MECG 409

KCPL and GMO Rate Increase

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Midwest Energy Consumers' Group

Overview

- Recent rate case history
- Comparison to National Average Rates
- Uncontrolled Administrative & General (A&G) Costs
- Missouri Ratemaking Methodology and Risk Balancing
- Utility Proposals to Shift Risk and Inflate Possibility of Overearnings
- KCPL and GMO Specific Proposals
- KCPL violations of the Regulatory Plan
- KCPL and GMO requests for double recovery
- Rate Stabilization
- Conclusion

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KCPL Rate Case History

- ER-2006-0314: 10.46% increase
  effective January 1, 2007
- ER-2007-0219: 6.50% increase
  Effective January 1, 2008
- ER-2009-0089: 16.16% increase
  Effective September 1, 2009
- ER-2010-0355: 5.23% increase
  Effective May 4, 2011

TOTAL: 43.80% increase between 2007 - 2011

MECG Exhibit No. 409
Date 10/17/12 Reporter MM
File No. ER-2012-0174
ER-2012-0175

KCPL Rate Case History

- In the current case, KCPL continues to seek an increase of $105.7 million (15.1%).
- With KCPL's proposed increase, KCPL electric rates will have increased by 65.5% in six years.

GMO Rate Case History

- ER-2007-0004:
  - MPS authorized 11.64% increase
  - L&P authorized 12.79% increase
- ER-2009-0090:
  - MPS authorized 10.46% increase
  - L&P authorized 11.85% increase
- ER-2010-0356:
  - MPS authorized 7.20% increase
  - L&P authorized 15.80% increase

GMO Rate Case History

- With GMO's proposed increase, electric rates for the MPS division will have increased by 46.54% in five years. Rates for the L&P division will have increased by 74.93%.
- Does not include rate increases automatically passing through the FAC.

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National Average Electric Rates Residential Rates

- Between 2006 – 2011, national average residential rates only increased by 25.7%.
- KCPL residential rates increased by **43.9%**
- GMO residential rates increased by **45%**.

  - Source: Staff Cost of Service Report, page 17

National Average Electric Rates Commercial Rates

- Between 2006-2011, national average commercial rates only increased by 17.65%.
- KCPL commercial rates increased by **39.1%**
- GMO commercial rates increased by **40%**.

  - Source: Staff Cost of Service Report, page 18

National Average Electric Rates Industrial Rates

- Between 2006-2011, national average industrial rates increased by only 15.9%.
- KCPL industrial rates increased by **37.83%**.
- GMO industrial rates increased by **41%**.

  - Source: Staff Cost of Service Report, page 19

National Average Electric Rates

- KCPL and GMO residential rates have grown 75% faster than the national average.
- KCPL and GMO commercial rates have grown 125% faster than the national average.
- KCPL industrial rates have grown 138% faster than the national average. GMO industrial rates have grown 158% faster than the national average.

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Administrative & General Costs are Excessive Customer Count Basis

Empire: $222.05 / customer
Ameren: $231.17 / customer
Westar: $255.06 / customer
KCPL and GMO: $296.07 / customer

- KCPL and GMO have 824,841 customers, therefore if KCPL and GMO reduced A&G down to level of Westar, rates would be $33.8 million lower.

- Source: Staff Cost of Service Report, page 250

Administrative & General Costs are Excessive Energy Production Basis

Westar: $5.38 / MWh
Ameren: $5.72 / MWh
Empire: $6.35 / MWh
KCPL and GMO: $8.45 / MWh

- KCPL and GMO have 28,894,997 MWh generated. Therefore if KCPL and GMO reduced A&G down to level of Empire, rates would be $60.7 million lower.

- Source: Staff Cost of Service Report, page 251

Administrative & General Costs are Excessive % of Operating Revenues

- Empire: 7.06% of operating revenues
- Westar: 7.59% of operating revenues
- Ameren: 8.53% of operating revenues
- KCPL and GMO: 10.54% of operating revenues

- KCPL and GMO have $2,318,008,530 of operating revenues. Therefore if KCPL and GMO reduced A&G down to level of Ameren, rates would be $48.6 million lower.

- Source: Staff Cost of Service Report, page 252

Administrative & General Costs are Excessive

- By any measure of administrative and general costs, KCPL and GMO rates would be $33.8 to $60.7 million lower if KCPL and GMO could just reduce their A&G expense to the second worst instead of being consistently the worst.

Why Note Past Increases?

- KCPL and GMO's rate increases aren't simply about rates. Many of the larger issues in KCPL and GMO's case concern mechanisms that will lead to more frequent or larger rate adjustments.
- This is typical of recent cases. Whenever a utility files a case, ask yourself, what do they want now??

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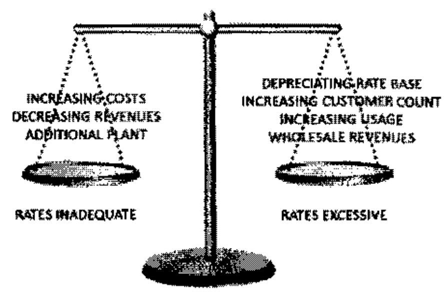
Missouri Ratemaking

- <u>The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval</u>. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making.

  Utility Consumers Council of Missouri (Mo. banc 1979)

- Missouri ratemaking is based upon, through the use of a test year relationship of revenues, expenses and rate base, a <u>balancing of the risk</u> of excessive rates and inadequate rates.



Missouri Ratemaking
Rates are Excessive

- Utilities have the opportunity for windfall profits if they can decrease costs. Therefore, a well timed debt refinancing, employee severance program, warmer weather or increased wholesale profits will lead to an immediate reduction in costs and increased profits to the utility. This is good because it provides utility an incentive to minimize costs.
- Shareholders realized a windfall of $35.4 million associated with the well-timed employee separation program (ORVS).
- Shareholders realized a windfall of $14.7 million in the second quarter of 2012 because of warm weather.

Missouri Ratemaking
Rates are Inadequate

- On the other hand, utilities accept the risk that it cannot control expenses and rates are not sufficient. Utility must accept these inadequate rates until its next rate case is completed.

Missouri Ratemaking

- The Missouri ratemaking paradigm has historically worked.
- With the completion of Wolf Creek in 1984, KCPL did not have another rate case for 22 years. In fact, during that time, rates were reduced 3 times.
- Declining Cost Business:
  - Depreciating Rate Base
  - Increased Customer Counts and Usage
  - Increased Wholesale Revenues
  - Decreasing Fuel and Freight Costs
- Only with the latest construction cycle have utilities been heard to complain about the ratemaking paradigm. Don't make long-term changes for short-term challenges.

Missouri Ratemaking

- Utilities **LOVE** the opportunity for windfall profits.
- Utilities **HATE** the risk of inadequate rates!!

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What To Do?

- How to reduce / eliminate the risk of inadequate rates, while still maintaining the opportunity for windfall profits?
- AAOs
- Adjustment Mechanisms
- Trackers
- Accounting Authorization

AAOs

- Test year ratemaking:

"The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection. A test year is a tool used to find the relationship between investment, revenues, and expenses."

  - GTE North, 835 S.W.2d 356 (Mo.App. 1992)

- Therefore, if a utility wants an expense considered for inclusion in rates, it should have to file a case and have it considered as part of the test year.

AAOs

- Accounting Authority Orders allow utilities to defeat the notion of test year ratemaking. A utility that may not need rate relief (e.g., overearning) is still allowed to defer certain costs for consideration and recovery in the next rate case. The overearnings are shielded and the expense is preserved for later recovery.
- Utility no longer bears the risk that this costs will make rates inadequate. The risk of this expense has been shifted to the ratepayers. The possibility that rates are excessive remains the same.

Adjustment Mechanisms

- Utility is allowed to automatically increase rates to account for increases in certain expenses. 40-50% of GMO's operation and maintenance expenses (fuel expense) is allowed to automatically pass through its fuel adjustment clause.
- Utility no longer bears this risk. The risk of this expense has been shifted to ratepayers. Also reduces utility's incentive to minimize these costs

Tracker Mechanisms

- A utility is permitted to exactly track an expense against a baseline level. If the expense increases, the utility is allowed to collect the difference in the next case. No consideration as to whether the company was overearning.
- The utility: (1) no longer bears any risk associated with this expense and (2) has no incentive to minimize these costs.
- Legality???

  "Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, §§ 393.270(3) and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses."

  - *Utility Consumers Council of Missouri* (Mo. banc 1979)

Accounting Authorization

- Like an AAO, except it is not directed at a certain, non-recurring expense. Instead, the utility seeks accounting treatment to defer any increased depreciation expense and carrying costs for recovery in next case. Again, no consideration of whether the utility is overearning.
- Utility no longer bears this risk. The risk of this expense has been shifted to the ratepayer

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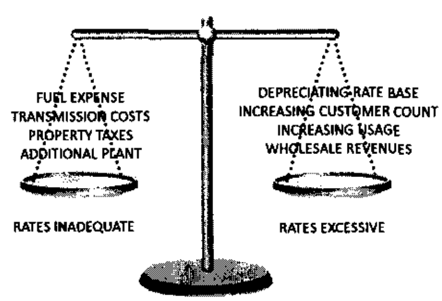
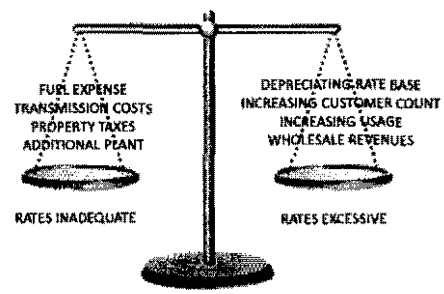
KCPL and GMO Requests

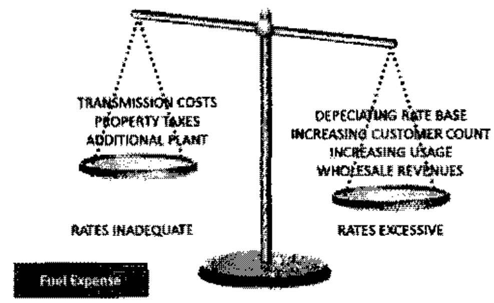
- Despite the fact that rates will have increased by 65% in the last six years, and in most cases have grown at twice the rate of the national average, KCPL and GMO wants mechanisms that will lead to larger future increases.
- These mechanisms will reduce the risk that rates will be inadequate and increase the risk the rates will be excessive.



Interim Energy Charge

- Shifts risk of increased fuel and purchased power costs to ratepayers.
- Contrary to the Regulatory Plan, provides KCPL an opportunity to realize windfall profits in the wholesale market.
- Violates retroactive ratemaking prohibition because of the possibility that ratepayers will have to pay more in the future because current rates are inadequate.



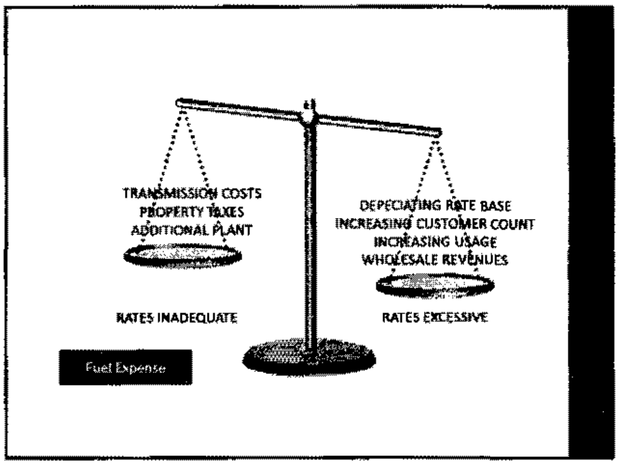


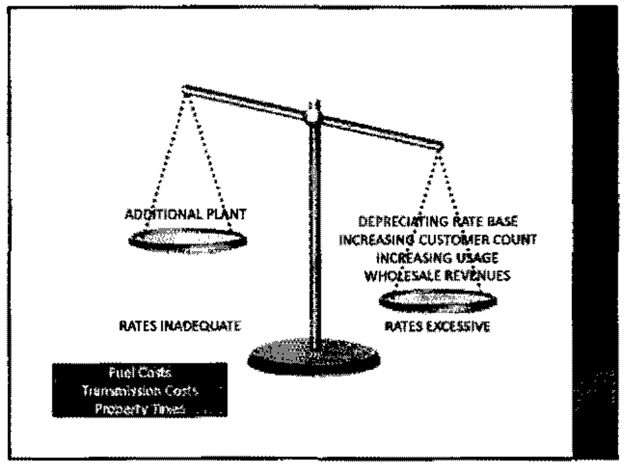
Tracker Mechanisms

- KCPL and GMO currently have tracker mechanisms related to vegetation management, infrastructure inspection, MEEIA / Energy Efficiency Costs, Renewable Energy Standards (RES) Costs and Pensions / OPEBs Costs.
- Now, KCPL and GMO want a transmission tracker mechanism to cover all of the costs and expenses associated with participation in the Southwest Power Pool.
- Costs are not volatile. Costs are not material. Capital costs may not comply with the CWIP prohibition. KCPL and GMO fail to account for the possibility of increased revenues associated with these projects.
- Will lead to larger rate case increases in the future.

Property Tax Tracker

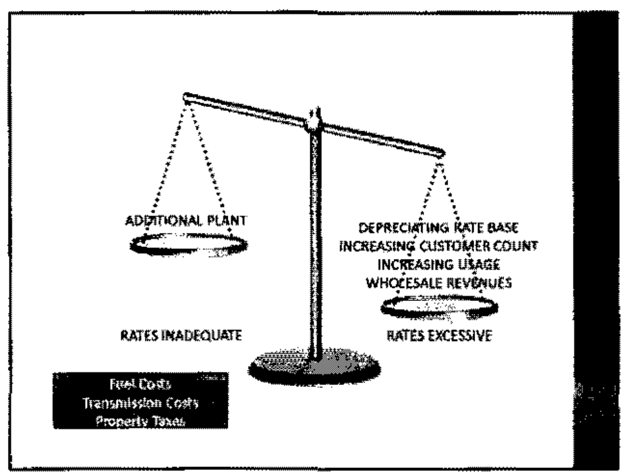
- Legality? Deferring past losses for later recovery from ratepayers.
- Incremental additional property taxes are not volatile or financially material.
- With the completion of Iatan 2, KCPL and GMO are not adding any large rate base items.
- Given the time lag between when property is assessed (January 1) and when the tax is due (December 31), KCPL and GMO could file and complete a rate case. The cost is easily manageable.
- Will lead to larger rate cases in the future.

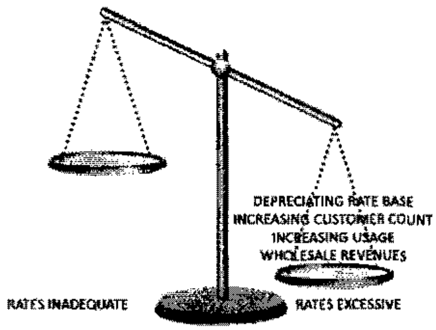




St. Joseph Infrastructure Program

- Construction Accounting for distribution replacement program. Replacement of unreliable portions of L&P distribution network
- Defers depreciation expense and capital costs from outside of test year for consideration in future case.
- Fails to consider offsetting items including:
  - Increased revenues: a more reliable network results in more electricity usage and higher revenues
  - Decreased maintenance expense: an updated distribution network will have lower maintenance expense.





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KCPL Regulatory Plan

- Carefully balanced consideration of shareholder and ratepayer interests.
- KCPL Benefits: Regulatory Amortizations that allowed the construction of Iatan 2 and other CEP programs.
- Regulatory Amortizations arguably violated the anti-CWIP statute, but ratepayers waived this legality.
- Ratepayer Benefits: KCPL waived ability to request any mechanisms under SB179. Any IEC must meet certain criteria.
- KCPL commitment not to share in off-system sales benefits.
- Will lead to larger rate cases in the future

KCPL Regulatory Plan

- KCPL has received all of its benefits under the Regulatory Plan.
- Now, when the ratepayer benefits are supposed to arrive, KCPL is seeking to negate its commitments under the Plan.

Interim Energy Charge

- Utility collects an amount of fuel and purchased power expense in permanent rates and an additional amount on an interim, subject to refund, basis. The interim amount is known as the ceiling. If fuel and purchased power goes above the ceiling, the utility suffers. If fuel and purchased power goes below the permanent amount, the utility benefits.
- KCPL Regulatory Plan has express provisions regarding the quantification of the ceiling.
- KCPL proposal is not an IEC. Rather, it is a disguised fuel adjustment clause contrary to the Regulatory Plan.
- KCPL proposal does not contain a ceiling. Contrary to the Regulatory Plan.

Off-System Sales

- KCPL commitment not to attempt to move any portion of off-system sales "below the line."
- KCPL includes an off-system sales sharing mechanism as part of its IEC proposal.
- Ratepayer advocates filed a Motion to Strike and Motion for Expedited Treatment addressing this portion of KCPL's proposal on May 25, 2012. To date, the Motion to Strike has not been addressed.

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Double Recovery

- Proposals for Organization Realignment and Voluntary Separation Program (ORVS); Merger Transition Costs and Hawthorn 5 all involve request to double recover the same costs.

Organizational Realignment / Voluntary Separation Program

- ORVS Program announced shortly after the true-up date in the last case. Parties abided by the test year concept and included inflated employee levels in rates. Therefore, rates in the last case were immediately excessive.
- Due to retroactive ratemaking, ratepayers are prohibited from seeking to collect these excess profits.
- Therefore, KCPL / GMO recovered the entirety of the costs of the program ($12.7 million) plus an additional $22.7 million.
- KCPL and GMO want to double recover these costs by collecting in rates in this case.
- This further exacerbates KCPL and GMO's inflated A&G cost profile.

Merger Transition Costs

- July of 2008: Great Plains completed acquisition of Aquila.
- Great Plains can time its integration of companies such that benefits flow primarily to shareholders and, only later, to ratepayers.
- Through March 2012, Great Plains shareholders have realized corporate savings of $305 million.
- Despite these increased profits, KCPL and GMO want to continue to recover its transition costs.
- Despite already recovering these costs in rates, KCPL and GMO want explicit recovery of these costs going forward.
- This further exacerbates KCPL and GMO's inflated A&G cost profile.

Hawthorn 5 Costs

- In 2000, KCPL added a Selective Catalytic Reduction to Hawthorn 5.
- The SCR never performed properly and KCPL continues to incur higher operating and maintenance costs on the SCR.
- KCPL reached a settlement with the contractor in lieu of the liquidated damages provision.
- KCPL did not pass the reduced value of the SCR to ratepayers. Ratepayers are paying a return and depreciation on this asset. Now, KCPL also wants ratepayers to pay the increased operating and maintenance cost as well.
- KCPL has already been compensated for the cost of this inferior generating asset. It should not also seek recovery from the ratepayers for this inferior product.

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Rate Stabilization

- KCPL and GMO's extortion plan. . .
- If the Commission gives us everything we want (inflated return on equity, IEC, more trackers, and modified Crossroads decision), it will help rate stabilization. (Position Statement, pages 6 and 7)
- Ratepayers don't want rate cases. But it is not the rate cases that are problematic, it is the higher rates that result from those rate cases.
- MECG clients would much prefer additional rate cases as compared to the continued inflated rates that come with granting KCPL and GMO everything that they want.

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Conclusion

- Treat this as another rate case. Consider a normalized level of revenues, expenses and rate base.
- Reject KCPL and GMO's risk shifting mechanisms:
  - KCPL IEC
  - KCPL and GMO Transmission Tracker
  - KCPL and GMO Property Tax Tracker
  - GMO Distribution Construction Accounting
- Award a Return on Equity that reflects the decreasing cost of capital. KCPL and GMO's witness admits that 9.8% is reasonable.
- Reduce KCPL and GMO rate case expense: many expenses are solely beneficial to shareholders.