BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of	)	
Kansas City Power & Light Company	)	**Docket No. 12-KCPE-764-RTS**
To Make Certain Changes in Its Charges	)	
for Electric Service	)	

POST HEARING BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD

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1. COMES NOW the Citizens' Utility Ratepayer Board ("CURB"), and submits its Post Hearing Brief ("Brief") in the above-captioned proceeding.[1]

I. INTRODUCTION

A. Overview

2. This is the first rate case filed by KCPL following the four rate cases filed pursuant to the Regulatory Plan approved by the Commission in Docket No. 04-KCPE-1025-GIE ("1025 Docket").

3. As indicated by ratepayers during the public hearing, KCPL customers are weary of the back-to-back-to-back-to-back rate increases experienced during the worst economic downturn in modern history. Not counting increases in surcharges,[2] the four Regulatory Plan rate cases resulted in rate increases totaling over $137.8 million, as follows:

- $29 million rate increase in Docket 06-KCPE-828-RTS.
- $28 million rate increase in Docket 07-KCPE-905-RTS.
- $59 million rate increase in Docket 09-KCPE-246-RTS.
- $21.8 million rate increase in Docket 10-KCPE-415-RTS.

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[1] CURB has attempted to follow the order of issues contained in the KCPL Brief for the Commission's convenience.
[2] KCPL surcharges include the energy cost adjustment (ECA), energy efficiency rider (EER), and property tax surcharge (PTS).

4. KCPL seeks an additional rate increase of $63.55 million in the Application in this docket. While this request has been reduced to $56.4 million as a result of the partial settlement, corrections, and updates made during the course of discovery, the rate increase needs to be reviewed and scrutinized with utmost care to ensure any rate increase awarded is limited to only those investments, expenses, and a return on equity that are absolutely necessary to provide safe and reliable service and that results in just and reasonable rates.

5. CURB's recommended rate base, revenue requirement, rate of return, and rate design adjustments are reflected in the testimony and schedules of Andrea Crane, Dr. J. Randall Woolridge, and Brian Kalcic, which are incorporated herein by reference.[3] CURB's filed position recommended a rate increase of $4.9 million. As a result of the partial settlement and some corrections and updates, and based on the Company's revised claim of $56.4 million, CURB's position has been revised to recommend a rate increase of no more than $9.579 million.

B. Legal Standards – Revenue Requirement and Rate Design

1. Revenue Requirement

6. The Kansas Commission has previously held that the utility filing the application bears the burden of proof to establish the basic facts to make a *prima facie* showing that *it has acted prudently.*[4] As a general rule, the burden of proof lies with the applicant or moving party.[5]

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[3] Direct Testimony and Schedules of Andrea Crane, J. Randal Woolridge, and Brian Kalcic; CURB Exhibits 5 and 6; Cross-Answering Testimony of Brian Kalcic.

[4] Order Denying Reconsideration, March 26, 2002, ¶ 5, *In the Matter of the Partial Suspension of the Monthly Cost of Gas Rider of OneOk, Inc., d/b/a Its Division, Kansas Gas Service Company Effective Date October 31, 2001; a Partial Suspension Pertaining to Any Amount That Is in Excess of the Obligation of KGS to Pay Kansas Pipeline Company Established by Their July 9, 1997 Settlement Agreement and the Commission's Order of April 19, 1997 in Docket No. 106,850-U*, KCC Docket No. 02-KGSG-329-PGA (citing *In re Estate of Robison,* 236 Kan. 431, 439, 690 P.2d 1383 (1984)).

[5] See *In re Sipe,* 44 Kan.App.2d 584, 592 (2010) ("[A]s a general rule the burden of proof lies with the moving party or the party asserting the affirmative of an issue." (citing *Wooderson v. Ortho Pharmaceutical Corp.,* 235 Kan. 387, 412 (1984) and *In re G.MA.,* 30 Kan.App.2d 587, 593 (2002)).

7. Under the Kansas Rules of Evidence the term "burden of proof' is synonymous with "burden of persuasion."[6] Burden of proof means a party has an obligation to meet the requirements of a rule of law that the fact to be established must be proven by a requisite degree of belief.[7] In a civil matter, this is by a preponderance of the evidence.[8]

8. In *Wycoff v. Board of County Commissioners,* the Kansas Supreme Court held: "It is well settled that the burden of proving a disputed fact or issue rests upon the party asserting it, or having the affirmative of the issue, and remains with him throughout the trial.[9] Similarly, in the case *In re G.M.A.,* the Kansas Court of Appeals held:

> It is often said that the burden of proof rests with the party who, absent meeting his or her burden, is not entitled to relief, or upon the party that would be unsuccessful if no evidence were introduced on either side. Also, the burden of proof generally falls upon the party seeking a change in the status quo."[10]

9. Likewise, the Commission has held that, "Generally, the burden of proof rests on the party who has the affirmative on the issue."[11] The Commission has further explained that, "More often than not, the burden of proof lies with the party who initiates an action"[12] and that the initiating party must prove the allegations of its application by a preponderance of the evidence.[13]

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[6] K.S.A. 60-401(d).
[7] *Id.*
[8] *Witschner v. City of Atchison,* 154 Kan. 212, 215, (1941); see a/so *In reG. M.A.,* 30 Kan. App.2d 587, 594 (2002).
[9] *Wycoff v. Board of County Commissioners,* 191 Kan. 658, 664-65 (1963) (citations omitted).
[10] *In re G.M.A.,* 30 Kan. App.2d 587, 593-594 (citing 29 Am. Jur. 2d, Evidence§ 158) (emphasis added).
[11] *Order No. 13: Order on Reconsideration,* KCC Docket No. 99-WPEE-818-RTS, at 1f 5 (July 18, 2000), 2000 Kan. PUC LEXIS 85; see a/so *Order No. 10: Order Denying Reconsideration of Order Establishing Rate Design,* KCC Docket Nos. 96-KG&E-100-RTS; 96-WSRE-101-DRS at 1f 6 (September 2, 1998).
[12] *Order No. 13: Order on Reconsideration,* KCC Docket No. 99-WPEE-818-RTS, at 1f 5 (July 18, 2000), 2000 Kan. PUC LEXIS 85; see a/so *Order No. 10: Order Denying Reconsideration of Order Establishing Rate Design,* KCC Docket Nos. 96-KG&E-100-RTS; 96-WSRE-101-DRS at 1f 6 (September 2, 1998).
[13] *Order Denying Reconsideration,* KCC Docket No. 02-KGSG-329-PGA, at ¶ 5 (March 26, 2002) *(citing In re Estate of Robison,* 236 Kan. 431, 439, 690 P.2d 1383 (1984).

10. Utilities in Commission proceedings have argued, unsuccessfully, that they were entitled to a presumption of prudence, but the Kansas Commission disagreed:

> 5. Generally, the burden of proof can refer to either the burden of persuasion or the burden of going forward with evidence. Under Kansas rules of evidence, the term "burden of proof' is synonymous with "the burden of persuasion." K.S.A. 60-401(d). The burden of persuasion means a party has an obligation to meet the requirements of a rule of law that the fact to be established must be proven by a requisite degree of belief. K.S.A. 60-401(d). As a general rule, burden of persuasion or the burden of proof lies with the party who initiates an action. The initiating party must prove the allegations of its application by a preponderance of the evidence. *In re Estate of Robison,* 236 Kan. 431, 439, 690 P.2d. 1383 (1984).
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> 6. The burden of going forward with evidence is the duty to a case to refute or explain a particular point, such as the need to make a ***prima facie*** showing. The burden of producing evidence is the obligation of a party to introduce evidence sufficient to avoid a ruling against the party on the issue. Under traditional legal theory, the burden of persuasion does not shift at any stage of the proceeding while the burden of coming forward with evidence may shift back and forth as the case progresses. Black's Law Dictionary, West Publishing Co., *5"* Ed., p. 178. If facts which give rise to a presumption are established, the burden is placed on the party against whom the presumption operates to put forth sufficient evidence to rebut the presumption; if sufficient rebuttal evidence is presented, the presumption vanishes. *Matter of Estate of Lewis,* 549 N.E.2d 960, 962 (1990).
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> 7. This proceeding was initiated upon application of KGS to set the gas sales rate under its COGR tariff. That application incorporates the transportation charges of Kansas Pipeline Company that were incurred under contracts, which were the subject matter of the Commission's investigation in Docket No. 97-WSRE-312-PGA. KGS must be prepared to establish the basic facts to make a ***prima facie*** showing that it has acted prudently to preserve its contract rights against the Kansas Pipeline Company. [14]

11. The standard of evidence the Commission must meet for its decisions to be lawful and valid was considered in *Zinke & Trumbo Ltd. v. Kansas Corp. Comm'n.* [15] In *Zinke*, the Court held that to be lawful and valid, the Commission's decision must be supported by substantial competent evidence, and must not be unreasonable, arbitrary, or capricious.[16]

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[14] Order Denying Reconsideration, March 26, 2002, ¶¶ 5-7, KCC Docket No. 02-KGSG-329-PGA, (emphasis added).
[15] 242 Kan. 470, 749 P.2d 21 (1988).
[16] 242 Kan. at 474.

12. Regulatory agencies may make major changes in prior policies or positions, but the subsequent policy or position must be based on substantial and competent evidence.[17]

13. Substantial competent evidence is evidence which "possesses something of substantial and relevant consequence and which furnishes a substantial basis of fact from which the issues tendered can reasonably be resolved."[18]

14. An order of the Commission is lawful if it is within the statutory authority of the Commission and if the prescribed statutory and procedural rules are followed in making the order.[19]

15. The filing requirements for rate proceedings before the Commission include the following:

> (a) Each electric, gas, telecommunications, or water utility whose rates are under review by the commission at the request of the utility *shall comply with this regulation* and shall be prepared to establish, by appropriate schedules and competent testimony, all relevant facts and data pertaining to its business and operations that will assist the commission in arriving at a determination of rates that are fair, just, and reasonable both to the utility and the public.
> ...
> (c) Class A utility rate proceedings: application and evidence. (1) Each major rate application by a class A utility *shall be* accompanied by schedules that will indicate to the commission the nature and extent of the relief requested.
> (2) Each application *shall be based upon data submitted for a test year.* The test year selected by the applicant may be disapproved by the commission for cause.
> ...
> (4) The form, order, and titles of each section shall conform to the following requirements:
> ...
> (I) Section 9: Test year and pro forma income statements. The first schedule shall present an operating income statement depicting the unadjusted test year operations, pro forma test year operations, and allocations to jurisdictions. Supporting schedules *shall set forth* a full and complete explanation of the

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[17] *Western Resources. Inc. v. Kansas Corporation Comm'n,* 30 Kan. App.2d 348, 360 (2002).
[18] *Jones v. Kansas Gas & Electric Co. v. Kansas Corp. Comm'n,* 222 Kan. 390, 565 (1977).
[19] *Central Power Co. v. State Corp. Comm'n,* 221 Kan. 505, 561 P.2d 779 (1977).

purpose and rationale for the pro forma adjustments. These pro forma adjustments *may* include the following:

...

(ii) adjustments for *known or determinable* changes in revenue and expenses.

...

(d) Revisions of applications and schedules. If the applicant desires to make revisions to its application and schedules, other than minor corrections and insertions that require only interlineations and do not unduly prolong the hearing with respect to the application or schedules, the applicant *shall file* with the commission those revised schedules that are necessary to reflect the desired revisions, as follows:

(1) Each page of any such revised section or schedule *shall* bear the same section letter designation, schedule number, and page number as the original page with the word "Revised" and the date of the revision immediately below the original section, schedule, or page designation.

(2) The same number of copies of any revised sections, schedules, or pages *shall be filed* as the number of copies originally required to be filed.

(3) A copy of each revised section, schedule, or page *shall also be served upon each party* whose intervention has previously been permitted by the commission pursuant to K.S.A. 77-521, and amendments thereto, and K.A.R. 82-1-225.

(4) All revised sections, schedules, and pages *shall be filed* in accordance with the provisions of K.A.R. 82-1-221, *unless otherwise ordered by the commission for good cause shown.*

(5) Substantial revisions of the schedules, including changing to a different test year, may constitute grounds for a continuance of a scheduled hearing to a later date to be granted by the commission.[20]

2. Rate Design

16. As acknowledged by KCPL, "The touchstone of public utility law is the rule that one class of consumers shall not be burdened with costs created by another class." [21] Other jurisdictions describe this principle as the "polestar" of utility ratemaking.[22]

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[20] K.A.R 82-1-231 (emphasis added).

[21] *Jones v. Kansas Gas and Electric Co.,* 222 Kan. 390, Syl. ¶ 10, 565 P.2d 597 (1977); Initial Post-Hearing Brief of Kansas City Power and Light Company (KCPL Initial Brief), ¶ 11 (citing, *Midwest Gas Users Ass'n v. Kansas Corporation Comm'n,* 3 Kan. App. 2d 376, 391, 595 P.2d 735 (1979)).

[22] CURB Exhibit 5: *Lloyd v. Pennsylvania PUC,* 904 A.2d 1010, 1020, Util. L. Rep. P 26,959 (Pa. Cmwth. 2006), appeal denied, 916 A.2d 1104, fn. 10 (2007) (cost of service should be the "polestar" of utility ratemaking).

17. Kansas Courts have held that "[i]f the KCC is convinced or the evidence indisputably demonstrates that a rate structure in fact imposes costs on one class costs created by another, the rate structure cannot withstand the test of *Jones.*"[23]

18. In *Lloyd v. Pennsylvania PUC,* [24] the Pennsylvania Commission's decision to limit rate increases to any rate class to 10% of the total bill purportedly based on the principle of gradualism was reversed on appeal by the Commonwealth Court of Pennsylvania. The *Lloyd v. Pennsylvania PUC* Court held:

> In this case, there is no dispute that there is a substantial difference in costs required to deliver services between classes. For such a rate differential to survive a discriminatory rate challenge brought under Section 1304 of the Code, 66 Pa.C.S. § 1304, it must be shown that the differential can be justified. In this case, the Commission offers essentially one justification—gradualism and rate shock.
>
> The Commission defines gradualism as limiting the increase to 10% of the total bill—period. It does not explain why 10% of the total bill is the magic number that will prevent rate shock; it is just a number before which all other considerations must fall. It also never explains how the acknowledged discriminatory rate class structures are going to be lessened, only that gradualism is served by limiting the total bill increase by less than 10%. However, while permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time. *Watergate East, Inc. v. Public Service Commission of District of Columbia,* 665 A.2d 943 (D.C.App.1995). Because the flat percentage increase in transmission charges increases any previous discrimination in rates, and the Commission offers no explanation how discrimination in distribution and transmission rate structures are eventually going to be gradually alleviated, in effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns—especially the polestar—cost of providing service.
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> ...

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[23] *Midwest Gas Users Ass'n and Armco Inc. v. v. Kansas Corporation Comm'n,* 5 Kan. App. 2d 653, 657-59, 623 P.2d 924 (1981) (citing, *Midwest Gas Users Ass'n. v. Kansas Corporation Comm'n,* 3 Kan. App 2d 376, 391(1979)).

[24] CURB Exhibit 5: *Lloyd v. Pennsylvania PUC,* 904 A.2d 1010, Util. L. Rep. P 26,959 (Pa. Cmwth. 2006), appeal denied, 916 A.2d 1104, fn. 10 (2007).

> Accordingly, we vacate the Commission's order regarding transmission and distribution rates and remand for the setting of non-discriminatory reasonable rates and rate structure for each service.[25]

19. Gradualism is only one of many factors to be considered by Commissions in determining rate designs, and the principle of gradualism cannot be allowed to trump all other valid ratemaking concerns such as ensuring that customer classes pay a fair share of the utility's costs of serving them.[26]

C. Partial Settlement Agreement

20. CURB concurs with KCPL's description of the Partial Settlement Agreement contained in paragraph 13 of KCPL's Initial Brief. However, the list of remaining contested issues specified in paragraph 14 of KCPL's Initial Brief is incomplete. The issues that remain in contention between CURB and KCPL are:

- Rate Of Return
- Post Test Year Rate Base
- Jurisdictional Allocations
- Incentive Compensation - Non Officers – Cash
- Incentive Compensation - Stock Awards – Officers
- Incentive Compensation-Stock Awards – Directors
- Pension Expense (Funded Status)
- Deferred Pension - Post Test Year
- Deferred Pension - Amortization Period
- SERP
- OPEB – Post Test Year
- OPEB – Amortization Period
- Other Benefits Expense
- Fines and Penalties
- Rate Case Expense
- Depreciation – Post Test Year
- Rate Design.

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[25] *Id.*, at p. 1020.
[26] *Id.*, at p. 1020; *Watergate East, Inc. v. Public Service Comm'n of District of Columbia,* 665 A.2d 943, 950 (D.C. 1995).

D. Abbreviated Rate Proceeding

21. CURB concurs with KCPL's description of this issue.

II. CONTESTED ISSUES

22. As noted above, the contested issues listed in paragraph 14 of KCPL's Initial Brief, as well as Section II, are incomplete. The issues that remain in contention between CURB and KCPL are specified in the matrix below, with the exception of the rate design issues.

A. Matrix of Contested Positions

23. CURB's original revenue requirement recommendation was based on the Company's original filing, which requested a rate increase of $63,550,528. The revenue requirement impact of each of CURB's adjustments is shown in Schedule ACC-44 of Ms. Crane's testimony. Many of the accounting issues in this case were resolved through the Partial Settlement that was executed by the parties on September 28, 2012.

24. Following is a matrix showing the revenue requirement impact of the issues that remain contested at this time. This matrix also includes the quantification of CURB's issues as presented by KCPL on page 8 of its Initial Brief submitted on October 19, 2012. In some cases, there are slight variations between CURB's quantification and the Company's quantification. Some of these variations are due to revisions made by the Company during the litigation process and the fact that KCPL's overall claim has now been revised to $56.4 million, albeit without the filing of any revised schedules. Other variations are due to the manner in which certain adjustments were presented by KCPL and the fact that CURB's quantification also includes the impact of recommended changes to the revenue multiplier. Finally, the resolution of some adjustments impacts other adjustments. For example, the resolution of the issue relating to jurisdictional allocations will impact the quantification of rate base adjustments, which will in

turn impact the quantification of rate of return adjustments. Therefore, this matrix is being provided to assist the KCC in evaluating the relative magnitude of CURB's adjustments. The precise impact of any specific adjustment cannot be quantified until the KCC makes a determination on each issue that remains contested.

Revenue Requirement Impact of Contested Issues ($000)
As Quantified by CURB and KCPL

Adjustment	CURB		KCPL	
Rate of Return	($29,908)	(A)	($28,079)	
Post Test Year Rate Base	(2,269)	(A)	(5,571)	(G)
Jurisdictional Allocations	(9,852)	(A)	(9,914)	
Incentive Compensation - Non Officers - Cash	(512)	(B)	(452)	
Incentive Compensation - Stock Awards – Officers	(275)	(C)	(274)	
Incentive Compensation - Stock Awards - Directors	(113)	(C)	(113)	
Pension Expense (Funded Status)	(536)	(D)	(522)	
Deferred Pension - Post Test Year	(633)	(E)	(1,422)	(H)
Deferred Pension - Amortization Period	(845)	(E)	Included in (H)	
SERP	(257)	(A)	(253)	
OPEB - Post Test Year	44	(F)	Included in (H)	
OPEB - Amortization Period	30	(F)	Included in (H)	
Other Benefits Expense	(1,503)	(A)	Included in (G)	
Fines and Penalties	(16)	(A)	Not Quantified	
Rate Case Expense	(206)	(A)	(206)	
Depreciation - Post Test Year	(620)	(A)	Included in (G)	

Sources:
(A) Per Schedule ACC-44.
(B) Includes portion of Incentive Compensation Expense - Cash Awards per Schedule ACC-44.
(C) Included in Incentive Compensation Expense - Stock Awards per Schedule ACC-44.
(D) Includes only funding status portion of Pension Expense Adjustment per Schedule ACC-44.
(E) Included in Amortization of Deferred Pension Expense per Schedule ACC-44.
(F) Included in Amortization of Deferred OPEB Expense per Schedule ACC-44.
(G) KCPL included rate base, other benefits expense, depreciation adjustments, and other adjustments in one adjustment entitled "June 30, 2012 Update".
(H) Includes both the change of amortization period and the inclusion of post test year costs for both pension and OPEB Expense.

B. Rate of Return and Capital Structure

1. Summary of Positions

25. CURB witness Dr. J. Randall Woolridge recommends an overall rate of return for KCPL of 7.58%.[27] Dr. Woolridge utilizes traditional cost of capital models, combining KCPL's proposed 6.63% embedded cost of debt and a recommended 8.50% return on equity (ROE). Dr. Woolridge accepted KCPL's proposed capital structure in arriving at his 7.58% overall rate of return.

26. In arriving at his 8.50% ROE, Dr. Woolridge used the discounted cash flow model(DCF), analyzed 33 similarly situated utilities in his proxy group, reviewed over 300 historic and forecasted growth rates and reviewed over 200 dividend yields spanning six months.[28] Reviewing both historical performance and forecasted growth rates for earnings, dividends and book value provides a robust DCF result and more closely mirrors the variety and type of information actual investor's review in making investment decisions. Dr. Woolridge also calculated at 7.7% ROE using the capital asset pricing model (CAPM), but did not rely on the result in making his overall ROE recommendation.

27. KCC staff witness Adam Gatewood recommends an overall rate of return of 7.85%[29], very similar to Dr. Woolridge. Mr. Gatewood uses GPE, KCPL's parent company's capital structure, 6.43% embedded cost of debt rate and proposes a ROE range of 8.7% to 9.5%, selecting 9.20% as his overall ROE recommendation.[30] Mr. Gatewood's four DCF models produce and average ROE of 8.93%, only slightly higher than Dr. Woolridge's DCF result. Mr.

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[27] Woolridge Direct, at 2; Exhibit JRW-1.
[28] Woolridge Direct, Exhibits JRW-4 and JRW-10.
[29] For a chart summarizing Staff's ROR recommendations, see Gatewood Direct, at 4.
[30] For a chart summarizing Staff's Cost of Equity recommendations, see Gatewood Direct, at 14.

Gatewood's DCF model incorporates earnings growth, dividend growth and a 4.55% forecasted nominal gross domestic product (nGDP) growth rate. Mr. Gatewood also utilized four forward looking risk premium models that resulted in an average ROE of 9.2% and a CAPM model resulting in an ROE of 9.27%. Mr. Gatewood, like Dr. Woolridge, performs a robust analysis in arriving at his ROE conclusion, reviewing numerous financial indicators as would any investor.

28. KCPL witness Dr. Samuel C. Hadaway preformed a very narrow financial analysis in arriving at his 8.57% overall rate of return recommendation. Dr. Hadaway states that KCPL management picked an initial[31] ROE of 10.4%[32], at the very top end of his ROE range. Dr. Hadaway supports the top-of-range ROE recommendation with model inputs that in every instance are biased upward. For example, to set the growth levels in his DCF model, Dr. Hadaway relies only on two estimates: expected earnings growth or long term historical nGDP averages. It is unrealistic to think that investors rely on only these two estimates without also considering historic earnings growth, historic and forecasted dividend growth, historic and forecasted book values and most importantly, widely available current nGDP forecasts, as did Dr. Woolridge and Mr. Gatewood. Dr. Hadaway removes certain analyst growth estimates from his DCF model if he believes they are too low but leaves in analyst growth rate estimates that appear high, creating an upward bias in his results. Finally, to arrive at his 5.7% nGDP growth estimate, Dr. Hadaway uses a weighted average of 60 years of historical nGDP data.[33] However, the average nGDP growth has been below 5.4% for 30 years, below 4.7% for the last 20 years and below 4% for the last 10 years.[34] Dr. Hadaway's 5.7% nGDP growth rate is unrealistic.

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[31] In rebuttal testimony, KCPL reduced its ROE recommendation to 10.3%.
[32] Hadaway, Tr. Vol. 3, at 664-665.
[33] Hadaway Direct, Schedule SCH-4; Hadaway Rebuttal Schedule SCH-10.
[34] *Id.*

Even with the bias built into his DCF model, Dr. Hadaway's DCF range is only 10% to 10.2%, below his 10.4% overall ROE recommendation.

29. To get to KCPL's 10.4% ROE request, Dr. Hadaway utilizes a risk premium model developed by comparing historically allowed ROE's with historical Moody's average utility debt costs to create an equity risk premium. The risk premium is then applied to current and forecasted government bond rates to create an equity ROE rate. Dr. Hadaway's risk premium model results in two point estimates for ROE; a "current interest rate model" at 9.95%[35] and a "forward looking interest rate model" at 10.42%.[36] The 10.42% forward looking risk premium estimate is the only estimate in the entire record before the Commission that supports KCPL's 10.4% request. When Dr. Hadaway recalculates his risk premium model in his rebuttal testimony, his forward looking risk premium estimate drops to 10.14%.[37]

30. Finally, Dr. Hadaway poses an overarching theory that interest rates are artificially low due to the intervention of the Federal Reserve and therefore the DCF and CAPM models produce results that are "not correct".[38] In the simplest sense, Dr. Hadaway urges the Commission to ignore the data and models in this case and use its "informed judgment" to arrive at an ROE above 10%. However, Dr. Hadaway's informed judgment appears to conflict with the informed judgment of Dr. Woolridge and Mr. Gatewood. It also appears to conflict with the informed judgment of Mr. Bill Gross, founder and CEO of the PIMCO bond fund, one of the largest bond funds in the world.[39] Mr. Gross finds utilities to be an attractive investment because "they pay big dividends because they continually are granted a 10 percent return on equity by

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[35] Hadaway Direct, Schedule SCH-6, page 2.
[36] Hadaway Direct, Schedule SCH-6, page 1.
[37] Hadaway Rebuttal, Schedule SCH-12, page 1.
[38] Hadaway, Tr. Vol. 3, at 650.
[39] Gatewood, Tr. Vol. 3, at 708.

regulators in a world where returns are moving much lower. After earning 10 percent, they can pay out 4 to 5 percent to investors."[40] As Mr. Gatewood neatly sums it up, Mr. Gross, "as somebody who is investing in dividend paying stocks, he is recognizing there's a disconnect between the market cost of capital and what regulators have been granting utilities lately."[41] CURB suggests the Commission follow the informed judgment of Mr. Gross, who makes a very successful living understanding opportunities in the market verses Dr. Hadaway, who makes a very successful living supporting high ROE estimates for utilities in the regulatory process.

2. Areas of General Agreement

31. There are several issues or areas of general agreement between the parties. In these areas, the parties have used the same numbers or the difference in the parties' numbers does not have a meaningful impact on the overall rate or return. The Commission need not focus much attention on these areas. Dr. Woolridge and Mr. Gatewood generally agree with using the GPE (KCPL parent company) end of June 2012 capital structure consisting of 47.57% debt, 0.61% preferred stock and 51.82% common equity.[42] Dr. Hadaway and Dr. Woolridge use KCPL's embedded cost of debt at 6.63%. Mr. Gatewood, consistent with using GPE's overall capital structure, uses GPE's embedded cost of debt of 6.43%. While Mr. Gatewood's 6.43% is consistent with using the GPE overall capital structure, and CURB is therefore agreeable to move to Mr. Gatewood's position, the overall impact on the rate of return is only 10 basis points.

32. Another area of general agreement is the dividend yield to be used in the DCF model. Dr. Woolridge uses 4.2% in his DCF model. Mr. Gatewood uses 4.27% in his DCF models. Dr. Hadaway uses between 4.40% and 4.45% in his direct testimony, but adjusts down

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[40] CURB Exh. 4.
[41] Gatewood, Tr. Vol. 3, at 709.
[42] Dr. Hadaway uses 47.57% debt, 0.61% preferred stock and 51.82% common equity. Hadaway Direct, at 7.

to 4.35% in his rebuttal testimony. While there is a slight difference in each dividend yield, on balance the difference of 15 basis points between the top and bottom of the range will not make a material impact on the overall ROE that results from the DCF analysis. While CURB thinks Dr. Woolridge's use of a full six months of data in generating his dividend yield is the most supportable result, and his 4.2% overall dividend yield compares with KCPL's 4.1% actual six month dividend yield, in terms of end result any number the Commission picks from this range is going to be acceptable.

3. Major Points of Contention

(i) Impact of the Federal Reserve intervention in the market

33. There is no question that the Federal Reserve has had, and will continue to have a policy of market intervention with the stated intention or keeping interest rates low.[43] As recently as September 2012 the Federal Reserve announced a new round of "quantitative easing" (QE3) that will last indefinitely into the future. Dr. Hadaway uses the Federal Reserve intervention in the market to conclude that low interest rates are artificial, cause artificially low dividend yields and therefore reduce ROE estimates in traditional rate of return estimation methods.[44] Dr. Hadaway argues that these lower estimates "do not reflect ongoing market volatility and increased equity market risk aversion."[45] He goes on to state that the DCF and CAPM model results "are not correct" at this time.[46] Dr. Hadaway's basic premise is that because currently available data and market results do not reflect current equity costs, the

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[43] For general discussion on the general economic climate and the actions of the Federal Reserve, *see* Woolridge Direct, at 5-12.
[44] Hadaway Direct, at 14.
[45] Hadaway Direct, at 15.
[46] Hadaway, Tr. Vol. 3, at 649-650.

Commission should ignore the data in this case and use its "informed judgment" to set a reasonable ROE for KCPL, preferably in the 10.4% range.

34. With the exception of the fact that the Federal Reserve is intervening in the market to keep interest rates low, virtually every other point made by Dr. Hadaway is demonstrably false. First, intervention in the markets by the Federal Reserve is monetary policy, which has an effect on markets, but it is not artificial. There has always been monetary intervention in the markets and markets and investors respond to that intervention. Even Dr. Hadaway recognizes that "the competitive market adjustment process is quick and continuous, so that market prices generally reflect investor expectations and the relative attractiveness of one investment verses another."[47] As explained by Mr. Gatewood, if you believe that interest rates are lower than they would otherwise be and attempt to remove the impact of lower interest rates from the model, you also have to remove the economic growth from the model that the low interest rates stimulate.[48] Dr. Hadaway is arguing for higher growth in the model and higher ROE's, which is the exact opposite effect that removing the "artificially low interest rates" would generate. Dr. Hadaway does not provide any evidence that dividend yields levels are not correct given the relative attractiveness of utility stocks compared to other industries. Dr. Hadaway does not provide any evidence that the DCF or CAPM models are not correct, given current information available to market participants and efficient investor choices.

35. Second, Dr. Hadaway claims there is investor aversion to the market. Investor's perceived risks do not appear to be higher now than before 2008. As Mr. Gatewood explains, dividend yields are low and stable, the stock market has earned back most of the losses it

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[47] Hadaway Direct, at 23.
[48] Gatewood, Tr. Vol. 3, at 718.

experienced in 2008 and annual earnings on the S&P 500 have hit two or three successive records.[49] Investors are forward looking, and if investors feared what will happen when the monetary policy retracts back to what had occurred historically, investors would not be pricing securities the way they are currently.[50] Markets are also not unusually volatile. The Volatility Index for the S&P 500 (VIX), a measure of near term expected market volatility was at 15 at the time of the KCPL hearing,[51] lower than the historic average of the VIX. Nothing in the current state of the market supports Dr. Hadaway's thesis.

36. Finally, the Commission always uses informed judgment in setting an appropriate rate of return for jurisdictional utilities. However, what Dr. Hadaway seeks is for the Commission to suspend judgment and simply believe that reasonable ROE's are in the 10.3%-10.4% range. The outcome sought by Dr. Hadaway is simply not supported by the data in the record or the evidence in the markets. Dr. Hadaway couldn't even support his 10.4% initial request at the time he filed rebuttal testimony. The Commission should review the data in the record and should not suspend judgment or second guess what the markets are telling us.

(ii) DCF growth rate

37. Determining the appropriate growth rate to use in the DCF model is the most important decision the Commission will make in setting KCPL's cost of capital. The majority of the difference in the parties' rate of return recommendations comes down to differences in the growth rate portion of the DCF model. There is a one-for-one correlation between changes in the growth rate in the DCF models and changes in the parties overall ROE recommendations.[52] Dr.

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[49] Gatewood, Tr. Vol.3, at 719.
[50] Gatewood, Tr. Vol.3, at 720.
[51] CURB Exhibit 3.
[52] Hadaway, Tr. Vol. 3, at 660.

Woolridge believes investors look at a number of historic and forecasted metrics for earnings, dividends and book value in setting future growth expectations and making investment decisions. Dr. Hadaway apparently believes investor expectations are based on only two things, either forecasted earnings per share or historic inflation levels. Mr. Gatewood falls in the middle of the two approaches. The Commission must find that the inputs to Dr. Hadaway's DCF models do not reflect the reality of the type and variety of information that current investors review forming future expectations and in making investment decisions.

a. Use of Analyst Growth Rates

38. Dr. Woolridge uses a far more robust set of analyst information than does Mr. Gatewood or Dr. Hadaway. For his 33 company proxy group, Dr. Woolridge reviews both 5-year and 10-year historic growth rates in earnings per share, dividends per share and book value per share from Value Line (average growth rate of 3.3%),[53] and the projected five-year growth rates in earnings per share, dividends per share and book value per share from Value Line (average growth rate of 4.2%).[54] Dr. Woolridge also reviews the sustainable growth rate from Value Line (average growth rate of 4.0%)[55] and analysts projected earnings per share growth rates presented by Yahoo, Zack's and Reuters (average growth rate of 4.6%).[56] All of these growth rates are publically available and commonly used by investors in making investment decisions. Investors are generally viewed to synthesize as much available information as possible in making investment decisions. Likewise, Dr. Woolridge synthesizes this information, giving greater weight to projected growth rate measures, and recommends an expected DCF growth rate in the

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[53] Woolridge Direct, Exhibit JRW-10, page 3.
[54] Woolridge Direct, Exhibit JRW-10, page 4
[55] *Id.*
[56] Woolridge Direct, Exhibit JRW-10, page 5.

range of 4.0% to 4.6% as reasonable for his proxy group. Dr. Woolridge uses the 4.3% midpoint of his range as a reasonable expected growth rate for his DCF model.[57]

39. While Mr. Gatewood presents various historic and analyst projected growth rates for his proxy group[58], when he calculates his DCF models, he relies exclusively on analyst earnings per share growth rates (average growth rate of 4.91%) and analyst dividend per share growth rates (average growth rate of 4.84%). Mr. Gatewood also uses a nGDP estimate in his models to capture long term growth, as will be discussed below, but generally, Mr. Gatewood's sole use of analyst expected earnings and dividend growth rates explains the majority of the difference in DCF results between Dr. Woolridge's 8.5% DCF result and Mr. Gatewood's 8.77%-9.0% DCF range. It is important to note that the lower band of Mr. Gatewood's DCF range is a mere 27 basis points from Dr. Woolridge's recommended ROE.

40. Dr. Hadaway uses a much narrower set of information to obtain his DCF growth rates. Dr. Hadaway obtains one set of growth rates by reviewing only the analyst projected earnings growth rates of his proxy group as found in Value Line, Zack's and Thomson.[59] In his direct testimony, the average analyst projected earnings growth rate is 5.61%, while in his rebuttal testimony his average analyst projected earnings growth rate drops to 5.48%. [60] Dr. Hadaway completely ignores widely available information about historic earnings growth, historic and projected dividend growth, and historic and projected book value. It is unrealistic to think that investors will ignore this available information in formulating opinions on expected future growth. Also, as shown in Dr. Woolridge's results, the analysts' expected earnings growth

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[57] Woolridge Direct, at 38.
[58] Gatewood Direct, Schedule AHG-4.
[59] Hadaway Direct, Schedule SCH-5, page 2.
[60] Hadaway Rebuttal, Schedule SCH-11, page 2.

rate is measurably higher than every other growth rate reviewed[61], which leads to the conclusion that Dr. Hadaway biases his DFC result upward by strategically using only the highest growth rate numbers available from the analysts. In fact, as can be seen from his results, picking the highest growth rate available is the only way Dr. Hadaway can get his DCF result into the 10% range. In Dr. Hadaway's rebuttal testimony, the DCF result from this same model falls to 9.8% from the 10.1% result in his direct testimony.[62]

41. Dr. Hadaway also creates additional upward bias in his analyst growth rate results by selectively removing the growth rate for one (or more) of his proxy companies where he deems the analysts growth rate too low. He removes the 2.0% growth rate for Edison International in his direct testimony.[63] He removes Edison International and Ameren entirely from his proxy group in his rebuttal testimony. Dr. Hadaway also criticizes Dr. Woolridge's proxy group for including companies with analyst growth rates below 2.5%, but Dr. Woolridge remains consistent in using the proxy companies that pass his screening test regardless of outcome. To do otherwise, amounts to gaming the model to produce a desired result.

42. Dr. Hadaway does not criticize Dr. Woolridge for having companies in his proxy group that have very high analyst growth rates. Nor does Dr. Hadaway remove any high growth rate companies from his own proxy group. For example, Hawaiian Electric has an expected earnings growth rate of 9.62% and Integrys Energy has a growth rate from Thomson of 13.9% and an overall analyst growth rate of 8.47%. Both of these companies seem out of the norm compared to the growth rates reported for other companies in Dr. Hadaway's proxy group in his direct testimony. Interestingly, in Dr. Hadaway's rebuttal testimony the updated analyst's

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[61] See Woolridge Direct, Appendix B for research on systematic overestimation of analyst earning forecasts.
[62] Hadaway Rebuttal, Schedule SCH-11, page 2.
[63] Hadaway Direct, Schedule SCH-5, page 2.

earnings growth rate of these two companies are lower than that used in his direct testimony. (Hawaiian Electric is still high at 8.42%) And not surprisingly, his overall growth rate result is down to 5.48% and his overall DCF result is down to 9.8%[64]. Simply removing Hawaiian Electric from his analysis moves Dr. Hadaway's growth rate down to 5.33% and his overall DCF result down to 9.67%, a far cry from the 10.4% supported in his direct testimony and the 10.3% supported in his rebuttal testimony. The Commission should reject Dr. Hadaway's growth rate estimate and DCF estimate as being biased upward and based on an unreasonably limited set of data.

b. Use of nGDP growth rates

43. Mr. Gatewood and Dr. Hadaway incorporate an nGDP estimate in their respective analysis to capture the long term growth rate aspects of the model. Mr. Gatewood uses 4.55% forecasted nGDP growth rate based on long-run nGDP forecasts published by the Energy Information Administration and the Social Security Administration.[65] These forecasts are readily available to investors, commonly used in the DCF analysis at the Federal Energy Regulatory Commission,[66] and are similar to other medium to long range real GDP forecasts available for other government and private industry sources.[67]

44. Dr. Hadaway uses a 5.70% nGDP growth in his DCF models. This 115 basis point difference in nGDP forecasts explains the majority of the difference between Mr. Gatewood's 9.2% overall ROE recommendation and Dr. Hadaway's 10.3% revised ROE recommendation. However, unlike Mr. Gatewood, who uses currently available nGDP and real

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[64] Hadaway Rebuttal, Schedule SCH-11, page 2.
[65] Gatewood Direct, at 26.
[66] *Id.*
[67] See comparison chart for other real GPD forecasts at Gatewood Direct, at 27.

GDP forecasts from a number of sources to inform his recommendation, Dr. Hadaway's nGDP forecast is not a forecast at all, but rather a compilation of historic averages for nGDP growth. In relying solely on historical average nGDP, Dr. Hadaway simply ignores or discredits all other currently available nGDP forecasts. Again, investors would not likely be so limited in their review of available data. While Dr. Hadaway may not agree with the forecasts, what is relevant for this Commission is that Dr. Hadaway cannot provide evidence that investors ignore this available information.

45. Dr. Hadaway's entire analysis is based on a 60 year historical listing of nGDP data.[68] He provides average nGDP growth rates for the past 10 years (4.0%), 20 years (4.7%), 30 years (5.4%), 40 years (6.7%), 50 years (6.9%), and 60 years (6.6%), and then takes an average of the averages to arrive at his 5.7% long-term nGDP growth. Dr. Hadaway rightfully argues that his average-of-averages approach increases the weighting given to the more recent lower nGDP growth rates, but this still does not offset the very high nGDP growth in the 1970's due to high inflation. Dr. Hadaway's 5.7% nGDP growth forecast is higher than average nGDP growth has been for over 30 years. In the last 20 years nGDP growth has averaged 4.7%, which is reasonably close to the nGDP forecast used by Mr. Gatewood. For the last 10 years nGDP growth averaged below 4%.

46. To reach Dr. Hadaway's 5.7% nGDP growth, Dr. Hadaway has to assume, based on his average-of-averages approach, that inflation will be at-or-above 3% going forward. Again, inflation above 3% has been a fairly rare occurrence in the last 20 years according to Dr. Hadaway's own data. In fact, Dr. Hadaway readily admits that the Federal Reserve has pumped

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[68] Hadaway Direct, Schedule SCH-4; Hadaway Rebuttal, Schedule SCH-10.

money into the financial system in fairly large quantities since 2008 and there has been no measurable increase in inflation.[69]

47. If the Commission chooses to use nGDP in the DCF model, it is clear that Dr. Hadaway's average of historical averages approach to setting future nGDP rates produces a result that is higher than any nGDP rates we have seen in reality in over 20 years. It is not remotely reasonable to suggest that investor expectations are based on historic nGDP averages where the 1960's and 1970's have more influence on investor expectations than the reality those investors have experienced in the last 20 years and the reality of current forward looking nGDP and real GDP forecasts available from government and private industry sources. Dr. Hadaway's thesis and data do not hold up to scrutiny. If the Commission uses an nGDP forecast in its DCF formulation, Mr. Gatewood's 4.55% nGDP forecast more closely aligns with current investor expectations.

(iii) Use of the CAPM model

48. Dr. Hadaway is critical of Mr. Gatewood's use of the CAPM model in this case, citing to Mr. Gatewood's testimony in a prior Westar docket in which Mr. Gatewood decided not to use the CAPM model.[70] In that prior docket, Mr. Gatewood chose not to use a CAPM model given the sensitivity of the CAPM model to yields on U.S. treasury debt and uncertainty at the time around the impact the Federal Reserve monetary policy was having on that debt.

49. The formulation of the CAPM that Mr. Gatewood was using at that time relied on historic treasury debt and historic equity returns. The CAPM model Mr. Gatewood uses in the current case is a forward looking model that seeks to examine analyst forward looking

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[69] Hadaway, Tr. Vol. 3, at 646.
[70] Hadaway Rebuttal, at 22-23.

expectations, and is not the same historically focused model that Mr. Gatewood used in prior cases. Mr. Gatewood uses forecasts of 10 year U.S. Treasury Bond rates and a forward looking equity forecast put out by J.P Morgan.[71] While this model may or may not be appropriate, it is a newly formulated CAPM. Dr. Hadaway's criticism of Mr. Gatewood's past decisions to use or not use a CAPM in his analysis is misplaced and irrelevant in this case. That said, Dr. Hadaway testifies that the DCF model is the most widely used regulatory cost of equity estimation model[72] and that he relies primarily on the DCF model in his cost of equity studies.[73] While Dr. Woolridge did create a CAPM model in this case, he did not rely on the results in making his ROE recommendation, choosing instead to rely on his DCF results. Since both Dr. Hadaway and Dr. Woolridge both prefer using the DCF model in this case, CURB recommends that the Commission ignore Mr. Gatewood's CAPM results in this case and instead focus on Mr. Gatewood's DCF model results in evaluating a reasonable ROE for KCPL. The Commission is best guided in this instance by limiting its review to the DCF formulations of the parties and making an ROE determination based thereon.

(iv) Range of recently allowed ROE's

50. Dr. Hadaway argues that ROE recommendation made by Dr. Woolridge and Mr. Gatewood are out of line with recent allowed ROE decisions from other states. In a graph on page 6 of his rebuttal testimony, he shows allowed ROE's for vertically integrated electric utilities from January through June 2012 as reported by Regulatory Research Associates. There are several glaring omissions in Dr. Hadaway's graph. First, Dr. Hadaway omits a 9.4% ROE decision on June 14 for Orange and Rockland Utilities. He likewise omits a 9.8% ROE decision

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[71] Gatewood Direct, at 31.
[72] Hadaway Direct, at 28.
[73] Hadaway Direct, at 34.

on July 16 for Pacificorp, a 9.81% ROE decision on July 20 for Delmarva Power and Light, and a 9.31% ROE on July 20 for Potomac Electric Power Company (MD). These results were readily available and listed in a chart on p. 7 of Mr. Gatewood's testimony. There is also a 9.5% ROE decision on September 23 for Potomac Electric Power Company (DC).

51. It is unclear from Dr. Hadaway's graph how long many of the cases reported in the first six months of the year were in process at the various regulatory Commissions before the decision was reported. It is possible that the reported ROE's represent record data and models that are well over a year old. What is clear from the graph is that the farther you move into 2012 the lower the Commission allowed ROE's. This is clearly the result of more current data showing lower cost of capital being presented and accepted by regulators. The Commissions are catching up to the market.

52. What is also not clear from Dr. Hadaway's graph is whether the reported ROE's are the result of litigation or settlements. Reported ROE's from settlements may be slightly higher than litigated ROE's because most utilities are sensitive about agreeing to a ROE. Utilities often are willing to trade a lower revenue requirement dollar value for a higher stated ROE that can be reported to the markets. That said, also not on Dr. Hadaway's graph is a proposed 9.6% settlement ROE on October 4 for Black Hills Electric in Colorado (Dkt 12AL-628g), a proposed 9.8% settlement ROE on September 9 for Rocky Mountain Power in Utah (Dkt 11-035-200), and a proposed 9.75% settlement ROE for Delmarva Power (Dkt 11-528 ruling expected on 11/20/12).

53. Finally, while Dr. Hadaway's graph is aimed at electric utilities there are other recent ROE decisions that are instructive from natural gas LDC cases or water cases. Not included on Dr. Hadaway's graph are a 9.16% ROE on September 20 for Questar Gas in

Wyoming (Dkt 30010-113-GR-11), a 9.34% ROE on September 19 for Illinois American Water (Dkt 11-0767), a 9.43% ROE on May 22 for Utilities Inc., in Illinois (Dkt 11-0561), and a 9.06% ROE on January 10 for Ameren Gas in Illinois (Dkt 11-0282). Also, San Jose Water, California Water Service and Golden State Water will all have their ROE reset to 9.43% starting January 1, 2013 under California's automatic adjustment process.

54. What is clear is that capital costs in the market are substantially lower than a year ago and Commission decisions are catching up to the market. If you fill out Dr. Hadaway's graph with more current data stated above, the inescapable conclusion is that ROE decisions are moving to the lower 9% range. Again, all of these decisions are based on data from some prior period over the last year. Neither Dr. Woolridge nor Mr. Gatewood provides ROE recommendations outside of a reasonable range of these reported decisions when you consider the more timely data in this case. What Dr. Hadaway does succeed at showing with his graph is how far outside the range of current ROE decisions is KCPL's 10.3% ROE request.

(v) KCPL chooses the single highest ROE possible

55. What is telling about KCPL's approach to the cost of capital question in this case is that KCPL chooses the highest possible ROE that any model produces at any point in time. In Dr. Hadaway's direct testimony, his DCF models produce a range of ROE's from 10.0% to 10.2% and his risk premium models produce two results, 9.95% and 10.42%. Reviewing these numbers, one would reasonably suspect KCPL to request an ROE in the 10.0% to 10.1% range. KCPL requests a 10.4% ROE, which is the single highest ROE possible under all of Dr. Hadaway's models and supported by only a single data point.

56. In rebuttal testimony, Dr. Hadaway reformulates his proxy group by removing companies with low growth rates and adding in new companies with higher growth rates. He also

adds a new terminal value DCF model formulation. Dr. Hadaway then updates his data for current market conditions. In rebuttal, Dr. Hadaway's DCF models produces a range of ROE's from 9.8% to 10.1 for his original DCF models and an ROE of 10.3% for his new terminal value DCF model. His risk premium models produce two results, 9.87% and 10.14%. Instead of choosing the 10.14% ROE from the risk premium estimate, as it did in its direct case, KCPL instead chooses the 10.3% ROE from the newly formulated terminal value DCF model. Again, KCPL chooses the single highest possible ROE indicated by the models and again chooses a number supported by a single data point.

57. A couple of points should be clear by now. First, one inescapable conclusion is that the current cost of capital is moving lower. Dr. Hadaway's DCF and risk premium model results were all lower in rebuttal testimony when updated to reflect more current market data. And these results were lower *even after* Dr. Hadaway removed low growth companies from his proxy group and added new higher growth companies. Without the new higher growth companies added in rebuttal, Dr. Hadaway's DFC model produces a range from 9.7% to 10.0% and his new terminal value model ROE is 10.25%.

58. Second, KCPL is not interested in a reasonable approach to choosing an appropriate ROE from a range of possible outcomes that result from different formulations of capital cost models. KCPL simply chose the highest ROE point estimate available. In direct testimony it was from a risk premium model. In rebuttal testimony it was from the new terminal value DCF model. The Commission must find that KCPL's approach to choosing its recommended ROE is not well reasoned or reasonable.

4. Conclusion: Cost of Capital

59. The Commission much chose a return on equity in this case that will provide a reasonable return for KCPL investors and allow KCPL access to capital markets. It is clear from all the available data that the cost of capital for utilities is moving much lower than it has been historically. Ultimately, to inform its decision in this case, the Commission must review available market data in much the same way as an investor would view available market data. An investor would not limit his/her data review to only historical data or to only future forecasts, and nor should the Commission.

60. Dr. Woolridge's 8.5% ROE recommendation is based on a data set containing both historical and expectational data for earnings growth, dividend growth and book value. Mr. Gatewood only uses expected earning and expected dividend growth. Dr. Hadaway uses only expected earnings growth. Of the three options, when viewing the data used, Dr. Woolridge provides the most robust analysis, Mr. Gatewood is less so and Dr. Hadaway's is extremely limited.

61. Where Dr. Hadaway and Mr. Gatewood also use nGDP growth, again Dr. Hadaway uses only vary narrow historical averages while ignoring current forecasts from government and private industry sources. Mr. Gatewood relies more on contemporaneous nGDP and real GDP forecasts, much as an investor would. Again, Dr. Hadaway's analysis is extremely limited and not representative of the types of information that investors will rely on.

62. Finally, allowed ROE's across the country are moving towards the lower 9% range. That is consistent with the data provided by Dr. Woolridge and Mr. Gatewood. While Mr. Gatewood recommends a 9.2% ROE, his range of reasonable ROE range goes as low as 8.7%, a mere 20 basis points above Dr. Woolridge. As Mr. Gatewood reiterated at trial, choosing an

8.7% ROE is within his reasonable range, and he would not make a recommendation to the Commission that would prevent KCPL for accessing the capital markets.[74] While CURB continues to support Dr. Woolridge's ROE as reasonable and based on substantial and competent evidence, CURB also believes that the Commission could choose an ROE between CURB's 8.5% and Staff's 9.2% ROE that would be reasonable. What is unreasonable in this case is KCPL's limited and biased models and KCPL's decision to choose the single highest data point available. KCPL's ROE estimates are not reasonable and should be rejected by the Commission.

C. Rate Base Issues

1. The 12-CP Jurisdictional Allocator Historically Used In Kansas Should Continue To Be Utilized

63. KCPL proposes to change the jurisdictional allocation methodology from the 12-CP allocator historically used in Kansas[75] to the 4-CP allocator used in Missouri. Since the Commission has consistently utilized the 12-CP allocator for KCPL since at least March 29, 1983,[76] KCPL bears the burden of proof for deviating from the historical use of the 12-CP allocator.[77] In order for the Commission to change its historical use of the 12-CP (prior policy or position), the change in policy must be based on substantial and competent evidence.[78]

64. All else equal, replacing the 12-CP methodology with the 4-CP methodology will shift approximately $10 million of revenue responsibility from the Company's Missouri Retail and FERC jurisdictions to KCPL's Kansas Retail jurisdiction at the Company's filed revenue

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[74] Gatewood, Tr. Vol. 3, at 710-11.
[75] Ives, Tr. Vol. 3, p. 814; Loos, Tr. Vol. 4, p. 935; CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 8.
[76] Grady Direct, pp. 13-14.
[77] *In re Estate of Robison,* 236 Kan. 431, 439, 690 P.2d. 1383 (1984).
[78] *Western Resources. Inc. v. Kansas Corporation Commission,* 30 Kan. App.2d 348, 360 (2002).

requirement level.[79] The Company agrees that the impact of the jurisdictional allocation methodology approved by the Commission on customers is an important consideration [80] and will increase the revenue requirement for Kansas ratepayers by $10 million.[81]

65. KCPL's proposal to utilize a 4-CP jurisdictional allocation methodology in Kansas is driven by its failure to convince the Missouri Commission to change to a 12-CP allocator,[82] rather than a change in its operational and planning realities or any other justifiable rationale. As will be demonstrated below, the Company's proposal to abandon the 12-CP jurisdictional allocator in favor of a 4-CP allocator is completely lacking in credibility, given the testimony of the Company in the 2006 Missouri rate case arguing 12-CP was the appropriate allocator under identical facts.

66. In the 2006 Missouri case, KCPL Senior Regulatory Analyst Mr. Don Frerking[83] testified on behalf of KCPL that 12-CP was the appropriate jurisdictional allocation methodology based upon the following rationale:

- The Company believes the 12-CP Demand allocation methodology is more appropriate, even though the Company is a summer peaking utility.[84]
- "The Company's rationale for the use of the 12-CP Demand allocation methodology is based on the *operating and capacity planning realities* of the Company's generation portfolio. The Company's *capacity planning process takes into account all hours of the year*, not just the peak hour or any seasonal peaks. In addition, the Company *utilizes periods of the year, typically in the spring and fall,* with lower retail and FERC jurisdictional wholesale peak loads *to perform necessary maintenance on its generating facilities and to pursue off-system sales while still maintaining adequate reserve margins.* All of these *operating and capacity planning realities are suggestive that a year-round view,*

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[79] Kalcic Direct, pp. 3-4; Crane Direct, p. 10.
[80] Ives, Tr. Vol. 3, p. 806.
[81] Ives, Tr. Vol. 3, p. 807.
[82] KCPL Initial Brief, ¶55.
[83] Mr. Frerking was and still is an employee of KCPL. Ives, Tr. Vol. 3, pp. 808, 811.
[84] Ives, Tr. Vol. 3, p. 810-11; CURB Exh. 7, Surrebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 3; Loos, Tr. Vol. 4, pp. 933-34; CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 3.

or a 12-CP methodology, is more appropriate with respect to Demand allocation *than simply relying on the summer month peaks.*"[85]

- The 12-CP methodology has historically been utilized in KCPL's FERC jurisdiction, and the Company's 2006 jurisdictional rates were established utilizing the 12-CP methodology.[86]
- Since there are no load requirements for off-system sales, Mr. Frerking quantified the effect of the off-system sales on the FERC tests by using total MWH sales, including off-system MWH sales, in the FERC tests. The results of this quantification were 13% for Test 1, 83% for Test 2, and 71% for Test 3, all falling well within the ranges for a 12-CP allocation methodology. [87]

67. In proposing the change from the 12-CP methodology historically used for KCPL, Company witness Larry Loos cites and relies upon a publication authored by Michael E. Small entitled, *A Guide To FERC Regulation And Ratemaking Of Electric Utilities And Other Power Suppliers*, Third Edition, 1994 ("Michael Small publication").[88] This publication states, in pertinent part:

- FERC has not established a hard and fast rule for determining which allocation method is appropriate.[89]
- While FERC has not established that hard and fast rule, it has stated that the following factors should be considered: the *full range of the Company's operating realities* including, in addition to system demand, *scheduled maintenance*, unscheduled outages, diversity, *reserve requirements and off-system sales commitments*.[90]
- To the extent a utility *uses the off-peak months to perform its scheduled maintenance, FERC has found that supportive of the use of a 12-CP method.*[91]
- However, the FERC recommendations further state that *scheduled maintenance must be considered together with the reserve available after the maintenance.*[92]

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[85] CURB Exh. 7, Surrebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 3 (emphasis added); Ives, Tr. Vol. 3, p. 811. *See also*, Loos, Tr. Vol. 4, pp. 932-34; CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, pp. 5-6.
[86] Loos, Tr. Vol. 4, pp. 935-36; CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 8.
[87] Loos, Tr. Vol. 4, pp. 938-39; CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 7.
[88] Loos Direct, p. 15, Schedule LWL-5; Larry Loos, Tr. Vol. 4, pp. 924-37.
[89] Loos, Tr. Vol. 4, pp. 924-25; Loos Direct, Schedule LWL-5, sheet 4 of 9.
[90] Loos, Tr. Vol. 4, pp. 925; Loos Direct, Schedule LWL-5, sheet 4 of 9 (emphasis added).
[91] Loos, Tr. Vol. 4, pp. 927-28; Loos Direct, Schedule LWL-5, sheet 8 of 9 (emphasis added).
[92] Loos, Tr. Vol. 4, pp. 927-28; Loos Direct, Schedule LWL-5, sheet 8 of 9 (emphasis added).

68. KCPL witness Larry Loos relied on the Michael Small publication, yet failed to acknowledge the above FERC factors and recommendations that were specifically relied upon by KCPL in concluding the 12-CP was the appropriate allocator in the 2006 Missouri rate case.[93] Even though the Michael Small publication clearly states that "scheduled maintenance must be considered together with the reserve available after the maintenance," Mr. Loos did not perform any analysis of the reserve margins before or after maintenance.[94] Because Mr. Loos clearly did not follow the FERC recommendations contained in the Michael Small publication he purportedly relied upon in reaching his conclusion that the 4-CP methodology is appropriate for KCPL, his testimony and recommendation to abandon the 12-CP methodology the Commission has historically used for KCPL should be disregarded.

69. KCPL's operational and planning realities are the same today as they were in 2006, when Mr. Frerking testified on behalf of the Company that the 12-CP jurisdictional allocation methodology was more appropriate for KCPL. Specifically:

- KCPL was a summer peaking utility in 2006, the same as it is today.
- The Company's capacity planning process in 2006 took into account all the hours of the year, not just the peak or seasonal peaks, just as it does today.
- The Company performed necessary maintenance in the off-peak months and pursued off-system sales while still maintaining adequate reserve margins in 2005, just as it does today.[95]

70. In its brief, KCPL attempts to characterize its 180-degree change in position on the appropriate jurisdictional allocation methodology as simply illustrative of the Company's

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[93] Loos, Tr. Vol. 4, pp. 929-34; CURB Exh. 7, Surrebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, p. 3 (emphasis added); CURB Exhibit 9, Rebuttal Testimony of Don Frerking, Mo. PUC Case No. ER-2006-1314, pp. 3-6.
[94] Loos, Tr. Vol. 4, pp. 927-28; Loos Direct, Schedule LWL-5, sheet 4 of 9 (emphasis added); Loos Rebuttal, p. 7.
[95] Ives, Tr. Vol. 3, pp. 812-13; Larry Loos, Tr. Vol. 4, pp. 925-26, 940.

"*consistent* attempts to get at least one of the Commissions to help solve this problem."[96] What KCPL has demonstrated, instead, is that the Company is willing to sponsor *inconsistent* testimony (without any qualms) recommending the polar opposite conclusion from the conclusion reached in previous testimony on the exact same issue and identical facts. Moreover, the Company fails to acknowledge or follow the specific FERC factors and recommendations contained in the Michael Small publication that the Company relied upon in the 2006 Missouri rate case where it concluded the 12-CP methodology was the more appropriate methodology for KCPL, with the identical operational and planning realities that are present today.

71. In its brief, KCPL has the audacity to argue that both Staff and CURB's jurisdictional allocation proposals ignore the "operating realities" of KCPL's generating resources.[97] This argument is disingenuous, given the polar opposite position taken in testimony KCPL provided in the 2006 Missouri rate case.

72. KCPL's argument is also inconsistent with the testimony of KCPL witness Paul Normand. Mr. Normand agreed that using his BIP methodology (which recognizes the operational realities of the Company's production facilities)[98] in KCPL's jurisdictional cost allocation study would actually produce a *lower* revenue requirement allocation to Kansas than the 12-CP methodology, as opined by CURB witness Brian Kalcic.[99]

73. The Company proposes to use the 4-CP methodology for both production and transmission-related capacity costs and related expenses,[100] even though this approach is

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[96] KCPL Initial Brief, ¶ 62.
[97] KCPL Initial Brief, ¶ 60.
[98] Normand Direct, pp. 8-12 ("The use of a production stacking approach such as the BIP method in the class allocation for the largest portion (approximately 74%) of a utility's costs is by far the most representative procedure that *mirrors both the planning as well as the operation of any utility's production facilities*." (emphasis added)).
[99] Normand, Tr. Vol. 1, p. 150-51; Kalcic Direct, pp. 6-7.
[100] KCPL Initial Brief, ¶ 56; Kalcic Direct, p. 5.

inconsistent with the preferred allocation methodology of its witness Larry Loos in the 415 Docket to classify a portion of production plant costs and expense as energy related and allocate them accordingly.[101] The Company asked that Mr. Loos limit his recommendation to the appropriate basis (4CP or 12CP) to allocate capacity-related costs among jurisdictions, rather than sponsor his preferred jurisdictional allocation methodology in this case.[102]

74. KCPL argues that Staff's jurisdictional allocation approach is a "step in the right direction."[103] To the contrary, Staff's approach is incomplete and wrong for Kansas, as it attempts to mirror only a *portion* of the BIP methodology proposed by KCPL for class cost of service allocation (which uses 4-CP to allocate peaking plant to rate classes). The problem with Staff's approach is that it ignores the fact that Mr. Normand's BIP methodology also allocates baseload plant using an *energy allocator.* If an energy allocation of baseload plant were to be added to Staff's methodology, using the same rationale used to apply the 4-CP to peaking plant, the end result would be much less costs being allocated to Kansas[104] because the vast majority of KCPL's dollar investment in production plant is for baseload units.[105]

75. KCPL argues semantics in saying that 4-CP does not result in cost shifting,[106] but all parties agree that use of 4-CP would result in assignment of approximately $10 million of additional revenue requirement to Kansas.[107] KCPL is clearly asking Kansas ratepayers to bear the entire burden of the costs KCPL seeks to recover as a result of the different jurisdictional allocators used by the Kansas and Missouri Commissions. The record doesn't reflect that KCPL

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[101] Loos Direct, pp. 4-5; Loos, Tr. Vol. 4, pp. 920-925.
[102] Loos Direct, p. 5; Loos, Tr. Vol. 4, pp. 922.
[103] KCPL Initial Brief, ¶ 57.
[104] Kalcic Direct, pp. 6-7; Kalcic Cross-Answering, pp. 1-6; Normand, Tr. Vol. 1, p. 150-51.
[105] Grady Direct, pp. 14, 20, Exhibit JTG-4, p. 19.
[106] KCPL Initial Brief, ¶ 63.
[107] Ives, Tr. Vol. 3, p. 807 (moving from a 12-CP to a 4-CP would increase the revenue requirement for Kansas ratepayers by $10.4 million).

has ever actively pursued or proposed a compromise between the two state Commissions and interested stakeholders,[108] something Company witness Larry Loos admitted would be "one way of approaching it."[109]

76. The perceived shortfall isn't being recovered from either jurisdiction, but the fact that Missouri refused to change to the more appropriate 12-CP as proposed by KCPL does not make the resulting shortfall Kansas' problem, particularly since Kansas has been consistent in its use of 12-CP since 1983.[110] Kansas ratepayers should not be forced to make KCPL whole for the shortfall simply because the Missouri Commission is utilizing the wrong jurisdictional allocation methodology.

77. KCPL rejects Staff's proposed jurisdictional cost methodology simply because it doesn't go far enough to address the Company's $10 million revenue shortfall.[111] As a compromise solution, KCPL proposes to use a 50/50 weighting of the 12-CP and 4-CP factors to allocate production plant[112] should likewise be rejected, as it is simply an *ad hoc* attempt to arrive at better outcome for shareholders. Mr. Loos supports the proposed 50/50 weighting based on the fact that KCPL's annual system load factor is approximately 50%.[113] Mr. Loos' load factor argument is inconsistent with the analyses used in his Direct Testimony, where he evaluated whether the 4-CP or the 12-CP is the more appropriate jurisdictional allocation for the Company.[114] Whereas Mr. Loos' Direct Testimony investigates whether the 4-CP or 12-CP (one or the other – not both) is more appropriate for Kansas, Mr. Loos reverses course in his rebuttal

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[108] Loos, Tr. Vol. 4, pp. 961-62.
[109] *Id.*
[110] Grady Direct, pp. 13-14.
[111] KCPL Initial Brief, ¶ 57.
[112] KCPL Initial Brief, ¶ 58.
[113] Loos Rebuttal, p. 12.
[114] Loos Direct, p. 7 (analyses focuses on determining whether KCPL is a summer peaking utility).

and concludes that it would, in fact, be appropriate to use *both* allocators in a 50/50 fashion to assign costs to Kansas. KCPL's alternative proposal to use a 50/50 weighting of the 12-CP and 4-CP factors to allocate production plant is simply an *ad hoc* attempt to arrive at better outcome for its shareholders. The KCC should reject it.

78. The Company's use of the 4-CP methodology results in the highest assignment of costs to Kansas ratepayers of any jurisdictional allocation methodology contained in the record. Ranking the methodologies from highest to lowest (in terms of Kansas cost assignment), the order is as follows: KCPL (4-CP), KCPL (alternative 50/50), Staff (weighted 4-CP/12-CP), CURB (12-CP) and corrected Staff (BIP).

79. Neither KCPL nor Staff has presented substantial competent evidence sufficient to justify changing the 12-CP jurisdictional allocation methodology historically applied to KCPL since 1983.[115] The FERC factors and recommendations contained in the Michael Small publication that the Company relied upon in the 2006 Missouri rate case support the use of the 12-CP methodology today just as they did in 2006, as the Company's operational and planning realities remain the same. The Commission should continue to use the 12-CP jurisdictional allocation methodology historically used for KCPL, as it is the appropriate allocator given the operational and planning realities of the Company.

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[115] Regulatory agencies may make major changes in prior policies or positions, but the subsequent policy or position must be based on substantial and competent evidence. *Western Resources. Inc. v. Kansas Corporation Commission,* 30 Kan. App.2d 348, 360 (2002).

2. The Test Year Should Not Be Updated To June 30, 2012, in the Absence of Revised Schedules as Required by K.A.R. 82-1-231

80. KCPL admits that its Application was based on a test year that ended December 31, 2011, with updated plant-in-service accounts reflecting actual data through February 29, 2012, and adjustments for "projected" amounts budgeted through June 30, 2012.[116]

81. The June 30, 2012, projected updates were updated through data requests, not through revised schedules as required by K.A.R. 82-1-231(d).[117] In fact, Mr. Weisensee testified he wasn't even aware of the language in K.A.R. 82-1-231(d) requiring the filing of revised schedules until it was brought to his attention during the October 1-4, 2012, hearing.[118]

82. Mr. Weisensee testified that the updated adjustments made by the Company in data request responses increased the revenue requirements by around $5.5 million.[119]

83. The updated adjustments were provided sometime after June 30, 2012, just prior to the time Staff and CURB were required to file their testimony.[120]

84. Mr. Weisensee agrees with Ms. Crane on the matching issue related to the updated test year, that all costs and expenses have not been updated. The Company only updated items *it* considered material and significant.[121]

85. Mr. Weisensee agreed that the purpose of the test year is to take a snapshot of the financial situation of the Company during a one-year period. [122] However, that snapshot becomes out of focus when it is selectively updated as proposed by KCPL and Staff.

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[116] KCPL Initial Brief, ¶ 65. Weisensee, Tr. Vol. 4, p. 899.
[117] Weisensee, Tr. Vol. 4, pp. 905-06.
[118] Weisensee, Tr. Vol. 4, pp. 904-05.
[119] Weisensee, Tr. Vol. 4, p. 911.
[120] Weisensee, Tr. Vol. 4, p. 905.
[121] Weisensee, Tr. Vol. 4, p. 910.
[122] Weisensee, Tr. Vol. 4, p. 913.

86. The updates to the test year performed by KCPL and Staff on certain rate base components and operating expenses cause problems with analysis, including trying to chase a moving target and review the data in a meaningful way - particularly when the Company does not even file a full set of updated schedules.[123] Mr. Weisensee understood Ms. Crane's concerns about there not being time to audit the updates.[124]

87. K.A.R. 82-1-231(d) requires that the applicant file revised schedules for revisions to the application, other than for minor corrections and insertions.[125]

88. KCPL argues that CURB "misconstrues the provision in K.A.R. 82-1-231 that addresses the process for an applicant to use if it desires to make revisions to its application and schedules after an initial filing," [126] and attempts to support this by stating that Applicants revise numbers throughout the course of dockets to reflect errors and agreed upon changes. However, as KCPL admits, K.A.R. 82-1-231(d) does not require revised schedules for minor corrections or insertions. According to KCPL's chief financial witness, John Weisensee, the updated test year adjustments provided informally through discovery increased the revenue requirement by $5.5 million, including impacts from depreciation expense related to updated plant, construction work in progress, and other benefits (medical costs).[127]

89. It is important to note that KCPL has still not provided updated or revised schedules, even in its post-hearing brief. This makes it extremely difficult for parties to evaluate the components of the revised $56.4 million requested rate increase, which is the reason revised schedules are required under K.A.R. 82-1-231(d).

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[123] Crane, Tr. Vol. 3, pp. 769, 771.
[124] Weisensee, Tr. Vol. 4, p. 890.
[125] Crane, Tr. Vol. 3, pp. 773.
[126] KCPL Initial Brief, ¶ 70.
[127] Weisensee, Tr. Vol. 4, pp. 890-92.

90. As a result, updating the test year by six months for select costs and expenses does not involve "minor corrections and insertions" that would not require revised schedules under K.A.R. 82-1-231(d). It involves, according to the Company's lead financial witness, an increase in the revenue requirement by $5.5 million, or about 10% of the amount KCPL is requesting. This is not a "minor correction or insertion" but instead a substantial change to the test year that should necessitate a change in the application and require revised schedules to be filed under K.A.R 82-1-231(d).

91. K.A.R. 82-1-231(c)(2) states that "[e]ach application shall be based upon *data* submitted for a test year. K.A.R. 82-1-231(c)(4) states that "[t]he form, order, and titles of each section *shall conform to the following requirements."* Section (c)(4)(I) contains the requirements for the test year and pro forma income statements.

92. The pro forma adjustments contemplated by K.A.R. 82-1-231(c)(4)(I) are adjustments for *known and determinable* changes in revenue and expenses. Contrary to KCPL's assertions, the projections contained in the application and schedules are not, by their very nature, *known and determinable* at the time the Company filed its case, but were only known and determinable at some future date. Any *known and determinable* adjustments must be included in the schedules filed with the application pursuant to K.A.R. 82-1-231, not provided informally through discovery responses that may or may not become part of the record. Any revisions to the application and schedules that are not minor corrections and insertions *must* be filed as revised schedules under K.A.R. 82-1-231(d).

93. Another difficulty with the recent practice of updating the test year is that it provides an uncertainty for Intervenors in investigating an application and filing testimony. For example, in this case, Staff updated the test year by six months. In the recent Kansas Gas

Service case, Staff used seven months. How are CURB and other parties supposed to know the parameters until Staff files its testimony, which is too late for CURB and the other parties to address the issue?

94. An order of the Commission is lawful if it is within the statutory authority of the Commission and if the prescribed statutory and procedural rules are followed in making the order.[128] Here, the Commission's procedural rules *were not followed* by KCPL or Staff in using projections (for the updated period) in the application and filed schedules and later informally updating the test year in discovery without filing revised schedules as required by K.A.R. 82-1-231(d).

95. KCPL cites *Kansas Gas Service Co. v. Kansas Corporation Commission*[129] in support of its post-test year adjustments.[130] However, KCPL has omitted crucial portions of the *Kansas Gas Service Co.* decision. The *Kansas Gas Service Co.* Court held that while the general rule is that the Commission may not arbitrarily disallow an *actual,* existing operating expense incurred *during* a test year, a "corollary to the general rule is that claims for future expenses which are *merely conjectural* should not be allowed in rate proceedings."[131]

96. As noted in KCPL's Initial Brief, Kansas courts have consistently held that in order to "neutralize the negative effects of *speculation and guesswork* about future economic conditions, it is accepted practice to base future rates upon *known past and present conditions* through the use of data gathered during a specified test year. "[132]

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[128] *Central Power Co. v. State Corp. Comm'n,* 221 Kan. 505, 511, 561 P.2d 779 (1977).
[129] 4 Kan. App.2d. 623, 609 P.2d 1157 (1980).
[130] KCPL Initial Brief, ¶ 71.
[131] *Gas Service Co.,* 4 Kan. App.2d at 635. *See also, Kansas Industrial Consumers v. State Corp. Comm'n,* 30 Kan. App. 2d 332, 343, 42 P.3d 110 (2002).
[132] *Kansas Industrial Consumers v. State Corp. Comm'n,* 30 Kan. App. 2d 332, 343, 42 P.3d 110 (2002) (emphasis added); *Gas Service Co.,* 4 Kan. App.2d at 635; KCPL Initial Brief, ¶ 71.

97. While a conflict exists between the need to lend some finality to ratemaking by utilizing a well-defined, finite test period and the need to base calculations upon the latest available relevant data which often pertains to time periods other than the test period, a satisfactory resolution of the conflict is that when *known and measurable* post test-year changes affect *with certainty* the test-year data, the commission may, within its discretion, give effect to those changes. [133]

98. The problem here is that the *projections* utilized in the Company's Application and filed schedules were not *known and measureable* post test-year changes that affected *with certainty* the test year data. They were *projections*,[134] not amounts that were known with any degree of certainty at the time the application was filed. Nor did the Company filed revised schedules, as Company's Regulatory Affairs Manager admitted he wasn't even aware of the requirements to file revised schedules under K.A.R. 82-1-231(d) until the October 1-4, 2012 hearing.[135] The actual data was not provided to parties until sometime after June 30, 2012, shortly before Intervenor testimony was required to be filed.[136]

99. The position taken by Staff on the updating of the test year issue is troubling and inconsistent with the position Staff took in KCPL's last rate case (415 Docket), as indicated by the brief and proposed findings of fact and conclusions of law filed by Staff in the 415 Docket:

> 134. KCP&L's proposed adjustments which do not meet the well-established "known and measurable" standard should be rejected.
> 135. Kansas Industrial Consumers v. State Corp. Comm'n, 30 Kan. App. 2d 332 (2002) states that "when known and measurable post-test-year changes affect with certainty the test-year data, the commission may, within, its sound discretion, give effect to those changes." [Citation omitted.] The beginning of the paragraph

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[133] *Id.*
[134] Weisensee, Tr. Vol. 4, pp. 899, 905-06.
[135] Weisensee, Tr. Vol. 4, pp. 904-06.
[136] *Id.*

in which this statement appears contains the general principle that test period data must be used to support future rates "*to neutralize the negative effects of speculation and guesswork.*" [Citation omitted.] *These negative effects can be avoided only when known and measurable data is used.*

136. The "known and measurable" standard has been established over the course of many years of Commission usage. It would be improper to stretch it beyond its well-established meaning to accommodate KCP&L's proposed adjustments. Thus, the standard cannot be stretched to support an adjustment based on an estimate. (KCC Docket No. 05-WSEE-981-RTS, Order on Rate Applications, ¶223, December 28, 2005; KCC Docket No. 04-AQLE-I065-RTS: Order on Application ¶82 [non-labor maintenance expense], January 28, 2005, Order on Reconsideration ¶35, March 14, 2005, both citing Gas Service Co. v. State Corporation Commission, 4 Kan.App.2d 623, 609 P.2d 1157 [1980], rev. denied 228 Kan. 806 [1980].).[137]

100. The projections contained in the Company's Application were not known and measureable but projections that constitute speculation and guesswork. The Company failed to file revised schedules at any time subsequent to the Application, as required by the Commission's regulation, K.A.R. 82-1-231(d). As a result, the updated test year should be rejected by the Commission for failing to follow the Commission's prescribed procedural rules.[138]

D. Income Statement Issues

1. Jurisdictional Allocation

101. This issue is addressed above.

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[137] Staff's Proposed Findings of Fact and Conclusions of Law, September 30, 2010, Docket No. 10-KCPE-415-RTS, pp. 43-44 (emphasis added); *See also,* , Staff's Post Hearing Brief, September 30, 2010, Docket No. KCPE-415-RTS, pp. 89-90, ¶ 322-324.

[138] *Central Power Co. v. State Corp. Comm'n,* 221 Kan. 505, 511, 561 P.2d 779 (1977).

2. Compensation

(i) KCPL's Non-Executive Incentive Compensation

102. While KCPL claims that it modified the criteria for its non-executive incentive compensation plan to eliminate the focus on profitability or earnings,[139] the plan has not eliminated profitability or earnings but merely revised the criteria to make it appear that profitability or earnings is not the criteria. The Company revised the non-executive incentive compensation plan, making the financial benchmark non-fuel O&M rather than earnings per share or total shareholder return. [140]

103. If the non-fuel O&M financial benchmark declines between rate cases, it directly benefits shareholders by increasing earnings which in turn increases shareholder return, all other things being equal. [141] Profitability or earnings, in the form of non-fuel O&M, therefore remains part of the criteria for KCPL's non-executive incentive compensation plan.

104. As a result, CURB's recommended disallowance of 25% of the costs ($511,141) of both of the non-executive incentive compensation plans (ValueLink Plan for non-union employees, and Rewards Plan for union employees) should be adopted by the Commission.[142]

(ii) Executive Long-Term Incentive Plan ("LTIP")

105. The LTIP consists of restricted stock awards that are awarded to the fourteen officers of the Company, eligibility consisting of simply being employed by the Company and being awarded in the event the officer is employed for three years.[143]

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[139] KCPL Initial Brief, ¶ 74. *See*, Weisensee, Tr. Vol. 4, p. 914.
[140] KCPL Initial Brief, ¶ 74. *See*, Weisensee, Tr. Vol. 4, p. 914.
[141] Murphy, Tr. Vol. 3, p. 871.
[142] Crane Direct, pp. 31-34; Schedule ACC-18.
[143] Fairchild, Tr. Vol. 3, pp. 850-54.

106. If these awards are made simply for being employed and staying with the Company for three years, it is difficult to understand why KCPL's executive restricted stock awards are considered incentive compensation. According to the Company, there is no criteria for the award other than being with the Company for three years. It appears to be simply a way to make executive salaries look lower. KCPL's officers are well compensated, with base salaries ranging from $300,000 to $800,000, without consideration of this purported incentive compensation.[144] IRS currently limits deductibility of executive compensation that is considered salary. This limitation provides an incentive for companies to shift compensation from base salaries to incentive plans, which are not typically limited by the IRS. Accordingly, since this limitation was imposed by the IRS, incentive compensation costs paid to executives have increased significantly at many companies.

107. CURB's recommended disallowance should therefore be adopted by the Commission.

(iii) Equity Portion of Board of Director Fees

108. KCPL's attempt to demonstrate that the stock awarded to Directors is not based on financial parameters is without merit. The references (undocumented) to the Company's Corporate Governance Guideline contained in KCPL witness Ellen Fairchild's Rebuttal testimony demonstrate that the Board:

- "is elected by *shareholders*"
- "*oversees shareholder's interests* in the long-term health and overall success of the business"
- "fulfill their responsibilities consistent with their *fiduciary duties to shareholders"*

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[144] Crane Direct, p. 33.

- "*as appropriate*, take into consideration the interests of other stakeholders, including *employees and members of communities* in which the Company operates" [145]

109. Not surprisingly, the Company's Corporate Governance Guideline cited by Ms. Fairchild contains no mention of overseeing ratepayer interests, a fiduciary duty to ratepayers, or taking into consideration the interests of ratepayers or customers. In fact, the undocumented references to the Company's Corporate Governance Guideline fail to mention ratepayers or customers in any respect, much less any duties or responsibilities to them.

110. Nonetheless, Ms. Fairchild's Rebuttal Testimony concludes, without any factual support, that the Board "should be fairly compensated for the *oversight that they provide that benefits both shareholders and customers.*" [146] KCPL makes a similar misplaced statement in its Initial Brief, by concluding that the Board "provides an essential corporate service to both shareholders and customers."[147]

111. The issue here isn't whether the Board should be compensated for its services – the Company is free to compensate the Board in any manner it chooses. The issue is whether ratepayers should be required to pay for the stock awarded to Directors for services they perform in *overseeing shareholder interests* and *fulfilling their fiduciary duty to shareholders.*

112. Based on the foregoing evidence in the record, CURB urges the Commission to disallow the stock awards to directors on the basis the awards are based on parameters that relate to their fiduciary duties to shareholder interests and not ratepayer interests.

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[145] Fairchild Rebuttal, pp. 14-15.
[146] KCPL Initial Brief, pp. 14-15.
[147] KCPL Initial Brief, pp. 14-15.

(iv) Supplemental Executive Retirement Plan ("SERP") Benefits

113. CURB recommends that the Commission disallow all SERP costs. KCPL has included $566,784 of GPE SERP expense in its filing. SERP costs relate to supplemental retirement benefits for officers and key executives that are provided by the Company. These SERP benefits are in addition to pension benefits received by officers and key executives pursuant to the normal pension plan benefits offered to all other employees. These additional retirement benefits generally exceed various limits imposed on retirement programs by the Internal Revenue Service ("IRS") and therefore are referred to as "non-qualified" plans.[148]

114. According to the Company's Proxy Statement, its SERP provides:

> ...an amount substantially equal to the difference between the amount that would have been payable under the Pension Plan in the absence of tax laws limiting pension benefits and earnings that may be considered in calculating pension benefits, and the amount actually payable under the Plan...Mr. Chesser and is credited with two years of service for every one year of service earned under our Pension Plan, with such amount payable under the SERP.[149]

115. The IRS currently limits the amount of annual compensation that can be considered for purposes of determining contributions to qualified pension plans to $250,000. Thus, in addition to SERP costs, ratepayers are paying all of the associated pension costs for officers up to the $250,000 limit. The SERP benefit is related to compensation exceeding $250,000 per year. In addition, Mr. Chesser is also credited with two years of service for each year of service earned under the pension plan, with such costs payable under the SERP.[150]

116. The officers of the Company are already well compensated. Moreover, these officers and key executives that receive SERP benefits also receive pension benefits pursuant to

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[148] Crane Direct, p. 42.
[149] *Id.*
[150] *Id.*, at pp. 42-43.

the Company's regular pension plan. Ratepayers are already paying for retirement benefits for these officers and executives through the FAS 87 pension costs included in the Company's revenue requirement for the regular pension plan. If KCPL wants to provide further retirement benefits to select officers and key executives, then shareholders rather than ratepayers should fund these excess benefits.[151]

117. While KCPL witness Darrin Ives testified that it was his "opinion" that the majority of the companies in the peer group used to benchmark executive compensation have a SERP program for their executives, he did not determine or conduct a study to determine whether the SERP costs for those companies were funded by ratepayers in rates or by shareholders.[152]

118. Mr. Ives criticized CURB witness Andrea Crane's testimony because she did not identify any specific regulatory commissions that had disallowed the recovery of SERP costs, yet neither he nor any consultant for KCPL conducted any research to determine if there were regulatory commissions that disallow SERP costs.[153]

119. While the Commission did allow SERP costs in KCPL's last rate case, there is no reason this issue shouldn't be revisited, especially in light of the dire economic conditions ratepayers are faced with after already enduring $137.8 million in rate increases since 2007 during these difficult economic times. One must ask the obvious question: why isn't a pension based on an annual salary of $250,000 considered sufficient for ratepayers to bear?

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[151] *Id.*, at pp. 43-44.
[152] Ives, Tr. Vol. 3, pp. 799-800.
[153] Ives Direct, p. 10; Ives, Tr. Vol. 3, pp. 801-02.

120. Contrary to the implication made by KCPL witness Darrin Ives, SERP costs have been denied by numerous commissions across the country, including the following:[154]

- **Arizona Corporation Commission**: Opinion and Order, February 23, 2006, p. 19, *In the Matter of the Application of Southwest Gas Corporation for Establishment of Just and Reasonable Rates and Charges Designed to Realize a Reasonable Rate of Return on the Fair Value of the Properties of Southwest Gas Corporation Devoted to Its Operations Throughout the State of Arizona,* Arizona Corporation Commission Docket No. G-01551A-04-0876, Decision No. 68487, http://images.edocket.azcc.gov/docketpdf/0000043905.pdf;
    - "We agree with RUCO's position on this issue. Although we rejected RUCO's arguments on this issue in the Company's last rate proceeding, we believe that the record in this case supports a finding that the provision of additional compensation to Southwest Gas' highest paid employees to remedy a perceived deficiency in retirement benefits relative to the Company's other employees is not a reasonable expense that should be recovered in rates. Without the SERP, the Company's officers still enjoy the same retirement benefits available to any other Southwest Gas employee and the attempt to make these executives "whole" in the sense of allowing a greater percentage of retirement benefits does not meet the burden of reasonableness. If the Company wishes to provide additional retirement benefits above the level permitted by IRS regulations applicable to all other employees it may do so at the expense of its shareholders. However, it is not reasonable to place this additional burden on ratepayers."
    - *See also,* Decision No. 70665, December 24, 2008, p. 20, *In Re Southwest Gas Corporation,* Docket No. G-01551A-07-0504, 270 P.U.R.4th 465, 2008 WL 5451505 (Ariz. C.C.).

- **Connecticut Department of Public Utility Control**: Decision, June 30, 2009, p. 49, *Application of Connecticut Natural Gas Corporation for a Rate Increase,* Docket No. 08-12-06, http://www.dpuc.state.ct.us/FINALDEC.NSF/0d1e102026cb64d98525644800691cfe/46b6a8267005ce59852575e7005d37db/$FILE/081206-063009.doc
    - "The Department agrees with OCC that ratepayers should not have to fund excessive benefits in these difficult economic times. The Department cites precedent in this issue where in the Decision dated October 13, 1995 in Docket No. 95-02-07, Application of the Connecticut Natural Gas Corporation for a Rate Increase PH01, the Department stated, "[a]lthough the Department has allowed this in past rate cases, it is too great of an

[154] Chairman Sievers' determined during the hearing that Commission decisions from other jurisdictions could be referenced and cited in briefs. Tr. Vol. 3, p. 802-04.

expense to be borne by ratepayers struggling under a poor economy." Decision, p. 45. Based on the aforementioned, the Department disallows for ratemaking purposes the EEC SERP expense. The Company has the option of charging this expense below the line for shareholders to pay."

- **District of Columbia Public Service Commission**: Opinion and Order, January 30, 2008, p. 74, In the Matter of the Application of the Potomac Electric Power Company for Authority to Increase Existing Retail Rates and Charges for Electric Distribution Service, Order No. 14712, http://www.dcpsc.org/edocket/docketsheets_pdf_FS.asp?caseno=FC1053&docketno=361&flag=C&show_result=Y
    - "The Commission will remove the entire amount of SERP, not just the amount expensed. The Commission previously explained its rationale for disallowing all costs associated with PEPCO's SERP and Executive Benefit Protection Plan. In Order No. 10646, the Commission ruled that 'if Pepco wishes to compensate its executives over and above its qualified pension plan, then this cost is properly borne by the shareholders, not the ratepayers...'"

- **Idaho Public Utilities Commission**: Order No. 32196, February 28, 2011, p. 20-21, In the Matter of the Application of PacifiCorp DBA Rocky Mountain Power for Approval of Changes to Its Electric Service Schedules, CASE NO. PAC-E-I0-07, http://www.puc.idaho.gov/internet/cases/elec/PAC/PACE1007/ordnotc/20110228FINAL_ORDER_NO_32196.PDF
    - "The Commission finds Staffs argument persuasive and finds it reasonable to disallow Company recovery of SERP costs of $2.6 million (total Company) in this case. The Company has not demonstrated that the costs are related to providing services to southeast Idaho. The responsibility for generous severance benefits for executives, we find, is the responsibility of the Company and its shareholders, not Idaho customers."

- **Michigan Public Service Commission**: Order, October 20, 2011, pp. 66-67, *In the Matter of the Application of The Detroit Edison Company for Authority to Increase Its Rates for the Generation and Distribution of Electricity and for Other Relief,* Michigan PUC Case No. U-16472, http://efile.mpsc.state.mi.us/efile/docs/16472/0374.pdf
    - "The Commission finds that Detroit Edison's exception is without merit. Detroit Edison has not sufficiently differentiated these costs from the ones disallowed in the previous rate case. As noted by the ALJ, these costs are non-qualified plan costs...attributable to the company's supplemental executive retirement plan (SERP) and the executive supplemental retirement plan (ESRP), which the Commission disallowed in the December 23, 2008 order in Case No. U-15244 – a previous Detroit

Edison rate case. (citation omitted). The Commission agrees with the ALJ that the SERP and the ESRP appear to be substantially the same as those costs which the Commission previously rejected. Detroit Edison has failed to persuade the Commission that these plans are now redesigned to benefit ratepayers rather than shareholders. Without such a persuasive analysis, the Commission concludes that the Staff's disallowance should be adopted."

- **Minnesota Public Utilities Commission**: Findings of Fact, Conclusions, and Order, April 25, 2011, p. 27, ftn. 26, *In the Matter of the Application of Otter Trail Power Company for Authority to Increase Rates for Electric Utility Service in Minnesota,* Minnesota PUC Docket No. E-017/GR-10-239, https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPoup&documentId={90D1BD5B-FB92-4E99-8A55-8505DF158480}&documentTitle=20114-61715-01
    - "Otter Tail initially sought to recover some $931,141 in test year costs for the ESSR. Following objections by the RUD-OAG *and the ALJ's recommendation to not allow such costs*, the Company accepted the ALJ recommendation."

- **Montana Public Service Commission**: August 18, 1989, p. 43, *In The Matter of the Application of the Montana Power Company for Authority To Adopt New Rates and Charges for Electric and Natural Gas Service in the State of Montana,* Docket No. 88.6.15, Order No. 5360d, http://psc.mt.gov/Docs/ElectronicDocuments/pdfFiles/88-6-15_5360d.pdf
    - "The Commission has found no evidence in this proceeding to support these plans in lieu of the current ERISA limitations, and in light of the legislative history of those limitations, as described above. As pensions should not be funded beyond the ERISA limits with tax dollars, as a policy matter, the Commission also believes the same is true for regulated rates. Therefore, the Commission accepts the adjustment by MCC witness Clark to remove $434,568 in expenses associated with the Benefit Restoration Plans."

- **Oklahoma Corporation Commission**: Final Order, October 9, 2007, p. 145, Application of Public Service Company of Oklahoma, an Oklahoma Corporation, for an Adjustment in Its Rates and Charges for Electric Service in the State of Oklahoma, Order No. 545168, Oklahoma Corporation Commission Cause No. PUD 200600285, http://imaging.occeweb.com/AP/Orders/0035DC7E.pdf
    - "q. Employee Benefits-Supplemental Executive Retirement Plan ("SERP"). PSO included $596,081 as Supplemental Executive Retirement Plan ("SERP") in its cost-of-service. The Commission adopts OIEC's proposal to remove the SERP Expense from the revenue requirement in this proceeding. The Commission adopts OIEC's recommendation that ratepayers pay for all of the executive benefits included in PSO's regular

pension plans and that shareholders pay for the additional executive benefits included in the supplemental plan."

- **Oregon Public Utility Commission**: Order No. 01-787, September 7, 2001, page 44, *In the Matter of PacifiCorp's Proposal to Restructure and Reprice its Services in Accordance with the Provisions of SB 1149,* Oregon PUC Docket No. EU 116, http://apps.puc.state.or.us/orders/2001ords/01-787.pdf
    - "The Commission has not allowed recovery of SERP expenses in other utility rate cases. PacifiCorp has not persuaded us that it is necessary to pay SERP to hire and retain executive officers. The SERP costs are not allowed."

- **Rhode Island Public Utilities Commission:** *Providence Gas. v. Malachowski*, 656 A.2d 949, 952 (R.I. 1995).

    "The PUC denied SERP because, in its judgment, the evidence presented by the company on SERP showed that it does not directly benefit ratepayers:

    > 'What the SERP benefit does is send a message * * * that the Company will, for pension benefit purposes, act as if they have been employed by the Company for most of their productive employment years, when in fact they have not. If that is something the shareholders desire to have the Company do, that is their business. We do not feel, however, that this is an economic burden that can reasonably be placed on the shoulders of the ratepayers.'

    We agree. The PUC rejected the company's attempt to reward executive talent for employment not dedicated to the company's ratepayers. The PUC's statement was clear: the SERP expense does not benefit ratepayers. The PUC rejected the SERP expense and called it an unreasonable and excessive expense that does not directly benefit ratepayers. The PUC's decision regarding SERP expenses was just, reasonable, lawful, and supported by legal evidence."

- **Texas Railroad Commission**: Final Order, December 14, 2010, p. 3, *Petition of the De Novo Review of the Denial of the Statements of Intent Filed by Texas Gas Service Company by the Cities of El Paso, Anthony, Clint, Horizon City, Socorro, and Village of Vinton, Texas,* Gas Utilities Docket No. 9988, http://www.rrc.state.tx.us/meetings/gspfd/9988-FinalOrder.pdf
    - "TGS is requesting recovery of $168,386 in expenses incurred for the Company's Supplemental Executive Retirement Plan ("SERP"). TGS' proposed SERP expense is unreasonable because it is not necessary for the provision of safe gas service to the public."

- **Washington State Utilities and Transportation** Commission: Final Order (Order 11), April 2, 2010, ¶ 81, *WUTC v. Puget Sound Energy, Inc.*, Docket Nos. UE-090704 and UG-090705, http://www.wutc.wa.gov/rms2.nsf/177d98baa5918c7388256a550064a61e/b5d9c55d1da81d02882576f9005e12c5!OpenDocument
    - "As to SERP, we find persuasive the arguments recommending removal of these costs. PSE has failed to provide an adequate justification for continuing to require ratepayers to fund supplemental retirement benefits for a small number of executives who already are highly compensated and entitled to the same levels of qualified retirement plan benefits as other employees, within the limits of what the IRS allows."

121. KCPL has failed to provide an adequate justification to require ratepayers to fund supplemental retirement benefits for a small number of executives who are already highly compensated and entitled to the same levels of qualified retirement plan benefits as other employees, within the limits of what the IRS allows. Numerous commissions across the country have concluded that SERP costs are not necessary for the provision of safe and reliable electric service to the public, constitute an unreasonable and excessive expense that do not directly benefit ratepayers, and would place an unreasonable economic burden on the shoulders of ratepayers already struggling in these difficult economic times.

122. CURB respectfully urges the Commission to adopt CURB's recommended disallowance for SERP costs shown in Schedule ACC-23.

3. Pension Funding Status Adjustment

123. This issue was fully litigated and addressed in the last case,[155] where the Company made an identical adjustment in the 415 Docket. In that case, the KCC found that "[a]fter reviewing the evidence presented on this issue, the Commission finds the evidence in the record supports Staff's proposed adjustment to ensure symmetrical pension funding. The

[155] Grady, Tr. Vol. 4, p. 1021.

Commission finds Staff's pension funding status adjustment is reasonable and adopts Staff's adjustment for this proceeding."[156]

124. KCPL has provided no new information or reasons to re-litigate the issue. If KCPL wished to appeal this issue, the Company had the opportunity in the last case yet chose not to file an appeal.[157]

125. If a pension adjustment was necessary, it should have been identified at the time of the Aquila acquisition, as noted in questions by Commissioner Albrecht.[158] Many factors have influenced pension costs since the merger, including the meltdown of the financial markets and the subsequent sluggish recovery. It is totally unreasonable to now go back and try to recreate separate pension funds.

126. Furthermore, this issue has been addressed in the pension tracker settlement, and KCPL is simply now attempting to renegotiate the terms of that settlement.[159]

127. Even assuming KCPL's argument that the Commission has the authority,[160] KCPL has presented insufficient reasons for the Commission to revisit the issue. As a result, the $1.5 million pension funding adjustment proposed by KCPL should be rejected, and the pension funding adjustment proposed by Staff and CURB should be adopted.

4. Pension Tracker Amortization Period

128. In KCC Docket No. 07-GIMX-1041-GIV, KCPL was authorized to defer the difference between its actual pension expense and the pension expense being collected in rates. The KCC authorized KCPL to begin this deferral at December 1, 2010. The Order approving the

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[156] Crane Direct, pp. 38-39; KCC Order in KCC Docket No. 10-KCPE-415-RTS, November 11, 2010, page 58.
[157] Tr. Vol. 4, pp. 1021-22.
[158] Tr. Vol. 4, pp. 1019-20.
[159] Grady, Tr. Vol. 4, p. 1021-22.
[160] KCPL Initial Brief, ¶ 83.

deferral also specified that deferred costs would be amortized in KCPL's next base rate case over a period not to exceed five years. Neither the deferral, nor any unamortized balances, are to be included in rate base. In this case, KCPL is proposing to recover pension costs deferred through June 30, 2012, six months beyond the test year. In addition, the Company is seeking to recover these costs over a three year period.[161]

129. CURB recommends that the KCC limit recovery of deferred pension expense to the pension expenses that had been deferred by December 31, 2012, the end of the test year. This recommendation is consistent with CURB's recommendations regarding other components of the Company's revenue requirement such as utility plant-in-service and CWIP. By including estimated costs through June 30, 2012, KCPL is effectively moving the test year from the historic twelve month period ending December 31, 2011, to a partially forecast period ending June 30, 2012. Any differences between actual pension expenses for the period January 1, 2012, through June 30, 2012, should continue to be deferred and the Company will recover these additional costs through an amortization approved as part of its next base rate case. [162]

130. CURB is also recommending that the KCC authorize a five-year recovery period for deferred costs, instead of the three-year period proposed by KCPL. As noted in Ms. Crane's testimony at page 41, a five-year deferral is consistent with the guidance provided in KCC Docket No. 07-GIMX-1041-GIV with regard to the appropriate amortization period. That Order expressly permitted amortization periods of up to five years. The use of a five-year amortization period will mitigate the impact of this deferral on the annual rates paid by Kansas customers.[163]

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[161] Crane Direct, p. 37.
[162] Crane Direct, p. 40.
[163] Crane Direct, p. 41.

131. Moreover, it is important to consider that in addition to this deferral, the Company is also seeking authorization to increase the pension expense included in rates from $35.4 million to $43.8 million. One would expect that future deferrals will be much smaller than those being claimed in this case, and could even result in refunds to ratepayers.[164] CURB has not proposed any adjustment to the prospective pension costs now being claimed by KCPL, other than elimination of the pension funding status adjustment.

132. Given the significant increase in the prospective pension costs to be included in base rates, the magnitude of the Company's rate increase request in this case, and the fact that a five-year deferral is permissible pursuant to the Order in KCC Docket No. 07-GIMX-1041-GIV, CURB recommends that the KCC adopt a five-year amortization period for deferred pension costs.

5. Other Post-Employment Benefits ("OPEB") Tracker Amortization Period

133. Similar to the treatment afforded pension expense, KCPL is also deferring the difference between its actual OPEB expense and the amount collected in rates. In this case, the amount collected in rates has generally been below the actual expense, resulting in a regulatory liability.[165] Consistent with other recommendations relating to post-test year adjustments, CURB recommends that only deferred OPEB costs through December 31, 2011, the end of the test year, be authorized for recovery in this case. In addition, consistent with CURB's recommendation regarding the amortization of deferred pension expenses, CURB recommends that the KCC approve a five-year amortization of deferred OPEB expenses. [166]

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[164] Crane Direct, pp. 36, 41.
[165] Crane Direct, at p. 45.
[166] Crane Direct, at p. 46.

134. Since the OPEB expense included in rates has been greater than the Company's actual costs, CURB's recommendations will increase the Company's revenue requirement. CURB's recommendation to include only deferred test year costs will increase the Company's revenue requirement by approximately $44,000 and the recommendation to amortize costs over five years will increase the Company's revenue requirement by approximately $30,000.

6. Rate Case Expense Amortization Period

135. CURB is recommending that the KCC adopt a four-year amortization period for rate case costs associated with the current rate case. A four-year amortization period is the amortization period that has traditionally been used by the KCC for amortization of KCPL's rate case costs and is the period that was used during the Regulatory Plan. While the KCC did order a three-year amortization period for costs incurred in the 415 Reconsideration Docket, that case was decided approximately one year after the original case. Using a three-year amortization period for the rate case costs incurred in the 415 Reconsideration Docket resulted in all of the 415 costs being amortized by January 2014 - the only difference was that the amortization of the 415 Docket costs began one year sooner than the amortization of costs for the 415 Reconsideration Docket.[167]

136. The use of a four-year period will mitigate the impact upon ratepayers. This is especially important given the significant rate case costs that KCPL has been incurring, which have been passed on to ratepayers. In this case, the Company originally sought to recovery almost $2.5 million in rate case costs. While it appears that actual costs may be somewhat less than originally projected, ratepayers will still be responsible for significant costs incurred by the Company to raise rates in this case. A longer amortization period will mitigate the impact on

[167] Crane Direct, at p. 60.

ratepayers and will also provide a greater incentive for the Company to minimize its actual rate case costs.

7. Update to June 30, 2012

137. According to KCPL witness John Weisensee, the updated adjustments made by the Company in data request responses (but not filed as revised schedules), increased the revenue requirements by around $5.5 million.[168] This issue was discussed previously in the section related to rate base issues and will not be repeated here.

8. Other Benefits Expenses

138. The Commission accepted an adjustment similar to this adjustment in the 415 Docket, where the Company used a methodology to project other benefits expense that was similar to the methodology utilized in this case. Here, like in the 415 Docket, KCPL is self-insured for health care costs. [169] Here, like in the 415 Docket, the health insurance plans are funded through contributions by both KCPL and its employees, and actual costs depend on the number and magnitude of claims made during the year.[170] Here, like in the 415, KCPL's projected costs reflect an increase of more than 15% over the actual test year costs.[171]

139. In its Order in the 415 Docket, the KCC found that:

> "The health care portion of Other Benefits Expense is hard to predict and depends upon the level of services needed for KCP&L's employees. The Commission finds KCP&L's proposed adjustment is speculative and not based on known and measurable expenses. The Commission agrees with CURB witness Andrea Crane that known and measurable expenses based upon actual costs during the test year is the most appropriate calculation to use for this expense. Therefore, the

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[168] Weisensee, Tr. Vol. 4, p. 911.
[169] Crane Direct, pp. 47; Order: 1) Addressing Prudence; 2) Approving Application, in Part; & 3) Ruling on Pending Requests, p. 59, KCC Docket No. 10-KCPE-415-RTS.
[170] *Id.*
[171] *Id.*

Commission approves CURB's adjustment reflecting the actual test year costs for Other Benefits Expense."[172]

140. The KCC should make a similar finding in this case and reject the Company's proposed adjustment to Other Benefits Expense as recommended by CURB witness Andrea Crane at Schedule ACC-26, which reflects the actual test year costs for Other Benefits Expense.

9. Fines and Penalties

141. While this is not a contested issue, it should be noted that in response to KCC-43, the Company stated that it "agrees that it would be appropriate for Staff to propose an adjustment to remove these costs from cost of service in this case."[173] As a result, the Commission should adopt CURB's adjustment shown in Schedule ACC-44 to remove these penalties from the Company's revenue requirement.

E. Class Cost of Service ("CCOS") Study

142. CURB concurs with the positions taken and arguments made by KCPL in paragraphs 98-102 of KCPL's Initial Brief, and incorporate them herein by reference.

143. With respect to KCPL's discussion in paragraph 101 regarding certain past increases to Large General Service and Residential classes, it is important to note that the past rate increases have been allocated consistent with Class Cost of Service Study (CCOSS) results in those dockets, and such consistency should continue in the proceeding.

144. As noted by KCPL, Doubletree's proposed across-the-board revenue allocation is inconsistent with the BIP CCOSS results. Because Large General Service and Large Power

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[172] Order: 1) Addressing Prudence; 2) Approving Application, in Part; & 3) Ruling on Pending Requests, p. 59, KCC Docket No. 10-KCPE-415-RTS; Crane Direct, pp. 48-49.
[173] Crane Direct, pp. 58-59.

classes are substantially below and are moving further away from the system rate of return,[174] an across-the-board revenue allocation would cause these classes to move even further away from the system average, resulting in even more discrimination in the rate design.[175] As a result, the proposal to apply any rate increase across the board would result in discriminatory rates, not only because the current rate structure is discriminatory, but because applying the across-the-board rate increase would exacerbate the existing subsidies.

145. While KCPL notes that a class cost of service study is not necessarily *legally* required for rate design purposes, a class cost of service study *was* performed by KCPL and admitted in the record in this case. Because KCPL's class cost of service study demonstrates that certain classes of customers *are* being burdened with the costs of another class, pursuant to the touchstone/polestar of public utility law, [176] the Commission must implement an allocation of any authorized rate increase that will not allow that burden to continue or become more burdensome. Kansas Courts have held that "[i]f the KCC is convinced or the evidence indisputably demonstrates that a rate structure in fact imposes costs on one class costs created by another, the rate structure cannot withstand the test of *Jones.*"[177]

146. KCPL argues that the Commission is not bound to set rate structures based *exclusively* on cost of service factors (the amount of money expended by a utility in providing service to each of its customer classes), but that instead the Commission is free to consider, *inter*

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[174] KCPL Exh. No. 2, line 2, Columns C-D.
[175] Glass, Tr. Vol. 2, at pp. 518.
[176] *Jones v. Kansas Gas and Electric Co.,* 222 Kan. 390, Syl. ¶ 10, 565 P.2d 597 (1977); Initial Post-Hearing Brief of Kansas City Power and Light Company (KCPL Initial Brief), ¶ 11 (citing, *Midwest Gas Users Ass'n v. Kansas Corporation Comm'n,* 3 Kan. App. 2d 376, 391, 595 P.2d 735 (1979)); CURB Exhibit 5: *Lloyd v. Pennsylvania PUC,* 904 A.2d 1010, 1020, Util. L. Rep. P 26,959 (Pa. Cmwth. 2006), appeal denied, 916 A.2d 1104, fn. 10 (2007) (cost of service should be the "polestar" of utility ratemaking).
[177] *Midwest Gas Users Ass'n and Armco Inc. v. v. Kansas Corporation Comm'n,* 5 Kan. App. 2d 653, 657-59, 623 P.2d 924 (1981) (citing, *Midwest Gas Users Ass'n. v. Kansas Corporation Comm'n,* 3 Kan. App 2d 376, 391(1979)).

alia, the value of service (capacity and willingness of different customer groups to bear increased costs and the intrinsic value of the commodity furnished) as well as matters of public policy. [178] To be clear, however, there is no evidence in the record related to the value of service or the intrinsic value of the commodity furnished by KCPL. No elasticity or other studies were offered by KCPL or any party related to the value of service, any intrinsic value of the commodity furnished by KCPL, or public policy reason that would justify a decision to allow current class subsidies to continue or actually increase.

147. Furthermore, the evidence demonstrates that the residential classes absorbed larger percentage increases in 2006 and 2007 than are being proposed by KCPL, Staff, and CURB for the large general service class in this Docket, even though the disparities in the rate of return index for the Large General Service class is much worse in this docket than they were for the residential class in 2006 and 2007. The Large General Service class Intervenors are, in the words of Staff witness Dr. Glass, "behaving differently" in this docket when it comes to revenue allocation than the positions taken in prior dockets when the shoe was on the other foot, so to speak.[179]

148. In the 415 Docket, the Commission determined that the BIP allocation process mirrored the planning and operation of KCPL's power system and was consistent with the allocation of energy costs and their benefit to all customers.[180] The Commission found the BIP method preferable to Staff's average-and-peak approach, that it provided more structure for modeling costs of production plant and use of generating resources, and it allowed for a detailed

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[178] KCPL Initial Brief, ¶ 10 (citing, *Midwest Gas Users Ass'n and Armco Inc. v. v. Kansas Corporation Comm'n,* 5 Kan. App. 2d 653, 657-59, 623 P.2d 924 (1981)).
[179] Glass, Tr. Vol. 2, pp. 461-469; KCPL Exh. No. 2.
[180] Order: 1) Addressing Prudence; 2) Approving Application, in Part; & 3) Ruling on Pending Requests, p. 116, KCC Docket No. 10-KCPE-415-RTS.

examination of seasonal costs and corresponding seasonal rate allocations.[181] Based on these findings, the Commission adopted Mr. Normand's CCOS Study to use as a basis for determining a rate design for KCPL:

> To minimize time spent on modeling and data issues and thus increase time devoted to fundamental rate design issues, the Commission orders that the KCPL CCOS Study prepared for this docket be the basis for the CCOS Study used in the new rate design docket. [182]

149. KCPL's CCOS study complies with the Commission's directive to use the BIP methodology and is the only CCOSS in the record in this proceeding. As a result, it is the only substantial competent evidence in the record that the Commission may base its decision on with respect to the assignment of revenue responsibility among rate classes. As a result, the Commission should reject Doubletree's proposal to apply any revenue increase evenly among rate classes, which would be inconsistent with the only CCOSS in the record.

F. Rate Design

150. In the 415 Docket, the Commission made the following findings:

> After reviewing the evidence in the record, the Commission concludes KCPL's current rate structure must be redesigned to *move customer classes closer to the principal of cost causation.* Each rate class should pay rates based on its costs so that the rate design equalizes the rates of return for all the different classes. To this end, the Commission concludes that a rate case will be opened specifically focused on rate design for KCPL.[183]

151. The Commission further ordered that the following factors shape the new rate design docket:

- The Christensen Associates Study of Dynamic Pricing potential in Kansas and, in particular, rate design options outlined in the final white paper from this study.
- Further simplification of rate structure for Residential Classes by reducing the number of subclasses.

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[181] *Id.*, at p. 117.
[182] *Id.*, at p. 124.
[183] *Id.*, at pp. 123-24.

- Rate design for Commercial and Industrial Classes should be simpler and more transparent.
- Eliminate rate structure with artificial incentives to encourage a customer to switch end use equipment.
- Incorporate the Commission's energy efficiency and energy conservation goals. [184]

152. CURB will demonstrate below that the rate design proposals recommended by CURB comply with the above Commission directives.

1. Residential

153. CURB's proposed inclining summer block rate for residential customers would give customers more of an incentive to conserve energy, or reduce usage, than the Company's proposed flat block summer rates.[185]

154. The Company's position that using rate design to incent customers to conserve energy constitutes some sort of inappropriate coercion is erroneous and hypocritical. The Company admits it uses its price structure (load factor rates) in the general service customer class tariffs to motivate customers to improve their load factors.[186]

155. CURB's proposed residential inclining summer block rate is inherently no different than the Company's load factor rates for general service customers – it simply provides a price signal, one that encourages residential customers to reduce their usage above the first block level. Prices are used to incent people in nearly all aspects of the economy, and in our economy price rations the supply of goods available.[187] CURB's proposal is to incent, or motivate, people to conserve energy over the long run, not penalize them or make one class of

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[184] *Id.*, at pp. 124-25.
[185] Kalcic, Tr. Vol. 2, pp. 401.
[186] Kalcic, Tr. Vol. 2, at pp. 402-03.
[187] Kalcic, Tr. Vol. 2, at p.415-16.

customer better or worse off than another.[188] To the extent this constitutes coercion, the Company's load factor rates for the general service classes constitutes the same type of coercion.[189]

156. Staff proposed an even more aggressive residential summer inclining block rate in the 415 Docket, and supported inclining block rates in other dockets, because Staff believed that inclining block rates send an appropriate price signal "to encourage the efficient use of electricity for all customers."[190]

157. Staff witness Dr. Glass testified that the average residential customer uses less than 1400 kWh in the summer, so CURB's proposal would not negatively affect the average customer since the break-even point between the Company's proposed flat block summer rates and CURB's inclining block rate is 1500 kWh.[191] Only residential customers using more than 1500 kWh per month in the summer would pay more under CURB's proposal, and CURB's proposal would provide a price incentive for those customers to do things with their facilities to conserve or reduce their energy usage.[192]

158. The advantages associated with CURB's residential inclining summer block rates include:

- It provides a greater conservation price signal than flat block rates.[193]
- Customers that keep their usage low will pay less, providing low income and low usage customers with a price break.[194]
- It would not impose excessive rate impacts on any residential subclass.[195]

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[188] Kalcic, Tr. Vol. 2, at p. 416.
[189] *Id.*
[190] Glass, Tr. Vol. 2, at p. 471-72.
[191] Glass, Tr. Vol. 2, at p. 474-75.
[192] Glass, Tr. Vol. 2, at pp. 475-76.
[193] Kalcic Tr. Vol. 2, at p. 401.
[194] Kalcic, Tr. Vol. 2, at p. 405; Glass, Tr. Vol. 2, at pp. 476-77.
[195] Kalcic Direct, Schedule BK-5; Kalcic Cross Answering, p. 10.

- It is revenue neutral within the residential class; i.e., would not shift cost responsibility to non-residential classes.[196]
- The cutoff or break-even point between the Company's proposed flat block summer rates and CURB's inclining block rate is 1500 kWh.[197]
- It complements DSM programs in that customers have a greater incentive to invest in energy efficiency.[198]
- It provides the same ultimate goal as DSM programs (reduced consumption) without the large upfront costs.[199]
- Inclining block rate designs are already in place in Kansas (Westar & Midwest Energy).[200]

159. KCPL considers CURB's conservation-oriented inclining block approach to constitute coercion, whereas the Company views DSM programs as appropriate. However, KCPL has spent $33.8 million on DSM programs to reduce energy consumption, at an average cost of RS kWh saved to date of $0.23 / kWh.[201] CURB's conservation-oriented inclining block proposal is designed to achieve the same goal without incurring a price tag of $0.23 per kWh.

160. CURB urges the Commission to approve CURB's summer residential inclining block proposal as fully described in the testimony of CURB witness Brian Kalcic.[202]

2. Small General Service ("SGS")

161. Contrary to KCPL's representation, CURB's SGS rate design is not intended to eliminate 50% of the winter price differential for SGS Space Heating customers, but is intended to eliminate 50% of the **excess** (non-cost based) discounts of SGSSA customers.[203]

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[196] Kalcic, Tr. Vol. 2, at p. 402.
[197] Kalcic, Tr. Vol. 2, at p. 414-15.
[198] Glass, Tr. Vol. 2, at pp. 475-76.
[199] Through December 31, 2011, KCPL had spent approximately $33.78 million on its Kansas DSM program portfolio. Kansas City Power & Light Company's Notice of Filing of Information Requested by CURB at Hearing, p. 2.
[200] Glass, Tr. Vol. 2, at pp. 472-73; Kalcic Direct, p. 19; Kalcic Cross Answering, p. 11.
[201] Kansas City Power & Light Company's Notice of Filing of Information Requested by CURB at Hearing, pp. 2-3.
[202] Kalcic Direct, pp. 12-20; Kalcic Cross-Answering, pp. 10-11.
[203] Kalcic Direct, pp. 22-24; Kalcic Cross-Answering, pp. 10-11.

162. CURB's SGS rate design is revenue neutral within the SGS class,[204] and would not result in excessive rate impacts on SGSSA customers.[205] Furthermore, the rate impact on SGSSA customers would decline with the level of KCPL's awarded revenue requirement.[206]

163. KCPL argues that CURB's proposal that the Commission direct KCPL to revise the availability sections of its General Service rate schedules would provide no real protection against rate-switching. That argument is simply a continuation of KCPL's longstanding resistance to finding solutions to the rate-switching red-herring flag that KCPL has raised for several successive rate cases.[207]

164. CURB's proposal would prohibit general service customers from seeking a lower bill that might be available on a different rate schedule **that they did not qualify for** – i.e., it would eliminate the rate migration problem that limits KCPL's ability to move general service rates toward their respective cost of service levels over time.[208]

3. Medium General Service ("MGS")

165. CURB concurs with KCPL and Staff's proposed allocation to the MGS class.

4. Large General Service ("LGS")

166. CURB takes no position on KCPL or Walmart's LGS rate design.

5. Energy Cost Adjustment ("ECA") Rider

167. Doubletree's ECA recommendation has merit, but the record may be insufficient to modify the ECA in this Docket.

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[204] Kalcic Cross-Answering, p. 11.
[205] Kalcic Direct, pp. 22, Schedule BK-8.
[206] Johnson, Tr. Vol. 2, pp. 377-78.
[207] KCPL Initial Brief, ¶ 108; Lutz, Tr. Vol. 1, pp. 266-669.
[208] Kalcic Direct, pp. 11-12.

6. Demand Side Management ("DSM") Programs

168. CURB has no DSM proposal in this docket.

III. CONCLUSION

169. KCPL's customers have endured $137.8 million in rate increases since 2007, during the worst economic downturn in modern history. CURB respectfully recommends that the Commission carefully consider and grant the recommendations made by CURB on rate base, revenue requirement, rate of return, and rate design, and for such further relief as may be just and equitable.

Respectfully submitted,

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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

I, C. Steven Rarrick, of lawful age, being first duly sworn upon his oath states:

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

C. Steven Rarrick

SUBSCRIBED AND SWORN to before me this 2nd day of November, 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-KCPE-764-RTS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 2nd day of November, 2012, to the following:

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