In the Matter of the Applications of Westar Energy, Inc. and Kansas Gas and Electric Company for Approval to Make Certain Changes in Their Charges for Electric Service

Docket No. 05-WSEE-981-RTS

Kansas Corporation Commission

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CORE TERMS: staff, recommended, customer, ratepayer, depreciation, transmission, off-system, net salvage, energy, terminal, margins, plant, rate base, investor, tariff, rebuttal, proxy, reduction, fuel, electric, recommendation, amortization, rate of return, environmental, decrease, rate case, annual, savings, merger, generation

PANEL: **[*1]** Before Commissioners: Brian J. Moline, Chair; Robert E. Krehbiel; Michael C. Moffet

OPINION: ORDER ON RATE APPLICATIONS

The above captioned matter comes before the State Corporation Commission of the State of Kansas (Commission) for consideration and decision. Having examined its files and records, and being duly advised in the premises, the Commission makes the following findings:

I. Introduction

A. Application and Jurisdiction

1. On May 2, 2005, Westar Energy, Inc. and Kansas Gas and Electric Company (collectively, Westar) filed their Joint Application, asking for approval to make certain changes in the rates they charge for electric service.

2. The Commission is given full power, authority and jurisdiction to supervise and control the electric public utilities, as defined in K.S.A. 66-101a, doing business in Kansas, and is empowered to do all things necessary and convenient for the exercise of such power, authority and jurisdiction. K.S.A. 66-101. K.S.A. 66-101a; K.S.A. 66-104. Electric public utilities subject **[*2]** to the Commission's jurisdiction are "required to furnish reasonably efficient and sufficient service and facilities for the use of any and all products or services rendered, furnished, supplied or produced by such electric public utility, to establish just and reasonable rates, charges and exactions and to make just and reasonable rules, classifications and regulations." K.S.A. 66-101b. Following the legislative mandate of K.S.A. 66-101g, this Commission applies a liberal construction to its grants of power, authority and jurisdiction. "All incidental powers necessary to carry into effect the provisions of [the Electric Public Utilities Act, K.S.A. 66-101 *et seq.*], are expressly granted to and conferred upon the commission." K.S.A. 66-101g.

B. Public Comments

3. Notice of the proposed rate increase, public hearings, and technical evidentiary

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that to protect Kansas ratepayers, the Commission should treat 100% of the Account 447 revenues at generation related. Kalcic, 7-8.

270. CURB argued the TDC revenue requirement includes ancillary services, which are included in base rates. CURB Brief, 46-47. CURB recommended that Westar credit the ancillary service charge revenues received from non-jurisdictional customers toward the base rate revenue requirement of its retail customers. CURB Brief, 47. CURB rejected the arguments by Westar that such an updated ancillary service revenue credit would require refund for an indefinite period of time. CURB Brief, 48.

3. KIC

271. KIC argued that Westar has not met the statutory requirements set forth at K.S.A. 66-1237 to recover costs through a TDC. KIC **[*119]** Brief, 55. KIC maintained that the statute does not permit the Commission to initially establish a TDC in an on-going rate proceeding. KIC Brief, 56. KIC also criticized the TDC as not being revenue neutral as required in the statute. KIC Brief, 58. KIC also criticized the TDC as based on speculation as to the transmission costs in FERC jurisdictional contracts. KIC Brief, 59.

4. USD 259

272. USD 259 also emphasized the revenue neutrality requirement of K.S.A. 66-1237. USD 259 Brief, 27. USD 259 made two recommendations regarding the TDC stipulation: (1) the TDC should use the revenues determined using the FERC rate in effect during the test year; and (2) the Commission should treat 100% of the Account 447 revenues as generation related. USD 259 Brief, 28.

5. KPP

273. KPP argued in favor of some procedural safeguards to provide Westar customers protection in its TDC filings. KPP Brief, 1-5. KPP recommended that 60 days would be more appropriate time period for reviewing the annual TDC filing. KPP Brief, 4. KPP also advocated in favor of an order from the Commission granting **[*120]** the right of customers to receive, review, and comment on the annual TDC filing. KPP Brief, 5.

C. Conclusion

274. The Commission finds that the TDC stipulation reached between Westar and Staff is reasonable and should be adopted. The Commission is satisfied that the responses set forth by Staff adequately address the concerns raised by CURB, KIC, USD 259, and KPP.

XI. Rate of Return Cost of Capital

A. Overview and Settled Issues

275. The overall rate of return includes a consideration of the utility's cost of debt and cost of equity. Gatewood, 7. The utility must receive a reasonable return for both. A just and reasonable rate of return permits the utility to collect in rates the interest expense on debt it has employed to finance its plant and equipment and

enables it to earn a new income that is sufficient to compensate the providers of equity capital with a return commensurate with the risks of the investment. Gatewood, 7.

276. The capital structure is the blend of financial instruments the company uses to finance its plant and equipment. Gatewood, 14. Gatewood agreed that Westar appropriately relied on its actual test year capital structure, which consists **[*121]** 53.65% debt, 45.64% equity, and 0.70% preferred equity. Gatewood, 15.

277. Gatewood recommended a cost of debt of 6.14% that is current as of June 30, 2005. Gatewood, 15. Gatewood testified that the updated cost of debt is more representative of Westar's cost of debt going forward and that Westar has been able to refinance its debt at a savings. Gatewood, 15-16, Westar agreed to this updated cost of debt. Greenwood Rebuttal, 5.

B. Arguments

1. Westar

a. Briefs

278. Westar proposed a revised **return on equity** of 11.35%. Westar Brief, 68-80. Westar emphasized that the ROE sponsored by CURB (8.75%) and by Staff (9.6%) were outliers. Westar Reply Brief, 41.

279. Westar addressed the argument of Staff, (Staff Brief, 91), that the 10.5% ROE for Aquila, a utility facing more risk than Westar, is lower than Westar's recommendation. Westar Reply Brief, 41-43. Westar argued that the Commission in the Aquila docket considered risks fairly attributable to Aquila's electric utility division rather than the overall risk of the company, which, suggested Westar, was the risk referred to by Greenwood, (Tr. 111, 469), when he said Aquila was a riskier utility. Westar Reply Brief, **[*122]** 41-42. Westar pointed out it faces risks not faced by Aquila such as risks associated with nuclear generation. Westar Reply Brief, 42.

280. Westar defended the importance of utilities achieving investment grade credit ratings. Westar Reply Brief, 43-45. Westar agreed that ratepayers should not be responsible for repairing damage caused by its non-utility operations, citing testimony by one of its own witnesses. Westar Reply Brief, 46. See Ruelle Rebuttal, 13. Further, Westar pointed out that Westar has met all of the Commission's financial mandates and only lacks adequate cash flow and a suitable rate case outcome for purposes of meeting investment grade credit. Westar Reply Brief, 46-47.

b. Testimony

281. Westar witness Avera gave the Commission his assessment of a fair rate of return on common equity (ROE) for Westar. Avera, 4. The ROE compensates shareholders for the use of their capital to finance the plant and equipment necessary to provide utility service. Avera, 5. Investors commit capital only if they expect to earn a return on their investment commensurate with returns available from alternative investments with comparable risks. Avera, 5. Generally, Avera reviewed **[*123]** the operations and finances of Westar and general conditions in the utility industry and economy. Avera, 6. Then, Avera developed principles underlying the cost of equity concept and conducted quantitative analyses to

estimate the cost of equity for a group of reference utilities. Avera, 6. He also completed a discounted cash flow (DCF) analysis and risk premium analysis. Avera, 6. Based on these estimates, and after adjusting for the specific risks and economic requirements for Westar, and consistent with restoration and preservation of its financial integrity, Avera arrived at his recommended fair rate of return of 11.5%. Avera, 6. Avera later adjusted his recommendation to 11.35%. Westar exh. 42; Avera, 90; Tr. XII, 2380.

282. Avera based his recommendation on the following broad considerations: (1) caution is required because of the uncertainties and challenges recently faced in the electric power industry; (2) accelerating economic growth and expected higher interest rates should be considered; (3) alternative quantitative methods implied a cost of equity between 10.8% to 11.8%; (4) incorporating a 20 basis-point allowance for equity flotation costs resulted in a fair rate of **[*124]** return range for the electric utility proxy group of 11.0% to 12.0%; and (5) considering the potential exposure associated with Westar's resource mix and the needs to support Westar's efforts to achieve investment grade credit ratings and to ensure its ability to attract capital. Avera, 6-7.

283. Avera described the **return on equity** component of setting utility rates as the cost of inducing and retaining investment in the utility's physical plant and assets. Avera, 34. An adequate **return on equity** is vital to: (1) fairly compensate capital investment; (2) enable the utility to attract new capital on reasonable terms; and (3) maintain the utility's financial integrity. Avera, 34. Also, Avera discussed the risk-return tradeoff principle. Avera, 35-36. Avera did not rely on any one single method or model in his analysis, and in fact relied upon the DCF model and risk premium methods for purposes of estimating the cost of Westar's equity. Avera, 39.

284. The DCF model attempts to replicate the market valuation process that sets the price investors are willing to pay for a share of a company's stock. Avera, 40. This model is premised on the theory that the price of a share of common stock **[*125]** is equal to the present value of the expected case flows (future dividends and capital gains) that will be received while holding the stock, discounted at investor's required rate of return, or the cost of equity. Avera, 40-41. Avera testified about the general form of the DCF model, (Avera, 41); the constant growth form, which is dependent on a number of assumptions, (Avera, 41-42); and the proxies used in his DCF model, which were publicly traded firms engaged in similar business activities but that were not rated below investment grade by S&P and had not recently completed a major corporate spin-off. Avera, 43.

285. In implementing the constant growth DCF model, Avera determined the expected dividend yield for the proxy companies using Value Line. Avera, 45-46. The dividend yields ranged from 2.5% to 5.5%, with the average being 4.3%. Avera, 56. Then Avera estimated investors' long-term growth expectations, downplaying the importance of dividend growth rates as a tool for estimating long-term growth and relying instead upon growth in earnings as a superior indicator of long-term growth expectations. Avera, 47-49. Avera testified the expected earnings growth rate reported by various **[*126]** analysts ranges from 4.4% to 5.7% for the group of proxy companies. Avera, 50.

286. Avera testified that there are costs associated with issuing new securities such as legal, accounting, and printing, as well as fees and discounts paid to brokers. Avera, 70-71. There is no way to recognize the costs of issuing new securities, and

no rate of return is authorized on such flotation costs. Avera, 71. The solution, maintained Avera, is an upward adjustment on the cost of equity to account for these costs. Avera, 71. In summary, after adjusting for flotation costs, Avera concluded that the cost of equity for the proxy group ranged from 11.0% to 12.0%, with 11.5% being the midpoint. Avera, 72-73. Avera later adjusted his recommendation to 11.35%. Westar exh. 42; Avera, 90; Tr. XII, 2380.

287. In response to an argument that granting an ECA would require a lower ROE, Avera testified that the ECA clauses are common. Avera, 79. Avera acknowledged that utilities with an ECA clause must bear additional risks. Avera, 80-81. Avera testified that without the ECA clause, a higher level of cost of equity would be necessary. Avera, 82-83. Avera testified that a value at the top of his range of 12.0% **[*127]** would be warranted. Avera, 83. However, Avera pointed out that even with the ECA clause, the utility still runs the risk of regulatory disallowance through a prudence review. Avera, 83.

288. In rebuttal, Avera testified that Staff witness Gatewood's DCF analysis had three shortcomings: (1) Gatewood failed to recognize the downward-biased nature of its earnings and intrinsic growth rates; (2) Gatewood did not adjust the impact of using year-end projections when calculating "bxr" growth rates; and (3) Gatewood's intrinsic growth analysis neglected to consider the impact of additional stock issuances on the growth rate, which is required under DCF theory. Avera Rebuttal, 14. After correcting for what Avera perceived as Gatewood's errors, Avera concluded that Gatewood's analysis should have yielded a range of 10.21% to 12.01, which an average of 11.11%. Avera Rebuttal, 14.

289. Avera was also critical of Gatewood's CAPM analysis, saying that it did not fully reflect investors' required rate of return for his proxy group. Avera Rebuttal, 15. Avera testified that Gatewood's interest rate assumptions were too low, and that Gatewood's CAPM analysis should use forward-looking estimates of **[*128]** investors' required rate of return. Avera Rebuttal, 15-19. After correcting what he perceived as errors in Gatewood's DCF and CAPM analyses, Avera concluded that Gatewood's proxy group should have a cost of equity of 10.60%. Avera Rebuttal, 20.

290. Avera addressed Gatewood's conclusion that Westar should be assigned an ROE at the bottom of the proxy range based on Staff's support for the ECRR and TDC and the concomitant reduction in risk to the utility. Avera Rebuttal, 22-28. Avera criticized Gatewood's conclusions, noting that band ratings are a more objective guide to making statements about risk. Avera Rebuttal, 22-23. Avera also noted that the ECRR and TDC are not mechanisms unique to Westar, (Avera Rebuttal, 25-27), and discussed the important role regulation plays in helping Westar attract capital, (Avera Rebuttal, 28-30). Avera concluded that Gatewood's ROE was inadequate for this purpose. Avera Rebuttal, 31-34. Avera also responded to numerous criticisms set forth by Gatewood. Avera Rebuttal, 34-45.

291. As to the CURB witness Woolridge analysis sponsored by CURB, Avera testified that Wooldridge's results are downwardly biased. Avera Rebuttal, 45-47. Avera responded to Wooldridge's **[*129]** testimony, (Woolridge, 56-61), that analysts' growth rate forecasts are biased, by noting that the accuracy of projections are irrelevant in assessing the expected growth that investors have incorporated into current stock prices as long as investors share the views of the analysists. Avera Rebuttal, 47. Avera criticized Woolridge's CAPM model for not being consistent with the forward-looking assumptions inherent in the model, (Avera Rebuttal, 52-54), and

for having little relation to the expectation of investors, (Avera Rebuttal, 55). As to Woolridge's recommendation (Woolridge, 55), to remove flotation costs, Avera disagreed, citing the necessity to include a flotation cost adjustment to compensate for past equity issues. Avera Rebuttal, 68-72.

292. Avera was critical of Dunn's analysis, saying (1) that it ignored Dunn's own observations of investor expectations of growth prospects; and (2) that it is improperly downwardly biased to compensate for past overearnings. Avera Rebuttal, 74-76.

2. Staff

a. Briefs

293. Staff addressed the ROE. Staff Brief, 91-104. Staff argued that if the Commission adopts the mechanisms that shift risk from Westar to the ratepayers, there **[*130]** should be a lower ROE. Staff Brief, 3. Consequently, Staff advocated in favor of a 9.6% ROE. Staff Brief, 3. In reply to Westar, Staff argued Westar was selective in its models and inputs. Staff Reply Brief, 20-21.

b. Testimony

294. Gatewood provided the Commission with an analysis of Westar's required **return on equity** to use in establishing its revenue requirement. Gatewood, 1. Gatewood recommended a ROE range between 9.60% to 10.60%, ultimately determining that 9.60% was the appropriate figure within that range. Gatewood, 2, 16.

295. Gatewood's recommendation assumed the Commission grants Westar the following: (1) the energy cost adjustment (ECA) mechanism; (2) the environmental cost recovery rider (ECRR); and (3) the transmission delivery charge (TDC) rider. Gatewood, 2-3. Gatewood assumed the Commission did not grant Westar the **return on equity** premium for meeting performance and reliability standards as proposed by Westar. Gatewood, 3.

296. The ROE is not designed to compensate investors for all risks associated with contributing capital to the utility because such investors can reduce some of the risk by diversifying. Gatewood, 8. Gatewood testified regarding systematic **[*131]** risks, which are global or macro-economic risks affecting all stocks, and unsystematic risks, which are risks unique to a company. Gatewood, 9. In an efficient market, investors are not compensated for unsystematic risks because those risks can be eliminated through diversification. Gatewood, 9. Gatewood testified that Staff's proposed overall rate of return is just and reasonable because it permits Westar to recover its interest costs and provides a return for stockholders based on the returns required from similarly situated electric utilities. Gatewood, 10.

297. Gatewood testified that bond yields and allowed **returns on equity** capital granted to electric utilities by regulatory commissions has decreased over the past decade. Gatewood, 11-12. Gatewood noted electric utilities have been able to earn the allowed returned granted by the state commissions and investors have a favorable view of the opportunities in electric utility stocks. Gatewood, 12-13. Gatewood testified that the dividends distributed for electric utilities is 3%, or twice that of the average S&P Industrials. Gatewood, 14.

298. The discounted cash flow (DCF) model estimates potential cash flow from an investment. **[*132]** Gatewood, 18. The capital asset pricing model (CAPM) is a measure of future return of a company relative to that of the entire market. Gatewood, 18. Equity investors are only entitled to a share of the company's earnings, therefore the investment is more risky than debt. Gatewood, 17.

299. Gatewood testified that Staff supports Westar's application for an energy cost adjustment (ECA) mechanism. Gatewood, 25. Gatewood testified that under the ECA, the ratepayers rather than the shareholders bear the risks of fluctuations of fuel prices. Gatewood, 25. Gatewood testified that most of the proxy companies in his analysis had some form of an ECA mechanism; thus, his analysis based on the proxy companies captures the effect of the ECA mechanism. Gatewood, 25. Gatewood testified that the end result was a less risky investment for shareholders. Gatewood, 26.

300. The environmental rider allows Westar to recover costs of environmental improvements at its plants. Gatewood, 26. The TDC allows Westar to recover through a cost recovery rider a formula based revenue requirement associated with its transmission assets. Gatewood, 26-27. Staff recommends the adoption of the ECRR as long as the Commission **[*133]** recognize the reduced risk that it brings, thereby adopting a lower end of the ROE range, or 9.60%. Gatewood, 27. Gatewood testified the ECRR reduces Westar's risk in the following ways: (1) it allows Westar to match cash inflows with capital expenditures; and (2) it allows Westar to earn a return on and a return of its investments in environmental upgrades without recognizing reductions in its net plant. Gatewood, 27-28. Gatewood testified that only two of the proxy companies have ECCR clauses. Gatewood, 29.

301. The transmission delivery charge (TDC) unbundles the costs associated with Westar's transmission network from its retail rates. Gatewood, 29. For the same two reasons cited above in connection with the ECRR, Gatewood testified that the TDC would reduce Westar's risk. Gatewood, 29-30.

302. Under the DCF model, the basic premise is that investors determine the value of a company's stock by discounting its future dividend payments back to the present at the investors' required rate of return. Gatewood, 30. Gatewood testified that the use of the intrinsic growth rate is a reasonable method to estimate the long-run, sustainable dividend growth for use in the DCF model. Gatewood, **[*134]** 37.

303. Gatewood's CAPM analysis resulted in a 9.63% cost of equity. Gatewood, 38. Gatewood testified that the CAPM model is an intuitive explanation of the positive linear relationship between risk and rates of return required by investors. Gatewood, 38. A stock's beta coefficient measures the volatility of a company's return relative to the volatility of returns earned by the equity market. Gatewood, 40. A stock with a beta of one is just as volatile as the market. Gatewood, 40 A stock with a beta of .5 is half as volatile. Gatewood, 40. A stock with a beta of 1.25 is 25% more volatile. Gatewood, 40.

304. Gatewood testified that his analysis included a flotation cost adjustment. Gatewood, 43. Gatewood explained that when a utility issues additional shares of stock, three is evidence of downward pressure on the stock price for a period of time after the new issuance, which results in a cost that is not reflected on the utilities books. Gatewood, 43. The flotation cost adjustment is designed to recover that

pricing pressure. Gatewood, 43. Gatewood testified that he is researching the flotation cost adjustment, noted arguments against using it, and suggested that Staff will likely **[*135]** oppose it in the future. Gatewood, 43. Gatewood testified Westar requests a 5% to 10% adjustment through the dividend yield to account for flotation costs. Gatewood, 44. Avera uses the low end of that range, or 5%, in his calculation. Gatewood, 44. Gatewood described the adjustment as a 5% increase in the dividend yield of the proxy group. Gatewood, 44. Gatewood testified the adjustment can be removed from his analysis by subtracting 25 basis points from Staff's recommended cost of equity. Gatewood, 44.

305. Gatewood was critical of Avera's analysis. Gatewood, 45. Gatewood testified Avera's analysis was not specific to Westar. Gatewood, 45. Rather, Avera's analysis focused on a broad group of utility companies. Gatewood, 45. Gatewood testified Avera's risk premium analysis was even less specific. Gatewood, 45.

306. Gatewood testified that Avera's two risk premium models do not specifically address the cost of equity for Westar because they depend on the electric utility industry generally. Gatewood, 49. Gatewood testified the Commission should give no weight to Avera's risk premium models because they do not rely on information specific to Westar. Gatewood, 50.

307. Gatewood testified **[*136]** that Avera's risk premium models have some use for purposes of determining the cost of equity for the electric industry as a whole. Gatewood, 52. Gatewood testified that Avera's models should be modified by replacing Avera's forecasted bond yields with current, market determined yields. Gatewood, 52. Using market determined yields, opined Gatewood, would incorporate all the information investors have factored into pricing utility bonds, including their beliefs about the future of the industry and the economy. Gatewood, 52.

308. Gatewood testified that only one of the four CAPM models used by Avera is dependable. Gatewood, 52-53. Gatewood testified that considering only the dependable model, Avera's CAPM model results yield a 10.50% cost of equity estimate for the proxy group. Gatewood, 53. Gatewood explained that the earnings estimates relied upon by Avera were overly optimistic and not realistic. Gatewood, 54. Gatewood was also critical of Avera's reliance on forecasted bond yields because they do not incorporate any market information about investors' expectations. Gatewood, 56.

309. Gatewood was also critical of the size premium proposed by Avera. Gatewood, 56-57. Gatewood explained **[*137]** that the data relied upon by Avera relate to companies in competitive markets rather than return regulated utility companies. Gatewood, 56.

310. In conclusion, Gatewood addressed the broad theme throughout Westar's testimony regarding regulatory support for returning Westar to financial health, specifically investment grade credit ratings. Gatewood, 57-58. Gatewood reminded the Commission that Westar's current financial condition was caused by Westar's board of directors and management. Gatewood, 57. Gatewood testified that Westar is asking the ratepayers to restore Westar to financial health, which is not the sole goal of setting a utility's revenue requirement. Gatewood, 57. Gatewood concluded by saying that the company's credit rating is just one of the many considerations the Commission must balance in these proceedings. Gatewood, 58.

3. CURB

a. Brief

311. CURB addressed the ROE, arguing in favor of Woolridge's 8.75% figure. CURB Brief, 6-23. CURB is critical of Dunn's analysis, citing a flawed proxy group. CURB Brief, 9. CURB is also critical of Gatewood's analysis, citing his reliance on Value Line growth estimates. CURB Brief, 9. CURB argued that the Commission **[*138]** should not include a floatation cost adjustment. CURB Brief, 21.

b. Testimony

312. Woolridge arrived at a cost of equity of 8.75%. Woolridge, 2. Woolridge emphasized that capital costs are at historically low levels. Woolridge, 3-8. Woolridge used the DCF method and, to a lesser extent, the CAPM method to estimate the cost of equity capital. Woolridge, 2-3, 17. Woolridge concluded that, based on his DCF and CAPM studies, that the two groups of electric utilities had a cost of equity between 8.0% and 9.0%. Woolridge, 28, 49-50. Woolridge considered Westar's lower bond rating higher beta, and concluded that Westar properly fell at 8.75%. Woolridge, 50.

313. Woolridge concluded his testimony with a critique of Avera's analysis. Woolridge, 52-77. Woolridge criticized Avera's analysis, saying (1) that Avera used an inappropriate proxy group; (2) that Avera used an upwardly-biased expected growth rate in his DCF equity cost rate; (3) that Avera used forecasted interest rates in excess of the current long-term market yields; (4) that Avera used an excessive risk premium estimates in his risk premium approaches; and (5) that Avera used an inappropriate flotation cost adjustment. Woolridge, **[*139]** 3, 53.

4. KIC

a. Brief

314. KIC addressed the issue of rate of return by taking a broad look at the evidence presented by the four ROE experts in this docket. KIC Brief, 39-45. KIC noted that the experts can be divided into two groups -- Gatewood, Woolridge, and Dunn in one group and Avera in another group. KIC Brief, 39-40. KIC reasoned that Avera, who proposed an ROE resulting in a $ 41 million revenue requirement above the averaged recommendation of the other three experts, was an outlier. KIC Brief, 40. KIC raised criticisms of Avera's risk premium analyses, arguing that they were not specific to Westar. KIC Brief, 44.

b. Testimony

315. Dunn used a DCF model to establish a benchmark cost of capital. Dunn, 38. Dunn concluded with a range of 10.3% to 11.05%. Dunn, 57. Based on his statistical risk measures, Dunn adjusted the proxy group cost of equity to result in a 10.0% figure -- a return lower than the lower limit of the range, which Dunn explained by citing Westar's historical overearnings. Dunn, 58-61.

5. USD 259

316. USD 259 supported the results reached by either Gatewood or Woolridge. USD

259 Brief, 20-21. USD 259 **[*140]** invited the Commission to consider which witness presented the most credible evidence. USD 259 Brief, 21. USD 259 also emphasized that the Commission should consider the shifting of risk that accompanies automatic adjustment clauses such as the ECA, ECRR, TDC. USD 259 Brief, 21.

6. KPP

317. KPP supported the rate of return analysis of Gatewood. KPP Brief, 1.

C. Conclusion

318. The Commission finds that the proper ROE in this docket is 10.00%. The Commission makes this determination in the context of other decisions in this order, namely the granting of the ECA, ECRR, and TDC. Staff's recommendation began with a range between 9.6% to 10.6%. Gatewood, 16-17. As a result of the ECRR and TDC, Staff recommended the lower end of that range, reasoning that the ECRR and TDC shifted risk from shareholders to ratepayers. Staff Brief, 93-94. However, the evidence showed that two or three of Gatewood's proxy companies also have environmental cost recovery mechanisms. Gatewood, 29 (testimony indicating that two of six Gatewood proxy companies have environmental riders); Avera Rebuttal, 25 (*testimony indicating* that three of **[*141]** six Gatewood proxy companies have environmental riders). As to the TDC, Westar produced evidence that Staff's proxy companies incorporate the effect of a transmission delivery charge. Avera Rebuttal, 25-26 (testimony indicating that one of Gatewood proxy companies has a transmission cost recovery mechanism). Westar also produced evidence that some of the Gatewood proxy companies have other automatic adjustment clauses that are not enjoyed by Westar. Avera Rebuttal, 26-27 (indicating that some proxy companies have energy conservation cost recovery clauses, storm damages clauses, pension and retiree health care clauses, and new generating facilities clauses). Staff acknowledged that the risk shifting associated with the ECA was likely captured by Staff's selection of proxy companies. Staff Brief, 94. Consequently, the Commission relies on the range reached by Staff witness Gatewood; however, the Commission finds that the determination of a particular ROE within that range should be upwardly adjusted. Accordingly, the Commission finds that the 10.0% ROE is a reasonable outcome given the extensive testimony provided by the various parties on this issue.

319. This ROE of 10.00%, taken together **[*142]** with the capital structure and a cost of debt of 6.14%, neither of which were disputed by the parties, yields an overall rate of return of 7.8907%, as reflected in the following table:

Description	Capitalization Ratio	Cost of Capital	Weighted Cost of Capital
Long Term Debt	52.4125%	6.1400%	3.2181%
Preferred Stock	0.68875%	4.5500%	0.0313%
Common Equity	44.5905%	10.0000%	4.4590%
Post 1 970 ITC	2.3083%	7.8907%	0.1821%
Total	100.0000%		7.8907%

XII. Class Cost of Service and Rate Design Issues