BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service.	))))	**Case No. ER-2014-0370**

REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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The Office of the Public Counsel (Public Counsel) offers the following reply to the initial briefs filed on July 22, 2015.

1. Policy Considerations

In the twenty-one (21) year period between 1986 and 2007, Kansas City Power & Light Company (KCPL) did not file for a single rate increase (*see Report and Order*, Case Nos. EO-85-185 and EO-85-224, and *Report and Order*, Case No. ER-2006-0314). KCPL filed the 1986 rate case to recover in rates the costs for the Wolf Creek Nuclear Plant (*Report and Order*, Case Nos. EO-85-185 and EO-85-224). During the period between 1986 and 2007, KCPL earned returns that consistently were above average, including returns as high as 18.2% in 2000 and 17% in 2004 (Ex. 215, pp.10-11). Since then, KCPL "dramatically increased its construction cycle, directly resulting in an increased cost of service" (Ex. 211, p.4). KCPL made significant upgrades to its facilities, including large environmental investments at the La Cygne generating station and infrastructure replacements at the Wolf Creek Nuclear Generating Station (*Id.*, p.5). Because of these expensive upgrades, "KCPL has filed five rate increases starting February 1, 2007 totaling $283.1 million in rate increases, an increase of over 57% over that period" (*Id.*).

This construction cycle is coming to an end, and the costs of these investments are now being recovered in rates or will be recovered in rates following this case (*Id.*). But instead of filing a narrow request to update rates for recent plant additions, KCPL goes much further. Most of the contested issues in this case involve KCPL's opportunistic attempts to use a rate case made necessary by the construction cycle as a catalyst to gain approval for ratemaking mechanisms that needlessly shift risks to customers and away from shareholders. The abnormal risk-shifting mechanisms KCPL bootstraps onto its rate case, sometimes quite late in the process, should be rejected.

The current regulatory model under which KCPL's rates are set worked very well for KCPL from 1986 to 2007, and now that the construction cycle is complete and the new construction costs are included in rates, KCPL will no longer have the downward pressure on earnings that the construction cycle causes (Ex. 211, p.4). One might reasonably conclude that with proper management, KCPL may return to extended periods of substantially above average earnings. But that is not good enough for KCPL. Yet, approving KCPL's requests for numerous risk-shifting mechanisms will only be exacerbated the likelihood of KCPL over-earning. If KCPL's requests are approved, the only remaining obstacle to KCPL's earnings really is KCPL's management, since "KCPL has the highest administrative and general ("A&G") costs of the Missouri electric utilities," which "contribute to KCPL's difficulties in earning its authorized returns" (*Id.*, p .5).

To support its arguments that the Commission should abandon the historical regulatory model, KCPL makes the unsupported claim that "load growth is flat, which translates into flat revenues" and "[a]verage use per customer is flat or declining" (KCPL Brief, p.35). KCPL's brief cites to no evidence to support these assertions. In fact, the facts actually show that "KCPL's residential class MWh use per customer (both actual and weather normalized) was the highest it has been since 2011 based on the Company's work papers in their recently filed triennial integrated resource plan (IRP) analysis in EO-2015-0254" (Ex. 301, p.4). Between 2005 and 2014, KCPL's load grew (*Id.*). Further, KCPL stated in its IRP that it expects energy consumption to grow .6% and peak demand to grow .7% annually from 2015-2035 (*Id.*). Indeed,

KCPL expects residential energy consumption to provide the most growth over the next 20 years.[1]

KCPL's arguments as to earnings impacts due to energy efficiency and conservation should be dismissed because KCPL glosses over a very relevant and offsetting factor regarding reduced revenues caused by energy efficiency and conservation. That is, KCPL already charges its customers a Missouri Energy Efficiency Investment Act (MEEIA) surcharge that "allows KCPL to fully recover costs associated with energy efficiencies from customers and declines in usage through lost revenues" (Ex. 211, p.4). In other words, KCPL is already employing a mechanism that accounts for revenue impacts caused by declines in usage, and, therefore, such usage declines provide no basis for KCPL's proposed single-issue ratemaking mechanisms.

Setting rates based upon an historical test year is a ratemaking model that has worked for decades, and will continue to work as intended so long as normal costs are not singled out for abnormal treatment. As KCPL's construction cycle is near completion, and as KCPL's construction costs will be recovered through rates following this case, a Commission order based upon an historical test year of expenses, rather than single-issue deferrals and surcharges, will provide a reasonable and lawful basis for establishing just and reasonable rates for KCPL and its customers.

2. **Return on Equity**

KCPL's brief relies exclusively upon the testimony of its witness, Mr. Robert Hevert, to support KCPL's requested return on equity (ROE). In Ameren Missouri's recent rate case, the Commission considered the testimony of Mr. Hevert and determined that Mr. Hevert's ROE recommendation was "excessive" (*Report and Order*, Case No. ER-2014-0258, p.66). The

[1] *Citing* EO-2015-0254 Kansas City Power & Light Company Integrated Resource Plan (April, 2015) Volume 3: Load Analysis and Load Forecasting, p. 1.

Commission concluded that this was due “in large part” to Mr. Hevert’s use of overly optimistic long-term Gross Domestic Product (GDP) growth rates; rates that are higher than the consensus of economist’ forward-looking real GDP growth rates (*Id*.). The Commission found it necessary to adjust Mr. Hevert’s analysis using the more reasonable growth estimates recommended by MIEC/MECG witness Mr. Michael Gorman (*Id.*).

The same analysis should apply in this case, as Mr. Hevert again continues to use excessive growth rates to support an excessive ROE recommendation (Ex. 551, p.8). Once again, Mr. Gorman has provided the Commission with reasonable adjustments that also should be applied to Mr. Hevert’s analysis (*Id*.). The Commission recently characterized Mr. Gorman’s analysis as “reliable” in the Ameren Missouri rate case – a characterization that the Commission did not apply to Mr. Hevert’s analysis (*Report and Order*, Case No. ER-2014-0258, p.66). The evidence in this case suggests that observation should be carried over and applied here as well.

KCPL compares its proposed ROE to a 10.0% ROE recently authorized by this Commission for Liberty Utilities in Case No. GR-2014-0152 (KCPL Brief, p.6). Liberty is a natural gas company and KCPL has provided no analysis or evidence showing that the risks are equal between the gas and electric industries. KCPL's own witness, Mr. Hevert, limited his analysis of comparable companies to vertically integrated electric companies and excluded all gas companies (Ex. 115, p.10). Further, in the Liberty case the Commission had at its disposal only two ROE proposals, the Staff’s proposed 8.7% and Mr. Hevert’s range of 10% to 10.5% (*Report and Order*, Case No. GR-2014-0152, pp.19, 26). In the present case, the Commission has the testimony of four ROE witnesses, and an ROE range of 9.0% to 9.25% is corroborated by three of those witnesses.

KCPL's arguments also highlighted the downward trend of authorized ROEs in fully litigated rate cases, but KCPL attempted to downplay that trend by arguing that it ignores ROEs approved through settlement (KCPL Brief, p. 19). Fully litigated rate case ROEs are based upon a commission's analysis of the ROE testimony, whereas settlement agreements do not receive benefit of the same level of analysis. ROE's resulting from settled rate cases are distorted by the fact that they involve give-and-take on multiple issues among the settling parties, and often include other considerations in exchange for a higher ROE. Fully litigated rate case results are, therefore, more representative of an ROE that results from a careful analysis of what is reasonable based upon the evidence presented.

KCPL's brief claims incorrectly that Mr. Gorman applied weighting to the different model results of his ROE analysis (KCPL Brief, p.5). However, Mr. Gorman states in surrebuttal testimony that he applied no weighting to the models (Ex. 552, p.7). And so, Mr. Hevert and KCPL have concocted a straw man analysis not performed in this case and then attacked that rather than respond to Mr. Gorman's analysis. Even if KCPL was correct and Mr. Gorman applied weighting to his analysis, removing such weighting and applying equal weight to each model does not reach the result KCPL might want. To do so would result in an ROE of 9.01%,[2] which supports Public Counsel's recommended 9.0% ROE.

KCPL also included a table entered into evidence during redirect examination of its own witness - thus preventing other parties from cross-examining the witness on the table - that purports to show a summary of authorized ROEs approved in 2014 and the first half of 2015 (Tr.180; KCPL Brief, p. 20, Ex. 139). However, no details on the underlying data are known. It

[2] Mr. Gorman's analysis produced a Discount Cash Flow (DCF) of 8.60%, a Capital Asset Pricing Model (CAPM) of 9.05%, and a Risk Premium analysis of 9.40% (Ex. 550).

is not known whether the companies included were truly comparable to KCPL, and it is not known just how many companies were included in the summary. A summary of one or two companies from far regions of the country that are not comparable to KCPL is substantially less compelling evidence than a summary based upon dozens of orders from comparable companies in regions closer to KCPL. Even if the data in KCPL's table was reliable, it indicates a downward trend in authorized ROEs between 2014 and 2015, with no evidence to suggest the trend will cease anytime soon. In addition, Mr. Gorman's testimony shows that there is a continuation of the downward trend. Mr. Gorman testified:

> My recommended return on equity does reflect a continuation of the downward trend of awarded authorized returns on equity for electric utility companies. This is reasonable based on an estimate of KCPL's current market cost of capital made by every return on equity model used by every witness in this proceeding, including Mr. Hevert's own models when reasonable and balanced data is used in his studies.

(Ex. 552, p.5). The 9.53% ROE the Commission authorized for Ameren Missouri, is comparable to many other ROE's authorized by regulatory commissions in 2014 (*Id.*, p.5; Ex. 227, p 4.). The downward trend in ROEs suggests an even lower ROE for KCPL is warranted (Ex. 552, p.5). According to the testimony of three ROE experts, a 9.0% ROE is within a reasonable range of ROEs that would enable KCPL to attract necessary capital.

3. <u>Fuel Adjustment Clause</u>

A. KCPL's FAC Request Violates the Stipulation and Agreement from Case No. EO-2005-0329

The Stipulation and Agreement from Case No. EO-2005-0329 states, "KCPL agrees that, prior to June 1, 2015, it will not seek to utilize any mechanism…" KCPL argues that the date of June 1, 2015 applies to the word "utilize" and not the word "seek" (KCPL Brief, p.38). KCPL's interpretation that separates the words "seek" and "utilize" and interprets them independently

should be rejected. The term "seek to utilize" has a particular meaning that refers to the action of requesting the authority to use a certain practice. This interpretation is consistent with the Commission's past use of the term, including a 2014 Commission order that stated:

> On December 9, 2013, Union Electric Company, d/b/a Ameren Missouri submitted a tariff revision along with a motion seeking a variance from Commission Rule 4 CSR 240-13.030, which governs the conditions under which Ameren Missouri may require a deposit from a new applicant for electric service. Ameren Missouri **seeks to utilize** the prospective customer's credit score to determine whether a deposit should be required. The submitted tariff carries an effective date of February 7, 2014.

(*Order Directing Notice and Establishing Time to Apply to Intervene*, Case No. ET-2014-0076, p.1, emphasis added). Here the Commission states that by filing the tariff revision, Ameren Missouri "seeks to utilize" the customer's credit score to assess a deposit. This is a term that cannot be separated into "seek" and "utilize" because when put together they suggest a single action – the act of requesting the authority to use a certain practice. In the Ameren Missouri case, the company requested the authority to use credit scoring to assess deposits, so the Commission accurately stated that the Company "seeks to utilize" credit scoring. In the present case, KCPL is requesting the authority to use an FAC, so KCPL seeks to utilize an FAC.

Each time the Commission has used this phrase in the past, it was referring to a company seeking the authority to use a certain practice. In 1993, the Commission stated, "The singular salient fact, here, is that the Company **seeks to utilize** a capital structure which did not exist, which does not now exist and which might not ever exist and seeks to postulate a cost for that hypothetical long term debt" (*Opinion*, Case No. WR-93-212, p.34, emphasis added). In 1975, the Commission stated, "Thus, where a particular utility **seeks to utilize** the accounting method proposed in this Order, the Commission must carefully determine the effect of this Order on that utility and its customers" (*Report and Order*, Case Nos. 18,246, 18,352 and 18,371, p.41,

emphasis added). In all three examples, the Commission used the term "seeks to utilize" in a manner consistent with Public Counsel's interpretation of "seek to utilize" in the present case. The term refers to the act of requesting a particular authority from the Commission; the company *seeks to use* credit scoring, a capital structure, an accounting method, or a rate mechanism. These interpretations all support a Commission order concluding that KCPL has violated the Stipulation and Agreement by seeking to utilize an FAC before June 1, 2015.

Even if KCPL's attempt to split apart the words in the term "seek to utilize" were followed, KCPL's argument still fails. KCPL argues that the plain and ordinary meaning of the word "seek" can be determined by a dictionary definition, which KCPL then purports to provide the Commission when it defines "seek" as "to try to get or achieve" (KCPL Brief, p.38). KCPL then drops the words "to get or achieve" and asserts that "seek" is synonymous with "try" (*Id.*). KCPL asserts this is the definition from the online version of the Merriam-Webster's Dictionary (*Id.*). In response, the definition provided by KCPL is not accurate, but is closest to the 4th definition of "seek" provided by Merriam-Webster's Dictionary, which defines seek as "to try to gain or acquire: aim at" (http://www.merriam-webster.com/dictionary/seek). If that definition were inserted into the disputed language, it would read, "KCPL agrees that, prior to June 1, 2015, it will not try to gain or acquire (the authority) to use any mechanism." Use of KCPL's suggested definition plainly does not accomplish what KCPL would like it to accomplish.

In addition, KCPL does not provide the Commission with the 3rd definition of "seek," according to Merriam-Webster's Dictionary, which is "to ask for: REQUEST" (*Id.*). To plug Merriam-Webster's 3rd definition of seek into the sentence would provide, "KCPL agrees that, prior to June 1, 2015, it will not request to use any mechanism…" (KCPL Brief, p.38). Again, the definition does not aid KCPL's argument.

KCPL also argues that had the parties intended to prohibit KCPL from filing a request for an FAC, it would have specifically stated that a tariff could not be filed prior to June 1, 2015 (KCPL Brief, p.38). But it was not known whether KCPL would be required to initiate any such request for an FAC with a tariff filing, or some other filing, because SB 179 was not law, and in fact, was still in committee at the time the agreement was signed by the parties (Tr.1504). By prohibiting KCPL from seeking to utilize an FAC, it prevented KCPL from initiating the request in any way. In the context of the agreement, "seek to utilize" means to seek to use the mechanism in whatever manner future law would allow.

The only extrinsic evidence KCPL produced to try to corroborate its strained interpretation of the Stipulation and Agreement is a quote from a former Public Counsel accountant, on the stand during questions from Commissioner Clayton, where he testified that the Stipulation and Agreement provides that KCPL "will not avail themselves of a single-issue mechanism for a period of approximately 10 years" (KCPL Brief, p.41). This quote does not support KCPL's interpretation in any way. For one, the quote is clearly a paraphrasing of the agreement, with no indication that the witness had the agreement in front of him. In addition, this testimony does not in any way explain what "to avail themselves" actually means.

The same witness quoted by KCPL also testified that per the Agreement, Public Counsel gave consideration with the agreement that "we would not question whether the Commission's authorization of an IEC is within [the Commission's] authority" (Case No. EO-2005-0329, Tr. 768). This testimony highlights the give and take of the agreement, and that Public Counsel was prohibited from raising a specific objection up until June 1, 2015 regarding the IEC. For filings made after June 1, 2015, Public Counsel was free to raise those objections. It does not make sense that the Agreement contemplated an overlap period where KCPL could, at the same time,

request both an IEC and an FAC, but other party objections on the grounds of single-issue and retroactive ratemaking would be limited to the FAC only. Nor is such a nonsensical agreement what the parties actually agreed to or intended to agree to. Objections on the grounds of single-issue and retroactive ratemaking apply equally to both mechanisms, and the prohibition against making such objections would provide no value to KCPL during this overlap period if the other parties were free to make single-issue and retroactive ratemaking arguments in the case. The prohibition against raising particular objections expired on June 1, 2015, because that is when KCPL became free to request whatever mechanisms were authorized by SB 179 or other subsequent legislation authorizing single-issue ratemaking mechanisms.

In summary, the Stipulation and Agreement signed by KCPL in Case No. EO-2005-0329 limited KCPL's right to request a rate adjustment mechanism authorized by SB 179. A plain and ordinary reading of the Agreement is that KCPL's request on October 30, 2014 for an FAC violated the requirement that prior to June 1, 2015 KCPL will not "seek to utilize" an FAC. This interpretation is confirmed by the near-contemporaneous interpretations provided by two of KCPL's own executive level employees, as explained in Public Counsel's initial brief (Public Counsel Brief, pp.14-18). To the extent the Commission determines the disputed language is ambiguous, Public Counsel's initial brief provides the rules of construction that would apply, which also support an order from the Commission that finds KCPL to be in violation of the Agreement (Public Counsel initial brief, pp.16-18). Accordingly, KCPL's request should be denied and all remaining FAC issues in this case declared moot.

B. KCPL Has Not Met the Commission's FAC Criteria

The criteria prescribed by the Commission's rules for determining whether a cost component is to be recovered through an FAC requires the Commission to consider the

magnitude of the cost, the manageability of the cost, the volatility of the cost, and the incentives that recovering the cost through an FAC surcharge would provide the company. 4 CSR 240-20.090(2)(C). KCPL's brief argues that its evidence shows that KCPL's fuel and purchased power costs are volatile (KCPL Brief, p.45). However, as explained by MIEC/MECG witness Mr. Brosch, "The Company's witnesses do not offer any detailed analysis of the magnitude, volatility or management control over all of the specific cost elements KCPL seeks to include in its FAC" (Ex. 502, p.8). Mr. Brosch also showed that KCPL's "primary fuel sources are coal and nuclear fuel, for which the Company's actual delivered costs have been and are expected to remain stable and non-volatile. Only these two fuel sources are large enough elements of the Company's fuel mix to be seriously considered in evaluation of an FAC" (Ex. 502, p.11). KCPL is distinctly different from other Missouri companies that use an FAC because, "KCPL has a significantly lower overall exposure to fluctuations in net energy costs than Ameren Missouri, Empire District Electric Company and KCP&L Greater Missouri Operations ("GMO")" (*Id.*). The weight of the evidence supports a conclusion that KCPL's fuel and purchased power costs, including transportation, are not volatile.

The following table provides undisputable proof that KCPL's coal costs are not volatile:

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This table shows KCPL's monthly coal cost by generating unit for 2013 and 2014 (Ex. 208, p.4). This table shows the lack of volatility in KCPL's coal costs, and it also shows KCPL exercises "considerable control over its coal fuel costs because of its purchasing and hedging strategies employed" (*Id.*). The evidence also shows a similar manageability and lack of volatility in KCPL's nuclear costs (*Id.*, p.6). KCPL appears to be under the impression that the criteria required by 4 CSR 240-20.090 are irrelevant to the Commission's decision, and that FACs should be granted simply because other electric companies in the state use FACs. But volatility, manageability, magnitude, and the incentives an FAC would provide are required considerations under the Commission's rules, as those criteria apply to KCPL only. 4 CSR 240-20.090.

C. If an FAC is Approved, a 50/50 Sharing is Lawful and Reasonable

If the Commission approves an FAC for KCPL, the Commission's authority to order a 50/50 sharing mechanism is clear. Section 386.266.1, RSMo, states, "The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel

and purchased-power procurement activities." Denying KCPL's request for an FAC would provide the greatest and most effective incentive to control fuel and purchased power costs. Ordering a 50/50 sharing would cut that incentive in half, but would still act as a strong incentive to KCPL to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

It is important to emphasize that a 50/50 sharing mechanism would not result in KCPL only recovering fifty percent (50%) of its fuel costs. KCPL would recover one-hundred percent (100%) of the FAC costs and revenues already included in its base rates (Ex. 309, p.31-32). A 50/50 sharing mechanism even provides KCPL an opportunity to recover more than 100% of its fuel costs if it improves the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities to be below the fuel and purchased power expense estimated by KCPL and adopted by Staff in this case (*Id.*).

KCPL argues in its brief, "A 100% reconciliation would provide customers with all of the benefits of any decrease in fuel costs, as well as provide the Company with the recovery of any additional costs. This is fair to both KCP&L and customers since fuel costs are not controlled by either of them" (KCPL Brief, p.47). KCPL's assertion would be true only if KCPL had no control over its fuel costs. As previously cited, KCPL has considerable control over its coal and nuclear fuel costs. Returning 100% of any decrease in fuel costs that it may be able to achieve through these activities removes *all* of the incentive for KCPL to continue to reduce costs and would reduce the benefits that the customers would receive absent some incentive for KCPL to continue its current practices.

KCPL misstates the testimony of Public Counsel witness, Ms. Lena Mantle, when it argues, "OPC witness Lena Mantle acknowledged that there are no utilities in the United States

today which have such a 50/50 allocation" (KCPL Brief, p.47, citing Tr. 1731-32). Ms. Mantle testified only that she was not aware of any utilities with a 50/50 sharing mechanism, which is a far cry from testifying that there are no such mechanisms. In fact, KCPL's incorrect characterization of Ms. Mantle's testimony is also incorrect as to the existence of 50/50 sharing mechanisms elsewhere because Public Counsel is aware of commissions that have approved a 50/50 sharing. For one, the Washington Utilities and Transportation Commission has repeatedly required a 50/50 sharing for electric companies (2015 Wash. UTC LEXIS 392 (Wash. UTC 2015); *see also* 2006 Wash. UTC LEXIS 249 (Wash. UTC 2006)). In addition, the Colorado Public Utility Commission also ordered a 50/50 mechanism for Aquila (2003 Colo. PUC LEXIS 676 (Colo. PUC 2003)).

Public Counsel's initial brief addressed this issue and argued that no more than 50% of changes above the base amount of fuel and purchased power costs and revenues, including transportation, should be recovered from ratepayers (Public Counsel brief, pp.31-32). A 50/50 sharing recognizes that KCPL alone has the ability to manage the risks of increases in fuel and purchased power costs, whereas customers have no ability to manage those risks (Ex. 309, p.31). In addition, a 50/50 sharing maintains proper incentives for KCPL to: 1) seek out the lowest price fuel; 2) achieve higher off-system sales margins; 3) work to keep transmission costs low; 4) manage its emission allowances; and 5) keep its generating plants running smoothly (*Id.*).

D. An FAC May Cause More Rate Cases

Granting KCPL an FAC may cause KCPL to file more rate cases than it did before it began its most recent construction cycle. Before it began its construction cycle, KCPL went 21 years without an FAC and without a single request for a rate increase. With an FAC, KCPL would be required to file a rate case once every four (4) years. § 386.266.4(3), RSMo. As KCPL

has shown in this case, each 4-year rate case filing would likely be accompanied with repeated requests for specialized accounting treatment for whatever costs happen to be increasing at that time, or other opportunistic attempts to shift risks to customers.

4. Trackers

A. § 393.140 Cannot Provide Tracker Authority Because it is Limited by the Rate Making Requirements of § 393.270

KCPL cites to § 393.140(4) and (8), RSMo, as the statutory authority for Commission approval of the tracker mechanisms it proposes (KCPL Brief, p.24). Section 393.140(4) and (8) provide that the Commission shall:

> (4) Have power, in its discretion, to prescribe uniform methods of keeping accounts, records and books, to be observed by gas corporations, electrical corporations, water corporations and sewer corporations engaged in the manufacture, sale or distribution of gas and electricity for light, heat or power, or in the distribution and sale of water for any purpose whatsoever, or in the collection, carriage, treatment and disposal of sewage for municipal, domestic or other necessary beneficial purpose. It may also, in its discretion, prescribe, by order, forms of accounts, records and memoranda to be kept by such persons and corporations. …
>
> (8) Have power to examine the accounts, books, contracts, records, documents and papers of any such corporation or person, and have power, after hearing, to prescribe by order the accounts in which particular outlays and receipts shall be entered, charged or credited.

KCPL does not provide any analysis regarding these sections, and merely cites to them and concludes that they "clearly" give the Commission tracker authority (KCPL Brief, p.24).

Section 393.140 sets out the general powers of the Commission. In *State ex rel. Utility Consumers Counsel of Missouri v. P.S.C.,* 585 S.W.2d 41 (Mo. 1979) (*UCCM*), the Supreme Court of Missouri stated that § 393.140, RSMo "gives the PSC broad discretion only *within* the circumference of the powers conferred on it by the legislature; the provision cannot in itself give

the PSC authority to change the rate making scheme set up by the legislature." *UCCM,* 585 S.W.2d at 56 (emphasis in original). The rate making scheme set up by the legislature requires that rates be set based on all relevant factors. § 393.270(4), RSMo; *UCCM,* 585 S.W.2d at 43. As explained in Public Counsel's initial brief, a tracking mechanism would isolate a single cost for special treatment without considering all relevant factors. To the extent future rates are based in part upon the tracked and deferred costs, those rates would not be based on all factors that are relevant to the period of time the costs were incurred, and would, therefore, be a violation of § 393.270(4), RSMo. As the Supreme Court of Missouri determined in *UCCM,* the Commission's authority to prescribe a uniform system of accounts cannot violate the rate making scheme set up by the legislature, including the requirement that rates be based upon all relevant factors. § 393.270(4), RSMo.

In addition, under the prospective language of §§ 393.270(3) and 393.140(5), past expenses "cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses." *UCCM*, 585 S.W.2d at 54. Sections 393.270(2) and (3) are clear that rates set by the Commission are for "service to be furnished," and setting rates that recover for services already furnished, would violate these provisions. Section 393.270(5) states that rates are to be set based "upon the value of property actually used in the public service" and cannot be based on property used to provide past services. Trackers purport to defer past expenses for the purpose of setting future rates to recover past losses, in violation of §§ 393.270(3) and 393.140(5) and the rate making scheme set up by the legislature. *UCCM,* 585 S.W.2d at 43.

B. <u>KCPL's Brief Misinterprets the Supreme Court in *UCCM*</u>

KCPL misinterprets *UCCM* when it argues that the Supreme Court's decision supports approval of KCPL's tracker requests. KCPL's main argument focuses on the analysis in *UCCM* of the Supreme Court's prior 1960 opinion in *Hotel Continental v. Burton*. KCPL argues:

> The question is not if there are conceivably <u>any</u> other cost decreases within the entire universe of the utility operations which could provide an "offset" to the cost being tracked. The question is whether there are cost factors which could change the actual cost component. The costs for which KCP&L has requested a tracker mechanism are all essentially direct costs. In other words, they are not affected by overall operations of the Company or changed by other costs. They are direct charges to the Company largely out of management's control. These costs are thus similar to the costs considered in *Hotel Continental v. Burton*, 334 S.W.2d 75, 77 (Mo. 1960).

Contrary to KCPL's assertion, the costs it seeks to defer are *not* similar to the costs deferred in *Hotel Continental v. Burton*, 334 S.W.2d 75 (Mo. 1960) ("*Hotel Continental*"). As the Court explained in *UCCM*, the facts of *Hotel Continental* involved a tax adjustment clause (TAC) that allowed a separate surcharge for taxes that were based upon the company's gross receipts. *UCCM,* 585 S.W.2d at 52. KCPL misinterprets what constitutes a "direct cost" according to the opinion in *Hotel Continental*. In *UCCM*, the Court explained, "the tax was a *direct* charge, exactly proportional to the customer's bill, the amount of which was directly determined by the amount of that bill" (*Id.*). KCPL's tracker requests do not involve direct costs because, unlike a tax based upon gross receipts, the costs KCPL seeks to track are not exactly proportional to the customer's bill. There is no direct relationship between a customer's bill and the expenses incurred by KCPL for property tax, CIP/cyber-security, or transmission. The Court in *Hotel Continental* found that "the only items of operating expense which are directly related to the company's gross revenues are the gross receipts tax and the state sales tax" and "other tax items (other than sales tax) do not lend themselves to such segregated handling" (*Hotel Continental*,

334 S.W.2d at 83). KCPL misinterprets the Supreme Court's opinions in *UCCM* and *Hotel Continental* because under the Court's analysis the trackers proposed by KCPL would not qualify for separate treatment in that the costs incurred by KCPL are not directly apportioned to the customer's use of the utility.

C. KCPL Seeks to Defer Costs That are Not "Extraordinary Items" and Violate the Uniform System of Accounts Required by 4 CSR-240-20.030(1)

To the extent the Commission concludes that § 393.140(4) gives the Commission the authority to defer costs as requested by KCPL through the Commission's authority to prescribe a uniform system of accounts, KCPL's requests also fail because they violate the accounting system adopted by the Commission's rules. The Commission prescribed uniform methods of keeping accounts, records and books through the adoption of rule 4 CSR 240-20.030(1), which requires electric utility companies to "keep all accounts in conformity with the Uniform System of Accounts Prescribed for Public Utilities and Licensees subject to the provisions of the Federal Power Act, as prescribed by the Federal Energy Regulatory Commission (FERC) and published at 18 CFR Part 101 (1992)." The FERC rules, and in turn, the Commission's rules, require all items of profit and loss to be reflected in the period incurred, with only a few limited exceptions that are not satisfied by KCPL's tracker requests.

FERC's General Instructions Numbers 7, *Extraordinary Items*, and 7.1, *Prior Period Items* state:

> 7. *Extraordinary Items.*
>
> It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant

effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future. (In determining significance, items should be considered individually and not in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate. To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary. (See accounts 434 and 435.)

7.1 *Prior period items.*

A. Items of profit and loss related to the following shall be accounted for as prior period adjustments and excluded from the determination of net income for the current year:

(1) Correction of an error in the financial statements of a prior year.

(2) Adjustments that result from realization of income tax benefits of pre-acquisition operating loss carryforwards of purchased subsidiaries.

B. All other items of profit and loss recognized during the year shall be included in the determination of net income for that year.

(18 C.F.R. Part 101, emphasis added). These rules clearly require profits and losses to be recognized in the determination of net income in the year they were incurred, with only a few very limited exceptions for "extraordinary items." To qualify as an extraordinary item, a cost must be: (1) unusual, abnormal and significantly different from the ordinary and typical activities of the company; (2) infrequent; (3) not reasonably expected to recur in the foreseeable future; and (4) of significant effect (more than approximately 5% of income) (4 CSR 240-20.030(1)).

Since the costs KCPL wishes to defer through tracking mechanisms are not extraordinary, as explained in detail below for KCPL's proposed property tax tracker, CIP/cyber-security tracker, and transmission expense tracker, the deferrals would violate 4 CSR 240-20.030(1), and should be rejected as unlawful and unreasonable.

D. <u>The Court of Appeals Opinion in *Sibley* Does Not Support the Requested Trackers</u>

KCPL's brief essentially admits that the expenses it seeks to track are not extraordinary. KCPL cites to the *Sibley* case, where the Court of Appeals affirmed a Commission order authorizing an Accounting Authority Order (AAO) for Missouri Public Service Company (MPS) (KCPL's predecessor) to defer and record depreciation expenses and carrying costs for two construction projects at the Sibley generation station. *State* ex rel. *Office of the Public Counsel v. P.S.C.*, 858 S.W.2d 806 (Mo. App. W.D. 1992) ("*Sibley*"). The AAO allowed MPS to track and defer costs incurred to rebuild two generation units, and costs incurred converting the plant to burn low-sulfur coal as mandated by the 1990 federal Clean Air Act (*Id.* at 808). The upgrades were expected to cost MPS approximately $54 million during the deferral period before the company's next rate case (*Id.*). The Commission found the costs to be unusual and extraordinary (*Id.* at 810). Public Counsel raised three points on appeal, but only points II and III are relevant to the tracker requests at issue in the present case.

Point II argued that the costs were not unusual or extraordinary under the Uniform System of Accounts adopted by the Commission in 4 CSR 240-20.030(1) (*Id.*). The Court concluded, "Because rates are set to recover continuing operating expenses plus a reasonable return on investment, only an extraordinary event should be permitted to adjust the balance to permit costs to be deferred for consideration in a later period" (*Id.* at 811). The Court concluded that extending the life of the Sibley generating units for twenty years and converting the station to burn low-sulfur coal were extraordinary events (*Id.*). The Court also concluded, "The projects for which substantial funds were expended and for which deferral is sought were unusual and not

recurring" (*Id.*). Point II was denied when the Court held that the Commission's order was supported by competent and substantial evidence (*Id.* at 812).

In point III, Public Counsel argued that the order constituted single-issue ratemaking in violation of § 393.270, RSMo because the deferral permitted one factor to be considered without considering all relevant factors (*Id.*). The Court noted that the Commission did not grant rate relief to MPS, and only permitted a deferral (*Id.* at 813). The Court stated, "The Commission's order does not preclude consideration of other relevant factors when the Commission considers the appropriate rate to be charged the utility's customers" and because of this, it "does not constitute single-issue rate making" (*Id.*). The Court in *Sibley* concluded only that the *deferral* did not constitute retroactive ratemaking, but implicit in the Court's conclusion is that in order to allow such costs to be included in future rates, the future decision should not preclude consideration of all relevant factors (*Id.*).

Notably in *Sibley*, the Court concluded that the Commission has authority for its decision to defer the costs of the projects, but the Court does not specifically identify the statutory source for that authority or provide any analysis (*Id.*). The Court also noted that the Commission's authority to defer costs to future periods was not contested, which may explain why the Court did not attempt to identify any source for such alleged authority (*Id.*).

KCPL cites to *Sibley* to support its argument that "the Court of Appeals did not explicitly limit deferral accounting to only extraordinary items" (KCPL Brief, p.26). This argument is wrong for two reasons. First, *Sibley* cannot be read as allowing deferrals beyond extraordinary items because the Court clearly determined that the items KCPL was deferring were extraordinary when the Court held that extending the life of the generating units and converting the station to burn low-sulfur coal "are extraordinary events" (*Sibley*, 858 S.W.2d at

811). Second, implicit in KCPL's argument against the need for deferred expenses to be extraordinary, is KCPL's recognition that the costs it seeks to defer are *not* extraordinary.

Sibley is significant to the present case because it confirms that under the Commission's rules, deferrals must be extraordinary and future attempts to include the deferred costs in rates must be based on all relevant factors. Here, KCPL is not proposing any process whereby all relevant factors will be considered in the next rate case when KCPL would seek to include the tracked costs in future rates. Accordingly, the deferrals are unreasonable because KCPL cannot lawfully include the costs it proposes to defer in future rates.

E. Advantages of Regulatory Lag

"Regulatory lag is the period of time between when an increase or decrease in expenses or revenues and investment costs is incurred and when they are recognized in rates" (Ex. 211, p.5). The lag period occurs because KCPL, and customers, must wait until the company's next rate case to recognize such revenue and cost changes in rates. KCPL asserts that there must be a "solution" for regulatory lag, and that solution is found in KCPL's requests for trackers and an FAC (KCPL Brief, p.27). KCPL would have the Commission believe that regulatory lag serves no purpose in monopoly regulation and must be eliminated as one seeks to eliminate a disease. The evidence demonstrates, however, that regulatory lag serves a necessary purpose and is the "cornerstone" of cost-of-service regulation (Ex. 215, p.6). Regulatory lag was described by famed economist Alfred E. Kahn in his book *The Economics of Regulation: Principles and Institutions* as serving the necessary purpose of encouraging positive utility management behavior (*Id.,* p.5).[3] Kahn explained that "freezing rates for the period of the lag imposes

[3] Kahn, A.E., The Economics of Regulation: Principles and Institutions (New York: John Wiley & Sons, 1970, Chapter 2).

penalties for inefficiency, excessive conservatism, and wrong guesses, and offers rewards for their opposites: companies can for a time keep the higher profits they reap from a superior performance and have to suffer the losses from a poor one" (*Id.*).

When regulatory lag is reduced or eliminated through trackers and other single-issue ratemaking mechanisms, the customer suffers because "utility managers are no longer under the pressure to act as efficiently and to keep expenses as low as possible. Expenses are now tracked and recovery is almost guaranteed. This lack of regulatory lag's quasi-competitive pressure results first in utility manager inefficiencies and gradually leads to imprudent utility management behavior." (*Id.*, p.6). Vitally, regulatory lag incentivizes "utility managers to work like managers of competitive businesses" (*Id.*).

Kahn explained further explained, "the inevitable delay that regulation imposes in the downward adjustment of rate levels that produce excessive rates of return and in the upward adjustments ordinarily called for if profits are too low - is thus to be regarded not as a deplorable imperfection of regulation but as a positive advantage" (*Id.,* p.5). Over the long run, there are no winners or losers due to regulatory lag in that it is "symmetrical, balanced, and unbiased" (*Id.*, p.8). Just as customers have benefited from regulatory lag in the past, so has KCPL. The benefits of regulatory lag from the utility's perspective are what enabled KCPL to reap higher profits for a prolonged period of time between 2000 and 2007 before the economic recession (*Id.*, p.6). Introducing trackers and other single-issue ratemaking mechanisms threatens to upset the regulatory balance that regulatory lag provides. Regulatory lag "only works when it is treated in a <u>symmetrical</u> and <u>balanced</u> manner" (*Id.*, p.28, emphasis added).

F. Transmission Expense Tracker

Even if the Commission had the authority to grant KCPL a transmission expense tracker, KCPL's late-filed request for a transmission expenses tracker also fails the criteria of 4 CSR 240-20.030(1) for deferred accounting.[4] Two years ago in 2013, and again one year ago, this Commission told KCPL that transmission costs were not extraordinary (*Report and Order,* Case No. ER-2012-0174, pp. 39-46; *Report and Order*, Case No. EU-2014-0077, p.8). The Commission's reasoning was clear – transmission expenses do not meet the criteria of the FERC's General Instruction No. 7 for extraordinary items (*Id.*). Surprisingly, KCPL's brief makes no mention of either order, nor does it attempt to identify any changed circumstances.

Last year the Commission denied KCPL's request for a transmission expense accounting authority order (AAO) to defer transmission costs for future recovery and held:

> Transmission expenses are part of the ordinary and normal costs of providing electric service by a utility and are ongoing. Transmission costs fluctuate due to load variations, but are escalating on an annual basis. The expansion of SPP's regional projects and the potential funding required by SPP's members has been known for some time. The transmission cost environment faced by Companies is the norm for electric utilities within SPP and in other regions. Companies' transmission expenses are not extraordinary.

(*Report and Order*, Case No. EU-2014-0077, p.8).

A year earlier, when the Commission rejected KCPL's request for a transmission expense tracker, the Commission provided a thorough nine-page explanation as to why transmission expenses cannot be tracked (*Report and Order,* Case No. ER-2012-0174, pp. 39-46.). The Commission determined that KCPL's transmission costs were increasing by approximately 14%

[4] As explained in Public Counsel's initial brief, KCPL's request for a transmission expense tracker violates 4 CSR 240-2.130(7) because it was not raised in KCPL's case-in-chief.

every year, and that those costs would continue rising at an accelerated pace (*Id.*). This is essentially the same evidence KCPL presents in this case (KCPL Brief, pp. 61-63). In 2013, the Commission rejected KCPL's request and stated:

- "The projected transmission cost increases are not "extraordinary" within the legal definition because they are not rare or current."
- "Transmission is an ordinary and typical, not an abnormal and significantly different, part of Applicants' activities."
- "…paying more for transmission than in the previous year is a foreseeably recurring event, not an unusual and infrequent event."
- "…'items related to the effects of' transmission cost increases are not rare and, therefore, are not extraordinary."
- "the Commission concludes that denying a tracker is consistent with the law and does not threaten safe and adequate service at just and reasonable rates, so the Commission will not order a transmission tracker"

(*Report and Order,* Case No. ER-2012-0174, pp. 39-46).

These reasons also apply to KCPL's request in this case. KCPL's transmission costs are not unusual or abnormal, nor are they incurred infrequently since transmission costs are a normal operating expense that KCPL incurs daily (Ex. 223, p.9). There is nothing extraordinary about KCPL's transmission expenses (*Id.*).

KCPL's decision to bring the same issue right back to the Commission after twice rejecting the same request in the last two years, provides additional support for rate case expense sharing. KCPL does not want to take 'no' for an answer and is forcing the other parties to argue in opposition to, and expend resources on, the identical transmission cost deferral issue in three separate cases in three consecutive years.

G. **Property Tax Expense Tracker**

Even if the Commission had the authority to grant KCPL a property tax tracker, KCPL's property tax tracker request does not satisfy any of the criteria required to treat a particular cost as extraordinary. 4 CSR 240-20.030(1). To qualify as an extraordinary item, a cost must be: (1) unusual, abnormal and significantly different from the ordinary and typical activities of the company; (2) infrequent; (3) not reasonably expected to recur in the foreseeable future; and (4) of significant effect (more than approximately 5% of income) (*Id.*).

Property tax is not unusual or abnormal, nor is it incurred infrequently since property tax is a normal operating expense that KCPL incurs annually (Ex. 223, pp. 23-24). Property tax is an ordinary and typical expense for KCPL, just as it is a normal expense for all businesses owning property (*Id.*). KCPL has not provided evidence to suggest that the effect of future property tax increases would satisfy the "significant" requirement and be more than 5% of income. The facts show that KCPL "has experienced gradual, single digit percentage increases in this expense from year to year, rather than any volatility or extreme levels of change in any recent year" (Ex. 502, p.21). Lastly, whatever property tax increase occurs will be due to a change in the tax code and will most likely recur in subsequent years (Ex. 223, p.24). Property tax fails the "extraordinary item" criteria required by 4 CSR 240-20.030(1).

To support its request for a property tax tracker, KCPL points to the fact that in the last rate case, the Staff's property tax amount was approximately $75 million, whereas in the present case, Staff and KCPL have agreed upon a property tax amount of $91 million (KCPL Brief, p.65). If anything, this evidence shows that the current method of recovering costs through base rates works as anticipated in that KCPL is using this rate case to recognize the increase in this cost item, and that the Staff has agreed with KCPL that an additional $15 million should be

included in rates to reflect this increase. The result will be an additional $15 million recovered annually by KCPL for property tax. This is proof that the current methods work; a tracker is unnecessary.

Deferring an expense such as property tax does not consider all relevant factors that may offset the property tax increase such as cost reductions in other expense items. For example, between 2012 and 2014 KCPL was able to reduce **

** (Ex. 502, Schedule MLB-6). Combined, KCPL was able to reduce these expenses by ** ** in just three years (*Id.*). This suggests KCPL may find similar levels and types of efficiencies and cost reductions in the years following this rate case. Such offsets are relevant factors that would not be recognized in a property tax deferral, or any other tracked cost.

H. <u>CIP/Cyber-Security Expense Tracker</u>

KCPL begins its critical infrastructure protection (CIP)/cyber-security tracker request argument by identifying "why KCPL has requested tracker treatment for CIP/cyber-security O&M expense" (KCPL Brief, p.72). KCPL's reasons are: (1) KCPL needs to meet governmentally-mandated requirements regarding CIP/cyber-security; (2) future costs for CIP/cyber-security are uncertain; (3) future costs will exceed historical costs; and (4) using historical costs will not reasonably match costs and revenues (KCPL Brief, p.72). These are not reasons this Commission has followed in the past when it authorized a cost to be deferred. To qualify as an extraordinary item, a cost must be: (1) unusual, abnormal and significantly different from the ordinary and typical activities of the company; (2) infrequent; (3) not reasonably expected to recur in the foreseeable future; and (4) of significant effect (more than approximately 5% of income) (4 CSR 240-20.030(1)).

KCPL is already required to meet cyber-security standards set by the North American Electric Reliability Corporation (NERC), and on April 1, 2016, KCPL anticipates new requirements under NERC's CIP version 5 and possibly additional requirements under CIP version 6 (Ex. 132, pp.7-8). KCPL also states that NERC is discussing a possible version 7 (*Id.*). This evidence shows that CIP/cyber-security expenses are not unusual or abnormal, nor are they incurred infrequently since CIP/cyber-security costs are an ordinary and typical expense for KCPL (Ex. 302, p.28). KCPL's evidence of anticipated CIP versions 5, 6 and 7, shows the costs are likely to recur in the foreseeable future (Ex. 132, pp.7-8). KCPL's first reason for the proposed tracker is, according to the Commission's rules, a reason to deny the tracker because the NERC requirements are an existing and ongoing expense that will recur in the future.

KCPL also states that the CIP/cyber-security costs will increase by an uncertain amount (KCPL Brief, p.72). But according to the Commission in KCPL's last rate case, the fact that a particular cost is increasing from historical levels and is uncertain is no reason to authorize a cost deferral (*Report and Order,* Case No. ER-2012-0174, pp. 39-46). The Commission twice denied KCPL deferral authority for transmission costs that were increasing and uncertain (*Id.*). KCPL has also not provided evidence to suggest that the effect of future CIP/cyber-security cost increases would satisfy the "significant" requirement and be more than 5% of income. CIP/cyber-security expenses fail the "extraordinary item" criteria. 4 CSR 240-20.030(1).

KCPL's last reason for the CIP/cyber-security tracker is an alleged mismatch between historical costs and realized costs and revenues (KCPL Brief, p.72). To the extent KCPL is concerned about a mismatch between when costs are incurred and when they are recovered in rates, deferring an expense incurred in a prior period to a future period does not cure any alleged

mismatch. Instead, it takes an alleged mismatch and creates a guaranteed mismatch if those costs are recovered in a future period.

The evidence also shows that KCPL has significant control over managing "cyber security costs in the salaries and wages paid to employees and whether contractors are used in lieu of employees" (Ex. 223, p.35). KCPL's witness Mr. Phelps-Roper "describes the numerous governance, project management, and cost control procedures to ensure that CIP/Cyber-security efforts are efficient and cost effective" (*Id.*). Approving KCPL's CIP/cyber-security tracker would be the worst thing the Commission could do to incentivize KCPL to control these expenses through smart and efficient management decisions (Ex. 502, p.14). The Commission previously concluded that "an after-the-fact prudence review is not a substitute for an appropriate financial incentive" to control costs (*Report and Order*, Case No. ER-2008-0318, p.119). KCPL argues that its incentive compensation plan would provide the missing incentive, but there is no evidence that any employee's incentive compensation plan is tied to benchmarks related to CIP/cyber-security costs. Even if there were, KCPL would be under no obligation to continue those benchmarks as they would be subject to management discretion.

KCPL also argues in its brief that the "higher CIP/cyber-security expenses actually incurred during the rate effective period will cause earnings shortfalls for KCPL" (KCPL Brief, p.74). There is no way to accurately predict what KCPL's earnings will look like in a year or two years from now - but one thing is certain - costs will vary, some rising and some falling, and every such change will impact KCPL's earnings (Ex. 223, p.33). To the extent there are CIP/cyber-security cost increases above the test-year level of CIP/cyber-security expenses to be included in base rates, such changes could very well be offset by the tens of millions of dollar in savings that KCPL asserts it finds every year (Ex. 502, Schedule MLB-6). There is no way for

KCPL to predict with any level of accuracy whether CIP/cyber-security expenses will cause earnings shortfalls for KCPL. Even if increases in this expense did create earnings shortfalls, that is not the standard used by the Commission for deferrals.

KCPL has been unable to identify a single electric utility, gas utility or water utility company in the United States with a CIP/cyber-security tracker (Ex. 302, p.29). Even if the Commission had the authority to grant KCPL a CIP/cyber-security tracker, KCPL's request for such tracker fails the Commission's extraordinary item standard. 4 CSR 240-20.030(1).

5. Transmission Expense True-Up: Independence Power and Light Adjustment

KCPL raises for the first time in true-up testimony an adjustment it proposes for transmission expense to reflect transmission cost increases that KCPL alleges will occur outside of the true-up period (Ex. 165, p.3). This adjustment should be rejected because the expense occurs outside of the test year and true-up period, and because it is unlikely that KCPL will ultimately incur these expenses without reimbursement. KCPL is challenging these transmission costs before the Federal Energy Regulatory Commission (FERC), and by denying this out-of-test-period adjustment the Commission will maintain KCPL's incentive to pursue that challenge (Ex. 165, p.3).

In the only order from the FERC on the issue, the FERC indicated that it did not believe that the Southwest Power Pool's (SPP) proposed tariff revisions on behalf of Independence Power and Light were just, reasonable or lawful (*Order Accepting Tariff Revisions and Establishing Hearing and Settlement Judge Procedures*, Docket No. ER15-1499-000, June 12, 2015, p.15). After carefully reciting and considering the arguments before it, the FERC stated, "Our preliminary analysis indicates that SPP's proposed Tariff revisions have not been shown to be just and reasonable and may be unjust, unreasonable, unduly discriminatory or preferential, or

otherwise unlawful" (*Id.*). Not only are these costs outside of the test year, but the most likely result is that the SPP tariff will be rejected and KCPL will not incur additional costs. KCPL's belated request should be denied.

6. Rate Switching True Up

KCPL and the Commission's Staff submitted true-up testimony on this issue which proposes to make a downward adjustment to KCPL's revenue estimate based upon the theory that a substantial number of large commercial customers will switch to a lower rate after new rates go into effect following this case (Ex. 253, pp.4-5; and Ex. 167, p.3). Staff witness Ms. Robin Kliethermes testified that a $250,000 adjustment was appropriate, whereas KCPL initially testified that a surprisingly rounded $1 million adjustment was appropriate, but during the evidentiary hearing reduced that figure to $590,000 (Ex. 253, p.5, Tr. 2032).

During the true-up hearing, the Commission and other parties were notified of a possible agreement between the Staff and KCPL that would allow a downward adjustment to revenues of $500,000 (Tr. 2014). Public Counsel has seen drafts of that agreement, but at the time that this brief was written, no such agreement had been filed.

Public Counsel objects to the proposed adjustment. First, it represents significant speculation and seeks to include potential revenue changes that *may* occur outside of the test year and true-up periods (Ex. 253, p.5). As Mr. Rush testified in the true-up hearing, the $500,000 adjustment presumes that *all* customers that would benefit from a rate change actually make the change (Tr. 2036). Second, to the extent the Commission allows this out-of-period adjustment to revenues, it should only be allowed so long as customers that could benefit from a rate switch are *all* notified of that fact prior to new rates or at the same time that the new rates take effect. KCPL should not be allowed to assume the $500,000 adjustment into rates before customers are

even made aware of the benefits of switching rates. To do otherwise, KCPL would have no basis for including the amounts in rates during the period between the effective date of rates and when customers switch rates. If there is a delay between when new rates go into effect and when customers are notified, which will impact when customers will likely switch, the $500,000 adjustment should be prorated to account for this delay in possible rate switching.

7. <u>Rate case expense</u>

KCPL argues that "it would be illegal for the Commission to adopt a new policy related to the recovery of rate case expense that would be applicable to KCPL and other public utilities without conducting a rulemaking proceeding" (KCPL Brief, p.88). No party to this case has requested that the Commission's rate case expense decision in this case be applied to any public utility other than KCPL. All arguments in regard to rate case expense, and all facts in this case regarding rate case expense, are specific to KCPL and the rate case expenses incurred by KCPL to present this case to the Commission.

Pursuant to the Commission's authority under § 393.140, RSMo to approve rates that are just and reasonable, the Commission would be well within its authority to order a disallowance in this case for excessive attorney fees, a disallowance for duplicative witnesses, and a 50/50 sharing of rate case expense. "[C]ourts do not and should not circumscribe regulatory agencies by any hard or fast formula. Each case must be determined upon its own facts and, oftentimes, varying factors that may be peculiarly relevant to a reasoned determination of the issue of "just and reasonable" rates under conditions then existing." *State* ex rel. *Missouri Water Co. v. Public Service Com.,* 308 S.W.2d 704, 718 (Mo. 1957). Section 393.140, RSMo., states:

> Whenever the commission shall be of the opinion, after a hearing had upon its own motion or upon complaint, that the rates or charges or the acts or regulations of any such persons or corporations are unjust, unreasonable, unjustly discriminatory or

> unduly preferential or in any wise in violation of any provision of law, the commission shall determine and prescribe the just and reasonable rates and charges thereafter to be in force for the service to be furnished

The Commission has the authority to find that charging customers more than 50% of KCPL's particular rate case expenses is unjust, unreasonable, unjustly discriminatory and unduly preferential because of the many reasons argued in initial briefs, including the fact that much of KCPL's rate case expenses were incurred to make arguments that benefit shareholders only and provide no service benefits or other benefits for customers.

The Commission's authority to order disallowances and a sharing of rate case expense is also shown by the Commission's exercise of its authority to limit rate case expenses on numerous occasions. In one case the Commission explained, "Rate case expenses are somewhat unique…in that they are incurred by utilities for the primary purpose of attaining rate relief. Consequently, when ratepayers pick up the tab for such expenses, they are, in effect, being required to finance the means by which their own rates are increased" (*Report and Order*, Case No. TC-89-14, et al., p.67). In another case, the Commission ordered a sharing of rate case expenses between the customers and the shareholders and explained:

> The Commission, though, has determined that Public Counsel's proposal of a one-half sharing in this case has validity. The Commission can only conclude that the increased rate filings are an attempt by Company to protect shareholders from any regulatory lag. No benefit to ratepayers can be derived from these premature and frequent filings. The Commission would also point out that Company has incurred rate case expense by seeking recovery for expenses which the Commission has had a long and consistent history of disallowing.
>
> The Commission considers the sharing of rate case expense appropriate in this case since Company has increased its rate case activity to protect the shareholders. …. The regulatory procedure was established to balance shareholder and ratepayer interests. A company's reasonable attempt to meet its obligations under this procedure is expected. When, as in this case, a company exceeded the reasonable

> bounds it could only be to benefit the shareholders, and thus a sharing of the expense is appropriate. The Commission will therefore adopt Public Counsel's proposed disallowance of one-half of rate case expense.

(*Report and Order*, Case No. ER-85-265, pp. 27-28). Here the Commission recognized that where a company's rate case involves issues that seek only to protect shareholders, a sharing is appropriate (*Id.*). In the present case, the vast majority of the issues seek to benefit shareholders solely or substantially more than they would benefit ratepayers, including KCPL's requests for an FAC, a property tax tracker, a CIP/cyber-security tracker, a transmission tracker, a 10.3% ROE, electric vehicle charging stations, and a $25 residential customer charge. This list of issues exceed "the reasonable bounds" because they "could only be to benefit the shareholders," and under the Commission's reasoning above, "sharing of the expense is appropriate" (*Id.*). KCPL characterizes a 50/50 sharing of rate case expense to be arbitrary, but there is nothing arbitrary about a Commission order finding that ratepayers and shareholders benefit equally from this rate case. Given that the overwhelming number of issues brought by KCPL benefit only KCPL shareholders, and the degree to which they do, not only is 50/50 sharing not arbitrary, it is, in fact, generous to shareholders.

KCPL's brief compares the number of attorneys it has used in this case to the number of attorneys from each of the other parties (KCPL Brief, p.99). KCPL references the four attorneys that entered appearances in the case on its behalf, but KCPL does not reference the number of attorneys working behind the scenes for KCPL that did not enter their appearance. Regardless, no party has attempted to disallow legal fees from an outside law firm on the grounds that the work is duplicative. While the work performed by KCPL's outside attorneys may be duplicative, the basis for Public Counsel's recommended disallowance is in regard to the outside attorneys' hourly rate, which KCPL fails to mention in its brief. As KCPL's in-house counsel merely sat

and observed the hearing, KCPL's outside counsel racked up enormous bills that KCPL now wishes to impose onto ratepayers. To put Mr. Zobrist's $485 hourly rate into perspective, it equals $8.08 *per minute*, which means Mr. Zobrist earned more per minute than a KCPL customer on minimum wage earns *per hour.* § 290.502, RSMo. In 40 minutes Mr. Zobrist earns more than a minimum wage worker earns in an *entire 40-hour week.* There is simply no reasonable basis for requiring KCPL's customers, many of whom are on minimum wage or no wage at all, to foot the bill for such exorbitant fees. This is just one glaring example of KCPL's imprudent rate case spending and should be disallowed as such.

8. <u>Management Audit</u>

As explained in Public Counsel's initial brief, witness Mr. Lane Kollen recommends to the Commission that KCPL be ordered to undergo a management audit because KCPL's administrative and general (A&G) expenses are excessive when compared to other utilities in the region (Ex. 500, p.13). Although KCPL has shown success cutting its operation and maintenance (O&M) expenses, Mr. Kollen recommends that the management audit also audit KCPL's O&M expenses since A&G and O&M expenses are closely related (*Id.*).

KCPL argues in its brief that KCPL's high A&G expenses are the result of differences between how utilities account for A&G and O&M expenses (KCPL Brief, p.112). But Mr. Kollen testified that he was well aware of those differences when making his recommendation for a management audit (Tr. 1205-1206). "There may be many reasons for [KCPL's high A&G costs], which is why the Commission should investigate the Company's cost structure through a detailed management audit" (Ex. 502, p.3). "There is no downside to this recommendation and there may be significant savings available that could mitigate future rate increases" (*Id.*).

KCPL's resistance to a management audit is not only detrimental to customers, but is also detrimental to KCPL's shareholders. Savings that would result from a management audit would "completely inure to the benefit of the utility shareholders until such time as another rate case is initiated and rates are rebased" (Ex. 501, p.12). It is unlikely that, without a management audit, KCPL will seek to reduce costs since "KCPL takes no responsibility with any earnings shortfall, simply concluding that the lower earnings are from high costs that KCPL cannot control and an inability to get adequate and timely rate recovery" (Ex. 212, p.36.). A management audit will help provide a fresh perspective and help KCPL see cost savings that overconfidence in its management abilities prevents KCPL from seeing.

This request for a management audit, proposed by the customers that pay virtually all costs caused by KCPL's management decisions, is not an extraordinary solution. The Commission has ordered companies to undergo management audits many times before, including Aquila, Inc. which KCPL purchased. *In the Matter of a Management Audit of Aquila, Inc., d/b/a Aquila Networks-MPS and Aquila Networks-L&P*, Case No. EO-2006-0356.[5] Management audits have in the past been useful in reducing costs, and the facts of this case support a Commission order directing KCPL to undergo an independent management audit.

9. Electric Vehicle Charging Stations (Clean Charge Network)

KCPL absurdly characterized the electric vehicle (EV) charging station proposal as a "pilot of limited size and scope" but the $20 million price tag and the 1,000 station proposal suggests that this, instead, is a full-scale rollout of one of the largest utility-owned EV charging station networks in the United States. KCPL's brief, and its lack of citation to facts in the record

[5] For additional examples of management audits, see Case Nos. GO-2001-249; WO-93-194; WR-95-205; SR-95-206; ER-90-101; EO-84-73; ER-83-163; EO-82-171; GO-82-110;18,596; ER-77-118; and 18,281.

that support KCPL's proposal, underscores how KCPL has not satisfied its burden of proving that EV charging station costs should be subsidized by KCPL's residential and business customers. KCPL's brief includes bullet points of the "public benefits" of the pilot project, but KCPL does not cite to any facts in the record to support those claims (KCPL Brief, pp. 125-126).

KCPL's *entire* case-in-chief, appearing in late-filed supplemental direct testimony, consists of a scant 6-page testimony from KCPL witness Darren Ives, and 286 pages of attachments that consist primarily of a lengthy report studying electric vehicles in the State of California (Ex. 119). Mr. Ives' testimony does not incorporate the attachments into his written testimony in any detail, nor did he explain how a California study is comparable to Missouri. To the contrary, Staff witness Mr. Byron Murray testified that comparing Missouri and California is an "apples to oranges" comparison (Tr. 690). Even a KCPL witness, Mr. Rush, when testifying on a California study involving low-income usage, downplayed the value of a California study simply because "it's California" and not Missouri (Tr. 410). No attempt has been made to explain how the data in the California study in Mr. Ives' testimony should be used to determine whether KCPL's customers should subsidize this service.

KCPL's brief also makes unsupported conclusions about the program that contradict earlier statements from the company. In its brief, KCPL argues that "all customers will benefit from this investment" (KCPL Brief, p.126). However, when KCPL first brought this proposal in February, KCPL repeatedly referred to such benefits as a "possibility" that "may" happen, and KCPL made clear that it has not performed a cost/benefit analysis (EFIS No. 98). KCPL further highlighted the premature nature of the proposal when it stated that the "pilot can be implemented without the need to address or resolve broader general regulatory and public policy issues attendant to pervasive and permanent utility-scale deployment of electric vehicle charging

stations in this rate case" and that "broader general regulatory and public policy issues should be addressed in the generic docket KCPL has proposed" (*Id.*). Here, KCPL admits that broader regulatory and policy issues must be addressed, which is a glaring recognition by KCPL that this proposal is too unstudied and prematurely implemented to make the mistake of forcing KCPL's customers to pay for KCPL's gamble.

KCPL's witness on this issue, Mr. Darren Ives, Vice President of Regulatory Affairs, testified that there are five (5) benefits of the EV charging station proposal, but when questioned on each alleged benefit, it became clear that KCPL has not conducted any meaningful analysis of its proposal, nor has KCPL provided any factual support for its alleged benefits. Mr. Ives testified as follows:

- KCPL has not estimated the annual kilowatt hour sales it expects to see (Tr. 578).
- KCPL has not conducted any study seeking to determine the daily recharge schedule for electric vehicle use in KCPL's territory (Tr. 579).
- KCPL cannot quantify the potential impact on the air quality in the Kansas City area (Tr. 580).
- KCPL has not provided an estimate of the number of jobs that will be created in the service territory (Tr. 582).
- KCPL has not estimated the gross savings that will accrue to electric vehicle owners in the company's service territory (*Id.*).

These are all areas where KCPL claims benefits for the public generally, but when KCPL is questioned on each claim it becomes clear each claim is entirely unsupported. KCPL asserts that these are uncertainties to be watched during the pilot period, but according to Dr. Dismukes, the existence of uncertainties associated with the program is no "justification for not having that cost benefit analysis, because it's very difficult, from a regulatory perspective, to go in and figure out

whether this is going to be used and useful or prudently incurred if you have no baseline upon which to compare it to" (Tr. 656).

Requiring KCPL's customers that do not own electric vehicles - that cannot *afford* electric vehicles – to subsidize the provision of this service for those that can afford an electric vehicle, would violate state law because requiring existing customers to subsidize this service for the benefit of the small number of electric vehicle owners (many of which may not even be KCPL customers) would be "unjust, unreasonable, unjustly discriminatory or unduly preferential." § 393.140, RSMo. For these reasons and those stated in Public Counsel's initial brief (pp.63-66), the Commission should reject KCPL's efforts to recover these costs in rates, and instead, open a working docket where all issues involving this pilot program can be studied.

10. Rate Design: Residential Customer Charge

The last issue to be addressed in this reply brief is KCPL's proposal to increase the monthly residential customer charge from $9.00 to $25.00. KCPL's brief argues that a $25 customer charge "would recover the customer-related and local distribution facilities costs of the residential class which are fixed and unrelated to the amount of energy used by the customer" (KCPL Brief, p.136). To support KCPL's claims of what constitutes "fixed" costs, KCPL cites to the testimony of KCPL's witness Mr. Tim Rush, a career KCPL employee with an MBA from Northwest Missouri State University (Ex. 134, p.1). Refuting Mr. Rush's assertions on cost causation is Public Counsel's witness Dr. David Dismukes, a full Professor, Executive Director, and Director of Policy Analysis at the Center for Energy Studies, Louisiana State University, with a PhD in Economics from Florida State University, and Masters of Science degrees in Economics and International Affairs, also from Florida State University (Ex. 303, p.1).

KCPL's proposed customer charge, and Mr. Rush's characterization that all distribution costs are "fixed," indicate a severe misunderstanding, or intentional misstatement, of how costs are incurred by an electric utility. Dr. Dismukes explained that there are three categories of costs, categories which every party in this case, including KCPL, recognized in their class cost of service studies:

- "**Demand-related costs** are associated with meeting maximum electricity demands. Electric substations and line transformers are designed, in part, to meet the maximum customer demand requirements. The most common demand allocation factors used in a CCOSS are those related to system coincident peaks ("CP") or non-coincident customer class peaks ("NCP") (*Id.*, p.5).

- "**Energy-related costs** are defined as those that tend to change with the amount of electricity sold and can be thought of as volumetric-related costs" (*Id.*).

- "**Customer-related costs** are those associated with connecting customers to the distribution system, metering household or business usage, and performing a variety of other customer support functions" (*Id.*, p.6).

KCPL's definition of "costs" is a combination of both customer and demand-related expenses, as opposed to those that are simply customer-related alone" (*Id.*, p.18). KCPL is not seeking to recover demand costs from industrial customers through a flat customer charge because industrial customers have demand-metering capabilities, meaning they use special meters that determine the customer's demand costs through a per kWh charge (*Id.*). Demand meters recognize that demand costs are tied to usage. Residential customers, however, do not have demand metering capabilities on their meters; demand-related costs attributed to residential customers are recovered through a per-kWh-of-usage rate (*Id.*, p.21). The problem with KCPL's proposal to recover all residential demand costs through a flat fixed charge, as explained by Dr.

Dismukes, is that it relies upon the incorrect assumption that all residential customers have the same level of demand:

> The Company's proposal to collect the local facilities demand distribution component as a fixed monthly customer charge assumes all residential customers have the same level of demand, which is an incorrect assumption. Therefore, it fails to collect costs in the manner in which they are incurred. Usage is more closely related to what causes demand-related costs to be incurred than the mere existence of a customer.

(Id.). An example provided by the Staff witness, Ms. Robin Kliethermes, is the cost for transformers (Tr. 453-454). Mr. Kliethermes testified that transformers should be removed from the customer charge because the cost is determined by demand – the larger the customer's demand, the larger the transformer and the higher the expense (*Id.*). Keeping demand cost recovery in KCPL's kWh-per-hour charge best apportions these costs fairly and in a manner that assigns those costs to the cost causer.

KCPL's incorrect assumptions on how demand costs are incurred, that is, costs that vary with the level of demand and are not "fixed" costs, would have a harmful impact on low-income customers and customers on fixed incomes, like retirees (Ex. 305, pp. 9-10). "Fixed income households that use less-than-average electricity could … end up paying a higher share of their fixed income on electricity than if they were assessed electric bills that collected a greater portion of the total charge through the volumetric charge, which would also give these customers greater flexibility to control their total bill" (*Id.*). These impacts, caused by shifting cost responsibility to the smallest users, are not supported by how costs are incurred, nor are they in the public interest.

KCPL points to the fact that Staff and Public Counsel have both calculated the customer-related costs to be $11.88/month per customer, and argues that "no record evidence justifies

retaining KCPL's current residential customer charge of $9/month" (KCPL Brief, p.138). KCPL's simplistic approach at setting a customer charge overlooks substantial evidence from Dr. Dismukes and even Mr. Rush that supports a $9/month customer charge. Dr. Dismukes explained, "the 'fixed charge equals fixed cost' dogma gets repeated so often that it can drown out meaningful discussions about other equally important considerations in setting rates in imperfect markets" (Ex. 303, p.16). "When designing rates a number of ratemaking objectives must be considered such as gradualism, rate continuity, and policy considerations" (*Id*., p.20). Mr. Rush also identifies "gradualism" as a consideration (Ex.134, p.60).

Other policy considerations when designing rates, which Mr. Rush himself characterized as "critical considerations," include such goals as to "minimize customer dissatisfaction" (*Id.*). Based upon the customer comments, customers would overwhelmingly be dissatisfied with an increase to the customer charge.[6] A related goal identified by J.C. Bonbright in his book *Principles of Public Utility Rates*, cited by KCPL's witness, is that a particular rate design must meet a "public acceptability" goal (Tr. 376, Ex. 134, p.60). This is different than simply minimizing dissatisfaction, as KCPL states as a goal, and instead implies that the public accepts the change. Given the public's opposition to redesigning rates by increasing the customer charge, an increase would not meet this important goal.

It is quite possible that the public opposition to this specific proposal would have been even stronger had the public been notified of KCPL's proposal to raise the customer charge from $9/month to $25/month. The notice sent to customers did not mention this proposed change, and only mentioned the overall average $14/month increase caused by the requested increase in the

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[6] *See* Tr. Vol. 3, pp. 8, 39, 40, and 43; Tr. Vol. 6, pp. 27 and 38; Tr. Vol. 7, pp. 6, 9, 13, 21, 45 and 53; Tr. Vol. 8, pp. 32 and 37; and Attachment to Public Counsel's Amended Initial Brief (EFIS-filed customer comments), pp.3-6, 21, 28-36, 47-50, 65-68, 80-83, 85-88, 90, 168-171, 185-193, and 195-198.

cost of service (Proposed Procedural Schedule, p.5, EFIS No. 63). The notice did not explain the proposed $16/month increase to the customer charge, which would create a compounded increase on top of the $14/month that hits low-usage customers the hardest (*Id.*). Even Mr. Rush found such an increase to be a problem when he testified, “if a customer were having to pay 20 or 30 dollars a month more for the same service and their bill were $20 initially, I'd probably have a concern, you know, if they were having a 100 percent rate increase” (Tr. 384). Yet, for many low-use customers this is exactly what KCPL proposes.

When questioned on cross-examination about public acceptability, Mr. Rush testified that this Bonbright goal would be met once the public realized that a $25 customer charge was the new rate (Tr. 379). Mr. Rush explained his version of public acceptability:

> “Once they get beyond the point of accepting -- or seeing that their service charge is now $25 and the willingness to understand that on a consistent basis, that's what it's going to be, that they would become accepting of that's the fact of what it costs for that business.”

(Tr. 379). In other words, to KCPL, public acceptability is bludgeoning the customer into either accepting the rate change or leaving the system. To Mr. Rush and KCPL, public acceptability occurs when the customer realizes, “If I want electricity at this place, this is what it's going to cost” (*Id.*). This is a severe misunderstanding of the concept of public acceptability and should give the Commission substantial concern.

Mr. Rush also identified impacts on energy efficiency and demand response programs as critical considerations (*Id.*). But during the evidentiary hearing, Mr. Rush testified that increasing the customer charge reduces the customer's ability to realize savings from energy efficiency (Tr. 374-375). He also testified that the reverse is true – lower customer charges increase a customer’s ability to see savings from energy efficiency (Tr. 375). Sierra Club

witness, Mr. Tim Woolf, concurred when he testified, "A $9 customer charge would … provide much more incentive for efficiency than a higher customer charge" (Tr. 428). Increasing the customer charge is not in the public interest.

And as the Commission held just recently in the Ameren Missouri rate case, residential customers should have as much control over the amount of their bills as possible so that they can reduce their monthly expenses by using less power, either for economic reasons or because of a general desire to conserve energy" (Report and Order, Case No. ER-2014-0258, pp. 76-77). Contrary to KCPL's argument in its brief, the overwhelming weight of the evidence supports no change to the customer charge.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all counsel of record this 3rd day of August 2015.

/s/ Marc Poston