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Kansas Corporation Commission
/S/ Kim Christiansen

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

In the Matter of the Application of Mid-Kansas Electric Company, LLC for Approval of a Debt Service Coverage Formula Based Ratemaking Pilot Plan for the Geographic Territory Served by Its Member-Owner Southern Pioneer Electric Company.	))))))	Docket No. 13-MKEE-452-MIS

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of Kansas

CURB'S RESPONSIVE BRIEF

The Citizens' Utility Ratepayer Board (CURB) herein files its responsive brief in opposition to the settlement agreement jointly filed with the Kansas Corporation Commission (Commission or KCC) in this docket by Mid-Kansas Electric Company LLC (MKEC), the Commission Staff and the Western Kansas Industrial Electric Consumers (WKIEC) (jointly, the Signatories).

I. Summary of the proposed formula rate plan

1. The settlement agreement, if approved, would establish a five-year formula-based ratemaking pilot plan that would allow Southern Pioneer, a member-owner non-profit C corporation of MKEC, to seek annual rate adjustments under an abbreviated ratemaking process. Rate adjustments would be based on maintaining a target debt service coverage (DSC) ratio of 1.75. In other words, MKEC is seeking to build equity capital in Southern Pioneer by collecting roughly 75% more in rates for debt service coverage than covering its debts actually costs the company. The company claims its great need for capital to repair, improve and maintain Southern Pioneers' aging infrastructure is prompting the need for frequent rate increases to build equity capital over the next five years.

2. In opposing the settlement, CURB is urging the Commission to consider the Signatories' agreement as proposing an extraordinary change in ratemaking policy in Kansas. Adopting formula rates, which by definition greatly limit or restrict the ability of the parties (including the Commission) to review the underlying costs, would take a giant step beyond the parameters of current policy. A decision of this magnitude should not be taken lightly. While CURB recognizes that Southern Pioneer's circumstances may merit additional infusions of capital to deal with its aging infrastructure, the legislature and the Commission, in similar circumstances, have developed mechanisms that provide utilities timely recovery for capital improvements while also protecting ratepayers from unwarranted risk and unnecessarily high rates. The Commission is not restricted from rejecting the settlement or modifying it so that it is consistent with the policies that have led the Commission and the legislature to build reasonable safeguards and limits into the surcharge mechanisms that they have approved.

II. CURB's objections to the settlement agreement

3. CURB's objections to the settlement focus on two key issues:

(1) The target DSC ratio is higher than is necessary for the plan to succeed, which will result in unreasonably high rate increases even in years where such large infusions of cash will not be needed.

(2) The formula rate plan proposed in the agreement is inconsistent with current policy in Kansas that provides that extraordinary recovery mechanisms should include only certain types of costs, provide adequate opportunity for review of the underlying expenses, and should provide safeguards against unreasonably high increases.

(1) The target DSC ratio is higher than is necessary for the plan to succeed, which will result in unreasonably high rate increases even in years where such large infusions of cash will not be needed.

4. The proposed agreement would allow the company to adjust rates annually using a formula that is based on maintaining a 1.75 debt service coverage (DSC) ratio. In other words, the goal is to allow the company to increase or decrease its rates so that it will collect 75% more for its debt service coverage than serving its debt actually costs. The purported purpose of the plan is to allow the company to build equity capital that will allow it to maintain its debt service coverage while taking on additional debt to make necessary infrastructure improvements. While CURB recognizes the need of the company to meet its loan covenants, which require the company to maintain a 1.35 DSC ratio, and also recognizes the need of the company for an infusion of capital to make infrastructure improvements possible, the 1.75 target DSC ratio proposed by the Signatories' agreement is higher than the DSC floor recommended by any party, including the company, and will result in rate increases even in years where the company anticipates meeting its lender requirements. Further, the plan's10% cap on annual increases is based on 10% of the total customer revenues, not just on the base rate revenues. (Crane, Test. In Opp., at 5). With a target DSC ratio of 1.75, annual base rate increases could be as much as 40%. (Crane, Test. In Opp., at 5, 8).

5. As CURB witness Andrea Crane testified, the adjustments will be based on projected needs and adjusted and trued-up annually, so only a minimal cushion over the lender-required DSC of 1.35 is necessary to ensure that the company will meet its lender requirements each year. (Crane, Dir. Test, at 28). Ms. Crane provided calculations in her Direct Testimony, based on the company's

projected debt service costs, to show that a target DSC ratio of 1.4 is more than sufficient to ensure that the company will not violate its loan covenants. (Crane, Dir. Test., at 29-30). The only reason for providing a larger margin would be if the rates approved were anticipated to be in place for several years, and were to be based on a past test year. In such circumstances, the risk of variations in year-to-year revenues might justify a larger margin of safety. (Crane, Dir. Test., at 27-28). However, with this plan, the annual rate adjustments made on the basis of company projections of future debt service costs will provide the margin of safety. These provisions in the plan vastly reduce the risk to the company that revenues will fall short and cause the company to violate its lender requirements. Therefore, there is no justification for providing a DSC target ratio of 1.75, a level that may generate base rate increases for customers of as much as 40%.

6. The original plan called for establishing a deadband range where rates would not be adjusted in years where current revenues were producing a DSC ratio within that range. (Crane, Dir. Test., at 7-8). Staff and the company both recommended adopting a minimum (floor) DSC ratio of 1.6. CURB recommended adopting a floor DSC ratio of 1.4. Ms. Crane noted that no party, even the company, presented evidence supporting a floor higher than 1.6. (Crane, Test. In Opp., at 5). Although Ms. Crane's analysis supports adopting a target DSC ratio of 1.4, the evidence presented by Staff and the company support only a target DSC ratio of 1.6. While CURB acknowledges that the Commission may find evidence in the record to support a target DSC ratio of 1.6, there is no evidence in the record to support the 1.75 target DSC ratio proposed by the settlement. A target DSC ratio of anywhere from 1.4 to 1.6 is supported by the record and will produce more moderate increases for customers, and the annual adjustments will protect the company from the risk of

violating its loan covenants. Providing a larger margin than necessary will take money out of customer pockets to cover risk for the company that is nonexistent under this plan.

(2) The formula rate plan proposed in the agreement is inconsistent with current policy in Kansas that provides that extraordinary recovery mechanisms should include only certain types of costs, provide adequate opportunity for review of the underlying expenses, and should provide safeguards against unreasonably high increases.

7. The formula rate plan proposed by the agreement, as described above, would allow the company to adjust retail base rates to maintain a 1.75 DSC ratio. (Crane, Test. In Opp., at 2). Filing of the application would trigger a 90-day clock during which Staff and intervenors will review the filing. (Crane, Test. In Opp., at 2). If Staff and intervenors file testimony opposing the increase, the Commission can extend the review period for an additional 30 days. (Crane, Test. In Opp., at 2). The Commission will retain the option, if necessary, to suspend the schedule for a full 240-day review, but the goal of the plan is to conclude the docket quickly as possible.

8. However, CURB has reservations about the short period for review of the applications. While shorter review periods may be appropriate when adjusting only a discrete set of a particular type of costs, such as property taxes or pension costs, the proposed plan will be adjusting the same wide range of the utility's costs that are reviewed in a normal 240-day rate case. Shorter review periods allow less room for finding and correcting errors. While Staff may be confident that 90 or 120 days is a sufficient period for review, Staff has more resources and employees than most intervenors. CURB is not so confident that intervenors with fewer employees than Staff will find it possible to complete an adequate review. Any party asking for more time will be faced with the task

of overcoming the company's objections and the built-in presumption that the review should be concluded within 90 to 120 days.

9. Additionally, the applications will be based on many projections of revenues and costs, not solely from a prior historic test year. Forward-looking projections, as compared to historical data, can be more controversial and more likely to generate the need for further discovery—a need that may not be met with such a short period of review. If the application is deficient or contains errors, the delay may eat further into the time that the parties have for review. Finally, this plan proposes a mechanism that is different than any other ratemaking mechanism in Kansas, so the very newness of this process is likely to create difficulties for those reviewing the data. Although the Commission will retain the option to suspend the schedule and adopt a 240-day schedule if necessary, the goal of the company is to conclude the docket as quickly as possible.

10. CURB believes that it would be more reasonable to suspend for 240 days, but initially develop a procedural schedule that has the goal of completing review in 90 to 120 days. If all goes well, conclude the docket within that time frame; if good cause is shown for allowing the parties more time for review, there is built-in room for it before the final order must be issued.

11. Other differences in this plan from other ratemaking mechanisms in Kansas are of greater concern to CURB. Rather than treating Southern Pioneer like any other C-corporation regulated by the Commission, the plan would treat the company like no other regulated utilityin Kansas. Recognizing that the unique circumstances of the company may justify a unique ratemaking mechanism, CURB is offering the Commission an alternative mechanism that is within the parameters of other mechanisms designed by the legislature and the Commission, and more reflective of the policies that shaped their design.

12. While CURB generally dislikes surcharge mechanisms—reviewing only one type of cost and making annual adjustments for that cost ignores the reality that other costs may have decreased that would sufficiently offset any increase in this category of costs. However, at least the surcharge mechanisms devised by the legislature and the Commission thus far are based on rational policy concerns. Most annual adjustment mechanisms have three basic characteristics: (1) they are limited to adjustments for discrete types of costs, (2) they are limited to non-discretionary costs that cannot be foreseen or controlled through prudent management, and (3) most have built-in limits on how large the surcharges may grow over a specified time period.

13. The policy supporting this basic framework is based on the fact that utilities have legal obligations to provide safe and efficient service; a utility can't refuse to repair broken pipes or downed lines just because they were unexpected. This policy is also based on the fact that under a traditional ratemaking structure, the utility has only a reasonable expectation—not a guarantee—of recovering its revenue requirement, and management is expected to be prudent in managing its costs. However, unexpected costs that cannot be foreseen or controlled even by the most prudent management team can put serious pressure on utility budgets. So the legislature and the Commission have, at times, approved mechanisms for recovery of certain non-discretionary costs that must be incurred by the utility. Most of them are also designed to ensure that the incremental adjustments have only a moderate impact on customer rates.

14. The surcharge for changes in property taxes is a typical example. The timing and magnitude of changes in property taxes is beyond the control of management. The Gas Safety and Reliability Surcharge (GSRS) allows natural gas companies to recover the costs of making safety-related repairs and the costs incurred as a result of public works projects. The GSRS limits the

annual increase of the monthly surcharge to no more 40 cents. Additionally, tracking mechanisms for pension and other post-employment costs have been approved by the Commission to ensure that the monies collected from customers for such costs are actually expended for their intended purpose. These all are consistent with the principle that extraordinary rate recovery should be limited to a particular set of non-discretionary costs, and that rate impacts on customers should not be severe.

15. By contrast, the mechanism proposed by the agreement goes far beyond the parameters set by the Commission and the legislature in designing other rate-adjustment mechanisms. The Commission has previously shown deference to the legislature in its policy choices: last year the Commission rejected a cast-iron pipe replacement surcharge proposed by Kansas Gas Service, concluding that "the cost should be recovered through the legislatively-approved GSRS mechanism .... At this time, the Commission does not wish to eschew the legislature's preferred mechanism for this situation." (12-KGSG-721-TAR, *Order Denying Kansas Gas Service's Application for Infrastructure Replacement Program Surcharge,* Sept. 13, 2012, at ¶¶27, 28). And while CURB appreciates the additional reporting requirements that the Signatories added to the original plan, the mechanism as proposed would adjust base rates across the board for any increase in overall costs, not just for a particular cost. Although the mechanism will be adjusted to maintain a target DSC ratio, the company will not be required to dedicate the additional infusions of cash to a particular purpose. There are no requirements to limit the adjustments to changes in the costs of debt service or to the costs associated with capital expenditures for infrastructure improvements.

16. So, unlike other surcharge mechanisms that are generally limited to adjustments of a particular category of costs, under this plan, increases in costs of any kind can result in an increase in

the surcharge. Additionally, cost recovery through the mechanism will not be limited to non-discretionary costs that prudent management cannot control. Further, rather than limiting the annual adjustments to small incremental increases, the proposed plan can increase non-fuel base rates by as much as 40% annually.

17. In short, the ratemaking mechanism proposed by the agreement goes well beyond the goal of providing a utility annual recovery of specific, non-discretionary costs while moderating the impact on customers. Instead, it would provide annual increases for the entire range of the company's costs, most of which have been long considered to be the responsibility of the utility to manage prudently between rate increases. This is inconsistent with the policies that have guided the Commission and the legislature in their development of other annual rate-adjustment mechanisms.

III. CURB's proposals for modifying the plan

18. If the Commission believes that the company has supported its claim that it needs an annual rate-adjustment mechanism, CURB urges the Commission to impose reasonable limitations on the costs to be included in the surcharge. If the company really needs a formula ratemaking plan to service its debt costs, increase its equity capital and address its infrastructure problems, then it should have no legitimate objection to the Commission limiting the adjustment to specific costs associated with these needs. This is more consistent with the existing policy of using annual adjustment mechanisms for particular types of non-discretionary costs. If the Commission does not limit the costs included to these specified costs, the Commission should impose the usual restriction of including only 50% of the costs of dues, donations and charitable contributions in the company's rates.

19. If the Commission approves the plan, it should require the company to base adjustments on a more reasonable target DSC ratio to moderate the impact on customer rates. The 1.75 target DSC ratio will generate annual increases of non-fuel base rates as large as 40% and will result in increases even when the company is projected to meet its loan covenants. As CURB has shown, a target DSC ratio of 1.4 will generate more moderate annual increases and still allow the margin of safety necessary for the company to be assured of meeting its lender requirements. Further, the annual adjustments will eliminate the risk of violating the company's loan covenants by ensuring the target level is maintained. Since no party supported a target "floor" higher than 1.6, the record only supports approval of a target DSC ratio of 1.4 to 1.6.

20. However, if the Commission approves the proposed target, then the Commission should impose a cap on the incremental annual increases to no more than 10% of non-fuel base rates, rather than the proposed cap of 10% of overall rates. This would be consistent with the existing policy of ensuring that annual rate-adjustment mechanisms do not generate major rate increases.

21. In considering a settlement agreement, the role of the Commission is not to simply find evidence that a proposal is legal or reasonable, but also to ensure that the proposal is consistent with sound regulatory policy. The Commission is not restricted from rejecting the settlement altogether or altering its terms to make it more consistent with the policies that have led the Commission and the legislature to build reasonable safeguards and limits into the surcharge mechanisms that they have approved. The company may be facing extraordinary circumstances, but that doesn't mean that an extraordinary departure from current ratemaking policy is necessary to address those circumstances. CURB is not convinced that the record would support such a

departure. However, CURB has presented evidence to the Commission that would support modifying the agreement to bring it more into line with current regulatory policy.

IV. Request for relief

22. In summary, CURB respectfully requests that the Commission either reject the proposed settlement agreement altogether, or modify the proposed formula rate plan as follows:

1. Utilize a target DSC ratio of 1.4, or at least no higher than 1.6, as the basis for adjusting rates.

2. If the proposed 1.75 DSC ratio is utilized, impose a cap on annual adjustments of no more than 10% of non-fuel base rates.

3. Limit costs to be adjusted by the mechanism to costs specifically related to debt service costs, increasing equity capital and addressing the company's infrastructure problems.

4. If the Commission does not limit the types of costs to be adjusted by the mechanism, then the Commission should impose its usual restriction of only including 50% of dues, donations and charitable contributions in rates.

5. Initially suspend the docket for 240 days, but develop a procedural schedule based on completing review within 90 to 120 days; extension of the schedule to 240 days should be granted for good cause shown.

6. Require the company make annual filings that identify new debt issuances, providing a debt service schedule showing the impact of each issuance on annual debt service costs.

7. Require the company to include in the annual filings information identifying the associated capital projects or other uses for any incremental debt.

8. Require the inclusion of any other information that would assist the Commission in verifying that the incremental debt costs paid for by customers are reasonable and that the underlying debt was being used for appropriate activities and projects.

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VERIFICATION

STATE OF KANSAS)
) ss:
COUNTY OF SHAWNEE)

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

That she is an attorney for the above named petitioner; that she has read the above and foregoing document, and, upon information and belief, states that the matters therein appearing are true and correct.

Niki Christopher

SUBSCRIBED AND SWORN to before me this 23rd day of August, 2013.

DELLA J. SMITH
Notary Public - State of Kansas
My Appt. Expires January 26, 2017

Notary Public

My Commission expires: 01-26-2017.

CERTIFICATE OF SERVICE

13-MKEE-452-MIS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing document was served by electronic service on this 23rd day of August, 2013, to the following parties who have waived receipt of follow-up hard copies:

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