

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

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service.	)	<b>File No. ER-2012-0174</b>
	)	Tariff No. YE-2012-0404
	)	

and

In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service.	)	<b>File No. ER-2012-0175</b>
	)	Tariff No. YE-2012-0405
	)	

**INITIAL BRIEF OF AARP**

COMES NOW AARP, on behalf of residential electric consumers 50 years of age and over, and hereby offers arguments on certain critical issues that remain contested in the Kansas City power & Light Company ("KCPL") and KCP&L Greater Missouri Operations ("GMO") general rate increase cases captioned above.

**1. Regulatory Policy and Economic Considerations**

Electricity is an essential service, and access to affordable electricity is especially critical for many older consumers. The Commission should set electric rates in these rate cases in a manner that fairly balances the interests of KCPL and GMO shareholders along with the interests of their captive consumers, keeping in mind that the Commission's *principal interest* is to serve and protect ratepayers. State ex rel. Crown Coach v. Public Service Commission, 179 S.W.2d 123, 126 (Mo. App. 1944). The Commission is charged with approving rate schedules that are as "just and reasonable" to consumers as they are to the utility. Valley Sewage Co. v. Public Service Commission, 515 S.W.2d 845, 851 (Mo. App. 1974). In determining what

electric rates are reasonable based on the record evidence, the Commission should carefully weigh the sworn testimony of customers who will be forced to pay any approved electric rate increases, by reviewing the transcripts of the local public hearings held in these rate cases.<sup>1</sup>

The testimony taken at these local public hearings confirm the fact that attempts to recover from the recent economic recession has been extremely difficult for many residential electric customers, partly due to the numerous recent rate increases that have already been approved for both KCPL and GMO in recent years. KCPL consumers in Missouri have already experienced a **43.80%** increase in electric rates since 2007, while experiencing an increase in average weekly wages of less than one-third of that amount (11.45%) over the same five-year time period.<sup>2</sup> GMO customers have experienced electric rate increases of **32.13%** in the MPS rate district and **46.14%** in the L&P rate district since 2007 (while experiencing increases in average weekly wages of only 11.80% and 14.72%, respectively).<sup>3</sup> During that same time period, the Consumer Price Index (“CPI”) increased only 11.58%.<sup>4</sup>

In these current rate cases, KCPL is asking for an additional revenue increase of \$105.7 million per year, while GMO is requesting an additional \$58.3 million per year from its MPS customers and an additional \$25.2 million per year from its customers in the St. Joseph, Missouri area (L&P rate district). As part of these requests, both electric companies are requesting an authorized return on common equity (“ROE”) of 10.4%. If

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<sup>1</sup> Transcript Volumes 7 (Nevada), Volume 8 (Sedalia), Volume 9 (St. Joseph), Volume 10 (Riverside), Volume 11 (Kansas City), and Volume 12 (Lee’s Summit).

<sup>2</sup> Exhibit 201, p. 6.

<sup>3</sup> Exhibit 259, p. 13-14.

<sup>4</sup> Exhibit 259, p. 13.

these additional rate increases are granted, the cumulative impact of energy price increases imposed since the recession will be staggering for many ordinary households that are struggling to meet every day economic needs.

Escalating electric company revenues and double-digit earnings are seriously out of sync with the overall macroeconomic picture, as most economists are currently projecting domestic economic growth to be lower in the long-term as compared to the growth rates achieved during the post-World War II era that existed before the recent recession.<sup>5</sup> Economists are now generally expecting the long-term nominal Gross Domestic Product ("GDP") growth rate to be in the range of 4% to 5%.<sup>6</sup> According to the Current Economic Conditions reported by the Federal Reserve Bank of St. Louis, Missouri's recovery has actually been slower compared to the nation, in terms of personal income and economic activity.<sup>7</sup> The unemployment rate in the KCPL area reached as high as 9.8% in 2010, and the mortgage debt delinquency rates in the area have grown significantly since 2007.<sup>8</sup>

These sobering economic facts, plus the local public hearing testimony, present compelling evidence on the record that the Commission should take into account when attempting to balance the interests of the utilities and their consumers in order to arrive at electric rates that are "just and reasonable" under Missouri law.<sup>9</sup> The Commission's should not view the "reasonableness" of rates from solely inside the bubble of "comparable utility" returns. In order to avoid the dangers of a feedback loop that leads to cyclical decision-making, the Commission should give appropriate weight to the

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<sup>5</sup> Exhibit 201, p. 24.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*, p. 9.

<sup>8</sup> *Id.*, p. 10-12.

<sup>9</sup> Section 393.130.1 RSMo.

evidence of economic conditions in the relevant service territories and to testimony of actual consumers, sworn under oath, regarding the potential economic harm that would result from further electric rate increases at this time. The Commission can promote the ratemaking goal of affordability by adopting the lower end of a zone of reasonableness for the allowed utility profit (ROE) in these cases. The testimony on the record regarding consumer impacts should also guide the Commission when it determines the proper rate design for residential consumers in this case, by mitigating the impact of any rate increases on the lowest energy users. Moreover, the Commission can protect consumers from unreasonable economic harm by eliminating or mitigating any piecemeal, single-issue ratemaking mechanisms, such as the fuel adjustment clause (“FAC”) and other proposed trackers that would unfairly transfer utility business risk onto captive consumers.

## **2. KCPL’s Requested “Interim Energy Charge”**

The “Interim Energy Charge” or “IEC” that KCPL is proposing is unlike any prior IEC that has ever been requested or has been approved by this Commission. This so-called “IEC” proposal contains more similarities to a Fuel Adjustment Clause (“FAC”), which is prohibited under the terms of the Stipulation and Agreement adopted by the Commission in 2005, which granted to KCPL its “Experimental Regulatory Plan” (also commonly known as the “KCPL Regulatory Plan”) that is currently in effect and controlling on the utility.<sup>10</sup> Section B(1)(c) of the KCPL Regulatory Plan contains a bargain made that prohibits KCPL from requesting any FAC surcharge for the duration

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<sup>10</sup> Filed on March 28, 2005 in Case No. EO-2005-0329. At the evidentiary hearing, the Commission took administrative notice of this filing, along with other past Commission orders approving IEC mechanisms which do comply with the Experimental Regulatory Plan. (Tr. \_\_\_\_\_).

of the plan, in exchange for permitting KCPL to request a narrowly-defined IEC mechanism:

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

(i) The rates and terms for such an IEC shall be established in a rate case along with a determination of the amount of fuel and purchased power costs to be included in the calculation of base rates.

(ii) The rate or terms for such an IEC shall not be subject to change outside of a general rate case where all relevant factors are considered.

(iii) The IEC rate “ceiling” may be based on both historical data and forecast data for fuel and purchased power costs, forecasted retail sales, mix of generating units, purchased power, and other factors including plant availability, anticipated outages, both planned and unplanned, and other factors affecting the costs of providing energy to retail customers.

(iv) The duration of any such IEC shall be established for a specified period of time, not to exceed two years.

(v) A refund mechanism shall be established which will allow any overcollections of fuel and purchased power amounts to be returned to ratepayers with interest following a review and true-up of variable fuel and purchased power costs at the conclusion of each IEC. Any uncontested amount of over-collection shall be refunded to ratepayers no later than 60 days following the filing of the IEC true-up recommendation of the Staff.

(vi) During any IEC period, KCPL shall provide to the Staff, Public Counsel and other interested Signatory Parties monthly reports that include any requested energy and fuel and purchase power cost data.<sup>11</sup>

The so-called “IEC” described in KCPL witness Rush’s prepared testimony and in the attached specimen tariff do not comply with this definition of an IEC.<sup>12</sup> Mr. Rush

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<sup>11</sup> Ibid., pp. 7-8 [emphasis added].

states that “At the end of the two years, if the amount in the deferred account were negative, then the company would refund that amount to customers. If the amount were positive, then no refund would occur.”<sup>13</sup> The actual language of the proposed specimen “IEC” tariff (sheet 24) states:

KCP&L shall refund the excess, if any, above the greater of the actual or the base, plus interest. Any margin amount to be retained by the company will be posted to a regulatory asset for inclusion in the next general rate case.<sup>14</sup>

Despite Mr. Rush’s claim that a refund would be possible under this confusingly crafted “IEC” proposal, the creation of a “regulatory asset” would not comply with the controlling definition of a true IEC and defeat the main consumer benefit in the regulatory plan--in that a “regulatory asset” could be interpreted to allow recovery from consumers in a subsequent rate case. Subsection (v) would be violated, as the “refund of overcollections” component of the IEC definition would be undermined. KCPL’s creative addition of this “regulatory asset” provision to the normally accepted terms of an IEC in Missouri would render the operation of this mechanism as nearly indistinguishable from an FAC, denying consumers the benefit of the bargain made in EO-2005-0329. It is important to realize that KCPL, over the past few years, has already secured most of the regulatory plans benefits that it had bargained for in the regulatory plan, primarily through hundreds of millions of dollars of “additional amortizations” that it would not otherwise have been allowed to charge under Missouri law. The Commission should continue to maintain the terms of the KCPL Regulatory Plan, so that consumers receive *their* full benefits pursuant of the bargain.

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<sup>12</sup> Exhibit KCPL-40; Schedule TMR-1.

<sup>13</sup> Rush Direct, Exhibit KCPL-40, p. 13.

<sup>14</sup> Id., Attached specimen tariff Schedule TMR-1 (Sheet 24).

Moreover, the phrase “the greater of the actual or the base” that is contained in the above quoted specimen “IEC” tariff is vague and appears to violate subsection (iii) of the IEC definition. Staff understands this phrase to suggest that KCPL would not provide a refund to the customers unless the “customer’s share” of the off-system sales margin is above any increase in fuel and purchased power costs.<sup>15</sup> Staff interprets the tariff as denying consumers any refund if the actual fuel and purchased power costs falls between the 40<sup>th</sup> and 60<sup>th</sup> percentile; that is, KCPL would keep all off system sales margin within that range.<sup>16</sup>

### **3. GMO’s Requested Fuel Adjustment Clause**

AARP opposes the continuation of Fuel Adjustment Clause (“FAC”) for GMO, as it has consistently done since the Commission first established this unfair surcharge for the utility’s predecessor, Aquila, Inc. For over 25 years prior to that time, the utility bore 100% of the risk of fuel and purchased power cost fluctuation, and consumers benefited from the incentive that the lack of a FAC provided to encourage prudent procurement practices. It is time to stop the use of this anti-consumer piecemeal mechanism, and require the utility to once again bear all of the risks and rewards of managing this aspect of its business.

The law gives the Commission the option to “reject” a request to continue a FAC, if the utility fails to make a sufficient case for its continuation in a general rate case.<sup>17</sup> The FAC should be rejected because it is unfair, in that it allows a rate increase to be

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<sup>15</sup> Mantle Rebuttal, Exhibit \_\_\_\_\_, p. 3-4.

<sup>16</sup> *Id.*

<sup>17</sup> Section 386.266.4 RSMo.

imposed upon ratepayers, even in the potential situation where a utility is over-earning based upon its overall cost of service. Furthermore, GMO's proposed FAC currently exposes consumers to a risk of rate volatility in-between general rate cases, which makes this surcharge unpopular due to the manner in which it frustrates the ability of consumers to adequately budget their own expenses.<sup>18</sup>

One of the best ways to understand the impact of an FAC is in terms of risk. Even though GMO is routinely allowed the opportunity to earn an ample ROE through rates in recognition of the utility's obligation to manage its business risk, GMO witness Tim Rush acknowledged that the utility would "prefer" if consumers bore 100% of the risk of utility's management of its fuel and purchased power costs.<sup>19</sup> However, if the Commission has now continues to grant GMO the privilege of charging a Fuel Adjustment Clause, the current sharing percentages should be modified to reflect that consumers must share no more than 50% of the risk of fuel cost volatility.

Staff witness Barnes makes a compelling case for the fact that the current 95%/5% sharing mechanism is not providing enough incentive ("skin in the game") to ensure that the utility is engaging in the most cost efficient fuel and purchased power practices, proposing a modest change to an incentive sharing plan of 85%/15%.<sup>20</sup> 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 willingness to use its FAC to its advantage and to the disadvantage of its customers.<sup>21</sup>

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<sup>18</sup> See local public hearing testimony, Volume 12, p. \_\_\_\_.

<sup>19</sup> Tr. 798.

<sup>20</sup> Ex. 259, p. 270.

<sup>21</sup> Id.

AARP believes that it is unreasonable and unfair to require consumers to bear any more than 50% of the risk of volatility in such costs going forward. The current FAC transfers a whopping 95% share of this risk onto consumers, even though GMO witness Rush acknowledged at hearing that that consumers have *no control* over these costs:

Q: And do you believe that the customers of GMO have any control over fuel and purchased power practices?

A [Rush]. **I think I would agree with you that they do not.**

Q. And does GMO have at least some control over fuel and purchased power prices?

A [Rush]. **We have a tremendous amount of control over fuel and purchased power prices.**<sup>22</sup>

How is it reasonable for the party that has no control over a particular expense to bear 95% of the risk, while the party that has a “tremendous amount of control” over the management of that expense bears only 5% of the risk? FAC prudence review cases do not involve the intervention of as many parties nor provokes the same level of scrutiny over expenses as occurs in general rate cases. The enormous administrative difficulty that the Commission Staff faces in investigating fuel procurement practices through an FAC prudence filing, renders it a poor substitute to the inherent incentive that is at work to encourage cost efficiency when a utility has a significant amount of skin in the game. The Commission should thus reject GMO’s request for a continuation of its current FAC, or in the alternative, mitigate the negative impact of the FAC by requiring GMO to share with consumers equally in the risk of volatility of fuel and purchased power expenses (which the utility alone is in a position to manage).

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<sup>22</sup> Tr. 798.

#### 4. Return on Common Equity (ROE)

The current economic environment is clearly favorable to utilities in terms of a lower cost of capital for debt and equity instruments, and the record contains evidence that the capital markets expect that authorized returns are going to drop lower in the near future.<sup>23</sup> These lower capital costs should be shared with ratepayers through a significantly lower authorized return on common equity (“ROEs”) for both KCPL and GMO. The capital market costs today are much lower than they were in 2011 when KCPL and GMO’s rates were last approved.<sup>24</sup> The capital market environment today supports the ability of utility commissions to authorize ROEs below 10%, and actually anticipates that authorized ROEs will be lowered further, given current economic conditions.<sup>25</sup>

Both KCPL and GMO are wholly-owned by Great Plains Energy (GPE), which issues publicly traded stock. Using widely-accepted methods of financial analysis, Staff witness David Murray has calculated a weighted average cost of capital for KCPL in the range of 7.14% to 7.66%.<sup>26</sup> (Schedule 23). Using the same methods, Mr. Murray calculates a nearly identical range for GMO’s average cost of capital.<sup>27</sup> These calculations, based upon Discounted Cash Flow (“DCF”) analyses and checked against a CAPM analysis and other standards measures of reasonableness, leads Mr. Murray to propose a zone of reasonableness for an authorized ROE in the range of 8.00% to

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<sup>23</sup> Ex. 201 (Staff Report), p. 27-28.

<sup>24</sup> Ex. 300, Gorman Direct, p. 3.

<sup>25</sup> Ex. 201, p. 28.

<sup>26</sup> Ex. 200, p. 65 (Schedule 23).

<sup>27</sup> Ex. 201, p. 69 (Schedule 23).

9.00% for each utility.<sup>28</sup> Although Mr. Murray suggests that the Commission adopt an ROE at the higher end of this range, AARP recommends that the Commission set the allowed ROE at low end of the range recommended by Staff (8.00%). An authorized ROE of 8.00% is within the zone of reasonableness, as derived from an expert analysis of market-driven data using traditional analytical tools.<sup>29</sup> Mr. Murray acknowledged that an authorized ROE of 8.00% would allow Ameren Missouri to attract capital at reasonable terms, thereby enabling it to provide safe and reliable electric service, that it is sufficient to ensure Ameren Missouri's financial integrity, and that it is commensurate with the cost of equity for enterprises having corresponding risks.<sup>30</sup> Such a result is thus consistent with United States Supreme Court case law regarding the constitutional requirements for authorized returns.<sup>31</sup>

Mr. Murray stated that while his calculation of the zone of reasonableness for the cost of capital takes into account the impact of the current economy on the utilities, it was not adjusted to reflect the economic hardships currently faced by consumers.<sup>32</sup> It is within the Commission's authority to recognize the lop-sided impact that the current economy has had on KCPL and GMO consumers, through its ability to choose an ROE towards the lower end of the zone of reasonableness.<sup>33</sup> Adopting an authorized ROE of 8.00% in KCPL's rate case would save its consumers \$47 million annually, compared

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<sup>28</sup> Ex. 201, p. 65; Ex. 259, p. 69..

<sup>29</sup> Tr. 463.

<sup>30</sup> Tr. 461-462.

<sup>31</sup> Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

<sup>32</sup> Tr. 459.

<sup>33</sup> Tr. 460-462; Ex. 302, p. 9; 309, p. 9.

with the KCPL's proposed ROE.<sup>34</sup> Similar savings would result from applying this reasonable and fully supportable authorized ROE to GMO's revenue requirements. AARP urges the Commission to protect consumers in this manner.

## **5. Rate Design**

With regard to GMO, AARP did not oppose the Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service and Rate Design, filed in Case No. ER-2012-0175 on October 29, 2012, which disposes of most of the rate design issues for the two GMO service territories. AARP is pleased that this agreement calls for no revenue neutral shifts of cost onto residential customers, and that the current residential customer charge will be retained.

With regard to KCPL, AARP objected to the Non-Unanimous Stipulation and Agreement Regarding Class Cost of Service/Rate Design, filed on October 29, 2012 in Case No. ER-2012-0174, specifically objecting to the joint proposal of some parties to increase residential true-up revenues by 1.00%, in addition to any other increase implemented by the Commission, with a corresponding equal-percentage revenue neutral decrease in the true-up revenues for all other non-lighting rate classes.<sup>35</sup> Furthermore, AARP specifically objected to any increase in the residential customer charge as a result of this non-unanimous stipulation.

The class cost of service results contained in the filed testimony of KCPL witness Normand also indicated that the residential class is consistent with the system average

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<sup>34</sup> Tr. 465-486.

<sup>35</sup> AARP Objection to Non-Unanimous Stipulation, filed on November 2, 2012.

rate of return and thus suggests that no revenue neutral shifts are warranted.<sup>36</sup> OPC witness Barb Meisenheimer proposes that any rate design change balance the cost of service with rate impact and affordability considerations.<sup>37</sup> Ms. Meisenheimer found no revenue shifts onto the residential class to be justified based upon her expert analysis in this case.<sup>38</sup> Thus AARP opposes any rate design shifts onto the residential class.

AARP also strongly recommends that the KCPL's current monthly customer charge be retained, applying any revenue increases to the volumetric rate components of electric rates for residential customers. KCPL's calculation in support of its recommended increase in the customer charge is improperly inflated by the allocation of uncollectible expenses, a practice that is inconsistent with the NARUC Cost Allocation Manual.<sup>39</sup> Retaining the current customer charge would both promote energy efficiency, as well as affordability by protecting KCPL's smallest users.

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<sup>36</sup> Ex. KCPL-38.

<sup>37</sup> Ex. 302, p. 3-5.

<sup>38</sup> Ex. 303, p. 3-4.

<sup>39</sup> See Tr. 997-1000.

## 6. Conclusion

AARP respectfully requests that the Commission issue a Report and Order in these rate cases which is consistent with its arguments contained herein and which produces just and reasonable electric rates for all effected consumers.

Respectfully submitted,

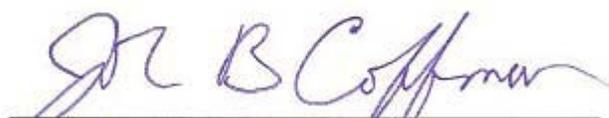
A handwritten signature in blue ink that reads "John B. Coffman". The signature is written in a cursive style and is positioned above a horizontal line.

John B. Coffman                      MBE #36591  
John B. Coffman, LLC  
871 Tuxedo Blvd.  
St. Louis, MO 63119-2044  
Ph: (573) 424-6779  
E-mail: [john@johncoffman.net](mailto:john@johncoffman.net)

Attorney for AARP

## CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to all parties on the official service list for these cases on this 28<sup>th</sup> day of November 2012:

  
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