TRANSMISSION TRACKER

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Transmission Tracker

- 1) Show how a tracking mechanism works
- 2) Discuss Missouri ratemaking and the balancing of risk established in the 1979 Missouri Supreme Court case.
- 3) Demonstrate how the implementation of tracker mechanisms reduce the risk that rates will be inadequate, enhance the risk that rates will be excessive, and therefore tip the careful balancing of risk envisioned by the Supreme Court.
- 4) Relying on the same Supreme Court discussion, show that a tracker mechanism violates the constitutional doctrine of retroactive ratemaking.
- 5) Show that transmission expenses don't meet the criteria necessary for implementation of an extraordinary mechanism like a tracker.

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How Tracker Works

- Transmission costs are set in a rate case
- "Company would then track its actual charges on an annual basis against this amount, with the Missouri jurisdictional portion of any excess treated as a regulatory asset."
  - Ives Direct, page 15.
- "We propose that the regulatory asset be amortized to cost of service in the Company's next rate proceeding."
  - Ives Direct, page 16.
- Therefore, Company future rates are used to guarantee the Company recovery of any loss associated with rates not perfectly matching expenses.

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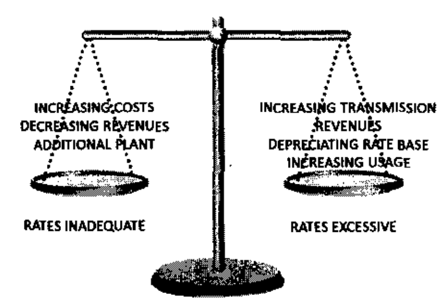
Missouri Ratemaking

- **"The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval.**
  - *Utility Consumers Council of Missouri*, 585 SW2d 41, 59 (Mo. banc 1979)
- Ratemaking, and by extension the proper balancing of these risks, is based upon a test year concept with a careful matching of expenses, revenues and rate base.
  - *GTE North*, 835 S.W.2d 356, 368 (Mo.App. 1992)

BALANCING OF RISK



Missouri Ratemaking - Excessive Rates are Possible

- 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 - Inadequate Rates are Possible

- 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 the Wolf Creek case in 1986, KCPL did not have another rate case for 20 years. In fact, during that time, rates were reduced 3 times. During this period, there were no trackers, adjustment mechanisms or AAOs.
- 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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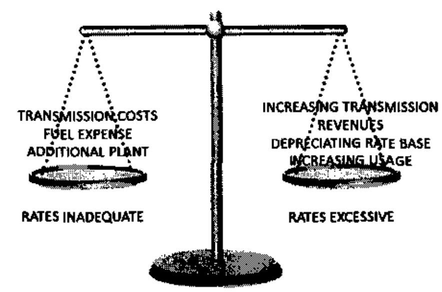
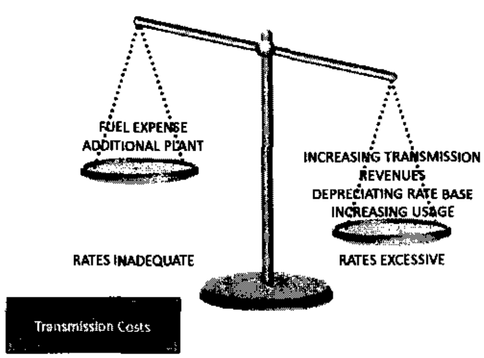
Tracker Mechanisms

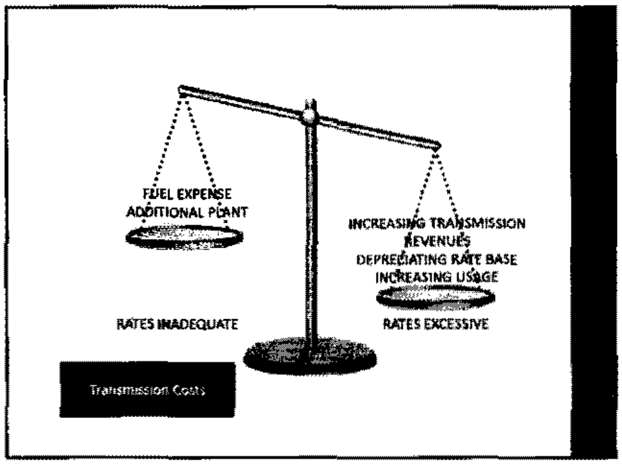
- A utility is permitted to exactly track an expense against a baseline level. If the expense increases, the utility is allowed to collect the difference in future rates.
- No consideration as to whether the company was overearning.
- The utility: (1) no longer bears any risk associated with this expense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

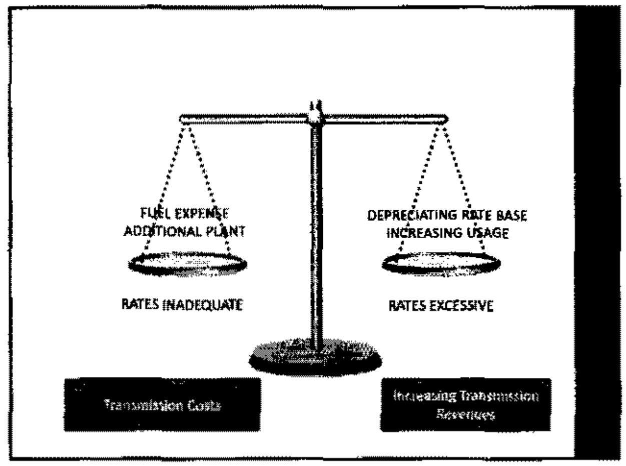




No Consideration of Revenues

- As a condition to KCPL's proposed tracker, Staff asserts that the tracker should also consider increased revenues that will result from these costs.
- In order to maintain proper matching of expenses, revenues and rate base, any revenues associated with these costs should also be included in the tracker.
- To date, KCPL has been unwilling to consider the revenues arising out of these costs. KCPL only wants to focus on costs. By leaving the revenues untracked, KCPL seeks to enhance the possibility that rates will be excessive.





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LEGALITY

"The utilities take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. **To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established. 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*, 585 S.W.2d 41, 59 (Mo. banc 1979)

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TRANSMISSION TRACKER – NOT NECESSARY

- MECG asserts that a tracker is an extraordinary mechanism that, given its questionable legality and its ability to distort the ratemaking methodology and balancing, should only be used in extraordinary circumstances.
- Transmission costs are (Dauphinais Direct, pages 7-9; Surrebuttal, pages 2-4):
  - 1) not large enough to present a financial threat to KCPL;
  - 2) not volatile
    - "Markets in which prices are volatile tend to go up and down in an unpredictable manner. . . . As a result, in those circumstances, a fuel adjustment clause may be needed to protect both the utility and its ratepayers from inappropriate low or high rates."
  - 3) capable of being reasonably managed through rate case process.