, GMO demonstrates that the current sharing mechanism, which places merely 5% of the risk on GMO, does not provide sufficient incentive for GMO to keep its fuel and purchased power costs down.

Further evidence that the current sharing mechanism provides insufficient incentive for GMO to keep its fuel and purchased power costs down is shown by GMO's energy purchases from KCPL during 2011, which demonstrate the willingness of GMO/KCPL/Great Plains Energy to use GMO's FAC to flow market-based costs on to GMO's ratepayers when lower contract costs were available, but were kept for the

[257] Ex. GMO-103, Rebuttal Testimony of GMO witness Wm. Edward Blunk, p. 9.

[258] Ex. GMO-104, Surrebuttal Testimony of GMO witness Wm. Edward Blunk, pp. 7-8.

benefit of KCPL, which does not have a FAC.[259] For example, in the hours that KCPL purchased energy from Dogwood in July and August 2011, most of the time KCPL sold at least the same amount of energy—and in most hours even more energy—to GMO at a higher price.[260] In addition, during the summer of 2011, the dollar per MWh at which GMO purchased power from KCPL—while KCPL itself was purchasing under contract—was generally higher than the dollar per MWh at which KCPL was purchasing power, giving KCPL a net margin of $3.9 million on the MWhs that it bought from that source.[261] GMO then passed the higher purchased power costs on to its customers through its FAC, for which customers were billed $3.7 million and GMO absorbed $195,000.[262] Although GMO has insufficient (is short on) long-term capacity, GMO's management (remember that KCPL manages GMO) still purchases short-term higher priced day-ahead, forward and spot energy for GMO rather than entering into a lower priced contract for energy—what KCPL did for itself.[263] How KCPL and GMO handled purchases/sales between them during the summer of 2011 shows that KCPL's managers did not manage KCPL (which does not have a FAC) and GMO (which has a FAC) independently, and that adoption of Staff's 85%/15% FAC sharing mechanism would provide the needed incentive for them to manage GMO independently—thereby

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[259] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 270, 275-277.

[260] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, pp. 8-9.

[261] Ex. Staff-259, Staff GMO Cost of Service Report, p. 275.

[262] Ex. Staff-259, Staff GMO Cost of Service Report, p. 275.

[263] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 9.

keeping GMO's fuel and purchased power costs down, to the benefit of its retail customers (ratepayers).[264]

Additional evidence that the current sharing mechanism provides insufficient incentive for GMO to keep its fuel and purchased power costs down is found in GMO's Chapter 22 resource planning filing in Case No. EO-2012-0324, as discussed in the Rebuttal Testimony of Staff witness Mr. Barnes in this case. There he shares GMO's plan to continue to rely on short-term purchased power agreements ("PPAs") to meet its capacity needs in the future.[265] As stated by Mr. Barnes,

> By planning to continue to rely on short-term PPAs at market prices to meet capacity in the future, GMO is unnecessarily introducing price risk to its long-run costs compared to putting steel-in-the-ground. Since GMO can pass through fuel and purchased power costs in its FAC this risk is transferred to GMO's customers.[266]

Accordingly, more of this planning risk should be placed on GMO by changing its FAC sharing mechanism to 85%/15% to give GMO incentive to keep its long-term fuel and purchased power costs down.

Furthermore, although in this case GMO is willing to "rebase" the FAC base energy cost, in its previous two rate cases—Case Nos. ER-2009-0090 and ER-2010-0356—it was reluctant to do so and, in fact, had to be ordered by the Commission to do so after a hearing in Case No. ER-2010-0356.[267] In its *Report and*

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[264] Ex. Staff-259, Staff GMO Cost of Service Report, p. 277; Ex. Staff 290, GMO Surrebuttal Testimony of Matthew J. Barnes, pp. 9-10.

[265] Ex. Staff-270, GMO Rebuttal Testimony of Matthew J. Barnes, pp. 2-5.

[266] *Id.* at p. 4.

[267] Ex. Staff-259, Staff GMO Cost of Service Report, p. 270; Ex. Staff 290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 5.

Order in that case issued on May 4, 2012, the Commission, beginning on page 208, stated:

> Even though not required by the FAC laws to rebase, the Commission determines that it is consistent with the purpose of those laws and in the public interest to rebase the FAC Base Energy Cost. *To fail to do so sends the wrong signal to the customers that the base rate they are paying includes the complete fuel costs and subjects those customers to the potential for paying interest charges.* The Commission determines that the FAC shall be rebased. (Emphasis added).

Consistent with the Commission's *Report and Order* quoted above, Staff witness Mr. Barnes testified in this case that GMO's reluctance to rebase the base energy costs in its previous two rate cases demonstrates GMO's indifference to the value of sending correct pricing signals to its customers when changes to base energy costs are first known, and a willingness to use its FAC to its advantage and to the disadvantage of its customers.[268] This further supports Staff's recommendation to change the FAC sharing mechanism to 85%/15%, since GMO would be less willing to absorb 15% than 5%. Additional support for Staff's recommendation include KCPL's off-system sales margin proposal in Case No. ER-2012-0174 (where KCPL proposed a modified 75%/25% sharing mechanism for off-system sales) and the need to simply provide a stronger incentive to GMO, as reflected by GMO's net income before taxes, to keep its fuel and purchased power costs down.[269]

It should also be remembered that Staff's proposal to change GMO's FAC sharing mechanism works in both directions. In other words, Staff is not attempting to punish GMO, as GMO claims. As stated by Mr. Barnes, the sharing mechanism is

[268] Ex. Staff-259, Staff GMO Cost of Service Report, p. 270.

[269] *Id.* at pp. 269-273.

intended to incent GMO to keep its fuel and purchased power costs net of off-system sales down and, as such, is both a carrot and a stick.[270] While GMO focuses solely on the stick aspect of the sharing mechanism, under Staff's proposal any decrease in fuel and purchased power costs net of off-system sales revenues will benefit GMO because it would get to keep 15% of such decrease, instead of only keeping 5% under its current FAC. In fact, in GMO's most recent FAC accumulation period case, GMO's base energy costs billed to customers exceeded GMO's actual total energy costs due to several factors, and GMO was allowed to retain 5% of the difference.[271] Had Staff's proposal been in effect during that period, GMO would have been allowed to retain 15% rather than just 5%.

Furthermore, the Commission should recall that prior to the passage of SB 179 in 2005 (the legislation which authorized electric fuel adjustment clauses), an amount representing fuel and purchased power costs was simply included in the determination of the utility's revenue requirement in a general electric rate case, and if actual fuel and purchased power costs turned out to be greater than the cost included in rates in the general rate increase proceeding, the electric utility absorbed *all* of the increased cost.[272] Comparatively, being able to bill its customers for 85% of the increase in its actual, prudently incurred fuel and purchased power costs net of off-system sales revenues is a benefit, not a penalty. An analogy is that GMO is asserting that it would

[270] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 2.

[271] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 265-267.

[272] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 261-262.

be penalized because its "cup" would be only 85% full when, in the not-so-distant past, the cup was completely empty.

For all of the reasons set forth above, GMO's FAC sharing mechanism should be changed from 95%/5% to 85%/15%.

c. Should both the revenues and the costs associated with Renewable Energy Certificates flow through GMO's FAC?

Staff recommends that the Commission order GMO's FAC tariff be modified to provide that revenues from the sale of Renewable Energy Certificates ("RECs") which are not needed for it to meet the Renewable Energy Standard[273] law ("RES") be flowed through GMO's FAC as an offset to costs which are flowed through the FAC.[274] However, costs associated with RECs, if any, should not flow through the FAC for reasons discussed below.[275]

A REC is generated when a MWh is produced by a renewable energy source, such as wind or solar. When the MWhs from that source are included in base rates, aside from the energy cost there is no separate cost to GMO to generate the RECs themselves.[276] Similarly, GMO acquires some RECs in conjunction with its purchased power agreements ("PPAs") from renewable energy sources; again, there is no extra cost to GMO for the RECs themselves.[277] Prudent management of these RECs would include selling those that GMO does not need to meet the RES law before the

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[273] See § 393.1030 RSMo and 4 CSR 240-20.100.

[274] Ex. Staff-259, Staff GMO Cost of Service Report, p. 278.

[275] See Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 7.

[276] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 7.

[277] Ex. Staff-259, Staff GMO Cost of Service Report, p. 278.

RECs expire.[278] Because the RECs are associated with energy that GMO's customers have already or will have paid for—either through the PPAs or through rate base inclusion of the generating source or through GMO's authorized RES cost recovery procedure—Staff recommends that the Commission order any future revenues from the sales of RECs be flowed through GMO's FAC as an offset to the other costs that flow through its FAC.[279] Since there is no extra cost to GMO to generate or acquire these RECs, and since the energy associated with these RECs has already been or will be paid for by GMO's customers, no "REC costs" should be flowed through GMO's FAC. And, if GMO purchases RECs by themselves to meet the RES, the costs of those RECs should be addressed through GMO's authorized RES cost recovery procedure, not through its FAC.

In fact, it would be contrary to the Commission's Rule on Electric Utility Renewable Energy Standard Requirements, 4 CSR 240-20.100, for the costs associated with RECs to flow through a FAC. Rule 4 CSR 240-20.100(6)(A)16 provides that "*RES 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." (Emphasis added). Therefore, it would be unlawful to flow costs associated with RECs used to meet the RES through GMO's FAC.

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[278] *Id*.

[279] Ex. Staff-259, Staff GMO Cost of Service Report, p. 278; Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 7.

For these reasons, Staff recommends that the Commission order GMO's FAC tariff be modified to provide that revenues, but not costs, associated with RECs be flowed through GMO's FAC.

d. Should GMO's FAC tariff be clarified to specify that the only transmission costs included in it are those that GMO incurs for purchased power and off-system sales, excluding the transmission costs related to the Crossroads Energy Center?

Staff recommends that the Commission order GMO's FAC tariff be modified to specifically state that the only transmission costs included in GMO's FAC are those transmission costs that are necessary for GMO to receive purchased power to serve its native load and transmission costs that are necessary for GMO to make off-system sales that are included in FERC Account Number 565, except for costs related to GMO's Crossroads Energy Center.[280] Modifying GMO's FAC tariff in this manner will help avoid confusion in future FAC prudence audits.[281]

In his Rebuttal Testimony, GMO witness Mr. Rush states that GMO does not oppose Staff's recommendation, except for the exclusion of transmission costs associated with Crossroads.[282] However, the Commission has already decided that transmission costs from Crossroads should be excluded, so Staff's recommendation regarding Crossroads transmission costs is nothing new. In the Commission's *Report*

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[280] Ex. Staff-259, Staff GMO Cost of Service Report, p. 279; Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, p. 32 and Sch. MJB-2-3; Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, Sch. MJB-1-3.

[281] Ex. Staff-259, Staff GMO Cost of Service Report, p. 279; Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, p. 32.

[282] Ex. GMO-135, Rebuttal Testimony of GMO witness Tim M. Rush, p. 30.

and Order issued on May 4, 2011, in GMO's last rate case, Case No. ER-2010-0356, beginning on page 218 the Commission stated:

> The Commission concludes that all transmission costs should not be included in GMO's adjustment clause because they are not included in section 386.266, RSMo. Supp. 2010, as a type of cost to be recovered through a fuel adjustment clause, they are inconsistent with the definitions of fuel and purchased power cost in 4 CSR 240-20.090(1)(B), and elsewhere, and they do not vary in a direct relationship with fuel or purchased power. With regard to the transmission costs specifically related to OSS [off-system sales], however, those costs shall be allowed *to the extent that they do **not** include transmission costs from the Crossroads facility*. (Emphasis added).

GMO has provided no reason that causes Staff to recommend to the Commission that it deviate from its prior decision; Staff agrees with the decision that transmission costs associated with Crossroads should not be included in GMO's FAC.[283]

Furthermore, as the Commission is aware, the issue of Crossroads transmission costs is a separate contested issue in this case and is covered in a separate section of this brief. Even if the Commission does not adopt Staff's position on that separate Crossroads issue, transmission costs related to Crossroads still should not be allowed to flow through GMO's FAC, because they are not the type of transmission costs which the Commission found should be included in a FAC (as shown above in the quotation from Case No. ER-2010-0356); they are not necessary for GMO to receive purchased power to serve its native load; and they are not transmission costs that are necessary for GMO to make off-system sales included in FERC Account Number 565.

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[283] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, p. 6.

e. Should GMO be ordered to provide or make available the additional information and documents requested by Staff to aid Staff in performing FAC tariff, prudence and true-up reviews?

Like its recommendations in GMO's last two general electric rate cases, Case Nos. ER-2009-0090 and ER-2010-0356, Staff again recommends that the Commission order GMO to provide or make available to it the information and documents set forth in the following list to aid Staff in performing FAC tariff, prudence and true-up reviews.[284] GMO is already providing most if not all of this information as the Commission ordered it to do in previous cases, but since GMO is requesting to continue its FAC, Staff feels it prudent to request once more that the Commission order GMO to continue to supply this information to Staff. Since GMO filed no testimony in opposition to this particular recommendation, there is no evidence on the record opposing it. The Commission should order GMO to provide or make available the following information and documents:

- As part of the information GMO submits when it files a tariff modification to change its Fuel and Purchased Power Adjustment rate, include GMO's calculation of the interest included in the proposed rate;

- Maintain at GMO's corporate headquarters or at some other mutually agreed upon place within a mutually agreed upon time for review, a copy of each and every nuclear fuel, coal and transportation contract GMO has that is in or was in effect for the previous four years;

- Within 30 days of the effective date of each and every nuclear fuel, coal and transportation contract GMO enters into, provide both notice to the Staff of the contract and opportunity to review the contract at GMO's corporate headquarters or at some other mutually agreed upon place;

[284] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 280-281.

- Maintain at GMO's corporate headquarters or provide at some other mutually agreed upon place within a mutually agreed upon time, a copy for review of each and every natural gas contract GMO has that is in effect;

- Within 30 days of the effective date of each and every natural gas contract GMO enters into, provide both notice to the Staff of the contract and opportunity for review of the contract at GMO's corporate headquarters or at some other mutually agreed upon place;

- Provide a copy of each and every GMO 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 GMO hedging policy, provide a copy of the changed hedging policy for Staff to retain;

- Provide a copy of GMO's internal policy for participating in the SPP, including any GMO sales/purchases from that market that are in effect at the time the tariff changes ordered by the Commission in this rate case go into effect for Staff to retain; and

- If GMO revises any internal policy for participating in the SPP, within 30 days of that revision, provide a copy of the revised policy with the revisions identified for Staff to retain.[285]

Changes to FAC Tariff Sheet Terminology

In this case Staff is recommending GMO's FAC tariff be modified to standardize the terminology in it to be consistent with the terminology Staff is proposing for the FAC's of all of the regulated electrical corporations in Missouri which have FAC's, where appropriate, to help avoid and minimize confusion when discussing the FAC's of Missouri's electric utilities.[286] Staff made the same recommendations in

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[285] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 280-281.

[286] Ex. Staff-259, Staff GMO Cost of Service Report, pp. 279-280; Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, pp. 30-31.

Ameren Missouri's most recent general electric rate case, Case No. ER-2012-0166.[287] It is not Staff's intent by these recommendations to change the intent or meaning of truly different concepts in the various utilities' FAC tariff sheets.[288] In this particular case, Staff is also recommending that, instead of simply adding more FAC tariff sheets as GMO has done in the past, GMO's new FAC tariff sheets replace the original first set of FAC tariff sheets in GMO's tariff.[289]

To implement this recommendation, along with some "clean up" suggestions, as well as Staff's substantive recommendations to modify GMO's FAC tariff discussed above under (b), (c), and (d), Staff submitted exemplar FAC tariff sheets as Schedules to Staff's Rate Design and Class Cost-of-Service Report in this case.[290] In his Rebuttal Testimony, GMO witness Mr. Rush addressed Staff's proposed tariff changes.[291] To address the concerns raised in Mr. Rush's Rebuttal Testimony, Staff witness Mr. Barnes submitted revised exemplar FAC tariff sheets as Schedules to his Surrebuttal Testimony.[292] Although, as reflected in (b) through (d) above, Staff and GMO are not in agreement regarding the FAC sharing mechanism, the exclusion of transmission costs related to Crossroads from GMO's FAC, and costs related to RECs, Staff agrees with Mr. Rush's terminology changes as reflected in the exemplar

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[287] Ex. Staff-259, Staff GMO Cost of Service Report, p. 279; Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, p. 31.

[288] *Id.*

[289] Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, p. 31.

[290] Ex. Staff-267, Staff GMO Rate Design and Class Cost-of-Service Report, Sch. MJB-2-1 through MJB-3-6.

[291] Ex. GMO-135, Rebuttal Testimony of GMO witness Tim M. Rush, pp. 30-32.

[292] Ex. Staff-290, GMO Surrebuttal Testimony of Matthew J. Barnes, Sch. MJB-1-1 through MJB-1-7.

FAC tariff sheets attached to Mr. Barnes' Surrebuttal Testimony. The Commission should order the adoption of those changes (except for the hedging language inserted on Schedule MJB-1-3) and Staff's recommendation that, instead of simply adding more FAC tariff sheets as GMO has done in the past, the new FAC tariff sheets replace the original first set of FAC tariff sheets in GMO's tariff.

Jeff Keevil

TRANSMISSION TRACKERS

Staff will next address KCPL's and GMO's requests for transmission trackers because KCPL and GMO intend for these trackers to affect their future rates and, since they affect shareholder risk, the Commission should consider them when it determines the return on common equity (Issue **II**.3.a.) in each case, if it authorizes KCPL and GMO to use transmission trackers. Those issues are:

> **II**.11. **<u>Transmission Tracker</u>**: (KCPL and GMO) Should the Commission authorize KCPL and GMO to compare their actual transmission expenses with the levels used for setting permanent rates in these cases, and to accrue and defer the difference for potential recovery in future rate cases, i.e., to employ a "tracker"?

KCPL and GMO request the same transmission tracker; therefore, Staff addresses them together. Even if properly redesigned per Staff's recommended modifications, the trackers should be rejected for inappropriately shifting risk from shareholders to ratepayers. KCPL and GMO are requesting authority to track changes in Southwest Power Pool (SPP) base plan expenses and point-to-point expenses, both of which are included in subaccounts of the FERC Uniform System of Accounts (USOA)

565 category of accounts.[293] KCPL and GMO are also requesting authority to track changes in SPP administrative fees, booked to USOA accounts 561.400, 561.800, and 575.700.[294] Finally, KCPL and GMO request to track FERC assessment Schedule 12 fees, which are booked to USOA account 928.003.[295] KCPL opposes including any transmission revenue it receives from the SPP in the transmission tracker mechanism.

The requested trackers, as designed, should be rejected as wholly inappropriate attempts to shift the regulatory paradigm in favor of KCPL and GMO. There are multiple options before the Commission. Among them, the Commission could:

1. Decline to grant the authority to deviate from normal USOA accounting, by denying any transmission tracker, as recommended by Staff.
2. Grant accounting authority to track all transmission expenses and revenues, conditioned as recommended by Staff.
3. Grant accounting authority to track transmission expenses, but offsetting with revenues only those expenses that each utility charges to itself and receives back to itself as revenues, as KCPL and GMO agreed to at the evidentiary hearing.
4. Grant the transmission tracker as initially requested.

Under all but the first option, the result would shift the risk of any increases in transmission costs between rate cases from shareholders to ratepayers. In addition to this unnecessary risk shift, accounting authority under any but the second option would

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[293] Vol. 18, Tr. 679, l. 23 – Tr. 680 l. 18.

[294] Vol. 18, Tr. 681 ll. 1-14.

[295] Vol. Tr. 683, ll. 9-19.

result in KCPL and GMO each having, under a variety of scenarios, the ability to defer and later collect phantom expenses. Their requests are not simply to shift risk. Instead, they have designed a regulatory device that would provide shareholders with double recoveries and windfall revenues, as explained below.

Grandfathered Agreements

KCPL and GMO each have transmission agreements that predate the SPP, and do not currently operate under the SPP tariff. When these "grandfathered" transmission agreements expire, any continued transmission service to these customers will be placed under the SPP tariff. While KCPL and GMO request to track several categories of transmission expenses,[296] they do not request to include in their tracker the expenses associated with the grandfathered transmission agreements.[297] At one point Mr. Ives' testified that KCPL and GMO would only record for tracking purposes the differential between what KCPL or GMO incur under the SPP tariffs as compared to current cost of transmission under current grandfathered agreements.[298] However, as Mr. Ives testified elsewhere, it appears that KCPL and GMO's requested transmission expense tracker would not operate in that manner.

As these grandfathered agreements expire, KCPL and GMO will no longer incur and book expense under them. However, KCPL and GMO will begin to incur and book expense for the same (or similar) replacement transmission service under SPP's tariff. Therefore, until their next rate cases, KCPL and GMO will continue to receive rate

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[296] Vol. 18, Tr. 679, l. 23 – Tr. 680, l. 18, Tr. 681, ll. 1-14, Tr. 683, ll. 9-19.

[297] Vol. 18, Tr. 681, ll. 20-24.

[298] Vol. 18, Tr. 682, ll. 3-20.

recovery for the totality of the transmission service, while also booking a regulatory liability for not only any incremental increase in the level of transmission expense associated with the grandfathered agreements, but for the entire cost of the same service as it is offered under the SPP tariff.

As an example: Imagine KCPL had a tracker to cover the cost of stocking the breakroom at its office. Let us say base rates included $500 for buying Folgers coffee at Gerbes, but then for one reason or another, KCPL switched to buying coffee at Hy-Vee and the cost of Folgers coffee through Hy-Vee is $550 per year. Instead of tracking the $50 difference in coffee expense, KCPL would be tracking $550 as a regulatory liability for future recovery, while continuing to collect the $500 in rates, which it would pocket. In other words, KCPL and GMO would be entitled to track not only any increase in transmission expense associated with expiration of grandfathered transmission agreements, but the entire cost of the new agreements offered under the SPP tariff, even though effectively much of that cost will already have been included in KCPL's and GMO's rates established in this case.

This element of KCPL's and GMO's requests goes far beyond simple risk shifting. The expiration of a given grandfathered agreement will result in a windfall to shareholders on the backs of ratepayers under the tracker mechanism requested. KCPL and GMO would record that "new" expense as a regulatory liability while continuing to collect the dollars to cover the "old" expense under existing rates, thus effecting a double recovery. Even if replacement service under the SPP tariff happened to be less expensive than service to KCPL, or GMO, under a given grandfathered agreement, KCPL, or GMO, would still record that "new" expense for future recovery in its entirety, instead of booking the net reduction of transmission expenses that it would actually experience.

FERC rate increases for KCPL or GMO, Part 1.

KCPL and GMO request to only track changes in transmission expense in their proposed tracker mechanism, and are opposed to tracking revenues.[299] Both KCPL and GMO expect to experience increasing FERC revenue requirements in the next three years.[300] Both KCPL and GMO expect to realize some increase in revenues through the SPP in the next three years through the FERC formula transmission rate approach under which they currently operate.[301] Under these conditions, inclusion of transmission expenses in the tracker, but not revenues, would create a mismatch and provide KCPL and GMO with an opportunity for windfall revenues and an over recovery of their true transmission revenue requirements.

Both KCPL and GMO have a test year transmission expense level and a test year transmission revenue level that are based upon test year transactions. If either utility's FERC transmission revenue requirement increases, that utility would only track any increases in expenses that might occur prior to the next rate case, while ignoring its increased revenues under the design of the proposed tracker. This mismatch could result in a situation where the difference between test year transmission expense net of revenues and incurred transmission expense net of revenues could be zero dollars or

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[299] Vol. 18, Tr. 687-688.

[300] Vol. 18, Tr. 687, ll. 13-16 and 22-23.

[301] Vol. 18, Tr. 687, ll. 17-23.

even negative, yet KCPL or GMO would be entitled to seek recovery of whatever its increase in expense in isolation happened to be.

FERC rate increases for KCPL or GMO, Part 2.

As discussed above for transmission transactions in general, KCPL and GMO seek to acknowledge only the expense side of the transaction, and refuse to recognize the revenues derived from transmission. The asymmetry of this request is all the more telling when the transmission transaction in question involves either KCPL as both buyer and seller of transmission services, or GMO as both buyer and seller. In these instances, KCPL's and GMO's requested trackers result in flagrant double-recovery and tracking of a "phantom" expense.

Both KCPL and GMO each incur transmission expense in serving their Missouri customers that is related to the facilities that each owns. .[302] Both KCPL and GMO then receive back revenues from the SPP related to that service.[303] Thus, both KCPL and GMO have transactions where the expense and revenue of the transaction directly offset one another.

KCPL and GMO would have the Commission ignore this offset. Under the transmission expense tracker KCPL and GMO have requested, if either obtains a FERC-approved transmission rate increase, it would get to charge Missouri ratepayers for the dollars that it took from its left hand to place in its right. In his opening statement Mr. Fischer accepted correction of this blatant flaw in the design of the requested

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[302] Vol. 18., Tr. 684, ll. 18-21.

[303] Vol. 18, Tr. 685, ll. 8-12.

tracker.[304] It is disconcerting to Staff that KCPL and GMO requested the Commission to approve such an obviously flawed tracker in the first instance.

Conclusion

The inclusion of the discussed elements in KCPL and GMO's requested transmission expense tracker is telling. As requested, KCPL and GMO are not reaching for a tool in the regulatory tool box, the utilities are smashing open the box and running with what they can grab. The appropriate regulatory reaction is to deny the request in its entirety.

Even under a more circumspect approach, as discussed in the testimonies of Mark Oligschlaeger and Dan Beck, it is simply not appropriate to implement a transmission tracker for KCPL and GMO at this time. Were a tracker to be implemented, it must contain the conditions described by Staff's witnesses – the very least of which is that any tracker include both revenues and expenses, and address the marked deficiencies discussed in this brief.

If the Commission authorizes the utilities to implement a transmission tracker, the Commission should order a number of conditions to that authorization. Staff discusses those conditions in turn, below:

1. As discussed above, any tracker must reflect both transmission revenues and expenses, and thereby operate as a two-way mechanism (i.e., tracking both under and over collections of net transmission costs).[305]

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[304] Vol. 18, Tr. 643, ll. 4-16.

[305] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, pp. 6-8; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, pp. 3-4.

2. That the utility will provide to all parties in this case on a monthly basis copies of billings from SPP for all SPP rate schedules that contain charges and revenues that will be included in the tracker and will report, per its general ledger, all expenses and revenues included in the tracker by month by Federal Energy Regulatory Commission (FERC) Uniform System of Accounts (USOA) account and utility subaccount or minor account. The utility shall also provide, on no less than a quarterly basis, the internally generated reports it relies upon for management of its ongoing levels of transmission expenses and revenues. The utility should also commit to notify the parties to this case of any changes to its existing reporting or additional internal reporting instituted to manage its transmission revenues and expenses.[306]

3. That all ratemaking considerations regarding transmission revenue and expense amounts deferred by the Company pursuant to a tracker be reserved to the utility's next rate proceeding, including examination of the prudence of the revenues and expenses.[307]

4. That KCPL and GMO must impute into the relevant tracker mechanism the level of transmission revenues earned by any transmission company affiliate related to facilities in the utility's Missouri jurisdictional service territory into its tracker mechanism to the extent necessary to ensure that no additional revenue requirement resulting from any decision by GPE to transfer responsibility for transmission construction activity from the utility's regulated business is passed on to the utility's Missouri retail customers

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[306] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, pp. 6 - 8; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, pp. 3-4.

[307] *Id*.

through the tracker.[308] Thus, any decision by GPE to transfer responsibility for construction of transmission projects from KCPL or GMO to a transmission company affiliate will also transfer primary ratemaking authority over the transmission project's costs and capital investment to the FERC. In recent years, FERC has adopted a number of ratemaking policies that would have the probable impact of increasing revenue requirements associated with these transmission projects above the level that would be normally established under this Commission's ratemaking policies. The purpose of this condition is to require KCPL and GMO to pass through SPP transmission revenue requirements to Missouri retail customers calculated on an equivalent basis with Missouri Commission ratemaking practices.[309]

5. That nothing in any order authorizing the utility's use of a transmission tracker is intended to amend, modify, alter, or supersede any previous Commission order or agreement approved by the Commission concerning that utility's involvement in SPP or treatment of SPP transmission revenues and expenses.[310]

6. That deferrals resulting from the transmission tracker mechanism cease under certain circumstances depending upon the utility's reported return on equity (ROE) level.[311] There is no reason for KCPL to defer the impact of under collections in rates of one cost of service element when it is earning in excess of its authorized ROE on an

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[308] *Id*.

[309] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, p. 10; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, p. 7.

[310] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, pp. 6-8; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, pp. 3-4.

[311] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, pp. 6-8; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, pp. 3-4.

overall basis. Conversely, if a tracker is authorized, there is no reason for KCPL to defer over collections in rates of one cost of service element when it is earning below its authorized ROE on an overall basis. For that reason, Staff recommends that if the Company reports it is earning at or in excess of its authorized ROE on a twelve-month rolling forward average basis in quarterly earnings "surveillance" reporting, any tracker deferrals of under collections in net transmission costs should cease from that point forward, and only resume on a prospective basis if this surveillance reporting shows it is now earning below its authorized ROE. Likewise, tracker deferrals of over collection of net transmission costs should cease from the point that surveillance shows it is earning below its authorized ROE. This is because the Commission has previously authorized trackers primarily as earnings protections, for both utilities and their customers.[312]

Sarah Kliethermes

RATE DESIGN AND CLASS COST OF SERVICE

Because they affect which customer groups will pay what rates, Staff next addresses the rate design and class cost of service issues. For KCPL those issues are:

I.6. **Rate Design/Class Cost Of Service Study**: (KCPL)

a. How should the class cost of service studies be relied on for determining shifts in customer class revenue responsibilities that are revenue neutral on an overall company basis?
   i. What methodology should be used to allocate demand-related (fixed) production costs in KCPL's class cost-of-service study?
   ii. What methodology should be used in the CCOS to allocate OSS margins?

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[312] Ex. Staff-252, Staff witness Mark Oligschlaeger KCPL Surrebuttal Testimony, pp. 11-12; Ex. Staff-3008, Staff witness Mark Oligschlaeger GMO Surrebuttal Testimony, p. 8.

b. How should any rate increase be allocated among the various customer classes?

c. How should rates be designed?

d. Should the Commission adopt Staff's proposal to increase by 5% the first energy block rate of the winter All-Electric General Services rates?

e. Should the Commission adopt Mr. Brubaker's LGS / LP rate design methodology?

f. Residential rate adjustments:
   i. Should current residential rates be adjusted to reflect a revenue-neutral shift seasonally and among residential rate schedules in the winter based on KCPL's class cost of service study?
   ii. How should any residential rate increase be assigned to rate elements?

g. Residential Space Heat services:
   i. Should KCPL's Residential Space Heat services be eliminated?
   ii. In the alternative, should KCPL's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?
   iii. Should the Commission adopt Staff's proposal to increase by 5% the first block of the residential space heating rates?

For GMO they are:

III.7. **<u>Rate Design/Class Cost of Service Study</u>**: (GMO)

a. How should the class cost of service studies be relied on for determining shifts in customer class revenue responsibilities that are revenue neutral on an overall company basis?

b. How should any rate increase be allocated among the various customer classes?

c. How should rates be designed?

d. Residential rate adjustments:
   i. Should current Residential rates be adjusted to reflect a revenue-neutral shift seasonally and among Residential rate schedules in the winter based on GMO's class cost of service study?
   ii. How should any Residential rate increase be assigned to rate elements?

e. Residential Space Heating services:

i. Should GMO's Residential Space Heating services be eliminated?

ii. In the alternative, should GMO's Residential Space Heating services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?

iii. Should the Commission adopt Staff's proposal to increase the residential space heating rates?

e.' (Labeled e. in Oct. 11, 2012 issues list.) Should the Commission adopt the Staff's proposal to increase the non-residential space heating rates?

f. Should GMO be required to conduct a comprehensive study on the impacts of its retail customers of eliminating the MPS and L&P rate districts and implementing company-wide uniform rate classes?

g. Should GMO be required to conduct a class cost of service study to determine the differences in its cost of service for each of the classes of MPS and L&P customers?

The Rate Design/Class Cost of Service issues are partially resolved. The resolutions of the rate design and cost of service issues are presented in the *Non-Unanimous Stipulations and Agreements Regarding Class Cost of Service/Rate Design* are supported by the studies filed by various experts in this proceeding.[313] Those resolutions will reasonably allocate any rate increase.[314] The Non-Unanimous Stipulation and Agreement resolves Issues I. 6.a.i, I.6.a.ii, I.6.b, I.6.c, and I.6.e. in the KCPL case, and Issues III.7.a, III.7.b, and III.7.c. in the GMO case.

Issues remaining for Commission consideration are I.6.d, I.6.f, and I.6.g. in the KCPL case. Issues remaining for Commission consideration in the GMO case are III.7.d, III.7.e, and III.7.e' (two issues are labeled 7.e. in the issues list)

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[313] Vol. 19, Tr. 1078, ll. 16-25.

[314] Vol. 19, Tr. 1021, ll. 21-25.

In the winter season, certain rate schedules not addressed by the *Non-Unanimous Stipulations and Agreements Regarding Class Cost of Service/Rate Design,* do not meet their cost of service. Those schedules are as follows:[315]

- KCPL RESB (residential general use and space heat – one meter)
- KCPL separately metered space heat rate of RESC (residential general use and space heat – two meters)
- KCPL's all-electric rate schedules for Small General Service (SGS)
- KCPL's all-electric rate schedules for Medium General Service (MGS)
- GMO's L&P rate district's MO 920 rate schedule (residential service with space heating)
- GMO's L&P rate district's MO 922 Frozen rate schedule (residential space heating / water heating – separate meter)
- GMO's MO 941 Frozen rate schedule (non-residential space heating/water heating – separate meter).

Eliminating entirely the differential between these rates and their costs of service would result in rate shock.[316] MGE advocates a set of alternatives: 1) revenue-neutral adjustments in current rates, 2) separate residential space heating schedules be eliminated – alternative of residential space heating schedules be scheduled for elimination in future case, or 3) design of charges based on revenue-neutral revenue adjustments, while KCPL and GMO oppose any adjustment to that differential.

[315] See Ex. Staff-255, p 3; Ex. Staff-3011, p 3.

[316] Vol. 19, Tr. 1078, ll. 2-16; Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

While Staff's recommendation does address the concerns MGE has raised, it does so without eliminating or freezing a rate schedule under which customers are currently taking service,[317] which addresses concerns raised by KCPL and GMO.

KCPL Rate Design

Issue I.6.d

Should the Commission adopt Staff's proposal to increase by 5% the first energy block rate of the winter All-Electric General Service rates?

Issue I.6.d deals with the winter first energy block of the all-electric rate schedules for Small General Service (SGS), Medium General Service (MGS), and Large General Service (LGS). However, paragraph 3 of the *Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service/ Rate Design* deals with the LGS group in its entirety which includes the all-electric LGS rate schedule. Therefore, the only issues remaining in I.6.d are the winter first energy block of the all electric rates for SGS and MGS.

The Commission should adopt Staff's recommendation. In the winter, these SGS and MGS all electric rates do not meet their cost of service.[318] To address this disparity, Staff recommends the first energy block rate of the winter all-electric general service rates (Small and Medium) be increased by an additional 5%. Staff recommends adjusting these rates to bring the winter season rates closer to its class cost of service

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[317] Vol. 19, Tr. 1080, l. 23 – Tr. 1081, l. 2.

[318] See Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

for the winter season. Eliminating the differential entirely would result in rate shock.[319] Staff does not recommend eliminating entirely the differential that exists under these rate schedules, but rather recommends bring the first energy block closer to its cost of service in the winter season.

Issues I.6.f (i and ii) Residential Rate Adjustments:

i. **Should current residential rates be adjusted to reflect a revenue-neutral shift seasonally and among residential rate schedules in the winter based on KCPL's class cost of Service study?**

ii. **How should any residential rate increase be assigned to rate elements?**

The Commission should adopt Staff's recommendation. In the winter, the RESB (residential general use and space heat – one meter) and the winter season separately metered space heat rate of RESC (residential general use and space heat – two meters) rates do not meet their cost of service.[320] Eliminating the differential entirely would result in rate shock considering the magnitude of electric increases for the last five years.[321] Although at hearing MGE was able to clarify some details of its residential proposal, to address this disparity, Staff continues to recommend the Commission reject MGE's more abrupt resolution and adopt Staff's more gradual move of the first winter block of RESB (residential general use and space heat – one meter) and the winter season separately metered space heat rate of RESC (residential general use and space

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[319] Vol. 19, Tr. 1078, ll. 2-16; Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

[320] See Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

[321] Vol. 19, Tr. 1078, ll. 2-16; Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

heat – two meters) be increased by an additional 5%. These rates are being adjusted to bring the residential rate classes RESB and RESC closer to its class cost of service for the winter season. While Staff's recommendation does address the concerns MGE has raised, it does so without eliminating or freezing a rate schedule under which customers are currently taking service,[322] which addresses KCPL's concerns.

Issues I.6.g (i, ii, and iii) Residential Space Heat Services:

i. **Should KCPL's Residential Space Heat services be eliminated?**

ii. **In the alternative, should KCPL's Residential Space Heat services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?**

iii. **Should the Commission adopt Staff's proposal to increase by 5% the first block of the residential space heating rates?**

This issues is addressed in Staff's discussion above: **Issues I.6.f (i and ii) Residential Rate Adjustments.**

<u>GMO Rate Design</u>

Issues III.7.d: (i and ii) Residential Rate Adjustments:

iii. **Should current residential rates be adjusted to reflect a revenue-neutral shift seasonally and among residential rate schedules in the winter based on GMO's class cost of Service study?**

iv. **How should any residential rate increase be assigned to rate elements?**

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[322] Vol. 19, Tr. 1080, l. 23 – Tr. 1081, l. 2.

The Commission should adopt Staff's recommendation. In the winter, in the L&P rate district the MO 920 rate schedule (residential service with space heating) and the MO 922 Frozen rate schedule (residential space heating / water heating – separate meter) rates do not meet their cost of service.[323] Eliminating the differential entirely would result in rate shock considering the magnitude of electric increases for the last five years.[324] Although at hearing MGE was able to clarify some details of its residential proposal, to address this disparity, Staff continues to recommend the Commission reject MGE's more abrupt resolution and adopt Staff's more gradual move of an additional 6% increase in the L&P rate district for the two winter energy block rates of the MO 920 rate schedule (residential service with space heating); and an additional 6% increase for the winter energy rate of the MO 922 Frozen rate schedule (residential space heating / water heating – separate meter). These rates are being adjusted to bring these rate schedules closer to their class cost of service for the winter season. While Staff's recommendation does address the concerns MGE has raised, it does so without eliminating a rate schedule under which customers are currently taking service,[325] which addresses GMO's concerns.

Issues III.7.e (i, ii, and iii) Residential Space Heating Services:

iv. Should GMO's Residential Space Heating services be eliminated?

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[323] Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

[324] Vol. 19, Tr. 1078, ll. 2-16; Ex. Staff-3011, p 3.

[325] Vol. 19, Tr. 1080, l. 23 – Tr. 1081, l. 2.

v. **In the alternative, should GMO's Residential Space Heating services be scheduled for elimination in a subsequent rate case by freezing their availability in this case?**

vi. **Should the Commission adopt Staff's proposal to increase the residential space heating rates?**

This issues is addressed in Staff's discussion above: **Issues III.7.e (i, ii, and iii) Residential Space Heating Services.**

Issues III.7.e' (The second issue labeled III.7.e. in the list of issues)

Should the Commission adopt the Staff's proposal to increase the non-residential space heating rates?

This issue deals with the winter energy block of the non-residential space heating rate class.

In the winter, the MO 941 Frozen rate schedule (non-residential space heating/water heating – separate meter) does not meet its cost of service.[326] To address this disparity, Staff recommends an additional 6% increase for the winter energy rate is appropriate. Staff recommends adjusting these rates to bring the winter season rates closer to its class cost of service for the winter season. Eliminating the differential entirely would result in rate shock.[327] Staff does not recommend eliminating

[326] See Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

[327] Vol. 19, Tr. 1078 ll. 2-16; Ex. Staff-255, KCPL Surrebuttal Testimony of Michael S. Scheperle, p 3; Ex. Staff-3011, GMO Surrebuttal Testimony of Michael S. Scheperle, p 3.

entirely the differential that exists under this rate schedules, but rather recommends bringing the energy rate closer to its cost of service in the winter season.

Sarah Kliethermes

OFF SYSTEMS SALES MARGINS

Staff has a concern with the frequency and magnitude of GMO's negative off-system sales margins. Although Staff has proposed no revenue requirement adjustment, Staff is presenting its concerns in this section of its brief. These concerns are included in the list of issues as follows:

> **III**.3. **Off Systems Sales Margins** (GMO): How should Purchases for Resale (including issues related to negative margins) be treated?

Staff reiterates its concern that—unlike any other investor-owned utility in Missouri—GMO consistently records negative off-system sales margins. The charts included in Mr. Harris' testimony[328] and highlighted at the October 26 hearing illustrate the dramatic collapse of GMO's margins since GMO's acquisition by GPE in 2008. GMO has suggested several possible explanations for these negative margins, all of which Staff finds unsatisfactory.

In testimony, GMO witness Burton Crawford stated that GMO's negative margins are driven by purchases for resale. Yet, as Mr. Harris testified, Aquila realized consistently positive margins despite a similar reliance on purchased power. GMO further testified that GMO's collapsed margins result from a new interpretation of

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[328] Ex. Staff -259, Staff GMO Cost of Service Report, pp. 107-8; Ex. Staff -275, GMORebuttal Testimony of V. William Harris, Sch. VWH-3; Ex. Staff-296, GMO Surrebuttal Testimony of V. William Harris, p. 3, l. 3.

the FERC Open Access Transmission Tariff that GMO adopted after the acquisition. This, too, fails to explain why GMO is the *only* Missouri IOU recording consistently negative margins.[329]

Of all the Missouri IOUs, Empire is most similar to GMO in terms of customers, rate base and revenues—and, like GMO, Empire sells a significant amount of purchased power into the off-system sales market.[330] At hearing GMO highlighted the fact that the two utilities do not serve *exactly* the same number of customers or generate *exactly* the same number of megawatts,[331] but these are distinctions without a difference. These distinctions fail to explain why GMO's off-system sales margins were consistently positive before the 2008 acquisition, and consistently negative afterwards.

Staff recommends that the Commission urge GMO to pursue a higher level of off-system sales margin.

John Borgmeyer

Staff is briefly responding to the issues the Sierra Club raised regarding KCPL's resource planning. That issue is:

I.9. **Resource Planning—La Cygne and Montrose** (KCPL): Should the Sierra Club's recommendations regarding the LaCygne and Montrose investments be adopted?

While it has not stated a position on this issue, it is Staff's view that this KCPL case is not the case to examine the prudency of KCPL's investments in emissions

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[329] Staff has no reason to believe that any other Missouri utility interprets the OATT different from GMO's current interpretation. Vol. 18, Tr. 758.

[330] Ex. Staff-296, GMO Surrebuttal Testimony of V. William Harris, p. 2, ll. 10-12.

[331] Vol. 18, Tr. 756-7.

reducing additions to its LaCygne and Montrose generating plants. Such an examination should be undertaken either in an investigation or in a rate case where KCPL is seeking to include them in its rate base. Neither circumstance exists in the currently pending KCPL rate case.

FEDERAL ENERGY *INDEPENDENCE AND SECURITY ACT OF 2007*

Finally, Staff addresses the non-contested issue of what further actions the Commission should take with regard to KCPL and GMO and the four standards of the federal *Energy Independence and Security Act of 2007*.

Energy Independence and Security Act of 2007 ("EISA") -- Non-Contested - KCPL

The Staff addressed in its Cost Of Service Revenue Requirement Report, in sections sponsored by Staff witnesses Natelle Dietrich and Randy S. Gross,[332] the four "new" Public Utility Regulatory Policies Act of 1978 ("PURPA") Section 111(d) standards for electric utilities established by Congress through the Energy Independence and Security Act of 2007 ("EISA"). The Commission is required to consider and determine whether it is appropriate to implement each of the new standards so as to carry out the purposes of PURPA, which are to encourage: (1) conservation of electric energy, (2) efficiency in the use of facilities and resources by electric utilities, and (3) equitable rates to consumers of electricity.[333] Should the Commission decline to implement a PURPA standard for which it determines the standard is appropriate to carry out the

[332] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, pp. 231-235; Ex. Staff-201, Staff KCPL Cost of Service Report, Gross KCPL Direct, pp. 238-245.

[333] PURPA Section 101.

above-noted purposes, the Commission is directed to state in writing its reasons.[334] The Commission is to complete its consideration and determination of each standard no later than December 19, 2009, two years after enactment of EISA. Absent such determination, the Commission is to consider in the first general rate case for each individual electric utility, commenced after December 19, 2010, whether or not it is appropriate to implement such standard to carry out the above noted purposes.[335]

The Commission established three files for the four EISA standards:

1) File No. EW-2009-0290: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(16) Integrated Resource Planning Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("IRP Docket");

2) File No. EW-2009-0291: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(17) Rate Design Modifications to Promote Energy Efficiency Investments Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("Rate Design Docket"); and

3) File No. EW-2009-0292: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(18), Smart Grid Investments Standard, and the PURPA Section 111(d)(19), Smart Grid Information Standard, as Required by Section 1307 of the Energy Independence and Security Act of 2007. ("Smart Grid Docket").[336]

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[334] PURPA Section 111(b)(2)(c)(2).

[335] PURPA Section 112(c).

[336] Congress mis-numbered the four new EISA standards, but corrected the mis-numbering in Section 408, Technical Corrections, enacted as part of the American Recovery and Reinvestment Act of 2009. Pub. L. No. 110-140, 121 Stat. 1492 (2007), amended by Section 408 of The American Recovery and Reinvestment Act of 2009 (the EISA, prior to this amendment, is codified at 16 USCS 2621 and 2622 (Cum. Supp. 2008)). PURPA is codified generally in 16 USCS 2601 et seq., but various provisions appear elsewhere in the United States Code.

The Commission, on November 23, 2009, issued *Order Finding Consideration / Implementation of New Federal Standards Through Workshop and Rulemaking Procedures Is Required* in File Nos. EW-2009-0290, EW-2009-0291, and EW-2009-0292, in which it stated at page 5:

> The Commission has satisfied the requirements for consideration of the new EISA standards, and on the basis of the quasi-legislative record created in these workshops, the Commission determines that no comparable standards have been considered that would constitute prior state action and prohibit the Commission from taking any further action in relation to the new EISA standards. . . .

Ms. Dietrich recommended in the Staff's Cost Of Service Revenue Requirement Report the Commission consider each standard and make its determination with respect to KCPL in the File No. ER-2012-0174 rate case based on the discussion in the Staff's Cost Of Service Revenue Requirement Report.[337]

No party filed any responsive testimony to Ms. Dietrich's or Mr. Gross' testimony on the four EISA / PURPA standards.

PURPA Section 111(d)(16), Integrated Resource Planning Standard as required by Section 532 of EISA, requires state commission consideration of whether to implement the following:

> (A) integrate energy efficiency resources into utility, State, and regional plans; and
>
> (B) adopt policies establishing cost-effective energy efficiency as a priority resource.

The Commission's promulgation of a rulemaking revising Chapter 22 Electric Resource Planning Rules in File No. EX-2010-0254, *In the Matter of a Proposed Rulemaking Regarding Revision of the Commission's Chapter 22 Electric Utility Resource Planning*

[337] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 241.

Rules became effective on June 30, 2011. Ms. Dietrich noted that the Commission has a workshop docket, Case No. EW-2010-0187, open to investigate how to achieve its statutory responsibilities under the Missouri Energy Efficiency Investment Act ("MEEIA"), Section 393.1075, RSMo., among other things, within the background of FERC policies that eliminate barriers to demand response and that direct the Midwest Independent Transmission System Operator ("MISO") and the Southwest Power Pool ("SPP") to accommodate state policy regarding retail customer demand-side activity.[338]

While not specifically making a determination to implement PURPA Section 111(d)(16), the Commission has promulgated rulemakings to address the principles of that section; therefore, Staff suggests there is nothing that remains for the Commission to determine in response to PURPA Section 111(d)(16), and recommends the Commission make such a finding in this rate case for KCPL.[339]

PURPA Section 111(d)(17), Rate Design Modifications to Promote Energy Efficiency Investments Standard as required by Section 532 of EISA, requires state commissions to consider whether to implement: (1) removing the throughput incentive and disincentives to energy efficiency; (2) providing utility incentives for successful management of energy efficiency programs; (3) including the impact of energy efficiency as one of the goals of retail rate design; (4) adopting rate designs that encourage energy efficiency; (5) allowing timely recovery of energy efficiency related costs; and (6) offering energy audits, demand-response programs, publicizing the benefits of home energy efficiency improvements and educating homeowners about

[338] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 241.

[339] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 242.

Federal and State incentives. In 2009, Governor Nixon signed Senate Bill 376, the "Missouri Energy Efficiency Investment Act," with a stated policy to "value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs." Section 393.1075.3

The Commission promulgated a rulemaking in File No. EX-2010-0368, *In the Matter of the Consideration and Implementation of Section 393.1075, The Missouri Energy Efficiency Investment Act*. The rules became effective on May 30, 2011 – Rules 4 CSR 240-20.093, 20.094, 3.163, and 3.164. KCPL submitted its MEEIA application on December 22, 2011, in File No. EO-2012-0008, but on February 17, 2012, KCPL filed its Notice Of Dismissal relating it had filed no prepared testimony or evidence. On February 22, 2012, KCPL filed Kansas City Power & Light Company's Response To Staff's Motion To Reject Tariff Sheets, which noted its Notice Of Dismissal withdrew the MEEIA tariff sheets filed on February 17, 2012. The Commission closed File No. File No. EO-2012-0008 on March 6, 2012. Ms. Dietrich related that although KCPL withdrew its MEEIA filing, the Commission has in place the framework necessary for it to make a determination on the associated PURPA principles as outlined above.[340]

Staff recommends that the Commission, in this case, make a determination that no further determination is needed in response to PURPA Section 111(d)(17) for KCPL.[341]

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[340] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, pp. 242-243.

[341] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 243.

In response to **PURPA Section 111(d)(18)**, Smart Grid Investments Standard, and **PURPA Section 111(d)(19),** Smart Grid Information Standard, as required by Section 1307 of EISA, the Commission, on December 29, 2010, issued an order to open File No. EW-2011-0175 as a repository for information concerning the Smart Grid in Missouri. Ms. Dietrich addresses the Smart Grid in general, in her section on EISA in the Cost Of Service Revenue Requirement Report, and Mr. Gross addresses in considerable detail KCPL's SmartGrid demonstration project, in his preceding section on KCPL Smart Grid Update. Within the boundaries of the SmartGrid demonstration project lies the KCPL Green Impact Zone project and therefore Mr. Gross' discussion of that matter.[342]

PURPA Section 111(d)(18), the Smart Grid Investments Standard, requires the Commission to consider and determine whether the following is appropriate to implement to carry out the purposes of PURPA:

> (A) IN GENERAL – Each State shall consider requiring that, prior to undertaking investments in nonadvanced grid technologies, an electric utility of the State demonstrate to the State that the electric utility considered an investment in a qualified smart grid system based on appropriate factors, including --
>
> (i) total costs;
> (ii) cost-effectiveness;
> (iii) improved reliability;
> (iv) security;
> (v) system performance; and
> (vi) societal benefit.
>
> (B) RATE RECOVERY – Each State shall consider authorizing each electric utility of the State to recover from ratepayers any capital, operating expenditure, or other costs of the electric utility relating to the

[342] Ex. Staff-201, Staff KCPL Cost of Service Report, Gross KCPL Direct, pp. 232-233.

deployment of a qualified smart grid system, including a reasonable rate of return on the capital expenditures of the electric utility for the deployment of the qualified smart grid system.

(C) OBSOLETE EQUIPMENT – Each State shall consider authorizing any electric utility or other party of the State to deploy a qualified smart grid system to recover in a timely manner the remaining book-value costs of any equipment rendered obsolete by the deployment of the qualified smart grid system, based on the remaining depreciable life of the obsolete equipment.

PURPA Section 111(d)(19), the Smart Grid Information Standard, requires the Commission to consider and determine whether it is appropriate that all electricity purchasers and other interested parties should be provided access to information from their electricity provider related to, among other things, time-based prices, usage, and sources of power and type of generation, with associated greenhouse gas emissions for each type of generation, to the extent such information is available on a cost-effective basis, so as to carry out the purposes of PURPA.[343] The standard appears in EISA as follows:

(A) STANDARD. – All electricity purchasers shall be provided direct access, in written or machine-readable form as appropriate, to information from their electricity provider as provided in subparagraph (B).

(B) INFORMATION. – Information provided under this section, to the extent practicable, shall include:

(i) PRICES. – Purchasers and other interested persons shall be provided with information on –

(I) time-based electricity process in the wholesale electricity market; and

(II) time-based electricity retail prices or rates that are available to the purchasers.

[343] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 245.

> (ii) USAGE. – Purchasers shall be provided with the number of electricity units, expressed in kwh, purchased by them.
>
> (iii) INTERVALS AND PROJECTIONS – Updates of information on prices and usage shall be offered on not less than a daily basis, shall include hourly price and use information, where available, and shall include a day-ahead projection of such price information to the extent available.
>
> (iv) SOURCES – Purchasers and other interested persons shall be provided annually with written information on the sources of the power provided by the utility, to the extent it can be determined, by type of generation, including greenhouse gas emissions associated with each type of generation, for intervals during which such information is available on a cost-effective basis.
>
> (C) ACCESS – Purchasers shall be able to access their own information at any time through the internet and on other means of communication elected by that utility for Smart Grid applications. Other interested persons shall be able to access information not specific to any purchaser through the Internet. Information specific to any purchaser shall be provided solely to that purchaser.

Ms. Dietrich relates in the Staff's Cost Of Service Revenue Requirement Report that the Staff, on January 13, 2011, filed the *Missouri Smart Grid Report* in File No. EW-2011-0175. Among other things, the *Missouri Smart Grid Report* presents issues and concerns and identifies key issues requiring further emphasis, including Smart Grid deployment, planning, implementation, cost recovery, cyber security and data privacy, customer acceptance and involvement, and customer savings and benefits. It recommends the Commission hold a Smart Grid workshop every six months for information exchange and sharing of best practices and educational opportunities; and also recommends the Commission open a docket to address cost recovery issues.[344]

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[344] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 244.

The Commission has held Smart Grid conferences on June 28, 2010, and November 29, 2011, and the Smart Grid was also the recent subject of the *PSConnection*, a publication of the Commission. On July 17, 2012, the Commission issued an *Order Directing Notice and Directing Filing* in File No. EW-2013-0011 to gather information related to cyber vulnerabilities and the integrity of the electric utilities' internal cybersecurity practices. This workshop proceeding provides another opportunity for the Commission to explore issues and take action related to the PURPA Smart Grid Investments standard. The Commission on October 5, 2012 issued a *Notice And Order Setting On-The-Record Proceeding* scheduling an on-the-record proceeding in File No. EW-2013-0011 for November 26, 2012 regarding cybersecurity practices.[345]

Staff recommends the Commission make a determination in this case that it has established the appropriate avenues for monitoring Smart Grid activities and no greater ongoing activity is needed in response to PURPA Section 111(d)(18) and PURPA Section 111(d)(19) in the context of KCPL.[346]

Energy Independence and Security Act of 2007 ("EISA") -- Non-Contested - GMO

The Staff addressed in its Cost Of Service Revenue Requirement Report, in sections sponsored by Staff witnesses Natelle Dietrich and Randy S. Gross,[347] the four "new" Public Utility Regulatory Policies Act of 1978 ("PURPA") Section 111(d) standards for electric utilities established by Congress through the Energy Independence and

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[345] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 244.

[346] Ex. Staff-201, Staff KCPL Cost of Service Report, Dietrich KCPL Direct, p. 245.

[347] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, pp. 239-246; Ex. Staff-259, Staff GMO Cost of Service Report, Gross GMO Direct, pp. 235-236.

Security Act of 2007 ("EISA"). The Commission is required to consider and determine whether it is appropriate to implement each of the new standards so as to carry out the purposes of PURPA, which are to encourage: (1) conservation of electric energy, (2) efficiency in the use of facilities and resources by electric utilities, and (3) equitable rates to consumers of electricity.[348] Should the Commission decline to implement a PURPA standard for which it determines the standard is appropriate to carry out the above-noted purposes, the Commission is directed to state in writing its reasons.[349] The Commission is to complete its consideration and determination of each standard no later than December 19, 2009, two years after enactment of EISA. Absent such determination, the Commission is to consider in the first general rate case for each individual electric utility, commenced after December 19, 2010, whether or not it is appropriate to implement such standard to carry out the above noted purposes.[350]

The Commission established three files for the four EISA standards:

1) File No. EW-2009-0290: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(16) Integrated Resource Planning Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("IRP Docket");

2) File No. EW-2009-0291: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(17) Rate Design Modifications to Promote Energy Efficiency Investments Standard as Required by Section 532 of the Energy Independence and Security Act of 2007. ("Rate Design Docket"); and

[348] PURPA Section 101.

[349] PURPA Section 111(b)(2)(c)(2).

[350] PURPA Section 112(c).

3) File No. EW-2009-0292: In the Matter of the Consideration of Adoption of the PURPA Section 111(d)(18), Smart Grid Investments Standard, and the PURPA Section 111(d)(19), Smart Grid Information Standard, as Required by Section 1307 of the Energy Independence and Security Act of 2007. ("Smart Grid Docket").[351]

The Commission, on November 23, 2009, issued *Order Finding Consideration / Implementation of New Federal Standards Through Workshop and Rulemaking Procedures Is Required* in File Nos. EW-2009-0290, EW-2009-0291, and EW-2009-0292, in which it stated at page 5:

> The Commission has satisfied the requirements for consideration of the new EISA standards, and on the basis of the quasi-legislative record created in these workshops, the Commission determines that no comparable standards have been considered that would constitute prior state action and prohibit the Commission from taking any further action in relation to the new EISA standards. . . .

Ms. Dietrich recommended in the Staff's Cost Of Service Revenue Requirement Report the Commission consider each standard and make its determination with respect to GMO in the File No. ER-2012-0175 rate case based on the discussion in the Staff's Cost Of Service Revenue Requirement Report.[352]

No party filed any responsive testimony to Ms. Dietrich's or Mr. Gross' testimony on the four EISA / PURPA standards.

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[351] Congress mis-numbered the four new EISA standards, but corrected the mis-numbering in Section 408, Technical Corrections, enacted as part of the American Recovery and Reinvestment Act of 2009. Pub. L. No. 110-140, 121 Stat. 1492 (2007), amended by Section 408 of The American Recovery and Reinvestment Act of 2009 (the EISA, prior to this amendment, is codified at 16 USCS 2621 and 2622 (Cum. Supp. 2008)). PURPA is codified generally in 16 USCS 2601 et seq., but various provisions appear elsewhere in the United States Code.

[352] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 241.

PURPA Section 111(d)(16), Integrated Resource Planning Standard as required by Section 532 of EISA, requires state commission consideration of whether to implement the following:

> (A) integrate energy efficiency resources into utility, State, and regional plans; and
>
> (B) adopt policies establishing cost-effective energy efficiency as a priority resource.

The Commission's promulgation of a rulemaking revising Chapter 22 Electric Resource Planning Rules in File No. EX-2010-0254, *In the Matter of a Proposed Rulemaking Regarding Revision of the Commission's Chapter 22 Electric Utility Resource Planning Rules* became effective on June 30, 2011. Ms. Dietrich noted that the Commission has a workshop docket, Case No. EW-2010-0187, open to investigate how to achieve its statutory responsibilities under the Missouri Energy Efficiency Investment Act ("MEEIA"), Section 393.1075, RSMo., among other things, within the background of FERC policies that eliminate barriers to demand response and that direct the Midwest Independent Transmission System Operator ("MISO") and the Southwest Power Pool ("SPP") to accommodate state policy regarding retail customer demand-side activity.[353]

While not specifically making a determination to implement PURPA Section 111(d)(16), the Commission has promulgated rulemakings to address the principles of that section; therefore, Staff suggests there is nothing that remains for the Commission to determine in response to PURPA Section 111(d)(16), and recommends the Commission make such a finding in this rate case for GMO.[354]

[353] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, pp. 241-242.

[354] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 243.

PURPA Section 111(d)(17), Rate Design Modifications to Promote Energy Efficiency Investments Standard as required by Section 532 of EISA, requires state commissions to consider whether to implement: (1) removing the throughput incentive and disincentives to energy efficiency; (2) providing utility incentives for successful management of energy efficiency programs; (3) including the impact of energy efficiency as one of the goals of retail rate design; (4) adopting rate designs that encourage energy efficiency; (5) allowing timely recovery of energy efficiency related costs; and (6) offering energy audits, demand-response programs, publicizing the benefits of home energy efficiency improvements and educating homeowners about Federal and State incentives. In 2009, Governor Nixon signed Senate Bill 376, the "Missouri Energy Efficiency Investment Act," with a stated policy to "value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs." Section 393.1075.3

The Commission promulgated a rulemaking in File No. EX-2010-0368, *In the Matter of the Consideration and Implementation of Section 393.1075, The Missouri Energy Efficiency Investment Act*. The rules became effective on May 30, 2011 – Rules 4 CSR 240-20.093, 20.094, 3.163, and 3.164. GMO submitted its MEEIA application on December 22, 2011, in File No. EO-2012-0009.[355] On October 29, 2012, the Commission received in the GMO MEEIA application case, File No. EO-2012-0009, a Non-Unanimous Stipulation And Agreement Resolving KCP&L Greater Missouri

[355] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 243.

Operations Company's MEEIA Filing, which document was also filed that date in File No. ER-2012-0175 as Exhibit No. 392 and was recently renumbered as Exhibit No. 391 at the True-Up Hearing on November 19, 2012 in File No. ER- 2012-0175. On November 7, 2012, in File Nos. ER-2012-0174 and ER-2012-0175, the Commission issued an *Order Incorporating Unopposed Non-Unanimous Stipulations And Agreements* in which it incorporated, as if fully set forth at length, the October 19, 2012 *Non-Unanimous Stipulation And Agreement As To Certain Issues*, as modified by the October 26, 2012 *Non-Unanimous Stipulation And Agreement Regarding Low-Income Weatherization And Withdrawal Of Objection And Request For Hearing* and October 29, 2012 *Non-Unanimous Stipulation And Agreement Resolving KCP&L Greater Missouri Operations Company's MEEIA Filing*, among other documents. On November 15, 2012, the Commission in File No. EO-2012-0009 issued an *Order Approving Non-Unanimous Stipulation And Agreement Resolving KCP&L Greater Missouri Operations Company's MEEIA Filing*.

Given the preceding, Staff recommends that the Commission, in this case, make a determination that no further determination is needed in response to PURPA Section 111(d)(17) for GMO.[356]

In response to **PURPA Section 111(d)(18)**, Smart Grid Investments Standard, and **PURPA Section 111(d)(19),** Smart Grid Information Standard, as required by Section 1307 of EISA, the Commission, on December 29, 2010, issued an order to open File No. EW-2011-0175 as a repository for information concerning the Smart Grid

[356] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 244.

in Missouri. Ms. Dietrich addresses the Smart Grid in general, in her section on EISA in the Cost Of Service Revenue Requirement Report, and Mr. Gross specifically addresses GMO's SmartGrid deployment in his preceding section on Smart Grid Update.[357]

PURPA Section 111(d)(18), the Smart Grid Investments Standard, requires the Commission to consider and determine whether the following is appropriate to implement to carry out the purposes of PURPA:

> (A) IN GENERAL – Each State shall consider requiring that, prior to undertaking investments in nonadvanced grid technologies, an electric utility of the State demonstrate to the State that the electric utility considered an investment in a qualified smart grid system based on appropriate factors, including --
>
> (i) total costs;
> (ii) cost-effectiveness;
> (iii) improved reliability;
> (iv) security;
> (v) system performance; and
> (vi) societal benefit.
>
> (B) RATE RECOVERY – Each State shall consider authorizing each electric utility of the State to recover from ratepayers any capital, operating expenditure, or other costs of the electric utility relating to the deployment of a qualified smart grid system, including a reasonable rate of return on the capital expenditures of the electric utility for the deployment of the qualified smart grid system.
>
> (C) OBSOLETE EQUIPMENT – Each State shall consider authorizing any electric utility or other party of the State to deploy a qualified smart grid system to recover in a timely manner the remaining book-value costs of any equipment rendered obsolete by the deployment of the qualified smart grid system, based on the remaining depreciable life of the obsolete equipment.

[357] Ex. Staff-259, Staff GMO Cost of Service Report, Gross GMO Direct, pp. 235-236.

PURPA Section 111(d)(19), the Smart Grid Information Standard, requires the Commission to consider and determine whether it is appropriate that all electricity purchasers and other interested parties should be provided access to information from their electricity provider related to, among other things, time-based prices, usage, and sources of power and type of generation, with associated greenhouse gas emissions for each type of generation, to the extent such information is available on a cost-effective basis, so as to carry out the purposes of PURPA.[358] The standard appears in EISA as follows:

> (A) STANDARD. – All electricity purchasers shall be provided direct access, in written or machine-readable form as appropriate, to information from their electricity provider as provided in subparagraph (B).
>
> (B) INFORMATION. – Information provided under this section, to the extent practicable, shall include:
>
> (i) PRICES. – Purchasers and other interested persons shall be provided with information on –
>
> (I) time-based electricity process in the wholesale electricity market; and
>
> (II) time-based electricity retail prices or rates that are available to the purchasers.
>
> (ii) USAGE. – Purchasers shall be provided with the number of electricity units, expressed in kwh, purchased by them.
>
> (iii) INTERVALS AND PROJECTIONS – Updates of information on prices and usage shall be offered on not less than a daily basis, shall include hourly price and use information, where available, and shall include a day-ahead projection of such price information to the extent available.
>
> (iv) SOURCES – Purchasers and other interested persons shall be provided annually with written information on the sources of the power

[358] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, pp. 245-246.

provided by the utility, to the extent it can be determined, by type of generation, including greenhouse gas emissions associated with each type of generation, for intervals during which such information is available on a cost-effective basis.

(C) ACCESS – Purchasers shall be able to access their own information at any time through the internet and on other means of communication elected by that utility for Smart Grid applications. Other interested persons shall be able to access information not specific to any purchaser through the Internet. Information specific to any purchaser shall be provided solely to that purchaser.

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[359] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 245.

internal cybersecurity practices. This workshop proceeding provides another opportunity for the Commission to explore issues and take action related to the PURPA Smart Grid Investments standard. The Commission on October 5, 2012 issued a *Notice And Order Setting On-The-Record Proceeding* scheduling an on-the-record proceeding in File No. EW-2013-0011 for November 26, 2012 regarding cybersecurity practices.[360]

Staff recommends the Commission make a determination in this case that it has established the appropriate avenues for monitoring Smart Grid activities and no greater ongoing activity is needed in response to PURPA Section 111(d)(18) and PURPA Section 111(d)(19) in the context of KCPL.[361]

Steven Dottheim

<u>CONCLUSION</u>

WHEREFORE, for the reasons set forth above, the Staff requests the Commission to adopt the Staff's position on each and every KCP&L Greater Missouri Operations Company specific issue that was presented in this case.

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[360] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich GMO Direct, p. 245.

[361] Ex. Staff-259, Staff GMO Cost of Service Report, Dietrich Direct, p. 246.

Respectfully submitted,

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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 28th day of November, 2012.

/s/ Nathan Williams