2012.03.14 14:52:24
Kansas Corporation Commission
/S/ Patrice Petersen-Klein

Received
on
MAR 14 2012
by
State Corporation Commission
of Kansas

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Joint Application of Westar Energy, Inc. and Kansas Gas and Electric Company for Approval to Make Certain Changes in Their Charges for Electric Service.	)))))	Docket No. 12-WSEE-112-RTS

POST-HEARING BRIEF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

March 14, 2012

Table of Contents

POST-HEARING BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD

I. Westar Energy's application

On August 25, 2011, Westar Energy, Inc. and Kansas Gas and Electric Company (Westar or company) filed a Joint Application seeking an order from the Kansas Corporation Commission (KCC or Commission) to make changes to Westar's charges for electric service. The company requested a rate increase of $90.8 million. The company also requested that the Commission modify the company's depreciation rates in accordance with the results of its depreciation study, and also requested the Commission allow Westar to maintain its Environmental Cost Recovery Rider as a line-item surcharge, rather than embedding the costs in base rates.

II. The stipulation and agreement

CURB opposes approval of the Stipulation and Agreement reached by Westar with the KCC Staff, Kroger, Unified School District No. 259, the Kansas Association of School Boards, the U.S. Department of Defense, the Kansas Industrial Consumers, Tyson Foods and Wal-Mart. The reason is simple: the settlement will not achieve just and reasonable rates, and does not protect the public interest in being protected from unnecessarily high rates.

Under the specified terms of the settlement, Westar will receive a rate increase of $50 million, with an authorized return of equity of 10% for purposes of calculating the return on items that Westar recovers through line-item surcharges like its Environmental Cost Recovery Rider (ECRR). The costs being recovered through the ECRR would not be rolled back into base rates. Westar agrees under the settlement to utilize Staff's depreciation study and adopt a five-year amortization for pension deferrals. Westar agreed to remove the restricted share unit (RSU) and executive bonus plan from rates as Staff had recommended, and to implement the less-aggressive vegetation management plan that Westar had presented as an alternative to its system-wide plan. Westar also agreed to forego its adjustment to include 2012 costs of its SCR catalyst costs in rates. If one looks solely at the dollar values of the specified terms of the settlement, Westar appears to have made a very good deal. As counsel for CURB pointed out at the evidentiary hearing, if you deduct the value of various terms that Westar agreed to from its requested $90.8 million request, the revenue increase under the settlement should have been about $43 million. Since Westar's requested increase assumed that costs in the ECRR would **not** be rolled back into rates, CURB's calculations are based on the same assumption:

Westar's requested revenue increase	+$90.8 million
ROE at 10%	-$16.3 million
Staff's Depreciation	-$13.2 million
Pension deferral- 5 yr. amort.	- $ 4.7 million
RSU/executive comp.	-$4.2 million
Vegetation Mgmt (alt. plan)	-$9.1 million
SCR catalyst	-$0.3 million
TOTAL	$43 million

(Exh. CURB 1). From CURB's point of view, that isn't going far enough, however. If one assesses the settlement in terms of how satisfactory the result is versus how satisfactory it might have been had the parties litigated, CURB believes the increase would have been somewhere around $22.5 million or less.

CURB reached this conclusion in assessing the chances of which positions would prevail if the parties had litigated this case. CURB believes all of the provisions of the settlement would have been adopted by the Commission, anyway, except the Commission would also likely have adopted an ROE no higher than Staff's recommended mid-range ROE of 9.5% (-$30.3 million). CURB also believes that it's likely that the Commission would have adopted CURB's adjustment on short-term incentive compensation and supplemental retirement plans (-$5.3 million), as well as CURB's adjustment to allocate the gain on the sale of #6 fuel oil to Westar's customers (-$1.5 million). If this assessment is correct, the resulting revenue requirement increase would have been about $22.2 million. CURB also believes that the Commission will continue to require that the ECRR costs are rolled back into base rates with every rate case. [1]

Here are the adjustments that CURB assumes would prevail:

Westar's requested revenue increase	+$90.8 million
Staff's Depreciation	-$13.2 million
Pension deferral- 5 yr. amort.	- $ 4.7 million
RSU/executive comp.	-$ 4.2 million
Vegetation Mgmt (alt. plan)	-$ 9.1 million
SCR catalyst	-$ 0.3 million
SUBTOTAL	$ 59.3 million
ROE at Staff's 9.5%	-$30.3 million
STIC and Suppl. Retirement	- $ 5.3 million
Gain on sale of fuel oil	-$ 1.5 million
TOTAL	+ $22.2 million

(Exh. CURB 1; Please note that the Power Point slide in CURB 1 illustrating this set of adjustments erroneously omitted the SCR catalyst adjustment in this calculation, resulting in a total of $22.5 million for the rate increase, not $22.2 million; this table corrects the error).

1 NOTE: Assuming that the Commission will continue to require that the ECRR costs are rolled back into base rates with every rate case, those costs would be added to the $22.5 million according to the adjustments that CURB witness Andrea Crane made in her Direct Testimony, and the ECRR would be emptied out except for a small amount of true-up costs. *See* Crane, Dir. T., Schedules ACC-10 and ACC-30. An interest synchronization adjustment would also be necessary. See *id.,* at ACC-31.

Given this assessment, CURB can only conclude that the outcome of this case should be an increase somewhere in the range of $22.2 million—or less, if other adjustments proposed by CURB are adopted. Even if they are not, the settlement should have been, at most, for a $43 million increase—not the $50 million agreed to in the settlement. Therefore, CURB opposes the settlement on the grounds that it will establish unreasonable rates and fail to protect the public interest from unnecessarily high prices. The Commission should not approve the settlement as it is, although there are provisions within the settlement that CURB supports CURB's recommendations to the Commission on how to resolve this case fairly and reasonably are below. CURB has also included arguments for its filed positions, in the event that the Commission rejects the settlement.

III. What is the "public interest"?

The Commission asked the parties in this docket about the public interest. The "public interest", quite simply, is what the Commission says it is. "It has been held that '(r)ules adopted by the State Corporation Commission to assist it **to define the public interest** and to serve the citizens of the state by prescribing orderly practice and procedure relating to all proceedings before it, carry out the policy declared by the Legislature, and have the force and effect of law'." *Gas Service Co. v. State Corporation Comm'n,* 6 Kan.App.2d 592, 596-97 (1981), citing *Cities Service Gas Co. v. State Corporation Comm'n,* 201 Kan. 223, Syl. ¶1 (1968) (emphasis added).

In the context of deciding whether criminal investigation documents should be disclosed to the public under the guidelines of the Kansas Open Records Act, the Kansas Supreme Court upheld the trial court's determination that the "public interest" in disclosure meant more than just "public curiosity" about the matter to be disclosed. *Harris Enterprises, Inc. v. Moore*, 241 Kan. 59, 66

(1987). The trial court held that "to be a matter involving public interest, it must be a matter which affects a right or expectancy of the community at large and must derive meaning within the legislative purpose embodied in the statute." *Id.* The Kansas Supreme Court agreed that the trial court had accurately defined "public interest" in the process of deciding not to release the particular documents at issue. *Id.* Although the news organization seeking disclosure had established there was a "definable public interest" in investigating controversies arising from the actions of public officials during the criminal investigation, the trial court exercised its discretion to make an *in camera* inspection of the documents, and found "no factual information which would promote the public interest" that would compel disclosure. *Id.*, at 66-67. The Kansas Supreme Court upheld the trial court's decision not to release the documents to the public. *Id.*, at 67.

When these two cases are considered together, it is clear that the "public interest" is a broader interest than that of the particular interests of the parties to a controversy, and that determining the public interest is a balancing process conducted by a decision maker in the context of the particular laws that apply and the circumstances under which the law is being applied. In ratemaking, the Commission is obliged by law to balance the interests of the utility and its customers, the interests of present ratepayers and future ratepayers, and to consider the public interest. *Kansas Gas and Electric Co. v. Kansas Corporation Comm'n*, 239 Kan. 483, 488, 720 P.2d 1063 (1986). While a compromise position between the extremes of the parties' positions may be supported by the evidence—and thus be upheld on review as fair, just and reasonable, within the zone of reasonableness, etc.—consideration of the public interest in this balancing process may result in a decision that is *more* fair, *more* just and reasonable—and supported by substantial evidence. In other words, the exercise of determining "the public interest" is not simply a mathematical exercise of finding a reasonable midpoint between the positions of Party A and Party B, but an exercise of reaching a decision which the evidence supports as reasonable *and* serves the public interest. A compromise position might be reasonable in light of the evidence, but not reasonable in light of the public interest. By virtue of the broad discretion authorized by the legislature in Commission decision making, the Commission has the authority and the obligation to look beyond the hard, cold facts of positions A and B to consider the rights and expectations of the community at large and the potential impact of its decision on matters and on parties outside the hearing room.

IV. $22.2 million or less: The case for establishing just and reasonable rates

This section of CURB's brief discusses the decisions the Commission should make in this case, most of which were supported by the parties to the settlement. If the Commission adopts the decisions and adjustments discussed in this section, the rate increase for Westar would be approximately $22.2 million.

A. Establish a more reasonable return on equity than 10%.

1. Cost of capital summary

The most important question the Commission must answer in this case is what an appropriate rate of return is for Westar's shareholders based on current market conditions. CURB recommends a return on equity (ROE) of 8.85% and an overall rate of return of 7.54%. CURB's 8.85% ROE is based on the combined results of a Discounted Cash Flow model (DCF) and a Capital Asset Pricing Model (CAPM). While Westar has objected to Ms. Crane's use of the CAPM in this case, which will be addressed below, CURB believes the following facts are relevant to show that CURB's ROE recommendation is reasonable:

(1) CURB's 8.85% ROE is only 15 basis points below the lower end of Staff's 9.0% to 10.0% range of reasonable ROEs. If Staff, which positions itself as a "neutral party," believes that the Commission can legally and justifiably conclude that a 9.0% ROE for Westar is reasonable and appropriate, a mere 15 basis points below Staff's position does not make CURB's recommendation unreasonable or "off the charts."

(2) CURB, KCC Staff and USD 259 all arrived at DCF results between 9.50% and 9.73%.: Ms. Crane at 9.73%, Mr. Gorman at 9.50%, Mr. Gatewood at 9.50%.

(3) If you eliminate CURB's CAPM result and Mr. Gatewood's Internal Rate of Return (IRR) result, then CURB, Staff and USD 259 all independently would have come to a recommended ROE within 8 basis points: 9.65% to 9.73%. Three independently-developed results within 8 basis points is a strong indication that an ROE below 10% is warranted in this case.

(4) While Staff chose not to use its CAPM results, Mr. Gatewood calculated a CAPM at 7.50%. Mr. Gatewood acknowledged that if you add 100 basis points to the 30-year Treasury bond rate in his analysis to offset his concern about the Federal Reserve intervening in the market, his CAPM analysis would still only be 8.50%. If averaged with his DCF result, the CAPM results then have the effect of reducing his overall recommended range of reasonable ROE. (Tr., Gatewood at 402).

(5) When Mr. Gatewood was asked whether he still thinks 9.50% is a solid number, he replied "even more so than when I filed," indicating that Staff believes capital costs in the market have continued to decline. (Tr., Gatewood at 418).

(6) On March 1, 2012, after the close of the hearing, Westar issued $250 million of 30-year first mortgage bonds at a rate of 4.125%, approximately 250 basis points lower than Westar's embedded cost of debt. This is indisputable evidence that current capital costs are low, and this lower cost of debt supports lowering Westar's overall rate of return.

(7) The cost of capital in the market is lower than it was when the Commission granted Kansas City Power & Light an ROE of 10.0%. KCPL does not enjoy the same level of regulatory and legal mechanisms as Westar. These two facts combined dictate that a reasonable ROE for Westar must be lower than 10.0%.

2. Based on the evidence, the 10.0% ROE in the settlement is excessive and is cause alone for the Commission to not approve the settlement.

While the overall rate of return is not explicitly stated by the settlement agreement, it does explicitly state that the 10% ROE will be applied to the Environmental Cost Recovery Rider (ECRR) going forward. The 10.0% ROE will also be applied to the AFUDC account. If the Commission approves the settlement, it will be sending a clear message to consumers that even in these difficult economic times, Westar shareholders still warrant 10.0% profits. Westar and Staff suggest that the 10.0% ROE in the settlement is not that significant, but CURB believes it is quite significant to customers and it is not supported by the underlying evidence in this case.

Westar puts great weight on the *Bluefield* standard for determining the appropriate rate of return. Under *Bluefield*, "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties" *Bluefield Waterworks & Imp. Co. v. PSC*, 262 U.S. 679, 692, 43 S. Ct. 675 L. Ed. 1176 (1923). Under this rationale, the Commission should look to its recent decision in the Kansas City Power & Light (KCP&L) rate case to find a reasonable level of return on a business of corresponding risks and uncertainties. Recently, the Commission, upon consideration of the full record, determined that 10% was a fair ROE for KCP&L in its November 22, 2010, Order in KCC Docket No 10-KCPE-415-RTS.

However, *Bluefield* cannot be read to require the Commission to inquire only into the level of return that has been granted to a nearby utility and then simply stop the inquiry. The Commission should not stop there, but should also update the rate of return to reflect current conditions in the market. If capital costs are trending down, then analysts expect the decisions coming out of commissions to also trend down. (Tr., Gatewood, at 404; *id.*, Ruelle, at p. 78-79). In fact, to be bound by the decisions of other commissions, irrespective of market conditions, would lead to circularity issues. (Tr., Gatewood, at 404).

The evidence is clear that capital costs have continued to trend down since the Commission issued its decision in the KCP&L case. When Staff filed its testimony in the KCP&L rate case in June 2010, and when the Commission issued its Order in November 2010 that set KCP&L's ROE at 10.0%, the yield on BBB/Baa Public Utility Bonds was 6.0%. By November 2011, the yield on those bonds had dropped to below 5.0%. (Gatewood, Dir. T., at 7).

Additionally, in the KCP&L case, Staff recommended an ROE range from 9.2% to 10.2%, a range that included a CAPM result as well as a DCF result. The Commission did not go to the top of that range in determining a 10.0% ROE for KCP&L. Now, even without a CAPM component to lower the results of its analysis, Staff's DCF range is down to 9.0% to 10.0%. Since Staff's current recommendation is based on market costs, again it is clear that the cost of capital in the market is trending down.

The Commission must also recognize that KCP&L's risk profile is different than Westar's. KCP&L does not have an Environmental Cost Recovery Rider or a Transmission Cost Recovery Rider. For KCPL's business on the Missouri side, there is no statutory preapproval of ratemaking treatment for projects or recovery for Construction Work in Progress[2]. Westar has all of these regulatory and legal mechanisms that reduce shareholder risk and revenue uncertainty between rate cases. As a result, Westar clearly has a less risky revenue profile than KCP&L. Thus, if *Bluefield* requires the Commission to compare Westar to a similar business with corresponding risks and

---

2 K.S.A. 66-128

uncertainties, and 10.0% is an appropriate ROE for KCP&L given its risk profile, then something less than 10.0% is an appropriate cost of capital for Westar, given its revenue and risk profile and current market conditions.

Additionally, Mr. Gatewood and Mr. Gorman both arrived at similar ROE recommendations of 9.50% and 9.65%, respectively. Neither of these recommendations includes any results from the CAPM analysis each witness performed. If the Commission chooses to take into account each of these witnesses' CAPM results (Mr. Gatewood at 7.5% and Mr. Gorman at 8.6%), then both of these witnesses' ROE recommendations would be lower. By selectively ignoring their CAPM results, both Mr. Gatewood and Mr. Gorman are supporting overstated ROE recommendations.

At trial, Mr. Gatewood referenced a January 16, 2012, *Barron's* article in which Mr. Bill Gross, the Founder and Chief Investment Officer of the PIMCO bond fund, one of the largest bond funds in the world, states why he likes utilities as an investment. Mr. Gross stated, "They pay big dividends because they are continually granted a 10% return on equity by regulators in a world where returns are moving much lower". (CURB Exhibit 9, at 9). Note the phrasing: not simply "lower," but "much lower". While this is simply one man's opinion, it's a knowledgeable one. Mr. Gross makes a very successful living investing other people's money in the market for one of the largest bond funds in the world. His opinion is not one that the Commission should dismiss out of hand, especially when it corroborates all the other evidence in the case that capital markets do not currently support a 10.0% ROE. (*See*, Tr., Gatewood, at 433).

As further evidence of a lower capital market, Westar issued 30-year first mortgage bonds in early March at an interest rate of 4.125%. This is almost 250 basis points lower than the 6.65% embedded cost of debt on Westar's books and used in the analyses of Ms. Crane, Mr. Gatewood and

Mr. Gorman. If their analyses were updated, at minimum these new bonds at this new lower interest level would decrease each witness's recommended cost of debt and overall rate of return.

While Mr. Ruelle attempts to persuade that Commission that there will be all sorts of negative reactions in the market if the Commission sets an ROE below 10.0%, the Commission must not let this rhetoric dictate its decision. In the KCP&L rate case, the Commission stated,

There are the expected arguments about the possible negative reaction of rating agencies to a decision not to allow a return on equity commensurate with what the company insists is required to attract equity capital. But consistent with determinations of other regulators, this Commission is not in the business of attempting to predict financial markets or rating agency reactions, nor of calibrating our decisions to what the utilities say the markets or agencies want or expect. It is the obligation of the utility's management to satisfy market expectations; it is our obligation to balance the investor and the consumer interests."

(KCPL *Order*, at 39).

It is important to note that Ms. Crane's ROE recommendation is based on the same set of proxy companies that Westar uses in its analysis. Ms. Crane's DCF recommendation is based on some of the same growth rates that Westar uses in its model. Ms. Crane chose to eliminate what she believes to be overly-optimistic future earnings growth rates, but CURB's recommended growth rate of 5.5% in its DCF model is above the projected five-year growth rate in dividends and book value of Value Line. That is also higher than the actual historic growth rates for the past five years in dividends or book value, and higher than the average growth rates over the past ten years in earnings, dividends or book value. (Crane, Dir. T., at 15). CURB's DCF result is 9.73%. Ms. Crane's ROE also contains a CAPM result of 6.15%, as discussed below.

Ms. Crane's overall ROE recommendation of 8.85% is the result of weighting her DCF result at 75% and her CAPM result at 25%. Ms. Crane's recommendation is within 15 basis points of the low end of Staff's ROE recommendation. Mr. Gatewood recommended an ROE in the range of 9.0% to 10.0%. According to Mr. Gatewood, the Commission can legally and justifiably conclude that a 9.0% ROE for Westar is reasonable and appropriate. A finding by the Commission, based on the evidence in the record, that a 9.0% ROE is reasonable and appropriate is sufficient to meet all legal standards, including the *Bluefield* standard. A Commission decision at the low end of Staff's recommended range would favor Westar's customers. It is not a surprise that Ms. Crane's recommendation on behalf of the customers CURB represents is also near the low end of Staff's recommended range of reasonable ROE outcomes.

Contrary to Westar's protests, the Commission should rightfully consider customer impacts and the general economic environment when it sets an appropriate ROE. As the Commission stated in KCP&L,

> . . . ours is a balancing function, and we cannot take the consumers out of the equation. It is reasonable for regulators to consider the consumer's ability to pay when making the rate of return decision. Fairness is about a shared experience. Utilities do not escape the consequences of hard economic times. They share in the prosperity of good economic times, as previously allowed rates of return by this Commission demonstrate. It is during tough economic times when consideration of consumer interests is at its peak.

Id. Based on all the evidence cited above, the Commission must conclude that the 10% ROE in the settlement, and therefore the settlement itself, are not just, reasonable or supported by the evidence. CURB agrees with Mr. Gatewood when he says, "I don't see any indication that a return at some level below 10% causes any dire consequence or will raise capital cost to an electric utility." (Tr., Gatewood, at 414).

3. Including the results of the Capital Asset Pricing Model (CAPM) in determining an appropriate ROE is a reasonable and commonly-utilized approach.

Ms. Crane's recommended ROE of 8.85% is based on the results of a CAPM and DCF analysis. Ms. Crane weights her recommendation 75% based on the DCF result and 25% based on the CAPM result. Use of the CAPM is not outrageous or out of the norm. Ms. Crane has used the CAPM in every testimony for over a decade. (Tr., Crane, at 373) Mr. Gatewood has used it in most of his testimonies since the late 1990s. (Tr., Gatewood, at 392). Mr. Gatewood recognizes that most industry witnesses use the CAPM model, and that Ms. Crane's use of the CAPM model does not make her some sort of outlier in terms of methodology. *Id.*

The Commission has traditionally considered the CAPM as part of its evaluation of an appropriate ROE. Recently, in the KCP&L case, the Commission stated,

> The last main capital issue raises the question of whether CAPM is appropriate to include in setting the ROE. For us, this is not a difficult question, and we find that in this case, under the economic conditions that exist and under which all parties have labored, CAPM should be included. We also conclude, as a matter of law, that we are afforded broad discretion in setting the ROE, and interpret that discretion to extend beyond a rigid formulaic approach. Therefore, after reviewing the evidence presented by all three parties on the CAPM question, we are most persuaded by the testimony offered by Crane and Gatewood. Using both CAPM and DCF generates an analysis that encompasses the current economic climate. While that blended approach generates lower ROE's than what has been reported in recent years, and below the average 10.48% authorized by state utility commissions in the first and second quarters of 2010, the Commission cannot ignore the downward trend which was documented at hearing. That trend was comprised of more decisions than the Indiana PUC order issued at 9.9%. In fact, the 30-year Treasury rate, as of August 26,2010 was 3.53%, which is 71 basis points lower than the May 19, 2010 rate used in Andrea Crane's pre-filed direct testimony as the risk free rate.

(KCPL Order at 43-44). In this case, Ms. Crane calculates a CAPM ROE result of 6.18%. This number is lower than one usually sees, but that alone does not make this result unreasonable. U.S Treasury debt is at historic lows due to a number of macro-economic issues in the world markets, so one expects a CAPM to produce lower-than-normal results. However, if the market is efficient, and the CAPM model is calculated correctly, then there is no reason to doubt the result.

Mr. Gatewood acknowledges as much, stating

> "Because capital markets are efficient, we can be confident that market participants act on pertinent information. Thus, the prices we observe in the capital markets reflect the available information about the economy and investors' predictions for the economy. One important observation is that the yield on the 30 Year U.S. Treasury Bond continues to decline, reaching a historic low in late December 2011."

(Gatewood, Dir. T, at 13). Mr. Gatewood goes on to state,

> . . . unemployment is going to be an awful number for several years to come and that's the really sad part about these types of recessions, but in terms of evaluating capital costs, I'm convinced you have to look at the markets and be very careful about trying to find reasons why the market are wrong. That's what I would caution against."

Id., at 438. As Mr. Gatewood cautions, Ms. Crane does not spend her time trying to find reasons why the market is wrong. But Mr. Gatewood didn't exactly follow his own advice.

Mr. Gatewood calculated a CAPM ROE of 7.5%, but then chose not to use the results. (Gatewood, Dir. T. at 32; *id.*, at Schedule AHG-7). Mr. Gatewood explains that monetary policy, coupled with a flight to U.S. Treasury Securities as a safe haven from European currency crises, has pushed yields on U.S Treasury Debt to record lows. Instead of accepting that low treasury rates are a true indication of the current market, Mr. Gatewood instead chooses to find reasons why the markets are wrong. Mr. Gatewood states that he cannot conclude how much of the low treasury rate is the result of true macro-economic forces, and how much is due to monetary policies of the Federal Reserve, specifically the Federal Reserve's "Operation Twist." (Gatewood, Dir. T. 32; Tr., Gatewood, at 393).

However, on cross-examination, Mr. Gatewood admitted that Operation Twist did not start until late September or early October, and that the yield on 30-year treasury bonds had already fallen below 3.5% by that time. (Tr., Gatewood, at 398; CURB Exh. 8). Mr. Gatewood also acknowledged that yields on the 30-year treasury bonds had already dropped in August due to a lack of confidence in European markets, despite a downgrade in U.S. treasuries. (Tr., Gatewood, at 399; CURB Exhibit 8).

In Mr. Gatewood's CAPM analysis, he calculates the risk-free return as the average yield on 30-year treasury bonds from June 27, 2011 through November 25, 2011, or 3.49%. (Gatewood, Dir. T., Schedule AHG-7). Instead of simply adjusting the time period he used to evaluate 30-year treasuries to exclude the period after September when the Federal Reserve implemented Operation Twist, Mr. Gatewood discards his analysis entirely. In doing so, he also discards the reduction in the yield for 30-year U.S. Treasuries prior to September due to the challenges in the European markets, which is a proper macro-economic indicator worthy of consideration. The yield on 30-year U.S. Treasuries was below 3.5% prior to the start of Operation Twist, and Mr. Gatewood calculates the risk-free return in his CAPM model as 3.49%. This indicates that it is likely Mr. Gatewood would have arrived at a very similar CAPM result had he eliminated the period of uncertainty caused by Operation Twist.

Additionally, if Operation Twist caused uncertainty for Mr. Gatewood about what level of yield on U.S. Treasuries is appropriate, the relevant question is how much uncertainty does this monetary intervention cause? On cross-examination, Mr. Gatewood admitted that even if 100 basis points were added to his risk-free rate of return to reverse the impact of the Federal Reserve monetary intervention (3.49% up to 4.49%), his CAPM result would still only be 8.5%. (Tr., Gatewood, at 402). When combined at any level with his DCF result, which is consistent with how he has historically calculated a recommended ROE, the effect would be to lower the bottom end of Mr. Gatewood's ROE range. *Id.*

Mr. Gorman also produced a CAPM result of 8.60%. (Gorman, Dir. T., Appendix B, at 29). While he chose to place little weight on the actual result, he does state that the CAPM study "is useful to check the reasonableness of the DCF and Risk Premium analysis, and supports the adoption of a return on equity at the low end of my range." *Id.* Mr. Gorman clearly recognizes that the CAPM, whatever its perceived faults at this point in time, indicates that capital costs are low. The fact that he does use the CAPM as guidance to recommend a result in the low end of his range is instructive. Interestingly, Mr. Gatewood praises Mr. Gorman's CAPM analysis as coming as close as anything he has seen in the last year that filters out the impacts of the Federal Reserve's monetary policy. (Tr., Gatewood, at 402).

Given the indicated results of each CAPM analysis, it is no surprise why Westar is pleased that Mr. Gatewood and Mr. Gorman choose not to use the result. However, simply because the CAPM result is low doesn't make the result invalid. Regardless of whether you adjust Mr. Gatewood's analysis to eliminate Operation Twist, or accept Mr. Gorman's analysis that attempts to filter out the impact of the Federal Reserve's monetary policy, the CAPM result is still lower than the DCF result. Using "judgment" to dismiss this inconvenient fact is really the same as arbitrarily overinflating ROE results to match a preconceived notion of what the ROE result should be. The Commission should not so lightly dismiss the CAPM results, nor accept Westar's criticism of Ms. Crane for using the CAPM result indicated by the market in a manner consistent with how she has historically used CAPM results.

4. Westar's ROE analysis has numerous flaws that make its conclusions unreasonable.

Westar's ROE recommendation is based on overly-optimistic earnings growth rates that result in unrealistic growth projections in Mr. Ruelle's DCF analysis. (Crane, Dir. T, at 20). As Mr. Gatewood explained, Westar uses analysts' five-year earnings growth rates as the "long term" grow rate in the DCF model. Westar's analysis focuses on the growth rates for the next three-to-five years; by doing so, it implicitly assumes such growth rate continues on for decades to come. "Even if analysts' five-year growth rates are accurate," cautioned Mr. Gatewood, "it needs to be recognized that growth in dividends are unlikely to continue indefinitely at a rate of 136 basis points higher than the growth in the broad, national economy." (Gatewood, Dir. T., at 11). Mr. Gorman also notes that Westar's growth rate in the DCF model "is too high to be sustainable indefinitely", and therefore results in an "inflated DCF result." (Gorman, Dir. T., App. B, at 36).

Mr. Ruelle's average and median three-to-five year analysts' growth rate projections used in his study are 5.82% and 5.88% respectively, compared to the long-term sustainable growth rate of U.S. Gross Domestic Product of 4.9%. (Gorman, Dir. T., App. B, at 37). Westar further inflates its DCF growth rates by using a quarter-year convention to inflate future dividend growth. Both Ms. Crane and Mr. Gatewood use a half-year convention, which increases dividend yield by one-half of the recommended dividend growth rate to account for the prospective nature of dividends and the expectation that dividends will grow over time. The methodology used by Ms. Crane and Mr. Gatewood assume that dividends will be increased annually, and that the companies in the proxy group may increase their dividends at different times during the year. Hence, on average, over the course of a year the dividends for the group will increase by ½ of the annual growth rate. This methodology is commonly employed in the ratesetting process and is the methodology routinely used not only by Ms. Crane but also by Mr. Gatewood. Westar is incorrect when it states on page 41 of its Post-Hearing Brief that the quarterly method used by Westar is also used by "the vast majority of other dividend paying utilities in the nation." Mr. Ruelle is confusing the paying of dividends, which all parties agree are generally paid quarterly, with increasing the dividend, which is generally done annually. Certainly, in Westar's case, the Company has not increased its dividend more frequently than annually, as acknowledged by Mr. Ruelle (Tr., Ruelle at 83). Thus, the quarterly compounding method used by Mr. Ruelle overstates the impact of growth on future dividend payments.

Mr. Ruelle also includes a floatation cost adjustment for stock issuance costs which increases his DCF result about 25 basis points. CURB does not believe a floatation cost adjustment is necessary, since the DCF is based on market values for equity that are not impacted by issuance costs. However, if the KCC allows a flotation cost adjustment, Mr. Ruelle's method of calculating the floatation adjustment results in an inflated adjustment. Mr. Ruelle simply increases the stock prices of his entire proxy group by 5% to represent stock issuance costs. This 5% increase is arbitrary, at best. There is no evidence presented that actual floatation costs incurred by Westar are anywhere near this level of expense. The result of Westar's methodology is a 25-basis point increase applied to all of Westar's existing equity, rather than to only any incremental equity issued by Westar. A 25-basis point increase applied to all Westar equity is an unreasonable windfall for Westar shareholders.

CURB also recommends the use of short-term debt in Westar's capital structure. While the Commission historically has not included short-term debt in utility capital structures, it is now appropriate under the new mandatory Kansas CWIP statute. Prior to the new CWIP statute, projects were not included in rate base until completed. Therefore, including short-term debt in the capital structure would have been viewed as providing the benefit of this lower-cost capital to ratepayers without requiring the ratepayers to pay a return on the assets being finance by the capital. Short-term debt is primarily used to fund capital project during construction. With the new mandatory CWIP statute, these projects funded with lower-cost short-term debt are now included in rate base and ratepayers are paying a return on the assets financed. Ratepayers should now get the benefit of this lower-cost capital. Moreover, the company's rate base also includes other components that are traditionally financed through short-term debt, such as materials and supplies, pre-payments and fuel inventory. If these items are included in rate base, then it is proper to also include the actual financing mechanism for these items in the Company's capital structure. That financing mechanism is short-term debt. While the inclusion of short-term debt would result in a departure from the KCC's past practice, the inclusion of significant amounts of CWIP in rate base clearly justifies a change from the KCC's past practice. While Mr. Ruelle disagrees with the use of short-term debt in the capital structure, he does agree that there are a number of state commissions that do include short-term debt in the capital structure.

Therefore, the method used by Ms. Crane that resulted in her recommendation of an 8.85% ROE to the Commission is reasonable and commonly used by analysts and commissions. Her choice to recognize current economic conditions in her analysis—rather than to sweep them under the rug—is a reasonable approach. The Commission, even if it does not adopt her specific ROE recommendation, should consider her recommendations as strong evidence that the ROE adopted by the settlement is too high. Although CURB views Staff's original recommendation to set the ROE at 9.5% as less reasonable than CURB's recommendation, it is certainly more reasonable than Westar's requested 10.35% ROE or the 10% ROE the settlement would establish. The Commission should reject the settlement and set the ROE at a level commensurate with Westar's risk profile and the economic conditions within which the company and its customers are living and operating today. The evidence strongly supports an ROE lower than 10%.

B. Environmental Cost Recovery Rider (ECRR) issues

1. Roll the ECRR costs back into base rates.

CURB supports rolling the costs being recovered through the Environmental Cost Recovery Rider back into base rates in each rate case. During the evidentiary hearing, Westar and the parties to the settlement informed the Commission that the parties would not consider the Commission's decision to retain the roll-back mechanism as a material change that would permit the parties to rescind their agreement. (Tr., Bregman, at 275). The Commission faces no risk of the parties withdrawing their settlement if the Commission orders Westar to retain the roll-back mechanism. The Commission should do so, because there are numerous good reasons for retaining this mechanism.

First of all, the ECRR was proposed and approved for the purpose of ensuring Westar full recovery of environmental expenditures between rate cases, not in perpetuity. In Westar's 2005 rate case, Westar witness Kelly Harrison testified that the company was facing substantial expenditures for required pollution control equipment upgrades to several plants in its generation fleet. (Harrison, Dir.T., at 12 – 25, KCC Docket No. 05-WSEE-981-RTS (981 Docket). Because of the magnitude of the projected expenditures from the present through the year 2014, Harrison said that Westar was "proposing to use an Environmental Cost Recovery Rider (ECCR) to recover the capital and operating and maintenance costs associated with installing new pollution control equipment. Between rate reviews, we would recover the annual revenue requirement through the ECRR. **At the time of the next rate review, the type of costs that had been previously recovered through the ECRR would be included in base rates.**" *Id.,* at 25 (emphasis added). The ECRR mechanism that the KCC approved adopted Westar's provision (bolded above) that provided that costs in the ECRR would be rolled back into base rates in each subsequent rate case—a mechanism often referred to as a "roll-back" mechanism.

As noted by CURB witness Andrea Crane in her Direct Testimony in this proceeding, the ECRR with its roll-back mechanism benefits Westar because it receives revenues for the costs of projects between rate cases, thus sooner than it would if it had to wait until the next rate case, but also protects ratepayers by ensuring meaningful review of the expenditures in each rate case, as well as properly placing on the company the normal risk of recovery of its expenditures over the long term. (Crane, Dir.T., at 24, citing *CURB Comments* in KCC Docket No. 08-WSEE-849-TAR [849 Docket], May 9, 2008, at 4). When Westar asked the Commission to eliminate the roll-back mechanism in 2008, the Commission denied the request. (849 Docket, *Order*, May 29, 2008, at ¶15). The company asked again to eliminate the roll-back mechanism in its 2008 rate case, but the settlement reached by the parties and approved by the Commission retained the roll-back mechanism. (KCC Docket No. 08-WSEE-1041-RTS, *Order,* Jan. 21, 2009, at ¶¶32, 76). Once again, Westar has requested in this rate case to eliminate the roll-back provision. CURB opposes this request as it has in previous cases, and for the same reasons. The so-called balance of benefits is entirely in the utility's favor. While costs are recovered in the ECRR, the company receives a guaranteed recovery of its authorized rate of return—at the same rate that it is authorized to earn for its more risky investments. It receives recovery from ratepayers sooner than it would under a traditional ratemaking approach. Furthermore, Staff's analysis of the costs versus benefits to customers of placing costs in the ECRR found that monetary benefits to customers "appears to be overstated." (Grady, Dir.T., at 49). While recognizing that Staff admitted that its current conclusions may not hold true in future years and on future projects, no one has provided one good reason why the ECRR is good for customers, and no one has provided one good reason why rolling back the costs in rate cases is a bad idea for customers.

A close look at the Staff's analysis is in order. In attempting to balance the interests of present ratepayers versus future ratepayers, the Commission Staff did a study on one plant project to compare the impact on rates for both sets of ratepayers of putting the costs in the ECRR versus putting the costs in base rates. (Grady, Dir. T., at 47-50). The study found, based on current economic conditions, that putting costs in the ECRR places a greater burden of the costs on current ratepayers than future ratepayers. *Id.*, at 48. Staff concluded, however, that the study was inconclusive, primarily because the results are strongly influenced by current economic conditions and the impossibility of predicting future economic conditions, and the difficulty over shorter time frames of determining how many current ratepayers will still be customers in the future, thereby also bearing lesser burdens in their later years as customers. (*Id.*, at 51). No data or estimate was offered regarding how many current customers are likely to still be customers ten or twenty years from now, so there is no evidence whatsoever to support the assumption that a sufficient number of customers who are being burdened with higher costs now will also enjoy lower costs later on to balance out the inequities between the current and future generations of ratepayers.

In its discussion about analyzing the ECRR for its value to the public interest, Staff noted that the results of analyses of each ECRR project could also vary because each would be commenced and completed in a different time frame, with potentially different economic conditions affecting the results. All in all, Staff concluded that comparing the net present value to ratepayers of paying for these projects through an ECRR or through base rates would have to be done on a project-specific basis, and noted "this is only one factor affecting the public interest." *Id.*

However, other than enumerating the public interest concerns, Staff made no attempt to analyze whether the ECRR serves or does not serve the public interest, which Staff said is served when "ratepayers are protected from unnecessarily high prices, discriminatory prices, financially unstable utilities and/or unreliable service." *Id.,* at 51. Since there have been no allegations of discriminatory pricing in this case, no allegations that Westar is financially unstable or provides unreliable service, the only thing to analyze on Staff's list of public interest concerns would whether Westar's ECRR results in unnecessarily high prices. Given that Staff's limited study of one project established that, under current economic conditions, current ratepayers will pay a disproportionate AMOUNT of the costs compared to future ratepayers, there is some evidence that indicates that recovering costs through the ECRR, today, in this rate case, results in unnecessarily high prices to current ratepayers. And on the other hand, the ECRR does nothing to protect customers from the evils of discriminatory pricing or the (non-existent) financial instability of Westar, nor does it contribute to reliability. To be fair, embedding these costs in base rates does little to protect customers from those evils, either, but the point is, the ECRR does not alleviate any public interest concerns, and, at least in one aspect, increasing customer costs, contributes to concern for the public interest.

The company and Staff have defended the value of the ECRR as an "educational" tool. However, anyone who believes that the ECRR has value as an "educational" tool has never sat in CURB's office and taken telephone calls from unhappy customers who assume that each new surcharge on their bills represents a type of cost that they've never had to pay before. Given the hundreds of kinds of costs that are embedded in base rates, the value of breaking out a chosen few types of costs for recovery through a separate rate is very difficult to explain to customers—especially when there's no good reason for doing so from the customer's point of view. The main reason for surcharges is the concern of the utility that it will not fully recover its costs and earn its return, rather than because they are distinct costs of service. Once a piece of necessary machinery is installed on a plant, its operation is integral to that of the rest of the plant: why include the cost of the turbine in base rates, but isolate the cost of an air scrubber attached to that turbine in a surcharge? The reason may make sense to utilities or regulators, but it makes no sense to customers.

From CURB's view, the only thing that all surcharges have in common is this: they are costs that can be isolated from other costs fairly simply. So a utility, in trying to find ways to reduce regulatory lag (shorthand for "to get the money sooner than later"), seizes on the easily-identifiable costs and insists that it needs a surcharge for these costs. So we now have surcharges for property taxes (just add up the bills); franchise fees (likewise); environmental upgrades (more difficult, but still isolatable from the underlying costs of the plants being upgraded); transmission costs (based on FERC-ordered rates); fuel costs, and the cost of energy-efficiency programs. There is no compelling reason related to the nature of these costs that would militate against recovering them in base rates; in fact, most of them were once included in base rates. While there may be volatility in some kinds of costs—fuel costs being the most notable of these—there is no particular volatility in property taxes, franchise fees or energy-efficiency programs that would lead to the conclusion that the company is placed at great risk of recovery if these costs are placed in base rates.

Furthermore, the costs of the original pollution control devices installed on Jeffrey Energy Center are being recovered through base rates: why is it necessary to have a separate surcharge for the new devices? The reason is simple: the utilities have convinced regulators that surcharges provide benefits to customers by lowering costs of capital and thereby lowering rates to customers and attracting investors. Unfortunately, when customers then seek to reap the benefit of a lowered cost of capital—including a lower return for the shareholders—the utility inevitably protests that lowering its return will hurt customers by discouraging investors. What's a customer to do?

If the only so-called benefit to customers from the ECRR is its "educational" value, customers can do without it. The information on Westar's environmental upgrade costs is readily available in public documents, and could be, if educating the customers is so important, included as a bill insert or prominently displayed on a page of the company's web site. It's still unclear to CURB—the representative of these customers—why this information is deemed so important: if the knowledge that government regulations are causing Westar to incur these costs is the "value" of this information, then why is it not equally important to inform customers of the other costs of government regulation: KCC and FERC regulatory fees; the costs of meeting water pollution standards, applying for permits, and monitoring usage; transportation regulations; the costs of compliance with local zoning laws, building codes, and safety codes; the costs of ensuring that the company doesn't violate equal opportunity laws, labor laws, or OSHA regulations; the costs of preparing tax returns, W-2 forms, W-4 forms, and 1099 forms, the KUSF and 911-user fees in the company's phone bills, etc., etc.? If the value of the information to customers is that the expense of environmental compliance is so enormous, then why not break out the even more enormous cost of the generation plants themselves, or the ginormous cost of paying Westar employee salaries, increases, bonuses, benefits and retirement benefits?

All told, if the ECRR has any educational value at all, one suspects that it resides in Westar's hope that customers will be motivated to enlist in the political battle against environmental regulation because of the costs it imposes on them. That may be a desirable goal for Westar, but the effort is failing: for the most part, customers just believe that Westar is charging them for something that they wouldn't have to pay for if we got rid of the surcharge.

But does anyone really believe that the ECRR has educational value? In truth, it appears that this value has been conjured up out of thin air to create the illusion of benefits to the customer from the ECRR. The truth is that the value of this surcharge accrues to Westar, and Westar only. The only two aspects of the ECRR that provide purported benefits to customers are (1) the true-up mechanism ensures that customers do not pay more than Westar spent and (2) the roll-back mechanism provides periodic opportunities to more thoroughly examine the legitimacy and accuracy of the costs. A closer analysis, however, reveals that even these so-called benefits are illusory.

The value to customers of the true-up mechanism is nonexistent where it is virtually certain that costs in the surcharge will continue to rise, and virtually certain that the costs will not decrease. To understand why, it is useful to compare the value of the true-up mechanism in the Energy Charge Adjustment (ECA), which is a surcharge that passes through Westar's actual cost of fuel to customers. Historically, fuel costs have been volatile, as illustrated recently by the recent impact on natural gas prices caused by the availability of additional supplies. If natural gas costs had been embedded in base rates when the prices started dropping, Westar would have reaped a windfall. With the ECA in place, however, customers' rates will reflect Westar's actual cost of natural gas. Natural gas is not the only fuel that Westar uses, however, so the ECA will also ensure that customers' rates will reflect Westar's actual costs of other fuels. If overall, fuel prices were on a downward trend generally, one would expect electric utilities to favor eliminating the ECA and embedding fuel prices in base rates. It has happened before, and may happen again.

Now, contrast the ECA with the ECRR. The ECRR was proposed and approved on the virtual certainty that Westar would be facing rapidly-escalating costs of meeting environmental regulations in the coming decade. There is no expectation whatsoever that Westar will face a significant reduction in these costs in the near-term or even the mid-to-long-term. In fact, new environmental regulations on the horizon make it even more likely that the period of high expenditures for pollution control and other environmental upgrades will continue long after the projects planned through 2014 are completed. While the market also can affect the prices of equipment and labor, it is highly unlikely that Westar's environmental costs in the years to come will drop significantly, and it is much more likely that they will continue to increase. All electric utilities in the United States are grappling with the higher costs of meeting new environmental regulations; while some utilities are facing higher costs than others, the heightened demand for the equipment necessary to attain compliance is likely to drive prices even higher for everyone. Demand for employees and contractors with the expertise to install this equipment is likely to drive labor costs higher. Common sense dictates that Westar's costs of environmental compliance will not decrease before it comes in for its next rate case, or the next one, either. Therefore, it is highly unlikely that Westar would reap a windfall benefit from customers if these costs were embedded in base rates—which makes the true-up mechanism in the ECRR worthless as a benefit to customers financially.

Since thorough review of the environmental costs occurs only in a rate case, whether or not those costs are embedded in base rates or recovered through the ECRR, the roll-back provision in the ECRR simply provides the same protection to ratepayers that they have when these costs are embedded in base rates. Removing this protection, however, greatly increases the risk to ratepayers that the costs that Westar places in the ECRR will never be thoroughly vetted, and greatly increases the risk that Westar will get just a little too comfortable with the security of knowing that it will receive risk-free recovery of anything it spends on environmental equipment and a risk-free guaranteed rate of return on the expanding rate base, as well.

CURB also notes for the record that **no one** has established the legitimacy of the supposition that the use of surcharges reduces regulatory costs, a phenomenon that is attributed to the so-called fact that utilities don't need base rate cases as often if they can adjust the surcharges between rate cases. There may be evidence out there somewhere that the regulatory costs of the utilities have decreased since the institution of line-item surcharges, but there has been no such evidence presented in this case. Given the frequency of Westar's most recent rate cases, in addition to the dozens of proceedings to update line-item surcharges between rate cases, there is good reason to doubt the legitimacy of this supposition. Certainly, surcharges haven't served to reduce the cost of rate cases, if Westar's claim for rate case expense in this case is any indication. Approval of surcharges, or approval of the elimination of the roll-back mechanism, should not be based on the unsupported supposition that surcharges have resulted in lower regulatory costs that customers must pay. There's simply no evidence in the record to support that supposition.

So: on balance, where is the benefit for customers in the ECRR versus the benefit to Westar? The roll-back mechanism (and the resulting rate-case-depth review of ECRR costs) is the only benefit of the ECRR to customers. If the roll-back mechanism is eliminated, there is no benefit to customers at all.

On balance, Westar derives all the benefits from the ECRR, and there is no evidence that there is any benefit to customers, and some evidence that it is harming current customers. The only thing that makes the ECRR less harmful is the roll-back mechanism, which periodically returns the normal risk of recovery to the utility and ensures that the costs are reviewed thoroughly during each rate case that follows. The original settlement agreement, if approved, would remove the only feature of the ECRR that (periodically) restores the balance of risk between the utility and the customers, and the only thing that ensures that costs recovered through the ECRR are periodically reviewed with the kind of scrutiny that protects ratepayers from the ECRR becoming a perpetually risk-free cash cow for Westar.

Fortunately for ratepayers, Westar and the other signatories to the settlement agreement indicated during the evidentiary hearing that they will not consider the Commission's decision to retain the roll-back provision as a material change to their agreement that would constitute valid cause to withdraw their assent to the agreement, so the Commission faces no risk that the settlement agreement will fall apart if it orders Westar to roll back the ECRR costs into base rates. The adjustments to rate base and expenses that are necessary to implement CURB's recommendation are contained in Ms. Crane's Direct Testimony at Schedules ACC-10 and ACC-30.

2. The return on equity for the ECRR should be reduced.

As Staff witness Jeff McClanahan testified, so long as environmental costs are recovered through a line-item surcharge like the ECRR, Westar is at no risk of undercollecting these costs, plus its authorized rate of return on rate base included in the surcharge. (McClanahan, Tr., at 221-22). Mr. McClanahan pointed out that Westar may not earn its authorized rate of return overall, but on those items flowing through surcharges, it would. *Id.* Therefore, the surcharges are virtually risk-free. When the Commission authorizes X% for a utility's overall rate of return, finding that X% is reflective of the utility's overall risk of recovery, then a rate of return less than X% should be appropriate for the portions of its rate base that Westar recovers through a dollar-for-dollar, risk-free surcharge. There is nothing preventing the Commission from determining that a lower rate of return is appropriate for rate base costs that Westar recovers through surcharges such as the ECRR. This is especially true for the ECRR, which is almost entirely composed of rate base costs. A substantial amount of rate base is being recovered through this risk-free mechanism, but at a guaranteed rate of return that was awarded on the overall risk of the utility. If the return on surcharges reflected the utility's true level of risk of recovery, the rate of return on costs recovered through surcharges would be substantially lower than the utility's overall rate of return.

The utilities have often claimed that surcharges reduce their costs of debt, but ratepayers aren't seeing reductions in the overall rates of return they must pay to shareholders. They should be getting some level of relief on the returns provided by surcharges that provide a risk-free revenue stream plus 100% of the utility's authorized rate of return. Thus, CURB proposes that the Commission authorize a separate return on rate base that is recovered through the ECRR, reflecting the reduced risk that ratepayers provide for Westar. While any relief would be welcome, CURB proposes that the Commission authorize a rate return on the ECRR that is 200 basis points lower than the overall authorized rate of return that the Commission approves in this case. If the

Commission adopts this proposal, the return on rate base would have to be recalculated to reflect the appropriate rate of return.

3. The rate design of the ECRR should be identical to the rate design of base rates.

The environmental costs recovered through Westar's ECRR are allocated to the various classes using a different methodology than the methodology used to allocate costs that are recovered through its base rates. As a result, residential and small-commercial customers are being allocated a larger proportion of ECRR costs than the customers with higher load factors. This inequity should be eliminated by adopting the same methodology for allocating ECRR costs that is being used to allocate base rates.

The methodology used by Westar to allocate costs to the various customer classes is called the "Four Coincident Peak", or 4CP methodology. The methodology used by KCC Staff to allocate costs to the various customer classes is called the "Peak and Average" method. The 4CP methodology allocates costs to the classes based on their contribution to summer coincident peak during the four hottest months—June through September. (Myrick, Dir. T., at 12). As Staff witness Dorothy Myrick explained in her Direct Testimony, the 4CP method allocates all production plant as demand- (i.e., peak) related. *Id.* at 16. As a result, Westar's using a 4CP methodology in its proposed class cost-of-service study allocates a higher proportion of production plant costs to residential customers than Staff's class cost-of-service study. *Id.* Ms. Myrick stated that the 4CP methodology "does not recognize that energy loads have some bearing on production plant costs." *Id.* However, she also noted that allocating the costs of production plant solely on the basis of energy would allocate a much greater portion of these costs to high load factor customers. *Id.* Thus, she said

KCC Staff "has consistently taken the position that the design and cost of generating facilities is not determined solely by forecasted peak load." *Id.*, at 13. The "Peak and Average" method that KCC Staff uses to allocate costs recognizes that both kinds of loads—energy and demand—impose costs on the production system of electric utilities, and strives to allocate the costs in a more equitable manner among the various customer classes.

Which brings us to the mismatch in how ECRR costs are allocated versus how base rate costs are allocated. In the past decade, the rate designs approved by the Commission for Westar's base rates have allocated plant costs to each customer class on the basis of Staff's Peak and Average model. However, Westar adheres to its preferred 4CP model in allocating ECRR costs. This results in allocating a higher percentage of ECRR costs to the residential customers than they would pay if these costs were allocated as they are in base rates.

Here is the problem: the pollution control equipment is attached, or will be attached, to Westar's base-load plants, and will operate to clean the emissions resulting from every kilowatt hour of energy produced by those plants. (Rohlfs, Tr., at 157). Although Mr. Rohlfs testified that he prefers using the 4CP model and did so in allocating the costs of the ECRR and the costs of plants in his class cost-of-service study (*Id.*), he admitted that, in current rates, the ECRR costs are allocated differently than base rates because Staff's methodology was utilized to allocate the costs that go into base rates. (Tr., Rohlfs, at 282-83). If Staff's proposed rate design is approved in this case, this mismatch will continue. Westar, in theory, should be neutral as to how costs are allocated to the various classes, so long as the rates based on those allocations are designed to recover its authorized revenues and rate of return. In practice, Westar has not challenged the Commission's preference in the past decade for Staff's method of allocating costs and designing rates. But the mismatch in methodologies used in the ECRR and base rates should not be allowed to continue. It makes no sense to allocate the costs of pollution control equipment installed on base-load plants differently than the costs of the base-load plants themselves. Regardless of whether the Commission approves the settlement agreement, it should order Westar to adopt the same methodology to allocate costs recovered through the ECRR that is approved in this case for allocating costs that are recovered through base rates. Doing so would eliminate the mismatch that currently shifts a higher proportion of ECRR costs to residential customers than they pay for production costs in base rates.

There was some concern raised by Staff witness Ms. Myrick at the hearing that rolling the ECRR costs back into rates and changing the allocation methodology will create a mismatch between revenues and rates. (Tr., Myrick, at 289). She admitted that residential customers would be paying slightly more, but she couldn't say how substantial it might be. *Id.,* at 292. CURB believes that this can be alleviated by comparing two ways of calculating the new base rates, as follows:

Determine the total ECRR revenues paid in the test year by each class of customers. Then, determine the percentages of the total ECRR revenues paid by each class. For instance, say that under Westar's modified 4CP allocation, residential customers paid 44% of ECRR costs. If, for example, total ECRR revenues were $100 million in the test year, residential customers would have paid $440,000 of those costs. By dividing $440,000 by the amount of kilowatt hours used by residential customers during the test year, the ECRR per-kilowatt-hour rate they paid can be determined. Westar suggests that adding that resulting ECRR rate to the base rates for residential customers determined in this case is the only way to roll the ECRR costs into base rates. However, in doing so, the ECRR going forward would be remain based on Westar's allocation method. If

Staff's allocation method is adopted for base rates and the ECRR, the ECRR going forward would not be based on Staff's allocation if calculated as Westar suggests.

So, assuming that Staff's allocation will be approved for both the ECRR and base rates, to synchronize the allocation of ECRR costs with other production-related costs in base rates, the way to calculate the new rate would be to begin again, back to the total ECRR revenues for the test year—in our example, $100 million. Now, apply the percentage allocations for each class that Staff's allocation method would call for. Let's assume it is 39.6% for residential customers, which would total $396,000. That $396,000 figure would be divided by the amount of kilowatt hours used by residential customers during the test year to determine the ECRR per-kilowatt-hour rate for customers going forward. That rate would be added to the residential base rate determined in this case. Going forward, the residential customers would be paying the same proportion of ECRR costs whether they were recovered through a surcharge or through base rates. CURB believes this is the only appropriate way to assure that there is no mismatch in allocations between the ECRR costs when recovered through surcharges and when they are recovered through base rates. This requires, of course, that the Commission adopt CURB's recommendation to adopt Staff's allocation method for base rates and the ECRR costs, as well. No matter which allocation method the Commission approves, however, the Commission should adopt the same method for allocating the ECRR costs as it adopts for allocating base rates.

4. Adjust interest expense for taxes if the ECRR costs are rolled back into rates.

Ms. Crane adjusted Westar's pro forma interest expense for income tax purposes, based on CURB's recommended rate base, capital structure and cost of capital. *Id.*, at 69. If the Commission adopts her recommendation to roll back the ECRR costs into base rates, Westar's pro forma interest expense will be higher. Because this expense is deductible on income taxes, however, Westar will have a lower overall tax liability. Her adjustment synchronizes Westar's interest expense that incorporates this lower tax burden and an increase to pro forma income at present rates. *Id.* Her adjustment is shown at ACC-31 in her Direct Testimony.

C. Depreciation Issues

1. Adjust depreciation expense to reflect rolling the ECRR costs into base rates.

As previously discussed, Ms. Crane recommended that costs recovered through the ECRR should be rolled back into base rates. Since Westar calculated its depreciation expense based on its request to keep recovering all of its environmental costs in the ECRR, it had removed depreciation expense associated with these costs from its base rate claim. Ms. Crane made an adjustment to add these expenses back into rate base, consistent with her recommendation that the environmental costs currently being recovered through the ECRR surcharge should be rolled back into base rates. Her adjustment is shown at Schedule ACC-30 in her Direct Testimony.

2. Accept Staff's depreciation adjustments to remove future terminal net salvage.

CURB did not engage a depreciation witness for this case, relying instead on Staff's analysis of Westar's depreciation study. CURB supports Staff's adjustments to Westar's depreciation rates to remove future terminal net salvage costs from rates, which were also accepted by the parties to the settlement. CURB agrees with Staff that until Westar has established a "reasonable and detailed plan to actually dismantle a generating facility upon retirement," costs of future terminal dismantlement may not be included in customer rates. This is consistent with the ruling in *Kansas Industrial Consumers, Inc. v. Kansas Corporation Comm'n*, 36 Kan.App.2d 83 (2006). There are exceptions to the rule, such as when the utility has a legal obligation to remove a nuclear plant, but the exceptions do not apply in this case.

In CURB's view, a reasonable and detailed plan for dismantling the plant includes a commitment to a firm date for removal. Otherwise, the "plan" is just an estimate of what removal might cost if the company dismantled it. That's not the same as having a plan to remove a plant. For example, anyone considering going on an ocean cruise can obtain estimates for what a cruise will cost, but the cost of a cruise will vary, depending on the season or the particular dates of travel. Until the person books passage on a particular ship for a particular set of dates, the person has no actual travel plans and has no basis for determining what the trip is likely to cost. Likewise, without an actual commitment to begin removing a plant on a certain date, estimates of what the removal will cost are purely speculative. CURB agrees with Staff that the costs of future terminal net salvage included in Westar's depreciation claim should be removed. As noted above, the parties to the settlement also agreed to this adjustment.

D. Adopt Westar's alternative proposal for improved vegetation management.

Westar made two proposals concerning its vegetation management program. Both proposals provide for additional recovery from customers to implement a more frequent cycle of trimming and clearing trees and other vegetation from around electric lines to improve reliability. Westar's preferred proposal to implement the program throughout its entire service area would reflect an increase in costs of almost 85% over actual test-year costs. *Id.,* at 58, 60. The alternative proposal would reflect an increase of almost 46% over actual test-year costs, but would concentrate acceleration of the trimming cycles primarily in the urban areas within Westar's territory. *Id.*, at 59, 60. Ms. Crane supported the alternative proposal. She noted under the less-costly proposal that the trimming program still would be implemented in most of Westar's territory, but would allow for Westar to gain experience with the new program before full-scale deployment across its entire service area.*Id.*, at 60. Her adjustment to reflect acceptance of the company's alternative proposal is shown at Schedule ACC-24 in her Direct Testimony.

Westar's alternative proposal also was adopted by the parties to the settlement agreement presented to the Commission in this docket.

Additionally, Ms. Crane rejected Westar's alternative proposal to implement a tracker mechanism to recover its actual costs of vegetation management. *Id.,* at 60-61. Consistent with her opposition to single-issue ratemaking that shifts more risk away from the utilities to ratepayers, she recommends that the Commission reject this alternative. *Id.*, at 61. The settlement also provides that no tracker mechanism would be implemented by Westar.

E. Adopt a five-year amortization for deferred benefit (pension-related) expenses.

Ms. Crane recommended amortizing Westar's deferred benefit expense over five years instead of three years, a provision adopted in the settlement. (Crane, Dir.T., at 47). This recommendation was adopted in the settlement presented to the Commission. Ms. Crane stated that a five-year amortization is consistent with the Commission's guidance in the order issued in KCC Docket No. 10-WSEE-135-ACT, where the Commission expressly permitted amortizations of up to five years for Westar's pension-related expenses. *Id.*, at 47-48. She also noted that Westar is requesting a significant increase—around $26 million—for pension expense over that currently included in rates, and that given the size of this particular increase, amortizing these amounts over five years would mitigate their impact on customer rates. *Id.,* at 48. Her adjustment is shown at Schedule ACC-18 in her Direct Testimony

F. Remove unreasonable bonus compensation expenses from rates.

The costs of compensation to Westar employees based on financial criteria should be borne by shareholders, not ratepayers. CURB proposed several adjustments to remove the cost of bonus compensation plans that are based on financial criteria from Westar's expense claims. The total of Ms. Crane's adjustments is $12.98 million: $3.4 million for the short-term incentive plan, $1.9 million for the supplemental executive retirement plan, and $7.68 million for the restricted share units (RSU) plan. The settlement provided that only $4.2 million of the costs of the RSU and executive compensation plans will be disallowed. Ms. Crane's adjustments and her reasons for making them are described in detail, below.

1. Remove 50% of short-term incentive compensation expense from rates.

Westar offers short-term incentive plans to its non-union employees. The payout to employees is based on measuring performance in four areas: financial, operational, customer satisfaction and safety. Westar has included $9,763,030 in its test-year claim for short-term incentives costs. (See CURB-16, Crane, Dir. T, App.C). The financial performance of Westar, as compared to a peer group of electric utilities, provides a larger potential payout than achievement in operations, customer satisfaction or safety. Although there are four areas of performance that are measured, 50% of the incentive award is directly tied to financial criteria. (Crane, Dir.T, at 44). In other words, serving shareholders' needs is rewarded more handsomely at Westar than serving customers' needs. Additionally, non-union employees at Westar have received eight payroll increases in six years (2006 through 2011), increasing their salaries by a total of 27.81%.

In spite of the generous raises Westar employees have enjoyed in recent years, CURB has is not proposing to reduce the amount of employee salaries included in rates. However, CURB does propose to share with Westar's shareholders the burden of providing incentive plans to its employees. Because Westar bases 50% of the incentive payouts on financial criteria that primarily benefit shareholders, Ms. Crane has proposed that shareholders bear 50% of the costs of these plans. Ms. Crane, at her Schedule ACC-15, made an adjustment to eliminate 50% of the cost of these incentives from rates. Additionally, at Schedule ACC-16 in her Direct Testimony, she has made an adjustment to payroll taxes to reflect this adjustment.

Mr. Banning, in his Rebuttal Testimony, says that encouraging employees to think about all facets of the business is good for everyone. It is, he says, "natural for an employee who works in the call center to fall into the trap of thinking only about customer service," in citing his reasons for supporting using financial criteria to make awards. (Banning, Reb.T., at 5-6). However, it's not clear how a call center employee, who presumably spends his or her entire shift performing customer service-related duties such as answering phone calls from customers, can be motivated by an awards program to take actions that affect Westar's financial performance—or can have much time to do so. Other than serving customers politely, accurately and efficiently—which should be the basic requirements for any customer service job, whether there are incentive programs or none—it is difficult to imagine a scenario in which a call-center employee, highly motivated by the awards program, could do anything to improve the financial performance of Westar. This is not to denigrate the role of call-center employees, but simply to point out that it makes sense to reward customer service employees based on customer-service related parameters, measuring something they can actually do better if sufficiently motivated by monetary awards.

Furthermore, the officers and executives at Westar who are paid the big bucks for bearing the primary responsibility for maintaining its financial health and pleasing shareholders *are not included in this plan*. Paying out awards largely based on financial criteria to non-executive employees who have no authority or discretion to do anything other than the tasks they are assigned to do doesn't make any sense to the ratepayers who are paying for it. If the shareholders want awards based on financial criteria that primarily benefits them, then they should foot the bill for those awards. Ratepayers do not think it is a good use of their money. Ms. Crane's adjustment to remove 50% of the cost of these rewards from the revenue requirement is shown at Schedule ACC-16 in her Direct Testimony.

2. Remove Restricted Share Unit (RSU) expense from rates.

Restricted share units are awarded to officers and executives instead of the short-term incentive plan discussed above. The criteria for the award, which grants common stock, is Westar's performance relative to a peer group of utilities. If Westar's performance is at or above the 50th percentile of the peer group, 100% of the target award is made. (Crane, Dir.T., at 45).

Ms. Crane recommended removing all of the costs of the RSU plan from rates. First, she objects to the use of targets that incorporate evaluation of the performance of other utilities. Setting compensation levels on a comparative basis with other utilities results in pressure on utilities to increase compensation. Where the goal is to bring salaries and incentive awards up to a given threshold, then each time the utilities increase compensation for their employees to meet the threshold, the threshold moves upward, triggering another round of increases. This comparative approach can only result in increases, merited or not, and is likely to lead to inflated compensation. *Id.*, at 46. Second, basing awards solely on financial criteria encourages executives and officers to focus on shareholders' interests without regard to ratepayers' interests. While officers and executives tend to have a greater role in making financial decisions than run-of-the-mill employees, they should nevertheless be encouraged to have as much interest in their customers' interests as their shareholders'. If shareholders want to provide incentives for good financial performance in preference to all other facets of performance, they should do so, but ratepayers should not have to pay for them.

Based on these conclusions, Ms. Crane recommended removing 100% of the RSU costs from the regulated cost of service. Her adjustment to revenues, including an adjustment for income taxes associated with this program, is shown at Schedule ACC-17 in her Direct Testimony.

3. Amortize deferred benefit expenses over five years.

Ms. Crane recommended amortizing Westar's deferred benefit expense over five years instead of three years. (Crane, Dir.T., at 47). This recommendation was adopted in the settlement presented to the Commission. Ms. Crane stated that a five-year amortization is consistent with the Commission's guidance in the order issued in KCC Docket No. 10-WSEE-135-ACT, where the Commission expressly permitted amortizations of up to five years for Westar's pension-related expenses. *Id.*, at 47-48. She also noted that Westar is requesting a significant increase—around $26 million—for pension expense over that currently included in rates, and that given the size of this particular increase, amortizing these amounts over five years would mitigate their impact on customer rates. *Id.,* at 48. Her adjustment is shown at Schedule ACC-18 in her Direct Testimony.

4. Remove the supplemental executive retirement expense.

Ms. Crane recommended eliminating the entire supplemental executive retirement plan expense. *Id.,* at 50. She testified that Westar offers these plans to officers and key executives in addition to the normal retirement plans offered to all non-union employees. Classified as "non-qualified" plans, they provide benefits in excess of those normally allowed by various IRS regulations. *Id.*, at 48-49. Ms. Crane stated that she believed these excess benefits for upper-level employees should be funded by shareholders, not ratepayers, especially given that ratepayers are also paying for normal retirement benefits for these employees. Her adjustment is shown at Schedule ACC-19 in her Direct Testimony.

G. Only actual test-year costs for the Selective Catalytic Reduction (SCR) Catalyst expense should be included in customer rates.

Westar averaged its test-year costs for its SCR catalyst with projected costs that it does not expect to incur until November 2012. *Id.*, 55-56. As Ms. Crane testified, Westar incurred significant actual test-year costs for the catalyst, and including projected costs is inconsistent with the traditional ratemaking policy of the KCC to set rates based on actual test-year costs. *Id.*, at 56. She also noted that there is limited historical data regarding the costs of the SCR catalyst, making Westar's projections for future years speculative at best. *Id.* Therefore, Ms. Crane recommended that the

Commission deny Westar's request to recover SCR catalyst costs based on an average of actual test-year costs and costs projected to be incurred far out of the test year. *Id.* Her adjustment to Westar's request, which would allow Westar to recover only the actual test-year SCR catalyst costs, is shown at Schedule ACC-21.

H. The gain on the sale of #6 fuel oil should be credited to ratepayers.

1. A rate base adjustment to fossil fuel inventory is necessary to credit ratepayers with 100% of this gain.

In response to air quality requirements imposed by the Environmental Protection Agency, Westar sold some of its #6 fuel oil inventory to reduce the amount of fuel oil in storage. (Crane, Dir.T., at 34). Westar made gains of about $8.5 million on the sale, and credited ratepayers with only 37.5% of the gains. *Id.* Mr. Kongs said he allocated the gains between shareholders and ratepayers pursuant to guidelines set forth in *Kansas Power & Light Co. v. KCC*, 5 Kan.App.2d 514 (1980). (Kongs, Dir.T, at 8, *et seq.*).

In that case, KP&L sold an office building and credited its shareholders with the gain. *Id.*, at 524. The KCC adopted Staff's adjustment to allocate $209,000 of the gain to ratepayers, on the grounds that although the ratepayers had no ownership interest in the building, they had paid its operating expenses, related taxes and a rate of return. The Kansas Court of Appeals overturned this decision, and said that while "As a general rule capital gains are retained by the utility and may be used for dividend distribution or reinvestment. When the utility seeks a rate adjustment, however, the KCC should consider the gain as a factor in the ratemaking process." *Id.*, at 528. The court offered five guidelines that the KCC should consider in determining how the gain should be allocated, noting that it regarded the list was not intended to be all inclusive:

(1) The risk of loss of investment capital.

(2) Contributions by the ratepayers to the value of the property, such as maintenance, upkeep and improvements.

(3) Financial integrity of the company, and the effect of the allocation on the price of the stock and the ability of the company to attract adequate capital.

(4) Increases in the value of the property due to inflation.

(5) Increases value of the property due to improvements in the neighborhood of the facilities sold as a result of special assessments for such things as curbing, guttering, sewage treatment plants, sewers, water, water treatment plants, general street facilities, neighborhood improvement districts, urban renewal, and other matters resulting in increased value of the property which were paid in whole or in part by the ratepayers.

Id., at 528-29.

Mr. Kongs, in his analysis beginning at page 8 of his Direct Testimony, determined that guidelines (1), (3) and (4) called for a 50/50 allocation of the gain between shareholders and ratepayers, and guidelines (2) called for a 100% allocation to shareholders. He determined that guideline (5) didn't apply under these circumstances, and CURB's Ms. Crane agreed with him on this point. (Crane, Dir.T., at 36). As a result of Mr. Kongs' analysis, he determined that shareholders should be allocated 62.5% of the gain.

Ms. Crane disagreed with Mr. Kongs' conclusions. She noted that fuel oil in inventory is a component of rate base, and ratepayers not only provide the expense component of fuel, but provide a return on the fuel while it remains in inventory, so shareholders were not at risk for loss of their investment in the fuel. *Id.*, at 36. Mr. Kongs determined that since fuel oil needs no maintenance, ratepayers had not contributed anything under guideline (2). (Kongs, Dir.T., at 9). Ms. Crane countered that ratepayers pay for the storage tanks, as well as a return (Crane, Dir.T., at 35-36); it should also be noted that if no maintenance is required for fuel oil, then the shareholders contributed nothing under guideline (2), either. She concluded that ratepayers should receive all of the benefits under guideline (2). She also concluded that allocation of this gain will not impact the financial health or integrity of the company under guideline (3), so it should be allocated to ratepayers. Regarding guideline (4), she agreed with the company that supply and demand rather than inflation determines fuel oil's value, but concluded that this guideline should be eliminated from the analysis, or, in the alternative, result in a 100% allocation to ratepayers. *Id.*, at 36. It should be noted that the ratepayers faced the risk in the decline or increase of the fuel oil's value, not shareholders, because they are responsible for funding the rate base and its return. Ms. Crane also noted that the sale was not the result of a good strategic move on behalf of company management, but because the company had to sell it to comply with new EPA requirements. *Id.*

Another factor to consider is to what extent these guidelines devised by the court in 1980 should apply today. The guidelines are decidedly tilted toward concern about the risks of recovery that utilities faced at the time. However, as Ms. Crane noted, Westar today enjoys considerably less risk than utilities faced over 30 years ago. *Id.*, at 37. Westar now recovers a great deal of its revenues through line-item surcharges that provide dollar-for-dollar recovery of expenses, plus a guaranteed return on the cost of rate base items flowed through surcharges. The costs of fuel, transmission, property taxes, energy-efficiency programs and environmental compliance projects are all now risk-free streams of revenue for Westar. Utilities can now come in before a project is commenced for predetermination of the rate treatment the project will receive, which also reduces their risk.

In summary, utilities have succeeded in the years since 1980 in shifting a great deal of their risk to ratepayers. Thus, in considering how the court's guidelines apply today, the Commission should take into account how much greater is the risk borne by ratepayers than in 1980. Since the court explicitly stated that the list of guidelines was "not intended to be all inclusive," the Commission should incorporate serious consideration of the risks faced by ratepayers today in its determination of the appropriate allocation of gains between the utility and its customers. In doing so, it should conclude that the ratepayers should be allocated the gains on the sale of the fuel oil.

2. A corresponding adjustment to Westar's expenses is necessary if the gain is credited to ratepayers.

Ms. Crane, as discussed above in the section addressing her rate base adjustments, recommended allocating 100% of the gain on the sale of #6 fuel oil to ratepayers. *Id.,* at 56. This necessitates a corresponding adjustment to expenses. Her adjustment is based on information on the after-tax gain that was provided by Westar in its response to data request KCC-346 (Crane, Dir.T, App. C), and utilizes the three-year amortization period recommended by Westar. *Id.*, at 57. Her adjustment is shown at Schedule ACC-22 in her Direct Testimony.

V. Additional adjustments and policy decisions that the Commission should adopt.

In an effort to keep the evidentiary hearing as short as possible, CURB opted not to cross-examine several witnesses regarding adjustments that Ms. Crane proposed in her direct testimony.

The fact that these adjustments were not discussed at the hearing does not mean they are not valid or important or sufficiently large to merit the Commission's consideration. Any of these adjustments made in conjunction with all the adjustments discussed above would result in an increase in Westar's rates of less than $22.2 million. Even if the Commission does not adopt all of CURB's recommendations discussed above, it should still consider these adjustments to Westar's claims. The adjustments are discussed below.

A. Rate base adjustments

1. Remove costs included as Construction Work in Progress (CWIP) that were not commenced and completed within one year.

Ms. Crane made an adjustment to Westar's Construction Work in Progress (CWIP) claim to remove non-generation projects for which Westar provided no documentation to support that the projects were eligible to be included in CWIP. The projects were to be completed within one year or less of the end of the test year, but Westar did not provide any proof that the projects had been "commenced and completed" in one year or less. (Crane, Dir.T., at 30). Ms. Crane made her decision to remove these projects based on the statute that governs whether costs of construction work are eligible for recovery, K.S.A. 66-128. The general rule is that property not yet "used or required to be used" in serving the public cannot be included in rate base for ratemaking purposes. K.S.A. 66-128(b)(1). In other words, the utility normally cannot recover the costs of a construction project from customers until the property is completed and serving customers.

However, there are a number of exceptions to the general rule enumerated in section (b)(2) of the statute. This section provides that certain projects shall be eligible for recovery from customers if certain conditions are met. Section (b)(2)(A) provides that property shall be eligible for recovery if "construction of the property will be commenced and completed in one year or less." Ms. Crane concluded from this language that projects that will be completed in one year or less, but without supporting evidence that they were also commenced within one year or less are ineligible for recovery as CWIP.

Ms. Crane based her conclusion on the particular phrasing of this section: commenced AND completed, indicating that both conditions listed must be met for the costs of the project to be included as CWIP. Her reasoning is sound. If the legislature had intended instead that property could be recovered as CWIP if (1) construction had commenced within one year or less, or (2) had been completed within one year or less, then the provision should read "commenced <u>or</u> completed." It doesn't; it reads "commenced <u>and</u> completed." Thus, these are not two distinct conditions, either one of which make a project eligible for recovery, but a single condition that has two requirements: short-term projects that are started ("commenced") AND finished ("completed") within one year are eligible for recovery. When Ms. Crane examined the evidence provided by Westar, she determined these non-generation projects did not fall within the parameters that would permit recovery under Section (b)(2). *Id.*, at 30. As a result, she made an adjustment to remove the costs of these projects from Westar's CWIP claim.

In his Rebuttal Testimony, Westar witness Mr. Kongs disagreed with this interpretation of the statute. He contended that the proper interpretation of the statute is that the legislature intended that projects "completed and placed in service" within one year should be eligible for recovery. (Kongs, Reb.T., at 15). He supplied no support for his contention that the phrase "commenced and completed" is equivalent in meaning to the phrase "completed and placed in service." He also supplied no evidence that supports his opinion about the intent of the legislature in enacting this particular exception to the general rule that projects must be completed and serving customers before they are eligible for recovery.

One must ask, if Mr. Kongs is correct, why did the legislature include any mention at all of the commencement of a project? After all, every completed project had a moment of commencement. If, as Mr. Kongs contends, when the project commenced is irrelevant, why is it mentioned at all? The statute could simply say, "if construction is to be completed within one year." The fact that it does not say that cannot be dismissed as meaningless.

There are canons of statutory interpretation that support CURB's contention that the word "and" does not mean the same thing as "or". Rather than trigger a volley of canons shot over our respective bows, CURB simply appeals to the common sense of the Commission. There is no need to resort to interpretive canons if the language of a statute is unambiguous. To determine whether Ms. Crane's interpretation of the statute is correct, the Commission should consider its answers to the following questions:

(1) Does "and" mean the same thing as "or"?

(2) Does "commenced and completed in one year or less" have the same meaning as "completed and placed in service in one year or less"?

(3) Assuming that the legislature indeed intended K.S.A. 66-128(b)(2)(1)(A) to allow recovery of CWIP costs regardless of when the project commenced, did the legislature succeed in its purpose by using this particular language?

If the Commission finds that the answer to each of these questions is "no," then the Commission must agree that Ms. Crane's interpretation of the statute is correct.The Commission should approve

Ms. Crane's adjustment to Westar's CWIP claim contained at Schedule ACC-11 in her Direct Testimony.

2. Summary of rate base adjustments

Because Ms. Crane recommended that the Commission roll back the ECRR costs into base rates, she added to Westar's pro forma rate base the rate base costs that are currently being recovered through the ECRR. As a result, her recommended rate base is significantly larger than that proposed by Westar. Including the adjustments she recommended that are discussed above, the resulting pro forma rate base is $3,749,762,254. Her adjustments are summarized at Schedule ACC-9 in her Direct Testimony.

B. Operating Income Issues

1. True-up of firm wholesale non-fuel revenues should continue.

CURB has made no recommendations to adjust the company's claim for pro forma revenue, but Ms. Crane recommends continuing to use the Annual Cost Adjustment (ACA) to flow through firm wholesale non-fuel revenues above or below the amount the Commission approves for inclusion in base rates. (Crane, Dir.T., at 39). Westar has proposed removing these revenues from the ACA and placing them in base rates, without truing them up. Ms. Crane testified that because wholesale customer revenues are based on formula rates, these revenues will change as the company's costs change. In addition, Westar's acquisition of new wholesale firm customers seems likely to continue, so the test-year revenues are not necessarily representative of the level of these revenues going forward. *Id.* She made no objection to Westar's adjustment to roll $20,361,658 of this revenue into base rates, but recommends truing up the difference between actual revenues over or under this amount through the ACA. *Id.*

2. Adjust SmartStar non-labor expense and amortize over five years.

Ms. Crane recommended that the Commission allow Westar to recover non-labor costs associated with the SmartStar project through October 2011, amortizing the costs over a five-year period. *Id.,* at 52. She recommended that the Commission deny Westar's request to include estimated costs to be incurred through the end of 2012. *Id.* Ms. Crane noted that Westar has received approval for an accounting order that will allow these costs to be recovered between rate cases. She also noted that the SmartStar project, which is a pilot project to see how automated meters work on a community-wide basis, will provide long-term benefits to Westar and its customers by establishing a basis for evaluating and assessing the value of energy control, management and metering, even if the initial project is not successful. *Id.* Therefore, she recommended recovery of these costs over a longer period than the three years requested by the company. *Id.* Her adjustment is shown at Schedule ACC-20 in her Direct Testimony.

3. Adjust bad debt expense to reflect pro forma revenues.

Ms. Crane accepts the use of a three-year average of net charge-offs to determine uncollectible expense, as proposed by Westar. *Id.*, at 57. The average is 0.422% of revenues. *Id.* However, she notes that it is "necessary to make an adjustment to the Company's claim to reflect the pro forma revenue levels contained in my testimony." *Id.* Her adjustment, based on her revenue requirement recommendation, is shown at Schedule ACC-23 in her Direct Testimony. She added that if the Commission approves a different revenue requirement than she recommends, it should make a similar adjustment, based on the 0.422% figure. *Id.*

4. Eliminate non-recurring expense.

Westar included in its revenue requirement claim the cost of a payment made to Ventex as a result of litigation that it made during the test year. *Id.,* at 61; *id.,* at KCC-38, Appendix C. Ms. Crane testified that because this one-time payment is an expense that is unlikely to reoccur in the future, she recommends removal of this cost from Westar's claim. Her adjustment is shown at Schedule ACC-25 in her Direct Testimony.

5. Reduce rate case expense to a more reasonable level.

Westar incurred costs of $739,732 for rate case expense in its last full rate case. *Id.,* at 64; *id.,* at CURB-39, App. C. In this case, Westar is claiming rate case expenses of $2.7 million. *Id.*, at 62. Ms. Crane noted that the issues in this case are no more numerous or complex than they were in the last case, and are less complex in some ways now that Westar has consolidated rates for its northern and southern territories. *Id.* Yet Westar is claiming rate case expenses of over three-and-a-half times more than it claimed in its last case.

Ms. Crane pointed out that Westar engaged one consultant to sponsor six accounting adjustments, an expense that, if accepted by the Commission, would cost ratepayers $152,030 for work that is usually produced by employees of the utility. *Id.,* at 63. She noted that the contract with this consultant pays $17,500 per month, and does not appear to be based on hourly rates or hours of work performed. *Id.* Westar provided no supporting documentation on the nature of the work performed in response to a data request. (Tr, Rohlfs, at 162.) The company engaged several other consultants for this case, the contracts for which were not awarded through a competitive bidding process. *Id.,* at 63; *id.*, at CURB-41, App. C.

More tellingly, Ms. Crane noted that Westar's actual rate case expenses through November 29, 2011, were only $635,346. *Id.*, at 64; *id.*, at KCC-380, App. C. Thus, the company's pro forma claim appears excessive. She recommended reducing the claim to $1.7 million, which is twice that of the last rate case, but more in line with Westar's actual expenses through November 2011. *Id.* She adopted Westar's recommendation to amortize the costs over three years. *Id.* Her adjustment is shown at Schedule ACC-26 in her Direct Testimony. It should be noted that her adjustment does not take into account the invoice for court reporter services that Mr. Rohlfs testified should not have been included as an expense for this case. (Tr., Rohlfs, at 165; *see* CURB Exh. 4, Hedburg & Foster invoice for KCC Docket No. 12-GIMX-337-GIV).

6. Remove non-service-related advertising expense and membership dues.

Ms. Crane reviewed Westar's claim for advertising costs, and found that the company had included the costs of advertising that is intended to promote Westar's corporate image, which is not necessary to the provision of safe and adequate electric service. *Id.,* at 65; *id.,* at KCC-174. She also found that the company had included membership dues, sponsorships and other activities that are intended to promote Westar's corporate image. *Id.*; *id.* At KCC-139, KCC-300, App. C. She recommended removing these advertising costs and membership dues from Westar's claim. Her adjustment of $27,445 is shown at Schedule ACC-27 in her Direct Testimony.

7. Disallow meals and entertainment expenses like the IRS does.

Ms. Crane made an adjustment to remove $474,471 in meals and entertainment expenses that Westar included in its expense claim. *Id.,* at 66. These costs are not deductible under IRS rules for business deductions, which disallows deductions of 50% of all meal and entertainment expenses. *Id.* For that reason, Ms. Crane said it is reasonable to exclude them from Westar's cost of service, as well. *Id.* Westar provided no evidence that any of these costs were appropriate for inclusion in rates, so Ms. Crane made an adjustment to remove them from Westar's revenue requirement. *Id.* Her adjustment is shown at Schedule ACC-28 in her Direct Testimony.

8. Synchronize interest on customer deposits.

Ms. Crane recommended an adjustment to Westar's pro forma interest expense. She noted that Westar, in calculating its rate base claim, had correctly allocated a portion of customer deposits to transmission (which is recovered through the Transmission Delivery Charge, not base rates), but had failed to make a corresponding allocation of its pro forma interest expense to transmission costs. *Id.,* at 67. To synchronize rate base and expenses associated with customer deposits, Ms. Crane made an adjustment to exclude interest on customer deposits that are allocated to transmission costs that are recovered through the Transmission Delivery Charge. This adjustment is shown at Schedule ACC-29 in Ms. Crane's Direct Testimony.

9. Adjust depreciation expense to reflect the ECRR costs in base rates.

As previously discussed, Ms. Crane recommended that costs recovered through the ECRR should be rolled back into base rates. Since Westar calculated its depreciation expense based on its request to keep recovering all of its environmental costs in the ECRR, it had removed depreciation expense associated with these costs from its base rate claim. Ms. Crane made an adjustment to add these expenses back into rate base, consistent with her recommendation that the environmental costs currently being recovered through the ECRR surcharge should be rolled back into base rates. Her adjustment is shown at Schedule ACC-30 in her Direct Testimony.

VI. Summary of the impact of CURB's recommendations on the revenue requirement

Ms. Crane testified that her recommendations would result in a determination that Westar's current base rates are producing a revenue deficiency of $44,858,841. *Id.*, at 70. Her adjustments to Westar's requested revenue requirement increase total $45,973,938. *Id.* This amount assumes that $56,461,006 in ECRR costs will be moved into base rates. *Id.* Only $268,130 relating to the prior year true-up will remain in the ECRR. In her Direct Testimony at Schedule ACC-34, Ms. Crane shows the impact of her recommendations and adjustments described herein. At Schedule ACC-35, Ms. Crane provides a pro forma income statement comparing Westar's claimed operating income at present rates, her recommended operating income at present rates, and operating income at Ms. Crane's recommended rate increase. Her recommendations will result in an overall return on rate base of 7.54% for Westar. *Id.*, at 71.

VII. Policy Issues

A. Absent mutual agreement among the parties, the accounting order review period should remain 240 days.

Ms. Crane testified that she approves of the checklist of items that Westar proposes should be filed with every application for an accounting order. She noted that the information listed is necessary to conduct an adequate review of the request. *Id.,* at 54. However, she disagreed with Westar that a shorter period of review than the usual 240 days should be adopted where KCC Staff recommends it. She instead recommended that the Commission retain the usual 240-day review period unless the parties unanimously agree that a shorter review period is acceptable. *Id.,* at 55. She noted that CURB or other parties with more limited resources than Staff may be put at a serious disadvantage if a shorter review period is adopted absent agreement by the parties that the shorter period is adequate to conduct their reviews. *Id.*, at 54-55.

B. Westar's $11 Million error should not be corrected.

Staff added $11.1 million to Westar's revenue increase request due to an error in the company's weather normalization claim. Westar witness Mr. Ruelle said the company "overlooked" this $11.1 million in calculating fuel expense as a part of the company's weather normalization adjustment. (Sanderson, Dir. T., at 11; Tr., Ruelle, at 142). Unsurprisingly, Westar witness Oakes accepted this adjustment in his rebuttal testimony. (Oakes Rebut. T., at 2). CURB does not agree with this adjustment, on the principle that the Commission, in balancing the interests of the company and its customers, should not award the company more than it asked for in its application.

VIII. Conclusions and request for relief

Westar, in its Post-Hearing Brief, implies that a rate increase lower than $50 million will leave Westar without gas for its trucks or money to trim its trees. (Westar PH Brf, at 29). However, CURB has made no proposals to reduce vehicle operating expenses or maintenance expenses and accepts Westar's alternate proposal for tree-trimming, which would be funded much more generously than it is now. The only thing that CURB has "kicked down the road" (*Id.*, at 3) is the way-out-of-test-year expenses of the SCR catalyst costs, which CURB rightly "kicked down the road" to the next rate case because they are to be incurred so far out of the test year that Westar should not have included them in this case. And, by the way—the settlement incorporates that decision.

By far, the largest adjustment that CURB has made to Westar's request is the reduction in profit for shareholders, which has no impact whatsoever on Westar's ability to fill its trucks with gas or trim its trees. This adjustment does have a big impact on Westar's request, but it is an impact that is warranted by Westar's current level of risk, the state of the economy and its cost of capital. CURB has also tossed out almost half a million dollars in meals and entertainment expenses, millions more in lavish bonuses based solely on financial criteria and a million in inflated rate case expenses. Not one of these adjustments has any impact whatsoever on Westar's ability to serve customers or maintain reliability. Further, CURB has not recommended cuts to operational costs or cuts to regular payroll, pension or benefits.

The KCC Staff, in agreeing to the settlement, has said that the settlement is in the public interest, but acknowledges that determining whether rates are an excessive burden on customers is the Commission's role. (Tr., McClanahan, at 208-09). Ms. Myrick testified that the settlement imposes no excessive burden on customers, but offered no evidence of the actual impact on customers of the increase. (Tr., Myrick, at 326). She said her "job is to balance . . . the needs of a company for their money and figure out which customers we are going to get it from" (*Id.*, at 327).

That doesn't sound much like "balancing" to CURB, and sounds more like Staff views its job as ensuring that the company gets its money. Staff can only make a guess about whether rates are affordable or excessively burdensome to customers. Furthermore, in accepting the settlement's agreement to shift $1 million more of the $50 million increase to residential and small commercial customers from large commercial and industrial customers as "in the public interest" (Tr., McClanahan, at 214-15), Staff has instead acted in its own interest to reach a settlement, whether it is in the public interest or not. Although it is clear that Ms. Myrick takes her role as a balancer seriously and seeks to be fair in her determinations, Staff's agreement to shift even more of the burden onto the ratepayers who are paying the bulk of this increase doesn't strike CURB as fair or balanced. The Commission should consider whether, in pursuing their interests in settling this case, it was fair of the parties to push costs from one class to another to induce some of the parties to settle.

In balancing the interests of the utility and its customers, the Commission should question whether the magnitude of the risk electric utilities face today is greater or smaller than it was in 1980, when the court in the *Kansas Power & Light v. KCC* case developed a method of determining whether a utility or its customers should be credited with the gains on a sale of utility property. Maybe that method isn't as valid as it was before columns of line-item surcharges started appearing on customer bills and providing utilities a virtually risk-free stream of revenues and a risk-free rate of return on the capital costs recovered through those surcharges.

In balancing the interests of the current ratepayers and future ratepayers, the Commission should note that Staff's study found that current ratepayers would benefit if environmental costs were embedded in base rates, but Staff supported continuing to recover these costs through the ECRR. In consideration of both generations of ratepayers, the Commission should consider the willingness of Westar to have current and future customers pay for future removal of plants that the company has no plans to remove. Staff and CURB agree that not only is that a bad idea, but is contrary to a Kansas court decision and commonly-accepted accounting practices. Westar, if the settlement isn't approved, will be free to argue that CURB and Staff are wrong, but for the sake of settling this case, Westar has chosen to accept that they are right.

In considering the interest of the public in reliable power and being protected from unnecessarily high rates, the Commission should remember that the public in Kansas has an interest in having reasonable rates for power so that communities can attract new businesses and so that current businesses can grow. The Commission should consider that CURB's proposed adjustments will not negatively impact operations or reliability. CURB is supporting a more aggressive tree-trimming program and has left it open for Westar to come back in its next case to request a system-wide expansion of the program once it has some evidence that improved reliability justifies the expansion. CURB is not opposed to customers paying for the SCR catalyst or other projects when it is appropriate to do so, but is opposed to paying speculative costs, out-of-test-year costs and costs that do not fall under the exceptions to the rule that plant must be completed and serving customers before the company may recover the costs of that plant from customers.

The Commission should consider whether customers should be protected against the temptation of the utility to be less prudent when costs are recovered dollar-for-dollar, rather than thorough, systematic examination of costs every few years in a rate case. If so, rolling back the ECRR into base rates with every rate case would protect customers better than if the roll-back provision is eliminated.

The Commission should, in considering whether to approve the settlement, consider whether the provisions of the settlement call for a $43 million rate hike rather than the $50 million agreed to by the parties. This difference is not an issue of each of the parties making its own assumptions about what the "black box" revenue requirement contains or doesn't contain. The provisions are explicit and have explicit dollar values that indicate that a $43 million increase is commensurate with those values. The Commission can reasonably decide, even if it likes most of the settlement's provisions, that the revenue requirement should be lower.

Most importantly, the Commission should consider whether, under current economic conditions, a 10% ROE for shareholders is just, reasonable, or fair. The Commission should consider setting the return on equity at a level more commensurate with Westar's risks and the reasonable expectations of investors.

The Commission should consider whether CURB's proposals are more reasonable than the settlement's proposals. The Commission should consider whether CURB's proposals are more reasonable than the prefiled positions of those who signed onto the settlement. Then, the Commission should adopt the proposals that it finds are just and reasonable, set reasonable rates and serve the public interest. That resulting number could be $43 million, or $22.5 million—or less. The Commission, in considering CURB's proposals, should keep in mind that these figures do not include the ECRR costs. If the ECRR is rolled into base rates, the revenue increase on base rates will be considerably higher, but the ECRR surcharge will be reduced to a handful of true-up costs.

Therefore CURB respectfully requests that the Commission find that the settlement is not just, reasonable, or in the public interest. CURB also requests that the Commission find that the proposals and arguments made herein are just, reasonable, and in the public interest.

Respectfully submitted,

David Springe #15619
Niki Christopher #19311
C. Steven Rarrick #13127
Citizens' Utility Ratepayer Board
1500 SW Arrowhead Road
Topeka, KS 66604
(785) 271-3200
(785) 271-3116 Fax

VERIFICATION

STATE OF KANSAS)

COUNTY OF SHAWNEE) ss:

I, Niki Christopher, of lawful age, being first duly sworn upon her oath states:

That she is an attorney for the Citizens' Utility Ratepayer Board, that she has read the above and foregoing document, and, upon information and belief, states that the matters therein appearing are true and correct.

Niki Christopher

SUBSCRIBED AND SWORN to before me this 14th day of March, 2012.

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2013

Notary Public

My Commission expires: 01-26-2013.

CERTIFICATE OF SERVICE

12-WSEE-112-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was sent by electronic service on the 14th day of March, 2012, to the following:

KEVIN K. LACHANCE
OFFICE OF STAFF JUDGE ADVOCATE
HQ, 1ST INFANTRY DIVISION & FORT RILEY
BUILDING 200, PATTON HALL
FORT RILEY, KS 66442-5017

MICHAEL E. AMASH, ATTORNEY
BLAKE & UHLIG PA
SUITE 475 NEW BROTHERHOOD BLDG
753 STATE AVE.
KANSAS CITY, KS 66101

KURT J. BOEHM, ATTORNEY
BOEHM, KURTZ & LOWRY
36 EAST SEVENTH STREET, SUITE 1510
CINCINNATI, OH 45202

JODY M. KYLER, ATTORNEY
BOEHM, KURTZ & LOWRY
36 EAST SEVENTH STREET, SUITE 1510
CINCINNATI, OH 45202

KEVIN HIGGINS
ENERGY STRATEGIES, LLC
PARKSIDE TOWERS
STE 200 215 S STATE ST
SALT LAKE CITY, UT 84111

PAUL LIRA, BUSINESS MANAGER
IBEW LOCAL UNION NO. 304
3906 NW 16TH STREET
TOPEKA, KS 66615

JOHN R. WINE
JOHN R. WINE, JR.
410 NE 43RD
TOPEKA, KS 66617

RAY BERGMEIER, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027

ROBERT A. FOX, SENIOR LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027

ANDREW SCHULTE, LITIGATION COUNSEL
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027

DOROTHY J. MYRICK
MYRICK CONSULTING SERVICES
5016 SE 29TH ST
TECUMSEH, KS 66542-9755

CARSON M. HINDERKS, ATTORNEY
SMITHYMAN & ZAKOURA, CHTD.
7400 W 110TH ST STE 750
OVERLAND PARK, KS 66210-2362

JAMES P. ZAKOURA, ATTORNEY
SMITHYMAN & ZAKOURA, CHTD.
7400 W 110TH ST STE 750
OVERLAND PARK, KS 66210-2362

MICHAEL D. FELIX
SPIRIT AEROSYSTEMS, INC.
PO BOX 780008, K06-10
WICHITA, KS 67278-0008

TIMOTHY E. MCKEE, ATTORNEY
TRIPLETT, WOOLF & GARRETSON, LLC
2959 N ROCK ROAD, SUITE 300
WICHITA, KS 67226

CERTIFICATE OF SERVICE

12-WSEE-112-RTS

SAMUEL D. RITCHIE, ATTORNEY
TRIPLETT, WOOLF & GARRETSON, LLC
2959 N ROCK ROAD, SUITE 300
WICHITA, KS 67226

ROBERT A. GANTON, ATTORNEY - REGULATORY LAW
UNITED STATES DEPARTMENT OF DEFENSE
US ARMY LEGAL SERVICES AGENCY
9275 GUNSTON ROAD, ATTN JALS-RL/IP
FORT BELVOIR, VA 22060-5546

MARTIN J. BREGMAN, EXEC DIR, LAW
WESTAR ENERGY, INC.
818 S KANSAS AVENUE
PO BOX 889
TOPEKA, KS 66601-0889

CATHRYN J. DINGES, CORPORATE COUNSEL
WESTAR ENERGY, INC.
818 S KANSAS AVENUE
PO BOX 889
TOPEKA, KS 66601-0889

JAMES G. FLAHERTY, ATTORNEY
ANDERSON & BYRD, L.L.P.
216 SOUTH HICKORY
PO BOX 17
OTTAWA, KS 66067

DAVID L. WOODSMALL
WOODSMALL LAW OFFICE
807 WINSTON CT
JEFFERSON CITY, MO 65101-2869

MELISSA DOEBLIN
KANSAS CORPORATION COMMISSION
1500 SW ARROWHEAD ROAD
TOPEKA, KS 66604-4027

Della Smith
Administrative Specialist