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-2012-0174**
In the Matter of KCP&L Greater Missouri Operations Company's Request for Authority to Implement a General Rate Increase for Electric Service.	))))	**Case No. ER-2012-0175**

POST-HEARING REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

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I. INTRODUCTION

This brief will address the same issues addressed in Public Counsel's Initial Brief as identified in the List of Issues:

1. Rate Design/Class Cost of Service Study
2. Resource Planning—La Cygne and Montrose
3. Cost of Capital (including Regulatory Policy and Economic Considerations)

II. RATE DESIGN/CLASS COST OF SERVICE STUDY

No party supported increases to customer charges in their initial briefs, so this brief will not address that issue. The only party that substantively addressed the inter-class revenue shift proposed in the non-unanimous stipulation and agreement in Case No. ER-2012-0174 is the Midwest Energy Consumers Group (MECG). While a number of parties mention the agreement and their support for it, only the MECG addresses the substance of the agreement and possible evidentiary bases for the Commission to adopt it. This brief will address the arguments raised by the MECG in support of the nonunanimous stipulation and agreement.

The Commission should not add to the burden on residential customers from the rate increase granted in this case by inflicting an additional 1% revenue-neutral increase upon them as the non-unanimous stipulation and agreement contemplates. The evidence does not support it and it would be bad policy.

MECG first raises the irrelevant fact that the Commission, in the organizational structure of Missouri state government, is within the Department of Economic Development. MECG does not cite a single statute, rule, executive order or any authority of any kind to support its argument that the Commission simply being within the Department of Economic Development means that

the Commission should raise rates on residential customers disproportionally with respect to the rates of other classes. There is no rational reason to do so.

The Commission's position in state government (and Public Counsel's as well) within the Department of Economic Development is simply a historical anachronism. The Department of Economic Development used to be the Department of Consumer Affairs, Regulatory and Licensing (affectionately known as CARL). When the department was renamed to reflect the focus of many of its divisions, the mission of the Public Service Commission did not change any more than did the mission of the Public Counsel. The Public Service Commission is still there to protect the interests of utility customers – all utility customers – from the inherent risks of state-sanctioned monopoly service providers. Without a statutory change, which has not happened, that role cannot and has not changed.

MECG next compares the rate of increase of KCPL's commercial and industrial rates during the course of KCPL's Regulatory Plan to the national average increases to commercial and industrial rates over that period. This is a wholly irrelevant point. The increases granted during the course of KCPL's regulatory plan affected residential customers **more than** commercial and industrial customers, and all of the increases to all of the classes were found by the Commission to be just and reasonable based upon the evidence submitted to it. Indeed many of those increases were granted pursuant to stipulations and agreements to which many commercial and industrial customers were signatories. Those decisions are not now subject to collateral attack, which is essentially what MECG is attempting to do here.

Moreover, MECG's sole citation to the record in this case (Exhibit 258, Staff Cost of Service Report, pages 17-19) actually shows that residential rates for KCPL customers have **increased more** during the Regulatory Plan than the rates for either commercial or industrial

customers. The table on page 17 of the Staff Cost of Service Report for KCPL residential customers shows that residential rates increased from 6.88 to 9.90, so that residential rates are now 1.43 times higher than they were in 2005.[1] Similar calculations for commercial and industrial rates show increases of 1.39 times and 1.37 times, respectively. Alternatively, a percentage increase can be calculated by taking the 2011 rate minus the 2005 rate and dividing by the 2005 rate. This calculation shows that residential rates have increased by 43.9%, while commercial rates have only increased by 39.0%, and industrial rates have only increased by 37.8%. Using either calculation shows that KCPL residential rates have recently been rising more steeply than either commercial or industrial rates. Imposing a relatively higher increase on residential customers in this case would only exacerbate the disproportionate increases that residential customers have already received. Enough is enough.

MECG next (at page 54) criticizes Public Counsel, Consumers Council of Missouri and AARP for not providing their own class cost of service study (CCOSS). There is no validity to this criticism. Public Counsel suggests that the identity of the party submitting (or not submitting) a CCOSS is relevant in only one respect: whether the party submitting it has a particular interest to advance. If the Commission finds that some or all of the CCOSSs in the record are reliable, sufficient and unbiased, then it does not matter which party prepared them. If the Commission finds that none of the CCOSSs are sufficient, reliable, and unbiased, then the Commission cannot impose a disproportionate rate increase on a particular class and must treat all classes equally; which is exactly what Public Counsel, Consumers Council and AARP advocate.

[1] Rates are all in cents per KWh. The increase is simply calculated by dividing the 2011 rate by the 2005 rate.

Similarly, the fact that three out of four[2] CCOSSs submitted indicate that residential customers should suffer a relatively higher increase in this case (as MECG points out at page 55) is only relevant if the Commission finds the five to be sufficient, reliable, and unbiased **and** finds the sixth (the KCPL CCOSS) to be insufficient, unreliable or biased. Of these four, only two are from parties that do not have a specific interest to advance: KCPL and Staff. Both of those parties used the Base, Intermediate and Peak (BIP) method to allocate production plant.

MECG asserts at pages 56-57 that Public Counsel expressly disavows the methods and allocations by which KCPL conducted its study, but that is not the case. Public Counsel simply did not have the resources to conduct its own study or to re-conduct KCPL's. As a result, Public Counsel was not able to fully endorse each and every detail of the KCPL study. Not fully endorsing is very different from "expressly disavowing." If Public Counsel expressly disavowed the KCPL methods and allocations, then Public Counsel would not be able to argue that the Commission should rely on it. While KCPL's CCOSS is not exactly what Public Counsel would have done, it is sound, and so Public Counsel chose not to spend scarce resources to produce another CCOSS that likely would have had similar results.

At pages 57 to 59, MECG raises three points that allegedly undermine KCPL's Base, Intermediate and Peak allocation method. At the outset, the Commission should realize (although MECG does not say so) that these criticisms apply equally to Staff's CCOSS, which also relied upon the BIP method. If it accepts MECG's criticisms of the BIP method with respect to KCPL's CCOSS, then the Commission must also accept them with respect to Staff's. If the Commission rejects the studies that relied on the BIP method, it will have eliminated the only

[2] The MECG refers to "six out of seven studies" at page 55. There are really only four: 1) KCPL; 2) Staff; 3) DOE; and 4) the Industrials. The Industrials simply submitted three variations of their study.

two CCOSSs from parties without a clear interest in the outcome of revenue shifts. But there is no reason to do so, because the three reasons that the MECG advances to reject them are groundless.

First, KCPL does not undercut its own study as MECG asserts at page 57. The cited portion of KCPL witness Rush's testimony (Exhibit 42, Rush Rebuttal, page 4) simply points out that **none** of the various methods for allocating production plant are inherently superior, but witness Johnstone's testimony is even worse. Mr. Johnstone's testimony is hearsay, and appears to disclose privileged and confidential statements made at a settlement conference. Rather than rely on this particular piece of testimony, the Commission should strike it from the record.

Second, MECG argues that the fact that KCPL decided to join in the nonunanimous stipulation and agreement means that KCPL no longer relies on its CCOSS. Besides being pure speculation and probably inaccurate, extending that reasoning to the other signatories to the nonunanimous stipulation and agreement would mean that they all have abandoned their CCOSSs. KCPL's signing on to the nonunanimous stipulation and agreement in this case is no different than any party in any case signing on to an agreement: there are always many factors in the decision to agree, and reaching agreement does not mean repudiation of a party's prior position.

MECG's third and final argument is that this Commission should adopt the Industrial's Average and Excess method because a different group of Commissioners, in a different case with a different record, concerning a different utility accepted that method. As an introduction to its main argument on this third point, MECG suggests that regulation is like the TV show Survivor. It argues that, since the BIP method has never been very popular among utility commissions, that this Commission should reject it for that reason alone. But the MECG fails to point out any

instances in which the Missouri Public Service Commission has considered the BIP among other methods, as it will in this case, and rejected the BIP method. In fact, it does not appear that the Missouri Commission has issued an order in a contested case in which it either accepted or rejected the BIP method.

But the current situation in which the Industrials' Average and Excess is pitted against an allocation method that is not as widely accepted is certainly not unique in Missouri. Industrial customers have been pitching variants of the Average and Excess method for a long time. For many years, the Missouri Commission rejected the Average and Excess method.

> Industrials' proposal to use the average and excess method is not reasonable because it is based upon a coincidental peak causation of production costs. Staff's method of calculating base period and peak period allocations is consistent with the TOU method and is reasonable.[3]

Simply because the Commission – in the one case cited by MECG on page 59 – accepted the Average and Excess method, does not mean that the Average and Excess method is to be used in every case regardless of circumstances. In this case, only industrial customers filed CCOSSs using the Average and Excess method. There is no reason for the Commission to find the testimony of the witnesses supporting the Industrials' CCOSS using the Average and Excess method to be more reliable and unbiased than the testimony of Staff and KCPL witnesses who supported the BIP method.

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[3] *In the Matter of the Determination of In-service Criteria for Union Electric Company's Callaway Nuclear Plant and Callaway Rate Base and Related Issues; In the Matter of Union Electric Company of St. Louis, Missouri, for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company;* Case Nos. EO-85-17 and ER-85-160; REPORT AND ORDER ON REMAND, issued December 7, 1988.

III. RESOURCE PLANNING

The Commission should take minimal proactive steps now in order to protect its ability to properly analyze the La Cygne and Montrose investments in the next rate case. No party opposes this simple proposition. KCPL and Staff argue that those steps need not be taken in this rate case, and Public Counsel does not necessarily disagree. But KCPL raised the issue of the investments it plans to make at these two facilities, and the Commission should order that a new case be created to examine the planning process to date, to create a consensus about the documentation necessary to evaluate KCPL's decisions, and the documentation necessary to review the implementation of those decisions. Without a clear order from the Commission now, there is a very real risk that the Commission will be faced with discovery disputes and a muddled record like the Iatan II case. It is in no party's interest to fail to adequately create and preserve a good record about the decisional and implementational prudence of KCPL's actions regarding La Cygne and Montrose. KCPL's only argument against creating an investigation case is a vague assertion that everything will be considered in its Integrated Resource Planning filings. Given the fact that the Commission – and the ratepayers it protects – will be facing the rate impact of hundreds of millions of dollars of investments in the very near future, it would be foolish not to make every effort to create and preserve the necessary data to evaluate the prudence of those investments.

IV. COST OF CAPITAL

This brief will address the two contested aspects of determining an appropriate rate of return in this case: return on equity; and capital structure.

Return on Equity

The evidence shows that the Commission should recognize an acceptable range for return on common equity (ROE) of 9.10% to 9.50% as presented by Public Counsel witness Mr. Gorman. (Exhibits 300 and 307, Gorman Direct Testimonies; Transcript, page 536) The evidence also shows that once the Commission has determined an acceptable range for return on common equity, it is just and reasonable for the Commission to authorize the low end of that range to promote affordability for customers.

The Companies' recommendation does not reflect the market realities today. In their Initial Brief (at pages 22-23), the Companies try to fault Mr. Gorman's analysis by saying: "Mr. Gorman's response to Dr. Hadaway's criticism is to reject any reliance upon historical data." However, it seems despite all the evidence to the contrary, the Companies are stuck in the good old days when growth rates were high, capital markets were high, bond yields were high and utility returns were also correspondingly high. But, that is not the reality of today. According to the Regulatory Research Associates, the first quarter average ROE was 10.84% (which included five cases in Virginia which had abnormally high ROE awards); in the second quarter the average ROE had declined to 9.92%; and in the third quarter average ROE had declined even more to 9.78%. (Exhibit 313; Transcript, page 423) Even the recommended ROE by the Company has gone down between the time the direct case was filed and today. (Transcript, page 421) What is relevant in this case is what the current market cost of equity is for the Companies. The Commission cannot look only to the past and ignore the present reality in setting just and reasonable rates.

Additionally, in their Initial Brief (at page 14), the Companies would have the Commission believe that the lower end of reasonable range of return on equity is somehow a

"drastic outcome" to be avoided by the Commission. The rule set out by the U.S. Supreme Court is not one party's biased opinion of a ROE being somehow drastic or on the edge of confiscatory but that a reasonable return on equity, as developed by in the *Bluefield* and *Hope*[4] cases, is: (1) adequate to attract capital at reasonable terms, thereby enabling KCPL and KCPL-GMO to provide safe and reliable electric service; (2) sufficient to ensure the Companies' financial integrity; and (3) commensurate with returns on investments in enterprises having corresponding risks. A ROE range that meets the requirements of *Bluefield* and *Hope* would be reasonable throughout that range.

In their Initial Brief (at page 18), the Companies state: "Given Sections 393.130.1 and 393.150.2 and other passages of the Public Service Commission Law that authorize "just and reasonable" rates, it is perfectly reasonable for the Commission to adopt a rate of return at the upper end of the zone of reasonableness." Public Counsel would point out that it is just as reasonable for the Commission to adopt a rate of return at the lower end of the zone of reasonableness. Once a reasonable range has been established by the Commission, specific issues such as affordability of the rates that would result or lowered risk for the utility due to trackers and other financial mechanisms should guide the Commission in its determination of where the ultimate return should be established. Therefore, Public Counsel asks that once the Commission has determined a just and reasonable ROE range, it should order the low end of the range in this case to promote affordability for KCPL and KCPL-GMO customers.

[4] *Bluefield Waterworks and Improvement Co. v. Public Service Commission of West Virginia, 262 U.S. 679 (1923); Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944).

Capital Structure

In their Initial Brief (at page 39), the Companies state: "Mr. Bryant explained that the Companies' plan was to refinance their short-term debt next year. Because a GPE $250 million debt issuance matures in 2013, he stated that the plan is to combine all of the short-term debt and to refinance it with a longer-term issue that would attract a bigger market, likely resulting in a lower interest rate and, therefore, lower utility debt costs." However, all the Companies have to report to the Commission at this time is a "plan." A plan may happen or it may not. The Commission will not know until the next rate case. The reality is that at the time of true-up, there was a significant amount of short-term debt that was not included in the Companies' proposed capital structure. This erroneously causes the amount of equity to exceed the amount of debt. The result will be an unnecessary and unjustified increase in the revenue deficiency and the customers will be forced to pay higher rates than are just and reasonable. Therefore, Public Counsel asks the Commission to use a hypothetical capital structure (50% debt/50% equity) in this case rather than GPE's projected actual capital structure at the end of August 2012.

WHEREFORE, Public Counsel respectfully offers this Post-hearing Reply Brief and prays that the Commission conform its decision in this case to the arguments contained herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all parties of record this 11th day of December 2012.

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