BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Determination of Carrying Costs for the Phase-In Tariffs of KCP&L Greater Missouri Operations Company.	)))	**Case No. ER-2012-0024**

STAFF'S BRIEF

COMES NOW the Staff of the Missouri Public Service Commission and for its brief states:

Summary

The four issues in this case, followed by a brief statement of Staff's position on each, are:

Issue 1: ***Does the Commission have jurisdiction in this case?***

This issue questions the Commission's jurisdiction to act after the Commission was served with Cole County Circuit Court writs to review Commission decisions in KCP&L Greater Missouri Operations Company's ("GMO") last general rate case, Case No. ER-2010-0356. The Cole County Circuit Court cases are Case Nos. 11AC-CC00415 (lead), 11AC-CC00474 and 11AC-CC00432.

The Commission's decisions in Case No. ER-2010-0356 that established GMO's revenue increase, directed part of that increase be phased-in over time, modified GMO's fuel adjustment clause, approved tariff sheets to implement the revenue increase not phased in and approved tariff sheets to implement the fuel adjustment clause terminally and completely resolved Case No. ER-2010-0356; therefore, the Commission has jurisdiction over the issues in this case. Section 393.155.1, RSMo. 2000, in part, explicitly provides: "In order to implement the phase-in, the commission may, in its discretion, approve tariff schedules which will take effect from time to time after the phase-in is initially approved." Unlike § 386.266.4, RSMo Supp. 2011,

pertaining to rate adjustment mechanisms such as fuel adjustment clauses, § 393.155.1, RSMo. 2000, does not require that the Commission establish all the parameters of the revenue increase phase-in in a general rate proceeding.

Issue 2 (authored by AG Processing, Inc. a cooperative)**:** ***Does the Commission decision consider all relevant factors?***

Based on statements counsel for AG Processing made during the evidentiary hearing of this case and its stated position on this issue, this issue is based on an assertion that because implementing the phase-in of the revenue increase from Case No. ER-2010-0356 involves changing customer rates, the Commission must consider all relevant factors at each point in time when those customer rates are changed.[1]

The customer rates the Commission approved in GMO's last general rate case, Case No. ER-2010-0356, are GMO's rates for electric service until the Commission again considers all relevant factors in a subsequent general electric rate proceeding or a court finds them unlawful or unreasonable. Therefore, in accord with the last sentence of § 393.155.1, RSMo. 2000—"In order to implement the phase-in, the commission may, in its discretion, approve tariff schedules which will take effect from time to time after the phase-in is initially approved," the Commission may now approve tariff sheets to implement the rate increase phase-in without having to consider all relevant factors that affect general rates when implementing the phase-in rate changes. However, if there is a proceeding to change GMO's general electric rates, then the unbilled part of the revenue increase phase-in will be one of the relevant factors the Commission considers

[1] Tr. Vol. 2, pp. 32-35; *AGP's Position Statements*, filed December 27, 2011.

when then determining GMO's revenue requirement and customer rates,[2] and the Commission-approved phase-in tariff schedules may no longer be "just and reasonable."

Issue 3: ***Should GMO's carrying costs in the phase-in tariff schedules filed in this proceeding be 3.25% per year?***

This issue is the rate the Commission should use to determine the "carrying costs"—the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in that is described in § 393.155.1, RSMo. 2000.

The Commission should use the rate of 3.25 percent per year to which Staff and GMO agree, and no party opposes on the merits of the rate,[3] to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in that is described in § 393.155.1, RSMo. 2000.

Only if the Commission decides that GMO's short-term debt cost is not the appropriate basis upon which to determine the "just and reasonable adjustment," then the Commission should determine the "just and reasonable adjustment" by using a forward-looking discount rate that an investor or valuation expert would employ, not one that is based on historical debt cost such as a Commission-approved overall rate of return used to set general rates. Staff recommends that forward-looking discount rate is 6.40 percent, if the Commission does not adopt the 3.25 percent rate to which Staff and GMO, and Public Counsel have agreed.

Issue 4: ***Should the Commission order that the tariff schedules filed with the Non-Unanimous Stipulation And Agreement on September 2, 2011, for the second, third and fourth year of the phase-in plan be allowed to become effective automatically in each***

[2] See *State ex. rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 49 and 56 (Mo. banc 1979).
[3] AG Processing argues the Commission has no jurisdiction to address this issue.

subsequent year on June 25 without further order of the Commission, unless suspended by the Commission for good cause shown?

This issue is whether the Commission should implement the general rate increase phase-in it ordered in Case No. ER-2010-0356 by issuing orders so that GMO's tariff includes tariff schedules that conform to the exemplar tariff schedules included in the *Non-Unanimous Stipulation and Agreement* filed in this case on September 2, 2011. Because AG Processing objected to this *Non-Unanimous Stipulation and Agreement*, by operation of Commission Rule 4 CSR 240-2.115(2)(D), it is "merely a position of the signatory parties to the stipulated position, except that no party shall be bound by it, [and] [a]ll issues . . . remain for determination after hearing."

The Commission should reject the phase-in tariff schedules GMO filed May 31, 2011, in Case No. ER-2010-0356 (Tracking Nos. YE-2011-0608, YE-2011-0609 and YE-2011-0610) that bear effective dates of June 4, 2012, 2013, and 2014, approve the exemplar tariff schedules marked as Exhibit A of the *Non-Unanimous Stipulation and Agreement* filed in this case on September 2, 2011, and order GMO to file compliance tariff schedules that conform to the exemplar tariff schedules to take effect on the respective dates of June 25th of 2012, 2013 and 2014 that the exemplar tariff sheets bear. If the Commission decides that GMO's short-term debt cost is not the appropriate basis upon which to determine the "just and reasonable adjustment," then it should not approve the exemplar tariff schedules marked as Exhibit A of the *Non-Unanimous Stipulation and Agreement*, but instead should order GMO to file compliance tariff schedules that conform to its resolution of the appropriate rate to use to determine the "just and reasonable adjustment" for the revenue increase phase-in.

However, if there is a proceeding to change GMO's general electric rates before the revenue increase phase-in is fully completed, then the unbilled part of the revenue increase phase-in would be one of the relevant factors the Commission considers when then determining GMO's revenue requirement and customer rates in the proceeding to change GMO's general electric rates,[4] and the Commission-approved phase-in tariff schedules may no longer be "just and reasonable."

Background

At the conclusion of GMO's last general electric rate case, Case No. ER-2010-0356, the Commission found GMO's rates should be increased to collect an additional $65.5 million per year (a 10.25% increase), by increasing rates in GMO's MPS rate district to collect an additional $35.7 million per year (a 7.15% increase) and by increasing rates in its L&P rate district to collect an additional $29.8 million per year (a 21.3% increase);[5] however, the Commission ordered $7.7 million of the increase in the L&P rate district to be phased-in over two years due to the magnitude of the increase and its impact on GMO's customers in that rate district.[6]

On June 15, 2011, the Commission approved tariff sheets GMO filed on May 21, 2011, to implement the Commission's findings in Case No. ER-2010-0356, except the tariff schedules GMO filed to implement the phase-in of the $7.7 million in the L&P rate district.[7] Before Staff completed its review of GMO's revenue increase phase-in tariff schedules, on June 2, 2011, both

[4] See *State ex. rel. Utility Consumers' Council of Missouri, Inc.*, 585 S.W.2d at 49 and 56.
[5] *Staff Recommendation to Approve Tariff Sheets* filed June 2, 2011, page 3 of 6 of Appendix A, *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.
[6] *Order of Clarification and Modification*, issued May 27, 2011, *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.
[7] *Order Approving Tariff Sheets and Setting Procedural Conference* issued June 15, 2011, *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.

Public Counsel and AG Processing objected to them.[8] Those filed, but still unapproved, tariff schedules bear respective proposed effective dates of June 4, 2012 (Tracking No. YE-2011-0608), June 4, 2013 (Tracking No. YE-2011-0609) and June 4, 2014 (Tracking No. YE-2011-0610).

Responding to the objections, the Commission issued its *Order Suspending Tariff Sheets and Directing Filing* that same day where, in part, it ordered, "3. No later than June 8, 2011, the parties shall file a pleading stating KCP&L Greater Missouri Operations Company's short-term debt and any arguments why the 'carrying costs' for the phased-in tariffs should not be equal to the short-term debt cost." No party, except GMO,[9] argued in response to that order the "carrying costs"—the rate used to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in—should not be equal to GMO's short-term debt cost.

Not until the *Non-Unanimous Stipulation and Agreement* with GMO that Staff and GMO filed in this case on September 2, 2011, has Staff recommended the Commission reject the revenue increase phase-in tariff schedules GMO filed May 21, 2011.[10]

Implementation of the revenue increase phase-in the Commission ordered in Case No. ER-2010-0356 by "tariff schedules which will take effect from time to time after the phase-in is initially approved" is the subject of this case.

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[8] *Public Counsel's Objections to Tariffs* and *Concurrence in Public Counsel's Tariff Objection by AG Processing, Inc. a cooperative, 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.

[9] *KCP&L Greater Missouri Operations Company's Response to Order Directing Filing*, filed June 8, 2011, *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.

[10] Ex. 1, *Non-Unanimous Stipulation and Agreement*, between Staff and GMO, dated September 2, 2011.

ARGUMENT

Issue 1: ***Does the Commission have jurisdiction in this case?***

A threshold issue is the Commission's jurisdiction in this case. Only AG Processing argues that the Cole County Circuit Court writs to review Commission decisions in GMO's last general rate case, Case No. ER-2010-0356, remove to the court from the Commission all issues relating to the revenue increase phase-in. When ruling on "whether the PSC, by refusing to grant a stay of the effectiveness of its decision, and by delaying its ruling on an application for rehearing, can lawfully, under the Missouri Constitution, deprive utility customers of their property without any hope of refund in the event of an ultimate reversal of the PSC decision" in *State ex rel. AG Processing, Inc. v. Public Service Commission*, 276 S.W.3d 303, 309 (Mo. App. 2008), the Missouri Western District Court of Appeals said:

> "Finality" is found when an administrative agency "arrives at a terminal, complete resolution of the case before it." *See City of Park Hills*, 26 S.W.3d at 404. "An order lacks finality in this sense while it remains tentative, provisional, or contingent, subject to recall, revision or reconsideration by the issuing agency." *Id.*

If AG Processing is correct that the Cole County Circuit Court's writs deprive this Commission of jurisdiction in this case to address issues related to the phase-in of the revenue increase it found in Case No. ER-2010-0356, then it follows that these issues should not be before that court because the Commission has not yet decided them. Stated differently, because the Commission has not yet addressed all the issues pertaining to the phase-in of the revenue increase, there was no terminal, complete resolution of the Case No. ER-2010-0356 general rate case and, therefore, no court should yet be reviewing the Commission's decisions in that case.

With this view of jurisdiction, court review of the Commission's decision on GMO's revenue increase in Case No. ER-2010-0356, which is already partially implemented through tariff sheets, will be delayed until after the Commission decides all the issues pertaining to the phase-in of the revenue increase in GMO's L&P rate district. This type of delay in court review while increased rates are in effect with the absence of any hope of refund to customers of the increased rates they pay until a court reverses the Commission, should it do so, is the same issue that was before the court in the *State ex rel. AG Processing, Inc.* case cited above. Staff does not believe this is a result the legislature intended by § 393.155.1, RSMo. 2000:

> 393.155. 1. If, after hearing, the commission determines that any electrical corporation should be allowed a total increase in revenue that is primarily due to an unusually large increase in the corporation's rate base, the commission, in its discretion, need not allow the full amount of such increase to take effect at one time, but may instead phase in such increase over a reasonable number of years. Any such phase-in shall allow the electrical corporation to recover the revenue which would have been allowed in the absence of a phase-in and shall make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years. In order to implement the phase-in, the commission may, in its discretion, approve tariff schedules which will take effect from time to time after the phase-in is initially approved.

By implementing that part of the revenue increase in Case No. ER-2010-0356 before determining the "carrying costs" for the revenue increase phase-in, the Commission afforded GMO earlier rate relief than it could have given had it waited to take evidence on the "carrying costs" and, if Staff and the Commission are correct regarding the Commission's jurisdiction, it did so without prejudice to GMO's customers.

AG Processing also argues that, because implementing the revenue increase phase-in from Case No. ER-2010-0356 involves changing customer rates, the Commission must consider all relevant factors at each point in time when those customer rates are changed. If it is right on this position as well as its position there is no terminal, complete resolution of Case No.

ER-2010-0356 until the Commission addresses all issues pertaining to the phase-in of the revenue increase, then there could be no court review of the Commission's determination of GMO's revenue increase or any tariff rate schedules implementing any part of that increase until the Commission ordered the last change in customer rates to implement the revenue increase—here, unless changed, over ***three years*** after the Commission determined GMO's revenue increase in Case No. ER-2010-0356.

Courts do not assume the legislature intends a statute to have an absurd or unreasonable effect.[11] Staff believes the legislature did not intend by § 393.155.1, RSMo. 2000, the result AG Processing advocates. It is Staff's opinion that by determining GMO's revenue increase, deciding part of that increase should be phased-in over time, modifying GMO's fuel adjustment clause, approving tariff sheets to implement that part of the revenue increase not phased in over time and approving its clause tariff sheets that implement its fuel adjustment clause, the Commission made a terminal, complete resolution of Case No. ER-2010-0356 and, therefore, the Cole County Circuit Court has jurisdiction over those issues in the cases (Case Nos. 11AC-CC00415 (lead), 11AC-CC00474 and 11AC-CC00432) before it, and the Commission has jurisdiction over the revenue increase phase-in issues in this case.

Issue 2 (authored by AG Processing)**:** ***Does the Commission decision consider all relevant factors?***

As stated above AG Processing argues that because implementing the revenue increase phase-in from Case No. ER-2010-0356 involves changing customer rates the Commission must consider all relevant factors at each point in time when those customer rates change. Staff addressed immediately above the interplay of AG Processing's argument on this issue with its argument on Commission jurisdiction and the absurd and unreasonable result they would create.

[11] *State ex rel. County of Jackson v. Public Service Commission*, 14 S.W.3d 99, 102 (Mo. App. 2000).

There Staff also pointed out that courts do not assume the legislature intends a statute have an absurd or unreasonable effect.[12]

The customer rates the Commission approved in Case No. ER-2010-0356 are presumptively correct until the Commission again considers all relevant factors for new customer rates in a subsequent general electric rate proceeding, or a court holds them to be unlawful and/or unreasonable.[13] Further, the last sentence of § 393.155.1, RSMo. 2000, specifically provides: "In order to implement the phase-in, the commission may, in its discretion, approve tariff schedules which will take effect from time to time after the phase-in is initially approved."

Based on these considerations, the better construction of § 393.155.1, RSMo. 2000, is that the Commission has the authority now to approve tariff sheets that are designed to implement the ordered revenue increase. Should circumstances change, *e.g.*, if the Commission later determines GMO's revenue requirement has changed from what it was when it decided Case No. ER-2010-0356, but before the phase-in of the revenue increase from Case No. ER-2010-0356 is fully billed, the Commission may at that time consider the unbilled part of the revenue increase as one of the all relevant factors it considers when then determining GMO's revenue requirement and customer rates.[14]

This is the construction the Commission has followed in the past. As GMO witness Bryant notes in footnote 1 of his direct testimony (Ex. 2), the Commission ordered Kansas City Power & Light Company's revenue increase due to its ownership in the Wolf Creek nuclear

[12] *Id*.
[13] § 386.490.2, RSMo 2000, and § 386.510, RSMo 2000 (repealed); *State ex rel. AG Processing, Inc.*, 276 S.W.3d 303, 305-06; see also §§ 386.510 and 520, RSMo Supp. 2011.
[14] See *State ex. rel. Utility Consumers' Council of Missouri, Inc.*, 585 S.W.2d at 49 and 56, and see also *State ex rel. Office of Public Counsel v. Missouri Public Service Commission*, 301 S.W.3d 556, 567 (Mo. App. 2009) (Amount deferred on books is a relevant factor in setting rates.).

generating unit to be phased in over seven years.[15] However, as he also notes, the Commission later modified that phase-in. It did so twice, first by an order it issued April 1, 1987, and then again by an order it issued November 23, 1987.[16]

Issue 3: ***Should GMO's carrying costs in the phase-in tariff schedules filed in this proceeding be 3.25% per year?***

3.25 Percent Rate

By their *Non-Unanimous Stipulation and Agreement* filed September 2, 2011, in this case, (Ex. 1) both Staff and GMO have taken the position the rate of 3.25 percent per year should be used to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in. Public Counsel concurs,[17] but AG Processing objects;[18] however, its objection is based on the Commission not having jurisdiction in this case to reach the issue, not the merits of the rate.

Using the rate of 3.25 percent per year to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in that is described in Section 393.155.1, RSMo. 2000, is supported by the testimony of Staff witnesses David Murray and Matthew J. Barnes and GMO witness Kevin E. Bryant.

As stated above, in its *Order Suspending Tariff Sheets and Directing Filing* issued June 2, 2011, in Case No. ER-2010-0356 the Commission, in part, ordered, "3. No later than June 8, 2011, the parties shall file a pleading stating KCP&L Greater Missouri Operations

[15] *In the Matter of Kansas City Power & Light Company*, 28 Mo.P.S.C. (N.S.) 228, 419 (*Report and Order* decided April 23, 1986).
[16] *In the Matter of Kansas City Power & Light Company*, 29 Mo.P.S.C. (N.S.) 295 (*Order Approving Joint Recommendation* decided November 23, 1987).
[17] *Public Counsel's Statement of Positions*, filed December 23, 2011.
[18] *Objection to Settlement and Request for Hearing*, filed September 8, 2011; *AGP's Position Statements*, filed December 27, 2011.

Company's short-term debt and any arguments why the 'carrying costs' for the phased-in tariffs should not be equal to the short-term debt cost." Other than GMO, no party then argued the "carrying costs"—the rate used to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in—should not be equal to GMO's short-term debt cost.

Despite having entered into a stipulation and agreement with Staff on September 2, 2011, for a 3.25 percent rate for determining the revenue increase phase-in "carrying costs" and filing a position statement on December 27, 2011, wherein GMO stated its position on Issue 3 to be, "The Commission should adopt the position of GMO[,] the Commission Staff, and OPC that the carrying costs in the phase-in tariff schedules filed in this proceeding should be 3.25% per year," through both its witness Kevin E. Bryant, whose testimony GMO prefiled October 21, 2011, and who testified at the January 4, 2012, evidentiary hearing, and through the opening statement of its attorney, GMO continues to argue the appropriate rate for determining the "carrying costs" is the Commission-allowed 8.414 percent overall rate of return from the rate case, Case No. ER-2010-0356.

GMO then states that to minimize litigation regarding the issue and to get the tariff schedules to implement the revenue increase approved by the Commission, GMO is willing to settle for the lower rate of 3.25 percent. That this is GMO's position is shown in the opening statement of GMO's counsel James M. Fischer when he stated, "Now, the company is willing to settle for this lower amount of carrying costs in order to minimize the litigation regarding this issue and get the phase-in tariffs approved by the Commission."[19] It is also shown in the testimony of GMO's witness Kevin E. Bryant, Vice President, Investor Relations and Treasurer, Kansas City Power & Light Company, where he testifies:

[19] Tr. Vol. 2, p. 20.

> As I have discussed above, the Company's carrying cost is actually higher than the amount agreed to with the settlement with Staff. However, in this proceeding, the Company is willing to settle for a lower amount in order to minimize the litigation regarding this issue and get the phase-in tariffs approved by the Commission.[20]

With § 393.155.1, RSMo. 2000, the legislature has charged the Commission when it phases in a revenue increase to "allow the electrical corporation to recover the revenue which would have been allowed in the absence of a phase-in and [to] make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years." Like most of the statutes pertaining to the Commission, this one leaves the Commission with wide discretion. If, as it indicated it would in its *Order Suspending Tariff Sheets and Directing Filing* issued June 2, 2011, in Case No. ER-2010-0356, the Commission uses GMO's short-term debt cost to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in, then the rate of 3.25 percent is supported by the filed positions of Staff, GMO and Public Counsel, and the testimony of Staff witnesses David Murray and Matthew J. Barnes and GMO witness Kevin E. Bryant. Where that rate is supported in the testimony of these witnesses is addressed in the paragraphs following.

In his direct testimony (Ex. 4), Staff witness David Murray discusses GMO's existing credit facility for meeting its needs for short-term debt. He explains that sixteen banks have committed to provide advances to GMO totaling up to $450 million at interest rates specified in the facility.[21] Those interest rates are primarily 2.75 percent plus the British Bankers Association LIBOR rate for an equivalent term loan or 1.75 percent plus the highest of (a) the Federal Funds

[20] Ex. 2, GMO witness Bryant Direct, p. 6.
[21] Ex. 4, Staff witness Murray Direct, p. 3

Rate plus one-half of one percent (1/2%), (b) Bank of America's publicly announced "prime rate" in effect and (c) the Eurodollar base rate plus one percent (1%).[22]

Mr. Murray, whose expertise on the issue of the "carrying costs" for the revenue increase phase-in is unchallenged, on direct testifies, "Although past interest rate experience does not assure similar future rates, the fact that the Federal Reserve has assured financial markets that it will maintain the Federal Funds rate at its current level for the next couple of years provides some certainty the current level of short-term rates will continue in the near future."[23]

Mr. Murray observes that GMO has been taking one month advances at LIBOR plus 2.75 percent and opines that over the phase-in period that one month advances rate would range from 2.95 to 3.10 percent.[24] He further projects, based on the three-month LIBOR rates since January 2010, that interest on three-month advances to GMO during the phase-in period could be as high as 3.25 percent.[25] Mr. Murray also states that the "prime rate" has been 3.25 percent for about the immediately past three years; therefore, the alternative rate GMO might pay during the phase-in period is 3.25 percent plus 1.75 percent or 5.00 percent.[26] Based on Staff witness Murray's analysis of GMO's weighted average cost of short-term debt through May 2011, GMO took an advance on May 11, 2011, at an interest rate of 5.00 percent.[27]

Based on the foregoing, Mr. Murray opines that if the Commission uses GMO's cost of short-term debt for determining the "carrying costs" for the revenue increase phase-in, 3.25 percent is a "fair and reasonable" rate to use for that purpose.[28]

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[22] *Id*.
[23] *Id*. at 4.
[24] *Id*. at 3.
[25] *Id*. at 4.
[26] *Id*.
[27] *Id*.
[28] *Id*. at 5.

In his direct testimony, Staff witness Matthew J. Barnes also supports the 3.25 percent interest rate by providing historical information related to GMO's fuel adjustment clause. In that clause "interest at [GMO's] short-term borrowing rate"—average interest paid on short-term debt—is used to calculate the "carrying costs" for the under- or over collection of the costs and revenues that flow through that clause as required by § 386.266.4(2),RSMo 2011. GMO's average interest on short-term debt used in its fuel adjustment clause, which changes monthly, ranged from just under two percent to just under four percent per year over the twenty months of January 2010 to August 2011. (Ex. 6).

GMO witness Bryant's tepid support of the 3.25 percent interest rate is found in the penultimate question and answer of his direct testimony (Ex. 2), which follows:

> Q. The Company and Staff have agreed that the carrying cost should be 3.25%. Do you support this agreement?
>
> A. Yes. As I have discussed above, the Company's carrying cost is actually higher than the amount agreed to with the settlement with Staff. However, in this proceeding, the Company is willing to settle for a lower amount in order to minimize the litigation regarding this issue and get the phase-in tariffs approved by the Commission.[29]

Unless the Commission now chooses to not carry out its apparent intention to use GMO's short-term debt cost to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in as expressed in its *Order Suspending Tariff Sheets and Directing Filing* issued June 2, 2011, in Case No. ER-2010-0356 where it, in part, ordered, "3. No later than June 8, 2011, the parties shall file a pleading stating KCP&L Greater Missouri Operations Company's short-term debt and any arguments why the 'carrying costs' for the phased-in tariffs should not be equal to the short-

[29] Ex. 2, GMO witness Bryant Direct, p. 6.

term debt cost," the Commission should use the rate of 3.25 percent that is supported by Staff, GMO and Public Counsel.

Alternative Rate

Should the Commission now decide to determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in based on something other than GMO's short-term debt cost, Staff recommends the Commission use the discount rate an investor would use to determine the decrease in the present value of GMO's cash flows resulting from the phase-in.[30] Based on Staff's analysis, which is presented in the testimony of Staff witness David Murray, an appropriate discount rate is 6.40 percent.[31] Because this discounting to present value analysis is forward looking, unlike the historical cost of debt used in setting general rates, the expected costs of debt during the phase-in period are used. In ratemaking, historical cost of debt is used because doing so allows the utility to recover all historical costs associated with issuing that debt.[32]

Staff witness David Murray testifies that, in his opinion, the language "and shall make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years" found in § 393.155.1, RSMo 2000, is best viewed from the perspective of an investor or valuation expert.[33] He testifies that such an investor or valuation expert would use a discount rate based on the company's cost of capital because the investor is discounting the cash flow to the company, a flow that is affected by the company's risks. Mr. Murray testifies such an investor would use a discount rate based on the company's post-tax weighted average

[30] Ex. 4, Staff witness Murray Direct, pp. 5-7.
[31] *Id*.
[32] Ex. 5, Staff witness Murray Rebuttal, p. 3.
[33] Ex. 4, Staff witness Murray Direct, pp. 5-7; Ex. 5, Staff witness Murray Rebuttal.

cost of capital that was derived using the company's current costs of debt and equity, including an adjustment to the cost of debt to account for the tax deductibility of the interest expense associated with debt. Mr. Murray then, without conceding it is correct, uses the 10.0 percent return on equity the Commission ordered in Case No. ER-2010-0356, as well as a capital structure of 48 percent equity and 52 percent long-term debt, a cost of debt of 5.0 percent and a tax rate of 38.30 percent to opine 6.40 percent is an appropriate discount rate to use to determine the "carrying costs" for the revenue increase phase-in.[34] Staff witness Murray points out that "[i]t is important for the Commission to remember that phase-in or no phase-in, there is no guarantee the utility company will realize the ordered rate increase; [t]his is why an investor would use a discount rate consistent with the cost of capital to determine a fair value of expected cash flows."[35]

Rather than taking an investor's or valuation expert's viewpoint, GMO witness Bryant argues that because the Commission used the overall rate of return it allowed in Kansas City Power & Light Company's rate case where the Wolf Creek nuclear generating unit was added to its rate base to determine the "carrying costs" for phasing in the revenue increase in that case,[36] the Commission should use the Commission-allowed overall rate of return from Case No. ER-2010-0356—8.414 percent—to determine the "carrying costs" here.[37] He most directly argues in favor of using the Commission-allowed overall rate of return for determining "carrying costs" for the revenue increase phase-in when he testifies, "This method [of using the Commission-allowed overall rate of return] will accomplish the statutory requirement of Section

[34] Ex. 4, Staff witness Murray Direct, pp. 5-7.
[35] Ex. 5, Staff witness Murray Rebuttal, p. 3.
[36] *In the Matter of Kansas City Power & Light Company*, 28 Mo.P.S.C. (N.S.) at 419.
[37] Ex. 2, GMO witness Bryant Direct, p. 4.

393.155.1 'to recover the revenue which would have been allowed in the absence of a phase-in,'" but that using a short-term borrowing rate will not.[38]

To make it easier to follow the statutory interpretation discussion that follows, § 393.155.1, RSMo 2000, is restated here:

> 393.155. 1. If, after hearing, the commission determines that any electrical corporation should be allowed a total increase in revenue that is primarily due to an unusually large increase in the corporation's rate base, the commission, in its discretion, need not allow the full amount of such increase to take effect at one time, but may instead phase in such increase over a reasonable number of years. Any such phase-in shall allow the electrical corporation to recover the revenue which would have been allowed in the absence of a phase-in and shall make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years. In order to implement the phase-in, the commission may, in its discretion, approve tariff schedules which will take effect from time to time after the phase-in is initially approved.

Mr. Bryant's argument is premised on an interpretation that the following language of § 393.155.1, RSMo 2000, "Any such phase-in shall allow the electrical corporation to recover the revenue which would have been allowed in the absence of a phase-in" means that "the revenue which would have been allowed in the absence of a phase-in" includes not only the revenue increase deferred, but also the opportunity cost of the cash flow detriment. If that had been the legislature's intent, then the language that follows in that same sentence, which Mr. Bryant does not address—"and shall make a just and reasonable adjustment thereto to reflect the fact that recovery of a part of such revenue is deferred to future years"—is surplusage.

The better interpretation is that the references to "revenue" in § 393.155.1, RSMo 2000, are to the revenue associated with a rate increase without a phase-in and the reference to "adjustment" is associated with the opportunity cost of the cash flow detriment associated with

[38] *Id*. at 4-5.

the deferral of part of the revenue increase. That opportunity cost is best evaluated from the perspective of an investor or valuation expert.

Mr. Bryant argues the opportunity cost it foregoes by the phase-in is the opportunity to invest the deferred revenue in its business and that it would have had the opportunity to earn that 8.414 percent by doing so.[39] This argument presupposes GMO would actually earn the 8.414 percent Commission-allowed overall rate-of-return on the deferred revenues by investing them in its business and that the legislature intended this result with § 393.155.1, RSMo 2000. As explained above, the cost of debt embedded in the 8.414 percent Commission-allowed overall rate-of-return is historical. Since foregone revenues are being discounted to a present value, the appropriate discount analysis relies on the projected costs of debt during the phase-in period, not historical cost of debt.

Only if the Commission decides that GMO's short-term debt cost is not the appropriate basis upon which to determine the "just and reasonable adjustment," then the Commission should determine the "just and reasonable adjustment" by using a forward-looking discount rate that an investor or valuation expert would employ, not one that is based on historical debt cost such as a Commission-approved overall rate of return used to set general rates. The Commission should find Staff's 6.40 percent forward-looking discount rate is such a rate.

Issue 4: ***Should the Commission order that the tariff schedules filed with the Non-Unanimous Stipulation And Agreement on September 2, 2011, for the second, third and fourth year of the phase-in plan be allowed to become effective automatically in each subsequent year on June 25 without further order of the Commission, unless suspended by the Commission for good cause shown?***

[39] *Id*. at 5.

The thrust of this issue is whether the Commission should implement the general rate increase phase-in it ordered in Case No. ER-2010-0356 by issuing orders so that GMO's tariff includes tariff schedules that conform to the exemplar tariff schedules included in the *Non-Unanimous Stipulation and Agreement* filed in this case on September 2, 2011.

Whatever decision the Commission makes on the rate to use for the "carrying costs" that determine the "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in, the Commission should reject the phase-in tariff schedules GMO filed May 31, 2011, in Case No. ER-2010-0356 (Tracking Nos. YE-2011-0608, YE-2011-0609 and YE-2011-0610) that bear effective dates of June 4, 2012, 2013, and 2014.

As both Staff witness Curt Wells and GMO witness Tim M. Rush testify, the exemplar tariff schedules marked as Exhibit A of the *Non-Unanimous Stipulation and Agreement* filed in this case on September 2, 2011, are designed to implement, and would implement, a "just and reasonable adjustment" to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the phase-in base on a rate of 3.25 percent per year for "carrying costs."[40] Therefore, if the Commission finds the "carrying costs" to be 3.25 percent, it should approve the exemplar tariff schedules marked as Exhibit A of the *Non-Unanimous Stipulation and Agreement* filed in this case, and order GMO to file compliance tariff schedules that conform to the exemplar tariff sheets to take effect on the respective dates of June 25th of 2012, 2013 and 2014 that the exemplar tariff sheets bear.

If the Commission decides that GMO's short-term debt cost is not the appropriate basis upon which to determine the "just and reasonable adjustment," then the Commission should order GMO to file compliance tariff schedules that conform to the Commission's resolution of

[40] Ex. 7, Staff witness Curt Wells Rebuttal; Ex. 3, GMO witness Tim M. Rush Direct.

the appropriate rate to use ("carrying costs") to determine the "just and reasonable adjustment," for the revenue increase phase-in.

Regardless of what determination the Commission makes on the "carrying costs" issue, if there is a future proceeding to change GMO's general electric rates before the revenue increase phase-in is fully completed, then the unbilled portion of the revenue increase phase-in would be one of the relevant factors the Commission considers when then determining GMO's revenue requirement and customer rates in the proceeding to change GMO's general electric rates,[41] and the phase-in tariff schedules the Commission approves in this case may no longer be "just and reasonable." As discussed in the argument for Issue 2, this is the approach the Commission has taken in the past. In 1986, the Commission ordered Kansas City Power & Light Company's revenue increase due to its ownership in the Wolf Creek nuclear generating unit to be phased in over seven years,[42] but the Commission later modified that phase-in twice, first on April 1, 1987, and then again on November 23, 1987.[43]

Conclusion

Staff recommends the Commission issue a report and order in which it sets out in its findings and conclusions that (1) it has jurisdiction to determine in this case the "carrying costs"—the "just and reasonable adjustment"—to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the revenue increase phase-in; (2) the legislature, through § 393.155.1, RSMo. 2000, has given the Commission jurisdiction to implement a revenue increase phase-in by approving tariff schedules which will take effect from time to time after the phase-in is initially approved, which permits it to do so now; (3) 3.25

[41] *State ex. rel. Utility Consumers' Council of Missouri, Inc.*, 585 S.W.2d at 49 and 56.
[42] *In the Matter of Kansas City Power & Light Company*, 28 Mo.P.S.C. (N.S.) at 419.
[43] *In the Matter of Kansas City Power & Light Company*, 29 Mo.P.S.C. (N.S.) 295.

percent is the appropriate rate to use to determine the "carrying costs"—the "just and reasonable adjustment"—to reflect deferral to the future of the recovery of revenue which would have been allowed in the absence of the revenue increase phase-in; however, if the Commission decides the rate should not be based on GMO's short-term debt costs, then 6.40 percent, based on discounted to present value of forgone cash flows based on projected debt costs is the appropriate rate to use to determine the "carrying costs"; (4) the phase-in tariff schedules GMO filed May 31, 2011, in Case No. ER-2010-0356 (Tracking Nos. YE-2011-0608, YE-2011-0609 and YE-2011-0610) that bear effective dates of June 4, 2012, 2013, and 2014, are rejected; (5) the exemplar tariff schedules marked as Exhibit A of the *Non-Unanimous Stipulation and Agreement* filed in this case would implement the Commission's decisions, if it finds 3.25 percent is the appropriate rate to use to determine the "carrying costs," otherwise they do not; (6) GMO should be ordered to file compliance tariff schedules that conform to the Commission's findings; (7) and in a future proceeding to change GMO's general electric rates, if the revenue increase phase-in has not yet been fully completed, then the revenue increase would be one of the relevant factors in that proceeding which the Commission considers when determining GMO's revenue requirement and customer rates in that general rate proceeding as required by law[44], and the phase-in tariff schedules the Commission approves in this case may no longer be "just and reasonable."

[44] See *State ex. rel. Utility Consumers' Council of Missouri, Inc.*, 585 S.W.2d at 49 and 56.

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 electronically mailed to all counsel of record this 2nd day of February, 2012.

/s/ Nathan Williams