BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Kansas City Power and Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Begin the Implementation of its Regulatory Plan.	**)**	**Case No. ER-2007-0291**

DOE/NNSA TRUE-UP BRIEF AND REPLY BRIEF

COMES NOW the United States Department of Energy and the United States National Nuclear Security Administration (DOE/NNSA), by and through DOE/NNSA's Counsel, and presents this its True-up Brief and Reply Brief.

TABLE OF CONTENTS

TRUE UP BRIEF.

I. Strict adherence to a September 30, 2007 actual capital structure that gives no weight to an unanticipated high level of short term debt should be rejected as "abnormal" and as inefficiently "high cost" for ratepayers.

KCPL and the MPSC are both recommending employment of an "actual" capital structure as of September 30, 2007 that includes the components of Long Term Debt, Preferred Stock and Common Equity. These are the typical long term securities that this Commission has assumed to be financing the Company's relatively permanent investment in rate base components.

Because GPE/KCPL did not complete a long term debt issuance planned to occur by September 30, 2007, the "actual" capital structure consisting of the noted three long term sources of capital has resulted in an unplanned and temporary anomaly. Specifically, GPE/KCPL did not complete the anticipated roll over of short term debt with a long term debt issuance by September 30, 2007 as planned and forecasted earlier in 2007 (Exhibit 36, Cline True Up Direct testimony, p. 2, L.18) but plans to complete the offering by [HC information at Exhibit 36, p.3, L.5]. Therefore, GPE/KCPL's "actual" capital structure at September 30, 2007 *temporarily* includes a common equity ratio of 57.62% - or approximately 4.0% higher than that originally forecast by the Company in its direct testimony filed in this case (53.43%) and employed by this Commission in Case No. ER-2006-0314 (53.69% - Page 20 of Report and Order from Case No. ER-2007-0314). Since KCPL intended to refinance its short term debt into long term debt and still intends to accomplish this refinancing within the time noted above the capital structure KCPL claims is a non-reoccurring event.

OPC witness Michael Gorman testified regarding Staff Exhibit 121 (Admitted onto evidence. V6, p. 242, L.14) which was a Regulatory Research Associates study of Major [utility] case decisions. Mr. Gorman testified that the requested 57.62% equity ratio of KCPL's proposed Capital Structure is higher than any of the 18 utility decisions studied by Regulatory Research Associates that had reported ROEs. (V.15, p.1171, L.11). Mr. Gorman further testified that the average equity ratio for the studied companies so far for 2007 has been 46.8% (V15, P.1169, L.2). It is notable that Exhibit 121 shows only two utilities with an equity ratio even close to KCPL. These are Arizona Public Service and Wisconsin Power and Light with equity ratios of 54.5% and 54.13% respectively.

Mr. Gorman explained why an equity heavy capital structure was unfair to ratepayers and proposed a sensible solution to the problem. Mr. Gorman testified, beginning at p. 1167 of Transcript V. 15:

I would look at their actual capital structure and I would question whether or not if that capital structure was -- was outside of some reasonableness tolerance, whether or not the rates they would be permitted to charge by the regulatory Commission would provide them an opportunity to earn their authorized return on equities.

Many commissions will only use actual capital structure if the utility management is prudent in managing that capital structure mix. A utility can manage its capital structure to the benefit of its shareholders by weighting it too heavily with common equity. Many regulatory commissions will reject that type of capital structure if the utility management does not create a reasonable mix of debt and equity within the capital structure.

In that instance, if a utility had common equity which was too thick, too high a

p. 1168

percentage of common equity, then I would conclude that, depending on the jurisdiction therein, there is a good chance that the Commission would not use that capital structure to set rates; they would use a hypothetical one which would do one of two things,

either incent the management to adjust their actual capital structure down to the capital structure the Commission finds appropriate and thereby preserve their opportunity to earn their authorized return on equity, or that utility would not because of management actions be able to earn their authorized return on equity (emphasis added).

The reason cited by KCPL witness Michael Cline explaining why GPE/KCPL did not issue the long term debt security by September 30, 2007 was because of adverse changes to the entire credit market that was caused by the subprime mortgage lending effect on financial markets. Mr. Cline testified:

Q. What were the conditions that precluded you from issuing that debt?

A. If you really look back, Mr. Chairman, at the conditions in the worldwide credit markets really starting at the end of June, it's been extremely difficult for borrowers under any credit scenario to access capital on attractive terms. You know, the subprime mortgage crisis really began in late June, and it's really put the worldwide market in -- into turmoil. And there was a period of time in really July and the first part of August when almost no credit market activity occurred. Even today it has recovered only marginally.

I mean, even this week, you know, Mr. Chairman, with the S&P down, you know, another 5 percent, that has a direct impact on the ability of borrowers to assess capital. And therefore, it just was -- was not possible for us to complete an offering of the size we contemplated on prudent, reasonable terms.

And in response to Mr. Mills' question, we would still contemplate completing the offering when it's prudent to do so. There's just no telling right now when that would be (Transcript V.15, p. 1153).

While GPE/KCPL did not meet the once-expected long term debt issuance date of September 30, 3007, it is in fact, as Mr. Cline testified above, still planning the issuance. Thus, because of quirk in the credit market, KCPL very *temporarily* has a capital structure that is more heavily leveraged with low cost

short term debt that was, and continues to be, expected to be replaced with long term debt.

This Commission has typically excluded short term debt when developing the capital structure assumed to be supporting rate base. OPC witness Trippensee explained how, pursuant the AFUDC formula, it is typically assumed that short term debt is supporting a utility's construction work in progress ("CWIP") investment (Exhibit 212, Trippensee True Up Direct p.5. L.15). Indeed, DOE-NNSA would *typically* support this very same assumption. The problem in the instant case, however, is that GPE/KCPL's *actual* capital structure includes a short term debt balance that exceeds its CWIP balance (Id. p.6, L.14). Even though GPE/KCPL's *actual* capital structure includes short term debt supporting rate base, the *regulatory* capital structure supported by the MPSC Staff and GPE/KCPL within their respective true up filings – consistent with past MPSC precedent – has excluded such short term debt. As explained by OPC witness Michael Gorman, this Staff and Company-proposed equity-rich capital structure results in "a significant increase that is unnecessary to support KCPL's credit rating during its construction program" (Exhibit 210, Gorman True-up Rebuttal, p.4, L.9).

DOE-NNSA support OPC witness Gorman's proposed capital structure which is fair to the Company as well as ratepayers. GPE/KCPL should not be allowed to profit from its inability to complete a planned debt security financing in a timely manner. Further, record evidence supports a conclusion that the long term debt financing will occur during the period that these rates will be in effect. It is clearly unfair to establish rates based upon a high cost and inefficient capital structure that was never planned – and is not expected to be experienced during the time that rates being established in this proceeding are expected to be in effect. That is the very definition of a non-recurring event. Mr. Gorman testified that Staff and Company's proposed capital structure would increase KCPL's claimed revenue

deficiency by $5.88 million compared to the capital structure he proposed and that is described in his True Up Schedule MPG-1 (Id. L.7).

DOE/NNSA RECOMMENDATION.

To both provide a fair revenue requirement for KCPL and treat ratepayers equitably DOE/NNSA recommends that the Commission adopt Mr. Gorman's proposed capital structure.

II. Deducting short term debt interest when calculating Funds From Operations for purposes of determining the level of Regulatory Plan Amortization Expense is contrary to the Stipulation and Agreement entered in Case No. EO-2005-0329.

OPC witness Russell Trippensee correctly points out that the MPSC Staff and KCPL have changed the calculation of the Regulatory Plan Amortization that was agreed to the parties – including KCPL and the MPSC Staff – in Case No. EO-2005-0329. The Stipulation and Agreement entered into by the parties, and contested only by the Sierra Club, that was ultimately authorized by the MPSC, provides that KCPL will be entitled to collect retail revenues above that which can be justified utilizing traditional cost of service methodologies when certain financial metrics determined to be necessary to achieve a minimum investment grade rating are not being achieved (Exhibit 212, Trippensee True Up Direct p.2, L.12). The calculations of additional revenues to be collected above that which can be justified using traditional cost of service methodologies, referred to as Regulatory Plan Amortization, were set forth in precise detail within Appendix F-3 attached to the Stipulation and Agreement filed in Case No. EO-2005-0329.

As shown in Appendix F-3, the Stipulation and Agreement clearly envisioned that only interest on long term debt was to be deducted from operating income to arrive at the level of Funds From Operations ("FFO") available to provide interest coverage. Note particularly that Attachment 1 to Appendix F clearly shows that the Line 31 "less interest Expense" adjustment to Operating Income comes from Line 15 "Interest Expense" which is calculated solely by multiplying Line 13 "Long

Term Debt" by Line 14 "Cost of Debt". Although Short Term Debt Interest is set out at Line 45, nowhere is it used as an adjustment to Operating Income to derive FFO. Notwithstanding this agreement and clear directive, the MPSC Staff and KCPL are now proposing to also deduct short term debt interest from operating income to arrive at the FFO available for interest coverage. KCPL witness Michael Cline claims this change is necessitated by Standard & Poor's change in the way FFO is to be calculated (Exhibit 36, Cline True Up Direct testimony, p.4, L.12).

Assuming *arguendo* that Standard & Poor's has, in fact, changed the way it intends to calculate FFO, this is not a calculation change that has been agreed to by the parties, and as such, it should be rejected. If KCPL desired a change in the calculation of FFO, it should have done so much earlier in the proceeding – and certainly not in its "11th hour" true-up filing. Indeed, the Stipulation and Agreement from Case No. EO-2007-0329 provides that "[i]f these ratio guidelines or ranges are changed or modified before June 1, 2010, the Signatory Parties will work together to determine the values for these ratios, including consideration of the use of the last published ranges for these ratios." (Page 20, S&A Case No. EO-2005-0329)

In summary, KCPL and MPSC Staff cannot unilaterally change the terms of a Stipulation and Agreement that affects the calculation of Regulatory Plan Amortization. Further, if KCPL was intending to do make such a change, the time to have suggested a change was *prior to* the true up phase of this proceeding that is established for the limited purpose of accepting facts and data in the case that simply were not available earlier in the proceeding.

DOE/NNSA RECOMENDATION

Staff and KCPL's newly determined methodology for calculating FFO for purposes of determining Regulatory Plan Amortization should be completely

rejected as untimely, beyond the scope of the True Up proceeding and in violation of the Stipulation & Agreement entered in Case EO-2005-0320.

REPLY BRIEF

INTRODUCTION

a) KCPL argues in its Post Hearing Brief that the Commission should continue the ROE set in Case ER-2006-0314 and argues that the Regulatory Plan does not justify a reduction in ROE due to a reduction in risk. DOE/NNSA adequately argued in its Post Hearing Brief the question of reduction in risk and the Commission can determine whether ROE should be reduced due to a reduction in risk. What DOE/NNSA argues here is that regardless of reduction of risk inherent in the Regulatory Plan Dr. Hadaway's methodology for determining ROE was flawed. If the parties did not recognize this flaw in the previous rate case is no reason to believe that the ROE granted in the previous case has become sacrosanct. In this case both DOE/NNSA and OPC recognized the flaw and have brought it to the Commission's attention. Additionally, DOE/NNSA have found that other Commissions have recognized this flaw and acted accordingly.

b) DOE/NNSA's initial brief demonstrated that:

   i) all credible studies show that Kansas City Power & Light Company's (the Company) rates markedly fail to reflect the costs of serving it various customer classes. The Company earns unequal rates of return from those classes. The resultant interclass subsidies impel users to engage in consumption patterns that are deleterious to their individual interests, the Company's, and the Commonweal's. (initial brief, p. 31 *et seq.*) The Commission began to address this problem by reallocating interclass revenues in the 2006 proceeding. The problem requires further alleviation. That can be achieved only by further reallocation of interclass revenues;

ii) the Stipulation and Agreement does not bar the Commission from further reallocation of interclass revenues in this proceeding. (initial brief, p. 36-37);

iii) the Commission should adopt, in this proceeding, a plan for a series of gradual steps toward further reallocation of interclass revenues. (initial brief, pp. 38-41);

iv) DOE's proposed plan will enable the Commission to do this, with minimal burden to residential ratepayers. (initial brief, pp. 43-46)[1]

The parties' initial briefs are much in confluence with this. DOE respectfully offers the following responses to certain portions of those briefs.

I. THE COMMISSION SHOULD REJECT KCPL'S USE OF HISTORIC NOMINAL GDP OF 6.6% AS BEING AN UNREALISTIC PROXY FOR INVESTOR'S EXPECTATION OF LONG-TERM GROWTH RATES

Dr. Hadaway used three versions of the DCF model in calculating ROE. All three, to varying degrees, use his historical nominal GDP growth figure of 6.60% that is derived from fifty-eight years of GDP history (Exhibit 11, Hadaway Direct, Schedule 5).

Solving for "g" (Growth) is the most important and controversial part of the ROE calculation formula since this is where judgment and analysis is required and is also where Dr. Hadaway's calculations fail. All of the pieces of information that go into solving for "g" must be valid. Dr. Hadaway has used one invalid piece of information that skews his entire set of DFC computations. This is the Long Term GDP growth rate of 6.6% which he derives from his Schedule 5 (Id.) He uses this 6.6% growth rate in each of his three DFC calculations of "g" in the equation to derive "k" or ROE.

[1] DOE's initial brief at pages 44-45 includes two paragraphs in which the average monthly increase to residentials under DOE's plan is calculated. The second of these paragraphs is the proper calculation. The first is an earlier calculation which had been re-done and discarded, but somehow found its way into the brief.

Dr. Hadaway eliminated the use of the Traditional Constant Growth DFC model for the reason the ROE calculated using the Traditional Constant Growth DCF Model did not satisfy Dr. Hadaway's criteria because it falls 100 basis points or more below his "range of reasonableness". The reason that it falls below his range of reasonableness is that it makes the least use of his flawed 6.6% GDP growth rate of his three DFC calculations and thus results in an ROE lower than KCPL desires (Exhibit 11, Hadaway Direct, p. 5, L.19). His model that relies the most on the 6.6% GDP growth rate, the Constant Growth DCF Model, produces the highest ROE (Id. Schedule 6 pages 1 and 3)

A number of state regulatory commissions have rejected the use of historic GDP growth to estimate ROE. The Illinois Commerce Commission has considered and rejected the use of historic GDP growth. In *Re South Beloit Water, Gas and Electric Company*, 236 P.U.R. 4th 353 (Ill. C.C. 2004), the Illinois Commission approved a 9.87% return on equity for the natural gas utility and explained its conclusion to reject the historic GDP growth approach. "The Commission shares Staff's concerns as to whether historical [nominal GDP growth] data can reasonably be relied on to estimate a forward-looking cost of common equity. Evidence presented by Staff … lends support to the Commission's view that the forecasts [by analysts of earnings growth] used by Staff [in its single stage DCF model], rather than the historic data used by the Company should be used as a proxy for future expectations in this instance." *Id*. at 383.

In *Re Commonwealth Edison Company*, 250 P.U.R. 4th 161 (Ill.C.C. 2006), Dr. Hadaway, a cost of capital witness in that case, relied on the same 6.60% historic nominal GDP growth rate over 57 years relied on in the present case to request an 11.0% return on equity for the electric utility in the Illinois case. *Id*. at 271, 276 (evidently in the Illinois case his calculation extended one year less than Schedule 5). The Illinois Commission granted instead a 10.045% return on

equity, concluding "that the ComEd proposal [for 11.0%] is excessively high due to its improper application of the GDP growth rates…." *Id*. at 287.

The Illinois Commission described testimony forming part of the basis for its decision: "[Staff] testified that the Company's argument for the use of an economy-wide GDP growth rate as a proxy for the growth of the individual utility companies in Dr. Hadaway's samples rests on the implicit assumption that investors expect the long-term growth rates for those utilities to be similar to Dr. Hadaway's estimate of the average long-term growth rate for the overall economy." *Id*. at 276.

"The Commission finds that the use of GDP growth rates to estimate long-term growth leads to an improper and overstated estimate of the cost of capital. Furthermore, the Commission does not find merit in the Company's assertion that a five-year period fails to adequately consider long-term growth expectations. Accordingly, ComEd's use of GDP growth rates is rejected." *Id*. at 286.

The Arkansas Public Service Commission rejected Dr. Hadaway's proposal to use nominal GDP growth in *Re CenterPoint Energy Arkla*, 245 P.U.R. 4th 384 (Ark. P.S.C. 2005) (The Commission allowed a ROE of 9.45% for that natural gas utility, rather than its normal midpoint of 9.65%, because of circumstances unique to that utility). The Commission concluded that "[Dr. Hadaway] has failed to demonstrate that industry-specific DCF investor-expected growth rates are also equal to the nominal GDP growth rate. This is a crucial distinction. For example, a mature industry may have a rich dividend yield and a small expected growth rate, while a young industry may, conversely, have a small dividend yield and a large expected growth rate." *Id*. at 410.

One year ago, the Washington Commission rejected Dr. Hadaway's proposal to use historical nominal GDP growth rates in the DCF formula. In doing so, that Commission concluded as well that "the simple constant-growth DCF method is

generally preferable to the more complex and assumption-intensive multi-stage method." *Washington Utilities and Transportation Commission v. Pacificorp*, 2006 WL 1517095, p.51 (Wash. U.T.C.).

The New Mexico Public Regulation Commission in Case No. 06-00210 UT Application of Public Service Company of New Mexico, (PNM), decided June 29, 2007, also rejected Dr. Hadaway's use of historical nominal GDP growth. The Hearing Examiner in his recommended Decision, which portion was adopted by the New Mexico Public Regulation Commission in its Final Order, stated at page 37, "In the present case Dr. Hadaway used three versions of the DCF model. All three, to varying degrees, use his historical nominal GDP growth figure of 6.60%. Nominal growth, according to Dr. Hadaway is 'the real growth change plus the change in inflation.' Significantly, PNM and Dr. Hadaway have not identified a single state utility commission decision accepting historical nominal GDP growth for use in a DCF model for any regulated public utility in the United States. Not one."

The hearing examiner continued at page 51, "In this case, as the Commission has done in many past cases, we rely on the constant growth DCF method. The Commission has never accepted using nominal historic GDP growth as a basis for determining the growth rate in a DCF model. Accordingly, we will not rely on Dr. Hadaway's use of nominal historic GDP growth. Consistent with this decision, we do not accept his long-term GDP growth constant growth DCF model or his two-stage growth DCF model, because of their significant reliance on nominal historic GDP growth. As other commissions have concluded, and as we agree, using such GDP growth inflates the return on equity results above a reasonable level. It could give PNM an improper optimal return of equity on 11.0% rather than a legally required fair rate of return.

Based on the record developed in this case we conclude that PNM's use of the traditional constant growth DCF model, if properly adjusted to remove its

reliance on historic nominal GDP growth as a basis for estimating growth, can provide the basis for determining a fair rate of return."

In approving this part of the Hearing Examiner's Recommended Decision the Commission stated in its Final Order at p. 9:

"20. The Commission also agrees with the Hearing Examiner's recommendation that Dr. Hadaway's nominal GDP growth factor should be rejected for the reasons stated in the RD [Recommended Decision] and in the decisions of a number of other state commissions that are cited in the RD. Although the Commission agrees with the RD's other findings and citation to the decisions of other state commissions with respect to this issue, the Commission finds particularly compelling the Hearing Examiner's finding that PNM has failed to show that investors expect the growth of Dr. Hadaway's comparable group of natural gas utilities to be the same as the overall economy, especially where that overall economic growth is based on Dr. Hadaway's 1947 -2004 nominal GDP average growth."

In its Final Order at page 48 the New Mexico Public Regulation Commission stated, "IT IS THEREFORE ORDERED:

A. Except as expressly modified or disapproved herein, the Orders contained in the RD as set forth in Exhibit 1 are incorporated by reference as if fully set forth herein and are ADOPTED, APPROVED and ACCEPTED as Orders of the Commission."

It should be disclosed that the New Mexico Public Regulation Commission's Final Order in NMPRC Case No. 06-00210 Ut. Is presently under appeal to the New Mexico Supreme Court.

DOE/NNSA RECOMMENDATION

The Commission should reject, as have other Commissions, Dr. Hadaway's use of nominal GDP average growth and make its decision based on the various parties' DCF models that do not include nominal GDP average

growth. DOE/NNSA recommended in its Post Hearing Brief and still recommends that "DOE/NNSA believes and therefore recommends that the ROE approved by the Commission be set at the mid-point between 9.1% and 10.3% or 9.7%."

II - KCPL RATES FAIL TO REFLECT COST OF SERVICE. THIS PRODUCES UNEQUAL RETURNS FROM, AND SUBSIDIES AMONG, RATE CLASSES

No party's initial brief denies or even questions the fact that KCPL rates fail to reflect the cost of serving the classes that they apply to, and that this produces unequal returns from, and subsidies among, rate classes. No party questions that this is deleterious to all, including residential ratepayers and the Company itself.

III -THE SIPULATION AND AGREEMENT DOES NOT BAR FURTHER REALLOCATION OF INTERCLASS REVENUES IN THIS PROCEEDING

(a) Staff's position - Staff agrees with DOE/NNSA's position that the Stipulation and Agreement does not bar changes in (RS/RD), including further reallocation of interclass revenues. (Staff initial brief, p. 40)

(b) The Company's position - The Company's brief asserts that the much-debated language of the Stipulation and Agreement (DOE initial brief, pp. 36-37) permits no changes in RS/RD except an across-the-board increase. (Company initial brief, p. 39) However, Company Witness Rush's directly stated in cross-examination that the Stipulation and Agreement does not in fact permit only such an across the board increase. (T- 729) Rather, he said that the parties to the Stipulation and Agreement must address any proposal that is made by a non-party thereto, (T-726) and that the Stipulation and Agreement does not prohibit changes that are proposed by entities which, like DOE did not sign it. (T-728 - 729) Thus, the Company directly acknowledges that the Stipulation and

Agreement permits changes in RS/RD, including further reallocation of interclass revenues.

(c) OPC's position - OPC alone argues that the Stipulation and Agreement bars the RS/RD changes that Staff , DOE, and others recommend. OPC argues, primarily, that the subject language of the Stipulation and Agreement constitutes a prohibition against the Commission adopting any change in RD/RD in this proceeding and in the next. In fact, the Stipulation and Agreement neither recites nor implies any such prohibition of changes in RS/RD. It provides only that *the parties to it* will not *themselves* propose changes in RS/RD. Thus, OPC is arguing that the Stipulation and Agreement, which prohibits only *certain parties* from *proposing* changes in RS/RD, has the effect of legally barring *the Commission itself* from adopting or even considering *any changes at all* in RS/RD, even if the changes are proposed by non-parties to the Stipulation and Agreement, and even if the Commission finds that the changes thus proposed will produce more equitable rates.

OPC argues next that the supposed prohibition must be adhered to because, by "providing certainty to the parties in the process of bringing Iatan 2 on line," it somehow "struck a balance" that must now be maintained. (OPC initial brief, p. 15) This is difficult to understand. The supposed prohibition - against the Commission changing RS/RD in ways that produce more equitable rates - cannot have provided "certainty," because the prohibition has never existed. Moreover, the prohibition, even if it existed, can have "struck a balance" only if it somehow involved identifiable countervailing interests. OPC does not identify, define or characterize the countervailing interests which, it would have the Commission suppose, were "balanced" by the prohibition. In sum, OPC is asserting that:

(1) a non-existent prohibition "struck" an unidentified "balance";

(2) the undefined "balance" which was "struck" by the non-existent prohibition bars the Commission from making equitable adjustments to rates.

OPC further argues that DOE may not oppose the non-existent prohibition because DOE benefited from the Stipulation and Agreement by avoiding litigation risk. (OPC initial brief, p. 15) There is not the slightest evidence that DOE benefited in that fashion. Moreover, even if that be assumed, OPC's argument amounts to asserting that DOE is bound by an agreement to which it is not a party, because the operation of that agreement happened to cause DOE to receive some entirely indeterminate benefit. This is directly contrary to elementary contract law.

OPC further claims that DOE has said that the Stipulation and Agreement was "in the public interest." In fact, the portion of the transcript which OPC recites in support of this claim (Meisenheimer rebuttal, p. 5-6) shows that DOE said only that it believed that *the Commission* could find the Stipulation and Agreement to be in the public interest, *i.e.,* that the Stipulation and Agreement was not arbitrary and capricious.

Finally, OPC argues that the non-existent prohibition binds DOE because DOE participated in the case and did not oppose the Stipulation and Agreement. (Meisenheimer rebuttal, p. 6) This is transparently specious.

IV - THERE IS NO VALID REASON TO DELAY FURTHER REALLOCATION

(a) Introduction DOE urges the Commission to act now to continue to reallocate revenues among the classes in gradual steps, as it began to do in the first rate proceeding. DOE has offered a plan under which the Commission may easily design and take such steps. (initial brief, pp. 43-46) In line with this, Staff recommends that the Commission take "the opportunity of this rate increase case to address remaining inequalities between class revenue contributions and cost of service that were identified in the CCOS studies performed for the last rate filing." (Staff initial brief, p. 39) Staff also agrees that it is "perhaps likely" that Iatan 2's 2010 entry into rate base in the fourth and final proceeding will require

significant rate increases, and that the necessity for those increases will cause the Commission to be less inclined to order further reallocation of interclass revenues at that time. (Staff initial brief, p. 42) Thus, further reallocation of interclass revenues is best begun now.

(b) The Company gives no valid reason to delay further revenue reallocation

The Company agrees that Iatan 2 will produce "a major change in the underlying cost structures." (Company initial brief, p. 4) Even so, it proffers two reasons to delay further interclass revenue reallocation.

It asserts, first, that further interclass reallocation may cause some customers to shift between classes, and that any resultant revenue shortfall will need to be reflected in whatever rates are established. (Company initial brief, p. 48) As Staff notes, this is not a valid reason to prohibit or avoid changes. If it were, even "a simple rate increase by equal percentages would be prohibited, (because) customers might chose to switch from utility sourced electricity to customer owned solar panels…wind generation, chilled water or steam, or gas…" (Staff initial brief, p. 41)

The Company's second proffered reason to delay further revenue reallocation is that "(r)ate design cases are a huge amount of work for everyone, and …it is a waste of resources…to go through that process…when there are no dramatic changes in the underlying costs." (Company initial brief, p. 4) This is inapposite. Further reallocation of interclass revenues does not at this juncture require a "rate design case." DOE/NNSA's initial brief demonstrates that it will not require "a huge amount of work" for the Commission to adopt and implement DOE/NNSA's proposal to move the classes further toward equality. (DOE/NNSA initial brief, pp. 43-46) Moreover, while alleging that there are no "dramatic changes in the underlying costs," the Company ignores the fact that there are very serious problems with the way in which those underlying costs are allocated among the classes. These problems will only worsen, and place the Commission

and the residential ratepayers in a more difficult position, if they are not further addressed at this time. (DOE initial brief, pp. 38-39)

V - THIS CASE IS THE BEST OPPPORTUNITY FOR REALLOCATION

When will the Commission address further reallocation of interclass revenues, if it does not begin to do so in this proceeding? There are only two more rate cases upcoming, and no party offers a plan to address the problem in those cases.

The Company is vague. It says only that the Commission should leave this "for a future case" or "future rate cases" (Company initial brief, p. 4) that will happen at some unidentified time or times "after Iatan 2 comes on line in 2010."(Company initial brief, p. 48) Thus, the Company would delay this urgent matter until the fourth and final rate proceeding, or even until some altogether indefinite time beyond that. This is not consistent with reason.

The Company says that the Commission should address this problem in some unidentified "future rate cases," because, at that undefined future time, "the parties will present cost of service studies, and the parties will be on notice that rate design will be an issue." (Company initial brief, p. 40) Again, the Company is asserting that a "rate design case" is necessary to address this problem at this time. It is not. As DOE has pointed out, no additional cost of service studies are needed to move toward further revenue reallocation now. (DOE initial brief, p. 45)Moreover, the Company's implied assertion that the parties were not "on notice" that rate design could be an issue in this present proceeding is not valid. Neither the Stipulation and Agreement nor anything else barred rate design from being an issue herein. In fact, rate design *is* an issue here, as several of the parties have filed specific proposals that address it. There was no lack of "notice" that rate design might be an issue. The Company and OPC simply choose to ignore that possibility, and to hope that the Commission would do the same.

OPC also hopes to persuade the Commission that it must refrain from any further interclass revenue reallocation now because the residentials were recently given a rate increase. (Meisenheimer rebuttal, p. 4; T-912) In fact, that increase was just 2% more than the increase which was received by other classes. (Company initial brief, p. 38) So small an increase should not constitute grounds for barring a small additional increase that is justified by sound ratemaking principles regarding recovery of the costs of serving each customer class. Moreover, small residential rate increases in this and the next two proceedings will enable the Commission to avoid imposition of a very large one-time rate increase upon residential users, in some "future rate case" which, although it may at present seem far distant, is in fact looming near and absolutely unavoidable.

VI - NO PARTY PRESENTED ANY VALID CRITICISM OF DOE'S PROPOSAL

In confluence with DOE, Staff urges the Commission to "note the underlying similarity of both Staff's and NNSA/DOE's concerns with the discrepancy between the revenues generated by each of KCP&L's customer classes and the cost of serving (them); and their concomitant proposals to mitigate these concerns." (Staff initial brief, pp. 42-43) Although Staff states nebulously that it "does not agree with the NNSA/DOE's mechanism for addressing and continuing the revenue shifts"'(Staff initial brief, p. 43) it puts forward no reason whatsoever for its disagreement.[2] It also says that it does not agree with DOE/NNSA's CCOS study. But the viability of DOE/NNSA's proposal does not depend upon adoption or even consideration of DOE/NNSA's CCOS study. (DOE/NNSA initial brief, pp. 45-46)

[2] Staff's direct testimony did express some criticisms of DOE's proposal. These were subjected to cross-examination and Staff did not put them forward in its initial brief. DOE therefore assumes that Staff has dropped those criticisms. However, in the interest of circumspection, DOE offers the following discussion of them.

The Company poses two objections to DOE's proposal. The first is that the proposal "would cause significant problems in implementation" because it would require "ongoing evaluation and adjustment to achieve the proposed levels." (Company initial brief, p. 49) It is difficult to understand this argument. "Ongoing evaluation and adjustment " are necessary to implement *any* proposal, including the Company's own proposal for across the board increases. Moreover, DOE's proposal is designed to be a guide to move the classes further toward parity. There are no hard and fast "proposed levels" to achieve.

The Company's second objection is that the DOE proposal "…would affect all of the remaining rate cases…" (Company initial brief, p. 49) This argument too is difficult to understand. Movement toward properly designed rates, which permit recovery from rate classes of the cost of serving those classes is highly desirable, and *should* "affect all of the remaining rate cases" Moreover, brief, the Commission can adjust DOE/NNSA's proposal to apply to only this one rate proceeding, or to as many others as the Commission may choose. (DOE initial brief, p. 44 *et seq.*) The DOE/NNSA proposal is designed for the Commission to operate with maximum latitude in fashioning a plan under which the Company will further reallocate revenues among the classes in multiple gradual steps that can be taken over sufficient time.

VII - CONCLUSION

Significant and very damaging interclass revenue subsidies exist, and they will not go away. If the process of further attending to the subsidies begins now, it can go forward gradually and with minimal burden to all, including the residential ratepayers. If the subsidies are left unattended until the fourth rate case in 2010, or until some "future rate case" at some indeterminate time beyond even that, the addition of Iatan 2 to rate base will make the necessary and altogether inevitable reallocation much more painful and problematic. DOE

therefore joins Staff in urging the Commission to further address this very serious problem here and now, in this proceeding.

DOE also wishes to express its appreciation for the immediate, expert, and courteous service which it received when it made inquires via the Commission's toll free number about how to use the Commission's website.

(a) Staff adjusted DOE's 2006 study to reflect the impact of revenues from the 2006 proceeding. Staff asserted that there was a disparity between what it called the "expected" results of that adjustment and the "actual" results of DOE's CCOS study. (Watkins surrebuttal, pp.5, 6) In fact there was no such disparity. Cross examination revealed that, in adjusting the 2006 Study, Staff *held everything other than the 2006 revenues constant*. DOE, however, had, as correctness and currency demanded, made a number of other changes in its 2007 study. It adjusted user cost data for the 2007 rather than the 2006 period and used new and different allocators. Thus, in claiming to have found unwarranted discrepancies between the 2006 "expected" results and the "actual" 2007 DOE study, Staff was comparing two studies whose bases were very different. Staff Witness Watkins acknowledged this in cross-examination. (T-980 – 982)

(b) Staff asserted that DOE had recommended that residential rates be increased in the 2006 case by 16.31%. It stated that, if that recommendation had been followed, residential rates would have to be decreased in this 2007 proceeding by 5.02%. (Watkins surrebuttal, p. 7) In fact, the 16.31% figure was the percentage increase that would have been necessary to move the residentials all the way to parity in that one case. DOE did not recommend that. Mr. Watkins acknowledged this in cross-examination. (T-978, 982-986)

(c) Staff suggested that certain DOE data might vary from weather normalized data or that DOE's allocation methods might be unstable. (Watkins surrebuttal p. 6) Staff's response to a DOE Data Request (DOE/NNSA Exh. 807)

stated that Mr. Watkins had no material or any analyses that would indicate that any of the problems he named actually existed. (DOE/NNSA Exh. 807, last paragraph)