

**REPORTS**  
**OF THE**  
**PUBLIC SERVICE COMMISSION**  
**OF**  
**THE STATE OF MISSOURI**

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**Volume 20 MPSC 3d**

**September 1, 2010 – July 31, 2011**

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**Morris Woodruff**  
Reporter of Opinions

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**JEFFERSON CITY, MISSOURI**  
**(2016)**



## PREFACE

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This volume of the *Reports of the Public Service Commission of the State of Missouri* contains selected Reports and Orders issued by this Commission during the period beginning September 1, 2010 through July 31, 2011. It is published pursuant to the provisions of Section 386.170, et seq., Revised Statutes of Missouri, 2000, as amended.

The syllabi or headnotes appended to the Reports and Orders are not a part of the findings and conclusions of the Commission, but are prepared for the purpose of facilitating reference to the opinions. In preparing the various syllabi for a particular case an effort has been made to include therein every point taken by the Commission essential to the decision.

The *Digest of Reports* found at the end of this volume has been prepared to assist in the finding of cases. Each of the syllabi found at the beginning of the cases has been catalogued under specific topics which in turn have been classified under more general topics. Case citations, including page numbers, follow each syllabi contained in the Digest.



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**In the Matter of Lake Region Water & Sewer Company's Application  
to Implement a General Rate Increase in Water and Sewer Service**

*Case Nos. SR-2010-0110 & WR-2010-0111  
Decided: September 1, 2010*

**Evidence, Practice And Procedure §27.** The Office of Public Counsel filed a motion for rehearing alleging that the filing by another party of a motion for extension of time regarding a previous stipulation and agreement created a new live issue to which Public Counsel was entitled to respond. In denying the request for rehearing, the Commission stated that Public Counsel waived any right to a hearing when it did not timely oppose the stipulation and agreement and did not request a stay of the Commission's report and order. The Commission noted that it opened a separate case solely for the purpose of allowing Public Counsel to address that issue.

**ORDER REGARDING MOTIONS FOR REHEARING, MOTION FOR  
RECONSIDERATION AND REQUEST FOR CLARIFICATION**

On August 27, 2010, Lake Region Water and Sewer Company (Lake Region") and the Office of the Public Counsel ("Public Counsel") filed motions for rehearing. Public Counsel also seeks clarification of the Commission's August 18, 2010 Report and Order. And the Commission's Staff filed a motion for reconsideration. Rehearing may be granted, if in the Commission's judgment, there is sufficient reason.<sup>1</sup>

**Executive Compensation and Rate Case Expense**

Public Counsel is the only party claiming error with the Commission's decisions regarding executive management compensation and rate case expense. Those issues were fully elucidated in the Report and Order and Public Counsel provides no sufficient reason for the Commission to grant a rehearing on these two issues.

**Availability Fees**

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<sup>1</sup> Section 386.500.1, RSMo 2000.

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Public Counsel and Lake Region both take issue with one point regarding the Commission's decision that imputing revenue from availability fees in this case would be unjust and unreasonable. Public Counsel also seeks clarification with regard to the Commission's decision in this regard. And, although the respective arguments are different, both motions address one point in common concerning the Commission's conclusions of law as to whether availability fees are a "commodity" under Section 386.020(48), Cum. Supp. 2009, which defines "service." For the Commission to have subject matter jurisdiction over availability fees, these fees must somehow fall under a definition of a regulated utility service. But, the parties not only take the discussion regarding the definition of the word commodity out of context, they fail to observe that the Commission specifically, and separately, concluded that under the facts of this case giving availability fees ratemaking treatment by either imputing revenue or classifying it as contributions in aid of construction would be unjust and unreasonable.

As stated in the Report and Order, Staff's subject matter experts have consistently testified, in this and in past cases, that availability fees are not a regulated utility "service." The Commission has also concluded in past cases that availability fees are not a regulated utility "service." While the Commission examined the facts in this case and discussed how the fees might possibly fall under the statutory definition that included the word "commodity," the Commission never made a finding of fact or conclusion of law that availability fees were, in fact, a commodity. The Commission stated in its Report and Order:

While the Commission has not done so in the past, availability fees **could be construed** to be a "commodity" and thus fall under the definition of a "service," despite its expert Staff's testimony to the contrary. (Emphasis added).

The parties have taken this statement completely out of context. The order immediately goes on to say:

To make this determination in this matter would be a substantial departure from past Commission decisions, policy and practice. And, although the Commission is not bound by *stare decisis* the rulings, interpretations, and decisions of a neutral, independent administrative agency, "while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed

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judgment to which **courts and litigants** may properly resort for guidance.” (Emphasis added). It has been established that Lake Region has indeed relied upon this Commission’s past decisions and the directions it received from the Commission’s Staff for guidance with how availability fee revenue was not regulated revenue and would not receive ratemaking treatment. And, Missouri Courts have applied the doctrine of quasi-estoppel to prevent agencies from taking positions contrary to, or inconsistent with, positions they have previously taken.<sup>1</sup>

Indeed, the Commission painstakingly delineated how rulemaking is necessary for re-defining service, reclassification of revenue streams and a complete reversal of its statement of general applicability that implements, interprets or prescribes law, policy, procedure and practice after at least 37 years of following one practice, based upon its interpretation and applications of the law. The Commission provided additional clarification regarding the declaration of its intent to address its jurisdiction over availability fees prospectively where found appropriate in the future in its order approving Lake Region’s compliance tariffs.<sup>2</sup>

On August 19, 2010, the Commission opened the workshops to lead to that rulemaking. And, on August 24, 2010, after issuing formal notice, the Commission specifically directed its Staff to perform an exhaustive review of all current water and sewer regulations and prepare a comprehensive set of definitions, uniform and in conformity with Section 386.020(48), Cum. Supp. 2009. As that order pointed out, the Commission has definitions for sewer service in its rules that may not conform with the statutory definition of service and that are inapposite to the arguments made by Public Counsel and Staff in this case that availability fees could constitute a utility “service.” Those rules specifically define sewer service as being only the removal and treatment of sewage.<sup>3</sup> During the workshop/rulemaking process the Commission will examine proposed definitions and finally determine whether availability fees are a commodity or if they fall under one or more of the other categories listed in the statute.

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<sup>1</sup> The legal citations from the quoted language have been omitted from this order, but are fully delineated in the Commission’s August 18, 2010 Report and Order.

<sup>2</sup> See pages 103-107 of the Report and Order.

<sup>3</sup> Commission Rules 4 CSR 240-3.300(3) and 60.101(3)(M). The Commission’s rules on water utilities are devoid of definitions.

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### **Racquet Club Stipulation**

Public Counsel offers one additional argument in its motion for rehearing. During the pendency of this case, Lake Region, Four Seasons Racquet and Country Club Condominium Property Owners Association, Inc. ("Racquet Club") and Staff entered into a stipulation involving the installation of flow meters to measure the water flow from the Country Club Hotel system and the Racquet Club system that ultimately enters Lake Region's wastewater treatment plant. The meters were to determine whether there is ground water infiltration into the system and whether the Racquet Club is subsidizing the Hotel in relation to the way service is measured and billed. Public Counsel did not oppose the stipulation and by operation of Commission rules waived any right to a hearing on the stipulation.

Public Counsel argues that the request for an extension of time to install the meters, filed on August 24, 2010, after the Report and Order had been issued on August 18, 2010, creates a "live issue" of potential customer rate subsidization thereby "cutting off any chance of Public Counsel bringing its position on that issue before the Commission." It should be noted, however, that the motion for the extension was filed before the effective date of the Report and Order (August 28, 2010), and that when Public Counsel objected it did not request a stay of the Commission's order for further proceedings. Further, the Commission responded by opening a separate case solely for the purpose of allowing Public Counsel to address this issue and should any material issues arise that require some adjustment in rates, the Commission can order Lake Region to return for a rate making proceeding earlier than the three-year deadline already directed. Public Counsel also has the option of filing a complaint. Public Counsel, being provided with an abundance of process, has not provided a sufficient reason for the Commission to rehear this case on this basis.

### **Staff's Motion for Reconsideration**

Finally, the Commission's Staff argues that the Report and Order does not appear to reflect what the Commissioners discussed at its Agenda meetings. The Commission is fully aware of the content of its orders and the decisions it issues in those orders. Staff's motion is meritless.

#### **THE COMMISSION ORDERS THAT:**

1. All motions for rehearing are denied.
2. The Staff of the Missouri Public Service Commission's motion for reconsideration is denied.

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3. To the extent the Commission's August 18, 2010 Report and Order required clarification, it is so clarified in the body of this order.

4. This order shall become effective immediately upon issuance.

Clayton, Chm., Gunn, and Kenney, CC., concur;  
Davis and Jarrett, CC., dissent.

Stearley, Senior Regulatory Law Judge

**In the Matter of an Investigation into the Quality of Wireline  
Telecommunications Services in the State of Missouri**

*File No. TO-2011-0047  
Decided: September 1, 2010*

**Telecommunications §26.** The Commission opened an investigation into the quality of service provided by telecommunications companies following deregulation.

**ORDER OPENING AN INVESTIGATION INTO THE QUALITY OF  
WIRELINE TELECOMMUNICATIONS SERVICES IN MISSOURI**

On August 24, 2010, the Commission's Staff filed a motion asking the Commission to open an investigation into the quality of wireline telecommunications service in Missouri. Staff's motion expresses concern that Missouri's wireline telecommunications system may have degraded in recent years due to a lack of proper testing, preventive maintenance, and timely replacement of facilities since the telecommunications system has been declared to be competitive and thus no longer subject to quality of service regulation. Staff indicates it has received an increasing number of customer service complaints about the quality of telephone service and wants to further investigate the problems described by those customers.

Specifically, Staff would like to determine whether the service problems reported by customers are isolated instances, or whether they indicate a systemic deterioration of facilities that would lead to a lower quality of service in large portions of the state. To that end, Staff asks the Commission to order all facilities-based local exchange telecommunications companies to answer a set of questions regarding the companies' maintenance efforts and procedures.



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The Commission will establish the investigative case that Staff has requested, and will order all facilities-based local exchange telecommunications companies doing business in Missouri to answer the questions posed by Staff.

This file will serve as a repository for documents and comments. Using this file, any person with an interest in this matter may view documents pertaining to the investigation and may submit any pertinent responsive comments or documents. As this is not a contested case, any person may file a comment without counsel and without *ex parte* constraints (arising from this matter). Intervention requests are not necessary to submit comments or view documents. Because this is not a contested case, Staff shall take no action in this case against any telecommunications provider, beyond reporting its finding to the Commission.

The public is welcome to submit comments by forwarding electronic communications through the electronic filing and information system (EFIS) or by mailing written comments. You may submit electronic comments at the Commission's website at <http://www.psc.mo.gov>. (Click on the EFIS/Case filings link on the left side of the page. Scroll down and click on the public comment link. Please reference file no.TO-2011-0047.) Written comments in hard copy should be addressed to the Commission at P.O. Box 360, Jefferson City, Missouri 65102 and should reference file no. TO-2011-0047. You can view the contents of the file by following the link at <http://www.psc.mo.gov>.

**THE COMMISSION ORDERS THAT:**

1. This case is established to investigate the quality of wireline telecommunications services in the State of Missouri.
2. The Commission's data center shall mail a copy of this notice to all local exchange telecommunications service providers certificated to provide service in Missouri.
3. The Commission's Public Information Office shall make this notice available to the news media of this state and to the members of the General Assembly.
4. All local exchange telecommunications service providers certificated to provide service in Missouri shall answer the following questions no later than November 1, 2010:
  - A. Does your company own or maintain telecommunications facilities in Missouri? If yes, please answer

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all of the following questions. If no, then your survey is complete and should be submitted at this point.

B. Does your company track on a regular basis any of the following: If yes, explain how your company tracks it (include whether such information is tracked by exchange or some other area). If no, explain why not.

i. Timeliness of installing service after a customer orders service.

ii. Timeliness of repairing service after a customer reports trouble.

iii. Amount of service trouble.

C. Please provide your most recent results for any of the information tracked above.

D. Explain your company's preventative maintenance procedures. Include in your explanation specific methods you utilize to be certain that telephone equipment and plant is kept in good working condition. State whether your preventative maintenance program is tracked by exchange, area, or state. Please provide results of this measurement for the past two years.

E. What percentage of your company's annual budget is spent on maintaining existing telephone plant?

F. What percentage of your company's annual budget is spent on training its technical staff?

5. This order shall become effective immediately upon issuance.

Clayton, Chm., Davis, Jarrett, Gunn,  
And Kenney, CC., concur.

Woodruff, Chief Regulatory Law Judge

**\*NOTE:** See page 136 for another order in this case.

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**CONCURRENCE OF COMMISSIONER JEFF DAVIS**

I concur with my colleagues' decision to investigate the rising number of complaints and inquiries about the quality of wireline telephone service in Missouri. The Commission has an obligation to investigate such matters on behalf of consumers and to report its findings to the Missouri General Assembly. It is perfectly within the Commission's right to do so. However, we should take much greater care in examining our staff's assertions. The Commission should also exercise some discretion in establishing the scope of who and what we're investigating. This investigation will require the participation of every telecommunications company in the state, even those having no complaints, or a small fraction of complaints relative to the number of lines they have in service.

On August 24, 2010, the Missouri PSC filed a Motion to Open an Investigatory Docket to "gather information about the quality of wireline telecommunications service in Missouri." Staff's motion included the affidavit of Carol Gay Fred, the PSC Consumer Services Department Manager. Mrs. Fred's affidavit is only three paragraphs long. The two most important paragraphs state:

In my recent observations there appears to be an increase in telecommunication consumer complaints and traceable inquiries regarding service quality issues as also mentioned in more detailed by Myron E. Couch affidavit, Utility Operations Technical Specialist II. In fact, it appears that there has been a 30.19% increase in telecommunication utility complaints and inquiries regarding service quality issues from August 31, 2007 to August 31, 2008 versus August 31, 2009 to August 1, 2010, which coincides with the change in law which eliminated the Commission's oversight of service quality issues, as a part of the 2008 House Bill 1779.

In addition to the increase in recent informal complaint cases, it's important to point out that the overall increase in consumer inquiries has increased significantly due to service quality issues. The Consumer Services Department has dealt with inquiries that have dealt with

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delays for installation of service, delays in repairing service, which has caused consumers to be without service for as long as 1-4 weeks. Utilities have generally referred to the long delays as manpower shortages. In fact, when reviewing the data from August 31, 2006 to September 1, 2007, when we received 250 inquiries, to a more current period August 31, 2009 to August 1, 2010, where we have received 1449 inquiries, it equates to a 579.6 percent increase in inquiries. While the numbers are significant it is only fair to mention that the increase has been steady, 2007-250 inquiries, 2008-466 inquiries, 2009-976 inquiries and 2010-1449 inquiries.

In preparation for today's agenda, I asked Mrs. Fred to provide answers to four questions:

1. Please provide the Commission with an itemized breakdown of how many of those complaints were against ILECs versus CLECs.
2. How many complaints are against VOIP or wireless providers over whom the Commission would have no jurisdiction?
3. Please provide a carrier-by-carrier breakdown of who the complaints/inquiries have been made against.
4. Please provide a list of the wireline providers of which there have been 10 or fewer inquiries against in the last two years.

Mrs. Fred responded that the numbers she referenced in her affidavit (Appendix B of Staff's motion) did not contain any complaints against VOIP or wireless providers over whom the Commission had no jurisdiction. More importantly, Mrs. Fred distributed two documents at agenda that the Commission did not have time to thoroughly review before making this decision.

Yes, I could have asked for more time to study this issue and, in retrospect, I should have – because after taking a more thorough look at the numbers, I am very disturbed by what appears to be a lack of evidence meriting even a formal investigatory docket at this point.

Attachment A is a two-page document summarizing the number of "Telephone Complaints and Inquiries." Since that document contains aggregated data, I am fairly confident it can be released to the public. Hence, it is attached.

Page #1 of the document indicates that for the 2009-2010 year (August 31, 2009 – August 1, 2010) there were 303 "Service Quality

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Complaints” and 29 “Service Quality Inquiries”. The numbers do reflect a 30% increase in the number of service quality complaints over the 2008-2009 timeframe (August 31, 2008 – August 31, 2009). However, when compared to the number of “Service Quality Complaints” and “Service Quality Inquiries” for the 2007-2008 period (August 31, 2007 – August 31, 2008), the numbers are virtually identical and actually represent a 22% decrease from 2006-2007 cycle (August 31, 2006 – August 31, 2007). Thus, all we actually have here is evidence of a year-over-year increase for the two most recent years – the first one since at least 2006-2007 and numbers that are virtually identical to the 2007-2008 timeframe.

Page #2 of Attachment A reflects the total number of complaints and inquiries filed over the same respective time periods referenced in the previous paragraphs. Yes, there is a consistent and marked increase in the number of “Inquiries” over the four year period and the actual number of telecommunications “Complaints” filed in 2009-2010 is 43.5% higher than it was in the 2008-2009 period. However, the number of actual “Complaints” is 15% less than the 2007-2008 period and 42.5% less than the number filed in the 2006-2007 period. Once again, the bottom line is that approximately 423 fewer “Complaints” were filed in the 2009-2010 period than three years earlier.

Of equal interest is the second “Highly Confidential” document labeled “MPSC Telephone Complaint/Inquiry Summary.” I cannot discuss an individual company’s numbers per se, but I believe that conclusions can be drawn from the data and there is at least one conclusion that merits being shared publicly.

AT&T is by far the largest provider of telecommunications services in Missouri and I think it’s logical to assume the collective AT&T companies represent a good cross-section of Missouri. How many wirelines they had three years ago or have now was not part of my request and consequently not part of the report that was prepared for today’s agenda meeting. What my brief inquiry did yield is that the number of “Inquiries” and “Complaints” filed against AT&T has remained virtually unchanged from the 2006-2007 period to the 2009-2010 period. There were some changes over the period on an annual basis, but the percentage of actual change for the entire three years in the number of complaints against the 4 companies is 0.44%.

**CONCLUSION:**

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This Commission has a right and a duty to investigate the quality of service being provided by wireline telecommunications providers in this state. Approximately 1,500 inquiries is a lot of inquiries and they need to be analyzed. However, having briefly examined the data on which staff based its recommendation, I've come to the conclusion that a formal investigation in the form of a working docket appears to be premature. Treating "Inquiries" and "Complaints" as if they are synonymous is not correct. It's a function of the PSC's Consumer Services Division to answer questions about telephone service. Answering questions about telephone service is a lot different from a "Complaint" – either formal or informal. I question whether the use of these inquiries is appropriate to justify the full-blown investigation of an entire industry without a lot more substantive analysis.

The data provided by staff today certainly doesn't suggest that every phone company in the state ought to be required to respond to the PSC Staff's requests for information. There are companies out there that haven't had any complaints that are apparently going to be asked to respond to requests for information. More importantly, I am concerned that forging ahead with this docket in this manner - without first talking to the companies and having some kind of forum like a "roundtable discussion" - will actually have a chilling effect on the willingness of some or possibly even many of the telecommunications companies that we have little or no regulatory authority over to cooperate with the PSC Staff when they are attempting to assist consumers in the future.

For the reasons I have set out above, I respectfully concur with the decision of my colleagues to open a docket but express strong reservations about the numbers forming the basis for the recommendation and proceeding in this manner without first discussing this matter with the industry in an open, public forum. In the future, I would encourage the PSC Staff to provide more detailed, impartial analysis before filing to open such dockets in the future.

**\*NOTE:** The Attachment to the Opinion has not been published. If needed, this document is available in the official case files of the Public Service Commission.

UNION ELECTRIC COMPANY, D/B/A AMERENUE

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**In the Matter of an Application of Union Electric Company, d/b/a AmerenUE, for an Order Authorizing the Sale and Transfer of Certain Assets of AmerenUE to St. James Municipal Utilities and Rolla Municipal Utilities**

*File No. EO-2010-0263  
Decided: September 15, 2010*

**Evidence, Practice and Procedure §8.** The Commission has the legal authority to accept a stipulation to resolve a case. The Commission need not make findings of fact or conclusions of law in an order accepting or approving a stipulation.

**ORDER APPROVING STIPULATION AND AGREEMENT**

On March 24,<sup>1</sup> Union Electric Company, d/b/a AmerenUE (“AmerenUE”), submitted an Application to the Commission. AmerenUE wants to transfer certain of its assets to St. James Municipal Utilities (“St. James”) and Rolla Municipal Utilities (“Rolla”), two wholesale customers of AmerenUE.<sup>2</sup>

AmerenUE’s application contains the asset purchase agreements and the resolution of AmerenUE approving the sale. The application also states that the sale would not be detrimental to the public interest. The sale is being proposed at the request of Rolla and St. James, who are wholesale customers of AmerenUE. AmerenUE further stated that no significant tax impact of this transaction is expected.

On September 7, AmerenUE, Rolla, St. James, and the Staff of the Commission (“Staff”) filed a Stipulation and Agreement (“Stipulation”). The signatories agree that the sale would not be detrimental to the public interest. To cite but one example, the sale would allow Rolla and St. James to improve its service reliability and reduce outage durations by having equipment, material and personnel available locally, rather than waiting on AmerenUE personnel, stationed over an hour away. Further, such sale will not result in any reduced level of service or reliability to any AmerenUE customer, nor impact AmerenUE’s rates. Also on September 7, the Office of the Public Counsel stated that it does not oppose the stipulation, and that it waives the seven days allowed for objection under Commission Rule 4 CSR

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<sup>1</sup> All calendar references are to 2010 unless otherwise noted.

<sup>2</sup> Namely, AmerenUE proposes to sell a substation, associated plant, and 34.5 kV circuits to Rolla and St. James.

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240-2.115(2)(B).

The Commission has the legal authority to accept a stipulation and agreement to resolve a case.<sup>3</sup> The Commission notes that “[e]very decision and order in a contested case shall be in writing and, except in default cases or cases disposed of by stipulation, consent order or agreed settlement . . . shall include . . . findings of fact and conclusions of law.”<sup>4</sup> Consequently, the Commission need not make findings of fact or conclusions of law in this order.

If no party objects to a stipulation and agreement, the Commission may treat the Agreement as unanimous.<sup>5</sup> Because all parties have either signed the Stipulation, or stated that they do not oppose the agreement, the Commission will treat the Stipulation as unanimous.

Section 393.190 requires an electrical corporation to get Commission approval before selling its assets. The Commission may not withhold approval of the sale unless the sale would be detrimental to the public interest.<sup>6</sup>

The Commission has reviewed the application and the Stipulation. The Commission independently finds and concludes that the proposed transaction is not detrimental to the public interest and should be approved.

**THE COMMISSION ORDERS THAT:**

1. The Application is granted.
2. The Commission grants Union Electric Company, d/b/a AmerenUE, the authority to sell the assets listed in its March 24, 2010 application.
3. The Stipulation and Agreement is approved, and its signatories are ordered to comply with its terms.
4. This order shall become effective on September 25, 2010.

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<sup>3</sup> See Section 536.060, RSMo 2000.

<sup>4</sup> Section 536.090, RSMo 2000.

<sup>5</sup> 4 CSR 240-2-115(2)(C).

<sup>6</sup> See *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468 (Mo.App.E.D. 1980).



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5. This case shall be closed on September 26, 2010.

Clayton, Chm., Jarrett, Gunn,  
and Kenney, CC., concur.  
Davis, C., concurs, with separate  
concurring opinion to follow.

Pridgin, Senior Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

\*NOTE: The Stipulation & Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

**In the Matter of the Application of Holtgrewe Farms Water Company, LLC, for a Certificate of Convenience and Necessity Authorizing it to Construct, Install, Own, Operate, Control, Manage, and Maintain a Water System for the Public, Located in an Unincorporated Area of Franklin County, Missouri**

*File No. WA-2010-0281*

*Decided: September 28, 2010*

**Water §2.** In making determinations to grant certificates of convenience and necessity, the Commission has used the following criteria: there must be a need for the service; the applicant must be qualified to provide the proposed service; the applicant must have the financial ability to provide the service; the applicant's proposal must be economically feasible; the service must promote the public interest.

**Water §2.** In making its determination of whether there is a need for the service, the term does not mean "essential" or "absolutely indispensable" but rather that the inconvenience to the public occasioned by the lack of the proposed service is great enough to amount to a necessity.

**ORDER GRANTING APPLICATION FOR CERTIFICATE OF  
CONVENIENCE AND NECESSITY**

This order grants to Holtgrewe Farms Water Company, LLC, the authority to construct, install, own, operate, control, manage, and maintain a water system. Additionally, the Commission directs the company to file a tariff consistent with the Staff of the Commission's recommendation.

## HOLTGREWE FARMS WATER COMPANY, LLC

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### **Background**

On April 8, 2010, Holtgrewe Farms Water Company, LLC, filed an application with the Commission for authority to provide water service, as described in the above caption. The Commission ordered that notice of the application be issued and informed those receiving such notice of the opportunity to intervene. No applications to intervene were filed. On August 13, the Staff of the Commission filed its recommendation, to which no party responded. Of note, the company also filed a companion application to provide sewer service for the same area.<sup>1</sup>

Concerned with inherent problems of small water companies serving subdivision, the Commission directed its Staff to file a pleading addressing some of those concerns, including: the prospect of joining the proposed system with established, larger systems; the provision of information to homebuyers regarding potential problems with such a system; fire protection plans; and appropriate time frames for rate reviews. Staff filed its pleading addressing the Commission's concerns to the Commission's satisfaction. Further, Staff facilitated the attendance of Tony Bequette, developer of the subdivision and owner of the water company, at a Commission Agenda meeting to further discuss the Commission's concerns. His responses to Commission concerns supplemented Staff's pleading.

### **Application**

Holtgrewe Farms Water Company, LLC is a Missouri corporation that proposes to provide water service to the public in subdivision on 38 acres outside of Washington, Missouri. There are currently no customers residing in the subdivision.

The source of the water system will be a deep well, located at the highest point of the subdivision, capable of delivering approximately 38 gallons per minute of flow. Applicant states that a public need exists for adequate water service within the proposed area and the public convenience and necessity will be promoted by the Commission granting the requested authority.

### **Staff Recommendation**

The Staff of the Commission filed its recommendation on August 13. Staff recommends that the Commission approve Holtgrewe's application, with conditions, and direct the company to file tariff sheets consistent with Staff's suggested customer charges, fees and depreciation rates.

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<sup>1</sup> Commission Case No. SA-2010-0282.

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Staff informs the Commission that the area for which the company seeks service is an unincorporated area of Franklin County near Washington, Missouri, in a new, 47-lot, single-family residential subdivision that is under construction. Staff states that a water district and the City of Washington serve the area but because of the distance to connect to the subdivision it would cost at least as much to construct and operate a new system. This conclusion was reached without considering necessary easements and other issues. Although there are no customers, Holtgrewe forecasts in its feasibility study that all 47 lots would be occupied within five years.

In determining its recommendation, Staff has applied the criteria of *Tartan Energy*<sup>2</sup> as follows:

- (1) Is there a need for the proposed service, and is there a need for the company to provide the proposed service?  
The Staff believes that a need for the proposed service clearly exists since it is desirable for the new proposed homes to have water. The Staff has also reviewed information that indicates that Franklin County Zoning Regulations require a dense subdivision to provide a central water system.
- (2) Is the company qualified to provide the proposed service?  
Based on its investigation, the Staff believes the company is capable of providing the proposed service. The owner is experienced in development in the area, is undertaking design and construction of the utility system using qualified consultants, and appears to be proceeding in a professional manner.
- (3) Does the company have the financial ability to provide the proposed service?  
The Staff believes the company will be adequately financed. The utility will be financed through the owner in the context of subdivision development, using a combination of bank and owner equity.
- (4) Is the company's proposal economically feasible?  
The company's proposal is economically feasible because they will be able to provide service at rates that are comparable to other regulated utility rates. However,

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<sup>2</sup> *In re Tartan Energy Company*, 3 Mo. P.S.C. 3d 173, 177 (1994).

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ongoing viability of the company depends upon the success of the subdivision development.

- (5) Does the company's proposal promote the public interest?

The water service is necessary and the company is capable of providing service in the area. As such, it is in the public interest. Additionally, the presumption in these types of cases is that if the other four criteria are met then this criterion is also met.

Pursuant to its audit, Staff recommends that the Commission direct Holtgrewe to file tariff sheets consistent with a monthly customer charge of \$15.10 and a commodity charge of \$4.66 per 1,000 gallons, with a connection charge of \$1,600 serving as Contribution in Aid of Construction. Staff points out that its calculations are not based on full occupancy but rather on occupancy of 40 customers. Staff further states that the company's out-of-pocket expenses will be recoverable at 14 customers and that expenses such as return on investment, depreciation and management salaries will be realized at 40 customers. Staff's assumptions are based on an annual revenue requirement of \$18,439. Staff anticipates that the average customers' monthly bill, based on 5,000 gallons of usage, will be \$38.41.

Finally, Staff recommends that this grant of authority should be conditioned upon the following:

- That the owners and operators should maintain a very detailed check register of all payments for expenditures related to the operation.
- That invoices of all payments for expenditures related to the water utility operations should be maintained.
- That very detailed records regarding all collections of revenues, CIAC fees and any other service charges collected to establish and maintain the utility service should be maintained.
- The owners and operators should establish and maintain a very detailed system of time sheet reporting for any individual(s) who incur wages, a salary, or other payment in the operations of the utility, including a description of the work performed and the number of hours.
- The owners and operators should maintain usage logs so mileage and hours of usage can be verified if vehicles and

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heavy duty equipment are used.

- The owners and operators should establish and maintain a competitive bid process or some other method of determining whether fair and competitive costs are being incurred for significant expenditures.

To its Memorandum, Staff attached depreciation rates,<sup>3</sup> which it recommends the Commission direct the company to implement. The company did not respond to Staff's recommendation.

**Discussion**

The Commission is authorized, under Section 393.170, RSMo, to grant certificates of convenience and necessity when it determines, after due hearing<sup>4</sup>, that the proposed project is "necessary or convenient for the public service." The term "necessity" does not mean "essential" or "absolutely indispensable," but rather that the proposed project "would be an improvement justifying its costs,"<sup>5</sup> and that the inconvenience to the public occasioned by a lack of the proposed service is great enough to amount to a necessity.<sup>6</sup>

In its application of this statutory authority, the Commission recognizes the *Tartan Energy* analysis set out by Staff in its Memorandum. Having reviewed the application and Staff's verified Memorandum, the Commission finds that the proposed service is necessary or convenient for the public service and will approve the application. Further, the Commission finds that the conditions suggested by Staff are reasonable and will direct the company to comply with them.

**THE COMMISSION ORDERS THAT:**

1. Holtgrewe Farms Water Company, LLC's application is approved and the company is granted a Certificate of Convenience and Necessity for water service subject to the conditions suggested by the Staff of the Commission and set out in body of this order.

2. Holtgrewe Farms Water Company, LLC is directed to file tariff sheets consistent with the rates and charges set out in Staff's Memorandum and discussed in the body of this order.

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<sup>3</sup> Attachment C to Staff's Memorandum.

<sup>4</sup> There was no request for hearing.

<sup>5</sup> *Intercon Gas, Inc.*, 848 S.W.2d 597; *State ex rel. Transport Delivery Service v. Burton*, 317 S.W.2d 661 (Mo. App. 1958).

<sup>6</sup> *Beaufort Transfer Co.* 504 S.W.2d at 219; *State ex rel. Transport Delivery Service v. Burton*, 317 S.W.2d 661 (Mo. App. 1958).

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3. The tariff sheets discussed in ordered paragraph 2 shall bear an effective date of at least 30 days after submission, and shall be filed no later than 60 days after the effective date of this order.

4. The depreciation accrual rates, Attachment C to Staff's Memorandum are approved and shall be implemented.

5. The Staff of the Commission is authorized to conduct a rate review within two years of actual operations of Holtgrewe Farms Water Company, LLC's utility system.

6. This order shall become effective on October 8, 2010.

Clayton, Chm., concurs, with separate concurring opinion to follow;  
Davis, Jarrett, Gunn, and Kenney, CC., concur.

Jones, Senior Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Chairman Clayton has been filed.

**In the Matter of the Application of Holtgrewe Farms Sewer Company, LLC, for a Certificate of Convenience and Necessity Authorizing it to Construct, Install, Own, Operate, Control, Manage, and Maintain a Sewer System for the Public, Located in an Unincorporated Area of Franklin County, Missouri**

*File No. SA-2010-0282*

*Decided: September 28, 2010*

**Sewer §2.** In making determinations to grant certificates of convenience and necessity, the Commission has used the following criteria: there must be a need for the service; the applicant must be qualified to provide the proposed service; the applicant must have the financial ability to provide the service; the applicant's proposal must be economically feasible; the service must promote the public interest.

**Sewer §2.** In making its determination of whether there is a need for the service, the term does not mean "essential" or "absolutely indispensable" but rather that the inconvenience to the public occasioned by the lack of the proposed service is great enough to amount to a necessity.

**ORDER GRANTING APPLICATION FOR CERTIFICATE OF  
CONVENIENCE AND NECESSITY**

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This order grants to Holtgrewe Farms Sewer Company, LLC, the authority to construct, install, own, operate, control, manage, and maintain a sewer system. Additionally, the Commission directs the company to file a tariff consistent with the Staff of the Commission's recommendation.

### **Background**

On April 8, 2010, Holtgrewe Farms Sewer Company, LLC, filed an application with the Commission for authority to provide sewer service, as described in the above caption. The Commission ordered that notice of the application be issued and informed those receiving such notice of the opportunity to intervene. No applications to intervene were filed. On August 13, the Staff of the Commission filed its recommendation, to which no party responded. Of note, the company also filed a companion application to provide water service for the same area.<sup>1</sup>

Concerned with inherent problems of small sewer companies serving subdivision, the Commission directed its Staff to file a pleading addressing some of those concerns, including: the prospect of joining the proposed system with established, larger systems; the provision of information to homebuyers regarding potential problems with such a system; and appropriate time frames for rate reviews. Staff filed its pleading addressing the Commission's concerns to the Commission's satisfaction. Further, Staff facilitated the attendance of Tony Bequette, developer of the subdivision and owner of the sewer company, at a Commission Agenda meeting to further discuss the Commission's concerns. His responses to Commission concerns supplemented Staff's pleading.

### **Application**

Holtgrewe Farms Sewer Company, LLC is a Missouri corporation that proposes to provide sewer service to the public in subdivision on 38 acres outside of Washington, Missouri. There are currently no customers residing in the subdivision.

The company explains that several system alternatives were available; including, construction of a three-cell lagoon, a mechanical treatment facility, a sand filter system or a packed media bed system. The company chose the packed media bed system. The treatment facility will be located at the lowest point of the subdivision. Applicant

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<sup>1</sup> Commission Case No. WA-2010-0281.

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states that a public need exists for adequate sewer service within the proposed area and the public convenience and necessity will be promoted by the Commission granting the requested authority.

**Staff Recommendation**

The Staff of the Commission filed its recommendation on August 13. Staff recommends that the Commission approve Holtgrewe's application, with conditions, and direct the company to file tariff sheets consistent with Staff's suggested customer charges, fees and depreciation rates.

Staff informs the Commission that the area for which the company seeks service is an unincorporated area of Franklin County near Washington, Missouri, in a new, 47-lot, single-family residential subdivision that is under construction. Although there are no customers, Holtgrewe forecasts in its feasibility that all 47 lots would be occupied within five years.

In determining its recommendation, Staff has applied the criteria of *Tartan Energy*<sup>2</sup> as follows:

- (1) Is there a need for the proposed service, and is there a need for the company to provide the proposed service?  
The Staff believes that a need for the proposed service clearly exists since it is desirable for the new proposed homes to have sewer. The Staff has also reviewed information that indicates that Franklin County Zoning Regulations require a dense subdivision to provide a central sewer system.
- (2) Is the company qualified to provide the proposed service?  
Based on its investigation, the Staff believes the company is capable of providing the proposed service. The owner is experienced in development in the area, is undertaking design and construction of the utility system using qualified consultants, and appears to be proceeding in a professional manner.
- (3) Does the company have the financial ability to provide the proposed service?  
The Staff believes the company will be adequately financed. The utility will be financed through the owner in the context of subdivision development, using a

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<sup>2</sup> *In re Tartan Energy Company*, 3 Mo. P.S.C. 3d 173, 177 (1994).



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- combination of bank and owner equity.
- (4) Is the company's proposal economically feasible?  
The company's proposal is economically feasible because they will be able to provide service at rates that are comparable to other regulated utility rates. However, ongoing viability of the company depends upon the success of the subdivision development.
- (5) Does the company's proposal promote the public interest?  
The sewer service is necessary and the company is capable of providing service in the area. As such, it is in the public interest. Additionally, the presumption in these types of cases is that if the other four criteria are met then this criterion is also met.

Pursuant to its audit, Staff recommends that the Commission direct Holtgrewe to file tariff sheets consistent with a flat monthly customer charge of \$39.25, with a connection charge of \$1,600 serving as Contribution in Aid of Construction. Staff points out that its calculations are not based on full occupancy but rather on occupancy of 40 customers. Staff further states that the company's out-of-pocket expenses will be recoverable at 14 customers and that expenses such as return on investment, depreciation and management salaries will be realized at 40 customers. Staff's assumptions are based on an annual revenue requirement of \$18,842.

Finally, Staff recommends that this grant of authority should be conditioned upon the following:

- That the owners and operators should maintain a very detailed check register of all payments for expenditures related to the operation.
- That invoices of all payments for expenditures related to the sewer utility operations should be maintained.
- That very detailed records regarding all collections of revenues, CIAC fees and any other service charges collected to establish and maintain the utility service should be maintained.
- The owners and operators should establish and maintain a very detailed system of time sheet reporting for any individual(s) who incur wages, a salary, or other payment in the operations of the utility, including a description of the

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- work performed and the number of hours.
- The owners and operators should maintain usage logs so mileage and hours of usage can be verified if vehicles and heavy duty equipment are used.
- The owners and operators should establish and maintain a competitive bid process or some other method of determining whether fair and competitive costs are being incurred for significant expenditures.

To its Memorandum, Staff attached depreciation rates,<sup>3</sup> which it recommends the Commission direct the company to implement. The company did not respond to Staff's recommendation.

**Discussion**

The Commission is authorized, under Section 393.170, RSMo, to grant certificates of convenience and necessity when it determines, after due hearing<sup>4</sup>, that the proposed project is "necessary or convenient for the public service." The term "necessity" does not mean "essential" or "absolutely indispensable," but rather that the proposed project "would be an improvement justifying its costs,"<sup>5</sup> and that the inconvenience to the public occasioned by a lack of the proposed service is great enough to amount to a necessity.<sup>6</sup>

In its application of this statutory authority, the Commission recognizes the *Tartan Energy* analysis set out by Staff in its Memorandum. Having reviewed the application and Staff's verified Memorandum, the Commission finds that the proposed service is necessary or convenient for the public service and will approve the application. Further, the Commission finds that the conditions suggested by Staff are reasonable and will direct the company to comply with them.

**THE COMMISSION ORDERS THAT:**

1. Holtgrewe Farms Sewer Company, LLC's application is approved and the company is granted a Certificate of Convenience and Necessity for sewer service subject to the conditions suggested by the Staff of the Commission and set out in body of this order.

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<sup>3</sup> Attachment C to Staff's Memorandum.

<sup>4</sup> There was no request for hearing.

<sup>5</sup> *Intercon Gas, Inc.*, 848 S.W.2d 597; *State ex rel. Transport Delivery Service v. Burton*, 317 S.W.2d 661 (Mo. App 1958).

<sup>6</sup> *Beaufort Transfer Co.* 504 S.W.2d at 219; *State ex rel. Transport Delivery Service v. Burton*, 317 S.W.2d 661 (Mo. App. 1958).

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2. Holtgrewe Farms Sewer Company, LLC is directed to file tariff sheets consistent with the rates and charges set out in Staff's Memorandum and discussed in the body of this order.

3. The tariff sheets discussed in ordered paragraph 2 shall bear an effective date of at least 30 days after submission, and shall be filed no later than 60 days after the effective date of this order.

4. The depreciation accrual rates, Attachment D to Staff's Memorandum are approved and shall be implemented.

5. The Staff of the Commission is authorized to conduct a rate review within two years of actual operations of Holtgrewe Farms Sewer Company, LLC's utility system.

6. This order shall become effective on October 8, 2010.

Clayton, Chm., concurs, with separate concurring opinion to follow;  
Davis, Jarrett, Gunn, and Kenney, CC., concur.

Jones, Senior Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Chairman Clayton has been filed.

**In The Matter Of The Consideration And Implementation Of Section 393.1075, The Missouri Energy Efficiency Investment Act\***

*File No. EX-2010-0368  
Filed: September 28, 2010*

**ELECTRIC §9.** Commissioner Terry M. Jarrett dissented from the Commission's decision to transmit administrative rules to the Secretary of State regarding Section 393.1075, RSMo, the Missouri Energy Efficiency Investment Act. Commissioner Jarrett states that some of the proposed rules are unlawful because they exceed the Commission's statutory authority. The enabling legislation did not authorize the Commission to establish energy and demand savings goals or impose penalties for failure to meet those goals.

**DISSENTING OPINION OF COMMISSIONER TERRY M. JARRETT**

The Public Service Commission ("Commission") has voted to transmit to the Secretary of State proposed rules regarding Senate Bill 376, codified at Section 393.1075, RSMo Cum. Supp. 2009, and known as the Missouri Energy Efficiency Investment Act ("MEEIA" or "Act"). MEEIA represents a positive step forward in promoting energy efficiency. However, transmitting proposed rules to the Secretary of State at this

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time is premature because some of the provisions are either unconstitutional or unlawful. These legal concerns should be addressed before formal rulemaking begins. Therefore, I dissent.

Portions of the proposed rules unlawfully exceed the scope of the Act and can only result in rules that are unlawful, unjust, arbitrary, and capricious. The rules as currently drafted reflect regulatory policy choices that are detrimental to electric utilities and the customers they serve – rather than enhancing the opportunities for electric utilities to develop effective energy efficiency programs as anticipated by the Act.

Following the law and promulgating rules that are within the grant of authority given to the Commission is critical to achieving the goals set out in MEEIA. Making policy choices that exceed the scope of the Act will not serve Missouri's citizens; rather, it will cause the rules implementing this important piece of energy legislation to be snarled in expensive, time-consuming and unnecessary legal entanglements. Even worse, the proposed rules as written will not encourage electric utilities to implement energy efficiency programs.

This Commission should propose lawful rules that will not only withstand the scrutiny of notice and comment, but also JCAR and the courts of this state. The proposed rules do not.

My concerns are not limited to those items outlined here, but the issues identified below are unlawful and do not merit transmittal to the Secretary of State. Senate Bill 376 stated unequivocally that it is the ***“policy of the state to value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs.”*** Section 393.1075.3. The portions of the rules that concern me are at odds with this stated policy.

1. **Rules are not mandatory.** Section 393.1075.11 provides: “The commission shall provide oversight and ***may*** adopt rules and procedures and approve corporation-specific settlements and tariff provisions, independent evaluation of demand-side programs, as necessary, to ensure that electric corporations can achieve the goals of this section.” (emphasis added). The use of the word “may” by the General Assembly means that this Commission is not required to adopt any rules. The Act is sufficient standing alone to implement its purposes. Rather than adopt rules, the Commission could choose to exercise its oversight in other proceedings, such as rate cases. It follows that if this Commission chooses to adopt rules, it should take great care to ensure that such rules do not go beyond the scope of the law. Unfortunately, the

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proposed rules go beyond the scope of the law in at least two important respects.

2. **Energy and demand “savings goals.”** 4 CSR 240-20.094 (2)(A) and (B) establish energy and demand savings goals, increasing for each year between 2012 and 2020. Interested persons in the workshop and rulemaking process did not and cannot show that these goals have any scientific basis or facts to support them, or are in any way relevant to Missouri’s electric utilities. Instead, the percentages—by admission of the Commission staff—are based on statutory choices made in other states, rules or policy announcements. These other states do not have the same statutory or regulatory structure that we have in Missouri, so the goals do not translate to Missouri and our electric utilities.

This Commission is an agency of limited jurisdiction and authority, and the lawfulness of its actions depends entirely upon whether or not it has statutory authority to act. The General Assembly could have adopted set percentages of demand-side savings for each individual Missouri electric utility or it could have instructed the Commission to set such targets as part of its rulemaking authority (other states’ statutes have done one or the other). Our General Assembly did neither. Instead, it stated simply that the programs need to be “cost-effective.” There is no express or implied authority for the Commission to adopt standard savings goals in the regulations implementing MEEIA. These two subsections should be removed from the proposed rule altogether.

3. **Penalties.** 4 CSR 240-20.094 (2) establishes that if a participating electric utility does not meet the energy savings goals discussed above, then the electric utility may be subject to a penalty or other, undefined, adverse consequences. The Act provides no express or implied authorization for the imposition of penalties or adverse consequences; to the contrary, the Act is designed to incent electric utilities to create programs which result in decreased sales. This unlawful provision negates the positive attributes of the Act. Cost recovery and incentives fail to outweigh the wide ranging risks of incurring the penalties or adverse consequences possible from an electric utility participating under the Act. Why would an electric utility spend a large amount of money to implement an energy efficiency program when it would face the risk of a penalty or other adverse consequences (such as negative treatment in a rate case) if arbitrary and unscientific goals are not achieved? The risk of penalties or adverse consequences stifle

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experimentation, creativity and innovation, three things that the Act was designed to encourage. The current language in 4 CSR 240-20.094 (2) goes beyond the Commission's statutory authority, works against the General Assembly's mandate to incent electric utilities to implement energy efficiency programs, and should be stricken from the rule.

### **Conclusion**

The proposed rules as currently written do not enable or encourage electric utilities to achieve the purposes of the Act. They need more work to bring them into compliance with the law. Therefore, they should not be transmitted to the Secretary of State until the unlawful provisions have been removed.

**\*NOTE:** The case was appealed to the Missouri Court of Appeals (WD) and was affirmed. See 397 SW3d 441 (Mo. App. W.D. 2013)

### **In the Matter of Application of U.S. Water Company to Sell its Water System Located in Lafayette County to the City of Lexington, Missouri**

*File No. WM-2011-0030  
Decided: October 6, 2010*

**Certificates §45.** The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff.

**Water §4.** The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff.

### **ORDER APPROVING APPLICATION**

The Missouri Public Service Commission is approving the *Application* of U.S. Water Company to sell its works and system to the City of Lexington, Missouri.

U.S. Water Company filed the application on August 3, 2010. By order dated August 6, 2010, the Commission ordered publication of notice of the application. In that same order, the Commission set a deadline for application to intervene at September 7, 2010. Staff filed its recommendation on September 13, 2010, favoring the application. On

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September 15, 2010, the Commission gave notice of tax revenue impact and gave affected political subdivisions until October 1, 2010, to file an application for intervention. As of the date of this order, the Commission has received no application to intervene. No law requires an evidentiary hearing,<sup>1</sup> and no person has sought one,<sup>2</sup> so this action is not a contested case.

The Commission has jurisdiction to rule on U.S. Water Company's sale under the following provision:

No . . . water corporation . . . shall hereafter sell . . . its . . . works or system . . . without having first secured from the commission an order authorizing it so to do. [<sup>3</sup>]

The Commission will only deny the application if approval would be detrimental to the public interest.<sup>4</sup>

Approval would not be detrimental to the public interest according to the verified filings. Staff recommends granting the application, conditioned on notice of the date on which the City of Lexington takes possession of the system. Upon such notice, the Commission can cancel U.S. Water Company's certificate of convenience and necessity, and U.S. Water Company's tariff.

Therefore, the Commission will approve the application subject to such condition.

**THE COMMISSION ORDERS THAT:**

1. The *Application* is approved, conditioned on U.S. Water Company filing, within five days of the transfer's effective date, notice of such transfer.
2. This order shall become effective on October 18, 2010.
3. This file shall remain open for notice of the transfer, and the cancellation of any associated tariff, and certificate of convenience and necessity.

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<sup>1</sup> Section 536.010(4), RSMo Supp. 2009.

<sup>2</sup> *State ex rel. Rex Deffenderfer Ent., Inc. v. Public Serv. Comm'n*, 776 S.W.2d 494, 496 (Mo. App., W.D. 1989).

<sup>3</sup> Section 393.190.1, RSMo 2000.

<sup>4</sup> *State ex rel. City of St. Louis v. Public Service Comm'n of Missouri*, 73 S.W.2d 393, 400 (Mo.1934).

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Clayton, Chm., Davis, Jarrett, Gunn,  
and Kenney, CC., concur.

Jordan, Regulatory Law Judge

**Bridgette Young v. Laclede Gas Company**

*File No. GC-2010-0248*  
*Decided: October 13, 2010*

**Evidence, Practice And Procedure §26.** The complainant bears the burden of proof to show the utility has engaged in unjust or unreasonable actions.

**REPORT AND ORDER**

**Appearances**

**Bridgette Young**, *pro se*.

**Rick Zucker**, Assistant General Counsel, Laclede Gas Company, 720 Olive Street, Room 1516, Saint Louis, Missouri 63101, for Laclede Gas Company.

**Samuel D. Ritchie**, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

**SENIOR REGULATORY LAW JUDGE: Ronald D. Pridgin**

***Procedural History***

On March 3, 2010, Bridgette Young (“Ms. Young”) filed a complaint against Laclede Gas Company (hereafter “Laclede”), alleging that Laclede overbilled her for her gas usage due to a leak in her service line. Laclede denied the allegations. The Staff of the Commission (hereafter “Staff”) filed a Recommendation concurring with Laclede’s position. The Commission convened an evidentiary hearing on August 18, 2010, and received post-hearing briefs from Laclede and Staff on September 23.

***Findings of Fact***

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. When making findings of fact based



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upon witness testimony, the Commission will assign the appropriate weight to the testimony of each witness based upon their qualifications, expertise and credibility with regard to the attested to subject matter.<sup>1</sup>

1. Ms. Young is a natural person and was, at all pertinent times, a customer of Laclede.<sup>2</sup>

2. Laclede is a Missouri corporation engaged in the sale of natural gas at retail to persons in the region of St. Louis, Missouri.

3. Staff is represented by the Commission's Staff Counsel's Office, acting independently of the Commission.

4. The Public Counsel is an official of the State of Missouri, appointed by the Director of the Missouri Department of Economic Development, and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"<sup>3</sup>

5. Ms. Young has no experience in gas service.<sup>4</sup>

6. Ms. Young has no training in reading gas meters.<sup>5</sup>

7. Laclede repaired a gas leak in front of Ms. Young's residence in August, 2008.<sup>6</sup>

8. The leak was in the street at the joint on the main pipe where her service line was connected, and the leak was not connected to any one customer.<sup>7</sup>

9. The leak could not affect her bill, as it was between the main and her meter.<sup>8</sup>

10. From August 10, 2007 to August 8, 2008, Ms. Young used 632 Ccf (one hundred cubic feet) of natural gas.<sup>9</sup>

11. From August 8, 2008 to August 10, 2009, Ms. Young used 615 Ccf of natural gas.<sup>10</sup>

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<sup>1</sup> Witness credibility is solely within the discretion of the Commission, who is free to believe all, some, or none of a witness' testimony. *State ex. rel. Missouri Gas Energy v. Public Service Comm'n*, 186 S.W.3d 376, 389 (Mo. App. 2005).

<sup>2</sup> Petitioner's complaint.

<sup>3</sup> Section 386.700, .710(2) RSMo 2000.

<sup>4</sup> Tr. 21.

<sup>5</sup> Id.

<sup>6</sup> Tr. 34, 55.

<sup>7</sup> Tr. 55.

<sup>8</sup> Tr. 57, 82.

<sup>9</sup> Ex. 2.

<sup>10</sup> Id.

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12. From August 10, 2009 to August 9, 2010, Ms. Young used 676 Ccf of natural gas.<sup>11</sup>

13. Ms. Young's usage history before and after the August, 2008 service line replacement is consistent.<sup>12</sup>

**Conclusions of Law**

The Missouri Public Service Commission has reached the following conclusions of law.

**Jurisdiction:**

Respondent is engaged in owning, controlling, managing, and operating gas plant for public use under a franchise granted by the state of Missouri or a political subdivision thereof, and is thus a gas corporation and a public utility within the intendments of Chapter 386, RSMo, and is subject to the jurisdiction of this Commission.

The Commission is authorized to hear and determine complaints made by customers against public utilities by § 386.390.1, which states:

1. Complaint may be made by ... any ... person ... by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any corporation ... or public utility, including any rule, regulation or charge heretofore established or fixed by or for any corporation, person or public utility, in violation, or claimed to be in violation, of any provision of law, or of any rule or order or decision of the commission[.]

However, authority to hear and determine the complaint does not necessarily equal authority to grant the relief therein requested. The Public Service Commission "is purely a creature of statute" and its "powers are limited to those conferred by the [Missouri] statutes, either expressly, or by clear implication as necessary to carry out the powers specifically granted."<sup>13</sup> While the Commission properly exercises "quasi judicial powers" that are "incidental and necessary to the proper discharge" of its administrative functions, its adjudicative authority is not plenary.<sup>14</sup> Further, the Commission cannot award pecuniary damages.<sup>15</sup>

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<sup>11</sup> Id.

<sup>12</sup> Tr. 59, Ex. 1, 2, 6.

<sup>13</sup> *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 47 (Mo. banc 1979); *State ex rel. City of West Plains v. Public Service Commission*, 310 S.W.2d 925, 928 (Mo. banc 1958).

<sup>14</sup> *State Tax Commission v. Administrative Hearing Commission*, 641 S.W.2d 69, 75 (Mo. 1982), quoting *Liechty v. Kansas City Bridge Co.*, 162 S.W.2d 275, 279 (Mo. 1942).

<sup>15</sup> *May Dept. Stores Co. v. Union Electric*, 107 S.W.2d 41, 58 (Mo. 1937).

**Burden of Proof:**

Ms. Young bears the burden of proof in a case such as this one in which the complainant alleges that a regulated utility has engaged in unjust or unreasonable actions.<sup>16</sup> Thus, she must establish all facts necessary to support the relief she seeks by a preponderance of the credible evidence.

**Decision**

Ms. Young asks for credit of an uncertain amount, but in the thousands, due to a belief that Laclede has overcharged her.<sup>17</sup> Ms. Young believes she was overcharged because Laclede repaired a leak in a gas main in front of her house in August, 2008. She believes she must have been paying for leaking gas before that repair was made.

However, the evidence expressly indicates that the leak was a "street leak", and, thus, the gas leaked **before** it could go through Ms. Young's meter.<sup>18</sup> If the leak had been on the "customer" side of the meter; in other words, in between the meter and the residence, Ms. Young would be billed for gas she could not use. But the leak was on the "street" side of the meter; in other words, in between the street and the meter. As a result, the gas escaping the pipe never reached Ms. Young's meter, and she was not billed for the leaking gas.

Furthermore, Ms. Young's gas usage was consistent before and after the leak. It follows that the leak was outside the meter and, therefore, did not affect Ms. Young's bill.

Laclede did not overcharge Ms. Young for her gas service. Her complaint is denied.

**THE COMMISSION ORDERS THAT:**

1. The complaint is denied.
2. All objections not ruled on are overruled and all motions or other requests for relief not specifically granted herein are denied.

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<sup>16</sup> *Ahlstrom v. Empire District Electric Company*, 4 Mo.P.S.C.3d 187, 202 (1995); *Margulis v. Union Electric Company*, 30 Mo.P.S.C. (N.S.) 517, 523 (1991); *State ex. rel. GS Technologies Operating Co., Inc. v. Public Service Comm'n*, 116 S.W.3d 680, 693 (Mo. App. 2003).

<sup>17</sup> Tr. 52, 76.

<sup>18</sup> Ex. 6HC, App. A; Ex. 6HC, Sch. 1, p. 1; Ex. 6HC, Sch. 6, p. 2; Tr. 57, 82.

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3. This order shall become effective on October 23, 2010.
4. This case shall be closed on October 24, 2010.

Clayton, Chm., Davis, Jarrett,  
Gunn, and Kenney, CC., concur  
and certify compliance with the  
provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,  
on this 13<sup>th</sup> day of October, 2010.

**In the Matter of Application of RDG Development, LLC For Authority  
to Sell Assets to Greenwood Hills Homeowners Association and, in  
Connection Therewith, Certain Other Related Transactions**

*Case No. SO-2011-0012  
Decided October 20, 2010*

**Evidence, Practice And Procedure §23.** Even in a contested case, if no party requests a hearing, the Commission may rule on the application without convening a hearing.

**Sewer §7.** The Commission has expressed its policy regarding jurisdiction over homeowners associations. Through these cases, the Commission has established a policy of not asserting jurisdiction over a system if certain criteria are met. Those criteria, known as the "Rocky Ridge Criteria", are reflected in the following factors:

- (a) The Association was organized as a not-for-profit corporation for the benefit of the property owners.
- (b) All customers currently served by the subject utility assets are members of the Association.
- (c) Only members of the Association will be served by the subject utility assets.
- (d) The Association's action regarding utility matters will be under the control of the members that are also the customers served by the subject utility assets.
- (e) The Association owns the subject assets and thus has control over such assets.

**ORDER APPROVING APPLICATION**

**Syllabus:** This order approves the application of RDG Development, LLC ("RDG") to sell its sewer system to Greenwood Hills Homeowners Association ("Greenwood Hills").

**Procedural History**

On July 12, 2010,<sup>1</sup> RDG filed an application. That application requests, among other things, authority from the Commission for RDG to sell its sewer system to Greenwood Hills. RDG and Greenwood Hills entered into an agreement on June 22, in which Greenwood Hills agreed to purchase RDG's sewer system.

The Commission issued notice of this application on July 14. In that notice, the Commission allowed anyone who wished to intervene until August 3 to request intervention. The Commission received no intervention requests.

Staff filed its Recommendation on October 5. Staff recommended that the Commission approve the transaction, with certain conditions. RDG replied on October 6, stating that it accepts Staff's Recommendation and conditions, and further stating that the Office of Public Counsel ("OPC") takes no position in this case.

**Discussion**

The application is within the Commission's jurisdiction to decide.<sup>2</sup> Because no party objects to the application, no evidentiary hearing is required.<sup>3</sup> Thus, the Commission deems the hearing waived,<sup>4</sup> and bases its findings on the verified filings, and makes its conclusions as follows.

The Commission issued RDG a certificate of convenience and necessity to provide sewer service on December 9, 2009 in File No. SA-2010-0096. RDG currently provides sewer service to 33 residential customers in Callaway County, Missouri.

Greenwood Hills is a Missouri non-profit corporation. It was formed on April 22, 2010, by residents of the Greenwood Hills Subdivision, to be the homeowners association for that subdivision, and to manage common property in the subdivision. The proposed sale should have negligible impact on the tax revenues of Callaway County, Missouri, as the assets will be assessed property tax at the same rate, regardless of whether RDG or Greenwood Hills owns them.

The Commission may approve of a sale of a sewer company if that sale is not detrimental to the public interest.<sup>5</sup> Based on the verified pleadings, the Commission finds that granting the application for the sale

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<sup>1</sup> All calendar references are to 2010 unless otherwise noted.

<sup>2</sup> Section 393.190 RSMo 2000.

<sup>3</sup> *State ex rel. Rex Deffenderfer Ent., Inc. v. Public Serv. Com'n*, 776 S.W.2d 494 (Mo. App. 1989).

<sup>4</sup> Section 536.060, RSMo 2000.

<sup>5</sup> See Commission Rule 4 CSR 240-3.310(1)(D).

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of the sewer company would not be detrimental to the public interest.

After the sale, the sewer system will be operated by a homeowners association. The Commission has expressed its policy regarding jurisdiction over homeowners associations in File Numbers WD-93-307, WO-2003-0086, and more recently, WD-2006-0157. Through these cases, the Commission has established a policy of not asserting jurisdiction over a system if certain criteria are met. Those criteria, known as the "Rocky Ridge Criteria", are reflected in the following factors:

- (a) The Association was organized as a not-for-profit corporation for the benefit of the property owners.<sup>6</sup>
- (b) All customers currently served by the subject utility assets are members of the Association.
- (c) Only members of the Association will be served by the subject utility assets.
- (d) The Association's action regarding utility matters will be under the control of the members that are also the customers served by the subject utility assets.
- (e) The Association owns the subject assets and thus has control over such assets.

Consistent with its policy, the Commission concludes that Greenwood Hills meets the Rocky Ridge Criteria. Thus, the Commission will not assert jurisdiction over Greenwood Hills in this matter.

The application will be granted.

**THE COMMISSION ORDERS THAT:**

1. The Application is granted.
2. The Commission will not assert jurisdiction over Greenwood Hills Homeowners Association.
3. RDG Development, LLC, is authorized to sell its sewer system to Greenwood Hills Homeowners Association as requested in the Application.
4. The Commission makes no ratemaking determination regarding any potential regulatory oversight, if any, over Greenwood Hills Homeowners Association.
5. The parties shall submit notice to the Commission regarding evidence of the transfer of assets to Greenwood Hills Homeowners Association within three business days after the transfer

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<sup>6</sup> The Commission takes administrative notice that the Missouri Secretary of State lists the Association as a not-for-profit corporation in good standing.

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and Commission approval is effective.

6. After the above notice of transfer is received, the parties shall file a motion in this case requesting that the certificate of convenience and necessity held by, and sewer tariff YS-2010-0397 on file for, RDG Development, LLC be cancelled. Should such notice not be received within 60 days of the Commission Order granting the transfer of ownership, ownership of the utility and responsibility to provide sewer service shall revert back to RDG Development and this case shall be closed.

7. RDG Development is not authorized to cease providing sewer services to customers in its service area until the Commission issues an order cancelling its certificate of convenience and necessity and its associated tariff.

8. This order shall become effective on October 30, 2010.

Clayton, Chm., Davis, Gunn,  
and Kenney, CC., concur;  
Jarrett, C., concurs, with separate  
concurring opinion to follow.

Pridgin, Senior Regulatory Law Judge

CONCURRING OPINION OF COMMISSIONER  
TERRY M. JARRETT

I concur with the majority in the result but disagree with any reliance for that result on past practice of the Commission noted as "policy" in the Order. The "Rocky Ridge Criteria" at best is guidance to the Commission and is not in any way mandatory in its application. To the extent that the "Rocky Ridge Criteria" has been adopted as "policy" of this Commission that criteria in essence is one of general applicability and is therefore being administered by this Commission as a rule, one that has not been properly promulgated through the rulemaking process.<sup>1,2</sup>

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<sup>1</sup> "Not every generally applicable statement or "announcement" of intent by a state agency is a rule. Implicit in the concept of the word "rule" is that the agency declaration has a potential, however, slight, of impacting the substantive or procedural rights of some member of the public." *Baugus v. Director of Revenue*, 878 S.W.2d 39, 42 (Mo. bane 1994).

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Commission policy is set in its rules, not by issuing Orders. Therefore I concur in the decision.

### **In The Matter of A Proposed Rulemaking Regarding Revision of The Commission's Chapter 22 Electric Utility Resource Planning Rules**

*Case No. EX-2010-0254  
Issued October 25, 2010*

**Electric §42.** Commissioner Davis advocated the Commission's IRP rule require the Commission acknowledge the reasonableness of an electric utility's resource plan as part of the IRP process.

### **DISSENT OF COMMISSIONER JEFF DAVIS TO THE PROPOSED RULEMAKING REVISING THE COMMISSION'S CHAPTER 22 ELECTRIC UTILITY RESOURCE PLANNING RULES**

I respectfully dissent from my colleagues' order to promulgate these rules as they are currently written.

Anyone who has ever been involved in the integrated resource planning (IRP) process knows these rules have desperately needed revision for years. It's taken a long time to get where we are. These rules are an improvement in some respects, but something important is missing: accountability for the Public Service Commission and the PSC Staff for any outcome in these IRP proceedings. It may seem like an antiquated note, but I think we need to take responsibility for the decisions we make – or in this case – fail to make.

Both the Missouri Energy Development Association (MEDA) and the Missouri Department of Natural Resources (MDNR) offered language whereby the Commission would at least "acknowledge" the utility's resource plan. "Acknowledgement" of the plan would enhance the process because it would force the parties and the staff to focus on outcomes as well as the process by which those outcomes were determined. After all, outcomes should be the purpose of the IRP process. More importantly, electric utilities could use the

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<sup>2</sup> See also, *NME Hospitals, Inc. v .Department of Social Services, Div. of Medical Services*, 850 S.W.2d 71, 74 (Mo. 1993) ("Changes in statewide policy are rules. Failure to comply with rulemaking procedures renders the purported rule void.").



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acknowledgement process to establish the prudence of making--or not making--certain large capital expenditures that are going to amount to billions of dollars over the next decade (e.g. – whether to shut down and decommission one or more coal plants or to continue retrofitting all of them) before they get to a rate case and have to argue over imprudence or lack thereof.

Whether and how we address IRP decisions will definitely impact customer rates for years to come. Failing to act on the substance of IRPs constitutes a decision in and of itself. The Commission's failure sends a message of uncertainty to the utilities we regulate, their investors and Wall Street saying either "we want to be free to disavow your plan and disallow the expenses later" or "we are afraid to be criticized for acknowledging a plan that later failed."

Ultimately, our failure to address the substance of utility resource plans increases financing costs for capital investment projects as well as litigation costs in future rate cases because parties will litigate the issue in future cases and knowing the Commission may disallow expenses, lenders and investors will want higher returns. That uncertainty will assuredly cause Missouri investor-owned electric utilities to place the least possible amount of investment capital at risk short-term. This is important because the cheapest plan today will not likely be the cheapest plan over the next one to five years, and even less likely over the long-term (from 30 to 50 years). Thus, the ratepayers could end up paying higher rates long-term so the utility can consistently save a few dollars on the front end, or because the utility opted for cheaper, less reliable technology.

The importance of this issue is best illustrated by the decisions the Commission faces regarding our aging fleet of coal plants. In September, Wood Mackenzie's North American power research group issued a startling report that almost 60 gigawatts of coal-fired electric plants could be retired over the next decade. Independent verification of that estimate comes from Ellen Lapson, Managing Director of Corporate Ratings for Fitch Rating Agency. On September 30, 2010, at the Financial Research Institute, Director Lapson said that Wood Mackenzie's number was a reasonable number. At least two Commissioners were present at that meeting.

The findings of the Wood Mackenzie report ought to send a shiver down the spine of everyone here at the PSC as well as anyone employed by a Missouri utility. More than 80% of the electricity consumed in this state is fueled by coal. Collectively, Missouri utilities

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probably own around 10,000 megawatts of coal-fired generation, if not more. Ameren Missouri is the largest Missouri utility and owns several thousand megawatts of coal-fired generation all by itself, but everyone including the utilities who've camouflaged themselves as being leaders in the green revolution have similar risks. So, when the Wall Street analysts say "Coal is in the crosshairs" they mean pretty much every Missouri utility, but especially Ameren because they own the most coal plants, and that ultimately every utility customer in the state is in the crosshairs. Each and every one of our investor-owned electric utilities is going to make significant investment decisions regarding the retirement or retrofitting of a large fleet of coal plants averaging more than 40 years or older as well as the addition of new resources to replace these retiring coal plants, meet growing demand and comply with government mandates for utilities to buy certain amounts of "renewable" electricity.

Presidents and governors don't punt and this Commission shouldn't punt either. Hundreds of millions, if not billions, of dollars are at stake when our electric utilities make these decisions and customer rates are hanging in the balance. We owe it to the ratepayers and to the utilities we regulate to be decisive and thereby meet this Commission's statutory obligation to assure safe and adequate service for consumers at a just and reasonable rate. It's silly and unconscionable to spend a couple of years working on more than 60 pages of rules that force the utility to think of every scenario, to document how every calculation is made, to check to see if the work was performed correctly and then do nothing with such documents except hold them, waiting to whip them out on some unsuspecting utility executive for not following a plan we don't intend to make them follow until the day they deviate from it.

In conclusion, a Commission majority that has shown a willingness to micro-manage electric utilities by requiring them to undertake low-income assistance programs and make our utilities buy Missouri wind-generated electricity ought not have a problem "acknowledging" whether an electric utility's preferred resource plan seems like a good or a bad one.

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**In the Matter of Union Electric Company, d/b/a AmerenUE's Tariff to Increase Its Annual Revenues for Electric Service**

*File No. ER-2011-0028  
Decided October 27, 2010*

**Evidence, Practice and Procedure §22.** The applications to intervene of the Natural Resource Defense Council and the Missouri Coalition for the Environment, d/b/a Renew Missouri were found to comply with the applicable regulation and were granted.

**ORDER GRANTING THE APPLICATION TO INTERVENE OF THE NATURAL RESOURCES DEFENSE COUNCIL AND GRANTING THE APPLICATION TO INTERVENE OF THE MISSOURI COALITION FOR THE ENVIRONMENT, D/B/A RENEW MISSOURI**

On September 3, 2010, Union Electric Company, d/b/a Ameren Missouri, filed a tariff designed to increase its annual revenues for electric service. The Commission suspended that tariff and established September 27 as the deadline for interested parties to apply to intervene.

The Natural Resource Defense Council (NRDC) and Renew Missouri filed an application to intervene on September 27. The NRDC is a New York nonprofit corporation with members in Missouri, many of whom are Ameren Missouri ratepayers. The NRDC indicates it and its members are interested in promoting energy efficiency, peak demand reduction, and renewable energy resources. More than ten days have passed since the NRDC applied to intervene and no party has objected to that application.

The Commission finds that the NRDC's interest in this case is different from that of the general public, and may be adversely affected by a final order arising from this case. Furthermore, the Commission finds that allowing the NRDC to intervene will serve the public interest. Therefore, in accordance with Commission Rule 4 CSR 240-2.075(4), the Commission will grant the NRDC's application to intervene.

Renew Missouri applied to intervene at the same time as the NRDC. In its initial application, Renew Missouri described itself as "a project of the Missouri Coalition for the Environment". The Missouri Coalition for the Environment is a nonprofit corporation, but Renew Missouri appeared to be just a project of that corporation, without any separate corporate existence. Furthermore, the initial application to intervene stated:

[T]he Coalition and its members have a strong interest in

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protecting Missouri's environment, including advocating for the reduction of air pollution from electric utilities, ensuring that nuclear plants do not contaminate the environment, avoiding damage to water quality and the environment from hydroelectric or pumped storage facilities, and advocating for other generating facilities to have as low an environmental impact as possible. The Coalition also supports aggressive implementation of cost-effective utility DSM programs."

The initial application did not indicate any interest of Renew Missouri separate from the described interest of the Coalition. Those facts indicated the correct entity to be granted intervenor status in this case might be the Missouri Coalition for the Environment rather than Renew Missouri.

Because of the confusion relating to Renew Missouri's initial application, the Commission directed Renew Missouri to further explain its application to intervene. The NRDC and Renew Missouri responded on October 25 by filing an amended application to intervene. The amended application explains that the Missouri Coalition for the Environment has registered Renew Missouri as a fictitious name with the Missouri Secretary of State. Thus, the party that is seeking to intervene is the Missouri Coalition for the Environment, d/b/a Renew Missouri.

The Commission finds that the Missouri Coalition for the Environment, d/b/a Renew Missouri's interest in this case is different from that of the general public, and may be adversely affected by a final order arising from this case. Furthermore, the Commission finds that allowing the Missouri Coalition for the Environment, d/b/a Renew Missouri to intervene will serve the public interest. Therefore, in accordance with Commission Rule 4 CSR 240-2.075(4), the Commission will grant the Missouri Coalition for the Environment, d/b/a Renew Missouri's application to intervene.

**THE COMMISSION ORDERS THAT:**

1. The Amended Application to Intervene of the Natural Resources Defense Council is granted.
2. The Amended Application to Intervene of the Missouri Coalition for the Environment, d/b/a Renew Missouri, is granted.
3. This order shall become effective on October 27, 2010.

Clayton, Chm., Davis, Gunn, and Kenney, CC., concur;  
Jarrett, C., concurs with separate concurring opinion to follow.

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Woodruff, Chief Regulatory Law Judge

\*NOTE: See pages 549, 562, and 662 for other orders in this case.

**CONCURRING OPINION OF COMMISSIONER TERRY M. JARRETT**

Because I have no substantive objection to allowing the Natural Resources Defense Council and the Missouri Coalition for the Environment d/b/a Renew Missouri to intervene, I concur in the result, but once again I am compelled to write because the applications to intervene do not comply with the Commission's intervention rules. I believe our standard procedure should be to allow the applicants to cure such deficiencies when we receive such applications.<sup>1</sup>

My Dissenting Opinion in Case ER-2010-0036 details the requirements for an application to intervene as well as the standard for granting intervention. Additionally, my concerns regarding deficient applications to intervene, and the granting of such deficient applications by the Commission, are also discussed in my Dissent.

Apparently, our intervention rules as promulgated are too difficult for some attorneys licensed in this state to follow, given the multiple times I have pointed out deficiencies in applications to intervene.<sup>2</sup> I am hopeful that the proposed rewrite of the intervention rules in the AX-2011-0094 docket will fix this reoccurring problem.

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<sup>1</sup> See *Dissenting Opinion of Commissioner Terry M. Jarrett*, Case ER-2010-0036, September 17, 2009.

<sup>2</sup> Most attorneys who practice before the Commission do scrupulously follow the rules, and this Commissioner appreciates all who make every effort to follow our rules.

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**Charles A. Harter v. Laclede Gas Company\***

*File No. GC-2010-0217  
Decided: November 3, 2010*

**Gas §33.** Laclede Gas Company was not in violation of the law when it began sending electronic bills to Complainant and, therefore within the law by sending an electronic notice of disconnection.

**REPORT AND ORDER**

***Appearances***

**Charles A. Harter**, 827 S. Sappington, St. Louis, Missouri 63126, Complainant, an Attorney representing himself.

**Rick Zucker**, Laclede Gas Company, 720 Olive Street, St. Louis, Missouri, Attorney for Laclede Gas Company.

**Jennifer Hernandez**, P.O. Box 360, 200 Madison, Jefferson City, Missouri 65102, Staff Counsel, Independent of the Commission.

**JUDGE:**           **Kennard Jones, Senior Regulatory Law Judge**

**Syllabus**

Charles A. Harter, Complainant, has not shown that Laclede Gas Company has violated any statute, tariff provision or any Commission rule or order by sending Complainant electronic bills or by notifying him of an impending disconnection.

**Background**

Complainant's wife arranged to pay their bills through Bank of America's "Bill Pay" program, by which the bank would automatically pay bills out of the customer's account without the customer's further participation. At around the same time as the Bill Pay program was set up Laclede received a request to send Complainant's bills electronically, rather than through the United States Postal Service. Complainant argues that he did not request electronic billing. Later, Complainant discontinued paying bills through his bank. However, Laclede continued to bill Complainant through his electronic mail account. Complainant's method of managing his bills depends on receiving bills through the mail. After automatic Bill Pay was cancelled, the electronic bills went unpaid and he accrued an arrearage. Due to the arrearage of about \$900,

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Laclede set a date for disconnection. When Complainant learned of the impending disconnection, he brought this matter to the Commission and filed this formal complaint.

Complainant does not allege that he does not owe the amount due and upon conclusion of the hearing, the parties agreed on a payment plan. Complainant's assertion is that Laclede violated the Commission's rule, 13.105(1)(T), requiring companies to send payments through the postal service. Although Complainant is aware that the Commission granted to Laclede a variance from this rule, he questions whether the Commission had the power to grant such a variance.

The Commission convened a prehearing conference on April 12, 2010, and on June 24 filed the following list of issues:

1. Until August 2008, the Respondent sent the Complainant paper bills delivered by regular mail. Beginning in August 2008 and extending through July 2009, the Respondent stopped mailing paper bills, and instead delivered electronic bills to Complainant.
  - a. When the Respondent stopped mailing paper bills to the Complainant and began sending e-bills, did the Respondent do so unilaterally and without the Complainant's knowledge or consent?
  - b. After the Complainant terminated his automatic bill pay program in February 2009, did the Respondent thereafter (through July 2009) fail and refuse to send the Complainant a bill for gas services by US Mail?
2. Did the Respondent violate any provision of its tariffs, any law, or any Commission rule or order when it issued e-bills to the Complainant?
3. Did Respondent violate any provision of its tariffs, any law, or any Commission rule or order when it issued disconnection notices either by e-mail or US Mail to the Complainant between July 29 and August 21, 2009?
4. May the Respondent or the Commission waive, through a tariff, the requirement of law of Rule 4 CSR240-13.015(1)(T) that requires the Respondent to send bills to consumers through the US Mail?

To resolve these issues, the Commission held an evidentiary hearing on July 8, 2010. The parties filed a joint stipulation of facts and, in addition to the offered testimony, the Commission received six exhibits into evidence.

Upon conclusion of the hearing, the parties were directed to file briefs, with Complainant filing an initial brief, Laclede and the Staff of the Commission responding, and finally, Complainant filing a reply.

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Complainant, however, later requested that he not be required to file an initial brief, but rather only a reply. In response to his request and after conferring with Staff, Laclede suggested that the parties either file simultaneous briefs or simultaneous proposed findings of fact and conclusions of law. The Commission directed the parties to file either document no later than September 20, the initial date by which Complainant would have filed a reply. Both Laclede and Staff filed Proposed Findings of Fact and Conclusions of Law on September 20. Complainant failed to make a filing, as directed by the Commission's order. Commission rule<sup>1</sup> allows no more than ten days for responsive pleadings. Ten days have expired and Complainant has not responded to the proposed findings and conclusions filed by Laclede and Staff. The Commission will therefore decide this matter without the benefit of Complainant's post-hearing input.

### **Findings of Fact**

1. Complainant is the named party on a Laclede Gas Company account at his residence.<sup>2</sup>

2. Respondent, Laclede Gas Company, is a public utility providing gas service to Complainant at his residence.<sup>3</sup>

3. In August of 2008, Charles Harter's wife took over paying the bills and initiated "Bill-Pay" through their bank, Bank of America.<sup>4</sup>

4. On August 6, 2008, Laclede received an electronic bill registration from its vendor, CheckFree.<sup>5</sup>

5. Checkfree is Laclede's vendor through which a customer may initiate electronic billing.<sup>6</sup>

6. If a customer registers for electronic billing through their bank, the bank will then send a notice to Checkfree, who then forwards that information to Laclede.<sup>7</sup>

7. Laclede does not decide how a customer pays bills.<sup>8</sup>

8. Electronic billing and electronic payment operate independent of one another. A customer may wish to have bills sent through the mail, while paying electronically. A customer may wish to

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<sup>1</sup> Commission rule 4 CSR 240-2.080(15).

<sup>2</sup> Exhibit 1, Stipulation of Facts.

<sup>3</sup> Exhibit 1, Stipulation of Facts.

<sup>4</sup> Transcript, page 45, lines 11-19. All references to Transcript are to Volume 2.

<sup>5</sup> Exhibit 2.

<sup>6</sup> Transcript, page 102, line 25 through page 103, line 3.

<sup>7</sup> Transcript, page 103, line 24 through page 104, line 3.

<sup>8</sup> Transcript, page 141, line 25 through page 142, line 6.



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have bills sent electronically, while paying through the mail. A customer may wish to have bills sent electronically, while paying electronically. Or, a customer may wish to have bills sent through the mail, while paying through the mail.<sup>9</sup>

9. To sign up for electronic billing, the customer's account information, name, address, and e-mail address must be used.<sup>10</sup>

10. Kevin Kellar, Laclede's witness, has been with the company for 17 years.<sup>11</sup>

11. Over 71,000 customers have electronic billing and Kevin Kellar has not heard of any claiming that they did not originate the process.<sup>12</sup>

12. During her time with the Commission in Customer Service, beginning in November of 2009, Mary Schierman-Duncan has not seen any customer complaints in which the customer claims they were registered for electronic billing without their knowledge or consent.<sup>13</sup>

13. Complainant did not know what was going on with regard to paying bills from August of 2008 to February of 2009 because he wasn't involved in paying the bills during that period.<sup>14</sup>

14. Complainant does not know whether his wife signed up for electronic billing.<sup>15</sup>

15. Complainant discontinued Bill Pay through his bank in February of 2009.<sup>16</sup>

16. In order to cancel electronic billing, the customer must contact Laclede. A customer service representative will then remove the electronic billing indicator.<sup>17</sup>

17. Complainant did not contact Laclede in February of 2009.<sup>18</sup>

18. Someone with access to Complainant's e-mail account opened electronic bills sent by Laclede for the service period of

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<sup>9</sup> Transcript, page 122, line 18 through page 123, line 2. And, page 151, line 9-11.

<sup>10</sup> Transcript, page 150, lines 1-17.

<sup>11</sup> Transcript, page 100, lines 8-9.

<sup>12</sup> Transcript, page 153, lines 10-13.

<sup>13</sup> Transcript, page 156, line 17 through page 157, line 4.

<sup>14</sup> Transcript, page 93, line 19 through page 94, line 10.

<sup>15</sup> Transcript, page 55, line 23 through 56, line 7; page 58, lines 3-6, page 72, lines 4-9.

<sup>16</sup> Transcript, page 83, lines 20-22.

<sup>17</sup> Transcript, page 105, lines 14-20.

<sup>18</sup> Transcript, page 112, lines 1-3. Exhibit 5, records of customers contacts from February of 2008 through January 2010.

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September of 2008 through July of 2009.<sup>19</sup>

19. Although Complainant did not make a payment in February of 2009, a payment of \$50 was made in March of 2009.<sup>20</sup>

20. No payment was made on Complainant's account since March of 2009.<sup>21</sup>

21. On July 31, 2009, Laclede sent a notice with an electronic bill informing Complainant that the account was subject to disconnection on August 21, 2009, for nonpayment.<sup>22</sup>

22. On August 18, 2009, Laclede notified Complainant through the mail of a disconnection to occur on August 21.<sup>23</sup>

23. Complainant called Laclede to cancel electronic billing on August 21, 2009.<sup>24</sup>

24. Laclede sent the next bill to Complainant by US Mail on August 28, 2009.<sup>25</sup>

### **Conclusions of Law**

#### **2. Jurisdiction**

Laclede is a gas corporation and a public utility as defined by Section 386.020(18) and (43), RSMo, and is subject to the Commission's jurisdiction under Sections 386.250 and 393.140, RSMo. Under 386.390, RSMo, a complaint may be made by any person, by petition or complaint, setting forth any act or thing done or omitted to be done by any public utility in violation of any provision of law, or of any rule or order or decision of the Commission. Complainant has filed such a complaint with the Commission, which the Commission has the authority to resolve.

#### **3. Burden of Proof**

Where a complainant alleges that a public utility has violated the law, as Complainant has in this case, the burden of proof lies with the Complainant to show that Laclede violated the law or a Commission rule or order.<sup>26</sup>

#### **4. Issue 1: Did Laclede begin sending E-bills to Complainant unilaterally and without his consent?**

<sup>19</sup> Transcript, page 109, line 14 through page 110, line 6.

<sup>20</sup> Transcript, page 123, lines 6-13.

<sup>21</sup> Transcript, page 125, lines 2-4. Exhibit 6, Staff Recommendation, Schedule 1-3.

<sup>22</sup> Transcript, page 115, lines 9-21; Exhibit 1, Schedule SOF (HC).

<sup>23</sup> Transcript, page 115, line 22 through page 116, line 1; page 119, lines 6-8.

<sup>24</sup> Exhibit 5. And, Transcript, page 114, lines 17-20.

<sup>25</sup> Transcript, page 115, lines 3-8.

<sup>26</sup> *State ex rel. GS Technologies Operating Co., Inc. v. Public Service Comm'n*, 116 S.W.3d 680, 693 (Mo. App. 2003).

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This issue is one purely of fact and requires no conclusion(s) of law. Because it is relevant to the conclusion of whether Laclede violated the law by sending Complainant's bills electronically, it is discussed below under that issue.

5. Issue 2: After Complainant terminated automatic Bill-Pay in February, did Laclede fail and refuse to send the Complainant a bill for gas services by US Mail?

Like the first issue, this issue is also one of pure fact and requires no conclusion(s) of law. Because it is relevant to the conclusion of whether Laclede violated the law when it notified Complainant of an impending disconnection, it is discussed below under that issue.

Issue 3: Did Laclede violate any provision of its tariffs, any law, or any Commission rule or order when it issued e-bills to Complainant?

The first issue presented by the parties is whether Laclede began sending e-bills to Complainant unilaterally and without his consent. As noted above, it is an issue solely of fact and is necessarily disposed of in reaching a conclusion as to whether Laclede violated the law when it began sending e-bills to Complainant.

Laclede's tariff defines an "E-bill" as a bill delivered electronically to the customer, or to a web site selected by the customer, that can be viewed on a computer screen.<sup>27</sup> Laclede's tariff defines "Rendition of a Bill" as the mailing, hand delivery or electronic posting or delivery of a bill by the company to a customer. The company shall be required to render a bill through only one of the foregoing methods.<sup>28</sup> Laclede's tariff defines a "bill" as a written demand for payment for service and the taxes and franchise fees related to it. Such bill may be in electronic form if agreed to by the customer and the company.<sup>29</sup> On July 25, 2002, in 4 CSR 240-13.015(1)(A), a bill is defined as a written demand for payment for service and the taxes and franchise fees related to it.<sup>30</sup> On July 25, 2002, in 4 CSR 240-13.015(1)(R), rendition of a bill is defined as the mailing or hand delivery of a bill by a utility to a customer.<sup>31</sup> On July 25,

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<sup>27</sup> Laclede's Tariff, P.S.C. MO. No. 5, First Revised Sheet No. R-3-a.

<sup>28</sup> Laclede's Tariff, P.C.S. MO. No. 5, First Revised Sheet No. R-3-b.

<sup>29</sup> Laclede's Tariff, P.S.C. MO. No. 5, Fourth Revised Sheet No. R-3

<sup>30</sup> See 4 CSR 240-13.015(1)(A), 12/31/95. The numbering of the rule has since been amended.

<sup>31</sup> See 4 CSR 240-13.015(1)(R), 12/31/95. Because the rules have been renumbered, (1)(T) is now the old (1)(R).

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2002, the Commission issued an order granting Laclede's application for a variance from Commission rules 4 CSR 240-13.015(1)(A) and (R), approving tariff pages enabling Laclede to send bills electronically.<sup>32</sup> A tariff has the same force and effect as a statute, and it becomes state law.<sup>33</sup>

Laclede's tariff allows the company to send bills electronically if requested to do so by the customer. Although Complainant asserts he did not request that Laclede send bills electronically, it is evident a request was made at the same time Complainant's wife set up Bill Pay with Bank of America. Complainant does not know whether his wife, while enrolling in Bill Pay, also requested that electronic bills be sent. The evidence supports an inference that Complainant's wife chose to receive bills electronically. Complainant has not shown otherwise.

Further, although it is not direct evidence of whether Laclede initiated electronic billing for Complainant, it is relevant that neither Laclede's nor Staff's witness is aware of a customer complaining of being signed up for electronic billing without their consent. This is in light of there being 71,000 customers who have electronic billing. Complainant has not shown that Laclede unilaterally begin sending electronic bills to Complainant. The Commission therefore concludes that Laclede has not violated any laws, Commission rule or orders when it began sending bills to Complainant electronically.

Issue 4: Did Laclede violate any provision of its tariff, any law, or any Commission rule or order when it issued disconnection notices either by e-mail or US mail to Complainant between July 29 and August 21, 2009?

Laclede's tariff allows disconnection of service for nonpayment of an undisputed delinquent charge.<sup>34</sup> Delinquent charge is defined in Laclede's tariff as a charge remaining unpaid by a customer after the delinquent date.<sup>35</sup> Delinquent date is defined in Laclede's tariff as being 21 days from the rendition of the bill by the company, or the extended payment date, if applicable, unless otherwise stated in the specific tariff sheet(s) under which gas service is provided.<sup>36</sup> Commission rule 4 CSR 240-13.50(5) states that a utility shall not discontinue residential service

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<sup>32</sup> Exhibit 1 attachment, Order Granting Application for Variance and Approving Tariff.

<sup>33</sup> *Bauer v. SW Bell Telephone Co.*, 958 S.W.2d 568, 570 (Mo. App. E.D. 1997), *State ex rel. Mo. Gas Energy v. Pub. Service Comm'n*, 210 S.W.3d 330, 337 (Mo. App. W.D. 2006).

<sup>34</sup> Laclede's tariff, P.S.C. MO. No. 5, Fourth Revised Sheet No. R-12.

<sup>35</sup> Laclede's tariff, P.S.C. MO. No. 5, Fourth Revised Sheet No. R-3.

<sup>36</sup> Laclede's tariff, P.S.C. MO. No. 5, Fourth Revised Sheet No. R-3-a.

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unless written notice by first class mail is sent to the customer at least 10 days prior to the date of the proposed discontinuance of service or hand delivered at least 96 hours prior to discontinuance. Laclede's tariff mirrors the Commission's rule with regard to the definition of delinquent charge, delinquent date and the conditions under which service may be disconnected.<sup>37</sup> Laclede's tariff allows the company to send notice of its intent to disconnect by electronic mail, if the customer has opted for electronic billing.<sup>38</sup> As an alternative to sending an electronic notice of disconnection, Laclede can hand-deliver a notice at least 96 hours prior to disconnection.<sup>39</sup>

Until the parties agreed on a payment plan at the close of the hearing on July 8, 2010, the last payment Complainant made was in March of 2009 in the amount of \$50. Laclede notified Complainant by electronic mail on July 31, 2009 of the impending disconnection scheduled for August 21. And, on August 18, sent notice by US Mail; the 96-hour notice. Although Laclede's tariff requires that a 96-hour notice be hand-delivered, this is an alternative to sending the notice 10 days prior to the disconnection date, which Laclede did.

The Commission has concluded that Laclede was within the law when it began sending electronic bills to complainant. Because it was lawfully sending electronic bills, it may lawfully send an electronic notice of disconnection. The bills were well over 21 days overdue and Laclede sent notice of disconnection at least 10 days prior to disconnection. However, Laclede never disconnected Complainant's service. All of the steps Laclede took in notifying Complainant of an impending disconnection were made under the presumption that disconnection would follow. The first sentence of the relevant tariff provision states in part; "[t]he Company shall not disconnect residential service . . . unless written notice is sent at least 10 days prior to the date of the proposed discontinuance." Because Laclede ultimately did not disconnect Complainant's service, the steps Laclede took to notify Complainant become moot. The Commission concludes that Laclede has not violated any law or Commission rule or order when it issued disconnection notices to Complainant.

Issue 5: May the Respondent or the Commission waive, through a tariff, the requirement of law of Rule 4 CSR 240-13.015(1)(T) that requires the Respondent to send bills to consumers

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<sup>37</sup> The Commission takes official notice of this fact.

<sup>38</sup> Laclede's tariff, P.S.C. MO. No. 5, First Revised Sheet No R-12-b.

<sup>39</sup> Laclede's tariff, P.S.C. MO. No. 5, First Revised Sheet No R-12-b.

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through US Mail?

The Commission may allow a variance of rule 13.015(1)(T) under Commission rule 4 CSR 240-13.065(1). By order, the Commission granted such variance, allowing Laclede to send bills electronically. Laclede's then revised its tariff to reflect that variance, which the Commission approved. Complainant has presented no evidence or law to suggest that the Commission's order granting the variance was unlawful. To specifically address the issue, the Commission has not "waived" the relevant rule but rather has allowed a variance of the rule. Nonetheless, the Commission's order granting a variance of the rule to Laclede, and allowing the company to send bill electronically, is lawful.

**Decision**

Although it is unfortunate that Complainant accrued an arrearage, Complainant has not shown that such was the result of any violation of the law by Laclede. Under 386.390.1 Complainant bears the burden of showing such violation. Laclede sending bills electronically and notifying Complainant of disconnection for unpaid bills were consistent with the law, and Commission rules and orders. Complainant has failed his burden and the Commission rules in favor of Laclede.

**THE COMMISSION ORDERS THAT:**

1. Complainant, Charles A. Harter, has failed to show that Laclede Gas Company has violated any law or Commission rule or order.
2. This Report and Order shall become effective on November 13, 2010.
3. This case shall be closed on November 14, 2010.

Davis, Jarrett, Gunn, and Kenney, CC.,  
concur, and certify compliance with the  
provisions of Section 563.080, RSMo.  
Clayton, Chm., absent.

Dated at Jefferson City, Missouri,  
on this 3<sup>rd</sup> day of November, 2010.

\*NOTE: This case was appealed to the Missouri Court of Appeals (WD) and affirmed. See 631 S.W. 3d 52 (Mo. App. W.D. 2012)

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**In the Matter of the PGA/ACA Filing of Atmos Energy Corporation  
for the West Area (Old Butler), West Area (Old Greeley),  
Southeastern Area (Old SEMO), Southeastern Area (Old Neelyville),  
Kirksville Area and the Northeastern Area**

*File No. GR-2008-0364  
Decided November 10, 2010*

**Evidence, Practice And Procedure §29.** The Commission granted a motion by its staff to compel a utility to provide documents regarding transactions between the utility and its marketing affiliate because the information was relevant or may lead to the discovery of admissible evidence.

**ORDER GRANTING STAFF'S MOTION TO COMPEL ATMOS TO  
RESPOND TO DATA REQUESTS AND REESTABLISHING  
PROCEDURAL SCHEDULE**

This case involves Atmos Energy Corporation's (Atmos) 2007-2008 Actual Cost Adjustment (ACA) filing. The purpose of the ACA filing is to reconcile Atmos' actual cost to purchase natural gas with the amount of cost it passed to its customers through the operation of the purchased gas adjustment (PGA) provisions of its tariff. As part of that reconciliation process, the Commission's Staff examines the prudence of Atmos' gas purchase contracts.

Staff filed its recommendation regarding Atmos' ACA filing on December 28, 2009. At that time, Staff recommended an adjustment of approximately \$363,000 to reduce Atmos' actual gas costs by the amount of profit earned by Atmos' affiliated gas marketing entity, Atmos Energy Marketing, for transactions involving sales of gas to Atmos. Atmos disagreed with Staff's proposed adjustment and the Commission established a procedural schedule.

On June 14, 2010, Staff filed a motion asking the Commission to compel Atmos to respond to certain data requests for documents relating to Atmos Energy Marketing's purchase of the natural gas it supplied to Atmos. The Commission granted Staff's motion to compel on July 15, and suspended the remaining procedural schedule while the disputed discovery proceeded.

Atmos complied with the Commission's order to compel by providing Staff with the documents it requested. On August 27, Staff issued follow-up data requests asking Atmos for more details about the transactions between Atmos Energy Marketing and its gas suppliers.

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Atmos objected to the follow-up data requests as irrelevant and not designed to lead to the discovery of admissible evidence. Staff responded by filing the current motion to compel on September 14.

Atmos filed a written response to Staff's motion to compel on September 22. On the same date, the Office of the Public Counsel filed its response in support of Staff's Motion to Compel. In addition, the Commission convened an oral argument regarding Staff's Motion to Compel on October 20.

Atmos contends the information Staff seeks is irrelevant to the issues before the Commission because all transactions between the regulated utility and the unregulated marketing company resulted from a competitive bidding process in which the subsidiary marketing company submitted the best bid. According to Atmos, the fact that the contracts resulted from competitive bidding should end the Commission's inquiry into the valuation of those contracts. Staff indicates it needs to review and evaluate the marketing affiliate's contracts with its suppliers to be able to determine whether the price that affiliate is charging the regulated company is in fact the fair market price.

The data requests for which Staff asks the Commission to compel a response require Atmos to provide Staff with additional documents to explain certain anomalies in the marketing affiliate's handling of gas supplies that the Staff believes could indicate manipulation of those supplies to the benefit of Atmos and the detriment of Atmos' ratepayers. Staff is also seeking further information to evaluate the integrity of Atmos' bid process for those supplies.

Ultimately, after hearing the evidence presented by the parties, the Commission may determine that the bidding process has established the fair market price and that Atmos has not provided a financial advantage to its affiliate. However, if Staff is to satisfy its obligation to evaluate Atmos' compliance with the affiliate transaction rule and perhaps present evidence on that question, it must be able to review and evaluate the supply contracts entered into by Atmos' affiliate. To do that it is entitled to obtain the additional information and documents it seeks.

For that reason, the Commission finds that the additional information Staff seeks is relevant, or may lead to the discovery of relevant, admissible evidence. Thus, under Rule 56.01(b)(1) of the Missouri Rules of Civil Procedure, the information Staff seeks is subject to discovery. Therefore, the Commission will grant Staff's motion to compel Atmos to respond to Staff's data requests.

The Commission is mindful of Atmos' concern that Staff not be



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allowed to proceed with a never-ending fishing expedition into Atmos' business dealings with its subsidiary gas marketing company. Staff purportedly completed its audit of Atmos' actual gas costs in December 2009, and proposed a disallowance at that time. While there is no statutorily imposed deadline for Commission action, Atmos deserves a reasonably prompt resolution of that proposed disallowance. Therefore, the Commission will order Atmos to respond to Staff's data request within twelve days and will direct Staff to complete its discovery thirty days thereafter. The Commission will also order all parties to file their surrebuttal testimony at that time. After the parties file their surrebuttal testimony, the Commission will entertain recommendations from the parties for the scheduling of an evidentiary hearing and attendant procedural matters.

**THE COMMISSION ORDERS THAT:**

1. Staff's Motion to Compel Atmos' Response to Staff Data Requests 117.1 and 131.1 is granted.
2. Atmos Energy Corporation shall respond to Staff's Data Requests 117.1 and 131.1 by November 22, 2010.
3. All parties may file surrebuttal testimony no later than December 22, 2010.
4. All parties may file recommendation regarding the scheduling of an evidentiary hearing and attendant procedural matters no later than December 29, 2010.
5. This order shall become effective immediately upon issuance.

Clayton, Chm., Davis, Gunn, and Kenney, CC., concur;  
Jarrett, C., dissents with dissenting opinion to follow.

Woodruff, Chief Regulatory Law Judge

\*NOTE: See page 336 for another order in this case.

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**DISSENTING OPINION OF COMMISSIONER TERRY M. JARRETT  
IN THE ORDER GRANTING STAFF'S MOTION TO COMPEL  
ATMOS TO RESPOND TO DATA REQUESTS**

To prevail on its Motion to Compel, the Staff must show that the discovery it seeks is relevant. I do not believe the Staff has met its burden of establishing relevance; therefore, I dissent.

*The Rules of Discovery and Evidence*

“[D]iscovery may be obtained by the same means and under the same conditions as in civil actions in the circuit court. [...]” 4 CSR 240-2.090(1). That includes the use of motions to compel along with subpoena power. The Affiliate Transactions and Marketing Affiliate Transactions rules, 4 CSR 240-40.015(3) and 4 CSR 240-40.016(4), provide evidentiary guidelines for Affiliate Transactions and Marketing Affiliate Transactions (the “affiliate rules”). These two rules purport to grant the Commission the “authority” to investigate the operations of an affiliated entity as well as review, inspect and audit books, accounts and other records kept by an affiliated entity – solely for the purpose of ensuring compliance with the rule as well as make findings available to the commission. See 4 CSR 240-40.015(6)(B)1, 2 4 and 4 CSR 240-40.016(7)(B)1, 2. The affiliate rules must be read against the limitations provided by Section 393.140(12), RSMo, which authorizes regulated utilities to engage in other businesses, provided that the businesses are not otherwise subject to the jurisdiction of the Commission, are not in the same business as the regulated utility, and is conducted in a way that is separate and apart from the regulated utility itself. The affiliate rules recognize the statutory limitations of Section 393.140(12) by limiting the scope and reach of the rule only to “ensuring compliance with the rule,” and notably restricting obligations associated with the rule to the regulated gas corporation alone.<sup>1</sup> The affiliate rules cannot be bootstrapped to allow the Staff to obtain records of an affiliate for any other purpose.

The Commission's discovery roadmap is also set out by the Supreme Court of Missouri in the Rules of Civil Procedure. Rule 56(b)(1) limits that which is discoverable by providing that “[I]t is not ground for objection that the information sought will be inadmissible at the trial if the

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<sup>1</sup> “Each regulated gas corporation shall ensure that its parent and any other affiliated entities ...” (emphasis added) (obligating regulated gas corporations to compliance with the affiliate rules 4 CSR 240-40.016(6)).

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information sought appears reasonably calculated to lead to the discovery of admissible evidence. The party seeking discovery shall bear the burden of establishing relevance.” Mo. Rules of Civ. Pro. The burden is with the Staff because they filed the motion to compel.

The Data Requests

The Staff in Data Request 117.1 indicated that the Companies response to Staff Data Request 117 revealed unexplained anomalies in the quantities of gas supplies provided by Atmos unregulated marketing affiliate Atmos Energy Marketing (AEM) to the Hannibal/Bowling Green service area. In Data Request 117.1, the request at issue here, the Staff sought documents related to the baseload supply acquired by AEM in three specific trades intended by AEM to provide flexible baseload service to Atmos’ LDC customers. Staff sought these documents it claims to explain the anomalies concluded by Staff in the quantities of gas supplies in these three trades.

In Staff Data Request 131.1, Staff requested AEM’s economic analysis of its sales obligation with Atmos LDC. Staff asserted that they need these documents to support their assessment of the fair market value of the gas supplies that AEM provided to Atmos LDC customers and for Staff to evaluate the integrity of Atmos’ bid process for those supplies.

Burden of Proof and Evidentiary Standards

For the Staff’s Motion to Compel to be granted, the Staff must establish relevance. Mo. Rules of Civ. Proc. 56(b)(1). Relevance has specific legal meaning, and it also must be considered in the appropriate legal context. In my opinion in Case No. EM-2007-0374, I provided a detailed primer on “relevance” which bears repeating here. “The law requires evidence to be both logically and **legally** relevant in order to be admissible. Evidence is logically relevant when it tends to prove or disprove a fact in issue or corroborates other relevant evidence which bears on the principle issue.<sup>2</sup> Even if logically relevant, the finder of fact has discretion to limit such evidence, or exclude it all together, if the fact-finder believes the evidence is not legally relevant.<sup>3</sup> Legal relevance refers to the probative value of the purported evidence outweighing its risks of unfair prejudice, confusion of issues, delay, waste of time or cumulativeness. Consequently, even logically relevant evidence may be

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<sup>2</sup> Footnotes omitted.

<sup>3</sup> Footnote omitted.

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excluded unless its benefits outweigh its costs.”<sup>4</sup> (emphasis in original) As to each DR at issue, in my opinion, the Staff failed to meet either relevance test.

It is undisputed that the transactions at issue occurred between a regulated gas corporation and an affiliate as set forth in the affiliate rules.<sup>5</sup> It is also undisputed that there are limits to the scope and reach of discovery. *See Mo. Rule Civ. Pro. 56.01*. The affiliate rules specifically dictate the evidentiary standards for affiliate transactions and limit what evidence may be sought under the authority of these rules. Therefore the determination of relevance, both legal and logical, is set forth by the affiliate rules.

Staff’s motion was made under the auspices of the affiliate rules. The affiliate rules’ specified purpose provides the bounds for relevancy and also serves as the standard for considering logical and legal relevance.

The basis for the affiliate rules is that when there are dealings between a regulated entity and its unregulated affiliate, an unfair advantage could be given to the unregulated affiliate by the regulated entity. The stated purpose of the affiliate rules are “to prevent regulated utilities from subsidizing their non-regulated operations.” In effect, the affiliate rules serve as a substitute for competition. The affiliate rules attempt to approximate an arm’s length transaction between a regulated entity (which the Commission regulates) and a non-regulated affiliate (which the Commission does not regulate). Compliance with the affiliate rules by the regulated entity thus make affiliate transactions capable of being viewed as occurring at arm’s length.

The proposition that a transaction occurring between a regulated entity and an affiliate, even in compliance with the affiliate rules, is incapable of occurring at arm’s length, sets up a construct where affiliate transactions can never be justified. This would make the rule a nullity. The Commission, by promulgating the affiliate rules, did not intend that transactions with affiliates be de facto prohibited, when the affiliate rules set out in great detail the manner in which such transactions are permitted.

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<sup>4</sup> Statement Responding to the “Statement in Dissent to Regulatory Law Judges’ Evidentiary Ruling and Objections to Procedural Irregularity.” *Case No. EM-2007-0374*, pgs. 2-3, May 16, 2008.

<sup>5</sup> References hereafter are to the “affiliate rule”, with any material differences between 4 CSR 240-40.015 Affiliate Transaction Rule and 4 CSR 240-40.016 Marketing Affiliates Transaction Rule noted as appropriate.

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No law prevents affiliate transactions; rather, Commission rules set out a process by which affiliate transactions may take place. To demonstrate compliance with the rules the regulated entity must meet the "Evidentiary Standards for Affiliate Transactions" set out at 40 CSR 240-40.016(4). The rules provide for a beginning and an end to these transactions, which allows regulated entities to move forward with new transactions. These standards, by which compliance is measured, are assumed to produce results which do not provide a financial advantage to an affiliate. 40 CSR 240-40.016(3). It would be absurd to interpret the affiliate rules to prohibit affiliate transactions.

Legal Analysis

Staff's purpose in seeking the disputed discovery was made clear in the October 20, 2010, oral argument:

[T]he staff is attempting to determine through its investigation of these transactions the fair market value of the gas supplies bought by AEM and to determine whether AEM's fair market value of gas supplies would be the same fair market value to the Atmos regulated LDC.

Tr. at p. 59, lines 12 – 16 (emphasis added). And,

In this 0708ACA (sic) case the Staff is trying to determine the prudence and reasonableness of Atmos gas purchasing transactions with its unregulated affiliate AEM. And to determine whether these purchases are prudent and reasonable, the Staff must determine the fair market value of gas supplies of the unregulated affiliate to determine whether that would be the same as fair market value of gas supplies to the LDC.

Tr. p. 57, lines 14 – 21 (emphasis added).

The relevant question is not whether the non-regulated AEM paid fair market value for the gas it bought. The relevant question is whether the Atmos regulated LDC paid fair market value for the gas it bought from AEM. Staff already has the information to make that determination, as indicated in the position statement it filed in this case on June 30, 2010:

It is staff's position that the rates charged by Atmos in its Butler and Hannibal service areas were NOT just and reasonable because the rates did not merely pass on the

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cost of the gas but included profits for Atmos' shareholders.

Position Statement at 1 (emphasis in the original). Further, Staff calculated the profit to be \$362,979 in total and asked that that amount be disallowed. *Id.* at 2. By subtracting the profit from the total amount paid to AEM by Atmos's regulated LDC, Staff knows exactly to the dollar the actual price of the gas paid for by the LDC. Staff can easily compare this amount to other information to which it has access in order to determine whether the regulated LDC paid fair market price for the gas. The position of Staff completely ignores the affiliate rules by advocating that Atmos should purchase gas from AEM not at a fair market price, nor at Atmos' fully distributed cost, but at AEM's cost. The fact that AEM may have made a profit on the sale is irrelevant to this inquiry under the affiliate rules. Non-affiliate providers of gas to Atmos' regulated LDC make a profit on their sales, and Staff does not object to that. It is unrealistic for Staff to assert that an affiliate should not make a profit as well.

Staff's real purpose, in my opinion, is to investigate whether there is an improper relationship between the non-regulated affiliate and the regulated entity, and they want the affiliate's records to prove this. To do so, Staff must pierce the "regulatory veil" between the two entities, because they are not authorized to investigate a non-regulated entity.<sup>6</sup> Staff wants the discovery under the auspices of the affiliate rules, but under the limited scope of the affiliate rules, Staff cannot use them to pierce that veil. Since Staff's investigation is not authorized by any law or rule of this Commission, the discovery it seeks is irrelevant.

If Staff wants to conduct a prudence evaluation, it can do so, but such an evaluation is different from a review under the affiliate rules, and has a different set of discovery parameters and evidentiary standards. Staff already has the information they need to determine fair market value for purposes of the affiliate rules. The discovery is irrelevant to the inquiry at issue, and I would have denied the Motion to Compel.

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<sup>6</sup> *Id.*

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**Southwestern Bell Telephone Company d/b/a AT&T Missouri's  
Petition for Compulsory Arbitration of Unresolved Issues for an  
Interconnection Agreement with Global Crossing Local Services,  
Inc. and Global Crossing Telemanagement, Inc.**

*File No. IO-2011-0057  
December 15, 2010*

**Telecommunications §46.** Missouri statute subjects interconnected voice over internet protocol traffic to the same charges as telecommunications services with an exception for information service providers.  
Missouri may govern access to dark fiber.

**Decision**

The Commission is deciding a petition for compulsory arbitration ("petition") of a telecommunications interconnection agreement ("agreement"). The parties to the agreement and this action are:

- Petitioner, Southwestern Bell Telephone Company d/b/a AT&T Missouri ("ATT"); and
- Respondents,
  - Global Crossing Telemanagement, Inc. ("Global Telemanagement"); and
  - Global Crossing Local Services, Inc. ("Global Local"); (together, "Global").

The Commission chooses between the parties' offers as follows.

<i>On the issue of:</i>	<i>the Commission adopts the offer of:</i>	<i>because:</i>
1. Intercarrier Compensation for Certain IP Traffic	Neither Party	Neither party's language sufficiently describes intercarrier compensation for interconnected VoIP within existing law.

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2: Dark Fiber Possession	ATT	ATT's proposed language provides non-discriminatory service.
3. Routine Network Maintenance	Global	Global's offer of undisputed language constitutes just and reasonable terms.

On each issue, language complying with the law's requirements as set forth below shall be part of the agreement. The Commission bases its decision on the law and facts as follows.

**I. Procedure**

The parties filed pleadings, statements and offers as follows. On August 27, 2010, AT&T filed the petition. On September 21, 2010, Global filed its response to the petition ("response"). The parties submitted final offers on September 27, 2010; jointly filed a revised statement of unresolved issues on September 28, 2010; and submitted subsequent final offers and jointly filed a final statement of unresolved issues on October 4, 2010.

The arbitrator convened the initial arbitration meeting on September 9, 2010; issued the procedural schedule on September 16, 2010; and convened the mark-up and pre-hearing conference ("conference") on October 5, 2010.

The parties waived hearing and other procedural formalities<sup>1</sup> as follows. On October 4, 2010, the parties filed *Joint Motion to Waive Cross-Examination and Cancel Hearing*, stipulating to a decision on pre-filed testimony. On October 5, 2010, the arbitrator issued an *Order Canceling Hearing, Allowing Late Filing and Allowing Entry into Record*. In that order, the arbitrator allowed ATT to file a discovery response from Global and enter it into the record as the parties stipulated at the conference. On October 8, 2010, ATT made that filing and entered Global's responses to data requests into the record.

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<sup>1</sup> Section 536.060, RSMo 2000.



The parties filed initial briefs as to Issue 1 on September 29, 2010, initial briefs as to Issues 2 and 3 on October 13, 2010. The filing of initial briefs “submitted [the case] for decision.”<sup>2</sup> The parties filed reply briefs on October 18, 2010.

Also on October 18, 2010, the “set time” for final post-offer negotiations, during which no draft report shall issue,<sup>3</sup> expired. On October 8, 2010, the arbitrator filed the draft report. The Commission received public comments as to the draft report from the parties on November 18, 2010. The Commission received no other public comments. On November 18, 2010, the time for filing public comments expired, and the case was ready for the arbitrator’s final report.

## **II. Generally as to All Issues**

Any interconnection agreement, negotiated or arbitrated, is subject to the Commission’s approval.<sup>4</sup> The filing of the petition vested jurisdiction to arbitrate the agreement in the Commission.<sup>5</sup> The Commission’s regulation gives the parties the right to an evidentiary hearing<sup>6</sup> so the arbitrator conducted this action as a contested case.<sup>7</sup>

### **A. Summary**

The Commission’s decision addresses only the issues as set forth in the parties’ pleadings, statements and offers.<sup>8</sup>

### **B. Facts**

1. An entity that transmits telephone communication service (“traffic”) is a carrier. Carriers transmit switched traffic on a set of transmission facilities called the Public Switched Telephone Network (“PSTN”).<sup>9</sup> Within the PSTN, the geographical area of service that has historically delineated basic service from long distance and toll service is a local exchange.<sup>10</sup>

2. A carrier that serves a local exchange is a local exchange carrier (“LEC”). A LEC that served a local exchange on December 31,

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<sup>2</sup> 4 CSR 240-36.040(23).

<sup>3</sup> 4 CSR 240-36.040(5)(C).

<sup>4</sup> 47 USC Section 252(e)(1).

<sup>5</sup> Section 386.230, RSMo 2000; 4 CSR 240-36.040(2); 47 USC Section 252(a)(2)(B)1.

<sup>6</sup> 4 CSR 240-36.040(10).

<sup>7</sup> Section 536.010(4), RSMo Supp. 2009.

<sup>8</sup> 47 USC Section 252(b)(4); 4 CSR 240-36.040(11).

<sup>9</sup> Traffic that does not go through a public switch, like traffic through a private line or other dedicated service, is called unswitched traffic (even though it may go through a private switch), and is not at issue.

<sup>10</sup> Provisions of law may organize more than one exchange into a local calling scope, treating such exchanges as a single exchange for billing purposes.

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1995, is an incumbent LEC ("ILEC"). A LEC that serves or seeks to serve a local exchange already served by an ILEC, is a competitive LEC ("CLEC").

3. Global is a CLEC. ATT is an ILEC. ATT and Global intend to send traffic through each others' facilities, which require interconnection, which requires an agreement.

C. Law

The Commission instructs the arbitrator that:

. . . in resolving these issues, the arbitrator shall ensure that such resolution meets the requirements of the Act [<sup>11</sup>]

The Act is 47 USC Sections 251 and 252 as enacted in the Telecommunications Act of 1996, under which ATT must allow access to its network:

. . . on rates, terms, and conditions that are just, reasonable, and nondiscriminatory [<sup>12</sup>]

Those standards generally determine the facts relevant to the issues.

As to the burden of proof, Global cites a sister-state commission order,<sup>13</sup> concluding that the burden of proof is on the party whose facilities are at issue, and ATT does not dispute the matter. The Commission concludes that ATT has the burden of proof. The Commission has considered each party's allegations and evidence on the whole record, and the Commission's findings of fact reflect the Commission's determinations of credibility.

The Commission's regulations direct the arbitrator to use final offer arbitration. Because the parties did not agree to an "entire package"<sup>14</sup> resolution, the arbitrator must use "issue-by-issue" resolution.

<sup>15</sup> Issue-by-issue resolution requires the arbitrator to:

. . . select the position of one of the parties as the arbitrator's decision on that issue [<sup>16</sup>]

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<sup>11</sup> 4 CSR 240-36.040(11).

<sup>12</sup> 47 USC Sections 252(b)(4)c and (c)1; and 251(e)(2)B; and (c)(2)(d).

<sup>13</sup> *AT&T Communications of the Midwest, Inc.*, Docket No. P-442,407/M-96-939 (Dec. 12, 1996) (order resolving arbitration issues and opening cost proceedings) slip order at 5.

<sup>14</sup> 4 CSR 240-36.040(5)(A).

<sup>15</sup> 4 CSR 240-36.040(5).

<sup>16</sup> 4 CSR 240-36.040(19).

except in the circumstances discussed in part C.1 below. In making the decision, the Commission has considered each party's theories and authorities. The Commission's conclusions of law reflect the Commission's resolution of conflicting arguments.

The arbitrator's draft report included a concise summary of each issue resolved by the arbitrator and a reasoned articulation of the basis for the decision on each issue. Such draft report also set forth how the decision meets the standards set in 47 USC Sections 251 and 252 ("the Act"). The arbitrator's final report included a statement of findings and conclusions on all the material issues of fact, law or discretion presented on the record. The arbitrator's final report also set forth the reasons or basis therefore.

The Commission's decision contains no discourse upon matters that are not determinative of the issues.

### **III. Specific Issues**

The issues remaining for the Commission's decision are three: intercarrier compensation for certain Internet Protocol format ("IP") traffic, dark fiber possession, and routine network maintenance.

#### **1. Intercarrier Compensation for Certain IP Traffic**

The issue is how ATT and Global shall bill one another ("intercarrier compensation") for traffic over the Public Switched Telephone Network ("PSTN") that uses IP at some point in such traffic ("IP traffic").

##### **A. Summary**

Generally, IP traffic is subject to the same charges as any other PSTN traffic—reciprocal compensation charges within a local calling area; or switched access charges between local calling areas—with certain exceptions. Neither party's offer follows that general principle and its exceptions. ATT argues that switched access charges apply to most of Global's proposed IP traffic. Global argues that only reciprocal compensation charges apply to IP traffic, if any charge applies at all. Therefore, the Commission adopts an alternative not set forth in either party's offer.

##### **B. Facts**

1. Carriers that own facilities may charge other carriers to use to such facilities generally as follows. If such use has both its origin and destination within the same local exchange, a reciprocal compensation charge applies. If such use has either its origin or its destination outside the local exchange, a switched access charge—also known as an exchange access charge—applies. Reciprocal compensation and

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switched access charges generally constitute<sup>17</sup> the methods of intercarrier compensation.

2. Any traffic may change format during its travels on the PSTN. Traffic that changes to IP, but has changed back when it reaches its destination, is IP-in-the-middle, which the parties treat like any other PSTN traffic.

3. Traffic that includes more than basic service, like computer processing, is information service ("IS"). A provider of direct access to the Internet is an internet service provider ("ISP"). ISPs generally transmit IS in IP.

4. IP is also useable for voice communications. IP may be present at different stages of voice traffic over the PSTN. Such use constitutes one example of Voice over Internet Protocol ("VoIP"). VoIP, when traveling over PSTN facilities, is interconnected VoIP traffic ("IVoIP").

5. IVoIP appears to the end user to be ordinary telephone service because it uses traditional telephone handsets, connects with PSTN, and reaches any other end user connected to the PSTN, including other IVoIP users, cell phone users or traditional land-line users. IVoIP may be geographically identifiable as to its points of origin and termination. IVoIP for which either the origin or destination is moveable and not geographically identifiable is nomadic.

#### C. Law

The Commission must apply existing law to the parties' offers as best it can, even where the federal government has not yet clarified the existing law.<sup>18</sup> Existing law includes Section 392.550.2, RSMo Supp. 2009,<sup>19</sup> ("the Missouri statute") which provides that:

Interconnected VoIP traffic shall be subject to appropriate exchange access charges to the same extent that telecommunications services are subject to such charges.

That language generally applies switched access charges to interconnected VoIP like any other switched traffic.

Exceptions are few. The Missouri statute does not apply to switched traffic that constitutes:

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<sup>17</sup> A third type of charge, called bill-and-keep, is not at issue.

<sup>18</sup> *UTEX Communications Corp.*, 24 F.C.C. 12573, 12577-78 (2009).

<sup>19</sup> RSMo Supp. 2009.

. . . commerce among the several states of this union, except insofar as the same may be permitted under the provisions of the Constitution of the United States and the acts of Congress.<sup>[20]</sup>

Generally, that provision and the federal impossibility doctrine exclude nomadic VoIP from switched access charges. Also, existing federal law provides an exception related to IS from intercarrier compensation (“IS exception”).

The parties’ final offers summarize their arguments and provide (disputed language in bold, ATT’s underlined, Global’s italicized) as follows:

6.14.1 For purposes of this Agreement only, Switched Access Traffic shall mean all traffic that originates from an End User physically located in one (1) local exchange and delivered for termination to an End User physically located in a different local exchange (excluding traffic from exchanges sharing a common mandatory local calling area as defined in AT&T-22STATE’s local exchange tariffs on file with the applicable state commission) **including, without limitation, any traffic that originates/terminates over a Party’s circuit switch, including traffic from a service that (i) terminates/originates over a circuit switch and uses Internet Protocol (IP) transport technology (regardless of how many providers are involved in providing IP transport) and/or (ii) terminates to/originates from the End User’s premises in IP format, except that Switched Access Traffic shall not include any traffic that originates and/or terminates at the End User’s**

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<sup>20</sup> Section 386.030, RSMo 2000.

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***premises in Internet Protocol format.***

Notwithstanding anything to the contrary in this Agreement, all Switched Access Traffic shall be delivered to the terminating Party over feature group access trunks per the terminating Party's access tariff(s) and shall be subject to applicable intrastate and interstate switched access charges. However, in states where applicable law provides, such compensation shall not exceed the compensation contained in the respective AT&T-22STATE tariff in whose exchange area the End User is located, provided, however, the following categories of Switched Access Traffic are not subject to the above stated requirement relating to routing over feature group access trunks[.]

In support of their respective positions, the parties read the law expansively, but inaccurately, and so err as to the IS exception, fixed location VoIP, and nomadic VoIP.

i. IS Exception

Global argues that the Missouri statute does not apply to any VoIP traffic. Global argues that Missouri law is not among the standards under which the Commission decides the petition for arbitration. But the Commission must apply existing law,<sup>21</sup> which includes the Missouri statute. The Commission has no authority to declare the Missouri statute invalid,<sup>22</sup> and Global cites no authority expressly invalidating or pre-empting the Missouri statute.

*a. Global's Arguments*

Instead, Global emphasizes its character as a wholesaler and the mutually exclusive classifications of IS and telecommunications services. The IS/telecommunications services distinction is older than the Act, from a time when the term for IS was ES, for enhanced service. Global's premise is that whether switched access charges apply depends on whether VoIP constitutes IS or telecommunications services.

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<sup>21</sup> *UTEX Communications Corp.*, 24 F.C.C. 12573, 12577-78 (2009).

<sup>22</sup> *State Tax Comm'n v. Administrative Hearing Comm'n*, 641 S.W.2d 69 (Mo. banc 1982).

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It is true—as the parties agree—that IP-in-the-middle is subject to switched access charges,<sup>23</sup> as the Missouri statute provides, because it constitutes a telecommunications service and not IS.<sup>24</sup> It is also true that IP-in-the-middle, by definition, ends in the same format as it starts. Global argues the reverse: that starting and ending in different formats (“net conversion”) equals IS.

Global cites *PAETEC Communications, Inc. v. CommPartners, LLC*,<sup>25</sup> which discussed a position issue similar to Global’s, which is that (1) origination and:

. . . termination of VoIP-originated calls is an “information service” exempt from access charges; and (2) that access charges cannot apply to VoIP-originated calls because “reciprocal compensation” applies instead.<sup>[26]</sup>

The court cited a holding in *Southwestern Bell Telephone, L.P. v. Missouri Public Service Comm’n*.<sup>27</sup>

. . . “[n]et-protocol conversion is a determinative indicator of whether a service is an enhanced or information service.”<sup>[28]</sup>

The *PAETEC* court found persuasive the authorities holding:

. . . that transmissions which include net format conversion from VoIP to TDM are information services exempt from access charges.<sup>[29]</sup>

Global argues that switched access charges cannot apply under that authority,

Global’s authorities provide the following. All conversion to IP is IS, and neither the courts nor the Federal Communications Commission (“F.C.C.”) have ever ruled that VoIP is not IS. IS, even when travelling

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<sup>23</sup> *In the matter of Petition for Declaratory Ruling that AT&T’s Phone-to-Phone IP Telephony Services are Exempt from Access Charges*, 19 F.C.C.R. 7457, 7465 (2004).

<sup>24</sup> *Id.*

<sup>25</sup> Civil Action No. 08-0397 (JR), 2010 WL 1767193, (D.D.C., Feb. 18, 2010).

<sup>26</sup> *PAETEC*, 2010 WL 1767193 at 2.

<sup>27</sup> 461 F.Supp.2d 1055, 1081 (E.D. Mo., 2006).

<sup>28</sup> *Id.*, (citations omitted).

<sup>29</sup> *PAETEC*, 2010 WL 1767193 at 3.

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over the PSTN, does not become telecommunications service.<sup>30</sup> All IS is exempt from access charges. Therefore, all conversion to IP is exempt from switched access charges, under Global's authorities.

But Global's authorities are incomplete. Federal authorities have not stated that VoIP is not IS because it doesn't matter for the IS exception. The IS exception does not classify services, it classifies companies.

*b. ATT's Arguments*

ATT's authorities show that the IS exception is both more and less than Global's authorities describe: more because there is a provision of law missing from Global's authorities; less because the missing provision narrows the IS exception. The missing provision is that the IS exception belongs only to ISPs.

The IS exception is a rule of the F.C.C. that pre-dates the Act.<sup>31</sup> It began as an exception for ESPs,<sup>32</sup> and survived the Act as an exception for ESPs, re-named ISPs.<sup>33</sup> The IS exception addresses the classification, not of service, but of carriers. An ISP would be just another carrier subject to switched access charges but for the IS exception, which classifies ISPs as end users. End users are not subject to switched access charges.

As ATT notes, the *Southwestern Bell Telephone, L.P.* and *PAETEC* courts overlooked their own description of the IS exception. As the court in *Southwestern Bell Telephone, L.P.* stated, the ISP exception simply:

. . . classifies enhanced service providers ("ESPs") as end users of telecommunications service. Because only "carriers" are subject to access charges, being an "end user" means that ESPs do not pay those charges. ESPs' status as end users places them outside the access charge regime "even

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<sup>30</sup> Citing *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967, 988-990 (2005).

<sup>31</sup> *MTS and WATS Market Structure*, 97 FCC 2d 682, 711-22 (1983).

<sup>32</sup> *Amendment of Section 64.702 of the Commission's Rules and Regulations*, 77 FCC 2d 384, 419-20 (1980).

<sup>33</sup> *In re Access Charge Reform*, 12 FCC Rcd. 15982, 16131-33 (1997).



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for calls that appear to traverse state boundaries.”<sup>34</sup>

Global does not claim to be, and is not, an ISP.

ATT cites *In re Time Warner Cable*,<sup>35</sup> to show that wholesaling IS does not make Global an ISP. That order also shows that interconnection rights in general—and intercarrier compensation in particular—depend on neither the wholesale/retail distinction, nor the IS/telecommunications distinction. In *Time Warner Cable*, the F.C.C. stated:

14. [W]e make clear that the rights of telecommunications carriers under sections 251 (a) and (b) apply regardless of whether the telecommunications services are wholesale or retail [.]

\* \* \*

15. [W]e clarify that the statutory classification of a third-party provider's VoIP service as [IS] or a telecommunications service is irrelevant to the issue of whether a wholesale provider of telecommunications may seek interconnection under section 251(a) and (b). . . . We thus reject the arguments that the regulatory status of VoIP is the underlying issue in this matter[.]

16. Finally, we emphasize that our ruling today is limited to telecommunications carriers that provide wholesale telecommunications service and that seek interconnection *in their own right* for the purpose of transmitting traffic to or from another service provider.

\* \* \*

17. Certain commenters ask us to reach other issues, including the application of

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<sup>34</sup> 461 F. Supp. 2d at 1081.

<sup>35</sup> 22 FCC Rcd. 3513 (2007).

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section 251(b)(5) and the classification of VoIP services. We do not find it appropriate or necessary here to resolve the complex issues surrounding the interpretation of Title II more generally or the subsections of section 251 more specifically that the Commission is currently addressing elsewhere on more comprehensive records. For example, the question concerning the proper statutory classification of VoIP remains pending in the *IP-Enabled Services* docket [<sup>36</sup>]

Thus, the F.C.C. remains silent on VoIP's classification expressly because it is irrelevant to the IS exception. The IS exception applies when an ISP provides service. When Global provides service to an ISP, the IS exception does not apply.

Finally, the FCC expressly refrained from determining a state's intercarrier compensation regime:

In the particular wholesale/retail provider relationship described by Time Warner in the instant petition, the wholesale telecommunications carriers have assumed responsibility for compensating the incumbent LEC for the termination of traffic under a section 251 arrangement between those two parties. We make such an arrangement an explicit condition to the section 251 rights provided herein. We do not, however, prejudge the [state] Commission's determination of what compensation is appropriate, or any other issues pending in the *Inter-carrier Compensation* docket. [<sup>37</sup>]

Under that language, intercarrier compensation is subject to determination by the relevant state jurisdiction.

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<sup>36</sup> *Id.* at 3520-23 (2007) (footnotes omitted).

<sup>37</sup> *Id.* at 3523 (footnotes omitted).

*ii. Reciprocal Charges for IVolP*

The Missouri statute provides that switched access charges apply to IVolP traffic. Global argues, in the alternative to its-IP-equals-IS-exception theory, that VolP is subject only to reciprocal compensation charges. In support, Global cites Section 251 of the Act.

(b) Each local exchange carrier has the following duties:

\* \* \*

(5) Reciprocal compensation

The duty to establish reciprocal compensation arrangements for the transport and termination of telecommunications.

But that provision does not require reciprocal communications charges to apply to any particular traffic. ATT also cites Section 251 of the Act's requirement to provide:

(g) . . . access and nondiscriminatory interconnection restrictions and obligations (including receipt of compensation) that apply to such carrier on the date immediately preceding February 8, 1996, under any court order, consent decree, or regulation, order, or policy of the Commission, until such restrictions and obligations are explicitly superseded by regulations prescribed by the Commission after February 8, 1996. During the period beginning on February 8, 1996, and until such restrictions and obligations are so superseded, such restrictions and obligations shall be enforceable in the same manner as regulations of the Commission.

As stated in the *Time-Warner Cable* decision, the FCC has left the applicable type of interconnection compensation to the state having jurisdiction over the traffic.

*iii. Fixed Location and Nomadic*

The issue of jurisdiction also finds some resolution in FCC decisions. Both parties cite *Vonage Holdings Corporation*,<sup>38</sup> Global to show that no IP is subject to state jurisdiction, and ATT to show that some IP is within state jurisdiction. ATT's reading is correct. The jurisdiction of a state and the F.C.C. depend on the traffic's geographic points of origination and destination under the Act:<sup>39</sup>

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<sup>38</sup> 19 F.C.C.R. 22404, 22412-13 (2004).

<sup>39</sup> *Id.*

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16. . . . In section 2(a) of the Act, Congress has given the [F.C.C.] exclusive jurisdiction over “all interstate and foreign communication” and “all persons engaged ... in such communication.” Section 2(b) of the Act reserves to the states jurisdiction “with respect to intrastate communication service ... of any carrier.”

17. In applying section 2 to specific services and facilities, the [F.C.C.] has traditionally applied its so-called “end-to-end analysis” based on the physical end points of the communication. Under this analysis, the [F.C.C.] considers the “continuous path of communications,” beginning with the end point at the inception of a communication to the end point at its completion, and has rejected attempts to divide communications at any intermediate points. Using an end-to-end approach, when the end points of a carrier's service are within the boundaries of a single state the service is deemed a purely intrastate service, subject to state jurisdiction for determining appropriate regulations to govern such service. When a service's end points are in different states or between a state and a point outside the United States, the service is deemed a purely interstate service subject to the [F.C.C.]'s exclusive jurisdiction. Services that are capable of communications both between intrastate end points and between interstate end points are deemed to be “mixed-use” or “jurisdictionally mixed” services. Mixed-use services are generally subject to dual federal/state jurisdiction, except

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where it is impossible or impractical to separate the service's intrastate from interstate components and the state regulation of the intrastate component interferes with valid federal rules or policies. In such circumstances, the [F.C.C.] may exercise its authority to preempt inconsistent state regulations that thwart federal objectives, treating jurisdictionally mixed services as interstate with respect to the preempted regulations.

That distinction applies (as in *Time-Warner Cable*) whether IP traffic constitutes IS or telecommunications.<sup>40</sup> The "impossibility exception"<sup>41</sup> controls the application of the Missouri statute under federal<sup>42</sup> and Missouri<sup>43</sup> law.

The state having jurisdiction over the traffic is generally determinable for fixed location VoIP. If fixed location VoIP does not "constitute commerce among the several states of this union,"<sup>44</sup> and Missouri otherwise has jurisdiction over such traffic, the Missouri statute applies. Therefore, fixed location VoIP is subject to the Missouri statute when it demonstrably originates and terminates in Missouri.

But whether the Missouri statute applies to nomadic VoIP traffic is generally impossible to prove. That is because nomadic VoIP traffic is generally, by definition, not subject to the geographic ascertainment necessary to separate the interstate and intrastate components and prove that such traffic is within any state's jurisdiction. That is not a problem in the agreement, ATT argues, so the Commission can order a blanket application of switched access charges to all VoIP traffic because Global can:

. . . identify the geographic location of its retail VoIP services customer when the customer places a call. It does so by account and originating ANI. [<sup>45</sup>]

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<sup>40</sup> *Vonage Holdings Corp.* at 22416-17.

<sup>41</sup> *Id.* at 22415.

<sup>42</sup> U.S. Const., Art. I, Section 8, clause 3 (the Commerce Clause).

<sup>43</sup> Section 386.030, RSMo 2000.

<sup>44</sup> *Id.*

<sup>45</sup> [ATT]'s *Entry of Discovery Responses into the Record*, Attachment A, paragraph 5.

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But ATT has not shown that Global's retail services customers constitute all of its prospective VoIP traffic, so no such blanket order is possible. Nor is it necessary: when it is impossible to determine that traffic is Missouri intrastate traffic, the Missouri statute cannot apply.<sup>46</sup>

*iv. Resolution*

The Commission has described the existing law regarding switched access charges, which finds no full reflection in parties' final offers. The final offer of one party over the other party generally constitutes the arbitrator's recommendation, but the Commission's regulation generally assumes that all parties' offers will:

Meet the requirements of section 251 of the Act, including the rules prescribed by the commission and the Federal Communications Commission pursuant to that section [<sup>47</sup>]

But, if the result of recommending an offer:

. . . would be clearly unreasonable or contrary to the public interest [<sup>48</sup>]

the Commission directs the arbitrator to make a recommendation in an alternative fashion by:

. . . adopting a result not submitted by any party that is consistent with the requirements of section 252(c) of the Act, and the rules prescribed by the commission and the Federal Communications Commission pursuant to that section. [<sup>49</sup>]

Under that standard, the Commission adopts neither party's disputed language and imposes clearer language in lieu of the disputed language as follows.

Consistent with Missouri law, interconnected voice over Internet protocol traffic that is not within one local exchange is subject to access charges as is any other switched traffic, regardless of format.

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<sup>46</sup> *Vonage Holdings Corp.*, 19 F.C.C.R. 22404, 22406 (2004).

<sup>47</sup> 4 CSR 240-36.040(5)(D)1.

<sup>48</sup> 4 CSR 240-36.040(19).

<sup>49</sup> 4 CSR 240-36.040(5)(E).

## 2. Dark Fiber Possession

Among the facilities that ILECs must make available to CLECs is dark fiber: a line, not yet in use, but ready to carry a telecommunications signal.

### A. Summary

As to dark fiber, the parties dispute two related matters.

- o Global seeks the right to possess all ATT's available dark fiber indefinitely.
- o ATT seeks to limit Global to 25% of available dark fiber and to retain the right to repossess amounts unused after two years.

The problem is that, if Global possesses dark fiber, no other CLECs and ATT can use it, even if Global never uses it.

### B. Facts

1. ATT's services include sending telecommunications signals by pulses of light through optical fiber ("fiber"). Dark fiber is fiber useable but not yet in use. ATT owns dark fiber, but dark fiber is a limited resource, and is not available throughout ATT's network.

2. For a CLEC to connect to dark fiber of an ILEC, the ILEC extends dark fiber to the CLEC, and the CLEC must connect to such extension. If one CLEC connects to ("possesses") any amount of dark fiber, such amount is unavailable to any other CLEC and the ILEC that owns it. Limiting the amount of dark fiber that any one CLEC may possess allows other CLECs, and the ILEC, a chance to possess the remainder.

3. ATT's certificate of public convenience and necessity<sup>50</sup> requires it to serve any customer, a status known as "carrier of last resort."

4. Under ATT's proposed contract language, any CLEC may possess 25 percent of dark fiber available. Available dark fiber means dark fiber not possessed by another carrier

5. Under ATT's proposed contract language, the LEC with the greatest initiative may possess the largest amount of dark fiber compared to any others, but such other CLECs and the ILEC may still compete and serve their customers.

6. ATT has several data bases that inventory, and track the use of, dark fiber and allocate its use among possessors.

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<sup>50</sup> Most carriers do business in Missouri under a "certificate of service authority," but the regulation of ATT's business in Missouri goes back to a regime set forth in 1879 statutes.

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7. Global has never ordered dark fiber from ATT, nor from any ILEC related to ATT.

C. Law

ATT must allow Global access to its facilities under federal law:

[E]ach [ILEC] has the following duties:

\* \* \*

(3) The duty to provide, to any requesting telecommunications carrier for the provision of a telecommunications service, nondiscriminatory access to network elements on an unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory in accordance with the terms and conditions of the agreement and the requirements of this section and section 252 of this title. An incumbent local exchange carrier shall provide such unbundled network elements in a manner that allows requesting carriers to combine such elements in order to provide such telecommunications service. <sup>[51]</sup>

Unbundled network elements (“UNEs”) include dark fiber. <sup>52</sup> As to whether any limitation of amount or time should restrain Global’s possession of ATT’s dark fiber, the scenarios are plain.

If any CLEC possesses all an ILEC’s dark fiber, such possession excludes all other CLECs and the ILEC from access to such fiber. That scenario assuredly burdens such other CLECs and the ILEC.

The F.C.C. has permitted limitations on dark fiber possession in similar circumstances as follows:

In addition, [parties to the action] argue that requiring incumbent LECs to unbundle fiber will reduce their incentive

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<sup>51</sup> Section 251(c)(3).

<sup>52</sup> *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 16 F.C.C. 1724, paragraph 326 (1999) (*Third Report and Order and Fourth Notice of Proposed Rulemaking*) (“UNE remand order”).



to build fiber loops in the first place. We remain skeptical that this is the case, because incumbents face loop unbundling obligations no matter which technology they deploy. We note, however, that the Texas commission has already established moderate restrictions governing the availability dark fiber. We do not wish to disturb the reasonable limitations and technical parameters for dark fiber unbundling that Texas or other states may have in place. If incumbent LECs are able to demonstrate to the state commission that unlimited access to unbundled dark fiber threatens their ability to provide service as a carrier of last resort, state commissions retain the flexibility to establish reasonable limitations governing access to dark fiber loops in their states.<sup>[53]</sup>

Global argues that, under that language, ATT must show impairment of its duties as carrier of last resort. ATT argues that, in context, the factors that the F.C.C. lists are sufficient, but not necessary, support for reasonable regulation of dark fiber possession. ATT is correct.

Global offers no policy support for its scheme and the Commission can find none. The only advantage possible is to Global. Possession of dark fiber allows Global to sublease it to competitors.

But if a CLEC can possess only a limited amount of available dark fiber, and must use it or lose it in a reasonable time, other CLECs and the ILEC can have access to dark fiber. ATT argues that the amount and duration of dark fiber possession are legitimate concerns that support reasonable limitations, and that such reasonable limitations include those set forth in ATT's proposed contract language. Global argues that ATT's language does not follow any F.C.C. regulation, but ATT's language does follow F.C.C. authority.

ATT cites an F.C.C. regulation reiterating the federal statutory requirement of just, reasonable, and nondiscriminatory terms and

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<sup>53</sup> *Id.* at paragraph 199 (footnote omitted).

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conditions.<sup>54</sup> ATT also cites an F.C.C. decision, which describes the ATT's arguments as "legitimate concerns" as follows:

[T]he Texas Commission allows incumbent LECs, upon establishing need to the satisfaction of the state commission, to revoke leased fiber from competitive LECs with 12 months notice. The Texas commission's dark fiber unbundling rules also allow incumbent LECs to take back underused (less than OC-12) fiber, and forbid competitors in any two year period from leasing more than 25% of the dark fiber in a given segment of the network. We believe the measures established by the Texas PUC address the incumbent LEC's legitimate concerns. [<sup>55</sup>]

Further, in that same decision, the F.C.C. allows:

State commissions . . . to establish reasonable limits governing access to dark fiber if incumbent LECs can show that they need to maintain fiber reserves. [<sup>56</sup>]

That language describes a regulatory remedy, and the parties cite no corresponding provision in the Commission's regulations, but ATT has shown the need for such provisions by evidence of record.

ATT submits the following language:

10.4.3. CLEC will not obtain any more than twenty-five (25%) percent of the spare UNE Dedicated Transport Dark Fiber contained in the requested segment during any two-year period.

10.7.2. Should CLEC not utilize the fiber strand(s) subscribed to within the twelve (12) month period following the date AT&T-21STATE provided the fiber(s),

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<sup>54</sup> 47 CFR Section 51.307(a).

<sup>55</sup> UNE remand order at 3696, fn. 694.

<sup>56</sup> *Id.*, part II, fourth paragraph, seventh bullet point.

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AT&T-21STATE may revoke CLEC's access to the UNE Dedicated Transport Dark Fiber and recover those fiber facilities and return them to AT&T-21STATE's inventory.

That language is similar to language that the Commission adopted in a previous decision.<sup>57</sup> Global submits no proposed contract language for this issue.

Global cites no authority to the contrary, and has shown no grounds for a different conclusion on this record. Global has shown no prejudice from ATT's language and the Commission concludes that there is none, especially because Global has never sought dark fiber possession from ATT. Therefore, the Commission concludes that existing law supports ATT's position.

The Commission concludes that ATT's proposed language constitutes "terms and conditions that are just, reasonable, and nondiscriminatory [<sup>58</sup>]" so the Commission decides Issue 2 by adopting ATT's proposed language.

### 3. Routine Network Modifications

Issue 3 relates to Routine Network Modifications ("RNMs"), which describes certain materials and labor.

#### A. Summary

The parties have partly resolved Issue 3. Since the beginning of this action, the parties have agreed that Global should pay for RNMs not already included in ATT's access charges. Until the conference, Global denied that there were any RNMs not already included in ATT's access charges. At the conference, Global stated that it no longer disputes that matter. Nevertheless, the parties still disagree as to the language that best describes the coverage of RNMs.

#### B. Facts

1. RNMs are materials and labor required to bring Global's signal up to industry standards. RNMs include a repeater, a device that regenerates a voice signal to amplify it up to industry standards. Those devices are not useful for providing advanced service.

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<sup>57</sup> *Southwestern Bell Telephone, L.P., d/b/a SBC Missouri's Petition for Compulsory Arbitration of Unresolved Issues for a Successful Interconnection Agreement to the Missouri 271 Agreement ("M2A")*, Case No. TO-2005-0336 (June 21, 2005) *Final Arbitrator's Report, Att. III.A, Part 6, Detailed Language Decision Matrix, CLEC Coalition Issue 27 (Section 5.4.6.2), aff'd in pertinent part*, Arbitration Order, July 11, 2005.

<sup>58</sup> 47 USC Sections 252(b)(4)c and (c)1; and 251(e)(2)B and (c)(2)(d).

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2. For accountancy purposes, repeaters and associated devices are capital items, not operating expenses. Nevertheless, ATT's charges do not factor in repeaters and associated devices. That is because ATT's charges include only costs expected in the future, and future capital items will not include repeaters.

3. The procedures of individual case basis ("ICB") and Special Construction ("SC") process are telecommunications industry standards for determining the cost of various matters including RNMs. The agreement specifies ICB or SC for certain matters and includes specific prices for others.

C. Law

ATT proposes the following bolded language:

11.1.7 AT&T-22STATE shall provide RNM at the rates, terms and conditions set forth in this Attachment and in the Pricing Schedule or at rates to be determined on an individual case basis (ICB) or through the Special Construction (SC) process; provided, however, that AT&T-22STATE will impose charges for RNM only in instances where such charges are not included in any costs already recovered through existing, applicable recurring and non-recurring charges. **The Parties agree that the RNM for which AT&T-22STATE is not recovering costs in existing recurring and non-recurring charges, and for which costs will be imposed on CLEC as an ICB/SC include, but are not limited to: (i) adding an equipment case, (ii) adding a doubler or repeater including associated line card(s), and (iii) installing a repeater shelf, and any other necessary work and parts associated with a repeater shelf.**

Global submits no proposed contract language of its own for this issue but argues that the disputed language introduces more vagueness than clarity.

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Global is correct. The named items no longer add clarity since Global ceased to deny, and the Commission has found, that none are included in ATT's recurring and non-recurring charges. Also, by naming items for ICB/SC "without limitation," ATT calls into question the Pricing Schedule.

The Commission concludes that the disputed language derogates the agreement's other "terms and conditions that are just, reasonable, and nondiscriminatory [<sup>59</sup>]" so the Commission decides Issue 3 by adopting neither party's disputed language and imposes only the undisputed language.

**IV. Order**

The Commission resolves the issues by adopting the following language for the agreement.

1. Intercarrier Compensation for Certain IP Traffic

6.14.1. For purposes of this Agreement only, Switched Access Traffic shall mean all traffic that originates from an End User physically located in one (1) local exchange and delivered for termination to an End User physically located in a different local exchange (excluding traffic from exchanges sharing a common mandatory local calling area as defined in AT&T-22STATE's local exchange tariffs on file with the applicable state commission). Consistent with Missouri law, interconnected voice over Internet protocol traffic that is not within one local exchange is subject to access charges as is any other switched traffic, regardless of format. Notwithstanding anything to the contrary in this Agreement, all Switched Access Traffic shall be delivered to the terminating Party over feature group access trunks per the terminating Party's access tariff(s) and shall be subject to

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<sup>59</sup> 47 USC Sections 252(b)(4)c and (c)1; and 251(e)(2)B and (c)(2)(d).

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applicable intrastate and interstate switched access charges. However, in states where applicable law provides, such compensation shall not exceed the compensation contained in the respective AT&T-22STATE tariff in whose exchange area the End User is located, provided, however, the following categories of Switched Access Traffic are not subject to the above stated requirement relating to routing over feature group access trunks[.]

2. Dark Fiber Possession

10.4.3. CLEC will not obtain any more than twenty-five (25%) percent of the spare UNE Dedicated Transport Dark Fiber contained in the requested segment during any two-year period.

10.7.2. Should CLEC not utilize the fiber strand(s) subscribed to within the twelve (12) month period following the date AT&T-21STATE provided the fiber(s), AT&T-21STATE may revoke CLEC's access to the UNE Dedicated Transport Dark Fiber and recover those fiber facilities and return them to AT&T-21STATE's inventory.

3. Routine Maintenance Equipment

11.1.7. AT&T-22STATE shall provide RNM at the rates, terms and conditions set forth in this Attachment and in the Pricing Schedule or at rates to be determined on an individual case basis (ICB) or through the Special Construction (SC) process; provided, however, that AT&T-22STATE will impose charges for RNM only in instances where such charges are not included in any costs already recovered

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through existing, applicable recurring  
and non-recurring charges.

Clayton, Chm., Davis, Jarrett, Gunn,  
and Kenney, CC., concur.

Jordan, Senior Regulatory Law Judge

\*NOTE: See page 118 for another order in this case.

**V. Appendix: Appearances**

For petitioner.

Southwestern Bell Telephone Company d/b/a AT&T Missouri:

Jeffrey E. Lewis,  
Leo J. Bub, and  
Robert Gryzmala,  
One AT&T Center, Room 3518,  
St. Louis MO 63101.

For respondents.

Global Crossing Local Services, Inc. and  
Global Crossing Telemangement Inc.:

Mark Johnson and  
Lisa Gilbreath, with  
Sonnenschein, Nath & Rosenthal,  
4520 Main Street Suite 1100  
Kansas City MO 64111.

R. Edward Price, Senior Counsel with  
Global Crossing Local Services, Inc. and  
Global Crossing Telemangement Inc.  
225 Kenneth Drive  
Rochester, NY 14623.

For the Missouri Public Service Commission.

Arbitrator: Daniel Jordan, Senior Regulatory Law Judge.  
Arbitrator's Advisory Staff:

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Colleen M. Dale, Senior Staff Counsel.  
William Voight, Supervisor, Rates and Tariffs.  
Myron Couch, Utility Operations Technical Specialist II.  
Dana Parish, Utility Policy Analyst.

**In the Matter of KCP&L Greater Missouri Operations Company for Authority to Implement Rate Adjustments Required by 4 CSR 240-20.090(4) and the Company's Approved Fuel and Purchased Power Cost Recovery Mechanism**

*File No. EO-2008-0216  
Decided December 22, 2010*

**Evidence, Practice, And Procedure §27.** Law of the case bars the Commission from re-trying a matter on which Court of Appeals reversed Commission's decision.

**ORDER DENYING REQUEST TO TAKE ADDITIONAL EVIDENCE  
REGARDING RETROACTIVE RATEMAKING AND DIRECTING THE  
FILING OF PROPOSED PROCEDURAL SCHEDULE**

This case is before the Commission on remand from the Missouri Western District Court of Appeals of the Commission's decision approving the fuel adjustment clause revision tariffs (FAC tariffs) of Aquila, Inc. (n.k.a. KCP&L Greater Missouri Operations Company and referred to in this order as "Aquila" or "GMO"). The Cole County Circuit Court issued its Mandate which "vacates the PSC's Order and remands for future proceedings consistent with the Court of Appeals opinion." It is the interpretation of that remand and a determination of what proceedings should be held that the Commission will address in this order. In preparation for this determination, the parties have submitted initial and reply briefs and presented oral arguments regarding their positions and what action is needed by the Commission to comply with the Courts' orders.

**I. Should the Commission take additional evidence, in order to explain why its earlier decision approving tariffs effective March 1, 2008, was not retro-active ratemaking?**

GMO argues that because the Court stated, "Nothing in the Commission's Order even attempts to justify its disregard of the applicable statutory language and the prohibition on retroactive



ratemaking . . . ,” the Commission is able to fix its order by including evidence and additional findings of fact which will justify its position. GMO wants the Commission to take additional evidence regarding the effect of the July 5, 2007 tariffs versus the effect of the March 1, 2008 tariffs. GMO argues that because the 2007 tariffs were “pro forma” tariffs containing only zeros in the adjustment amounts, the customers could not have known any more on July 5, 2007, than on June 1, 2007, about how to calculate their rates under the FAC clause. It was not until March 1, 2008, that tariffs with actual rates became effective. Thus, GMO believes that the Commission can take this additional evidence and explain to the Court of Appeals that this was not retroactive ratemaking.

Public Counsel argues that even if the Commission agrees that the Court of Appeals made the wrong decision, there is nothing the Commission can do now that the appeal is final. The opinion is final and this is the law of this case. Therefore, the Commission must simply undo its unlawful actions by determining how much money should be refunded to ratepayers and under what mechanism. The intervenors, Ag Processing, Inc., and Sedalia Industrial Energy Users Association, agree with Public Counsel.

Staff agrees that the Court of Appeals decision has found the Commission’s order unlawful and no additional evidence should be taken in an attempt to fix the order with additional findings of fact. Staff disagrees that the Commission can order any type of refund.

As GMO argues, the Court of Appeals did state that the Commission’s order did not explain why its decision was not retroactive ratemaking. The Court of Appeals was clear, however, when it said, “any adjustment to the cost of electricity based on electricity that had already been consumed by Aquila customers prior to the effective date clearly constitutes retroactive ratemaking.” The Court of Appeals was also very clear that the accumulation period could not begin before the tariff effective date. To do so, according to the Court of Appeals is retroactive ratemaking. Thus, the Commission will not take additional evidence on this point. GMO’s request for hearing on this issue is denied.

## **II. What further Commission proceedings are necessary?**

Having decided not to take additional evidence on why this is not retroactive ratemaking, the Commission must now determine what further proceedings are necessary in this matter. Still at issue in the case are: 1) the date that the initial accumulation period begins; 2) whether the Commission has the authority to order a refund or

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adjustment in a future FAC period for the over-collection; 3) what the amount of the refund or adjustment is; and 4) the exact mechanism for a refund or adjustment. These items at issue will require the taking of additional evidence or argument. Therefore, the Commission will direct the parties to file proposed procedural schedules including a hearing for the taking of additional evidence.

**THE COMMISSION ORDERS THAT:**

1. GMO's motion to take additional evidence regarding the issue of retroactive rate-making is denied.
2. No later than January 12, 2011, the parties shall file either jointly or separately proposed procedural schedules which include dates for a hearing and the taking of additional arguments on the issues set out above.
3. This order shall become effective upon issuance.

Clayton, Chm., Gunn and Kenney, CC.,  
concur.

Davis, C., dissents; separate dissenting  
opinion may follow.

Jarrett, C., dissents, with separate dissenting  
opinion to follow.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: At time of publication, no opinion of Commissioner Davis has been filed.

**DISSENTING OPINION OF COMMISSIONER TERRY M. JARRETT IN  
THE ORDER DENYING REQUEST TO TAKE ADDITIONAL EVIDENCE  
REGARDING RETROACTIVE RATEMAKING AND DIRECTING THE  
FILING OF PROPOSED PROCEDURAL SCHEDULE**

I respectfully dissent because I believe that the KCP&L Greater Missouri Operations Company (GMO) should be allowed to present additional evidence on all issues relating to the Court of Appeals opinion, including evidence on the retroactive ratemaking issue, and not just on the issues that the majority allowed in the Order.

GMO (then Aquila) was the first company to file for a Fuel Adjustment Clause (FA C) under section 386.266, RSMo. Cum. Supp. 2009. This statute, enacted in 2005, changed the regulatory landscape in

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Missouri as far as rate adjustment mechanisms, including fuel costs. The statute was enacted in response to the Supreme Court of Missouri's decision in State ex rel. Utility Consumers' Council of Missouri, Inc. v. PSC, 585 S.W.2d 41 (Mo. bane 1979)(the UCCM case). That case held that a FAC was beyond the statutory authority of the PSC. Section 386.266 in effect overruled a portion of the UCCM case by allowing the Commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in prudently incurred fuel and purchased-power costs, including transportation.

The present case offered several issues of first impression to the Commission, and subsequently the Courts. It is possible that a full and complete record was not developed to adequately address the changes enacted by section 386.266, including the difference between "rates" and "rate adjustment mechanisms." Given that the Court of Appeals may not have had a full and complete record on which to base its decision, I would afford GMO the opportunity to present additional evidence on this important issue, especially since the Commission will be taking additional evidence on other issues. Due process requires that the company have an opportunity to be heard.

**Director of the Manufactured Housing and Modular Units Program  
of the Public Service Commission v. 5 Star Homes and  
Development Company, Inc.**

*File No. MC-2010-0311  
Decided December 12, 2010*

**Manufactured Housing §4.** Under Section 700.100.2, RSMO, the Commission may consider a complaint charging a registered manufactured housing dealer with failure to arrange for proper initial setup of any modular home.

**Manufactured Housing §17.** Under Commission rule 4 CSR 240-123.095(11), failure to pay a re-inspection fee constitutes grounds for the denial, suspension or revocation, or placing on probation of a dealer's certificate of registration.

**Manufactured Housing §17.** Under Section 700.100.2(6) RSMO, failure to arrange for proper initial setup of a modular home constitutes grounds for suspension, revocation or placing on probation of a manufactures dealer registration.

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**Manufactured Housing §19.** Under Section 700.115.2 RSMo, whoever violated any provision of Chapter 700, RSMo, shall be liable to the state of Missouri for a civil penalty in an amount which shall not exceed \$1,000 for each violation.

**REPORT AND ORDER**

***Appearances***

**Robert S. Berlin**, Deputy General Counsel, P.O. Box 360, Jefferson City, Missouri 65102, for Complainant, Staff Counsel, Independent of the Commission

**JUDGE: Kennard Jones, Senior Regulatory Law Judge**

**Syllabus:** Through this Report and Order, the Commission finds in favor of the Director of the Manufactured Housing and Modular Units Program of the Public Service Commission and grants to the Director the requested relief, which includes formal non-renewal of the dealer's registration and authorization to seek penalties in Circuit Court.

**Background**

On May 5, 2010, Staff Counsel filed a complaint against 5 Star Homes and Development Company, Inc. In its complaint, the Director alleged that 5 Star failed to correct code violations on a home, failed to arrange for setup on several homes, and failed to pay a re-inspection fee. For its relief, the Director seeks a formal non-renewal of the company's dealer registration and authorization to seek penalties in Circuit Court.

Although not represented, the company filed a timely response to the complaint. Thereupon, the Commission notified<sup>1</sup> the company that an attorney would have to file an answer. The Commission allowed a considerable amount of time to elapse. Then, on August 31, 2010, Derek Thrasher, an attorney licensed to practice law in the state of Missouri, filed an entry of appearance and was granted<sup>2</sup> additional time to file an answer.

The company filed its answer on September 7, generally asserting its 5<sup>th</sup> Amendment right against self-incrimination. On September 29, however, Mr. Thrasher filed an uncontested Motion to Withdraw. Soon thereafter, the Director of Manufactured Housing

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<sup>1</sup> *Notice of Deficiency* issued by the Commission on June 28.

<sup>2</sup> *Order Granting Additional Time* issued by the Commission on August 31.

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responded to Mr. Thrasher's motion and moved the Commission to determine this matter on the pleadings. The Commission then granted the motion to withdraw and set an evidentiary hearing, which was held on November 9. Twelve exhibits were received into evidence. The president of 5 Star Homes, Jeffrey Kasten, was present without an attorney and stated that he is no longer seeking a license to be in the modular homes business. The Director pointed out that Mr. Kasten was representing himself and not 5 Star.

**Findings of Fact**

1. 5 Star Homes and Development Company, Inc., is a modular unit dealer as defined in Section 700.010(4).<sup>3</sup>

2. 5 Star Homes was, until December 31, 2009, registered as a licensed Manufactured Home or Modular Unit Dealer.<sup>4</sup>

3. The Director inspected the home of Jeff and Ann Grady on November 24, 2009.<sup>5</sup>

4. The Director conducted a re-inspection of the home of Jeff and Ann Grady on January 5, 2010.<sup>6</sup>

5. The Director made a second re-inspection of the Grady Home of March 19, 2010.<sup>7</sup>

6. Code violations, discovered by the Director during inspection, were not corrected by 5 Star.<sup>8</sup>

7. The Director sent a final notice, dated March 11, 2010, to 5 Star in an attempt to get a response concerning four consumer complaints received by the Director.<sup>9</sup>

8. On November 3, 2009, the Director sent a letter to 5 Star notifying the company of a consumer complaint from Timothy and Donna Gordon, urging the company to correct the problems.<sup>10</sup>

9. 5 Star failed to effect delivery and setup of the Gordon Family Home.<sup>11</sup>

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<sup>3</sup> Exhibit 12, *Complaint*.

<sup>4</sup> *Answer to Complaint*, paragraph 3.

<sup>5</sup> Transcript, page 13, lines 5-11, Exhibit 1.

<sup>6</sup> Transcript, page 15, line 4-14., Exhibit 2.

<sup>7</sup> Transcript, page 18, line 9 – page 19, line 16. Exhibit 3A.

<sup>8</sup> Transcript, page 15-19.

<sup>9</sup> Transcript, page 19, line 17– page 20, line 7. Exhibit 3.

<sup>10</sup> Transcript, page 20, line 15– page 21, line 5. Exhibit 4.

<sup>11</sup> Transcript, page 21, line 22- page 22, line 9. Exhibit 5.

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10. On November 3, 2009, the Director sent a letter to 5 Star notifying the company as a consumer complaint from Kenneth White, urging the company to correct the problems.<sup>12</sup>

11. 5 Star failed to effect delivery and setup of the Kenneth White Home.<sup>13</sup>

12. On February 1, 2010, the Director notified 5 Star of a consumer complaint from Michelle and Hans Mugler.<sup>14</sup>

13. 5 Star failed to effect delivery and setup of the Mugler Home.<sup>15</sup>

14. The Director sent 5 Star an invoice, dated January 11, 2010, in the amount of \$200 for the re-inspection of the Grady home.<sup>16</sup>

15. 5 Star did not pay the re-inspection fee of \$200.<sup>17</sup>

16. On January 25, 2010 the Director received an application for renewal of 5 Star's dealer registration.<sup>18</sup>

17. Because of multiple outstanding consumer complaints and the inability to contact 5 Star to verify the company's primary business address, the Director did not renew 5 Star's license.<sup>19</sup>

**Conclusions of Law**

1. The Commission has jurisdiction over manufactured and modular unit homes dealers under Chapter 700, RSMo.

2. Because 5 Star is a modular unit home dealer, the Commission has jurisdiction over 5 Star.

3. Under Section 700.100.2, RSMo, the Commission may consider a complaint charging a registered dealer with failure to arrange for proper initial setup of any new or used unit sold. Because the Director has alleged such failure with regard to 5 Star, the Commission has jurisdiction over this subject matter.

4. Through Commission rule 4 CSR 240-123.020, the Commission has delegated its authority under Chapter 700, RSMo, to the Director through Commission rule 4 CSR 240-123.020.

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<sup>12</sup> Exhibit 6.

<sup>13</sup> Transcript, page 23, line 3-12. Exhibits 6 and 7.

<sup>14</sup> Exhibit 8.

<sup>15</sup> Transcript, page 24, lines 16-22. Exhibits 8 and 9.

<sup>16</sup> Exhibit 10.

<sup>17</sup> Transcript, page 29, lines 2-12.

<sup>18</sup> Exhibit 11.

<sup>19</sup> Transcript, page 30, lines 5-11.

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5. Under Commission rule 4 CSR 230-123.095 the Commission may assess to 5 Star a re-inspection fee associated with the Grady Home. The Director, by its delegated powers, assessed to 5 Star a fee of \$200, as authorized by 4 CSR 240.123.095(9), for the re-inspection.

6. Under Commission rule 4 CSR 240-123.095(11), failure to pay a re-inspection fee constitutes grounds for the denial, suspension or revocation, or placing on probation of a dealer's certificate of registration. Because 5 Star has failed to pay the re-inspection fee associated with the Grady Home, the Commission will not renew the company's dealer registration.

7. For its failure to correct code violations with regard to the Grady Home, 5 Star has violated Section 700.045(5).

8. Under Section 700.100.3(6) failure to arrange for proper initial setup of a modular home, constitutes grounds the suspension, revocation or placing on probation of a manufacturer's dealer registration.

9. Under Section 700.115.2 RSMo, whoever violates any provision of Chapter 700 shall be liable to the state of Missouri for a civil penalty in an amount which shall not exceed one thousand dollars for each such violation. 5 Star has violated Section 700.100.3(6), and 700.045(5) of Chapter 700 and is liable for civil penalties consistent with the facts of this case.

**Decision**

The Commission will rule in favor of the Director. Because 5 Star has not complied with the relevant Missouri Statutes and Commission rules, the Commission will not renew the company's registration. Further, the Commission will authorize its General Counsel to seek penalties in Circuit Court, consistent with the facts of this case and the relevant law.

**THE COMMISSION ORDERS THAT:**

1. The dealer registration of 5 Star Homes and Development Company, Inc. shall not be renewed.

2. The General Counsel of the Missouri Public Service Commission is authorized to seek penalties in Circuit Court, consistent with the facts of this case and the controlling law.

3. This order shall become effective on January 1, 2011.

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4. This case shall be closed on January 2, 2011.

Clayton, Chm., Davis, Jarrett,  
Gunn, and Kenney, CC., concur and  
certify compliance with the provisions  
of Section 536.080, RSMo.

**The Staff of the Missouri Public Service Commission v. Laclede Gas  
Company, Laclede Energy Resources and The Laclede Group**

*File No. GC-2011-0098  
Decided December 22, 2010*

**Evidence, Practice and Procedures §24.** When disposing of a matter on the pleadings the facts alleged in the challenged pleading are accepted as true. If those assumed facts are insufficient as a matter of law a judgment on the pleadings is appropriate.

**Gas §36.** Alleging the existence of circumstances that are expressly allowed by the affiliate transactions rule does not allege a violation of that rule and does not state a claim upon which relief can be granted.

**ORDER DISMISSING STAFF'S SECOND AMENDED COMPLAINT  
AGAINST LACLEDE ENERGY RESOURCES, INC., AND THE  
LACLEDE GROUP, INC.**

On October 6, 2010, the Commission's Staff filed a complaint against Laclede Gas Company, Laclede Energy Resources, Inc., and The Laclede Group, Inc.<sup>1</sup> Laclede Gas Company is a natural gas distribution utility in eastern Missouri and is regulated by this Commission as a gas corporation as defined by Section 386.020(18) RSMo (Supp. 2009). Staff's complaint also names The Laclede Group and Laclede Energy Resources as respondents. Laclede Energy Resources is a gas marketing company that is not regulated by this Commission. The Laclede Group is a holding company that wholly owns both Laclede Gas Company and Laclede Energy Resources, as well as other affiliated companies that are not named as respondents in this complaint. It also is not regulated by this Commission.

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<sup>1</sup> Staff first amended its complaint on October 7 to include a more specific prayer for relief. The Commission granted Staff's motion for leave to amend its complaint on November 12.



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Laclede Gas Company filed its answer and a motion to dismiss count 2 of Staff's complaint on November 8. On the same day, Laclede Energy Resources and The Laclede Group filed a separate answer and a motion to dismiss Staff's complaint as to those two respondents. Staff responded on November 22 by filing two pleadings. The first is denominated "Staff's Answer to Laclede's Motion to Dismiss." The second is entitled "Staff's Response to Laclede Gas Company's Motion to Dismiss Count II, The Laclede Group and Laclede Energy Resources' Motion to Dismiss and Amended Complaint." Staff did not request leave to file this second amended complaint.

Laclede Energy Resources and The Laclede Group responded to Staff's second amended complaint on November 30 by filing a joint motion asking the Commission to dismiss that complaint as it concerns Laclede Energy Resources and The Laclede Group. Those two parties further responded on December 2 by filing their answer and affirmative defenses to Staff's second amended complaint. Laclede Gas Company did not initially respond to Staff's amended complaint.

On December 3, the Commission, acting on its own motion, granted Staff leave to file its second amended complaint. In the same order, the Commission required Laclede Gas Company to file its answer to Staff's second amended complaint by December 10, and gave Laclede Gas Company leave to file a new motion to dismiss all or part of that second amended complaint if it wished to do so.

Laclede Gas Company filed its Answer to Staff's Second Amended Complaint, Motion to Dismiss Counts I and V, and Counterclaim on December 10. The Commission will address that pleading in a separate order. This order will address only the joint motion to dismiss filed by The Laclede Group and Laclede Energy Resources.

The Commission has the authority to decide this matter on the pleadings pursuant to Commission Rule 4 CSR 240-2.117(2), which states:

Except in a case seeking a rate increase or which is subject to an operation of law date, the commission may, on its own motion or on the motion of any party, dispose of all or any part of a case on the pleadings whenever such disposition is not otherwise contrary to law or contrary to the public interest.

The Commission's rules do not establish standards for when it is

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appropriate to dispose of a case on the pleadings, so the Commission will instead look to Missouri's civil procedures for guidance.

In indicating when a case may be disposed on the pleadings, the Missouri Supreme Court has stated that for purposes of the motion, all facts stated in the challenged pleading are accepted as true. If those assumed facts are insufficient as a matter of law, the trial court may properly grant a motion for judgment on the pleadings.<sup>2</sup>

Laclede Energy Resources and The Laclede Group contend Staff's second amended complaint against them should be dismissed because it fails to allege any violation of law or regulation by either company, and thus fails to state a claim upon which relief can be granted.

Staff's second amended complaint contains five counts. Count I of that amended complaint alleges The Laclede Group is affiliated with Laclede Gas Company and Laclede Energy Resources. It also alleges The Laclede Group and Laclede Energy Resources are subject to the Commission's jurisdiction because The Laclede Group signed a stipulation and agreement in an earlier case, GM-2001-342, in which the Commission approved a holding company corporate structure for The Laclede Group and the affiliated companies it owns. Staff further alleges the stipulation and agreement requires The Laclede Group to make certain books and records available for review by the Commission's Staff. Finally, Staff alleges The Laclede Group, Laclede Energy Resources, and Laclede Gas Company must comply with the requirements of the Commission's affiliate transaction rules.<sup>3</sup> However, despite setting out the above described assertions about jurisdiction and the responsibilities of the companies, Count I does not allege The Laclede Group, Laclede Energy Resources, or Laclede Gas Company have violated any provision of the affiliate transaction rule or any other statute or regulation. Thus, Count I does not state a claim against The Laclede Group or Laclede Energy Resources.

Count II of Staff's second amended complaint alleges the cost allocation manual prepared and submitted by Laclede Gas Company violates the Commission's affiliate transaction rules. Staff further alleges

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<sup>2</sup> *State ex rel. Nixon v. American Tobacco Co., Inc.*, 34 S.W.3d 122, 134 (Mo 2000).

<sup>3</sup> Staff also alleges that the respondents must comply with the holding of *State ex rel. Atmos Energy Corp. v. Public Service Com'n*, 103 S.W.3d 753 (Mo. banc 2003). That case upheld the validity of the Commission's affiliate transaction rules. However, in doing so, the Supreme Court did not establish any additional standards, apart from the requirements of the rules, with which any respondent is required to comply.

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the deficient cost allocation manual allows Laclede Gas Company to give Laclede Energy Resources a prohibited financial advantage. Nothing in the count makes any allegation against either The Laclede Group or Laclede Energy Resources, and thus does not state a claim against either company.

Count III of Staff's second amended complaint alleges Laclede Gas Company has never applied to the Commission for approval of its cost allocation manual. Count IV alleges Laclede Gas Company has not annually updated its cost allocation manual. Again, neither count makes an allegation against The Laclede Group or Laclede Energy Resources and does not state a claim against either company.

Finally, in Count V, Staff alleges Laclede Gas Company has violated the affiliate transaction rules by providing confidential market information to its affiliate, presumably Laclede Energy Resources, that was not available to non-affiliates. Staff alleges Laclede Gas Company committed this violation "by permitting Kenneth J. Neises, who, until September 30, 2010, was an executive officer with operational responsibilities for both Laclede [Laclede Gas Company] and LER [Laclede Energy Resources], and had full access to all information about both entities." Staff's complaint does not allege what Mr. Neises was permitted to do, but presumably, Staff is concerned about his dual role as executive officer with both Laclede Gas Company and Laclede Energy Resource. The only specific allegation Staff makes about Mr. Neises' dual role is that he signed for Laclede Energy Resources in contracts with Laclede Gas Company.

The Laclede Group and Laclede Energy Resources do not deny that Mr. Neises held executive positions with Laclede Energy Resources and Laclede Gas Company. However, they point out that such a dual management role is allowed to exist by the affiliate transaction rule. Specifically, 4 CSR 240-40.015(2)(B), a provision in the general affiliate transaction rule, states:

**Except as necessary to provide corporate support functions**, the regulated gas corporation shall conduct its business in such a way as not to provide any preferential service, information or treatment to an affiliated entity over another party at any time. (emphasis added)

The rule defines corporate support as:

joint corporate oversight, **governance**, support systems

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and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities. (emphasis added)<sup>4</sup>

Thus, the affiliate transaction rule specifically contemplates that Mr. Neises can hold dual governing roles in affiliated companies.

The affiliate transaction rule does not allow Laclede Gas Company to conduct its business in such a way as to provide preferential information or treatment to an affiliated entity. However, Staff's complaint does not allege any specific conduct by The Laclede Group or Laclede Energy Resources that would violate that requirement of the rule. Instead, Staff merely asserts that through its shared officers and directors and especially Mr. Neises, Laclede Energy Resources would have had "full access to information about Laclede's gas operations", and asserts that it is "unrealistic" to think that a conflict of interest can be avoided in that situation.

Regardless of Staff's opinion about how realistic the affiliate transaction rules may be, those rules clearly allow for the existence of shared officers and directors. By merely alleging the existence of circumstances that are expressly allowed by the affiliate transaction rules, Staff has not alleged a violation of those rules, and has not stated a claim upon which relief against Laclede Energy Resources or The Laclede Group can be granted. Indeed, Staff's prayer for relief at the end of its second amended complaint does not ask the Commission for any relief against those two companies.

Staff has not responded to the joint motion to dismiss filed by Laclede Energy Resources and The Laclede Group on November 30. However, in Staff's November 22 answer to the previous version of that motion, Staff asserts that complaints before the Commission are not to be tested by technical pleading rules, are to be liberally construed and are sufficient if they "fairly present[s] for determination some matter which falls within the jurisdiction of the Commission."<sup>5</sup> In this case, Staff merely alleges the existence of circumstances that are allowed by the controlling regulation and fails to fairly present for determination any

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<sup>4</sup> Commission Rule 4 CSR 240-40.015(1)(D). Exactly the same rule and definition are found in the Commission's rule that specifically regulates marketing affiliate transactions at 4 CSR 240-40.016(3)(B) and (1)(D).

<sup>5</sup> Staff quoted *State ex rel. St. Louis-San Francisco Ry. Co. v. Public Service Com'n*, 53 S.W.2d 868, 871 (Mo. 1932).

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violation of statute or regulation by The Laclede Group or Laclede Energy Resources. Under these circumstances, the Commission will dismiss Staff's complaint against those two unregulated companies.

**THE COMMISSION ORDERS THAT:**

1. The Joint Motion to Dismiss Second Amended Complaint on Behalf of Laclede Energy Resources, Inc. and The Laclede Group, Inc., is granted.
2. This order shall become effective on January 1, 2011.

Davis and Gunn, CC., concur;  
Jarrett, C., concurs with separate concurring opinion attached;  
Clayton, Chm., and Kenney, C., dissent.

Woodruff, Chief Regulatory Law Judge

**CONCURRING OPINION OF COMMISSIONER TERRY M. JARRETT  
IN THE ORDER DISMISSING STAFF'S SECOND AMENDED  
COMPLAINT AGAINST LACLEDE ENERGY RESOURCES, INC., AND  
THE LACLEDE GROUP INC.**

The majority of the Commission assumes in its Order that the Commission has jurisdiction over Laclede Energy Resources and The Laclede Group in granting the dismissal of Staff's Second Amended Complaint Against Laclede Energy Resources, Inc., and The Laclede Group Inc. for failure to state a claim. I concur in the result of the majority but not in the methodology for reaching that result.

Staff argues that the affiliates are subject to jurisdiction because of a signed Stipulation and Agreement in an earlier case. However, jurisdiction is a matter of law. Section 393.140(12), RSMo 2000 limits this Commission's jurisdiction over other businesses operated by entities regulated by the Commission, specifically outlining the thresholds - which if and when crossed - would establish a basis for jurisdiction by the Commission. Nothing before this Commission demonstrates that the "regulatory veil" has been pierced so as to place this matter before the Commission. Jurisdiction is not a matter of "agreement" between parties to settlement agreements, and no stipulation and agreement can confer

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jurisdiction to this Commission which is not conferred by law. Therefore, I would have dismissed the Staff's Second Amended Complaint Against Laclede Energy Resources, Inc., and The Laclede Group, Inc., for a lack of jurisdiction over these two entities, as opposed to dismissal for failure to state a claim.

The basis for dismissal here, failure to state a claim, misses the mark because it implies that this Commission currently has jurisdiction over the two Laclede affiliates. Finally, neither the Affiliate Transaction Rule or the Marketing Affiliate Transaction Rule, 4 CSR 240.04.015 and 4 CSR 240.04.016 respectively, confer jurisdiction to this Commission over the Laclede affiliates. While transactions and activities of affiliates are encompassed within these two rules, jurisdiction of this Commission is limited to the regulated entity, unless the limitations set out in Section 393.140(12), RSMo 2000 are met, and only then can this Commission assert jurisdiction over an affiliate.

Because this Commission lacks jurisdiction over the two Laclede affiliates at this time I concur in the result of this Commission Order but differ on the manner in which I would have reached that result.

**In the Matter of the Application of Cardwell Lumber, Inc., for Approval of a Change of Electric Supplier at its 5927 Highway 50 West, Jefferson City, Missouri Location from Union Electric Company to Three Rivers Electric Cooperative**

*File No. EO-2011-0052  
Decided January 5, 2011*

**Electric §4.1.** In determining whether a change of supplier will be granted, the Commission questions whether such change is for a reason other than a rate differential and in the public interest, which may be determined by answering ten questions: (1) whether the needs of the customer can be adequately met by the current supplier; (2) health or safety issue with regard to the amount or quality of power; (3) alternative the customer has considered; (4) whether there has been damage to the customer's equipment as a result of a problem with the current supplier; (5) the effect that the loss of the customer would have on the present supplier; (6) whether a change of supplier would result in duplicative services or facilities; (7) the overall burden on the customer caused by inadequate service; (8) efforts made by the present supplier to solve or mitigate the problems; (9) the impact the Commission's decision may have on economic development; and, (10) the effect the granting of authority might have on any territorial agreements or on the negotiation thereof.

**REPORT AND ORDER**

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***Appearances***

**Craig S. Johnson**, Johnson & Sporleder, LLP, 304 East High Street, Suite 200, Post Office Box 1670, Jefferson City, Missouri 65102, for Applicant, Cardwell Lumber, Inc.

**Wendy K. Tatro**, Associate General Counsel, Union Electric Company, d/b/a Ameren Missouri, Post Office Box 66149, 1901 Chouteau Avenue, St. Louis, Missouri 63101, for Union Electric Company, d/b/a Ameren Missouri.

**Andrew J. Sporleder**, Johnson & Sporleder, LLP, 304 East High Street, Suite 200, Post Office Box 1670, Jefferson City, Missouri 65102, for Three Rivers Electric Cooperative.

**Lewis R. Mills, Jr.**, Public Counsel, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

**Eric Dearthmont**, Legal Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Commission, Independent of the Commission

**JUDGE: Kennard Jones, Senior Regulatory Law Judge**

**Syllabus:** Through this order, the Missouri Public Service Commission concludes that Cardwell Lumber's request to change its electric supplier is for a reason other than a rate differential and that such request is in the public interest. The Commission therefore finds in favor of the applicant and will grant the requested relief.

**Background**

On August 21, 2010, Cardwell Lumber, Inc., filed an application with this Commission seeking approval to change its electric supplier from Union Electric Company d/b/a Ameren Missouri to Three Rivers Electric Cooperative. Cardwell is a Small Primary Service customer of Ameren, which is a configuration that holds Cardwell responsible for maintaining electric facilities beyond the "metering point."

Cardwell states that its reasons for wanting a change of supplier are: the need to replace the primary facility distribution system with

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facilities that Cardwell is not responsible for maintaining; its preference for rural cooperative service; dissatisfaction with Ameren's service, its right to use Three Rivers to serve new structures; its desire to have a single power supplier and avoid duplication of services; and, the absence of any adverse impact on Ameren.

Ameren opposes the change, arguing that the necessity of having to repair or replace Cardwell's facilities does not provide a reason for why a change of supplier is in the public interest. The Staff of the Commission agrees that the application should be denied, but alternatively argues that Cardwell's request constitutes a rate differential.

The Commission held an evidentiary hearing on November 12. The parties submitted post-hearing briefs on November 24. Citing to Commission decisions, all of the parties set out the following factors that may be considered when determining whether a change of supplier is in the public interest:

1. The customer's needs cannot adequately be met by the present supplier with respect to either the amount or quality of power;
2. Health or safety issues involving the amount or quality of power;
3. Alternatives the customer has considered, including alternatives with the present supplier;
4. The customer's equipment has been damaged or destroyed as a result of a problem with the electric supply;
5. The effect the loss of the customer would have on the present supplier;
6. Whether a change of supplier would result in a duplication of services or facilities, especially in comparison with alternatives available from the present supplier, which would include (a) the distance involved and the cost of any new extension, including the burden on others, and (b) the burden on the customer relating to the cost of time involved, not including the cost of the electricity itself;
7. Overall burden on the customer caused by the inadequate service, including any economic burden not related to the cost of the electricity itself, and any burden not considered with respect to factor (6)(b) above;
8. Efforts that have been made by the present supplier to solve or mitigate the problems;
9. The impact the Commission's decision may have on economic development, on an individual or cumulative basis; and



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10. The effect the granting of authority might have on any territorial agreements between the two suppliers in question, or on the negotiation of territorial agreements between suppliers.

The law with regard to changes of electric suppliers is that the Commission may order a change of supplier on the basis that it is in the public interest for a reason other than a rate differential.<sup>1</sup> Although the above factors have been used by the Commission in past cases, the Commission's decisions have no precedential value.<sup>2</sup> Applications for changes of supplier are therefore decided on a case-by-case basis.

**Findings of Fact**

1. Cardwell Lumber, Inc. is a Missouri corporation engaged in the lumber business at 5927 Business Highway 50 West, St. Martins, Missouri.<sup>3</sup>

2. Union Electric Company d/b/a Ameren Missouri is an electric utility subject to the jurisdiction of the Missouri Public Service Commission.<sup>4</sup>

3. Three Rivers Electric Cooperative is a rural electric cooperative.<sup>5</sup>

4. On August 21, 2010, Cardwell Lumber, Inc. filed an application with this Commission seeking approval to change its electric supplier from Ameren to Three Rivers Electric Cooperative.<sup>6</sup>

5. Cardwell is a primary customer of Ameren, which means after a certain metering point, Cardwell is responsible for maintenance of the electrical system serving its facilities, which includes 15 poles and 18 transformers.<sup>7</sup>

6. Upon moving onto the property, Cardwell did not know what to expect as an owner of a primary metered system.<sup>8</sup>

7. Cardwell has businesses in Novelty and Frankford, Missouri which are served by cooperatives and Cardwell is not responsible for maintenance of those systems.<sup>9</sup>

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<sup>1</sup> Section 393.106.2, RSMo.

<sup>2</sup> *State ex rel. AG Processing, Inc. v. Public Service Comm'n*, 120 S.W.3d 732, 736 (Mo. banc 2003).

<sup>3</sup> Stipulated to by parties.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> Application filed on August 21, 2010.

<sup>7</sup> Transcript, page 52, lines 8-11.

<sup>8</sup> Transcript, page 137, lines 21-25.

<sup>9</sup> Transcript, page 76, lines 18-24.

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8. Because Cardwell receives service under a small primary service rate, Ameren saves on the investment in the installation and the customer receives a lower kilowatt hour rate.<sup>10</sup>

9. Ameren told Cardwell that it would be cheaper to pay the rate for a primary metering system and maintain the system, which should stand a long time, than it would be to change to a secondary metering system.<sup>11</sup>

10. The metering pole belongs to Cardwell. The meter box belongs to Ameren. The transformers attached to the pole belong to Ameren and the fuses on top of the pole belong to Cardwell.<sup>12</sup>

11. If the fuses on top of the primary metering pole have tripped, then the line to the meter is cold.<sup>13</sup>

12. Cardwell has been told by Meyer Electric, a contractor, that the fuses are Ameren's responsibility.<sup>14</sup>

13. Although the fuses at the top of the metering pole belong to Cardwell, Ameren has repaired/replaced a fuse at least once.<sup>15</sup>

14. Although Ameren's service manual states that the pole upon which the primary meter is located does not belong to Ameren, this is not stated in the company's tariff.<sup>16</sup>

15. Cardwell has been unclear as to whether it is responsible for maintaining the primary metering pole, including the fuses that sit on top of the pole.<sup>17</sup>

16. Cardwell does not have any in-house employees that are qualified to do work on high voltage lines.<sup>18</sup>

17. Cardwell does not want to be in the business of maintaining poles, lines, transformers, etc. and specifically does not want to be a primary customer.<sup>19</sup>

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<sup>10</sup> Transcript, page 148, lines 4-11.

<sup>11</sup> Transcript, page 99, line 18- page 100, line 8.

<sup>12</sup> Transcript, page 149, line 22 – p. 150, line 7.

<sup>13</sup> Transcript, page 181, lines 23-25.

<sup>14</sup> Transcript, page 75, lines 13-21.

<sup>15</sup> Transcript, page 185, lines 11-14.

<sup>16</sup> Transcript, page 191, lines 13-20.

<sup>17</sup> Transcript, page 61, lines 22-25; page 65, line 22 – page 66, line 9.

<sup>18</sup> Transcript, page 76, lines 13-17.

<sup>19</sup> Transcript, page 78, lines 11-19.

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18. In order to serve Cardwell's property, Ameren's line must cross Highway 50 to the primary service pole on Cardwell's side of the Highway.<sup>20</sup>

19. Three Rivers' service pole is on the same side of the highway and within 10-12 feet of Cardwell's office.<sup>21</sup>

20. In 2007, because it was no longer interested in maintaining the high voltage system, Cardwell asked Ameren to come out and look at the system.<sup>22</sup>

21. In 2007, upon looking at Cardwell's system, Ameren told Cardwell that the system was deteriorated and that it was not interested in taking it over; further, that if Ameren did take it over, it would be very expensive. Despite Cardwell's prompt, Ameren did not give an estimate of the cost.<sup>23</sup>

22. Cardwell approached Ameren a second time about Ameren taking over the system and was again not given a quote, but was told that it would cost an "arm and a leg."<sup>24</sup>

23. As a result of the December 2007 ice storm, Cardwell had lines down in its yard and, because Ameren had to attend to its own facilities and did not have the manpower or time, it could not assist Cardwell.<sup>25</sup>

24. In 2008 Cardwell sought to change its electric supplier from Ameren to Three Rivers due to transformer, pole and line liability and the problems with Ameren.<sup>26</sup>

25. Cardwell's 2008 application was not filed by an attorney and was dismissed by the Commission on April 4, 2009, for failure to prosecute.<sup>27</sup>

26. All parties agree that the electrical system Cardwell is now responsible for maintaining has to be repaired or replaced, as Ameren and Three Rivers have made it clear that they want no part of the current system.<sup>28</sup>

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<sup>20</sup> Transcript, pages 56-58.

<sup>21</sup> Transcript, pages 56-58.

<sup>22</sup> Transcript, page 82, lines 6-19.

<sup>23</sup> Transcript, page 83, lines 11-22.

<sup>24</sup> Transcript, page 84, lines 3-7.

<sup>25</sup> Transcript, page 84, lines 23-25. Page 158, lines 7-22.

<sup>26</sup> Exhibit 15.

<sup>27</sup> See Case No. EO-2009-0246.

<sup>28</sup> Transcript, page 78, line 22 – page 79, line 2. Joint Stipulation of Facts and Law.

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27. Since 2004, when it moved onto the premises, Cardwell has spent about \$13,000 with Meyer Electric for maintenance or repair of the system.<sup>29</sup>

28. Cardwell has discussed with Ameren reconfiguring the lines and poles on Cardwell's property in order to make room for business operations, but Ameren was not amenable to any alternatives suggested by Cardwell.<sup>30</sup>

29. Cardwell has been under the impression that Ameren tells Cardwell what it wants to do and that's the end of the conversation.<sup>31</sup>

30. Cardwell's relationship with Ameren is strained and has been for some time. When Cardwell asks Ameren for things, Ameren tries to direct Cardwell in the direction that Ameren wants to go, rather than trying to address Cardwell's needs. Cardwell does not experience this at its other locations where it is served by rural cooperatives.<sup>32</sup>

31. Cardwell states that this case is not about rates.<sup>33</sup>

32. Cardwell understands that because it is a primary customer, it pays a lower monthly bill than it would if it were a secondary customer.<sup>34</sup>

33. Specific information concerning how much Cardwell would save, while staying with Ameren, if it went from a primary service rate to a general service rate, was not given to Cardwell until the date of the evidentiary hearing.<sup>35</sup>

34. If the Commission's order is unfavorable to Cardwell, then the company will shut its doors. If it is favorable, the company will grow its business.<sup>36</sup>

35. Cardwell intends to expand the business into millwork and retail lumber.<sup>37</sup>

36. Cardwell will want Three Rivers to serve any new facilities on the property, while, without a change of supplier, the old facilities will continue to be served by Ameren.<sup>38</sup>

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<sup>29</sup> Transcript, page 88, lines 12-14.

<sup>30</sup> Transcript, page 103, line 16 – p. 104, line 10.

<sup>31</sup> Transcript, page 105, lines 1-10.

<sup>32</sup> Transcript, page 126, lines 14-16.

<sup>33</sup> Transcript, page 107, lines 5-6.

<sup>34</sup> Transcript, page 121, lines 20-23.

<sup>35</sup> Transcript, page 196, lines 7-17. Page 144, lines 7-22.

<sup>36</sup> Transcript, page 122.

<sup>37</sup> Transcript, page 36, lines 7-14.

<sup>38</sup> Transcript, page 126, lines 14-16.

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37. If Ameren had given Cardwell a bid when they first talked, Cardwell would not have pursued this case to hearing.<sup>39</sup>

38. Outages experienced by Cardwell were compounded by problems with their own system.<sup>40</sup>

39. Cardwell has had no outages due to Ameren for the last 3 years.<sup>41</sup>

40. Ameren's 2009 Missouri jurisdictional revenues were \$2.63 billion.<sup>42</sup>

41. Cardwell's total bill for the year 2009 was \$10,668.

42. If Cardwell gets permission to change suppliers, Ameren would not suffer any significant stranded investment.<sup>43</sup>

43. In the electric industry, rates are typically described as the price one would pay for some amount of usage.<sup>44</sup>

44. Cardwell's desire not to be responsible for maintaining electric lines and poles is a legitimate business decision.<sup>45</sup>

**Conclusions of Law**

1. Section 393.106.2 RSMo states that the "public service commission, upon application made by an affected party, may order a change of supplier on the basis that it is in the public interest for a reason other than a rate differential." Cardwell has filed such an application over which the Commission has jurisdiction. Also, as the party asserting this cause of action, the burden of proof lies with Cardwell.<sup>46</sup>

2. The first question the Commission must ask is whether the requested change is in the public interest. In post-hearing briefs, the parties have set out 10 factors that the Commission has used in past cases to determine whether a change of supplier is in the public interest. To entertain the parties, the Commission will discuss these factors. However, the Commission points out that its decisions have no precedential value and the Commission is not bound by *stare decisis*.<sup>47</sup>

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<sup>39</sup> Transcript, page 131, lines 6-8.

<sup>40</sup> Transcript, page 142, line 10- p. 143, line 16.

<sup>41</sup> Transcript, page 160, lines 14-17.

<sup>42</sup> Ameren's Annual Report.

<sup>43</sup> Transcript, page 196, lines 1-4.

<sup>44</sup> Transcript, page 213, lines 13-16.

<sup>45</sup> Transcript, page 217, lines 3-10.

<sup>46</sup> *Stofer v. Dunham*, 208 S.W. 641 (Mo. App. 1919).

<sup>47</sup> *State ex rel. AG Processing, Inc. v. Public Service Comm'n*, 120 S.W.3d 732, 736 (Mo. Banc 2003).

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It follows that each Commission case is decided on a case-by case basis.

**Decision**

**Public Interest**

The First Factor: Whether Cardwell's needs cannot adequately be met by Ameren with respect to either the amount or quality of power. Cardwell has not demonstrated that Ameren is unable to provide Cardwell enough power. Although there was discussion of outages, those outages appear to have been cause by Cardwell's equipment, rather than Ameren's.

Second: Health or safety issues with regard to the amount or quality of power. There was some discussion concerning downed lines in Cardwell's yard during an ice storm. Those lines were Cardwell's responsibility. Ameren stated that it could not help during that time because it had to immediately tend to its own system. However, it is relevant that Cardwell does not want to be responsible for downed lines and that over the years Ameren has not adequately responded to Cardwell's concerns in this regard.

One single fact does stand out as to safety in the context of the public interest. That is, in order for Ameren to serve Cardwell, a single line must cross from Ameren's system on one side of Highway 50 to Cardwell's facility on the other. Because Three Rivers' lines are on the same side of the Highway as Cardwell's facilities, this would be unnecessary if Cardwell was served by Three Rivers.

Third: Alternatives the customer has considered, including alternatives with the present supplier. Cardwell realizes that its system must come down because of the condition it is in, and after repair/replacement, Cardwell does not desire to remain a primary customer responsible for maintaining an electric system. To do this, Cardwell has approached, and desires to work with, Three Rivers. It may be true that Ameren has recently presented Cardwell with alternatives. Cardwell, however, has expressed dissatisfaction with Ameren's timeliness and effectively forcing Cardwell to file the application for change of supplier. Cardwell has not therefore had a meaningful opportunity to consider Ameren's alternatives.

Fourth: Whether the customer's equipment has been damaged or destroyed as a result of a problem with the electric supply. Although there was discussion concerning "trips" with Cardwell's boiler, the company has not shown that Ameren was at fault. In fact, it appears more likely than not that Cardwell's system was the cause.

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Nevertheless, there was no evidence that equipment has been damaged or destroyed. Though Cardwell made this assertion in its application filed in 2008, the facts do not support a finding as such.

Fifth: The effect the loss of the customer would have on the present supplier. It is clear, not only in dollar amounts but through statements made by Ameren, that the loss of this single customer would not be significant.

Sixth: Whether a change of supplier would result in duplicative services or facilities, especially in comparison with alternatives available from the present supplier, which would include (a) the distance involved and the cost of any new extension, including the burden on others and (b) the burden on the customer relating to the cost of time involved, including the cost of the electricity itself. Cardwell has stated that if it is not granted a change of supplier, it would close up. If that happens, the factor becomes irrelevant. On the other hand, there are indications that Cardwell intends to expand its business. In this case, if the Commission does not approve this change of supplier, then the structures currently on Cardwell's facilities will continue to be served by Ameren. If Cardwell adds new structures, it intends to have those structures served by Three Rivers. There would then be a duplication of services.

Seventh: The overall burden on the customer caused by the inadequate service, including any economic burden not related to the cost of electricity itself. Cardwell began its relationship with Ameren without knowing what its full responsibilities were. For instance, Cardwell, even on the day of the hearing, did not know who the metering pole belongs to. The company's confusion is well-founded. The fuses, on top of the pole, belong to Cardwell. The transformers, on the sides of the pole, belong to Ameren as well as the meter which sits lower on the pole.

Since 2004, when Cardwell moved onto the premises, it has spent about \$13,000 for maintenance and repair of the system. There are no employees at the company qualified to work on high voltage lines and Cardwell does not desire to be responsible for its system, which consists of 15 poles and 18 transformers. Since 2004, Cardwell has tried to work with Ameren to no satisfaction. Cardwell's dissatisfaction is evident by having once unsuccessfully filed for an application for a change of supplier, only to again do so two years later. Cardwell has clearly been under a burden while a customer of Ameren.

Eighth: Efforts made by the present supplier to solve or mitigate the problems. Cardwell has made it clear that its relationship with

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Ameren is strained and has been for some time. This is largely due to Ameren's unwillingness or inability to address Cardwell's concerns over the past years to Cardwell's satisfaction. Only until recently, after the filing of this case, did Ameren give Cardwell a bid on building new electric facilities. Cardwell even states that if Ameren had given Cardwell this information some time ago, this hearing would not have been necessary. In fact, Cardwell's frustration with Ameren is such that if the Commission does not grant the change of supplier, Cardwell will close its business at St. Martins; which leads to the ninth factor.

Ninth: The impact the Commission's decision may have on economic development, on an individual or cumulative basis. As stated above, if the Commission does not approve the change of supplier, Cardwell has indicated that it will close its business. On the other hand, if the Commission approves the transfer, Cardwell intends to expand.

Tenth: The effect the granting of authority might have on any territorial agreements or on the negotiation of territorial agreements between the two suppliers. The parties all agree that this factor is not at issue.

Both Staff and Ameren refer to Commission cases, finding that customer preference alone is an insufficient basis to order a change of supplier. However, if thought out, a customer's preference is what drives an application for a change of supplier. The customer "prefers" another supplier over its current supplier. Most certainly, some of the factors discussed above play a part in a customer's preference for an alternate supplier.

Notably, a customer's preference is guided by whether its needs can be met by the current supplier, health and safety issues, available alternatives, damage to equipment, whether there will be duplicative services, overall burden on the customer, efforts made by the current supplier to solve or mitigate problems and, particularly in this case, the impact the decision may have on economic development. That leaves only two factors that do not impact customer preference; effect on territorial agreements and the effect the loss of the customer will have on the present supplier.

Nevertheless, if the Commission does not grant a change of supplier, the line running across Highway 50 will remain and pose a possible safety issue. Further, Cardwell will either shut its doors or, if Cardwell develops the property, it will choose to employ Three Rivers as the supplier for any new structures. This will result in duplicative services. If the Commission grants the change of supplier, Cardwell will



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remain open and may even expand its operations. It will not be responsible for maintaining equipment it neither has the expertise nor desire to maintain. Cardwell's preference runs much deeper than a mere whim. The company has had a bad relationship with Ameren and has had better experiences with cooperatives at its other locations. The Commission concludes that the public interest will be served by granting Cardwell's application.

**Reason Other Than A Rate Differential**

The second prong of the relevant statute is that Cardwell's reason for the change be for something other than a rate differential. Cardwell's reasons are set out, and none of those reasons have to do with a rate differential. Ameren's rates are described in its tariff at page 27. None of these rates have anything to do with the cost associated with Cardwell choosing to rebuild the system with Three Rivers as opposed to Ameren. Cardwell states that this case is not about rates, while Staff states that typically, when we discuss rates, we are talking about the price one would pay for some amount of usage. The Commission concludes that Cardwell's reason for a change of supplier is for reasons other than a rate differential.

The Commission has concluded that Cardwell's request to change suppliers is for a reason other than a rate differential and that such a change is in the public interest. The Commission will therefore grant Cardwell's request to change its supplier from Ameren to Three Rivers.

**THE COMMISSION ORDERS THAT:**

1. Cardwell Lumber, Inc.'s application requesting a change of electric supplier from Union Electric Company d/b/a Ameren Missouri to Three Rivers Electric Cooperative is granted.
2. This order shall become effective on January 15, 2011.
3. This case shall be closed on January 16, 2011.

Clayton, Chm., Davis, Jarrett,  
Gunn, and Kenney, CC., concur  
and certify compliance with the  
provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,  
on this 5<sup>th</sup> day of January, 2011.

KANSAS CITY POWER & LIGHT COMPANY AND  
KCP&L GREATER MISSOURI OPERATIONS COMPANY

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**In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan**

**In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service**

*File No. ER-2010-0355 and ER-2010-0356  
Decided January 12, 2011*

**Evidence, Practice and Procedure §32.** The Commission may appoint a special master to review attorney-client privilege claims for objections to discovery requests.

**ORDER DENYING MOTIONS IN LIMINE, GRANTING, IN PART,  
MOTION TO COMPEL, AND GRANTING MOTION TO LATE-FILE  
EXHIBIT**

This order denies the motions in limine filed by the Staff of the Missouri Public Service Commission regarding testimony on the topics of demand-side management programs (DSM) and interim energy charges (IECs). The order also grants the portion of the Staff's motion to compel requiring production of documents to the special master for further determination of the attorney-client privilege claim. In addition, this order grants the motion of Kansas City Power & Light Company (KCPL) and KCP&L Greater Missouri Operations Company's (GMO) to late-file an inadvertently omitted schedule to the Rebuttal Testimony of Chris B. Giles.

On November 24, 2010, in both File Nos. ER-2010-0355 and ER-2010-0356, Staff filed essentially the same motion in limine requesting that the Commission order that portions of the Direct Testimony of Tim M. Rush filed by KCPL and GMO and pertaining to the topic of DSM Programs Cost Recovery will not be received as evidence herein. Staff made this argument because those portions of the testimony specifically stated that the company is not presenting any revisions to the current cost recovery mechanisms, yet it hopes that the Commission will change the mechanism in its ongoing rulemaking case<sup>1</sup>

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<sup>1</sup> File No. EX-2010-0368, *In the Matter of the Consideration and Implementation of Section*

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and that the change “will become a part of the outcome in this proceeding.”

As both sides argue, the Commission rules require that a company set out its entire case in chief in its direct testimony.<sup>2</sup> KCPL and GMO claim that they intended to put the other parties to this case on notice about this issue which may develop further as the case progresses. The Commission must have substantial and competent evidence before it in order to support it taking some action (which KCPL and GMO have not requested, but merely “hoped” would happen anyway) with regard to DSM programs cost recovery. The Commission sees no harm in including the statements in the prefiled testimony and will not forbid the offering of such at the hearing. The motions in limine are denied.

Staff also filed a motion in limine in File No. ER-2010-0355 on November 22, 2010, regarding prefiled direct testimony and schedules of Tim M. Rush on the topic of the IEC. Staff argues that those portions of Mr. Rush’s testimony are irrelevant and requests that the Commission preclude the company from offering testimony related to the IEC because Mr. Rush states in his testimony that the company is not requesting an IEC in this case (ER-2010-0355). Mr. Rush goes on to state in that same testimony that although the company is not requesting an IEC in this case, the IEC may “become the preferred method” given the “expected increases in fuel and purchased power costs beyond the time rates take [e]ffect in this case.”<sup>3</sup>

As with the previous motion in limine, the rules require that the company make its entire case-in-chief in its direct testimony. The Commission cannot determine in advance of the offering of this testimony at hearing that it is irrelevant. Within the testimony itself, KCPL states that it may yet seek an IEC before this case is final; thus, it appears that the IEC is relevant and that testimony regarding it should not be excluded prior to the hearing. The motion in limine is denied.

Next, the Staff filed a motion to compel the production of documents by KCPL and GMO in both cases related to Staff’s Data Request 580, part 6, which requests, “[a] copy of any correspondence, including emails, between Mr. Giles and any Schiff Hardin employee

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*393.1075, the Missouri Energy Efficiency Investment Act.*

<sup>2</sup> 4 CSR 240-2.130(7).

<sup>3</sup> Direct Testimony of Tim Rush, p. 16, Ins. 7-9.

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from January 1, 2006 through the current date[.]” KCPL and GMO responded to the motion and objected to that portion of the Data Request because the information is attorney-client privileged and because it believes the Staff’s request is so late that it should be barred. KCPL and GMO state in their unsupported response that because of the nature of Mr. Giles’ work for the companies, any e-mails between him and the Schiff Hardin law firm consultant are necessarily attorney-client privileged material. Also, KCPL and GMO estimate that there are approximately 3,800 e-mails and that to require production at such a late date in the case process would “prejudice and disrupt the efforts of KCP&L and GMO to prepare for hearing.”

The Commission determines that the request was not made so late (December 20, 2010 originally) as to hinder the companies’ preparation for hearing. Therefore, the Commission will overrule the objection to the Data Request on that ground. Answering the Data Request, however, may very well require the submission of attorney-client privileged documents. The Commission has previously appointed Senior Regulatory Law Judge Harold Stearley as a Special Master to review attorney-client privilege claims and thus the Commission will grant the motion to compel, in part, by requiring that the companies provide the documents to the Special Master for his determination of privilege as set out below.

Finally, on December 23, 2010, KCPL and GMO filed a motion to late-file Schedule CBG2010-5 of the Rebuttal Testimony of Chris B. Giles filed December 8, 2010 in File No. ER-2010-0355 and filed December 15, 2010 in File No. ER-2010-0356. KCPL and GMO state that the schedule was inadvertently omitted from those filings. No party responded to the motion and the time to do so has passed. Therefore, the Commission will grant the motion and the schedules shall be considered attached to the rebuttal testimony.

**THE COMMISSION ORDERS THAT:**

1. Staff’s Motion in Limine Regarding Interim Energy Charge filed on November 22, 2010, in File No. ER-2010-0355 is denied.
2. Staff’s Motions in Limine Regarding DSM Programs Cost Recovery filed on November 24, 2010, in File Nos. ER-2010-0355 and ER-2010-0356 are denied.
3. Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company’s Motion to Late-File Exhibit, filed on December 23, 2010, is granted.
4. Staff’s January 4, 2011 Motion to Compel Production

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of Documents is granted to the extent that the companies shall produce to the Special Master the e-mails responsive to Data Request 508 part 6, no later than January 20, 2011, for a determination by Judge Stearley of whether the documents are, in fact, attorney-client privileged material.

5. The documents set out in ordered paragraph 4 shall be provided to the Special Master in an electronic format and the Special Master may conduct a sampling of the material to determine if it is, in fact, attorney-client privileged in its entirety as claimed.

6. This order shall become effective upon issuance.

Clayton, Chm., Jarrett, Gunn, and  
Kenney, CC., concur;  
Davis, C., concurs, with separate  
concurring opinion to follow.

Dippell, Deputy Chief Regulatory Law Judge

**NOTE:** See pages 142, 186, 189, 328, 368 and 534 for other orders in these cases.

**NOTE:** At the time of publication, no opinion of Commissioner Davis has been filed.

**In the Matter of Union Electric Company d/b/a AmerenUE for  
Authority to File Tariffs Increasing Rates for Natural Gas Service  
Provided to Customers in the Company's Missouri Service Area**

*File No. GR-2010-0363  
Decided January 19, 2011*

**Gas §18.** The Commission approved a Stipulation and Agreement authorizing an increase of \$9 million in AmerenUE's retail base rate, which includes \$700,000 in annual funding, increasing to \$850,000 over the next three years, for natural gas energy efficient programs.

**ORDER APPROVING STIPULATION AND AGREEMENT**

On June 11, 2010, Union Electric Company d/b/a AmerenUE submitted proposed tariff sheets implementing a general rate increase of \$11.9 million for natural gas service provided to its Missouri customers.<sup>1</sup> In order to properly consider Ameren's requested rate increase, the Commission issued an order suspending the proposed tariff sheets until

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<sup>1</sup> Direct Testimony of Warner Baxter, page 3, lines 17-18.

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May 8, 2011.

On January 4, 2011, the parties<sup>2</sup> filed a Unanimous Stipulation and Agreement. The agreement authorizes Ameren to file tariff sheets increasing its retail base rate by \$9 million, which includes \$700,000 of annual funding for natural gas energy efficiency programs; increasing over the next three years to approximately \$850,000. A copy of the stipulation and agreement is attached to this order as Attachment 1.

If the Commission unconditionally accepts the terms of the agreement, the parties agree to waive their rights: (1) to call, examine and cross-examine witnesses; (2) to present oral argument and written briefs; (3) to seek rehearing; and (4) to judicial review.

The Commission has the authority to accept a stipulation and agreement as a resolution of the case.<sup>3</sup> Further, when approving a stipulation and agreement, the Commission need not make findings of fact or conclusions of law.<sup>4</sup> The parties agree to the admission into evidence of all prefiled testimony, exhibits and agreements with any attachments thereto. The parties further agree that such evidence constitutes competent and substantial evidence supporting the Commission's approval of this stipulation.

The Commission concludes that the agreed-upon revenue requirement will result in just and reasonable rates and charges. The Commission will therefore approve the agreement.

**THE COMMISSION ORDERS THAT:**

1. The Stipulation and Agreement filed by the parties on January 4, 2011, is approved and the parties shall abide by its terms and conditions.
2. This order shall become effective on January 29, 2011.

Clayton, Chm., Davis, Jarrett,  
Gunn, and Kenney, CC., concur.

Jones, Senior Regulatory Law Judge

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<sup>2</sup> Union Electric Company d/b/a AmerenUE (Now Ameren Missouri); Missouri Department of Natural Resources; The Office of the Public Counsel; Staff of the Missouri Public Service Commission (independent of the Commission).

<sup>3</sup> Section 536.060, RSMo.

<sup>4</sup> Section 536.090, RSMo.

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\*NOTE: The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

**CONCURRING OPINION OF CHAIRMAN ROBERT M. CLAYTON III**

This Commissioner concurs in the Commission's approval of the Unanimous Stipulation and Agreement addressing a rate increase request of Union Electric Company d/b/a AmerenUE.<sup>1</sup> Although rate increases are never welcome, increased costs borne by Ameren Missouri demand slightly higher rates. While the increase amounts to roughly \$3.30, per month for a typical residential customer, any rate increase during challenging economic times will have a negative impact on family budgets. However, for the following reasons, this Commissioner believes that the agreement presented to the Commission supporting a modest increase should be approved.

First, the Commission continues to make a strong stand on funding of Energy Efficiency (EE) programs. As part of the Commission's recent shift of policy on EE, this rate case results in another example of the Commission pressing to achieve EE funding of .5% of a company's gross operating revenues. Starting now at an annual level of \$700,000, the Agreement requires that Ameren Missouri ramp up its investment in EE programs to a target level of \$850,000 by 2014. Consumers will be subject to increased availability of education and other financial programs to encourage smart decisions on energy usage from utilizing new technologies and switching to more efficient appliances. Natural gas costs are relatively low today, but there is no question of the potential for future price spikes. Now is the time for all customers to be prepared for challenging days in the future. Additionally, stakeholders in the Ameren Missouri footprint will have the opportunity in formulating policy through the Ameren Missouri Energy Efficiency Advisory Group (Advisory Group), which will be responsible for evaluating the planning and the implementation of energy efficiency programs.

It is this Commissioner's hope that the Advisory Group can operate in a consensus and advisory fashion and, if any roadblocks occur, that the Commission can engage to move the programs forward. Program types, as well as feedback from the rate payers, are concerns that the Commission will have the ability to monitor and offer guidance to

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<sup>1</sup> Now known as Ameren Missouri.

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the dialogue. If the Advisory Group is unable to move forward due to lack of consensus, the parties are welcome to petition the Commission for relief. The goals of increased EE funding will be addressed regularly through on-going Commission involvement should the Group fail to reach agreement or run into policy differences.

Second, as part of the enhanced EE funding program, Ameren Missouri will refresh its efforts of assisting low income customers who struggle with the costs of heating homes during the winter months with its commitment to weatherization amounting to \$263,000, annually. These funds are critical in empowering customers to more effectively take control of their energy costs. This is a substantial improvement compared to the \$150,000 currently being invested by the company in weatherization programs for low income customers. Funds will be delivered to the Environmental Improvement and Energy Resources Authority (EI ERA), which administers weatherization of homes of Ameren Missouri's low-income natural gas customers.

Finally, this Commissioner is compelled to commend the parties involved in this case who have effectively settled a vast majority of issues relating to purchased gas adjustments, rate design and other issues. While the Commission is prepared to make challenging decisions on controversial and complicated matters, the public can take solace that each of the stipulating parties have placed their names on the line to responsibly reach a compromise on an appropriate level of rates. Though rate increases are never easy or welcome, the evidence in this case demonstrates that higher rates are both prudent and necessary. The Commission has approved this increase unanimously and will engage in future filings to ensure that the Commission's directives are realized. The Commission has a responsibility to ensure that the utility offers safe and adequate service at "just and reasonable" rates. Following Staff's audit, this settlement and transparent Commissioner deliberations, the Commission finds these rates to be "just and reasonable."

For the foregoing reasons, this Commissioner concurs.



SOUTHWESTERN BELL TELEPHONE COMPANY,  
D/B/A AT&T MISSOURI

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**Southwestern Bell Telephone Company d/b/a AT&T Missouri's  
Petition for Compulsory Arbitration of Unresolved Issues for an  
Interconnection Agreement with Global Crossing Local Services,  
Inc. and Global Crossing Telemanagement, Inc.**

*File No. IO-2011-0057  
Decided January 19, 2014*

**Evidence, Practice, And Procedure §28.** In arbitration of telecommunications interconnection agreement, post-decision practice is subject to federal statutes and the Missouri regulations made pursuant to federal regulations, to the exclusion of State statutes and regulations made under State statutes.

**Telecommunications §46.1.** In arbitration of telecommunications interconnection agreement, post-decision practice is subject to federal statutes and the Missouri regulations made pursuant to federal regulations, to the exclusion of State statutes and regulations made under State statutes.

**Order Denying Rehearing and Reconsideration**

The Commission is denying the motion for reconsideration or rehearing, because rehearing does not apply to this action, and the motion does not meet the standard for reconsideration or rehearing.

**A. Background**

This action addresses an interconnection agreement ("agreement") between Southwestern Bell Telephone Company d/b/a AT&T Missouri ("ATT"); and Global Crossing Local Services, Inc. and Global Crossing Telemanagement, Inc., ("Global"). The Commission disposed of all disputed matters on the merits in the *Decision* issued and effective on December 15, 2010. As provided in Commission regulation 4 CSR 240-36.050 ("the regulation"), ATT filed the agreement as conformed to the *Decision* ("conformed agreement") for the Commission's review. Global filed an *Application for Rehearing or, in the Alternative, Motion for Reconsideration* ("motion") on December 27, 2010. ATT filed *AT&T Missouri's Response In Opposition To Global Crossing's Application For Rehearing, Or In The Alternative, Motion For Reconsideration* on January 6, 2010.

**B. Rehearing and Reconsideration**

Commission regulation 4 CSR 240-2.160, which is in the Commission's general regulations on practice and procedure, addresses reconsideration and rehearing. Rehearing is a creation of Section

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386.500, RSMo 2000 (“the rehearing statute”). The rehearing statute states that a motion for rehearing is necessary to preserve matters for review in circuit court.

The rehearing statute provides:

2. No cause or action arising out of any order or decision of the commission shall accrue in any court to any [person] unless that party shall have made, before the effective date of such order or decision, application to the commission for a rehearing. . . .The applicant shall not in any court urge or rely on any ground not so set forth in its application for rehearing.

By making the *Decision* effective on the date of issuance, Global argues, the Commission denied Global the right to preserve matters for judicial review.

But judicial review of this action is not subject to the rehearing statute because this action is not subject to judicial review in circuit court. Unlike other Commission actions, the federal district courts have jurisdiction to review this action under the federal statutes that create this action:

. . . In any case in which a State commission makes a determination under this section, any party aggrieved by such determination may bring an action in an appropriate Federal district court to determine whether the agreement or statement meets the requirements of section 251 of this title and this section. [<sup>1</sup>]

That federal statute also finds mention in the regulation:

(6) Review of Commission Decision-- Any party aggrieved by a commission decision made under this rule may seek relief in an appropriate federal district court pursuant to [47 USC] section 252(e)(6).[.]

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<sup>1</sup> 47 USC Section 252(e)(6).

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Global cites no authority under which the state statute determines the issues in federal district court.<sup>2</sup>

C. Post-Decision Procedure in this Action

In lieu of rehearing, the regulation provides multiple opportunities for post-decision evidence and argument pending the Commission's determination on the conformed agreement.

First, the parties must file statements:

(1) . . . Concurrently with the filing of the conformed agreement, the parties shall each file statements that indicate whether the agreement complies with the requirements of sections 251 and 252 of the Act, Missouri statutes, and the commission's rules.

On December 28, 2010, ATT filed the conformed agreement with *AT&T Missouri's Filing of the Fully Conformed Interconnection Agreement, and Statement of Compliance*. On December 28, 2010, Global filed *Global Crossing Statement*.

Next, the parties may file comments under the regulation.

(2) Within ten (10) days of the filing of the agreement, anyone may file comments concerning the agreement; however, such comments shall be limited to the standards for review referenced in section 4 CSR 240-36.050(4) of this chapter [.]

Global filed *Global Crossing Comments Concerning Agreement* on January 10, 2011.

In addition, the regulation allows additional informal hearings and oral argument.

(2) . . . The commission, upon its own motion, may hold additional informal hearings and may hear oral argument from the parties to the arbitration.

No party sought additional informal hearings or oral argument.

Those provisions appear under 4 CSR 240-36, relating to arbitration of interconnection agreements specifically. Publishing those specific provisions was a meaningless act if the general provisions of 4

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<sup>2</sup> See also U.S. Const., Art. VI, cl. 2.

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CSR 240-2 already applied. The law presumes against meaningless acts<sup>3</sup> so the Commission concludes that rehearing and reconsideration do not apply to this action.

D. Sufficient Cause

Even if rehearing and reconsideration applied to this action, the Commission would still reject the motion, because the motion does not meet the standard for rehearing and reconsideration. The rehearing statute provides that:

1. [T]he commission shall grant and hold such rehearing, if in its judgment sufficient reason therefor be made to appear [;]

and:

4. If, after a rehearing and a consideration of the facts, including those arising since the making of the order or decision, the commission shall be of the opinion that the original order or decision or any part thereof is in any respect unjust or unwarranted, or should be changed, the commission may abrogate, change or modify the same [.]

Those standards, the statute provides, apply to:

2. . . . the ground or grounds on which the applicant considers said order or decision to be unlawful, unjust or unreasonable.

A motion for reconsideration is subject to the same standard.<sup>4</sup> Global alleges no facts arising since the making of the *Decision*, and the *Decision* determined all the arguments in the motion. Therefore, sufficient reason for rehearing does not appear in the motion. That conclusion supports denial of both reconsideration and rehearing.

E. Ruling

The rehearing and reconsideration provisions do not apply and, if they did, the Commission would still deny motion.

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<sup>3</sup> *Missouri ex rel. Bouchard v. Grady*, 86 S.W.3d 121, 123 (Mo. App., E.D. 2002).

<sup>4</sup> 4 CSR 240-2.160(2).

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**THE COMMISSION ORDERS THAT:**

1. The *Application for Rehearing or, in the Alternative, Motion for Reconsideration* is denied.
2. This order shall become effective immediately upon issuance.

Clayton, Chm., Davis, Jarrett, Gunn,  
and Kenney, CC., concur.

Jordan, Senior Regulatory Law Judge

\*NOTE: See page 60 for another order in this case.

**In the Matter of a Proposed Rulemaking Regarding Electric Utility  
Renewable Energy Standard Requirements**

*File No. EX-2010-0169*  
*Issue Date: January 26, 2011*

**Electric §14.** The Commission purported to withdraw two rule provisions that had previously been rejected by the Joint Committee on Administrative Rules (JCAR).

**ORDER WITHDRAWING GEOGRAPHIC SOURCING PROVISIONS**  
**(2)(A) AND (2)(B)2 OF 4 CSR 240-20.100 PURSUANT TO THE**  
**ACTIONS OF JCAR**

By this order, the Public Service Commission withdraws subsection (2)(A) and paragraph (2)(B)2. of 4 CSR 240-20.100 pursuant to the disapproval of the Joint Committee on Administrative Rules (JCAR) under Section 536.021, RSMo Supp. 2009. A notice of proposed rulemaking containing the text of the proposed rule was published in the *Missouri Register* on February 16, 2010 (35 MoReg 365). The Order of Rulemaking was published in the *Missouri Register* on August 16, 2010 (35 MoReg 1183). With the exception of the two provisions being withdrawn by this order, the final rule was published in the *Code of State Regulations* on August 31, 2010, and became effective on September 30, 2010.

Subsection (2)(A) and paragraph (2)(B)2. of 4 CSR 240-20.100

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were not published in the *Code of State Regulations* because of the disapproval of those provisions on July 1, 2010, by JCAR. The Commission is therefore withdrawing those provisions in compliance with this action.

The Commission has not presented the disapproved provisions to the Secretary of State for publication and will not do so in the future. On July 6, 2010, the Commission submitted a letter to the Secretary of State<sup>1</sup> in which it explained that even though the Order of Rulemaking included the disapproved portions, because of the Joint Committee on Administrative Rules' action the Commission was not filing those provisions for publication. The Commission is withdrawing those provisions and again requests that subsection (2)(A) and paragraph (2)(B)2. of 4 CSR 240-20.100 not be published or become effective.

### **THE COMMISSION ORDERS THAT:**

1. Subsection (2)(A) and paragraph (2)(B)2. of 4 CSR 240-20.100 relating to geographic sourcing are withdrawn.
2. Any implied request for publication of subsection (2)(A) and paragraph (2)(B)2. of 4 CSR 240-20.100 as a part of this rulemaking is withdrawn.
3. This order shall become effective upon issuance.

Clayton, Chm., Gunn and Kenney, CC., concur.  
Davis, C., dissents in part, concurs in part,  
with separate opinion to follow.  
Jarrett, C., dissents, with separate dissenting  
opinion attached.

Dippell, Deputy Chief Regulatory Law Judge

**\*NOTE:** The attachment to the order in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

**\*NOTE:** At the time of publication, no opinion of Commissioner Davis has been filed.

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<sup>1</sup> Attached hereto as Attachment A.

**DISSENTING OPINION OF**  
**COMMISSIONER TERRY M. JARRETT**

The law is not a thing to be skirted, diverted or maneuvered; instead, it must be followed. In issuing the “Order Withdrawing Geographic Sourcing Provisions (2)(A) and (2)(B)2 of 4 CSR 240-20.100 Pursuant to the Actions Of JCAR,” the majority of this Commission has side-stepped the law and acted without legal authority. The law provides that the time for this Commission to withdraw two provisions of a rule it has adopted expired six months ago. The only lawful way for the Commission to “withdraw” the two rule provisions which are being held in abeyance by the Joint Committee on Administrative Rules (“JCAR”) is to initiate a subsequent Order of Rulemaking that is first published as a proposed rule, permitted to be commented on by the public, and is published as adopted in a Final Order of Rulemaking in the Missouri Register.

Section 536.021.5, RSMo 2000, is clear that withdrawing a rule must be done within a certain window of time:

Within ninety days after the expiration of the time for filing statements in support of or in opposition to the proposed rulemaking, **or within ninety days after the hearing on such proposed rulemaking if a hearing is held thereon**, the state agency proposing the rule shall file with the secretary of state a final order of rulemaking either adopting the proposed rule, with or without further changes, **or withdrawing the proposed rule**, which order of rulemaking shall be published in the Missouri Register. Such ninety days shall be tolled for the time period any rule is held under abeyance pursuant to an executive order. If the state agency fails to file the order of rulemaking as indicated in this subsection, the proposed rule shall lapse and shall be null, void and unenforceable.

(emphasis added).

The Commission held its hearing on the proposed rule on April 6, 2010, meaning that the ninety day window to withdraw expired on July 6, 2010. On July 7, 2010, the Commission filed with the Secretary of State its final Order of Rulemaking adopting 4 CSR 240-20.100, including the two provisions at issue. Once the Commission issued the final Order of Rulemaking adopting the rule, the Commission lost any authority to

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withdraw the rule or provisions of the rule that have been adopted. Verbal representations by other agency personnel that we have such authority are not the law. As I made clear during the agenda discussion on the Order of Withdrawal, the only legal way to “withdraw” at that point is to initiate a new rule making process.

An agency cannot unilaterally repeal provisions of a regulation merely by declaring that the portions are withdrawn. While I believe the Order issued by the Commission today is void, what that Order seems to be doing is promulgating a new rule, without any notice, opportunity for comment or other due process protections contained in Chapter 536. I agree with the majority’s position that the provisions should be repealed. However, it must be done in accordance with the requirements of Chapter 536 so that the law is followed and due process is ensured to all interested persons.

**In the Matter of the Determination of the Weighted Statewide Average Rate of Nonwireless Basic Local Telecommunication Services**

*File No. TO-2011-0073  
Decided January 26, 2011*

**TELECOMMUNICATIONS §14.** As required by Section 392.245.13, RSMo, the Commission calculated the weighted, statewide average rate of nonwireless basic local telecommunications services and determined that no legislative changes were recommended to the state legislature.

**ORDER DETERMINING STATEWIDE AVERAGE RATE  
AND CLOSING CASE**

Pursuant to Section 392.245.13, RSMo Cum. Supp. 2009, the Commission opened this matter on September 22, 2010, to determine the weighted, statewide average rate of nonwireless basic local telecommunications services. Since that time, the Staff of the Commission has surveyed telecommunications carriers in Missouri to determine their rates as of August 28, 2010.

On January 19, 2011, Staff filed its Report for 2010, in which it calculated the statewide average rates as \$17.11 for residential customers, \$34.35 for business customers, and \$22.49 overall. These



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rates represent an increase in the average greater than the increase in the Consumer Price Index (CPI). The Staff also provided the information on which it based its calculations and stated that it does not recommend any legislative changes.

**THE COMMISSION ORDERS THAT:**

1. The Commission determines the statewide average rates to be \$17.11 for residential customers, \$34.35 for business customers, and \$22.49 overall.
2. The Public Information Office of the Missouri Public Service Commission shall provide notice of this order to the members of the General Assembly.
3. For the reasons stated in Staff's Report, the Commission does not recommend any legislative changes.
4. This order shall become effective on January 26, 2011.
5. This case may be closed on January 27, 2011.

Clayton, Chm., Jarrett, Gunn,  
and Kenney, CC., concur.  
Davis, C., concurs, with separate  
concurring opinion to follow.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

**The Staff of the Missouri Public Service Commission v. Laclede Gas Company**

*File No. GC-2011-0098  
Decided January 26, 2011*

**Evidence, Practice and Procedures §24.** The Commission granted Laclede's motion to dismiss count I of Staff's complaint where that count merely alleged the Commission's jurisdiction over Laclede while not asserting a claim that Laclede had violated any provision of law or tariff.

**ORDER REGARDING LACLEDE'S MOTION TO DISMISS COUNTS I  
AND V OF STAFF'S COMPLAINT**

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On October 6, 2010, the Commission's Staff filed a complaint against Laclede Gas Company, Laclede Energy Resources, Inc., and The Laclede Group, Inc. Staff initially amended that complaint on October 7, and then filed a second amended complaint against all three respondents on November 22. On December 22, the Commission dismissed Staff's second amended complaint against Laclede Energy Resources and The Laclede Group, but the complaint against Laclede Gas Company (Laclede) remains pending.

Laclede filed its answer to Staff's second amended complaint on December 10, and at the same time, filed a motion asking the Commission to dismiss Counts I and V of Staff's complaint as failing to state a claim upon which relief can be granted. Staff did not respond to Laclede's motion to dismiss within the ten-day period allowed by Commission rule.<sup>1</sup> However, Staff filed a responsive pleading on January 18, along with a motion seeking leave to late-file its response.

On January 25, Staff filed a notice dismissing Count V of its complaint without prejudice. Commission rule 4 CSR 240-2.116 allows a complainant to voluntarily dismiss its complaint without an order of the Commission at any time before prepared testimony has been filed or oral evidence has been offered. No testimony or evidence has yet been offered in this case, so Staff is free to dismiss all or any part of its complaint. With Staff having dismissed Count V, the only remaining issue regarding Laclede's motion to dismiss concerns Count I of that complaint.

The Commission has the authority to decide this matter on the pleadings pursuant to Commission Rule 4 CSR 240-2.117(2), which states:

Except in a case seeking a rate increase or which is subject to an operation of law date, the commission may, on its own motion or on the motion of any party, dispose of all or any part of a case on the pleadings whenever such disposition is not otherwise contrary to law or contrary to the public interest.

The Commission's rules do not establish standards for when it is appropriate to dispose of a case on the pleadings, so the Commission will instead look to Missouri's civil procedures for guidance.

In indicating when a case may be disposed on the pleadings, the

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<sup>1</sup> Commission rule 4 CSR 240-2.080(15).

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Missouri Supreme Court has stated that for purposes of the motion, all facts stated in the challenged pleading are accepted as true. If those assumed facts are insufficient as a matter of law, the trial court may properly grant a motion for judgment on the pleadings.<sup>2</sup>

Staff's second amended complaint now contains four counts, of which, Laclede challenges only the first count. Count I of that amended complaint offers a series of allegations intended to establish the Commission's jurisdiction over Laclede and its affiliates, The Laclede Group and Laclede Energy Resources. Aside from asserting the Commission's jurisdiction, Count I does not allege that Laclede has violated any statute, regulation, or tariff.

The Commission has already dismissed The Laclede Group and Laclede Energy Resources from this complaint so Staff's allegations purporting to establish jurisdiction over those companies is no longer relevant. Laclede is a natural gas distribution utility in eastern Missouri and is regulated by this Commission as a gas corporation as defined by Section 386.020(18) RSMo (Supp. 2009). Thus, the Commission's jurisdiction over Laclede is not in question.

Laclede asks the Commission to dismiss Count I because it fails to state a claim against Laclede. In fact, Count I does not state a claim against Laclede, or anyone else, nor does it appear to be intended to state such a claim. Rather, it simply asserts the Commission's jurisdiction over the respondents. To the extent Count I remains relevant after the dismissal of The Laclede Group and Laclede Energy Resources, it serves only to establish background information that may be relevant to the remaining counts of the complaint. Therefore, it is not properly denominated as a separate count.

The Commission will dismiss Count I, but since those paragraphs may retain some relevance to the remaining counts of the complaint, there is no reason to strike them from the complaint. Indeed, Laclede does not seek that relief. Therefore, the Commission will grant Laclede's motion to dismiss Count I of Staff's complaint, but will allow those paragraphs denominated as Count I to remain as background for the complaint.

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<sup>2</sup> *State ex rel. Nixon v. American Tobacco Co., Inc.*, 34 S.W.3d 122, 134 (Mo 2000).

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**THE COMMISSION ORDERS THAT:**

1. Laclede Gas Company's motion to dismiss Count I of Staff's second amended complaint is granted.
2. This order shall become effective immediately upon issuance.

Clayton, Chm., Davis, Jarrett, Gunn,  
and Kenney, CC., concur;  
with Davis, C., concurring opinion to follow.

Woodruff, Chief Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

\*NOTE: See page 664 for another order in this case.

**The Staff of the Missouri Public Service Commission v. Laclede Gas Company\***

*File No. GC-2011-0006  
Decided February 4, 2011*

**Evidence, Practice and Procedures §24.** The Commission granted summary determination in favor of Staff's complaint against Laclede for violating a stipulation and agreement by which Laclede agreed not to object to the production of documents on the basis that such documents were in the possession of its corporate parent rather than itself.

**REPORT AND ORDER REGARDING  
MOTIONS FOR SUMMARY DETERMINATION**

**Syllabus:** This order grants summary determination in favor of the Staff of the Commission. It also denies Laclede Gas Company's motion for summary determination.

**Background and Procedural History**

On July 7, 2010, the Staff of the Commission filed a complaint against Laclede Gas Company. Laclede filed its answer to that complaint on August 9. Laclede filed a counterclaim against Staff on September 22, which the Commission dismissed on November 3. An evidentiary hearing on Staff's complaint is scheduled for February 22-25, 2011.

Staff filed a motion for summary determination on December 15.

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Laclede responded on December 22 by filing its own motion for summary determination. Both motions were accompanied by supporting legal memorandums. Staff filed suggestions in opposition to Laclede's motion for summary determination on January 12, 2011. Laclede filed its response to Staff's motion on January 14.

### **FINDINGS OF FACT**

Based upon undisputed facts, the Commission makes these Findings of Fact.

1. This complaint is brought by the Staff of the Missouri Public Service Commission, acting through the Chief Staff Counsel.

2. Laclede Gas Company is a Missouri general business corporation in good standing, incorporated on March 2, 1857 as The Laclede Gas Light Company. Its principal place of business is located at 720 Olive Street, St. Louis, Missouri 63101.

3. Laclede is a natural gas distribution company that serves approximately 630,000 residential, commercial, and industrial customers in the City of St. Louis and ten other counties in Eastern Missouri.

4. Laclede is a "gas corporation" as defined by section 386.020(18), RSMo 2000, and is a "public utility" as defined by section 386.020(43), RSMo 2000.

5. Laclede is a wholly-owned subsidiary of The Laclede Group, Inc., a Missouri general business corporation in good standing, incorporated on October 18, 2000. The Laclede Group's principal place of business is located at 720 Olive Street, St. Louis, Missouri. The Laclede Group is a public utility holding company.

6. Laclede Energy Resources, Inc., is a Missouri general business corporation in good standing. It was incorporated on May 28, 1981 and its principal place of business is located at 720 Olive Street, St. Louis, Missouri 63101. Laclede Energy Resources is also a wholly-owned subsidiary of The Laclede Group.

7. Laclede Energy Resources engages in the marketing of natural gas and is not regulated by this Commission.

8. From time to time Laclede purchases natural gas from Laclede Energy Resources.

9. On December 1, 2000, Laclede applied to this Commission for authority to restructure itself as a holding company with subsidiaries. The Commission assigned that application File Number GM-2001-342.

10. Laclede's application for authority to restructure was resolved through a stipulation and agreement, which the Commission

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approved on August 14, 2001. The approved stipulation and agreement was signed by Laclede and by The Laclede Group, Inc.

11. The approved stipulation and agreement provided that Laclede would be authorized to restructure itself, subject to certain conditions set forth in the stipulation and agreement.

12. Subsection VI.1 of the approved stipulation and agreement provides in part:

Upon implementation of the Proposed Restructuring, transactions involving transfers of goods or services between Laclede Gas Company and one or more of the Company's affiliated entities shall be conducted and accounted for in compliance with the provisions of a Cost Allocation Manual ("CAM") ...

13. Section IV of the approved stipulation and agreement is entitled "Access to Information Conditions."

14. Subsection IV.2 can be divided into three portions. The first portion states:

Upon request, Laclede Gas Company and The Laclede Group, Inc. agree to make available to Staff, Public Counsel and PACE,<sup>1</sup> upon written notice during normal working hours and subject to appropriate confidentiality and discovery procedures, all books, records and employees of the Laclede Group, Inc., Laclede Gas Company and its affiliates as may be reasonably required to verify compliance with the CAM and the conditions set forth in this Stipulation and Agreement.

15. The second portion relates to PACE and establishes special terms regarding the provision of information to the unions. That portion is not relevant to this case.

16. The third portion of IV.2 once again concerns the sharing of information with Staff and Public Counsel. The third portion states:

Laclede Gas Company and The Laclede Group, Inc. shall also provide Staff and Public Counsel any other such information (including access to employees) relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over Laclede Gas Company; provided that Laclede Gas

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<sup>1</sup> PACE was an affiliation of the labor unions that represented Laclede's employees.

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Company and any affiliate or subsidiary of The Laclede Group, Inc. shall have the right to object to such production of records or personnel on any basis under applicable law and Commission rules, excluding any objection that such records and personnel of affiliates or subsidiaries: (a) are not within the possession or control of Laclede Gas Company; or (b) are either not relevant or are not subject to the Commission's jurisdiction and statutory authority by virtue of or as a result of the implementation of the Proposed Restructuring.

17. A discovery dispute arose between Staff and Laclede during proceedings related to two actual cost adjustment (ACA) cases, GR-2005-0203 and GR-2006-0288. In such ACA cases, Laclede's estimated cost of procuring gas supplies on an annual basis is adjusted to reflect Laclede's actual cost to obtain those supplies, which costs are further adjusted to exclude any imprudent costs.

18. In examining Laclede's actual costs for procuring gas supplies, Staff was particularly concerned with Laclede's purchase of gas supplies from its affiliate, Laclede Energy Resources.

19. On October 20, 2008, acting in case numbers GR-2005-0203 and GR-2006-0288, the Commission granted Staff's motion to compel Laclede to produce certain information and documents concerning Laclede Energy Resources.

20. After the Commission denied Laclede's request to reconsider its October 20, 2008 order, Laclede filed a Request for Clarification on December 26, 2008. That motion asked the Commission to conduct an evidentiary hearing before allowing Staff to investigate Laclede Energy Resources.

21. On January 21, 2009, the Commission clarified its October 20, 2008 order compelling Laclede to produce documents by stating:

The Commission has ordered Laclede to produce information about its affiliate according to the rules of discovery not under the Commission's Affiliate Transaction Rule. Although it is true that by granting Staff's motion, Staff is permitted to investigate Laclede's affiliate transactions, such investigation is limited to information that may lead to evidence that is relevant to these ACA cases. To the extent that Laclede is in possession of the information, the Commission clarifies

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its order compelling Laclede to produce the information requested by Staff.

The Commission specifically denied Laclede's request for a hearing and again ordered Laclede to produce the information it was ordered to produce in the October 20, 2008 order.

22. At various times throughout the ACA cases, Staff has confirmed that it is seeking information from Laclede regarding the prudence of its gas purchases from Laclede Energy Resources and that its investigation is not aimed at determining whether Laclede violated the affiliate transaction rule or its Cost Allocation Manual.

23. On April 22, 2009, after hearing still more arguments from the parties, the Commission reversed its position and issued an Order Denying Motion to Compel, concluding "the information Staff seeks is not reasonably calculated to lead to the discovery of admissible evidence."

24. Staff and Public Counsel asked the Commission to reconsider its April 22, 2009 order, and on September 9, 2009, the Commission granted reconsideration and ordered the parties to present additional oral argument.

25. Finally, after hearing additional argument, the Commission issued an order on November 4, 2009, that again directed Laclede to produce the information that Staff sought. In its order, the Commission stated:

The Commission emphasizes that Staff's discovery request is not an investigation under the Commission's Affiliate Transaction rule nor is it a complaint through which Staff or Public Counsel seeks enforcement of the agreement reached in Case No. GM-2001-342. These issues have but served as red herrings in what is a discovery request governed by the rules of civil procedure. Mirroring what was set out in the Commission's initial order granting Staff's motion to compel, Commission rule 4 CSR 240-2.090(1) states that discovery may be obtained by the same means and under the same conditions as in civil actions. Under the rules of civil procedure, "it is not grounds for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence." (citations omitted).



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26. Laclede did not comply with the discovery request to Staff's satisfaction and on February 24, 2010, the Commission directed its General Counsel to seek enforcement of the Commission's order in circuit court.

27. The Commission's General Counsel proceeded to file a petition for a writ of mandamus in the Circuit Court of Cole County, seeking to compel Laclede to comply with the Commission's discovery orders.

28. During the course of an oral argument held on May 11, 2010, before the Honorable Paul C. Wilson, Judge of Division II of the 19<sup>th</sup> Judicial Circuit, Cole County, Michael Pendergast, legal counsel for Laclede, argued to the court that Laclede should not be compelled to give Staff the documents of Laclede Energy Resources it seeks because those documents were not in the possession, custody, or control of Laclede. Pendergast told the circuit court that Laclede was taking that position under the general rules of civil discovery as the Commission had, in its previous orders declared that the affiliate transaction rule, the Cost Allocation Manual, and the stipulation and agreement did not control Staff's discovery request.<sup>2</sup>

29. On June 25, 2010, the Circuit Court of Cole County issued a Judgment and Writ of Mandamus that ordered Laclede to file a return by July 30, 2010, indicating that it has "produced all of the information sought by the PSC Discovery Order that is within its possession, custody or control." Laclede filed the required return on July 30, 2010.

### **CONCLUSIONS OF LAW**

The Missouri Public Service Commission has reached the following conclusions of law:

#### **Jurisdiction**

This Commission has jurisdiction and authority over gas corporations that provide service within Missouri.<sup>3</sup> The Commission has authority to hear and decide complaints brought against public utilities operating in Missouri.<sup>4</sup>

#### **Authority to Seek Penalties for Violation of Commission Orders**

The relevant portion of section 386.570.1, RSMo 2000, provides:

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<sup>2</sup> The transcript of the proceedings before the circuit court are attached to Staff's complaint. Laclede's argument is found on pages 13 and 14 of the transcript.

<sup>3</sup> Section 393.140, RSMo 2000.

<sup>4</sup> Section 386.390, RSMo 2000.

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[a]ny corporation, person or public utility which ... fails, omits or neglects to obey, observe or comply with any order, decision, decree, rule, direction, demand or requirement, or any part or provision thereof, of the commission in a case in which a penalty has not herein been provided for such corporation, person or public utility, is subject to a penalty of not less than one hundred dollars nor more than two thousand dollars for each offense.

Section 386.570.2, RSMo 2000, indicates that every violation of a Commission order is a separate and distinct offense and that each day's continuance of a violation is also a separate and distinct offense.

Section 386.570.3, RSMo 2000, provides that for purposes of enforcing this penalty provision, the acts of an employee of a public utility, acting within the scope of his or her employment, are to be deemed the acts of the public utility.

Section 386.600, RSMo 2000, allows the Commission's General Counsel to bring an action in circuit court to recover a penalty for the violation of a Commission order.

**Standard of Review for Summary Determination**

Commission Rule 4 CSR 240-2.117, which is titled "Summary Disposition," authorizes the Commission to decide all or any part of "a contested case by disposition in the nature of summary judgment or judgment on the pleadings."

Commission Rule 4 CSR 240-2.117(1), provides, in relevant part:

4. (A) Except in a case seeking a rate increase or which is subject to an operation of law date, any party may by motion, with or without supporting affidavits, seek disposition of all or any part of a case by summary determination at any time after the filing of a responsive pleading, if there is a respondent, or at any time after the close of the intervention period.

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5. (E) The commission may grant the motion for summary determination if the pleadings, testimony, discovery, affidavits, and memoranda on file show that there is no genuine issue as to any material fact, that any party is entitled to relief as a matter of law as to all

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or any part of the case, and the commission determines that it is in the public interest. An order granting summary determination shall include findings of fact and conclusions of law.

This is not a case seeking a rate increase, or a case subject to an operation of law date. Moreover, as set out below, to grant summary determination in this case will not be “otherwise contrary to law” since no genuine factual dispute remains for hearing,<sup>5</sup> one of the parties is entitled to a determination in its favor as a matter of law,<sup>6</sup> and the contents of the parties’ pleadings make it plain that the merits of this controversy can be fairly and fully decided in a summary manner. Moreover, the public interest clearly favors the quick and efficient resolution of this matter by summary determination without an evidentiary hearing<sup>7</sup> inasmuch as “[t]he time and cost to hold hearings on [a] matter when there is no genuine issue as to any material fact would be contrary to the public interest.”<sup>8</sup> Therefore, the Commission may finally dispose of this case on the basis of the law and the undisputed material facts before it.<sup>9</sup>

### **DECISION**

Staff alleges that Laclede has violated Section IV.2 of the stipulation and agreement by which the Commission granted Laclede

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<sup>5</sup> *Determination on the Pleadings, In the Matter of the Cancellation of the Certificate of Service Authority and Accompanying Tariff of ConnectAmerica, Inc.*, Case No. TD-2003-0582 (Nov. 4, 2004). See also *Order Denying Motion for Determination on the Pleadings, Tony Walker v. Kansas City Power & Light Company*, Case No. EC-2006-0451 (Aug. 28, 2006) (*denying request for determination on the pleadings under 4 CSR 240-2.117(2) as contrary to law and the public interest where it was obvious that the parties did not agree on the essential facts underlying the complainant’s claim for relief*); *McGuire v. Dir. of Revenue*, 174 S.W.3d 87, 89 (Mo. App. E.D. 2005) (*a motion for judgment on the pleadings should be denied where there is a genuine issue of material fact on the face of the pleadings*).

<sup>6</sup> *Determination on the Pleadings, In the Matter of the Cancellation of the Certificate of Service Authority and Accompanying Tariff of ConnectAmerica, Inc.*, Case No. TD-2003-0582 (Nov. 4, 2004); *Neel v. Strong*, 114 S.W.3d 272, 274 (Mo. App. E.D. 2003) (“*A motion for judgment on the pleadings is properly granted . . . if, from the face of the pleadings, the moving party is entitled to judgment as a matter of law.*”).

<sup>7</sup> See, e.g., *Determination on the Pleadings, The Staff of the Missouri Public Service Commission v. Taney County Utilities Corporation*, Case No. WC-2004-0342 (Oct. 19, 2004).

<sup>8</sup> *Determination on the Pleadings, In the Matter of the Application of Aquila Inc. for an Accounting Authority Order Concerning Fuel Purchases*, Case No. EU-2005-0041 (Oct. 7, 2004).

<sup>9</sup> See, e.g., *Determination on the Pleadings, The Staff of the Missouri Public Service Commission v. Taney County Utilities Corporation*, Case No. WC-2004-0342 (Oct. 19, 2004).

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authority to reorganize itself under a holding company structure. Specifically, Staff contends Laclede violated the stipulation and agreement by arguing to the circuit court that the Laclede Energy Resources documents sought by Staff were not in the possession, custody, or control of Laclede.

Laclede counters by arguing that in its string of orders regarding Staff's discovery requests, the Commission has decided that in seeking discovery, Staff was proceeding under general civil discovery principles and that therefore the requirements of the stipulation and agreement do not apply in this case.

6. The first step in evaluating the parties' arguments is to take a closer look at the stipulation and agreement. The first portion of subsection IV.2 of the approved stipulation and agreement requires Laclede and The Laclede Group, Inc. to make available to Staff, Public Counsel, and PACE all records of all affiliates "as may be reasonably required to verify compliance with the CAM and the conditions set forth in the Stipulation and Agreement."

7. By its clear terms, that portion of the stipulation and agreement requires Laclede and its affiliates to turn over documents that are connected to an investigation into compliance with the Cost Allocation Manual and the conditions set forth in the stipulation and agreement. Staff has repeatedly indicated that it is not seeking documents from Laclede as part of an effort to verify compliance with the Cost Allocation Manual, the stipulation and agreement, or the affiliate transaction rules. If this first portion of subsection IV.2 were the entire agreement, Laclede would be entitled to prevail on its motion for summary determination.

8. However, the agreement embodied in subsection IV.2 does not end with the first portion. In the third portion of that subsection, Laclede and The Laclede Group agree that they will provide Staff and Public Counsel any other information that is "relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over Laclede Gas Company."

9. This portion of the agreement is not limited to situations in which Staff, Public Counsel, or PACE are seeking to verify compliance with the Cost Allocation Manual or the terms of the stipulation and agreement. Instead, it applies to general discovery requests. It allows Laclede, The Laclede Group, and any affiliated company the right to object to the production of such records on any lawful basis with two exceptions. Laclede, The Laclede Group, and affiliated companies are

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not allowed to object that the records are “not within the possession or control of Laclede Gas Company,” and they are not allowed to object that the records are no longer relevant or subject to the Commission’s jurisdiction and statutory authority because of the restructuring.

10. When Laclede restructured and formed a holding company with attendant unregulated affiliates, a portion of the business Laclede conducts was transformed into unregulated activity that might evade the Commission’s review. In effect, this portion of the subsection allows Staff and Public Counsel the same access to business records related to Laclede’s activities as they would have had before the restructuring.

11. When Laclede argued to the circuit court that it should not have to produce documents belonging to Laclede Energy Resources because it did not have possession or control of those documents, it was asserting a defense that it had relinquished under the explicit requirements of the third portion of section IV.2 of the stipulation and agreement.

12. Laclede attempts to avoid that conclusion by arguing that Staff is collaterally attacking the Commission’s previous orders, as well as the order issued by the circuit court, which found that Staff is seeking to compel Laclede to produce documents under the general rules of civil discovery. But those orders are not inconsistent with the Commission’s conclusion that Laclede has violated the stipulation and agreement.

13. Only the first portion of subsection IV.2 of the stipulation and agreement is limited to discovery related to compliance with the Cost Allocation Manual and the terms of the stipulation and agreement. The third portion of that subsection, the portion that is relevant in this case, applies to the discovery requests Staff has made under the general rules of civil discovery.

14. Laclede also argues that in one of its previous orders, the Commission explicitly limited Laclede’s obligation by requiring it to produce those documents in its possession. The sentence in question is found in the Commission’s January 21, 2009 Order Regarding Request for Clarification. That order is quoted extensively in paragraph 21 of the Findings of Fact section of this order, but the particular sentence in question states “[t]o the extent that Laclede is in possession of the information, the Commission clarifies its order compelling Laclede to produce the information requested by Staff.”

15. The Commission did not intend to relieve Laclede of its obligation to produce documents by including that sentence in the body of its order. Laclede had not asked the Commission for clarification

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regarding its obligation to produce information not in its possession and the only actual clarification the Commission ordered was a denial of Laclede's request for an evidentiary hearing. Furthermore, in that order, the Commission once again required Laclede to comply with Staff's discovery requests. In any event, the Commission has never set aside the stipulation and agreement and its limitation on Laclede's ability to challenge discovery requests.

16. Thus, when Laclede argued to the circuit court that it does not have possession of documents belonging to its affiliate, Laclede Energy Resources, to avoid compliance with Staff's discovery request, it violated the explicit terms of the stipulation and agreement. When the Commission approved that stipulation and agreement it became an order of the Commission, and the violation of that order subjects Laclede to the penalty provisions of Section 386.570.

17. The Commission emphasizes that this order resolving Staff's complaint is not about the interpretation of the Cost Allocation Manual or the affiliate transaction rules. Laclede would like to argue again that the information Staff seeks is not relevant, but that question is not currently before the Commission. Ultimately, the questions about the applicability and interpretation of the Cost Allocation Manual and the affiliate transaction rules will be resolved in the underlying ACA cases, but not in this complaint.

18. The Commission has found that Laclede is subject to a penalty for its violation of the stipulation and agreement and the order that approved that stipulation and agreement. The Commission will authorize its General Counsel to seek such a penalty in circuit court, but the Commission is not seeking to impose a harsh punishment on Laclede for its past actions. Rather, the Commission wants to emphasize to Laclede that it must comply with the stipulation and agreement and with the Commission's orders regarding discovery.

### **THE COMMISSION ORDERS THAT:**

1. The Motion for Summary Determination filed by the Staff of the Commission is granted.
2. The Motion for Summary Determination filed by Laclede Gas Company is denied.
3. The Commission's General Counsel is authorized to proceed to circuit court to pursue appropriate penalties against Laclede Gas Company.
4. With Summary Determination having been granted, the remaining procedural schedule, including the evidentiary hearing

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scheduled for February 22-25, 2011, is canceled.

5. This order shall become effective on February 14, 2011.

Clayton, Chm., Gunn, and Kenney, CC., concur;  
Davis and Jarrett, CC., dissent, with dissenting opinion  
of Jarrett to follow.

Woodruff, Chief Regulatory Law Judge

**DISSENT OF COMMISSIONER TERRY M. JARRETT TO THE  
REPORT AND ORDER REGARDING MOTIONS  
FOR SUMMARY DETERMINATION**

I respectfully dissent. The Staff is not entitled to Summary Determination because it has not established that there is no genuine issue as to any material fact that would entitle them to such relief.

Commission Rule 4 CSR 240-2.117(E) sets out the standard for granting a motion for summary determination:

The commission may grant the motion for summary determination if the pleadings, testimony, discovery, affidavits, and memoranda on file show that there is no genuine issue as to any material fact, that any party is entitled to relief as a matter of law as to all or any part of the case, and the commission determines that it is in the public interest. An order granting summary determination shall include findings of fact and conclusions of law.

In its Motion, Staff argues that Laclede has violated a prior Commission order by violating the approved Stipulation and Agreement in Case No. GM-2001-342. Specifically, Staff asserts that, during a hearing on Case No. 10AC-CC00170 on May 11, 2010, Michael Pendergast, attorney for Laclede, argued that the documents sought by the Staff and ordered by the Commission to be provided, "aren't something that Laclede Gas has possession, custody or control over." And, Mr. Pendergast further argued that "We have, being Laclede Gas Company, have provided everything we have in our possession. We have indication to the Commission that we have provided everything that's in our possession." Staff makes further allegations that in other on the record presentations, hearings or communications, Mr. Pendergast stated that Laclede is not in possession of the documents sought by

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Staff. Staff also alleges that in Laclede Gas Company's Return to the Writ of Mandamus that Laclede states that it does not have the documents.

The pertinent part of the Stipulation and Agreement reads as follows:

Laclede Gas Company and The Laclede Group, Inc., shall also provide Staff and Public Counsel any other such information (including access to employees) relevant to the Commission's ratemaking, financing, safety, quality of service and other regulatory authority over Laclede Gas Company; **provided that Laclede Gas Company and any affiliate or subsidiary of The Laclede Group, Inc. shall have the right to object to such production of records or personnel on any basis under applicable law and Commission rules, excluding any objection that such records and personnel of affiliates or subsidiaries: (a) are not within the possession or control of Laclede Gas Company; or (b) are either not relevant or are not subject to the Commission's jurisdiction and statutory authority by virtue of or as a result of the implementation of the Proposed Restructuring. (Emphasis supplied.)**

The key phrase here is "right to object." According to the Stipulation and Agreement, Laclede has no right to **object** that the records sought by Staff are not within the possession and control of Laclede.

To "object" is a legal term of art. It is defined as follows:

In legal proceedings, to object (*e.g.*, to the admission of evidence) is to interpose a declaration to the effect that the particular matter or thing under consideration is not done or admitted with the consent of the party objecting, by is by him considered improper or illegal, and referring the question of its propriety or legality to the court.<sup>10</sup>

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<sup>10</sup> Black's Law Dictionary, 5th ed. at 967 (1979).



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Nowhere in Staff's Motion does it allege, much less show by the pleadings, testimony, discovery, affidavits, and memoranda on file, that Laclede ever "objected" to the production of the records at issue. The context of Laclede's representations in Circuit Court and appellate courts, and other hearings and communications relied on by Staff in its Motion, are not **objections**. In fact, they are representations in oral arguments before the Courts and this Commission and in other communications with Staff. In its Motion, Staff never asserts or proves by competent and substantial evidence that any Court or this Commission was ever presented with an objection by Laclede. The words spoken or written were not the type of objection contemplated by the Stipulation and Agreement.

Words in the law have meaning, and, the meaning of words does make a difference. What Staff accuses Laclede of doing simply did not occur, or at least Staff has not shown any evidence that Laclede objected as contemplated by the Stipulation and Agreement.

Based on the analysis set out above, Summary Determination is not appropriate. Staff's Motion should have been denied.

**\*NOTE:** This case was appealed to the Missouri Court of Appeals (WD) and affirmed. See 392 SW3d 24 (Mo. App. W.D. 2012)

**In The Matter of the Application of KCP&L Greater Missouri Operations Company for Permission and Approval and a Certificate of Public Convenience and Necessity Authorizing it to Acquire, Construct, Install, Own, Operate, Maintain, and otherwise Control and Manage Electrical Production and Related Facilities in Certain Areas of Buchanan County, Missouri Near the City of St. Joseph.**

*File No. EA-2011-0165  
Decided February 4, 2011*

**Electric §3.** The Commission approves an application to construct a facility for producing electricity powered by landfill gas.

**Electric §30.** The Commission approves an application to construct a facility for producing electricity powered by landfill gas.

**ORDER GRANTING CERTIFICATE OF  
CONVENIENCE AND NECESSITY**

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The Commission is granting the application (“application”) of KCP&L Greater Missouri Operations Company (“GMO”), and issuing a certificate of convenience and necessity for those purposes, for constructing electrical production and related facilities (“facilities”) powered by landfill gas from the City of St. Joseph Landfill, a renewable fuel.

Procedure

GMO filed the application with a supporting affidavit on December 7, 2010, and filed supplementary documents on December 10, 2010. The Commission gave notice of the application, solicited the Staff’s recommendation, and set a deadline for motions to intervene on December 9, 2010. On January 18, 2011, the Commission granted the application to intervene of the Missouri Department of Natural Resources (“DNR”).

The application is subject to the following procedure:

The commission shall have the power to grant the permission and approval herein specified whenever it shall after **due hearing** determine that such construction or such exercise of the right, privilege or franchise is necessary or convenient for the public service.<sup>1</sup>

The statutory provision for a “due hearing”<sup>2</sup> means that the Commission may grant the unopposed application without a hearing.<sup>3</sup> On January 14, 2011, Staff filed its recommendation with a supporting affidavit in favor of granting the application.

As of the date of this order, no party has filed any response to the recommendation.<sup>4</sup> Therefore, this action is a non-contested case and the Commission need not separately state its findings of fact. The Commission bases its findings of fact on the verified filings.

Standard

The application seeks the Commission’s permission and

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<sup>1</sup> Section 393.170.3, RSMo 2000.

<sup>2</sup> Section 393.170.3, RSMo 2000.

<sup>3</sup> *State ex rel. Rex Deffenderfer Ent., Inc. v. Public Serv. Comm’n*, 776 S.W.2d 494, 496 (Mo. App., W.D. 1989).

<sup>4</sup> Under 4 CSR 240-2.010(11), OPC is a party to this action unless it elects to “file a notice of their intention not to participate within the period of time established for interventions by commission rule or order.” As of the date of this order, no notice of intention not to participate is on file.

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approval to construct an electrical production facility powered by the renewable fuel of landfill gas from the City of St. Joseph Landfill. Electrical facility construction<sup>5</sup> and service<sup>6</sup> require the Commission's prior permission and approval. Such permission and approval depend on GMO showing:

. . . that the granting of the application is required by the public convenience and necessity[;<sup>7</sup>]

and the Commission determining:

. . . that such construction or such exercise of the right, privilege or franchise is necessary or convenient for the public service[.<sup>8</sup>]

Further, the Commission may condition its approval and permission as follows:

The commission may by its order impose such condition or conditions as it may deem reasonable and necessary [.<sup>9</sup>]

"Necessary" and "necessity" relate to the regulation of competition, cost justification, and safe and adequate service.<sup>10</sup> On finding convenience and necessity, the Commission embodies its permission and approval in a certificate,<sup>11</sup> which the statutes call a certificate of convenience and necessity.<sup>12</sup>

Findings and Conclusions

The verified filings support the convenience and necessity of GMO's proposed construction as follows:

1. GMO is a Missouri corporation in good standing authorized to do business as an electrical corporation and the area in which GMO proposes to install the facilities is

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<sup>5</sup> Section 393.170.1, RSMo 2000.

<sup>6</sup> Section 393.170.2, RSMo 2000, first sentence.

<sup>7</sup> 4 CSR 240-3.205(1)(E).

<sup>8</sup> Section 393.170.3, RSMo 2000.

<sup>9</sup> *Id.*

<sup>10</sup> *State ex rel. Intercon Sewer, Inc. v. Public Serv. Comm'n of Mo.*, 848 S.W.2d 593, 597 (Mo. App., W.D. 1993).

<sup>11</sup> Section 393.170.2, RSMo 2000, second sentence.

<sup>12</sup> Section 393.170.3, RSMo 2000, third sentence.

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within GMO's service territory.<sup>13</sup>

2. The application has support from the City of St. Joseph, Buchanan County, and DNR.

3. GMO will finance the project with general funds, federal tax credits and Missouri Biogas Energy Subgrants.

On those grounds, the Commission independently finds and concludes that the facilities are necessary and convenient for the public service. Therefore, the Commission will grant the application.

**THE COMMISSION ORDERS THAT:**

1. The application is granted, and a certificate of convenience and necessity reflecting such permission and approval shall be issued to KCP&L Greater Missouri Operations Company ("company") for the facilities described in the application.

2. Nothing in this order precludes the Commission from considering any ratemaking treatment of any future company expenditure, and any other matter, pertaining to the certificate of convenience and necessity.

3. This order shall become effective on February 14, 2011 and this file shall close February 15, 2011.

Clayton, Chm., Davis, Jarrett, Gunn  
and Kenney, CC., concur.

Jordan, Senior Regulatory Law Judge

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<sup>13</sup> The proposed service area's legal description is in the application's Appendix 2. A depiction is in the application's Exhibit A.

OSAGE VALLEY ELECTIC COOPERATIVE

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**In the Matter of the Application of Osage Valley Electric Cooperative for Approval of a Change in Electrical Suppliers for Certain Customers Within the City of Clinton for Reasons in the Public Interest.**

*File No. EO-2011-0137  
Decided February 7, 2011*

**Electric §4.1.** The Commission may order a change of suppliers for property served by a cooperative or a municipally owned or operated electric power system on the basis that the change is in the public interest for a reason other than a rate differential. The cost the cooperative must incur to repair and replace the infrastructure for the properties in question outweighs the revenue the sales from the infrastructure would generate, and the public utility and property owners agreeing to the change, are all factors supporting that the change would be in the public interest.

**ORDER APPROVING CHANGE OF ELECTRIC SERVICE SUPPLIER**

On November 9, 2010, Osage Valley Electric Cooperative (hereafter "Osage Valley") asked the Commission to allow it to transfer the service of four properties (hereafter "the properties") within the City of Clinton to Kansas City Power & Light – Greater Missouri Operations Company (hereafter "GMO"). The Commission granted the intervention requests of GMO, and of an owner of two of the properties to be transferred, Robert Robinson.

On January 20, 2011, Staff filed its recommendation. Staff indicated the request for a change in supplier was in the public interest for a reason other than a rate differential, and recommended the Commission approve the request. Staff explained that the cost Osage Valley must incur to repair and replace the infrastructure to serve the properties is not justified by the revenue generated from serving the properties. Staff further notes that although the relevant statute does not require the property owners to consent to the transfer, the owners of properties have consented to the change. GMO is also willing to serve those properties. These are all factors supporting a Commission finding that the change in suppliers would be in the public interest for a reason other than a rate differential.

Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to pleadings. No party has responded to the Staff Recommendation.

Section 394.315.2, RSMo 2000, gives the Commission authority to order a change of suppliers for property served by a municipally

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owned or operated electric power system on the basis that the change is in the public interest for a reason other than a rate differential. The Commission has reviewed the application and Staff's verified recommendation, which are hereby admitted into evidence. For the reasons elucidated by Staff, the Commission finds that the change of supplier is in the public interest for a reason other than a rate differential. Therefore, the Commission will grant the application.

**THE COMMISSION ORDERS THAT:**

1. The November 9, 2010 Application for Change of Electrical Power Suppliers filed by Osage Valley Electric Cooperative is granted.
2. This order shall become effective on February 17, 2011.
3. This case shall be closed on February 18, 2011.

Ronald D. Pridgin, Senior Regulatory  
Law Judge, by delegation of authority  
pursuant to Section 386.240, RSMo 2000.

Dated at Jefferson City, Missouri,  
on this 7<sup>th</sup> day of February, 2011.

**In the Matter of an Investigation into the Quality of Wireline  
Telecommunications Services in the State of Missouri**

*File No. TO-2011-0047  
Decided February 23, 2011*

**Telecommunications §26.** The Commission accepted a Staff investigative report that concluded that deregulated local exchange telecommunications companies continue to provide an acceptable quality of service to their customers.

**ORDER ACCEPTING STAFF'S REPORT ON ITS INVESTIGATION  
INTO THE QUALITY OF WIRELINE TELECOMMUNICATIONS  
SERVICES IN MISSOURI**

On September 1, 2010, the Commission directed its Staff to

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open an investigation into the quality of wireline telecommunications service in Missouri. Staff asked that it be authorized to conduct such an investigation because it was concerned that Missouri's wireline telecommunications system may have degraded in recent years due to a lack of proper testing, preventive maintenance, and timely replacement of facilities since the telecommunications system has been declared to be competitive and thus no longer subject to quality of service regulation.

At Staff's request, the Commission ordered all facilities-based local exchange telecommunications companies to answer a set of questions regarding the companies' maintenance efforts and procedures. Staff also collected comments from the public regarding the service they have received from their landline telephone carriers. On January 31, 2011, Staff filed a report detailing the results of its investigation.

Staff reports that the telecommunications companies it surveyed continue to track the quality of service they provide to their customers: most use the same quality of service measurements prescribed in the Commission's quality of service regulation. Staff also reports that companies are generally installing and repairing telephone service in a timely manner. Finally, Staff indicates the telecommunications companies have preventative maintenance procedures in place. Staff concludes its investigation has demonstrated that companies are continuing to monitor the quality of service provided to customers.

In a revised report filed on February 9, Staff further explains that all responding companies submitted results on a company-wide basis. Although such results do not definitely address the quality of service on an exchange-specific basis, the submitted results suggest most companies are providing an acceptable level of service. More detailed information would be needed to determine if there are certain exchanges that require additional analysis, but there is no specific information to suggest further analysis is necessary at this time. Staff recommends this case be closed.

Since Staff does not recommend any further action or continued investigation, the Commission will accept Staff's report and close this file.

### **THE COMMISSION ORDERS THAT:**

1. The Commission accepts Staff's Report as filed on January 31, 2011, and as revised on February 9, 2011, including the Second Addendum filed on February 16, 2011, and the additional Addendum filed on February 23, 2011.

2. This order shall become effective on March 5, 2011.

3. This file shall be closed on March 6, 2011.

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Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.

Woodruff, Chief Regulatory Law Judge

\*NOTE: See page 5 for another order in this case.

**In the Matter of the Application of Lake Region Water & Sewer Company for a Certificate of Convenience and Necessity Authorizing It to Construct, Install, Own, Operate, Control, Manage and Maintain a Sewer System for the Public Located in an Unincorporated Area in Camden County, Missouri**

*File No. SA-2011-0174*

*Decided March 9, 2011*

**Sewer §2.** The Commission may grant a sewer corporation a certificate of convenience and necessity to operate after determining that the construction and operation are either "necessary or convenient for the public service." The Commission has stated five criteria that it will use:

- 1) There must be a need for the service;
- 2) The applicant must be qualified to provide the proposed service;
- 3) The applicant must have the financial ability to provide the service;
- 4) The applicant's proposal must be economically feasible; and

The service must promote the public interest.

**ORDER GRANTING CERTIFICATE OF CONVENIENCE AND NECESSITY**

**Procedural History**

On December 21, 2010, Lake Region Water & Sewer Company ("Lake Region") filed an application with the Missouri Public Service Commission, pursuant to Section 393.170, RSMo 2000, requesting that the Commission grant it authority to construct, install, own, operate, control, manage and maintain a sewer system for the public in unincorporated Camden County, Missouri. Lake Region asks for a certificate to serve certain sections of Township 40 North, Range 16 West in Camden County, Missouri.

The Commission allowed potential intervenors until January 12, 2011 to request intervention. The Commission received no intervention



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requests.

On February 14, 2011, the Commission's Staff (hereafter "Staff") filed a Recommendation that asks the Commission to approve the application, subject to certain conditions. Commission Rule 4 CSR 240-2.080(15) allows parties ten days to respond to pleadings. No party responded to Staff's Recommendation; therefore, the Commission finds that no party objects to the Commission granting Lake Region the certificate subject to the conditions requested by Staff.

**Decision**

The Commission may grant a sewer corporation a certificate of convenience and necessity to operate after determining that the construction and operation are either "necessary or convenient for the public service."<sup>1</sup> The Commission has stated five criteria that it will use:

- 1) There must be a need for the service;
- 2) The applicant must be qualified to provide the proposed service;
- 3) The applicant must have the financial ability to provide the service;
- 4) The applicant's proposal must be economically feasible; and
- 5) The service must promote the public interest.<sup>2</sup>

Based on the verified application and the verified recommendation of Staff, the Commission finds that granting Lake Region's application for a certificate of convenience and necessity to provide sewer service meet the above listed criteria.<sup>3</sup> The application will be granted.

The Commission reminds Lake Region that failure to comply with its regulatory obligations may result in the assessment of penalties against it. These regulatory obligations include, but are not limited to, the following:

- A) The obligation to file an annual report, as established by Section 393.140(6), RSMo 2000. Failure to comply with this obligation will make the utility liable to a penalty of \$100 and an additional \$100 per day that the violation continues. Commission Rule 4 CSR 240-3.335

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<sup>1</sup> Section 393.170, RSMo 2000.

<sup>2</sup> *In re Tartan Energy Company*, 3 Mo.P.S.C. 173, 177 (1994).

<sup>3</sup> The requirement for a hearing is met when the opportunity for hearing is provided and no proper party requests the opportunity to present evidence. No party requested a hearing in this matter; thus, no hearing is necessary. *State ex rel. Deffenderfer Enterprises, Inc. v. Public Service Comm'n of the State of Missouri*, 776 S.W.2d 494 (Mo. App. W.D. 1989).

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requires sewer utilities to file their annual report on or before April 15 of each year.

B) The obligation to pay an annual assessment fee established by the Commission, as required by Section 386.370, RSMo 2000. Because assessments are facilitated by order of the Commission, failure to comply with the order will subject the company to penalties ranging from \$100 to \$2,000 for each day of noncompliance pursuant to Section 386.570, RSMo 2000.

C) The obligation to provide safe and adequate service at just and reasonable rates, pursuant to Section 393.130, RSMo Supp. 2009.

D) The obligation to comply with all relevant state and federal laws and regulations, including but not limited to, rules of this Commission, the Department of Natural Resources, and the Environmental Protection Agency.

E) The obligation to comply with orders issued by the Commission. If the company fails to comply it is subject to penalties for noncompliance ranging from \$100 to \$2,000 per day of noncompliance, pursuant to Section 386.570, RSMo 2000.

F) The obligation to keep the Commission informed of its current address and telephone number.

The certificate is granted conditioned upon the compliance of the company with all of these obligations, as well as the obligations listed below in the ordered paragraphs.

Moreover, if the Commission finds, upon conducting a hearing, that the company fails to provide safe and adequate service, or has defaulted on any indebtedness, the Commission shall petition the circuit court for an order attaching the assets, and placing the company under the control of a receiver, as permitted by Section 393.145, RSMo Supp. 2009. As a condition of granting this certificate, the company hereby consents to the appointment of a temporary receiver until such time as the circuit court grants or denies the petition for receivership.

The company is also placed on notice that Section 386.310.1, RSMo 2000, provides that the Commission can, without first holding a hearing, issue an order in any case "in which the commission determines that the failure to do so would result in the likelihood of imminent threat of serious harm to life or property."

Furthermore, the company is reminded that, as a corporation, its officers may not represent the company before the Commission. Instead, the corporation must be represented by an attorney licensed to

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practice in Missouri.

**THE COMMISSION ORDERS THAT:**

1. Lake Region Water & Sewer Company is granted permission, approval, and a certificate of convenience and necessity to construct, install, own, operate, control, manage, and maintain a sewer system for the public in Camden County, Missouri, as more particularly described in its application.

2. This certificate of convenience and necessity is granted upon the conditions set out in the body of this order.

3. The Commission approves Lake Region Water & Sewer Company's existing monthly customer rate of \$29.39, general service charges and depreciation rates to be applicable to the service area more particularly described in the application.

3. Lake Region Water & Sewer Company must submit new and revised tariff sheets; specifically, Rule 12(A)(9) Sheet No. 28, within 30 days after the date of this order, with the tariff sheets to bear an effective date that is at least 30 days from the date the tariff sheets are submitted to the Commission.

4. Lake Region Water & Sewer Company shall comply with all Missouri statutes and Commission rules.

5. Nothing in the Staff Recommendation or this order shall bind the Commission on any ratemaking issue in any future rate proceeding.

6. This order shall become effective on March 19, 2011.

Gunn, Chm., Clayton, Davis,  
Jarrett, and Kenney, CC., concur.

Pridgin, Senior Regulatory Law Judge

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**In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan.**

**In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service.**

*File Nos. ER-2010-0355 and ER-2010-0356  
Decided March 16, 2011*

**Accounting §38.** Under Section 211(b) of the Tax Reform Act of 1986, all credits for tax years open under the statute of limitations at the time a final determination is rendered by a state utility regulatory commission inconsistent with normalization requirements are recaptured.

**Evidence, Practice and Procedure §9.** Private letter rulings are entitled to evidentiary weight, are relied upon by courts as an instructive tool, and are helpful in ascertaining doctrines applied by the Internal Revenue Service.

**REPORT AND ORDER DIRECTING KCPL AND GMO TO APPLY TO  
THE IRS TO REVISE THE MEMORANDUM OF UNDERSTANDING  
REGARDING THE ADVANCED COAL TAX CREDITS FOR IATAN**

This order directs Kansas City Power & Light Company (KCPL) and KCP&L Greater Missouri Operations Company (GMO) to apply to the Internal Revenue Service (IRS) for an amendment of the 2010 MOU that if agreed to by the IRS would allow GMO to obtain a share of Section 48A tax credits equal to its relative ownership share of Iatan 2 and a reallocation of credits in the amounts of \$80,725,000 for KCPL and \$26,562,500 for GMO.

*Procedural History*

On June 4, 2010, KCPL and GMO each filed tariffs and direct testimony in order to begin a general rate proceeding whereby their rates for electric service would increase. KCPL's tariff has an effective date of May 4, 2011. GMO's tariff has an effective date of June 4, 2011.

Interventions were allowed, and direct, rebuttal, and surrebuttal testimony was prefiled. Evidentiary hearings were held from January 18 - February 4, 2011, February 14 - 17, 2011, and March 3 - 4, 2011.

One of the issues raised during the course of the proceedings

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was whether a portion of the advanced coal tax credits received by KCPL should be allocated to GMO.<sup>1</sup> On February 24, 2011, the Commission directed the parties to fully brief this issue with their initial briefs filed on March 10, 2011 and to state any objection to the Commission hearing this issue separately from the rate issues in the case. The parties filed their briefs on March 10, 2011, as directed and no objections were filed. Thus, in this order the Commission takes up the limited issue of the allocation of the coal tax credit and no other issue.<sup>2</sup>

*Declassification of Evidence*

*Schedule 1 of Paul R. Harrison's Surrebuttal Testimony*<sup>3</sup> was designated as "highly confidential" in its entirety during these proceedings. This schedule is a copy of the Final Arbitration Award issued during a private arbitration of a dispute between The Empire District Electric Company (Empire), the Missouri Joint Municipal Electric Utility Commission (MJMEUC) and the Kansas Electric Power Cooperative, Inc. (KEPCo). In addition, Volume 37, Page 3947, was designated as "highly confidential" by the Regulatory Law Judge even though the conversation was not in camera at the time. It has since come to the Commission's attention that much of the arbitrator's award is public information as shown by Missouri Lawyers Weekly articles published on March 30, 2010, and April 4, 2010.<sup>4</sup> Therefore, the Commission will designate as "public" the portions of Schedule 1 to Exhibits KCPL-223 and GMO-222 which are reported in the Missouri Lawyers Weekly articles and all of Volume 37 of the Transcript from February 14, 2011.

*Findings of Fact*

1. KCPL is a Missouri corporation engaged in the generation, transmission, distribution, and sale of electricity in western Missouri and eastern Kansas, operating primarily in the Kansas City metropolitan area. KCPL is a subsidiary of Great Plains Energy,

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<sup>1</sup> *Kansas City Power & Light Company's and KCP&L Greater Missouri Operations Company's List of Issues, Hearing Schedule and Order of Cross-Examination*, (filed January 1, 2011), p. 8; *List of Issues*, (filed January 7, 2011), p. 13.

<sup>2</sup> This includes the related issues of the prudence of the defense of the arbitration and the disallowance of the costs of arbitration. Those issues will be decided with the remaining rate case issues.

<sup>3</sup> Ex. KCPL-223 and GMO-222.

<sup>4</sup> *Power companies fight over \$125M tax credit*, Missouri Lawyers Weekly, March 30, 2010, and *Light fights Empire*, Missouri Lawyers Weekly, April 4, 2010.

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Incorporated (GPE).

2. GMO is a Missouri corporation engaged in the generation, transmission, distribution, and sale of electricity in western Missouri. GMO was formerly known as Aquila, Inc., and was purchased by GPE on July 14, 2008.

3. The Energy Policy Act of 2005 enacted a series of tax incentives including Section 48A of the Internal Revenue Code.<sup>5</sup> Section 48A provided for \$500 million of advanced coal project tax credits.

4. KCPL, GMO, Empire, MJMEUC, and KEPCo entered into a joint ownership agreement to build what is referred to as Iatan 2. Joint ownership is held as follows: KCPL 54.71%, GMO 18.00%, Empire 12%, MJMEUC 11.76%, and KEPCo 3.5%.<sup>6</sup>

5. In August 2006 KCPL applied to the Department of Energy and the IRS for advanced coal tax credits for Iatan 2, but was denied.<sup>7</sup>

6. KCPL did not include any of the other Iatan 2 co-owners in its application for the coal tax credit<sup>8</sup> and did not inform any of the co-owners about the credit or its plans to apply.<sup>9</sup>

7. On October 30, 2007, KCPL again applied to the Department of Energy and the IRS for advanced coal tax credits for Iatan 2.<sup>10</sup>

8. In April 2008, the IRS accepted the application and allocated \$125 million of advanced coal tax credits for Iatan 2.

9. KCPL signed a Memorandum of Understanding (MOU) regarding the award of the credits with the IRS in the summer of 2008.<sup>11</sup>

10. None of the other co-owners of the Iatan 2 project (Aquila, Empire, MJMEUC, and KEPCo) applied for such credits in 2007.

11. On October 9, 2008, Empire notified KCPL of a controversy regarding the advanced coal tax credits.<sup>12</sup>

12. On October 31, 2008, both GMO and Empire filed

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<sup>5</sup> 26 U.S.C. § 48A.

<sup>6</sup> Exhibit KCPL-107, p. 12; Transcript p. 3941.

<sup>7</sup> Ex. KCPL-223 and GMO-222, Harrison Surrebuttal.

<sup>8</sup> Tr. 3910.

<sup>9</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>10</sup> Ex. KCPL-223 and GMO-222, Sched. 3-5.

<sup>11</sup> Ex. KCPL-223 and GMO-222, Sched. 3.

<sup>12</sup> Ex. KCPL-297.

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applications with the IRS seeking advanced coal tax credits for Iatan 2. The IRS denied both applications indicating that the full \$125 million of credits available for Iatan 2 had already been awarded to KCPL.<sup>13</sup>

13. Empire, MJMEUC, and KEPCo<sup>14</sup> initiated arbitration proceedings against KCPL, claiming that they were either entitled to their proportionate share of the tax credits according to their ownership shares in Iatan 2 or the monetary equivalent thereof.

14. GMO did not give notice to arbitrate its entitlement to a portion of the \$125 million advanced coal tax credits.<sup>15</sup>

15. On December 30, 2009, a private arbitration panel denied the claims of MJMEUC and KEPCo, but found in favor of Empire. The panel concluded that KCPL was in violation of the ownership agreement by failing to include the co-owners in the filing for the tax credit<sup>16</sup> or even telling the other co-owners about its application or its efforts to lobby Congress for an amendment to Section 48A.<sup>17</sup>

16. The panel directed KCPL and Empire to apply to the IRS for an amendment of the 2008 MOU to allow Empire to share in the Section 48A tax credits equal to \$17,712,500.<sup>18</sup>

17. The arbitration panel also directed KCPL to pay Empire the \$17.7 million in the event that the IRS did not agree to amend the MOU.<sup>19</sup>

18. MJMEUC and KEPCo are not tax-paying entities as MJMEUC is a political subdivision and KEPCo is a not-for-profit corporation.<sup>20</sup> Because MJMEUC and KEPCo were not eligible for the tax credits, the arbitration panel denied their claims against KCPL.<sup>21</sup>

19. KCPL and Empire applied to the IRS for a reallocation of the Section 48A advanced coal project credits. A revised MOU between the IRS and KCPL was agreed to by the IRS on August 19,

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<sup>13</sup> Ex. KCPL-223 and GMO-222, pp. 12-13 and Sched. 7-2; Tr. 3911.

<sup>14</sup> On July 10, 2009, July 15, 2009, and July 17, 2009, respectively.

<sup>15</sup> Tr. 3920.

<sup>16</sup> EX-KCPL-223 and GMO-222, Sched. 1; Tr. 3913.

<sup>17</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>18</sup> Ex. KCPL-223 and GMO-222, Sched. 1.

<sup>19</sup> Tr. 3914.

<sup>20</sup> Tr. 3927; Ex. KCPL-223 and GMO-222, Sched. 1-1.

<sup>21</sup> Ex. KCPL-223 and GMO-222, Sched. 1-1.

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2010 and delivered to KCPL on September 9, 2010.<sup>22</sup> The revised MOU reallocated the advanced coal project credits between KCPL and Empire according to their relative ownership shares in the amounts of \$107,287,500 and \$17,712,500, respectively.<sup>23</sup>

20. Section 9.1(a) of the Iatan 2 Agreement states that the co-owners did not intend to create a partnership, and Section 9.1(b) states that “to the extent possible” the co-owners “shall each separately report and pay for all real property, franchise, business, or other taxes and fees ... arising out of the acquisition, construction, operation, disposition and co-ownership of Iatan 2; ....”<sup>24</sup>

21. Great Plains Energy and its affiliates file joint tax returns.<sup>25</sup>

22. KCPL was obligated to share costs and benefits of Iatan 2 and to notify the other co-owners of significant events under the Iatan 2 ownership agreement.<sup>26</sup>

KCPL charged GMO and the other co-owners a small portion of the costs of making the application for the tax credits. This amount has since been refunded.<sup>27</sup>

23. If the advanced coal tax credits are imputed to GMO, it will lower the cost of service for GMO and also lower rates.<sup>28</sup>

24. Any attempt by this Commission to reallocate tax credits or indirectly to accomplish a reallocation through adjustments to rate base may constitute a normalization violation.<sup>29</sup>

25. If a normalization violation occurs, it will affect not only the Section 48A advanced coal credits, but also all other investment tax credits on the books of KCPL.<sup>30</sup> Specifically, this would require KCPL to repay the IRS \$52,294,411, which consists of (a) \$29,151,153 in advanced coal credits that have been claimed, as well as (b) \$23,143,258 in other claimed investment tax credits. In addition, KCPL

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<sup>22</sup> Tr. 3928.

<sup>23</sup> Ex. KCPL-223 and GMO-222, Sched. 3, pp. 5-9.

<sup>24</sup> Ex. GMO-18, Hardesty Rebuttal at 10-11.

<sup>25</sup> Tr. 3922-3923.

<sup>26</sup> Ex. KCPL-223 and GMO-222, Sched. 1; Ex. KCPL-105; Tr. 3909.

<sup>27</sup> Tr. 3921.

<sup>28</sup> Ex. KCPL-223 and GMO-222, p. 24.

<sup>29</sup> Tr. 3936-37 and 3961-67.

<sup>30</sup> Ex. KCPL-30 and GMO-18, pp. 10-11.



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would lose the ability to offset future tax liabilities with \$77,957,534 of advanced coal credits that have not yet been claimed. The total penalty to KCPL for such a normalization violation would be \$130,251,945.<sup>31</sup>

26. Additionally, because GMO would purportedly receive reallocated tax credits from the Commission, not the IRS, GMO might also be subject to a normalization violation and lose all of its existing tax credits, which amount to \$3,963,573 for its MPS Division and \$287,722 for its L&P Division, for a total of \$4,251,295.<sup>32</sup>

27. The parties agree that a reallocation may be accomplished without a normalization violation by an amendment to the 2010 MOU to which KCPL and the IRS are parties.

*Conclusions of Law*

1. KCPL is an “electrical corporation” and “public utility” as those terms are defined in Section 386.020, RSMo, and, as such, is subject to the jurisdiction of the Commission as provided by law.

2. GMO is an “electrical corporation” and “public utility” as those terms are defined in Section 386.020, RSMo, and, as such, is subject to the jurisdiction of the Commission as provided by law.

3. This Commission is not bound by the decision of a private arbitration panel formed under the terms of the Iatan 2 Agreement.<sup>33</sup>

4. Private Letter Ruling No. 200945006 (Nov. 6, 2009) states that: “If a normalization violation occurs, the results under [the tax laws] would be the disallowance or recapture of all of the unamortized investment tax credit of Taxpayer with respect to public utility property.”<sup>34</sup> Additionally, under Section 211(b) of the Tax Reform Act of 1986, “all credits for tax years open under the statute of limitations at the time a final determination is rendered [by a state utility regulatory commission] inconsistent with normalization requirements are recaptured.”<sup>35</sup> Therefore, a normalization violation may result if the Commission orders a reallocation of the tax credits between KCPL and GMO.<sup>36</sup>

<sup>31</sup> Ex. KCPL-30 and GMO-18, p. 11; Tr. 3936-37.

<sup>32</sup> Ex. GMO-18, pp. 10-11; Tr. 3936-37 and 3961-67.

<sup>33</sup> See *Jim Walter Resources, Inc. v. Federal Mine Safety and Health Review Comm’n*, 920 F.2d 738, 749-50 (11th Cir. 1990) (regulatory commission need not defer to an arbitrator’s award).

<sup>34</sup> Ex. 106 at p. 3.

<sup>35</sup> *Id.* at 7.

<sup>36</sup> See § 211(b), Tax Reform Act of 1986, Pub. L. No. 99-514, 99<sup>th</sup> Cong., 2d Sess. (1986);

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5. Private letter rulings are entitled to evidentiary weight, are relied upon by courts as an instructive tool, and are helpful in ascertaining doctrines applied by the IRS.<sup>37</sup>

6. The latan owners are “tenants in common, each with an undivided ownership interest therein ....”<sup>38</sup> Since the parties to the latan 2 Agreement are tenants-in-common, and not partners or joint venturers, each party was responsible for its own tax matters and for submitting its own tax filings to the IRS.

7. As the operator of latan 2, under Section 6.5(d) of the latan 2 Agreement, KCPL owed a special duty to notify its co-owners of significant events related to latan 2.<sup>39</sup>

*Decision*

Although the Commission is not bound by the decision of the arbitration panel, the Commission accepts the findings of the arbitration panel. Even though each party under the latan 2 Agreement was responsible for paying and filing its own taxes, as the operator of latan KCPL owed a special duty to its co-owners. KCPL should have advised GMO and the other co-owners of its intent to request the availability of Section 48A credits and of its lobbying efforts to amend the law so that latan 2 qualified for the tax credits. The tax credits in the amount of \$125 million were certainly significant to the operation and construction of the facility, and were obviously part of KCPL’s operations strategy.

In addition, once arbitration proceedings had begun, GMO should have been involved, in order to protect its own interest. It is clear that even though KCPL may not have realized it at the time, KCPL could not adequately represent the interest of GMO in the arbitration proceedings.

Because a normalization violation would eliminate the value of tax credits for both KCPL and GMO, causing harm to both of the companies and their customers, the Commission will not impute the tax credit to GMO unless the MOU cannot be amended. The Commission

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Treas. Reg. 1.46-6; Private Letter Ruling 200945006 (Nov. 6, 2009) (KCPL Exhibit 106). See generally R. Matheny, *Taxation of Public Utilities* (Matthew Bender, 2010), § 9.05, Investment Tax Credit Normalization Requirements (attached as Exhibit A).

<sup>37</sup> See *Hanover Bank v. Commissioner*, 369 U.S. 672, 686 (1962); *O’Shaughnessy v. Commissioner*, 332 F.3d 1125, 1131 (8th Cir. 2003); *Thom v. United States*, 283 F.3d 939, 934 (8th Cir. 2002); *Xerox Corp. v. United States*, 656 F.2d 659, 660 (Ct. Cl. 1981).

<sup>38</sup> See latan 2 Agreement, Exhibit 105, p. 1.

<sup>39</sup> Tr. 3909.

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agrees with Staff that KCPL could have avoided the issue by alerting the other co-owners about the application, giving them an opportunity to join in its application for the coal tax credits.

If the normalization violation can be avoided, but GMO will receive its fair share of the tax allocations, that is the best course of action. Therefore, the Commission directs KCPL and GMO to apply to the IRS for an amendment of the 2010 MOU to reallocate the advanced coal project credits that KCPL now holds in revised amounts by a ratio that would reflect the proportionate ownership interests of KCPL at 54.71% and GMO at 18.00% (without regard to the ownership percentages of the non-taxpaying entities, MJMEUC and KEPCo), that is, \$80,725,000 and \$26,562,500, respectively.

Since Great Plains Energy and its affiliates file joint tax returns<sup>40</sup> it does not matter to the shareholders whether KCPL or GMO has the tax credits. But, which company has the tax credits can make a difference to the ratepayers<sup>41</sup> because it may affect the cost of service. If the advanced coal tax credits are imputed to GMO it will lower the cost of GMO to serve its customers and, therefore, lower GMO rates.

**THE COMMISSION ORDERS THAT:**

1. The Commission will change the designation from "highly confidential" to "public" portions of Schedule 1 to Exhibits KCPL-223 and GMO-222 which are reported in the Missouri Lawyers Weekly articles and all of Volume 37 of the Transcript from February 14, 2011. The Commission's Data Center shall change the designation of Volume 37 in the Commission's Electronic Filing and Information System (EFIS).

2. No later than April 5, 2011, GMO and KCPL shall apply, at the shareholders' expense, to the Internal Revenue Service for an amendment of the Memorandum of Understanding that would allow KCP&L Greater Missouri Operations Company to obtain a share of the Section 48A tax credits for Iatan 2, Section 48A tax credits equal to \$26,500,000.

3. If the application to amend the Memorandum of Understanding is denied, or if less than \$26,500,000 in Section 48A tax credits is allocated to KCP&L Greater Missouri Operations Company, then the Commission shall impute a proportionate amount of credits as a

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<sup>40</sup> Tr. 3922-3923.

<sup>41</sup> Tr. 3928-3029.

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reduction to KCP&L Greater Missouri Operations Company's cost of service.

4. This Report and Order shall be effective on March 26, 2011.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur and certify  
compliance with the provisions of  
Section 536.080, RSMo 2000.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: See pages 111, 186, 189, 328, 367 and 534 for other orders in these cases.

**In the Matter of the Small Company Rate Increase, Of Timber Creek  
Sewer Company**

*File No. SR-2010-0320  
Decided March 30, 2011*

**Sewer §16.** The Commission determined that Timber Creek, a small sewer company with four employees, had met its burden of proof in establishing that the salaries authorized for its well-qualified employees were just and reasonable amounts to be recovered from rates as compensation. This determination was based on four Relevant Salary Determination Factors and commensurate with experience and a cost of living adjustment. The Commission reasoned that the increase in salaries would help ensure the retention of quality and experienced employees.

Likewise, Timber Creek sufficiently proved that \$36,170 was a just and reasonable amount to be recovered in rates for rate case expense for costs associated with adjudicating this rate increase request. An additional \$18,175 rate case expense recovery requested for an earlier rate case was denied because it would constitute unlawful retroactive ratemaking by permitting recovery of past losses. Recovery for the alleged under-recovery of Commission assessments from prior years was denied for similar reasons.

**Sewer §13.** Timber Creek was not entitled to recover expenses associated with drilling an exploratory pilot gas well or other exploration for alternative energy sources because the drilling venture's potential return was too speculative and ultimately provided no benefit to customers.

**Sewer §14.** Timber Creek was not entitled to implement a \$.50 per month per customer surcharge to establish an emergency repair fund where factual evidence demonstrated that that the company was able to fund unplanned events and repairs without financial hardship.

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Report and Order

**APPEARANCES**

APPEARING FOR TIMBER CREEK SEWER COMPANY:

**Jeremiah D. Finnegan**, Finnegan, Conrad & Peterson, L.C., 1209 Penntower Office Center, 3100 Broadway, Kansas City, Missouri 64111.

APPEARING FOR THE OFFICE OF THE PUBLIC COUNSEL AND THE PUBLIC:

**Christina Baker**, Assistant Public Counsel, Governor Office Building, 200 Madison Street, Suite 650, Post Office Box 2230, Jefferson City, Missouri 65102.

APPEARING FOR THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION:

**Jamie Ott**, Legal Counsel, and **Rachel Lewis**, Deputy Counsel, Governor Office Building, 200 Madison Street, Jefferson City, Missouri 65102.

**REGULATORY LAW JUDGE:** Harold Stearley, Senior Regulatory Law Judge

**I. Procedural History**

On May 10, 2010, Timber Creek Sewer Company ("Timber Creek") filed a request to increase its rates for sewer service pursuant to the small company rate case procedure in 4 CSR 240-3.050. Timber Creek sought an increase of \$63,500 in its annual sewer system operating revenues, representing an increase in rates of approximately 9%. On October 7, 2010, the deadline for Timber Creek and the Commission's Staff to file a disposition agreement, Staff filed a request to open a contested case, which the Commission granted.

On December 29, 2010, the parties jointly filed a list of issues they believed required decisions from the Commission. Their list included: (1) Timber Creek Staff Compensation / Timesheets / Overtime; (2) Rate Case Expense; (3) Alternative Energy Gas Well Cost Recovery;

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(4) PSC Assessment; and (5) Contingency / Emergency Repair Fund. The Commission did not adopt the parties' list of issues, or limit the scope of the issues in this matter. To address these, and any other, issues the Commission held a local public hearing on November 17, 2010<sup>1</sup> and an evidentiary hearing on January 5, 2010.<sup>2</sup>

### **II. Rate Making Standards and Practices**

The Commission has exclusive jurisdiction to establish public utility rates,<sup>3</sup> and the rates it sets have the force and effect of law.<sup>4</sup> A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;<sup>5</sup> neither can a public utility change its rates without first seeking authority from the Commission.<sup>6</sup> A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's,<sup>7</sup> subject to judicial review on the question of reasonableness.<sup>8</sup>

A "just and reasonable" rate is one that is fair to both the utility and its customers;<sup>9</sup> it is no more than is sufficient to "keep public utility

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<sup>1</sup> Transcript, Volume 2. The hearing was held at the Wilson Theater in the Platte City High School. At the conclusion of the local public hearing, the Commission had received the sworn testimony of one customer. No exhibits were offered or admitted into the record. All of the parties were given the opportunity to cross-examine the witness

<sup>2</sup> Transcript, Volume 3. In total, the Commission admitted the testimony of 8 witnesses and received 30 exhibits into evidence. Post-hearing briefs and proposed findings of fact and conclusions of law were filed on February 4, 2011. The case was deemed submitted for the Commission's decision on March 15, 2011 when the Commission closed the record. "The record of a case shall stand submitted for consideration by the commission after the recording of all evidence or, if applicable, after the filing of briefs or the presentation of oral argument." Commission Rule 4 CSR 240-2.150(1).

<sup>3</sup> *May Dep't Stores*, 107 S.W.2d at 57.

<sup>4</sup> *Utility Consumers Council*, 585 S.W.2d at 49.

<sup>5</sup> *Id.*

<sup>6</sup> *Deaconess Manor Ass'n v. Pub. Serv. Comm'n*, 994 S.W.2d 602, 610 (Mo. App. 1999).

<sup>7</sup> *May Dep't Stores*, 107 S.W.2d at 50.

<sup>8</sup> *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (1918), *error dis'd*, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd*, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

<sup>9</sup> *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App.,

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plants in proper repair for effective public service, [and]. . . to insure to the investors a reasonable return upon funds invested.”<sup>10</sup> The Commission’s guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.<sup>11</sup> However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.<sup>12</sup> “There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment.”<sup>13</sup>

Rate-making involves two successive processes:<sup>14</sup> first, the determination of the “revenue requirement,” that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.<sup>15</sup> The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers.

Revenue requirement is usually established based upon a historical test year which focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.<sup>16</sup> The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less

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K.C.D. 1974).

<sup>10</sup> *St. ex rel. Washington University et al. v. Pub. Serv. Comm’n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (Mo. banc 1925).

<sup>11</sup> *May Dep’t Stores Co. v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (1937).

<sup>12</sup> *St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm’n*, 585 S.W.2d 41, 49 (Mo. banc 1979).

<sup>13</sup> *St. ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

<sup>14</sup> It is worth noting here that Missouri recognizes two distinct ratemaking methods: the “file-and-suspend” method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility’s rates are not just and reasonable. See *Utility Consumers Council*, 585 S.W.2d at 48-49; *St. ex rel. Jackson County v. Pub. Serv. Comm’n*, 532 S.W.2d 20, 28-29 (Mo. banc 1975).

<sup>15</sup> *St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm’n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).

<sup>16</sup> *Id.*, citing Colton, “Excess Capacity: Who Gets the Charge From the Power Plant?,” 34 *Hastings L.J.* 1133, 1134 & 1149-50 (1983).

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accumulated depreciation.<sup>17</sup> For any utility, its fair rate of return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of common equity, the cost used is its estimated cost.<sup>18</sup>

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<sup>17</sup> *State ex rel. Missouri Office of Public Counsel v. Public Service Comm'n of State*, 293 S.W.3d 63, 75 -76 (Mo. App. S.D. 2009); *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988). The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of any water and sewer corporation operating in Missouri, that is, to determine the rate base. Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

<sup>18</sup> Estimating the cost of common equity capital is a difficult task, as academic commentators have recognized. See Phillips, *The Regulation of Public Utilities*, Public Utilities Reports, Inc., p. 394 (1993). The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must guide the Commission in its task. *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923). In the earlier of these cases, *Bluefield Water Works*, the Court stated that: Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment. *Bluefield, supra*, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.



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In the final analysis, it is not the method employed, but the result reached, that is important.<sup>19</sup> The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."<sup>20</sup>

### **III. Findings of Fact**

#### **A. The Parties**

1. **Timber Creek Sewer Company** ("Timber Creek") is a corporation in good standing organized under the laws of the State of Missouri. Its principal place of business is located at 18305 Cable Bridge Road, Platte City, MO 64079. Timber Creek possesses a certificate of convenience and necessity ("CCN") to provide sewer service that was issued in File No. SA-95-110. That CCN went into effect on June 1, 1995. Timber Creek provides sewer service to approximately 1,525 single-family residential customers, primarily located in Platte and Clay counties. The Company also provides sewer service to one wholesale account in Platte City. The wholesale account includes a subdivision of 78 multi-family dwellings (comprising 366 units) and two strip malls containing the YMCA, a community center, a public library, a medical clinic, a bank, a daycare, a hardware store, and two restaurants.<sup>21</sup>

2. **The Office of the Public Counsel** ("Public Counsel") "may represent and protect the interests of the public in any proceeding before or appeal from the public service commission."<sup>22</sup> Public Counsel "shall have discretion to represent or refrain from representing the public in any proceeding."<sup>23</sup>

3. **The Staff of the Missouri Public Service Commission** ("Staff") is a party in all Commission investigations, contested cases and

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<sup>19</sup> Within a wide range of discretion the Commission may select the methodology. *Missouri Gas Energy v. Public Service Comm'n*, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. *State ex rel. City of Lake Lotawana v. Public Service Comm'n of State*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

<sup>20</sup> *Fed. Power Comm'n v. Nat. Gas Pipeline Co.*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

<sup>21</sup> Exh. 1 - *Unanimous Partial Agreement*; Exh. 2 - *Unanimous Stipulation of Undisputed Facts*; EFIS Docket Entry No. 11, *Stipulation of Timber Creek Sewer Company to Factual Assertions in Attachments to Unanimous Partial Agreement*, filed on October 18, 2010; EFIS Docket Entry No. 12, *The Office of the Public Counsel's Stipulation*, filed on October 20, 2010. EFIS is the Commission's Electronic Information and Filing System.

<sup>22</sup> Section 386.710(2), RSMo 2000; Commission Rules 4 CSR 240-2.010(16) and 2.040(2).

<sup>23</sup> Section 386.710(3), RSMo 2000; Commission Rules 4 CSR 240-2.010(16) and 2.040(2).

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other proceedings, unless it files a notice of its intention not to participate in the proceeding within the intervention deadline set by the Commission.<sup>24</sup>

### **B. Witnesses**

4. The Commission finds that any given witness's qualifications and overall credibility are not dispositive as to each and every portion of that witness's testimony. The Commission gives each item or portion of a witness's testimony individual weight based upon the detail, depth, knowledge, expertise and credibility demonstrated with regard to that specific testimony. Consequently, the Commission will make specific weight and credibility decisions throughout this order as to specific items of testimony as is necessary.<sup>25</sup>

5. Any finding of fact reflecting the Commission has made a determination between conflicting evidence is indicative that the Commission attributed greater weight to that evidence and found the source of that evidence more credible and more persuasive than that of the conflicting evidence.<sup>26</sup>

### **C. Stipulated Facts and Admissions**

6. On October 7, 2010, Timber Creek, Staff and the Public Counsel filed a "Unanimous Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase" ("Partial Agreement").<sup>27</sup>

7. The Partial Agreement addresses rate design methodology, a schedule of depreciation rates, test year and true-up period, and various accounting measures.<sup>28</sup>

8. Two attachments were incorporated into the Partial Agreement by reference; the first being a schedule of depreciation rates and the second being the Staff's Engineering and Management Services Department's ("EMSD") "Report of Customer Service and Business

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<sup>24</sup> Commission Rules 4 CSR 240-2.010(11) and 2.040(1).

<sup>25</sup> Witness credibility is solely a matter for the fact-finder, "which is free to believe none, part, or all of the testimony. *State ex rel. Public Counsel v. Missouri Public Service Comm'n*, 289 S.W.3d 240, 247 (Mo. App. 2009).

<sup>26</sup> An Administrative Agency, as factfinder, also receives deference when choosing between conflicting evidence. *State ex rel. Missouri Office of Public Counsel v. Public Service Comm'n of State*, 293 S.W.3d 63, 80 (Mo. App. 2009)

<sup>27</sup> Exh. 1 - *Unanimous Partial Agreement*; EFIS Docket Entry No. 11, *Stipulation of Timber Creek Sewer*

*Company to Factual Assertions in Attachments to Unanimous Partial Agreement*, filed on October 18, 2010; EFIS Docket Entry No. 12, *The Office of the Public Counsel's Stipulation*, filed on October 20, 2010.

<sup>28</sup> *Id.*

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Operations Review.”<sup>29</sup>

9. The attachments, and factual assertions contained therein, were verified by affidavit by Guy C. Gilbert, a Staff Utility Regulatory Engineer II, and Nila S. Hagemeyer, a Staff Utility Management Analyst III.<sup>30</sup>

10. Timber Creek and Public Counsel stipulated to the factual assertions in the attachments.<sup>31</sup>

11. On December 29, 2010, the parties jointly filed a Unanimous Stipulation of Undisputed Facts (“Second Agreement”).<sup>32</sup>

12. In the Second Agreement, the parties agreed that the Partial Agreement resolved all issues except for the amounts recoverable in rates for: (1) salaries and overtime; (2) rate case expense; (3) an alternative energy source gas well; (4) the Public Service Commission Assessment; and (5) a contingency and energy repair fund.<sup>33</sup>

13. The Second Agreement also establishes that the parties had not resolved an issue as to the use of time sheets for Timber Creek’s employees. However, Timber Creek has conceded on this issue and states it will implement the use of timesheets resolving this issue.<sup>34</sup>

**Timber Creek’s Sewer System**

14. The Engineering and Management Services Department Report of Customer Service and Business Operations (“ESMD Report” - Attachment B Partial Agreement) contains an overview of Timber Creek’s operations, including the company’s history and administrative structure, customer billing practices, credit and collection practices, complaint and inquiry practices, customer communication practices, security and record storage practices.<sup>35</sup>

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* The only factual assertion Timber Creek would not admit was the need to have a time reporting mechanism for its employees; however, Timber Creek conceded this issue during the evidentiary hearing. See Finding of Fact Number 13.

<sup>32</sup> Exh. 2, *Unanimous Stipulation of Undisputed Facts*.

<sup>33</sup> *Id.*

<sup>34</sup> Transcript, p. 134; EFIS Docket Entry No. 79, Post Hearing Brief of Timber Creek Sewer Company, filed February 4, 2011, p 6.

<sup>35</sup> Exh. 1 - Unanimous Partial Agreement; EFIS Docket Entry No. 11, Stipulation of Timber Creek Sewer Company to Factual Assertions in Attachments to Unanimous Partial Agreement, filed on October 18, 2010; EFIS Docket Entry No. 12, The Office of the Public Counsel’s Stipulation, filed on October 20, 2010. EFIS is the Commission’s Electronic Information and Filing System.

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15. Based upon the parties' unanimous stipulation and the Commission's independent review of Timber Creek's operations, the Commission adopts the overview on pages 2 through 16 of the EMSD Report as findings of fact.

**Test year and True Up<sup>36</sup>**

16. The appropriate historical time period for determining the revenue requirement calculation is the test year consisting of the 12-month period ending December 31, 2009.<sup>37</sup>

17. The appropriate time period to true up material changes in revenue and expenses from the test year is the period ending June 30, 2010.<sup>38</sup>

**Rate Base, Capital Structure and Weighted Cost of Capital**

18. Timber Creek's rate base as presented in Staff's Accounting Schedules is as follows.<sup>39</sup>

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<sup>36</sup> For a full discussion on general ratemaking principles see *In the Matter of Lake Region Water & Sewer Company's Application to Implement a General Rate Increase in Water and Sewer Service*, Report and Order, Finding of Facts Numbers 42-72, 2010 WL 3378384, Mo.P.S.C. 2010, Issued August 18, 2010, Effective August 28, 2010.

<sup>37</sup> Exh. 1 - Unanimous Partial Agreement; EFIS Docket Entry No. 11, Stipulation of Timber Creek Sewer Company to Factual Assertions in Attachments to Unanimous Partial Agreement, filed on October 18, 2010; EFIS Docket Entry No. 12, The Office of the Public Counsel's Stipulation, filed on October 20, 2010.

<sup>38</sup> *Id.*

<sup>39</sup> Exh. 7, *Staff Accounting Schedules*, Schedule 2; Exh. 8, Prenger Direct, pp. 6-7.

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Line Number	A Rate Base Description	B Percentage Rate	C Dollar Amount
1	Plant in Service		\$3,170,997
2	Less Accumulated Depreciation Reserve		\$893,483
3	Net Plant in Service		\$2,277,514
4	ADD TO NET PLANT IN SERVICE		
5	Cash Working Capital		\$0
6	Materials & Supplies		\$0
7	Prepayments		\$0
8	Total Accumulated CIAC related Depreciation		\$796,113
9	TOTAL ADD TO NET PLANT IN SERVICE		\$796,113
10	SUBTRACT FROM NET PLANT		
11	Federal Tax Offset	38.0822%	\$0
12	State Tax Offset	38.0822%	\$0
13	City Tax Offset	38.0822%	\$0
14	Interest Expense Offset	38.0822%	\$0
15	Contribution in Aid of Construction		\$2,886,733
16	Customer Advances		\$0
17	Customer Deposits		\$0
18	Deferred Income Taxes		\$0
19	Accrued Pension Liability		\$0
20	TOTAL SUBTRACT FROM NET PLANT		\$2,886,733
21	Total Rate Base		\$186,894

19. The parties concede that Timber Creek's total rate base is \$186,894.<sup>40</sup>

20. Based upon the parties' agreement and the Commission's independent review of Staff's accounting schedules Timber Creek's total rate base is \$186,894.

21. Timber Creek's Capital Structure, as presented in Staff's Accounting Schedules, is as follows:<sup>41</sup>

Capital Component Description	Dollar Amount	Percentage of Total Capital Structure	Embedded Cost of Capital	Weighted Cost of Capital		
				7.67%	7.67%	7.67%
Common Stock	\$0	0.00%	-----	0.00%	0.00%	0.00%
Common Equity	\$46,724	25.00%	11.07%	2.768%	2.768%	2.768%
Preferred	\$0	0.00%	0.00%	0.00%	0.00%	0.00%

<sup>40</sup> Transcript, p. 17.

<sup>41</sup> Exh. 7, Staff Accounting Schedules, Schedule 1; Exh. 8, Prenger Direct, pp. 6-7.

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Stock						
Long-Term Debt	\$140,171	75.00%	6.53%	4.897%	4.897%	4.897%
Short-Term Debt	\$0	0.00%	0.00%	0.00%	0.00%	0.00%
Other Security Tax Deductible	\$0	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Total Capitalization</b>	<b>\$186,895</b>	<b>100.00%</b>		<b>7.665%</b>	<b>7.665%</b>	<b>7.665%</b>

14.

22. Staff's recommended weighted average cost of capital ("WACC"), or Rate of Return, for Timber Creek is 7.67%. The WACC is calculated by multiplying each component ratio of the appropriate capital structure by its cost and then summing the results.<sup>42</sup>

23. The only two types of capital included in Staff's recommended WACC were common equity and long-term debt.<sup>43</sup>

24. Based on Staff's calculations' Timber Creek's embedded cost of debt was 6.53% as of the test year.<sup>44</sup>

25. Staff estimated the Company's cost of equity to be 11.07% based on the assumption that Timber Creek's capital structure consisted of 25% equity and 75% debt.<sup>45</sup>

26. The parties concede that Staff's accounting of Timber Creek's capital structure is correct.<sup>46</sup>

27. Based upon the parties' agreement and the Commission's independent review of Staff's accounting schedules, Timber Creek's embedded cost of debt was 6.53% as of the test year.

28. Based upon the parties' agreement and the Commission's independent review of Staff's accounting schedules, Timber Creek's embedded cost of equity is 11.07%.

29. Based upon a rate of return of 7.67% and a rate base of \$186,894, Timber Creek's Net Operating Income Requirement is

<sup>42</sup> Exh. 27, *Verified Memorandum of Shana Atkinson: Timber Creek Cost of Capital Explanation*.

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*

<sup>45</sup> *Id.*

<sup>46</sup> Transcript, p. 17.

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\$14,325.<sup>47</sup>

30. Timber Creek's Gross Revenue Requirement cannot be determined until the Commission decides the contested issues in this matter.

**Rate Design, Depreciation Rates, Various Accounting Measures & Conditions**

31. In the Partial Agreement, the parties unanimously agreed that:<sup>48</sup>

- (1) Staffs rate design methodology of an equal percent increase to existing rates is acceptable;
- (2) The schedule of depreciation rates attached hereto as Attachment A and incorporated herein by reference, which includes the depreciation rates used by Staff in its revenue requirement analysis, shall be the prescribed schedule of sewer plant depreciation rates for the Company;
- (3) Within ninety (90) days of the effective date of an order approving this Unanimous Partial Disposition Agreement, the Company shall implement the following recommendations from the Auditing Department:
  - a. The Company shall keep a detailed list of invoices for future purchases within the Uniform System of Accounts ("USDA") including, but not limited to, the accounts Laboratory Equipment and Tools and Shop Equipment;
  - b. The Company shall maintain its financial and accounting records using the USDA guidelines for a Class A Sewer Company for its revenues, expenses and investment costs;
- (4) Within ninety (90) days of the effective date of an order approving this Unanimous Partial Disposition Agreement, the Company shall implement the following recommendations contained in the Engineering & Management Services Department ("EMSD") Report,

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<sup>47</sup> Exh. 7, *Staff Accounting Schedules*, Schedule 2.

<sup>48</sup> Exh. 1 - Unanimous Partial Agreement; EFIS Docket Entry No. 11, Stipulation of Timber Creek Sewer Company to Factual Assertions in Attachments to Unanimous Partial Agreement, filed on October 18, 2010; EFIS Docket Entry No. 12, The Office of the Public Counsel's Stipulation, filed on October 20, 2010.

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except any recommendation associated with time sheets or any other contested items. The EMSD Report is attached hereto as Attachment B and incorporated by reference herein. These recommendations include the following:

a. The Company shall display the Company's logo on the Company's vehicle;

(5) Within ninety (90) days of the effective date of an order approving this Unanimous Partial Disposition Agreement, the Company shall implement the following recommendations from Depreciation Staff associated with EMSD:

a. The Company shall adjust the Company's general ledger to reflect the plant and reserve account balances shown in the Staff EMS exhibit, attached hereto as Attachment A and incorporated by reference herein;

b. The Company shall adjust the Contributions in Aid of Construction ("CIAC") and the amortized CIAC account balances shown in the Staff EMS exhibit, attached hereto as Attachment A and incorporated by reference herein;

c. The Company shall implement a work order system to track material cost, labor cost, overhead cost, and record cost of removal and gross salvage for all new, replaced or retired plant; and

d. The Company shall follow National Association of Regulatory Utility Commissioners' ("NARUC") USOA guidelines for the recording of cost of removal and gross salvage in the Company ledger as adjustments to plant and reserves;

(6) Within six (6) months of the effective date of an order approving this Unanimous Partial Disposition Agreement, the Company shall implement the following recommendations from Depreciation Staff associated with EMSD:

a. The Company shall estimate the original



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installed cost of the Johnson Ridge and Oakbrook collection and treatment facilities which were installed by a developer and transferred (donated) to the Company as contributed plant, and to provide these estimates to Depreciation Staff. This contributed plant relating to the collection and treatment facilities is to be included in plant in service and would be treated as a contribution in aid of construction an offset (reduction) to rate base;

(7) Staff and/or OPC may conduct follow-up reviews of the Company's operations to ensure that the Company has complied with the provisions of this Unanimous Partial Disposition Agreement;

(8) Staff and/or OPC may file a formal complaint against the Company, if the Company does not comply with the provisions of this Unanimous Partial Disposition Agreement;

(9) The Company agrees that it has read the foregoing Unanimous Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase Request; that facts stated therein are true and accurate to the best of the Company's knowledge and belief; that the foregoing conditions accurately reflect the partial agreement reached between the Company, OPC and Staff; and that the Company freely and voluntarily enters into this partial agreement; and

(10) The above partial agreements satisfactorily resolve all issues identified and addressed in the above paragraphs by Staff, OPC and the Company regarding the Company's Request.

32. Based upon the parties' unanimous Partial Agreement and the Commission's independent review, the Commission finds that the proper method to implement any over-all revenue increase is through Staff's rate design methodology.

33. Based upon the parties' unanimous Partial Agreement and the Commission's independent review, the Commission finds that the proper schedule of depreciation rates for setting a just and reasonable revenue requirement is delineated in Attachment A to the Partial

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Agreement. Those rates are:

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**Schedule F - DEPRECIATION RATES**  
**(SEWER Class B)**  
**SR-2010-0320**

<b>ACCOUNT NUMBER</b>	<b>ACCOUNT DESCRIPTION</b>	<b>DEPRECIATION RATE</b>	<b>AVERAGE SERVICE LIFE (YEARS)</b>	<b>NET SALVAGE</b>
<b>COLLECTION PLANT</b>				
351	Structures & Improvements	4.0%	25	
352.1	Collection Sewers (Force)	2.0%	50	
352.2	Collection Sewers (Gravity)	2.0%	50	
353	Services	2.0%	50	
354	Flow Measurement Devices	3.3%	30	
<b>PUMPING PLANT</b>				
361	Structures & Improvements	4.0%	25	
362	Receiving Wells	4.0%	25	
363	Electric Pumping Equipment	10.0%	10	
<b>TREATMENT &amp; DISPOSAL PLANT</b>				
371	Structures & Improvements	3.3%	30	
372	Treatment & Disposal Facilities	5.0%	20	
372.1	Oxidation Lagoons or Septic tank	4.0%	25	
373	Plant Sewers	2.5%	40	
374	Outfall Sewer Lines	2.0%	50	
<b>GENERAL PLANT</b>				
390	Structures & Improvements	2.5%	40	
391	Office Furniture & Equipment	3.3%	30	
391.1	Office Electronic & Computer Equip.	14.3%	7	
392	Transportation Equipment	13.0%	7	9%
393	Stores Equipment	4.0%	25	
394	Tools, Shop, and Garage Equipment	5.0%	20	
395	Laboratory Equipment	5.0%	20	
396	Power Operated Equipment	6.7%	13	13%
397	Communication Equipment	6.7%	15	
399.1	OSHA Required Safety Equipment	20.0%	5	

34. Based upon the parties' unanimous Partial Agreement and the Commission's independent review, the Commission finds it is just and reasonable for Timber Creek to implement the recommendations from Staff's Auditing Department as described in the Partial Agreement.

35. Based upon the parties' unanimous Partial Agreement and

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the Commission's independent review, the Commission finds it is just and reasonable for Timber Creek to implement the recommendations from Staff's EMSD Report.

36. Based upon the parties' unanimous Partial Agreement and the Commission's independent review, the Commission finds it is just and reasonable for Timber Creek to implement all other conditions contained in the Partial Agreement.

37. Upon review of the record and the Partial Agreement, the Commission independently finds that the Partial Agreement's proposed terms support the provision of safe and adequate service.

**D. Employee Compensation**

38. Water and sewer companies need quality employees to ensure that their operations are run effectively and efficiently and that their customers receive safe and adequate service.<sup>49</sup>

39. Timber Creek's employees occupy four positions: Operations Manager, General Manager, System Operator and Office Manager.<sup>50</sup>

40. Determining the appropriate compensation level for these employees involves considering many factors including: (a) an examination of the individual job descriptions, i.e., the employee's duties and responsibilities along with the employee's experience level; (b) an examination of labor statistics reports and market salary reports for the relevant comparable positions in the appropriate geographical area factoring in the experience level of the employees; (c) a comparison to prior Commission rate cases salary data; and, (d) a comparison of salaries for similarly sized and type of utilities, including examining the number of customers served and the number of persons employed to serve those customers (Collectively referred to as "Relevant Salary Determination Factors").<sup>51</sup>

41. The following table presents the parties positions on salaries and overtime:<sup>52</sup>

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<sup>49</sup> Transcript, p. 94.

<sup>50</sup> Exh. 4, Sherry Direct, pp. 4-5.

<sup>51</sup> Exh. 8, Prenger Direct, Exh. 9, Prenger Rebuttal; Exh. 10, Prenger Surrebuttal.

<sup>52</sup> Exh. 3, Reconciliation.

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<b>Position</b>	<b>Current Salary</b>	<b>Timber Creek</b>	<b>Staff</b>	<b>OPC</b>
<b><u>Operations Manager</u></b> <b>Overtime</b>	<b>\$78,660</b> <b>\$0.00</b>	<b>\$78,660</b> <b>\$0.00</b>	<b>\$81,020</b> <b>\$0.00</b>	<b>\$59,258</b> <b>\$0.00</b>
<b><u>General Manager</u></b> <b>Overtime</b>	<b>\$72,450</b> <b>\$0.00</b>	<b>\$94,529</b> <b>\$0.00</b>	<b>\$76,862</b> <b>\$0.00</b>	<b>\$52,768</b> <b>\$0.00</b>
<b><u>System Operator</u></b> <b>Overtime</b>	<b>\$40,980</b> <b>\$0.00</b>	<b>\$49,290</b> <b>\$7,234.83</b>	<b>\$39,000</b> <b>\$7,000</b>	<b>\$45,867</b> <b>\$0.00</b>
<b><u>Office Manager</u></b> <b>Overtime</b>	<b>\$40,349</b> <b>\$0.00</b>	<b>\$43,263</b> <b>\$2,604.45</b>	<b>\$41,559</b> <b>\$0.00</b>	<b>\$32,650</b> <b>\$0.00</b>
<b>Workers' Comp. Ins.</b>	<b>\$0.00</b>	<b>\$194.07</b>	<b>\$0.00</b>	<b>\$0.00</b>
<b>Total Payroll</b>	<b>\$232,439.00</b>	<b>\$275,775.35</b>	<b>\$245,441.00</b>	<b>\$190,543.00</b>

42. In order to determine the proper compensation for Timber Creek's employees, Staff audited the Company's books, records, invoices and vouchers, conducted a review of the Company's customer service and general business practices, and reviewed the Company's existing tariff.<sup>53</sup>

43. Staff identified the current compensation level for each employee and the individual salaries that were found to be just and reasonable in prior Commission rate cases.<sup>54</sup>

44. Staff conducted on-site visits, inspecting the facilities and reviewing their operations, including the areas planned for expansion in Platte County.<sup>55</sup>

45. To gain specific job function information for Timber Creek's four employees, Staff interviewed Timber Creek personnel, reviewed Timber Creek's responses to requests for information issued in this and

<sup>53</sup> *Id.*; Exh. 8, Prenger Direct, p. 4-5.

<sup>54</sup> Exh. 9, *Prenger* Rebuttal, pp. 2-3; Transcript, p. 104.

<sup>55</sup> Exh. 8, Prenger Direct, p. 4-5.

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other previous cases and reviewed the job description for each Timber Creek employee.<sup>56</sup>

46. The comparison of actual job documentation in the form of job descriptions combined with company employee interviews is critical in determining compensation levels because not all job duties may be documented and not all documented job duties may be performed.

47. When making its recommendations on compensation, Staff also used outside sources necessary to complete the review; including information from the Bureau of Labor Statistics, the Missouri Economic Research and Information Center (“MERIC”) and the cost of living adjustment (“COLA”) the federal government authorizes for social security.<sup>57</sup>

48. Staff also relied upon a comparison of relevant regional utilities, including the

15. Platte Country Regional Sewer District, Johnson County Wastewater, and the Wyandotte County Wastewater-Unified Government Treatment Plants.<sup>58</sup>

49. Staff’s payroll analysis also involved a comparison of previous Commission rate case salary evaluations in the water and sewer industry, including the recent rate case for Lake Region Water and Sewer Company.<sup>59</sup>

50. Timber Creek based its salary analysis on its comparison of current salaries with MERIC’s occupational wages for the Kansas City region and the American Water Works Association 2009 Salary Study of Water and Wastewater. Timber Creek also examined additional market data from positions in the Kansas City Area.<sup>60</sup>

51. Timber Creek failed to distinguish the utility and its employees from similar duties and responsibilities of other sewer companies.<sup>61</sup>

52. While Timber Creek used some of the same sources as Staff when assessing the appropriate compensation level for its

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<sup>56</sup> Exh. 8, Prenger Direct, p. 4-5, 10; Transcript, pp. 74.

<sup>57</sup> Exh. 8, Prenger Direct, p. 4-5; Exh. 9, Prenger Rebuttal, pp. 2-3; Transcript, pp. 74, 103. MERIC is a database for Missouri employment data, including salaries and wages for specific jobs. Exh. 8, Prenger Direct, p. 11.

<sup>58</sup> Exh. 9, Prenger Rebuttal, pp. 2-3.

<sup>59</sup> *Id.*

<sup>60</sup> Exh. 4, Sherry Direct, pp. 5-7.

<sup>61</sup> Exh. 8, Prenger Direct, pp. 8-16; Exh. 9 Prenger Rebuttal, pp. 3-16, and accompanying schedules; Exh. 10, Prenger Surrebuttal, pp. 2-18, and accompanying schedules.

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employees, it failed to recognize and account for the differences between general market studies and utility specific markets and differences in the utilities that were used for comparison in terms of the size of the utility, the size of the customer base and the total number of employees.<sup>62</sup>

53. The evidence Timber Creek offered to support its request for employee compensation is incomplete and lacks credibility.

54. The Office of the Public Counsel based its analysis on compensation on a review of the MERIC Occupation Wages for the Kansas City Region. However, Public Counsel did not properly consider the duties of the individual positions, nor did it properly consider the experience level of all of Timber Creek's employees, nor did it properly consider the size and scope of Timber Creek's operations.<sup>63</sup> For example, Public Counsel did not take into consideration the General Manager's prior seventeen years executive experience including his prior positions at Johnson County Wastewater and Sprint.<sup>64</sup> Also, at one point during the hearing, Public Counsel's witness did not appear to recognize his own work papers, solidifying the impression that he could not have prepared a thorough analysis.<sup>65</sup>

55. The evidence Public Counsel offered to support its position on employee compensation is insubstantial and lacks credibility.

56. Staff used the correct methodology to determine the appropriate compensation level for Timber Creek's employees.

57. Staff presented the most comprehensive and accurate analysis of the appropriate compensation level for Timber Creek's employees.

58. Staff's evidence on the proper compensation for Timber Creek's employees is credible, substantial and persuasive.

### **Operations Manager**

59. Staff Witness Prenger fully and accurately delineated the duties and responsibilities of the Operations Manager (Plant Manager).<sup>66</sup>

60. Reviewing the Relevant Salary Determination Factors, (See FOF Number 40), as they apply to an employee with the duties and responsibilities described in detail by Witness Prenger, the Commission finds Staff's analysis is correct and the appropriate annual salary for the

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<sup>62</sup> *Id.* Transcript, p. 86.

<sup>63</sup> *Id.*; Transcript, pp. 72-158, 225-245, 247; Exhibit 23, *Robertson Rebuttal*, p. 10, line 18.

<sup>64</sup> Exhibit 4, *Sherry Direct*, pp. 1- 2.

<sup>65</sup> Transcript, p. 231-232.

<sup>66</sup> Exhibit 8, *Prenger Direct*, pp. 10-15.

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Operations Manager position is \$81,020.

61. The \$81,020 salary for the Operations Manager includes a three percent COLA over the existing salary for this position.<sup>67</sup>

62. The COLA is justified because Timber Creek employees have not received a pay increase since 2008, because it was necessary to compensate for the higher cost of living, and because of the importance of this position to ensure the delivery of safe and adequate service.<sup>68</sup>

**General Manager**

63. Staff Witness Prenger fully and accurately delineated the duties and responsibilities of the General Manager.<sup>69</sup>

64. Reviewing the Relevant Salary Determination Factors (See FOF Number 40), as they apply to an employee with the duties and responsibilities described in detail by Witness Prenger, the Commission finds the appropriate annual salary for the General Manager position is \$76,862.<sup>70</sup>

65. The \$76,862 salary for the General Manager includes a three percent COLA, plus an additional three percent increase.<sup>71</sup>

66. The COLA is justified because Timber Creek employees have not received a pay increase since 2008, and because it was necessary to compensate for the higher cost of living.<sup>72</sup>

67. The additional three percent increase is justified to address the wage gap that currently exists between the Operations Manager's position and the General Manager's position. The General Manager's position carries with it more responsibilities for the overall operations of Timber Creek and should receive compensation more closely aligned, although not completely matched, with the Operations

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<sup>67</sup> Exh. 8, Prenger Direct, pp. 8-9; Exh. 9, Prenger Rebuttal, p. 2-6; Exh. 10, Prenger Surrebuttal, p. 13-14.

<sup>68</sup> Exh. 8, Prenger Direct, pp. 8-9; Exh. 9, Prenger Rebuttal, p. 2-6; Exh. 10, Prenger Surrebuttal, pp. 12-14.

<sup>69</sup> Exh. 8, Prenger Direct, pp. 10-15.

<sup>70</sup> The General Manager's salary authorized for Lake Region Water and Sewer Company, a utility comparable to Timber Creek with a similar customer base and annual revenues, was recently set at \$80,614.34. Exh. 9, Prenger Rebuttal, p. 11-12, line 7. See also File Nos. SR-2010-0110 and WR-2010-0111.

<sup>71</sup> Exh. 8, Prenger Direct, pp. 9, 15-16; Exh. 9, Prenger Rebuttal, pp. 2-3.

<sup>72</sup> Exh. 8, Prenger Direct, pp. 8-9; Exh. 9, Prenger Rebuttal, p. 2-6; Exh. 10, Prenger Surrebuttal, pp. 11-12.

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Manager.<sup>73</sup>

68. The remaining wage gap between the Operations Manager's Position and the General Manager's position, is justified because of the Missouri Department of Natural Resources' requirement for the Operations Manager to obtain and maintain a Class A operator's license to oversee the operations of a sewer company the size of Timber Creek.<sup>74</sup>

69. The General Manager does not possess a Class A operator's license, and it reasonable that the Operations Manager should be paid more than the General Manager at this time because the operator's license is required to maintain Timber Creek's operations in a safe and reliable manner.<sup>75</sup>

**Collection Systems Operator**

70. Staff Witness Prenger fully and accurately delineated the duties and responsibilities of the Collection Systems Operator (Systems Operator or Assistant Operator).<sup>76</sup>

71. Reviewing the Relevant Salary Determination Factors (See FOF Number 40), as they apply to an employee with the duties and responsibilities described in detail by Witness Prenger, the Commission finds the appropriate annual salary for the Collection Systems Operator position is \$39,000. An additional amount of \$7,000 is authorized for overtime.

72. The \$39,000 salary for the Collection Systems Operator is a reduction from the position's current salary of \$40,980. This reduction brings the salary in line with proper market analysis.<sup>77</sup>

73. The \$7,000 in overtime for this position is justified based upon the implementation of time reporting, the legal requirement to book this position as a non-exempt position once time reporting is initiated, and an estimate of the activities associated with the position in 2009 that would generate overtime wages.<sup>78</sup>

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<sup>73</sup> Exh. 8, Prenger Direct, pp. 15-16; Exh. 9, Prenger Rebuttal, p. 2-6.

<sup>74</sup> Exh. 9, Prenger Rebuttal, p. 2, 5-6.

<sup>75</sup> Exh. 9, Prenger Rebuttal, p. 2, 5-6.

<sup>76</sup> Exhibit 8, Prenger Direct, pp. 10-15.

<sup>77</sup> Exh. 8, Prenger Direct, pp. 8-11; Exh. 9, Prenger Rebuttal, p. 2-7, 14-20; Exh. 10, Prenger Surrebuttal, pp. 5-11.

<sup>78</sup> Exh. 8, Prenger Direct, pp. 8-11; Exh. 9, Prenger Rebuttal, p. 2-7, 14-20; Exh. 10, Prenger Surrebuttal, pp. 5-11. Transcript, pp. 50, 81-82. Timber Creek conceded on the dispute about keeping time sheets. For a discussion on proper rational for maintain time reporting see Exh. 11, Hagemeyer Direct and Exh. 12 Hagemeyer Rebuttal.



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**Office Manager**

74. Staff Witness Prenger fully and accurately delineated the duties and responsibilities of the Office Manager.<sup>79</sup>

75. These duties of the Office Manager for Timber Creek go beyond clerical support making this position ineligible for overtime, but eligible (as a salaried employee and not an hourly employee) for a salary higher than that of performing a solely a clerical role.<sup>80</sup>

76. Reviewing the Relevant Salary Determination Factors (See FOF Number 40), as they apply to an employee with the duties and responsibilities described in detail by Witness Prenger, the Commission finds the appropriate annual salary for the Office Manager position is \$41,559.

77. The \$41,559 salary for the Office Manager includes a three percent COLA over the existing salary for this position.<sup>81</sup>

78. The COLA is justified because Timber Creek employees have not received a pay increase since 2008, and because it was necessary to compensate for the higher cost of living.<sup>82</sup>

79. With regard to the appropriate level of compensation for all of Timber Creek's employees, the Commission finds that those portions of Staff Witness Prenger's testimony that support the ultimate findings of fact above (Findings of Fact Numbers 38 through 78) to be accurate and supported by proper methodology.<sup>83</sup>

**E. Rate Case Expense**

80. The amount of verified, actual rate case expenses incurred by Timber Creek up to January 31, 2011 is \$30,630.<sup>84</sup>

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<sup>79</sup> Exhibit 8, Prenger Direct, pp. 10-15.

<sup>80</sup> Exh. 8, Prenger Direct, pp. 11; Exh. 9, Prenger Rebuttal, p. 2-7, 16-20; Exh. 10, Prenger Surrebuttal, pp. 14-17.

<sup>81</sup> Exh. 8, Prenger Direct, pp. 9, 15-16; Exh. 9, Prenger Rebuttal, pp. 2-3.

<sup>82</sup> Exh. 8, Prenger Direct, pp. 8-9; Exh. 9, Prenger Rebuttal, p. 2-7, 16-20; Exh. 10, Prenger Surrebuttal, pp. 10-12, 14-17.

<sup>83</sup> Exh. 8, Prenger Direct; Exh. 9, Prenger Rebuttal; Exh. 10, Prenger surrebuttal; and all accompanying schedules to these exhibits; Transcript, pp. 72-107.

<sup>84</sup> Exh. 28, Staff's Late-Filed Exhibit: Affidavits of V. William Harris and Bret G. Prenger, executed on February 3, 2011, Attachment A (Adjustment E-196) and Reconciliation, filed on February 3, 2011 as a late-filed exhibited and admitted, without objection, into evidence on February 23, 2011; Exh. 29, Timber Creek Sewer Company's Late-Filed Exhibit RE Additional Rate Case Expense: Exhibits A-D, filed on February 5, 2011, and admitted, without objection, into evidence on March 8, 2011; Exh. 30, Staff's Response to Timber Creek Sewer Company's late-Filed Exhibit Regarding Additional Rate Case Expense: Affidavit of V. William Harris executed on March 2, 2011 and attached billing statement,

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81. The amount of verified, actual rate case expenses incurred by Timber Creek from February 1, 2011 through February 25, 2011 is \$5,540.<sup>85</sup>

82. The total amount of verified, actual rate case expense of \$36,170 was prudently incurred and it is appropriate and reasonable to allow recovery of these expenses in customer rates.<sup>86</sup>

83. For reasons more fully explained in the conclusions of law section, the appropriate amount of rate case expense that Timber Creek is authorized to recover in rates, amortized over three years, is \$36,170.

**F. Alternative Energy Exploration Expense Recovery**

84. Because Timber Creek's electric service rates had risen, it spent \$10,849.42 on a venture drilling for natural gas on its property to serve as an alternative energy source.<sup>87</sup>

85. Based upon all of Timber Creek's preliminary studies, the company believed it had a fifty percent chance, or better, of finding commercial quantities of natural gas.<sup>88</sup>

86. Timber Creek's decision to explore the natural gas option was known to be the lowest cost alternative energy source, but also involved the highest risk of success.<sup>89</sup>

87. The natural gas industry would give this venture a fifty percent chance of finding commercial quantities of natural gas.<sup>90</sup>

88. Commercial quantities of natural gas are required to power a generator to produce electricity for Timber Creek's operations.<sup>91</sup>

89. Timber Creek is not an energy company.<sup>92</sup>

90. Timber Creek's pilot well confirmed natural gas was not present.<sup>93</sup>

91. Timber Creek's customers are receiving no benefit from the drilling venture.<sup>94</sup>

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filed on March 4, 2011 and admitted, without objection, into evidence on March 15, 2011.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

<sup>87</sup> Exh. 4, Sherry Direct, pp. 12-15.

<sup>88</sup> Transcript, p. 57-58, 117-122.

<sup>89</sup> Transcript, p. 131.

<sup>90</sup> Transcript, p. 57.

<sup>91</sup> *Id.* Exh. 17, Hummel Direct, pp. 2-3.

<sup>92</sup> Transcript, p. 70.

<sup>93</sup> Exh. 4, Sherry Direct, pp. 14.

<sup>94</sup> Transcript, p. 62; Exh. 22, Robinson Direct, p. 7; Exh. 23, Robinson Rebuttal, pp. 25-28;

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92. Given the totality of the circumstances, Timber Creek's assumption that natural gas would be present was speculative.<sup>95</sup>

93. For reasons more fully explained in the conclusions of law section, the appropriate amount of the expense associated with the exploratory pilot gas well that Timber Creek is authorized to recover in rates is \$0.00.

94. For reasons more fully explained in the conclusions of law section, the appropriate amount of expense associated with additional exploration for alternative energy sources that Timber Creek is authorized to recover in rates is \$0.00.

### **G. PSC Assessment**

95. The Commission's assessment allocation percentage for sewer companies was 6.94% for fiscal year 2008, 8.74% for fiscal year 2009, 11.22% for fiscal year 2010 and 9.34% for fiscal year 2011.<sup>96</sup>

96. Timber Creek recovered sufficient revenues to cover the expenses associated with Commission's assessment for the years in between this action and its last rate case, File No. SR-2008-0080.<sup>97</sup>

97. The correct 2011 fiscal year Commission Assessment for Timber Creek, as calculated pursuant to Section 386.370, RSMo 2000, is \$62,590.

98. For reasons more fully explained in the conclusions of law section, the appropriate amount of the PSC Assessment Timber Creek is authorized to recover in rates is \$62,590, the amount Timber Creek was assessed for the 2011 fiscal year.

99. For reasons more fully explained in the conclusions of law section, it is improper to pass-through the cost of the Commission assessment as a separate item on each customer's bill because it would increase the regulatory burden on utilities and the Commission's Staff increasing costs for the ratepayers. Additionally, to adopt such a practice would constitute a statement of general applicability of law or policy that would require a rulemaking.<sup>98</sup>

### **H. Contingency / Emergency Repair Fund**

100. Timber Creek seeks Commission approval to establish a

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<sup>95</sup> Exh. 17, Hummel Direct, p. 2-3 ; Exh. 18, Hummel Rebuttal, pp. 1-2; Transcript, pp. 197-199.

<sup>96</sup> Exh. 4, Sherry Direct, pp. 15-17.

<sup>97</sup> Exh. 14, Harris Rebuttal, pp. 4-7; Exh. 16, Calculation of Excess Revenues over Expenses.

<sup>98</sup> Exh. 19, Busch Direct, pp. 4-7; Exh. 20 Busch Rebuttal, pp. 3-7.

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fund to be used for unplanned events that it believes could substantially impact its utility operations, either financially or operationally, with the potential to interrupt its ability to provide safe, dependable and adequate service.<sup>99</sup>

101. There are many factors that must be considered when determining whether such a fund is appropriate including, but not limited to, the actual need for the fund, the type of account to be created, the appropriate level of reserve in the fund, the types of expenses the fund could cover, the types of expenses it would not cover, appropriate reporting requirements, appropriate oversight, treatment of any excess reserve collections, and deciding when and how the company would have access to the fund.<sup>100</sup>

102. Tiber Creek's proposal involves implementing a surcharge of \$0.50 per month per customer (approximately \$9,347 per year) for nineteen years to collect a total fund balance of \$177,604.<sup>101</sup> Timber Creek believes this balance is approximately equal to three months of its regular expenses.<sup>102</sup>

103. Timber Creek used a model for its proposed contingency fund that the Environmental Protection Agency uses as part of an assessment management awareness program to have utilities become proactive about managing aging infrastructure.<sup>103</sup>

104. Timber Creek completed a comparison of actual repair and failure rates with the model it prepared.<sup>104</sup>

105. Timber Creek did not offer any evidence that it is unable to fund unplanned events that it believes could substantially impact its utility operations at its current operational income level without establishing a contingency fund.<sup>105</sup> In fact, the evidence demonstrates the opposite.<sup>106</sup> Timber Creek recently experienced a pump failure caused when lightning struck a control panel and had no financial difficulty with repairing the

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<sup>99</sup> Exh. 4, Sherry Direct, pp. 17-21 and Schedule DS-7; Exh. 5, Sherry Rebuttal, pp. 5-6; Transcript, pp. 65-70, 135-136, 148-150.

<sup>100</sup> Exhibit 20, Busch Rebuttal, pp. 8-11.

<sup>101</sup> *Id.*

<sup>102</sup> Transcript, pp. 123-125.

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> Transcript, pp. 65, 248

<sup>106</sup> *Id.*

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damage from this unplanned event.<sup>107</sup>

106. For reasons more fully explained in the conclusions of law section, the appropriate amount Timber Creek is authorized to recover in rates for a contingency and emergency repair fund is \$0.00.

### **I. Service Quality**

107. There are no deficiencies, problems or issues with the quality of service provided by Timber Creek.

108. There are no deficiencies, problems or issues with Timber Creek's billing for services.

109. There are no deficiencies, problems or issues with Timber Creek's response to customer calls.

110. Timber Creek's employees are well qualified, their system is run very well, and the Commission's Staff works with Timber Creek to teach others in the small water and sewer industry.<sup>108</sup>

### **IV. Conclusions of Law**

The Missouri Public Service Commission has arrived at the following conclusions of law.

#### **A. Jurisdiction, Burden of Proof, Presumption of Prudence and the Public Interest<sup>109</sup>**

Timber Creek is a sewer corporation pursuant to Section 386.020(49) RSMo Supp. 2010, and subsequently a public utility within the meaning of 386.020(42) RSMo Supp. 2010. As a public utility, Timber Creek is subject to the personal jurisdiction, supervision, control and regulation of the Commission under Chapters 386 and 393 of the Missouri Revised Statutes. The Commission's subject matter jurisdiction over Timber Creek's rate increase request is established under Section 393.150, RSMo 2000.

Sections 393.130 and 393.140, RSMo 2000, mandate that the Commission ensure that all utilities are providing safe and adequate service and that all rates set by the Commission are just and reasonable. Section 393.150.2 makes clear that at any hearing involving a requested rate increase the burden of proof to show the proposed increase is just and reasonable rests on the utility seeking the rate increase. As the party requesting the rate increase, Timber Creek bears the burden of proving that its proposed rate increase is just and reasonable. In order to carry its burden of proof, Timber Creek must meet the preponderance

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<sup>107</sup> Transcript, p. 125.

<sup>108</sup> Transcript, p. 103.

<sup>109</sup> See Findings of Fact Numbers 1-3 for this section.

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of the evidence standard.<sup>110</sup> And in order to meet this standard, Timber Creek must convince the Commission it is “more likely than not” that Timber Creek’s proposed rate increase is just and reasonable.<sup>111</sup>

While a utility has the burden of proof to justify its proposed rate increase, there is initially a presumption that its expenditures, comprising one component of its revenue requirement, are prudent. This presumption can be rebutted upon a showing of serious doubt as to the prudence of expenditure, at which point the utility must dispel this doubt and prove the questioned expenditure is prudent.<sup>112</sup>

While the standard for evaluating the proposed rate increase pursuant to Section 393.150 is clear, and while Timber Creek receives an initial presumption that its expenditures are prudent, the Commission must also consider the “public interest” when it makes its determination as to if the proposed increased rates are just and reasonable.<sup>113</sup> The public interest is a matter of policy to be determined by the Commission.<sup>114</sup> It is within the discretion of the Public Service Commission to determine when the evidence indicates the public interest would be served.<sup>115</sup> Determining what is in the interest of the public is a

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<sup>110</sup> *Bonney v. Environmental Engineering, Inc.*, 224 S.W.3d 109, 120 (Mo. App. 2007); *State ex rel. Amrine v. Roper*, 102 S.W.3d 541, 548 (Mo. banc 2003); *Rodriguez v. Suzuki Motor Corp.*, 936 S.W.2d 104, 110 (Mo. banc 1996) citing to, *Addington v. Texas*, 441 U.S. 418, 423, 99 S.Ct. 1804, 1808, 60 L.Ed.2d 323, 329 (1979).

<sup>111</sup> *Holt v. Director of Revenue, State of Mo.*, 3 S.W.3d 427, 430 (Mo. App. 1999); *McNear v. Rhoades*, 992 S.W.2d 877, 885 (Mo. App. 1999); *Rodriguez*, 936 S.W.2d at 109 -111; *Wollen v. DePaul Health Center*, 828 S.W.2d 681, 685 (Mo. banc 1992).

<sup>112</sup> *In the Matter of Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (quoting *Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission*, 669 F.2d 779, (D.C. Cir. 1981)).

<sup>113</sup> *In re Rahn’s Estate*, 316 Mo. 492, 501, 291 S.W. 120, 123 (Mo. 1926); *Morrishead v. Railways Co.*, Mo. 121 165, 96 S.W. 261, 271 (Mo. banc 1907); *Missouri Public Service Co. v. City of Trenton*, 509 S.W.2d 770, 775 (Mo. App. 1974). The legislature delegated the task of determining the public interest in relation to the regulation of public utilities to the Commission when it enacted Chapter 386, and all other chapters and sections related to the exercise of the Commission’s authority.

<sup>114</sup> *State ex rel. Public Water Supply District v. Public Service Commission*, 600 S.W.2d 147, 154 (Mo. App. 1980); *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission*, 288 S.W.2d 679, 682 (Mo. App. 1956).

<sup>115</sup> *State ex rel. Intercon Gas, Inc. v. Public Service Com’n of Missouri* 848 S.W.2d 593, 597 -598 (Mo. App. 1993). That discretion and the exercise, however, are not absolute and are subject to a review by the courts for determining whether orders of the P.S.C. are lawful and reasonable. *State ex rel. Public Water Supply Dist. No. 8 of Jefferson County v. Public Service Commission*, 600 S.W.2d 147, 154 (Mo. App. 1980).

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balancing process.<sup>116</sup> In making such a determination, the total interests of the public served must be assessed.<sup>117</sup> This means that some of the public may suffer adverse consequences for the total public interest.<sup>118</sup> Individual rights are subservient to the rights of the public.<sup>119</sup> The “public interest” necessarily must include the interests of both the ratepaying public and the investing public;<sup>120</sup> however, as noted, the rights of individual groups are subservient to the rights of the public in general.

### **B. Rate Base, Capital Structure and Weighted Cost of Capital**<sup>121</sup>

The parties have agreed to the calculations of Timber Creek’s rate base, capital structure and the appropriate weighted cost of capital as presented in Staff’s Accounting Schedules. Based on the agreed-upon rate of return of 7.67% and the agreed-upon rate base of \$186,894, Timber Creek’s Net Operating Income Requirement is \$14,325.

The Commission finds it highly persuasive that multiple parties representing diverse interests reached agreement on these calculations.

The Commission has compared the substantial and competent evidence on the whole record with the parties’ stipulation and admissions as to rate base, capital structure and the appropriate weighted cost of capital. After undertaking an independent review of all relevant factors,<sup>122</sup> the Commission determines that the substantial and

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<sup>116</sup> *In the Matter of Sho-Me Power Electric Cooperative’s Conversion from a Chapter 351 Corporation to a Chapter 394 Rural Electric Cooperative*, Case No. EO-93-0259, Report and Order issued September 17, 1993, 1993 WL 719871 (Mo. P.S.C.).

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *State ex rel. Mo. Pac. Freight Transport Co. v. Public Service Commission*, 288 S.W.2d 679, 682 (Mo. App. 1956).

<sup>120</sup> The United States Supreme Court tells us simply that “the fixing of ‘just and reasonable’ rates, involves a balancing of the investor and the consumer interests.” *State ex rel. Missouri Gas Energy v. Public Service Com’n*, 186 S.W.3d 376, 383 (Mo. App. W.D. 2005), citing to, *Fed. Power Comm’n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944). The Missouri Supreme Court has also previously held that the Commission must consider the interests of the investing public and that failure to do so would deny them a right important to the ownership of property. See *State ex rel. City of St. Louis v. Public Service Com’n of Missouri*, 73 S.W.2d 393, 400 (Mo. banc 1934).

<sup>121</sup> Refer to Findings of Facts Numbers 6-30 for this section.

<sup>122</sup> When interpreting Section 386.420, the statute delineating the Commission’s procedural requirements for conducting hearings and making its reports, Missouri Courts have held that in contested cases the Commission must include findings of fact in its written report. Section 386.420, RSMo 2000; *State ex rel. Monsanto Co. v. Public Serv. Comm’n of Missouri*, 716 S.W.2d 791, 794-795 (Mo. banc 1986); *State ex rel. Rice v. Public Serv. Comm’n*, 359 Mo. 109, 220 S.W.2d 61, 65 (Mo. banc 1949); *State ex rel. Fischer v. Public*

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competent evidence on the record as a whole supports the conclusion that Timber Creek's Net Operating Income Requirement is \$14,325. While the Commission recognizes that Timber Creek's Gross Revenue Requirement cannot be determined until the Commission decides the contested issues in this matter, the Commission independently finds and concludes that the rate base, capital structure and the weighted cost of capital agreed to by the parties will lead to the setting of just and reasonable rates.

### **C. Rate Design, Depreciation Rates, Various Accounting Measures & Conditions<sup>123</sup>**

The parties have also reached agreement on the proper rate design methodology, depreciation rates, specific accounting measures and some additional conditions, as are fully outlined in the Partial Agreement and in the Commission's findings of fact. Based upon the parties' unanimous agreement and the Commission's independent review of all relevant factors, the Commission determines that the substantial and competent evidence on the record as a whole supports the conclusion that the proper method to implement any over-all revenue increase is through Staff's rate design methodology to implement an equal percentage increase to existing rates.

Similarly, based upon the parties' unanimous agreement and the Commission's independent review of all relevant factors, the Commission determines that the substantial and competent evidence on the record as a whole supports the conclusion that the proper depreciation rates and the accounting measures and other conditions are delineated in the Partial Agreement and in the Commission's findings of fact. While, the Commission recognizes that Timber Creek's Gross Revenue Requirement cannot be determined until the Commission decides the contested issues in this matter, the Commission independently finds and concludes that the depreciation rates, specific accounting measures and the additional conditions outlined in the Partial Agreement will lead to the setting of just and reasonable rates and will

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*Serv. Comm'n*, 645 S.W.2d 39, 42-43 (Mo. App. 1982). The Commission cannot merely adopt agreements or positions of the parties on the ultimate legal issues presented because such action fails to satisfy the competent and substantial evidence standard embodied in the Missouri Constitution, Article V, Section 18. *Id.* Litigants cannot stipulate as to questions of law. *State v. Biddle*, 599 S.W.2d 182, 186 and n. 4 (Mo. banc 1980). The Commission must independently and impartially review the facts and make a separate and independent determination. *Kennedy v. Missouri Real Estate Comm'n*, 762 S.W.2d 454, 457 (Mo. App. 1988).

<sup>123</sup> Refer to Findings of Facts Numbers 31-37 for this section.



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promote the provision of safe and adequate service.

### **D. Employee Compensation**<sup>124</sup>

Based upon the Commission's independent review of all relevant factors, the Commission determines that the substantial and competent evidence on the record as a whole supports the conclusion that the appropriate compensation for Timber Creek's employees is the position advocated by the Commission's Staff's, i.e., Operations Manager - \$81,020; General Manager - \$76,862; Collection Systems Operator - \$39,000, plus \$7,000 for overtime; Office Manager position - \$41,559. Allowing Timber Creek to recover these salaries in rates is just and reasonable and will help to ensure the retention of quality and experienced employees to provide safe and adequate service.

### **E. Rate Case Expense**<sup>125</sup>

In addition to the \$36,170 of rate case expense associated with adjudicating this rate increase request, Timber Creek is also requesting recovery of \$18,175 in rate case expenses from a previous rate case, File No. SR-2008-0080. At the time of that action, Timber Creek's current General Manager, Derek Sherry, was serving as an uncompensated officer and member of Timber Creek's Board of Directors.<sup>126</sup> However, Mr. Sherry claims to have been acting in a consulting capacity for SR-2008-0080, and that due to the way Staff classified him this expense was not recovered in rates.<sup>127</sup> Staff and Public Counsel have argued that to allow this recovery would be a violation of the matching principle and unlawful retroactive ratemaking. Public Counsel also seeks a disallowance of some of the expenses associated with this case.

Retroactive ratemaking is "the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with rate actually established."<sup>128</sup> The matching principle is an accounting principle in which the expenditure (rate case expense at that time) be matched with the benefits received (revenue from rates

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<sup>124</sup> Refer to Findings of Facts Numbers 38-79 for this section.

<sup>125</sup> See Finding of Facts Numbers 80-83 for this section.

<sup>126</sup> Exhibit 4, Sherry Direct, pp. 11-12; Transcript, pp. 116-117, 145-147, 184-186, 208-210.

<sup>127</sup> *Id.*

<sup>128</sup> *State ex. Rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission of Missouri*, 585 S.W.2d 41, 59 (Mo. banc 1979).

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established at that time).<sup>129</sup> Under the matching principle, this case's expenses must be matched with the revenue generated from the rates established in this case.

File number SR-2008-0080 reveals that the parties settled the issues in that action by means of a stipulation and agreement.<sup>130</sup> Mr. Sherry testified that he was active during the settlement process.<sup>131</sup> No provision was placed in the settlement agreement to allow additional recovery of the \$18,175. The company did not request an accounting authority order that would have allowed recovery at a later date. If there is any error to be had with the loss of recovery of this additional expense, the fault would rest on Timber Creek. The Commission concludes that under the specific facts of this case, to allow Timber Creek to recover that expense in this action, even if prudently incurred, would constitute unlawful retroactive ratemaking.<sup>132</sup>

Addressing Public Counsel's request for a disallowance, contrary to Public Counsel's position, Timber Creek has advanced important positions with regard to the proper recovery of rate case expenses, expenses associated with developing alternative energy, a potential contingency fund, and recovery of the Commission's assessment. The Commission recognizes these issues can be particularly troublesome for smaller utilities and welcomes creative approaches to ensure that proper recovery of expenditures will ensure safe and adequate service. The Commission demonstrated its interest and concern regarding these issues while ferreting out the facts during the hearing and during its deliberative process when reaching its final decision.

There should also be no mistake that a ruling against recovery of any particular expense item does not equate with the request being frivolous in any manner. That simply means that the Commission has

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<sup>129</sup> New York State Society of CPAs (NYSSCPA).

<sup>130</sup> Transcript, pp. 116-117, 145-147, 184-186, 208-210; See File No. sr-2008-0080, in particular: *Order Approving Small Company Rate Increase on an Interim Basis, Subject to Refund, and Approving Tariff*, issued October 30, 2007; *Unanimous Stipulation*, filed January 4, 2008; and *Order Approving Unanimous Stipulation and Agreement*, issued January 29, 2008.

<sup>131</sup> Transcript, p. 116-117.

<sup>132</sup> Having found that allowing this recovery would be unlawful retroactive ratemaking, the Commission need not discuss the matching principle. However, the Commission notes, that it is not bound by that principle when setting rates. Commission Rule 4 CSR-240-61.020(4), provides: "In prescribing the system of accounts the commission does not commit itself to the approval or acceptance of any item set out in any such account for the purpose of fixing rates or in determining other matters before the commission."

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found, under the specific facts of the case, that recovery is not warranted. What Public Counsel appears to be proposing is that any time a utility does not settle a claim and takes its issues to hearing the utility should be denied rate case expense. To adopt such a position would indeed place a chill on a full and fair adjudicative process.

The substantial and competent evidence in the record as a whole supports the conclusion that Timber Creek prudently incurred \$36,170 of rate case expense associated with adjudicating this rate increase request. Timber Creek will be authorized to recover this amount in rates, amortized over three years.

### **F. Alternative Energy Exploration Expense Recovery<sup>133</sup>**

Timber Creek is not requesting that it recover the \$10,849 it expended in its attempt to drill for natural gas. Nor would the Commission grant such recovery because the substantial and competent evidence in the record as a whole supports the conclusion that this venture was speculative and the expenses associated with it were not prudently incurred. Timber Creek, however, is requesting to recover virtually the same amount, amortized over three years, to continue to explore alternative energy options.

While the Commission is sensitive to the fact that Timber Creek's energy costs are rising, and while the Commission supports the concept of using an alternative energy sources to reduce costs for the company and the ratepayers, all the Commission has in this record is speculation as to the possibility of developing wind, solar, or biogas technologies.<sup>134</sup> With no concrete plans for development, and no actual plant in the ground that is benefiting the rate payers, the Commission will not authorize recovery of speculative expenses that may or may not benefit the ratepayers.

The Commission observes that there are many issues that small utilities face that pose unique challenges for these companies under traditional ratemaking practices. With that in mind, the Commission opened a workshop, File Number WW-2009-0386, to explore possible solutions to these challenges. The Commission believes the recovery of expenses associated with alternative energy sources exploration can be addressed in that workshop. That process may lead to new rules outlining how such cost recovery may best be implemented.

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<sup>133</sup> See Finding of Facts Numbers 84-94 for this section.

<sup>134</sup> Transcript, pp. 58-63, 129-132, 147-148, 197-199.

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### **G. PSC Assessment**<sup>135</sup>

Section 386.370, RSMo 2000, governs the process for the Commission's assessments on utilities. No party is contesting the amount of the 2011 fiscal year assessment on Timber Creek and there is no evidence that the \$62,590 was calculated incorrectly or inappropriately levied on the company. Timber Creek, however, not only requests recovery of the 2011 assessment, but also amounts it believes it under-recovered from prior years, specifically the time that elapsed since its last rate case. Timber Creek argues that the amount built into rates from its last rate case were based upon the 2008 assessment rate of 6.4%, and because the assessment increased each successive fiscal year, that it was unable to fully recover the assessment amounts from its customers. Timber Creek believes it under-recovered \$45,902 over that time period.<sup>136</sup>

The Commission need not repeat the definition for unlawful retroactive ratemaking it discussed when addressing rate case expense. Suffice it to say that allowing recovery of these alleged under-recoveries from prior years in the manner advocated by Timber Creek would constitute prohibited retroactive ratemaking. Timber Creek was able to fully recover these expenses through the growth in the number of its customers.<sup>137</sup>

Timber Creek has also requested it be allowed to directly pass the assessment through as a separate item on its customers' bills. However, the PSC assessment is a cost of doing business, just like all other costs, and utilities currently have an amount built into their cost of service and are able to collect in rates from its customers the dollars needed to pay the assessment. This amount is determined in the course of a rate case where all relevant costs, expenses, and revenues can properly be considered. To make this single item a pass-through places additional burdens on utilities because: (1) each would require a new rate case so base rates could be re-adjusted to remove the PSC assessment from their current rates and create a new pass-through amount on customer bills; (2) a true-up process would be required because of the changing assessment percentages; (3) additional reporting would be required from each utility; and (4) additional Staff would be required to handle the

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<sup>135</sup> See Finding of Facts Numbers 95-99 for this section.

<sup>136</sup> Exh. 4, Sherry direct, p. 17.

<sup>137</sup> Exh. 14, Harris Rebuttal, pp. 4-7; Exh. 16, Calculation of Excess Revenues over Expenses.

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review of the approximately 80 small water and sewer companies that the Commission regulates.<sup>138</sup> All of these additional requirements would increase transaction and regulatory costs and those costs would have to be borne by the ratepayers.

The Commission believes that the pass-through issue is more appropriately addressed in its ongoing workshop, File Number WW-2009-0386. Crafting an appropriate mechanism to address rate recovery of the Commission's assessment will in all likelihood require articulating a statement of general applicability prescribing law or policy that will apply to all small sewer companies or potentially all utilities regulated by the Commission; an action that must be effected through rulemaking.

The substantial and competent evidence in the record as a whole supports the conclusion that the appropriate amount for Timber Creek to recover in rates for the Commission's assessment is \$62,590, the amount Timber Creek was assessed for the 2011 fiscal year.

### **H. Contingency / Emergency Repair Fund<sup>139</sup>**

Timber Creek seeks approval to establish a Contingency/Emergency Repair Fund to fund emergency repairs on existing infrastructure and assets serving existing ratepayers. In support of establishing the fund, Timber Creek cites to Section 393.270.4, which provides:

In determining the price to be charged for gas, electricity, or water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

Although Section 393,270 contemplates making reservations out of income for contingencies, there is no guidance in terms of when it would be appropriate and how such a fund should be established, maintained, or regulated. There are many factors that go into determining whether such a fund is appropriate including, but not limited to, the type of account to be created, the appropriate level of reserve in the fund, the types of expenses the fund could cover, the types of expenses it would not cover, appropriate reporting requirements,

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<sup>138</sup> Exh. 20, Busch Rebuttal, pp. 3-7.

<sup>139</sup> See Finding of Facts Numbers 100-106 for this section.

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appropriate oversight, treatment of any excess reserve collections, as well as determining when and how the company would have access to the fund.<sup>140</sup> And the Commission would need to make an initial determination as to whether it was a necessity for the utility to have such a fund.

Timber Creek fails to establish that it requires such a fund and the multiple factors involved with establishing and properly regulating such a fund lend themselves to rulemaking not a single adjudication. The Commission believes that its ongoing workshop, File Number WW-2009-0386, is the appropriate forum to address this issue.

The substantial and competent evidence in the record as a whole supports the conclusion that Timber Creek has failed to establish the need for a Contingency/Emergency Repair Fund. Consequently, the Commission will not authorize any recovery in rates for such a fund.

### **IV. Final Decision**

In making this decision, the Commission has considered the positions and arguments of all of the parties. After applying the facts, as it has found them, to the law to reach its conclusions, the Commission has reached the following final decision.

Timber Creek has, by a preponderance of the evidence, met its burden of proving that the salaries authorized for its employees in this order are the just and reasonable amounts to be recovered in rates for employee compensation. Timber Creek has also, by a preponderance of the evidence, met its burden of proving that \$36,170 is the just and reasonable amount to be recovered in rates for rate case expense, as amortized and allocated as described. Timber Creek has failed to meet its burden to recover in rates amounts requested for rate case expense from its prior rate case, for alternative energy exploration, for the alleged under-recovery of Commission assessments, and for a contingency/emergency repair fund.

The Commission further concludes, based upon its independent review of the whole record that the rates approved in this order are just and reasonable and support the provision of safe and adequate service. The revenue increase approved by the Commission today is concluded to be no more than what is sufficient to keep Timber Creek's utility plants in proper repair for effective public service, and insure to Timber Creek's investors an opportunity to earn a reasonable return upon funds

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<sup>140</sup> Exhibit 20, Busch Rebuttal, pp. 8-11; Transcript, pp. 212-220.

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invested.

**THE COMMISSION ORDERS THAT:**

1. Timber Creek Sewer Company shall file tariff sheets in compliance with this order sufficient to recover revenues approved in the body of this order no later than April 6, 2011.
2. No later than April 11, 2011, the Staff of the Missouri Public Service Commission shall file its recommendation concerning approval of Timber Creek Sewer Company's compliance tariff sheets.
3. No later than April 11, 2011, the Staff of the Missouri Public Service Commission and Timber Creek Sewer Company shall jointly file updated and revised rate Accounting Schedule 1 that was originally filed by Staff Witness Bret Prenger to reflect the approved gross revenue requirement. These parties shall also jointly file a statement comparing average residential monthly bills prior to and after the implementation of the newly approved rates.
4. The "Unanimous Partial Agreement Regarding Disposition of Small Sewer Company Revenue Increase," filed on October 7, 2010 is approved. The parties shall comply with the terms of this agreement. A copy of that agreement is attached to this order as "Attachment A" and it is incorporated by reference as if fully set forth.
5. Timber Creek Sewer Company shall establish a time recording system for each of its employees.
6. All objections not ruled on are overruled and all pending motions not otherwise disposed of herein, or by separate order, are hereby denied.
7. This Report and Order shall become effective on April 9, 2011.

Gunn, Chm., Davis, Jarrett, and Kenney, CC., concur,  
Clayton, C., concurs with separate concurring opinion to follow;  
and certify compliance with the provisions  
of Section 536.080, RSMo 2000.

Dated at Jefferson City, Missouri,  
on this 30<sup>th</sup> day of March, 2011.

KANSAS CITY POWER & LIGHT COMPANY AND  
KCP&L GREATER MISSOURI OPERATIONS

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**In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan**

**In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service**

*File Nos. ER-2010-0355 & ER-2010-0356  
Decided March 30, 2011*

**Accounting §38.** The Commission intended to avoid a normalization error. Thus, the Commission clarified its Report and Order to say that if the advanced coal tax credits are allocated to GMO, it will lower the cost of service for GMO and also lower rates.

**ORDER GRANTING CLARIFICATION OF REPORT AND ORDER  
DIRECTING KCPL AND GMO TO APPLY TO THE IRS TO REVISE  
THE MEMORANDUM OF UNDERSTANDING REGARDING  
THE ADVANCED COAL TAX CREDITS FOR IATAN**

On March 16, 2011, the Commission issued its Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan (Report and Order). The Staff of the Missouri Public Service Commission filed a Motion to Clarify Report and Order<sup>1</sup> requesting that the Commission make three points of clarification. In addition, Kansas City Power & Light Company (KCPL) and KCP&L Greater Missouri Operations Company (GMO) filed an application for rehearing and motion for clarification<sup>2</sup> regarding similar points as Staff and requesting rehearing.

The first point is a rounding error by the Commission at ordered paragraph 2 of the Report and Order. The Commission uses the rounded figure of \$26,500,000 when it should use \$26,562,500. With this order the Commission will correct that error.

Second, Staff suggests that the Commission had intended<sup>3</sup> to

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<sup>1</sup> Filed March 18, 2011.

<sup>2</sup> Filed March 25, 2011.

<sup>3</sup> Staff points to a conversation between Commissioner Davis and Mr. Zobrist (Transcript p.



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include a provision requiring KCPL to provide its application to the Internal Revenue Service for reallocation of the Section 48A tax credits to Staff for review before the application is made. KCPL reports that it has contacted the IRS in preparation for making the request and indicates that there is no formal "application." KCPL, however, is not opposed to providing the letter requesting the reallocation to Staff for its review prior to sending it to the IRS. The Commission will clarify its Report and Order to include this requirement.

Staff's third point is requesting clarification of the Commission's ordered paragraph 3 which indicates that if the IRS does not agree to alter the Memorandum of Understanding (MOU), then the Commission will "impute" credits to GMO. Staff requests the Commission clarify when this imputation will occur. KCPL also asks for rehearing or clarification of this point. KCPL, however, believes that the entire paragraph should be removed from the order as it will cause a normalization violation which the Commission's order clearly indicates it wishes to avoid. KCPL also requests that the Commission clarify the Commission's intent that if KCPL is unsuccessful in getting a modification of the MOU, then the Commission intends for a ratable portion of the \$26,562,500 calculated on the basis of the book life of latan 2 assets to be included as a reduction of cost of service in a future GMO rate proceeding. In addition, KCPL requests guidance from the Commission as to whether its credits will be reduced by a like amount. Finally, KCPL requests that the Commission delete the word "imputed" and replace it with the word "allocated" in Finding of Fact 24 to clarify this intent.

KCPL is correct in that the Commission's intent is to avoid a normalization error. KCP&L is also correct that this Commission and future Commissions are not prohibited in future rate cases from considering the ratemaking treatment afforded to future events. Thus, with this order the Commission clarifies that KCPL's understanding of the Commission's intent is correct. The Commission did not intend to "impute" the tax credits. The Commission's intent was to make it clear that KCPL has created an inequity for GMO customers and the Commission intends for GMO's customers to be made whole. Thus, the Commission is directing KCPL to request the IRS to alter the MOU. If that alteration does not occur, then the Commission will consider the ratemaking treatment to afford the tax credit in a future rate case. Therefore, the Commission will clarify its Report and Order by removing

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3902) and the testimony of Paul Harrison (Ex. KCP&L-223, p. 20 and Ex. GMO-222, p. 22).

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ordered paragraph 3 and replacing the word "imputed" in Finding of Fact 24.

KCPL also requests rehearing of the Commission's Report and Order. KCPL raises no new issues for the Commission's consideration and the Commission denies rehearing.

**THE COMMISSION ORDERS THAT:**

1. The application for rehearing of the Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan is denied.

2. Ordered paragraph 2 of the Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan is corrected by replacing "\$26,500,000" with "\$26,562,500."

3. Finding of Fact 24 of the Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan is clarified by replacing the word "imputed" with the word "allocated."

4. The Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan is further clarified by deleting ordered paragraph 3.

5. Kansas City Power & Light Company shall present its letter and other information being presented to the IRS as a request for amendment of the Memorandum of Understanding to the Staff of the Commission for its review prior to sending it to the Internal Revenue Service.

6. The Staff of the Commission shall advise the Commission if it is unsatisfied with the request set out in paragraph 5.

7. Kansas City Power & Light Company shall advise the Commission of the outcome of its request that the Internal Revenue Service modify and amend the Memorandum of Understanding.

8. This order shall become effective on April 5, 2011.

Gunn, Chm., Clayton, Davis,  
Jarrett, and Kenney, CC., concur.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: See pages 111, 142, 189, 328, 367 and 534 for other orders in these cases.

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**In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan**

*File No. ER-2010-0355*

*April 12, 2011*

**Evidence, Practice And Procedure §26.** The Commission presumes a utility's costs were prudently incurred. Utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures are prudent. Any party can challenge the presumption of prudence by creating a serious doubt as to the prudence of an expenditure. Once a serious doubt is raised, the burden shifts to the utility to dispel those doubts and prove prudence.

**Expense §22.** A party must provide evidence that the utility's actions caused higher costs than if prudent decisions had been made. This includes evidence as to the amount that the expenditures would have been had the utility acted in a prudent manner.

**REPORT AND ORDER**

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**Steven Dottheim, Esq.**, Chief Deputy Counsel, **Kevin Thompson, Esq.**, Chief Staff Counsel, **Nathan Williams, Esq.**, Deputy Counsel, and **Sara Kliethermes, Esq., Jaime Ott, Esq., Jennifer Hernandez, Esq., Eric Dearmont, Esq., Annette Slack, Esq., and Meghan McClowry, Esq.**, Legal Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

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**REGULATORY LAW JUDGES: Ronald D. Pridgin, Senior, and  
Nancy Dippell, Deputy Chief**

**In Memoriam**

The Commissioners and all the employees at the Commission express their deepest sympathy to Curtis Blanc's family, friends, and colleagues for his untimely death which occurred on February 16, 2011, while he was in Jefferson City in order to attend the scheduled hearings for these cases.

**Procedural History**

On June 4, 2010, Kansas City Power & Light Company submitted to the Commission proposed tariff sheets, effective for service on and after May 4, 2011, that are intended to implement a general rate increase for electrical service provided in its Missouri service area. KCP&L's proposed tariffs would increase its Missouri jurisdictional revenues by approximately \$92 million, or by 13.78%. The Commission issued an Order and Notice on June 11, in which it gave interested parties until July 1 to request intervention.<sup>1</sup>

The Commission received timely intervention requests from: Union Electric Company, d/b/a Ameren Missouri, Missouri Gas Energy, a Division of Southern Union Company; Hospital Intervenors<sup>2</sup>, the United States Department of Energy, AARP, Consumers Council of Missouri, and the Missouri Retailers Association. In addition, the Commission received untimely intervention requests from the Dogwood Energy, LLC, and IBEW Local Unions 1464, 1613, and 412. The Commission granted these requests.

In addition, in Commission File No. EO-2005-0329, KCP&L had entered into a Stipulation and Agreement regarding an Experimental Regulatory Plan, which was the genesis for this rate case. A portion of that agreement provided that the non-KCP&L signatories would automatically become intervenors in this rate case. The non-KCP&L signatories to the Stipulation and Agreement in File No. EO-2005-0329 that are intervenors in this case are: the Staff of the Commission; the

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<sup>1</sup> Calendar dates refer to 2010 unless otherwise noted.

<sup>2</sup> Consisting of Carondelet Health, Crittenton Children's Center, HCA Midwest Health System, North Kansas City Hospital, Research Medical Center, Research Psychiatric Center, Saint Luke's Cancer Institute, Saint Luke's Health System, Saint Luke's Hospital of Kansas City, Saint Luke's Northland Hospital – Barry Road Campus, St. Joseph Medical Center, and Truman Medical Center, Inc.

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Office of the Public Counsel; the Missouri Department of Natural Resources; Praxair, Inc.; Missouri Industrial Energy Consumers; Ford Motor Co.; The Empire District Electric Company; Missouri Joint Municipal Electric Utility Commission; and the City of Kansas City, Missouri.

The test year is the 12 months ending December 31, 2009, updated for known and measureable changes through June 30, 2010, and true-up through December 31, 2010.<sup>3</sup> The Commission held local public hearings in Nevada, St. Joseph, Kansas City, Riverside, Lee's Summit, and Carrollton. The evidentiary hearing went from January 18 through February 4, 2010. The true-up hearing was on March 3-4, 2010.<sup>4</sup>

### **Non-Unanimous Stipulations and Agreements**

The Commission received seven Non-Unanimous Stipulations and Agreements from February 2 to March 23, 2011. Those stipulations resolved: depreciation, amortizations, an Economic Relief Pilot Program, employee severance cost, Supplemental Executive Retirement Pension cost, advertising cost, bad debt expense, cash working capital, production management, allocation methodology for off-system sales margins, talent assessment program cost, Proposition C expenses, call center reporting, tracker use for latan operation and maintenance expenses, transmission expense and revenue tracker, SO2 emission allowance regulatory liability, outdoor lighting, class cost of service and rate design, pensions and other post employment benefits, and latan common costs.

No parties objected. Therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulations as if they were unanimous. The Commission finds the above-referenced stipulations reasonable and approves them.

### **General Findings of Fact**

1. Kansas City Power & Light Company ("KCP&L") and KCP&L Greater Missouri Operations Company ("GMO") are both wholly owned by Great Plains Energy, Inc. ("GPE"). Their service areas in Missouri are shown on Schedule 2 to the direct testimony of Cary G.

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<sup>3</sup> Ex. KCP&L 210, p. 9.

<sup>4</sup> Some issues between KCP&L/GMO were "common" issues, most of which were also heard during this time. The remainder of the issues were heard during the GMO hearing. Because KCP&L and GMO are separate companies with separate tariffs, the Commission will issue a separate Report and Order for GMO later.

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Featherstone.<sup>5</sup>

2. Collectively, KCP&L and GMO operate and present themselves to the public under the brand and service mark "KCP&L." The workforce for GMO consists of KCP&L employees; GMO has no employees of its own. Before it was acquired by GPE, GMO was named Aquila, Inc., and before that, Utilicorp United, Inc.<sup>6</sup>

3. KCP&L serves approximately 509,000 customers, of which about 450,000 are residential customers, about 57,000 are commercial customers and the remaining about 2,000 are industrial, municipal and other utility customers. To serve these customers, KCP&L owns and operates 571 MW of nuclear generating capacity and, with Iatan 2, about 2,774 MW of coal capacity,<sup>7</sup> and with Spearville 2, 148 MW of wind capacity, 829 MW of natural gas-fired combustion turbine capacity, and 302 MW of oil-fired combustion turbine capacity. It also purchases power.<sup>8</sup>

4. GMO has approximately 312,000 customers, of which about 273,500 are residential customers, about 38,000 are commercial customers and the remaining about 500 customers are industrial, municipal and other utility customers. To serve these customers, GMO owns, with Iatan 2, 2,128 MW of generating capacity, of which 1,045 MW is coal capacity,<sup>9</sup> 1,019 MW is natural gas-fired combustion turbine capacity, and 64 MW is oil-fired combustion turbine capacity. Like KCP&L, it also purchases power.<sup>10</sup>

5. These two rate cases started on June 4, 2010, when KCP&L and GMO filed applications and proposed tariff changes to implement general electric rate increases. The cases are File Nos. ER-2010-0355 and ER-2010-0356, respectively. KCP&L stated its application was designed to recover an additional \$92.1 million per year in rate revenues, a 13.8% increase.<sup>11</sup> By its true-up direct case filed on February 22, 2011, KCP&L stated its revenue deficiency is \$55.8

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<sup>5</sup> Ex. KCP&L 215.

<sup>6</sup> Ex. KCP&L 210, p. 1; Ex. KCP&L 215, pp. 3-4 & 12; Ex. GMO 210, p. 1; Ex. GMO 215, pp. 3, 11.

<sup>7</sup> Iatan 2 ownership is 54.7% of 850 MW, equaling 465 MW.

<sup>8</sup> Ex. KCP&L 210, pp. 1-2; Ex. KCP&L 215, p. 43.

<sup>9</sup> Iatan 2 ownership is 18% of 850 MW, equaling 153 MW.

<sup>10</sup> Ex. GMO 210, pp. 1-2; Ex. GMO 215, p. 34.

<sup>11</sup> Ex. KCP&L 215, pp. 10-11; Ex. GMO 215, pp. 3-4.



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million.<sup>12</sup> In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement of \$9.6 million.<sup>13</sup>

6. GMO's service area is divided into two separate rate districts referred to as MPS and L&P. The MPS rate district includes parts of Kansas City, Lee's Summit, Sedalia, Warrensburg and surrounding areas. The L&P rate district is in and about St. Joseph, Missouri. GMO stated its application was designed to recover an additional \$75.8 million per year in rate revenues from its customers in its MPS rate district, a 14.4% increase, and an additional \$22.1 million per year in rate revenues from its customers in its L&P rate district a 13.9% increase.<sup>14</sup> By its true-up direct case filed on February 22, 2011, GMO stated its revenue deficiency for MPS is \$65.2 million and its revenue deficiency for L&P is \$23.2 million.<sup>15</sup> In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement for MPS of \$4.6 million and an increase of \$16.6 million for L&P.<sup>16</sup>

### **General Conclusions of Law**

1. The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision.

2. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision. When making findings of fact based upon witness testimony, the Commission will assign the appropriate weight to the testimony of each witness based upon their qualifications, expertise and credibility with regard to the attested to subject matter.<sup>17</sup>

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<sup>12</sup> Ex. KCP&L 114, p. 1; Ex. KCP&L 117, p. 1 (but per the Staff's reconciliation, KCP&L's requested revenue increase is \$66.5 million).

<sup>13</sup> Ex. KCP&L 304, p. 4.

<sup>14</sup> Ex. GMO 210, p. 7; Ex. GMO 215, pp. 3, 10; Ex. KCP&L 215, Sch. 2.

<sup>15</sup> Ex. GMO 58, p. 1.

<sup>16</sup> Ex. KCP&L 304, p. 4.

<sup>17</sup> Witness credibility is solely within the discretion of the Commission, who is free to believe all, some, or none of a witness' testimony. *State ex. rel. Missouri Gas Energy v. Public Service Comm'n*, 186 S.W.3d 376, 389 (Mo. App. 2005).

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### Conclusions of Law Regarding Jurisdiction

3. KCP&L is an electric utility and a public utility subject to Commission jurisdiction.<sup>18</sup> The Commission has authority to regulate the rates KCP&L may charge for electricity.<sup>19</sup>

4. The Commission is authorized to value the property of electric utilities in Missouri.<sup>20</sup> Necessarily, that includes property and other assets proposed for inclusion in rate base. In determining value, “the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . .”<sup>21</sup> The courts have held that this statute means that the Commission’s determination of the proper rate must be based on consideration of all relevant factors.<sup>22</sup> Relevant factors include questions raised by stakeholders about the prudence and necessity of utility construction decisions and expenditures.

5. In making its determination, the Commission may adopt or reject any or all of any witnesses’ testimony.<sup>23</sup> Testimony need not be refuted or controverted to be disbelieved by the Commission.<sup>24</sup> The Commission determines what weight to accord to the evidence adduced.<sup>25</sup> “It may disregard evidence which in its judgment is not credible, even though there is no countervailing evidence to dispute or contradict it.”<sup>26</sup> The Commission may evaluate the expert testimony presented to it and choose between the various experts.<sup>27</sup>

6. The Staff of the Commission is represented by the Commission’s Staff Counsel, an employee of the Commission authorized

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<sup>18</sup> Section 386.020(15), (42) RSMo 2006 (all statutory cites to RSMo 2006 unless otherwise indicated).

<sup>19</sup> Section 393.140(11).

<sup>20</sup> Section 393.230.1, RSMo.

<sup>21</sup> Section 393.270.4, RSMo.

<sup>22</sup> *State ex rel. Missouri Water Co. v. Public Service Commission*, 308 S.W.2d 704, 719 (Mo. 1957); *State ex rel. Midwest Gas Users’ Association v. Public Service Commission*, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); *State ex rel. Office of Public Counsel v. Public Service Commission of Missouri*, 858 S.W.2d 806 (Mo. App., W.D. 1993).

<sup>23</sup> *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

<sup>24</sup> *State ex rel. Rice v. Public Service Commission*, 359 Mo. 109, \_\_\_, 220 S.W.2d 61, 65 (banc 1949).

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Associated Natural Gas, supra*, 706 S.W.2d at 882.

by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]"<sup>28</sup> The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"<sup>29</sup> The remaining parties include governmental entities, other electric utilities, and industrial and commercial consumers.

#### **Burden of Proof**

7. "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."<sup>30</sup>

#### **Ratemaking Standards and Practices**

8. The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,<sup>31</sup> subject to judicial review of the question of reasonableness.<sup>32</sup> A "just and reasonable" rate is one that is fair to both the utility and its customers;<sup>33</sup> it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."<sup>34</sup> In 1925, the Missouri Supreme Court stated:<sup>35</sup>

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<sup>28</sup> Section 386.071.

<sup>29</sup> Sections 386.700 and 386.710.

<sup>30</sup> Section 393.150.2.

<sup>31</sup> Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

<sup>32</sup> *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (Mo. banc. 1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (Mo. banc. 1918), *error dis'd*, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd*, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

<sup>33</sup> *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App. 1974).

<sup>34</sup> *St. ex rel. Washington University et al. v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (Mo. banc 1925).

<sup>35</sup> *Id.*

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The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. \* \* \* These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

9. The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.<sup>36</sup> "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."<sup>37</sup> However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.<sup>38</sup> "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."<sup>39</sup>

10. The Commission has exclusive jurisdiction to establish public utility rates,<sup>40</sup> and the rates it sets have the force and effect of law.<sup>41</sup> A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;<sup>42</sup> neither can a public utility change its rates without first seeking authority from the Commission.<sup>43</sup> A public utility may submit rate schedules or

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<sup>36</sup> *May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (Mo. App. 1937).

<sup>37</sup> *St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n*, 179 S.W.2d 123, 126 (1944).

<sup>38</sup> *St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 49 (Mo. banc 1979).

<sup>39</sup> *St. ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App. 1981).

<sup>40</sup> *May Dep't Stores, supra*, 107 S.W.2d at 57.

<sup>41</sup> *Utility Consumers Council, supra*, 585 S.W.2d at 49.

<sup>42</sup> *Id.*

<sup>43</sup> *Deaconess Manor Ass'n v. Pub. Serv. Comm'n*, 994 S.W.2d 602, 610 (Mo. App. 1999).

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"tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.<sup>44</sup> Thus, "[r]atemaking is a balancing process."<sup>45</sup>

11. Ratemaking involves two successive processes: first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.<sup>46</sup>

12. The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where:

RR	=	Revenue Requirement;
C	=	Prudent Operating Costs, including Depreciation Expense and Taxes;
V	=	Gross Value of Utility Plant in Service;
D	=	Accumulated Depreciation; and
R	=	Overall Rate of Return or Weighted Cost of Capital.

13. The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.<sup>47</sup>

14. The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. The Commission can prescribe uniform methods of accounting for

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<sup>44</sup> *May Dep't Stores, supra*, 107 S.W.2d at 50.

<sup>45</sup> *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988).

<sup>46</sup> *St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).

<sup>47</sup> *See St. ex rel. Union Elec. Co.*, 765 S.W.2d at 622.

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utilities, and can examine a utility's books and records and, after hearing, can determine the accounting treatment of any particular transaction.<sup>48</sup> In this way, the Commission can determine the utility's prudent operating costs. The Commission can value the property of electric utilities operating in Missouri that is used and useful to determine the rate base.<sup>49</sup> Finally, the Commission can set depreciation rates and adjust a utility's depreciation reserve from time-to-time as may be necessary.<sup>50</sup>

15. The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a rate of return. For any utility, its fair rate of return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

16. Because the parties have no dispute regarding rate design or depreciation, the Commission will resolve the issues below in the following order: rate base, rate of return, and expenses.

### The Issues

Being unable to agree on how to phrase many issues, KCP&L and Staff submitted separate lists of issues for determination by the Commission. The Commission phrases and resolves the issues herein.

#### I. Rate Base

##### A. Iatan

***Should the Iatan 1 and 2 Rate Base Additions be included in rate base in this proceeding?***

***Should the Commission presume that the costs of those additions were prudently incurred until a serious doubt has been raised as to the prudence of the investment by a party to this proceeding?***

***Has a serious doubt regarding the prudence of the Iatan 1 and 2 additions been raised?***

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<sup>48</sup> Section 393.140.

<sup>49</sup> Section 393.230. Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

<sup>50</sup> Section 393.240.

***Should the Company's conduct be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight?***

***Did KCP&L prudently manage the Iatan 1 and 2 projects?***

***Is the December 2006 Control Budget Estimate the definitive estimate?***

***Should the costs of the Iatan 1 and 2 projects be measured against the Control Budget Estimate?***

***Should the Iatan 1, 2 and common regulatory assets be included in rate base, as well as the annualized amortization expense?***

**Findings of Fact – Iatan**

7. On August 5, 2005, the Commission approved the Stipulation and Agreement in File No. EO-2005-0329 (“Regulatory Plan”). Under the Regulatory Plan, KCP&L has embarked upon a series of infrastructure and customer enhancement projects valued at over \$2.64 billion. Section III.B.4. of the Regulatory Plan which identifies the required level of KCP&L’s reporting of the Comprehensive Energy Plan (“CEP”) Projects states: Section III.B.4. of the Regulatory Plan identifies the required level of KCP&L’s reporting of the CEP Projects:

KCPL shall provide status updates on these infrastructure commitments to the Staff, Public Counsel, MDNR and all other interested Signatory Parties on a quarterly basis. Such reports will explain why these investment decisions are in the public interest. In addition, KCPL will continue to work with the Staff, Public Counsel and all other interested Signatory Parties in its long-term resource planning efforts to ensure that its current plans and commitments are consistent with the future needs of its customers and the energy needs of the State of Missouri.<sup>51</sup>

8. KCP&L complied with this requirement by providing nineteen (19) written Quarterly Reports to Staff, OPC, and any other interested party, starting with the first quarter of 2006 through the third quarter of 2010.<sup>52</sup>

9. KCP&L recently submitted the 20<sup>th</sup> Quarterly Report on

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<sup>51</sup> See Commission File No. EO-2005-0329, Stipulation and Agreement at III.B.4, p. 46.

<sup>52</sup> See Tr. pp. 1160-65; Ex. KCP&L 69, pp. 19-24; Ex. KCP&L 70, pp. 2, 4, 8, 38,

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February 15, 2011. Those Quarterly Reports discuss the status of the Regulatory Plan infrastructure investments, and other specific significant issues existing during the reporting period. KCP&L also met regularly with Staff, OPC, and representatives of the Signatory Parties to discuss the contents of the Quarterly Reports, as well as provide more current information if available at the time of the meeting.<sup>53</sup>

10. In addition, the Missouri Retailers Association's ("MRA") consultant, Walter Drabinski and his colleagues from Vantage Consulting, also received the Quarterly Reports and attended the Quarterly Meetings that KCP&L held with the Kansas Corporation Commission ("KCC") Staff.<sup>54</sup>

11. Mr. Drabinski visited the Iatan Project site and met with KCP&L on seventeen (17) separate occasions.<sup>55</sup>

12. KCP&L responded to Mr. Drabinski's data requests and provided to Mr. Drabinski unfettered access to KCP&L's project personnel, its consultants, and the Iatan Project documentation. Mr. Drabinski agreed that the information provided was sufficient for him to perform a prudence analysis.<sup>56</sup>

13. The Quarterly Reports identified the Iatan Project's risks as they were known throughout the Project and KCP&L's strategy for mitigating those risks. In the first quarter 2007 Quarterly Report, KCP&L began including a specific section entitled "Identification of Project Risks" to describe the key issues recognized by management regarding Iatan Unit 2.<sup>57</sup>

14. The risks identified and tracked in the Quarterly Reports were primarily the same risks that KCP&L identified in the analysis of contingency that was performed in establishing the Control Budget Estimate in December 2006.<sup>58</sup>

15. Mr. Giles describes in his testimony the risks and mitigation plans that KCP&L was tracking throughout the life of the Project.<sup>59</sup>

### Cost Control System and Unidentified Cost Overruns

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<sup>53</sup> See Tr. pp. 1160-64.

<sup>54</sup> Tr. pp. 1586-1590.

<sup>55</sup> Id.

<sup>56</sup> See Tr. p. 1586, ln. 22 to p. 1590, ln. 25.

<sup>57</sup> See Ex. KCP&L 71 ; see also Ex. KCP&L 24, pp. 18-26; Ex. KCP&L 25, pp. 37-41.

<sup>58</sup> See Ex. KCP&L 24, pp. 20-24; Ex. KCP&L-25, pp. 39- 41.

<sup>59</sup> See Ex. KCP&L 24, pp. 20-24.



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16. Both Staff and KCP&L agreed that for purposes of the Stipulation, the Control Budget Estimate would serve as the baseline budget for the Projects and the Definitive Estimate from which the Iatan Units 1 and 2 Projects would be measured.<sup>60</sup>

17. KCP&L's witnesses Mr. Archibald, Mr. Meyer and Mr. Nielsen, as well as the Missouri Retailer's Association witness Mr. Walter Drabinski and Staff's Mr. Elliott, each showed that the Cost Control System that KCP&L developed for the Iatan Project allowed for any interested party to fully examine the costs incurred on the Iatan Project.<sup>61</sup>

18. KCP&L's Cost Control System provided the guidance needed to establish the Iatan Project's Cost Portfolio, which it uses for day-to-day tracking and management of Iatan Project's costs.<sup>62</sup>

19. The Cost Control System contains all the information needed to both identify and explain each of the overruns to the Control Budget Estimate that occurred on the Iatan Project.<sup>63</sup>

20. Mr. Meyer placed KCP&L's Cost Control System in the top quartile of those he has seen, and believes this system has allowed for the effective cost management of the Iatan Projects.<sup>64</sup>

21. KCP&L's cost control system is consistent with industry best practices.<sup>65</sup>

22. KCP&L's cost control system allows any interested party to this matter to track every dollar that KCP&L spent on the Iatan Project, regardless of whether the costs were anticipated in the Control Budget Estimate or constitute a cost overrun to the Control Budget Estimate: "Our system allows you to track through every dollar that's spent from cradle to grave and understand where it was spent and wherever the overrun occurred."<sup>66</sup>

23. KCP&L complied with the requirements in the Regulatory Plan regarding the cost control process for construction expenditures. Section III.B.1.q. of the Regulatory Plan requires that KCP&L do the following:

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<sup>60</sup> See Tr. at 1095-97; 2643-44.

<sup>61</sup> See Ex. KCP&L 25, pp. 20-22; Ex. KCP&L 4, pp. 3-4; Tr. pp. 2176-77.

<sup>62</sup> Ex. KCP&L 205, p. 10; see also Ex. KCP&L 44, pp. 3, 10-12, p. 30, and Schs. DFM2010-17 to DFM2010-24; Ex. KCP&L 46, p. 26.

<sup>63</sup> See Ex. KCP&L 205, pp. 11-13.

<sup>64</sup> See Ex. KCP&L 44, pp. 3, 7-8.

<sup>65</sup> See Ex. KCP&L-43, p. 5, ln. 10; Ex. KCP&L 46, pp. 249-250.

<sup>66</sup> Tr. at 2176-77.

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KCP&L must develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate during the construction period of the Iatan 2 project, the wind generation projects and the environmental investments.

24. KCP&L has complied with these requirements. First, KCP&L developed a comprehensive Cost Control System which provides key guidance to each of the CEP Projects governed by the Stipulation.<sup>67</sup>

25. KCP&L's Cost Control System, which was transmitted to the Staff and the other Signatory Parties' representatives on July 10, 2006, "describes the governance considerations, management procedures, and cost control protocols for the CEP Projects" including the Iatan Project.<sup>68</sup>

26. On July 11, 2006, KCP&L representatives met with members of the Staff and the other interested parties. Staff raised no concerns at that meeting.<sup>69</sup>

27. Additionally, KCP&L has conducted quarterly meetings addressing Project issues, including costs, and provided Staff with thousands of well-organized and detailed documents describing and explaining the cost overruns and has explained to Staff multiple times in face-to-face meetings how the documents can be used to identify and explain the overruns on the Iatan Project.<sup>70</sup>

28. Further, the Cost Control System states that the Iatan Project's cost performance would be measured against the Project's Control Budget Estimate (i.e., Definitive Estimate), and to do so, the Iatan Project's Control Budget "will identify the original budget amount (whether contracted or estimated) for each line item of the Project's costs and will track those budget line items against the following:

- Costs committed to date
- Actual paid to date
- Change orders to date
- Expected at completion, based on current forecasts."<sup>71</sup>

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<sup>67</sup> Ex. KCP&L 38, at Sch. SJ2010-1.

<sup>68</sup> Ex. KCP&L 25, p. 21, ln. 9-11; KCP&L 38, Sch. SJ2010-1, p. 3.

<sup>69</sup> Ex. KCP&L 25, p. 22.

<sup>70</sup> Ex. KCP&L 25, p. 4, ln. 4-7.

<sup>71</sup> Ex. KCP&L 38, Sch. SJ2010-1, p. 17.

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29. The Cost Control System also identified the Iatan Project's actual and budgeted costs would be tracked in comparison to Iatan Unit 1 Project's and Iatan Unit 2 Project's respective Definitive Estimates. The Cost Control System states that:

The Project Team will develop a Definitive Estimate for each Project that will provide an analytical baseline for evaluating Project costs. The estimate will establish anticipated costs for individual work activities and all procurements. The Definitive Estimate will be used to establish each Project's Control Budget.<sup>72</sup>

30. Second, KCP&L created a Definitive Estimate. KCP&L's prefiled Testimony describes in detail the process KCP&L used for developing the Control Budget Estimates for both Iatan 1 and 2.<sup>73</sup>

31. Staff and KCP&L agreed that the Control Budget Estimate would serve as the baseline budget for the Projects and the Definitive Estimate from which the Iatan Units 1 and 2 Projects would be measured.<sup>74</sup>

32. Third, KCP&L met its obligation to report on the status of the Definitive Estimate. Once each Project's Control Budget Estimate was in place, the Iatan Project team began tracking costs in the manner described in the Cost Control System.<sup>75</sup>

33. As the Iatan Project progressed, KCP&L met its obligation to "identify and explain" all cost overruns on the Iatan Project. With the Definitive Estimate in place, the Iatan Project team developed a "Cost Portfolio" which it uses for day-to-day tracking and management of Iatan Project's costs.<sup>76</sup>

34. KCP&L's Cost Portfolio comprises the necessary management reports and information needed for cost tracking, cash flow, change order tracking and management.<sup>77</sup>

35. Within the Cost Portfolio, there is a specific report entitled the "K-Report" which is the report that delineates discrete line items of cost including each and every budget change that has occurred

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<sup>72</sup> *Id.* at Sch. SJ2010-1, at p. 8.

<sup>73</sup> Ex. KCP&L 24, pp. 15-18, Ex. KCP&L 43, pp. 6-16.

<sup>74</sup> See Tr. pp. 1095-97, 2643-44), Staff's Position Statement, p. 9.

<sup>75</sup> See Ex. KCP&L 25, pp. 20-22.

<sup>76</sup> See Ex. KCP&L 4, pp. 3-4.

<sup>77</sup> *Id.*

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along with all costs actually expended.<sup>78</sup>

36. KCP&L has provided this report to Staff in summary form each quarter since the creation of the Control Budget Estimate in the first quarter of 2007, and has provided Staff with access to the detailed Cost Portfolio on a monthly basis since that time.<sup>79</sup>

37. Staff admits that KCP&L's cost control system has the ability to track cost overruns. As the Staff's own report states: "KCPL's control budget is very detailed with hundreds of line items. It is clear that KCPL has the ability to track, identify and explain control budget overruns."<sup>80</sup>

38. In keeping with the collaborative process that KCP&L began when it negotiated the Stipulation, KCP&L made every effort at every stage of the process to be fully transparent and accommodating for all the Signatory Parties to access its records and information to ensure that the Iatan Project stayed on track, as well as self-reporting all variances in cost and schedule.<sup>81</sup>

39. Moreover, KCP&L transparently reported each and every major decision that KCP&L makes, the basis for those decisions, the risks both real and perceived and the implications to those decisions to the Project's cost and schedule so that Staff could render its own independent assessment to the Commission regarding KCP&L's prudence.<sup>82</sup>

40. As a prime example of this transparency, KCP&L invited the Staff to participate in the 2008 cost reforecast process and all of the documents that KCP&L generated in each cost reforecast (collectively the "Cost Reforecasts") were timely provided to Staff for its review.<sup>83</sup>

41. KCP&L also met with Staff at the conclusion of each of the Cost Reforecasts to discuss the resultant changes to the Iatan Project's projected estimate at completion ("EAC").<sup>84</sup>

Cost Variance Identification

42. Mr. Meyer was engaged by KCP&L as part of the Schiff Hardin team and his role on the Iatan Project included examining the

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<sup>78</sup> *Id.*

<sup>79</sup> See Ex. KCP&L 25, pp. 22-23.

<sup>80</sup> Ex. KCP&L 205, p. 37.

<sup>81</sup> Ex. KCP&L 25, pp. 20-25; Ex. KCP&L 44, pp. 9-11.

<sup>82</sup> Ex. KCP&L 25, pp. 20-23; Ex. KCP&L 4, pp. 14-15.

<sup>83</sup> Tr. pp. 1091-92.

<sup>84</sup> Ex. KCP&L 25, pp. 24-25.

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changes that have been necessary for each Unit's Control Budget Estimate.<sup>85</sup>

43. Mr. Meyer participated in the oversight of the Iatan Project's base cost estimate that ultimately became the Iatan Project's Control Budget Estimates, each of the Iatan Project's cost reforecasts, and has examined in reasonable detail all of the documents that identify and explain the cost overruns that have occurred on the Iatan Project.<sup>86</sup>

44. Mr. Meyer concludes, "While the Iatan Project is very complex, identifying variances based on the cost system is not, and KCP&L's project documentation, which was readily available to Staff, explains the reasons for those variances."<sup>87</sup>

45. Mr. Meyer provides an overview of this analysis of the Iatan Project costs, which consisted of: "1) Identif[ication] from a side-by-side comparison of the Iatan Project's Control Budget Estimate and actual costs the largest cost overruns by line-item; and 2) Drill-down through KCP&L's well-organized back-up documentation on each line item so as to obtain a better understanding of the cause of those overruns."<sup>88</sup>

46. The variances were not caused by management imprudence. The size of the overruns was much lower than overall cost increases that were occurring in the industry at-large at the same time for similar projects.<sup>89</sup>

47. Mr. Meyer reviewed the Iatan Project's cost trends as part of his and Schiff Hardin's oversight of KCP&L's four Cost Reforecasts during the life of the Project.<sup>90</sup>

48. Mr. Meyer's analysis is described in detail in his Rebuttal Testimony and attached Schedules.<sup>91</sup>

49. The "drill down" that Mr. Meyer describes involved review of the documents described above from KCP&L's Cost Control System. Starting with the K-Report, Mr. Meyer identified the cost overruns from the Control Budget Estimate. He performed his analysis by narrowing the scope of his review to those items that "on their face appear to be overruns or underruns" which he describes as a standard

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<sup>85</sup> Ex. KCP&L 44, p. 3.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 3-4.

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 17.

<sup>91</sup> *Id.* at 17-44; Sch. DFM2010-7 to DFM2010-27.

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approach.<sup>92</sup>

50. Mr. Meyer did this by examining the aforementioned K-Report and performing comparisons of the Control Budget Estimate's line items to confirm negative variances without regard to contingency transfers.<sup>93</sup>

51. In other words, Mr. Meyer verified on a line-by-line basis which items cost more than the original estimate anticipated they would regardless of how KCP&L treated it within its Cost Portfolio. Using this method, Mr. Meyer was able to isolate the cost overruns and examine the root cause of each category of costs where an overrun occurs and thus make a determination regarding KCP&L's prudence in association with that overrun. Mr. Meyer then analyzed and applied the Project's unallocated contingency from the Control Budget Estimate in the same manner as employed by the project team to determine the extent of the actual cost overrun on the Project.<sup>94</sup>

52. Mr. Meyer then examined the Recommendation to Award Letters, Cost Reforecasts, Change Orders and Purchase Orders to evaluate the explanations provided by KCP&L regarding these overruns. Based on this review, Mr. Meyer describes how he initially identified certain items as "omissions" because they were omissions from the Control Budget Estimate and were needed for the construction of the Iatan Project.<sup>95</sup>

53. These omitted costs are essentially scope additions to the Iatan Project and required an adjustment to the Control Budget Estimate due to the fact that these items "could not have reasonably characterized as avoidable costs due to any action or inaction on the part of KCP&L's management."<sup>96</sup>

54. After making these adjustments, Mr. Meyer was left with a list of variances in the K-Report that formed the basis of his analysis.<sup>97</sup>

55. Because Mr. Meyer only evaluated the negative variances (the overruns) and did not take into account any of the positive variances (the underruns), the amount of these negative variances

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<sup>92</sup> *Id.*

<sup>93</sup> *Id.* at 18.

<sup>94</sup> *Id.* at 18-20.

<sup>95</sup> *Id.* at Sch. DFM2010-14.

<sup>96</sup> *Id.* at 22.

<sup>97</sup> *Id.* at 23.

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actually exceeded the total overrun for the later Project.<sup>98</sup>

56. Then, utilizing the project's documentation in the Cost Portfolio, Mr. Meyer assessed the identified root causes of these cost overruns, and "bucketed" them into the following five categories:<sup>99</sup>

Reason Code	Definition
1	<b>DESIGN MATURATION:</b> This category captures work that is related to the original scope of work, and is necessary for the design or construction of the Unit. This could include field changes or necessary design changes based upon information that became known after the original contract.
2	<b>PRICING ESCALATION/CHANGES:</b> This category captures increase in material costs or rates from the original contracted amounts.
3	<b>NEW SCOPE:</b> This category captures the cost increases associated with work scope that was never anticipated to be a part of a particular contractor's scope.
4	<b>DESIGN AND/OR FABRICATION ERRORS:</b> This category captures scope and costs associated with engineering which caused rework in the field by the affected contractor.
5	<b>COST INCREASES DUE TO SCHEDULE:</b> This category captures additional costs paid to the contractor due to delays, compression, acceleration or lost productivity.

57. Mr. Meyer identified the methodology for his categorization of the cost overruns he identified, and explained his reasoning for allocation of costs into each of these categories.<sup>100</sup>

58. Mr. Meyer used these reason codes so that these cost items could be understood as part of general categories; however, his analysis required review of the cost items themselves and all related supporting documentation. Mr. Meyer describes the application of these Reason Code Categories in his Rebuttal Testimony.<sup>101</sup>

59. There are two areas of Mr. Meyer's analysis, Design Maturation and Cost Increases Due to Schedule, that encompass the majority of the later Project's cost overruns that Mr. Meyer examined. Based on his drill down from the Project's documentation, Mr. Meyer

<sup>98</sup> *Id.* at 24.

<sup>99</sup> *Id.* at 26.

<sup>100</sup> *Id.* at 27-29.

<sup>101</sup> *Id.* at 25-44.

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assigned change orders to Category 1 (Design Maturation) and the related Category 3 (New Scope) that represented costs “the Owner would have incurred regardless of any act or omission on the part of the Owner.”<sup>102</sup>

60. Mr. Meyer’s analysis of these items was further guided by the concepts of “betterment” or “added value”. The Control Budget Estimate was impacted by design maturation:

**Q: What portions of the Project were most impacted by design maturation in the time period from the December 2006 CBE to June 2008?**

A: For Unit 2, design maturation most readily impacted areas of the final design that were dependent on the details and workings of the major pieces of plant equipment, functionality of that equipment and operational aspects of that equipment in concert with other systems. Portions of the design that were impacted most by maturation included plant systems such as electrical, water, air, ventilation and mechanical operations. The final design of these plant systems requires significant coordination and a full understanding of the physical size, locations and functionality of adjacent equipment and structural elements.

**Q: Do costs of a project always rise as a result of design maturation?**

A: I would not say that “costs rise” due to design maturation but rather one’s ability to more accurately forecast the end cost of a project is enhanced as the design is completed and that sometimes results in cost projections increasing. As the design matures and the project’s scope becomes more defined, the work quantities and related configurations can more readily be determined. This in turn has an effect on work sequences, overall schedule considerations, work-area sharing arrangements, and time-function expenses. Design evolution enhances an owner’s understanding of the nature of a project’s various cost streams. As that knowledge and understanding is incrementally accrued, the project’s contingency should be re-evaluated in light

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<sup>102</sup> *Id.* at 27.



thereof.

**Q: When was the impact of design maturation most apparent on the Iatan Unit 2 Project's costs?**

A: During the period between the establishment of the CBE in December 2006 and the May 2008 Cost Reforecast, the design matured from approximately 20% complete to approximately 70% complete. A large percentage of the R&O's that the Project Team had identified during this period reflected the increase of such design maturity.

**Q: Based on your analysis of the 2008 reforecasted estimate, did the increase in costs from design maturation that the Iatan Unit 2 Project experienced from December 2006 to May 2008 result from any imprudent acts by KCP&L?**

A: No.<sup>103</sup>

61. Because much of the impact of Design Maturation was captured in documentation that KCP&L's Project Team developed in support of the 2008 Cost Reforecast, Mr. Meyer utilized the backup information from this reforecast to measure the impact of the design maturation on the Iatan Project's costs. One example of Design Maturation is the R&O from the Iatan Unit 1 Project's 2008 Cost Reforecast which calls for the inclusion of work on the existing Unit 1 Economizer.<sup>104</sup>

62. Mr. Meyer identified from the documentation that the work involved cooling the exit gas temperature from the existing economizer to the new SCR purchased from ALSTOM, an issue that was not known until after the design had matured and it was recognized that these modifications were necessary.<sup>105</sup>

63. Mr. Meyer explained that this R&O item resulted in changes to both the Iatan Unit 1 budget and schedule.<sup>106</sup>

64. Mr. Meyer concluded that the cost overruns on the Iatan Project that were the result of Design Maturation and New Scope, and the explanations provided by KCP&L show that these overruns were prudently incurred. Mr. Meyer's analysis of the effects of Design

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<sup>103</sup> Ex. KCP&L 43; pp. 26-27.

<sup>104</sup> Ex. KCP&L 44, Sch. DFM-2010-06 and Sch. DFM2010-25.

<sup>105</sup> *Id.*; see also Ex. KCP&L 44, pp. 47-49.

<sup>106</sup> *Id.*

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Maturation on the Iatan Project's costs is further confirmed by Mr. Davis, Mr. Archibald, Mr. Giles and Mr. Roberts.<sup>107</sup>

65. Mr. Meyer's analysis of the Cost Increases due to Schedule followed the same methodology. Mr. Meyer examined the root causes of the costs related to schedule changes, including those to ALSTOM's schedule of work for Iatan Unit 1 and Iatan Unit 2, resulting in the ALSTOM settlement agreements, and found that the explanation provided by KCP&L's project team was sufficient to support that KCP&L managed these changed conditions prudently.<sup>108</sup>

66. Mr. Meyer's opinion is supported by abundant testimony from Mr. Downey, Mr. Davis, Mr. Bell and Mr. Roberts, who each testified at length regarding the prudence of the decisions KCP&L made to compensate ALSTOM for revisions to the Iatan Project's schedule.<sup>109</sup>

67. Mr. Meyer's analysis shows that KCP&L's documentation allows for the performance of a prudence analysis of the Iatan Project's cost overruns. Mr. Meyer's analysis was only one of several such analyses that have been performed. MRA's consultant Mr. Drabinski describes how he and his team reviewed the Iatan Project's change orders and purchase orders and determined the basis for his testimony in this case.<sup>110</sup>

68. Mr. Drabinski agreed that the information provided to him was sufficient for his prudence analysis.<sup>111</sup>

69. While KCP&L disagrees with both Mr. Drabinski's methodology and his conclusions, Mr. Drabinski never raised any concerns with KCP&L's Cost Control System. In addition, while he says he did not examine cost, Mr. David Elliott never had any issues with KCP&L's Cost Control System and was able to perform his analysis of the engineering necessity of the change orders with the documents provided by KCP&L. Mr. Elliott's review included "bucketing" change orders in a manner very similar to the one employed by Mr. Meyer.<sup>112</sup>

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<sup>107</sup> Ex. KCP&L 4, pp. 16-22, 25-27; Ex. KCP&L 18, pp. 9-12 (citing to Sch. BCD2010-01); Ex. KCP&L 19, pp. 11, 27-28, 55-58 and 99-100; Ex. KCP&L 24, pp. 20-21; Ex. KCP&L 25, pp. 12, 26-27 and 35; Ex. KCP&L 51, Roberts Rebuttal Testimony pp. 21-24.

<sup>108</sup> Ex. KCP&L 44, pp. 31-34.

<sup>109</sup> Ex. KCP&L 51, pp. 9-10; Ex. KCP&L 22, pp. 35-36; Ex. KCP&L 21, pp. 13-14; Ex. KCP&L 50, pp. 15-16; Ex. KCP&L 18, pp. 20-21; Ex. KCP&L 22, pp. 25-28; Ex. KCP&L 51, p. 7-9; Ex. KCP&L 19, pp. 47-51, 110; Ex. KCP&L 46, pp. 127-132.

<sup>110</sup> Tr. at 1598-9, 1607-8, 1634-6, 1703-4; see also Ex. KCP&L 2601, pp. 204-213.

<sup>111</sup> Tr. p. 1586-1590.

<sup>112</sup> Tr. pp. 2398-2400; Ex. KCP&L 205, p. 10; Ex. KCP&L 19, pp. 10-12; Ex. KCP&L 25, p.

70. Dr. Nielsen concluded that but for two examples, his prudence review of the Iatan Project demonstrated that KCP&L prudently managed the Iatan Project. Dr. Nielsen testified that, “Pegasus-Global was able to track cost overruns back to root causes for those overruns through the project records maintained by KCP&L during the execution of the project.”<sup>113</sup>

Staff Perspective of Cost Control System

71. Despite all of the evidence that KCP&L has presented, Staff alleges that KCP&L has exhibited a “knowing and willful disregard of its obligations under the Experimental Alternative Regulatory Plan (‘EARP’)” by failing to identify and explain cost overruns on the Iatan Project.<sup>114</sup>

72. Staff claims that, “the record will show that the Iatan Construction Project’s cost control system does not identify and explain cost overruns as specified in KCP&L’s Regulatory Plan but only provides fragmented information regarding budget variances leaving for Staff to identify and explain cost overruns.”<sup>115</sup>

73. Staff further claims that KCP&L’s cost control system is also “deficient” when compared to those used for Wolf Creek and Callaway.<sup>116</sup>

74. Staff adds that KCP&L’s tracking of “budget variances is not what the KCP&L Regulatory Plan requires” because, “budget variances and cost overruns are not necessarily the same thing.”<sup>117</sup>

75. However, despite these allegations, as noted, Staff admits that KCP&L had the capability to track cost overruns on the Iatan Project.<sup>118</sup>

76. Staff had full access to the same documents that Mr. Meyer, Mr. Archibald, Mr. Drabinski, Mr. Elliott and Dr. Nielsen had in performing their work.<sup>119</sup>

77. As Mr. Blanc testified, “Staff’s Iatan Report reads as

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<sup>113</sup> Ex. KCP&L 46, p. 26, ln. 16-20.

<sup>114</sup> Staff’s Initial Brief at p. 19.

<sup>115</sup> *Id.* at p. 25.

<sup>116</sup> *Id.*

<sup>117</sup> *Id.* at 39.

<sup>118</sup> Ex. KCP&L 205, p. 37.

<sup>119</sup> Ex. KCP&L 44, p. 3; see also Tr. 1160-64; Ex. KCP&L 69, p. 19; Ex. KCP&L 70, p. 2, 4, 8, 38.

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though it expected the cost control system to be a piece of paper that lists and explains every dollar spent over the December 2006 CBE. That is an overly simplistic notion and does not accurately represent the purpose of a cost control system, which is to manage the costs of project, which KCP&L's system effectively did."<sup>120</sup>

78. While the Commission has previously approved an adjustment for costs that were deemed to be "unauditable," such a finding has only been made in very extreme circumstances that do not apply here. For example, a category of costs was determined to be unauditabile when the utility: (1) failed to have a cost control system in place; (2) failed to provide documentation that could be broken down or traced to the budget; and (3) failed provide evidence regarding its expenditures.<sup>121</sup>

79. Additionally, the Commission has previously rejected Staff's proposed disallowances for "unauditable" costs.<sup>122</sup>

80. For example, Staff alleged that certain categories of costs in the original construction of Unit 1 were unauditabile based on Staff's conclusion that it was unable to reconcile the costs at issue against any variance report or Staff's definitive estimate.<sup>123</sup>

81. Specifically, Staff asserted the following costs were "unauditabile:" (1) the difference between Staff's definitive estimate and the company's definitive estimate; and (2) the project contingency fund.<sup>124</sup> The Commission accepted the company's definitive estimate which eliminated Staff's first category of "unauditabile" costs and also rejected the Staff's assertion that the contingency fund was an "unauditabile" cost.

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<sup>120</sup> Ex. KCP&L 8, p. 9.

<sup>121</sup> See *Re Kansas City Power & Light Co.*, 48 P.U.R.4<sup>th</sup> 598, 616 (1982); see also *Re Kansas City Power & Light Co.*, 55 P.U.R.4<sup>th</sup> 468 (1983) (disallowance of "unexplained" costs premised on a complete lack of any competent and substantial evidence, failure of both the Company and Staff to address specific factors or causes for the changes, and the Commission's conclusion that no one knows to what the unexplained differences are attributed.); Staff's Initial Brief at p. 31.

<sup>122</sup> See *Re Kansas City Power & Light Co.*, 48 P.U.R.4<sup>th</sup> 598, 616.

<sup>123</sup> In the referenced case, Staff and KCP&L disagreed regarding the what estimate was the "Definitive Estimate." Staff's calculation of "unauditabile" costs was based on the estimate it asserted was the Definitive Estimate. In rejecting the Staff's claim of "unauditabile" costs, the Commission found that the Company's estimate was what should be used as the Definitive Estimate to determine cost overruns. See *Re Kansas City Power & Light Co.*, 43 P.U.R.4<sup>th</sup> 559, 585 (1981).

<sup>124</sup> *Id.*

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82. KCP&L has provided abundant evidence regarding the creation, implementation, and use of an industry standard cost control system for the Iatan Project and all costs incurred on the Project enabling Staff to audit all of the Iatan Project's costs.<sup>125</sup>

83. Project Contingency is an unallocated pool of money that is intended to cover the project's risks as they occur, and that KCP&L's method of distributing contingency on an as-needed basis is standard in the industry.<sup>126</sup>

84. A budget estimate should not determine whether a utility's decision to incur a particular expenditure was prudent:

I don't really know, other than for regulatory purposes, what any of the budget estimates have to do with prudence. You're not prudent whether you're above or below a budget or cost estimate. You're prudent whether you do something that causes costs to rise due to imprudent or unreasonable management. I don't believe that the control budget or definitive estimate should be a starting point. What if the very first dollar on a project was spent imprudently? Are you not able to go back and identify it and deduct it because it's below the CBE? . . . I don't believe there's a real relationship between cost estimates or budgets with the question before this Commission with what was the reasonable or imprudent cost of the project.<sup>127</sup>

85. Regardless, if Staff did not agree, all it had to do was look at the contingency log that KCP&L provides to Staff each month. Staff could have done what Mr. Meyer did – apply the contingency in exactly the same manner as KCP&L's project team as part of the prudence review.<sup>128</sup>

86. If Staff still had questions, all Staff had to do next was call Mr. Archibald, who opened his calendar every Friday afternoon for Staff to call with questions. Or, Staff could have asked questions in one of the nineteen Quarterly Meetings.<sup>129</sup> If Staff, after applying

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<sup>125</sup> Ex. KCP&L 38, Sch. SJ2010-1; Ex. KCP&L 25, pp. 4, 21-22; Ex. KCP&L 24, pp. 15-18; KCP&L 43, pp. 6-16.

<sup>126</sup> Ex. KCP&L 44, pp. 15-16.

<sup>127</sup> Tr., p. 1713.

<sup>128</sup> Ex. KCP&L 44, pp. 15-16.

<sup>129</sup> Tr. pp. 2216-17; Ex. KCP&L 25: pp. 4, 11-12, 38-41.

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contingency as KCP&L did, then wanted to examine only those items that were added to the budget after contingency was applied, it easily could have done so. KCP&L identified to Staff where contingency would be exhausted when it informed Staff in the second quarter of 2007 of the need to reforecast the Iatan Project's Control Budget Estimate.<sup>130</sup>

87. Mr. Giles called Mr. Henderson to invite Staff to observe the reforecasting of the Control Budget Estimate that concluded with the 2008 Cost Reforecast, though Staff declined the invitation.<sup>131</sup>

88. Had Staff wanted to look at the actual costs that were expended on the Iatan Project, it could have taken the K-Report referred to above, compared the "Control Budget Estimate" column with the column labeled "Actuals Plus Accruals," found the contracts where the actual costs exceeded the Control Budget Estimate amount and reviewed the change orders associated with these increases. Such a "list" not only exists, as Mr. Archibald stated, it is reported as part of the regular regime in the Cost Portfolio. Perhaps such an exercise would be time consuming, but it is, in essence, no different than what Mr. Elliott did when he reviewed the engineering necessity of the Iatan Project's change orders.<sup>132</sup>

89. In fact, had Audit Staff merely requested a copy of what Mr. Elliott prepared in his work papers, it would have had a "list" that consists of 227 change orders with a value over \$50,000 on Iatan Unit 1 and 647 similar change orders on Iatan Unit 2. However, Audit Staff never once sought Mr. Elliott's assistance in preparing this prudence audit other than the one section he authored for Staff's December 31, 2009 and November 2010 Reports, and didn't know that Mr. Elliott had even prepared these "lists."<sup>133</sup>

90. Mr. Featherstone described a system that Staff once used that combined both pure auditing of costs with the expertise and judgment of the engineering Staff.<sup>134</sup>

91. Engineering conclusions have guided all of Staff's prior audit reports and associated disallowance recommendations. The evidence demonstrated in this case that the Audit Staff did not consult

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<sup>130</sup> Ex. KCP&L 71, pp. 5-7.

<sup>131</sup> Tr. p. 1091.

<sup>132</sup> Tr. pp. 2398-2400; Ex. KCP&L 205, pp. 10, 30-31; Ex. KCP&L 19, pp. 10-12; Ex. KCP&L 25, p. 14

<sup>133</sup> Tr. pp. 2313, 2387, 2400, 2661, 2828.

<sup>134</sup> Tr. p. 332, 337, 339.

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the Engineering Staff in developing its recommended disallowances.<sup>135</sup>

92. Mr. Henderson took accountability for the change in this procedure, which ultimately resulted in Staff's unprecedented recommended disallowance of all costs over the Iatan Project's Control Budget Estimate based solely on the recommendation of Mr. Hyneman.<sup>136</sup>

93. Staff's approach to the audit of the Iatan Project is especially curious in light of Chairman Gunn's expressed concerns in the April 2010 Hearing:

But we have an Order saying do an audit, complete—and then we have an order saying complete the audit. We have a brand-new—and this is a Iatan 1, which we've talked about the total cost of this project, which is huge, and we want to get that done because we know that we've got Iatan 2 coming, which is enormous.

And yet it didn't appear to be viewed by anybody that this was an important audit. As a matter of fact, we decided to pull it out of the normal way that we do it and have one person take it on themselves because other people were so reluctant to take it on because there was chaos, that they weren't—they didn't want to do it.

So we have one person doing a—trying to do an enormous audit with an Order of the Commission that potentially conflicts with a position in the—in a stipulation, which could theoretically, under what Mr. Dottheim pointed out yesterday, unravel a Stipulation & Agreement in an enormous rate case that we spent an entire time on it, and no one is expressing this to the Commission. No one is coming in and saying, we have a problem here.

We are stumbling around in the dark. You're putting Band-Aids on that stuff, trying to use the resources that you have, trying to figure out a way to do it, and no one is coming to us and saying, we don't have the resources to complete this. It's just me. I've got people that don't know what they're doing. Operations and services can't get together and pull their stuff

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<sup>135</sup> Tr. pp. 2400, 2412, 2421, 2633-34, 2636-37, 2654-55, 2659, 2661.

<sup>136</sup> Tr. pp. 2299-2300.

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together and come up with a single unified plan on how to deal with this.<sup>137</sup>

94. After the April 2010 Hearing, it does not appear that Staff made any significant modifications to its approach to the Iatan Project audit. Mr. Hyneman performed most of the audit by himself, with some help on a few issues with Mr. Majors.. There was no coordination or unified plan between the Audit Staff and Utility Operations Staff.<sup>138</sup> Finally, Staff failed to raise any issues it was having in performing its audit or utilizing KCP&L's Cost Control System with the Commission.

95. An evaluation of the *Wolf Creek* and the *Callaway* cases provides an interesting comparison of the differences in approach Staff previously employed in its prudence reviews as compared to this case.<sup>139</sup>

96. An important difference in both *Wolf Creek* and *Callaway* from this case is that in those cases, the Staff hired consultants with expertise in the industry to analyze the utility's management of the project and perform an analysis of the costs.<sup>140</sup>

97. Staff, in this case, voluntarily chose not to hire a consultant despite having a budget to do so.<sup>141</sup>

98. Staff's proposed disallowance in this case is inappropriate and inequitable when compared to how the utilities managed the Callaway and Wolf Creek projects, and the resulting disallowances in those cases. As the Companies discussed in their Initial Brief, in Callaway and Wolf Creek, the cost overruns approached 200% and the schedule delays were multiple years.<sup>142</sup>

99. In those cases, there were clear problems of owner control over the project, such as the lack of integration of the design and construction schedules, accepting the Contractor's data without any verification, and a complete lack of a cost control or tracking system. The Iatan Project is projected to complete only 15-16% above budget

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<sup>137</sup> File No. EO-2010-0259, Tr. pp. 515-16.

<sup>138</sup> Tr. pp. 2400, 2412, 2421, 2535, 2540-41, 2633-34, 2636-37, 2654-55, 2659, 2661.

<sup>139</sup> See *Kansas City Power & Light Co.*, 28 Mo. P.S.C. (N.S.) 228, 290, 75 P.U.R.4<sup>th</sup> 1 (1986) (regarding the Wolf Creek Generating Station); *Union Electric Company*, 27 Mo. P.S.C. (N.S.) 183, 199; 66 P.U.R.4<sup>th</sup> 202 (1985) (regarding Callaway Nuclear Plant).

<sup>140</sup> See *Kansas City Power & Light Co.*, 28 Mo. P.S.C. (N.S.) pp. 287-88 (Staff hired Touche Ross & Co. and Project Management Associates to perform a review of the effectiveness of SNUPPS/NPI's management of Bechtel); *Union Electric Company*, 27 Mo. P.S.C. (N.S.) pp. 229-230 (Touche Ross analyzed change/extra work notices).

<sup>141</sup> Tr. at 2288-89.

<sup>142</sup> Ex. KCP&L 8, pp. 16-18.



once all the costs are in: it was constructed during a challenging economic climate and finished within three months of the original target date, and the evidence establishes that KCP&L actively managed the Iatan Project and put the proper controls in place.<sup>143</sup>

*Specific Disallowances Proposed by Staff*

ALSTOM 1 Settlement Agreement

100. A team led by KCP&L that included members of Burns & McDonnell, Kiewit and ALSTOM determined the most advantageous Unit 1 completion and Outage Schedule was “the Tiger Team Schedule.”<sup>144</sup>

101. The Tiger Team ultimately recommended an extension to the Unit 1 Outage to a duration of seventy-three (73) days and a delay to the start of the Unit 1 Outage by approximately one month (the “Tiger Team Schedule”).<sup>145</sup>

102. Implementation of this schedule would have a financial impact on ALSTOM for which it was entitled to be compensated under the Contract. KCP&L needed ALSTOM to agree to extend the Unit 1 Outage in accordance with the Tiger Team Schedule.<sup>146</sup>

103. ALSTOM agreed to a series of specific interim dates called “construction turn-over” (“CTO”) dates to ensure timely completion of ALSTOM’s work.<sup>147</sup>

104. KCP&L recognized that since it had entered into the Contract with ALSTOM at the end of 2006, the complexity of the work on the Iatan Unit 1 Outage had increased significantly as KCP&L recognized the opportunity to use this outage to optimize the unit’s performance and reduce future performance risk. The added Unit 1 Outage scope included: (1) economizer surface area addition, necessary for the Unit 1 SCR installation; (2) installation of turning vanes in the existing ductwork; (3) upgrades and replacement of the DCS controls; (4) refurbishment of the submerged and dry flight conveyors; and (5) addition of the low NOx burners. In addition, Tiger Team 1 was concerned about the DCS change out, which creates added risk to the unit’s start-up. These additions added to the work ALSTOM had to complete within the time frame of the outage as well as added to the general congestion in relatively tight spaces. Additionally, despite the

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<sup>143</sup> *Id.*

<sup>144</sup> Ex. KCP&L 22, p. 29.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.* at 28- 29.

<sup>147</sup> Ex. KCP&L 51, p. 10.

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Project Team's efforts, there were a number of open commercial and technical issues that could not be resolved at the Project level. The potential impacts from these unresolved issues were beginning to manifest themselves and it was clear that KCP&L would not be able to resolve them without executive-level involvement. The Quarterly Reports submitted to Staff from the 1st and 2nd quarter of 2008 reflect these discussions with ALSTOM's management and KCP&L's approach to these issues.<sup>148</sup>

105. Staff has proposed two disallowances based upon the ALSTOM Unit 1 Settlement Agreement.<sup>149</sup>

106. The proposed adjustments are based upon two separate items: 1) the actual amount paid to ALSTOM under the Settlement Agreement; and 2) Staff's calculation of alleged "foregone" liquidated damages.<sup>150</sup>

107. With respect to both proposed disallowances, Staff has failed to "raise a serious doubt" that would override the presumption of prudence. Mr. Hyneman testified that Staff's reasoning for disallowing the costs of the Unit 1 Settlement Agreement was not because the decision to enter into the Settlement Agreement by KCP&L was imprudent, but because it was "inappropriate" to charge the cost of the Settlement to rate payers.<sup>151</sup> By making no determination on prudence, Staff has not overcome the presumption of prudence afforded to KCP&L with respect to this expenditure, as it has failed to raise a serious doubt as to the prudence of the cost of the ALSTOM Settlement Agreement.

ALSTOM Unit 1 Settlement Amount

108. As an initial matter, Staff has failed to raise a serious doubt which would defeat the presumption of prudence afforded to KCP&L. In its pre-filed testimony and November 2010 Report, Staff's reasoning for its proposed disallowance, that "Staff is not convinced that ALSTOM's claims against KCP&L were not the fault of KCP&L's project management, raising the question of KCP&L's prudence and whether KCP&L's ratepayers should be responsible for these costs."<sup>152</sup>

109. However, Staff has admitted that it currently does not have an opinion about the prudence of KCP&L's decision to enter into

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<sup>148</sup> Ex. KCP&L 22, pp. 28-29.

<sup>149</sup> Ex. KCP&L 44, Sch. DFM2010-13.

<sup>150</sup> *Id.*

<sup>151</sup> Tr. at 2768.

<sup>152</sup> Ex. KCP&L 205, p. 56.

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the settlement.<sup>153</sup>

110. Furthermore, neither in Staff's November 2010 Report, nor in its prefiled or hearing testimony does Staff provide any substantive, competent evidence that the amounts paid by KCP&L were due to the fault of KCP&L's project management. In fact, Staff's only evidence is simply a complaint that "KCP&L made no attempt to quantify the costs that may have been caused by its own project management team or the owner-engineering firm it hired, Burns & McDonnell ("B&McD"), or any other Unit 1 contractor or subcontractor."<sup>154</sup>

111. Staff has not provided any evidence that the amounts paid to ALSTOM under the settlement were caused by B&McD or any other Unit 1 contractor or subcontractor.<sup>155</sup>

112. Using the management tools available to it, such as the schedule, KCP&L could see when the contractors were not performing as expected. KCP&L would then meet with the contractors weekly and, when necessary, daily to resolve any coordination issues and discuss ways in which the contractor's productivity could be improved and the schedule dates met.<sup>156</sup>

113. Additionally, KCP&L set up a sophisticated dispute resolution process with ALSTOM so that it could ensure that it received the best deal possible for itself and its customers.<sup>157</sup>

114. KCP&L organized and participated in several facilitation sessions with a nationally-renowned mediator in order to help find solutions and remediation plans to help get the project back on track.<sup>158</sup>

Unit 1 Liquidated Damages

115. Staff is arguing that an additional adjustment based on KCP&L's alleged choice to forego liquidated damages for ALSTOM's Guaranteed Unit 1 Provisional Acceptance.<sup>159</sup>

116. Under Missouri Law, the term "liquidated damages" refers to "that amount which, at the time of contracting, the parties agree shall be payable in the case of breach."<sup>160</sup>

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<sup>153</sup> Tr. at 2768.

<sup>154</sup> Ex. KCP&L 205, p. 57..

<sup>155</sup> *Id.*; see also Ex. KCP&L 51, p. 9.

<sup>156</sup> Ex. KCP&L 18, p. 20.

<sup>157</sup> Ex. KCP&L 22, pp. 40-41; Ex. KCP&L 51, p. 8.

<sup>158</sup> *Id.*; KCP&L-51, p. 8.

<sup>159</sup> Ex. KCP&L 205, p. 59.

<sup>160</sup> See *Goldberg v. Charlie's Chevrolet, Inc.*, 672 S.W.2d 177, 179 (Mo. App. 1984).

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117. Under ALSTOM's original Contract, KCP&L would be entitled to collect liquidated damages from ALSTOM on Unit 1 **only** if ALSTOM was unable to meet its "Provisional Acceptance Date" (otherwise known as the "in-service date") for Unit 1 as required by the Contract. The Unit 1 Provisional Acceptance Date in the ALSTOM Contract was December 16, 2008.<sup>161</sup>

118. This means that KCP&L was not entitled to collect liquidated damages until after that date had passed. KCP&L and ALSTOM negotiated the Unit 1 Settlement Agreement in the first half of 2008 and it was executed on July 18, 2008, several months before any breach could be declared or any liquidated damages had accrued. Once KCP&L and ALSTOM entered into the Settlement Agreement and agreed to modify the Provisional Acceptance date, any discussion about what KCP&L "could have" potentially collected under the original December 2008 contractual date is highly speculative, and completely unrealistic. A contractor is not going to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid.<sup>162</sup>

119. Two events occurred that show that even if ALSTOM had been late in completing its Unit 1 work, KCP&L would not have been able to collect liquidated damages.<sup>163</sup> These events were the economizer casing repair and the turbine rotor repair.

120. During the Unit 1 Outage, the construction team discovered a latent defect in the economizer casing. This defect and the necessary repairs impacted the duration of the Unit 1 Outage by thirty-two (32) days.<sup>164</sup>

121. Additionally, during the start-up after the Unit 1 Outage, a vibration event with the turbine caused an additional delay to start-up of the Unit.<sup>165</sup>

122. The effect of the economizer incident and the turbine would have made it impossible for ALSTOM to achieve its contractual dates (and even pushed out the revised dates under the Settlement Agreement). These two events added additional time to the schedule,

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<sup>161</sup> Tr. pp. 1816-17.

<sup>162</sup> Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 59-60; Ex. KCP&L 51, pp. 11-12; Ex. KCP&L 46, pp. 266-68.

<sup>163</sup> Ex. KCP&L 19, p. 59; Ex. KCP&L 71.

<sup>164</sup> *Id.*

<sup>165</sup> Ex. KCP&L 19, p. 60.

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for which ALSTOM was not responsible.<sup>166</sup>

123. As a result, ALSTOM would have been entitled to an adjustment of its contractual Provisional Acceptance Date and KCP&L would not have been able to impose liquidated damages on ALSTOM. Accordingly, the evidence in KCP&L's prefiled testimony and at the evidentiary hearing demonstrate that ALSTOM achieved the contractually modified Guaranteed Unit 1 Provisional Acceptance Date and liquidated damages did not apply.

ALSTOM Unit 2 Settlement Agreement Adjustment  
Incentive Payments

124. Staff argues that KCP&L should not be entitled to recover any amounts it paid to ALSTOM under the Unit 2 Settlement Agreement. Staff revised the amount of its disallowance from the November 2010 Report to the total amount KCP&L paid ALSTOM under the terms of the Settlement Agreement. KCP&L's witnesses provided extensive detail regarding the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement, including Mr. Downey, Mr. Roberts and Dr. Nielsen.<sup>167</sup>

125. There were two main reasons KCP&L decided to enter into a Settlement Agreement with ALSTOM. First, ALSTOM had presented KCP&L with a significant delay claim based primarily on weather delays that needed to be resolved. Regardless of whether ALSTOM's claim had merit, defending against the claim would be both expensive and time consuming.<sup>168</sup>

126. Additionally, it would have mired the KCP&L and ALSTOM project teams in a commercial dispute at a time when it was important for the focus to be on cooperatively completing the project. Second, Kiewit had told KCP&L that it would cost a substantial amount for Kiewit to be able to support the dates in ALSTOM's schedule.<sup>169</sup>

127. The Commission finds that the value for the benefits KCP&L received exceeded the amount of incentive payments.<sup>170</sup>

128. KCP&L considered and balanced both cost and schedule in creating a revised schedule and fostering cooperation

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<sup>166</sup> *Id.* at 59-60.

<sup>167</sup> Ex. KCP&L 22, pp. 39-47; Ex. KCP&L 51, pp. 12-18; Ex. KCP&L 46, pp. 275-85.

<sup>168</sup> Ex. KCP&L 51, p. 15.

<sup>169</sup> Ex. KCP&L 22, p. 41.

<sup>170</sup> KCP&L's Post Hearing Exhibit filed on February 22, 2011.

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between the main contractors.<sup>171</sup>

129. Based upon a prudence analysis, KCP&L's decision to enter into the ALSTOM Unit 2 Settlement Agreement was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

Unit 2 Liquidated Damages

130. In his true-up testimony, Mr. Hyneman alleges, "Since Alstom's performance compared to contractual requirements were [sic] likely the cause of some if not most of these incremental costs, KCP&L should have assessed and collected these costs from Alstom under the liquidated damages provision of the Alstom-KCP&L contract. KCP&L decided not to make such an assessment. If Alstom's performance did not meet its contract requirements and failed to protect itself from such performance by taking advantage of its rights under its contract with Alstom, KCP&L was unreasonable / inappropriate in its conduct and should bear the costs incurred."<sup>172</sup>

131. Mr. Hyneman's testimony is transparently based on speculation and hindsight and reveals that Staff has not performed any analysis of KCP&L's prudence regarding its decision to engage in the Settlement Agreement with ALSTOM. Mr. Hyneman also states, "If some or all of the delay in project completion was not the fault of ALSTOM, KCP&L should determine who was at fault and hold that entity (including itself) responsible for these incremental later Project costs."<sup>173</sup> Mr. Hyneman clearly admits that he does not know the basis of this agreement, or whether ALSTOM, KCP&L or anyone else for that matter was "at fault."

132. As stated, the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement and KCP&L's analysis of the agreement are discussed in detail by several KCP&L Company witnesses, including Mr. Downey, Mr. Roberts and Dr. Nielsen.<sup>174</sup>

133. It is mere hindsight to imply that KCP&L could have but did not assess liquidated damages. KCP&L's witnesses provided competent evidence that the Unit 2 Provisional Acceptance date was subsequently revised from the original contract date.<sup>175</sup>

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<sup>171</sup> Ex. KCP&L 22, p. 40.

<sup>172</sup> Ex. KCP&L 308, p. 3.

<sup>173</sup> *Id.*

<sup>174</sup> See Ex. KCP&L 22, pp. 39-47; Ex. KCP&L 51, pp. 12-18; Ex. KCP&L 46, pp. 275-285.

<sup>175</sup> See Ex. KCP&L 112, pp. 10-11; Data Request 658.

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134. Because Staff's proposed disallowance is a calculation regarding what KCP&L "could have" potentially collected had the original contractual date of June 1, 2010 remained in effect, the disallowance is not only highly speculative but factually irrelevant.<sup>176</sup>

135. Staff states that there was no evidence of KCP&L's analysis quantifying the events associated with the Unit 1 ALSTOM Settlement Agreement.<sup>177</sup>

136. However, the record establishes that KCP&L has provided Staff with all necessary documents related to the ALSTOM Unit 1 Settlement and that the agreement was prudent. Staff had access to KCP&L project management and senior project staff, and KCP&L has filed extensive testimony regarding this issue in File No. ER-2009-0089 ("0089 Case").<sup>178</sup>

137. KCP&L has put forth credible testimony of industry experts such as Dr. Nielsen and Mr. Roberts who have testified that the ALSTOM Unit 1 Settlement was a prudent expenditure on the part of KCP&L, and KCP&L witnesses who testified as to the detailed evaluation that was performed.<sup>179</sup>

138. The evidence establishes that KCP&L fully evaluated the benefits and risks associated with the ALSTOM Unit 1 Settlement Agreement. The evidence establishes that KCP&L's decision to settle with ALSTOM was prudent in light of all of the circumstances and information known to KCP&L's senior management at the time.

139. Mr. Hyneman also alleges, "Since Alstom did not obtain Provisional Acceptance of Unit 2 until September 23, 2010 when it was required by contract to obtain this project milestone on June 1, 2010. Because of this delay in project completion, KCPL incurred costs and harm."<sup>180</sup>

140. This is the identical argument that Staff advances in

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<sup>176</sup> See Ex. KCP&L 112, p. 6; Ex. KCP&L 22, p. 36-38; Ex. KCP&L 19, p. 58-60; Ex. KCP&L 51, p. 11-12; Ex. KCP&L 46, pp. 266-268.

<sup>177</sup> See Staff's Initial Brief at p. 48.

<sup>178</sup> See Davis Rebuttal Testimony (0089 Case) at pp. 3-6 and 19-20 (discussing the Unit 1 Outage and the Tiger Team Schedule and describing meeting with the MPSC Staff that occurred on September 23, 2008 where the Unit 1 Settlement was discussed in detail and relevant documents were provided); Downey Rebuttal Testimony (0089 Case) at p. 17 In. 20 to p. 20, In. 23.

<sup>179</sup> Ex. KCP&L 46, pp. 263-275; Ex. KCP&L 51, pp. 7-12; Ex. KCP&L 22, pp. 28-29, 32, 34, Sch. WHD2010-05.

<sup>180</sup> Ex. KCP&L 308, p. 3.

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Staff's Report regarding the "forsaken" liquidated damages on the Iatan Unit 1 Project, and will be rejected for the same reasons KCP&L's witnesses have previously articulated.<sup>181</sup>

141. Although KCP&L technically declared that ALSTOM met the Provisional Acceptance Date on September 23, 2010, it could have done so much earlier, but chose not to for valid commercial reasons:

Technically, KCP&L could have declared that ALSTOM had achieved Provisional Acceptance on this date, but chose to rely on some technical language in the Contract so that KCP&L could wait until after ALSTOM could show that the unit could be started up with no problems after an extended outage. This was to ensure that there were no latent problems in ALSTOM's work before KCP&L released ALSTOM from liability for liquidated damages. As a result, KCP&L considers the "commercial operation" date (the definition on which Provisional Acceptance is based) of the Iatan Unit 2 plant to be August 26, 2010, or 67 days earlier than ALSTOM's [revised] contractual date. It is important to note that KCP&L has always targeted Provisional Acceptance for the Project in the "Summer of 2010", which was achieved. KCP&L does not consider the Iatan Project to have been "late."<sup>182</sup>

142. Because Staff's proposed disallowance is a calculation regarding what KCP&L "could have" potentially collected had the original contractual date of June 1, 2010 remained in effect, the disallowance is not only highly speculative but factually irrelevant. ALSTOM was not required to nor would it have any reason to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid.<sup>183</sup>

### Schiff Hardin LLP Adjustments - Iatan

143. Schiff Hardin brought value to the Iatan Project, from the initial setup of the commercial strategy and strategic schedule, the negotiation of the Iatan Project's contracts through the Project itself, all

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<sup>181</sup> Ex. KCP&L 112, p. 5-12; Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 59-60; Ex. KCP&L 51, pp. 11-12; Ex. KCP&L 46, pp. 266-268; Ex. KCP&L 205, p. 59.

<sup>182</sup> Ex. KCP&L 112, pp. 10-11.

<sup>183</sup> *Id.* at 6; Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 58-60; Ex. KCP&L 51, pp. 11-12; and Ex. KCP&L 46, pp. 266-268.



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the while providing KCP&L's senior management team information it needed to oversee the Iatan Project's management.<sup>184</sup>

144. He is not an attorney himself, and has not presented any evidence that he has ever contracted for legal services at any point in his career.<sup>185</sup>

145. Mr. Hyneman admits that he is not an expert at evaluating the quality of legal work and he is not offering an opinion as to the quality of Schiff's work on the Iatan Project.<sup>186</sup>

146. KCP&L's procedures do not require that all services are subjected to a competitive bidding process.<sup>187</sup>

147. Moreover, there was considerable vetting of Schiff Hardin and their fees, not just at the outset of the Project but also as the Project progressed.<sup>188</sup>

148. KCP&L's decision to utilize Schiff Hardin was well considered on the basis of a vetting of both the needs for a firm of this type and the Schiff Hardin's unique set of qualifications, and KCP&L's day-to-day management of Schiff Hardin's work was robust.<sup>189</sup>

149. Schiff Hardin only performed the work that KCP&L requested it perform, and the quality of their work and their advice is not being questioned.<sup>190</sup>

150. If only hours incurred by Schiff Hardin personnel were considered, then the statistics would reflect Iatan Oversight (32%), Iatan Project Control (10%), Contracts (10%), Contract Administration (46%) and other (2%).<sup>191</sup>

Schiff Hardin LLP Adjustments – Spearville 2 Wind Project

151. Mr. Hyneman also provides insufficient evidence to raise a serious doubt regarding KCP&L's prudence in utilizing Schiff Hardin's services for the Spearville 2 Wind Project.<sup>192</sup>

152. The bases for exclusion of Schiff Hardin's fees is Mr.

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<sup>184</sup> Ex. KCP&L 8, pp. 22-23; Ex. KCP&L 22, p. 6; Ex. KCP&L 25, p. 16, Ex. KCP&L 19, p. 5; Ex. KCP&L 6, p. 2.

<sup>185</sup> Tr. at 2589.

<sup>186</sup> Tr. at 2649-50.

<sup>187</sup> Ex. KCP&L 8, pp. 20-21.

<sup>188</sup> Tr. at 1436-37.

<sup>189</sup> Tr. at 1439-41.

<sup>190</sup> Tr. at 1644; Ex. KCP&L 1203, p. 82.

<sup>191</sup> Ex. KCP&L 8, p. 31.

<sup>192</sup> Ex. KCP&L 112, pp. 13-15.

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Hyneman's concerns raised regarding Schiff Hardin's sole source award for work on the Iatan Project.<sup>193</sup>

153. KCP&L has demonstrated that using Schiff Hardin to provide legal services, whether on this work or the Iatan Project, was prudent because of Schiff Hardin's qualifications to perform such work.<sup>194</sup>

154. Additionally, Schiff's services directly contributed to the successful completion of the Spearville 2 project and were cost effective.<sup>195</sup>

155. Schiff's services resolved a complicated contract dispute involving 32 wind turbines at a very low cost and with Schiff's assistance, the project was constructed on time and on budget.<sup>196</sup>

156. Second, Staff offers no evidence to support its recommended disallowance. Staff did not evaluate the nature or extent of the services that Schiff Hardin provided on the Spearville 2 Project. Similarly, Staff offers no testimony regarding the typical range of legal fees associated with conducting a mediation. As stated, Staff relies solely on its allegations regarding the impropriety of sole sourcing legal services for the Iatan Project as its basis to support a disallowance for services performed on an entirely different project.<sup>197</sup>

157. Finally, Staff's position that the portion of fees not excluded is the "level of charges [necessary] to this type of project" is completely without basis.<sup>198</sup>

Pullman Adjustment

158. Pullman was a contractor on the Iatan Construction Project and part of its duties was to install the new chimney liner.<sup>199</sup>

159. Although Staff includes in Schedule 1-1 of its November 2010 Report two proposed disallowances related to Pullman, the Chimney contractor, there is no explanation anywhere in Staff's November 2010 Report as to Staff's evaluation of these costs or why they have been deemed to be imprudent.

160. Staff's argument that a statement in the Kiewit Recommendation to Award Letter that "Pullman's Performance on the

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<sup>193</sup> Ex. KCP&L 308 HC, pp. 14-16.

<sup>194</sup> Ex. KCP&L 8, pp. 20-21; Tr. pp. 496-503, 1436-37, 1439, 1441, 1644, 1860-62.

<sup>195</sup> Tr. at 4618.

<sup>196</sup> See *id.*

<sup>197</sup> Ex. KCP&L 308, pp. 14-16.

<sup>198</sup> *Id.* at 16.

<sup>199</sup> Ex. KCP&L 250, p. 8.

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Project was well below expectations” does not explain why Staff would disallow the costs to put a performance bond in place, nor is there any analysis that identifies 1) how KCP&L had Pullman’s performance within its control; or 2) how KCP&L acted imprudently that led to the disallowed costs. By its silence, Staff has not created a “serious doubt” as to these expenditures. Thus, Staff has not created a “serious doubt” as to these expenditures and base upon a prudence analysis, KCP&L’s payments to Pullman are deemed to be prudent.

Severance Adjustment

161. The sole basis for Staff’s disallowance is the Commission’s “recent” decision in 2006 that severance costs should not be recovered from rate payers.<sup>200</sup>

162. However, the Commission finds that severance costs in this case are an ongoing cost KCP&L incurs to serve its customers.<sup>201</sup>

Affiliate Transaction

163. Staff has proposed a disallowance for costs incurred by KCP&L’s affiliate, Great Plains Power (“GPP”) for work performed that was ultimately used as a part of the development of the Iatan Unit 2 project. As cited by Staff in its November 2010 Report, KCP&L identified the work performed as pertaining to “environmental permitting and engineering which defined the project scope and plant design.”<sup>202</sup>

164. Staff simply states that it “was not convinced that the costs incurred by GPP in its nonregulated activities were necessary for the construction of Iatan 2.” However, Staff’s November 2010 Report does not identify the reasons for this belief, nor does it provide any sort of prudence analysis of the costs incurred.<sup>203</sup> As a result, Staff has not raised a serious doubt as to the prudence of these costs that can overcome the presumption of prudence afforded to KCP&L. Based upon a prudence analysis, the affiliate transactions were prudent when looking at the circumstances known by KCP&L at the time the decision was made.

165. The use of existing GPP development work resulted in a substantial reduction in schedule and additional costs that would have had to be recreated or incurred going forward.<sup>204</sup>

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<sup>200</sup> See Staff’s Initial Brief at pp. 46-47.

<sup>201</sup> Ex. KCP&L 23 (NP), p. 4.

<sup>202</sup> See Ex. KCP&L 205, p. 51.

<sup>203</sup> *Id.*

<sup>204</sup> Ex. KCP&L 113, p. 15.

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166. The site where GPP began the development of its generation facility became the site that is known as the Iatan 2 generation facility. Work that had already been completed by the GPP subsidiary regarding initial environmental permitting and engineering was applicable and beneficial to the development of Iatan 2.<sup>205</sup>

167. It would not have been in the best interest of rate payers to recreate the work and delay schedule simply due to the fact that the initial development of Iatan 2 generation facility began with the GPP subsidiary.<sup>206</sup>

168. As far as the affiliate transaction rule (4 CSR 240-20.015(2)(A)), the rule requires that the compensation to GPP be the lower of the fair market price or the cost to provide the services for itself. In this case, it would have been of no value to complete a market review of what it would cost to do an environmental permitting and engineering study at the time of purchase of the GPP work as the study was being purchased at cost.<sup>207</sup>

169. The Companies agree that they were in error for not reporting the transaction in the annual affiliate transaction report. However, this reporting failure does not change the fact that certain environmental and engineering needed to take place.<sup>208</sup>

Additional AFUDC Due to Iatan 1 Turbine Start-Up Failure

170. Staff has not proposed an adjustment for the costs of the turbine trip. AFUDC costs are a component of the project's total costs and the turbine work was required to return Iatan Unit 1 and the AQCS environmental upgrades to service.<sup>209</sup>

171. In Staff's November 3 report, Staff made an adjustment regarding AFUDC costs incurred on the Iatan 1 AQCS project during the outage associated with the turbine trip. Staff's rationale was "it is Staff's belief that the increase in AFUDC accrued during the 33-day delay should be removed from plant balance of the Iatan 1 AQCS and charged to the work order capturing the costs for the turbine trip."<sup>210</sup>

172. The turbine work (including new rotor installation, replacement of low pressure sections to increase output, reworking of

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<sup>205</sup> *Id.*

<sup>206</sup> *Id.* at 16.

<sup>207</sup> *Id.* at 16.

<sup>208</sup> *Id.* at 15.

<sup>209</sup> See KCP&L/GMO's Initial Brief at ¶193.

<sup>210</sup> Ex. KCP&L 205, p.90; Ex. KCP&L 201, p. 124; Ex. KCP&L 113, p. 10.

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turbine spindle in or to support the performance of the new AQCS equipment) was required to support the Unit 1 AQCS retrofit project.<sup>211</sup>

173. Staff has not proposed any disallowance associated with the turbine trip work, but attempts to penalize the Companies for the turbine failure by not allowing the AFUDC costs incurred on the Unit 1 AQCS project costs during the outage associated with this work. AFUDC costs are a component of the construction projects total costs and shall not be disallowed when costs associated with prudent work required to return the unit to service have not been proposed to be disallowed.<sup>212</sup>

Advanced Coal Credit AFUDC Adjustment

174. Staff argues that since from 2007 to 2009, KCP&L had a free source of cash from Section 48 advanced coal investment credits, it had access to free cash flow to offset the financing costs for the construction of Unit 2.<sup>213</sup>

175. Staff's free cash flow position is unsupported and unfounded as it attempts to impute a cost savings that does not exist and ratepayers will receive the benefits of the advanced coal investment tax credits over time. As explained by Company witness Ives, the borrowing or financing costs of KCP&L and GPE did not increase as a result of GPE not utilizing the advanced coal investment tax credits in 2008 and 2009.<sup>214</sup>

AFUDC Accrued on Staff's Proposed Disallowances

176. Staff has calculated the AFUDC value associated with each of the proposed construction cost disallowances detailed in the Staff's "Construction Audit and Prudence Review" report of the Unit 2 Construction Project which was filed on November 3, 2010, as updated on Schedule 1 to Staff witness Hyneman's true-up direct testimony.<sup>215</sup> AFUDC and carrying costs related to any specific adjustment should follow that adjustment.

JLG Accident Adjustment

177. Staff believes that KCP&L was unreasonable for executing the JLG Settlement Agreement.<sup>216</sup>

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<sup>211</sup> See Ex. KCP&L 19, p. 61.

<sup>212</sup> See Ex. KCP&L 113, p. 11.

<sup>213</sup> See Staff's Initial Brief at p. 77.

<sup>214</sup> Ex. KCP&L 113, p. 13.

<sup>215</sup> *Id.* at 8.

<sup>216</sup> Ex. KCP&L 205, p. 46.

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178. KCP&L and ALSTOM chose to escalate this issue for resolution as part of a broader commercial strategy, and that this issue was one of several that KCP&L and ALSTOM ultimately resolved in this manner.<sup>217</sup>

179. In its November 2010 Report, Staff has failed to raise a serious doubt as to the prudence of KCP&L's settlement of the JLG accident costs. Based upon a prudence analysis, KCP&L's decision to settle ALSTOM's JLG claim was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

May 23, 2008 Crane Accident Adjustment

180. On May 23, 2008, one of the largest mobile cranes in the world, a Manitowoc 18000 crane, collapsed while performing an unloaded test lift on the Iatan Project (the "Crane Incident"). As a result of the collapse, one person was killed and others were injured.<sup>218</sup>

181. KCP&L's EPC Contractor, ALSTOM, was responsible for the operation of the crane at the time of the incident.<sup>219</sup>

182. In Staff's November 2010 Report, Staff disallowance is based on a meeting that Staff had with KCP&L, and Staff's "impression" regarding KCP&L's expected future recovery of the costs associated with the Crane Incident.<sup>220</sup>

183. Staff admits that it has not done a detailed review of project costs to determine if the charges are accurate and complete, even though many of these charges were incurred by KCP&L over two years ago.<sup>221</sup>

184. Staff has failed to raise a serious doubt as to the prudence of these expenditures. Based upon a prudence analysis, KCP&L's decision to take swift action immediately after the Crane Incident on the Iatan Site was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

185. The Commission finds that the costs incurred by KCP&L due to the Crane Incident were prudently incurred.<sup>222</sup>

Cushman Project Management Rate Adjustment

186. Staff's proposed disallowance for a rate adjustment

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<sup>217</sup> Ex. KCP&L 19, pp. 54-55.

<sup>218</sup> Ex. KCP&L 22 (NP), p. 14.

<sup>219</sup> *Id.*

<sup>220</sup> Ex. KCP&L 205, p. 41.

<sup>221</sup> *Id.*

<sup>222</sup> Ex. KCP&L 22, pp. 23-24.

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relating to Mr. Cushman's fees was based on an assessment that Mr. Cushman's fees were unreasonable.<sup>223</sup>

187. Cushman was hired to develop processes and procedures for the Iatan Project including the Project Execution Plan ("PEP"). Mr. Cushman is highly respected in the industry and had a proven track record with KCP&L from Hawthorn.<sup>224</sup>

188. KCP&L evaluated the costs for Cushman's specialized services and determined that the costs were reasonable.<sup>225</sup>

### Adjustment from KCC Staff Audits

189. Staff proposes adjustments in the amount of almost \$2 million based on a KCC Staff audit. The KCC Staff audit is not before this Commission and is non-credible hearsay. The fact that KCP&L decided not to challenge those adjustments in its Kansas case does not in and of itself create a serious doubt as to the imprudence of those expenditures. KCP&L has denied that those expenditures were imprudent. Because Staff presented no evidence of imprudence, the Commission finds the costs were prudently spent on the Project.<sup>226</sup>

### Employee Mileage Charge Adjustment

190. Employees assigned to the Iatan Project were only going to be travelling to Iatan on a temporary basis.<sup>227</sup>

191. To require employees to work at the Iatan project site on a temporary, five-year project without compensation for mileage costs would not have been equitable and likely would have been viewed as a deterrent to working on the Iatan projects.<sup>228</sup>

### Inappropriate Charges Adjustment

192. Staff has attached Schedules 4 and 5 that purport to support Staff's disallowances for the inappropriate charges. However, the Schedules identify only \$18,351 of items charged to Unit 2 that Staff deemed as inappropriate. Staff's amount for the proposed disallowances are only "estimates" which are wholly arbitrary.<sup>229</sup> Staff has no basis for its estimates, and as a result, they will be disregarded by the Commission.

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<sup>223</sup> Ex. KCP&L 205, p. 98.

<sup>224</sup> Ex. KCP&L 19, p. 66.

<sup>225</sup> *Id.*

<sup>226</sup> Ex. KCP&L 19, pp. 71-72.

<sup>227</sup> Ex. KCP&L 8, p. 39.

<sup>228</sup> *Id.*

<sup>229</sup> Ex. KCP&L 8, p. 40.

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*Disallowances Proposed by Missouri Retailers Association  
("MRA")*

latan 2

193. There are significant portions of Mr. Drabinski's testimony on behalf of the MRA that are not only flawed from a factual and analytical standpoint, but they do not factor in any way in Mr. Drabinski's actual recommendation for the disallowance of \$219 million. These include Mr. Drabinski's allegations that:

- Mr. Drabinski's entire "Plant Comparison" analysis, "Comparison to Trimble County 2" and "Analysis of Budgets and Reforecasts", which he abandoned in exclusive favor of his single recommended \$219 million disallowance.<sup>230</sup>
- Any measured cost "increase" from any project estimate prior to the December 2006 Control Budget Estimate, including Mr. Drabinski's claim that a preliminary estimate prepared in January 2006 has some significance.<sup>231</sup>
- Mr. Drabinski's repeated allegation that KCP&L mismanaged the Project "early on," which he defines as the year 2006 to early 2007. This unsupported opinion based in hindsight conflicts with Mr. Drabinski's testimony that KCP&L pursued the critical path work through 2006 with great success.<sup>232</sup>
- Mr. Drabinski's allegation that Burns & McDonnell was "late" in producing critical drawings is completely contradicted by the fact that Burns & McDonnell completed the foundation drawings on time for critical turnovers to ALSTOM and Kiewit.<sup>233</sup>
- Mr. Drabinski's hindsight-based allegation that KCP&L's decision related to the Iatan Project's contracting methodology, i.e. to perform the Iatan Project on a multiple prime and not an EPC basis, increased the Project's cost (i.e., EPC vs. Multi-Prime) or was in and of itself imprudent.<sup>234</sup> Drabinski testifies, "I never stated that the decision to use a Multi-Prime rather than an EPC approach

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<sup>230</sup> Tr. p. 1597.

<sup>231</sup> Tr. pp. 1593-1594.

<sup>232</sup> Tr. pp. 1648-1653.

<sup>233</sup> Tr. p. 1650.

<sup>234</sup> Tr. p. 1593.



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- was, in itself, imprudent.”<sup>235</sup>
- KCP&L and Kiewit had some specious deal regarding an artificially low contract price.<sup>236</sup>
  - KCP&L made an untimely decision to hire Kiewit as the primary Balance of Plant (“BOP”) contractor at a premium price; as explained further below, Mr. Drabinski does not know how to quantify this alleged premium.<sup>237</sup>
  - The “turbine building bust” and “the cost of the unintended consequences of the decision to add a de-aerator to the project. Evidence shows that the cost of the enlarged turbine building was at least \$106 million and perhaps over \$200 million. This was part of the reason for the large increase in balance of plant costs.”<sup>238</sup> Company witness Mr. Meyer explains that while the Balance of Plant work increased due to design maturation, these were not in any way imprudent cost increases, as Mr. Drabinski obliquely asserts without examination of the facts.<sup>239</sup>
  - The cost of the Balance of Plant work increased from “\$350 million to a billion dollars on this Project.”<sup>240</sup>
  - KCP&L could not manage a multi-prime project, a fact disputed by numerous KCP&L witnesses.<sup>241</sup>
  - The development and implementation of the PEP and other project tools such as SKIRE were untimely and increased Project costs; a fact disputed by numerous KCP&L witnesses and which Mr. Drabinski never ties to any disallowance. The contracts used for the major contractors were inadequate in that these contracts did not adequately shift risk to the contractors and did not contain a formulaic basis for calculating loss of efficiency change orders. Mr. Drabinski never cites a single sentence in any contract that was employed on the Iatan Project, yet he concludes

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<sup>235</sup> Ex. KCP&L 2602, p. 24.

<sup>236</sup> Ex. KCP&L 2601, p. 159.

<sup>237</sup> Ex. KCP&L 45, pp. 47-53.

<sup>238</sup> Ex. KCP&L 2601, p. 33.

<sup>239</sup> Ex. KCP&L 45, pp. 48- 49.

<sup>240</sup> Tr. p. 1615.

<sup>241</sup> Ex. KCP&L 6, pp. 14-15; Ex. KCP&L 19, pp. 20-26, 104-107; Ex. KCP&L-21, p. 27; Ex. KCP&L-22, pp. 74-80; Ex. KCP&L 46, pp. 94-97; Ex. KCP&L 52, pp. 33-44.

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that KCP&L employed “poorly written contracts” because “every time a problem arose, rather than being able to use the contract to resolve it, they went to a settlement.”<sup>242</sup>

- KCP&L failed to timely implement expert advice, which Mr. Roberts thoroughly disputes.<sup>243</sup>
- KCP&L’s planned construction schedule was compressed and was made worse by KCP&L’s failure to timely hire Burns & McDonnell as the Owner’s Engineer.<sup>244</sup>

194. Dr. Nielsen credibly addresses Mr. Drabinski’s failure to create a nexus between KCP&L’s alleged imprudent actions and his proposed disallowances in his Rebuttal Testimony. Specifically, Dr. Nielsen testifies:

Pegasus-Global’s examination of Mr. Drabinski’s “Review of Purchase Orders and Change Orders” determined that Mr. Drabinski again provided no nexus of causation between any unreasonable or imprudent decision or action by KCP&L and specific cost disallowance. Mr. Drabinski simply notes that its “analysis was in-depth and extremely data intensive” [Drabinski Direct Testimony at p. 204, In. 11] and that based on that analysis it “determined if all or part of the cost should not be permitted into the rate base” [Drabinski Direct Testimony at p. 204, In. 19 through p. 205, In. 1]. Nowhere in Mr. Drabinski’s testimony was there a single statement which linked a specific Purchase Order or Change Order, or a part of a specific Purchase Order or Change Order, to any decision made or action taken by KCP&L during the execution of the Iatan Unit 2 project.<sup>245</sup>

195. Mr. Drabinski’s Direct Testimony includes four separate methodologies and four separate potential disallowance calculations though he agreed at the hearing that the only actual recommendation that he is advancing to the Commission is his so called “Review of Initial Purchase Orders and Change Orders.”<sup>246</sup>

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<sup>242</sup> Tr. p. 1645.

<sup>243</sup> Ex. KCP&L 52, p. 2.

<sup>244</sup> *Id.* at 45-47.

<sup>245</sup> Ex. KCP&L 46, p. 227.

<sup>246</sup> Ex. KCP&L 2601; Tr. p. 1597.

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196. Mr. Drabinski makes only a cursory attempt to tie a handful of the proceeding two-hundred and two pages of his Direct Testimony to this final section of his actual recommendation to the Commission. On one hand, Mr. Drabinski claims that his recommended disallowance is tied to specific Purchase Orders and Change Orders.<sup>247</sup>

197. However, he described his method of choosing the change orders that make up his recommended disallowance as follows:

How you come up with the allocation of imprudent costs is not based on a specific purchase order, but based on the overall testimony that shows that imprudent mismanagement took place, costs rose beyond expectations and reasonable levels and, therefore, certain areas warrant adjustment.<sup>248</sup>

198. 15 major flaws are apparent in Mr. Drabinski's analysis.<sup>249</sup>

- 1) Drabinski applied an erroneous standard for prudence reviews.
- 2) Drabinski finds imprudence as a consequence of the results attained rather than evaluating decisions and the decision making process, causally connecting the allegations and then properly quantifying the impact.
- 3) Drabinski improperly asserts that Drabinski's opinion is preferable to prudence opinions which may be held by the Commission.
- 4) Drabinski improperly asserts that Drabinski's opinion is preferable to KCP&L's management decisions and improperly employs hindsight in doing so rather than evaluating management decisions made at the time.
- 5) Drabinski did not perform a prudence audit, but rather, engaged in what is essentially an inappropriate mixing of construction claims approaches and construction/financial audit approaches.
- 6) Drabinski failed to recognize the Iatan Project as a mega-project and thus, failed to evaluate the Iatan Project within the proper context of that definition.
- 7) Drabinski used selected "sound bites" drawn from

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<sup>247</sup> Tr. p. 1601.

<sup>248</sup> Tr. pp. 1638-39.

<sup>249</sup> Ex. KCP&L 46, pp. 27-30.

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internal audits and consultant reports performed by or at the request of KCP&L to support Drabinski's assertion of imprudence, ignoring information from those audits which runs contrary to Drabinski's position and not presenting these selections in context, including the proper time context.

8) Drabinski inappropriately uses KCP&L's internal audits to criticize KCP&L's decisions ignoring the fact that the process of conducting on-going internal audits during a complex construction project is considered part of the prudent management decision making process.

9) Drabinski's opinion relies upon an incorrect understanding of facts, and often directly conflicts with documented evidence regarding events on the Iatan Project, and conditions and circumstances that were known and/or reasonably known by KCP&L management.

10) Drabinski submits conclusions of imprudence without providing supporting explanation or documentation other than the selected "sound bites".

11) Drabinski fails to provide a connection between Drabinski's allegations of imprudence and any actual costs incurred as a direct result of the alleged imprudence.

12) Drabinski's analyses and conclusions display a lack of experience and understanding of construction industry practices, procedures and standards on a project like the Iatan Project. For example, Drabinski's analyses and conclusions display a misunderstanding of the cost estimating process and the proper use of various levels of cost estimates created during the planning and execution phases of a mega-project like the Iatan Project.

13) Drabinski substitutes his judgment rather than analyzing whether KCP&L's decision-making processes and procedures, and KCP&L's decisions fell within a zone of reasonableness, and thus would be prudent.

14) Drabinski uses impermissible hindsight to determine prudence.

15) Drabinski's analyses and conclusions filed in this

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case are inconsistent with testimony filed by Drabinski in the Kansas Commission case in July 16, 2010. For example, in the Kansas Commission case Mr. Drabinski testified that the project peer review differential it calculated supported a disallowance of \$530 million while in Drabinski's filed testimony in this MPSC case the project peer review differential he calculated supported a disallowance of \$316 million, a difference of \$214 million. The Kansas Commission in its 21 November 22, 2010 Order (Docket No. 10-KCPE-415-RTS) also found that Drabinski's analysis was flawed for similar reasons noted above and stated in that order.

199. Mr. Drabinski testified at the hearing: I made significant changes to my testimony, both as far as the prudence standard, and I also added a significant amount of analysis and detail based on what I learned from the time that my testimony was produced in the spring of 2010 until November 2010 when it was due here. You don't sit through weeks of hearing and go through thousands of data requests without learning a little more."<sup>250</sup>

200. While the 'perfect' estimate may be an industry goal, it rarely, if ever, exists in reality. It is not uncommon within the industry to see cost increases. In other words, even if KCP&L had a 'perfect' estimate back on day-one of the Project, KCP&L would still have incurred these costs but the Control Budget Estimate would have been higher."<sup>251</sup>

latan 1

201. Mr. Drabinski has proposed a \$13,938,795 disallowance for latan 1 (or \$5,220,079 KCP&L Missouri Jurisdictional share and \$2,508,983 GMO share) based upon an analysis he performed for the Kansas Commission almost two years ago.

202. The Commission finds that Mr. Drabinski has failed to provide the Commission with substantive and competent evidence to support those disallowances. MRA's recommended disallowance is based upon Mr. Drabinski's identification of five separate R&O (Risk/Opportunity) packages related to the latan Unit 1 AQCS and

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<sup>250</sup> Tr. p. 1707.

<sup>251</sup> Ex. KCP&L 44, p. 27.

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Common plant projects that he believes reflect KCP&L's management's imprudence.<sup>252</sup>

203. KCP&L's witnesses provided substantial evidence regarding the prudence of these expenditures.<sup>253</sup>

Iatan Disallowances

WSI

204. KCP&L's Prudence consultant, Dr. Kris Nielsen of Pegasus-Global, whom the Commission finds credible, asserts that expenditures paid to ALSTOM in connection with work performed by WSI in an effort to overcome ALSTOM's failure to adhere to schedule were imprudent. KCP&L's consultant further determined that costs incurred by KCP&L in connection with the ALSTOM/WSI work, were imprudent.<sup>254</sup>

205. Dr. Nielsen recommended a \$12.7 million disallowance in connection with the ALSTOM/WSI work and concomitant KCP&L costs. Staff concurs in Dr. Nielsen's quantification of these imprudent costs, and recommends their disallowance from rate base.<sup>255</sup>

206. ALSTOM was responsible for costs due to delays unless the delays were the result of actions by KCP&L or a third party responsible to KCP&L.<sup>256</sup>

207. Staff reviewed relevant WSI change orders and found no evidence that the ALSTOM-related delays were the responsibility of KCP&L or any party responsible to KCP&L.<sup>257</sup>

208. KCP&L's prudent course would have been to hold ALSTOM responsible financially for the costs associated with recovering the ALSTOM work schedule, including work performed by WSI. KCP&L's ratepayers should not bear financial responsibility for these charges that should have been appropriately borne by ALSTOM.

Temporary Boiler

209. Removal and readdition of auxiliary boiler was imprudent, and costs of \$5,346,049 should be disallowed.<sup>258</sup>

210. In highly confidential testimony, Nielsen credibly

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<sup>252</sup> See Ex. KCP&L 2601, Sch. WPD-8.

<sup>253</sup> See fn. 54-56, 60-61, 65-66, 90-91, 94, 96, 99, 106, 108, 112-114, 146-170, 188-196, 205-06, 214-17, *supra*.

<sup>254</sup> See Ex. KCP&L 210, pp. 100-101.

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.*

<sup>258</sup> Ex. KCP&L 46 (NP), p. 17; Tr. p. 2089.

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explained why those costs should be disallowed.<sup>259</sup>

Campus Relocation

211. The original campus design and location was developed in the summer and fall of 2006. Facility construction began in the summer of 2006. The initial trailers on site were for KCP&L, and the major latan construction contractors, Kissick, Pullman and ALSTOM, each of whom mobilized to the site in late-summer and fall of 2006.<sup>260</sup>

212. In the summer of 2007, the balance-of-plant contractor, Kiewit, developed a revised plan for laydown space needed for access to the turbine generator building. This plan included providing a new path for unloading the turbine generator into the turbine bay.<sup>261</sup>

213. Kiewit's plan necessitated moving the existing campus trailers to provide the area for laydown space. Additionally, Kiewit's new plan of where it wanted to locate erection cranes caused concerns because Kiewit would be lifting loads near or over the campus. Each of the trailers was moved approximately 100 feet east in the spring and summer of 2008.<sup>262</sup>

214. Total cost incurred for the campus relocation through June 2010 is \$1,563,727. Of this amount, KCP&L charged \$456,608 to latan 1 and \$1,107,119 to latan 2.<sup>263</sup>

215. The only justifiable reasons why KCP&L would agree to incur over \$1.6 million in costs to relocate construction trailers at the latan site is

- 1) KCPL realized the original design and location of the latan campus was faulty and did not provide sufficient room and laydown space for the transporting the turbine generator into the latan 2 turbine bay. In this case KCPL would incur the cost and seek backcharges from the contractor who was responsible for the campus design and trailer locations. The backcharged costs would be credited against the project when collected.
- 2) The cost savings or other benefits to the latan construction project resulting from the relocation would exceed the cost of the relocation charged to the project.

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<sup>259</sup> Ex. KCP&L 46 (HC), pp. 235ff.

<sup>260</sup> Ex. KCP&L 205, p. 43.

<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

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In other words, the design and location of the campus was sufficient for the successful completion of the project but a change in the trailer locations would result in project savings and/or other benefits that exceed the cost of the relocation.<sup>264</sup>

216. Staff requested a meeting with KCP&L on this issue, and the meeting was held on December 7, 2009. In attendance at this meeting was Mr. Eric Gould, a Schiff Project Controls Analyst. Mr. Gould advised that the relocation resulted in cost savings. He advised Staff that he was going to look for documentation of cost savings on the Balance of Plant contract as a result of the \$1.6 million campus relocation. Subsequent to this meeting Staff has been advised that Mr. Gould was unable to locate any documentation supporting a cost savings associated with the campus relocation.<sup>265</sup>

217. The allocation of any costs of the campus relocation to the latan Project is inappropriate. The reason for the cost appears to be a significant design error. The most appropriate method for KCP&L to recover these costs is to seek backcharges for the cost of this work from the entity who was responsible for the design of the construction campus laydown area.<sup>266</sup>

218. According to information from KCP&L, a design error occurred.<sup>267</sup>

219. If the campus were designed correctly, there would have been enough space between the campus and where the boiler had to go.<sup>268</sup>

220. Moving the campus essentially doubled the cost of constructing the campus.<sup>269</sup>

221. Because KCP&L's original design and location of the latan campus was faulty, KCP&L incurred expenses in moving construction trailers at the latan site approximately 100 feet east when construction began on the turbine generator building.<sup>270</sup>

222. Correction of KCP&L's failure to engage in adequate

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<sup>264</sup> *Id.* at 43-44.

<sup>265</sup> *Id.*

<sup>266</sup> *Id.*

<sup>267</sup> Tr. p. 2659.

<sup>268</sup> *Id.* at 2817.

<sup>269</sup> *Id.* at 2817-18.

<sup>270</sup> Ex. KCP&L 210, p. 43.



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planning prior to initially siting the trailers – or KCP&L’s failure to adequately design the initial siting of the trailers – is not of benefit to Missouri ratepayers. Costs incurred to correct this faulty design should not be borne by Missouri ratepayers.<sup>271</sup>

Construction Resurfacing Project Adjustment

223. KCP&L paid money to ALSTOM in connection with claims related to delays to ALSTOM’s work and acceleration of other ALSTOM work related to the Iatan site being resurfaced.<sup>272</sup>

224. KCP&L also paid to have the site resurfaced.<sup>273</sup> The Commission found no credible evidence that the site needed resurfacing.

Conclusions of Law – Iatan

17. The prudence standard is articulated in the *Associated Natural Gas Case* as follows:

[A] utility’s costs are presumed to be prudently incurred.... However, the presumption does not survive “a showing of inefficiency or improvidence.”

. . . [W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).

In the [Union Electric] case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:

[T]he company’s conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.<sup>274</sup>

18. As stated above, under the prudence standard, the Commission presumes that the utility’s costs were prudently incurred.<sup>275</sup>

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<sup>271</sup> Ex. KCP&L 89 (HC).

<sup>272</sup> Ex. KCP&L 205, p. 47.

<sup>273</sup> *Id.*

<sup>274</sup> See *State ex. Re. Associated Natural Gas v. Public Serv. Comm’n*, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997).

<sup>275</sup> See *State ex. Re. Associated Natural Gas v. Public Serv. Comm’n*, 954 S.W.2d 520

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This means that utilities seeking a rate increase are not required to demonstrate their cases-in-chief that all expenditures were prudent.<sup>276</sup>

19. Staff or any other party can challenge the presumption of prudence by creating “a serious doubt” as to the prudence of an expenditure. Once a serious doubt has been raised, then the burden shifts to KCP&L to dispel those doubts and prove that the questioned expenditure was prudent.

20. In a prior case involving a prudence review and construction audit, the Commission stated:<sup>277</sup>

The Federal Power Act imposes on the Company the “burden of proof to show that the increased rate or charge is just and reasonable.” Edison relies on Supreme Court precedent for the proposition that a utility’s cost are [sic] presumed to be prudently incurred. However, the presumption does not survive “a showing of inefficiency or improvidence.” As the Commission has explained, “utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.”

21. Thus, in the first instance, it is the parties challenging the decisions and expenditures of a utility that have the initial burden defeating the presumption of prudence accorded the utility.<sup>278</sup>

Under the prudence standard, the Commission looks at whether the utility’s conduct was reasonable at the time, under all of the circumstances. In applying this standard, the Commission presumes that the utility’s

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(Mo. App. W.D. 1997); *State ex rel. GS Technologies Operating Co. Inc. v. Public Serv. Comm’n*, 116 S.W.3d 680 (Mo. App. W.D. 2003 (citations omitted)).

<sup>276</sup> See *Union Electric*, 66 P.U.R.4th at 212.

<sup>277</sup> *In the Matter of Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (quoting *Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission*, 669 F.2d 779 (D.C. Cir. 1981)) (citations omitted).

<sup>278</sup> *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528-529 (Mo. App., W.D. 1997).

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costs were prudently incurred.<sup>279</sup>

22. Once the presumption of prudence is dispelled, the utility has the burden of showing that the challenged items were indeed prudent.<sup>280</sup>

23. The Commission has adopted a standard of reasonable care requiring due diligence for evaluating the prudence of a utility's conduct.<sup>281</sup> The Commission has described this standard as follows:<sup>282</sup>

5. The Commission will assess management decisions at the time they are made and ask the question, "Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?"

24. In the *Associated Natural Gas* case, the Missouri Court of Appeals held that the Staff must provide evidence that the utility's actions caused higher costs than if prudent decisions had been made.<sup>283</sup> Substantive and competent evidence regarding higher costs includes evidence about the particular controversial expenditures and evidence as to the "amount that the expenditures would have been if the [utility] had acted in a prudent manner."<sup>284</sup>

25. In other words, Staff or the other parties must satisfy the following two-pronged evidentiary test to support a disallowance: 1) identify the imprudent action based upon industry standards and the circumstances at the time the decision or action was made; and 2) provide proof of the increased costs caused by KCP&L's imprudent decisions. To meet this standard, a party must provide substantive, competent evidence establishing a causal connection or "nexus" between the alleged imprudent action and the costs incurred.

**Decision – latan**

The costs for construction resurfacing, campus relocation for the latan 2 Turbine Building, the WSI change order, and the temporary auxiliary boiler shall be excluded from rate base. All other rate base

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<sup>279</sup> *State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission*, 116 S.W.3d 680 (Mo. App., W.D. 2003).

<sup>280</sup> *Associated Natural Gas, supra*, 954 S.W.2d at 528-529.

<sup>281</sup> *Union Electric*, 27 Mo.P.S.C. (N.S.) at 194.

<sup>282</sup> *Id.*

<sup>283</sup> *See Associated Natural Gas*, 945 S.W.2d at 529.

<sup>284</sup> *See id.*

additions shall be included in rate base.

**B. Hawthorn**

***Should Hawthorn SCR settlement payments be included in either the depreciation reserve or plant cost?***

***Should Hawthorn settlement payments be included in either the depreciation reserve or plant cost?***

**Findings of Fact – Hawthorn**

225. In 2005, KCP&L had a transformer outage at the Hawthorn 5 coal unit.<sup>285</sup>

226. KCP&L sought reimbursement from Siemens, the vendor who built the transformer, to recover the damages associated with the outage, almost entirely consisting of replacement power costs during the outage. KCP&L's claim resulted in a settlement with Siemens in the amount of \$6.7 million, which was received in 2008.<sup>286</sup>

227. Staff proposed an adjustment to reflect the \$6.7 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received."<sup>287</sup>

228. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCP&L of the operation of Hawthorne [sic] 5 resulting from the step-up transformer failure were paid by KCP&L customers in utility rates."<sup>288</sup>

229. KCP&L normalized fuel and purchased power expense in the years related to the Hawthorn 5 SCR and transformer outages.<sup>289</sup>

230. Further, KCP&L did not have a fuel adjustment clause which would have permitted the pass through of those increased fuel and related costs. Therefore, customers did not pay any additional expenses associated with the outages.<sup>290</sup>

231. In 2007, KCP&L had an outage to replace the catalyst in the selective catalytic reduction system (SCR) at the Hawthorn 5 coal unit. The outage period was from February 24 - March 9, 2007. KCP&L sought reimbursement from Babcock and Wilcox, the vendor who built the SCR, to recover the damages associated with the outage, the

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<sup>285</sup> Ex. KCP&L 8, p. 51.

<sup>286</sup> *Id.* at 51, 52.

<sup>287</sup> *Id.* at p. 51.

<sup>288</sup> Ex. KCP&L 210, p. 111.

<sup>289</sup> Ex. KCP&L 8, p. 52.

<sup>290</sup> *Id.* at 49-52.

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majority of which were replacement power costs during the outage. KCP&L's claim resulted in a settlement with Babcock and Wilcox in the amount of \$2.8 million, which was received in 2007.<sup>291</sup>

232. Staff proposed an adjustment to reflect the \$2.8 million settlement proceeds "as an increase to the depreciation reserve and a decrease in depreciation expense, as if the plant cost had been adjusted for the total settlement proceeds received."<sup>292</sup>

233. Staff's adjustment is based on its belief that "[a]ll the increased costs to KCP&L were and are currently being paid by KCP&L customers in utility rates."<sup>293</sup>

234. However, the proceeds of this litigation are non-recurring revenue and are also outside the test year in this case.<sup>294</sup>

235. Unusual, non-recurring events (expenses or revenues) are excluded from the test year because they do not reflect the ongoing cost of service of the company.<sup>295</sup>

236. Further, the cost of replacement power and additional ammonia expense that resulted from the catalyst outage was never paid by customers. Customers did not pay for replacement power or additional ammonia expense because KCP&L did not have a fuel adjustment clause at the time of the outage and also KCP&L normalizes fuel and purchased power expenses in its rate cases so test year anomalies are disregarded.<sup>296</sup>

237. KCP&L's customers have not paid for any increased costs because KCP&L didn't have a fuel adjustment clause at the time of the outages.<sup>297</sup>

238. Additionally, there were no incremental costs to the company and, in turn, to its customers related to work assigned to KCP&L personnel as a result of the outage.<sup>298</sup>

**Conclusions of Law – Hawthorn**

There are no additional conclusions of law for this section.

**Decision – Hawthorn**

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<sup>291</sup> Ex. KCP&L 8, p. 49

<sup>292</sup> Ex. KCP&L 8, p. 48.

<sup>293</sup> See Ex. KCP&L 210, p. 109.

<sup>294</sup> Ex. KCP&L 8, p. 50.

<sup>295</sup> *Id.*

<sup>296</sup> *Id.* at 49-50.

<sup>297</sup> *Id.* at 49-52.

<sup>298</sup> *Id.*

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The Commission finds that the Hawthorn costs discussed above shall be included in rate base.

**C. Demand-Side Management**

***a. Should DSM investments be included in rate base in this proceeding?***

***b. How should DSM amortization expense be determined in this case?***

***i. Should DSM programs be expanded if the current DSM portfolio does not meet the Missouri Energy Efficiency Investment Act's (MEEIA) goal of achieving all cost-effective demand-side savings?***

***ii. Should the amortization period for the energy efficiency regulatory asset account be shortened from 10 years to 6 years?***

***iii. Should the shortening of the amortization period be contingent on the continuation and/or expansion of the DSM portfolio?***

***c. Should the Company be required to fund DSM programs at the current level?***

***d. Should KCP&L be required to make a compliance filing with the Commission regarding MEEIA legislation as proposed by Staff?***

***Findings of Fact – Demand-Side Management***

239. In KCP&L's last Chapter 22 Electric Utility Resource Planning filing,<sup>299</sup> KCP&L's adopted preferred integrated resource plan (IRP) included five residential DSM programs and four commercial and industrial programs.<sup>300</sup>

240. These programs are in addition to KCP&L's Energy Optimizer and MPower programs that it implemented as part of its Experimental Regulatory Plan (ERP or "Regulatory Plan").<sup>301</sup>

241. As part of GMO's Chapter 22 compliance filing,<sup>302</sup> GMO's adopted preferred IRP included DSM programs.<sup>303</sup>

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<sup>299</sup> File No. EE-2008-0034.

<sup>300</sup> Kansas City Power & Light Integrated Resource Plan, File No. EE-2008-0034, Book 1 of 2, Volume 5: Demand-Side Resource Analysis, pp. 54 through 69.

<sup>301</sup> See File No. EO-2005-0329; Ex. KCP&L 239, p. 6.

<sup>302</sup> File No. EE-2009-0237.

<sup>303</sup> Ex. GMO 240, p. 14.

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242. Demand Side Management (DSM) programs introduced in the early years of KCP&L's five-year regulatory plan are nearing their expiration dates.<sup>304</sup>

243. The timing of the conclusion of the regulatory plan and the anticipated implementation of the rules resulting from the Missouri Energy Efficiency Investment Act (MEEIA)<sup>305</sup> create a period of time in which KCP&L and GMO will not have guidance from the Commission with regard to appropriate DSM investment or energy savings targets.<sup>306</sup>

244. This gap could be relatively lengthy, possibly years.<sup>307</sup> The Company acknowledged the uncertainty of this gap.<sup>308</sup>

245. Many of the current DSM programs "have met or are exceeding their five-year savings goals" and in some cases "have met or exceeded their performance and participation goals."<sup>309</sup> KCP&L has "met and exceeded the expectations established in the Regulatory Plan. . . . [T]hrough June 30, 2010 the budget for all Company demand-side programs is \$24,001,009 and the actual total expenditures through this period are \$27,442,517 . . . ." <sup>310</sup>

246. DSM programs need time to raise customer awareness through promotional campaigns and develop partnerships with trade allies. If programs are curtailed, there would be a loss of experience developed by KCP&L and GMO over the past five years.<sup>311</sup>

247. "[A]ll of the evidence suggests that customer interest in these programs has increased since 2005, and there is no evidence to suggest that customers will become less interested in realizing the benefits that these programs offer."<sup>312</sup> For instance, participation in KCP&L's Home Performance with Energy Star program increased from 27 homes in the second quarter of 2009 to 718 homes at the end of the third quarter of 2010.

248. The Companies are currently continuing their DSM

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<sup>304</sup> Ex. KCP&L 603, Sch. AB2010-1R.

<sup>305</sup> Section 393.1075, RSMo.

<sup>306</sup> Ex. KCP&L 601 at p. 2.

<sup>307</sup> Ex. KCP&L 601, p. 4; Ex. GMO 601, p. 4.

<sup>308</sup> Tr. 3542; Tr. 3539-3540.

<sup>309</sup> Ex. KCP&L 603, p. 5 and as shown on Mr. Bickford's highly confidential rebuttal schedule AB2010-2R, Ex. KCP&L 604 HC.

<sup>310</sup> Ex. KCP&L 210, p. 127. See also, Ex. KCP&L 56, p. 4.

<sup>311</sup> Ex. KCP&L 603, p. 6-7.

<sup>312</sup> Ex. KCP&L 603, p. 6.

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programs contained in their tariffs.<sup>313</sup>

249. During its Customer Programs Advisory Group (CPAG) meetings throughout 2010, KCP&L stated to Staff that it had stopped processing new customer applications for its voluntary large customer MPower demand response program.<sup>314</sup> During the similar DSM Advisory Group meetings held for GMO in 2010, GMO also made statements regarding the curtailing of current DSM programs and delaying implementation of planned DSM programs.<sup>315</sup> In those statements and at the hearing, both KCP&L and GMO expressed a position to slow spending for the programs.<sup>316</sup>

250. Both companies, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration. The companies acknowledged this fact.<sup>317</sup> And in the case of KCP&L, increasing DSM funding is preferred to curtailing program spending when evaluating the need for additional supply-side resources over the next 25 years.<sup>318</sup>

251. Under the existing cost recovery mechanism, KCP&L first funds the DSM programs and the costs are placed into a regulatory asset account for consideration of recovery in the next rate case. Assuming the DSM costs are determined to be recoverable, those costs are then amortized over a ten-year period without the inclusion in rate base.

252. KCP&L is willing to continue the Customer Program Advisory Group (CPAG) through the bridge periods and to extend CPAG or a similar collaborative to GMO through the same period.<sup>319</sup>

253. Staff recommends the Commission accept its ratemaking calculations for DSM deferrals and AFUDC returns in Staff Adjustments E-144.4 through E-144.7, and E-144.8 through E-144.11.<sup>320</sup> Staff's recommendations included annual amortizations (10-year deferral period) for the following DSM vintage deferrals:<sup>321</sup>

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<sup>313</sup> Ex. KCP&L 210, p. 126-30; Ex. KCP&L 239 at p. 2.

<sup>314</sup> Ex. KCP&L 239, p. 6.

<sup>315</sup> Ex. GMO-240, p. 12.

<sup>316</sup> Tr. 3539-3540; Tr. 3571.

<sup>317</sup> Ex. KCP&L 239, p. 6-7, Ex. GMO-240, p. 15.

<sup>318</sup> Ex. KCP&L 239, p. 7.

<sup>319</sup> Tr. 3543.

<sup>320</sup> Ex. KCP&L 225, As updated in true up.

<sup>321</sup> Ex. KCP&L 225, As updated in true up.



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<u>DSM deferral</u>	<u>Case</u>	<u>Amount</u>
Vintage 1	ER-2006-0314	\$239,666
Vintage 2	ER-2007-0291	\$448,624
Vintage 3	ER-2009-0089	\$193,663
Vintage 4	ER-2010-0355	<u>\$1,810,223</u>

254. Staff calculated the total unamortized balance of DSM Vintages 1 through 4 as \$24,368,761 as of December 31, 2010.<sup>322</sup> The AFUDC rate Staff applied to this unamortized DSM balance was 3.46%, and is KCP&L's December 2010 AFUDC rate.<sup>323</sup> Under Staff's calculations, the AFUDC return amount totals \$843,159, for a total increase in revenue requirement from DSM deferrals of approximately \$3.5 million.<sup>324</sup>

255. Staff recommends that the existing levels of DSM investments should be mandated by the Commission to continue and the existing cost recovery mechanism should be maintained.<sup>325</sup>

256. In its adjustments Staff nets unrelated issues with DSM program costs.<sup>326</sup> Staff includes negative costs against the unamortized balance of DSM program costs for purposes of computing an annual amortization and return. These negative costs are those that the Commission has previously ordered to be returned to ratepayers over ten years and include excess margins on off-system sales (OSS) and net reparations from the litigation of Montrose coal freight rates before the Surface Transportation Board (STB), but are unrelated to DSM Program costs.

257. The Commission ordered in prior cases that the carrying costs for the excess margins on OSS would be established at LIBOR plus 32 basis points and that this interest would be included in the unamortized balance of excess OSS margins for amortization over ten (10) years. The Commission also prohibited rate base recognition for the unamortized balance of net reparations from the litigation of Montrose coal freight rates before the STB and did not otherwise order carrying costs.

258. Staff could set up and keep track of these separate cost

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<sup>322</sup> Ex. KCP&L 225, As updated in true up

<sup>323</sup> Ex. KCP&L 225, As updated in true up

<sup>324</sup> Ex. KCP&L 225, As updated in true up

<sup>325</sup> Ex. KCP&L 210, at p. 126-30; Ex. KCP&L 239 at p. 2.

<sup>326</sup> Ex. KCP&L 210, at p. 131-37; Ex. KCP&L 226 at p. 63.

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items, but believed this would be cumbersome and inefficient.<sup>327</sup>

259. Staff also recommends continuing the ten-year amortization for DSM expenses incurred after the end of the regulatory plan.

260. To apply a ten-year amortization to DSM expenses incurred after the end of the regulatory plan for KCP&L and after the test year in GMO's rate case would be a disincentive to KCP&L and GMO to invest in demand side programs.<sup>328</sup>

261. A temporary adjustment from 10 years to 6 years amortization for new and ongoing DSM expenses incurred during the "gap period" until MEEIA rules are fully implemented would reduce the disincentive.<sup>329</sup>

262. An adjustment from 10 years to 6 years amortization for new and ongoing DSM expenditures would also make the Companies' cost recovery opportunities more consistent with Ameren Missouri's DSM program cost recovery agreed to by the parties and approved by the Commission in File No. ER-2010-0036.<sup>330</sup>

263. Netting the DSM regulatory asset account amortization with three unrelated accounts is complex and confusing and causes an inaccurate result.<sup>331</sup>

264. Staff's netting calculation may put DSM cost recovery at risk or it may cause the perception of putting DSM cost recovery at risk. Either of those effects could be a disincentive to future DSM spending by utilities.<sup>332</sup>

265. KCP&L recommends that DSM expenses referred to as "Vintage 4," be amortized for six years rather than for ten years.<sup>333</sup>

266. Neither KCP&L nor GMO has recommended in any substantial detail in these rate proceedings what they consider to be an appropriate cost recovery mechanism.<sup>334</sup> In fact, in their direct filings both KCP&L and GMO only requested the continuation of their current cost

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<sup>327</sup> Ex. KCP&L 226, p. 63.

<sup>328</sup> Ex. KCP&L 55, p. 5-6; Ex. KCP&L 605, pp. 4-5.

<sup>329</sup> Ex. KCP&L 55, pp. 5-6; Ex. KCP&L 605, p. 4-5.

<sup>330</sup> Ex. GMO 601, p. 10.

<sup>331</sup> Ex. KCP&L 64 at p. 6-18.

<sup>332</sup> Ex. KCP&L 55, pp. 5-6; Ex. KCP&L 605, p. 4-5.

<sup>333</sup> Ex. KCP&L 55 at pp. 5-6; Initial Brief at pp. 192-193.

<sup>334</sup> Ex. KCP&L 239, p. 5, Ex. GMO 240, pp. 13-14, Ex. GMO 241, p. 3. Ex. KCP&L 240, p. 3.

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recovery mechanisms.<sup>335</sup> In their brief, however, they state that for the purposes of this case, KCP&L has proposed that the cost recovery mechanism should be consistent with the recent *Order Approving First Stipulation and Agreement* in the AmerenUE rate case, File No. ER-2010-0036 (March 24, 2010).<sup>336</sup> This would change KCP&L's amortization period for the DSM regulatory assets from ten years to six years, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010.<sup>337</sup> The six year amortization period would be applied to DSM program expenditures referred to by Staff as being incurred in "Vintage 4," that is, those subsequent to September 30, 2008. Prior expenditures would continue to be amortized over the originally authorized ten-year period. Additionally, KCP&L would defer the costs of the DSM programs in Account 182 and, beginning with the December 31, 2010 True Up date in this case, calculate AFUDC monthly using the monthly value of the annual AFUDC rate.<sup>338</sup>

267. Mr. Rush acknowledged that KCP&L and GMO may propose a different method of recovery regardless of whether specific Commission rules are in place or not.<sup>339</sup> He also acknowledged the companies' obligation to comply with MEEIA regardless of whether rules are in place.<sup>340</sup>

268. MDNR's position is that the Commission should direct KCP&L and GMO to follow the intent of the MEEIA goal of achieving all cost-effective demand-side savings, and should further require KCP&L and GMO to expand their DSM programs toward the MEEIA goal of achieving all cost-effective demand-side savings during the "gap" period between the end of these current rate cases and the establishment of the MEEIA rules. The Commission needs to provide guidance with regard to appropriate DSM investment or energy savings targets, continuation and expansion of existing programs.<sup>341</sup>

269. It is unnecessary for the Commission to require KCP&L and GMO to make a filing with the Commission regarding

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<sup>335</sup> Ex. KCP&L 239, p. 5, Ex. GMO 240, pp. 13-14.

<sup>336</sup> Tr. pp. 3531-32.

<sup>337</sup> Tr. pp. 3501-03.

<sup>338</sup> Ex. KCP&L 55 at pp. 5-6, Rush Rebuttal.

<sup>339</sup> Tr. Vol. 32, p.3547, line 1-4.

<sup>340</sup> Tr. 3546-7.

<sup>341</sup> Ex. KCP&L 210, p. 127; Ex KCP&L. 602, p. 3.

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MEEIA legislation as proposed by the Staff.<sup>342</sup>

### **Conclusions of Law– Demand-Side Management**

26. Utilities within the Commission’s jurisdiction must comply with The Missouri Energy Efficiency Investment Act (MEEIA)<sup>343</sup> regardless of whether or not proposed rules under the law are effective. The language of MEEIA allows KCP&L and GMO to propose a different method of recovery regardless of whether specific Commission rules are in place or not.

27. MEEIA states, “The Commission shall permit electric corporations to implement commission-approved demand-side programs proposed pursuant to this section with a goal of achieving all cost-effective demand-side savings.”<sup>344</sup> However, the timing of the conclusion of these rate cases and the anticipated implementation of the rules resulting from MEEIA creates a period of time in which KCP&L and GMO will not have guidance from the Commission with regard to appropriate DSM investment or energy savings targets.

28. Amortizing DSM expenses referred to as “Vintage 4,” for six years rather than for ten years is inconsistent with the KCP&L regulatory plan. To the extent that costs included in Vintage 4 were incurred as early as September 30, 2008, the regulatory plan would apply to the recovery of Vintage 4 costs.

29. The Commission ordered in prior cases that the carrying costs for the excess margins on OSS would be established at LIBOR plus 32 basis points and that this interest would be included in the unamortized balance of excess OSS margins for amortization over ten (10) years. The Commission also prohibited rate base recognition for the unamortized balance of net reparations from the litigation of Montrose coal freight rates before the STB and did not otherwise order carrying costs. Staff’s netting of DSM costs with unrelated items is inconsistent with the Commission’s previous orders.<sup>345</sup>

### **Decision– Demand-Side Management**

The parties did a poor job of defining the issues for this case, but especially with regard to the DSM issues. The Commission, however,

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<sup>342</sup> Ex. KCP&L 56 (NP), Rush Surrebuttal at p. 3.

<sup>343</sup> Section 393.1075, RSMo.

<sup>344</sup> Section 393.1075.4, RSMo.

<sup>345</sup> Non-Unanimous Stipulation and Agreement, p. 8, File No. ER-2010-0089; In the Matter of the Application of Kansas City Power and Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement Its Regulatory Plan, File No. ER-2007-0291, Report and Order (issued December 6, 2007), p. 39.

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has redefined those issues. The over-arching DSM issue is whether the Commission should order the continuance of a DSM program at all. Because of the gap between the MEEIA rules being implemented and the end of the Regulatory Plan, there is a need for the Commission to set out guidance for KCP&L and GMO with regard to the continuance or implementation of DSM programs and cost recovery for those programs. Despite the success and forward momentum created by the implementation of their existing DSM programs and the fact that the programs are currently continuing, both KCP&L and GMO have expressed a position to slow spending for the programs. This decision comes even though both companies realize that they, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration.

The Companies have argued that the Commission should reject Staff's and MDNR's recommendations to direct the Companies to invest in DSM programs without any assurance that the full costs and lost revenues associated with these programs will be recognized in rates. Instead, the Companies urge the Commission to implement the cost recovery issue expeditiously, including the recovery of lost revenues associated with the specific DSM programs. While the Companies express a need to have an appropriate cost recovery mechanism, they did not recommend a new recovery mechanism in this case except to propose in their briefs that the mechanism be consistent with that recently ordered for Ameren.

The Commission concludes that the continuance of the DSM programs is in the public interest as shown by the customer participation and clear policies of this state to encourage DSM programs. In the absence of a clear proposal for a cost recovery mechanism and during the gap between the end of the true-up for this case and the implementation of a program under MEEIA, the Commission concludes that the Companies should continue to fund and promote or implement, the DSM programs in the 2005 Agreement (KCP&L only), and in its last adopted preferred resource plan (both KCP&L and GMO). In addition, the Commission directs that those costs be placed in a regulatory asset account and be given the treatment as further described below.

Having determined that the programs should continue, the remaining issues are related to the regulatory treatment to be given to cost recovery and the three different types of regulatory assets. First are the "old" investments -- those DSM investments incurred prior to the last rate case true-up period ending September 30, 2008 (Vintages 1-3).

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Second, are the “current” investments referred to as “Vintage 4” -- those DSM investments since September 30, 2008, and through the end of the true-up period for this case, December 31, 2010. Third, are the “future” investments -- those DSM investments from December 31, 2010, through the next rate case or until a program is implemented under the MEEIA rules.<sup>346</sup>

The issues common to these regulatory assets are the length of the amortization period to be given them and how that amortization should be calculated. In other words, should those assets be amortized over a six- or a ten-year period, and should Staff's netting calculation be used to determine the amounts to be amortized. The final issue is should the unamortized balances be added to rate base.

It appears after all the arguments, that there are actually some areas of agreement among and between some of the primary parties. One area of agreement is that the “old” regulatory assets (Vintages 1, 2, and 3) should be governed by the previous decisions to amortize those regulatory asset accounts over a ten-year period and that amortization period should not change. The Commission also agrees and directs that Vintages 1, 2, and 3 continue to be amortized over a ten-year period.

A second area of agreement is that the CPAG should be continued after the end of the regulatory plan and the GMOAG continue for GMO. The Commission also agrees and directs that the advisory groups (or similar groups) shall continue through the “bridge” period until replaced by the implementation of the MEEIA rules or other Commission order.

A third agreement is between KCP&L and GMO and MDNR. Those parties agree that Staff's netting calculation is confusing because it mixes assets unrelated to DSM with DSM assets. In addition, as KCP&L and GMO point out, it causes the calculations to be incorrect because those OSS and STB amounts require different carrying costs calculations as previously ordered by the Commission. Thus, the Commission determines that the DSM account should stand alone and not be netted against unrelated accounts. In addition, the carrying costs should be calculated at the AFUDC rate as set out in the regulatory plan.

The main disagreements among the parties lie with the amortization period for the “current” and “future” investments and whether the unamortized balances should be included in rate base. MDNR supports a temporary adjustment from ten years to six years for

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<sup>346</sup> Or some other unknown legislative or Commission intervention.

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the “future” investments amortization period with a carrying cost equal to the AFUDC rate applied to the unamortized balance until KCP&L and GMO have DSM plans and recovery methods in place under MEEIA rules. This would reduce the disincentive for the companies to have these programs and allow the companies to recover their DSM program costs in a timeframe closer to when they occurred. This also makes the treatment of these future costs similar to those of Ameren Missouri in ER-2010-0036.

KCP&L agrees with MDNR regarding the treatment for “future” investments. The Commission agrees as well and will direct that DSM program costs for investments made from December 31, 2010, until a future recovery mechanism is in place shall be placed in a regulatory asset account and amortized over six years with a carrying cost equal to the AFUDC rate applied to the unamortized balance.

With regard to the “current” investments, it would be inconsistent with previous Commission orders to authorize a six-year amortization for the current investments (Vintage 4). The Commission determines that these Vintage 4 investments should continue to be amortized over a ten-year period.

Finally, the Commission must decide whether to include the unamortized balances in rate base. The Commission has determined that it is important to reduce the disincentives to the Companies to having robust DSM programs. The Companies have clearly indicated that delayed recovery is one of those disincentives. By adding the unamortized balances to rate base the Commission will encourage DSM programs and promote the policy of this state as stated in MEEIA. Thus, the Commission determines that the unamortized balances of the regulatory asset accounts shall be included in rate base for determining rates in this case.

### **D. Fuel Switching Program**

***Should the Commission adopt MGE’s fuel switching proposal?***

### **Findings of Fact– Fuel Switching Program**

270. Missouri Gas Energy, a division of Southern Union Company, has proposed to compel KCP&L and GMO, competitors of MGE, to provide incentives to the Companies’ customers to decrease their electric usage and convert that consumption to its product—natural gas. MGE’s proposal is based on its allegation that natural gas would be

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more energy efficient.<sup>347</sup>

271. Under the proposed program, KCP&L, GMO, and MGE would offer financial incentives with the aim of converting inefficient electric appliances with fuel-efficient natural gas replacements. KCP&L and GMO would offer financial incentives in the form of rebates or bill credits to residential and multi-family customers to encourage fuel switching from electric water heaters and electric resistance space heating to natural gas.<sup>348</sup> The fuel switching program would be available to current MGE customers as well as customers in MGE's service area who currently do not have natural gas service.<sup>349</sup> In turn, MGE would continue to offer financial incentives to customers for the purchase of energy efficient natural gas appliances through its existing energy efficiency programs. The KCP&L and GMO rebates would serve to defray some of the cost of installing interior piping and ventilation ductwork and other installation costs of new appliances.<sup>350</sup>

272. MGE estimates that 800 customers may participate for GMO<sup>351</sup> and 400 customers may participate from the KCP&L service territory.<sup>352</sup> GMO's total annual program spending for this fuel switching program is estimated at \$596,000 and MGE's spending is estimated at \$51,200 for energy efficiency appliance incentives plus the cost to install 800 service lines (approximately \$1,416,000).<sup>353</sup> KCP&L's program spending for this fuel switching program is estimated at \$298,000 and MGE's spending is estimated at \$25,600 for energy efficient appliance incentives plus the cost to install 400 service lines (approximately \$708,000).<sup>354</sup>

273. MGE gives examples of economic savings for customers switching from electric to natural gas. According to MGE's evidence, a consumer switching from electricity to natural gas would save

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<sup>347</sup> Ex. KCP&L 220, Reed Direct Testimony at p. 2.

<sup>348</sup> Ex. GMO 2201 at pp. 21-22 and Ex. KCP&L 2201 at p. 22. As noted in MGE's testimony, if a customer does not have gas service and does not have a natural gas line to their home, MGE's currently effective tariff provisions regarding facilities extensions would be used. Under this tariff, customer contributions may be required if the extension exceeds 60 linear feet. See Ex. KCP&L 2201 and Ex. GMO 2201 at pp. 22-23.

<sup>349</sup> Ex. KCP&L 2201 and Ex. GMO 2201 at pp. 22-23.

<sup>350</sup> See Ex. KCP&L 2201 at pp. 23-24 and Ex. GMO 2201 at p. 23.

<sup>351</sup> See Ex. GMO 2201, p. 27.

<sup>352</sup> See Ex. KCP&L 2201 at p. 27.

<sup>353</sup> See Ex. GMO 2201 at pp. 27-28.

<sup>354</sup> See Ex. KCP&L 2201 at pp. 27-28.



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approximately \$606 (GMO) and \$536 (KCP&L) for space heating and up to \$200 (GMO)<sup>355</sup> and \$172 (KCP&L)<sup>356</sup> per year for water heating.

274. MGE's proposal is built on the full fuel cycle or source energy model.<sup>357</sup>

275. Traditionally, appliance efficiency measurements have been "site based," in that they only consider the energy efficiency at the site where the energy is consumed.<sup>358</sup> In contrast, the full fuel cycle approach measures energy consumption over the entire cycle of energy use from extraction or production to transmission, distribution, and finally at the site where the energy is used, such as an appliance.<sup>359</sup> The full-fuel cycle approach considers all of the energy consumed to power the end use application including greenhouse gas emissions.<sup>360</sup>

276. MGE bases its proposal in part on a report from the National Research Council ("NRC") in response to a request from the Department of Energy ("DOE"), Office of Energy Efficiency and Renewable Energy ("EERE") to review the DOE's appliance standard program.<sup>361</sup>

277. The DOE is considering whether to adopt the Full-Fuel Cycle approach as an alternative method for measuring energy consumption.<sup>362</sup> The context of the DOE's inquiry is whether to use the Full-Fuel Cycle approach<sup>363</sup> in measuring energy consumption for inclusion on the yellow Energy Guide labels found on home appliances, or whether to continue using the site-based approach.<sup>364</sup> A pending recommendation to the DOE is that the full fuel cycle approach be

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<sup>355</sup> Ex. GMO 2201 at p. 12.

<sup>356</sup> Ex. KCP&L 2203 at p. 23. As noted in Mr. Reed's surrebuttal testimony, there was a calculation error in his direct testimony that was corrected in his surrebuttal testimony. Replacement schedules were also filed in his surrebuttal testimony.

<sup>357</sup> Ex. KCP&L 220 at pp. 4-11; Tr. at 3101-02.

<sup>358</sup> Ex. KCP&L/GMO 2201 at p. 5, quoting "A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances," American Gas Association Energy Analysis, EA 2009-3, Oct. 20, 2009.

<sup>359</sup> See Ex. KCP&L/GMO. 2201 at pp. 5-6; Tr. at 3104.

<sup>360</sup> *Id.* at p. 6.

<sup>361</sup> Ex. KCP&L 2201, Reed Direct at 5; Hearing Tr. at 3101-02.

<sup>362</sup> Ex. KCP&L 2201, Reed Direct at p. 5.

<sup>363</sup> The full fuel cycle approach is a method of measuring energy consumption not just at the point of use in the home but also the upstream consumption, including production, generation and transmission and delivery of the appliance. Reed Direct at 5-6; Tr. at 3104.

<sup>364</sup> Ex. KCP&L 2209.

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adopted nationally to provide more comprehensive information to consumers through labels and other means.<sup>365</sup>

278. In appointing a committee to conduct the review of appliance standards, the NRC stated the “committee will not address whether energy conservation standards are appropriate government policy or what levels may or may not be appropriate.”<sup>366</sup> Rather, the committee’s task was “to evaluate or critique the methodology used for setting energy conservation standards” on appliance and commercial equipment.<sup>367</sup> Further, the committee was not unanimous in its recommendation.<sup>368</sup>

279. All traditional, customer-centric measurement of appliance efficiency show electric appliances are consistently more efficient than a similar gas alternative.<sup>369</sup> The Full-Fuel-Cycle model, however, loads the cost of operation for electrical appliances with the cost of upstream losses. Only then do the gas appliances surpass electric appliances.

280. Committee Member Ellen Berman indicated that switching from a site-based approach to appliance standards to the Full-Fuel Cycle approach is complex and will not benefit consumers, in part because consumers have no control over the upstream costs included in the Full-Fuel Cycle methodology.<sup>370</sup>

281. A primary tenet of the Full-Fuel Cycle is environmental impact.

282. MGE’s testimony is silent with respect to the release of methane, a potent greenhouse gas, caused by the extraction of natural gas.<sup>371</sup> In addition, hydraulic fracturing of shale formations, the primary method currently used to procure new sources of natural gas, has been linked to environmental and health concerns, but has not been thoroughly examined in the course of this proceeding.<sup>372</sup>

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<sup>365</sup> See Ex. KCP&L 2201 and Ex. GMO 2201 p. 6-7, citing “Review of Site (Point of Use) and Full-Fuel Cycle Measurement Approaches to DOE/EERE Building Appliance Energy Efficiency Standards,” National Research Council, May 15, 2009, p. 10.

<sup>366</sup> Ex. KCP&L 2209, Review of Site & Full-Cycle Measurement at p. 16.

<sup>367</sup> Ex. KCP&L 2209, Review of Site & Full-Cycle Measurement at p. 16.

<sup>368</sup> See Ex. KCP&L 2209, Review of Site & Full-Cycle Measurement, Minority Opinion of Committee Member David H. Archer.

<sup>369</sup> Ex. KCP&L 220, at p. 10, Table 1.

<sup>370</sup> Ex. KCP&L 2209, Review of Site & Full-Cycle Measurement at 39-40.

<sup>371</sup> Tr. at 3130.

<sup>372</sup> Ex. KCP&L 26 at 10-12; Tr. at 3152.

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283. Fuel switching programs have been adopted by other state's public utility commissions for both combination electric and natural gas utilities as well as stand-alone electric companies across the country.<sup>373</sup>

284. MGE uses several companies with fuel switching programs as examples to support its position. These "comparable" companies, however, differ from both KCP&L and GMO. For instance, where KCP&L and GMO are electric service providers only, the "comparable" companies include diversified companies (electricity, natural gas, pipelines and energy marketing), or combined companies (provider of both electric and natural gas services).<sup>374</sup> Additionally, both KCP&L and GMO are strong summer peaking utilities, while at least two of MGE's "comparable" companies are winter peaking utilities.<sup>375</sup>

285. Evidence was presented regarding the carbon dioxide emissions of natural gas residences verses an all-electric home and those emissions for natural gas appliances.<sup>376</sup> However, there was not sufficient evidence for the Commission to make a determination about the environmental effects of natural gas verses electric appliances for KCP&L and GMO customers.

286. MGE cites to Energy Star Performance Rating Methodology for Incorporating Source Energy Use (December 2007).<sup>377</sup> This report, among other things, calculates the source-site ratio for various types of energy. Table 1 on page 3 of the report shows that fuel oil (diesel, kerosene), propane and even wood have similar values to natural gas.

287. The Energy Star Performance Methodology for Incorporating Source Energy Use also discusses the "potential for inefficiency in the conversion of primary fuels" and the "potential for loss

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<sup>373</sup> Fuel switching programs have been approved in Washington, Oregon, Texas, Idaho, and Pennsylvania, among other states. See Ex. KCP&L/GMO 2201 at p. 20; Ex. KCP&L/GMO 2206.

<sup>374</sup> Ex. KCP&L 239, Rebuttal Testimony of John A. Rogers, pp. 10-11; Ex. GMO 240, Rebuttal Testimony of John A. Rogers, pp. 19-21.

<sup>375</sup> Ex. KCP&L 239, Rebuttal Testimony of John A. Rogers, pp. 10-11; Ex. GMO 240, Rebuttal Testimony of John A. Rogers, pp. 19-21.

<sup>376</sup> See KCP&L Ex. 2201 and Ex. GMO 2201 at p. 12, *citing* "A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances," American Gas Association, Energy Analysis, EA 2009-3, October 20, 2009, p. 4, *citing to* p. 11 the AGA report cited in FN 22. CO2 emissions were 6.4 metric tons for natural gas appliances and 10.1 metric tons for electric appliances.

<sup>377</sup> Ex. KCP&L 2201, Reed Direct at p. 8, fn. 6.

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when either primary or secondary fuels are transmitted/distributed to individual sites.<sup>378</sup>

288. MGE included its own tables which show comparisons of electric and natural gas consumption under the Full-Fuel Cycle, whereby natural gas appears to be the more attractive fuel choice.<sup>379</sup> The data used by MGE, however, is not specific to KCP&L, and MGE has not demonstrated that the general data it received from the American Gas Association (“AGA”) is applicable to KCP&L.<sup>380</sup> The footnotes which accompany MGE’s tables state that the data is from a document entitled “A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances” prepared by the AGA.<sup>381</sup> This document indicates that the AGA’s information was developed, in turn, by the Gas Technology Institute for Codes & Standards Research Consortium in a paper entitled “Source Energy and Emission Factors for Building Energy Consumption” (August 2009).<sup>382</sup> The original source of the information relied upon by MGE includes the following statement:

Average energy and emissions calculations may be appropriate for inventory purposes, but they do not necessarily provide good information when evaluating competing energy efficiency measures.<sup>383</sup>

289. In Table 3 MGE demonstrates the estimated annual cost savings when using water heating and space heating gas and electric appliances.<sup>384</sup> MGE’s calculations, however, contain errors. Specifically, the prices used by MGE are not measured in the same units as the consumption. “[T]he consumption is measured in MMBtu, but the price is stated in terms of Dollars per hundred kWh.”<sup>385</sup> Correcting for errors shows customers who switch from electricity to natural gas for their water heating needs alone will experience no savings. Rather, their annual bill will increase by over \$200 per year.<sup>386</sup>

290. MGE did not provide the results of any Total Resource

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<sup>378</sup> Ex. KCP&L 2201, Reed Direct at p. 2.

<sup>379</sup> Ex. KCP&L 2201, Reed Direct at pp. 10-11.

<sup>380</sup> See Ex. KCP&L 26, Goble Rebuttal at p. 20.

<sup>381</sup> See Ex. KCP&L 26, Goble Rebuttal at p. 20.

<sup>382</sup> See Ex. KCP&L 26, Goble Rebuttal at p. 20.

<sup>383</sup> See Ex. KCP&L 26, Goble Rebuttal at p. 20-21.

<sup>384</sup> Ex. KCP&L 2201, Reed Direct at p. 13.

<sup>385</sup> Ex. KCP&L 26, Goble Rebuttal at p. 22.

<sup>386</sup> Ex. KCP&L 26, Goble Rebuttal at p. 24.

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Cost (“TRC”) test for its proposed water heating and space heating fuel substitution program. The Commission has routinely employed the TRC test in its economic analysis of potential energy efficiency measures.<sup>387</sup>

291. For MGE’s proposal to be considered a viable energy efficiency measure, the results of the benefit-cost tests would have to be evaluated. KCP&L’s witness Goble estimated the required data in order to provide a rough analysis. Mr. Goble’s analysis showed that “[t]he costs exceed the benefits in absolute as well as on a present worth basis. . . . [T]he Benefit-Cost ratio is . . . 0.5.”<sup>388</sup> Mr. Goble acknowledged that not all water heater fuel substitution programs are unacceptable. However, even with limited data available for his analysis, Mr. Goble concluded “that it would be imprudent to implement the hastily designed electric to gas water heater substitution program recommended by MGE’s witness . . . on the basis of economics.”<sup>389</sup>

292. Mr. Goble also conducted a Ratepayer Impact Measure (“RIM”) test and a Total Participant test. The results of the RIM test indicated that the costs exceed the benefits in every year as well as on a present worth basis, suggesting that implementation of MGE’s proposed water heater fuel substitution program will result in higher rates for KCP&L’s customers.<sup>390</sup> Similarly, customers’ costs would exceed the benefits in every year as well as on a present worth basis under the Total Participant test. “Even using very favorable assumptions, the Benefit-Cost ratio is only 0.6.”<sup>391</sup>

293. KCP&L also performed an analysis of MGE’s proposed space heating electric to natural gas fuel substitution program. In general, the results of the TRC test for space heating were comparable to the results for water heating.<sup>392</sup> The results of the RIM and Total Participant tests revealed costs slightly in excess of the benefits.<sup>393</sup>

294. Like other DSM programs, a fuel switching program has the potential to assist with reducing or deferring KCP&L’s and GMO’s capital investments in transmission and generation capacity.<sup>394</sup> MGE,

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<sup>387</sup> Ex. KCP&L 2201, Reed Direct at p. 39.

<sup>388</sup> Ex. KCP&L 26, Goble Rebuttal at p. 26.

<sup>389</sup> Ex. KCP&L 26, Goble Rebuttal at p. 26.

<sup>390</sup> Ex. KCP&L 26, Goble Rebuttal at p. 26-27.

<sup>391</sup> Ex. KCP&L 26, Goble Rebuttal at p. 27.

<sup>392</sup> Ex. KCP&L 26, Goble Rebuttal at p. 27.

<sup>393</sup> Ex. KCP&L 26, Goble Rebuttal at p. 27.

<sup>394</sup> *Id.* at p. 30-31, which describes this and other benefits of the proposed program to

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however, has neither evaluated its proposed fuel switching program through a Chapter 22 integrated resource analysis, nor performed any analysis of the cost effectiveness of the proposed fuel switching program for KCP&L or GMO.

### **Conclusions of Law– Fuel Switching Program**

30. Demand-side programs are required to undergo scrutiny and review within a 4 CSR 240-22 (Chapter 22) Electric Utility Resource Planning integration analysis. Evaluation of demand-side resources in Missouri must be in compliance with the Commission's Chapter 22 Electric Utility Resource Planning rules. Such rules evaluate all supply-side and demand-side resources on an equivalent basis through comprehensive resource analysis, integration analysis, risk analysis and strategy selection. The electric utility uses the Total Resource Cost (TRC) test only in the screening of DSM measures and DSM programs. The electric utility then forwards on the demand-side programs that pass the TRC screening test for consideration as demand-side resources in the utility's Chapter 22 integrated resource analysis.

### **Decision– Fuel Switching Program**

MGE asserts that the Commission should accept the DOE recommendation of the Full-Fuel Cycle to shape the policy of this Commission.<sup>395</sup> KCP&L and GMO contend that the Full-Fuel Cycle model is misleading to the customer and does not reflect any policy guidance. Staff is opposed to the fuel-switching proposal because MGE fails to address two important points: (1) requiring the involuntary adoption of a demand-side program by KCP&L and GMO as proposed by a competitor; and (2) KCP&L and GMO's adoption of demand-side programs that have not been analyzed and reviewed through the Chapter 22 Integrated Resource Planning integration analysis. The Commission is in agreement with Staff.

MGE points to several companies with such fuel switching programs to support its position. These companies, however, differ drastically from both KCP&L and GMO. The Commission finds those differences irreconcilable in that KCP&L and GMO provided electric service only, while MGE's comparables include diversified companies (electricity, natural gas, pipelines and energy marketing) or combined

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KCP&L/GMO.

<sup>395</sup> Ex. KCP&L 220, Reed Direct Testimony at p. 5; Hearing Tr. at 3101-02; MGE's Initial Brief at 3.

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companies (provider of both electric and natural gas services).<sup>396</sup> Additionally, both KCP&L and GMO are strong summer peaking utilities, while at least two of MGE's comparable companies are winter peaking utilities.<sup>397</sup>

These differences are significant. The fuel switching programs for these comparable companies would result in money moving from "one pocket to the other" within the utility. But, MGE's proposed fuel switching program results in money moving from KCP&L's and GMO's pockets to the pocket of MGE, its competitor. MGE has pointed to no market failure or other evidence that persuades the Commission to take such action.

Furthermore, the Commission determines that there is a need for company demand-side programs to undergo scrutiny and review within a Chapter 22 Electric Utility Resource Planning integration analysis. Such rules evaluate all supply-side and demand-side resources on an equivalent basis through comprehensive resource analysis, integration analysis, risk analysis, and strategy selection. MGE has neither evaluated its proposed fuel switching program through a Chapter 22 integrated resource analysis, nor performed any analysis of the cost effectiveness of the proposed fuel switching program specifically related to KCP&L or GMO.

In addition, MGE's data with regard to which appliances are most energy efficient relied on studies and reports that have not been shown to be directly related to KCP&L and GMO's customers, contain calculation errors, or are not reliable for the purposes intended by MGE. The Commission was persuaded by Mr. Goble's analysis for the efficiency, or lack thereof for the proposal. Thus, the Commission gives little weight to the reports and recommendations relied on by MGE in this proceeding.

Finally, as KCP&L points out, the DOE recommendation is not yet final and the environmental issues associated with this fuel switching proposal have not been completely examined in this proceeding. MGE is silent on at least two major environmental concerns with natural gas – the release of methane and hydraulic fracturing. The Commission does not have sufficient evidence in this record regarding the environmental

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<sup>396</sup> Ex. KCP&L 239, Rebuttal Testimony of John. A. Rogers, pp. 10-11; Ex. GMO 240, Rebuttal Testimony of John A. Rogers, pp. 19-21.

<sup>397</sup> Ex. KCP&L 239, Rebuttal Testimony of John. A. Rogers, pp. 10-11; Ex. GMO 240, Rebuttal Testimony of John A. Rogers, pp. 19-21.

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effects to determine in this case that natural gas is less harmful to the environment.

There may be some advantages to fuel switching in the appropriate situations and the Commission, by this order, is not indicating that it will not consider such proposals in the future. The Commission, however, does not find this proposal by KCP&L's and GMO's competitor within those utilities' rate cases to be one of those situations. The Commission concludes it is not in the best interests of Missouri ratepayers to adopt the fuel switching program based on the findings and conclusions above. Therefore, the Commission will not require the fuel switching program as proposed by MGE.

### **II. Rate of Return**

Having determined what should be included in rate base, the Commission will now decide what rate of return should be included in rates to compensate GPE's shareholders and creditors.

#### **A. Return on Equity**

***What return on common equity should be used for determining KCP&L's rate of return?***

#### **Findings of Fact – Return on Equity**

295. A utility's cost of common equity is the return investors require on an investment in that company. Investors expect to achieve their return by receiving dividends and stock price appreciation. Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow (DCF) method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows.<sup>398</sup>

296. The Risk Premium method assumes that all of the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds.<sup>399</sup>

297. The Capital Asset Pricing Method (CAPM) assumes the investor's required rate of return on equity is equal to a risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio.<sup>400</sup>

298. Three financial analysts offered recommendations

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<sup>398</sup> Ex. KCP&L 1203, pp. 13-14.

<sup>399</sup> Ex. KCP&L 27, p. 14.

<sup>400</sup> Ex. KCP&L 1203, p. 32.



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regarding an appropriate return on equity in this case.

KCP&L Witness Hadaway

299. Dr. Hadaway recommends an ROE of 10.75%. His range of ROE recommendations is from 10.2% to 10.8%, with a midpoint of 10.5%. However, he also adds 25 basis points to his ROE recommendation based on what he considers to be KCP&L's excellent customer service, to arrive at 10.75%.<sup>401</sup>

300. He began by constructing a proxy group of 31 companies.<sup>402</sup> Those companies were at least BBB (investment grade), get at least 70% of revenues from regulated utility sales, have consistent financial records unaffected by recent mergers or restructuring, and a consistent dividend record with no cuts the past two years.<sup>403</sup>

301. Dr. Hadaway testified that the techniques for estimating ROE fall into three categories: comparable earnings methods, risk premium methods, and Discounted Cash Flow (DCF) methods.<sup>404</sup> The DCF is the most widely used regulatory ROE method.<sup>405</sup>

302. The DCF concept is based on the theory that stock prices represent the present value or discounted value of all future dividends investors expect.<sup>406</sup> The DCF is simply the sum of the expected dividend yield and the expected long-term dividend (or price) growth rate.<sup>407</sup>

303. Dr. Hadaway applied three DCF versions to his proxy group. First, he applied a constant growth method. Second, he used a non-constant method, using estimated long-term GDP for estimated growth. Third, he employed a two-stage growth method, with stage one based on ValueLine's 3-5 year dividend projections, and stage two based on long-term projected growth in GDP.<sup>408</sup>

304. Dr. Hadaway's DCF results with the traditional constant growth model were a range of 10.5-10.7%. With the GDP growth rate, his constant growth model showed an ROE of 11%. His Multistage DCF yielded a 10.8% result. The overall results of his DCF show a range of

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<sup>401</sup> Ex. KCP&L 28, pp. 2, 22.

<sup>402</sup> Ex. KCP&L 27, p. 6.

<sup>403</sup> *Id.* at 4.

<sup>404</sup> *Id.* at 13.

<sup>405</sup> *Id.* at 15.

<sup>406</sup> *Id.* at 16.

<sup>407</sup> *Id.* at 15.

<sup>408</sup> *Id.* at 39.

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10.5-11%.<sup>409</sup> These results are in line with Dr. Hadaway's risk premium ROE range of 10.61-10.82%.<sup>410</sup>

MEUA, MIEC and DOE Witness Gorman

305. Mr. Gorman suggests that 9.65% is the appropriate ROE.<sup>411</sup> He bases his recommendation on using a constant grown DCF, a sustainable growth DCF, a multi-stage growth DCF, risk premium, and Capital Asset Pricing Model ("CAPM").<sup>412</sup>

306. Mr. Gorman applied those five ROE methods to the same proxy group Dr. Hadaway used.<sup>413</sup> Mr. Gorman posits that because the proxy group's senior secured credit rating from Moody's is "A3", which is identical to KCP&L's senior secured credit rating, the proxy group has a comparable total investment risk to KCP&L.<sup>414</sup>

307. Mr. Gorman stated that the average and median growth rates for constant growth DCF are 5.68 and 5.41%, respectively.<sup>415</sup> Further, the average and median constant growth DCF ROE's are 10.48 and 10.39%, respectively.

308. His sustainable growth DCF, which is based on the percentage of earnings retained and reinvested, showed average and median growth rates of 4.92% and 4.59%, respectively. The average and median ROE for sustainable growth DCF was 9.74% and 9.38%, respectively.<sup>416</sup>

309. Mr. Gorman's multistage growth DCF, which reflect a chance of non-constant growth, showed an estimate of 4.75% long-term growth. His ROE analysis revealed a 9.78% average and 9.86% median.<sup>417</sup>

310. Mr. Gorman's also arrived at an ROE range using a risk premium analysis. His results showed an ROE range of 9.41% to 9.94%, with a midpoint of 9.68%.<sup>418</sup> Finally, his CAPM method to estimate ROE showed a range of 8.33 to 9.38%. His overall range of

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<sup>409</sup> *Id.* at 42.

<sup>410</sup> *Id.* at 43.

<sup>411</sup> Ex. KCP&L 1203, p. 37.

<sup>412</sup> *Id.* at 2.

<sup>413</sup> *Id.* at 11.

<sup>414</sup> *Id.*

<sup>415</sup> *Id.* at 20.

<sup>416</sup> *Id.* at 24.

<sup>417</sup> *Id.* at 26.

<sup>418</sup> *Id.* at 32.

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ROEs using these five methods was 9.4% to 9.9%, with a midpoint of 9.65%.<sup>419</sup>

Staff Witness Murray

311. Mr. Murray arrived at an ROE range of 8.5-9.5%, with 9.0% being the midpoint.<sup>420</sup> As did Dr. Hadaway and Mr. Gorman, Mr. Murray constructed a proxy group. The criteria for his proxy group were: 1) an electric utility by ValueLine; 2) publicly traded stock; 3) classified as regulated utility by EEI or not followed by EEI; 4) at least 70% of revenues from electric operations or not followed by AUS; 5) ten years of Value Line historical growth data available; 6) no reduced dividend since 2007; 7) projected growth available from Value Line and Reuters; 8) at least investment grade credit rating; 9) company-owned generating assets; 10) significant merger or acquisition accounted in last three years.<sup>421</sup>

312. Mr. Murray also used a constant growth DCF. His dividend yield was produced by dividing a weighted average of the 2010 (25%) and 2011 (75%) Value Line projected dividends per share by the monthly high/low average stock price for the three months ending September 30, 2010.<sup>422</sup>

313. Mr. Murray stated that the cost of equity is sum of dividend yield and growth rate. To estimate growth rate, he considered actual dividends per share, earnings per share and book value per share. The historical growth rates are volatile. Due to volatility and wide dispersions of historical and projected DPS, EPS and BVPS, Staff instead use an alternative input. Using a growth rate of 4-5%, and a projected dividend yield of 4.7%, Mr. Murray arrived at a constant growth DCF of 8.7-9.7%. But, the constant growth DCF is not instructive if the industry or economic circumstances cause expected near-term growth to be inconsistent with sustainable perpetual growth. This is the case here. So, Staff instead is using a multistage DCF.<sup>423</sup>

314. A three-stage DCF is used in Staff's analysis. The stages are years 1-5, 6-10, and 11 to infinity. For stage one, Staff gave full weight to analysts' five-year EPS growth estimates. For stage two, Staff linearly reduced the growth rate from the stage one level to the

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<sup>419</sup> *Id.* at 37.

<sup>420</sup> Ex. KCP&L 210 at 11.

<sup>421</sup> *Id.* at 26.

<sup>422</sup> *Id.* at 27.

<sup>423</sup> *Id.* at 28-29.

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constant-growth third stage level. The estimated ROE for the proxy group is about 8.7 to 9.4%, with a midpoint of 9.05%.<sup>424</sup>

315. Mr. Murray also tested the reasonableness of his DCF results by using CAPM and other evidence. For the risk-free rate in its CAPM, he used the average yield on 30-year Treasury bonds for the three months ending September 30, 2010, which was 3.85%. The average beta for the proxy group is 0.65. For market risk premium, Staff relied on risk premium estimates based on historical differences between earned returns on stocks and on bonds. The first risk premium was based on long-term arithmetic average of differences from 1926 to 2009, which was 6%. The second was based on geometric average, which was 4.4%. The CAPM results are 7.72% for arithmetic and 6.69% for geometric. Also, Staff's estimation of ROE by adding risk premium to yield to maturity of the company's long-term debt gives an ROE of 8.14-8.71%.<sup>425</sup>

316. Staff submitted testimony concerning recent average ROEs. According to RRA, average ROEs for electrics for first three quarters of 2010 was 10.36%. For the first quarter, 10.66%, 17 decisions. Second quarter 10.08%, 14 decisions. Third quarter, 10.27%, 12 decisions. For 2009, average was 10.48%. First quarter, 10.29%, 9 decisions. Second quarter, 10.55%, 10 decisions. Third quarter, 10.46%, 3 decisions. Fourth quarter, 10.54%, 17 decisions. Staff's ROR (not ROE) is in line w/ the average RORs for first three quarters of 2010.<sup>426</sup>

### **Analysis – Return on Equity**

317. Dr. Hadaway relies exclusively on three variations of the DCF analysis.<sup>427</sup>

318. First, Dr. Hadaway conducted a constant growth DCF analysis relying on analysts' growth estimates which resulted in a return on equity of 10.2% to 10.4%.<sup>428</sup>

319. Second, Dr. Hadaway conducted a constant growth DCF

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<sup>424</sup> *Id.* at 30.

<sup>425</sup> *Id.* at 35-36.

<sup>426</sup> Ex. KCP&L 210, p. 37.

<sup>427</sup> While Dr. Hadaway initially included the results of his risk premium analysis in his direct testimony (Ex. KCP&L 27, p. 43), he subsequently recommended that the results of his updated risk premium analysis in his rebuttal testimony should be discounted (Ex. KCP&L 28, p. 23). The results of that updated risk premium analysis indicate an ROE range of 10.05% - 10.24%. (*Id.*)

<sup>428</sup> Ex. KCP&L 28, Sch. SCH2010-11

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analysis that substituted his own subjective estimation of the long-term GDP growth rate. The result of this analysis is a return on equity of 10.7% to 10.8%.<sup>429</sup>

320. Finally, Dr. Hadaway combines the analysts' growth estimates and his own estimation of long-term GDP growth into a multi-stage DCF analysis. The result of his multi-stage DCF analysis is a return on equity of 10.5%.<sup>430</sup>

321. Thus, Dr. Hadaway recommends a return on equity range of 10.2% - 10.8%, with a midpoint of 10.5%.<sup>431</sup>

322. In its testimony, however, KCP&L asks that the Commission set its return on equity at 10.75%, at the top end of Dr. Hadaway's recommended range.<sup>432</sup>

323. KCP&L does so "to reflect the Company's reliability and customer satisfaction achievements."<sup>433</sup>

324. Michael Gorman testified on behalf of MEUA, MIEC and the Department of Energy.<sup>434</sup>

325. Mr. Gorman conducts three versions of the DCF analysis, a risk premium analysis and a CAPM analysis. First, Mr. Gorman conducts a constant growth DCF analysis based upon analysts' growth rates resulting in a return on equity of 10.39%.<sup>435</sup>

326. Second, Mr. Gorman conducts a sustainable growth

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<sup>429</sup> *Id.*

<sup>430</sup> *Id.*

<sup>431</sup> *Id.* at p. 22.

<sup>432</sup> In KCP&L/GMO's testimony, they refer to their request as a "return on equity commensurate with the top of Dr. Hadaway's range." (Ex. KCP&L 7, p. 10). In their brief, however, KCP&L/GMO refers to their request as "an additional 25 basis points be added to the midpoint." (KCP&L/GMO Brief at p. 151). While the methods of getting to the actual request are different, the practical effect of either methods is a requested return on equity of 10.75%.

<sup>433</sup> Ex. KCP&L 7, p. 10.

<sup>434</sup> Mr. Gorman initially presented the results of his return on equity analysis in the context of his KCP&L Direct Testimony (Ex. KCP&L 1203). His recommendation in his Direct Testimony is a midpoint return on equity of 9.65%. Like Dr. Hadaway, Mr. Gorman subsequently updated his analysis in his GMO Direct Testimony resulting in a midpoint return on equity of 9.50%. (Ex. KCP&L 1403). On the stand, however, Mr. Gorman restored his original recommendation of 9.65% to account for the subsequent increase in capital market bond yields. (Tr. 2852-2853). Therefore, the results set forth in this order reflect the "restored" position contained in Mr. Gorman's KCP&L Direct Testimony of 9.40% to 9.90% with a midpoint of 9.65%. (Ex. KCP&L 1203, p. 37).

<sup>435</sup> Ex. KCP&L 1203, pp. 20 and 27.

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DCF analysis which resulted in a return on equity of 9.38%.<sup>436</sup>

327. Third, Mr. Gorman conducts a multi-stage DCF analysis which results in a return on equity of 9.86%.<sup>437</sup>

328. Thus, the average of Mr. Gorman's three DCF analyses is a return on equity of 9.88%.<sup>438</sup>

329. Next, Mr. Gorman undertook a risk premium analysis with a return on equity range of 9.41% to 9.94% with a midpoint of 9.68%.<sup>439</sup>

330. Finally, Mr. Gorman conducts a CAPM analysis resulting in a return on equity of 9.40%.<sup>440</sup>

331. The ultimate result of Mr. Gorman's multiple analyses is a recommended return on equity of 9.40% to 9.90% with a midpoint of 9.65%.<sup>441</sup>

332. Staff witness Murray listed the expected long-term growth rate in electricity demand, plus inflation, in support of his ROE recommendation of 8.5-9.5%, with a midpoint of 9.0%.

333. He also listed the "Rule of Thumb": a rough estimate of the current cost of equity calculated by adding a 3-4% risk premium to the cost of long-term debt. In this case, the "rule of thumb" suggests a cost of common equity in the range of 8.14%-9.71%.<sup>442</sup>

334. Finally, Murray also used the perpetual growth rate used by Goldman Sachs when performing DCF analyses of regulated electric companies, which is 2.5%.<sup>443</sup>

Growth Rates

335. As previously mentioned, all three experts rely upon analysts' growth rates for use in their initial constant growth DCF. As the Commission found in its recent AmerenUE decision, these analysts' growth rates are currently troublesome in that they are "based on a unsustainably high dividend yield and median growth rate."<sup>444</sup>

336. While the DCF methodology is intended to be perpetual

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<sup>436</sup> *Id.* at pp. 24 and 27.

<sup>437</sup> *Id.* at pp. 26 and 27.

<sup>438</sup> *Id.* at p. 27.

<sup>439</sup> *Id.* at p. 32.

<sup>440</sup> *Id.* at p. 37.

<sup>441</sup> *Id.*

<sup>442</sup> Ex. KCP&L 235, p. 5.

<sup>443</sup> *Id.*, p. 9.

<sup>444</sup> *Report and Order*, File No. ER-2010-0036, ("AmerenUE") p. 21.

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in nature, these underlying analyst growth estimates are only focused on the short-term. As Mr. Gorman explains, therefore, these current short-term growth rates are based upon the expectation of increased earnings resulting from the large construction cycle currently seen in the electric industry. Such growth rates are not reflective of more normalized levels of construction and are therefore not sustainable.<sup>445</sup>

337. In order to avoid the short-term nature of analysts' growth rates, Dr. Hadaway replaces the analysts' growth rates with an estimate of long-term GDP growth. While the use of a long-term GDP growth rate certainly appears more reasonable than the analysts' growth estimates, the GDP growth estimation provided by Dr. Hadaway is troublesome. As pointed out by Mr. Gorman, Dr. Hadaway rejects all recognized measures of GDP growth and instead provides his own estimate of GDP growth (6.0%)<sup>446</sup> based upon historical average GDP growth rates.<sup>447</sup>

338. If Dr. Hadaway's subjective estimate of GDP growth (6.0%) is replaced with publicly available estimate of GDP growth (Mr. Gorman uses the 4.75% estimate provided by *Blue Chip Economic Indicators*), the result of Dr. Hadaway's constant growth (GDP) DCF analyses drops from 10.7% to 9.6%.<sup>448</sup>

339. By replacing Dr. Hadaway's subjective GDP growth estimate with a publicly available GDP growth estimate, Dr. Hadaway's DCF analysis leads to results that fall comfortably within the range recommended by Mr. Gorman (9.4% - 9.9%).<sup>449</sup>

Other Return on Equity Methodologies

340. Dr. Hadaway initially conducted a risk premium analysis. As contained in his direct testimony, Dr. Hadaway considered the results of the risk premium analysis when it resulted in a return on equity of 10.61% to 10.82%.<sup>450</sup>

341. Given the significant passage of time (six months between filing direct testimony and rebuttal testimony), Dr. Hadaway updated his analysis in his rebuttal testimony.<sup>451</sup>

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<sup>445</sup> Ex. KCP&L 1203, p. 22.

<sup>446</sup> Ex. KCP&L 27, p. 41.

<sup>447</sup> Ex. KCP&L 1204, pp. 7-8.

<sup>448</sup> Ex. KCP&L 1205, p. 10.

<sup>449</sup> Ex. KCP&L 1205, p. 12.

<sup>450</sup> Ex. KCP&L 27, p. 43.

<sup>451</sup> Ex. KCP&L 28, p. 22.

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342. In that testimony, Dr. Hadaway's risk premium analysis decreased significantly to a range of 10.05% to 10.24%.<sup>452</sup>

343. Based upon his belief that "current utility bond yields are artificially depressed by government monetary policy," Dr. Hadaway decided to "discount these results."<sup>453</sup>

344. The Commission finds Mr. Gorman's testimony to be more credible than the testimony of Mr. Murray and Dr. Hadaway. However, Mr. Gorman's testimony also gives the Commission some concern. For example, Mr. Gorman's Constant Growth DCF model using analysts' growth rates yields 10.39% (KCP&L) and 10.33% (GMO) ROE estimates, whereas Dr. Hadaway's model runs from 10.2% to 10.4%, essentially agreeing with Mr. Gorman. It is therefore ironic that the Industrials criticize Dr. Hadaway's Constant Growth DCF model, when their own expert essentially agrees with the Hadaway analysis.<sup>454</sup>

345. Mr. Gorman took a CAPM range of 8.12% to 9.17%, relied on the high-end of that range, and then rounded it up to 9.20%.<sup>455</sup>

346. When assessing growth rates, Mr. Gorman utilized a *median* growth rate of 5.41% for his Constant Growth DCF analysis, instead of *average* growth rates (5.68% for KPC&L or 5.63% for GMO) which would have boosted his ROE estimate.<sup>456</sup>

347. Similarly, for his long-term Growth DCF analysis, Mr. Gorman chose *median* growth rates for KCP&L and GMO of 4.59% and 4.61%, compared with *average* rates of 4.92% and 4.89%, respectively, that would have increased his ROE calculation.<sup>457</sup>

348. Mr. Gorman also arbitrarily eliminated Empire District Electric Company growth rates from his Constant Growth DCF models which would have increased the median ROE two basis points.<sup>458</sup>

349. Staff witness Murray did not use data that could be confirmed by either government or industry statistics, and chose instead to reject a 5.97% growth rate based on Value Line and Reuters data,

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<sup>452</sup> *Id.* at 23.

<sup>453</sup> *Id.*

<sup>454</sup> Ex. KCP&L 1203, p. 27; Ex. GMO 1403, p. 29; Ex. KCP&L 27, p. 22 and Sch. SCH2010-11, p. 2.

<sup>455</sup> Ex. GMO 1403, p. 39.

<sup>456</sup> Ex. KCP&L 1203, p. 20; Ex. GMO 1403, p. 21.

<sup>457</sup> Ex. KCP&L 1203, p. 24; Ex. GMO 1403, p. 25.

<sup>458</sup> Ex. KCP&L 28, pp. 17-18.



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finding it “non-sustainable.”<sup>459</sup>

350. He then arrived at a 4.0%-5.0% growth rate “based upon Staff’s expertise and understanding of current market conditions.”<sup>460</sup>

351. Admitting that he cited no authority to reduce the 5.97% growth rate by 100 to 200 basis points,<sup>461</sup> Mr. Murray was vague on whom he consulted and how this process of reducing a growth rate based on public information occurred.

Return on Equity Awards in Other Jurisdictions

352. The Commission must not only look at the experts’ evidence, but must also award a return on equity “equal to that generally being made at the same time *and in the same general part of the country* on investments in other business undertakings which are attended by corresponding risks and uncertainties.”<sup>462</sup>

353. KCP&L itself asks for the Commission to look at Midwestern ROE’s to assist the Commission in setting KCP&L’s ROE, stating that “If the Commission is concerned about attracting capital to Missouri’s utilities, it will pay attention to ROEs issued by other states in the Midwest.”<sup>463</sup>

354. A review of recent return on equity awards reveals that nine vertically integrated utilities in states that border Missouri (except for Northern Indiana Public Service) have received an average return on equity award of approximately 10.25%.<sup>464</sup>

KCP&L Request for Adder Due to Customer Service Excellence

355. Further, KCP&L / GMO ask that the Commission set its return on equity at the upper half of the recommended range of return on equity “to reflect the Company’s reliability and customer satisfaction achievements.”<sup>465</sup> In its Direct Testimony, KCP&L/GMO allege heightened customer satisfaction and reliability. In support of this claim, KCP&L/GMO reference the Commission to an annual Edison Electric Institute Reliability Survey and recent JD Power awards.

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<sup>459</sup> Tr., p. 2992.

<sup>460</sup> Ex. KCP&L 210; Tr. at 2992-98.

<sup>461</sup> Tr. p. 2998.

<sup>462</sup> *Bluefield v. PSC*, 262 U.S. at 692 (emphasis added).

<sup>463</sup> See KCP&L Reply Brief at 86.

<sup>464</sup> Ex. KCP&L 102 (Interstate Power & Light – 10.8, Westar Energy – 10.4, Kansas Gas & Electric – 10.4, Union Electric – 10.1, Entergy Arkansas – 10.2, Kentucky Power – 10.5, Northern Indiana Public Service – 9.9, KCP&L – 10.0, Interstate Power & Light – 10.)

<sup>465</sup> Ex. KCP&L 7, p. 10.

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356. Evidence provided by Staff, however, provides real world evidence that KCP&L/GMO's performance is the lowest among the Missouri electric utilities. While KCP&L's current rating is 655, this represents a dramatic decrease from the 697 score received in just 2007.<sup>466</sup>

357. KCP&L's customer satisfaction, as measured by Commission complaints is the worst in the state.

And KCPL from 2008, 2009, 2010, if I calculated this correctly, they are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase. But KCPL dramatic increase in customer complaints.<sup>467</sup>

**Conclusions of Law – Return on Equity**

31. The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.<sup>468</sup> The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task.<sup>469</sup> In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>470</sup>

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same

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<sup>466</sup> Tr. 2960-2961.

<sup>467</sup> Tr. 2962.

<sup>468</sup> C.F. Phillips, Jr., *The Regulation of Public Utilities*, 390 (1993); Goodman, 1 *The Process of Ratemaking*, *supra*, at 606.

<sup>469</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

<sup>470</sup> *Bluefield*, *supra*, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.<sup>471</sup>

The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>472</sup>

32. The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions. Pursuant to those decisions, returns for GPE's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a

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<sup>471</sup> *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

<sup>472</sup> *Hope Nat. Gas Co.*, *supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

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quantification of risk.

33. Investor expectations are not the sole determiners of ROE under *Hope* and *Bluefield*; we must also look to the performance of other companies that are similar to KCP&L in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

34. The Commission cannot simply find a rate of return on equity that is “correct”; a “correct” rate does not exist. However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. The Commission stated that it does not believe that its return on equity finding should “unthinkingly mirror the national average.”<sup>473</sup> Nevertheless, the national average is an indicator of the capital market in which MGE will have to compete for necessary capital.

35. The Commission has described a “zone of reasonableness” extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations.<sup>474</sup> Because the evidence shows the recent national average ROE for electric utilities is 10.34%,<sup>475</sup> that “zone of reasonableness” for this case is 9.34% to 11.34%.

36. The Commission has wide latitude in setting an ROE within the zone of reasonableness.<sup>476</sup> The zone of reasonableness is simply a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone.

37. In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.<sup>477</sup> “If the total effect of

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<sup>473</sup> *In re Missouri Gas Energy*, 12 Mo.P.S.C.3d 581, 593 (Report and Order issued September 21, 2004).

<sup>474</sup> *Id.*

<sup>475</sup> Ex. KCP&L 102.

<sup>476</sup> *State ex. rel. Public Counsel*, 274 S.W.3d at 574 (citing *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968)) (“**courts are without authority** to set aside **any** rate selected by the Commission [that] is within a ‘zone of reasonableness’”(emphasis supplied).

<sup>477</sup> *State ex. rel. Arkansas Power & Light Company v. Missouri Public Service Commission*,

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the rate order cannot be said to be unjust or unreasonable, judicial inquiry is at an end.<sup>478</sup> “It is the impact of the rate order which counts; the methodology is not significant.”<sup>479</sup> Within a wide range of discretion, the Commission may select the methodology.<sup>480</sup>

38. The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.<sup>481</sup> It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.<sup>482</sup> “No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use different approaches in different cases.”<sup>483</sup>

39. The Constitution “does not bind ratemaking bodies to the service of any single formula or combination of formulas.”<sup>484</sup> “Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.”<sup>485</sup>

### **Decision – Return on Equity**

After careful review of the evidence and of return on equity awards in nearby states, the Commission finds that KCP&L should receive a return on equity award of 10.0%. This is very near the Midwestern average for 2010, and supported by the evidence.

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736 S.W.2d 457, 462 (Mo. App., W.D. 1987); *State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri*, 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

<sup>478</sup> *Hope, supra*, 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at \_\_\_\_ .

<sup>479</sup> *State ex rel. GTE North, Inc. v. Public Serv. Commission*, 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

<sup>480</sup> *Missouri Gas Energy v. Public Service Commission*, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); *State ex rel. Missouri Public Service Company v. Fraas*, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

<sup>481</sup> *State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

<sup>482</sup> *State ex rel. City of Lake Lotawana v. Public Service Commission*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

<sup>483</sup> *Arkansas Power & Light, supra*, 736 S.W.2d at 462.

<sup>484</sup> *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

<sup>485</sup> *Id.*

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For example, Mr. Gorman found the average constant growth DCF to be 10.48, and the average sustainable growth to be 9.74.<sup>486</sup> The average of those two numbers is 10.1.

Likewise, he found the median constant growth DCF to be 10.39, and the median sustainable growth DCF to be 9.83.<sup>487</sup> The average of those two numbers is also 10.1.

Further, Hadaway and Gorman, in their critiques of each other's work, point out that if the other witness' work had been properly, their ROE analysis would yield a result of about 10%.<sup>488</sup>

**B. Cost of debt**

***What capital structure should be used for determining the rate of return?***

**Findings of Fact – Cost of Debt**

358. Staff and KPC&L generally agree on capital structure, and their cost of debt recommendations are close, with Staff proposing a cost of 6.825% and KCP&L, 6.82%.<sup>489</sup>

359. However, Mr. Murray has suggested that a consolidated cost of debt be used for both KCP&L and GMO, "at least for future rate cases."<sup>490</sup>

360. Then, in his true-up rebuttal, Murray expanded on this theory, suggesting two alternative figures, based upon a hypothetical assignment of \$250 million of 2.75% Senior Notes that Great Plains Energy issued solely for the benefit of GMO in August 2010.<sup>491</sup>

361. At the true-up evidentiary hearing, Mr. Murray adhered to his cost of debt recommendation of 6.825%, clarifying that the figures noted in his true-up rebuttal testimony were merely "contingent" based upon the \$250 million Senior Notes being allocated to KCP&L.<sup>492</sup>

362. Since the record is clear from Mr. Cline's testimony that this debt was issued only for the benefit of GMO, there is no reason to engage in hypothetical debt assignment for KCP&L and no reason, at this late time, to consider a consolidated cost of debt proposal which has

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<sup>486</sup> Ex. KCP&L 1203, pp. 20, 24.

<sup>487</sup> *Id.*

<sup>488</sup> Ex. KCP&L 1204, pp. 5, 10; Ex. KCP&L 28, p. 16.

<sup>489</sup> Ex. KCP&L 311, p. 3; Ex. KCP&L 109, p. 1.

<sup>490</sup> Ex. KCP&L 311, p. 4.

<sup>491</sup> Ex. KCP&L 312, pp. 3-4, 6-8; Ex. KCP&L 110, pp. 1-5.

<sup>492</sup> Tr. pp. 4899-4903.

not been properly presented to the Commission.<sup>493</sup>

**Conclusions of Law – Cost of Debt**

There are no additional Conclusions of Law for this section.

**Decision – Cost of Debt**

The Commission finds this issue in favor of KCP&L.

**C. Equity Linked Convertible Debt**

***Should GPE's equity linked convertible debt be included in KCP&L's capital structure? If so, at what interest rate?***

**Findings of Fact – Equity Linked Convertible Debt**

363. The equity-linked convertible debt known as Equity Units should be part of the companies' capital structure and should be included at their cost of 13.59%. GPE raised gross proceeds of \$450 million in May 2009 through a simultaneous issuance of 11.5 million shares of common stock (\$14/share resulting in gross proceeds of \$161 million) and 5.75 million Equity Units (\$50/unit resulting in gross proceeds of \$287.5 million). It was cheaper for GPE to raise capital through the equity units because a portion of the quarterly distribution is tax deductible.<sup>494</sup>

364. As a result, the Equity Units were a lower cost alternative to issuing common stock and would ultimately cost ratepayers less.<sup>495</sup>

365. The only basis for Staff's argument that the cost of the Equity Units should be 11.14% (or 245 basis points below the actual cost to GPE) is that a much larger utility, FPL Group (the parent of Florida Power & Light Co.) issued its Equity Units at a lower cost. Mr. Murray testified that Staff's adjustment of 245 basis points was not based on any other equity offering that any other company made in 2009.<sup>496</sup>

366. Unlike Mr. Cline and the authors of Schedules MWC 2010-4 through 2010-6 (Goldman Sachs & Co. and J.P. Morgan), Mr. Murray has never been employed by a firm that served as manager of an offering of equity units, nor has he ever worked for a company that issued such equity units. He agreed with the Goldman Sachs analysis that GPE's offering price was the third best pricing of any offering of equity units in 2009.<sup>497</sup>

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<sup>493</sup> Ex. KCP&L 110, pp. 1-4.

<sup>494</sup> See Tr. p. 2902.

<sup>495</sup> *Id.*

<sup>496</sup> See Tr. p. 2975.

<sup>497</sup> See Tr. pp. 2980-81; Sch. MWC 2010-6 at 3GPE's offering was priced at a 6.08%

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367. J.P. Morgan also explained that the FPL equity units represented only 1.5% of its equity market capitalization, in comparison with the GPE's offering which was 16.6% of its equity market capitalization.<sup>498</sup>

368. Additionally, Mr. Cline noted that J.P. Morgan stated that FPL's equity units offering was more senior in the capital structure of the company, in comparison with GPE, where its Equity Units were further subordinated to other debt.<sup>499</sup>

369. Finally, FPL had previously issued \$506 million of Equity Units in 2002 and had a track record that investors could rely on, whereas GPE had never before issued Equity Units.<sup>500</sup>

370. Mr. Murray did accept Mr. Cline's testimony, consistent with the Goldman Sachs reports (Cline Schedule MWC 2010-4 and 2010-5), which stated that investors in Equity Units "demand higher yield than common stock" and that "security [is] more expensive than equity in [a] downside scenario."<sup>501</sup>

371. Although Staff noted that Schedule MWC 2010-5 was prepared after Staff had filed its initial case, Mr. Cline testified that the report was entirely consistent with the earlier Goldman Sachs report (MWC-2010-4) that was prepared on March 17, 2009.<sup>502</sup>

372. Although Staff suggested that the cost of the Equity Units was greater because of the negative impact of GMO on GPE's credit ratings, Mr. Cline, while rejecting Staff's premise, did not elaborate given his further explanation that GPE's dividend yield, not its credit rating, was the primary factor in the pricing of these Equity Units.<sup>503</sup>

373. Overall, the cost of the Equity Units was reasonable and was incurred in the best interests of the ratepayers.<sup>504</sup>

**Conclusions of Law– Equity Linked Convertible Debt**

There are no additional Conclusions of Law for this section.

**Decision– Equity Linked Convertible Debt**

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spread over its common dividend yield, representing the third best pricing of any transaction in 2009 (behind FPL at 4.98% and Johnson Controls at 5.69%).

<sup>498</sup> *Id.*

<sup>499</sup> *Id.*

<sup>500</sup> See Sch. MWC 2010-5, pp. 1, 4; Sch. MWC 2010-6 at p. 1.

<sup>501</sup> Tr. p. 2977.

<sup>502</sup> Tr. pp. 2900-01.

<sup>503</sup> Tr. pp. 2903; Ex. KCP&L 12, pp. 8-10.

<sup>504</sup> Tr. pp 2902-03.



The Commission finds this issue in favor of KCP&L. Given that GPE acted in the best interests of both KCP&L and GMO at a time when the country was in the midst of a severe economic recession, and the pricing terms were as favorable as could be obtained, there is no sound reason for accepting Staff's 245 basis point adjustment in the cost of the Equity Units.

**D. Off-system Sales**

**Findings of Fact – Off system Sales**

***Should KCP&L's rates continue to be set at the 25<sup>th</sup> percentile of non-firm off-system sales margin as projected by KCP&L, or at the 40<sup>th</sup> percentile as proposed by Staff and the Industrials?***

374. KCP&L has more power available for off-system sales now that Iatan 2 is on-line – an additional 472 MW at Iatan 2 alone.<sup>505</sup>

375. Other things being equal, it is more likely that KCP&L will make a higher volume of off-system sales than it would without the addition of Iatan 2 because there are additional MWs to sell.<sup>506</sup>

376. KCP&L has more power available for off-system sales with the completion of additional 48 megawatts of wind generation at Spearville 2.<sup>507</sup>

377. KCP&L will significantly increase the generating capacity of Wolf Creek Nuclear Station in the spring of 2011 with an upgrade to its steam turbine generator.<sup>508</sup>

378. A significant capacity sale agreement with Missouri Joint Municipal Electric Utility Commission (MJMEUC) ended December 31, 2010, releasing energy commitments that will result in more off-system sales.<sup>509</sup>

379. The 40<sup>th</sup> percentile would necessarily be a greater incentive to KCP&L to engage in off-system sales.<sup>510</sup>

380. KCP&L's off-system sales margins have declined every year since 2004.<sup>511</sup> KCP&L's off-system sales in 2009 were about half of

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<sup>505</sup> Ex. KCP&L 116, p. 2; Ex. KCP&L 307, p. 5.

<sup>506</sup> Ex. KCP&L 116, pp. 2-3.

<sup>507</sup> Ex. KCP&L 307, p. 3.

<sup>508</sup> *Id.*

<sup>509</sup> *Id.* at p. 6

<sup>510</sup> *Id.*

<sup>511</sup> *Id.* at 5.

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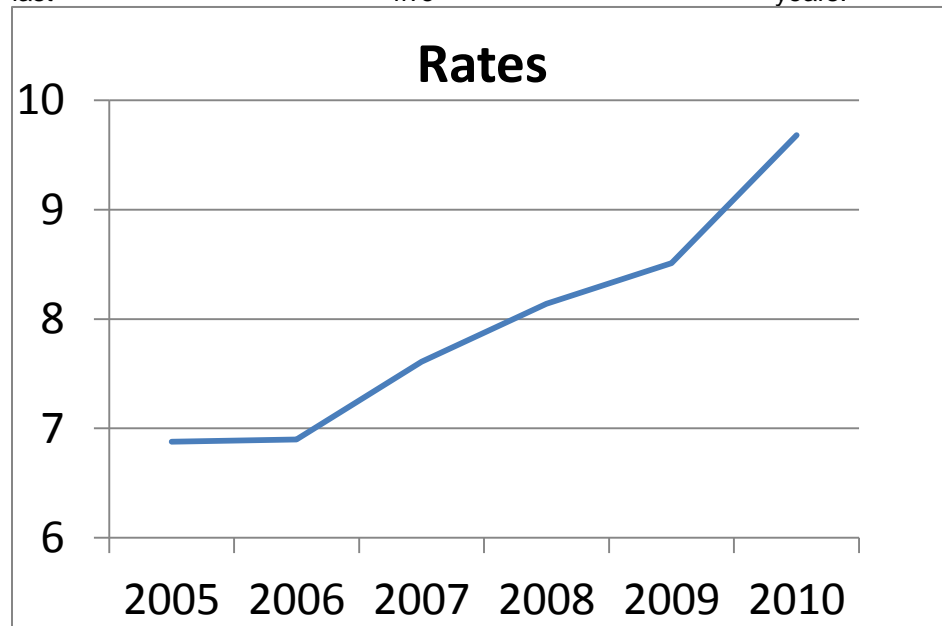
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the 2007 figure; the 2009 figure is roughly one-third of the 2004 figure.<sup>512</sup>

381. Setting the off-system sales margins level presumed in rates at the 25<sup>th</sup> percentile has done nothing to encourage KCP&L to exceed that level.<sup>513</sup>

382. At the 40<sup>th</sup> percentile, KCP&L would still have a 60% chance of exceeding the off-system sales margins level presumed in rates.<sup>514</sup>

383. KCP&L's retail rates have increased dramatically in the last five years.<sup>515</sup>



384. While this increase in retail rates has undoubtedly been

<sup>512</sup> *Id.*

<sup>513</sup> Expert witness Greg Meyer pointed out, "Despite having a 50 / 50 probability of exceeding the 50<sup>th</sup> percentile, KCPL has not exceeded the 50<sup>th</sup> percentile once during the past four years under the Regulatory Plan"; and "I believe that KCPL has not achieved higher levels of OSS largely because of a lack of incentive[.]" Meyer, *op. cit.*, p. 28.

<sup>514</sup> Harris, *supra*.

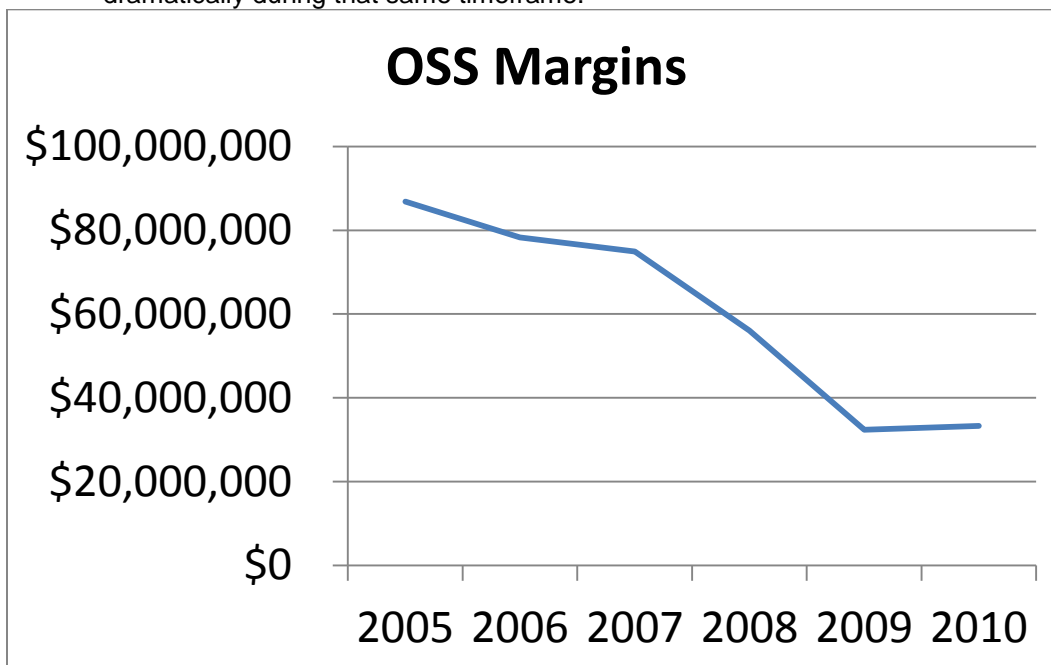
<sup>515</sup> Ex. KCP&L 215, p. 46.

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affected by the construction projects in the Regulatory Plan, it is also unquestioned that they have been affected, at least in part, by KCP&L's decreased profits in the wholesale market. As the following chart indicates, KCP&L's off-system sales margins have decreased dramatically during that same timeframe.<sup>516</sup>



385. Prior to 2006, Kansas and Missouri both allocated off-system sales margins on the basis of the energy allocator. Through the use of the same allocator, a consistent allocation was assured between Missouri and Kansas. In 2006, KCP&L proposed the use of the unused energy allocator in Kansas and Missouri.<sup>517</sup>

386. Because this methodology allocated a greater percentage of off-system margins to Kansas, the Kansas Commission adopted the proposed methodology.<sup>518</sup> This Commission, however,

<sup>516</sup> Ex. KCP&L 1210

<sup>517</sup> Tr. 3365.

<sup>518</sup> *Id.*

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found the unused energy allocator to be problematic.

A primary concern is the underlying philosophy implied by utilization of the unused energy allocator. Specifically, the unused energy allocator rewards the lower load factor of KCPL's Kansas retail jurisdiction by allocating a greater percentage of the profit from non-firm off-system sales to that jurisdiction. Load Factor is average energy usage divided by peak demand. The higher the load factor, the closer the average load is to peak demand. The lower load factor of KCPL's Kansas jurisdiction causes the Company to build higher energy cost combustion turbines, which provide KCPL with less opportunity to make off-system sales.<sup>519</sup>

387. Interestingly, KCP&L now recognizes the same flaws in the unused energy allocator expressed by this Commission in its 2006 Order. As KCP&L's witness in Kansas recently acknowledged:

I believe that KCP&L proposed the unused energy allocator without sufficient study of its implications and reasonableness. Since the unused energy allocator allocates more off-system sales margins (and hence, lower overall costs) to the Kansas jurisdiction, the other parties may not have devoted the resources to study its reasonableness. Based on the analysis that I present here, I believe that the unused energy allocator is not an appropriate method for allocating off-system sales margins.<sup>520</sup>

388. Given the flawed nature of the unused energy allocator, KCP&L asked the Kansas Commission to discontinue its use. The Kansas Commission recognized, however, the beneficial nature of the unused energy allocator to Kansas ratepayers.<sup>521</sup>

389. As such, the Kansas Commission recently rejected

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<sup>519</sup> *Id.* at pp. 38-39. This Commission also found that the unused energy allocator creates a disincentive for demand side management programs which are "aimed at increasing load factor" and ignores the fact that fuel costs, the primary component of off-system sales, are allocated via the energy allocator. (*Id.*)

<sup>520</sup> Tr. pp. 3367-3368.

<sup>521</sup> Elimination of the unused energy allocator would reduce the allocation of off-system sales margins from 47.70% to 45.64%. Order: 1) *Addressing Prudence*; 2) *Approving Application, In Part*; and 3) *Ruling on Pending Requests*, Case No. 10-KCPL-415-RTS, p. 126 (Kansas Corporation Commission, issued November 22, 2010).

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KCP&L's request to eliminate the unused energy allocator.<sup>522</sup>

390. The practical effect of the different allocators in Missouri and Kansas is not inconsequential. As KCP&L witnesses testified, this difference, caused by KCP&L proposing the unused energy allocator "without sufficient study," has now created a disincentive for KCP&L to engage in off-system sales.

By that, I mean that for every dollar of off-system sales margin that the Company makes from selling off-system sales, it costs the Company one dollar and five cents, or a loss of five cents on the dollar. **This does not make any sense, and serves as an economic disincentive for the Company to pursue off-system sales.**<sup>523</sup>

391. The second regulatory decision that affected KCP&L's performance in the wholesale market was this Commission's decision to decrease its expectations for KCP&L in the wholesale market and set rates using the 25<sup>th</sup> percentile. As the 2006 order indicates:

The Commission finds that the competent and substantial evidence supports KCPL's position, and finds this issue in favor of the alternative KCPL sponsored in which it would agree to book any amount over the 25th percentile as a regulatory liability, and would flow that money back to ratepayers in the next rate case.<sup>524</sup>

392. Given the financial disincentive and the low expectations set by the Missouri Commission, KCP&L has only participated in the wholesale market to the levels expected by this Commission. Despite the "fairly substantial chance" envisioned by the Commission in 2006, additional margins never fully materialized.<sup>525</sup>

393. The interesting part of KCP&L's recent performance, however, is that it has demonstrated the ability to achieve increased levels of off-system sales margins when expectations are increased. As

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<sup>522</sup> *Id.* at p. 127.

<sup>523</sup> Tr. 3367 (emphasis added). See also, Ex. KCP&L 7, p. 46 ("Because Missouri and Kansas adopt different allocation methodologies to derive what portion of the margins KCP&L's Kansas and Missouri customers should receive, KCP&L presently gives to its customers about 105% of its off-system sales margins. That is punitive and should stop, but requires this Commission and the KCC to adopt the same allocation methodology, which to date they have chosen not to do.").

<sup>524</sup> 2006 Order at p. 33, as modified by Order Regarding Motions for Rehearing, issued January 18, 2007, at pp. 2-3.

<sup>525</sup> Ex. KCP&L 7, pp. 12-13; Ex. KCP&L 1209.

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the chart indicates, expected levels of off-system sales margins in the 2006 and 2007 cases were both set at the 25<sup>th</sup> percentile. KCP&L's performance achieved this level, but the prospect of significantly more off-system sales never materialized. In 2009, however, KCP&L agreed to a specified level of off-system sales to include in rates. The evidence indicates that this specified level of off-system sales was equivalent to the 44.5 percentile.<sup>526</sup> Despite the increased expectations, the evidence indicates that KCP&L achieved and even slightly exceeded this level of off-system margins. Thus, KCP&L's recent performance indicates that, when expectations are increased, KCP&L is capable of overcoming the financial disincentives and earn increased profits in the wholesale market.

394. Fortunately, the reasons for once setting rates at the 25<sup>th</sup> percentile are no longer applicable. The evidence indicates that both reasons provided by the Commission in the 2006 order are no longer in existence. For instance, off-system sales margins no longer comprise such a significant portion of KCP&L's overall earnings. Where off-system sales margins once represented over 60% of KCP&L's earnings, today those margins barely make up 20% of KCP&L's earnings.<sup>527</sup>

395. Furthermore, KCP&L no longer faces the capital pressures associated with the construction projects in the Regulatory Plan. At various points during the Regulatory Plan, KCP&L's five year capital expenditures were expected to more than double KCP&L's existing plant in-service. Today, however, projected capital expenditures have returned to more normal levels.<sup>528</sup>

396. In fact, the evidence shows that the use of the 40<sup>th</sup> percentile is actually a slight step backwards from the expectations agreed to by KCP&L in the Stipulation from the last case. As previously indicated, in the Stipulation and Agreement in the last case, KCP&L expressly agreed to setting rates based upon the 44.5 percentile.<sup>529</sup> Ultimately, KCP&L was able to meet these heightened expectations.<sup>530</sup>

397. The 40<sup>th</sup> percentile is also conservative and easily achievable in that it represents a point where KCP&L has a better than

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<sup>526</sup> Ex. KCP&L 121, p. 3

<sup>527</sup> Ex. KCP&L 1212 (years 2005-2009), Ex. KCP&L 1213 (year 2010), Ex. KCP&L 1210 (years 2005-2009) and Ex. KCP&L. 1209 (year 2010).

<sup>528</sup> Ex. KCP&L 1215; Ex. KCP&L 1211

<sup>529</sup> Ex. KCP&L 121, p. 3.

<sup>530</sup> Ex. KCP&L 1209.

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equal probability of meeting or exceeding expectations. While the median point (50<sup>th</sup> percentile) provides an equal opportunity to exceed or fall short, the 40<sup>th</sup> percentile provides KCP&L a 60% probability of exceeding.<sup>531</sup> Therefore, by pure statistics, MEUA's recommendation is conservative and easily achievable.

398. In addition, the 40<sup>th</sup> percentile is the appropriate amount of off-system sales margins to include in rates because it represents the single most likely outcome of the Schnitzer analysis. As shown in Schnitzer's testimony, the possible outcomes of his analysis form a bell curve.<sup>532</sup>

399. The "single most likely outcome" is the result represented by the 40<sup>th</sup> percentile.<sup>533</sup>

400. Finally, it is important to note that, unlike in previous years, the Commission will not have an immediate opportunity to correct its low expectations. As a result of the Regulatory Plan, KCP&L was scheduled to file annual rate cases.<sup>534</sup>

401. Given this, the Commission was assured that it would have an opportunity within a year, to fix the level of off-system sales margins. With the completion of the Regulatory Plan, KCP&L has stated that it has no definite plans for its next rate case.<sup>535</sup>

402. Having decided on the 40<sup>th</sup> percentile, the Commission must choose between the Schnitzer's true-up analysis, as advocated by Staff, or the analysis contained in Mr. Schnitzer's Direct Testimony as recommended by MEUA. MEUA has alleged two fundamental problems with the assumptions provided by KCP&L to Mr. Schnitzer for use in his true-up analysis.

403. First, MEUA notes that KCP&L assumed a higher than expected amount of planned outages. Effectively, by having the model assume that its baseload units are unavailable due to a planned outage, the model will be unable to model any off-system sales from that unit. In its true-up testimony, MEUA compared the level of planned outages in the KCP&L model against KCP&L's actual planned outage schedule.<sup>536</sup> By comparing to the actual KCP&L planned outage schedule, it became

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<sup>531</sup> Ex. KCP&L 1216, p. 9.

<sup>532</sup> Ex. KCP&L 58, Sch. MMS2010-3.

<sup>533</sup> Ex. KCP&L 121, p. 2.

<sup>534</sup> Tr. p. 3372.

<sup>535</sup> Tr. p. 3373.

<sup>536</sup> Ex. KCP&L 1216, Sch. GRM-TU-2, pp. 1-2.

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apparent that KCP&L's assumed level of planned outages in the Schnitzer model is inflated.

404. Second, MEUA expressed concerns with KCP&L's level of Firm Load Obligations in the Schnitzer model. In making this determination, MEUA compared KCP&L's Firm Load Obligation in its off-system sales model against the actual firm load obligation contained in the KCP&L fuel model. Again, KCP&L's assumption in its wholesale model is unnecessarily high. As Mr. Meyer explains, "by causing the off-system sales model to believe that these units are needed to provide energy for native load that does not truly exist, KCP&L has artificially lowered the projected off-system sales margins."<sup>537</sup> While it raises some question whether MEUA properly considered the impact of spinning reserves, KCP&L acknowledges that at least a portion of MEUA's claim is appropriate. Therefore, by KCP&L's own admission, the Firm Load Obligation in the Schnitzer model is inflated.

405. What is more, given the addition of Iatan 2, KCP&L's own evidence shows that adding KCP&L's 2010's off-system sales to the level of off-system sales Schnitzer estimates for Iatan 2 would exceed the 40<sup>th</sup> percentile listed in Schnitzer's direct testimony.<sup>538</sup>

406. This is more credible than KCP&L's evidence that despite Iatan 2, KCP&L would actually make *less* off-system sales than it did in 2010.<sup>539</sup>

407. Given the acknowledged flaws in the assumptions provided by KCP&L to Mr. Schnitzer for use in his True-Up Analysis, the Commission agrees that Mr. Schnitzer's Direct Testimony analysis is the appropriate model to use in this case. Furthermore, as previously held, the Commission believes that the 40<sup>th</sup> percentile is the appropriate point in that model to set retail rates.

***Should the adjustments to Mr. Schnitzer's 25<sup>th</sup> percentile projected as recommended by KCP&L witness Crawford (purchases for resale, SPP line losses and revenue neutrality uplift charges) be included as components of the off-system sales margins ordered in this case?***

408. KCP&L's witness Burton Crawford recommends three adjustments related to (1) Purchases for Resale, (2) Southwest Power Pool (SPP) line loss charges, and (3) SPP Revenue Neutrality Uplift

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<sup>537</sup> Ex. KCP&L 1216, p. 7.

<sup>538</sup> Ex. KCP&L 1216, pp. 4-5.

<sup>539</sup> *Id.*, pp. 8-9.



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charges.<sup>540</sup>

409. **(1) Purchases for Resale.** As a result of participating in the wholesale energy market, in particular the SPP Energy Imbalance Service (EIS) market, KCP&L earns revenue and incurs expense as a result of the wholesale transactions described by Mr. Crawford to ensure that adequate energy is available in real-time to reliably meet all of its energy obligations.<sup>541</sup>

410. Staff does not oppose this adjustment.<sup>542</sup>

411. The only opposition to this adjustment was offered by the Industrials, whose witness Mr. Meyer accepted Mr. Crawford's Post Analysis calculation, which determined the actual benefits from these off-system sales.<sup>543</sup>

412. Mr. Meyer stated: "I do not have any information to disagree with Mr. Crawford's statement regarding the Post Analysis Program."<sup>544</sup>

413. Mr. Meyer simply wants an additional analysis or study done as he was unable to determine to cause of these losses.<sup>545</sup> This is not a sufficient reason to oppose KCP&L's adjustment, which has been agreed to by Staff.

414. **(2) SPP Line Losses.** Mr. Crawford also proposed an adjustment for charges that SPP levies on wholesale energy transactions that exit the SPP EIS market. This charge relates to transmission system energy losses, and results in both payments that KCP&L makes on a portion of its off-system sales, as well as revenue that it receives on a share of the loss charges collected by SPP. The adjustment proposed by KCP&L reflects the net loss revenue of \$264,889.<sup>546</sup>

415. Staff agrees with KCP&L that an adjustment should be made to reflect the revenues associated with SPP compensating payments from other SPP members.<sup>547</sup>

416. However, it opposes an unspecified portion of the line loss charges related to sales not in the database analyzed by Mr.

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<sup>540</sup> Ex. KCP&L 15 (NP), pp. 10-11.

<sup>541</sup> *Id.*; see also Sch. BLC 2010-5 (HC).

<sup>542</sup> Ex. KCP&L 210, p. 69; Tr. p. 3419.

<sup>543</sup> Ex. KCP&L 16, p. 5.

<sup>544</sup> Ex. KCP&L 1202, p. 6.

<sup>545</sup> Ex. KCP&L 1201, p. 9.

<sup>546</sup> Ex. KCP&L 15, pp. 14-15, Sch. BLC 2010-6.

<sup>547</sup> Ex. KCP&L 210, p. 69.

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Schnitzer and the NorthBridge Group. Although the Industrials oppose SPP line losses as an adjustment to OSS margin, they do not oppose Mr. Crawford's request that such costs, at the very least, be included and recovered in KCP&L's revenue requirement, which is the identical position of Staff.<sup>548</sup>

417. **(3) Revenue Neutrality Uplift (RNU) Charges.** RNU charges consist of revenue and expenses related to SPP's EIS market. As total revenues collected by SPP do not always match the total required disbursements, imbalances in revenue and expense are shared by market participants as either a charge (if SPP is short of funds) or a credit (if SPP has over-collected). The actual RNU charges incurred by KCP&L for test year 2009 are \$685,578.<sup>549</sup>

418. Staff does not oppose this adjustment, as proposed by Mr. Crawford.<sup>550</sup>

419. Although the Industrials oppose RNU charges as an adjustment to OSS margins, they agree that these costs are a component of KCP&L's cost of service and should be put into cost of service.<sup>551</sup>

### **Conclusions of Law – Off-system Sales**

There are no additional Conclusions of Law for this section.

### **Decision – Off-system Sales**

The Commission finds this issue partially in favor of KCP&L and partially in favor of the Industrials and Staff. KCP&L's rates shall be set at the 40<sup>th</sup> percentile of non-firm off-system sales margin as projected by KCP&L, as listed in KCP&L witness Schnitzer's Direct Testimony. Margins above the 40<sup>th</sup> percentile shall be returned to ratepayers in a subsequent rate case or cases. The adjustments to the projection as recommended by KCP&L witness Crawford shall be included as components of the off system sales margins.

## **III. Expenses**

### **A. Fuel and Purchased Power Expense**

***a. How should natural gas costs be determined?***

***b. How should Wolf Creek fuel oil expense be determined?***

***(KCP&L only)***

***c. Should MEJMEUC margin be included in native load and***

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<sup>548</sup> Tr. pp. 3421, 3426.

<sup>549</sup> Ex. KCP&L 15, pp. 15-16; Sch. BLC 2010-8.

<sup>550</sup> Ex. KCP&L 210, p. 69; Tr. p. 3419.

<sup>551</sup> Ex. KCP&L 1201, p. 13; Tr. pp. 3426-27.

**OSS margins? (KCP&L only)****d. How should spot market purchased power prices be determined?****Findings of Fact – Fuel and Purchased Power Expense**

420. No party opposed the forecasting process proposed by KCP&L Witness W. Edward Blunk for natural gas costs. Under this process, natural gas prices are based on the first of the month index price published in Platt's Inside FERC, as well as NYMEX closing prices related to Henry Hub natural gas futures contracts.<sup>552</sup>

421. Mr. Blunk stated in his Direct Testimony that the Companies expected to true-up 2010 natural gas prices for their cost of service to actual prices at the conclusion of the case.<sup>553</sup>

422. In True-Up Direct Testimony, KCP&L Witness Burton L. Crawford confirmed that natural gas costs were updated to reflect the actual monthly purchase prices for January through December 2010.<sup>554</sup>

423. At the hearing there was no cross-examination for Mr. Blunk.<sup>555</sup> Similarly, no party offered pre-filed true-up rebuttal testimony opposing the true-up direct testimony filed by Mr. Crawford in each of the cases.

424. Mr. Weisensee testified in true-up rebuttal testimony that KCP&L had been working closely with Staff in the reconciliation process, that there was a need to update the respective revenue deficiencies, that the process would continue through the filing of Staff's final reconciliation on March 2, and that KCP&L's revised position would be reflected in that reconciliation.<sup>556</sup>

425. Fuel oil is used at the Wolf Creek Nuclear Plant for multiple purposes, such as building heat and the start-up of operations. These costs are continuing expenses incurred in the normal course of station operations.

426. There is no disagreement on the general inclusion of fuel oil expense for Wolf Creek.<sup>557</sup> There is a disagreement as to whether

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<sup>552</sup> Ex. KCP&L 10; Ex. GMO 7.

<sup>553</sup> Ex. KCP&L 10, Blunk Direct Testimony at p.14; Ex. GMO 7, Blunk Direct Testimony at p. 10.

<sup>554</sup> Ex. KCP&L 111 at p. 2; GMO 56 at p. 2. (These costs are reflected in Sch. JPW 2010-9, attached to the True-Up Direct testimonies of John P. Weisensee, Ex. KCP&L 117 and Ex. GMO 59.)

<sup>555</sup> Tr. p. 3198.

<sup>556</sup> Ex. KCP&L 118 at p. 8.

<sup>557</sup> Tr. pp. 3194, 3195, 3210-11.

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KCP&L can adopt the fuel oil expense position as stated in the reconciliation.

427. In true-up testimony oil prices were updated to December 2010 purchase prices.<sup>558</sup> KCP&L's true-up shows an overall revenue deficiency of \$55.8 million.<sup>559</sup>

428. With the filing of the March 2, 2011 reconciliation, KCP&L accepted Staff's number for fuel oil expense. A review of the true-up reconciliation<sup>560</sup> indicates that through this adoption, KCP&L has sought to increase its revenue requirement by \$9,783,534 over the amount stated in its true-up testimony. The primary component of the increase is \$7,913,431 of additional fuel expense that Staff modeled.

429. The adoption by KCP&L of the Staff's revenue numbers is found on line 74 of page 2 of 5 of the Staff's March 2, 2011 reconciliation.<sup>561</sup> The adoption of Staff's fuel expense number is found on line 102 of page 2 of 5 of the Staff's March 2, 2011 reconciliation.<sup>562</sup> Both of these items, along with other adjustments, are components of the \$9,783,534 increase in KCP&L's case shown on line 1 ("Sub-total of Adjustments to KCP&L Revenue Requirement") of page 1 of 3.<sup>563</sup>

430. The MJMEUC contract has expired and supply related to that contract is now available for off-system sales.<sup>564</sup> There is no disagreement to the general issue of including the megawatts from the former MJMEUC contract as being available for sale.

431. Michael Schnitzer testified that his model assumed that there were no contractual obligations to MJMEUC and that all of the hours previously related to that contract were now available for sale in the off-system market.<sup>565</sup>

432. KCP&L recommends using the MIDAS™ model to forecast spot market electricity prices.

433. MIDAS™ is a proprietary production cost model that

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<sup>558</sup> Ex. KCP&L 111 at p. 2; Ex. GMO 56 at p. 2.

<sup>559</sup> Ex. KCP&L 114, Rush True-Up Direct, p. 1.

<sup>560</sup> Ex. KCP&L 328.

<sup>561</sup> Ex. KCP&L 328.

<sup>562</sup> Ex. KCP&L 328.

<sup>563</sup> Ex. KCP&L 328. Staff filed an additional reconciliation on March 18, 2011 containing revisions to its revenue requirement adjustments to show an additional \$10,178,564 instead of the \$9,783,534 contained in the March 2, 2011 reconciliation. None of the additional adjustments affect the amount of fuel oil expense.

<sup>564</sup> Tr. pp. 3206-07; Tr. pp. 3211-12.

<sup>565</sup> Tr. pp. 3307-08.

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includes a large amount of data including information supplied by electric utilities in their FERC Form 1 filings, as well as data submitted to the U.S. Department of Energy's Energy Information Administration and to the Continuous Emissions Monitoring System (CEMS)<sup>566</sup> of the U.S. Environmental Protection Agency.<sup>567</sup> Using this data, the MIDAS™ model is designed "to simulate the wholesale power markets to develop an hourly price of power for the wholesale market. That information then gets fed also into the model and another portion of the model to determine the normalized level of fuel and purchase power for the company."<sup>568</sup> Portions of KCP&L's model are "based on the historical experience" of KCP&L, the model is also "based on a production simulation for the Eastern Interconnect."<sup>569</sup>

434. Staff's model relies exclusively on historical data.<sup>570</sup> Staff employs a statistical calculation based upon the historical weather adjusted loads and the truncated normal distribution curve to represent the hourly purchased power prices in the spot market.<sup>571</sup> Staff obtained the actual hourly non-contract transaction prices from the companies and used this data in its calculation.<sup>572</sup> Staff used the combined data from both KCP&L and GMO to reflect the market that exists in this region.<sup>573</sup> Staff's method yields a spot energy price for each hour of the year.<sup>574</sup> This data set, containing 8,760 hourly spot energy prices, is then used as one of the inputs to Staff's production cost model.<sup>575</sup>

435. Staff only uses KCP&L and GMO data, and no data from any other utility to arrive at a recommendation of spot market prices.<sup>576</sup> Staff's model "does not consider the impact of other market price drivers, such as natural gas prices, environmental allowances or other factors of electric production."<sup>577</sup>

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<sup>566</sup> Tr. 3205; Ex. KCP&L 15, Crawford Direct at 3.

<sup>567</sup> Tr. pp. 3205-06.

<sup>568</sup> Tr. p. 3205.

<sup>569</sup> Tr. pp. 3203-04.

<sup>570</sup> Tr. p. 3215.

<sup>571</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>572</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>573</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>574</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>575</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>576</sup> Tr. p. 3217.

<sup>577</sup> Ex. KCP&L 16 and Ex. GMO 11.

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436. Ms. Maloney testifying for Staff indicated that she was not familiar with all of the inputs to the MIDAS™ model and that she had never worked the model herself.<sup>578</sup>

**Conclusions of Law – Fuel and Purchased Power Expense**

40. It is within the Commission's discretion and within its area of expertise to determine the methods to set rates regarding off-system sales, as well as fuel and purchased power.<sup>579</sup>

**Decision – Fuel and Purchased Power Expense**

There were multiple issues related to fuel and purchased power expense presented to the Commission. Several of the issues were resolved during the course of the testimony and do not appear to remain in controversy. The Commission will address those issues first.

No party opposed the forecasting process proposed by KCP&L Witness W. Edward Blunk for natural gas costs. Under this process, natural gas prices are based on the first of the month index price published in Platt's Inside FERC, as well as NYMEX closing prices related to Henry Hub natural gas futures contracts. The Commission adopts this method of determining natural gas costs.

The parties agree and the Commission determines that the megawatts formerly associated with KCP&L's contract to sell power to MJMEUC should be considered available for off-system sales. The disagreement relating to the MJMEUC contract is in relation to Mr. Schnitzer's levels of OSS and whether his calculations with regard to his true-up testimony contain those contracts. The Commission addresses the issue of Mr. Schnitzer's testimony under its OSS determinations and therefore it does not need to re-examine that issue here.

KCP&L and Staff have agreed that the fuel oil expenses related to the Wolf Creek Nuclear Plant should be included in rates. The Commission agrees that the fuel oil expenses related to Wolf Creek should be included in rates. Fuel oil prices, however, have been updated through December 2010 and it is this update that is in controversy.

In True-Up Direct Testimony, KCP&L stated its requested increase in revenue requirement is \$55.8 million rather than the original figure of \$92.1 million. Later, during the true-up hearing, KCP&L indicated that its increase in revenue requirement was \$66.1 million.<sup>580</sup> KCP&L has attributed this discrepancy to the adoption of certain

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<sup>578</sup> Tr. pp. 3217-19.

<sup>579</sup> *State ex rel. Missouri Gas Energy v. PCS*, 186 S.W.3d 376, 382 (Mo. App. W.D. 2005).

<sup>580</sup> See Ex. 119, p. 2.

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numbers in Staff's Reconciliation filed on March 2, 2011.<sup>581</sup> The Industrials contend in their briefs that KCP&L's request for \$66.1 million is not supported by the testimony.

A review of the true-up reconciliation<sup>582</sup> indicates that the primary component of the difference between KCP&L's true-up position and its adoption of the reconciliation number is \$7,913,431 of additional fuel expense that Staff modeled. KCP&L stated openly in its true-up testimony that additional updates would be made with regard to working out the reconciliation and that its final position would be included in the reconciliation. In addition, Staff's audit and testimony further supports the reconciliation and the fuel oil expense revenues in the reconciliation.

It is not uncommon for KCP&L or Staff to adopt each other's positions on issues as the case progresses and up until the final Staff reconciliation filing. Contrary to the Industrials' claim that it was uninformed of KCP&L's position, KCP&L alerted all the parties in true-up rebuttal testimony that it had been working closely with Staff in the reconciliation process, that there was a need to update the respective revenue deficiencies, that the process would continue through the filing of Staff's final reconciliation on March 2, and that KCP&L's revised position would be reflected in that reconciliation.<sup>583</sup>

In preparing the final reconciliation, there were scores of differences between KCP&L and Staff where KCP&L accepted Staff's position including allocation differences, immaterial differences, differences in approach to the true-up and differences that have existed throughout the case but have not been made an issue. Some of these adoptions of Staff's positions resulting in increases to KCP&L's revenue requirement some resulted in decreases. The Industrials do not complain equally about the decreases to the revenue requirement.

With regard to Staff's fuel expense number, KCP&L accepted the Staff's position as a consequence of adopting Staff's sales revenues. Due to the matching principle, if KCP&L uses the Staff's sales revenues when calculating revenue requirement, it also needs to use Staff's system requirements for fuel used to produce those sales.

The Industrials also argue that the Commission should not utilize the Staff's fuel expense number since KCP&L would have more experience with its fuel costs. This argument ignores the fact that

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<sup>581</sup> Ex. KCP&L 328.

<sup>582</sup> Ex. KCP&L 328.

<sup>583</sup> Ex. KCP&L 118 at p. 8.

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KCP&L's experience with its fuel costs led it to adopt Staff's fuel expense number. The Empire case cited by the Industrials (ER-2006-0315) does not apply to this case as Empire and the Staff were each advocating different fuel models and the Commission chose Empire's model. In this case, the Staff and KCP&L have agreed to Staff's position and since no party has put forth evidence as to why this number does not reflect KCP&L's cost of service, it should be adopted by the Commission.

The Commission determines there is ample evidence to support KCP&L's adoption of Staff's position in this case as the new fuel expense number contained in the Staff's reconciliation. The March 2, 2011 reconciliation numbers shall be used for determination of revenue requirement on this issue.

Finally, the Commission must address how the spot market purchased power prices shall be determined. The Companies ask the Commission to use its MIDAS™ model which forecasts spot market electricity prices. Staff proposes to use its 1996 model which uses only historical market prices and loads.

The MIDAS™ model contains historical information, including the experience of KCP&L, but is also based on a production simulation for the entire Eastern Interconnection. This model includes an extensive amount of data, both historical and forecasted.

Staff's model relies only upon historical data of KCP&L. It relies on no data from any other utility and does not use any projected data.

The Commission must set the level of fuel expense and purchased power expense for the Companies in this case, and determines that it should use the greatest amount of information available to set spot market prices for determining that expense. Given the multitude of variables that affect electricity prices, the Commission accepts the MIDAS™ model is superior because it considers a vast amount of information, both historical and projected.

Staff wants only historical data from the Companies to be considered arguing that use of the traditional historical test year prevents the Commission from relying upon forecasted data. To the contrary, the Commission is afforded considerable discretion in setting rates, and in this instance determines the utilization of a nationally recognized tool like the MIDAS™ model is appropriate to determine spot market prices.

### **B. Merger Transition Cost Recovery**

***What, if any, is the appropriate amount of merger transition costs to include in rates in this case?***

### ***Findings of Fact – Transition Cost Recovery***



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437. In July of 2008, the Commission approved the acquisition of Aquila by Great Plains Energy Incorporated (GPE).<sup>584</sup>

438. The merger of KCP&L and Aquila, Inc. was consummated on July 14, 2008.

439. In consummating that transaction, Great Plains Energy incurred certain costs. These costs have been labeled as either transaction costs or transition costs. “[T]ransaction costs include investment bankers’ fees, as well as consulting and legal fees associated with the evaluation, bid, negotiation and structure of the transaction.”<sup>585</sup> Transition costs, on the other hand, are “costs incurred to successfully coordinate and integrate the utility operations of KCP&L and GMO . . . . These costs include non-executive severance costs for employees terminated as a result of the merger, facilities integration costs, and incremental third-party and other non-labor expenses incurred to support the integration of the companies.”<sup>586</sup>

440. The Commission considered and addressed the proper treatment of transition cost recovery in the Merger Order.<sup>587</sup>

441. In Missouri, it is well established that there is a lag between when a cost or revenue is incurred and when that cost or revenue is reflected in rates. This is known as regulatory lag.<sup>588</sup>

442. As a result of regulatory lag, if a utility experiences a cost decrease, there is a lag in time until that reduced cost is reflected in rates. During that lag, the Company shareholders reap, in the form of increased earnings, the entirety of the benefit associated with reduced costs. The Company shareholders also reap, in the form of decreased earnings, the entirety of the loss associated with increased costs.

443. The Commission “authorize[d] KCP&L and Aquila to

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<sup>584</sup> *Report and Order, In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, File No. EM-2007-0374 (issued Jul. 1, 2008). Hereinafter referred to as “Merger Order.”

<sup>585</sup> Ex. 35, p. 6.

<sup>586</sup> Merger Order at 4.

<sup>587</sup> *Report and Order, In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, File No. EM-2007-0374 (issued Jul. 1, 2008). Hereinafter referred to as “Merger Order.”

<sup>588</sup> Ex. KCP&L 210 at p. 190.

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defer transition costs to be amortized over five years.”<sup>589</sup>

444. The Commission qualified its authorization by stating that, “The Commission will give consideration to . . . [the transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCP&L and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.”<sup>590</sup> The Commission contemplated that the recovery would only happen if the synergy savings were greater than the costs to achieve those savings.<sup>591</sup>

445. With regard to the recovery of transition costs, the Merger Order contains a summary of what KCP&L had originally requested. That summary states in part, “This period would begin with the first rate cases post-transaction for Aquila and KCP&L subject to ‘true up’ of actual transition . . . costs in future cases.”<sup>592</sup>

446. In the current rate cases, the Companies seek to recover the merger transition costs in rates over five years beginning with rates effective from this case.

447. The Companies projected that over the first five-year period, the total operational synergies projected to result from the merger were \$305 million, and \$755 million over the first 10-year period.<sup>593</sup> The Commission found these estimates to be “accurate, realistic and achievable,” and also recognized that “the synergies actually realized from the merger have a very high probability of exceeding the [company’s] estimates.”<sup>594</sup> The Commission also found that there was “no detriment to customers” by allowing the companies to recover synergy savings through regulatory lag.<sup>595</sup>

448. KCP&L and GMO began to retain synergy savings, in the form of reduced costs, immediately upon the closing of the acquisition. Given that KCP&L and GMO did not have its next rate case completed until September 1, 2009, the Great Plains shareholders

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<sup>589</sup> Merger Order at 241.

<sup>590</sup> Merger Order at 241, footnote 930.

<sup>591</sup> Merger Order at 240.

<sup>592</sup> Merger Order at 239.

<sup>593</sup> Merger Order at 234.

<sup>594</sup> Merger Order at 238.

<sup>595</sup> Merger Order at 120 and 238; Tr. at 3473.

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retained the entirety of these synergy savings for that period of time.<sup>596</sup>

449. The Companies developed and maintained a Synergy Tracking Model which demonstrated that the merger synergy savings for non-fuel operations and maintenance expense exceed the amortization of merger transition costs.<sup>597</sup>

450. The Companies also developed and maintained a synergy project charter database to track synergies not ordered to be tracked by the Commission.<sup>598</sup>

451. Staff performed an analysis of both the Commission ordered synergy savings tracking model and KCP&L created synergy project charter database. Staff's analysis showed that the amount of synergies in the synergy project database exceeded those in the Commission-ordered tracking system.<sup>599</sup>

452. As of September 1, 2009, the shareholders of KCP&L and GMO had realized over \$59.3 million in synergy savings.<sup>600</sup>

453. As of June 30, 2010, the shareholders of KCP&L and GMO had realized approximately \$121 million in retained synergy savings.<sup>601</sup>

454. KCP&L and GMO project that total synergy savings through 2013 will be \$344 million.<sup>602</sup> Of that amount, KCP&L and GMO project that ratepayers will receive \$150 million.<sup>603</sup>

455. The synergy savings exceed the level of the amortized costs.<sup>604</sup>

456. The Companies stopped the deferral of transition costs as of December 31, 2010.

457. No party challenged the reasonableness or prudence of incurring the merger transition costs. In addition, Staff's witness stated that the transition costs incurred by the company were not unreasonable

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<sup>596</sup> Ex. KCP&L 230.

<sup>597</sup> Ex. KCP&L 35; Ex. KCP&L 230 at p. 7.

<sup>598</sup> Ex. KCP&L 230 at pp. 7-8; Ex. KCP&L 35 at pp. 7-10

<sup>599</sup> Ex. KCP&L 230 at pp. 7-8.

<sup>600</sup> Ex. 230, Majors Rebuttal, p. 12.

<sup>601</sup> Ex. 230, Majors Rebuttal, p. 9.

<sup>602</sup> Ex. 230, Majors Rebuttal, p. 14.

<sup>603</sup> Ex. 230, Majors Rebuttal, p. 14.

<sup>604</sup> Ex. KCP&L 35, Ives Direct at 4, 7-10; Ex. KCP&L 230 Majors Rebuttal at 7-8; Tr. at 3472.

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or imprudent.<sup>605</sup>

458. Staff did an analysis of the Companies' Administrative & General (A&G) expenses and other electric utilities in the region.<sup>606</sup> Staff's analysis indicates that on a combined company basis, KCP&L and GMO have the highest A&G expenses per customer, per megawatt hour sold and per dollar of operating revenue.<sup>607</sup>

**Conclusions of Law – Transition Cost Recovery**

41. In the Merger Order, the Commission expressly precluded any recovery of transaction costs,<sup>608</sup> but the Commission reserved consideration of recovery of the transition costs when it said:

The Commission will give consideration to their [transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCP&L and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.<sup>609</sup>

42. While leaving the possibility for future recovery of transition costs, the Commission expressly reserved that decision for a "later proceeding" stating in the ordered paragraphs that:

13. Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.

14. The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.<sup>610</sup>

43. With regard to the recovery of transition costs, the Merger Order contains a summary of what KCP&L had originally requested. That summary states in part, "This period would begin with the first rate cases post-transaction for Aquila and KCP&L subject to 'true

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<sup>605</sup> Tr. at 3448, 3470, 3489.

<sup>606</sup> Ex. KCP&L 231 at p. 16.

<sup>607</sup> Ex. KCP&L 231 at pp. 16-17.

<sup>608</sup> Merger Order at 239-240.

<sup>609</sup> Merger Order at 241, footnote 930.

<sup>610</sup> Merger Order at 284.

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up' of actual transition . . . costs in future cases.”<sup>611</sup>

44. In the Merger Order, the Commission “authorize[d] KCP&L and Aquila to defer transition costs to be amortized over five years.”<sup>612</sup>

45. The Companies accumulated all transition costs consistent with the Merger Order. The Commission concludes that the Companies have complied with the Merger Order as it relates to recovery of transition costs.

46. The Commission further concludes that the Merger Order contemplated the Companies would be permitted to retain synergy savings through regulatory lag.

47. “The PSC is not bound by *stare decisis* based on prior administrative decisions, so long as its current decision is not otherwise unreasonable or unlawful.”<sup>613</sup> Thus, even had the Merger Order not expressly reserved any questions regarding ratemaking treatment to a “later proceeding,” this Commission would still have the ability to consider the issue without being bound by the previous Commission’s decision.

48. Generally, conflicting provisions “must be read together, and so harmonized as to give effect to [all] when this can be reasonably and consistently done.”<sup>614</sup>

**Decision – Transition Cost Recovery**

Staff and the Industrials argue that because retained synergy savings resulting from regulatory lag exceeded the amount of transition costs, recovery of the transition costs would constitute double recovery and therefore be unreasonable and inequitable. In response, the Companies argue that the Commission created an expectation in its Merger Order, that so long as the transition costs were deemed reasonable and prudent, and the Companies could demonstrate that synergy savings exceed the level of amortized transition costs, the Companies would be permitted to recover the transition costs in rates.

No party to this proceeding has challenged the reasonableness and prudence of the claimed transition costs or challenged the amount of

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<sup>611</sup> Merger Order at 239.

<sup>612</sup> Merger Order at 241.

<sup>613</sup> State ex rel. Ag Processing, Inc. v. Public Service Commission, 120 S.W.3d 732, 736 (Mo. banc 2003).

<sup>614</sup> State ex rel. McClellan v. Godfrey, 519 S.W.2d 4, 8 (Mo. banc 1975) (citing to Straughan v. Meyers, 187 S.W. 1159 (Mo. 1916)).

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synergy savings. While true that the Companies' shareholders have enjoyed the benefit of regulatory lag in retaining synergy savings since the merger was consummated, the Commission finds that this outcome was specifically contemplated in its consideration of the appropriate treatment for synergy savings in the merger case and as set out in the Merger Order. The Commission also finds that it specifically contemplated that synergy savings would be higher than predicted.

This outcome does not constitute double recovery because the costs were not authorized to be recovered, but rather were deferred by the Merger Order to be considered in a later rate case – this case. The Commission expected that recovery would only occur if the Companies incurred the costs prudently and reasonably and demonstrated that the synergy savings were more than the transition costs. The Companies have done this.

To read the Merger Order as Staff and the Industrials would read it makes the order contradict itself. If the transition costs could not be recovered unless they were more than the synergy savings, yet they could not be recovered until netted against the synergy savings, there would be no costs to defer or to amortize over a five-year period.

Staff also argues that the A&G expenses of the Companies were higher than average and attempted to make a connection to the transition costs being unreasonable. The Commission gives little weight to that argument since Staff's witness testified that these transition costs were not incurred unreasonably or imprudently. The Commission concludes that the transition costs were reasonable and prudent.

Staff also argues that the companies should have begun amortizing these costs in the previous rate cases per the Merger Order.<sup>615</sup> At first glance, the Merger Order does imply that the five-year amortization will begin from the first rate case after the transaction is consummated.<sup>616</sup> However, that statement is just a restatement of what the Companies were proposing. The Commission never specifically orders that treatment. Furthermore those rate cases were resolved through settlement and this issue was not addressed in that settlement so the issue never came before the Commission for consideration. Thus, this is the first opportunity for the amortizations to begin and Commission determines they will be amortized over five years beginning with this rate case.

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<sup>615</sup> Staff Report, Ex. GMO 210, p.221.

<sup>616</sup> Merger Order at 239.

The evidence in this case supports the Commission's original findings in the Merger Order that the Companies should be permitted to recover the merger transition costs in rates over five years beginning with rates effective from this case.

**C. Rate Case Expense**

***What is the appropriate level of rate case expense to include in this proceeding?***

***Findings of Fact – Rate Case Expense***

459. KCP&L and GMO seek to recover rate case expenses incurred through the true-up date of December 31, 2010, of \$4,593,427 in the KCP&L case and \$3,177,725 for GMO<sup>617</sup> the case (rounded to \$7.7 million total rate case expense).<sup>618</sup>

460. Per an informal agreement with Staff, a substantial amount of rate case expense that occurred after the April 30, 2009 true-up date of the 2009 KCP&L (ER-2009-0089) and GMO rate cases (ER-2009-0090) was transferred to the current rate case.<sup>619</sup> Approximately 50% of the total rate case costs in the 2009 KCP&L rate case and 40% in the GMO 2009 rate case were recorded after the true-up in those cases and these costs were transferred to the current rate cases.<sup>620</sup>

461. Of the \$7.7 million total, \$1.6 million is deferred rate case expense from those previous rate cases. The total additional rate case expense sought for these cases, ER-2010-0355 and ER-2010-0356, through the true-up period is \$6.1 million.

462. Staff does not object to the Companies' proposal to defer rate case expense incurred after December 31, 2010, for consideration in a future rate case so long as Staff has an opportunity to review those expenses for prudence and reasonableness in that subsequent case.<sup>621</sup> No other party objected to this proposal.

463. Staff's detailed requests for rate case expense disallowances appeared in the true-up portion of the proceeding. Staff claims this was because it did not receive adequate supporting documentation from the Companies on a timely basis.<sup>622</sup>

464. On June 25, 2010, Staff requested all rate case expense

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<sup>617</sup> This breaks down to \$2,001,855 for MPS and \$1,175,870 for L&P.

<sup>618</sup> Ex. KCP&L 309, p. 9.

<sup>619</sup> Ex. KCP&L 63 at p.61.

<sup>620</sup> Ex. KCP&L 64 at pp. 22-23; Ex. GMO 43 at p. 4.

<sup>621</sup> Ex. KCP&L 310 at p. 2.

<sup>622</sup> Ex. KCP&L 309 at p. 2.

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invoices from KCP&L in Data Request (DR) No. 141.<sup>623</sup> KCP&L responded on July 12, 2010, indicating that the request was “voluminous” and “If a specific vendor invoice or invoices is required, please advise.”<sup>624</sup> Staff followed up with DR 141.1 on September 3, 2010, with a narrower request for invoices over \$5,000.<sup>625</sup> KCP&L responded on September 23, 2010, by providing “face sheets” for certain legal expenses.<sup>626</sup> These face sheets provided very little information about the charges.

465. Face sheets were provided in prior cases and if additional detail was required, the company provided it. The face sheets were timely provided in response to Staffs request for legal invoices. When additional detail was requested, the detail was also provided in a timely manner with redactions for privileged material made.<sup>627</sup>

466. Staff issued DR 141.2 on November 3, 2010, seeking full invoice detail for the invoices.<sup>628</sup> KCP&L responded on November 24, 2010.<sup>629</sup> On November 24, 2010, Staff expanded its invoice request with DR 141.3 which asked for all invoices over \$1,000.<sup>630</sup> KCP&L provided the invoices on December 30, 2010.<sup>631</sup> KCP&L made no objection or assertion of privilege to DR 141.3.<sup>632</sup>

467. Staff initially advocated disallowance of all legal expenses from vendors Stinson, Morrison & Hecker; Schiff Hardin; Pegasus Global; and Morgan, Lewis, & Bockius. After reviewing the invoices, however, Staff changed its position in its true-up testimony to advocate a disallowance of all legal expenses of Morgan, Lewis & Bockius; an adjustment to rate case expenses charged by Schiff Hardin; an adjustment for NextSource; and an adjustment for services of The Communication Counsel of America.<sup>633</sup>

468. The hourly rates of Morgan, Lewis & Bockius were

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<sup>623</sup> Ex. KCP&L 291, Ex. KCP&L 231, p. 27.

<sup>624</sup> Ex. KCP&L 291.

<sup>625</sup> KCP&L 231, p.27.

<sup>626</sup> KCP&L 231, p. 27; and Ex. KCP&L 292.

<sup>627</sup> Tr. pp. 3640-42.

<sup>628</sup> Ex. KCP&L 231, p. 28.

<sup>629</sup> Ex. KCP&L 231, p. 28.

<sup>630</sup> Ex. KCP&L 231, p. 28.

<sup>631</sup> Ex. KCP&L 231, p. 28.

<sup>632</sup> Ex. KCP&L 231, p. 28.

<sup>633</sup> Ex. KCP&L 309 at pp. 2-9.



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significantly higher than the highest paid attorney from a Missouri firm in this case.<sup>634</sup> The Kansas Corporation Commission also found this vendor's services to be duplicative. The KCC noted the duplicative nature of Ms. Barbara Van Gelder's services for the firm and noted she was retained to cross-examine one particular Staff witness, but that four capable attorneys for KCP&L were in the hearing room while she did so.<sup>635</sup>

469. During the cross-examination on rate case expense, two external counsel and two internal counsel were present in the hearing room for KCP&L and GMO.<sup>636</sup> Also, during the April 2010 proceedings related to File No. EO-2010-0259, several KCP&L outside attorneys were present at one time or another, including Mr. Riggins, former general counsel at KCP&L, an attorney from SNR Denton, an attorney from Fischer & Dority, an attorney from Stinson, Morrison & Hecker, and an attorney from Morgan, Lewis & Bockius.

470. Morgan Lewis was employed in Commission File No. EO-2010-0259 which has been consolidated with the current rate case so that the information could be readily shared between files. File No. EO-2010-259 was an on-the-record proceeding to determine the status of Staff's latan 1 audit. That proceeding was important to the rate case in that the Staff was to explain every aspect of the latan 1 construction audit. That audit is part of this rate case and the data requests in that docket are linked to this rate case.

471. With regard to the invoices related to Schiff Hardin, Staff proposes to disallow a portion of the expenses by, in effect, discounting the rate charged by Schiff Hardin attorneys to the hourly rate charged by Pegasus Global Holdings.<sup>637</sup> Staff claims this discount is reasonable "given the number of attorneys retained in these proceedings" it is reasonable to "assume" there was duplicative legal services.<sup>638</sup> Staff also reasons that because Pegasus Global Holdings provided services to KCP&L and GMO for expert testimony on the prudence of latan, and because Schiff Hardin provided expert testimony on the prudence of latan, that it is reasonable to assume there is some duplication of services.

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<sup>634</sup> Ex. KCP&L 309 at pp. 2-9.

<sup>635</sup> Ex. KCP&L 231 at Sch. 5.

<sup>636</sup> Tr. pp. 3629-3632.

<sup>637</sup> Ex. KCP&L 309, at 6.

<sup>638</sup> Ex. KCP&L 309, at 6-7.

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472. Schiff Hardin's hourly rates for attorneys and consultants were almost two times that of Pegasus' fees.<sup>639</sup>

473. The hourly rate charged by Schiff Hardin in the KCC case exceeded those for experienced attorneys in the Kansas City metropolitan area.<sup>640</sup>

474. The Kansas Corporation Commission heard many of the same issues that are before this Commission including rate case expense.<sup>641</sup> The KCC found that the expenses requested for Schiff Hardin were "particularly troubling."<sup>642</sup> And, while the KCC noted the case contained complex issues concerning the construction of a major generating facility, it found it "unreasonable to require ratepayers to be responsible for the entire rate case expense costs being sought by KCP&L."<sup>643</sup>

475. KCP&L and GMO did not object to any of Schiff Hardin's bills for legal services or any experts' invoices, or ask them to make any adjustments or corrections.<sup>644</sup>

476. In its last litigated rate case, KCP&L in-house attorneys shared in a great deal of the work associated with litigating that case. Those attorneys, whose salary and benefits are already recovered through rates, litigated issues associated with policy, off-system sales margins, Hawthorn 5 settlement costs and uranium enrichment overcharges.<sup>645</sup>

477. At least six outside attorneys with four different firms entered an appearance for KCP&L and GMO in this case.<sup>646</sup>

478. Regarding NextSource, Staff initially removed "all dollars KCP&L has included in rate case expense related to Mr. Giles' services as an independent contractor."<sup>647</sup>

479. Mr. Giles is currently a regulatory consultant to KCP&L. He has been in that capacity since his retirement in July 2009 from his position as KCP&L's Vice President, Regulatory Affairs. His

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<sup>639</sup> These highly confidential numbers are provided at Ex. KCP&L 309, p. 7.

<sup>640</sup> Ex. KCP&L 231, Surrebuttal Testimony of Keith Majors, Sch. 5-13.

<sup>641</sup> Docket No. 10-KCPE-415-RTS, Order dated Nov. 22, 2010 (KCC Order).

<sup>642</sup> Ex. KCP&L 231, Sch. 5-13.

<sup>643</sup> Ex. KCP&L 231, Sch. 5.

<sup>644</sup> Tr. 267-268.

<sup>645</sup> Ex. 1217

<sup>646</sup> See *generally*, Hearing Transcripts.

<sup>647</sup> Ex. KCP&L 9 at p. 6, quoting Majors Rebuttal Testimony, Ex. KCP&L 230 at p. 21.

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responsibilities “include assisting and advising the current Senior Director, Regulatory Affairs.”<sup>648</sup>

480. At the time of his testimony, Mr. Blanc was the current Senior Director, Regulatory Affairs, assuming many of the duties that Mr. Giles’ did before his retirement.

481. Mr. Giles’ salary and benefits were included in the rates that resulted from GMO’s last rate case (ER-2010-0090) and have been in GMO’s revenue requirement used to set its electric utility rates for many years. While Mr. Giles’ job duties are not exactly the same as Mr. Blanc’s as Mr. Blanc’s his work is somewhat duplicative.<sup>649</sup>

482. The KCC did not include any expenses for NextSource (Mr. Giles) because KCP&L could not explain why its own employees could not perform the work done by this vendor.<sup>650</sup>

483. In the true-up case, with regard to Mr. Giles’ consulting fees, Staff proposed to reallocate the total adjustment between KCP&L and GMO using the payroll factors for labor expenses used in Staff’s payroll annualization.<sup>651</sup> Staff recommends allocating the disallowance within the true-up to 67% to KCP&L, 23% to GMO-MPS and 10% to GMO-L&P.

484. Staff also proposes removing the costs associated with The Communication Counsel of America from rate case expense. The services provided by The Communication Counsel of America related to witness development and coaching services. These are routine tasks typically performed by retained counsel, internal or otherwise.<sup>652</sup> Specifically, The Communication Counsel of America was engaged to prepare the Companies’ later prudential witnesses.

485. The CCA also trained KCP&L witnesses for the KCC hearing.<sup>653</sup> The KCC disallowed expenses related to The Communication Counsel of America as unjust and unreasonable.<sup>654</sup> While the KCC noted witness preparation as important it stated that, “such preparation is routinely part of the service counsel performs before a hearing.”<sup>655</sup>

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<sup>648</sup> Ex. KCP&L 24 at p. 1.

<sup>649</sup> Ex. KCP&L 230 at p.12.

<sup>650</sup> Ex. KCP&L 231, Sch. pp. 5-11.

<sup>651</sup> Ex. KCP&L 309 at p. 8.

<sup>652</sup> Ex. KCP&L 309 at p. 8.

<sup>653</sup> Ex. KCP&L 231, Sch. p. 5-11.

<sup>654</sup> Ex. KCP&L 231, Sch. p. 5-11.

<sup>655</sup> Ex. KCP&L 231, Sch. p. 5-11.

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486. The Companies' shareholders benefit from having good advocates and experts for rate cases. Specifically, the Companies receive the benefit of a greater recovery of [the Companies'] costs . . . for decades to come".<sup>656</sup>

487. The Companies' ratepayers benefit from having good advocates and experts for rate cases. Specifically, the ratepayers receive the benefit of reduced costs of borrowing for the Companies if the Companies get a sufficient recovery of assets in rates.<sup>657</sup>

488. The benefits to shareholders and ratepayers of having good advocates and experts are more significant with a large dollar and complex issue such as the latan prudence issues.<sup>658</sup>

489. KCP&L and GMO relied heavily on the use of outside consultants for the litigation of these cases. The following consultants each filed testimony in this matter and were charged to Missouri rate case expense: Chris Giles;<sup>659</sup> Gary Goble;<sup>660</sup> Samuel Hadaway;<sup>661</sup> Steven Jones;<sup>662</sup> Larry Loos;<sup>663</sup> Daniel Meyer;<sup>664</sup> Kris Nielsen;<sup>665</sup> Paul Normand;<sup>666</sup> Kenneth Roberts;<sup>667</sup> Michael Schnitzer;<sup>668</sup> John Spanos;<sup>669</sup> and Ken Vogl.<sup>670</sup>

490. Staff has no objection to KCP&L and GMO amortizing its rate case expense over a two-year period and deferring expenses incurred after the December 31, 2010, true-up date with Staff review for prudence and reasonableness.<sup>671</sup>

491. The KCC ordered a four-year amortization period for rate

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<sup>656</sup> Tr. 3647.

<sup>657</sup> Tr. 3648-3649.

<sup>658</sup> Tr. 3648.

<sup>659</sup> Exs. KCP&L 24 and 25.

<sup>660</sup> Ex. KCP&L 26.

<sup>661</sup> Exs. KCP&L 27-29.

<sup>662</sup> Ex. KCP&L 38.

<sup>663</sup> Exs. KCP&L 39-41.

<sup>664</sup> Ex. 43-45.

<sup>665</sup> Ex. 46.

<sup>666</sup> Ex. 47-49.

<sup>667</sup> Ex. 50-53.

<sup>668</sup> Ex. 58.

<sup>669</sup> Ex. 59-61.

<sup>670</sup> Ex. 62.

<sup>671</sup> Ex. KCP&L 310, p. 2.

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case expense.<sup>672</sup>

492. KCP&L and GMO have no plans to file their next rate cases.<sup>673</sup>

493. Some adjustment in the amortization period for rate case expense is reasonable. The Commission finds that a three-year amortization period is sufficient.

**Conclusions of Law – Rate Case Expense**

49. The Commission can disallow costs that are not of benefit to ratepayers, and there does not need to be a showing of bad faith or abuse of discretion for the Commission to disallow costs.<sup>674</sup>

50. In File No. GR-2004-0209, the Commission reduced the amount of rate case expense incurred by Missouri Gas Energy (MGE) by the disallowance of certain attorney fees. In that Report and Order, the Commission recognized the unfairness of charging ratepayers high attorney fees.<sup>675</sup>

51. In a 1993 Missouri-American decision, the Commission attempted to provide some definition by which to measure whether rate case expense is necessary and prudently incurred. In that case the Commission based its decision on whether actual evidence exists of cost containment.

The Commission must continue to look to the record for evidence in support of rate case expense and in this case that evidence is lacking. Disallowing all expense, or perhaps even disallowing any prudently incurred rate case expense could be viewed as violating the Company's procedural rights. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. **The operative words here, however, are necessary and prudently incurred. The record does not reflect efforts at cost containment and**

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<sup>672</sup> Docket No. 10-KCPE-415-RTS, Order dated Nov. 22, 2010, ordered paragraph R, p. 140.

<sup>673</sup> Tr. 3373.

<sup>674</sup> *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 600 S.W.2d 222, 228-29 (Mo. App., W.D. 1980), *app. dis'd*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 55-56 (Mo. App., W.D. 1982).

<sup>675</sup> *Report and Order*, File No. WR-93-212 (issued November 18, 1993). (Emphasis Added.)

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**consequently it does not support that these expenses have been prudently incurred.**<sup>676</sup>

Absent evidence of cost containment, the Commission in that case disallowed approximately one-third of Missouri American's rate case expense.

***Decision – Rate Case Expense***

KCP&L and GMO ask that they be allowed to recover the entirety of their \$7.7 million rate case expense (including \$1.6 million from the previous cases and \$6.1 million combined for the current cases) in rates amortized over a two-year period with any rate case expense incurred after the true-up period to be deferred to the next rate cases. In response, Staff and MEUA propose to disallow a certain portion of those costs. Staff sets out specific disallowances while MEUA proposes an across the board 33% reduction.<sup>677</sup> In addition, MEUA suggests that the Commission amortize the rate case expense over a four-year period instead of a two-year period.<sup>678</sup>

The Companies were somewhat obstructive in responding to Staff's data requests by not providing full information up front and thus requiring Staff to make several requests before obtaining the information it had requested. Staff, however, does not explain its own delays in making follow-up requests, nor did Staff bring the non-responsive answers to Commission's attention in an expedient manner through a discovery conference or at the status conferences held for this purpose. Therefore, the Commission finds that both parties were to blame for the delays in getting information to Staff. Because the Companies are partially to blame for this delay, the Commission finds that it was proper for the Staff to bring its specific rate case disallowances to the true-up proceeding.

Although the Commission acknowledges the complexity and significance of these rate cases, the Commission is concerned with the

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<sup>676</sup> *Id.*

<sup>677</sup> MEUA incorrectly argues that the total rate case expense for ER-2010-0355 and ER-2010-0356 will be \$13.8 million. First, MEUA includes the \$1.6 million for the previous rate cases in its beginning figure, then it adds an additional \$6.1 million as testified to by Mr. Weisensee (Tr. 3634). MEUA, however, misinterprets Mr. Weisensee's testimony. The Commission interprets Mr. Weisensee as stating that the rate case expense being claimed for ER-2010-0355 and ER-2010-0356 is \$6.1 million through the end of the true-up period. There will certainly be a substantial amount more rate case expense to follow; however, the evidence is unclear what additional rate case expense for these cases will be deferred to the next rate case.

<sup>678</sup> Industrials' Initial Brief p. 66-67.

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continued increase of rate case expenses. It is undisputable that shareholders benefit from hiring the very best advocates and experts. This clearly aids in their ability to argue for a higher return on equity as well as the recovery of a greater percentage of costs. Yet, given the magnitude of these expenses (\$7.7 million dollars), with substantially more to be deferred to the next case, the Commission would expect to see some evidence that KCP&L and GMO had engaged in some cost containment. Mr. Blanc, however, testified that of the invoices received for legal fees and expert consultants not one was questioned by the Companies.

Certainly, given the benefits enjoyed by the shareholders, the evidence presented by Staff, and absent some sort of cost containment some disallowances are necessary. The Commission also recognizes that, unlike the period during the Regulatory Plan, KCP&L and GMO have no definitive schedule for their next rate case. Faced with similar seemingly exorbitant expenses, the KCC ordered a four-year, rather than a two-year amortization period for rate case expense. The Commission determines that an extended amortization period for rate case expense is in order; however, based on the Commission's experience with these companies and the amount of rate case and other expenses being deferred to a future proceeding, the Commission determines that a three-year amortization period for rate case expense is sufficient.

With regard to Staff's proposed adjustment to remove all legal expenses of Morgan, Lewis & Bockius, Staff claims the attorneys' rates are excessive when compared to local attorneys, the expenses are not related to the current rate case and work is duplicative of other attorneys work. The Commission cannot determine that it is reasonable to apply the rates of Missouri law firm rates to the rates charged by attorneys practicing in other, possibly more expensive locations without better evidence. The Commission concludes the legal expenses of Morgan, Lewis & Bockius should not be eliminated as the costs were not duplicative or the evidence sufficiently competent to prove the fees were excessive.

The Commission concludes the Schiff Hardin and Pegasus witnesses each provided testimony on separate, discrete issues related to the reasonableness of the expenditures related to the construction of latan. As a result, there was no duplication of effort and Staff "assumed" incorrectly. Thus, the Commission rejects Staff's proposed disallowance, including a reduction to Schiff Hardin's rate as the evidence was not sufficiently competent to prove the fees were excessive.

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With regard to NextSource, however, the Commission concludes Mr. Giles and Mr. Blanc's work were somewhat duplicative. In addition, the question was raised but never answered as to why KCP&L internal employees were not able to provide the services Mr. Giles provided? Based on the record, the Commission determines that the expenses with regard to NextSource as allocated by Staff between the companies shall be disallowed.

Finally, Staff has proposed the disallowance of the expenses for the services of the CCA. The CCA provided witness development and coaching services, routine tasks typically performed by retained counsel, internal or otherwise. The KCC also disallowed similar expenses as unjust and unreasonable. The Commission determines that the CCA expense should be disallowed as duplicative of other services that were performed or should have been performed KCPL's and GMO's attorneys.

The amounts allowed and disallowed represent the true-up amounts recorded as of December 31, 2010, and are not final rate case expenses. Rate case expenses for these cases after the true-up will be deferred for possible recovery in the next rate case, subject to review for prudence and reasonableness.

### **D. Arbitration Fees**

***Should fees incurred in the advanced coal tax credit arbitration case be recoverable by KCP&L?***

#### ***Findings of Fact – Arbitration Fees***

494. The Commission previously issued its report and order related to the advanced coal tax credits for Iatan<sup>679</sup> (Coal Tax Credit Order) and adopts the findings of facts and conclusions of law in this order.

495. In 2008, KCP&L applied for and received a \$125 million qualifying advanced coal tax credit from the IRS associated with the construction of Iatan 2.<sup>680</sup>

496. Although there were several co-owners in the project, including The Empire District Electric Company (Empire), GMO, the Missouri Joint Municipal Electric Utility Commission (MJMEUC), and

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<sup>679</sup> File No. ER-2010-0355, *Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan* (issued March 16, 2011); clarified by File No. ER-2010-0355, *Order Granting Clarification of Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan* (issued March 30, 2011).

<sup>680</sup> Ex. KCP&L 223, p. 4.



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Kansas Electric Power Cooperative, Inc. (KEPCo), KCP&L sought to keep the entirety of the tax credit for itself.<sup>681</sup>

497. Upon realizing that KCP&L intended to keep the entirety of this credit, Empire filed a notice of arbitration in 2009 seeking its proportionate share of the tax credit (or the monetary equivalent).<sup>682</sup>

498. On December 30, 2009, the Arbitration Panel issued its Final Arbitration Award. In its decision, the Arbitration Panel harshly criticized the actions of KCP&L in failing to include the remaining co-owners in the tax credit, while sharing information with GMO with which it was about to be affiliated.<sup>683</sup>

499. As of October 31, 2010, KCP&L had paid the SNR Denton law firm over \$617,000 for “both the arbitration proceedings and its appeal of the arbitration panel’s decision.”<sup>684</sup> KCP&L seeks to recover that amount in this rate case.

500. The expenses that KCP&L incurred in defending the arbitration claims brought by Empire, MJMEUC, and KEPCo, including efforts taken after the arbitration award was issued, were to preserve its rights including the appellate rights of KCP&L while it approached the IRS to amend the 2008 MOU and to assure that a normalization violation did not occur.

501. The ratepayers would not have been in the position of needing to defend the tax credits from a normalization violation if KCP&L had not acted inappropriately with regard to not including GMO and Empire in the tax credit application.<sup>685</sup> Neither the ratepayers of GMO or KCP&L have been provided any benefit associated with this expense.<sup>686</sup>

**Conclusions of Law – Arbitration Fees**

52. The Commission adopts the conclusions of law from its Coal Tax Credit Order.<sup>687</sup>

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<sup>681</sup> Ex. KCP&L 223, p. 4.

<sup>682</sup> Ex. KCP&L 223, pp. 4-5.

<sup>683</sup> Ex. KCP&L 223, at Sch. 1-3.

<sup>684</sup> Ex. KCP&L 231, p. 19.

<sup>685</sup> Coal Tax Credit Order.

<sup>686</sup> Ex. 231, Majors Surrebuttal, p. 19.

<sup>687</sup> File No. ER-2010-0355, *Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan* (issued March 16, 2011); clarified by File No. ER-2010-0355, *Order Granting Clarification of Report and Order Directing KCPL and GMO to Apply to the IRS to Revise the Memorandum of Understanding Regarding the Advanced Coal Tax Credits for Iatan* (issued March 30, 2011).

***Decision – Arbitration Fees***

In 2008, KCP&L applied for and received a \$125 million qualifying advanced coal tax credit from the IRS associated with the construction of latan 2. Although KCP&L had several other partners in the project, including GMO, KCP&L did not inform its partners of its applications. KCP&L now seeks to recover from the ratepayers the fees for the arbitration in which it then had to defend itself to keep its tax credits intact.

Even though the ratepayers benefit from the tax credits, they have been provided no benefit associated with the defense of those tax credits caused by KCP&L's imprudent conduct in not including its co-owners in the applications. If the Commission grants KCP&L recovery of these legal fees, the Commission will be encouraging this utility to engage in improper actions.

The Commission determines that the arbitration expenses KCP&L has incurred in defending itself for its imprudent acts are disallowed from KCP&L's cost of service for setting rates.

**E. Low Income Weatherization Program**

***A. Should KCP&L and GMO continue to fund their low-income weatherization programs at the current levels of funding?***

***B. If so, should the funds continue to be administered under current procedures or should the Commission order they be deposited into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and MDNR?***

***Findings of Fact – Low Income Weatherization***

502. Current funding by KCP&L and GMO for low income weatherization programs annually is \$573,888 and \$150,000, respectively.<sup>688</sup>

503. KCP&L has spent approximately ninety-six percent (96%) of the budgeted funds for its existing low-income weatherization program.<sup>689</sup>

504. GMO has utilized a much lower percentage of the 2007 through 2010 budgeted funds for weatherization.<sup>690</sup>

505. Staff recommended that KCP&L and GMO be required

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<sup>688</sup> Ex. KCP&L 210, Staff's COS Report, p. 143; Ex. GMO 210, p. 156.

<sup>689</sup> Ex. KCP&L 246, Warren Surrebuttal at p. 4; Tr. p. 3606.

<sup>690</sup> The exact number is contained in the "Highly Confidential" Testimony of Henry E. Warren (HC), Staff Report, Revenue Requirement Cost of Service. Ex. GMO 210, p.154

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to continue to provide annual funding of \$573,888 and \$150,000, respectively. Staff also suggested that unspent weatherization funds should be placed into an account with EIERA.<sup>691</sup>

506. The Environmental Improvement and Energy Resources Authority (EIERA) is a program affiliated with MDNR. EIERA is a separate and distinct entity—a quasi-governmental agency—and is not a party to these cases. EIERA has a much broader scope and mission than just administering weatherization funds under MDNR guidelines. EIERA is “involved in numerous projects and programs including providing bond financing for environmental projects such as water and wastewater treatment facilities, energy efficiency loans and other pollution control projects. . . . EIERA has broad statutory authority that goes significantly beyond managing and disbursing federal and other weatherization funding for MDNR.”<sup>692</sup>

507. The EIERA program has recently spent a much lower percentage of its funds than KCP&L for weatherization purposes.<sup>693</sup>

508. KCP&L and GMO disagree with both of Staff proposals.

509. The Customer Program Advisory Group (CPAG) includes Staff, the Office of the Public Counsel, the Missouri Department of Natural Resources, the City of Kansas City, and Praxair, Inc. The CPAG has tracked, discussed, and overseen the implementation and evaluation of KCP&L's Low-Income Weatherization Program.<sup>694</sup>

510. The GMO Advisory Group (GMOAG) includes Staff, the Public Counsel, the MDNR, the City of Kansas City, and the Sedalia Industrial Energy Users Association. The GMOAG has tracked, discussed, and overseen the implementation and evaluation of GMO's Low-Income Weatherization Program.<sup>695</sup>

511. Prior to Staff's proposal in this proceeding, MDNR had not been approached by any party regarding the proposal to transfer funds to EIERA. To accommodate Staff's request, EIERA would have to balance resources with other projects they are involved in, and consider whether there are significant design differences between the federal

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<sup>691</sup> Ex. KCP&L 246 and Ex. GMO 247, Warren Surrebuttal.

<sup>692</sup> Ex. GMO 603, Bickford Surrebuttal at p. 3.

<sup>693</sup> Tr. p. 3608.

<sup>694</sup> KCP&L-GMO Low Income Weatherization Program Evaluation, Opinion Dynamics Corporation, August, 2010.

<sup>695</sup> KCP&L-GMO Low Income Weatherization Program Evaluation, Opinion Dynamics Corporation, August, 2010.

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weatherization programs and KCP&L's program.<sup>696</sup>

512. There are a number of administrative burdens for MDNR and EI ERA that must be considered in order to place these funds in EI ERA. No other public utility--gas or electric--has been ordered to deposit weatherization funds with EI ERA; in every other case it has been the utility that requested such an arrangement. Furthermore, payment of funds could not be effectuated prior to execution of an agreement with EI ERA, which in all other cases has taken the form of a Cooperation and Funding Agreement entered into voluntarily by EI ERA, MDNR, the Missouri Public Service Commission and the public utility.<sup>697</sup>

513. In addition, KCP&L and GMO would need to commit to annual up-front funding for low-income weatherization programs for the Staff's proposed approach to be workable and the additional burdens to be justified.<sup>698</sup>

514. The benefits of placing these funds up-front with EI ERA would be to provide a definite amount of weatherization funding on an up-front basis, and provide for unspent funds, including interest, to be available to local weatherization agencies so that the funds remain available for the purpose for which they are dedicated, especially after American Recovery and Reinvestment Act funds are expended.<sup>699</sup>

515. No other public utility--gas or electric--has been ordered by this Commission without the utility's consent and support to deposit weatherization funds with EI ERA. In every other case it has been the utility that requested such an arrangement.<sup>700</sup>

516. Additionally, Staff is recommending that the Companies modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. To implement Staff's recommendation would be harmful to the Companies' cash flow and place an undue burden on the Companies.<sup>701</sup>

517. Staff further recommends that KCP&L and GMO deposit into an EI ERA account any budgeted money that has not been disbursed at the end of each fiscal year and that has been specifically targeted for the Low Income Weatherization Program to be utilized by the Community

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<sup>696</sup> Ex. KCP&L 605 and Ex. GMO 603, Bickford Surrebuttal at p. 3.

<sup>697</sup> Tr. 3605.

<sup>698</sup> Ex. KCP&L 605, Bickford Surrebuttal at p. 3.

<sup>699</sup> Ex. KCP&L 605 and Ex. GMO 603, pp. 2-3.

<sup>700</sup> Tr. 3604-3605.

<sup>701</sup> Ex. KCP&L 55 at p. 3; Ex. GMO 33 at pp. 12-13.

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Action agencies or other local agencies. Additionally, any funds that have not been spent as included in KCP&L's regulatory plan and GMO's 2007 through 2010 budget Staff recommends those funds should be put in an EIERA account.

518. Staff also recommends that funds expended be placed in the DSM regulatory asset account at the time it is provided to the weatherization agency or when sent to EIERA.

***Conclusions of Law – Low Income Weatherization***

53. The Commission has required spending by other utilities when the amount is recovered in rates as an expense.<sup>702</sup>

***Decision – Low Income Weatherization***

Two issues have been presented to the Commission for decision with regard to Low Income Weatherization programs: should the Companies be required to continue those programs and at the current level of funding; and if so, how should those funds be administered.

Staff recommended that KCP&L and GMO be required to continue to provide annual funding for low income weatherization programs in the amounts of \$573,888 and \$150,000, respectively.<sup>703</sup> Staff also suggested that unspent weatherization funds should be placed into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and the Missouri Department of Natural Resources (MDNR).<sup>704</sup>

MDNR agrees that the Companies should continue to fund their low income weatherization programs at the current funding levels, but recommends against Staff's proposed method of administration.

The Companies contend that this rate case is not the proper forum for a decision to continue the current funding levels for low income weatherization. KCP&L and GMO argue that such proposals should be first vetted with the advisory groups. The companies further argue that a Commission determination of the recovery mechanism for such programs should be made before a decision on the level of weatherization funding is made.

This rate case is the proper forum to discuss the issue of the

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<sup>702</sup> *In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*, Report and Order, File No. ER-2008-0318, (issued Jan. 27, 2009).

<sup>703</sup> Ex. KCP&L 210, Staff's COS Report, p. 143; Ex. GMO 210, p. 156.

<sup>704</sup> Ex. KCP&L 246 and Ex. GMO 247.

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Low Income Weatherization Program funding. The CPAG has tracked, discussed, and overseen the implementation and evaluation of KCP&L's Low-Income Weatherization Program. The GMOAG has tracked, discussed, and overseen the implementation and evaluation of GMO's Low-Income Weatherization Program.<sup>705</sup> However, as the name implies, these are *advisory* groups for implementing and evaluating the demand-side programs. The advisory groups cannot and should not decide the budget for low-income energy efficiency programs.

The Companies argue that the Commission cannot order spending without a cost recovery mechanism. KCP&L and GMO suggest it would be unlawful for the Commission to mandate specific funding for low income weatherization without a mechanism for the Companies to recover mandated expenditures. However, Staff's recommendations stem from programs and policies that KCP&L and GMO previously set in place. In addition, the Commission has required spending by other utilities when the amount is included in the case as an expense as it will be in this instance.<sup>706</sup>

Staff requests the Commission to order KCP&L and GMO to deposit low income weatherization funds into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and MDNR. While GMO failed to fully expend its low income weatherization funding budgeted during the regulatory plan, and recognizing there are some benefits to placing utility weatherization funds into an EIERA account, placing the funds with EIERA is not appropriate at this time. There may be significant program design differences between the federal low-income weatherization program and the companies' current low-income weatherization programs that would make program management and monitoring more difficult for MDNR. As described in MDNR witness Bickford's testimony, there are a number of administrative burdens for MDNR and EIERA that must be considered and KCP&L and GMO would need to commit to annual up-front funding for low-income weatherization programs for the Staff's proposed approach to be workable and the additional burdens to be justified. In addition, no other public utility--gas or electric--has been ordered by this Commission without the utility's consent and support to deposit weatherization funds with EIERA. In every other case it has been the utility that requested such an arrangement.

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<sup>705</sup> *Id.*

<sup>706</sup> File No. ER-2008-0318.

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Furthermore, while the EIERA is affiliated with MDNR, EIERA is a separate and distinct entity—a quasi-governmental agency--and is not a party to these cases. EIERA is “involved in numerous projects and programs including providing bond financing for environmental projects such as water and wastewater treatment facilities, energy efficiency loans and other pollution control projects. . . .EIERA has broad statutory authority that goes significantly beyond managing and disbursing federal and other weatherization funding for MDNR.”<sup>707</sup> The Commission also concludes that it is unreasonable to require that KCP&L deposit funds into an EIERA account until the advisory groups have reviewed and made a recommendation on the proposal.

The Commission also concludes that it will not adopt Staff’s recommendation that the Companies be required to modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. The Commission concludes that this recommendation would be harmful to the Companies’ cash flow and place an undue burden on the Companies.

The Commission determines that KCP&L and GMO shall: continue their respective low-income weatherization programs at their current levels of funding; continue working with local community action agencies; and evaluate transition of the low income weatherization funds to the EIERA and administration of the programs to DNR and present that evaluation to the CPAG or GMOAG for consideration. If the CPAG or GMOAG determines that MDNR administration of funds to be provided to EIERA is appropriate, a Cooperative Funding Agreement will be presented to the Commission, consistent with the method of funding other utility weatherization programs.

**THE COMMISSION ORDERS THAT:**

1. The seven Nonunanimous Stipulations and Agreements referenced in this Report and Order are approved, and the signatories thereto are ordered to comply with those Nonunanimous Stipulations and Agreements..
2. The proposed tariff sheets filed by Kansas City Power & Light Company on June 4, 2010, Tariff No. JE-2010-0692, are rejected.
3. Kansas City Power & Light Company shall file tariffs that comport with this Report and Order no later than April 18, 2011.
4. The Staff of the Commission shall file a recommendation regarding the tariffs ordered in paragraph 3 no later than April 22, 2011.

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<sup>707</sup> Ex. GMO 603, p. 3.

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Any party that wishes to object to the tariffs ordered in paragraph 3 shall do so no later than April 22, 2011.

5. Staff's March 18, 2011 objection to Kansas City Power & Light's late-filed exhibit is overruled, and the exhibit is admitted into evidence as KCP&L Exhibit 127.

6. The late-filed exhibit filed on March 2, 2011 by Kansas City Power & Light is admitted into evidence as KCP&L Exhibit 128.

7. All pending motions and other requests for relief not granted are denied.

8. This Report and Order shall become effective on April 22, 2011.

Gunn, Chm., concurs;  
Clayton, Davis, and Jarrett, CC., concur,  
each with a separate concurring opinion  
to follow;  
Kenney, CC., concurs; separate concurring  
opinion may follow;  
and certify compliance with the provisions  
of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,  
on this 12<sup>th</sup> day of April, 2011.

\*NOTE: See pages 111, 142, 186 and 328 for other orders in this case.

\*NOTE: At the time of publication, no opinions of Commissioners Clayton, Davis and Kenney have been filed.

**CONCURRING OPINION OF COMMISSIONER TERRY M. JARRETT  
IN THE REPORT AND ORDER**

I believe that the final Report and Order in total allows for just and reasonable rates and the delivery of safe, adequate and reliable service while also providing an opportunity to earn a fair rate of return for the shareholder. However, there are three issues that I wish to address in my concurrence; (1) rate case expense, specifically attorney's fees (2) Demand Side Management ("DSM"), and (3) Low Income Weatherization.

**Rate Case Expense – Attorneys Fees**

In this case, nearly all of the rate case expenses were allowed. I agree with how rate case expenses were handled in this case. My



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concern is that, in this case, and in other prior Commission cases, some Commissioners suggested that utility shareholders should share in rate case expense because shareholders benefit from rate case expense. In this case, at least one party argued that a rate increase tariff filing allows the utility the opportunity to argue for a higher return on equity as well as the recovery of imprudent or unreasonable costs.

What these arguments fail to recognize is that both shareholders and ratepayers benefit from all kinds of spending by the utility. Ratepayers receive many benefits from expenses that are born solely by the ratepayers (for example, executive bonus programs used to retain excellent managers typically are not included in rate base). Should this Commission require the ratepayers to pay a share of those expenses because they receive the benefit of a properly managed utility? I do not think any ratepayer advocate would argue for that. Rate case expense is a necessary cost of doing business because utilities have a legal obligation to provide safe, adequate and reliable service to ratepayers, and that meeting that obligation may only be achieved through the rate making process. When their costs rise, the utilities' only recourse is to come to the Commission and ask for a rate increase to recover those additional costs. Routinely Staff and other parties vigorously oppose such increases. Utilities must hire lawyers and experts to prove their case because utilities have the burden of proof. It has been my experience that utilities rarely, if ever, receive everything they ask for.

In a cost based regulatory system, like we have here in Missouri, recovery of prudently incurred costs by the utility ensures a balance of the regulatory paradigm. Singling out a cost for different rate treatment, where the same rationale for different treatment could be applied to any other cost, risks disincentivizing utilities to meet their statutory obligations. Because the rate increase proceeding is the only mechanism available to the utility for meeting its regulatory obligations, I believe it is inappropriate, in a cost based regulatory system, to disallow any prudently incurred rate case expenses.<sup>1</sup>

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<sup>1</sup> I should note that I supported the Commission's Order to open an investigatory docket to look at this issue (Case No. AW-2011-0330). While I am open to receiving the result of the investigation, I am mindful that if this Commission were to decide that shareholders should not recover all prudently incurred rate case expenses, this Commission would be virtually alone in advancing this novel theory. I am also concerned that denying a utility the right to recover prudently incurred costs in a cost-based regulatory system like Missouri's would be confiscatory and thus unconstitutional.

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### Demand Side Management (DSM) Programs

In 2009 the Missouri Legislature passed Senate Bill 376, the “Missouri Efficiency Investment Act” (“MEEIA”) which became law on August 28, 2009. The law makes clear the policy of this state with regard to demand-side investments which is that they be *valued* equal to traditional investments in supply and delivery infrastructure and that a utility be allowed recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs. Section 393.1075.3 RSMo Cum. Supp. 2009. This policy statement, made by the Missouri Legislature, does not set a requirement that a utility have demand side investments, rather it sets forth the manner in which those *voluntary investments* will be treated for valuation purposes.<sup>2</sup>

The Commission’s Integrated Resource Planning (“IRP”) Rule also does not mandate or require any particular demand side investment by a utility; rather, the IRP serves as a guide for future generation planning, and allows for flexibility on the part of the utility. Both MEEIA and the IRP maintain separation between the regulator, the legislature and the utility in the management of the utility, ensuring that neither the law nor the Commission’s rules encroach on the province of the utilities’ management.

This Order’s proscription of a DSM program is a far cry from DSM being a balanced proposition as is described in the Report and Order.<sup>3</sup> The apparent concern about DSM was three fold; (1) how to treat the current DSM program, (2) how to handle any DSM program that arises between the completion of the Regulatory Plan and the effective date of rules under MEEIA (“Bridge”) and (3) treatment for DSM after MEEIA rules are effective.

The resolution of the Bridge in the Order is the issue that is of the most concern to me. The Order mandates that KCP&L and GMO spend an amount commensurate with the amounts it has previously spent in the DSM programs in the 2005 Agreement (KCP&L only), and in its last adopted preferred resource plan (both KCP&L and GMO). The General Assembly did not make DSM mandatory, but rather MEEIA sets out the mechanism for determining the *value* associated with DSM and

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<sup>2</sup> Report and Order, pg. 90; “The Commission concludes that the continuance of the DSM programs is in the public interest as shown by the customer participation and *clear policies of this state to encourage DSM programs.*” (Emphasis added).

<sup>3</sup> Witness Rush, Tr. 3565, Ins. 15 – 18; “So we’re -- what happens is, we are in a paradigm where we’re trying to do something which we think is right, but essentially *we’re hurting our shareholders for every dollar we spend.*” (Emphasis added).

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the allowable recovery. Therefore, in this Order, the Commission has done what MEEIA does not do, which is to mandate participation in DSM. Because I support MEEIA, I am concerned that the Order purports to solve a problem – the Bridge period – by mandating DSM spending. This is a solution in search of a problem. KCP&L's voluntary decision to participate in DSM programs is not a problem this Commission should be concerned with resolving. That is a decision that should be left to the management of the utility.

Low-Income Weatherization Programs

The Commission orders KCP&L and GMO to make specific dollar contributions for low income weatherization programs. My opinion here is similar to my Concurring Opinion in ER-2008-0318 regarding the Hot Weather Safety Program. I *do* support programs such as low income weatherization, and believe these programs serve an important function provided that the program includes a tracking mechanism or some other methodology for recovery of the costs associated with it. I fully support the need to consider options protecting low-income ratepayers, but without a linked cost recovery mechanism, such programs may not be efficient or meet the goals of the programs. Utilities might be more inclined to vigorously embrace and fund programs such as low-income weatherization if the Commission would ensure that costs incurred in those programs are recovered in a timely manner. To order a utility to fund such programs without these assurances is nothing more than forcing the Commission's social policy choices on the utilities shareholders by choosing how *their* money should be spent, a position I believe is inappropriate.

There is a balance that regulators can achieve in administering low-income programs, and that balance must not ignore the rights of the shareholders and ratepayers at the expense of the program's beneficiaries.

Conclusion

The Report and Order represents an enormous undertaking as this case not only embodied a rate increase request, but it also included the addition of new plant into service. The Iatan II plant should provide benefits to KCPL's ratepayers for many years to come. In a day and age where coal is a four letter word, the development, building and placing into service of a coal fired power plant is an achievement worth noting.

In all respects I reaffirm my support for the Report and Order in this case.

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**In the Matter of a Voluntary Docket to Study the Benefits of and to Encourage Utilities' Efforts to Procure Goods and Services from Diverse Suppliers**

*File No. AO-2011-0332  
Decided April 12, 2011*

**Public Utilities §19.** This file is established as a repository for documents and comments regarding Missouri's regulated utilities' procurement of goods and services from diverse suppliers.

**ORDER OPENING REPOSITORY FILE**

Missouri's regulated, investor-owned utilities provide essential services throughout the state to the majority of Missouri's citizens. The customers that receive these essential services are a diverse group of citizens, including women, minorities, small businesses and others that may be overlooked when utilities seek out vendors and contractors.

The Missouri Public Service Commission is interested in gathering information concerning the benefits Missouri's regulated utilities might reap, and the concerns they might face, when seeking to procure goods and services from diverse suppliers. Toward this end, the Commission is opening this file to receive information and documents from potentially interested entities.

Although not exhaustive, the Commission notes that the following considerations may aid in understanding efforts with regard to utilities seeking to procure goods and services from diverse suppliers:

- How should "diverse suppliers" be defined;
- What goods and services do utilities procure from outside suppliers;
- Who are the diverse suppliers in the state of Missouri that could serve Missouri's utilities;
- Which utilities already have supplier diversity programs in place;
- Among those utilities that have a supplier diversity programs in place, how is success measured;
- What incentives might encourage utilities to procure goods and services from diverse suppliers;
- What barriers exist that might discourage utilities from procuring goods and services from diverse suppliers;

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- What barriers exist for diverse suppliers seeking to work with regulated utilities;
- How do utilities currently seek vendors and do current selection methods tend to create barriers for diverse suppliers;
- Are there "best practices" that can be adopted to facilitate and encourage procurement of services from diverse suppliers.

This file shall serve as a repository for documents and comments. Any person or entity with an interest in this matter may view documents and may submit comments or documents without counsel. Accordingly, intervention requests are unnecessary.

The public is welcome to submit comments by forwarding electronic communications through the electronic and information system (EFIS) or by mailing documents or written comments. Electronic comments and information will be submitted at the Commission's website at <http://www.psc.mo.gov>. (Click on the EFIS/Case filings on the left side of the page. Scroll down and click on the public comments link. Please refer to this file number.) Mail will be sent to: Secretary, Missouri Public Service Commission, P.O. Box 360, Jefferson City, Missouri 65102 and should also reference this file number.

A date for the filing of documents and comments is set out below, in the ordered paragraphs. At some point in the near future, the Commission will hold discussions. The ordered filing date is therefore set to facilitate progress toward that discussion and is not a date to prohibit filings made thereafter.

The Commission will direct the Data Center of the Commission to send this order to all utilities in the State of Missouri. Additionally, the Commission will direct the Public Information Office to make notice of this order available to all members of the General Assembly and the media. Finally, the Commission will direct the Data Center to notify all entities included on the attached service list.

**THE COMMISSION ORDERS THAT:**

1. This file is established as a repository for documents and comments regarding Missouri's regulated utilities' procurement of goods and services from diverse suppliers.
2. Documents and Comments shall be filed in this case by May 13, 2010.
3. The Data Center and Public Information Office of the

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Commission shall send notice as set out in the body of this order.

4. This order shall become effective upon issuance.

Gunn, Chm., Clayton, Jarrett,  
and Kenney, CC., concur.  
Davis, C., concurs, with separate  
concurring opinion to follow.

Jones, Senior Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

**In the Matter of the Application of Kansas City Power & Light  
Company or Approval to Make Certain Changes in its Charges for  
Electric Service to Continue the Implementation of Its Regulatory  
Plan**

*File No. ER-2010-0355*

*Decided April 19, 2011*

**Evidence, Practice And Procedure §24.** Because no party adequately supported KCP&L's number for fuel expense as filed in its true-up testimony, the Commission found that KCP&L's true-up testimony on the dollar amount was less reliable than the dollar amount presented by Staff.

**ORDER OF CLARIFICATION**

On April 12, 2011, the Commission issued its Report and Order. Staff filed a motion for clarification regarding fuel expense on April 13, 2011. The time for responses to the motion was shortened and responses were received from Kansas City Power & Light Company (KCP&L) and jointly from the Office of the Public Counsel (OPC) and the Midwest Energy Users' Association (MEUA).

Staff's motion states that it believes the Commission's order has an inconsistency when it states regarding fuel expense on page 146-150 of its Report and Order that "the March 2, 2011 reconciliation numbers shall be used for determination of revenue requirement on this issue" and then further concludes that spot market purchased power prices shall be determined by using KCP&L's MIDAS™ model. OPC and

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MEUA responded that they also believe the Commission should clarify the *Report and Order* regarding this and the other fuel sub issues. KCP&L responded that the Report and Order need not be clarified because the:

Commission did not state that fuel expense should be re-calculated based on the fuel issues addressed in the Report and Order. As the Commission pointed out on p. 148 of the Report and Order, there were scores of differences between the Staff and KCP&L, going both ways and including the fuel issues addressed in the Report and Order as well as many fuel differences not identified as issues in this case. As a result, the Commission determined that Staff's fuel expense taken as a whole and as reflected on the March 2 reconciliation was appropriate, without modification.<sup>1</sup>

The Commission determines that its Report and Order should be clarified.

The MIDAS™ model, for which KCP&L argued, is a superior model for determining spot market prices in many instances. During this case, however, no party adequately supported using KCP&L's number for fuel expense as filed in its true-up testimony. The true-up testimony itself indicates that the true-up number provided is not KCP&L's final number and once the March 2 reconciliation was filed KCP&L abandoned that figure in favor of the Staff's presentation. Therefore, the Commission found KCP&L's true-up testimony on this dollar amount to be less reliable than the number presented by Staff for this line item.

Staff's number is adequately supported with its audit findings and its testimony and even though the Commission favors KCP&L's methodology, the Commission did not adopt that methodology with regard to the fuel expense dollar amount. The Commission will clarify its Report and Order adding a Finding of Fact to the Fuel and Purchased Power section stating: "Because KCP&L abandoned its true-up testimony position on fuel expense and adopted Staff's fuel expense amount, the Commission finds Staff's methodology to be more reliable for determining the fuel expense." In addition, the Commission will make the following changes to its "Decision – Fuel and Purchased Power Expense" section:

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<sup>1</sup> *Kansas City Power & Light Company's Response to Staff's Motion for Clarification*, (filed April 14, 2011) pp. 1-2.

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- On page 146. The sentence “The Commission adopts this method of determining natural gas costs.” is deleted.
- On page 150 of the Report and order. The last two paragraphs of that section will now read:

The Commission must set the level of fuel expense and purchased power expense for the Companies in this case, and determines that it ~~should~~ it prefers to use the greatest amount of information available to set spot market prices for determining that expense. Given the multitude of variables that affect electricity prices, the Commission accepts the MIDAS™ model ~~is~~ as superior in many instances because it considers a vast amount of information, both historical and projected.

Staff wants only historical data from the Companies to be considered arguing that use of the traditional historical test year prevents the Commission from relying upon forecasted data. To the contrary, the Commission is afforded considerable discretion in setting rates, and ~~in this instance~~ determines that the utilization of a nationally recognized tool like the MIDAS™ model is appropriate in many instances to determine spot market prices.<sup>2</sup> In this case, however, because the Companies have abandoned their model in favor of the Staff's numbers, which are supported by reliable historical data providing greater certainty and producing a just and reasonable result, the Commission concludes that the fuel expense amount on Staff's March 2 reconciliation shall be used to determine revenue requirement.

With regard to any perceived inconsistency, the Commission clarifies its Report and Order as stated above.

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<sup>2</sup> The underlined text is to be added while the strike-through text will be deleted from the Report and Order.



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**THE COMMISSION ORDERS THAT:**

1. Staff's Motion for Clarification and Response to Order Directing Filing filed on April 13, 2011, is granted to the extent set out above.

2. This order shall become effective on April 22, 2011.

Gunn, Chm., Clayton, Davis,  
Jarrett, and Kenney, CC., concur.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: See pages 111, 142, 186 and 189 for other orders in this case.

**In the Matter of, Utility Workers Union of America, Local 335, and Missouri-American Water Company**

*File No. WC-2011-0291  
Decided April 19, 2011*

**WATER §27.** The Commission granted union's request to make Missouri-American Water Company's officer salaries public information to be published in its 2009 Annual Report. The Commission reasoned that the public interest would be served by requiring disclosure of the salaries, given the utility's monopoly status. This was true even though the utility had previously provided all requested information in its 2009 Annual Report and had committed no violation.

**ORDER REGARDING REQUEST FOR DISCLOSURE PURSUANT TO COMMISSION RULE 4 CSR 240-3.640(5)**

**Local 335's Request**

On March 17, 2011, Utility Workers Union of America, Local 335 ("Local 335"), filed pleading captioned "Complaint" with the Commission regarding Missouri-American Water Company's ("MAWC") 2009 Annual Report. Local 335 objects to MAWC designating the salaries of its officers as being "nonpublic."

Commission Rule 4 CSR 240-3.640(5)<sup>1</sup> provides:

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<sup>1</sup> Commission Rule 4 CSR 240-3.640 outlines the annual report submission requirements for water utilities.

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If an entity asserts that any of the information contained in the nonpublic version of the annual report should be made available to the public, then that entity must file a pleading with the commission requesting an order to make the information available to the public, and shall serve a copy of the pleading on the utility affected by the request. The pleading must explain how the public interest is better served by disclosure of the information than the reason provided by the utility justifying why the information should be kept under seal. The utility affected by the request may file a response to a pleading filed under these provisions within fifteen (15) days after the filing of such a pleading. Within five (5) business days after the due date for the filing of the utility's response to a request filed under these provisions, the general counsel by filing of a pleading will make a recommendation to the commission advising whether the request should be granted.

Local 335 claims that disclosure of the salaries of MAWC's officers is in the public interest, and because of the highly regulated nature of the water industry, the public has a right to know the compensation paid to MAWC's officers.

### **MAWC's Response**

On April 1, 2011, MAWC responded. MAWC points out that it filed its 2009 Annual Report on April 15, 2010, and provided all information requested by the Commission. Among other things, the annual report requested the name, title, office address and salary of each MAWC officer whose annual salary is \$50,000 or more. The title and names of MAWC's seventeen corporate officers (president, vice presidents, and the assistant secretaries, treasurers and comptrollers) were provided in the public document. However, in accordance with Commission Rule 4 CSR 240-3.640, MAWC identified the salary information as nonpublic.<sup>2</sup> On August 27, 2010, the Commission Staff sent correspondence to MAWC indicating the annual report filing requirements had been satisfied and that no further response was

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<sup>2</sup> Commission Rule 4 CSR 240-3.640(4), provides in pertinent part: "If a water utility subject to this rule considers the information requested on the annual report form to be nonpublic information, it must submit both a fully completed version to be kept under seal and a redacted public version that clearly informs the reader that the redacted information has been submitted as nonpublic information to be kept under seal."

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necessary.

According to MAWC, Local 335's argument is directly contrary to the Missouri statutes. MAWC cites Section 386.480, RSMo 2000, which creates the opposite presumption – that is, that information provided by a public utility should not be open to public inspection and not be made public, unless certain exceptions exist. MAWC believes that since the information is provided to the Commission and its Staff as a part of the annual report filing, public disclosure is not necessary because the persons and entities responsible for regulating MAWC already have access to this information. MAWC's financial information is provided in even greater detail in the course of MAWC's general rate cases, where the setting of just and reasonable rates is at issue. The Commission, its Staff and the Office of the Public Counsel have always had, and continue to have, access to this specific salary information for purposes relevant to the regulation of MAWC.

MAWC also argues that the Commission has already determined that the public interest is served by protecting this information. Commission Rule 4 CSR 240-2.135(1)(B) provides, in part, that "highly confidential" information includes "employee-sensitive personnel information." No information is more employee sensitive than the employee salaries sought by Local 335's request, MAWC argues. MAWC believes release of this information would be contrary to this general policy determination that the Commission made previously.

**Staff Counsel's Recommendation**

On April 6, 2011, Staff Counsel filed its recommendation.<sup>3</sup> Staff Counsel recommends that the request for declassification be granted, because it believes the public interest in disclosing the information in question outweighs any possible private interest in keeping it confidential. According to Staff Counsel, MAWC is the monopoly provider of a necessity of life to its ratepayers, and therefore the public has a right to access such information as may be necessary to understand exactly what is included in the "just and reasonable" rates for this service. Executive compensation is necessarily a matter of abiding and legitimate public concern, particularly as rising costs make utility service increasingly less affordable to a segment of the public. The state, which exists to serve and protect its citizens, has granted and sustains the monopoly enjoyed by MAWC and, moreover, sets the rates

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<sup>3</sup> On March 21, 2011, the General Counsel delegated the duty to provide the requested recommendation to the Chief Staff Counsel.

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for its services. Consequently, according to Staff Counsel, withholding the information from the public can only result in an erosion of public trust.

### **MAWC's Reply**

On April 13, 2011, MAWC filed a reply to Staff's recommendation. MAWC asserts that Staff is unable to identify a basis for its alleged "public interest," beyond the basic statement that MAWC is a regulated public utility. MAWC also does not believe that making the salary information public will serve Staff's stated purpose of understanding what is included in the just and reasonable rates, because rate cases are based on a historical test year that may or may not be match a calendar year, because adjustments to the historical figures are frequently made by Staff, and because salaries change over time. Consequently, the salaries reported in MAWC's 2009 Annual Report, according to MAWC, are almost certainly not exactly what is included in the "just and reasonable rates" and not even the same exact information that was examined by the parties involved in setting those rates.

MAWC further asserts that if a party wants to find out what salaries are examined for the purpose of setting rates, this can be done within the context of a rate case and Local 335, being a party to MAWC's rate cases, has had the opportunity to request and examine, albeit subject to the Commission's confidentiality rule, the requested salary information. MAWC states there is no "withholding" of information and there can be no erosion of public trust as Staff has claimed.

MAWC also challenges Staff's suggestion that the requested information should be provided to the public because the state "has granted and sustains the monopoly enjoyed by MAWC". MAWC claims it has been found previously that a certificate does not provide an exclusive right to serve.

Finally, MAWC believes that maintaining the confidentiality of this salary information will protect from public disclosure personal and sensitive information that is specific to individual employees and might be used to harass or embarrass those employees. And, maintaining the subject information as nonpublic is consistent with the policy found in both Missouri statutes and the Commission's rules.

### **Decision**

The Commission notes that while Local 335 captioned its request as being a complaint, it has alleged no violation of any statute, regulation or tariff provision. Consequently, the Commission's decision on Local 335's request does not involve a finding of any violation or any

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potential adverse consequences that might normally be associated with such a violation. Indeed, the Commission's Staff has advised MAWC that its 2009 Annual Report requirements were satisfied. That being said, the Commission agrees with Local 335 and Staff Counsel that it is in the public interest to require disclosure of MAWC's officers' salaries.

**THE COMMISSION ORDERS THAT:**

1. Utility Workers Union of America, Local 335's request to have Missouri-American Water Company disclose the salaries of its officers is granted.

2. No later than May 16, 2011, Missouri-American Water Company shall re-classify the salaries of its officers as public information in its 2009 Annual Report, and shall include that information in the public version of its 2009 Annual Report.

3. No later than May 16, 2011, Missouri-American Water Company shall re-classify the salaries of its officers as public information in its 2010 Annual Report, and shall include that information in the public version of its 2010 Annual Report.

4. This order shall become effective on April 29, 2011.

5. This file shall be closed on April 30, 2011.

Gunn, Chm., Clayton, Davis, and Kenney, CC., concur.  
Jarrett, C., concurs, with separate concurring opinion to follow.

Stearley, Senior Regulatory Law Judge

**CONCURRING OPINION OF COMMISSIONER TERRY M. JARRETT**  
**IN THE ORDER REGARDING REQUEST FOR DISCLOSURE**  
**PURSUANT TO**  
**COMMISSION RULE 4 CSR 240-3.640(5)**

I concur in the result in this particular case on the facts set out by the Utility Worker's Union of America, Local 335 ("Local 355"). I disagree with the reasoning advanced by Local 335 and Staff Counsel as to what constitutes the public interest in this matter.

Local 355's argument is that the highly regulated nature of the water industry creates a "right" for the public to know the salaries of MAWC's officers, and that this right is essentially synonymous with the public interest. Also, Staff Counsel states that " ... MAWC is a monopoly

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provider of a necessity of life to its ratepayers, and therefore **the public has a right to access** such information as may be necessary to understand exactly what is included in the "just and reasonable" rates for this service."

If Local 335's and Staff's purported standards were followed by this Commission, then no evidence in any proceedings could ever be highly confidential or proprietary. This is in direct conflict with state law and Commission Rules.<sup>1</sup> This Commission frequently considers highly confidential and proprietary information in proceedings, and frequently goes in camera to hear such evidence. To say that the public has a right to know everything that goes into the ratemaking decision flies in the face of state law, Commission rules, and long-standing Commission practice.

That said, under the facts of this case J do not see a problem releasing the salaries of MAWC's officers previously designated nonpublic in MAWC's annual report. Therefore, I concur in the result.

### **In the Matter of the PGA/ACA Filing of Atmos Energy Corporation for the West Area (Old Butler), West Area (Old Greeley), Southeastern Area (Old SEMO), Southeastern Area (Old Neelyville), Kirksville Area and the Northeastern Area**

*File No. GR-2008-0364*

*Decided April 27, 2011*

**EVIDENCE, PRACTICE AND PROCEDURE §5.** The Commission denied a motion by the utility to strike Staff evidence presented for the first time in surrebuttal testimony to justify a disallowance. The Commission found that the utility was not prejudiced by presenting the evidence in surrebuttal rather than in earlier testimony because the utility had three months before the hearing to prepare for cross-examination and did not request to supplement its own testimony to address that issue.

### **ORDER DENYING ATMOS' MOTION TO STRIKE TESTIMONY**

This case concerns Staff's Actual Cost Adjustment audit of

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<sup>1</sup> See Section 386.480 RSMo (2000); see also 4 C.S.R. 240-2.010(9) and (17); see also 4 C.S.R. 240-2.010-2.090 *passim*.

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Atmos Energy Corporation for the 2007-2008 period. Staff filed its audit report in December 2009, and recommended a \$363,000 adjustment to reduce Atmos' recoverable gas costs by the amount of profit that an unregulated affiliated gas marketing company, Atmos Energy Marketing, earned by supplying natural gas to Atmos. Atmos opposed Staff's proposed adjustment and three rounds of testimony were filed by Staff and Atmos.

In David Sommerer's surrebuttal testimony filed on December 22, 2010, Staff presented a new theory to justify either a \$52,000 or \$86,000 disallowance of a portion of Atmos' gas costs. That new disallowance alleges Atmos imprudently failed to nominate sufficient baseload gas supplies for the month of December 2007. At the hearing, held on March 23 and 24, 2011, Atmos moved to strike those portions of Sommerer's surrebuttal testimony that relate to the newly proposed disallowance.

At the hearing, the presiding officer deferred making a ruling on the motion to strike to allow the Commission an opportunity to decide the motion. Subject to a later ruling, Staff was allowed to present testimony about its new disallowance and Atmos was allowed to cross-examine Staff's witness on that disallowance.

Atmos contends the newly proposed disallowance set forth in Sommerer's surrebuttal testimony is improper because it was not raised by Staff until surrebuttal testimony, thus depriving Atmos of an opportunity to respond to that testimony. To support its motion to strike, Atmos relies on Commission Rule 4 CSR 240-2.130(7), which requires that direct testimony include "all testimony and exhibits asserting and explaining that party's entire case-in-chief." The same rule limits surrebuttal testimony to "material which is responsive to matters raised in another party's rebuttal testimony.

In response, Staff argued Atmos had concealed the circumstances surrounding the December 2007 baseload nominations from Staff until after Staff had filed its rebuttal testimony and for that reason, Staff could not present the new disallowance until it filed its surrebuttal testimony.

The Commission's rule regarding the prefiling of testimony is designed to move through the rounds of testimony in an orderly fashion to focus the various issues for a decision by the Commission. For that reason, all parties should present their entire case in their direct testimony so that subsequent rounds of testimony can be used to respond to that case in chief. When a party introduces a new theory

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about its case for the first time in its surrebuttal testimony it causes problems for the other parties because they have a more limited opportunity to present testimony to rebut that new theory.

However, the Commission's rules should not be interpreted to place blinders on the Commission that would preclude it from considering a new theory that arises for the first time in surrebuttal testimony. That is particularly true where, as here, the party presenting the new theory or evidence explains that it was unable to offer that theory or evidence earlier in the proceeding.

In this case, Staff's witness presented a new theory to justify a disallowance in his surrebuttal testimony that was filed in December 2010. The evidentiary hearing did not take place until March 2011. Obviously, Atmos was not surprised at the hearing by Staff's new theory. While it did not have an opportunity to prefile rebuttal testimony, it certainly had ample opportunity to prepare its cross-examination to attack Staff's theory and did effectively cross-examine Staff's witness. In addition, Atmos could have asked for an opportunity to supplement its testimony either by filing additional prefiled testimony, or by seeking leave to offer live direct or rebuttal testimony at the hearing. Instead, Atmos chose to wait until the hearing to make a motion to strike Staff's testimony.

The Commission concludes that Atmos was not prejudiced by Staff's presentation of a new disallowance in its surrebuttal testimony and on that basis will deny Atmos' motion to strike. This order does not make any findings regarding the merits of the disallowance proposed by Staff.

**THE COMMISSION ORDERS THAT:**

1. Atmos Energy Corporation's Motion to Strike a Portion of Staff's Testimony is denied.
2. This order shall become effective immediately upon issuance.

Gunn, Chm., Clayton and Kenney, CC., concur;  
Davis and Jarrett, CC., dissent with dissenting opinions to follow.

Woodruff, Chief Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

\*NOTE: See page 52 for another order in this case.



**DISSENTING OPINION OF COMMISSIONER TERRY M. JARRETT  
REGARDING ORDER DENYING ATMOS' MOTION TO STRIKE  
TESTIMONY**

I write in Dissent to the Order Denying Atmos' motion to strike testimony because I believe that this Commission should follow its rules. The Commission did not follow its rules with regard to the motion, so I dissent from the majority's Order Denying Atmos' Motion to Strike Testimony.

*The Rule*

Commission Rule 4 CSR 240-2.130(7), requires that direct testimony include "all testimony and exhibits asserting and explaining that party's entire case-in-chief." The same rule limits surrebuttal testimony to "material which is responsive to matters raised in another party's rebuttal testimony." There is no dispute that the matters included in Mr. Sommerer's surrebuttal testimony are outside the scope of the Commission's rule regarding pre-filed testimony. The Commission's rule can be waived for good cause; however, **Staff did not seek leave from this Commission to file the surrebuttal testimony outside the scope of the rule.** The surrebuttal testimony filed by Staff should have been rejected for failure to comply with the rules.

As I have stated in prior concurrences and dissents, the rules of this Commission are law. In this case, the Staff – being in the position to know and understand that the testimony it was prepared to file as surrebuttal would present a new theory, was also in a position to seek a waiver of the Commission's rules prior to filing the surrebuttal testimony, but it did not.

The standard for waiver of a Commission rule is set forth in 4 CSR 240-2.015(1), which declares that "[A] rule in this chapter may be waived by the Commission for good cause." In this case, the reasons cited by Staff and other parties do not rise to the level of "good cause" and as such, the motion by Atmos should have been granted. Although the term "good cause" is frequently used in the law,<sup>1</sup> the rule does not define it. Therefore, it is appropriate to resort to the dictionary to determine its ordinary meaning.<sup>2</sup> Good cause "generally means a

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<sup>1</sup> *State v. Davis*, 469 S.W.2d 1, 5 (Mo. 1971).

<sup>2</sup> See *State ex rel. Hall v. Wolf*, 710 S.W.2d 302, 303 (Mo. App. E.D. 1986) (in absence of legislative definition, court used dictionary to ascertain the ordinary meaning of the term "good cause" as used in a Missouri statute); *Davis*, 469 S.W.2d at 4 – 5 (same).

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substantial reason amounting in law to a **legal excuse** for failing to perform an act required by law.”<sup>3</sup> (Emphasis added). Similarly, “good cause” has also been judicially defined as a “**substantial reason or cause** which would cause or justify the ordinary person **to neglect one of his [legal] duties.**”<sup>4</sup> (Emphasis added). Of course, not just any cause or excuse will do. To constitute good cause, the reason or legal excuse given “must be real not imaginary, substantial not trifling, and reasonable not whimsical.”<sup>5</sup> And some legitimate factual showing is required, not just the mere conclusion of a party or his attorney.<sup>6</sup>

The Staff, by failing to seek a waiver, evaded Commission rules. Now, after the fact, Staff points the finger at Atmos to defend its motion to strike. Staff Counsel during oral argument did not argue “good cause.” Instead, Staff Counsel argued that reliability was the issue that led to the inclusion of a new theory in surrebuttal. The reliability concerns underlying Staff’s new theory was based on information which Staff knew prior to the filing of direct testimony in this case. Tr. 711, Ins. 22 – 25 and Tr. 712, Ins. 1 – 3.

The burden to show good cause is not on Atmos here, it is on Staff. Staff offered nothing that would constitute good cause justifying a waiver of Commission rules. The majority, in my opinion, ignored the well-settled good cause standard and instead has substituted its own, lesser standard. I would have granted the motion because the Staff knowingly proceeded in a manner which disregarded the Commission’s rules, and because Staff failed to show good cause for denying Atmos’ motion.

### *Due Process*

Not until after an Order ruling on Atmos’ motion to strike is effective is Atmos’ right to seek an opportunity to rebut that surrebuttal testimony ripe. Any suggestion that Atmos could have tried the issues in Mr. Sommerer’s testimony during the March 23, and 24, 2011 hearing,

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<sup>3</sup> *Black’s Law Dictionary*, p. 692 (6th ed. 1990).

<sup>4</sup> *Graham v. State*, 134 N.W. 249, 250 (Neb. 1912). Missouri appellate courts have also recognized and applied an objective “ordinary person” standard. See, e.g., *Cent. Mo. Paving Co. v. Labor & Indus. Relations Comm’n*, 575 S.W.2d 889, 892 (Mo. App. W.D. 1978) (“[T]he standard by which good cause is measured is one of reasonableness as applied to the average man or woman.”)

<sup>5</sup> *Belle State Bank v. Indus. Comm’n*, 547 S.W.2d 841, 846 (Mo. App. S.D. 1977). See also *Barclay White Co. v. Unemployment Compensation Bd.*, 50 A.2d 336, 339 (Pa. 1947) (to show good cause, reason given must be real, substantial, and reasonable).

<sup>6</sup> See generally *Haynes v. Williams*, 522 S.W.2d 623, 627 (Mo. App. E.D. 1975).

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would call into question the very motion which Atmos had placed before the Commission for determination. The majority's Order states:

While it did not have an opportunity to prefile rebuttal testimony, it certainly had ample opportunity to prepare its cross-examination to attack Staff's theory and did effectively cross-examine Staff's witness. In addition, Atmos could have asked for an opportunity to supplement its testimony either by filing additional prefiled testimony, or by seeking leave to offer live direct or rebuttal testimony at the hearing. Instead, Atmos chose to wait until the hearing to make a motion to strike Staff's testimony.

This language suggests that Atmos should have taken action **before** their motion to strike was ruled on with regard to examination of the witness or the filing of additional testimony.<sup>7</sup> This language also suggests that Atmos "sat on its rights" and therefore has waived them with respect to an opportunity to respond to the surrebuttal testimony.

The Order gets it wrong. Filing something in EFIS does not constitute offering evidence. Atmos followed proper practice and procedure by timely objecting to the surrebuttal testimony at the time it was offered into evidence. To imply that it was Atmos' responsibility to request leave to file additional testimony before its motion to strike was ruled on turns proper hearing practice and procedure on its head.<sup>8</sup> Just being able to cross-examine a witness on his new theory is not adequate – Atmos deserves the right to file rebuttal testimony and to call its own witnesses to address the new theory injected into the case in Staff's surrebuttal testimony. If the record is not reopened to allow Atmos the opportunity to provide its own testimony and evidence in response to the admission of the surrebuttal testimony, then I believe that Atmos' due process rights will be violated.

### Conclusion

I believe that Commission Staff, as well as all parties appearing before this Commission, should adhere to this Commission's rules. The rules do not allow a new issue to be interjected into a case in surrebuttal testimony. If a party wants to do so, that party must request a waiver and show good cause. In this case, Staff did not do so. Further, Atmos was

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<sup>7</sup> Commission rules do not provide for the filing of pre-filed testimony after surrebuttal testimony is filed.

<sup>8</sup> Atmos' motion to strike was not ruled on until after the hearing was concluded, so Atmos had no meaningful opportunity to offer its own testimony or evidence.

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not allowed to file rebuttal testimony or present its own evidence on the new issue. I would have granted Atmos' motion to strike portions of Mr. Sommerer's surrebuttal testimony.

For all of these reasons, I respectfully dissent.

**In the Matter of the First Prudence Review of Costs Subject to the Commission-Approved Fuel Adjustment Clause of Union Electric Company, d/b/a Ameren Missouri\***

*Case No. EO-2010-0255  
Decided April 27, 2011*

**Electric §39.** Off-system contracts for the sale of electricity were not long-term full and partial requirements sales within the meaning of the utility's tariff and could not be excluded from the utilities off-system sales for purposes of calculating the balances in its fuel adjustment clause.

**Rates §101.** The Commission is not obligated to interpret the language of a fuel adjustment tariff in a manner that protects the utility's ability to earn a fair return on equity. Rather such tariffs are to be interpreted in the same manner as any other tariff.

**APPEARANCES**

**Thomas M. Byrne**, Managing Assoc. General Counsel, Ameren Services Company, P.O. Box 66149, 1901 Chouteau Ave., St. Louis, Missouri 63103; and

**L. Russell Mitten**, Attorney at Law, BRYDON, SWEARENGEN & ENGLAND, PC, P.O. Box 456, 312 East Capitol Avenue, Jefferson City, Missouri 65102

For Union Electric Company, d/b/a Ameren Missouri.

**Jaime N. Ott**, Associate Staff Counsel, P.O. Box 360, 200 Madison Street, Jefferson City, Missouri 65102

For the Staff of the Missouri Public Service Commission.

**Lewis R. Mills, Jr.**, Public Counsel, P.O. Box 2230, 200 Madison Street, Suite 650, Jefferson City, Missouri 65102

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For the Office of the Public Counsel and the Public.

**Diana Vuylsteke**, Attorney at Law, and **Brent Roam**, Attorney at Law, Bryan Cave, LLP, 211 N. Broadway, Suite 3600, St. Louis, Missouri 63102.

For Missouri Industrial Energy Consumers.

**Lisa C. Langeneckert**, Attorney at Law, Sandberg, Phoenix & Von Gontard, P.C., 515 N. 6<sup>th</sup> Street, St. Louis, Missouri 63101.

For Missouri Energy Group.

**CHIEF REGULATORY LAW JUDGE:** **Morris L. Woodruff**

**REPORT AND ORDER**

The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

**Summary**

This order determines that Union Electric Company d/b/a Ameren Missouri acted imprudently, improperly and unlawfully when it excluded revenues derived from power sales agreements with AEP and Wabash from off-system sales revenue when calculating the rates charged under its fuel adjustment clause.

**Procedural History**

On August 31, 2010, the Commission's Staff filed a Prudence Report and Recommendation regarding its first prudence review of Ameren Missouri's costs related to its fuel adjustment clause (FAC). In its Report, Staff concluded that Ameren Missouri acted imprudently in not including certain costs and revenues in calculating the FAC rate it billed to its customers. The costs and revenues Staff contends were

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improperly excluded from the fuel adjustment clause are associated with Ameren Missouri's sales of energy to American Electric Power Operating Companies (AEP) and to Wabash Valley Power Association, Inc. (Wabash). Staff advised the Commission to order Ameren Missouri to refund approximately \$24.1 million plus interest to its customers by an adjustment to its FAC charge. Subsequently, on October 12, 2010, Staff corrected its prudence report and recommendation to reflect revised calculations that indicate Ameren Missouri over-collected \$17,169,838 during the recovery periods in question, rather than the \$24,073,236 over-collection Staff had shown in its initial prudence report.

Ameren Missouri disputed Staff's claim of imprudence and on September 9, 2010, requested a hearing regarding Staff's recommendation.<sup>1</sup> Commission Rule 4 CSR 240-3.161(10) provides that parties to the rate case in which the Commission established Ameren Missouri's fuel adjustment clause are automatically parties to this prudence audit case, without the necessity of having to apply for intervention. By that rule, the Commission recognized the following entities as parties to this case:

AARP;

Consumers Council of Missouri;

IBEW Local Union 1455, 1439, 2, 309, 649, and 702;

International Union of Operating Engineers – Local No. 148;

Laclede Gas Company;

Missouri Coalition for the Environment;

Missouri Department of Natural Resources;

Missouri Energy Group;

Missouri Industrial Energy Consumers;

Missourians for Safe Energy;

Noranda Aluminum;

State of Missouri; and

The Commercial Group.

In addition, the Commission allowed the Missouri Retailers Association, which was not an automatic party, to intervene.

On September 29, 2010, following a prehearing conference, the Commission established a procedural schedule leading to an evidentiary hearing regarding Staff's recommended adjustment to Ameren Missouri's FAC charge. In compliance with the established procedural schedule,

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<sup>1</sup> The Office of the Public Counsel, the Missouri Retailers Association, and the Missouri Industrial Energy Consumers support Staff's proposed adjustment, but also requested a hearing in pleadings filed on September 10, 2010.

the interested parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing was held on January 10 and 11, 2011. The parties filed post-hearing briefs on February 10, 2011, with reply briefs following on February 24.

**Findings of Fact**

1. On January 27, 2009, the Commission issued a Report and Order<sup>2</sup> in Commission File Number ER-2008-0318 concerning Ameren Missouri's request for a general rate increase. As part of that Report and Order, the Commission approved for the first time Ameren Missouri's request to implement a fuel adjustment clause.

2. The next day, January 28, 2009, Southeastern Missouri was struck by a terrible ice storm.<sup>3</sup> The ice storm knocked down the power lines that serve the aluminum smelter operated by Noranda Aluminum, Inc. As a result, the smelter lost electric power in mid-cycle, causing the molten aluminum to solidify in the smelting equipment. Noranda quickly restored one of the three production lines, but could not immediately put the second and third lines back into production. Two-thirds of Noranda's production capacity was lost while the solidified aluminum was jackhammered out of the equipment.<sup>4</sup>

3. When Noranda lost production capacity, it reduced the amount of electricity it purchased from Ameren Missouri. The loss of sales to Noranda was a serious problem for Ameren Missouri because Noranda normally buys a lot of electricity. Before the damage resulting from the ice storm, Noranda hourly consumed more than 460 megawatts of electricity at a very high load factor, meaning it used nearly the same amount of electric power every hour of every day throughout the year.<sup>5</sup>

4. Because of the damage to Noranda's production capacity, Ameren Missouri stood to lose approximately \$90 million per year of its normal electric sales to Noranda.<sup>6</sup> That amounts to approximately four percent of Ameren Missouri's base-rate revenue requirement from which the company's rates were developed.<sup>7</sup>

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<sup>2</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase Its Annual Revenues for Electric Service*, Report and Order, File No. ER-2008-0318 (January 27, 2009).

<sup>3</sup> Barnes Direct, Ex. 3, Page 5, Lines 19-24.

<sup>4</sup> Barnes Direct, Ex. 3, Page 6, Lines 4-10.

<sup>5</sup> Haro Direct, Ex. 1, Page 6.

<sup>6</sup> Barnes Direct, Ex. 3, Page 6, Lines 12-15.

<sup>7</sup> Barnes Surrebuttal, Ex. 4, Page 2, Lines 19-20.

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5. Since Ameren Missouri would not be selling as much electric power to Noranda, it would have more electric power available to sell on the off-system market. Such off-system sales could partially offset the revenue lost on sales of power to Noranda. However, there was a problem with off-system sales.

6. Under the fuel adjustment clause that the Commission approved the day before the ice storm, revenue from off-system sales is used to offset Ameren Missouri's fuel purchase costs, subject to a 95/5 sharing mechanism.<sup>8</sup> That means Ameren Missouri is allowed to pass 95 percent of any net changes in fuel/purchased power costs through to its customers outside of a general rate case. The other 5 percent must be absorbed by the company's shareholders.

7. Normally, the fuel adjustment clause would benefit Ameren Missouri because the company would be allowed to pass through to customers 95 percent of what were anticipated to be rising fuel costs without having to experience the delay that would result if the company had to file a new rate case to recover those increased fuel costs. However, that 95/5 sharing mechanism also applied to off-system sales. That means 95 percent of any increase in off-system sales would benefit ratepayers rather than the company by offsetting rising fuel costs under the fuel adjustment clause's formula.

8. Thus, if Ameren Missouri simply replaced the revenue it could no longer earn by selling power to Noranda - revenue that is not subject to sharing mechanism of the fuel adjustment clause - by selling more power off-system, it would be unable to retain 95 percent of that replacement revenue. That would result in a revenue shortfall for Ameren Missouri's shareholders.

9. Ameren Missouri first attempted to avoid that revenue shortfall by asking the Commission to rehear its Report and Order and modify the approved fuel adjustment clause to exclude revenue from those off-system sales used to offset the lost sales to Noranda.<sup>9</sup> The Commission denied Ameren Missouri's application for rehearing in an order issued on February 19, 2009.<sup>10</sup>

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<sup>8</sup> Eaves Direct/Rebuttal, Ex.11, Page 3, Lines 4-9.

<sup>9</sup> *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs To Increase its Annual Revenues for Electric Service*, File No. ER-2008-0318, Application for Rehearing and Motion for Expedited Treatment (February 5, 2009).

<sup>10</sup> *In the Matter of Union Electric Company d/b/a AmerenUE's Tariffs To Increase its Annual Revenues for Electric Service*, File No. ER-2008-0318, Order Denying AmerenUE's Application for Rehearing (February 19, 2009).



10. In its February 19 order denying Ameren Missouri's application for rehearing, the Commission found that it could not modify the fuel adjustment clause tariff in the manner Ameren Missouri requested without setting aside the approved stipulation and agreement regarding the fuel adjustment clause, reopening the record to take evidence on the appropriateness of the proposed change, and making a decision before the March 1, 2009 operation of law date. The Commission concluded that such action was "obviously impossible" and on that basis denied Ameren Missouri's application for rehearing. The Commission's order did not make any decision or ruling on the merits of Ameren Missouri's proposal, nor did the Commission take any evidence on the merits of that proposal.

11. After the Commission denied Ameren Missouri's application for rehearing, the company's revised tariff, now including the fuel adjustment clause, went into effect on March 1, 2009.

12. With the fuel adjustment clause now in effect, Ameren Missouri began looking for a means to sell power to replace the lost Noranda load. In replacing that load, Ameren Missouri sought to enter into sales contracts that would most closely resemble the service to Noranda by rebalancing the load with regard to the type of customer served and credit exposure faced by Ameren Missouri.<sup>11</sup> Ameren Missouri also acknowledged that it was seeking to enter into a contract that would be excluded from operation of the fuel adjustment clause.<sup>12</sup>

13. Ameren Missouri subsequently entered into two contracts that it describes as long-term partial requirements contracts. The first contract was with American Electric Power Service Corporation (AEP) for 100 megawatts for a duration of 15 months. The second contract was with Wabash Valley Power Association, Inc., to serve Citizen Electric load in Missouri. That contract was for 150 megawatts for a duration of 18 months.<sup>13</sup>

14. Ameren Missouri's description of these contracts as long-term partial requirements contracts is important because of the controlling terms found in the fuel adjustment clause tariff. That tariff provides:

Off-System Sales shall include all sales transactions  
(including MISO revenues in FERC Account Number

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<sup>11</sup> Haro Direct, Ex. 1, Pages 4-5, Lines 8-22, 1-17.

<sup>12</sup> Transcript, Page 118, Lines 7-11.

<sup>13</sup> Haro Direct, Ex. 1, Page 7, Lines 1-10.

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447), excluding Missouri retail sales and long-term full and partial requirements sales, that are associated with (1) AmerenUE Missouri jurisdictional generating units, (2) power purchases made to serve Missouri retail load, and (3) any related transmission.<sup>14</sup> (emphasis added).

Ameren Missouri contends these contracts fall within the tariff's exclusion for long-term full and partial requirements sales, the other parties contend they do not. The question then becomes: what are the appropriate definitions of "long term" and "full and partial requirements" sales?

15. Before examining those definitions in more detail, it is important to understand the genesis of Ameren Missouri's fuel adjustment clause tariff. The definition of off-system sales that is at issue in this case was initially proposed through the testimony of Ameren Missouri's witness, Marty Lyons, as part of Ameren Missouri's request for a fuel adjustment clause in Ameren Missouri's rate case, ER-2008-0318.<sup>15</sup>

16. The parties in ER-2008-0318 did not agree that Ameren Missouri should be allowed to implement a fuel adjustment clause and the Commission resolved that overall issue in its report and order. However, the parties were able to agree upon the details of the language that would be included in the fuel adjustment clause tariff if the Commission decided to allow Ameren Missouri to implement a fuel adjustment clause. The exact language of the tariff, including the definition of off-system sales, was agreed to in a stipulation and agreement that the Commission approved as part of the resolution of ER-2008-0318.<sup>16</sup>

17. The only testimony about the intent of the parties when they agreed upon the definition of off-system sales was offered by Lena Mantle on behalf of Staff.<sup>17</sup> As case coordinator and expert witness for Staff, Mantle was involved in negotiations surrounding the development of Ameren Missouri's fuel adjustment tariff. She testified that, based on conversations with Ameren Missouri's representatives, she understood that the tariff definition was designed to exclude from operation of the

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<sup>14</sup> Eaves Direct/Rebuttal, Ex. 11, Schedule DEE-5-3.

<sup>15</sup> Transcript, Page 350, Lines 5-17.

<sup>16</sup> Barnes Direct, Ex. 3, Pages 3-4, Lines 23-24, 1-5.

<sup>17</sup> Mantle is the Manager of the Energy Department, Utility Operations Division of the Missouri Public Service Commission.

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fuel adjustment clause the wholesale electric supply contracts that Ameren Missouri had entered into with various municipal utilities.<sup>18</sup>

18. The exclusion of those municipal contracts from the operation of the fuel adjustment clause makes sense, because in the pending rate case, ER-2008-0318, Ameren Missouri's costs were allocated to municipal utilities through energy and demand allocators. In other words, Ameren Missouri's costs to provide wholesale service to the municipalities were not being flowed through the Fuel Adjustment Clause, so it would have been inappropriate to flow the revenues received from the municipalities through the Fuel Adjustment Clause. Including those revenues within the fuel adjustment clause would have required Ameren Missouri to pay all the costs of those contracts while receiving credit for only five percent of the revenues generated through those contracts.<sup>19</sup>

19. When Ameren Missouri's fuel adjustment tariff was once again before the Commission in Ameren Missouri's next rate case, ER-2010-0036, the parties, including Ameren Missouri, stipulated that the tariff's definition of off-system sales would be changed to specifically exclude long-term full and partial requirements sales to Missouri municipalities.<sup>20</sup> As a result, under the revised tariff, revenue from both the Wabash and the AEP contracts would be treated as off-system sales and would be flowed through the fuel adjustment clause.

20. With that background, we can now return to a discussion of the definitions of "long-term" and "full and partial requirements" sales. Ameren Missouri's fuel adjustment clause tariff does not define either term, so the parties proposed their own definitions. Ameren Missouri would base its definitions on the way in which such contracts are currently treated in the wholesale electric marketplace. The other parties would define those terms in what they describe as a more traditional regulatory context.

21. In the context of today's marketplace for wholesale electric power, a long-term power supply contract is one that covers a period of one year or more. That was amply demonstrated through the testimony of Jaime Haro, Director, Asset Management and Trading for Ameren Missouri,<sup>21</sup> and Duane Highley, Director of Power Production for

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<sup>18</sup> Mantle Direct/Rebuttal, Ex. 12, Page 4, Lines 3-25.

<sup>19</sup> Mantle Direct/Rebuttal, Ex. 12, Page 5, Lines 1-16.

<sup>20</sup> Transcript, Page 357, Lines 1-11, and Page 82, Lines 7-22.

<sup>21</sup> Haro Direct, Ex. 1, Page 1, Lines 4-6.

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Associated Electric Cooperative, Inc.<sup>22</sup> Both men have marketed and traded power for several years and concur that in the context of that marketplace, “a ‘long-term’ power supply agreement would be one which covers a period of one year or more. A short-term agreement is commonly understood to be one with a term of less than one year.”<sup>23</sup>

22. While a contract with a duration of one year or more is treated as a long-term contract within the context of the wholesale electric market, this Commission is not seeking to define the term in that context. Rather, the Commission must define long-term within a regulatory context. In that context, Staff’s witness points to a definition of long-term found in the FERC Form 1 used by Ameren Missouri in filing annual reports with FERC and this Commission. By that definition, a long-term contract is one that lasts five years or longer, an intermediate term contract is longer than one year, but less than five years, and a short-term contract is one year or less.<sup>24</sup> For purposes of its annual reports, Ameren Missouri does not classify either the Wabash or the AEP contracts as long-term requirements contracts.<sup>25</sup>

23. A similar disagreement exists between the parties regarding the appropriate definition of a requirements contract. Again, Jaime Haro and Duane Highley explain that within the context of the marketplace, “a long-term partial requirements sale is an agreement where the seller provides resources sufficient to meet part of the purchasing entity’s load obligation during the term of the agreement.”<sup>26</sup> The other parties counter that in a regulatory context, the definition of a requirements contract is more restrictive.

24. Jaime Haro testified that his definition of a partial requirements contract is based on his “understanding of the market” and the only regulatory authority he cited to support his definition was the definition offered by the Edison Electric Institute (EEI).<sup>27</sup>

25. Ameren Missouri refers to the definition of “Partial Requirements” offered by the Edison Electric Institute as support for its definition of a partial requirements contract. That definition is as follows:

A wholesale customer who purchases, or is committed

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<sup>22</sup> Highley Surrebuttal, Ex. 7, Page 1, Lines 10-13.

<sup>23</sup> Highley Surrebuttal, Ex. 7, Page 6, Lines 7-9.

<sup>24</sup> Eaves Direct/Rebuttal, Ex. 11, Pages 10-11, Lines 24-26, 1-18.

<sup>25</sup> Eaves Direct/Rebuttal, Ex. 11, Page 11, Lines 29-31.

<sup>26</sup> Haro Surrebuttal, Ex. 2, Page 2, Lines 1-3.

<sup>27</sup> Transcript, Page 50, Lines 7-24.

to purchase, only a portion of its electric power generation need from a particular entity. There is often a specified contractual ceiling on the amount of power that a partial requirements customer can take from the entity. In contrast, a "requirements" or "full requirements" customer is committed to purchase all of its needs from a single entity and generally would not have a ceiling on the amount of power it can take.<sup>28</sup>

26. Edison Electric Institute also offers a definition of "Full Requirements" as follows:

A wholesale customer (utility) that is committed to purchase all of its electric power generation from a single generator and generally there is not a ceiling on the amount of power purchased.<sup>29</sup>

27. Neither the definition of "Partial Requirements," nor the definition of "Full Requirements," actually defines "Requirements." Instead, they simply define the difference between partial and full requirements. If the meaning of "Requirements" is to be understood in either definition, reference must be made back to the definition offered for Requirements Service.

28. The Edison Electric Institute defines "Requirement Service" as:

Service that the supplier plans to provide on an ongoing basis (i.e. the supplier includes projected load for this service in its system planning). In addition, the reliability of requirements service must be the same as, or second only to, the supplier's service to its own ultimate customers.<sup>30</sup>

The same definition of requirement service is found in the instructions for completion of the FERC Form 1.<sup>31</sup>

29. Consistent with those definitions, the commonly understood concept of requirements service is the provision of power to municipal customers or rural electric cooperatives on a basis whereby

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<sup>28</sup> Haro Surrebuttal, Ex. 2, Schedule JH-S5.

<sup>29</sup> Haro Surrebuttal, Ex. 2, Schedule JH-S5.

<sup>30</sup> Brubaker Direct, Ex. 14, Schedule MEB-3.

<sup>31</sup> Haro Surrebuttal, Ex. 2, Schedule JH-S3.

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the selling utility incorporates the requirements of these customers into its resource planning.<sup>32</sup>

30. The key phrase in the definition of requirements service is that it is service the supplier plans to provide on an ongoing basis. The Wabash and AEP contracts are for terms of only 18 and 15 months and Ameren Missouri acknowledged that it entered into those contracts to replace the Noranda load lost due to the ice storm.<sup>33</sup> Those contracts expired on May 31, 2010, and October 31, 2010, and were not renewed.<sup>34</sup> In short, it is clear that Ameren Missouri did not intend to provide these services to Wabash and AEP on an ongoing basis.

31. In an effort to fit the Wabash and AEP contracts into the EEI and FERC definitions of requirement service, Ameren Missouri's witness, Jaime Haro, suggested that the definitions' statement that requirement services are to be provided on an ongoing basis could simply mean that they are to be provided for the term of the contract.<sup>35</sup> When pressed on cross-examination, Haro conceded that his definition of ongoing basis as meaning the term of the contract could apply to contracts with a term of a single day.<sup>36</sup>

32. All parties agree that Ameren Missouri's existing electric sales contracts with various municipalities are requirements sales that are properly excluded from the tariff's definition of off-system sales. The Wabash and AEP contracts differ substantially from Ameren Missouri's contracts with the municipalities in that Ameren Missouri provides substantially more capacity and energy services to the municipalities than it did to Wabash and AEP under their contracts. The contracts with AEP and Wabash strictly provide capacity and energy, leaving the buyer to arrange the transmission, pay for transmission and for all other services required to accept the power from the seller. In addition, the municipal contracts were longer in length than the AEP and Wabash contracts.<sup>37</sup>

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<sup>32</sup> Brubaker Direct, Ex. 14, Page 3, Lines 3-7.

<sup>33</sup> Haro Direct, Ex. 1, Page 7, Lines 1-10.

<sup>34</sup> Transcript, Page 49, Lines 10-12.

<sup>35</sup> Transcript, Page 68, Lines 7-13.

<sup>36</sup> Transcript, Page 87, Lines 19-25.

<sup>37</sup> Brubaker Direct, Ex. 14, Page 5, Lines 3-19. Brubaker designated this testimony describing the terms of the contracts as highly confidential because Ameren Missouri had designated the contracts as highly confidential at the time. At the hearing, Ameren Missouri agreed that the contracts could be treated as public information and the Commission so designated them. See. Transcript, Page 519. Therefore, the witness'

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33. In short, the contracts with the municipalities are for requirements service and Ameren Missouri designated them as such in its 2009 FERC Form 1 filing. In contrast, Ameren Missouri categorized the Wabash and AEP as Intermediate Firm Service, and not as Requirements Service in that same 2009 FERC Form 1 filing.<sup>38</sup>

34. Ameren Missouri testified that in view of the new, more competitive wholesale energy market, it would not be offering requirements service to the municipalities in the coming years after those existing contracts terminate according to their terms.<sup>39</sup>

35. If the revenues Ameren Missouri received from the Wabash and AEP contracts during the recovery periods at issue in this case are flowed through the Fuel Adjustment Clause, Ameren Missouri must refund its customers \$17,169,838 as calculated in the Correction to Staff's Prudence Report and Recommendation filed on October 12, 2010.

**Conclusions of Law**

1. Ameren Missouri is a public utility, and an electrical corporation as those terms are defined in Section 386.020(43) and (15), RSMo Supp. 2010. As such, Ameren Missouri is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

2. Section 386.266.4(4), RSMo Supp. 2010, gives the Commission authority to approve an electrical corporation's fuel adjustment tariff if it finds that the tariff includes "provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rates." The fuel adjustment tariff that the Commission approved for Ameren Missouri contains such provisions.

3. Commission Rule 4 CSR 240-20.090(7) establishes procedures for the conduct of prudence reviews respecting fuel adjustment tariffs.

4. In order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that the utility acted imprudently and that such imprudence resulted in harm to the utility's ratepayers.<sup>40</sup>

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description of the terms of the contract is also treated as public information.

<sup>38</sup> Brubaker Direct, Ex. 14, Page 3, Lines 1-24.

<sup>39</sup> Wills Surrebuttal, Ex. 6, Page 6, Lines 23-26.

<sup>40</sup> *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App.

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5. The Commission established its standard for determining the prudence of a utility's expenditures in a 1985 decision. In that decision, the Commission held that a utility's expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent.<sup>41</sup>

6. Section 386.266.4(1), RSMo Supp. 2010, gives the Commission authority to approve an electrical corporation's fuel adjustment tariff if it finds that the tariff is "reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity." The Commission has approved such a tariff for Ameren Missouri and no one challenges that tariff in this case. Ameren Missouri argues that this provision also requires the Commission to interpret the language of the previously approved tariff in a manner that protects the utility's ability to earn a fair return on equity. There is no such requirement in the plain language of the statute and the Commission will interpret this tariff in the same manner it would interpret any other tariff.

7. Under Missouri law, once the Commission approved the fuel adjustment tariff, that tariff acquired "the same force and effect as a statute directly prescribed from the legislature."<sup>42</sup> Therefore, a reviewing court is to interpret a tariff in the same manner it interprets a statute.<sup>43</sup>

8. In interpreting Ameren Missouri's fuel adjustment tariff, the Commission must "ascertain the intent of [Ameren Missouri and the Commission] from the language used, to give effect to that intent if possible, and to consider the words used in their plain and ordinary meaning."<sup>44</sup> The Commission may look beyond the plain and ordinary language of Ameren Missouri's tariff "only when the meaning is ambiguous or [acceptance of the plain and ordinary language] would

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W.D. 1997).

<sup>41</sup> *In the matter of the determination of in-service criteria for the Union Electric Company's Callaway Nuclear Plant and Callaway rate base and related issues. And In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.* 27 Mo. P.S.C. (N.S.) 183 (1985).

<sup>42</sup> *State ex rel. Laclède Gas Company v. Pub. Serv. Comm'n*, 156 S.W.3d 513, 521 (Mo App. W.D. 2005), quoting *All-States Transworld Vanlines, Inc. v. Southwestern Bell Tel. Co.*, 937 S.W. 2d 314, 317 (Mo. App. E.D. 1996).

<sup>43</sup> *Id.*

<sup>44</sup> *Id.*, quoting *Wolff Shoe Co. v. Dir. Of Revenue*, 762 S.W. 2d 29, 31 (Mo. banc 1988).



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lead to an illogical result defeating the purpose of the [tariff].”<sup>45</sup>

**Decision**

The language from Ameren Missouri’s tariff that is in question is as follows:

Off-System Sales shall include all sales transactions (including MISO revenues in FERC Account Number 447), excluding Missouri retail sales and long-term full and partial requirements sales, that are associated with (1) AmerenUE Missouri jurisdictional generating units, (2) power purchases made to serve Missouri retail load, and (3) any related transmission.

As explained more fully in the findings of facts section of this report and order, that definition of off-system sales determines what revenue is to be run through the fuel adjustment clause subject to a 95/5 sharing mechanism. Ameren Missouri is able to keep 100 percent of revenue that the definition excludes from off-system sales, which explains the company’s desire to exclude revenue derived from the Wabash and AEP sales from off-system sales.

Some confusion was injected into the hearing by Staff’s misreading of part of the tariff language. That misreading derives from a confusingly placed comma in the definition. Staff would read the second part of the definition as if there were no comma between “sales” and “that”. Thus, the definition would state “excluding Missouri retail sales and long-term full and partial requirements sales that are associated with (1) AmerenUE Missouri jurisdictional generating units, (2) power purchases made to serve Missouri retail load, and (3) any related transmission.” In other words, the numbered provisions at the end of the sentence would modify “long-term full and partial requirement sales”. However, there is a comma before “excluding” and after “sales”, and that creates a parenthetical expression that modifies “all sales transactions” at the start of the sentence.

The intended meaning of the definition would be clearer if it were rearranged as follows:

Off-System Sales shall include all sales transactions (including MISO revenues in FERC Account Number

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<sup>45</sup> *Id.*, quoting *State ex rel. Maryland Heights Fire Prot. Dist. v. Campbell*, 736 S.W. 2d 383,387 (Mo. banc 1987).

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447) that are associated with (1) AmerenUE Missouri jurisdictional generating units, (2) power purchases made to serve Missouri retail load, and (3) any related transmission, excluding Missouri retail sales and long-term full and partial requirements sales.

Aside from grammatical construction, the correctness of that meaning of the definition is clear because if the numbered provisions at the end of the sentence are taken to be limitations on the exclusion rather than the inclusion, then all sales transactions would be unlimited and off-system sales would be defined as including transactions that are associated with non-Missouri jurisdictional generating units. That would not be a reasonable interpretation of the definition.

No one questions the exclusion of Missouri retail sales from the definition of of-system sales, but the intended meaning of the exclusion of “long-term full and partial requirements sales” is much less clear. In interpreting the meaning of the phrase “long-term full and partial requirements sales”, the Commission must look first to the plain and ordinary meaning of those words and may look beyond those words only if their meaning is ambiguous. In the context of Ameren Missouri’s sales of electric power to Wabash and AEP, those words are ambiguous. They are not defined anywhere in the tariff and they do not have a plain and ordinary meaning outside the tariff. Therefore, the Commission will attempt to ascertain the intent of Staff, Ameren Missouri, and the other parties when they agreed to this tariff language through their stipulation and agreement.

The parties presented arguments about the tariff language as if there were two provisions to be interpreted, “long-term” and “full and partial requirement sales”. However, the tariff language can best be understood as a single provision, a description of a type of sale that is to be excluded from the definition of off-system sales.

The type of sale to be excluded is described in the Edison Electric Institute and FERC Form 1 definitions as “requirements service”. That is the type of sales contract that Ameren Missouri had entered into with municipal utilities, cooperatives, and other investor owned utilities over the years. It is also a type of sales contract that has become much less common in recent years, as the wholesale electric market has become less regulated.

The key phrase in the definition of “requirements service” is the requirement that the supplier plans to provide such service “on an

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ongoing basis (i.e. the supplier included projected load for this service in its system planning).” As the wholesale electric market has changed in recent years, Ameren Missouri has moved away from requirements service contracts, leaving only the remnant municipal requirements contracts, which Ameren Missouri intends to not renew when their terms expire.

The tariff’s definition of long-term full and partial requirements sales was not limited to municipal customers, but by the time the parties were negotiating the language of the tariff, those were the only such existing customer contracts that would fall within the definition. That also explains the statement that Lena Mantle testified she heard from a representative of Ameren Missouri during those negotiations. Since the municipal contracts were the only ones in existence at that time that would fall within the definition, it is reasonable to conclude that Ameren Missouri’s employees would name those contracts when asked about the definition of long-term full and partial requirements sales.

Thus, the tariff’s definition of off-system sales was intended to exclude requirements sales of the type exemplified by the existing requirements sales to the municipalities. The question then becomes, are the Wabash and AEP contracts the sort of requirements sales that fall within the intent of the tariff?

The Commission concludes that the Wabash and AEP contracts are not long-term full or partial requirements contracts as defined by Ameren Missouri’s tariff. They simply do not have the characteristics to qualify as such contracts. Ameren Missouri calls them such, but it must stretch the definition beyond the breaking point to do so.

If Ameren Missouri’s definition were accepted, nearly any sales contract of over one-year duration would qualify as a long-term full or partial requirements contract that could be excluded from the fuel adjustment clause. Ameren Missouri would be able to choose unilaterally to define an off-system sale out of the fuel adjustment clause and thereby increase its profits at the expense of its ratepayers. Such a broad definition would render the tariff’s definition of off-system sales nearly meaningless and would make the fuel adjustment clause extremely one-sided in a way that was not intended by the Commission or by the parties to the stipulation and agreement that presented that tariff language to the Commission for approval. Ameren Missouri describes its contracts with Wabash and AEP as long-term full or partial requirements contracts, but, to paraphrase MIEC’s witness, Maurice Brubaker, calling a dog a duck does not make it quack, and calling

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Ameren Missouri's contracts with Wabash and AEP long-term full or partial requirements contracts does not make them so.

Ameren Missouri also argues that it did not act imprudently in entering into the Wabash and AEP contracts and that nothing it did has harmed ratepayers. On that basis, it argues that the Commission has no basis to find the imprudence necessary to require it to refund money to its ratepayers.

Ameren Missouri bases that argument on the fact that had there been no ice storm and Noranda had not been forced to curtail its production and resulting purchases of electricity, the money Noranda paid to Ameren Missouri would not have been flowed through the fuel adjustment clause and the company would not have had to share 95 percent of that revenue with its ratepayers. Ameren Missouri contends that the revenue it received from the Wabash and AEP contracts merely replaced the revenue it lost from Noranda and therefore, its ratepayers are no worse off than they would have been had there been no ice storm.

Ameren Missouri's argument would however deprive its ratepayers of the benefit of the bargain implicit in the Commission's approval of the fuel adjustment tariff language proposed in the stipulation and agreement among the parties to the rate case, ER-2008-0318. The bargain implicit in the approved fuel adjustment clause is that ratepayers will pay more to help the company when the utility's fuel costs rise or offsetting revenue from off-system sales drop. On the other hand, ratepayers will benefit from decreased rates if fuel costs drop or offsetting revenue from off-system sales increase. Here offsetting revenue from off-system sales, as those revenues were defined in the tariff, increased and ratepayers should have benefited in the amount of \$17,169,838. However, Ameren Missouri sought to deprive ratepayers of that benefit by branding the Wabash and AEP contracts as long-term full or partial requirements contracts when they do not qualify as such under the terms of the company's tariff. In doing so, Ameren Missouri acted contrary to the requirements of its tariff and therefore acted inappropriately.

**THE COMMISSION ORDERS THAT:**

1. Union Electric Company, d/b/a Ameren Missouri shall refund \$17,169,838 to its ratepayers by an adjustment to its FAC charge to correct an over collection of revenues for the period of March 1, 2009, to September 30, 2009.

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2. This report and order shall become effective on May 7, 2011.

Gunn, Chm., Clayton, and Kenney, CC., concur;  
Davis, C., dissents, with dissenting opinion to follow;  
Jarrett, C., dissents.  
and certify compliance with the  
provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,  
on this 27<sup>th</sup> day of April, 2011.

\*NOTE: At the time of publication, no opinion of Commissioner Davis has been filed.

\*NOTE: See page 532 for another order in this case.

**DISSENTING OPINION OF COMMISSIONER TERRY M. JARRETT  
IN THE REPORT AND ORDER**

I dissent from the Commission's Report and Order ("Order") because I believe that it reaches the wrong conclusion, is not based upon the law, and is fundamentally flawed in its legal analysis and evidentiary basis for reaching its conclusion.

**Findings of Fact**

The findings of fact adopted by the majority are inadequate. Many of them are not findings of fact at all. Rather, they are a mixture of regurgitation of allegations and statements of conclusions of law. Following are the facts that I find dispositive of this case:

1. On January 28, 2009, Southeastern Missouri was struck by a terrible ice storm. (Barnes Direct, Exhibit 3, p. 5, Ins. 19-24).

2. The ice storm knocked down the power lines that serve the aluminum smelter operated by Noranda Aluminum, Inc. As a result, the smelter lost electric power in midcycle, causing the molten aluminum to solidify in the smelting equipment. Noranda quickly restored one of the three production lines, but could not immediately put the second and third lines back into production. Two-thirds of Noranda's production capacity was lost while the solidified aluminum was jack hammered out of the equipment. (Barnes Direct, Exhibit 3, p.6, Ins. 4-10).

3. When Noranda lost production capacity, it reduced the amount of electricity it purchased from Ameren Missouri. The loss of sales to Noranda was a serious problem for Ameren Missouri because Noranda normally buys a lot of electricity. Before the damage resulting from the

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ice storm, Noranda hourly consumed more than 460 megawatts of electricity at a very high load factor, meaning it used nearly the same amount of electric power every hour of every day throughout the year. (See *Report and Order*, Finding of Fact No. 3, see also, Haro Direct, Exhibit 1, pgs. 5-6.)

4. Because of the damage to Noranda's production capacity, Ameren Missouri stood to lose approximately \$90 million per year of its normal electric sales to Noranda. (Barnes Direct, Exhibit 3, p. 6, Ins. 12-15). That amounts to approximately four percent of Ameren Missouri's base-rate revenue requirement from which the company's rates were developed. (Barnes Surrebuttal, Exhibit 4, p. 2, Ins. 19-20).

5. Ameren Missouri began looking for a means to sell power to replace the lost Noranda load. In replacing that load, Ameren Missouri sought to enter into sales contracts that would most closely resemble the service to Noranda by rebalancing the load with regard to the type of customer served and credit exposure faced by Ameren Missouri. (Haro Direct, Exhibit 1, pgs. 4-5, Ins. 8-22, 1-17).

6. Ameren Missouri subsequently entered into two contracts that the contracts themselves described as partial requirements contracts. The first contract was with American Electric Power Service Corporation ("AEP") for 100 megawatts for a duration of 15 months. The second contract was with Wabash Valley Power Association, Inc. ("Wabash"), to serve Citizen Electric load in Missouri. That contract was for 150 megawatts for a duration of 18 months. (Haro Direct, Exhibit 1, p. 7, Ins. 1-10).

7. At all relevant times during this case, Ameren Missouri was subject to a fuel adjustment clause (FAC). Off-Systems Sales were subject to the FAC, with some exclusions, including long-term full and partial requirements sales. The fuel adjustment clause tariff provides:

Off-System Sales shall include all sales transactions (including MISO revenues in FERC Account Number 447), excluding Missouri retail sales and long-term full and partial requirements sales, that are associated with (1) AmerenUE Missouri jurisdictional generating units, (2) power purchases made to serve Missouri retail load, and (3) any related transmission.

(Eaves Direct/Rebuttal, Exhibit 11, pg. 4, Ins. 8-12, Sched. DEE-5).

8. In the context of today's marketplace for wholesale electric power, a long-term power supply contract is one that covers a period of

one year or more. (Haro Direct Exhibit 1, p. 1, Ins. 4-6; Highley Surrebuttal, Exhibit 7, p. 5, Ins. 10-13).

9. Ameren Missouri entered into the Wabash and AEP contracts to replace the Noranda load lost due to the ice storm. (Haro Direct, Exhibit 1, p. 7, Ins. 12-13).

10. Ameren Missouri, Wabash, and AEP intended that the contracts were long-term partial requirements contracts. (Tr. p. 52, Ins. 7-11; Haro Direct, Exhibit 1, p. 3, In. 19; Barnes Direct, Exhibit 3, p. 3, Ins. 5-6, p. 8, Ins. 5-20).

11. By structuring the AEP and Wabash contracts as long-term partial requirements contracts, Ameren Missouri ratepayers received no detrimental impact. They received the same treatment as if the Noranda load had never been curtailed. If the contracts had not been structured that way, ratepayers would have received a windfall from the ice storm. (Barnes Direct, Exhibit 3, p. 8, Ins. 11-16).

12. Ameren Missouri's fuel and purchase power expenses were prudent. (Staff's Prudence Report, Exhibit 8, pp. 7, 10-12, 14, 16).

13. Ameren Missouri's entering into the Wabash and AEP contracts to replace the Noranda load lost due to the ice storm was prudent. (Staff's Prudence Report, Exhibit 8, p. 18; Tr. p. 500, Ins. 9-19).

#### **Analysis**

This case was a prudence review of costs subject to the Commission-approved fuel adjustment clause of Ameren Missouri. The only question before the Commission was whether Ameren's fuel and purchase power expenses run through the fuel adjustment clause were prudent. It is undisputed that Ameren Missouri's fuel and purchase power expenses were prudent. As such, no disallowances were appropriate and the analysis should have ended there.

Instead, the majority went further, and focused upon the interpretation of a Commission approved tariff as it applied to the terms of contracts between Ameren Missouri and AEP and Ameren Missouri and Wabash. This was beyond the scope of review. The question of the application of the contracts to the FAC is a matter of applying the law (the tariff) to the facts (the contract). This application is not one of prudence, it is instead rooted in the regulatory function of ratemaking and specifically – rate treatment for the costs associated with the contracts (either included or excluded from the FAC). Staff's characterization of this analysis as prudence is a misapplication of the principles of prudence. The allocation of the contracts as off system sales by Ameren

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is a question of law. There is no dispute that the contracts themselves were prudently entered into.

To find prudence under the majority's chosen context would require that Ameren know in advance the answer to the question of law regarding the contract's application to the terms of the FAC by this Commission. This prudence review was not the proper vehicle to challenge the contracts' application to the FAC.

That said, for purposes of argument only, if one assumes that this was the appropriate case for challenging the classification of the contracts, then Ameren Missouri still prevails based upon the competent and substantial evidence in the record. The evidence in this case demonstrates that in determining whether the contracts at issue fall within or outside of the FAC exception for off-system sales, that the circumstances at the time of the decision to enter into the contracts is controlling as to the prudence of the contracts themselves. Ameren Missouri made its best efforts to place itself in a position that was as close to its position that had existed prior to the massive ice storm and the loss of its single largest power customer.<sup>1</sup>

Ameren Missouri's action in securing contracts with AEP and Wabash maintained the status quo regulatory context which was envisioned when the FAC was ordered by this Commission. Ameren Missouri's action was the type of sound business judgment decision a utility should make under circumstances such as those presented. No evidence, *none*, shows that the contracts with AEP or Wabash were imprudent. For a utility to lose a 500MW customer unexpectedly overnight, for reasons known only to Mother Nature, calls for prompt and decisive action; action that protects not only ratepayers, but also shareholders.

That is exactly what Ameren Missouri did by securing contracts with AEP and Wabash. Any suggestion that Ameren Missouri's contracts, as drafted, were intended to achieve a result which was not harmonious with its position in relation to its shareholders and ratepayers before the ice storm is not supported by any evidence in this case. No questions were raised in this case that the resulting Order in Case No. ER-2010-0036 fails to meet the legislatures mandate in Section 386.266.4(1) RSMo Cum. Supp. (2009) with regard to the operation of a

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<sup>1</sup> *Report and Order*, ER-2011-0028, pg. 8, pg. 12 "In replacing that load, Ameren Missouri sought to enter into sales contracts that would most closely resemble the service to Noranda by rebalancing the load with regard to the type of customer serviced and credit exposure by Ameren Missouri." See *also*, Haro Direct, Ex. 1, Pages 4-5, Lines 8-22, 1-17.



FAC. As such, the FAC tariff must be in harmony with the law. The majority cannot retroactively create conflict between these two provisions of law.

Just as duly promulgated rules of the Commission have the force and effect of law, so do Orders of the Commission. It is also well established that “[A] tariff that has been approved by the Public Service Commission becomes Missouri law and has the same force and effect as a statute enacted by the legislature.” *Bauer v. Southwestern Bell Telephone Co.*, 958 S.W.2d 568, 570 (Mo. App. E.D. 1997). This concept also comports with *Foremost-McKesson, Inc., v. Davis*, 488 S.W.2d 193, 201 (Mo. Banc 1972) where the Court stated that “[I]t is a well-established principle that administrative rules, which were promulgated to implement the act, *must be read in conjunction and harmony therewith and, so read, the rules do not eliminate any statutory requisite of intent or effect.*” (Emphasis added).

To suggest that a contract entered into by Ameren Missouri could have as its result, the creation of an unlawful construct between the FAC tariff and Section 386.266.4(1) would require a finding that Ameren Missouri acted against its own interests, an allegation that was not proven by any evidence presented. What the majority does here is conclude that Ameren Missouri’s contracts with AEP and Wabash, when tested against the FAC tariff, left Ameren Missouri in a different position after the ice storm than before the ice storm, which is not what was intended by Ameren Missouri when it entered into the contracts with AEP and Wabash. The evidence in the case supports Ameren Missouri on this point.

Because a utility has a duty to serve, it cannot merely engage in a transaction which would sell the power formerly used by its largest customer to anyone else, the agreement to sell had to be one that offered Ameren Missouri the flexibility to resume service to Noranda at a time of Noranda’s choosing and that also fit within the resource plans of the utility. This is the statutory confine of service, within which Ameren was legally required to operate. Ameren Missouri, faced with an unprecedented situation, entered into contracts with AEP and Wabash to sell power that would have otherwise been delivered to Noranda. The contracts were intended to place Ameren Missouri in the same, or as similar a situation as possible, as to that which existed prior to the ice storm, and in fact did just that. The Commission’s focus should have been on those two contracts and their prudence, and ended at that point, in favor of Ameren Missouri. The simple reason is that a prudence review

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does not rely upon hindsight to reach its determination; rather, the review places itself into the shoes of the person making the decision at the time and asks whether a reasonable person, knowing all of the facts and circumstances known at that time, would make the same decision today.

The majority instead works its way through a tortured analysis involving statutory construction, while grafting onto the analysis aspects of contract interpretation as well. Ameren Missouri's definition of long term partial requirements sales is dispositive. There was no evidence presented that at the time the two contracts were entered into that anything other than Ameren Missouri's definition was intended by the parties to the contract. The opponents to Ameren Missouri in this matter, and the majority of the Commission, ultimately are saying that no matter what terms, words, or phrases were selected by Ameren Missouri in the contracts with AEP and Wabash, that because Ameren Missouri's words would have been self serving, they are therefore irrelevant. They are not. To the contrary, Ameren Missouri had every incentive to choose words that would ensure its contractual bargain was met, that the contracts when applied to the FAC achieved the result it desired (keeping it in a position as close to that which existed before the ice storms), and that the contracts' application to the FAC tariff and the terms of the Order in ER-2010-0036 conformed to the law.

The majority makes much ado about ambiguity. What type of contracts existed between Ameren Missouri, AEP and Wabash were between those parties. Any ambiguities' as to those contracts are to be construed under *contract construction standards*. Ameren's representations as to these contracts are undisputed facts because no other party to those contracts presented any evidence or testimony to the contrary; specifically, AEP or Wabash. Mr. Haro testified for Ameren Missouri:

Well, at the time when I entered a contract, I did not look for particular definitions. *What I did was I contacted counterparties and said I need to enter into a long-term partial requirement deal and that's the kind of the section I entered into.* (Tr. p. 52, Ins. 7-11) (Emphasis added).

Mr. Haro testified that he told AEP and Wabash that they were entering into long-term partial requirements contracts, and there is no evidence in the record to the contrary. Any other parties' thoughts, beliefs or interpretations are completely and wholly irrelevant. As such, the AEP and Wabash contracts are long-term partial requirements contracts, as

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those terms are known by the wholesale electricity marketplace.<sup>2</sup> Ameren Missouri also understood that the FAC tariff was constructed within the wholesale electricity marketplace, the same as the two contracts. These are the facts that were known to Ameren Missouri at the time the contracts were entered into, and no hindsight considerations (or definitions) can change these facts.

The Commission's Staff in interpreting the application of the contracts to the FAC tariff arrived at a definition for long term partial requirements contracts *after* the contracts were executed. Any evidence in the record suggesting otherwise is unpersuasive, contradictory and unreliable. Because of the timing in which Staff's definition arose, it is implausible that such a definition was even plausible *at the time* (without hindsight) the AEP and Wabash contracts were executed. This same absurdity as to timing of the definition is again repeated in Staff's definitional recommendation with regard to the FAC, again a definition applied in hindsight.

Further, Staff's proposed definition ignores the regulatory compact that has existed in Missouri since this Commission was created. This Commission was created to serve the public interest. That is, since regulated utilities are monopolies, this Commission acts as a substitute

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<sup>2</sup> Many definitions were offered by the parties in this case for "requirements sales." Missouri law offers a definition for requirements sales under the Uniform Commercial Code. While the UCC is dispositive as to "goods," and therefore not applicable as law to electricity, it is most certainly persuasive authority in this case. Furthermore, the UCC's applicability to gas sales is instructive since many terms and definitions used in the gas business are used with regard to electricity. Also, the UCC's definition of requirement sales appears to be the primordial basis for other definitions in other contexts; a comparison not drawn by any party to this case. Missouri Revised Statutes Section 400.2-306 (1) A term which measures the quantity by the output of the seller or the requirements of the buyer means such actual output or requirements as may occur in good faith, except that no quantity unreasonably disproportionate to any stated estimate or in the absence of a stated estimate to any normal or otherwise comparable prior output or requirements may be tendered or demanded. (2) A lawful agreement by either the seller or the buyer for exclusive dealing in the kind of goods concerned imposes unless otherwise agreed an obligation by the seller to use best efforts to supply the goods and by the buyer to use best efforts to promote their sale.

Other references within the UCC for definitional purposes in this case are also persuasive as well, including the UCC treatment of trade usage. Therefore, to dismiss the UCC out of hand in favor of options proposed in this case would be to overlook well established law, which has a long and thorough history in Missouri.

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for the marketplace.<sup>1</sup> It follows that if the marketplace provides a solution, then a regulatory solution is not necessary. Thus, the fact that the marketplace defined long-term as one year or more is dispositive. That Staff would look somewhere else other than the marketplace for a definition of long-term is contrary to the regulatory compact.

**Conclusion**

What the majority has done here is to punish Ameren Missouri for a sound business judgment and to give the ratepayers a windfall that they did not deserve. This does not balance the interests of the shareholders with the interests of the ratepayers as the law requires this Commission to do. While this may fit the majority's idea of redistributive social policy, it ignores the facts and violates the law. For that reason, and the other reasons discussed above, I strongly dissent.

**\*NOTE:** This case was appealed to the Missouri Court of Appeals (WD) and affirmed. See 399 SW 3d 467 (Mo. App. WD. 2013)

**In the Matter of the Joint Application of Missouri-American Water Company and Loma Linda Water Company for Authority for Missouri-American Water Company to Acquire Certain Assets of Loma Linda Water Company and, in Connection Therewith, Certain Other Related Transactions**

*File No. WO-2011-0015*

*Decided May 2, 2011*

**WATER §4.** After approving the transfer of assets from Loma Linda Water Company to Missouri-American Water Company, the Commission cancelled the certificate granted to Loma Linda.

**ORDER CANCELING AUTHORITY UNDER CERTIFICATE  
AND CANCELING TARIFF**

On November 3, 2010, the Missouri Public Service Commission issued an order approving the transfer of Loma Linda Water Company's assets to Missouri-American Water Company. Included in the transfer of those assets was Loma Linda's Certificate of Service Authority. Because the Commission has authorized the transfer of Loma Linda's authority to

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<sup>1</sup> Charles F. Phillips, Jr., *The Regulation of Public Utilities*, 3rd ed., p. 182 (1993).

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operate as a water company in the state of Missouri, the Commission herein cancels the company's authority as well as its corresponding tariff.

**THE COMMISSION ORDERS THAT:**

1. Loma Linda Water Company's authority under its certificate, granted in Commission Case No. WA-92-187, is cancelled.
2. Loma Linda Water Company's tariff, JW-2002-0034, is cancelled.
3. This order shall become effective on May 12, 2011.
4. This case shall be closed on May 13, 2011.

Kennard L. Jones, Senior Regulatory  
Law Judge, by delegation of authority  
pursuant to Section 386.240, RSMo 2000.  
Dated at Jefferson City, Missouri,  
on this 2nd day of May, 2011.

**In the Matter of the Application of KCP&L Greater Missouri  
Operations Company for Approval to Make Certain Changes in its  
Charges for Electric Service\***

*File No. ER-2010-0356  
Decided May 4, 2011*

**Evidence, Practice And Procedure §26.** The Commission presumes that a utility's costs were prudently incurred. Any party can rebut that presumption by creating a "serious doubt" as to the prudence of an expenditure. The serious doubt is created upon identifying an imprudent action based on industry standards and the circumstances at the time the decision was made, and proof of increased costs due to that decision. Once a serious doubt has been raised, the burden shifts back to the utility to dispel those doubts and prove the expenditure was prudent.

**Rates §3.** The Commission has described a "zone of reasonableness" extending from 100 basis points above to 100 basis points below the recent national average of awarded return on equity ("ROE") to help the Commission evaluate ROE recommendations. The Commission has wide latitude in setting an ROE within the zone of reasonableness. If the total effect of the rate order is not unjust or unreasonable, judicial inquiry is at an end.

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**REPORT AND ORDER**

***Appearances***

**James M. Fischer** and **Larry W. Dority**, Fischer & Dority, P.C., 101 Madison Street, Suite 400, Jefferson City, Missouri 65101,

**and**

**Heather A. Humphrey**, General Counsel, and **Roger W. Steiner**, Corporate Counsel, Kansas City Power & Light Company, Kansas City Power & Light Company, Post Office Box 418679, Kansas City, Missouri 64141-9679,

**and**

**Karl Zobrist** and **Susan B. Cunningham**, SNR Denton US LLP, 4250 Main Street, Suite 1100, Kansas City, Missouri 64111,

**and**

**Glenda Cafer**, Cafer Law Office, L.L.C., 3321 Southwest Sixth Street, Topeka, Kansas 66606,

**and**

**Charles W. Hatfield**, Stinson Morrison Hecker, LLP, 230 West McCarty Street, Jefferson City, Missouri 65101, for Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company.

**Douglas L. Healy**, Healy & Healy, LLC, 939 North Boonville Avenue, Suite A, Springfield, Missouri 65802, for Missouri Joint Municipal Electric Utility Commission.

**Stuart W. Conrad**, and **David L. Woodsmall**, Finnegan, Conrad & Peterson, L.C., 1209 Penntower Office Center, 3100 Broadway, Kansas City, Missouri 64111, for Praxair, Inc.; Ag Processing, Inc., a Cooperative; Sedalia Industrial Energy Users' Association; and Missouri Energy Users' Association (the Industrial Intervenors).

**Carl J. Lumley**, Curtis, Heinz, Garrett & O'Keefe, P.C., 130 South Bemiston, Suite 200, Clayton, Missouri, 63105, for Dogwood Energy, LLC.

**Todd J. Jacobs**, Senior Attorney, Missouri Gas Energy, 3420 Broadway, Kansas City, Missouri 64111,

**and**

**Dean L. Cooper**, Brydon, Swearngen & England P.C., 312 East Capitol Avenue, Post Office Box 436, Jefferson City, Missouri 65102, for

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Missouri Gas Energy, an Operating Division of Southern Union Company.

**Thomas R. Schwarz, Jr.**, Blitz, Bardgett & Deutsch, L.C., 308 East High Street, Suite 301, Jefferson City, Missouri 65101, for the Missouri Retailers Association.

**Mark. W. Comley**, Newman, Comley & Ruth P.C., 601 Monroe Street, Suite 301, Post Office Box 537, Jefferson City, Missouri 65102-0537, for the City of Kansas City, Missouri, and the City of Lee's Summit, Missouri.

**Michael R. Tripp**, **Sarah E. Giboney**, and **James B. Lowery**, Smith Lewis, LLP, 111 South 9<sup>th</sup> Street, Columbia, Missouri 65201, for Union Electric Company, d/b/a Ameren Missouri (formerly d/b/a AmerenUE),

**James C. Swearengen**, **L. Russell Mitten**, and **Diana C. Carter**, Brydon, Swearengen & England P.C., 312 East Capitol Avenue, Post Office Box 436, Jefferson City, Missouri 65102, for The Empire District Electric Company.

**Arthur Perry Bruder**, Attorney-Advisor, Office of Assistant General Counsel for Electricity and Fossil Energy, United States Department of Energy, 1000 Independence Avenue, SW, Washington, D.C. 20585, for the United States Department of Energy.

**Shayla L. McNeill, Captain, USAF**, Air Force Legal Operations Agency, 139 Barnes Drive, Suite 1, Tyndall Air Force Base, Florida 32403-5319, for the Federal Executive Agencies.

**Michael E. Amash**, Blake & Uhlig, P.A., 753 State Avenue, Suite 475, Kansas City, Kansas 66101, for the International Brotherhood of Electrical Workers Local Unions No. 412, 1464, and 1613.

**William D. Steinmeier**, William D. Steinmeier, P.C., 2031 Tower Drive, Post Office Box 104595, Jefferson City, Missouri 65110-4595, for the City of St. Joseph, Missouri.

**Sarah Mangelsdorf**, Assistant General Counsel, Office of Attorney General, Post Office Box 899, Jefferson City, Missouri 65102, for the Missouri Department of Natural Resources.

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**John R. Kindschuh**, Bryan Cave LLP, 13220 Metcalf, Suite 320, Overland Park, Kansas 66213, for the Missouri Industrial Energy Consumers, and Ford Motor Company.

**John B. Coffman**, John B. Coffman, LLC, 871 Tuxedo Boulevard, St. Louis, Missouri 63119-2004, for the American Association of Retired Persons (AARP) and the Consumers Council of Missouri.

**Robert Wagner**, 9005 North Chatham Avenue, Kansas City, Missouri 64154, *pro se*.

**Lewis R. Mills, Jr.**, Public Counsel, Office of the Public Counsel, 200 Madison Street, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

**Kevin A. Thompson**, Chief Staff Counsel, **Steven Dottheim**, Chief Deputy Staff Counsel, **Nathan Williams**, Deputy Staff Counsel, **Jaime N. Ott**, Assistant Staff Counsel, **Jennifer Hernandez**, Associate Staff Counsel, **Sarah Kliethermes**, Associate Staff Counsel, **Eric Dearthmont**, Assistant Staff Counsel, **Annette Slack**, Chief Litigation Counsel, and **Meghan McClowry**, Assistant Staff Counsel, Missouri Public Service Commission, 200 Madison Street, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

**Regulatory Law Judges:**

**Nancy Dippell, Deputy Chief, Regulatory Law Judge**

**Ronald D. Pridgin, Senior Regulatory Law Judge**



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### **In Memoriam**

The Commissioners and all the employees at the Commission express their deepest sympathy to Curtis Blanc's family, friends, and colleagues for his untimely death which occurred on February 16, 2011, while he was in Jefferson City in order to attend the scheduled hearings for these cases.

### **Procedural History**

On June 4, 2010, KCP&L Greater Missouri Operations Company (GMO) submitted to the Commission proposed tariff sheets, effective for service on and after May 4, 2011, that are intended to implement a general rate increase for electrical service provided in its Missouri service area. GMO's proposed tariffs would increase its Missouri jurisdictional revenues by approximately \$75.8 million and \$22.1 million for its MPS and L&P service territories, respectively. According to GMO, this represented a 14.43% rate increase for MPS based on current Missouri jurisdictional revenue, including fuel adjustment clause revenue of approximately \$525 million. It also represents a 13.87% increase for L&P based on current Missouri jurisdictional revenues, including a fuel adjustment clause revenue of approximately \$159 million. The Commission issued an Order and Notice on June 11, in which it gave interested parties until July 1 to request intervention.<sup>1</sup> GMO voluntarily extended the tariff effective date until June 4, 2011.

The Commission received timely intervention requests from: Dogwood Energy, LLC; the City of Kansas City, Missouri; Ag Processing, Inc., a Cooperative; the Sedalia Industrial Energy Users Association (SIEUA); Union Electric Company, d/b/a Ameren Missouri; the City of Lee's Summit, Missouri; the Hospital Intervenors,<sup>2</sup> Missouri Gas Energy, a Division of Southern Union Company; Robert Wagner; the Federal Executive Agencies; the American Association of Retired Persons (AARP), the Consumers Council of Missouri, The Empire District Electric Company; Missouri Retailers Association; the Missouri Department of Natural Resources; and the City of St. Joseph, Missouri. The Commission granted these requests.

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<sup>1</sup> Calendar dates refer to 2010 unless otherwise noted.

<sup>2</sup> Consisting of Lee's Summit Medical Center, Liberty Hospital, Research Belton Hospital, Saint Luke's East – Lee's Summit, St. Mary's Medical Center, Saint Luke's Northland Hospital – Smithville Campus, and North Kansas City Hospital.

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The test year is the 12 months ending December 31, 2009, updated for known and measureable changes through June 30, 2010, and true-up through December 31, 2010.<sup>3</sup> Portions of the hearings in this case were held simultaneously with the hearings in ER-2010-0355 for Kansas City Power & Light Company (KCP&L). Common issues were also addressed in the Report and Order in ER-2010-0355 but will be repeated in this order. The Commission held local public hearings in Nevada, St. Joseph, Kansas City, Riverside, Lee's Summit, and Carrollton. The evidentiary hearing went from January 18 through February 4, 2011, February 14 through February 17, 2011, and the true-up hearing was held on March 3-4, 2011.

### **Non-Unanimous Stipulations and Agreements**

The Commission received seven Non-unanimous Stipulations and Agreements from February 2 to March 23, 2011. With regard to GMO, those stipulations resolved: depreciation, amortizations, an Economic Relief Pilot Program, employee severance cost, Supplemental Executive Retirement Pension cost, advertising cost, bad debt expense, cash working capital imputed accounts receivable program, Proposition C expenses, call center reporting, tracker use for latan operation and maintenance expenses, transmission expense and revenue tracker, outdoor lighting, class cost of service and rate design, MGE rate design issue, pensions and other post-employment benefits, and latan common costs.

No parties objected to the nonunanimous stipulation and agreements. Therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulations as if they were unanimous. The Commission finds the above-referenced stipulations reasonable and approves them.

### **General Findings of Fact**

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but

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<sup>3</sup> Ex. GMO 210, p. 8.

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indicates rather that the omitted material was not dispositive of this decision. When making findings of fact based upon witness testimony, the Commission will assign the appropriate weight to the testimony of each witness based upon their qualifications, expertise and credibility with regard to the attested to subject matter.<sup>4</sup>

1. Kansas City Power & Light Company (“KCP&L”) and KCP&L Greater Missouri Operations Company (“GMO”) are both wholly owned by Great Plains Energy, Inc. (“GPE”). Their service areas in Missouri are shown on Schedule 2 to the direct testimony of Cary G. Featherstone.<sup>5</sup>

2. Collectively, KCP&L and GMO operate and present themselves to the public under the brand and service mark “KCP&L.” The workforce for GMO consists of KCP&L employees; GMO has no employees of its own. Before it was acquired by GPE, GMO was named Aquila, Inc., and before that, Utilicorp United, Inc.<sup>6</sup>

3. KCP&L serves approximately 509,000 customers, of which about 450,000 are residential customers, about 57,000 are commercial customers and the remaining about 2,000 are industrial, municipal and other utility customers. To serve these customers, KCP&L owns and operates 571 MW of nuclear generating capacity and, with Iatan 2, about 2,774 MW of coal capacity,<sup>7</sup> and with Spearville 2, 148 MW of wind capacity, 829 MW of natural gas-fired combustion turbine capacity, and 302 MW of oil-fired combustion turbine capacity. It also purchases power.<sup>8</sup>

4. GMO has approximately 312,000 customers, of which about 273,500 are residential customers, about 38,000 are commercial customers and the remaining about 500 customers are industrial, municipal and other utility customers. To serve these customers, GMO owns, with Iatan 2, 2,128 MW of generating capacity, of which 1,045 MW is coal capacity,<sup>9</sup> 1,019 MW is natural gas-fired combustion turbine

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<sup>4</sup> Witness credibility is solely within the discretion of the Commission, who is free to believe all, some, or none of a witness’ testimony. *State ex. rel. Missouri Gas Energy v. Public Service Comm’n*, 186 S.W.3d 376, 389 (Mo. App. 2005).

<sup>5</sup> Ex. KCP&L 215.

<sup>6</sup> Ex. KCP&L 210, p. 1; Ex. KCP&L 215, pp. 3-4 & 12; Ex. GMO 210, p. 1; Ex. GMO 215, pp. 3, 11.

<sup>7</sup> Iatan 2 ownership is 54.7% of 850 MW, equaling 465 MW.

<sup>8</sup> Ex. KCP&L 210, pp. 1-2; Ex. KCP&L 215, p. 43.

<sup>9</sup> Iatan 2 ownership is 18% of 850 MW, equaling 153 MW.

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capacity, and 64 MW is oil-fired combustion turbine capacity. Like KCP&L, it also purchases power.<sup>10</sup>

5. These two rate cases started on June 4, 2010, when KCP&L and GMO filed applications and proposed tariff changes to implement general electric rate increases. The cases are File Nos. ER-2010-0355 and ER-2010-0356, respectively. KCP&L stated its application was designed to recover an additional \$92.1 million per year in rate revenues, a 13.8% increase.<sup>11</sup> By its true-up direct case filed on February 22, 2011, KCP&L stated its revenue deficiency is \$55.8 million.<sup>12</sup> In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement of \$9.6 million.<sup>13</sup>

6. GMO's service area is divided into two separate rate districts referred to as MPS and L&P. The MPS rate district includes parts of Kansas City, Lee's Summit, Sedalia, Warrensburg and surrounding areas. The L&P rate district is in and about St. Joseph, Missouri. GMO stated its application was designed to recover an additional \$75.8 million per year in rate revenues from its customers in its MPS rate district, a 14.4% increase, and an additional \$22.1 million per year in rate revenues from its customers in its L&P rate district a 13.9% increase.<sup>14</sup> By its true-up direct case filed on February 22, 2011, GMO stated its revenue deficiency for MPS is \$65.2 million and its revenue deficiency for L&P is \$23.2 million.<sup>15</sup> In its true-up direct case filed that same day, Staff recommended an annual increase in revenue requirement for MPS of \$4.6 million and an increase of \$16.6 million for L&P.<sup>16</sup>

### **General Conclusions of Law**

#### **Conclusions of Law Regarding Jurisdiction**

1. GMO is an electric utility and a public utility subject to Commission jurisdiction.<sup>17</sup> The Commission has authority to regulate the rates GMO may charge for electricity.<sup>18</sup>

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<sup>10</sup> Ex. GMO 210, pp. 1-2; Ex. GMO 215, p. 34.

<sup>11</sup> Ex. KCP&L 215, pp. 10-11; Ex. GMO 215, pp. 3-4.

<sup>12</sup> Ex. KCP&L 114, p. 1; Ex. KCP&L 117, p. 1 (but per the Staff's reconciliation, KCP&L's requested revenue increase is \$66.5 million).

<sup>13</sup> Ex. KCP&L 304, p. 4.

<sup>14</sup> Ex. GMO 210, p. 7; Ex. GMO 215, pp. 3, 10; Ex. KCP&L 215, Sch. 2.

<sup>15</sup> Ex. GMO 58, p. 1.

<sup>16</sup> Ex. KCP&L 304, p. 4.

<sup>17</sup> Section 386.020(15), (42), RSMo 2010 (all statutory cites to RSMo 2010 unless

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2. The Commission is authorized to value the property of electric utilities in Missouri.<sup>19</sup> Necessarily, that includes property and other assets proposed for inclusion in rate base. In determining value, “the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . .”<sup>20</sup> The courts have held that this statute means that the Commission’s determination of the proper rate must be based on consideration of all relevant factors.<sup>21</sup> Relevant factors include questions raised by stakeholders about the prudence and necessity of utility construction decisions and expenditures.

3. In making its determination, the Commission may adopt or reject any or all of any witnesses’ testimony.<sup>22</sup> Testimony need not be refuted or controverted to be disbelieved by the Commission.<sup>23</sup> The Commission determines what weight to accord to the evidence adduced.<sup>24</sup> “It may disregard evidence which in its judgment is not credible, even though there is no countervailing evidence to dispute or contradict it.”<sup>25</sup> The Commission may evaluate the expert testimony presented to it and choose between the various experts.<sup>26</sup>

4. The Staff of the Commission is represented by the Commission’s Staff Counsel, who has been delegated the duties of the Commission’s General Counsel, an employee of the Commission authorized by statute to “represent and appear for the commission in all actions and proceedings involving this or any other law [involving the commission.]”<sup>27</sup> The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to “represent and protect the interests of the public in any proceeding

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otherwise indicated).

<sup>18</sup> Section 393.140(11).

<sup>19</sup> Section 393.230.1, RSMo.

<sup>20</sup> Section 393.270.4, RSMo.

<sup>21</sup> *State ex rel. Missouri Water Co. v. Public Service Commission*, 308 S.W.2d 704, 719 (Mo. 1957); *State ex rel. Midwest Gas Users’ Association v. Public Service Commission*, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); *State ex rel. Office of Public Counsel v. Public Service Commission of Missouri*, 858 S.W.2d 806 (Mo. App., W.D. 1993).

<sup>22</sup> *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

<sup>23</sup> *State ex rel. Rice v. Public Service Commission*, 359 Mo. 109, 116, 220 S.W.2d 61, 65 (banc 1949).

<sup>24</sup> *Id.*

<sup>25</sup> *Id.*

<sup>26</sup> *Associated Natural Gas*, *supra*, 706 S.W.2d at 882.

<sup>27</sup> Section 386.071.

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before or appeal from the public service commission[.]”<sup>28</sup> The remaining parties include governmental entities, other electric utilities, and consumers.

### **Burden of Proof**

5. “At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.”<sup>29</sup>

### **Ratemaking Standards and Practices**

6. The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,<sup>30</sup> subject to judicial review of the question of reasonableness.<sup>31</sup> A “just and reasonable” rate is one that is fair to both the utility and its customers,<sup>32</sup> it is no more than is sufficient to “keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested.”<sup>33</sup> In 1925, the Missouri Supreme Court stated:<sup>34</sup>

The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a

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<sup>28</sup> Sections 386.700 and 386.710.

<sup>29</sup> Section 393.150.2.

<sup>30</sup> Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

<sup>31</sup> *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (Mo. banc. 1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (Mo. banc. 1918), *error dis'd*, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd*, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

<sup>32</sup> *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App. 1974).

<sup>33</sup> *St. ex rel. Washington University et al. v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (Mo. banc 1925).

<sup>34</sup> *Id.*

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reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. \* \* \* These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

7. The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.<sup>35</sup> "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."<sup>36</sup> However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.<sup>37</sup> "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."<sup>38</sup>

8. The Commission has exclusive jurisdiction to establish public utility rates,<sup>39</sup> and the rates it sets have the force and effect of law.<sup>40</sup> A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;<sup>41</sup> neither can a public utility change its rates without first seeking authority from the Commission.<sup>42</sup> A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.<sup>43</sup> Thus, "[r]atemaking is a balancing process."<sup>44</sup>

9. Ratemaking involves two successive processes: first, the determination of the "revenue requirement," that is, the amount of

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<sup>35</sup> *May Dep't Stores Co. v. Union Elec. Light & Power Co.*, 341 Mo. 299, 107 S.W.2d 41, 48 (Mo. App. 1937).

<sup>36</sup> *St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n*, 179 S.W.2d 123, 126 (1944).

<sup>37</sup> *St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 49 (Mo. banc 1979).

<sup>38</sup> *St. ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App. 1981).

<sup>39</sup> *May Dep't Stores, supra*, 107 S.W.2d at 57.

<sup>40</sup> *Utility Consumers Council, supra*, 585 S.W.2d at 49.

<sup>41</sup> *Id.*

<sup>42</sup> *Deaconess Manor Ass'n v. Pub. Serv. Comm'n*, 994 S.W.2d 602, 610 (Mo. App. 1999).

<sup>43</sup> *May Dep't Stores, supra*, 107 S.W.2d at 50.

<sup>44</sup> *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988).

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revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.<sup>45</sup>

10. The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The calculation of revenue requirement from these four factors is expressed in the following formula:

$$RR = C + (V - D) R$$

where:

RR	=	Revenue Requirement;
C	=	Prudent Operating Costs, including Depreciation Expense and Taxes;
V	=	Gross Value of Utility Plant in Service;
D	=	Accumulated Depreciation; and
R	=	Overall Rate of Return or Weighted Cost of Capital.

11. The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.<sup>46</sup>

12. The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. The Commission can prescribe uniform methods of accounting for utilities, and can examine a utility's books and records and, after hearing, can determine the accounting treatment of any particular transaction.<sup>47</sup> In this way, the Commission can determine the utility's prudent operating costs. The Commission can value the property of electric utilities operating in Missouri that is used and useful to determine the rate

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<sup>45</sup> *St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).

<sup>46</sup> *See St. ex rel. Union Elec. Co.*, 765 S.W.2d at 622.

<sup>47</sup> Section 393.140.



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base.<sup>48</sup> Finally, the Commission can set depreciation rates and adjust a utility's depreciation reserve from time-to-time as may be necessary.<sup>49</sup>

13. The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a rate of return. For any utility, its fair rate of return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of Common Equity, the cost used is its estimated cost.

14. Because the parties have no dispute regarding rate design or depreciation, the Commission will resolve the issues below generally in the following order: rate base, rate of return, and expenses.

### **The Issues**

Being unable to agree on how to phrase many issues, GMO (jointly with KCPL) and Staff submitted separate lists of issues for determination by the Commission. The Commission phrases and resolves the issues herein. The issues listed at the beginning of each section may be phrased differently than those presented and may not be inclusive of all issues decided. The Commission has previously decided the issues common to KCPL and GMO<sup>50</sup> and those decisions will be repeated here as they apply to GMO.

### **I. Rate Base**

#### **A. Iatan**

***Should the Iatan 1 and 2 Rate Base Additions be included in rate base in this proceeding?***

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<sup>48</sup> Section 393.230. Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

<sup>49</sup> Section 393.240.

<sup>50</sup> File No. ER-2010-0355, *In the Matter of the Application of Kansas City Power & Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Continue the Implementation of Its Regulatory Plan*, Report and Order (issued April 12, 2011); and Order of Clarification (issued April 19, 2011).

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***Should the Commission presume that the costs of those additions were prudently incurred until a serious doubt has been raised as to the prudence of the investment by a party to this proceeding?***

***Has a serious doubt regarding the prudence of the Iatan 1 and 2 additions been raised?***

***Should the Company's conduct be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight?***

***Did KCP&L prudently manage the Iatan 1 and 2 projects?***

***Is the December 2006 Control Budget Estimate the definitive estimate?***

***Should the costs of the Iatan 1 and 2 projects be measured against the Control Budget Estimate?***

***Should the Iatan 1, 2 and common regulatory assets be included in rate base, as well as the annualized amortization expense?***

**Findings of Fact – Iatan**

7. On August 5, 2005, the Commission approved the Stipulation and Agreement in File No. EO-2005-0329 (“Regulatory Plan”). Under the Regulatory Plan, KCP&L<sup>51</sup> has embarked upon a series of infrastructure and customer enhancement projects valued at over \$2.64 billion. Section III.B.4. of the Regulatory Plan which identifies the required level of KCP&L’s reporting of the Comprehensive Energy Plan (“CEP”) Projects states: Section III.B.4. of the Regulatory Plan identifies the required level of KCP&L’s reporting of the CEP Projects:

KCP&L shall provide status updates on these infrastructure commitments to the Staff, Public Counsel, MDNR and all other interested Signatory Parties on a

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<sup>51</sup> Because KCP&L is the managing entity for each of the co-owners of the Iatan Project, KCP&L is the entity referred to in the Iatan section of this Report and Order.

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quarterly basis. Such reports will explain why these investment decisions are in the public interest. In addition, KCPL will continue to work with the Staff, Public Counsel and all other interested Signatory Parties in its long-term resource planning efforts to ensure that its current plans and commitments are consistent with the future needs of its customers and the energy needs of the State of Missouri.<sup>52</sup>

8. KCP&L complied with this requirement by providing nineteen (19) written Quarterly Reports to Staff, OPC, and any other interested party, starting with the first quarter of 2006 through the third quarter of 2010.<sup>53</sup>

9. KCP&L recently submitted the 20<sup>th</sup> Quarterly Report on February 15, 2011. Those Quarterly Reports discuss the status of the Regulatory Plan infrastructure investments, and other specific significant issues existing during the reporting period. KCP&L also met regularly with Staff, OPC, and representatives of the Signatory Parties to discuss the contents of the Quarterly Reports, as well as provide more current information if available at the time of the meeting.<sup>54</sup>

10. In addition, the Missouri Retailers Association's ("MRA") consultant, Walter Drabinski and his colleagues from Vantage Consulting, also received the Quarterly Reports and attended the Quarterly Meetings that KCP&L held with the Kansas Corporation Commission ("KCC") Staff.<sup>55</sup>

11. Mr. Drabinski visited the Iatan Project site and met with KCP&L on seventeen (17) separate occasions.<sup>56</sup>

12. KCP&L responded to Mr. Drabinski's data requests and provided to Mr. Drabinski unfettered access to KCP&L's project personnel, its consultants, and the Iatan Project documentation. Mr. Drabinski agreed that the information provided was sufficient for him to perform a prudence analysis.<sup>57</sup>

13. The Quarterly Reports identified the Iatan Project's risks as they were known throughout the Project and KCP&L's strategy for mitigating those risks. In the first quarter 2007 Quarterly Report, KCP&L

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<sup>52</sup> See Commission File No. EO-2005-0329, Stipulation and Agreement at III.B.4, p. 46.

<sup>53</sup> Tr. 1160-65; Ex. KCP&L 69, pp. 19-24; Ex. KCP&L 70, pp. 2, 4, 8, 38,

<sup>54</sup> Tr. 1160-64.

<sup>55</sup> Tr. 1586-1590.

<sup>56</sup> Id.

<sup>57</sup> Tr. 1586, ln. 22, to 1590, ln. 25.

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began including a specific section entitled "Identification of Project Risks" to describe the key issues recognized by management regarding Iatan Unit 2.<sup>58</sup>

14. The risks identified and tracked in the Quarterly Reports were primarily the same risks that KCP&L identified in the analysis of contingency that was performed in establishing the Control Budget Estimate in December 2006.<sup>59</sup>

15. Mr. Giles describes in his testimony the risks and mitigation plans that KCP&L was tracking throughout the life of the Project.<sup>60</sup>

### Cost Control System and Unidentified Cost Overruns

16. Both Staff and KCP&L agreed that for purposes of the Stipulation, the Control Budget Estimate would serve as the baseline budget for the Projects and the Definitive Estimate from which the Iatan Units 1 and 2 Projects would be measured.<sup>61</sup>

17. KCP&L's witnesses Mr. Archibald, Mr. Meyer and Mr. Nielsen, as well as the Missouri Retailer's Association witness Mr. Walter Drabinski and Staff's Mr. Elliott, each showed that the Cost Control System that KCP&L developed for the Iatan Project allowed for any interested party to fully examine the costs incurred on the Iatan Project.<sup>62</sup>

18. KCP&L's Cost Control System provided the guidance needed to establish the Iatan Project's Cost Portfolio, which it uses for day-to-day tracking and management of Iatan Project's costs.<sup>63</sup>

19. The Cost Control System contains all the information needed to both identify and explain each of the overruns to the Control Budget Estimate that occurred on the Iatan Project.<sup>64</sup>

20. Mr. Meyer placed KCP&L's Cost Control System in the top quartile of those he has seen, and believes this system has allowed for the effective cost management of the Iatan Projects.<sup>65</sup>

21. KCP&L's cost control system is consistent with industry best practices.<sup>66</sup>

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<sup>58</sup> See Ex. KCP&L 71 ; see also Ex. KCP&L 24, pp. 18-26; Ex. KCP&L 25, pp. 37-41.

<sup>59</sup> See Ex. KCP&L 24, pp. 20-24; Ex. KCP&L-25, pp. 39- 41.

<sup>60</sup> See Ex. KCP&L 24, pp. 20-24.

<sup>61</sup> Tr. 1095-97; 2643-44.

<sup>62</sup> See Ex. KCP&L 25, pp. 20-22; Ex. KCP&L 4, pp. 3-4; Tr. pp. 2176-77.

<sup>63</sup> Ex. KCP&L 205, p. 10; see also Ex. KCP&L 44, pp. 3, 10-12, p. 30, and Schs. DFM2010-17 to DFM2010-24; Ex. KCP&L 46, p. 26.

<sup>64</sup> See Ex. KCP&L 205, pp. 11-13.

<sup>65</sup> See Ex. KCP&L 44, pp. 3, 7-8.

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22. KCP&L's cost control system allows any interested party to this matter to track every dollar that KCP&L spent on the Iatan Project, regardless of whether the costs were anticipated in the Control Budget Estimate or constitute a cost overrun to the Control Budget Estimate: "Our system allows you to track through every dollar that's spent from cradle to grave and understand where it was spent and wherever the overrun occurred."<sup>67</sup>

23. KCP&L complied with the requirements in the Regulatory Plan regarding the cost control process for construction expenditures. Section III.B.1.q. of the Regulatory Plan requires that KCP&L do the following:

KCP&L must develop and have a cost control system in place that identifies and explains any cost overruns above the definitive estimate during the construction period of the Iatan 2 project, the wind generation projects and the environmental investments.

24. KCP&L has complied with these requirements. First, KCP&L developed a comprehensive Cost Control System which provides key guidance to each of the CEP Projects governed by the Stipulation.<sup>68</sup>

25. KCP&L's Cost Control System, which was transmitted to the Staff and the other Signatory Parties' representatives on July 10, 2006, "describes the governance considerations, management procedures, and cost control protocols for the CEP Projects" including the Iatan Project.<sup>69</sup>

26. On July 11, 2006, KCP&L representatives met with members of the Staff and the other interested parties. Staff raised no concerns at that meeting.<sup>70</sup>

27. Additionally, KCP&L has conducted quarterly meetings addressing Project issues, including costs, and provided Staff with thousands of well-organized and detailed documents describing and explaining the cost overruns and has explained to Staff multiple times in face-to-face meetings how the documents can be used to identify and explain the overruns on the Iatan Project.<sup>71</sup>

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<sup>66</sup> See Ex. KCP&L-43, p. 5, ln. 10; Ex. KCP&L 46, pp. 249-250.

<sup>67</sup> Tr. 2176-77.

<sup>68</sup> Ex. KCP&L 38, at Sch. SJ2010-1.

<sup>69</sup> Ex. KCP&L 25, p. 21, ln. 9-11; KCP&L 38, Sch. SJ2010-1, p. 3.

<sup>70</sup> Ex. KCP&L 25, p. 22.

<sup>71</sup> Ex. KCP&L 25, p. 4, ln. 4-7.

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28. Further, the Cost Control System states that the Iatan Project's cost performance would be measured against the Project's Control Budget Estimate (i.e., Definitive Estimate), and to do so, the Iatan Project's Control Budget "will identify the original budget amount (whether contracted or estimated) for each line item of the Project's costs and will track those budget line items against the following:

- Costs committed to date
- Actual paid to date
- Change orders to date
- Expected at completion, based on current forecasts."<sup>72</sup>

29. The Cost Control System also identified the Iatan Project's actual and budgeted costs would be tracked in comparison to Iatan Unit 1 Project's and Iatan Unit 2 Project's respective Definitive Estimates. The Cost Control System states that:

The Project Team will develop a Definitive Estimate for each Project that will provide an analytical baseline for evaluating Project costs. The estimate will establish anticipated costs for individual work activities and all procurements. The Definitive Estimate will be used to establish each Project's Control Budget.<sup>73</sup>

30. Second, KCP&L created a Definitive Estimate. KCP&L's prefiled Testimony describes in detail the process KCP&L used for developing the Control Budget Estimates for both Iatan 1 and 2.<sup>74</sup>

31. Staff and KCP&L agreed that the Control Budget Estimate would serve as the baseline budget for the Projects and the Definitive Estimate from which the Iatan Units 1 and 2 Projects would be measured.<sup>75</sup>

32. Third, KCP&L met its obligation to report on the status of the Definitive Estimate. Once each Project's Control Budget Estimate was in place, the Iatan Project team began tracking costs in the manner described in the Cost Control System.<sup>76</sup>

33. As the Iatan Project progressed, KCP&L met its obligation to "identify and explain" all cost overruns on the Iatan Project. With the Definitive Estimate in place, the Iatan Project team developed a

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<sup>72</sup> Ex. KCP&L 38, Sch. SJ2010-1, p. 17.

<sup>73</sup> *Id.* at Sch. SJ2010-1, at p. 8.

<sup>74</sup> Ex. KCP&L 24, pp. 15-18, Ex. KCP&L 43, pp. 6-16.

<sup>75</sup> Tr. 1095-97, 2643-44, Staff's Position Statement, p. 9.

<sup>76</sup> See Ex. KCP&L 25, pp. 20-22.

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“Cost Portfolio” which it uses for day-to-day tracking and management of Iatan Project’s costs.<sup>77</sup>

34. KCP&L’s Cost Portfolio comprises the necessary management reports and information needed for cost tracking, cash flow, change order tracking and management.<sup>78</sup>

35. Within the Cost Portfolio, there is a specific report entitled the “K-Report” which is the report that delineates discrete line items of cost including each and every budget change that has occurred along with all costs actually expended.<sup>79</sup>

36. KCP&L has provided this report to Staff in summary form each quarter since the creation of the Control Budget Estimate in the first quarter of 2007, and has provided Staff with access to the detailed Cost Portfolio on a monthly basis since that time.<sup>80</sup>

37. Staff admits that KCP&L’s cost control system has the ability to track cost overruns. As the Staff’s own report states: “KCPL’s control budget is very detailed with hundreds of line items. It is clear that KCPL has the ability to track, identify and explain control budget overruns.”<sup>81</sup>

38. In keeping with the collaborative process that KCP&L began when it negotiated the Stipulation, KCP&L made every effort at every stage of the process to be fully transparent and accommodating for all the Signatory Parties to access its records and information to ensure that the Iatan Project stayed on track, as well as self-reporting all variances in cost and schedule.<sup>82</sup>

39. Moreover, KCP&L transparently reported each and every major decision that KCP&L makes, the basis for those decisions, the risks both real and perceived and the implications to those decisions to the Project’s cost and schedule so that Staff could render its own independent assessment to the Commission regarding KCP&L’s prudence.<sup>83</sup>

40. As a prime example of this transparency, KCP&L invited the Staff to participate in the 2008 cost reforecast process and all of the

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<sup>77</sup> See Ex. KCP&L 4, pp. 3-4.

<sup>78</sup> *Id.*

<sup>79</sup> *Id.*

<sup>80</sup> See Ex. KCP&L 25, pp. 22-23.

<sup>81</sup> Ex. KCP&L 205, p. 37.

<sup>82</sup> Ex. KCP&L 25, pp. 20- 25; Ex. KCP&L 44, pp. 9-11.

<sup>83</sup> Ex. KCP&L 25, pp. 20-23; Ex. KCP&L 4, pp. 14-15.

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documents that KCP&L generated in each cost reforecast (collectively the "Cost Reforecasts") were timely provided to Staff for its review.<sup>84</sup>

41. KCP&L also met with Staff at the conclusion of each of the Cost Reforecasts to discuss the resultant changes to the Iatan Project's projected estimate at completion ("EAC").<sup>85</sup>

### Cost Variance Identification

42. Mr. Meyer was engaged by KCP&L as part of the Schiff Hardin team and his role on the Iatan Project included examining the changes that have been necessary for each Unit's Control Budget Estimate.<sup>86</sup>

43. Mr. Meyer participated in the oversight of the Iatan Project's base cost estimate that ultimately became the Iatan Project's Control Budget Estimates, each of the Iatan Project's cost reforecasts, and has examined in reasonable detail all of the documents that identify and explain the cost overruns that have occurred on the Iatan Project.<sup>87</sup>

44. Mr. Meyer concludes, "While the Iatan Project is very complex, identifying variances based on the cost system is not, and KCP&L's project documentation, which was readily available to Staff, explains the reasons for those variances."<sup>88</sup>

45. Mr. Meyer provides an overview of this analysis of the Iatan Project costs, which consisted of: "1) Identifi[cation] from a side-by-side comparison of the Iatan Project's Control Budget Estimate and actual costs the largest cost overruns by line-item; and 2) Drill-down through KCP&L's well-organized back-up documentation on each line item so as to obtain a better understanding of the cause of those overruns."<sup>89</sup>

46. The variances were not caused by management imprudence. The size of the overruns was much lower than overall cost increases that were occurring in the industry at-large at the same time for similar projects.<sup>90</sup>

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<sup>84</sup> Tr. pp. 1091-92.

<sup>85</sup> Ex. KCP&L 25, pp. 24-25.

<sup>86</sup> Ex. KCP&L 44, p. 3.

<sup>87</sup> *Id.*

<sup>88</sup> *Id.*

<sup>89</sup> *Id.* at 3-4.

<sup>90</sup> *Id.*



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47. Mr. Meyer reviewed the Iatan Project's cost trends as part of his and Schiff Hardin's oversight of KCP&L's four Cost Reforecasts during the life of the Project.<sup>91</sup>

48. Mr. Meyer's analysis is described in detail in his Rebuttal Testimony and attached Schedules.<sup>92</sup>

49. The "drill down" that Mr. Meyer describes involved review of the documents described above from KCP&L's Cost Control System. Starting with the K-Report, Mr. Meyer identified the cost overruns from the Control Budget Estimate. He performed his analysis by narrowing the scope of his review to those items that "on their face appear to be overruns or underruns" which he describes as a standard approach.<sup>93</sup>

50. Mr. Meyer did this by examining the aforementioned K-Report and performing comparisons of the Control Budget Estimate's line items to confirm negative variances without regard to contingency transfers.<sup>94</sup>

51. In other words, Mr. Meyer verified on a line-by-line basis which items cost more than the original estimate anticipated they would regardless of how KCP&L treated it within its Cost Portfolio. Using this method, Mr. Meyer was able to isolate the cost overruns and examine the root cause of each category of costs where an overrun occurs and thus make a determination regarding KCP&L's prudence in association with that overrun. Mr. Meyer then analyzed and applied the Project's unallocated contingency from the Control Budget Estimate in the same manner as employed by the project team to determine the extent of the actual cost overrun on the Project.<sup>95</sup>

52. Mr. Meyer then examined the Recommendation to Award Letters, Cost Reforecasts, Change Orders and Purchase Orders to evaluate the explanations provided by KCP&L regarding these overruns. Based on this review, Mr. Meyer describes how he initially identified certain items as "omissions" because they were omissions from the Control Budget Estimate and were needed for the construction of the Iatan Project.<sup>96</sup>

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<sup>91</sup> *Id.* at 17.

<sup>92</sup> *Id.* at 17-44; Sch. DFM2010-7 to DFM2010-27.

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at 18.

<sup>95</sup> *Id.* at 18-20.

<sup>96</sup> *Id.* at Sch. DFM2010-14.

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53. These omitted costs are essentially scope additions to the Iatan Project and required an adjustment to the Control Budget Estimate due to the fact that these items “could not have reasonably characterized as avoidable costs due to any action or inaction on the part of KCP&L’s management.”<sup>97</sup>

54. After making these adjustments, Mr. Meyer was left with a list of variances in the K-Report that formed the basis of his analysis.<sup>98</sup>

55. Because Mr. Meyer only evaluated the negative variances (the overruns) and did not take into account any of the positive variances (the underruns), the amount of these negative variances actually exceeded the total overrun for the Iatan Project.<sup>99</sup>

56. Then, utilizing the project’s documentation in the Cost Portfolio, Mr. Meyer assessed the identified root causes of these cost overruns, and “bucketed” them into the following five categories:<sup>100</sup>

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<sup>97</sup> *Id.* at 22.

<sup>98</sup> *Id.* at 23.

<sup>99</sup> *Id.* at 24.

<sup>100</sup> *Id.* at 26.

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Reason Code	Definition
1	<b>DESIGN MATURATION:</b> This category captures work that is related to the original scope of work, and is necessary for the design or construction of the Unit. This could include field changes or necessary design changes based upon information that became known after the original contract.
2	<b>PRICING ESCALATION/CHANGES:</b> This category captures increase in material costs or rates from the original contracted amounts.
3	<b>NEW SCOPE:</b> This category captures the cost increases associated with work scope that was never anticipated to be a part of a particular contractor's scope.
4	<b>DESIGN AND/OR FABRICATION ERRORS:</b> This category captures scope and costs associated with engineering which caused rework in the field by the affected contractor.
5	<b>COST INCREASES DUE TO SCHEDULE:</b> This category captures additional costs paid to the contractor due to delays, compression, acceleration or lost productivity.

57. Mr. Meyer identified the methodology for his categorization of the cost overruns he identified, and explained his reasoning for allocation of costs into each of these categories.<sup>101</sup>

58. Mr. Meyer used these reason codes so that these cost items could be understood as part of general categories; however, his analysis required review of the cost items themselves and all related supporting documentation. Mr. Meyer describes the application of these Reason Code Categories in his Rebuttal Testimony.<sup>102</sup>

59. There are two areas of Mr. Meyer's analysis, Design Maturation and Cost Increases Due to Schedule, that encompass the majority of the Iatan Project's cost overruns that Mr. Meyer examined. Based on his drill down from the Project's documentation, Mr. Meyer

<sup>101</sup> *Id.* at 27-29.

<sup>102</sup> *Id.* at 25-44.

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assigned change orders to Category 1 (Design Maturation) and the related Category 3 (New Scope) that represented costs “the Owner would have incurred regardless of any act or omission on the part of the Owner.”<sup>103</sup>

60. Mr. Meyer’s analysis of these items was further guided by the concepts of “betterment” or “added value”. The Control Budget Estimate was impacted by design maturation:

**Q: What portions of the Project were most impacted by design maturation in the time period from the December 2006 CBE to June 2008?**

A: For Unit 2, design maturation most readily impacted areas of the final design that were dependent on the details and workings of the major pieces of plant equipment, functionality of that equipment and operational aspects of that equipment in concert with other systems. Portions of the design that were impacted most by maturation included plant systems such as electrical, water, air, ventilation and mechanical operations. The final design of these plant systems requires significant coordination and a full understanding of the physical size, locations and functionality of adjacent equipment and structural elements.

**Q: Do costs of a project always rise as a result of design maturation?**

A: I would not say that “costs rise” due to design maturation but rather one’s ability to more accurately forecast the end cost of a project is enhanced as the design is completed and that sometimes results in cost projections increasing. As the design matures and the project’s scope becomes more defined, the work quantities and related configurations can more readily be determined. This in turn has an effect on work sequences, overall schedule considerations, work-area sharing arrangements, and time-function expenses. Design evolution enhances an owner’s understanding of the nature of a project’s various cost streams. As that knowledge and understanding is incrementally accrued,

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<sup>103</sup> *Id.* at 27.

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the project's contingency should be re-evaluated in light thereof.

**Q: When was the impact of design maturation most apparent on the Iatan Unit 2 Project's costs?**

A: During the period between the establishment of the CBE in December 2006 and the May 2008 Cost Reforecast, the design matured from approximately 20% complete to approximately 70% complete. A large percentage of the R&O's that the Project Team had identified during this period reflected the increase of such design maturity.

**Q: Based on your analysis of the 2008 reforecasted estimate, did the increase in costs from design maturation that the Iatan Unit 2 Project experienced from December 2006 to May 2008 result from any imprudent acts by KCP&L?**

A: No.<sup>104</sup>

61. Because much of the impact of Design Maturation was captured in documentation that KCP&L's Project Team developed in support of the 2008 Cost Reforecast, Mr. Meyer utilized the backup information from this reforecast to measure the impact of the design maturation on the Iatan Project's costs. One example of Design Maturation is the R&O from the Iatan Unit 1 Project's 2008 Cost Reforecast which calls for the inclusion of work on the existing Unit 1 Economizer.<sup>105</sup>

62. Mr. Meyer identified from the documentation that the work involved cooling the exit gas temperature from the existing economizer to the new SCR purchased from ALSTOM, an issue that was not known until after the design had matured and it was recognized that these modifications were necessary.<sup>106</sup>

63. Mr. Meyer explained that this R&O item resulted in changes to both the Iatan Unit 1 budget and schedule.<sup>107</sup>

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<sup>104</sup> Ex. KCP&L 43, pp. 26-27.

<sup>105</sup> Ex. KCP&L 44, Sch. DFM-2010-06 and Sch. DFM2010-25.

<sup>106</sup> *Id.*; see also Ex. KCP&L 44, pp. 47-49.

<sup>107</sup> *Id.*

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64. Mr. Meyer concluded that the cost overruns on the Iatan Project that were the result of Design Maturation and New Scope, and the explanations provided by KCP&L show that these overruns were prudently incurred. Mr. Meyer's analysis of the effects of Design Maturation on the Iatan Project's costs is further confirmed by Mr. Davis, Mr. Archibald, Mr. Giles and Mr. Roberts.<sup>108</sup>

65. Mr. Meyer's analysis of the Cost Increases due to Schedule followed the same methodology. Mr. Meyer examined the root causes of the costs related to schedule changes, including those to ALSTOM's schedule of work for Iatan Unit 1 and Iatan Unit 2, resulting in the ALSTOM settlement agreements, and found that the explanation provided by KCP&L's project team was sufficient to support that KCP&L managed these changed conditions prudently.<sup>109</sup>

66. Mr. Meyer's opinion is supported by abundant testimony from Mr. Downey, Mr. Davis, Mr. Bell and Mr. Roberts, who each testified at length regarding the prudence of the decisions KCP&L made to compensate ALSTOM for revisions to the Iatan Project's schedule.<sup>110</sup>

67. Mr. Meyer's analysis shows that KCP&L's documentation allows for the performance of a prudence analysis of the Iatan Project's cost overruns. Mr. Meyer's analysis was only one of several such analyses that have been performed. MRA's consultant Mr. Drabinski describes how he and his team reviewed the Iatan Project's change orders and purchase orders and determined the basis for his testimony in this case.<sup>111</sup>

68. Mr. Drabinski agreed that the information provided to him was sufficient for his prudence analysis.<sup>112</sup>

69. While KCP&L disagrees with both Mr. Drabinski's methodology and his conclusions, Mr. Drabinski never raised any concerns with KCP&L's Cost Control System. In addition, while he says he did not examine cost, Mr. David Elliott never had any issues with KCP&L's Cost Control System and was able to perform his analysis of the engineering necessity of the change orders with the documents

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<sup>108</sup> Ex. KCP&L 4, pp. 16-22, 25-27; Ex. KCP&L 18, pp. 9-12 (citing to Sch. BCD2010-01); Ex. KCP&L 19, pp. 11, 27-28, 55-58 and 99-100; Ex. KCP&L 24, pp. 20-21; Ex. KCP&L 25, pp. 12, 26-27 and 35; Ex. KCP&L 51, Roberts Rebuttal Testimony pp. 21-24.

<sup>109</sup> Ex. KCP&L 44, pp. 31-34.

<sup>110</sup> Ex. KCP&L 51, pp. 9-10; Ex. KCP&L 22, pp. 35-36; Ex. KCP&L 21, pp. 13-14; Ex. KCP&L 50, pp. 15-16; Ex. KCP&L 18, pp. 20-21; Ex. KCP&L 22, pp. 25-28; Ex. KCP&L 51, p. 7-9; Ex. KCP&L 19, pp. 47-51, 110,; Ex. KCP&L 46, pp. 127-132.

<sup>111</sup> Tr. 1598-9, 1607-8, 1634-6, 1703-4; see also Ex. KCP&L 2601, pp. 204-213.

<sup>112</sup> Tr. p. 1586-1590.

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provided by KCP&L. Mr. Elliott's review included "bucketing" change orders in a manner very similar to the one employed by Mr. Meyer.<sup>113</sup>

70. Dr. Nielsen concluded that but for two examples, his prudence review of the Iatan Project demonstrated that KCP&L prudently managed the Iatan Project. Dr. Nielsen testified that, "Pegasus-Global was able to track cost overruns back to root causes for those overruns through the project records maintained by KCP&L during the execution of the project."<sup>114</sup>

### Staff Perspective of Cost Control System

71. Despite all of the evidence that KCP&L has presented, Staff alleges that KCP&L has exhibited a "knowing and willful disregard of its obligations under the Experimental Alternative Regulatory Plan ('EARP') by failing to identify and explain cost overruns on the Iatan Project."<sup>115</sup>

72. Staff claims that, "the record will show that the Iatan Construction Project's cost control system does not identify and explain cost overruns as specified in KCP&L's Regulatory Plan but only provides fragmented information regarding budget variances leaving for Staff to identify and explain cost overruns."<sup>116</sup>

73. Staff further claims that KCP&L's cost control system is also "deficient" when compared to those used for Wolf Creek and Callaway.<sup>117</sup>

74. Staff adds that KCP&L's tracking of "budget variances is not what the KCP&L Regulatory Plan requires" because, "budget variances and cost overruns are not necessarily the same thing."<sup>118</sup>

75. However, despite these allegations, as noted, Staff admits that KCP&L had the capability to track cost overruns on the Iatan Project.<sup>119</sup>

76. Staff had full access to the same documents that Mr. Meyer, Mr. Archibald, Mr. Drabinski, Mr. Elliott and Dr. Nielsen had in performing their work.<sup>120</sup>

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<sup>113</sup> Tr. pp. 2398-2400; Ex. KCP&L 205, p. 10; Ex. KCP&L 19, pp. 10-12; Ex. KCP&L 25, p. 14.

<sup>114</sup> Ex. KCP&L 46, p. 26, ln. 16-20.

<sup>115</sup> Staff's Initial Brief at p. 19.

<sup>116</sup> *Id.* at p. 25.

<sup>117</sup> *Id.*

<sup>118</sup> *Id.* at 39.

<sup>119</sup> Ex. KCP&L 205, p. 37.

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77. As Mr. Blanc testified, “Staff’s later Report reads as though it expected the cost control system to be a piece of paper that lists and explains every dollar spent over the December 2006 CBE. That is an overly simplistic notion and does not accurately represent the purpose of a cost control system, which is to manage the costs of project, which KCP&L’s system effectively did.”<sup>121</sup>

78. While the Commission has previously approved an adjustment for costs that were deemed to be “unauditable,” such a finding has only been made in very extreme circumstances that do not apply here. For example, a category of costs was determined to be unauditible when the utility: (1) failed to have a cost control system in place; (2) failed to provide documentation that could be broken down or traced to the budget; and (3) failed provide evidence regarding its expenditures.<sup>122</sup>

79. Additionally, the Commission has previously rejected Staff’s proposed disallowances for “unauditable” costs.<sup>123</sup>

80. For example, Staff alleged that certain categories of costs in the original construction of later Unit 1 were unauditible based on Staff’s conclusion that it was unable to reconcile the costs at issue against any variance report or Staff’s definitive estimate.<sup>124</sup>

81. Specifically, Staff asserted the following costs were “unauditible:” (1) the difference between Staff’s definitive estimate and the company’s definitive estimate; and (2) the project contingency fund.<sup>125</sup> The Commission accepted the company’s definitive estimate which eliminated Staff’s first category of “unauditible” costs and also

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<sup>120</sup> Ex. KCP&L 44, p. 3; see also Tr. 1160-64; Ex. KCP&L 69, p. 19; Ex. KCP&L 70, p. 2, 4, 8, 38.

<sup>121</sup> Ex. KCP&L 8, p. 9.

<sup>122</sup> See *Re Kansas City Power & Light Co.*, 48 P.U.R.4<sup>th</sup> 598, 616 (1982); see also *Re Kansas City Power & Light Co.*, 55 P.U.R.4<sup>th</sup> 468 (1983) (disallowance of “unexplained” costs premised on a complete lack of any competent and substantial evidence, failure of both the Company and Staff to address specific factors or causes for the changes, and the Commission’s conclusion that no one knows to what the unexplained differences are attributed.); Staff’s Initial Brief at p. 31.

<sup>123</sup> See *Re Kansas City Power & Light Co.*, 48 P.U.R.4<sup>th</sup> 598, 616.

<sup>124</sup> In the referenced case, Staff and KCP&L disagreed regarding the what estimate was the “Definitive Estimate.” Staff’s calculation of “unauditible” costs was based on the estimate it asserted was the Definitive Estimate. In rejecting the Staff’s claim of “unauditible” costs, the Commission found that the Company’s estimate was what should be used as the Definitive Estimate to determine cost overruns. See *Re Kansas City Power & Light Co.*, 43 P.U.R.4<sup>th</sup> 559, 585 (1981).

<sup>125</sup> *Id.*



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rejected the Staff's assertion that the contingency fund was an "unauditable" cost.

82. KCP&L has provided abundant evidence regarding the creation, implementation, and use of an industry standard cost control system for the Iatan Project and all costs incurred on the Project enabling Staff to audit all of the Iatan Project's costs.<sup>126</sup>

83. Project Contingency is an unallocated pool of money that is intended to cover the project's risks as they occur, and that KCP&L's method of distributing contingency on an as-needed basis is standard in the industry.<sup>127</sup>

84. A budget estimate should not determine whether a utility's decision to incur a particular expenditure was prudent:

I don't really know, other than for regulatory purposes, what any of the budget estimates have to do with prudence. You're not prudent whether you're above or below a budget or cost estimate. You're prudent whether you do something that causes costs to rise due to imprudent or unreasonable management. I don't believe that the control budget or definitive estimate should be a starting point. What if the very first dollar on a project was spent imprudently? Are you not able to go back and identify it and deduct it because it's below the CBE? . . . I don't believe there's a real relationship between cost estimates or budgets with the question before this Commission with what was the reasonable or imprudent cost of the project.<sup>128</sup>

85. Regardless, if Staff did not agree, all it had to do was look at the contingency log that KCP&L provides to Staff each month. Staff could have done what Mr. Meyer did – apply the contingency in exactly the same manner as KCP&L's project team as part of the prudence review.<sup>129</sup>

86. If Staff still had questions, all Staff had to do next was call Mr. Archibald, who opened his calendar every Friday afternoon for Staff to call with questions. Or, Staff could have asked questions in one

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<sup>126</sup> Ex. KCP&L 38, Sch. SJ2010-1; Ex. KCP&L 25, pp. 4, 21-22; Ex. KCP&L 24, pp. 15-18; KCP&L 43, pp. 6-16.

<sup>127</sup> Ex. KCP&L 44, pp. 15-16.

<sup>128</sup> Tr., p. 1713.

<sup>129</sup> Ex. KCP&L 44, pp. 15-16.

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of the nineteen Quarterly Meetings.<sup>130</sup> If Staff, after applying contingency as KCP&L did, then wanted to examine only those items that were added to the budget after contingency was applied, it easily could have done so. KCP&L identified to Staff where contingency would be exhausted when it informed Staff in the second quarter of 2007 of the need to reforecast the Iatan Project's Control Budget Estimate.<sup>131</sup>

87. Mr. Giles called Mr. Henderson to invite Staff to observe the reforecasting of the Control Budget Estimate that concluded with the 2008 Cost Reforecast, though Staff declined the invitation.<sup>132</sup>

88. Had Staff wanted to look at the actual costs that were expended on the Iatan Project, it could have taken the K-Report referred to above, compared the "Control Budget Estimate" column with the column labeled "Actuals Plus Accruals," found the contracts where the actual costs exceeded the Control Budget Estimate amount and reviewed the change orders associated with these increases. Such a "list" not only exists, as Mr. Archibald stated, it is reported as part of the regular regime in the Cost Portfolio. Perhaps such an exercise would be time consuming, but it is, in essence, no different than what Mr. Elliott did when he reviewed the engineering necessity of the Iatan Project's change orders.<sup>133</sup>

89. In fact, had Audit Staff merely requested a copy of what Mr. Elliott prepared in his work papers, it would have had a "list" that consists of 227 change orders with a value over \$50,000 on Iatan Unit 1 and 647 similar change orders on Iatan Unit 2. However, Audit Staff never once sought Mr. Elliott's assistance in preparing this prudence audit other than the one section he authored for Staff's December 31, 2009 and November 2010 Reports, and didn't know that Mr. Elliott had even prepared these "lists."<sup>134</sup>

90. Mr. Featherstone described a system that Staff once used that combined both pure auditing of costs with the expertise and judgment of the engineering Staff.<sup>135</sup>

91. Engineering conclusions have guided all of Staff's prior audit reports and associated disallowance recommendations. The

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<sup>130</sup> Tr. 2216-17; Ex. KCP&L 25: pp. 4, 11-12, 38-41.

<sup>131</sup> Ex. KCP&L 71, pp. 5-7.

<sup>132</sup> Tr. 1091.

<sup>133</sup> Tr. 2398-2400; Ex. KCP&L 205, pp. 10, 30-31; Ex. KCP&L 19, pp. 10-12; Ex. KCP&L 25, p. 14

<sup>134</sup> Tr. 2313, 2387, 2400, 2661, 2828.

<sup>135</sup> Tr. 332, 337, 339.

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evidence demonstrated in this case that the Audit Staff did not consult the Engineering Staff in developing its recommended disallowances.<sup>136</sup>

92. Mr. Henderson took accountability for the change in this procedure, which ultimately resulted in Staff's unprecedented recommended disallowance of all costs over the Iatan Project's Control Budget Estimate based solely on the recommendation of Mr. Hyneman.<sup>137</sup>

93. Staff's approach to the audit of the Iatan Project is especially curious in light of Chairman Gunn's expressed concerns in the April 2010 Hearing:

But we have an Order saying do an audit, complete—and then we have an order saying complete the audit. We have a brand-new—and this is a Iatan 1, which we've talked about the total cost of this project, which is huge, and we want to get that done because we know that we've got Iatan 2 coming, which is enormous.

And yet it didn't appear to be viewed by anybody that this was an important audit. As a matter of fact, we decided to pull it out of the normal way that we do it and have one person take it on themselves because other people were so reluctant to take it on because there was chaos, that they weren't—they didn't want to do it.

So we have one person doing a—trying to do an enormous audit with an Order of the Commission that potentially conflicts with a position in the—in a stipulation, which could theoretically, under what Mr. Dottheim pointed out yesterday, unravel a Stipulation & Agreement in an enormous rate case that we spent an entire time on it, and no one is expressing this to the Commission. No one is coming in and saying, we have a problem here.

We are stumbling around in the dark. You're putting Band-Aids on that stuff, trying to use the resources that you have, trying to figure out a way to do it, and no one is coming to us and saying, we don't have the resources to complete this. It's just me. I've got people that don't know what they're doing. Operations

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<sup>136</sup> Tr. 2400, 2412, 2421, 2633-34, 2636-37, 2654-55, 2659, 2661.

<sup>137</sup> Tr. 2299-2300.

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and services can't get together and pull their stuff together and come up with a single unified plan on how to deal with this.<sup>138</sup>

94. After the April 2010 Hearing, it does not appear that Staff made any significant modifications to its approach to the Iatan Project audit. Mr. Hyneman performed most of the audit by himself, with some help on a few issues with Mr. Majors. There was no coordination or unified plan between the Audit Staff and Utility Operations Staff.<sup>139</sup> Finally, Staff failed to raise any issues it was having in performing its audit or utilizing KCP&L's Cost Control System with the Commission.

95. An evaluation of the *Wolf Creek* and the *Callaway* cases provides an interesting comparison of the differences in approach Staff previously employed in its prudence reviews as compared to this case.<sup>140</sup>

96. An important difference in both *Wolf Creek* and *Callaway* from this case is that in those cases, the Staff hired consultants with expertise in the industry to analyze the utility's management of the project and perform an analysis of the costs.<sup>141</sup>

97. Staff, in this case, voluntarily chose not to hire a consultant despite having a budget to do so.<sup>142</sup>

98. Staff's proposed disallowance in this case is inappropriate and inequitable when compared to how the utilities managed the *Callaway* and *Wolf Creek* projects, and the resulting disallowances in those cases. As the Companies discussed in their Initial Brief, in *Callaway* and *Wolf Creek*, the cost overruns approached 200% and the schedule delays were multiple years.<sup>143</sup>

99. In those cases, there were clear problems of owner control over the project, such as the lack of integration of the design and construction schedules, accepting the Contractor's data without any verification, and a complete lack of a cost control or tracking system. The Iatan Project is projected to complete only 15-16% above budget

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<sup>138</sup> File No. EO-2010-0259, Tr. 515-16.

<sup>139</sup> Tr. 2400, 2412, 2421, 2535, 2540-41, 2633-34, 2636-37, 2654-55, 2659, 2661.

<sup>140</sup> See *Kansas City Power & Light Co.*, 28 Mo. P.S.C. (N.S.) 228, 290, 75 P.U.R.4<sup>th</sup> 1 (1986) (regarding the *Wolf Creek* Generating Station); *Union Electric Company*, 27 Mo. P.S.C. (N.S.) 183, 199; 66 P.U.R.4<sup>th</sup> 202 (1985) (regarding *Callaway* Nuclear Plant).

<sup>141</sup> See *Kansas City Power & Light Co.*, 28 Mo. P.S.C. (N.S.) pp. 287-88 (Staff hired Touche Ross & Co. and Project Management Associates to perform a review of the effectiveness of SNUPPS/NPI's management of Bechtel); *Union Electric Company*, 27 Mo. P.S.C. (N.S.) pp. 229-230 (Touche Ross analyzed change/extra work notices).

<sup>142</sup> Tr. 2288-89.

<sup>143</sup> Ex. KCP&L 8, pp. 16-18.

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once all the costs are in: it was constructed during a challenging economic climate and finished within three months of the original target date, and the evidence establishes that KCP&L actively managed the Iatan Project and put the proper controls in place.<sup>144</sup>

### Specific Disallowances Proposed by Staff

#### ALSTOM 1 Settlement Agreement

100. A team led by KCP&L that included members of Burns & McDonnell, Kiewit, and ALSTOM determined the most advantageous Unit 1 completion and Outage Schedule was “the Tiger Team Schedule.”<sup>145</sup>

101. The Tiger Team ultimately recommended an extension to the Unit 1 Outage to a duration of seventy-three (73) days and a delay to the start of the Unit 1 Outage by approximately one month (the “Tiger Team Schedule”).<sup>146</sup>

102. Implementation of this schedule would have a financial impact on ALSTOM for which it was entitled to be compensated under the Contract. KCP&L needed ALSTOM to agree to extend the Unit 1 Outage in accordance with the Tiger Team Schedule.<sup>147</sup>

103. ALSTOM agreed to a series of specific interim dates called “construction turn-over” (“CTO”) dates to ensure timely completion of ALSTOM’s work.<sup>148</sup>

104. KCP&L recognized that since it had entered into the Contract with ALSTOM at the end of 2006, the complexity of the work on the Iatan Unit 1 Outage had increased significantly as KCP&L recognized the opportunity to use this outage to optimize the unit’s performance and reduce future performance risk. The added Unit 1 Outage scope included: (1) economizer surface area addition, necessary for the Unit 1 SCR installation; (2) installation of turning vanes in the existing ductwork; (3) upgrades and replacement of the DCS controls; (4) refurbishment of the submerged and dry flight conveyors; and (5) addition of the low NOx burners. In addition, Tiger Team 1 was concerned about the DCS change out, which creates added risk to the unit’s start-up. These additions added to the work ALSTOM had to complete within the time frame of the outage as well as added to the

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<sup>144</sup> *Id.*

<sup>145</sup> Ex. KCP&L 22, p. 29.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.* at 28- 29.

<sup>148</sup> Ex. KCP&L 51, p. 10.

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general congestion in relatively tight spaces. Additionally, despite the Project Team's efforts, there were a number of open commercial and technical issues that could not be resolved at the Project level. The potential impacts from these unresolved issues were beginning to manifest themselves and it was clear that KCP&L would not be able to resolve them without executive-level involvement. The Quarterly Reports submitted to Staff from the 1st and 2nd quarter of 2008 reflect these discussions with ALSTOM's management and KCP&L's approach to these issues.<sup>149</sup>

105. Staff has proposed two disallowances based upon the ALSTOM Unit 1 Settlement Agreement.<sup>150</sup>

106. The proposed adjustments are based upon two separate items: 1) the actual amount paid to ALSTOM under the Settlement Agreement; and 2) Staff's calculation of alleged "foregone" liquidated damages.<sup>151</sup>

107. With respect to both proposed disallowances, Staff has failed to "raise a serious doubt" that would override the presumption of prudence. Mr. Hyneman testified that Staff's reasoning for disallowing the costs of the Unit 1 Settlement Agreement was not because the decision to enter into the Settlement Agreement by KCP&L was imprudent, but because it was "inappropriate" to charge the cost of the Settlement to rate payers.<sup>152</sup> By making no determination on prudence, Staff has not overcome the presumption of prudence afforded to KCP&L with respect to this expenditure, as it has failed to raise a serious doubt as to the prudence of the cost of the ALSTOM Settlement Agreement.

### ALSTOM Unit 1 Settlement Amount

108. As an initial matter, Staff has failed to raise a serious doubt which would defeat the presumption of prudence afforded to KCP&L. In its pre-filed testimony and November 2010 Report, Staff's reasoning for its proposed disallowance, that "Staff is not convinced that ALSTOM's claims against KCP&L were not the fault of KCP&L's project management, raising the question of KCP&L's prudence and whether KCP&L's ratepayers should be responsible for these costs."<sup>153</sup>

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<sup>149</sup> Ex. KCP&L 22, pp. 28-29.

<sup>150</sup> Ex. KCP&L 44, Sch. DFM2010-13.

<sup>151</sup> *Id.*

<sup>152</sup> Tr. 2768.

<sup>153</sup> Ex. KCP&L 205, p. 56.

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109. However, Staff has admitted that it currently does not have an opinion about the prudence of KCP&L's decision to enter into the settlement.<sup>154</sup>

110. Furthermore, neither in Staff's November 2010 Report, nor in its prefiled or hearing testimony does Staff provide any substantive, competent evidence that the amounts paid by KCP&L were due to the fault of KCP&L's project management. In fact, Staff's only evidence is simply a complaint that "KCP&L made no attempt to quantify the costs that may have been caused by its own project management team or the owner-engineering firm it hired, Burns & McDonnell ("B&McD"), or any other latan 1 contractor or subcontractor."<sup>155</sup>

111. Staff has not provided any evidence that the amounts paid to ALSTOM under the settlement were caused by B&McD or any other latan 1 contractor or subcontractor.<sup>156</sup>

112. Using the management tools available to it, such as the schedule, KCP&L could see when the contractors were not performing as expected. KCP&L would then meet with the contractors weekly and, when necessary, daily to resolve any coordination issues and discuss ways in which the contractor's productivity could be improved and the schedule dates met.<sup>157</sup>

113. Additionally, KCP&L set up a sophisticated dispute resolution process with ALSTOM so that it could ensure that it received the best deal possible for itself and its customers.<sup>158</sup>

114. KCP&L organized and participated in several facilitation sessions with a nationally-renowned mediator in order to help find solutions and remediation plans to help get the project back on track.<sup>159</sup>

### Unit 1 Liquidated Damages

115. Staff is arguing that an additional adjustment based on KCP&L's alleged choice to forego liquidated damages for ALSTOM's Guaranteed Unit 1 Provisional Acceptance.<sup>160</sup>

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<sup>154</sup> Tr. 2768.

<sup>155</sup> Ex. KCP&L 205, p. 57..

<sup>156</sup> *Id.*; see also Ex. KCP&L 51, p. 9.

<sup>157</sup> Ex. KCP&L 18, p. 20.

<sup>158</sup> Ex. KCP&L 22, pp. 40-41; Ex. KCP&L 51, p. 8.

<sup>159</sup> *Id.*; KCP&L-51, p. 8.

<sup>160</sup> Ex. KCP&L 205, p. 59.

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116. Under Missouri Law, the term “liquidated damages” refers to “that amount which, at the time of contracting, the parties agree shall be payable in the case of breach.”<sup>161</sup>

117. Under ALSTOM’s original Contract, KCP&L would be entitled to collect liquidated damages from ALSTOM on Unit 1 **only** if ALSTOM was unable to meet its “Provisional Acceptance Date” (otherwise known as the “in-service date”) for Unit 1 as required by the Contract. The Unit 1 Provisional Acceptance Date in the ALSTOM Contract was December 16, 2008.<sup>162</sup>

118. This means that KCP&L was not entitled to collect liquidated damages until after that date had passed. KCP&L and ALSTOM negotiated the Unit 1 Settlement Agreement in the first half of 2008 and it was executed on July 18, 2008, several months before any breach could be declared or any liquidated damages had accrued. Once KCP&L and ALSTOM entered into the Settlement Agreement and agreed to modify the Provisional Acceptance date, any discussion about what KCP&L “could have” potentially collected under the original December 2008 contractual date is highly speculative, and completely unrealistic. A contractor is not going to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid.<sup>163</sup>

119. Two events occurred that show that even if ALSTOM had been late in completing its Unit 1 work, KCP&L would not have been able to collect liquidated damages.<sup>164</sup> These events were the economizer casing repair and the turbine rotor repair.

120. During the Unit 1 Outage, the construction team discovered a latent defect in the economizer casing. This defect and the necessary repairs impacted the duration of the Unit 1 Outage by thirty-two (32) days.<sup>165</sup>

121. Additionally, during the start-up after the Unit 1 Outage, a vibration event with the turbine caused an additional delay to start-up of the Unit.<sup>166</sup>

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<sup>161</sup> See *Goldberg v. Charlie's Chevrolet, Inc.*, 672 S.W.2d 177, 179 (Mo. App. 1984).

<sup>162</sup> Tr. 1816-17.

<sup>163</sup> Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 59-60; Ex. KCP&L 51, pp. 11-12; Ex. KCP&L 46, pp. 266-68.

<sup>164</sup> Ex. KCP&L 19, p. 59; Ex. KCP&L 71.

<sup>165</sup> *Id.*

<sup>166</sup> Ex. KCP&L 19, p. 60.



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122. The effect of the economizer incident and the turbine would have made it impossible for ALSTOM to achieve its contractual dates (and even pushed out the revised dates under the Settlement Agreement). These two events added additional time to the schedule, for which ALSTOM was not responsible.<sup>167</sup>

123. As a result, ALSTOM would have been entitled to an adjustment of its contractual Provisional Acceptance Date and KCP&L would not have been able to impose liquidated damages on ALSTOM. Accordingly, the evidence in KCP&L's prefiled testimony and at the evidentiary hearing demonstrate that ALSTOM achieved the contractually modified Guaranteed Unit 1 Provisional Acceptance Date and liquidated damages did not apply.

### ALSTOM Unit 2 Settlement Agreement Adjustment Incentive Payments

124. Staff argues that KCP&L should not be entitled to recover any amounts it paid to ALSTOM under the Unit 2 Settlement Agreement. Staff revised the amount of its disallowance from the November 2010 Report to the total amount KCP&L paid ALSTOM under the terms of the Settlement Agreement. KCP&L's witnesses provided extensive detail regarding the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement, including Mr. Downey, Mr. Roberts and Dr. Nielsen.<sup>168</sup>

125. There were two main reasons KCP&L decided to enter into a Settlement Agreement with ALSTOM. First, ALSTOM had presented KCP&L with a significant delay claim based primarily on weather delays that needed to be resolved. Regardless of whether ALSTOM's claim had merit, defending against the claim would be both expensive and time consuming.<sup>169</sup>

126. Additionally, it would have mired the KCP&L and ALSTOM project teams in a commercial dispute at a time when it was important for the focus to be on cooperatively completing the project. Second, Kiewit had told KCP&L that it would cost a substantial amount for Kiewit to be able to support the dates in ALSTOM's schedule.<sup>170</sup>

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<sup>167</sup> *Id.* at 59-60.

<sup>168</sup> Ex. KCP&L 22, pp. 39-47; Ex. KCP&L 51, pp. 12-18; Ex. KCP&L 46, pp. 275-85.

<sup>169</sup> Ex. KCP&L 51, p. 15.

<sup>170</sup> Ex. KCP&L 22, p. 41.

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127. The Commission finds that the value for the benefits KCP&L received exceeded the amount of incentive payments.<sup>171</sup>

128. KCP&L considered and balanced both cost and schedule in creating a revised schedule and fostering cooperation between the main contractors.<sup>172</sup>

129. Based upon a prudence analysis, KCP&L's decision to enter into the ALSTOM Unit 2 Settlement Agreement was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

### Unit 2 Liquidated Damages

130. In his true-up testimony, Mr. Hyneman alleges, "Since Alstom's performance compared to contractual requirements were [sic] likely the cause of some if not most of these incremental costs, KCP&L should have assessed and collected these costs from Alstom under the liquidated damages provision of the Alstom-KCP&L contract. KCP&L decided not to make such an assessment. If Alstom's performance did not meet its contract requirements and failed to protect itself from such performance by taking advantage of its rights under its contract with Alstom, KCP&L was unreasonable / inappropriate in its conduct and should bear the costs incurred."<sup>173</sup>

131. Mr. Hyneman's testimony is transparently based on speculation and hindsight and reveals that Staff has not performed any analysis of KCP&L's prudence regarding its decision to engage in the Settlement Agreement with ALSTOM. Mr. Hyneman also states, "If some or all of the delay in project completion was not the fault of ALSTOM, KCP&L should determine who was at fault and hold that entity (including itself) responsible for these incremental Project costs."<sup>174</sup> Mr. Hyneman clearly admits that he does not know the basis of this agreement, or whether ALSTOM, KCP&L or anyone else for that matter was "at fault."

132. As stated, the circumstances surrounding the ALSTOM Unit 2 Settlement Agreement and KCP&L's analysis of the agreement are discussed in detail by several KCP&L Company witnesses, including Mr. Downey, Mr. Roberts and Dr. Nielsen.<sup>175</sup>

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<sup>171</sup> KCP&L's Post Hearing Exhibit filed on February 22, 2011.

<sup>172</sup> Ex. KCP&L 22, p. 40.

<sup>173</sup> Ex. KCP&L 308, p. 3.

<sup>174</sup> *Id.*

<sup>175</sup> See Ex. KCP&L 22, pp. 39-47; Ex. KCP&L 51, pp. 12-18; Ex. KCP&L 46, pp. 275-285.

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133. It is mere hindsight to imply that KCP&L could have but did not assess liquidated damages. KCP&L's witnesses provided competent evidence that the Unit 2 Provisional Acceptance date was subsequently revised from the original contract date.<sup>176</sup>

134. Because Staff's proposed disallowance is a calculation regarding what KCP&L "could have" potentially collected had the original contractual date of June 1, 2010 remained in effect, the disallowance is not only highly speculative but factually irrelevant.<sup>177</sup>

135. Staff states that there was no evidence of KCP&L's analysis quantifying the events associated with the Unit 1 ALSTOM Settlement Agreement.<sup>178</sup>

136. However, the record establishes that KCP&L has provided Staff with all necessary documents related to the ALSTOM Unit 1 Settlement and that the agreement was prudent. Staff had access to KCP&L project management and senior project staff, and KCP&L has filed extensive testimony regarding this issue in File No. ER-2009-0089 ("0089 Case").<sup>179</sup>

137. KCP&L has put forth credible testimony of industry experts such as Dr. Nielsen and Mr. Roberts who have testified that the ALSTOM Unit 1 Settlement was a prudent expenditure on the part of KCP&L, and KCP&L witnesses who testified as to the detailed evaluation that was performed.<sup>180</sup>

138. The evidence establishes that KCP&L fully evaluated the benefits and risks associated with the ALSTOM Unit 1 Settlement Agreement. The evidence establishes that KCP&L's decision to settle with ALSTOM was prudent in light of all of the circumstances and information known to KCP&L's senior management at the time.

139. Mr. Hyneman also alleges, "Since Alstom did not obtain Provisional Acceptance of Unit 2 until September 23, 2010 when it was required by contract to obtain this project milestone on June 1,

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<sup>176</sup> See Ex. KCP&L 112, pp. 10-11; Data Request 658.

<sup>177</sup> See Ex. KCP&L 112, p. 6; Ex. KCP&L 22, p. 36-38; Ex. KCP&L 19, p. 58-60; Ex. KCP&L 51, p. 11-12; Ex. KCP&L 46, pp. 266-268.

<sup>178</sup> See Staff's Initial Brief at p. 48.

<sup>179</sup> See Davis Rebuttal Testimony (0089 Case) at pp. 3-6 and 19-20 (discussing the Unit 1 Outage and the Tiger Team Schedule and describing meeting with the MPSC Staff that occurred on September 23, 2008 where the Unit 1 Settlement was discussed in detail and relevant documents were provided); Downey Rebuttal Testimony (0089 Case) at p. 17 In. 20 to p. 20, In. 23.

<sup>180</sup> Ex. KCP&L 46, pp. 263-275; Ex. KCP&L 51, pp. 7-12; Ex. KCP&L 22, pp. 28-29, 32, 34, Sch. WHD2010-05.

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2010. Because of this delay in project completion, KCPL incurred costs and harm.”<sup>181</sup>

140. This is the identical argument that Staff advances in Staff’s Report regarding the “forsaken” liquidated damages on the Iatan Unit 1 Project, and will be rejected for the same reasons KCP&L’s witnesses have previously articulated.<sup>182</sup>

141. Although KCP&L technically declared that ALSTOM met the Provisional Acceptance Date on September 23, 2010, it could have done so much earlier, but chose not to for valid commercial reasons:

Technically, KCP&L could have declared that ALSTOM had achieved Provisional Acceptance on this date, but chose to rely on some technical language in the Contract so that KCP&L could wait until after ALSTOM could show that the unit could be started up with no problems after an extended outage. This was to ensure that there were no latent problems in ALSTOM’s work before KCP&L released ALSTOM from liability for liquidated damages. As a result, KCP&L considers the “commercial operation” date (the definition on which Provisional Acceptance is based) of the Iatan Unit 2 plant to be August 26, 2010, or 67 days earlier than ALSTOM’s [revised] contractual date. It is important to note that KCP&L has always targeted Provisional Acceptance for the Project in the “Summer of 2010”, which was achieved. KCP&L does not consider the Iatan Project to have been “late.”<sup>183</sup>

142. Because Staff’s proposed disallowance is a calculation regarding what KCP&L “could have” potentially collected had the original contractual date of June 1, 2010 remained in effect, the disallowance is not only highly speculative but factually irrelevant. ALSTOM was not required to nor would it have any reason to attempt to meet (much less spend additional money to meet) a contractual date that is no longer valid.<sup>184</sup>

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<sup>181</sup> Ex. KCP&L 308, p. 3.

<sup>182</sup> Ex. KCP&L 112, p. 5-12; Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 59-60; Ex. KCP&L 51, pp. 11-12; Ex. KCP&L 46, pp. 266-268; Ex. KCP&L 205, p. 59.

<sup>183</sup> Ex. KCP&L 112, pp. 10-11.

<sup>184</sup> *Id.* at 6; Ex. KCP&L 22, pp. 36-38; Ex. KCP&L 19, pp. 58-60; Ex. KCP&L 51, pp. 11-12; and Ex. KCP&L 46, pp. 266-268.

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Schiff Hardin LLP Adjustments - Iatan

143. Schiff Hardin brought value to the Iatan Project, from the initial setup of the commercial strategy and strategic schedule, the negotiation of the Iatan Project's contracts through the Project itself, all the while providing KCP&L's senior management team information it needed to oversee the Iatan Project's management.<sup>185</sup>

144. He is not an attorney himself, and has not presented any evidence that he has ever contracted for legal services at any point in his career.<sup>186</sup>

145. Mr. Hyneman admits that he is not an expert at evaluating the quality of legal work and he is not offering an opinion as to the quality of Schiff's work on the Iatan Project.<sup>187</sup>

146. KCP&L's procedures do not require that all services are subjected to a competitive bidding process.<sup>188</sup>

147. Moreover, there was considerable vetting of Schiff Hardin and their fees, not just at the outset of the Project but also as the Project progressed.<sup>189</sup>

148. KCP&L's decision to utilize Schiff Hardin was well considered on the basis of a vetting of both the needs for a firm of this type and the Schiff Hardin's unique set of qualifications, and KCP&L's day-to-day management of Schiff Hardin's work was robust.<sup>190</sup>

149. Schiff Hardin only performed the work that KCP&L requested it perform, and the quality of their work and their advice is not being questioned.<sup>191</sup>

150. If only hours incurred by Schiff Hardin personnel were considered, then the statistics would reflect Iatan Oversight (32%), Iatan Project Control (10%), Contracts (10%), Contract Administration (46%) and other (2%).<sup>192</sup>

151. KCP&L has demonstrated that using Schiff Hardin to provide legal services on the Iatan Project, was prudent because of Schiff Hardin's qualifications to perform such work.<sup>193</sup>

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<sup>185</sup> Ex. KCP&L 8, pp. 22-23; Ex. KCP&L 22, p. 6; Ex. KCP&L 25, p. 16, Ex. KCP&L 19, p. 5; Ex. KCP&L 6, p. 2.

<sup>186</sup> Tr. 2589.

<sup>187</sup> Tr. 2649-50.

<sup>188</sup> Ex. KCP&L 8, pp. 20-21.

<sup>189</sup> Tr. 1436-37.

<sup>190</sup> Tr. 1439-41.

<sup>191</sup> Tr. 1644; Ex. KCP&L 1203, p. 82.

<sup>192</sup> Ex. KCP&L 8, p. 31.

<sup>193</sup> Ex. KCP&L 8, pp. 20-21; Tr. 496-503, 1436-37, 1439, 1441, 1644, 1860-62.

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### Pullman Adjustment

152. Pullman was a contractor on the Iatan Construction Project and part of its duties was to install the new chimney liner.<sup>194</sup>

153. Although Staff includes in Schedule 1-1 of its November 2010 Report two proposed disallowances related to Pullman, the Chimney contractor, there is no explanation anywhere in Staff's November 2010 Report as to Staff's evaluation of these costs or why they have been deemed to be imprudent.

154. Staff's argument that a statement in the Kiewit Recommendation to Award Letter that "Pullman's Performance on the Project was well below expectations" does not explain why Staff would disallow the costs to put a performance bond in place, nor is there any analysis that identifies 1) how KCP&L had Pullman's performance within its control; or 2) how KCP&L acted imprudently that led to the disallowed costs. By its silence, Staff has not created a "serious doubt" as to these expenditures. Thus, Staff has not created a "serious doubt" as to these expenditures and base upon a prudence analysis, KCP&L's payments to Pullman are deemed to be prudent.

155. The sole basis for Staff's disallowance is the Commission's "recent" decision in 2006 that severance costs should not be recovered from rate payers.<sup>195</sup>

156. However, the Commission finds that severance costs in this case are an ongoing cost KCP&L incurs to serve its customers.<sup>196</sup>

### Affiliate Transaction

157. Staff has proposed a disallowance for costs incurred by KCP&L's affiliate, Great Plains Power ("GPP") for work performed that was ultimately used as a part of the development of the Iatan Unit 2 project. As cited by Staff in its November 2010 Report, KCP&L identified the work performed as pertaining to "environmental permitting and engineering which defined the project scope and plant design."<sup>197</sup>

158. Staff simply states that it "was not convinced that the costs incurred by GPP in its nonregulated activities were necessary for the construction of Iatan 2." However, Staff's November 2010 Report does not identify the reasons for this belief, nor does it provide any sort

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<sup>194</sup> Ex. KCP&L 250, p. 8.

<sup>195</sup> See Staff's Initial Brief at pp. 46-47.

<sup>196</sup> Ex. KCP&L 23 (NP), p. 4.

<sup>197</sup> See Ex. KCP&L 205, p. 51.

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of prudence analysis of the costs incurred.<sup>198</sup> As a result, Staff has not raised a serious doubt as to the prudence of these costs that can overcome the presumption of prudence afforded to KCP&L. Based upon a prudence analysis, the affiliate transactions were prudent when looking at the circumstances known by KCP&L at the time the decision was made.

159. The use of existing GPP development work resulted in a substantial reduction in schedule and additional costs that would had to have been recreated or incurred going forward.<sup>199</sup>

160. The site where GPP began the development of its generation facility became the site that is known as the Iatan 2 generation facility. Work that had already been completed by the GPP subsidiary regarding initial environmental permitting and engineering was applicable and beneficial to the development of Iatan 2.<sup>200</sup>

161. It would not have been in the best interest of rate payers to recreate the work and delay schedule simply due to the fact that the initial development of Iatan 2 generation facility began with the GPP subsidiary.<sup>201</sup>

162. As far as the affiliate transaction rule (4 CSR 240-20.015(2)(A)), the rule requires that the compensation to GPP be the lower of the fair market price or the cost to provide the services for itself. In this case, it would have been of no value to complete a market review of what it would cost to do an environmental permitting and engineering study at the time of purchase of the GPP work as the study was being purchased at cost.<sup>202</sup>

163. The Companies agree that they were in error for not reporting the transaction in the annual affiliate transaction report. However, this reporting failure does not change the fact that certain environmental and engineering needed to take place.<sup>203</sup>

### Additional AFUDC Due to Iatan 1 Turbine Start-Up Failure

164. Staff has not proposed an adjustment for the costs of the turbine trip. AFUDC costs are a component of the project's total costs

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<sup>198</sup> *Id.*

<sup>199</sup> Ex. KCP&L 113, p. 15.

<sup>200</sup> *Id.*

<sup>201</sup> *Id.* at 16.

<sup>202</sup> *Id.* at 16.

<sup>203</sup> *Id.* at 15.

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and the turbine work was required to return Iatan Unit 1 and the AQCS environmental upgrades to service.<sup>204</sup>

165. In Staff's November 3 report, Staff made an adjustment regarding AFUDC costs incurred on the Iatan 1 AQCS project during the outage associated with the turbine trip. Staff's rationale was "it is Staff's belief that the increase in AFUDC accrued during the 33-day delay should be removed from plant balance of the Iatan 1 AQCS and charged to the work order capturing the costs for the turbine trip."<sup>205</sup>

166. The turbine work (including new rotor installation, replacement of low pressure sections to increase output, reworking of turbine spindle in or to support the performance of the new AQCS equipment) was required to support the Unit 1 AQCS retrofit project.<sup>206</sup>

167. Staff has not proposed any disallowance associated with the turbine trip work, but attempts to penalize the Companies for the turbine failure by not allowing the AFUDC costs incurred on the Iatan 1 AQCS project costs during the outage associated with this work. AFUDC costs are a component of the construction projects total costs and shall not be disallowed when costs associated with prudent work required to return the unit to service have not been proposed to be disallowed.<sup>207</sup>

### Advanced Coal Credit AFUDC Adjustment

168. Staff argues that since KCP&L had a free source of cash from Section 48 advanced coal investment credits from 2007 to 2009, it had access to free cash flow to offset the financing costs for the construction of Iatan 2.<sup>208</sup>

169. Staff's free cash flow position is unsupported and unfounded as it attempts to impute a cost savings that does not exist and ratepayers will receive the benefits of the advanced coal investment tax credits over time. As explained by Company witness Ives, the borrowing or financing costs of KCP&L and GPE did not increase as a result of GPE not utilizing the advanced coal investment tax credits in 2008 and 2009.<sup>209</sup>

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<sup>204</sup> See KCP&L/GMO's Initial Brief at ¶193.

<sup>205</sup> Ex. KCP&L 205, p.90; Ex. KCP&L 201, p. 124; Ex. KCP&L 113, p. 10.

<sup>206</sup> See Ex. KCP&L 19, p. 61.

<sup>207</sup> See Ex. KCP&L 113, p. 11.

<sup>208</sup> See Staff's Initial Brief at p. 77.

<sup>209</sup> Ex. KCP&L 113, p. 13.



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### AFUDC Accrued on Staff's Proposed Disallowances

170. Staff has calculated the AFUDC value associated with each of the proposed construction cost disallowances detailed in the Staff's "Construction Audit and Prudence Review" report of the Iatan Construction Project which was filed on November 3, 2010, as updated on Schedule 1 to Staff witness Hyneman's true-up direct testimony.<sup>210</sup> AFUDC and carrying costs related to any specific adjustment should follow that adjustment.

### JLG Accident Adjustment

171. Staff believes that KCP&L was unreasonable for executing the JLG Settlement Agreement.<sup>211</sup>

172. KCP&L and ALSTOM chose to escalate this issue for resolution as part of a broader commercial strategy, and that this issue was one of several that KCP&L and ALSTOM ultimately resolved in this manner.<sup>212</sup>

173. In its November 2010 Report, Staff has failed to raise a serious doubt as to the prudence of KCP&L's settlement of the JLG accident costs. Based upon a prudence analysis, KCP&L's decision to settle ALSTOM's JLG claim was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

### May 23, 2008 Crane Accident Adjustment

174. On May 23, 2008, one of the largest mobile cranes in the world, a Manitowoc 18000 crane, collapsed while performing an unloaded test lift on the Iatan Project (the "Crane Incident"). As a result of the collapse, one person was killed and others were injured.<sup>213</sup>

175. KCP&L's EPC Contractor, ALSTOM, was responsible for the operation of the crane at the time of the incident.<sup>214</sup>

176. In Staff's November 2010 Report, Staff disallowance is based on a meeting that Staff had with KCP&L, and Staff's "impression" regarding KCP&L's expected future recovery of the costs associated with the Crane Incident.<sup>215</sup>

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<sup>210</sup> *Id.* at 8.

<sup>211</sup> Ex. KCP&L 205, p. 46.

<sup>212</sup> Ex. KCP&L 19, pp. 54-55.

<sup>213</sup> Ex. KCP&L 22 (NP), p. 14.

<sup>214</sup> *Id.*

<sup>215</sup> Ex. KCP&L 205, p. 41.

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177. Staff admits that it has not done a detailed review of project costs to determine if the charges are accurate and complete, even though many of these charges were incurred by KCP&L over two years ago.<sup>216</sup>

178. Staff has failed to raise a serious doubt as to the prudence of these expenditures. Based upon a prudence analysis, KCP&L's decision to take swift action immediately after the Crane Incident on the Iatan Site was a prudent decision when looking at the circumstances known by KCP&L at the time the decision was made.

179. The Commission finds that the costs incurred by KCP&L due to the Crane Incident were prudently incurred.<sup>217</sup>

### Cushman Project Management Rate Adjustment

180. Staff's proposed disallowance for a rate adjustment relating to Mr. Cushman's fees was based on an assessment that Mr. Cushman's fees were unreasonable.<sup>218</sup>

181. Cushman was hired to develop processes and procedures for the Iatan Project including the Project Execution Plan ("PEP"). Mr. Cushman is highly respected in the industry and had a proven track record with KCP&L from Hawthorn.<sup>219</sup>

182. KCP&L evaluated the costs for Cushman's specialized services and determined that the costs were reasonable.<sup>220</sup>

### Adjustment from KCC Staff Audits

183. Staff proposes adjustments in the amount of almost \$2 million based on a KCC Staff audit. The KCC Staff audit is not before this Commission and is non-credible hearsay. The fact that KCP&L decided not to challenge those adjustments in its Kansas case does not in and of itself create a serious doubt as to the imprudence of those expenditures. KCP&L has denied that those expenditures were imprudent. Because Staff presented no evidence of imprudence, the Commission finds the costs were prudently spent on the Project.<sup>221</sup>

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<sup>216</sup> *Id.*

<sup>217</sup> Ex. KCP&L 22, pp. 23-24.

<sup>218</sup> Ex. KCP&L 205, p. 98.

<sup>219</sup> Ex. KCP&L 19, p. 66.

<sup>220</sup> *Id.*

<sup>221</sup> Ex. KCP&L 19, pp. 71-72.

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Employee Mileage Charge Adjustment

184. Employees assigned to the Iatan Project were only going to be travelling to Iatan on a temporary basis.<sup>222</sup>

185. To require employees to work at the Iatan project site on a temporary, five-year project without compensation for mileage costs would not have been equitable and likely would have been viewed as a deterrent to working on the Iatan projects.<sup>223</sup>

Inappropriate Charges Adjustment

186. Staff has attached Schedules 4 and 5 that purport to support Staff's disallowances for the inappropriate charges. However, the Schedules identify only \$18,351 of items charged to Unit 2 that Staff deemed as inappropriate. Staff's amount for the proposed disallowances are only "estimates" which are wholly arbitrary.<sup>224</sup> Staff has no basis for its estimates, and as a result, they will be disregarded by the Commission.

Disallowances Proposed by Missouri Retailers Association ("MRA")

Iatan 2

187. There are significant portions of Mr. Drabinski's testimony on behalf of the MRA that are not only flawed from a factual and analytical standpoint, but they do not factor in any way in Mr. Drabinski's actual recommendation for the disallowance of \$219 million. These include Mr. Drabinski's allegations that:

- Mr. Drabinski's entire "Plant Comparison" analysis, "Comparison to Trimble County 2" and "Analysis of Budgets and Reforecasts", which he abandoned in exclusive favor of his single recommended \$219 million disallowance.<sup>225</sup>
- Any measured cost "increase" from any project estimate prior to the December 2006 Control Budget Estimate, including Mr. Drabinski's claim that a preliminary estimate prepared in January 2006 has some significance.<sup>226</sup>
- Mr. Drabinski's repeated allegation that KCP&L mismanaged the Project "early on," which he defines as the year 2006 to

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<sup>222</sup> Ex. KCP&L 8, p. 39.

<sup>223</sup> *Id.*

<sup>224</sup> Ex. KCP&L 8, p. 40.

<sup>225</sup> Tr. 1597.

<sup>226</sup> Tr. 1593-1594.

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early 2007. This unsupported opinion based in hindsight conflicts with Mr. Drabinski's testimony that KCP&L pursued the critical path work through 2006 with great success.<sup>227</sup>

- Mr. Drabinski's allegation that Burns & McDonnell was "late" in producing critical drawings is completely contradicted by the fact that Burns & McDonnell completed the foundation drawings on time for critical turnovers to ALSTOM and Kiewit.<sup>228</sup>
- Mr. Drabinski's hindsight-based allegation that KCP&L's decision related to the latan Project's contracting methodology, i.e. to perform the latan Project on a multiple prime and not an EPC basis, increased the Project's cost (i.e., EPC vs. Multi-Prime) or was in and of itself imprudent.<sup>229</sup> Drabinski testifies, "I never stated that the decision to use a Multi-Prime rather than an EPC approach was, in itself, imprudent."<sup>230</sup>
- KCP&L and Kiewit had some specious deal regarding an artificially low contract price.<sup>231</sup>
- KCP&L made an untimely decision to hire Kiewit as the primary Balance of Plant ("BOP") contractor at a premium price; as explained further below, Mr. Drabinski does not know how to quantify this alleged premium.<sup>232</sup>
- The "turbine building bust" and "the cost of the unintended consequences of the decision to add a de-aerator to the project. Evidence shows that the cost of the enlarged turbine building was at least \$106 million and perhaps over \$200 million. This was part of the reason for the large increase in balance of plant costs."<sup>233</sup> Company witness Mr. Meyer explains that while the Balance of Plant work increased due to design maturation, these were not in any way imprudent cost increases, as Mr. Drabinski obliquely asserts without examination of the facts.<sup>234</sup>

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<sup>227</sup> Tr. 1648-1653.

<sup>228</sup> Tr. 1650.

<sup>229</sup> Tr. 1593.

<sup>230</sup> Ex. KCP&L 2602, p. 24.

<sup>231</sup> Ex. KCP&L 2601, p. 159.

<sup>232</sup> Ex. KCP&L 45, pp. 47-53.

<sup>233</sup> Ex. KCP&L 2601, p. 33.

<sup>234</sup> Ex. KCP&L 45, pp. 48-49.

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- The cost of the Balance of Plant work increased from “\$350 million to a billion dollars on this Project.”<sup>235</sup>
- KCP&L could not manage a multi-prime project, a fact disputed by numerous KCP&L witnesses.<sup>236</sup>
- The development and implementation of the PEP and other project tools such as SKIRE were untimely and increased Project costs; a fact disputed by numerous KCP&L witnesses and which Mr. Drabinski never ties to any disallowance. The contracts used for the major contractors were inadequate in that these contracts did not adequately shift risk to the contractors and did not contain a formulaic basis for calculating loss of efficiency change orders. Mr. Drabinski never cites a single sentence in any contract that was employed on the latan Project, yet he concludes that KCP&L employed “poorly written contracts” because “every time a problem arose, rather than being able to use the contract to resolve it, they went to a settlement.”<sup>237</sup>
- KCP&L failed to timely implement expert advice, which Mr. Roberts thoroughly disputes.<sup>238</sup>
- KCP&L’s planned construction schedule was compressed and was made worse by KCP&L’s failure to timely hire Burns & McDonnell as the Owner’s Engineer.<sup>239</sup>

188. Dr. Nielsen credibly addresses Mr. Drabinski’s failure to create a nexus between KCP&L’s alleged imprudent actions and his proposed disallowances in his Rebuttal Testimony. Specifically, Dr. Nielsen testifies:

Pegasus-Global’s examination of Mr. Drabinski’s “Review of Purchase Orders and Change Orders” determined that Mr. Drabinski again provided no nexus of causation between any unreasonable or imprudent decision or action by KCP&L and specific cost disallowance. Mr. Drabinski simply notes that its “analysis was in-depth and extremely data intensive” [Drabinski Direct Testimony at p. 204, ln. 11] and that

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<sup>235</sup> Tr. 1615.

<sup>236</sup> Ex. KCP&L 6, pp. 14-15; Ex. KCP&L 19, pp. 20-26, 104-107; Ex. KCP&L-21, p. 27; Ex. KCP&L-22, pp. 74-80; Ex. KCP&L 46, pp. 94-97; Ex. KCP&L 52, pp. 33-44.

<sup>237</sup> Tr. 1645.

<sup>238</sup> Ex. KCP&L 52, p. 2.

<sup>239</sup> *Id.* at 45-47.

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based on that analysis it "determined if all or part of the cost should not be permitted into the rate base" [Drabinski Direct Testimony at p. 204, ln. 19 through p. 205, ln. 1]. Nowhere in Mr. Drabinski's testimony was there a single statement which linked a specific Purchase Order or Change Order, or a part of a specific Purchase Order or Change Order, to any decision made or action taken by KCP&L during the execution of the Iatan Unit 2 project.<sup>240</sup>

189. Mr. Drabinski's Direct Testimony includes four separate methodologies and four separate potential disallowance calculations though he agreed at the hearing that the only actual recommendation that he is advancing to the Commission is his so called "Review of Initial Purchase Orders and Change Orders."<sup>241</sup>

190. Mr. Drabinski makes only a cursory attempt to tie a handful of the preceding two-hundred and two pages of his Direct Testimony to this final section of his actual recommendation to the Commission. On one hand, Mr. Drabinski claims that his recommended disallowance is tied to specific Purchase Orders and Change Orders.<sup>242</sup>

191. However, he described his method of choosing the change orders that make up his recommended disallowance as follows:

How you come up with the allocation of imprudent costs is not based on a specific purchase order, but based on the overall testimony that shows that imprudent mismanagement took place, costs rose beyond expectations and reasonable levels and, therefore, certain areas warrant adjustment.<sup>243</sup>

192. Fifteen major flaws are apparent in Mr. Drabinski's analysis.<sup>244</sup>

- 1) Drabinski applied an erroneous standard for prudence reviews.
- 2) Drabinski finds imprudence as a consequence of the results attained rather than evaluating decisions and the decision making process, causally connecting the allegations and then properly quantifying the impact.

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<sup>240</sup> Ex. KCP&L 46, p. 227.

<sup>241</sup> Ex. KCP&L 2601; Tr. 1597.

<sup>242</sup> Tr. 1601.

<sup>243</sup> Tr. 1638-39.

<sup>244</sup> Ex. KCP&L 46, pp. 27-30.

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- 3) Drabinski improperly asserts that Drabinski's opinion is preferable to prudence opinions which may be held by the Commission.
- 4) Drabinski improperly asserts that Drabinski's opinion is preferable to KCP&L's management decisions and improperly employs hindsight in doing so rather than evaluating management decisions made at the time.
- 5) Drabinski did not perform a prudence audit, but rather, engaged in what is essentially an inappropriate mixing of construction claims approaches and construction/financial audit approaches.
- 6) Drabinski failed to recognize the Iatan Project as a mega-project and thus, failed to evaluate the Iatan Project within the proper context of that definition.
- 7) Drabinski used selected "sound bites" drawn from internal audits and consultant reports performed by or at the request of KCP&L to support Drabinski's assertion of imprudence, ignoring information from those audits which runs contrary to Drabinski's position and not presenting these selections in context, including the proper time context.
- 8) Drabinski inappropriately uses KCP&L's internal audits to criticize KCP&L's decisions ignoring the fact that the process of conducting on-going internal audits during a complex construction project is considered part of the prudent management decision making process.
- 9) Drabinski's opinion relies upon an incorrect understanding of facts, and often directly conflicts with documented evidence regarding events on the Iatan Project, and conditions and circumstances that were known and/or reasonably known by KCP&L management.
- 10) Drabinski submits conclusions of imprudence without providing supporting explanation or documentation other than the selected "sound bites".
- 11) Drabinski fails to provide a connection between Drabinski's allegations of imprudence and any actual costs incurred as a direct result of the alleged imprudence.

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12) Drabinski's analyses and conclusions display a lack of experience and understanding of construction industry practices, procedures and standards on a project like the Iatan Project. For example, Drabinski's analyses and conclusions display a misunderstanding of the cost estimating process and the proper use of various levels of cost estimates created during the planning and execution phases of a mega-project like the Iatan Project.

13) Drabinski substitutes his judgment rather than analyzing whether KCP&L's decision-making processes and procedures, and KCP&L's decisions fell within a zone of reasonableness, and thus would be prudent.

14) Drabinski uses impermissible hindsight to determine prudence.

15) Drabinski's analyses and conclusions filed in this case are inconsistent with testimony filed by Drabinski in the Kansas Commission case in July 16, 2010. For example, in the Kansas Commission case Mr. Drabinski testified that the project peer review differential it calculated supported a disallowance of \$530 million while in Drabinski's filed testimony in this MPSC case the project peer review differential he calculated supported a disallowance of \$316 million, a difference of \$214 million. The Kansas Commission in its 21 November 22, 2010 Order (Docket No. 10-KCPE-415-RTS) also found that Drabinski's analysis was flawed for similar reasons noted above and stated in that order.

193. Mr. Drabinski testified at the hearing:

I made significant changes to my testimony, both as far as the prudence standard, and I also added a significant amount of analysis and detail based on what I learned from the time that my testimony was produced in the spring of 2010 until November 2010 when it was due here. You don't sit through weeks of hearing and go through thousands of data requests without learning a little more.<sup>245</sup>

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<sup>245</sup> Tr. 1707.



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194. While the 'perfect' estimate may be an industry goal, it rarely, if ever, exists in reality. It is not uncommon within the industry to see cost increases. In other words, even if KCP&L had a 'perfect' estimate back on day-one of the Project, KCP&L would still have incurred these costs but the Control Budget Estimate would have been higher.<sup>246</sup>

### latan 1

195. Mr. Drabinski has proposed a \$13,938,795 disallowance for latan 1 (or \$5,220,079 KCP&L Missouri Jurisdictional share and \$2,508,983 GMO share) based upon an analysis he performed for the Kansas Commission almost two years ago.

196. The Commission finds that Mr. Drabinski has failed to provide the Commission with substantive and competent evidence to support those disallowances. MRA's recommended disallowance is based upon Mr. Drabinski's identification of five separate R&O (Risk/Opportunity) packages related to the latan Unit 1 AQCS and Common plant projects that he believes reflect KCP&L's management's imprudence.<sup>247</sup>

197. KCP&L's witnesses provided substantial evidence regarding the prudence of these expenditures.<sup>248</sup>

### latan Disallowances

#### WSI

198. KCP&L's Prudence consultant, Dr. Kris Nielsen of Pegasus-Global, whom the Commission finds credible, asserts that expenditures paid to ALSTOM in connection with work performed by WSI in an effort to overcome ALSTOM's failure to adhere to schedule were imprudent. KCP&L's consultant further determined that costs incurred by KCP&L in connection with the ALSTOM/WSI work, were imprudent.<sup>249</sup>

199. Dr. Nielsen recommended a \$12.7 million disallowance in connection with the ALSTOM/WSI work and concomitant KCP&L costs. Staff concurs in Dr. Nielsen's quantification of these imprudent costs, and recommends their disallowance from rate base.<sup>250</sup>

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<sup>246</sup> Ex. KCP&L 44, p. 27.

<sup>247</sup> See Ex. KCP&L 2601, Sch. WPD-8.

<sup>248</sup> See fn. 54-56, 60-61, 65-66, 90-91, 94, 96, 99, 106, 108, 112-114, 146-170, 188-196, 205-06, 214-17, *supra*.

<sup>249</sup> See Ex. KCP&L 210, pp. 100-101.

<sup>250</sup> *Id.*

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200. ALSTOM was responsible for costs due to delays unless the delays were the result of actions by KCP&L or a third party responsible to KCP&L.<sup>251</sup>

201. Staff reviewed relevant WSI change orders and found no evidence that the ALSTOM-related delays were the responsibility of KCP&L or any party responsible to KCP&L.<sup>252</sup>

202. KCP&L's prudent course would have been to hold ALSTOM responsible financially for the costs associated with recovering the ALSTOM work schedule, including work performed by WSI. KCP&L's ratepayers should not bear financial responsibility for these charges that should have been appropriately borne by ALSTOM.

### Temporary Boiler

203. Removal and readdition of auxiliary boiler was imprudent, and costs of \$5,346,049 should be disallowed.<sup>253</sup>

204. In highly confidential testimony, Nielsen credibly explained why those costs should be disallowed.<sup>254</sup>

### Campus Relocation

205. The original campus design and location was developed in the summer and fall of 2006. Facility construction began in the summer of 2006. The initial trailers on site were for KCP&L, and the major latan construction contractors, Kissick, Pullman, and ALSTOM, each of whom mobilized to the site in late-summer and fall of 2006.<sup>255</sup>

206. In the summer of 2007, the balance-of-plant contractor, Kiewit, developed a revised plan for laydown space needed for access to the turbine generator building. This plan included providing a new path for unloading the turbine generator into the turbine bay.<sup>256</sup>

207. Kiewit's plan necessitated moving the existing campus trailers to provide the area for laydown space. Additionally, Kiewit's new plan of where it wanted to locate erection cranes caused concerns because Kiewit would be lifting loads near or over the campus. Each of

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<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> Ex. KCP&L 46 (NP), p. 17; Tr. 2089.

<sup>254</sup> Ex. KCP&L 46 (HC), pp. 235ff.

<sup>255</sup> Ex. KCP&L 205, p. 43.

<sup>256</sup> *Id.*

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the trailers was moved approximately 100 feet east in the spring and summer of 2008.<sup>257</sup>

208. Total cost incurred for the campus relocation through June 2010 is \$1,563,727. Of this amount, KCP&L charged \$456,608 to latan 1 and \$1,107,119 to latan 2.<sup>258</sup>

209. The only justifiable reasons why KCP&L would agree to incur over \$1.6 million in costs to relocate construction trailers at the latan site is

1) KCPL realized the original design and location of the latan campus was faulty and did not provide sufficient room and laydown space for the transporting the turbine generator into the latan 2 turbine bay. In this case KCPL would incur the cost and seek backcharges from the contractor who was responsible for the campus design and trailer locations. The backcharged costs would be credited against the project when collected.

2) The cost savings or other benefits to the latan construction project resulting from the relocation would exceed the cost of the relocation charged to the project. In other words, the design and location of the campus was sufficient for the successful completion of the project but a change in the trailer locations would result in project savings and/or other benefits that exceed the cost of the relocation.<sup>259</sup>

210. Staff requested a meeting with KCP&L on this issue, and the meeting was held on December 7, 2009. In attendance at this meeting was Mr. Eric Gould, a Schiff Project Controls Analyst. Mr. Gould advised that the relocation resulted in cost savings. He advised Staff that he was going to look for documentation of cost savings on the Balance of Plant contract as a result of the \$1.6 million campus relocation. Subsequent to this meeting Staff has been advised that Mr. Gould was unable to locate any documentation supporting a cost savings associated with the campus relocation.<sup>260</sup>

211. The allocation of any costs of the campus relocation to the latan Project is inappropriate. The reason for the cost appears to be a significant design error. The most appropriate method for KCP&L to

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<sup>257</sup> *Id.*

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* at 43-44.

<sup>260</sup> *Id.*

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recover these costs is to seek backcharges for the cost of this work from the entity who was responsible for the design of the construction campus laydown area.<sup>261</sup>

212. According to information from KCP&L, a design error occurred.<sup>262</sup>

213. If the campus were designed correctly, there would have been enough space between the campus and where the boiler had to go.<sup>263</sup>

214. Moving the campus essentially doubled the cost of constructing the campus.<sup>264</sup>

215. Because KCP&L's original design and location of the latan campus was faulty, KCP&L incurred expenses in moving construction trailers at the latan site approximately 100 feet east when construction began on the turbine generator building.<sup>265</sup>

216. Correction of KCP&L's failure to engage in adequate planning prior to initially siting the trailers – or KCP&L's failure to adequately design the initial siting of the trailers – is not of benefit to Missouri ratepayers. Costs incurred to correct this faulty design should not be borne by Missouri ratepayers.<sup>266</sup>

Construction Resurfacing Project Adjustment

217. KCP&L paid money to ALSTOM in connection with claims related to delays to ALSTOM's work and acceleration of other ALSTOM work related to the latan site being resurfaced.<sup>267</sup>

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<sup>261</sup> *Id.*

<sup>262</sup> Tr. 2659.

<sup>263</sup> *Id.* at 2817.

<sup>264</sup> *Id.* at 2817-18.

<sup>265</sup> Ex. KCP&L 210, p. 43.

<sup>266</sup> Ex. KCP&L 89 (HC).

<sup>267</sup> Ex. KCP&L 205, p. 47.

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218. KCP&L also paid to have the site resurfaced.<sup>268</sup> The Commission found no credible evidence that the site needed resurfacing.

### **Conclusions of Law – Iatan**

15. The prudence standard is articulated in the *Associated Natural Gas Case* as follows:

[A] utility's costs are presumed to be prudently incurred.... However, the presumption does not survive "a showing of inefficiency or improvidence."

. . . [W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. (Citations omitted).

In the [Union Electric] case, the PSC noted that this test of prudence should not be based upon hindsight, but upon a reasonableness standard:

[T]he company's conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the company had to solve its problem prospectively rather than in reliance on hindsight. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company.<sup>269</sup>

16. As stated above, under the prudence standard, the Commission presumes that the utility's costs were prudently incurred.<sup>270</sup> This means that utilities seeking a rate increase are not required to demonstrate their cases-in-chief that all expenditures were prudent.<sup>271</sup>

17. Staff or any other party can challenge the presumption of prudence by creating "a serious doubt" as to the prudence of an expenditure. Once a serious doubt has been raised, then the burden shifts to KCP&L to dispel those doubts and prove that the questioned expenditure was prudent.

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<sup>268</sup> *Id.*

<sup>269</sup> See *State ex. Re. Associated Natural Gas v. Public Serv. Comm'n*, 954 S.W.2d 520, 528-529 (Mo. App. W.D. 1997).

<sup>270</sup> See *State ex. Re. Associated Natural Gas v. Public Serv. Comm'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997); *State ex rel. GS Technologies Operating Co. Inc. v. Public Serv. Comm'n*, 116 S.W.3d 680 (Mo. App. W.D. 2003 (citations omitted)).

<sup>271</sup> See *Union Electric*, 66 P.U.R.4th at 212.

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18. In a prior case involving a prudence review and construction audit, the Commission stated:<sup>272</sup>

The Federal Power Act imposes on the Company the “burden of proof to show that the increased rate or charge is just and reasonable.” Edison relies on Supreme Court precedent for the proposition that a utility’s cost are [sic] presumed to be prudently incurred. However, the presumption does not survive “a showing of inefficiency or improvidence.” As the Commission has explained, “utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent . . . However, where some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.”

19. Thus, in the first instance, it is the parties challenging the decisions and expenditures of a utility that have the initial burden defeating the presumption of prudence accorded the utility.<sup>273</sup>

Under the prudence standard, the Commission looks at whether the utility’s conduct was reasonable at the time, under all of the circumstances. In applying this standard, the Commission presumes that the utility’s costs were prudently incurred.<sup>274</sup>

20. Once the presumption of prudence is dispelled, the utility has the burden of showing that the challenged items were indeed prudent.<sup>275</sup>

21. The Commission has adopted a standard of reasonable care requiring due diligence for evaluating the prudence of a utility’s conduct.<sup>276</sup> The Commission has described this standard as follows:<sup>277</sup>

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<sup>272</sup> *In the Matter of Union Electric Company*, 27 Mo.P.S.C. (N.S.) 183, 193 (1985) (quoting *Anaheim, Riverside, etc. v. Federal Energy Regulatory Commission*, 669 F.2d 779 (D.C. Cir. 1981)) (citations omitted).

<sup>273</sup> *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 954 S.W.2d 520, 528-529 (Mo. App., W.D. 1997).

<sup>274</sup> *State ex rel. GS Technologies Operating Company, Inc. v. Public Service Commission*, 116 S.W.3d 680 (Mo. App., W.D. 2003).

<sup>275</sup> *Associated Natural Gas*, *supra*, 954 S.W.2d at 528-529.

<sup>276</sup> *Union Electric*, 27 Mo.P.S.C. (N.S.) at 194.

<sup>277</sup> *Id.*

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The Commission will assess management decisions at the time they are made and ask the question, “Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?”

22. In the *Associated Natural Gas* case, the Missouri Court of Appeals held that the Staff must provide evidence that the utility’s actions caused higher costs than if prudent decisions had been made.<sup>278</sup> Substantive and competent evidence regarding higher costs includes evidence about the particular controversial expenditures and evidence as to the “amount that the expenditures would have been if the [utility] had acted in a prudent manner.”<sup>279</sup>

23. In other words, Staff or the other parties must satisfy the following two-pronged evidentiary test to support a disallowance: 1) identify the imprudent action based upon industry standards and the circumstances at the time the decision or action was made; and 2) provide proof of the increased costs caused by KCP&L’s imprudent decisions. To meet this standard, a party must provide substantive, competent evidence establishing a causal connection or “nexus” between the alleged imprudent action and the costs incurred.

### **Decision – Iatan**

The costs for construction resurfacing, campus relocation for the Iatan 2 Turbine Building, the WSI change order, and the temporary auxiliary boiler shall be excluded from rate base. All other rate base additions shall be included in rate base.

### **B. Crossroads**

**Was the decision to add the approximately 300 MW of capacity from Crossroads prudent?**

**If the decision to add Crossroads was prudent, what is the appropriate valuation of Crossroads?**

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<sup>278</sup> See *Associated Natural Gas*, 945 S.W.2d at 529.

<sup>279</sup> See *id.*

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**If Crossroads is included in rate base, should the accumulated deferred taxes associated with Crossroads be used as an offset to rate base?**

**If Crossroads is included in rate base, should the transmission expense to get the energy from Crossroads to MPS's territory be included in expenses?**

**If transmission expense is included, should the Commission reflect any transmission cost savings to the Company resulting in its future participation in SPP as a network service customer related to the Crossroads plant be an offset?**

### **Findings of Fact – Crossroads**

219. GMO seeks recovery of costs associated with its capacity planning, namely: (1) the construction of three 105 MW combustion turbines at South Harper and a 200 MW system-participation based purchased power agreement (“PPA”); and (2) adding Crossroads Energy Center (“Crossroads”) to the MPS generation fleet. Staff, the Industrials, and Dogwood Energy dispute the prudence of these decisions and their associated costs.

### **History and Prudence**

220. The Crossroads issues have their genesis from GMO's (then known as Aquila, Inc.) anticipation in the late 1990's and early 2000's of the deregulation and decoupling of generation from regulated electric utility operations in Missouri and its participation in the energy market in Missouri and other states through a non-regulated subsidiary, Aquila Merchant Services, Inc.

221. As part of its merchant generation activities, in 2000, Aquila Merchant, with Calpine, built the Aries Plant (now known as Dogwood). The Aries Plant is a natural gas-fired, 585 MW, combined-cycle, intermediate generating facility within Aquila, Inc.'s MPS service area. A five-year PPA with Aquila, Inc. that expired in May 2005 was used as an anchor for building the facility.<sup>280</sup>

222. Aquila Merchant also purchased eighteen 75 MW model 7EA combustion turbines from General Electric and, in 2002, at least

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<sup>280</sup> Ex. GMO 210, p. 91.



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three 105 MW model 501D combustion turbines from Siemens-Westinghouse.<sup>281</sup>

223. Aquila Merchant used four of the 75 MW combustion turbines at the facility it built near Clarksdale, Mississippi in 2002—Crossroads.<sup>282</sup> Aquila Merchant sold, at substantial discounts from its cost, three of the 75 MW combustion turbines to unaffiliated entities in 2003. Aquila Merchant released one of the 75 MW combustion turbines back to the manufacturer, and in 2003 installed six of them at the Goose Creek Energy Center and the other four at the Raccoon Creek Energy Center, both in Illinois.<sup>283</sup> Aquila Merchant kept the three 105 MW Siemens-Westinghouse combustion turbines it purchased in 2002 intending to install them at the 585 MW, combined-cycle generating facility for a purchased power agreement with GMO after the 5-year purchased power agreement with GMO expired in May 2005. When it could not sell them, they were stored until 2005 when they were installed as regulated units at South Harper to be used for the MPS service area.<sup>284</sup>

224. Aquila Merchant sold both its Goose Creek Energy Center and its Raccoon Creek Energy Center to Union Electric Company d/b/a AmerenUE (now d/b/a Ameren Missouri) at substantially below book value in 2006.<sup>285</sup>

225. The table that follows shows the installed cost per kilowatt of 17 of the combustion turbines Aquila Merchant bought and took delivery of, and the price per kilowatt it received when it disposed of them:<sup>286</sup>

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<sup>281</sup> Ex. GMO 215, pp. 39, 48.

<sup>282</sup> Ex. GMO 216, p. 4.

<sup>283</sup> Ex. GMO 215, pp. 47-51.

<sup>284</sup> Ex. GMO 215, pp. 39-40.

<sup>285</sup> Ex. GMO 215, p. 47.

<sup>286</sup> Ex. GMO 215, p. 51; Ex. GMO 262, Staff MPS Accounting Schedules 3-1, 3-2, 6-1 and 6-2.

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Installed site	No. of Turbines	Date Installation / Sold	Cost	Capacity	Price per kilowatt
Raccoon Creek	4	2003 installed	\$175 million	850,000 kW	\$205.88
Goose Creek	6	2006 sold to Ameren			
South Harper	3	2001 Purchased  2005 installed	At Dec 31, 2010 Plant \$120.4 million Reserve \$24.4 Net \$95.9	315,000 kW	\$382.16
Crossroads	4	2002 installed  2008 transferred to MPS regulated	At Dec 31, 2010 Plant \$119.2 million Reserve 32.1 Net \$87.1 million  Transmission upgrades (intangibles) Plant \$22.5 million Reserve 4.4 Net \$18.1 million  Total Plant \$141.7 million Reserve 36.5 Net \$105.2 million	300,000 kW	\$427.46

226. Although every other investor-owned electric utility in Missouri built generation, Aquila, Inc. had a corporate policy not to build regulated generating units that it followed until it built South Harper in 2005.<sup>287</sup> Instead, Aquila, Inc. relied exclusively on purchased power to meet its retail customers' increasing demands for electricity.

227. In 2000, Aquila, Inc. entered into the five-year purchased power agreement for power from the Aries Plant. That agreement, which

<sup>287</sup> Ex. GMO 217, pp. 34 and 39.

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expired in May 2005, provided for 500 MW of capacity in the summer and 320 MW in the winter.<sup>288</sup>

228. Aquila, Inc. knew in 2000 when it began taking power under the five-year purchased power agreement that it would have to replace that capacity by June of 2005.<sup>289</sup>

229. In 2001, Aquila, Inc. began exploring what options might be available in 2005 to replace the 500 MW of capacity. It did so by issuing a request for proposals (“RFPs”) in the spring of 2001 for delivery of energy beginning in June of 2005. Because of changes in the industry, Aquila, Inc. reissued those RFPs in early 2003.<sup>290</sup>

230. Staff has criticized and challenged GMO’s<sup>291</sup> capacity planning in rate cases over the past decade. It did so in File Nos. ER-2001-672 and ER-2004-0034, criticizing Aquila, Inc. for entering into the five-year purchased power agreement for power from a 585 MW natural gas-fired combined cycle generating unit built by Calpine and Aquila, Inc.’s affiliate Aquila Merchant Services, Inc., instead of building generation it owned. Staff also criticized Aquila, Inc. in File No. ER-2005-0436, challenging the prudence of how Aquila, Inc. built South Harper in the face of opposition to the siting of that facility and its decision to only install three 105 MW combustion turbines instead of five. And Staff had criticism again in File Nos. ER-2007-0004 and ER-2009-0090, taking issue with the prudence of Aquila, Inc./GMO for installing three 105 MW combustion turbines in 2005 instead of five.

231. At Aquila, Inc.’s June 26, 2003, resource planning update meeting with Staff and the Office of the Public Counsel, it presented the results of its analysis of the proposals it received. With the exception of one proposal, the proposals were for purchased power agreements, with the source of the capacity and energy varying among wind, coal, combustion turbines, and combined-cycle units. Aquila, Inc. also disclosed then that one bid for 600 MW of capacity which Aquila, Inc. considered to be “excellent” had been made. By September 10, 2003, however, the bid had been withdrawn and not replaced.<sup>292</sup>

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<sup>288</sup> Ex. GMO 210, p. 91; Ex. GMO 233, p. 4.

<sup>289</sup> Ex. GMO 3601, pp. 3-5 and 8-11. Other capacity issues which will also create pressure for GMO to find new capacity solutions include the expiration of a 75 MW purchased power agreement with the Nebraska Public Power District (“NPPD”) in 2014 (Ex. GMO 11, p. 6; and Tr. 4045) coal plant retirements, and integration of intermittent resources such as wind generation (Ex. GMO 3601, pp. 4 and 10-13).

<sup>290</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1, p. 1.

<sup>291</sup> Even when it was known as Aquila, Inc.

<sup>292</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1 at pp. 1-2.

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232. On January 27, 2004, only sixteen months before its 500 MW capacity agreement would expire, Aquila, Inc. met with and informed Staff of Aquila, Inc.'s power acquisition process for the following five years. In that meeting GMO presented its preferred/proposed resource plan to build what became South Harper, and enter into three-to-five year purchased power agreements for the balance of its resource needs based on the responses to the spring 2003 request for proposals. Staff responded it was concerned that Aquila, Inc. would become overly dependent on short-term purchased power agreements and needed to evaluate adding baseload generation.<sup>293</sup>

233. At its next resource planning update, on February 9, 2004, Aquila, Inc., based on a twenty-year planning period, disclosed that its least cost resource plan was to build five 105 MW combustion turbines in 2005 and buy a small amount of capacity from the market in 2005, meet load growth with additional market purchases until 2009, when it would build an additional 105 MW combustion turbine and a second in 2010, as well as pursue adding baseload capacity for 2010. Therefore, in February of 2004, about sixteen months before its five-year 500 MW purchased power agreement expired, Aquila, Inc.'s least cost resource plan included building five 105 MW combustion turbines in 2005.<sup>294</sup>

234. At its following semi-annual update to Staff and the Office of the Public Counsel, held on July 9, 2004, GMO disclosed it had entered into an agreement to purchase 75 MW of power from NPPD, but that its least cost plan still included building five 105 MW combustion turbines in 2005, although its preferred plan still was to build three 105 MW combustion turbines in 2005 and rely on purchased power for the balance of its needs. Therefore, in July of 2004, about eleven months before its five-year 100 MW purchased power agreement expired, Aquila, Inc.'s least cost resource plan included building five 105 MW combustion turbines in 2005.<sup>295</sup>

235. After prudently exploring and planning its capacity needs following the expiration of its five-year 500 MW purchased power agreement in May of 2005, GMO elected not to build five combustion turbines, and instead built three 105 MW combustion turbines at South Harper, a site designed for up to six 105 MW combustion turbines, and entered into PPA that included base load capacity in order to diversify its

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<sup>293</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1 at p. 2.

<sup>294</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1 at p. 3.

<sup>295</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1 at p. 3.

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resource portfolio additions. “GMO concluded that it would be prudent to spread the execution and operating risks from the resource additions between building combustion turbines and adding a PPA that contained some level of base load capacity.”<sup>296</sup>

236. Staff argues that its adjustments<sup>297</sup> “reflect the continuation of Staff’s position that GMO should have prudently addressed its capacity needs for MPS to replace the Aires PPA when it expired on May 31, 2005.”<sup>298</sup> Notably, Staff’s conclusion is based on the same analysis as that developed and used by the Company in deciding to pursue the three combustion turbine/system-participation PPA.

237. The difference between Staff’s preferred five combustion turbine plan and the Company’s three Combustion turbine/system-participation PPA plan is minimal.<sup>299</sup> Even Staff witness Lena Mantle testifies that she did not believe the cost difference between the Company’s preferred plan and Staff’s five combustion turbine option over 20 years was significant,<sup>300</sup> and that she did not find the Company’s decision based on this difference to be imprudent.<sup>301</sup>

238. Ultimately, the Company did not precisely implement its preferred plan. Based on the 2004 analysis, the preferred plan called for three 105 MW combustion turbines and a 200 MW system PPA. The three combustion turbines were completed in the summer of 2005, but the Company was unable to complete the system PPA. Instead, the Company entered into a 9-year 75 MW base load contract with the Nebraska Public Power District (“NPPD”) and purchased power from Crossroads short-term for the remaining 200 MW.<sup>302</sup>

239. After a thorough analysis of available options, the Company determined the 300 MW Crossroads Energy Center was the lowest cost option for meeting its requirements.

240. In August 2008, after the Great Plains Energy acquisition of Aquila, the Crossroads unit was transferred to the regulated books of GMO.<sup>303</sup>

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<sup>296</sup> Ex. GMO 11, p. 4.

<sup>297</sup> The Company denotes the two additional 105 MW combustion turbines Staff would impute to GMO instead of Crossroads as “phantom turbines.”

<sup>298</sup> Ex. GMO 210, p.103.

<sup>299</sup> Ex. GMO 217, Sch. 119.

<sup>300</sup> Tr. 4090.

<sup>301</sup> Tr. 4091.

<sup>302</sup> Ex. GMO 210, Appendix 5, Sch. LMM-1, pp. 1 and 3.

<sup>303</sup> Ex. 216, p. 5.

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241. In 2010, per the Stipulation and Agreement in GMO's last rate case, GMO conducted a 20-year analysis to determine a preferred plan after reviewing and analyzing the responses from a 2007 Request for Proposals for supply resources.<sup>304</sup> The analysis showed that Crossroads would result in the lowest 20-year net present value of revenue requirements ("NPVRR").

### **Delivered Natural Gas Prices**

242. Historically the prices of natural gas delivered to Crossroads (Clarksdale, Mississippi) have been higher than the prices of natural gas delivered to South Harper (Peculiar, Missouri).<sup>305</sup> More recently, in the first ten months of 2010, the average commodity cost for natural gas shipped to Crossroads was less than gas shipped to South Harper. Moreover, the average delivered cost of natural gas to Crossroads was about half the average delivered cost of natural gas to South Harper.<sup>306</sup> The explanation is that while the commodity prices of natural gas are higher at Crossroads than at South Harper, adding the firm transportation costs to the commodity price for natural gas at South Harper results in a higher natural gas price at South Harper than the natural gas price that was paid at Crossroads the past two years—2009 and 2010.<sup>307</sup>

243. One of the benefits of Crossroads over the two turbines at South Harper "is that natural gas shipped to Crossroads typically comes from a different supply region than natural gas shipped to South Harper. This allows the GMO to take advantage of short-term pricing disparities."<sup>308</sup> With Crossroads in the portfolio "the Company can choose to generate electricity from the region with the lower priced natural gas."<sup>309</sup> However, the lower natural gas prices at Crossroads are offset by much higher electric transmission costs, discussed below.<sup>310</sup>

### **Transmission Cost**

244. Staff argues that the cost of transmission to move energy from Crossroads in Mississippi to GMO's service territory justifies, in part, removing Crossroads from GMO's cost of service. The Company

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<sup>304</sup> Ex. GMO 11, p. 8.

<sup>305</sup> Ex. GMO 217, p. 43.

<sup>306</sup> Ex. GMO 8, p. 2.

<sup>307</sup> Ex. GMO 217, p. 44.

<sup>308</sup> Ex. GMO 8, pp. 4-5.

<sup>309</sup> Ex. GMO 8, p. 5.

<sup>310</sup> Ex. GMO 217, p. 44.

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argues that the cost of transmission is offset by the lower gas reservation costs.

245. The cost of transmission to move energy from Crossroads to customers served by MPS is a very significant cost that is far greater than the transmission costs for power plants located in the MPS district.<sup>311</sup> The annual energy transmission cost was estimated as \$406,000 per month.<sup>312</sup> This is also substantially higher on an annual basis than the transmission plant costs for the Aries site where the three South Harper Turbines were originally planned to be installed.<sup>313</sup>

246. This higher transmission cost is an ongoing cost that will be paid every year that Crossroads is operating to provide electricity to customers located in and about Kansas City, Missouri. GMO does not incur any transmission costs for its other production facilities that are located in its MPS district that are used to serve its native load customers in that district. This ongoing transmission cost GMO incurs for Crossroads is a cost that it does not incur for South Harper, and is the cause of one of the biggest differences in the on-going operating costs between the two facilities.

247. It is not just and reasonable to require ratepayers to pay for the added transmission costs of electricity generated so far away in a transmission constricted location. Thus, the Commission will exclude the excessive transmission costs from recovery in rates.

### **Special Protection Scheme**

248. Crossroads faces local (Mississippi) transmission constraints, because the existing lines cannot carry the full load of the plant under certain circumstances.<sup>314</sup> As a result, it is subject to a special protection scheme mandated by the Southwest Power Pool ("SPP").<sup>315</sup>

249. The special protection scheme requires the ramp down of the output of one of its four combustion turbines if a particular one of the two transmission lines used to move energy from Crossroads to MPS becomes unavailable. This risk of capacity loss is one of the transmission-related risks of Crossroads. GMO's MPS retail customers should bear neither the costs nor risks associated with the transmission

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<sup>311</sup> Ex. GMO 217, p.7; Ex. GMO 11, p. 10.

<sup>312</sup> Tr. 4050.

<sup>313</sup> Ex. GMO 217, p. 7.

<sup>314</sup> Tr. 4050.

<sup>315</sup> Ex. GMO 3601, p. 8; Tr. 4051, Ex. GMO 3603, p. 14 and pp. 31-33; Tr. 4125.

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limitations in getting electricity from Crossroads to MPS.<sup>316</sup> In determining that transmission costs will be excluded, the Commission has sufficiently addressed these risks and costs.

### **Plant Managerial Oversight**

250. Staff also expressed concern with GMO's ability to provide appropriate management oversight of a plant located in Mississippi.

251. To reduce transmission losses and outages power plants are built close to where the electricity is needed—close to customers.<sup>317</sup> Crossroads, however, is located over 9 hours and 525 miles from Kansas City, Missouri.<sup>318</sup>

252. No KCPL employees operate Crossroads, rather, GMO has contracted with the City of Clarksdale, Mississippi to operate Crossroads under an agreement with the Clarksdale Public Utilities Commission.<sup>319</sup>

253. A tolling agreement for the capacity and energy of the plant was originally held by MEP Clarksdale Power, LLC, which became Aquila Merchant Services, which assigned the agreement to Aquila, Inc., which is now GMO. The agreement runs through 2032 with a right to extend up to ten more years. GMO also holds a purchase option, but does not intend to exercise it because the advantages of tax exempt financing would be lost.<sup>320</sup> The municipal ownership facilitated tax exempt financing.<sup>321</sup>

254. GMO witness Rollison identifies the agreement as a "Generation, Operations and Maintenance Agreement" between Clarksdale and GMO. The agreement "permits GMO to receive the output of the plant in exchange for payments that cover fixed and variable costs to produce the electrical output, as well as to maintain and operate the facility."<sup>322</sup> The Generation Agreement between the Clarksdale Public Utilities Commission and GMO states that "GMO has the right to review and approve the annual Operating Plan which constitutes a comprehensive and detailed plan for operating the facility for [the] coming two-year period."<sup>323</sup> In addition, GMO has the authority

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<sup>316</sup> Ex. GMO 233, pp. 5-6.

<sup>317</sup> Ex. GMO 217, p. 42.

<sup>318</sup> Ex. GMO 217, p. 42.

<sup>319</sup> Ex. GMO 31, p. 2.

<sup>320</sup> Ex. GMO 3601, p. 7-8; Ex. GMO 31, p. 2; Ex. GMO 42, p. 55; Tr. 4053 and 4059.

<sup>321</sup> Tr. 4053.

<sup>322</sup> Ex. GMO 31, p. 2-3.

<sup>323</sup> Ex. GMO 31, p. 3.



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to review and approve the annual operating plan and budget, as well as to audit costs and inspect the facility.<sup>324</sup>

255. GMO is supposed to pay Clarksdale an “Availability Incentive Bonus Fee” for increased availability of generation and has the right to invoke an “Availability Liquidated Damages” clause for reduced availability, although there is no evidence as to whether or how often such clauses have actually been applied.<sup>325</sup> There would be no comparable internal fees if GMO owned and operated the plant itself.<sup>326</sup>

256. The City agrees to protect GMO from various risks by means of an indemnification clause.<sup>327</sup>

257. With the exceptions of the Wolf Creek nuclear plant (of which KCPL is a minority owner) and the Jeffrey Energy Center (of which GMO is a minority owner), KCPL employees operate all other KCPL and GMO plants.<sup>328</sup>

258. GMO also has ownership interest in other generating facilities operated and managed by non-GMO employees. It is not uncommon in the industry to have plants run by someone other than the owner. For example, KCP&L runs plants for Westar, Empire, GMO and MJMEUC. Further, other utilities run Wolf Creek and Jeffrey Energy Center, of which KCP&L and GMO, respectively, are minority owners.

259. GMO personnel have visited the site six times over the past two years.<sup>329</sup>

260. The ability of GMO to provide managerial oversight to the plant is only slightly hampered by the long distance location of the plant facilities.

261. The management oversight has not proven to be a problem and therefore is not a reason for denial of recovery.

### **Ultimate Finding Regarding Prudence of Crossroads**

262. Considering the costs involved, the fact that this was an affiliate transaction rather than an arms-length transaction, the relative reliability of transmission, the excessive costs of that transmission, the reduced costs for natural gas and the alternative supply source, the distance of the power in location to the customers served, and the other facts set out above, the Commission finds that the decision not to build

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<sup>324</sup> Ex. GMO 31, p. 3; Tr. 4078-79.

<sup>325</sup> Tr. 4076.

<sup>326</sup> Tr. 4076.

<sup>327</sup> Ex. GMO 31, p. 4.

<sup>328</sup> Tr. 4054, 4075 and 4079.

<sup>329</sup> Ex. GMO 3601, pp. 4-5; Tr. 4052-54; and Tr. 4078-79.

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two more 105 MW combustion turbines at South Harper was not imprudent. In addition, the decision to include Crossroads in the generation fleet at an appropriate value was prudent with the exception of the additional transmission expense, when other low-cost options were available. Paying the additional transmission costs required to bring energy all the way from Crossroads and including Crossroads at net book value with no disallowances, is not just and reasonable and is discussed in detail below.

### Valuation of Crossroads

263. With regard to the valuation of Crossroads, Staff's primary recommendation is that Crossroads should be disallowed in its entirety.<sup>330</sup> It argues alternatively that if the Commission decides to allow Crossroads in GMO's cost of service, then the value of Crossroads for ratemaking purposes is \$51.6 million or another alternative of \$61.8 million. GMO believes its valuation of Crossroads at \$104 million is appropriate.<sup>331</sup>

264. GMO argues that because it did not dismantle the plant and it was able to obtain transmission from Crossroads to GMO, the value of the plant was \$94.75 million, assuming that \$20 million in transmission upgrades would be required. GMO was ultimately able to obtain transmission service with only a minimal transmission investment of \$145,000, bringing its estimated value of Crossroads to \$114.60 million.<sup>332</sup> This value is more than the net book value of \$104 million GMO has requested for ratemaking treatment in this case.<sup>333</sup>

265. At December 31, 2010, the plant and transmission facilities values for Crossroads were:<sup>334</sup>

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<sup>330</sup> Ex. GMO 210, p. 92.

<sup>331</sup> Ex. GMO 12, p. 3.

<sup>332</sup> Ex. GMO 12, p. 3.

<sup>333</sup> Ex. GMO 12, p. 3.

<sup>334</sup> Ex. GMO 262, Schs. 3-1, 3-2, 6-1 and 6-2.

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Plant in Service	\$119.1 million
Depreciation Reserve	\$ 32.1 million
Net Plant	\$ 87.0 million
Transmission Rights -- Intangible Reserve	\$ 22.5 million
	\$ 4.4 million
Net Transmission	\$ 18.1 million
Total Crossroads Plant	\$141.7 million
Reserve	\$ 36.5 million
Net Plant	\$105.2 million

266. Aquila, Inc. attempted to sell Crossroads, but was unable to sell it.<sup>335</sup> It follows that, absent a write-down which GMO has not taken, the market value of Crossroads is less than its booked value.

267. In February 2007, Great Plains Energy announced that it was seeking to acquire Aquila, Inc. Given several recent divestitures by Aquila, Great Plains acquisition amounted to simply the Missouri regulated electric operations as well as the Crossroads Energy Center. Over the next several months, Great Plains made three separate filings with the Securities Exchange Commission regarding the “fair value” of the Crossroads unit. As Great Plains indicated:

The preliminary internal analysis indicated a fair value estimate of Aquila’s non-regulated Crossroads power generating facility of approximately \$51.6 million. This analysis is significantly affected by assumptions regarding the current market for sales of units of similar capacity. The \$66.3 million adjustment reflects the difference between the fair value of the combustion turbines at \$51.6 million and the \$117.9 million book value of the facility at March 31, 2007. Great Plains Energy management believes this to be an appropriate estimate of the fair value of the facility.<sup>336</sup>

The valuations disclosed by Great Plains to the Securities Exchange Commission were made under oath.

268. GMO claims that the fair market value of Crossroads is established by an RFP conducted in March 2007, prior to the SEC

<sup>335</sup> See the specifics regarding bids in the “Highly Confidential” Information at Ex. GMO 216, p. 13.

<sup>336</sup> Ex. GMO 216, p. 12 (citing to Great Plains Energy & Aquila Joint Proxy Statement / Prospectus, filed with the SEC on May 8, 2007, at page 175).

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disclosures. GMO postulates that, the responses to this RFP, demonstrate that fair market value is comparable to the proposed net book value. GMO fails to explain, however, given the alleged results of the RFP, why it announced to the Securities Exchange Commission, mere months later, that “fair value” was only \$51.6 million.

269. GMO’s assertion is also inconsistent with real world evidence as to the diminution in value experienced by these deregulated generating assets. The evidence indicates that, following the crash of the deregulated electric market and the bankruptcy of Enron, many deregulated generating assets, including combustion turbines identical to those in service at Crossroads, experienced a significant devaluation.<sup>337</sup> Specifically, the evidence indicates that Aquila sold General Electric combustion turbines, identical to those installed at Crossroads in 2006. At that time, Aquila also sold its ownership interest in Raccoon Creek and Goose Creek in Illinois to AmerenUE. Given the deterioration in the deregulated market, Aquila took a write-off, from net book value, of \$99.7 million.<sup>338</sup> Aquila sold other General Electric turbines to Nebraska and Colorado utilities.<sup>339</sup> Again, the price received by Aquila was significantly affected by the deterioration in the deregulated energy market.<sup>340</sup>

270. These sales by Aquila, of combustion turbines identical to those installed at Crossroads, are not only a good indicator of the fair market value, but also clearly show that the fair market value of these General Electric combustion turbines was significantly below the net book value.

271. When conducting its due diligence review of Aquila’s assets for determining its offer price for Aquila, GPE would have considered the transmission constraints and other problems associated with Crossroads.<sup>341</sup> It is incomprehensible that GPE would pay book value for generating facilities in Mississippi to serve retail customers in and about Kansas City, Missouri. And, it is a virtual certainty that GPE management was able to negotiate a price for Aquila that considered the distressed nature of Crossroads as a merchant plant which Aquila Merchant was unable to sell despite trying for several years. Further, it is equally likely that GPE was in as good a position to negotiate a price

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<sup>337</sup> Ex. GMO 215, p. 58; Ex. GMO 217, p. 6.

<sup>338</sup> Ex. GMO 215, p. 51.

<sup>339</sup> Ex. GMO 215, p. 48.

<sup>340</sup> Ex. GMO 215, p. 48.

<sup>341</sup> Ex. GMO 216, p. 7.

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for Crossroads as AmerenUE was when it negotiated the purchases of Raccoon Creek and Goose Creek, both located in Illinois, from Aquila Merchant in 2006.

272. The ten 75 MW General Electric model 7EA combustion turbines installed at Raccoon Creek and Goose Creek that Aquila Merchant sold to AmerenUE in 2006 are ten of the eighteen combustion turbines Aquila Merchant bought at the same time. Four of those eighteen were installed at Crossroads. The turbines sold at an average installed cost of \$205.88 per kW.<sup>342</sup> Based on that average installed cost of \$205.88 per kW, the 300 MW of combustion turbines at Crossroads would have an installed cost of \$61.8 million.

273. Aquila Merchant purchased a total of 21 combustion turbines. It offered three of them at below its cost to several entities, including KCPL, in 2002 before it stored them. These turbines were eventually installed at South Harper and are in MPS's rate base at a discount from what Aquila Merchant paid for them. Aquila merchant also sold thirteen other combustion turbines below its cost to buy them as follows.<sup>343</sup>

- Goose Creek—6 General Electric turbines sold to AmerenUE in 2006.
- Raccoon Creek—4 General Electric turbines sold to AmerenUE in 2006.
- Utility in Beatrice, Nebraska – 2 General Electric turbines sold in 2002.
- Utility in Colorado – 1 General Electric turbines sold in 2002.

274. All the above generating assets are now serving customers at prices consistent with the turbine market after the Enron collapse.<sup>344</sup> Even Aquila wrote-down from what Aquila Merchant paid for them the combustion turbines it installed at South Harper to comply with the Commission's affiliated transaction rule.<sup>345</sup> Yet, in this case GMO is seeking to include the full value of Crossroads on its books, without a write-down, in MPS's rate base.

275. Considering the depressed market as exhibited by the sale of similar turbines to Ameren, and the valuation of these assets reported to the SEC by GPE, the Commission finds that \$61.8 million is

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<sup>342</sup> Ex. GMO 215, pp. 50-51.

<sup>343</sup> Ex. GMO 216, pp. 47 and 49.

<sup>344</sup> Ex. GMO 215, pp. 48-51.

<sup>345</sup> Ex. GMO 216, pp. 17-18.

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an accurate reflection of the fair market value of Crossroads as required by the affiliate transaction rule as of July 14, 2008.

### **Deferred Income Taxes**

276. Since Crossroads became part of the non-regulated operations of Aquila Merchant in 2002, deferred income taxes accumulated.<sup>346</sup> In all instances, KCPL and GMO use deferred income taxes relating to regulated investment assets as an offset (reduction) to rate base, except now for Crossroads.<sup>347</sup> It is GMO's position that since Crossroads was not part of its regulated operations when those deferred taxes were created, they should not be used as an offset to MPS's rate base now. If the Commission authorizes GMO to rate base Crossroads in this case, then it is Staff's position that all the accumulated deferred income taxes associated with Crossroads should be offset against rate base attributable to MPS.

277. The accumulated deferred taxes associated with Crossroads should be applied as an offset to MPS's rate base.<sup>348</sup>

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<sup>346</sup> Ex. GMO 210, p. 109.

<sup>347</sup> Ex. GMO 210, p. 109.

<sup>348</sup> Ex. GMO 210, p. 110.

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### **Dogwood**

278. Dogwood Energy, LLC (Dogwood) is both a retail power customer of GMO and a wholesale power supplier to GMO.<sup>349</sup> As a customer, Dogwood supported Staff's disallowance of Crossroads and imputation of two phantom turbines in order "to protect GMO's retail customers, including Dogwood, against exorbitant rates."<sup>350</sup> With regard to its interest as a wholesale supplier to GMO, Dogwood suggests that the Commission discourage GMO from using the Crossroads facility and instead replace it with a local unit -- such as Dogwood's combined cycle facility.<sup>351</sup>

279. Dogwood argues that the cost of natural gas to Dogwood is cheaper than to Crossroads, transmission service to Crossroads is problematic and the Company's resource planning analyses are flawed because the Company failed to contact Dogwood. In addition, Dogwood makes a number of legal challenges to inclusion of Crossroads in rates.

280. Contrary to Dogwood's arguments, the testimony and evidence presented in this case demonstrate that the delivered cost of natural gas is cheaper to Crossroads than to Dogwood, however that cost is offset by the transmission costs. In addition, GMO's firm transmission service is reliable and sufficient and GMO has repeatedly considered Dogwood in its resource planning decisions, including the Company's recent 2010 Stipulation 8 Capacity Study.

281. Dogwood has not been the lowest cost resource option.

### **Conclusions of Law – Crossroads**

24. This issue concerns the appropriate valuation to place on the Crossroads generating unit recently devoted by GMO to serving its ratepayers. The Supreme Court has held that the utility must be permitted to earn a return on the "fair value" of the property devoted to the public convenience.

The corporation may not be required to use its property for the benefit of the public without receiving just compensation for the services rendered by it. . . . We hold, however, that the basis of all calculations as to the reasonableness of rates to be charged by a corporation . . . must be the **fair value of the property being used**

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<sup>349</sup> Ex. GMO 3601, p. 3.

<sup>350</sup> Ex. GMO 3601, p. 4.

<sup>351</sup> Ex. GMO 3601, p. 4.

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**by it for the convenience of the public.** What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be extracted from it than the services rendered by it are reasonably worth.<sup>352</sup>

25. The Commission's authority to establish the valuation of an electric corporation's plant has also been memorialized in Section 393.230:

**The commission shall have the power to ascertain the value of the property of every . . . electrical corporation . . . in this state and every fact which in its judgment may or does have any bearing on such value.** The commission shall have power to make revaluations from time to time and to ascertain all new construction, extensions and additions to the property of every . . . electrical corporation. (emphasis added).

26. Recognizing that Crossroads was transferred from a non-regulated affiliate to the Missouri regulated operations, the Commission's affiliate transaction rule is implicated. The affiliate transaction rule, as it applies to the immediate issue, provides that the purchase of "goods or services" from an affiliate shall be "the **lesser** of: (a) fair market price; or (b) the fully distributed cost."<sup>353</sup>

27. The Commission concludes that if included in rate base at a fair market value, rather than the higher net book value paid to its affiliate, and except for the additional cost of transmission from Mississippi to Missouri, the Company's 2004 decision to pursue the construction of three 105 MW combustion turbines at South Harper and pursue a 200 MW system-participation based purchased power agreement, and the Company's decision to add the Crossroads generating facility to the MPS generation fleet were prudent and reasonable decisions.

28. The Commission rejects Staff's adjustment to disallow the recovery of the entirety of Crossroads in the Company's cost of service and instead recover the cost of the "phantom turbines." The Commission concludes, however, that GMO is requesting the Commission value these turbines based on that overly high valuation

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<sup>352</sup> *Smyth v. Ames*, 169 U.S. 466, 546-547 (1898) (emphasis added).

<sup>353</sup> 4 CSR 240-20.015(2)(A) (emphasis added).



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(net book value) and that Crossroads includes significantly higher transmission costs it will incur over the life of Crossroads. The Commission concludes that Crossroads should be included in rate base at a value of \$61.8 million based on the average installed dollar per kilowatt basis AmerenUE paid for the combustion turbines at Racoon Creek and Goose Creek.

29. In addition to the valuation, the Commission concludes that but for the location of Crossroads customers would not have to pay the excessive cost of transmission. Therefore, transmission costs from the Crossroads facility, including any related to OSS shall be disallowed from expenses in rates and therefore also not recoverable through GMO's fuel adjustment clause ("FAC").

30. The Commission concludes deferred taxes shall be an offset to rate base.

31. The Commission rejects the Industrials' position to the extent and for the same reasons set out in response to Staff's arguments.

### **Decision – Crossroads**

The Commission rejects Staff's adjustment to disallow the recovery of Crossroads in the Company's cost of service and replace it with the cost of two "phantom turbines." The Commission also rejects GMO's inclusion of Crossroads in rate base at its net book value. The Commission determines that given Great Plains' statements to the Securities Exchange Commission shortly before the transfer of the Crossroads unit to the Missouri regulated operations, as well as the arms-length sale of other General Electric combustion turbines by Aquila, that the fair market value of Crossroads at the time of transfer (August 2008) was \$61.8 million. Given the subsequent 32 months, the fair market value of Crossroads for purposes of establishing rate base in this case should also reflect 32 months of depreciation on that unit.

The Commission further determines that it is not just and reasonable for GMO customers to pay the excessive cost of transmission from Mississippi and it shall be excluded. Finally, deferred income taxes shall also be an offset to rate base.

### **C. Jeffrey FGD Rebuild Project**

**Should the Jeffrey Rate Base Additions be included in rate base in this proceeding?**

**Should the Commission presume that the costs of the Jeffrey Rate Base Additions were prudently incurred until a serious**

**doubt has been raised as to the prudence of the investment by a party to this proceeding?**

**Has a serious doubt regarding the prudence of the Jeffrey Rate Base Additions been raised by any party in this proceeding?**

**Should the Company's conduct be judged by asking whether the conduct was reasonable at the time, under all the circumstances, considering that the Company had to solve its problem prospectively rather than in reliance on hindsight? ("prudence standard")?**

**Has GMO demonstrated that it properly managed these complex projects and properly managed matters within its control?**

**Findings of Fact – Jeffrey FGD Rebuild Project**

282. The Jeffrey Energy Center ("JEC") is a coal-fired electric generating facility consisting of three 720 MW units located in St. Marys, Kansas.<sup>354</sup> GMO owns 8% of the JEC facility for a total of 172.8 MW, which is assigned to MPS. Westar Energy is the operating partner who owns the remaining 92%.<sup>355</sup> Westar is also the primary constructor of this project.

283. In 2004, the U.S. Environmental Protection Agency (EPA) served a Notice of Violation at the JEC, identifying the need for compliance with new environmental regulations.<sup>356</sup> To avoid civil penalties, Westar decided to rebuild the cold-side electrostatic precipitators for particulate removal and the limestone-based wet flue gas desulfurization ("FGD") systems, or "scrubbers" on each unit.<sup>357</sup> GMO agreed with Westar's decision to rebuild the scrubbers on all three JEC units.<sup>358</sup>

284. Powerplant Maintenance Specialists, Inc. ("PMSI") was the largest vendor on the Jeffrey FGD Rebuild Project and it was the general construction work contractor.<sup>359</sup> PMSI's initial contract amount is confidential,<sup>360</sup> but was originally a fixed price contract without a performance bond.<sup>361</sup> GMO's witness, Leonard R. Ruzicka, testified on cross-examination during an *in camera* portion of the hearing as to the

<sup>354</sup> Ex. GMO 210, p. 42, ll. 11-12.

<sup>355</sup> Ex. GMO 210, p. 42, ll. 12-14.

<sup>356</sup> Ex. GMO 210, p. 42, ll. 20-22.

<sup>357</sup> Ex. GMO 210, p. 42, ll. 15-17, 21-22.

<sup>358</sup> Ex. GMO 210, p. 43, l. 1.

<sup>359</sup> Ex. GMO 210, p. 44, ll. 9-10.

<sup>360</sup> Ex. GMO 210, p. 44, ll. 11-12.

<sup>361</sup> Tr. 4252, ll. 12-14.

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reasons that PMSI did not have a performance bond.<sup>362</sup> While Westar and GMO did not require PMSI to obtain a performance bond, they required other contractors on the Jeffrey FGD Rebuild Project to obtain a performance bond.<sup>363</sup>

285. Burns & McDonnell was hired as the owners' engineer for the Jeffrey FGD Rebuild Project.<sup>364</sup> Burns & McDonnell provided monthly status reports that addressed project concerns, scheduling, and budget.<sup>365</sup> Monthly status reports and cost reports provided by Westar were reviewed and monitored by GMO for prudence and reasonableness.

286. In this proceeding, Staff is proposing a prudence disallowance of \$59,110,980, the total cost of the project of which GMO's 8% share is \$4,831,649.

287. Staff's first argument is that: "Westar imprudently contracted with a vendor whose financial instability and poor performance report resulted in additional costs to the project."<sup>366</sup> Secondly, Staff argues that "It was unreasonable of Westar and GMO not to require PMSI to obtain a performance bond, and this failure to require a performance bond exposed GMO to inappropriate, unreasonable and unnecessary level of financial risk, risk that materialized."<sup>367</sup> Third, Staff argues that: "Westar failed to conduct proper due diligence when evaluating PMSI as a potential contractor." Staff also criticizes Westar for not applying the Federal Acquisition Regulations.<sup>368</sup> Finally, Staff criticized Westar for failing to seek liquidated damages against PMSI.<sup>369</sup> For the reasons stated below, the Commission finds that none of Staff's arguments and criticisms of Westar's actions are well founded.

288. Mr. Terry S. Hedrick, KCP&L's Director of Supply Engineering, explained at length the reasons why Westar and GMO hired the contractor and did not require the contractor to obtain a performance bond. Much of the information was provided as confidential information. However, the contractor's bid was

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<sup>362</sup> Tr. 4282, ll. 12-18.

<sup>363</sup> Ex. GMO 210, p. 45, ll. 30-31; See Ex. GMO 210, Appendix 3, Schs. 6, 7 and 8.

<sup>364</sup> Ex. GMO 230, p. 44, ll. 14-15.

<sup>365</sup> Ex. GMO 230, p. 44, ll. 15-16.

<sup>366</sup> *Staff's Initial Brief of Issues Specific to KCP&L Greater Missouri Operations Company* at 44.

<sup>367</sup> Staff Initial Br., pp. 47-48; See also, Ex. GMO 210, pp. 42-47; Ex. GMO 21, p. 3.

<sup>368</sup> Staff Br., pp. 48-49.

<sup>369</sup> Staff Br., p. 50.

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substantially lower than competing bids, and it made economic sense to accept the bid even though the contractor was unable to obtain a performance bond.

289. Mr. Leonard Ruzicka, an expert in construction law, was retained by KCP&L to review documents and interview individuals as necessary to determine the appropriateness of the awarding of a contract to PMSI for the general construction work on the rebuild of the scrubber systems on the three units of the Jeffrey Energy Center coal-fired generating station. Mr. Ruzicka is a partner in the law firm of Stinson Morrison Hecker LLP and previously had 20 years experience as a Senior Vice President and General Counsel for Fru-Con Corporation, a large international company engaged in construction, engineering and real estate development.<sup>370</sup> He was also retained to review the testimony of Mr. Keith Majors and give his assessment of the opinions expressed by Mr. Majors in that testimony.

290. Mr. Ruzicka, conducted an independent review of the facts and circumstances surrounding this project. He concluded that Westar/GMO had acted appropriately and reasonably in its decision to award the general construction contract to PMSI.<sup>371</sup> Mr. Ruzicka also explained the reasons why it was appropriate to award the contract as Westar/GMO did, based upon the facts and circumstances that were known at the time. Much of the information was provided as confidential information, but the Commission finds that Mr. Ruzicka's review substantiates the prudence of Westar's decision to retain PMSI.

291. The record demonstrates that Westar performed reference checks on prior work performed by PMSI as well as obtained reports from Dun & Bradstreet.<sup>372</sup> In addition, Westar conducted an extensive evaluation of PMSI and was aware of the fact that it could not obtain a performance bond due to its financial condition.<sup>373</sup> However, given the substantial difference in the PMSI bid and the next lowest bid (which would have a bonding cost in addition to the bid), the Commission finds that it was reasonable and prudent for Westar to proceed with the acceptance of the PMSI bid without a performance bond.<sup>374</sup>

292. Staff also criticizes Westar for not applying the Federal Acquisition Regulations which Staff admits do not have any applicability

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<sup>370</sup> Ex. GMO 36, p. 1; Tr. 4271-72, 4341.

<sup>371</sup> Ex. GMO 36 (NP), pp. 2-5.

<sup>372</sup> Ex. GMO 230, p. 37.

<sup>373</sup> Ex. GMO 21 (HC), p. 3.

<sup>374</sup> Tr. 4356-47.

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to private industry.<sup>375</sup> In addition, Staff criticizes Mr. Ruzicka for not following “any auditing standards when reviewing the work related to PMSI, thus creating serious concerns to the value of his opinion testimony.”<sup>376</sup> The Commission finds that it takes more than “auditing” expertise to judge the prudence of construction project decisions. Mr. Ruzicka is an experienced construction law expert, and did not conduct an audit. Instead he reviewed the prudence of the decisions made by Westar, based upon extensive documentary evidence and interview with Westar personnel. Ultimately, he concluded that Westar and GMO were indeed prudent in their decision-making related to the Jeffrey Energy Center FGD Rebuild Project.<sup>377</sup> The Commission finds the testimony of Mr. Ruzicka to be persuasive.

293. Staff asserts that “Mr. Ruzicka testified that PMSI could easily have been replaced.”<sup>378</sup> However, on redirect examination, Mr. Ruzicka explained his answer and indicated that it would have been very costly to replace the contractor at that point in the project.<sup>379</sup> Also, as Mr. Ruzicka explained, there was no basis for asserting a claim for liquidated damages, and Staff’s criticism was incorrect.<sup>380</sup>

### **Conclusions of Law – Jeffrey FGD Rebuild Project**

32. The Federal Acquisition Regulations are not applicable to private industry.<sup>381</sup>

33. Based upon the competent and substantial evidence in the record, the Commission concludes that the JEC additions were prudent and should be included in rate base in this proceeding. The Commission concludes that Staff’s proposed disallowance is based upon hindsight, is unreasonable and not supported by competent and substantial evidence. The Commission will therefore reject Staff’s proposed prudence disallowance.

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<sup>375</sup> Staff Br. at 48-49.

<sup>376</sup> Staff Br. at 49; *citing* Tr. 4336.

<sup>377</sup> Ex. GMO 36 (NP), pp. 2-5.

<sup>378</sup> Staff Br. at 49.

<sup>379</sup> Tr. 4343.

<sup>380</sup> Tr. 4349-52; *See also* Tr. 4266; 4356-57).

<sup>381</sup> Ex. GMO 260, § 9.104-1.

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### **Decision – Jeffrey FGD Rebuild Project**

The Commission determines that the Jeffrey Energy Center additions were prudent and should be included in rate base in this proceeding. The Commission further determines that Staff's proposed prudence disallowance is rejected.

### **D. Demand-Side Management**

- a. Should DSM investments be included in rate base in this proceeding?***
- b. How should DSM amortization expense be determined in this case?***
  - i. Should DSM programs be expanded if the current DSM portfolio does not meet the Missouri Energy Efficiency Investment Act's (MEEIA) goal of achieving all cost-effective demand-side savings?***
  - ii. Should the amortization period for the energy efficiency regulatory asset account be shortened from 10 years to 6 years?***
  - iii. Should the shortening of the amortization period be contingent on the continuation and/or expansion of the DSM portfolio?***
- c. Should the Company be required to fund DSM programs at the current level?***
- d. Should KCP&L be required to make a compliance filing with the Commission regarding MEEIA legislation as proposed by Staff?***

### **Findings of Fact – Demand-Side Management**

294. In KCP&L's last Chapter 22 Electric Utility Resource Planning filing,<sup>382</sup> KCP&L's adopted preferred integrated resource plan (IRP) included five residential DSM programs and four commercial and industrial programs.<sup>383</sup>

295. These programs are in addition to KCP&L's Energy Optimizer and MPower programs that it implemented as part of its Experimental Regulatory Plan (ERP or "Regulatory Plan").<sup>384</sup>

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<sup>382</sup> File No. EE-2008-0034.

<sup>383</sup> Kansas City Power & Light Integrated Resource Plan, File No. EE-2008-0034, Book 1 of 2, Volume 5: Demand-Side Resource Analysis, pp. 54 through 69.

<sup>384</sup> See File No. EO-2005-0329; Ex. KCP&L 239, p. 6.

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296. As part of GMO's Chapter 22 compliance filing,<sup>385</sup> GMO's adopted preferred IRP included DSM programs.<sup>386</sup>

297. Demand Side Management (DSM) programs introduced in the early years of KCP&L's five-year regulatory plan are nearing their expiration dates.<sup>387</sup>

298. The timing of the conclusion of the regulatory plan and the anticipated implementation of the rules resulting from the Missouri Energy Efficiency Investment Act (MEEIA)<sup>388</sup> create a period of time in which KCP&L and GMO will not have guidance from the Commission with regard to appropriate DSM investment or energy savings targets.<sup>389</sup>

299. This gap could be relatively lengthy, possibly years.<sup>390</sup> The Company acknowledged the uncertainty of this gap.<sup>391</sup>

300. Many of the current DSM programs "have met or are exceeding their five-year savings goals" and in some cases "have met or exceeded their performance and participation goals."<sup>392</sup> KCP&L has "met and exceeded the expectations established in the Regulatory Plan. . . . [T]hrough June 30, 2010 the budget for all Company demand-side programs is \$24,001,009 and the actual total expenditures through this period are \$27,442,517 . . . ."<sup>393</sup>

301. DSM programs need time to raise customer awareness through promotional campaigns and develop partnerships with trade allies. If programs are curtailed, there would be a loss of experience developed by KCP&L and GMO over the past five years.<sup>394</sup>

302. "[A]ll of the evidence suggests that customer interest in these programs has increased since 2005, and there is no evidence to suggest that customers will become less interested in realizing the benefits that these programs offer."<sup>395</sup> For instance, participation in KCP&L's Home Performance with Energy Star program increased from

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<sup>385</sup> File No. EE-2009-0237.

<sup>386</sup> Ex. GMO 240, p. 14.

<sup>387</sup> Ex. KCP&L 603, Sch. AB2010-1R.

<sup>388</sup> Section 393.1075, RSMo.

<sup>389</sup> Ex. KCP&L 601, p. 2.

<sup>390</sup> Ex. KCP&L 601, p. 4; Ex. GMO 601, p. 4.

<sup>391</sup> Tr. 3542; Tr. 3539-3540.

<sup>392</sup> Ex. KCP&L 603, p. 5 and as shown on Mr. Bickford's highly confidential rebuttal schedule AB2010-2R, Ex. KCP&L 604 HC.

<sup>393</sup> Ex. KCP&L 210, p. 127. See *also*, Ex. KCP&L 56, p. 4.

<sup>394</sup> Ex. KCP&L 603, p. 6-7.

<sup>395</sup> Ex. KCP&L 603, p. 6.

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27 homes in the second quarter of 2009 to 718 homes at the end of the third quarter of 2010.

303. The Companies are currently continuing their DSM programs contained in their tariffs.<sup>396</sup>

304. During its Customer Programs Advisory Group (CPAG) meetings throughout 2010, KCP&L stated to Staff that it had stopped processing new customer applications for its voluntary large customer MPower demand response program.<sup>397</sup> During the similar DSM Advisory Group meetings held for GMO in 2010, GMO also made statements regarding the curtailing of current DSM programs and delaying implementation of planned DSM programs.<sup>398</sup> In those statements and at the hearing, both KCP&L and GMO expressed a position to slow spending for the programs.<sup>399</sup>

305. Both companies, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration. The companies acknowledge this fact.<sup>400</sup> And in the case of KCP&L, increasing DSM funding is preferred to curtailing program spending when evaluating the need for additional supply-side resources over the next 25 years.<sup>401</sup>

306. Under the existing cost recovery mechanism, KCP&L first funds the DSM programs and the costs are placed into a regulatory asset account for consideration of recovery in the next rate case. Assuming the DSM costs are determined to be recoverable, those costs are then amortized over a ten-year period without the inclusion in rate base.

307. KCP&L is willing to continue the Customer Program Advisory Group (CPAG) through the bridge periods and to extend CPAG or a similar collaborative to GMO through the same period.<sup>402</sup>

308. Staff recommends the Commission accept its ratemaking calculations for DSM deferrals and AFUDC returns in Staff Adjustments E-144.4 through E-144.7, and E-144.8 through E-144.11.<sup>403</sup> Staff's recommendations included annual amortizations (10-year deferral period) for the following DSM vintage deferrals:<sup>404</sup>

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<sup>396</sup> Ex. KCP&L 210, p. 126-30; Ex. KCP&L 239 at p. 2.

<sup>397</sup> Ex. KCP&L 239, p. 6.

<sup>398</sup> Ex. GMO 240, p. 12.

<sup>399</sup> Tr. 3539-3540; Tr. 3571.

<sup>400</sup> Ex. KCP&L 239, p. 6-7, Ex. GMO 240, p. 15.

<sup>401</sup> Ex. KCP&L 239, p. 7.

<sup>402</sup> Tr. 3543.

<sup>403</sup> Ex. KCP&L 225, as updated in true-up.

<sup>404</sup> Ex. KCP&L 225, as updated in true-up.



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DSM deferral	Case	Amount
Vintage 1	ER-2006-0314	\$239,666
Vintage 2	ER-2007-0291	\$448,624
Vintage 3	ER-2009-0089	\$193,663
Vintage 4	ER-2010-0355	<u>\$1,810,223</u>

309. Staff calculated the total unamortized balance of DSM Vintages 1 through 4 as \$24,368,761 as of December 31, 2010.<sup>405</sup> The AFUDC rate Staff applied to this unamortized DSM balance was 3.46%, and is KCP&L's December 2010 AFUDC rate.<sup>406</sup> Under Staff's calculations, the AFUDC return amount totals \$843,159, for a total increase in revenue requirement from DSM deferrals of approximately \$3.5 million.<sup>407</sup>

310. Staff recommends that the existing levels of DSM investments should be mandated by the Commission to continue and the existing cost recovery mechanism should be maintained.<sup>408</sup>

311. In its adjustments Staff nets unrelated issues with DSM program costs.<sup>409</sup> Staff includes negative costs against the unamortized balance of DSM program costs for purposes of computing an annual amortization and return. These negative costs are those that the Commission has previously ordered to be returned to ratepayers over ten years and include excess margins on off-system sales ("OSS") and net reparations from the litigation of Montrose coal freight rates before the Surface Transportation Board ("STB"), but are unrelated to DSM Program costs.

312. The Commission ordered in prior cases that the carrying costs for the excess margins on OSS would be established at LIBOR plus 32 basis points and that this interest would be included in the unamortized balance of excess OSS margins for amortization over ten (10) years. The Commission also prohibited rate base recognition for the unamortized balance of net reparations from the litigation of Montrose coal freight rates before the STB and did not otherwise order carrying costs.

313. Staff could set up and keep track of these separate cost items, but believed this would be cumbersome and inefficient.<sup>410</sup>

<sup>405</sup> Ex. KCP&L 225, as updated in true-up.

<sup>406</sup> Ex. KCP&L 225, as updated in true-up.

<sup>407</sup> Ex. KCP&L 225, as updated in true-up.

<sup>408</sup> Ex. KCP&L 210, pp. 126-30; Ex. KCP&L 239, p. 2.

<sup>409</sup> Ex. KCP&L 210, pp. 131-37; Ex. KCP&L 226, p. 63.

<sup>410</sup> Ex. KCP&L 226, p. 63.

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314. Staff also recommends continuing the ten-year amortization for DSM expenses incurred after the end of the regulatory plan.

315. To apply a ten-year amortization to DSM expenses incurred after the end of the regulatory plan for KCP&L and after the test year in GMO's rate case would be a disincentive to KCP&L and GMO to invest in demand side programs.<sup>411</sup>

316. A temporary adjustment from 10 years to 6 years amortization for new and ongoing DSM expenses incurred during the "gap period" until MEEIA rules are fully implemented would reduce the disincentive.<sup>412</sup>

317. An adjustment from 10 years to 6 years amortization for new and ongoing DSM expenditures would also make the Companies' cost recovery opportunities more consistent with Ameren Missouri's DSM program cost recovery agreed to by the parties and approved by the Commission in File No. ER-2010-0036.<sup>413</sup>

318. Netting the DSM regulatory asset account amortization with three unrelated accounts is complex and confusing and causes an inaccurate result.<sup>414</sup>

319. Staff's netting calculation may put DSM cost recovery at risk or it may cause the perception of putting DSM cost recovery at risk. Either of those effects could be a disincentive to future DSM spending by utilities.<sup>415</sup>

320. KCP&L recommends that DSM expenses referred to as "Vintage 4," be amortized for six years rather than for ten years.<sup>416</sup>

321. Neither KCP&L nor GMO has recommended in any substantial detail in these rate proceedings what they consider to be an appropriate cost recovery mechanism.<sup>417</sup> In fact, in their direct filings both KCP&L and GMO only requested the continuation of their current cost recovery mechanisms.<sup>418</sup> In their brief, however, they state that for the purposes of this case, KCP&L has proposed that the cost recovery mechanism should be consistent with the recent *Order*

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<sup>411</sup> Ex. KCP&L 55, p. 5-6; Ex. KCP&L 605, pp. 4-5.

<sup>412</sup> Ex. KCP&L 55, pp. 5-6; Ex. KCP&L 605, p. 4-5.

<sup>413</sup> Ex. GMO 601, p. 10.

<sup>414</sup> Ex. KCP&L 64 p. 6-18.

<sup>415</sup> Ex. KCP&L 55, pp. 5-6; Ex. KCP&L 605, pp. 4-5.

<sup>416</sup> Ex. KCP&L 55, pp. 5-6; Initial Brief at pp. 192-193.

<sup>417</sup> Ex. KCP&L 239, p. 5, Ex. GMO 240, pp. 13-14, Ex. GMO 241, p. 3. Ex. KCP&L 240, p.

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<sup>418</sup> Ex. KCP&L 239, p. 5, Ex. GMO 240, pp. 13-14.

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*Approving First Stipulation and Agreement* in the AmerenUE rate case, File No. ER-2010-0036 (March 24, 2010).<sup>419</sup> This would change KCP&L's amortization period for the DSM regulatory assets from ten years to six years, and include the unamortized balance in rate base for actual expenditures booked to the DSM regulatory asset up through the period of December 31, 2010.<sup>420</sup> The six year amortization period would be applied to DSM program expenditures referred to by Staff as being incurred in "Vintage 4," that is, those subsequent to September 30, 2008. Prior expenditures would continue to be amortized over the originally authorized ten-year period. Additionally, KCP&L would defer the costs of the DSM programs in Account 182 and, beginning with the December 31, 2010 True Up date in this case, calculate AFUDC monthly using the monthly value of the annual AFUDC rate.<sup>421</sup>

322. Mr. Rush acknowledged that KCP&L and GMO may propose a different method of recovery regardless of whether specific Commission rules are in place or not.<sup>422</sup> He also acknowledged the companies' obligation to comply with MEEIA regardless of whether rules are in place.<sup>423</sup>

323. MDNR's position is that the Commission should direct KCP&L and GMO to follow the intent of the MEEIA goal of achieving all cost-effective demand-side savings, and should further require KCP&L and GMO to expand their DSM programs toward the MEEIA goal of achieving all cost-effective demand-side savings during the "gap" period between the end of these current rate cases and the establishment of the MEEIA rules. The Commission needs to provide guidance with regard to appropriate DSM investment or energy savings targets, continuation and expansion of existing programs.<sup>424</sup>

324. It is unnecessary for the Commission to require KCP&L and GMO to make a filing with the Commission regarding MEEIA legislation as proposed by the Staff.<sup>425</sup>

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<sup>419</sup> Tr. 3531-32.

<sup>420</sup> Tr. 3501-03.

<sup>421</sup> Ex. KCP&L 55, pp. 5-6.

<sup>422</sup> Tr. 3547.

<sup>423</sup> Tr. 3546-7.

<sup>424</sup> Ex. KCP&L 210, p. 127; Ex KCP&L 602, p. 3.

<sup>425</sup> Ex. KCP&L 56, p. 3.

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### **Conclusions of Law – Demand-Side Management**

34. Utilities within the Commission’s jurisdiction must comply with The Missouri Energy Efficiency Investment Act (“MEEIA”)<sup>426</sup> regardless of whether or not proposed rules under the law are effective. The language of MEEIA allows KCP&L and GMO to propose a different method of recovery regardless of whether specific Commission rules are in place or not.

35. MEEIA states, “The Commission shall permit electric corporations to implement commission-approved demand-side programs proposed pursuant to this section with a goal of achieving all cost-effective demand-side savings.”<sup>427</sup> However, the timing of the conclusion of these rate cases and the anticipated implementation of the rules resulting from MEEIA creates a period of time in which KCP&L and GMO will not have guidance from the Commission with regard to appropriate DSM investment or energy savings targets.

36. Amortizing DSM expenses referred to as “Vintage 4,” for six years rather than for ten years is inconsistent with the KCP&L regulatory plan. To the extent that costs included in Vintage 4 were incurred as early as September 30, 2008, the regulatory plan would apply to the recovery of Vintage 4 costs.

37. The Commission ordered in prior cases that the carrying costs for the excess margins on OSS would be established at LIBOR plus 32 basis points and that this interest would be included in the unamortized balance of excess OSS margins for amortization over ten years. The Commission also prohibited rate base recognition for the unamortized balance of net reparations from the litigation of Montrose coal freight rates before the STB and did not otherwise order carrying costs. Staff’s netting of DSM costs with unrelated items is inconsistent with the Commission’s previous orders.<sup>428</sup>

### **Decision – Demand-Side Management**

The parties did a poor job of defining the issues for this case, but especially with regard to the DSM issues. The Commission, however, has redefined those issues. The over-arching DSM issue is whether the

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<sup>426</sup> Section 393.1075, RSMo.

<sup>427</sup> Section 393.1075.4, RSMo.

<sup>428</sup> *Non-Unanimous Stipulation and Agreement*, p. 8, File No. ER-2010-0089; *In the Matter of the Application of Kansas City Power and Light Company for Approval to Make Certain Changes in its Charges for Electric Service to Implement Its Regulatory Plan*, File No. ER-2007-0291, *Report and Order* (issued December 6, 2007), p. 39.

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Commission should order the continuance of a DSM program at all. Because of the gap between the MEEIA rules being implemented and the end of the Regulatory Plan, there is a need for the Commission to set out guidance for KCP&L and GMO with regard to the continuance or implementation of DSM programs and cost recovery for those programs. Despite the success and forward momentum created by the implementation of their existing DSM programs and the fact that the programs are currently continuing, both KCP&L and GMO have expressed a position to slow spending for the programs. This decision comes even though both companies realize that they, as well as the ratepayers, stand to benefit from continuing efforts to achieve more DSM programs and improved DSM penetration.

The Companies have argued that the Commission should reject Staff's and MDNR's recommendations to direct the Companies to invest in DSM programs without any assurance that the full costs and lost revenues associated with these programs will be recognized in rates. Instead, the Companies urge the Commission to implement the cost recovery issue expeditiously, including the recovery of lost revenues associated with the specific DSM programs. While the Companies express a need to have an appropriate cost recovery mechanism, they did not recommend a new recovery mechanism in this case except to propose in their briefs that the mechanism be consistent with that recently ordered for Ameren.

The Commission concludes that the continuance of the DSM programs is in the public interest as shown by the customer participation and clear policies of this state to encourage DSM programs. In the absence of a clear proposal for a cost recovery mechanism and during the gap between the end of the true-up for this case and the implementation of a program under MEEIA, the Commission concludes that the Companies should continue to fund and promote or implement, the DSM programs in the 2005 Agreement (KCP&L only), and in its last adopted preferred resource plan (both KCP&L and GMO). In addition, the Commission directs that those costs be placed in a regulatory asset account and be given the treatment as further described below.

Having determined that the programs should continue, the remaining issues are related to the regulatory treatment to be given to cost recovery and the three different types of regulatory assets. First are the "old" investments -- those DSM investments incurred prior to the last rate case true-up period ending September 30, 2008 (Vintages 1-3). Second, are the "current" investments referred to as "Vintage 4" -- those

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DSM investments since September 30, 2008, and through the end of the true-up period for this case, December 31, 2010. Third, are the “future” investments -- those DSM investments from December 31, 2010, through the next rate case or until a program is implemented under the MEEIA rules.<sup>429</sup>

The issues common to these regulatory assets are the length of the amortization period to be given them and how that amortization should be calculated. In other words, should those assets be amortized over a six- or a ten-year period, and should Staff’s netting calculation be used to determine the amounts to be amortized. The final issue is should the unamortized balances be added to rate base.

It appears after all the arguments, that there are actually some areas of agreement among and between some of the primary parties. One area of agreement is that the “old” regulatory assets (Vintages 1, 2, and 3) should be governed by the previous decisions to amortize those regulatory asset accounts over a ten-year period and that amortization period should not change. The Commission also agrees and directs that Vintages 1, 2, and 3 continue to be amortized over a ten-year period.

A second area of agreement is that the CPAG should be continued after the end of the regulatory plan and the GMOAG continue for GMO. The Commission also agrees and directs that the advisory groups (or similar groups) shall continue through the “bridge” period until replaced by the implementation of the MEEIA rules or other Commission order.

A third agreement is between KCP&L and GMO and MDNR. Those parties agree that Staff’s netting calculation is confusing because it mixes assets unrelated to DSM with DSM assets. In addition, as KCP&L and GMO point out, it causes the calculations to be incorrect because those OSS and STB amounts require different carrying costs calculations as previously ordered by the Commission. Thus, the Commission determines that the DSM account should stand alone and not be netted against unrelated accounts. In addition, the carrying costs should be calculated at the AFUDC rate as set out in the regulatory plan.

The main disagreements among the parties lie with the amortization period for the “current” and “future” investments and whether the unamortized balances should be included in rate base. MDNR supports a temporary adjustment from ten years to six years for the “future” investments amortization period with a carrying cost equal to

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<sup>429</sup> Or some other unknown legislative or Commission intervention.

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the AFUDC rate applied to the unamortized balance until KCP&L and GMO have DSM plans and recovery methods in place under MEEIA rules. This would reduce the disincentive for the companies to have these programs and allow the companies to recover their DSM program costs in a timeframe closer to when they occurred. This also makes the treatment of these future costs similar to those of Ameren Missouri in ER-2010-0036.

KCP&L agrees with MDNR regarding the treatment for “future” investments. The Commission agrees as well and will direct that DSM program costs for investments made from December 31, 2010, until a future recovery mechanism is in place shall be placed in a regulatory asset account and amortized over six years with a carrying cost equal to the AFUDC rate applied to the unamortized balance.

With regard to the “current” investments, it would be inconsistent with previous Commission orders to authorize a six-year amortization for the current investments (Vintage 4). The Commission determines that these Vintage 4 investments should continue to be amortized over a ten-year period.

Finally, the Commission must decide whether to include the unamortized balances in rate base. The Commission has determined that it is important to reduce the disincentives to the Companies to having robust DSM programs. The Companies have clearly indicated that delayed recovery is one of those disincentives. By adding the unamortized balances to rate base the Commission will encourage DSM programs and promote the policy of this state as stated in MEEIA. Thus, the Commission determines that the unamortized balances of the regulatory asset accounts shall be included in rate base for determining rates in this case.

### **E. Fuel Switching Program**

***Should the Commission adopt MGE’s fuel switching proposal?***

### **Findings of Fact – Fuel Switching Program**

325. Missouri Gas Energy, a division of Southern Union Company, has proposed to compel KCP&L and GMO, competitors of MGE, to provide incentives to the Companies’ customers to decrease their electric usage and convert that consumption to its product—natural

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gas. MGE's proposal is based on its allegation that natural gas would be more energy efficient.<sup>430</sup>

326. Under the proposed program, KCP&L, GMO, and MGE would offer financial incentives with the aim of converting inefficient electric appliances with fuel-efficient natural gas replacements. KCP&L and GMO would offer financial incentives in the form of rebates or bill credits to residential and multi-family customers to encourage fuel switching from electric water heaters and electric resistance space heating to natural gas.<sup>431</sup> The fuel switching program would be available to current MGE customers as well as customers in MGE's service area who currently do not have natural gas service.<sup>432</sup> In turn, MGE would continue to offer financial incentives to customers for the purchase of energy efficient natural gas appliances through its existing energy efficiency programs. The KCP&L and GMO rebates would serve to defray some of the cost of installing interior piping and ventilation ductwork and other installation costs of new appliances.<sup>433</sup>

327. MGE estimates that 800 customers may participate for GMO<sup>434</sup> and 400 customers may participate from the KCP&L service territory.<sup>435</sup> GMO's total annual program spending for this fuel switching program is estimated at \$596,000 and MGE's spending is estimated at \$51,200 for energy efficiency appliance incentives plus the cost to install 800 service lines (approximately \$1,416,000).<sup>436</sup> KCP&L's program spending for this fuel switching program is estimated at \$298,000 and MGE's spending is estimated at \$25,600 for energy efficient appliance incentives plus the cost to install 400 service lines (approximately \$708,000).<sup>437</sup>

328. MGE gives examples of economic savings for customers switching from electric to natural gas. According to MGE's evidence, a consumer switching from electricity to natural gas would save

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<sup>430</sup> Ex. KCP&L 220, Reed Direct Testimony at p. 2.

<sup>431</sup> Ex. GMO 2201, pp. 21-22 and Ex. KCP&L 2201, p. 22. As noted in MGE's testimony, if a customer does not have gas service and does not have a natural gas line to their home, MGE's currently effective tariff provisions regarding facilities extensions would be used. Under this tariff, customer contributions may be required if the extension exceeds 60 linear feet. See Ex. KCP&L 2201 and Ex. GMO 2201, pp. 22-23.

<sup>432</sup> Ex. KCP&L 2201 and Ex. GMO 2201, pp. 22-23.

<sup>433</sup> See Ex. KCP&L 2201, pp. 23-24 and Ex. GMO 2201, p. 23.

<sup>434</sup> See Ex. GMO 2201, p. 27.

<sup>435</sup> See Ex. KCP&L 2201, p. 27.

<sup>436</sup> See Ex. GMO 2201, pp. 27-28.

<sup>437</sup> See Ex. KCP&L 2201, pp. 27-28.



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approximately \$606 (GMO) and \$536 (KCP&L) for space heating and up to \$200 (GMO)<sup>438</sup> and \$172 (KCP&L)<sup>439</sup> per year for water heating.

329. MGE's proposal is built on the full fuel cycle or source energy model.<sup>440</sup>

330. Traditionally, appliance efficiency measurements have been "site based," in that they only consider the energy efficiency at the site where the energy is consumed.<sup>441</sup> In contrast, the full fuel cycle approach measures energy consumption over the entire cycle of energy use from extraction or production to transmission, distribution, and finally at the site where the energy is used, such as an appliance.<sup>442</sup> The full-fuel cycle approach considers all of the energy consumed to power the end use application including greenhouse gas emissions.<sup>443</sup>

331. MGE bases its proposal in part on a report from the National Research Council ("NRC") in response to a request from the Department of Energy ("DOE"), Office of Energy Efficiency and Renewable Energy ("EERE") to review the DOE's appliance standard program.<sup>444</sup>

332. The DOE is considering whether to adopt the Full-Fuel Cycle approach as an alternative method for measuring energy consumption.<sup>445</sup> The context of the DOE's inquiry is whether to use the Full-Fuel Cycle approach<sup>446</sup> in measuring energy consumption for inclusion on the yellow Energy Guide labels found on home appliances, or whether to continue using the site-based approach.<sup>447</sup> A pending recommendation to the DOE is that the full fuel cycle approach be

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<sup>438</sup> Ex. GMO 2201, p. 12.

<sup>439</sup> Ex. KCP&L 2203, p. 23. As noted in Mr. Reed's surrebuttal testimony, there was a calculation error in his direct testimony that was corrected in his surrebuttal testimony. Replacement schedules were also filed in his surrebuttal testimony.

<sup>440</sup> Ex. KCP&L 220, pp. 4-11; Tr. 3101-02.

<sup>441</sup> Ex. KCP&L/GMO 2201, p. 5, quoting "A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances," American Gas Association Energy Analysis, EA 2009-3, Oct. 20, 2009.

<sup>442</sup> See Ex. KCP&L/GMO. 2201, pp. 5-6; Tr. 3104.

<sup>443</sup> *Id.* at p. 6.

<sup>444</sup> Ex. KCP&L 2201, p. 5; Tr. 3101-02.

<sup>445</sup> Ex. KCP&L 2201, p. 5.

<sup>446</sup> The full fuel cycle approach is a method of measuring energy consumption not just at the point of use in the home but also the upstream consumption, including production, generation and transmission and delivery of the appliance. Reed Direct at 5-6; Tr. 3104.

<sup>447</sup> Ex. KCP&L 2209.

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adopted nationally to provide more comprehensive information to consumers through labels and other means.<sup>448</sup>

333. In appointing a committee to conduct the review of appliance standards, the NRC stated the “committee will not address whether energy conservation standards are appropriate government policy or what levels may or may not be appropriate.”<sup>449</sup> Rather, the committee’s task was “to evaluate or critique the methodology used for setting energy conservation standards” on appliance and commercial equipment.<sup>450</sup> Further, the committee was not unanimous in its recommendation.<sup>451</sup>

334. All traditional, customer-centric measurement of appliance efficiency show electric appliances are consistently more efficient than a similar gas alternative.<sup>452</sup> The Full-Fuel-Cycle model, however, loads the cost of operation for electrical appliances with the cost of upstream losses. Only then do the gas appliances surpass electric appliances.

335. Committee Member Ellen Berman indicated that switching from a site-based approach to appliance standards to the Full-Fuel Cycle approach is complex and will not benefit consumers, in part because consumers have no control over the upstream costs included in the Full-Fuel Cycle methodology.<sup>453</sup>

336. A primary tenet of the Full-Fuel Cycle is environmental impact.

337. MGE’s testimony is silent with respect to the release of methane, a potent greenhouse gas, caused by the extraction of natural gas.<sup>454</sup> In addition, hydraulic fracturing of shale formations, the primary method currently used to procure new sources of natural gas, has been linked to environmental and health concerns, but has not been thoroughly examined in the course of this proceeding.<sup>455</sup>

338. Fuel switching programs have been adopted by other state’s public utility commissions for both combination electric and

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<sup>448</sup> See Ex. KCP&L 2201 and Ex. GMO 2201 pp. 6-7, citing “Review of Site (Point of Use) and Full-Fuel Cycle Measurement Approaches to DOE/EERE Building Appliance Energy Efficiency Standards,” National Research Council, May 15, 2009, p. 10.

<sup>449</sup> Ex. KCP&L 2209, p. 16.

<sup>450</sup> Ex. KCP&L 2209, p. 16.

<sup>451</sup> Ex. KCP&L 2209, .

<sup>452</sup> Ex. KCP&L 220, p. 10, Table 1.

<sup>453</sup> Ex. KCP&L 2209, Review of Site & Full-Cycle Measurement at 39-40.

<sup>454</sup> Tr. 3130.

<sup>455</sup> Ex. KCP&L 26, pp. 10-12; Tr. 3152.

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natural gas utilities as well as stand-alone electric companies across the country.<sup>456</sup>

339. MGE uses several companies with fuel switching programs as examples to support its position. These “comparable” companies, however, differ from both KCP&L and GMO. For instance, where KCP&L and GMO are electric service providers only, the “comparable” companies include diversified companies (electricity, natural gas, pipelines and energy marketing), or combined companies (provider of both electric and natural gas services).<sup>457</sup> Additionally, both KCP&L and GMO are strong summer peaking utilities, while at least two of MGE’s “comparable” companies are winter peaking utilities.<sup>458</sup>

340. Evidence was presented regarding the carbon dioxide emissions of natural gas residences verses an all-electric home and those emissions for natural gas appliances.<sup>459</sup> However, there was not sufficient evidence for the Commission to make a determination about the environmental effects of natural gas verses electric appliances for KCP&L and GMO customers.

341. MGE cites to Energy Star Performance Rating Methodology for Incorporating Source Energy Use (December 2007).<sup>460</sup> This report, among other things, calculates the source-site ratio for various types of energy. Table 1 on page 3 of the report shows that fuel oil (diesel, kerosene), propane and even wood have similar values to natural gas.

342. The Energy Star Performance Methodology for Incorporating Source Energy Use also discusses the “potential for inefficiency in the conversion of primary fuels” and the “potential for loss when either primary or secondary fuels are transmitted/distributed to individual sites.”<sup>461</sup>

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<sup>456</sup> Fuel switching programs have been approved in Washington, Oregon, Texas, Idaho, and Pennsylvania, among other states. See Ex. KCP&L/GMO 2201, p. 20; Ex. KCP&L/GMO 2206.

<sup>457</sup> Ex. KCP&L 239, pp. 10-11; Ex. GMO 240, pp. 19-21.

<sup>458</sup> Ex. KCP&L 239, pp. 10-11; Ex. GMO 240, pp. 19-21.

<sup>459</sup> See KCP&L Ex. 2201 and Ex. GMO 2201 at p. 12, *citing* “A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances,” American Gas Association, Energy Analysis, EA 2009-3, October 20, 2009, p. 4, *citing to* p. 11 the AGA report cited in FN 22. CO2 emissions were 6.4 metric tons for natural gas appliances and 10.1 metric tons for electric appliances.

<sup>460</sup> Ex. KCP&L 2201, p. 8, fn. 6.

<sup>461</sup> Ex. KCP&L 2201, p. 2.

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343. MGE included its own tables which show comparisons of electric and natural gas consumption under the Full-Fuel Cycle, whereby natural gas appears to be the more attractive fuel choice.<sup>462</sup> The data used by MGE, however, is not specific to KCP&L, and MGE has not demonstrated that the general data it received from the American Gas Association (“AGA”) is applicable to KCP&L.<sup>463</sup> The footnotes which accompany MGE’s tables state that the data is from a document entitled “A Comparison of Energy Use, Operating Costs, and Carbon Dioxide Emissions of Home Appliances” prepared by the AGA.<sup>464</sup> This document indicates that the AGA’s information was developed, in turn, by the Gas Technology Institute for Codes & Standards Research Consortium in a paper entitled “Source Energy and Emission Factors for Building Energy Consumption” (August 2009).<sup>465</sup> The original source of the information relied upon by MGE includes the following statement:

Average energy and emissions calculations may be appropriate for inventory purposes, but they do not necessarily provide good information when evaluating competing energy efficiency measures.<sup>466</sup>

344. In Table 3 MGE demonstrates the estimated annual cost savings when using water heating and space heating gas and electric appliances.<sup>467</sup> MGE’s calculations, however, contain errors. Specifically, the prices used by MGE are not measured in the same units as the consumption. “[T]he consumption is measured in MMBtu, but the price is stated in terms of Dollars per hundred kWh.”<sup>468</sup> Correcting for errors shows customers who switch from electricity to natural gas for their water heating needs alone will experience no savings. Rather, their annual bill will increase by over \$200 per year.<sup>469</sup>

345. MGE did not provide the results of any Total Resource Cost (“TRC”) test for its proposed water heating and space heating fuel substitution program. The Commission has routinely employed the TRC test in its economic analysis of potential energy efficiency measures.<sup>470</sup>

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<sup>462</sup> Ex. KCP&L 2201, pp. 10-11.

<sup>463</sup> See Ex. KCP&L 26, p. 20.

<sup>464</sup> See Ex. KCP&L 26, p. 20.

<sup>465</sup> See Ex. KCP&L 26, p. 20.

<sup>466</sup> See Ex. KCP&L 26, p. 20-21.

<sup>467</sup> Ex. KCP&L 2201, p. 13.

<sup>468</sup> Ex. KCP&L 26, p. 22.

<sup>469</sup> Ex. KCP&L 26, p. 24.

<sup>470</sup> Ex. KCP&L 2201, p. 39.

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346. For MGE's proposal to be considered a viable energy efficiency measure, the results of the benefit-cost tests would have to be evaluated. KCP&L's witness Goble estimated the required data in order to provide a rough analysis. Mr. Goble's analysis showed that "[t]he costs exceed the benefits in absolute as well as on a present worth basis. . . . [T]he Benefit-Cost ratio is . . . 0.5."<sup>471</sup> Mr. Goble acknowledged that not all water heater fuel substitution programs are unacceptable. However, even with limited data available for his analysis, Mr. Goble concluded "that it would be imprudent to implement the hastily designed electric to gas water heater substitution program recommended by MGE's witness . . . on the basis of economics."<sup>472</sup>

347. Mr. Goble also conducted a Ratepayer Impact Measure ("RIM") test and a Total Participant test. The results of the RIM test indicated that the costs exceed the benefits in every year as well as on a present worth basis, suggesting that implementation of MGE's proposed water heater fuel substitution program will result in higher rates for KCP&L's customers.<sup>473</sup> Similarly, customers' costs would exceed the benefits in every year as well as on a present worth basis under the Total Participant test. "Even using very favorable assumptions, the Benefit-Cost ratio is only 0.6."<sup>474</sup>

348. KCP&L also performed an analysis of MGE's proposed space heating electric to natural gas fuel substitution program. In general, the results of the TRC test for space heating were comparable to the results for water heating.<sup>475</sup> The results of the RIM and Total Participant tests revealed costs slightly in excess of the benefits.<sup>476</sup>

349. Like other DSM programs, a fuel switching program has the potential to assist with reducing or deferring KCP&L's and GMO's capital investments in transmission and generation capacity.<sup>477</sup> MGE, however, has neither evaluated its proposed fuel switching program through a Chapter 22 integrated resource analysis, nor performed any analysis of the cost effectiveness of the proposed fuel switching program for KCP&L or GMO.

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<sup>471</sup> Ex. KCP&L 26, p. 26.

<sup>472</sup> Ex. KCP&L 26, p. 26.

<sup>473</sup> Ex. KCP&L 26, p. 26-27.

<sup>474</sup> Ex. KCP&L 26, p. 27.

<sup>475</sup> Ex. KCP&L 26, p. 27.

<sup>476</sup> Ex. KCP&L 26, p. 27.

<sup>477</sup> *Id.* at p. 30-31, which describes this and other benefits of the proposed program to KCP&L/GMO.

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### **Conclusions of Law – Fuel Switching Program**

38. Demand-side programs are required to undergo scrutiny and review within a 4 CSR 240-22 (Chapter 22) Electric Utility Resource Planning integration analysis. Evaluation of demand-side resources in Missouri must be in compliance with the Commission's Chapter 22 Electric Utility Resource Planning rules. Such rules evaluate all supply-side and demand-side resources on an equivalent basis through comprehensive resource analysis, integration analysis, risk analysis and strategy selection. The electric utility uses the Total Resource Cost (TRC) test only in the screening of DSM measures and DSM programs. The electric utility then forwards on the demand-side programs that pass the TRC screening test for consideration as demand-side resources in the utility's Chapter 22 integrated resource analysis.

### **Decision – Fuel Switching Program**

MGE asserts that the Commission should accept the DOE recommendation of the Full-Fuel Cycle to shape the policy of this Commission.<sup>478</sup> KCP&L and GMO contend that the Full-Fuel Cycle model is misleading to the customer and does not reflect any policy guidance. Staff is opposed to the fuel-switching proposal because MGE fails to address two important points: (1) requiring the involuntary adoption of a demand-side program by KCP&L and GMO as proposed by a competitor; and (2) KCP&L and GMO's adoption of demand-side programs that have not been analyzed and reviewed through the Chapter 22 Integrated Resource Planning integration analysis. The Commission is in agreement with Staff.

MGE points to several companies with such fuel switching programs to support its position. These companies, however, differ drastically from both KCP&L and GMO. The Commission finds those differences irreconcilable in that KCP&L and GMO provided electric service only, while MGE's comparables include diversified companies (electricity, natural gas, pipelines and energy marketing) or combined companies (provider of both electric and natural gas services).<sup>479</sup> Additionally, both KCP&L and GMO are strong summer peaking utilities, while at least two of MGE's comparable companies are winter peaking utilities.<sup>480</sup>

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<sup>478</sup> Ex. KCP&L 220, p. 5; Tr. 3101-02; MGE's Initial Brief at 3.

<sup>479</sup> Ex. KCP&L 239, pp. 10-11; Ex. GMO 240, pp. 19-21.

<sup>480</sup> Ex. KCP&L 239, pp. 10-11; Ex. GMO 240, pp. 19-21.

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These differences are significant. The fuel switching programs for these comparable companies would result in money moving from “one pocket to the other” within the utility. But, MGE’s proposed fuel switching program results in money moving from KCP&L’s and GMO’s pockets to the pocket of MGE, its competitor. MGE has pointed to no market failure or other evidence that persuades the Commission to take such action.

Furthermore, the Commission determines that there is a need for company demand-side programs to undergo scrutiny and review within a Chapter 22 Electric Utility Resource Planning integration analysis. Such rules evaluate all supply-side and demand-side resources on an equivalent basis through comprehensive resource analysis, integration analysis, risk analysis, and strategy selection. MGE has neither evaluated its proposed fuel switching program through a Chapter 22 integrated resource analysis, nor performed any analysis of the cost effectiveness of the proposed fuel switching program specifically related to KCP&L or GMO.

In addition, MGE’s data with regard to which appliances are most energy efficient relied on studies and reports that have not been shown to be directly related to KCP&L and GMO’s customers, contain calculation errors, or are not reliable for the purposes intended by MGE. The Commission was persuaded by Mr. Goble’s analysis for the efficiency, or lack thereof for the proposal. Thus, the Commission gives little weight to the reports and recommendations relied on by MGE in this proceeding.

Finally, as KCP&L points out, the DOE recommendation is not yet final and the environmental issues associated with this fuel switching proposal have not been completely examined in this proceeding. MGE is silent on at least two major environmental concerns with natural gas – the release of methane and hydraulic fracturing. The Commission does not have sufficient evidence in this record regarding the environmental effects to determine in this case that natural gas is less harmful to the environment.

There may be some advantages to fuel switching in the appropriate situations and the Commission, by this order, is not indicating that it will not consider such proposals in the future. The Commission, however, does not find this proposal by KCP&L’s and GMO’s competitor within those utilities’ rate cases to be one of those situations. The Commission concludes it is not in the best interests of Missouri ratepayers to adopt the fuel switching program based on the

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findings and conclusions above. Therefore, the Commission will not require the fuel switching program as proposed by MGE.

### **II. Rate of Return**

Having determined what should be included in rate base, the Commission will now decide what rate of return should be included in rates to compensate GPE's shareholders and creditors.

#### **A. Return on Equity**

***What return on common equity should be used for determining KCP&L's rate of return?***

#### **Findings of Fact – Return on Equity**

350. A utility's cost of common equity is the return investors require on an investment in that company. Investors expect to achieve their return by receiving dividends and stock price appreciation. Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow ("DCF") method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows.<sup>481</sup>

351. The Risk Premium method assumes that all of the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds.<sup>482</sup>

352. The Capital Asset Pricing Method ("CAPM") assumes the investor's required rate of return on equity is equal to a risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio.<sup>483</sup>

353. Three financial analysts offered recommendations regarding an appropriate return on equity in this case.

#### **KCP&L Witness Hadaway**

354. Dr. Hadaway recommends an ROE of 10.75%. His range of ROE recommendations is from 10.2% to 10.8%, with a midpoint of 10.5%. However, he also adds 25 basis points to his ROE

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<sup>481</sup> Ex. KCP&L 1203, pp. 13-14.

<sup>482</sup> Ex. KCP&L 27, p. 14.

<sup>483</sup> Ex. KCP&L 1203, p. 32.



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recommendation based on what he considers to be KCP&L's excellent customer service, to arrive at 10.75%.<sup>484</sup>

355. He began by constructing a proxy group of 31 companies.<sup>485</sup> Those companies were at least BBB (investment grade), get at least 70% of revenues from regulated utility sales, have consistent financial records unaffected by recent mergers or restructuring, and a consistent dividend record with no cuts the past two years.<sup>486</sup>

356. Dr. Hadaway testified that the techniques for estimating ROE fall into three categories: comparable earnings methods, risk premium methods, and Discounted Cash Flow ("DCF") methods.<sup>487</sup> The DCF is the most widely used regulatory ROE method.<sup>488</sup>

357. The DCF concept is based on the theory that stock prices represent the present value or discounted value of all future dividends investors expect.<sup>489</sup> The DCF is simply the sum of the expected dividend yield and the expected long-term dividend (or price) growth rate.<sup>490</sup>

358. Dr. Hadaway applied three DCF versions to his proxy group. First, he applied a constant growth method. Second, he used a non-constant method, using estimated long-term GDP for estimated growth. Third, he employed a two-stage growth method, with stage one based on ValueLine's 3-5 year dividend projections, and stage two based on long-term projected growth in GDP.<sup>491</sup>

359. Dr. Hadaway's DCF results with the traditional constant growth model were a range of 10.5-10.7%. With the GDP growth rate, his constant growth model showed an ROE of 11%. His Multistage DCF yielded a 10.8% result. The overall results of his DCF show a range of 10.5-11%.<sup>492</sup> These results are in line with Dr. Hadaway's risk premium ROE range of 10.61-10.82%.<sup>493</sup>

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<sup>484</sup> Ex. KCP&L 28, pp. 2, 22.

<sup>485</sup> Ex. KCP&L 27, p. 6.

<sup>486</sup> *Id.* at 4.

<sup>487</sup> *Id.* at 13.

<sup>488</sup> *Id.* at 15.

<sup>489</sup> *Id.* at 16.

<sup>490</sup> *Id.* at 15.

<sup>491</sup> *Id.* at 39.

<sup>492</sup> *Id.* at 42.

<sup>493</sup> *Id.* at 43.

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MEUA, MIEC and DOE Witness Gorman

360. Mr. Gorman suggests that 9.65% is the appropriate ROE.<sup>494</sup> He bases his recommendation on using a constant grown DCF, a sustainable growth DCF, a multi-stage growth DCF, risk premium, and Capital Asset Pricing Model (“CAPM”).<sup>495</sup>

361. Mr. Gorman applied those five ROE methods to the same proxy group Dr. Hadaway used.<sup>496</sup> Mr. Gorman posits that because the proxy group’s senior secured credit rating from Moody’s is “A3”, which is identical to KCP&L’s senior secured credit rating, the proxy group has a comparable total investment risk to KCP&L.<sup>497</sup>

362. Mr. Gorman stated that the average and median growth rates for constant growth DCF are 5.68 and 5.41%, respectively.<sup>498</sup> Further, the average and median constant growth DCF ROE’s are 10.48 and 10.39%, respectively.

363. His sustainable growth DCF, which is based on the percentage of earnings retained and reinvested, showed average and median growth rates of 4.92% and 4.59%, respectively. The average and median ROE for sustainable growth DCF was 9.74% and 9.38%, respectively.<sup>499</sup>

364. Mr. Gorman’s multistage growth DCF, which reflect a chance of non-constant growth, showed an estimate of 4.75% long-term growth. His ROE analysis revealed a 9.78% average and 9.86% median.<sup>500</sup>

365. Mr. Gorman’s also arrived at an ROE range using a risk premium analysis. His results showed an ROE range of 9.41% to 9.94%, with a midpoint of 9.68%.<sup>501</sup> Finally, his CAPM method to estimate ROE showed a range of 8.33 to 9.38%. His overall range of ROEs using these five methods was 9.4% to 9.9%, with a midpoint of 9.65%.<sup>502</sup>

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<sup>494</sup> Ex. KCP&L 1203, p. 37.

<sup>495</sup> *Id.* at 2.

<sup>496</sup> *Id.* at 11.

<sup>497</sup> *Id.*

<sup>498</sup> *Id.* at 20.

<sup>499</sup> *Id.* at 24.

<sup>500</sup> *Id.* at 26.

<sup>501</sup> *Id.* at 32.

<sup>502</sup> *Id.* at 37.

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### Staff Witness Murray

366. Mr. Murray arrived at an ROE range of 8.5-9.5%, with 9.0% being the midpoint.<sup>503</sup> As did Dr. Hadaway and Mr. Gorman, Mr. Murray constructed a proxy group. The criteria for his proxy group were: 1) an electric utility by Value Line; 2) publicly traded stock; 3) classified as regulated utility by EEI or not followed by EEI; 4) at least 70% of revenues from electric operations or not followed by AUS; 5) ten years of Value Line historical growth data available; 6) no reduced dividend since 2007; 7) projected growth available from Value Line and Reuters; 8) at least investment grade credit rating; 9) company-owned generating assets; 10) significant merger or acquisition accounted in last three years.<sup>504</sup>

367. Mr. Murray also used a constant growth DCF. His dividend yield was produced by dividing a weighted average of the 2010 (25%) and 2011 (75%) Value Line projected dividends per share by the monthly high/low average stock price for the three months ending September 30, 2010.<sup>505</sup>

368. Mr. Murray stated that the cost of equity is sum of dividend yield and growth rate. To estimate growth rate, he considered actual dividends per share, earnings per share and book value per share. The historical growth rates are volatile. Due to volatility and wide dispersions of historical and projected DPS, EPS and BVPS, Staff instead use an alternative input. Using a growth rate of 4-5%, and a projected dividend yield of 4.7%, Mr. Murray arrived at a constant growth DCF of 8.7-9.7%. But, the constant growth DCF is not instructive if the industry or economic circumstances cause expected near-term growth to be inconsistent with sustainable perpetual growth. This is the case here. So, Staff instead is using a multistage DCF.<sup>506</sup>

369. A three-stage DCF is used in Staff's analysis. The stages are years 1-5, 6-10, and 11 to infinity. For stage one, Staff gave full weight to analysts' five-year EPS growth estimates. For stage two, Staff linearly reduced the growth rate from the stage one level to the constant-growth third stage level. The estimated ROE for the proxy group is about 8.7 to 9.4%, with a midpoint of 9.05%.<sup>507</sup>

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<sup>503</sup> Ex. KCP&L 210, p. 11.

<sup>504</sup> *Id.* at 26.

<sup>505</sup> *Id.* at 27.

<sup>506</sup> *Id.* at 28-29.

<sup>507</sup> *Id.* at 30.

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370. Mr. Murray also tested the reasonableness of his DCF results by using CAPM and other evidence. For the risk-free rate in its CAPM, he used the average yield on 30-year Treasury bonds for the three months ending September 30, 2010, which was 3.85%. The average beta for the proxy group is 0.65. For market risk premium, Staff relied on risk premium estimates based on historical differences between earned returns on stocks and on bonds. The first risk premium was based on long-term arithmetic average of differences from 1926 to 2009, which was 6%. The second was based on geometric average, which was 4.4%. The CAPM results are 7.72% for arithmetic and 6.69% for geometric. Also, Staff's estimation of ROE by adding risk premium to yield to maturity of the company's long-term debt gives an ROE of 8.14-8.71.<sup>508</sup>

371. Staff submitted testimony concerning recent average ROEs. According to RRA, average ROEs for electrics for first three quarters of 2010 was 10.36%. For the first quarter, 10.66%, 17 decisions. Second quarter 10.08%, 14 decisions. Third quarter, 10.27%, 12 decisions. For 2009, average was 10.48%. First quarter, 10.29%, 9 decisions. Second quarter, 10.55%, 10 decisions. Third quarter, 10.46%, 3 decisions. Fourth quarter, 10.54%, 17 decisions. Staff's ROR (not ROE) is in line w/ the average RORs for first three quarters of 2010.<sup>509</sup>

### **Analysis – Return on Equity**

372. Dr. Hadaway relies exclusively on three variations of the DCF analysis.<sup>510</sup>

373. First, Dr. Hadaway conducted a constant growth DCF analysis relying on analysts' growth estimates which resulted in a return on equity of 10.2% to 10.4%.<sup>511</sup>

374. Second, Dr. Hadaway conducted a constant growth DCF analysis that substituted his own subjective estimation of the long-term

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<sup>508</sup> *Id.* at 35-36.

<sup>509</sup> Ex. KCP&L 210, p. 37.

<sup>510</sup> While Dr. Hadaway initially included the results of his risk premium analysis in his direct testimony (Ex. KCP&L 27, p. 43), he subsequently recommended that the results of his updated risk premium analysis in his rebuttal testimony should be discounted (Ex. KCP&L 28, p. 23). The results of that updated risk premium analysis indicate an ROE range of 10.05% - 10.24%. (*Id.*)

<sup>511</sup> Ex. KCP&L 28, Sch. SCH2010-11

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GDP growth rate. The result of this analysis is a return on equity of 10.7% to 10.8%.<sup>512</sup>

375. Finally, Dr. Hadaway combines the analysts' growth estimates and his own estimation of long-term GDP growth into a multi-stage DCF analysis. The result of his multi-stage DCF analysis is a return on equity of 10.5%.<sup>513</sup>

376. Thus, Dr. Hadaway recommends a return on equity range of 10.2% - 10.8%, with a midpoint of 10.5%.<sup>514</sup>

377. In its testimony, however, KCP&L asks that the Commission set its return on equity at 10.75%, at the top end of Dr. Hadaway's recommended range.<sup>515</sup>

378. KCP&L does so "to reflect the Company's reliability and customer satisfaction achievements."<sup>516</sup>

379. Michael Gorman testified on behalf of MEUA, MIEC and the Department of Energy.<sup>517</sup>

380. Mr. Gorman conducts three versions of the DCF analysis, a risk premium analysis and a CAPM analysis. First, Mr. Gorman conducts a constant growth DCF analysis based upon analysts' growth rates resulting in a return on equity of 10.39%.<sup>518</sup>

381. Second, Mr. Gorman conducts a sustainable growth DCF analysis which resulted in a return on equity of 9.38%.<sup>519</sup>

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<sup>512</sup> *Id.*

<sup>513</sup> *Id.*

<sup>514</sup> *Id.* at p. 22.

<sup>515</sup> In KCP&L/GMO's testimony, they refer to their request as a "return on equity commensurate with the top of Dr. Hadaway's range." (Ex. KCP&L 7, p. 10). In their brief, however, KCP&L/GMO refers to their request as "an additional 25 basis points be added to the midpoint." (KCP&L/GMO Brief at p. 151). While the methods of getting to the actual request are different, the practical effect of either methods is a requested return on equity of 10.75%.

<sup>516</sup> Ex. KCP&L 7, p. 10.

<sup>517</sup> Mr. Gorman initially presented the results of his return on equity analysis in the context of his KCP&L Direct Testimony (Ex. KCP&L 1203). His recommendation in his Direct Testimony is a midpoint return on equity of 9.65%. Like Dr. Hadaway, Mr. Gorman subsequently updated his analysis in his GMO Direct Testimony resulting in a midpoint return on equity of 9.50%. (Ex. KCP&L 1403). On the stand, however, Mr. Gorman restored his original recommendation of 9.65% to account for the subsequent increase in capital market bond yields. (Tr. 2852-2853). Therefore, the results set forth in this order reflect the "restored" position contained in Mr. Gorman's KCP&L Direct Testimony of 9.40% to 9.90% with a midpoint of 9.65%. (Ex. KCP&L 1203, p. 37).

<sup>518</sup> Ex. KCP&L 1203, pp. 20 and 27.

<sup>519</sup> *Id.* at pp. 24 and 27.

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382. Third, Mr. Gorman conducts a multi-stage DCF analysis which results in a return on equity of 9.86%.<sup>520</sup>

383. Thus, the average of Mr. Gorman's three DCF analyses is a return on equity of 9.88%.<sup>521</sup>

384. Next, Mr. Gorman undertook a risk premium analysis with a return on equity range of 9.41% to 9.94% with a midpoint of 9.68%.<sup>522</sup>

385. Finally, Mr. Gorman conducts a CAPM analysis resulting in a return on equity of 9.40%.<sup>523</sup>

386. The ultimate result of Mr. Gorman's multiple analyses is a recommended return on equity of 9.40% to 9.90% with a midpoint of 9.65%.<sup>524</sup>

387. Staff witness Murray listed the expected long-term growth rate in electricity demand, plus inflation, in support of his ROE recommendation of 8.5-9.5%, with a midpoint of 9.0%.

388. He also listed the "Rule of Thumb": a rough estimate of the current cost of equity calculated by adding a 3-4% risk premium to the cost of long-term debt. In this case, the "rule of thumb" suggests a cost of common equity in the range of 8.14%-9.71%.<sup>525</sup>

389. Finally, Murray also used the perpetual growth rate used by Goldman Sachs when performing DCF analyses of regulated electric companies, which is 2.5%.<sup>526</sup>

### Growth Rates

390. As previously mentioned, all three experts rely upon analysts' growth rates for use in their initial constant growth DCF. As the Commission found in its recent AmerenUE decision, these analysts' growth rates are currently troublesome in that they are "based on a unsustainably high dividend yield and median growth rate."<sup>527</sup>

391. While the DCF methodology is intended to be perpetual in nature, these underlying analyst growth estimates are only focused on the short-term. As Mr. Gorman explains, therefore, these current short-

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<sup>520</sup> *Id.* at pp. 26 and 27.

<sup>521</sup> *Id.* at p. 27.

<sup>522</sup> *Id.* at p. 32.

<sup>523</sup> *Id.* at p. 37.

<sup>524</sup> *Id.*

<sup>525</sup> Ex. KCP&L 235, p. 5.

<sup>526</sup> *Id.*, p. 9.

<sup>527</sup> *Report and Order*, File No. ER-2010-0036, ("AmerenUE") p. 21.

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term growth rates are based upon the expectation of increased earnings resulting from the large construction cycle currently seen in the electric industry. Such growth rates are not reflective of more normalized levels of construction and are therefore not sustainable.<sup>528</sup>

392. In order to avoid the short-term nature of analysts' growth rates, Dr. Hadaway replaces the analysts' growth rates with an estimate of long-term GDP growth. While the use of a long-term GDP growth rate certainly appears more reasonable than the analysts' growth estimates, the GDP growth estimation provided by Dr. Hadaway is troublesome. As pointed out by Mr. Gorman, Dr. Hadaway rejects all recognized measures of GDP growth and instead provides his own estimate of GDP growth (6.0%)<sup>529</sup> based upon historical average GDP growth rates.<sup>530</sup>

393. If Dr. Hadaway's subjective estimate of GDP growth (6.0%) is replaced with publicly available estimate of GDP growth (Mr. Gorman uses the 4.75% estimate provided by *Blue Chip Economic Indicators*), the result of Dr. Hadaway's constant growth (GDP) DCF analyses drops from 10.7% to 9.6%.<sup>531</sup>

394. By replacing Dr. Hadaway's subjective GDP growth estimate with a publicly available GDP growth estimate, Dr. Hadaway's DCF analysis leads to results that fall comfortably within the range recommended by Mr. Gorman (9.4% - 9.9%).<sup>532</sup>

### Other Return on Equity Methodologies

395. Dr. Hadaway initially conducted a risk premium analysis. As contained in his direct testimony, Dr. Hadaway considered the results of the risk premium analysis when it resulted in a return on equity of 10.61% to 10.82%.<sup>533</sup>

396. Given the significant passage of time (six months between filing direct testimony and rebuttal testimony), Dr. Hadaway updated his analysis in his rebuttal testimony.<sup>534</sup>

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<sup>528</sup> Ex. KCP&L 1203, p. 22.

<sup>529</sup> Ex. KCP&L 27, p. 41.

<sup>530</sup> Ex. KCP&L 1204, pp. 7-8.

<sup>531</sup> Ex. KCP&L 1205, p. 10.

<sup>532</sup> Ex. KCP&L 1205, p 12.

<sup>533</sup> Ex. KCP&L 27, p. 43.

<sup>534</sup> Ex. KCP&L 28, p. 22.

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397. In that testimony, Dr. Hadaway's risk premium analysis decreased significantly to a range of 10.05% to 10.24%.<sup>535</sup>

398. Based upon his belief that "current utility bond yields are artificially depressed by government monetary policy," Dr. Hadaway decided to "discount these results."<sup>536</sup>

399. The Commission finds Mr. Gorman's testimony to be more credible than the testimony of Mr. Murray and Dr. Hadaway. However, Mr. Gorman's testimony also gives the Commission some concern. For example, Mr. Gorman's Constant Growth DCF model using analysts' growth rates yields 10.39% (KCP&L) and 10.33% (GMO) ROE estimates, whereas Dr. Hadaway's model runs from 10.2% to 10.4%, essentially agreeing with Mr. Gorman. It is therefore ironic that the Industrials criticize Dr. Hadaway's Constant Growth DCF model, when their own expert essentially agrees with the Hadaway analysis.<sup>537</sup>

400. Mr. Gorman took a CAPM range of 8.12% to 9.17%, relied on the high-end of that range, and then rounded it up to 9.20%.<sup>538</sup>

401. When assessing growth rates, Mr. Gorman utilized a *median* growth rate of 5.41% for his Constant Growth DCF analysis, instead of *average* growth rates (5.68% for KPC&L or 5.63% for GMO) which would have boosted his ROE estimate.<sup>539</sup>

402. Similarly, for his long-term Growth DCF analysis, Mr. Gorman chose *median* growth rates for KCP&L and GMO of 4.59% and 4.61%, compared with *average* rates of 4.92% and 4.89%, respectively, that would have increased his ROE calculation.<sup>540</sup>

403. Mr. Gorman also arbitrarily eliminated Empire District Electric Company growth rates from his Constant Growth DCF models which would have increased the median ROE two basis points.<sup>541</sup>

404. Staff witness Murray did not use data that could be confirmed by either government or industry statistics, and chose instead to reject a 5.97% growth rate based on Value Line and Reuters data, finding it "non-sustainable."<sup>542</sup>

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<sup>535</sup> *Id.* at 23.

<sup>536</sup> *Id.*

<sup>537</sup> Ex. KCP&L 1203, p. 27; Ex. GMO 1403, p. 29; Ex. KCP&L 27, p. 22 and Sch. SCH2010-11, p. 2.

<sup>538</sup> Ex. GMO 1403, p. 39.

<sup>539</sup> Ex. KCP&L 1203, p. 20; Ex. GMO 1403, p. 21.

<sup>540</sup> Ex. KCP&L 1203, p. 24; Ex. GMO 1403, p. 25.

<sup>541</sup> Ex. KCP&L 28, pp. 17-18.

<sup>542</sup> Tr., 2992.



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405. He then arrived at a 4.0%-5.0% growth rate “based upon Staff’s expertise and understanding of current market conditions.”<sup>543</sup>

406. Admitting that he cited no authority to reduce the 5.97% growth rate by 100 to 200 basis points,<sup>544</sup> Mr. Murray was vague on whom he consulted and how this process of reducing a growth rate based on public information occurred.

### Return on Equity Awards in Other Jurisdictions

407. The Commission must not only look at the experts’ evidence, but must also award a return on equity “equal to that generally being made at the same time *and in the same general part of the country* on investments in other business undertakings which are attended by corresponding risks and uncertainties.”<sup>545</sup>

408. KCP&L itself asks for the Commission to look at Midwestern ROE’s to assist the Commission in setting KCP&L’s ROE, stating that “If the Commission is concerned about attracting capital to Missouri’s utilities, it will pay attention to ROEs issued by other states in the Midwest.”<sup>546</sup>

409. A review of recent return on equity awards reveals that nine vertically integrated utilities in states that border Missouri (except for Northern Indiana Public Service) have received an average return on equity award of approximately 10.25%.<sup>547</sup>

### KCP&L Request for Adder Due to Customer Service Excellence

410. Further, KCP&L/GMO ask that the Commission set its return on equity at the upper half of the recommended range of return on equity “to reflect the Company’s reliability and customer satisfaction achievements.”<sup>548</sup> In its Direct Testimony, KCP&L/GMO allege heightened customer satisfaction and reliability. In support of this claim, KCP&L/GMO reference the Commission to an annual Edison Electric Institute Reliability Survey and recent J.D. Power awards.

411. Evidence provided by Staff, however, provides real world evidence that KCP&L/GMO’s performance is the lowest among the

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<sup>543</sup> Ex. KCP&L 210; Tr. 2992-98.

<sup>544</sup> Tr. 2998.

<sup>545</sup> *Bluefield v. PSC*, 262 U.S. at 692 (emphasis added).

<sup>546</sup> See KCP&L Reply Brief at 86.

<sup>547</sup> Ex. KCP&L 102 (Interstate Power & Light – 10.8, Westar Energy – 10.4, Kansas Gas & Electric – 10.4, Union Electric – 10.1, Entergy Arkansas – 10.2, Kentucky Power – 10.5, Northern Indiana Public Service – 9.9, KCP&L – 10.0, Interstate Power & Light – 10.)

<sup>548</sup> Ex. KCP&L 7, p. 10.

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Missouri electric utilities. While KCP&L's current rating is 655, this represents a dramatic decrease from the 697 score received in just 2007.<sup>549</sup>

412. KCP&L's customer satisfaction, as measured by Commission complaints is the worst in the state.

And KCPL from 2008, 2009, 2010, if I calculated this correctly, they are actually 48 percent higher in residential complaints from 2010 to 2008. Empire has declined. Ameren has I would say remained relatively constant. GMO, a little bit of increase. But KCPL dramatic increase in customer complaints.<sup>550</sup>

### **Conclusions of Law – Return on Equity**

39. The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.<sup>551</sup> The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task.<sup>552</sup> In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>553</sup>

In the same case, the Court provided the following guidance as to the return due to equity owners:

A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by

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<sup>549</sup> Tr. 2960-2961.

<sup>550</sup> Tr. 2962.

<sup>551</sup> C.F. Phillips, Jr., *The Regulation of Public Utilities*, 390 (1993); Goodman, 1 *The Process of Ratemaking*, *supra*, at 606.

<sup>552</sup> *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

<sup>553</sup> *Bluefield*, *supra*, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

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corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.<sup>554</sup>

The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>555</sup>

40. The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions. Pursuant to those decisions, returns for GPE's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a quantification of risk.

41. Investor expectations are not the sole determiners of ROE under *Hope* and *Bluefield*; we must also look to the performance of

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<sup>554</sup> *Id.*, 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

<sup>555</sup> *Hope Nat. Gas Co.*, *supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

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other companies that are similar to KCP&L in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

42. The Commission cannot simply find a rate of return on equity that is “correct”; a “correct” rate does not exist. However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. The Commission stated that it does not believe that its return on equity finding should “unthinkingly mirror the national average.”<sup>556</sup> Nevertheless, the national average is an indicator of the capital market in which MGE will have to compete for necessary capital.

43. The Commission has described a “zone of reasonableness” extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations.<sup>557</sup> Because the evidence shows the recent national average ROE for electric utilities is 10.34%,<sup>558</sup> that “zone of reasonableness” for this case is 9.34% to 11.34%.

44. The Commission has wide latitude in setting an ROE within the zone of reasonableness.<sup>559</sup> The zone of reasonableness is simply a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone.

45. In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.<sup>560</sup> “If the total effect of the rate order cannot be said to be unjust or unreasonable, judicial

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<sup>556</sup> *In re Missouri Gas Energy*, 12 Mo.P.S.C.3d 581, 593 (Report and Order issued September 21, 2004).

<sup>557</sup> *Id.*

<sup>558</sup> Ex. KCP&L 102.

<sup>559</sup> *State ex. rel. Public Counsel*, 274 S.W.3d at 574 (citing *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968)) (“**courts are without authority** to set aside **any** rate selected by the Commission [that] is within a ‘zone of reasonableness’” (emphasis supplied)).

<sup>560</sup> *State ex. rel. Arkansas Power & Light Company v. Missouri Public Service Commission*, 736 S.W.2d 457, 462 (Mo. App., W.D. 1987); *State ex. rel. Associated Natural Gas Company v. Public Service Commission of Missouri*, 706 S.W.2d 870, 879 (Mo. App., W.D. 1985).

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inquiry is at an end.”<sup>561</sup> “It is the impact of the rate order which counts; the methodology is not significant.”<sup>562</sup> Within a wide range of discretion, the Commission may select the methodology.<sup>563</sup>

46. The Commission may select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances.<sup>564</sup> It may employ a combination of methodologies and vary its approach from case-to-case and from company-to-company.<sup>565</sup> “No methodology being statutorily prescribed, and ratemaking being an inexact science, requiring use of different formulas, the Commission may use different approaches in different cases.”<sup>566</sup>

47. The Constitution “does not bind ratemaking bodies to the service of any single formula or combination of formulas.”<sup>567</sup> “Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.”<sup>568</sup>

### **Decision – Return on Equity**

After careful review of the evidence and of return on equity awards in nearby states, the Commission finds that KCP&L should receive a return on equity award of 10.0%. This is very near the Midwestern average for 2010, and supported by the evidence.

For example, Mr. Gorman found the average constant growth DCF to be 10.48, and the average sustainable growth to be 9.74.<sup>569</sup> The average of those two numbers is 10.1.

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<sup>561</sup> *Hope, supra*, 320 U.S. at 602, 64 S.Ct. at 287, 88 L.Ed. 345 at \_\_\_\_.

<sup>562</sup> *State ex rel. GTE North, Inc. v. Public Serv. Commission*, 835 S.W.2d 356, 361, 371 (Mo. App., W.D. 1992).

<sup>563</sup> *Missouri Gas Energy v. Public Service Commission*, 978 S.W.2d 434 (Mo. App., W.D. 1998), *rehearing and/or transfer denied*; *State ex rel. Associated Natural Gas Company v. Public Service Commission*, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); *State ex rel. Missouri Public Service Company v. Fraas*, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981).

<sup>564</sup> *State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).

<sup>565</sup> *State ex rel. City of Lake Lotawana v. Public Service Commission*, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).

<sup>566</sup> *Arkansas Power & Light, supra*, 736 S.W.2d at 462.

<sup>567</sup> *Federal Power Commission v. Natural Gas Pipeline Company*, 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

<sup>568</sup> *Id.*

<sup>569</sup> Ex. KCP&L 1203, pp. 20, 24.

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Likewise, he found the median constant growth DCF to be 10.39, and the median sustainable growth DCF to be 9.83.<sup>570</sup> The average of those two numbers is also 10.1.

Further, Hadaway and Gorman, in their critiques of each other's work, point out that if the other witness' work had been done properly, their ROE analysis would yield a result of about 10%.<sup>571</sup>

### **B. Cost of Debt**

***What capital structure should be used for determining the rate of return?***

#### **Findings of Fact – Cost of Debt**

413. The issue of KCP&L's cost of debt was decided in the Report and Order issued in ER-2010-0355. Thus, only GMO's cost of debt is addressed here.

414. GMO has proposed a capital structure that reflects its actual cost of debt with the exception of only one debt issuance. The Company's cost of debt was originally projected to be 6.73%, but based upon year-end 2010 actual results, GMO has lowered this figure to 6.42%.<sup>572</sup>

415. GMO's cost of debt is generally based upon GMO's actual debt cost, with the exception of one issue, the 11.875% Senior Notes of \$500 million. These Senior Notes continue to use a hypothetical cost of 6.26% which was first assigned by GMO's predecessor Aquila. This hypothetical cost was part of Aquila's commitment to the Commission to hold its customers harmless from the effects of Aquila's unsuccessful non-regulated operations. Since Aquila's acquisition by Great Plains Energy in July 2008, both Great Plains Energy and GMO have continued this commitment which serves to benefit ratepayers.<sup>573</sup>

416. Staff recommends using The Empire Electric District as a proxy for GMO's debt on the Senior Notes 6.36%.<sup>574</sup> Staff cites as

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<sup>570</sup> *Id.*

<sup>571</sup> Ex. KCP&L 1204, pp. 5, 10; Ex. KCP&L 28, p. 16.

<sup>572</sup> Ex. GMO 15, p. 6; Ex. GMO 54, pp. 1-2.

<sup>573</sup> See *Report and Order, In re Great Plains Energy Inc.*, File No. EM-2007-0374 at 145-46, 156 and n. 609, 248-50 (July 1, 2008) ("Merger Order").

<sup>574</sup> Ex. GMO 269, p. 3.

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support for its position that GMO's cost of debt assignment process is "not based on market-driven, arm's-length transactions."<sup>575</sup>

417. The factors that dictate a utility's cost of debt include the maturity of the debt; the timing and amount of the debt; the terms and conditions of the debt; the credit profile of the company when the debt is issued; alternative sources of funding; the utility's market capitalization; and the financial market conditions existing when the debt is issued.<sup>576</sup> Staff did not utilize any of these factors in arriving at its recommendation to use Empire's debt as a proxy for GMO.<sup>577</sup>

418. There are substantial differences between Empire and GMO, including that: Empire serves no major metropolitan while GMO does; Empire has only 170,000 customers compared to GMO's over 300,000 customers; and Empire has a generation capacity significantly lower than GMO's 2,000 MWs. In addition, Empire does business in four states, is subject to four separate regulatory commissions, and operates a natural gas distribution utility, whereas GMO operates only in Missouri as an electric utility.<sup>578</sup>

419. The 11.875% Senior Notes mature in mid-2012. Because of this there is no reason to depart from the current cost of debt assigned to this issue or to GMO. As such, there is no need to adopt as a proxy for GMO's cost of debt the debt cost of a proxy which Staff proposed. Staff's recommendation that the Commission use the cost of debt of The Empire District Electric Company is not reasonable as Empire's debt does not reflect the debt of GMO.

420. The Commission finds that GMO's cost of debt is 6.42%.

421. The Commission finds that at this time the use of a consolidated debt structure, which was not specifically proposed by Staff, is not necessary.

### **Conclusions of Law – Cost of Debt**

There are no additional Conclusions of Law for this section.

### **Decision – Cost of Debt**

The Commission finds this issue in favor of GMO.

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<sup>575</sup> Ex. GMO 235, p. 26.

<sup>576</sup> Ex. GMO 9, p. 7.

<sup>577</sup> Tr. 4017.

<sup>578</sup> Tr. 4015-17.

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### **C. Equity Linked Convertible Debt**

***Should GPE's equity linked convertible debt be included in KCP&L's capital structure? If so, at what interest rate?***

#### **Findings of Fact – Equity Linked Convertible Debt**

422. The equity-linked convertible debt known as Equity Units should be part of the companies' capital structure and should be included at their cost of 13.59%. GPE raised gross proceeds of \$450 million in May 2009 through a simultaneous issuance of 11.5 million shares of common stock (\$14/share resulting in gross proceeds of \$161 million) and 5.75 million Equity Units (\$50/unit resulting in gross proceeds of \$287.5 million). It was cheaper for GPE to raise capital through the equity units because a portion of the quarterly distribution is tax deductible.<sup>579</sup>

423. As a result, the Equity Units were a lower cost alternative to issuing common stock and would ultimately cost ratepayers less.<sup>580</sup>

424. The only basis for Staff's argument that the cost of the Equity Units should be 11.14% (or 245 basis points below the actual cost to GPE) is that a much larger utility, FPL Group (the parent of Florida Power & Light Co.) issued its Equity Units at a lower cost. Mr. Murray testified that Staff's adjustment of 245 basis points was not based on any other equity offering that any other company made in 2009.<sup>581</sup>

425. Unlike Mr. Cline and the authors of Schedules MWC 2010-4 through 2010-6 (Goldman Sachs & Co. and J.P. Morgan), Mr. Murray has never been employed by a firm that served as manager of an offering of equity units, nor has he ever worked for a company that issued such equity units. He agreed with the Goldman Sachs analysis that GPE's offering price was the third best pricing of any offering of equity units in 2009.<sup>582</sup>

426. J.P. Morgan also explained that the FPL equity units represented only 1.5% of its equity market capitalization, in comparison

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<sup>579</sup> See Tr. 2902.

<sup>580</sup> *Id.*

<sup>581</sup> See Tr. 2975.

<sup>582</sup> See Tr. 2980-81; Sch. MWC 2010-6 at 3GPE's offering was priced at a 6.08% spread over its common dividend yield, representing the third best pricing of any transaction in 2009 (behind FPL at 4.98% and Johnson Controls at 5.69%).



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with the GPE's offering which was 16.6% of its equity market capitalization.<sup>583</sup>

427. Additionally, Mr. Cline noted that J.P. Morgan stated that FPL's equity units offering was more senior in the capital structure of the company, in comparison with GPE, where its Equity Units were further subordinated to other debt.<sup>584</sup>

428. Finally, FPL had previously issued \$506 million of Equity Units in 2002 and had a track record that investors could rely on, whereas GPE had never before issued Equity Units.<sup>585</sup>

429. Mr. Murray did accept Mr. Cline's testimony, consistent with the Goldman Sachs reports (Cline Schedule MWC 2010-4 and 2010-5), which stated that investors in Equity Units "demand higher yield than common stock" and that "security [is] more expensive than equity in [a] downside scenario."<sup>586</sup>

430. Although Staff noted that Schedule MWC 2010-5 was prepared after Staff had filed its initial case, Mr. Cline testified that the report was entirely consistent with the earlier Goldman Sachs report (MWC-2010-4) that was prepared on March 17, 2009.<sup>587</sup>

431. Although Staff suggested that the cost of the Equity Units was greater because of the negative impact of GMO on GPE's credit ratings, Mr. Cline, while rejecting Staff's premise, did not elaborate given his further explanation that GPE's dividend yield, not its credit rating, was the primary factor in the pricing of these Equity Units.<sup>588</sup>

432. Overall, the cost of the Equity Units was reasonable and was incurred in the best interests of the ratepayers.<sup>589</sup>

### **Conclusions of Law – Equity Linked Convertible Debt**

There are no additional Conclusions of Law for this section.

### **Decision – Equity Linked Convertible Debt**

The Commission finds this issue in favor of KCP&L and GMO. Given that GPE acted in the best interests of both KCP&L and GMO at a time when the country was in the midst of a severe economic recession,

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<sup>583</sup> *Id.*

<sup>584</sup> *Id.*

<sup>585</sup> See Sch. MWC 2010-5, pp. 1, 4; Sch. MWC 2010-6, p. 1.

<sup>586</sup> Tr. 2977.

<sup>587</sup> Tr. 2900-01.

<sup>588</sup> Tr. 2903; Ex. KCP&L 12, pp. 8-10.

<sup>589</sup> Tr. 2902-03.

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and the pricing terms were as favorable as could be obtained, there is no sound reason for accepting Staff's 245 basis point adjustment in the cost of the Equity Units.

### **D. Off-System Sales**

#### **Findings of Fact – Off-System Sales**

##### ***How should off-system sales margins be determined?***

433. GMO has more power available for off-system sales ("OSS") now that latan 2 is on-line.

434. The Company used 2009 normalized test-year data produced through the use of the MIDAS™ model to set rates for off-system sales. This process was also used to normalize test-year fuel and purchased power costs.<sup>590</sup>

435. In this case the Commission accepted the agreement of the parties to use 2009 as the test year, with a true-up as of December 31, 2010.<sup>591</sup>

436. Staff proposes to set rates for off-system sales using historical data from 2007-2008 based upon its view that GMO's off-system sales for the last two years did not represent an adequate level of off-system sales. Consequently, Staff witness V. William Harris recommended that sales levels from 2007-2008 be used.<sup>592</sup>

437. Substantial changes have occurred in the wholesale electricity market in the prices for electricity from 2007-2009 to the present time. The average market price during 2007-2008 was approximately \$50/MWh, and since that time, the average price has dropped to approximately \$30/MWh.<sup>593</sup>

438. Data supplied by Company witness Michael Schnitzer of the NorthBridge Group reviewed SPP-North spot market prices for electricity, and indicated that electricity prices were higher in 2007-2008 than in the period from 2009 to the present.<sup>594</sup> For example, the average around-the-clock price of electricity in SPP-North for the second quarter of 2007 and 2008 were \$49.79 and \$61.23, respectively, whereas the

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<sup>590</sup> Ex. GMO 10, pp. 5-9.

<sup>591</sup> *Order Approving Nonunanimous Stipulation and Agreement, Setting Procedural Schedule, and Clarifying Order Regarding Construction and Prudence Audit* at 2, ¶ 3 (Aug. 18, 2010).

<sup>592</sup> Ex. GMO 210, pp. 77-78; Ex. GMO 220, pp. 2-4.

<sup>593</sup> Ex. GMO 11, p. 16.

<sup>594</sup> Ex. KCP&L 122.

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average price for the same commodity in the second quarter of 2010 was \$30.40.<sup>595</sup>

439. Additionally, the operating costs of the units from which excess generation is sold in the wholesale market have risen since 2007-2008, and, consequently, with higher expenses and lower prices, margins have decreased.<sup>596</sup>

440. With the expiration of GMO's purchased power contract with NPPD and the addition of 153 MW from GMO's share of latan 2, off-system sales in 2011, even based on a test year of 2009 (as trued-up), will not be similar to the 2007-2008 historical levels utilized by Staff.<sup>597</sup>

441. Aquila and GMO/KCP&L had different interpretations of what was permissible under their respective Federal Energy Regulatory Commission ("FERC") tariffs regarding the use of network transmission service to facilitate off-system sales.<sup>598</sup>

442. In 2005 FERC clarified that it is not appropriate for a utility to use network transmission service to facilitate purchases of energy for resale at a profit, and this largely eliminated GMO's ability to purchase power for resale.<sup>599</sup> Since the acquisition of Aquila by Great Plains Energy in 2008, both Aquila and GMO/KCP&L have adhered to FERC policy which has contributed to a decline in off-system sales.<sup>600</sup>

443. Staff's recommendation to use 2007-2008 historical data to set off-system sales is not based upon any analysis or research concerning energy prices in the SPP-North region.<sup>601</sup> Staff's witness Mr. Harris failed to observe that natural gas prices have declined since 2007-2008, which is significant since electricity prices in SPP-North are primarily the product of natural gas prices.<sup>602</sup> Mr. Harris also failed to note that the region has experienced less demand for wholesale power as a result of the economic recession.<sup>603</sup>

444. Staff did not conduct any research regarding the use of network transmission service to facilitate off-system sales, and its

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<sup>595</sup> Ex. KCP&L 122, p. 1.

<sup>596</sup> Ex. GMO 11, p. 16.

<sup>597</sup> Ex. GMO 11, p. 17.

<sup>598</sup> Tr. 4221-22.

<sup>599</sup> Ex. GMO 6, p. 6; Tr. 4425-26.

<sup>600</sup> Tr. 4221-22; Tr. 4225-27.

<sup>601</sup> Tr. 4228-29.

<sup>602</sup> Ex. GMO 6, p. 6; Ex. KCP&L 58, pp. 6-7.

<sup>603</sup> Ex. GMO 6, p. 6.

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witness was not familiar with FERC policies that govern network transmission service.<sup>604</sup>

445. Staff's proposal to set rates for off-system sales based upon data that does not reflect test-year data from 2009, as trued-up, or the decline in electricity prices since 2007-2008 is contrary to the Commission's traditional reliance upon a test-year in deciding general rate cases.

### **Conclusions of Law – Off-System Sales**

48. Staff's recommendation to use 2007-2008 data, instead of 2009 test-year data is inconsistent with the Commission's preference for test-year data. The purpose of a test year is to provide a period for which complete data is available in order to permit review by Staff and others, as well as to provide the Commission with a basis to estimate future revenue requirements.<sup>605</sup> While information other than the "strict test year" concept is permitted, such data typically reflects "a change that actually took place during or after the test year" or "a forward-looking test year."<sup>606</sup>

49. Missouri has followed the test-year concept and has not departed from it, except to account for future developments or to normalize a level of revenue or expense that will be "most representative of future expenses."<sup>607</sup>

50. FERC has clarified that it is not appropriate for a utility to use network transmission service to facilitate purchases of energy for resale at a profit.<sup>608</sup> FERC stated in this case that utilities are not to use network service to advance their own OSS, and that network transmission service should only be used to satisfy a utility's native load. In Mid-American the Audit Report of FERC Staff described a variety of irregularities, which the utility settled by agreeing to construct \$9.2 million of previously unplanned transmission upgrades, and to forego recovery of all costs associated with these projects for six years from the time the

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<sup>604</sup> Ex. GMO 6, p. 6; Tr. 4230-31.

<sup>605</sup> See, C. Phillips, *The Regulation of Public Utilities*, (1993) at 196.

<sup>606</sup> *Id.*

<sup>607</sup> *In re Union Elec. Co., Report and Order*, File No. ER-2010-0036 (May 28, 2010) at 50. See, *State ex rel. Missouri Power & Light Co. v. PSC*, 669 S.W.2d 941, 945 (Mo. App. W.D. 1984); *State ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 887-90 (Mo. App. W.D. 1981).

<sup>608</sup> See, *Mid-American Energy Co.*, 112 FERC ¶61, 346, 2005 WL 2430182 (2005).

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assets are placed in service.<sup>609</sup> FERC approved the Audit Report “in its entirety without modification.”<sup>610</sup>

51. Regarding transmission service and off-system sales, the Audit Report stated: “MidAmerican’s wholesale merchant function (Electric Trading) used network transmission service to deliver short-term energy purchases to a generator in its control area when it concurrently made short-term off-system sales. Electric Trading is allowed to use network transmission service to deliver energy from designated network resources and to deliver economy energy purchases to their network load. However, Electric Trading may not use network transmission service to deliver energy that is used to support off-system sales.”<sup>611</sup>

### **Decision – Off-System Sales**

Staff’s proposal to set OSS based on data from 2007-2008 is beyond the test year, is not representative of current energy prices, and is rejected. The Company’s method of calculating the OSS using the test year 2009 data is adopted.

### **III. Expenses**

#### **A. Fuel and Purchased Power Expense**

***How should natural gas costs be determined?***

***How should spot market purchased power prices be determined?***

#### **Findings of Fact – Fuel and Purchased Power Expense**

446. No party opposed the forecasting process proposed by KCP&L/GMO Witness W. Edward Blunk for natural gas costs. Under this process, natural gas prices are based on the first of the month index price published in Platt’s Inside FERC, as well as NYMEX closing prices related to Henry Hub natural gas futures contracts.<sup>612</sup>

447. Mr. Blunk stated in his Direct Testimony that the Companies expected to true-up 2010 natural gas prices for their cost of service to actual prices at the conclusion of the case.<sup>613</sup>

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<sup>609</sup> *Id.* at 2-3.

<sup>610</sup> *Id.* at 3.

<sup>611</sup> *Id.* at 6.

<sup>612</sup> Ex. KCP&L 10; Ex. GMO 7.

<sup>613</sup> Ex. KCP&L 10, p.14; Ex. GMO 7, p. 10.

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448. In True-Up Direct Testimony, KCP&L Witness Burton L. Crawford confirmed that natural gas costs were updated to reflect the actual monthly purchase prices for January through December 2010.<sup>614</sup>

449. At the hearing there was no cross-examination for Mr. Blunk.<sup>615</sup> Similarly, no party offered pre-filed true-up rebuttal testimony opposing the true-up direct testimony filed by Mr. Crawford in each of the cases.

450. Mr. Weisensee testified in true-up rebuttal testimony that KCP&L had been working closely with Staff in the reconciliation process, that there was a need to update the respective revenue deficiencies, that the process would continue through the filing of Staff's final reconciliation on March 2, and that KCP&L's revised position would be reflected in that reconciliation.<sup>616</sup>

451. GMO's true-up testimony indicates an overall revenue deficiency of \$65.2 million for MPS and \$23.2 million for L&P.<sup>617</sup> The March 2, 2011 reconciliation reflects GMO's further revisions showing a \$65,967,384 deficiency for MPS and a \$23,125,151 deficiency for L&P.

452. GMO recommends using the MIDAS™ model to forecast spot market electricity prices.<sup>618</sup>

453. MIDAS™ is a proprietary production cost model that includes a large amount of data including information supplied by electric utilities in their FERC Form 1 filings, as well as data submitted to the U.S. Department of Energy's Energy Information Administration and to the Continuous Emissions Monitoring System ("CEMS")<sup>619</sup> of the U.S. Environmental Protection Agency.<sup>620</sup> Using this data, the MIDAS™ model is designed "to simulate the wholesale power markets to develop an hourly price of power for the wholesale market. That information then gets fed also into the model and another portion of the model to determine the normalized level of fuel and purchase power for the company."<sup>621</sup> Portions of GMO's model are "based on the historical

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<sup>614</sup> Ex. KCP&L 111, p. 2; Ex. GMO 56, p. 2. (These costs are reflected in Sch. JPW 2010-9, attached to the True-Up Direct testimonies of John P. Weisensee, Ex. KCP&L 117 and Ex. GMO 59.)

<sup>615</sup> Tr. 3198.

<sup>616</sup> Ex. GMO 60, p. 6.

<sup>617</sup> Ex. GMO 115, p. 1.

<sup>618</sup> Ex. GMO 10, p. 2.

<sup>619</sup> Tr. 3205; Ex. GMO 10, p. 3.

<sup>620</sup> Tr. 3205-06.

<sup>621</sup> Tr. 3205.

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experience” of GMO, the model is also “based on a production simulation for the Eastern Interconnect.”<sup>622</sup>

454. Staff’s model relies exclusively on historical data.<sup>623</sup> Staff employs a statistical calculation based upon the historical weather adjusted loads and the truncated normal distribution curve to represent the hourly purchased power prices in the spot market.<sup>624</sup> Staff obtained the actual hourly non-contract transaction prices from the companies and used this data in its calculation.<sup>625</sup> Staff used the combined data from both KCP&L and GMO to reflect the market that exists in this region.<sup>626</sup> Staff’s method yields a spot energy price for each hour of the year.<sup>627</sup> This data set, containing 8,760 hourly spot energy prices, is then used as one of the inputs to Staff’s production cost model.<sup>628</sup>

455. Staff only uses KCP&L and GMO data, and no data from any other utility to arrive at a recommendation of spot market prices.<sup>629</sup> Staff’s model “does not consider the impact of other market price drivers, such as natural gas prices, environmental allowances or other factors of electric production.”<sup>630</sup>

456. Ms. Maloney testifying for Staff indicated that she was not familiar with all of the inputs to the MIDAS™ model and that she had never worked the model herself.<sup>631</sup>

### **Conclusions of Law – Fuel and Purchased Power Expense**

52. It is within the Commission’s discretion and within its area of expertise to determine the methods to set rates regarding off-system sales, as well as fuel and purchased power.<sup>632</sup>

### ***Decision – Fuel and Purchased Power Expense***

Two issues related to fuel and purchased power expense were presented to the Commission with regard to GMO.

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<sup>622</sup> Tr. 3203-04.

<sup>623</sup> Tr. 3215.

<sup>624</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>625</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>626</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>627</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>628</sup> Ex. KCP&L 210, pp. 77-78; Ex. GMO 210, pp. 84-85; Ex. GMO 231, pp. 1-2.

<sup>629</sup> Tr. 3217.

<sup>630</sup> Ex. KCP&L 16 and Ex. GMO 11.

<sup>631</sup> Tr. 3217-19.

<sup>632</sup> *State ex rel. Missouri Gas Energy v. PSC*, 186 S.W.3d 376, 382 (Mo. App. W.D. 2005).

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The first issue does not appear to be in controversy. No party opposed the forecasting process proposed by KCP&L Witness W. Edward Blunk for natural gas costs. Under this process, natural gas prices are based on the first of the month index price published in Platt's Inside FERC, as well as NYMEX closing prices related to Henry Hub natural gas futures contracts. The Commission adopts this method of determining natural gas costs.

The second issue the Commission must address how the spot market purchased power prices shall be determined. GMO asks the Commission to use its MIDAS™ model which forecasts spot market electricity prices. Staff proposes to use its 1996 model which uses only historical market prices and loads.

The MIDAS™ model contains historical information, including the experience of GMO, but is also based on a production simulation for the entire Eastern Interconnection. This model includes an extensive amount of data, both historical and forecasted.

Staff's model relies only upon historical data of KCP&L. It relies on no data from any other utility and does not use any projected data.

The Commission must set the level of fuel expense and purchased power expense for GMO in this case, and it prefers to use the greatest amount of information available to set spot market prices for determining that expense. Given the multitude of variables that affect electricity prices, the Commission accepts the MIDAS™ model as superior in many instances because it considers a vast amount of information, both historical and projected.

Staff wants only historical data from GMO to be considered arguing that use of the traditional historical test year prevents the Commission from relying on forecasted data. To the contrary, the Commission is afforded considerable discretion in setting rates, and in this instance determines that the utilization of a nationally recognized tool like the MIDAS™ model is appropriate to determine spot market prices in setting just and reasonable rates.<sup>633</sup>

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<sup>633</sup> In File No. ER-2010-0355 regarding GMO's sister company, KCP&L, the Commission decided this issue in favor of using the numbers recommended by Staff for fuel expense. Even though the management of the two companies is the same, the circumstances of that case were different and warranted a different result. Specifically, KCP&L abandoned its model in the KCP&L case in favor of Staff's and that fact helped persuade the Commission that Staff's model was more reliable in that instance. No similar abandonment has occurred with regard to GMO.



**B. Merger Transition Cost Recovery**

***What, if any, is the appropriate amount of merger transition costs to include in rates in this case?***

***Findings of Fact – Transition Cost Recovery***

457. In July of 2008, the Commission approved the acquisition of Aquila by Great Plains Energy Incorporated (“GPE”).<sup>634</sup>

458. The acquisition of Aquila, Inc. was consummated on July 14, 2008.

459. In consummating that transaction, GPE incurred certain costs. These costs have been labeled as either transaction costs or transition costs. “[T]ransaction costs include investment bankers’ fees, as well as consulting and legal fees associated with the evaluation, bid, negotiation and structure of the transaction.”<sup>635</sup> Transition costs, on the other hand, are “costs incurred to successfully coordinate and integrate the utility operations of KCP&L and GMO . . . . These costs include non-executive severance costs for employees terminated as a result of the merger, facilities integration costs, and incremental third-party and other non-labor expenses incurred to support the integration of the companies.”<sup>636</sup>

460. The Commission considered and addressed the proper treatment of transition cost recovery in the Merger Order.<sup>637</sup>

461. In Missouri, it is well established that there is a lag between when a cost or revenue is incurred and when that cost or revenue is reflected in rates. This is known as regulatory lag.<sup>638</sup>

462. As a result of regulatory lag, if a utility experiences a cost decrease, there is a lag in time until that reduced cost is reflected in rates. During that lag, the Company shareholders reap, in the form of increased earnings, the entirety of the benefit associated with reduced

<sup>634</sup> *Report and Order, In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, File No. EM-2007-0374 (issued Jul. 1, 2008). Hereinafter referred to as “Merger Order.”

<sup>635</sup> Ex. KCPL 35, p. 6.

<sup>636</sup> Merger Order at 4.

<sup>637</sup> *Report and Order, In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc., for Approval of the Merger of Aquila, Inc., with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief*, File No. EM-2007-0374 (issued Jul. 1, 2008). Hereinafter referred to as “Merger Order.”

<sup>638</sup> Ex. KCP&L 210, p. 190.

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costs. The Company shareholders also reap, in the form of decreased earnings, the entirety of the loss associated with increased costs.

463. The Commission “authorize[d] KCP&L and Aquila to defer transition costs to be amortized over five years.”<sup>639</sup>

464. The Commission qualified its authorization by stating that, “The Commission will give consideration to . . . [the transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCP&L and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.”<sup>640</sup> The Commission contemplated that the recovery would only happen if the synergy savings were greater than the costs to achieve those savings.<sup>641</sup>

465. With regard to the recovery of transition costs, the Merger Order contains a summary of what KCP&L and Aquila had originally requested. That summary states in part, “This period would begin with the first rate cases post-transaction for Aquila and KCP&L subject to ‘true up’ of actual transition . . . costs in future cases.”<sup>642</sup>

466. In the current rate cases, the Companies seek to recover the merger transition costs in rates over five years beginning with rates effective from this case.

467. The Companies projected that over the first five-year period, the total operational synergies projected to result from the merger were \$305 million, and \$755 million over the first 10-year period.<sup>643</sup> The Commission found these estimates to be “accurate, realistic and achievable,” and also recognized that “the synergies actually realized from the merger have a very high probability of exceeding the [company’s] estimates.”<sup>644</sup> The Commission also found that there was “no detriment to customers” by allowing the companies to recover synergy savings through regulatory lag.<sup>645</sup>

468. KCP&L and GMO began to retain synergy savings, in the form of reduced costs, immediately upon the closing of the acquisition. Given that KCP&L and GMO did not have its next rate case

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<sup>639</sup> Merger Order at 241.

<sup>640</sup> Merger Order at 241, footnote 930.

<sup>641</sup> Merger Order at 240.

<sup>642</sup> Merger Order at 239.

<sup>643</sup> Merger Order at 234.

<sup>644</sup> Merger Order at 238.

<sup>645</sup> Merger Order at 120 and 238; Tr. 3473.

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completed until September 1, 2009, the Great Plains shareholders retained the entirety of these synergy savings for that period of time.<sup>646</sup>

469. The Companies developed and maintained a Synergy Tracking Model which demonstrated that the merger synergy savings for non-fuel operations and maintenance expense exceed the amortization of merger transition costs.<sup>647</sup>

470. The Companies also developed and maintained a synergy project charter database to track synergies not ordered to be tracked by the Commission.<sup>648</sup>

471. Staff performed an analysis of both the Commission ordered synergy savings tracking model and KCP&L created synergy project charter database. Staff's analysis showed that the amount of synergies in the synergy project database exceeded those in the Commission-ordered tracking system.<sup>649</sup>

472. As of September 1, 2009, the shareholders of KCP&L and GMO had realized over \$59.3 million in synergy savings.<sup>650</sup>

473. As of June 30, 2010, the shareholders of KCP&L and GMO had realized approximately \$121 million in retained synergy savings.<sup>651</sup>

474. KCP&L and GMO project that total synergy savings through 2013 will be \$344 million.<sup>652</sup> Of that amount, KCP&L and GMO project that ratepayers will receive \$150 million.<sup>653</sup>

475. The synergy savings exceed the level of the amortized costs.<sup>654</sup>

476. The Companies stopped the deferral of transition costs as of December 31, 2010.

477. No party challenged the reasonableness or prudence of incurring the merger transition costs. In addition, Staff's witness stated that the transition costs incurred by the company were not unreasonable or imprudent.<sup>655</sup>

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<sup>646</sup> Ex. KCP&L 230.

<sup>647</sup> Ex. KCP&L 35; Ex. KCP&L 230, p. 7.

<sup>648</sup> Ex. KCP&L 230, pp. 7-8; Ex. KCP&L 35, pp. 7-10

<sup>649</sup> Ex. KCP&L 230, pp. 7-8.

<sup>650</sup> Ex. KCP&L 230, p. 12.

<sup>651</sup> Ex. KCP&L 230, p. 9.

<sup>652</sup> Ex. KCP&L 230, p. 14.

<sup>653</sup> Ex. KCP&L 230, p. 14.

<sup>654</sup> Ex. KCP&L 35, pp. 4, 7-10; Ex. KCP&L 230, pp. 7-8; Tr. 3472.

<sup>655</sup> Tr. 3448, 3470, 3489.

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478. Staff did an analysis of the Companies' Administrative & General ("A&G") expenses and other electric utilities in the region.<sup>656</sup> Staff's analysis indicates that on a combined company basis, KCP&L and GMO have the highest A&G expenses per customer, per megawatt hour sold and per dollar of operating revenue.<sup>657</sup>

### ***Conclusions of Law – Transition Cost Recovery***

53. In the Merger Order, the Commission expressly precluded any recovery of transaction costs,<sup>658</sup> but the Commission reserved consideration of recovery of the transition costs when it said:

The Commission will give consideration to their [transition costs] recovery in future rate cases making an evaluation as to their reasonableness and prudence. At that time, the Commission will expect that KCP&L and Aquila demonstrate that the synergy savings exceed the level of the amortized transition costs included in the test year cost of service expenses in future rate cases.<sup>659</sup>

54. While leaving the possibility for future recovery of transition costs, the Commission expressly reserved that decision for a "later proceeding" stating in the ordered paragraphs that:

13. Nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.

14. The Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.<sup>660</sup>

55. With regard to the recovery of transition costs, the Merger Order contains a summary of what KCP&L and Aquila had originally requested. That summary states in part, "This period would begin with the first rate cases post-transaction for Aquila and KCP&L subject to 'true up' of actual transition . . . costs."<sup>661</sup>

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<sup>656</sup> Ex. KCP&L 231, p. 16.

<sup>657</sup> Ex. KCP&L 231, pp. 16-17.

<sup>658</sup> Merger Order at 239-240.

<sup>659</sup> Merger Order at 241, footnote 930.

<sup>660</sup> Merger Order at 284.

<sup>661</sup> Merger Order at 239.

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56. In the Merger Order, the Commission “authorize[d] KCP&L and Aquila to defer transition costs to be amortized over five years.”<sup>662</sup>

57. The Companies accumulated all transition costs consistent with the Merger Order. The Commission concludes that the Companies have complied with the Merger Order as it relates to recovery of transition costs.

58. The Commission further concludes that the Merger Order contemplated the Companies would be permitted to retain synergy savings through regulatory lag.

59. “The PSC is not bound by **stare decisis** based on prior administrative decisions, so long as its current decision is not otherwise unreasonable or unlawful.”<sup>663</sup> Thus, even had the Merger Order not expressly reserved any questions regarding ratemaking treatment to a “later proceeding,” this Commission would still have the ability to consider the issue without being bound by the previous Commission’s decision.

60. Generally, conflicting provisions “must be read together, and so harmonized as to give effect to [all] when this can be reasonably and consistently done.”<sup>664</sup>

### **Decision – Transition Cost Recovery**

Staff and the Industrials argue that because retained synergy savings resulting from regulatory lag exceeded the amount of transition costs, recovery of the transition costs would constitute double recovery and therefore be unreasonable and inequitable. In response, the Companies argue that the Commission created an expectation in its Merger Order, that so long as the transition costs were deemed reasonable and prudent, and the Companies could demonstrate that synergy savings exceed the level of amortized transition costs, the Companies would be permitted to recover the transition costs in rates.

No party to this proceeding has challenged the reasonableness and prudence of the claimed transition costs or challenged the amount of synergy savings. While true that the Companies’ shareholders have enjoyed the benefit of regulatory lag in retaining synergy savings since

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<sup>662</sup> Merger Order at 241.

<sup>663</sup> *State ex rel. Ag Processing, Inc. v. Public Service Commission*, 120 S.W.3d 732, 736 (Mo. banc 2003).

<sup>664</sup> *State ex rel. McClellan v. Godfrey*, 519 S.W.2d 4, 8 (Mo. banc 1975) (citing to *Straughan v. Meyers*, 187 S.W. 1159 (Mo. 1916)).

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the merger was consummated, the Commission finds that this outcome was specifically contemplated in its consideration of the appropriate treatment for synergy savings in the merger case and as set out in the Merger Order. The Commission also finds that it specifically contemplated that synergy savings would be higher than predicted.

This outcome does not constitute double recovery because the costs were not authorized to be recovered, but rather were deferred by the Merger Order to be considered in a later rate case – this case. The Commission expected that recovery would only occur if the Companies incurred the costs prudently and reasonably and demonstrated that the synergy savings were more than the transition costs. The Companies have done this.

To read the Merger Order as Staff and the Industrials would read it makes the order contradict itself. If the transition costs could not be recovered unless they were more than the synergy savings, yet they could not be recovered until netted against the synergy savings, there would be no costs to defer or to amortize over a five-year period.

Staff also argues that the A&G expenses of the Companies were higher than average and attempted to make a connection to the transition costs being unreasonable. The Commission gives little weight to that argument since Staff's witness testified that these transition costs were not incurred unreasonably or imprudently. The Commission concludes that the transition costs were reasonable and prudent.

Staff also argues that the companies should have begun amortizing these costs in the previous rate cases per the Merger Order.<sup>665</sup> At first glance, the Merger Order does imply that the five-year amortization will begin from the first rate case after the transaction is consummated.<sup>666</sup> However, that statement is just a restatement of what the Companies were proposing. The Commission never specifically orders that treatment. Furthermore those rate cases were resolved through settlement and this issue was not addressed in that settlement so the issue never came before the Commission for consideration. Thus, this is the first opportunity for the amortizations to begin and Commission determines they will be amortized over five years beginning with this rate case.

The evidence in this case supports the Commission's original findings in the Merger Order that the Companies should be permitted to

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<sup>665</sup> Ex. GMO 210, p.221.

<sup>666</sup> Merger Order at 239.

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recover the merger transition costs in rates over five years beginning with rates effective from this case.

### **C. Rate Case Expense**

***What is the appropriate level of rate case expense to include in this proceeding?***

#### ***Findings of Fact – Rate Case Expense***

479. KCP&L and GMO seek to recover rate case expenses incurred through the true-up date of December 31, 2010, of \$4,593,427 in the KCP&L case and \$3,177,725 for GMO<sup>667</sup> the case (rounded to \$7.7 million total rate case expense).<sup>668</sup>

480. Per an informal agreement with Staff, a substantial amount of rate case expense that occurred after the April 30, 2009 true-up date of the 2009 KCP&L (ER-2009-0089) and GMO rate cases (ER-2009-0090) was transferred to the current rate case.<sup>669</sup> Approximately 50% of the total rate case costs in the 2009 KCP&L rate case and 40% in the GMO 2009 rate case were recorded after the true-up in those cases and these costs were transferred to the current rate cases.<sup>670</sup>

481. Of the \$7.7 million total, \$1.6 million is deferred rate case expense from those previous rate cases. The total additional rate case expense sought for these cases, ER-2010-0355 and ER-2010-0356, through the true-up period is \$6.1 million.

482. Staff does not object to the Companies' proposal to defer rate case expense incurred after December 31, 2010, for consideration in a future rate case so long as Staff has an opportunity to review those expenses for prudence and reasonableness in that subsequent case.<sup>671</sup> No other party objected to this proposal.

483. Staff's detailed requests for rate case expense disallowances appeared in the true-up portion of the proceeding. Staff claims this was because it did not receive adequate supporting documentation from the Companies on a timely basis.<sup>672</sup>

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<sup>667</sup> This breaks down to \$2,001,855 for MPS and \$1,175,870 for L&P.

<sup>668</sup> Ex. KCP&L 309, p. 9.

<sup>669</sup> Ex. KCP&L 63, p. 61.

<sup>670</sup> Ex. KCP&L 64, pp. 22-23; Ex. GMO 43, p. 4.

<sup>671</sup> Ex. KCP&L 310, p. 2.

<sup>672</sup> Ex. KCP&L 309, p. 2.

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484. On June 25, 2010, Staff requested all rate case expense invoices from KCP&L in Data Request (“DR”) No. 141.<sup>673</sup> KCP&L responded on July 12, 2010, indicating that the request was “voluminous” and “If a specific vendor invoice or invoices is required, please advise.”<sup>674</sup> Staff followed up with DR 141.1 on September 3, 2010, with a narrower request for invoices over \$5,000.<sup>675</sup> KCP&L responded on September 23, 2010, by providing “face sheets” for certain legal expenses.<sup>676</sup> These face sheets provided very little information about the charges.

485. Face sheets were provided in prior cases and if additional detail was required, the company provided it. The face sheets were timely provided in response to Staffs request for legal invoices. When additional detail was requested, the detail was also provided in a timely manner with redactions for privileged material made.<sup>677</sup>

486. Staff issued DR 141.2 on November 3, 2010, seeking full invoice detail for the invoices.<sup>678</sup> KCP&L responded on November 24, 2010.<sup>679</sup> On November 24, 2010, Staff expanded its invoice request with DR 141.3 which asked for all invoices over \$1,000.<sup>680</sup> KCP&L provided the invoices on December 30, 2010.<sup>681</sup> KCP&L made no objection or assertion of privilege to DR 141.3.<sup>682</sup>

487. Staff initially advocated disallowance of all legal expenses from vendors Stinson, Morrison & Hecker; Schiff Hardin; Pegasus Global; and Morgan, Lewis & Bockius. After reviewing the invoices, however, Staff changed its position in its true-up testimony to advocate a disallowance of all legal expenses of Morgan, Lewis & Bockius; an adjustment to rate case expenses charged by Schiff Hardin; an adjustment for NextSource; and an adjustment for services of The Communication Counsel of America.<sup>683</sup>

488. The hourly rates of Morgan, Lewis & Bockius were significantly higher than the highest paid attorney from a Missouri firm in

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<sup>673</sup> Ex. KCP&L 291, Ex. KCP&L 231, p. 27.

<sup>674</sup> Ex. KCP&L 291.

<sup>675</sup> Ex. KCP&L 231, p.27.

<sup>676</sup> Ex. KCP&L 231, p. 27; and Ex. KCP&L 292.

<sup>677</sup> Tr. 3640-42.

<sup>678</sup> Ex. KCP&L 231, p. 28.

<sup>679</sup> Ex. KCP&L 231, p. 28.

<sup>680</sup> Ex. KCP&L 231, p. 28.

<sup>681</sup> Ex. KCP&L 231, p. 28.

<sup>682</sup> Ex. KCP&L 231, p. 28.

<sup>683</sup> Ex. KCP&L 309, pp. 2-9.



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this case.<sup>684</sup> The Kansas Corporation Commission also found this vendor's services to be duplicative. The KCC noted the duplicative nature of Ms. Barbara Van Gelder's services for the firm and noted she was retained to cross-examine one particular Staff witness, but that four capable attorneys for KCP&L were in the hearing room while she did so.<sup>685</sup>

489. During the cross-examination on rate case expense, two external counsel and two internal counsel were present in the hearing room for KCP&L and GMO.<sup>686</sup> Also, during the April 2010 proceedings related to File No. EO-2010-0259, several KCP&L outside attorneys were present at one time or another, including Mr. Riggins, former general counsel at KCP&L, an attorney from SNR Denton, an attorney from Fischer & Dority, an attorney from Stinson, Morrison & Hecker, and an attorney from Morgan, Lewis & Bockius.

490. Morgan Lewis was employed in Commission File No. EO-2010-0259 which has been consolidated with the current rate case so that the information could be readily shared between files. File No. EO-2010-259 was an on-the-record proceeding to determine the status of Staff's Iatan 1 audit. That proceeding was important to the rate case in that the Staff was to explain every aspect of the Iatan 1 construction audit. That audit is part of this rate case and the data requests in that docket are linked to this rate case.

491. With regard to the invoices related to Schiff Hardin, Staff proposes to disallow a portion of the expenses by, in effect, discounting the rate charged by Schiff Hardin attorneys to the hourly rate charged by Pegasus Global Holdings.<sup>687</sup> Staff claims this discount is reasonable "given the number of attorneys retained in these proceedings" it is reasonable to "assume" there was duplicative legal services.<sup>688</sup> Staff also reasons that because Pegasus Global Holdings provided services to KCP&L and GMO for expert testimony on the prudence of Iatan, and because Schiff Hardin provided expert testimony on the prudence of Iatan, that it is reasonable to assume there is some duplication of services.

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<sup>684</sup> Ex. KCP&L 309, pp. 2-9.

<sup>685</sup> Ex. KCP&L 231, Sch. 5.

<sup>686</sup> Tr. 3629-3632.

<sup>687</sup> Ex. KCP&L 309, p. 6.

<sup>688</sup> Ex. KCP&L 309, pp. 6-7.

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492. Schiff Hardin's hourly rates for attorneys and consultants were almost two times that of Pegasus' fees.<sup>689</sup>

493. The hourly rate charged by Schiff Hardin in the KCC case exceeded those for experienced attorneys in the Kansas City metropolitan area.<sup>690</sup>

494. The Kansas Corporation Commission heard many of the same issues that are before this Commission including rate case expense.<sup>691</sup> The KCC found that the expenses requested for Schiff Hardin were "particularly troubling."<sup>692</sup> And, while the KCC noted the case contained complex issues concerning the construction of a major generating facility, it found it "unreasonable to require ratepayers to be responsible for the entire rate case expense costs being sought by KCP&L."<sup>693</sup>

495. KCP&L and GMO did not object to any of Schiff Hardin's bills for legal services or any experts' invoices, or ask them to make any adjustments or corrections.<sup>694</sup>

496. In its last litigated rate case, KCP&L in-house attorneys shared in a great deal of the work associated with litigating that case. Those attorneys, whose salary and benefits are already recovered through rates, litigated issues associated with policy, off-system sales margins, Hawthorn 5 settlement costs and uranium enrichment overcharges.<sup>695</sup>

497. At least six outside attorneys with four different firms entered an appearance for KCP&L and GMO in this case.<sup>696</sup>

498. Regarding NextSource, Staff initially removed "all dollars KCP&L has included in rate case expense related to Mr. Giles' services as an independent contractor."<sup>697</sup>

499. Mr. Giles is currently a regulatory consultant to KCP&L. He has been in that capacity since his retirement in July 2009 from his position as KCP&L's Vice President, Regulatory Affairs. His

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<sup>689</sup> These highly confidential numbers are provided at Ex. KCP&L 309, p. 7.

<sup>690</sup> Ex. KCP&L 231, Sch. 5-13.

<sup>691</sup> Docket No. 10-KCPE-415-RTS, Order dated Nov. 22, 2010 (KCC Order).

<sup>692</sup> Ex. KCP&L 231, Sch. 5-13.

<sup>693</sup> Ex. KCP&L 231, Sch. 5.

<sup>694</sup> Tr. 267-268.

<sup>695</sup> Ex. KCP&L 1217.

<sup>696</sup> See *generally*, Hearing Transcripts.

<sup>697</sup> Ex. KCP&L 9, p. 6, quoting Ex. KCP&L 230, p. 21.

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responsibilities “include assisting and advising the current Senior Director, Regulatory Affairs.”<sup>698</sup>

500. At the time of his testimony, Mr. Blanc was the current Senior Director, Regulatory Affairs, assuming many of the duties that Mr. Giles’ did before his retirement.

501. Mr. Giles’ salary and benefits were included in the rates that resulted from GMO’s last rate case (ER-2010-0090) and have been in GMO’s revenue requirement used to set its electric utility rates for many years. While Mr. Giles’ job duties are not exactly the same as Mr. Blanc’s as Mr. Blanc’s his work is somewhat duplicative.<sup>699</sup>

502. The KCC did not include any expenses for NextSource (Mr. Giles) because KCP&L could not explain why its own employees could not perform the work done by this vendor.<sup>700</sup>

503. In the true-up case, with regard to Mr. Giles’ consulting fees, Staff proposed to reallocate the total adjustment between KCP&L and GMO using the payroll factors for labor expenses used in Staff’s payroll annualization.<sup>701</sup> Staff recommends allocating the disallowance within the true-up to 67% to KCP&L, 23% to GMO-MPS and 10% to GMO-L&P.

504. Staff also proposes removing the costs associated with The Communication Counsel of America from rate case expense. The services provided by The Communication Counsel of America related to witness development and coaching services. These are routine tasks typically performed by retained counsel, internal or otherwise.<sup>702</sup> Specifically, The Communication Counsel of America was engaged to prepare the Companies’ own prudence witnesses.

505. The CCA also trained KCP&L witnesses for the KCC hearing.<sup>703</sup> The KCC disallowed expenses related to The Communication Counsel of America as unjust and unreasonable.<sup>704</sup> While the KCC noted witness preparation as important it stated that, “such preparation is routinely part of the service counsel performs before a hearing.”<sup>705</sup>

506. The Companies’ shareholders benefit from having good advocates and experts for rate cases. Specifically, the Companies

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<sup>698</sup> Ex. KCP&L 24, p. 1.

<sup>699</sup> Ex. KCP&L 230, p.12.

<sup>700</sup> Ex. KCP&L 231, Sch. pp. 5-11.

<sup>701</sup> Ex. KCP&L 309, p. 8.

<sup>702</sup> Ex. KCP&L 309, p. 8.

<sup>703</sup> Ex. KCP&L 231, Sch. p. 5-11.

<sup>704</sup> Ex. KCP&L 231, Sch. p. 5-11.

<sup>705</sup> Ex. KCP&L 231, Sch. p. 5-11.

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receive the benefit of a greater recovery of [the Companies'] costs . . . for decades to come".<sup>706</sup>

507. The Companies' ratepayers benefit from having good advocates and experts for rate cases. Specifically, the ratepayers receive the benefit of reduced costs of borrowing for the Companies if the Companies get a sufficient recovery of assets in rates.<sup>707</sup>

508. The benefits to shareholders and ratepayers of having good advocates and experts are more significant with a large dollar and complex issue such as the latan prudence issues.<sup>708</sup>

509. KCP&L and GMO relied heavily on the use of outside consultants for the litigation of these cases. The following consultants each filed testimony in this matter and were charged to Missouri rate case expense: Chris Giles;<sup>709</sup> Gary Goble;<sup>710</sup> Samuel Hadaway;<sup>711</sup> Steven Jones;<sup>712</sup> Larry Loos;<sup>713</sup> Daniel Meyer;<sup>714</sup> Kris Nielsen;<sup>715</sup> Paul Normand;<sup>716</sup> Kenneth Roberts;<sup>717</sup> Michael Schnitzer;<sup>718</sup> John Spanos;<sup>719</sup> and Ken Vogl.<sup>720</sup>

510. Staff has no objection to KCP&L and GMO amortizing its rate case expense over a two-year period and deferring expenses incurred after the December 31, 2010, true-up date with Staff review for prudence and reasonableness.<sup>721</sup>

511. The KCC ordered a four-year amortization period for rate case expense.<sup>722</sup>

512. KCP&L and GMO have no plans to file their next rate cases.<sup>723</sup>

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<sup>706</sup> Tr. 3647.

<sup>707</sup> Tr. 3648-3649.

<sup>708</sup> Tr. 3648.

<sup>709</sup> Exs. KCP&L 24 and 25.

<sup>710</sup> Ex. KCP&L 26.

<sup>711</sup> Exs. KCP&L 27-29.

<sup>712</sup> Ex. KCP&L 38.

<sup>713</sup> Exs. KCP&L 39-41.

<sup>714</sup> Exs. KCP&L 43-45.

<sup>715</sup> Exs. KCP&L 46.

<sup>716</sup> Exs. KCP&L 47-49.

<sup>717</sup> Exs. KCP&L 50-53.

<sup>718</sup> Ex. KCP&L 58.

<sup>719</sup> Exs. KCP&L 59-61.

<sup>720</sup> Ex. KCP&L 62.

<sup>721</sup> Ex. KCP&L 310, p. 2.

<sup>722</sup> Docket No. 10-KCPE-415-RTS, Order dated Nov. 22, 2010, ordered paragraph R, p. 140.

<sup>723</sup> Tr. 3373.

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513. Some adjustment in the amortization period for rate case expense is reasonable. The Commission finds that a three-year amortization period is sufficient.

### ***Conclusions of Law – Rate Case Expense***

61. The Commission can disallow costs that are not of benefit to ratepayers, and there does not need to be a showing of bad faith or abuse of discretion for the Commission to disallow costs.<sup>724</sup>

62. In File No. GR-2004-0209, the Commission reduced the amount of rate case expense incurred by Missouri Gas Energy (MGE) by the disallowance of certain attorney fees. In that Report and Order, the Commission recognized the unfairness of charging ratepayers high attorney fees.<sup>725</sup>

63. In a 1993 Missouri-American decision, the Commission attempted to provide some definition by which to measure whether rate case expense is necessary and prudently incurred. In that case the Commission based its decision on whether actual evidence exists of cost containment.

The Commission must continue to look to the record for evidence in support of rate case expense and in this case that evidence is lacking. Disallowing all expense, or perhaps even disallowing any prudently incurred rate case expense could be viewed as violating the Company's procedural rights. The Commission does not want to put itself in the position of discouraging necessary rate cases by discouraging rate case expense. **The operative words here, however, are necessary and prudently incurred. The record does not reflect efforts at cost containment and consequently it does not support that these expenses have been prudently incurred.**<sup>726</sup>

Absent evidence of cost containment, the Commission in that case disallowed approximately one-third of Missouri American's rate case expense.

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<sup>724</sup> *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 600 S.W.2d 222, 228-29 (Mo. App., W.D. 1980), *app. dis'd*, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed.2d 795 (1981); *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 645 S.W.2d 44, 55-56 (Mo. App., W.D. 1982).

<sup>725</sup> *Report and Order*, File No. WR-93-212 (issued November 18, 1993). (Emphasis Added.)

<sup>726</sup> *Id.*

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### ***Decision – Rate Case Expense***

KCP&L and GMO ask that they be allowed to recover the entirety of their \$7.7 million rate case expense (including \$1.6 million from the previous cases and \$6.1 million combined for the current cases) in rates amortized over a two-year period with any rate case expense incurred after the true-up period to be deferred to the next rate cases. In response, Staff and MEUA propose to disallow a certain portion of those costs. Staff sets out specific disallowances while MEUA proposes an across the board 33% reduction.<sup>727</sup> In addition, MEUA suggests that the Commission amortize the rate case expense over a four-year period instead of a two-year period.<sup>728</sup>

The Companies were somewhat obstructive in responding to Staff's data requests by not providing full information up front and thus requiring Staff to make several requests before obtaining the information it had requested. Staff, however, does not explain its own delays in making follow-up requests, nor did Staff bring the non-responsive answers to Commission's attention in an expedient manner through a discovery conference or at the status conferences held for this purpose. Therefore, the Commission finds that both parties were to blame for the delays in getting information to Staff. Because the Companies are partially to blame for this delay, the Commission finds that it was proper for the Staff to bring its specific rate case disallowances to the true-up proceeding.

Although the Commission acknowledges the complexity and significance of these rate cases, the Commission is concerned with the continued increase of rate case expenses. It is undisputable that shareholders benefit from hiring the very best advocates and experts. This clearly aids in their ability to argue for a higher return on equity as well as the recovery of a greater percentage of costs. Yet, given the magnitude of these expenses (\$7.7 million), with substantially more to be

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<sup>727</sup> MEUA incorrectly argues that the total rate case expense for ER-2010-0355 and ER-2010-0356 will be \$13.8 million. First, MEUA includes the \$1.6 million for the previous rate cases in its beginning figure, then it adds an additional \$6.1 million as testified to by Mr. Weisensee (Tr. 3634). MEUA, however, misinterprets Mr. Weisensee's testimony. The Commission interprets Mr. Weisensee as stating that the rate case expense being claimed for ER-2010-0355 and ER-2010-0356 is \$6.1 million through the end of the true-up period. There will certainly be a substantial amount more rate case expense to follow; however, the evidence is unclear what additional rate case expense for these cases will be deferred to the next rate case.

<sup>728</sup> Industrials' Initial Brief p. 66-67.

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deferred to the next case, the Commission would expect to see some evidence that KCP&L and GMO had engaged in some cost containment. Mr. Blanc, however, testified that of the invoices received for legal fees and expert consultants not one was questioned by the Companies.

Certainly, given the benefits enjoyed by the shareholders, the evidence presented by Staff, and absent some sort of cost containment some disallowances are necessary. The Commission also recognizes that, unlike the period during the Regulatory Plan, KCP&L and GMO have no definitive schedule for their next rate case. Faced with similar seemingly exorbitant expenses, the KCC ordered a four-year, rather than a two-year amortization period for rate case expense. The Commission determines that an extended amortization period for rate case expense is in order; however, based on the Commission's experience with these companies and the amount of rate case and other expenses being deferred to a future proceeding, the Commission determines that a three-year amortization period for rate case expense is sufficient.

With regard to Staff's proposed adjustment to remove all legal expenses of Morgan, Lewis & Bockius, Staff claims the attorneys' rates are excessive when compared to local attorneys, the expenses are not related to the current rate case and work is duplicative of other attorneys' work. The Commission cannot determine that it is reasonable to apply the rates of Missouri law firm rates to the rates charged by attorneys practicing in other, possibly more expensive locations without better evidence. The Commission concludes the legal expenses of Morgan, Lewis & Bockius should not be eliminated as the costs were not duplicative or the evidence sufficiently competent to prove the fees were excessive.

The Commission concludes the Schiff Hardin and Pegasus witnesses each provided testimony on separate, discrete issues related to the reasonableness of the expenditures related to the construction of latan. As a result, there was no duplication of effort and Staff "assumed" incorrectly. Thus, the Commission rejects Staff's proposed disallowance, including a reduction to Schiff Hardin's rate as the evidence was not sufficiently competent to prove the fees were excessive.

With regard to NextSource, however, the Commission concludes Mr. Giles and Mr. Blanc's work were somewhat duplicative. In addition, the question was raised but never answered as to why KCP&L internal employees were not able to provide the services Mr. Giles provided? Based on the record, the Commission determines that the

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expenses with regard to NextSource as allocated by Staff between the companies shall be disallowed.

Finally, Staff has proposed the disallowance of the expenses for the services of the CCA. The CCA provided witness development and coaching services, routine tasks typically performed by retained counsel, internal or otherwise. The KCC also disallowed similar expenses as unjust and unreasonable. The Commission determines that the CCA expense should be disallowed as duplicative of other services that were performed or should have been performed KCP&L's and GMO's attorneys.

The amounts allowed and disallowed represent the true-up amounts recorded as of December 31, 2010, and are not final rate case expenses. Rate case expenses for these cases after the true-up will be deferred for possible recovery in the next rate case, subject to review for prudence and reasonableness.

### **D. Low Income Weatherization Program**

**A. *Should KCP&L and GMO continue to fund their low-income weatherization programs at the current levels of funding?***

**B. *If so, should the funds continue to be administered under current procedures or should the Commission order they be deposited into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and MDNR?***

### ***Findings of Fact – Low Income Weatherization***

514. Current funding by KCP&L and GMO for low income weatherization programs annually is \$573,888 and \$150,000, respectively.<sup>729</sup>

515. KCP&L has spent approximately ninety-six percent (96%) of the budgeted funds for its existing low-income weatherization program.<sup>730</sup>

516. GMO has utilized a much lower percentage of the 2007 through 2010 budgeted funds for weatherization.<sup>731</sup>

517. Staff recommended that KCP&L and GMO be required to continue to provide annual funding of \$573,888 and \$150,000,

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<sup>729</sup> Ex. KCP&L 210, p. 143; Ex. GMO 210, p. 156.

<sup>730</sup> Ex. KCP&L 246, p. 4; Tr. 3606.

<sup>731</sup> The exact number is contained in the "Highly Confidential" Testimony of Henry E. Warren (HC), Staff Report, Revenue Requirement Cost of Service. Ex. GMO 210, p.154.



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respectively. Staff also suggested that unspent weatherization funds should be placed into an account with EIERA.<sup>732</sup>

518. The Environmental Improvement and Energy Resources Authority (EIERA) is a program affiliated with MDNR. EIERA is a separate and distinct entity—a quasi-governmental agency--and is not a party to these cases. EIERA has a much broader scope and mission than just administering weatherization funds under MDNR guidelines. EIERA is “involved in numerous projects and programs including providing bond financing for environmental projects such as water and wastewater treatment facilities, energy efficiency loans and other pollution control projects. . . . EIERA has broad statutory authority that goes significantly beyond managing and disbursing federal and other weatherization funding for MDNR.”<sup>733</sup>

519. The EIERA program has recently spent a much lower percentage of its funds than KCP&L for weatherization purposes.<sup>734</sup>

520. KCP&L and GMO disagree with both of Staff proposals.

521. The Customer Program Advisory Group (CPAG) includes Staff, the Office of the Public Counsel, the Missouri Department of Natural Resources, the City of Kansas City, and Praxair, Inc. The CPAG has tracked, discussed, and overseen the implementation and evaluation of KCP&L's Low-Income Weatherization Program.<sup>735</sup>

522. The GMO Advisory Group (GMOAG) includes Staff, the Public Counsel, the MDNR, the City of Kansas City, and the Sedalia Industrial Energy Users Association. The GMOAG has tracked, discussed, and overseen the implementation and evaluation of GMO's Low-Income Weatherization Program.<sup>736</sup>

523. Prior to Staff's proposal in this proceeding, MDNR had not been approached by any party regarding the proposal to transfer funds to EIERA. To accommodate Staff's request, EIERA would have to balance resources with other projects they are involved in, and consider whether there are significant design differences between the federal weatherization programs and KCP&L's program.<sup>737</sup>

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<sup>732</sup> Ex. KCP&L 246 and Ex. GMO 247.

<sup>733</sup> Ex. GMO 603, p. 3.

<sup>734</sup> Tr. 3608.

<sup>735</sup> KCP&L-GMO Low Income Weatherization Program Evaluation, Opinion Dynamics Corporation, August, 2010.

<sup>736</sup> KCP&L-GMO Low Income Weatherization Program Evaluation, Opinion Dynamics Corporation, August, 2010.

<sup>737</sup> Ex. KCP&L 605 and Ex. GMO 603, p. 3.

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524. There are a number of administrative burdens for MDNR and EIERA that must be considered in order to place these funds in EIERA. No other public utility--gas or electric--has been ordered to deposit weatherization funds with EIERA; in every other case it has been the utility that requested such an arrangement. Furthermore, payment of funds could not be effectuated prior to execution of an agreement with EIERA, which in all other cases has taken the form of a Cooperation and Funding Agreement entered into voluntarily by EIERA, MDNR, the Missouri Public Service Commission and the public utility.<sup>738</sup>

525. In addition, KCP&L and GMO would need to commit to annual up-front funding for low-income weatherization programs for the Staff's proposed approach to be workable and the additional burdens to be justified.<sup>739</sup>

526. The benefits of placing these funds up-front with EIERA would be to provide a definite amount of weatherization funding on an up-front basis, and provide for unspent funds, including interest, to be available to local weatherization agencies so that the funds remain available for the purpose for which they are dedicated, especially after American Recovery and Reinvestment Act funds are expended.<sup>740</sup>

527. No other public utility--gas or electric--has been ordered by this Commission without the utility's consent and support to deposit weatherization funds with EIERA. In every other case it has been the utility that requested such an arrangement.<sup>741</sup>

528. Additionally, Staff is recommending that the Companies modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. To implement Staff's recommendation would be harmful to the Companies' cash flow and place an undue burden on the Companies.<sup>742</sup>

529. Staff further recommends that KCP&L and GMO deposit into an EIERA account any budgeted money that has not been disbursed at the end of each fiscal year and that has been specifically targeted for the Low Income Weatherization Program to be utilized by the Community Action agencies or other local agencies. Additionally, any funds that have not been spent as included in KCP&L's regulatory plan and GMO's

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<sup>738</sup> Tr. 3605.

<sup>739</sup> Ex. KCP&L 605, p. 3.

<sup>740</sup> Ex. KCP&L 605 and Ex. GMO 603, pp. 2-3.

<sup>741</sup> Tr. 3604-3605.

<sup>742</sup> Ex. KCP&L 55, p. 3; Ex. GMO 33, pp. 12-13.

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2007 through 2010 budget Staff recommends those funds should be put in an EIERA account.

530. Staff also recommends that funds expended be placed in the DSM regulatory asset account at the time it is provided to the weatherization agency or when sent to EIERA.

### ***Conclusions of Law – Low Income Weatherization***

64. The Commission has required spending by other utilities when the amount is recovered in rates as an expense.<sup>743</sup>

### **Decision – Low Income Weatherization**

Two issues have been presented to the Commission for decision with regard to Low Income Weatherization programs: should the Companies be required to continue those programs and at the current level of funding; and if so, how should those funds be administered.

Staff recommended that KCP&L and GMO be required to continue to provide annual funding for low income weatherization programs in the amounts of \$573,888 and \$150,000, respectively.<sup>744</sup> Staff also suggested that unspent weatherization funds should be placed into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and the Missouri Department of Natural Resources (MDNR).<sup>745</sup>

MDNR agrees that the Companies should continue to fund their low income weatherization programs at the current funding levels, but recommends against Staff's proposed method of administration.

The Companies contend that this rate case is not the proper forum for a decision to continue the current funding levels for low income weatherization. KCP&L and GMO argue that such proposals should be first vetted with the advisory groups. The companies further argue that a Commission determination of the recovery mechanism for such programs should be made before a decision on the level of weatherization funding is made.

This rate case is the proper forum to discuss the issue of the Low Income Weatherization Program funding. The CPAG has tracked, discussed, and overseen the implementation and evaluation of KCP&L's

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<sup>743</sup> *In the Matter of Union Electric Company d/b/a AmerenUE for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*, Report and Order, File No. ER-2008-0318, (issued Jan. 27, 2009).

<sup>744</sup> Ex. KCP&L 210, p. 143; Ex. GMO 210, p. 156.

<sup>745</sup> Ex. KCP&L 246 and Ex. GMO 247.

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Low-Income Weatherization Program. The GMOAG has tracked, discussed, and overseen the implementation and evaluation of GMO's Low-Income Weatherization Program.<sup>746</sup> However, as the name implies, these are *advisory* groups for implementing and evaluating the demand-side programs. The advisory groups cannot and should not decide the budget for low-income energy efficiency programs.

The Companies argue that the Commission cannot order spending without a cost recovery mechanism. KCP&L and GMO suggest it would be unlawful for the Commission to mandate specific funding for low income weatherization without a mechanism for the Companies to recover mandated expenditures. However, Staff's recommendations stem from programs and policies that KCP&L and GMO previously set in place. In addition, the Commission has required spending by other utilities when the amount is included in the case as an expense as it will be in this instance.<sup>747</sup>

Staff requests the Commission to order KCP&L and GMO to deposit low income weatherization funds into an account with the Environmental Improvement and Energy Resources Authority (EIERA) to be administered by EIERA and MDNR. While GMO failed to fully expend its low income weatherization funding budgeted during the regulatory plan, and recognizing there are some benefits to placing utility weatherization funds into an EIERA account, placing the funds with EIERA is not appropriate at this time. There may be significant program design differences between the federal low-income weatherization program and the companies' current low-income weatherization programs that would make program management and monitoring more difficult for MDNR. As described in MDNR witness Bickford's testimony, there are a number of administrative burdens for MDNR and EIERA that must be considered and KCP&L and GMO would need to commit to annual up-front funding for low-income weatherization programs for the Staff's proposed approach to be workable and the additional burdens to be justified. In addition, no other public utility--gas or electric--has been ordered by this Commission without the utility's consent and support to deposit weatherization funds with EIERA. In every other case it has been the utility that requested such an arrangement.

Furthermore, while the EIERA is affiliated with MDNR, EIERA is a separate and distinct entity—a quasi-governmental agency--and is not

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<sup>746</sup> *Id.*

<sup>747</sup> File No. ER-2008-0318.

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a party to these cases. EIERA is “involved in numerous projects and programs including providing bond financing for environmental projects such as water and wastewater treatment facilities, energy efficiency loans and other pollution control projects. . . . EIERA has broad statutory authority that goes significantly beyond managing and disbursing federal and other weatherization funding for MDNR.”<sup>748</sup> The Commission also concludes that it is unreasonable to require that KCP&L deposit funds into an EIERA account until the advisory groups have reviewed and made a recommendation on the proposal.

The Commission also concludes that it will not adopt Staff’s recommendation that the Companies be required to modify their direct reimbursement payment method to the weatherization agencies from monthly to annual. The Commission concludes that this recommendation would be harmful to the Companies’ cash flow and place an undue burden on the Companies.

The Commission determines that KCP&L and GMO shall: continue their respective low-income weatherization programs at their current levels of funding; continue working with local community action agencies; and evaluate transition of the low income weatherization funds to the EIERA and administration of the programs to DNR and present that evaluation to the CPAG or GMOAG for consideration. If the CPAG or GMOAG determines that MDNR administration of funds to be provided to EIERA is appropriate, a Cooperative Funding Agreement will be presented to the Commission, consistent with the method of funding other utility weatherization programs.

### **E. Allocation of Iatan 2 Between L&P and MPS**

***What is the appropriate supply allocation between the L&P and MPS service territories?***

#### ***Findings of Fact – Allocation of Iatan 2 Between L&P and MPS***

531. This issue originates with the merger of UtiliCorp United, Inc., and St. Joseph Light & Power Company in 2000. In obtaining approval from this Commission for that merger, UtiliCorp, now named GMO, committed to not changing the rates of the former St. Joseph Light & Power Company customers due to the merger. Since that time GMO has had two rate districts, one in and about St. Joseph, Missouri—the

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<sup>748</sup> Ex. GMO 603, p. 3.

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L&P rate district—and one for the remainder of its service area—the MPS rate district. Since that merger in 2000, the premerger ownership of assets of the MPS and L&P districts have been used as the basis for assigning and allocating costs and revenues for determining rates for these two districts.<sup>749</sup>

532. For this case, GMO proposes allocating 41 MW of latan 2 to the L&P service area, and the remaining 112 MW to the MPS service area, based upon the balancing of the respective baseload capacity needs of L&P and the MPS service areas, as well as the resulting rate impacts upon its customers.<sup>750</sup>

533. GMO's proposed allocation of latan 2 results in 60% of L&P's 2011 projected peak demand to be met with base load capacity, and 61% of MPS's projected peak to be met with base load capacity. Using GMO's allocation proposal, both service areas would have nearly identical percentages of base capacity.<sup>751</sup> GMO's proposal also recognizes that latan 2 is jointly dispatched between both the L&P and MPS service areas, based upon economics rather than previous corporate history.<sup>752</sup>

534. The Staff is recommending that a substantially larger share of latan 2 be allocated to the L&P service area than what GMO has requested. Staff recommends allocating 100 MW of latan 2 to the L&P rate jurisdiction. Only 53 MWs would be allocated to MPS under Staff's proposal.<sup>753</sup> Staff's proposal would have 73% of L&P's peak met with base load capacity, and only 57% of MPS's peak would be met with base load capacity.<sup>754</sup>

535. The latan 2 Allocation issue is more akin to a rate design issue since it determines the relative amount of the rate increase that will be received by both the MPS and the L&P service areas rather than the overall revenue requirement impact of latan 2.<sup>755</sup>

536. "Until this case, with the addition of latan 2 at a nearly \$2 billion cost, GMO's capacity costs were easily identifiable to either MPS or L&P. Although MPS and L&P generation is jointly dispatched, GMO has not needed additional capacity to serve L&P customers until now.

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<sup>749</sup> Ex. GMO-210, pp. 94-95 and Appendix 5, Sch. LMM-3.

<sup>750</sup> Ex. GMO 33, pp. 10-12.; Ex. GMO-5, pp. 7-10; Ex. GMO 11, pp. 14-16.

<sup>751</sup> Ex. GMO 11, pp. 15-16.

<sup>752</sup> Tr. 3847.

<sup>753</sup> Tr. 3853.

<sup>754</sup> Tr. 3844; Ex. GMO 11, pp. 15-16.

<sup>755</sup> Tr. 3821.

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Prior to the addition of latan 2, GMO's capacity addition investment and costs since the merger have all been assigned to MPS.<sup>756</sup>

537. When Utilicorp and St. Joseph Light & Power Company merged, St. Joseph Light & Power Company had more than enough generation resources to serve its load, including growth, for many years, and MPS needed significant additional capacity to replace its 500 MW purchased power contract that ended in May of 2005.<sup>757</sup>

538. Later, Aquila (now known as GMO), due to its poor financial condition, only had the opportunity to be a part owner of latan 2 because it had acquired St. Joseph Light & Power Company's ownership in the latan station in the 2000 merger.<sup>758</sup>

539. Because it was the MPS rate district that needed additional capacity to serve its retail customers, the costs of South Harper were assigned to MPS.<sup>759</sup>

540. Ownership rights of the previous stand-alone companies and the effect of the historical allocations are compelling reasons to continue the allocations based on the costs of the assets being used to serve the customers absent a full proposal to have single tariff pricing for the company.<sup>760</sup>

541. Staff's proposal more correctly matches the proper level of latan 2 costs to customers who originally supported the latan plant facility and who need replacement of the base load purchased power capacity that has expired. Without this amount of capacity, L&P, if it was a stand-alone utility, would not have sufficient capacity to meet the energy requirements of its customers.<sup>761</sup> Because MPS will also need additional base load capacity, Staff has assigned the remainder of GMO's share of latan 2 to MPS.

542. GMO's methodology, which results in a similar mix of base/non-base generation, is not supported by the load requirements of MPS and L&P. L&P's winter heating load is of nearly the same magnitude as its summer cooling load, signifying a high saturation of electric heating whereas MPS's load showed little response to winter. As a percentage of load, L&P has more industrial load than MPS and MPS

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<sup>756</sup> Ex. GMO 210, p. 95.

<sup>757</sup> Ex. GMO 210, p. 91; Ex. GMO 233, p. 4.

<sup>758</sup> Ex. GMO 210, p. 99; Ex. GMO 217, pp. 45-48.

<sup>759</sup> Ex. GMO 210, pp. 85, 95, 105-106.

<sup>760</sup> Ex. GMO 232, p. 8.

<sup>761</sup> Ex. GMO 210, p. 99; Ex. GMO 232, p. 8; Ex. GMO 233.

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has more weather-sensitive commercial load than L&P. All of which means L&P can more efficiently use additional baseload capacity such as Iatan 2 than MPS.<sup>762</sup> L&P has more baseload energy needs than MPS and, therefore, should be allocated more of Iatan 2. As a result, it is appropriate it have more baseload generation in L&P's mix than MPS's.

543. Staff's allocation takes into account not only the difference in capital costs assigned to MPS and L&P, but also the impact on fuel costs. Iatan 2 is expected to be GMO's lowest cost generation unit.<sup>763</sup> And, it is expected to "provide inexpensive energy for at least half a century[.]"<sup>764</sup>

544. With the addition of Iatan 2, GMO's more expensive to run natural gas-fired units will be used less, resulting in lowered MPS fuel costs. While L&P will reap the same benefit, the beneficial impact on L&P's fuel costs will be less since power from Iatan 2 will replace low-cost energy L&P has been getting through a 100 MW purchased power agreement that ends in May of 2011. Further, for each incremental MW less than 100 MW of Iatan 2 that is allocated to L&P (the capacity of the expiring purchased power agreement), L&P's fuel costs will greatly increase because, in each hour, the low-cost Iatan 2 energy L&P would have gotten will be replaced by energy from MPS's highest operating cost unit that is running. Therefore, Staff's recommendation of allocating more MWs to L&P results in the lower fuel costs for L&P than MPS's recommended allocation.<sup>765</sup>

545. Counting "fuel savings of 4 to \$5 million a year . . . over [a] 50-year time period, . . . [equates to] over a half a billion dollars of savings based on their [L&P's] allocation."<sup>766</sup> The Commission is persuaded by Staff that it is in the long-term best interest of the L&P customers to take a larger share of the allocation of Iatan 2 as an upfront cost, thereby avoiding some fuel costs and some capacity charges and giving those customers, lower-cost baseload generation for the long-term.

546. Having determined that L&P customers would benefit in the long-run from Staff's proposed allocation, the Commission still cannot, however, ignore the immediate effect on those customer's rates.

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<sup>762</sup> Ex. GMO 233, pp. 10-11.

<sup>763</sup> Tim M. Rush, Tr. 3815.

<sup>764</sup> Tr. 3862.

<sup>765</sup> Ex. GMO 232, p. 5.

<sup>766</sup> Tr. 3871-72.



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It is undisputed that economic conditions are tough and that the rate impact of adding 100 MW to L&P customers “will not be easy for many of its customers.”<sup>767</sup>

547. Staff’s proposal would increase the revenue requirement for the L&P service area by approximately \$20 million above GMO’s request.<sup>768</sup> GMO requested a \$22 million total increase for the L&P area after considering all of the other cost drivers in the case. Adding another \$20 million to account for Staff’s proposed allocation of Iatan 2, will have too much of an adverse impact upon GMO’s customers that live in the St. Joseph and other L&P service areas.<sup>769</sup>

548. “All additions of large base load units in Missouri initially have resulted in a large increase on the utility’s revenue requirement. . . . The initial inclusion of St. Joseph Light & Power Company’s investment and costs in Iatan 1 in its revenue requirement caused its rates to increase by over 26%. When Union Electric Company’s investment and costs in the Callaway Nuclear Plant were initially included in its revenue requirement, despite having a large customer base, it caused Union Electric Company’s rates to increase by 45%. Further, when KCPL’s investment and costs of the Wolf Creek Nuclear plant was first included in KCPL’s revenue requirement, it caused KCPL’s rates in Missouri to increase by 21.75%. Despite the initial large increase in rates when these base load units were first included in the utilities’ revenue requirements, in the long-term they have resulted in lower rates for the customers of these utilities - lower rates which those customers are now enjoying.”<sup>770</sup> Those customers who initially paid higher rates for generating facilities still being used to serve them—primarily Iatan 1—should get the benefit of the now relatively lower cost of those units to generate electricity.

549. GMO jointly dispatches its generating units to serve load in both the MPS and L&P, and has stated since it acquired St. Joseph Light & Power Company it has a long-term goal of having a uniform tariff, including uniform rates throughout its service territory.<sup>771</sup>

550. GMO’s retail rates for MPS and L&P not only differ significantly, they have differed significantly for many years. The

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<sup>767</sup> Ex. GMO 210, p. 95

<sup>768</sup> Tr. 3820.

<sup>769</sup> Tr. 3820.

<sup>770</sup> Ex. GMO 210, p. 103.

<sup>771</sup> Ex. GMO 210, p. 95.

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following table shows, for residential customers, a comparison of residential rates:<sup>772</sup>

<b>Residential rate (¢/kWh)</b>	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
KCPL- Kansas	9.07	8.43	7.43	6.92	6.88
KCPL-Missouri	8.51	8.14	7.61	6.90	6.88
<b>MPS</b>	<b>9.67</b>	<b>9.10</b>	<b>8.64</b>	<b>8.08</b>	<b>7.45</b>
<b>L&amp;P</b>	<b>7.43</b>	<b>7.03</b>	<b>6.78</b>	<b>6.31</b>	<b>5.97</b>
Ameren Missouri	7.03	6.53	6.60	6.60	6.52
Empire	9.75	9.19	9.10	8.35	7.98
Missouri Average	7.77	7.27	5.93	6.96	6.77
USA Average	11.72	11.52	10.95	10.62	9.60

As this table shows, current MPS residential rates exceed the average of Missouri residential rates of rate regulated utilities (9.67 ¢/kWh vs. 7.77 ¢/kWh) and current L&P residential rates are below the average of Missouri residential rates of rate regulated utilities (7.43 ¢/kWh vs. 7.77 ¢/kWh).

551. GMO's proposal would have the effect of widening the gap between MPS and L&P rates;<sup>773</sup> Staff's proposal would not.

552. The evidence indicates that there is more than one allocation scenario for allocating latan 2 that would be reasonable.<sup>774</sup> In fact, Staff analyzed five different scenarios in the Cost of Service Report. Emphasizing different factors (such as rate impact, fuels costs, "ownership" rights, and capacity needs of each area) each of the 5 Scenarios may be reasonable.<sup>775</sup> In addition, Ms. Mantle testified during questioning from Commissioner Davis, that some other allocation may be reasonable.<sup>776</sup>

553. The scenarios examined by Staff are:
- Scenario 1: 153 MW to L&P and 0 MW to MPS
  - Scenario 2: 100 MW to L&P and 53 MW to MPS
  - Scenario 3: 53 MW to L& P and 100 MW to MPS

<sup>772</sup> Ex. GMO 215, p. 37.

<sup>773</sup> Ex. GMO 232, p. 6.

<sup>774</sup> Tr. 3851.

<sup>775</sup> Tr. 3851.

<sup>776</sup> Tr. 3883-3884.

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Scenario 4: 41 MW to L&P and 112 MW to MPS  
 Scenario 5: 153 MW to MPS and 0 MW to L&P.<sup>777</sup>

554. The effects of each scenario on the MPS and L&P areas and the percentages of current revenues for each are as follows:<sup>778</sup>

MPS				
Scenario	Capital Costs	Change in Fuel Costs	Total	% of Current Revenue
1	\$0	\$14,115,884	\$14,115,884	2.6%
2	\$18,645,319	\$10,532,214	\$29,177,533	5.3%
3	\$35,180,760	\$6,079,896	\$41,260,656	7.5%
4	\$39,401,433	\$4,764,849	\$44,166,282	8.0%
5	\$53,825,174	\$0	\$53,825,174	9.8%

L&P					
Scenario	Capital Costs	Change in Fuel Costs	NPPD Capacity Payment	Total	% of Current Revenue
1	\$53,446,831	\$0	\$12,120,000	\$41,326,831	31.4%
2	\$34,933,389	\$3,583,635	\$12,120,000	\$26,397,024	20.1%
3	\$18,514,261	\$8,035,858	\$12,120,000	\$14,430,119	11.0%
4	\$14,322,353	\$9,350,953	\$12,120,000	\$11,553,306	8.8%
5	\$0	\$14,115,8100	\$12,120,000	\$1,995,810	1.5%

555. Following the precedent of using the pre-2000 merger ownership of assets as a basis for assigning and allocating costs related to generating units for determining rates for MPS and L&P, Staff has relied on the following to shape its recommendation and the Commission also relies on these factors in making its decision: 1) It was St. Joseph

<sup>777</sup> Ex. GMO 210, p. 98.

<sup>778</sup> Ex. GMO 210, p. 101.

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Light & Power Company that had an ownership interest in the Iatan station before the construction of Iatan 2; 2) it was St. Joseph Light & Power Company that entered into a long-term purchased power contract with NPPD for 100 MW of baseload capacity that expires in May 2011, while MPS does not have a similar agreement that will expire as imminently<sup>779</sup>; and 3) the effects on MPS's and L&P's rates of different allocations of Iatan 2.<sup>780</sup>

556. Based on these considerations, the precedent of looking at the capacity needs of each district, and considering all the interests presented both long-term and short-term, the Commission finds that Scenario 3 (53 MW to L&P and 100 MW to MPS) is the allocation that is just and reasonable and in the public interest.

557. With this allocation, both L&P and MPS will receive some of the Iatan 2 base load capacity. In addition, although a larger percentage increase in rates than proposed by GMO, L&P customers are currently paying lower rates and they will benefit long-term from the lower-cost generation far into the future.

### ***Conclusions of Law – Allocation of Iatan 2 Between L&P and MPS***

65. Based on the findings above, the Commission concludes that Staff's Scenario 3 (53 MW to L&P and 100 MW to MPS) is the allocation that is just and reasonable and in the public interest.

### **Decision – Allocation of Iatan 2 Between L&P and MPS**

The Commission concludes that it should balance the varied interests of GMO's MPS and L&P district customers. In analyzing these interests, GMO (and the interested intervenors including the City of St. Joseph) and Staff have each presented good arguments for their allocations. The Commission has determined that allocating Iatan 2 by assigning 53 MW to the L&P district and 100 MW to the MPS district is the appropriate allocation is just and reasonable and in the public interest.

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<sup>779</sup> MPS has a 75 MW purchased power agreement with NPPD, but it does not expire until 2014. Ex. GMO 11, pp. 6-7; Ex. GMO 33, p. 11, Tim M. Rush, Tr. 3880; Mantle Tr. 3867-68.

<sup>780</sup> Ex. GMO 233, p. 8.

**IV. Fuel Adjustment Clause**

Several outstanding issues exist with regard to GMO's fuel adjustment clause ("FAC") and whether it should continue or be modified. The Commission determines these issues as set out below.

**A. FAC Rebasing**

***Should the Company be required to rebase its fuel and purchase power expenses, net of off system sales, in excess of such amounts built into base rates?***

**Findings of Fact – FAC Rebasing**

558. The Company did not propose to increase base rates by rebasing or resetting its Base Energy Costs, as defined in its Fuel and Purchased Power Adjustment Clause ("FAC") tariff sheets. These base costs are the core energy costs to which are applied (a) variable fuel component costs, (b) purchased power energy charges, (c) emission allowance costs, (d) adjustments for recovery period sales variations, and (e) interest on deferred electric energy costs.<sup>781</sup>

559. Staff has proposed to rebase the FAC Base Energy Cost. The effect of rebasing is to increase base rates equal to the normalized Based Energy Costs for fuel and purchased power costs, less off-system sales revenue in the 2009 test year, as trued-up, for both the MPS and the L&P Divisions.<sup>782</sup>

560. Based on the true-up information as of December 31, 2010, rebasing the FAC using Staff's recommended revenue requirements has the effect of increasing GMO's fuel adjustment clause base energy cost for MPS and L&P by 2.3% and 30.1%, respectively. But these percentages are deceptive because the FAC charge would also be lowered.<sup>783</sup> Customers are already paying 95% of the charges plus possible interest accruals, as part of the FAC.

561. GMO stated that it proposed to keep the current base amounts for the MPS Division (\$0.02348/KWh net system input) and the L&P Division (\$0.01642/KWh net system input) in order to keep GMO's overall rate request to as low an amount as reasonable, yet still provide a fair return to the Company.<sup>784</sup> And, because GMO has not rebased these Base Energy Costs and has, thus, not adjusted the FAC to reflect

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<sup>781</sup> See, GMO Tariff Sheets 124-126.1, Proposed Tariff Change Schedules.

<sup>782</sup> See Ex. GMO 210, pp. 199-201.

<sup>783</sup> Ex. GMO 241, pp. 8-9.

<sup>784</sup> Ex. GMO 33, p. 3; Ex. GMO 34, p. 26.

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such rebasing, GMO has agreed to forego 5% of the increase in its future fuel and purchased power expenses under the current FAC that only allows it to recover 95% of its prudently incurred costs.<sup>785</sup> Under GMO's proposal customers may be subjected to paying interest charges which can occur if the FAC is not rebased.<sup>786</sup>

562. The Commission agrees with Staff that customers in each general rate case should be assured that they receive the correct price signals through fixed rates as soon as possible.<sup>787</sup> GMO's proposal does not send the correct price signal to the customers.

563. The Commission will adopt Staff's recommendation to match the base energy costs in the FAC to the base energy cost in the test year total revenue requirement used for setting the general rates because doing so ensures that retail customers get the correct price signal through fixed rates for the utility's cost to serve them as soon as possible.<sup>788</sup> In addition, the utility's retail customers will avoid paying interest on fuel and purchased power costs that may be collected later through its fuel adjustment clause.<sup>789</sup>

564. As Staff demonstrated three examples to support rebasing that the Commission found persuasive:

Case 1 illustrates that if the Base Energy Cost in the FAC is equal to the Base Energy Cost in the test year revenue requirement, the utility does not benefit nor is it penalized as a result of the level of actual energy costs.

Case 2 illustrates that if the Base Energy Cost in the FAC is less than the Base Energy Cost in the test year revenue requirement, the utility is expected to benefit and customers are expected to be penalized regardless of the level of actual of [sic] energy costs.

Case 3 illustrated that if the Base Energy Cost in the FAC is greater than the Base Energy Cost in the test year revenue requirement, the utility is expected to be penalized and customers are expected to benefit regardless of the level of actual energy costs.

These three cases illustrate the importance of setting the Base Energy Cost in the FAC correctly, i.e.

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<sup>785</sup> Ex. GMO 33, pp. 3-4.

<sup>786</sup> Ex. GMO 241.

<sup>787</sup> Ex. GMO 241, p. 7.

<sup>788</sup> Ex. GMO 241, pp. 6-9; Ex. GMO 210, pp. 199-201.

<sup>789</sup> Ex. GMO 241, pp. 6-9; Ex. GMO 210, pp. 199-201.

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equal to the Base Energy Cost in the test year true-up revenue requirement.<sup>790</sup>

565. To accomplish the purpose of a FAC—to protect utilities and their customers from delay in recognizing changes in the costs of fuel and purchased power—the net base fuel cost in GMO’s fuel adjustment clause should match with the base energy cost in the test year total revenue requirement used for setting rates in this case. GMO’s Fuel Adjustment Clause should be modified to require the base energy cost in the Fuel Adjustment Clause equal the base energy cost in the test year total revenue requirement used for setting rates in the rate case.

### **Conclusions of Law – FAC Rebasing**

66. No provision in Section 386.266, RSMo, requires the rebasing of Base Energy Costs in general rate cases subsequent to the proceeding that implements an FAC or other rate adjustment mechanism.

67. The Commission’s fuel adjustment clause regulations found in 4 CSR 240-3.161 and 4 CSR 240-20.090 do not require a rebasing of Base Energy Costs in an FAC when a utility files a general rate case that requests that its rate adjustment mechanism be continued.

68. There is no provision in the Company’s fuel adjustment clause tariffs or any of its other tariffs that requires the rebasing of its Base Energy Costs when it files a general rate case.

69. The Commission concludes, however, that the purpose of a fuel adjustment clause is to protect utilities and their customers from delay in recognizing changes in the costs of fuel and purchased power.

70. To accomplish that purpose the net base fuel cost in GMO’s fuel adjustment clause should match with the base energy cost in the test year total revenue requirement used for setting rates in this case.

### **Decision – FAC Rebasing**

Even though not required by the FAC laws to rebase, the Commission determines that it is consistent with the purpose of those laws and in the public interest to rebase the FAC Base Energy Cost. To fail to do so sends the wrong signal to the customers that the base rate they are paying includes the complete fuel costs and subjects those customers to the potential for paying interest charges. The Commission determines that the FAC shall be rebased.

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<sup>790</sup> Ex. GMO 210, pp. 200-201.

**B. FAC Sharing Mechanism**

***Should the FAC sharing mechanism be changed from 95/5 to 75/25 as proposed by Staff?***

**Findings of Fact – FAC Sharing Mechanism**

566. GMO's FAC was established and approved in the final rate case of its predecessor Aquila, where the Commission set forth the current sharing mechanism at a 95% to 5% ratio. In that decision the Commission found that allowing Aquila to pass 95% of its prudently incurred fuel and purchased power costs, above those included in its base rates, through an FAC is appropriate. The Commission stated that with the 95% pass-through Aquila would be protected from extreme fluctuations in fuel and purchased power costs, yet retain an incentive to take all reasonable actions to keep its fuel and purchased power costs as low as possible, and still have an opportunity to earn a fair return on its investment. It concluded that a 95% pass-through would not violate Section 386.226.4(1) because it would still afford Aquila a sufficient opportunity to earn a fair return on equity.<sup>791</sup>

567. Since the FAC was established, Aquila/GMO have made six Cost Adjustment Factor (CAF) filings which, in total, the parties agreed resulted in the under-collection of \$121 million over a 3-year period.<sup>792</sup> Of this amount, approximately \$6 million was absorbed by the Company pursuant to the 95/5 sharing mechanism.<sup>793</sup>

568. In this case, Staff recommends that the sharing mechanism be modified to a 75% to 25% ratio whereby GMO would only be permitted to pass 75% of its prudently incurred fuel costs above those fuel costs included in base rates to customers. The remaining 25% would be borne by GMO itself. Intervenors AARP and Consumers Council recommend a 70/30 sharing mechanism.

569. Staff "found no evidence of imprudent decisions by the Company's management related to procurement of fuel for generation, purchased power and off-system sales."<sup>794</sup> At the evidentiary hearing, Staff's witness John Rogers confirmed that this was Staff's finding.<sup>795</sup>

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<sup>791</sup> See, *In re Aquila, Inc.*, Report and Order, File No. ER-2007-0004 (May 17, 2007) at 54-55.

<sup>792</sup> Ex. GMO 210, pp. 196-97.

<sup>793</sup> *Id.* at 197.

<sup>794</sup> Ex. GMO 210, p. 193.

<sup>795</sup> Tr. 4476-77.



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570. The Staff Report and Mr. Rogers stated that prior to the inception of the Company's FAC, Aquila/GMO had under-collected \$116 million during 2004-06 "for which GMO's customers were responsible for paying \$0."<sup>796</sup> Mr. Rogers stated on cross-examination that those losses contributed to Aquila's financial problems at the time.<sup>797</sup>

571. GMO summarized the sharing mechanisms applicable to fuel adjustment clauses and off-system sales margin in eleven other Midwestern states.<sup>798</sup> Based on that exhibit, other companies in the Midwest do not operate under a 95/5 sharing mechanism like GMO and other Missouri companies.<sup>799</sup>

572. GMO Witness Gary M. Rygh, a Managing Director of Barclays Capital Inc., testified that there would be potential adverse effects of altering the 95/5 sharing mechanism to a 75/25 ratio. He was generally familiar with fuel adjustment clauses being utilized by integrated electric utilities in the United States, most of which do not have a sharing mechanism.<sup>800</sup>

573. The Commission finds Mr. Rygh's background and experience relevant to this issue, and finds that his opinions are authoritative and credible.

574. Given that there is no evidence in the record that GMO has not competently managed its fuel operating expense, the investment community would take a negative view of the proposals before the Commission to change the 95/5 sharing mechanism to 75/25 or 70/30.<sup>801</sup>

575. Given the lack of findings of imprudence by GMO in its fuel procurement practices, there is no basis for changing the existing FAC and past-through mechanism so that GMO is not able to pass through to its customers 95% of its prudently incurred fuel and related costs.

576. Since the Company's acquisition by Great Plains Energy Inc., it has achieved an improved financial outlook with investment grade credit ratings.<sup>802</sup> At this time there is no basis for changing the 95/5 sharing mechanism, which would otherwise bring uncertainty to the

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<sup>796</sup> Ex. GMO 241, p. 17.

<sup>797</sup> Tr. 4486.

<sup>798</sup> Ex. GMO 51.

<sup>799</sup> Ex. GMO 51; and Tr. 4448-51.

<sup>800</sup> Ex. GMO 37.

<sup>801</sup> Ex. GMO 37 pp. 11 and 14.

<sup>802</sup> Ex. GMO 210, pp. 18-19 and App. 2, Att. E (noting BBB credit rating).

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minds of investors and raise unnecessary questions for a company with a good operating record.<sup>803</sup>

### **Conclusions of Law – FAC Sharing Mechanism**

71. Section 386.266, RSMo, established the policy for Missouri that cost recovery for prudently incurred fuel expenses should occur through the use of “periodic” or “interim” adjustments to rates.

### **Decision – FAC Sharing Mechanism**

The Commission determines that there is no reason to change the current FAC sharing mechanism. GMO shall maintain the 95%/5% sharing mechanism whereby it passes 95% of its fuel costs to customers through the FAC and 5% of those costs are borne by the Company itself.

## **C. FAC Other Issues**

### **Findings of Fact – FAC Other Issues**

#### **Crossroads Generating Station Factor**

577. If the Commission accepts Staff’s position on fuel costs in the Crossroads issue, Staff recommends the Commission authorize and require modification of GMO’s fuel adjustment clause to include a new factor that would exclude an increment of GMO’s fuel costs for its Crossroads generating station from Fuel and Purchased Power Adjustments (GMO FAC “FPAs”). Consistent with its position that GMO’s ratepayers should pay costs based on two 105 megawatt combustion turbines built in 2005 and located at the South Harper site, GMO’s fuel clause should be modified so that its customers do not bear the incremental costs associated with higher gas prices and transmission costs of the Crossroads Energy Center which is located near Clarksdale, Mississippi.

578. Staff proposes the “CPG” factor be \$740,071 annually; \$370,035 for each six-month accumulation period. Staff proposes this factor consistent with its position fuel costs for Crossroads are higher than they would be had GMO built two additional 105MW combustion turbines at South Harper in 2005.<sup>804</sup>

579. The Commission has not accepted Staff’s position relating to the two additional turbines at South Harper.

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<sup>803</sup> Ex. GMO 37, pp. 11-16.

<sup>804</sup> Ex. GMO 211, p. 34, Sch. JAR-2-14; Ex. GMO 241, Sch. JAR-2-14 Revised.

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Forecasted Retail Net System Input Definition

580. Staff recommends the Commission authorize and require modification of GMO's FAC so that the factor RNSI (forecasted retail net system input) in GMO's FAC use be redefined to clarify that it is based on net system input *at the generator*.<sup>805</sup>

581. This change should have no substantive effect.

582. GMO does not oppose this clarification.

583. The FAC should be clarified as proposed.

Only Sales to Missouri Municipalities Excluded From OSS Revenues

584. Staff recommends the Commission authorize and require modification of GMO's FAC to clarify that only sales to Missouri municipalities are excluded from off-system sales revenues (GMO FAC factor "OSSR").<sup>806</sup>

585. This change should have no substantive effect.

586. GMO does not oppose this clarification.

587. The FAC should be clarified as proposed.

Additional Clarifications

588. Staff recommends the Commission authorize and require certain other modifications to GMO's FAC tariff sheets to clarify and improve them as shown in the example tariff sheets attached to Staff's Rate Design and Class Cost-of-Service Report, as revised in schedules attached to the surrebuttal testimony of Staff witness John A. Rogers.<sup>807</sup>

589. GMO agrees to these modifications to the extent that Staff's proposed changes match changes proposed by GMO witness Tim Rush.<sup>808</sup>

590. The FAC should be clarified as proposed.

Transmission Expenses

591. The Company had requested in its initial filing that all transmission costs be included in the FAC tariff or, in the alternative, that

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<sup>805</sup> Ex. GMO 211, p. 33, Sch. JAR-2-16.

<sup>806</sup> Ex. GMO 211, p. 34, Sch. JAR-2-15; Ex. GMO 241, Sch. JAR-2-15 Revised.

<sup>807</sup> Ex. GMO 211, Schs. JAR-1 and JAR-2; Ex. GMO 241, Schs. JAR-1-10 Revised, JAR-2-14 Revised and JAR-2-15 Revised

<sup>808</sup> Ex. GMO 2, Sch. TMR2010-3.

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a transmission tracker be established to ensure the appropriate recovery of transmission costs.

592. Staff opposes GMO's proposed modification to include transmission expenses and, in addition, proposes GMO's fuel adjustment clause be modified to remove from the definition of Purchased Power Cost in the clause two FERC accounts—FERC account numbers 565 and 575.<sup>809</sup>

593. The issue of a transmission tracker was settled in the Non-Unanimous Stipulation and Agreement as to Miscellaneous Issues, filed on February 3, 2011 ("Miscellaneous Issues Stipulation"). In the section related to Transmission Expense and Revenue Tracker, the stipulation provides: "The Signatories agree that a tracker for changes in certain transmission-related expenses should not be implemented in this case."<sup>810</sup>

594. The Company opposes the Staff's proposed exclusion of expenses currently included in the FAC tariffs, including the transmission expenses that are now in the FAC.

595. The only transmission costs currently included in the FAC are those costs attributable to off-system sales.<sup>811</sup> These costs are essential to determine overall off-system sales cost and margins. The transmission costs associated with off-system sales are variable costs and are only incurred when off-system sales are made.

596. The FACs utilized by both The Empire District Electric Company and Ameren-Missouri contain similar transmission cost recovery language as does GMO's proposed tariff.

597. GMO's proposal to include all transmission expenses in its fuel adjustment clause is based on its faulty interpretation that "transportation" costs as used in 4 CSR 240-20.090(1)(B) and therefore, Section 386.266.1, RSMo. Supp. 2010, includes transmission costs.<sup>812</sup> GMO witness Tim Rush even draws a distinction between "transportation" and "transmission" costs in his direct testimony when he says, "The increasing prices for natural gas, coal, coal *transportation* and *transmission* costs are not costs that can be controlled by the Company, nor are they costs that can be absorbed by reducing other costs."<sup>813</sup>

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<sup>809</sup> Ex. GMO 211, Sch. JAR-2-15; Ex. GMO 241, Sch. JAR-2-15 Revised.

<sup>810</sup> See, Miscellaneous Issues Stipulation at 8.

<sup>811</sup> Ex. GMO 32, p. 19.

<sup>812</sup> Ex. GMO 35, p. 2.

<sup>813</sup> Ex. GMO 32, p. 6. (Emphasis added.)

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598. There was no evidence that transmission expenses vary in a direct relationship with fuel or purchased power.

599. GMO's original proposal to include all transmission costs in its FAC tariff is rejected.

600. Staff's position that the transmission costs necessary to make off-system sales should somehow be excluded from the FAC is rejected. However, the Commission has previously found in this order that it is not just and reasonable for customers to pay for the transmission expenses from the Crossroads facility. Because no transmission expenses from the Crossroads facility will be included in rates, those expenses shall also not be allowed through the FAC .

**Conclusions of Law – FAC Other Issues**

72. Both Empire<sup>814</sup> and Ameren<sup>815</sup> have tariffs which include the same transmission costs that Staff is now recommending be removed from the GMO FAC tariffs.

73. Section 386.266.1 states:

Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including **transportation**. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.<sup>816</sup>

74. The statutes at Section 386.520.1 make a distinction between transmission and transportation. That subsection states in part:

. . . In case the order or decision of the commission is stayed or suspended, the order or judgment of the court shall not become effective until a suspending bond shall

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<sup>814</sup> The Empire District Electric Company, P.S.C. Mo. No. 5 Sec. 4, 7th Revised Sheet No.

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<sup>815</sup> Ameren-Missouri, MO.P.S.C. SCHEDULE NO. 5, 1st Revised SHEET NO. 98.1. (Under the Ameren tariff, the reference to transmission costs is found in the description of Account 565, which is the FERC account containing transmission costs.)

<sup>816</sup> Emphasis added.

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first have been executed and filed with, and approved by, the circuit court, payable to the state of Missouri, and sufficient in amount and security to secure the prompt payment, by the party petitioning for the review, of all damages caused by the delay in the enforcement of the order or decision of the commission, and of all moneys which any person or corporation may be compelled to pay, pending the review proceedings, for **transportation, transmission**, product, commodity or service in excess of the charges fixed by the order or decision of the commission, in case such order or decision is sustained.<sup>817</sup>

75. Commission rule 4 CSR 240-20.090(1)(B) states in part:

(B) Fuel and purchased power costs means prudently incurred and used fuel and purchased power costs, **including transportation costs**. Prudently incurred costs do not include any increased costs resulting from negligent or wrongful acts or omissions by the utility. If not inconsistent with a commission approved incentive plan, fuel and purchased power costs also include prudently incurred actual costs of net cash payments or receipts associated with hedging instruments tied to specific volumes of fuel and associated **transportation costs**.

1. If off-system sales revenues are not reflected in the rate adjustment mechanism (RAM), fuel and purchased power costs only reflect the prudently incurred fuel and purchased power costs necessary to serve the electric utility's Missouri retail customers.

2. If off-system sales revenues are reflected in the RAM, fuel and purchased power costs reflect both:

A. The prudently incurred fuel and purchased power costs necessary to serve the electric utility's Missouri retail customers; and

B. The prudently incurred fuel and purchased power costs associated with the electric utility's off-system sales;

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<sup>817</sup> Section 386.520.1, RSMo. 2000. (Emphasis added.)

(C) Fuel adjustment clause (FAC) means a mechanism established in a general rate proceeding that allows periodic rate adjustments, outside a general rate proceeding, to reflect increases and decreases in an electric utility's prudently incurred fuel and purchased power costs. *The FAC may or may not include off-system sales revenues and associated costs.* The commission shall determine whether or not to reflect off-system sales revenues *and associated costs* in a FAC in the general rate proceeding that establishes, continues or modifies the FAC;<sup>818</sup>

76. The Commission concludes that all transmission costs should not be included in GMO's adjustment clause because they are not included in section 386.266, RSMo. Supp. 2010, as a type of cost to be recovered through a fuel adjustment clause, they are inconsistent with the definitions of fuel and purchased power cost in 4 CSR 240-20.090(1)(B), and elsewhere, and they do not vary in a direct relationship with fuel or purchased power. With regard to the transmission costs specifically related to OSS, however, those costs shall be allowed to the extent that they do not include transmission costs from the Crossroads facility.

**Decision – FAC Other Issues**

The Commission did not find in favor of Staff's prudence disallowance and imputed costs for two additional turbines at South Harper. Therefore, the Commission will not add the Crossroads Generating Station Factor in the FAC.

GMO's FAC shall be modified so that the factor RNSI (forecasted retail net system input) is redefined to clarify that it is based on net system input *at the generator* as set out in Exhibit GMO 211, Staff Rate Design and Class Cost-of-Service Report, at page 33, Schedule JAR-2-16.

GMO's FAC shall be modified to clarify that only sales to Missouri municipalities are excluded from off-system sales revenues (GMO FAC factor "OSSR") as set out in Exhibit GMO 241, Surrebuttal Testimony of John Rogers, Schedule JAR-2-15 Revised.

GMO's FAC tariff sheets shall be modified to clarify and improve them as shown in the example tariff sheets attached to Staff's Rate Design and Class Cost-of-Service Report, as revised in schedules

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<sup>818</sup> Emphasis added.

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attached to the Surrebuttal Testimony of John A. Rogers to the extent that Staff's proposed changes match changes proposed by GMO in the Direct Testimony of Tim M. Rush.

The Commission determines that transmission costs for OSS are appropriately included in the FAC under the Commission's rule 4 CSR 20.090(1)(B). All other transmission costs are not appropriate and shall not be included. In addition, because the Commission has determined that transmission costs from the Crossroads facility shall not be borne by the ratepayers, those costs shall also be excluded from the FAC mechanism. Staff's position that the transmission costs necessary to make off-system sales should be excluded is rejected.

**THE COMMISSION ORDERS THAT:**

1. The seven Nonunanimous Stipulations and Agreements referenced in this Report and Order are approved, and the signatories thereto are ordered to comply with those Nonunanimous Stipulations and Agreements. The agreements and dates filed are:

Non Unanimous Stipulation and Agreement Regarding Depreciation and Accumulated Additional Amortization	February 2, 2011
Non-unanimous Stipulation and Agreement as to Outdoor Lighting Issues	February 3, 2011
Non-unanimous Stipulation and Agreement as to Miscellaneous Issues	February 3, 2011
Non-unanimous Stipulation and Agreement as to Class Cost of Service / Rate Design	February 17, 2011
Non-unanimous Stipulation and Agreement as to MGE Rate Design Issue	February 17, 2011
Non-unanimous Stipulation and Agreement Regarding Pensions and Other Post-employment Benefits	March 23, 2011
Non-unanimous Stipulation and Agreement as to Iatan Common Costs	March 23, 2011



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2. The proposed tariff sheets filed by KCP&L Greater Missouri Operations Company on June 4, 2010, Tariff No. JE-2010-0693, are rejected.

3. KCP&L Greater Missouri Operations Company shall file tariffs that comport with this Report and Order no later than May 12, 2011.

4. The Staff of the Commission shall file a recommendation regarding the tariffs ordered in paragraph [3] no later than May 16, 2011. Any party that wishes to object to the tariffs ordered in paragraph [3] shall do so no later than May 16, 2011.

5. Staff's March 18, 2011 objection to Kansas City Power & Light's late-filed exhibit is overruled, and the exhibit is admitted into evidence as KCP&L Exhibit 127.

6. The late-filed exhibit filed on March 2, 2011 by Kansas City Power & Light is admitted into evidence as KCP&L Exhibit 128.

7. Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company's Motion to Late-File Exhibit filed on March 3, 2011 is granted; Exhibit GMO 49 is admitted into evidence.

8. The Staff of the Missouri Public Service Commission's amended motion to file late Exhibit GMO 265 filed on March 29, 2011 is granted; Exhibit GMO 265 is admitted into evidence.

9. All pending motions and other requests for relief not granted are denied.

10. This Report and Order shall become effective on May 14, 2011.

Gunn, Chm., Clayton, Davis,  
Jarrett, and Kenney, CC., concur  
and certify compliance with the  
provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri,  
on this 4<sup>th</sup> day of May, 2011.

**\*NOTE:** This case was appealed to the Missouri Court of Appeals (WD) and affirmed. See 408 SW 3d 153. (Mo. App. W.D. 2013)

**\*NOTE:** See pages 111, 142, 186 and 534 for other orders in this case.

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**In the Matter of the First Prudence Review of Costs Subject to the Commission-Approved Fuel Adjustment Clause of Union Electric Company, d/b/a Ameren Missouri**

*Case No. EO-2010-0255  
Decided May 26, 2011*

**Rates §101.** The Commission approved a stipulation and agreement to clarify the amount of interest owed by the utility pursuant to the decision announced in the report and order.

**ORDER APPROVING STIPULATION AND AGREEMENT TO CLARIFY  
THE COMMISSION'S REPORT AND ORDER**

On April 27, 2011, the Commission issued a Report and Order that required Union Electric Company, d/b/a Ameren Missouri to refund \$17,169,838 to its ratepayers by an adjustment to its FAC charge to correct an over collection of revenues for the period of March 1, 2009, to September 30, 2009. By its terms, that report and order became effective on May 7, 2011. Ameren Missouri filed a timely application for rehearing that the Commission will address in a separate order. This order will address a motion for clarification that Staff filed on May 5, as well as a stipulation and agreement filed by Staff and Ameren Missouri on May 6.

The motion for clarification and the stipulation and agreement relate to the question of how interest is to be calculated on the amount the Commission has ordered Ameren Missouri to refund to its ratepayers. Staff's motion for clarification raises the question of the amount of interest included in the specific refund amount established in the report and order. The stipulation and agreement answers that question to the satisfaction of both Staff and Ameren Missouri by stating that the \$17,169,838 refund ordered by the Commission includes interest at Ameren Missouri's short-term borrowing rate through September 30, 2009, which is the end of the review period. Staff and Ameren Missouri also agree that interest has continued to accrue at Ameren Missouri's short-term borrowing rate after September 30, 2009, and will continue to accrue until Ameren Missouri refunds the money to its ratepayers.

The stipulation and agreement filed by Staff and Ameren Missouri is non-unanimous in that the Office of the Public Counsel did

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not sign.<sup>1</sup> However, Commission rule 4 CSR 240-2.115(2) provides that the Commission may treat a non-unanimous stipulation and agreement as unanimous if no party objects within seven days. No party has objected to the non-unanimous stipulation and agreement and the Commission will treat it as unanimous.

After reviewing the stipulation and agreement, the Commission finds that it appropriately clarifies the Commission's report and order by establishing that the ordered refund amount includes interest only through the end of the review period on September 30, 2009, not through May 2010, as had been erroneously indicated by Staff during the hearing. The effect of the stipulation is to increase the amount of interest Ameren Missouri will have to pay in addition to the specific refund amount ordered in the Commission's report and order.

**THE COMMISSION ORDERS THAT:**

1. The stipulation and agreement filed by Staff and Union Electric Company d/b/a Ameren Missouri is approved as a clarification of the Commission's report and order issued on April 27, 2011.
2. This order shall become effective immediately upon issuance.

Gunn, Chm., Clayton, and Kenney, CC., concur;  
Jarrett and Davis, CC., dissent.  
Woodruff, Chief Regulatory Law Judge

**\*NOTE:** The Stipulation and Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

**\*NOTE:** See page 342 for another order in this case.

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<sup>1</sup> The Stipulation and Agreement represents that Counsel for the Office of the Public Counsel has indicated that Public Counsel does not oppose the agreement.

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**In the Matter of the Application of KCP&L Greater Missouri Operations Company for Approval to Make Certain Changes in its Charges for Electric Service**

*File No. ER-2010-0356*  
*Issue Date: May 27, 2011*

**Rates §3.** The Commission may phase in a rate increase that is primarily due to an unusually large increase in the utility's rate based. Because the rate base increased more than 100% as a result of this rate case, there is an unusually large increase in rate base.

**ORDER OF CLARIFICATION AND MODIFICATION**

On May 4, 2011, the Commission issued its Report and Order. Timely applications for rehearing were filed by KCP&L Greater Missouri Operations Company (GMO), Ag Processing Inc., a cooperative, the Office of the Public Counsel, and Dogwood Energy, LLC. After receiving additional responses and arguments, the Commission held a brief on-the-record question and answer session on May 26, 2011, in order to better understand the requests for rehearing and clarification regarding the latan allocation issue.

Section 386.500.1, RSMo Cum. Supp. 2010, states that the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." With the exception of the portions of the applications for rehearing addressed below, those applications merely restate positions and arguments the Commission has previously rejected in its Report and Order. Except as set out below, in the judgment of the Commission, the parties have not shown sufficient reason to rehear the Report and Order and the Commission denies the applications for rehearing.

With regard to the requests for clarification, the Commission also finds no sufficient reason to clarify the Report and Order except as set out below.

**Stipulation and Agreement**

GMO and Staff filed a Second Nonunanimous Stipulation and Agreement Regarding Pensions and Other Post-Employment Benefits on May 13, 2011. The agreement was intended to revise the previously approved agreement settling these issues in accordance with the allocation of latan 2 to the MPS and L&P service areas. No objections to the stipulation and agreement were received. Under 4 CSR 240-2.115 if

no party objects to an agreement and no hearing is requested, then it is deemed to be a unanimous agreement. The Commission has reviewed the agreement and finds it just and reasonable. Therefore the agreement is approved.

**Correction**

On May 13, 2011, Ag Processing and the Sedalia Industrial Energy Users' Association (SIEUA) filed a motion for clarification. The motion requests that the Commission correct an error in the Report and Order at page 100, which included the wrong number of months of depreciation for the Crossroads facility. GMO requested a similar clarification in its May 13, 2011 pleading. The Commission will correct this error.

**Crossroads Accumulated Deferred Income Tax Reserve Amount**

GMO further requested clarification of the Report and Order regarding the accumulated deferred income tax reserve amount for the Crossroads facility. GMO argues that because the Commission valued Crossroads at \$61.8 million, which is less than the valuation put forth by GMO, the amount of accumulated deferred income tax also needs to be recalculated based on that lower valuation.

Ag Processing and SIEUA oppose this clarification. Ag Processing and SIEUA argue that because Aquila Merchant was not profitable, it would have never been able to take the benefits of a depreciation deduction without its affiliation with a profitable regulated business. Secondly, Ag Processing and SIEUA argue that, as found by the Commission, Great Plains Energy (GPE) would have considered this deferred tax balance in its valuation of Crossroads when conducting its due diligence before the purchase. Third, AG Processing and SIEUA argue that the Commission's valuation of Crossroads is already generous and thus, the Commission should not further "increase" the value by recalculating the deferred income tax reserve amount.

The Commission agrees with Ag Processing and SIEUA's assessment. The Commission set the value of Crossroads considering all relevant factors presented and found that GPE had conducted due diligence in its purchase of Aquila, Inc. Therefore, the Commission need not clarify this point in the Report and Order.

**Rebased Fuel and Purchased Power Amounts**

In its request for clarification, GMO requested that the Commission clarify whether GMO's MIDAS™ model or Staff's historical

model should be used to calculate the revenue requirement fuel numbers for the “rebased” fuel and purchased power amounts. GMO indicated that the revenue requirement filing made by Staff on May 11, 2011, uses the Staff’s historical model for these costs. In addition, GMO argues that Staff’s model does not include many of the energy costs which the Commission stated in its Report and Order should be rebased to match the FAC. GMO filed an additional response on May 25, 2011, which included specific revenue requirement numbers to support its clarification request.

Ag Processing and SIEUA oppose this clarification and argue that the fuel and purchased power expense should not be clarified in this manner and questioned GMO’s motives for requesting the clarification.

Staff also filed a response to the fuel and purchased power clarification request. In its response Staff agrees that it erred in not including certain fuel-related costs in its model. Staff also agrees that those items should be included in determining revenue requirements for GMO. Staff indicates that to include the additional items in the fuel-related costs would increase those items by a total of \$5.5 million for GMO (\$5.1 million for MPS and \$479,000 for L&P).

To the extent needed the Commission will clarify the Report and Order. The Report and Order is clear that the Commission determined the MIDAS™ model should be used for spot market purchased power prices. In addition, the Commission adopted the method presented by GMO for determining natural gas costs. All other variable components should be calculated as presented to the Commission using Staff’s traditional historical model. In addition, the Report and Order intends for the items admittedly missing from Staff’s calculations but ordered to be included in the FAC calculation to be included in the revenue requirement.

#### **Item 2 Allocation Between MPS and L&P**

The Commission received applications for rehearing from Ag Processing and Public Counsel based on the decision of the Commission to allocate the L&P portion of GMO’s rate increase to an amount that was greater than the amount GMO originally asked to be attributed to the L&P division. The specific objection was to the lack of notice to the L&P customers of a 21% increase since the original notices stated that the company was requesting a 13.78% increase. GMO also requested that the Commission reconsider or rehear its decision with regard to the item allocation and adopt instead the allocation presented by the company. And, the City of St. Joseph filed a response urging the

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Commission to reconsider its decision with regard to the severe effect that a 21% increase in base rates would have on L&P customers. In addition to the requests for rehearing and reconsideration, the Commission received objections from Ag Processing and SIEUA and Public Counsel to the compliance tariffs filed by GMO alleging that the compliance tariffs should not become effective for the same reasons as argued in the applications for rehearing. Ag Processing also suggested as a possible solution that the rate increase for L&P customers be phased-in. This phase-in option was argued in-depth during the on-the-record session on May 26, 2011.

Section 393.155.1, RSMo, states that the Commission may phase in a rate increase that is “primarily due to an unusually large increase in the corporation’s rate base.” Rate base in GMO’s previous rate case<sup>1</sup> was \$190,475,404. Rate base as a result of this case is \$422,039,507. Thus, there is an “unusually large increase” in rate base in this case.

The Commission previously heard evidence on the effect a large rate increase would have on GMO’s customers.<sup>2</sup> In fact, the Commission has already taken that effect into consideration in deciding how much of latan 2 to allocate between the MPS and L&P service territories.<sup>3</sup> After reviewing the requests for rehearing and the objections to the tariffs, and after hearing additional oral arguments on the allocation issue, the Commission has reconsidered the effect on the customers. The Commission determines that it has made a just and reasonable determination as to the proper allocation of latan 2 between the MPS and L&P territories. However, because of the large increase in rate base in this case, and considering the effects of such an unusually large increase on L&P’s customers, a just and reasonable alternative is to phase in the rate increase for the L&P customers pursuant to Section 393.155.1, RSMo 2000.

The Commission observes that although the Report and Order had an effective date of May 14, 2011, it is well settled law that an order lacks finality “while it remains tentative, provisional, or contingent, subject to recall, revision or reconsideration by the issuing agency.”<sup>4</sup> The

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<sup>1</sup> File No. ER-2009-0090.

<sup>2</sup> *Report and Order*, Finding of Fact 546.

<sup>3</sup> *Report and Order*, Finding of Facts 546-557.

<sup>4</sup> *City of Park Hills v. Public Service Comm'n of State of Mo.*, 26 S.W.3d 401, 404 (Mo. App. 2000).

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Commission's decisions are not final decisions while applications for rehearing are pending.<sup>5</sup>

Based upon its review of the record, the Commission will, on its own motion, modify its Report and Order with regard to the allocation of latan 2 between the L&P and MPS rate classes by adding the following Conclusions of Law at page 204 of the Report and Order:

65A. Section 393.155.1, RSMo, states that the Commission may phase-in a rate increase that is "primarily due to an unusually large increase in the corporation's rate base." Because of the magnitude of the rate increase and the effects on the ratepayers in the L&P service area, the Commission determines that, in its discretion, a phase-in of the rate increase is a just and reasonable method of implementing this large increase. The Commission further concludes that rates for L&P service area should initially be set at an amount equal to the \$22.1 million originally proposed by GMO with the remaining increase being phased-in in equal parts over a two year period.

65B. In addition, GMO shall be allowed "to recover the revenue which would have been allowed in the absence of a phase-in . . . ."<sup>6</sup>

And, the Report and Order shall be modified by adding the following sentences to the end of the Decision paragraph on page 204:

Because of the magnitude of the rate increase and the effects on the ratepayers in the L&P service area, the Commission determines in its discretion that a just and reasonable method of implementing this large increase is by phasing it in over a reasonable number of years.

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<sup>5</sup> *State ex rel. AG Processing, Inc. v. Public Service Comm'n*, 276 S.W.3d 303 (Mo. App. 2008). Furthermore, Missouri courts have recognized the Commission's authority to amend or abrogate its prior orders pursuant to Section 386.490, RSMo 2000, even after an order has become final. *State ex rel. Jackson County v. Public Service Commission*, 532 S.W.2d 20, 29 -30 (Mo. banc 1975).

<sup>6</sup> Section 393.155.1.



The Commission further concludes that rates for L&P service area should initially be set at an amount equal to the \$22.1 million originally proposed by GMO with the remaining increase plus carrying costs being phased-in in equal parts over a two year period.

### **Compliance Tariffs and Motions for Expedited Treatment**

In order to comply with the Commission's Report and Order as issued on May 4, 2011, GMO filed tariffs on May 12, 2011, and revised tariffs sheets on May 16 and 17, 2011. GMO filed motions requesting expedited treatment of the tariffs so that they would become effective in less than 30 days on June 4, 2011.

As previously mentioned, objections to the tariffs were filed by Public Counsel and Ag Processing on the basis of the allocation of latan 2 between the MPS and L&P service territories. Public Counsel, Ag Processing, and the Sedalia Industrial Energy Users' Association (SIEUA) also objected to the fuel adjustment clause (FAC) portions of the tariff sheets.

On May 17, 2011, Staff filed a recommendation to approve the tariffs. Staff indicated that in its opinion, the tariff sheets comply with the Report and Order.

Public Counsel, Ag Processing, and SIEUA argue that the FAC portion of the tariffs cannot become effective on June 4, 2011 as requested, but rather, must become effective on the first of the month following the effective date of the Commission order approving the FAC. Public Counsel, Ag Processing, and SIEUA argue that Section 386.266.4(2), RSMo Cum. Supp. 2010, states that an FAC must provide for "an annual true-up which shall **accurately** and appropriately remedy any over- or under-collections, including interest . . ." <sup>7</sup> Public Counsel further argues that the Commission promulgated 4 CSR 240-3.161(1)(G) in order to implement this requirement. That definition provides:

True-up year means the twelve (12) month period beginning on the first day of the first calendar month following the effective date of the commission order approving a RAM [rate adjustment mechanism] unless the effective date is on the first day of the calendar month.

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<sup>7</sup> Emphasis added.

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GMO filed a response to Public Counsel, Ag Processing, and SIEUA on May 25, 2011. In its response, GMO argues “the request that the tariffs become effective on June 4 does not relate to the definition of „true-up year“ in the regulations.” The Commission disagrees.

As Public Counsel, Ag Processing, and SIEUA argue, this rule is designed around the fact that utilities keep financial records on a monthly, not a daily, basis. Thus, the FAC could not have an **accurate** true-up as required by Section 386.220.4 if the true-up begins on a day other than the first day of the month.

The Commission does agree, however, with GMO’s next argument that the Commission is not prohibited from determining a different effective date of a tariff if good cause exists to do so.<sup>8</sup> In this case however, there is no good cause to do so for the FAC portion of the tariffs. Because the current FAC will remain in effect until replaced by these tariff sheets, GMO will not be harmed by the delay. The only way to reconcile the language of the statute requiring an accurate true-up with the language of the regulation under the facts of this case is for the FAC to become effective on the first of the month, because the evidence demonstrated that the utility maintains financial records on a monthly basis and not a daily basis.

The Commission, therefore, denies the motions for expedited treatment with regard to the FAC portion of the tariffs. Because the Commission has made other decisions in this order which will affect the FAC tariffs, the Commission will reject those tariff sheets and require GMO to file revised tariff sheets to implement the FAC, with a tariff effective date of July 1, 2011.

Because the Commission has clarified and modified its Report and Order, new tariff sheets must be filed to comply with those clarifications and modifications. The tariffs as filed will be rejected. The Commission finds good cause, however, to grant expedited treatment for all but the FAC portions of GMO’s compliance tariffs to become effective on less than 30 days notice and GMO need not file an additional motion requesting expedited treatment with its new tariff filing.

**THE COMMISSION ORDERS THAT:**

1. The Second Nonunanimous Stipulation and Agreement Regarding Pensions and Other Post-Employment Benefits is approved. The signatories of that agreement are ordered to comply with its terms.

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<sup>8</sup> Section 393.140(11), RSMo.

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2. The Motion for Clarification filed by Ag Processing, Inc. a cooperative, and the Sedalia Industrial Energy Users' Association and similar request made by KCP&L Greater Missouri Operations Company to correct the number of months of depreciation for the Crossroads facility is granted. Page 100 of the Report and Order is corrected to read:

Given the subsequent 29 months through the ordered true-up date, the fair market value of Crossroads for purposes of establishing rate base in this case should also reflect 29 months of depreciation on that unit.

3. Except as set out in the ordered paragraphs above, the Motion for Clarification and/or Reconsideration and Application for Rehearing of KCP&L Greater Missouri Operations Company on May 13, 2011, is denied.

4. Dogwood Energy, LLC's Application for Rehearing is denied.

5. Public Counsel's Application for Rehearing is denied.

6. The Application for Rehearing by Ag Processing Inc., a cooperative, is denied.

7. The requests for clarification are determined as set out in the body of this order and the Report and Order is clarified as indicated above. All other requests for clarification are denied.

8. With regard to the allocation of latan 2 between the MPS and L&P service areas, the Report and Order is modified as stated in the body of this order.

9. The motions for expedited treatment are granted in part and denied in part as set out above.

10. The fuel adjustment clause (FAC) tariff sheets, Tariff No. YE-2011-0577, are rejected, and KCP&L Greater Missouri Operations Company is authorized to refile those tariff sheets in compliance with this order including an effective date of July 1, 2011.

11. The remaining compliance tariff sheets, Tariff No. YE-2011-0567, are rejected and KCP&L Greater Missouri Operations Company is authorized to refile those tariff sheets in compliance with this order and may file those tariff sheets with an effective date of June 4, 2011, without the need for filing an additional motion for expedited treatment.

12. KCP&L Greater Missouri Operations Company shall file any revisions necessary to comply with the correction and clarifications set out in this order no later than May 31, 2011, at 1:00 p.m.

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13. Any objections to the compliance tariffs containing a June 4, 2011 tariff effective date shall be filed no later than June 2, 2011, at 9:00 a.m.

14. This order shall become effective on June 3, 2011.

Gunn, Chm., Davis, Jarrett, and  
Kenney, CC., concur;  
Clayton, C., dissents, with separate  
dissenting opinion to follow;  
and certify compliance with the  
provisions of Section 536.080, RSMo.

Dippell, Deputy Chief Regulatory Law Judge

\*NOTE: At the time of publication, no opinion of Commissioner Clayton has been filed.

\*NOTE: See pages 111, 142, 186 and 367 for other orders in this case.

**In the Matter of The Empire District Electric Company of  
Joplin, Missouri for Authority to File Tariffs Increasing  
Rates for Electric Service Provided to Customers in the  
Missouri Service Area of the Company**

*File No. ER-2011-0004*

*Decided June 1, 2011*

**ELECTRIC §20.** The Commission approved a non-unanimous Global Agreement resolving a tariff issue concerning Empire District Electric Company's jurisdictional gross annual electric revenues by \$18,650,000. Empire had previously attempted to set rates that would increase its annual gross revenues by approximately \$36.5 million. The Commission found that Empire had met its burden of proof by a preponderance of the evidence that the rates set forth in the Global Agreement were just and reasonable.

**ORDER APPROVING GLOBAL AGREEMENT**

**Procedural History**

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On September 28, 2010, The Empire District Electric Company (“Empire”) submitted a tariff designed to implement a general rate increase for electric service. Empire indicated that the proposed electric service rates were designed to increase its gross annual revenues by approximately \$36.5 million, exclusive of applicable gross receipts, sales, franchise or occupational fees or taxes. The tariff sheets were suspended, notice was issued, and a procedural schedule was set that culminated in an evidentiary hearing to begin on May 23, 2011.

At the parties request, the procedural schedule was suspended, and on May 27, 2011 several of the parties filed a non-unanimous Global Agreement (“Agreement”) purporting to resolve all issues in this matter. The signatory parties include Empire, the Commission’s Staff, the Missouri Department of Natural Resources (“MDNR”) and the Office of the Public Counsel (“Public Counsel”). The remaining parties, the City of Joplin, Missouri (“Joplin”), the Midwest Energy Users Association (“MEUA”)<sup>1</sup> and Kansas City Power and Light Company (“KCPL”) are non-signatories.

The Commission held an on-the-record proceeding on May 31, 2011 to direct questions to the parties regarding the Agreement. Joplin and MEUA did not appear at the proceeding.<sup>2</sup> While the Agreement is not unanimous, none of the non-signatories have objected to the Agreement, or any part of the Agreement.<sup>3</sup>

### **The Agreement**

The Agreement waives procedural requirements that would otherwise be necessary before final decision.<sup>4</sup> Also, because the settlement disposes of this action, the Commission need not separately state its findings of fact.<sup>5</sup> The parties expressly ask for an order

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<sup>1</sup> MEUA is an unincorporated ad-hoc association of large commercial and industrial users of electricity. For purposes of this case, MEUA participants are Praxair, Inc., Explorer Pipeline Company, and Enbridge Energy, LLP, each of which is an Empire customer.

<sup>2</sup> MEUA was not represented as an association, and none of MEUA’s participants appeared individually.

<sup>3</sup> Commission Rule 4 CSR 240-2.115 provides that the Commission may consider a non-unanimous stipulation to be unanimous if no party files an objection within seven days of the filing of the agreement. While seven days have not passed since the filing of the Global Agreement, KCPL, Joplin and MEUA have indicated that they have no objection to the Agreement. Moreover, this provision of this order approving the Agreement does not become effective until June 6, 2011, thus, providing ten days since the filing of the Global Agreement for any objections to be filed.

<sup>4</sup> Section 536.060, RSMo 2000.

<sup>5</sup> Section 536.090, RSMo 2000.

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approving all of the specific terms and conditions of the Agreement. Therefore, the Commission incorporates the terms of the Agreement into this order.

The Agreement's terms include an increase to Empire's Missouri jurisdictional gross annual electric revenues in the amount of \$18,685,000, exclusive of any applicable license, occupation, franchise, gross receipts taxes, or similar fees or taxes. The Agreement also includes specimen tariff sheets and appendices, which include provisions for rate design, specific assumptions underlying the Agreement and depreciation rates for latan 2.

The parties further request the Commission to order Empire to file tariff sheets no later than June 3, 2011 in compliance with the specimen tariff sheets, and that those tariff sheets be made effective on an expedited basis on June 15, 2011. And, without further discussion, the Commission incorporates all provisions of the Agreement, as if fully set forth, into this order.

### **Ratemaking Standards**

The standard for rates is "just and reasonable,"<sup>6</sup> a standard founded on constitutional provisions, as the United States Supreme Court has explained:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>7</sup>

But the Commission must also consider the customers:

The rate-making process . . . i.e., the fixing of 'just and reasonable' rates, involves a balancing of the investor and the consumer interests.<sup>8</sup>

Further, that balancing has no single formula:

The Constitution does not bind rate-making bodies to the service of any single formula or combination of formulas. Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory

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<sup>6</sup> *Id.* and Section 393.150.2, RSMo 2000.

<sup>7</sup> *Bluefield Water Works & Improvement Co. v. Public Serv. Com'n of the State of West Virginia*, 262 U.S. 679, 690 (1923).

<sup>8</sup> *Federal Power Com'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

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authority, to make the pragmatic adjustments which may be called for by particular circumstances.<sup>9</sup>

Moreover, making such pragmatic adjustments is part of the Commission's duty:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts.<sup>10</sup>

And:

[T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.'<sup>11</sup>

Thus, the law requires a just and reasonable end, but does not specify a means:

Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling. It is not theory but the impact of the rate order which counts.<sup>12</sup>

Determining whether a rate adjustment is necessary requires comparing Empire's current net income to Empire's revenue requirement. Revenue requirement is the amount of money that a utility may collect per year, which depends on the requirements for providing safe and effective service at a profit. Those requirements are tangible and intangible:

From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock.<sup>13</sup>

That and similar holdings have led to a conventional analysis of the resources devoted to service, from which the Commission determines revenue requirement as follows.

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<sup>9</sup> *Federal Power Com'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)

<sup>10</sup> *Bluefield*, 262 U.S. at 692.

<sup>11</sup> *State ex rel. Associated Natural Gas Co. v. Public. Serv. Com'n*, 706 S.W.2d 870, 873 (Mo. App. 1985) (citing *Hope Natural Gas Co.*, 320 U.S. at 602-03).

<sup>12</sup> *Id.*

<sup>13</sup> *Hope Natural Gas Co.*, 320 U.S. at 603 (1944).

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To provide service, a utility devotes resources, which accounting conventions classify as either expense or investment. Expenses include operation, replacement of capital items as they depreciate ("current depreciation"), and taxes on the return. Investment is the basis ("rate base") on which the utility seeks profit ("return"). Return is therefore a percentage ("rate of return") of rate base. Rate base includes capital assets ("gross plant"), less historic deterioration of such assets ("accumulated depreciation"), plus other items.

Those components relate to each other in the following formula:

Revenue Requirement = Cost of Providing Utility Service or  $RR = O + (V - D) R$  where,

RR = Revenue Requirement;

O = Operating Costs; (such as fuel, payroll, maintenance, etc.,  
Depreciation and Taxes);

V = Gross Valuation of Property Used for Providing Service;

D = Accumulated Depreciation Representing the Capital  
Recovery of Gross Property Investment.

(V - D) = Rate Base (Gross Property Investment less  
Accumulated Depreciation = Net Property Investment)

R = Overall Rate of Return or Weighted Cost of Capital

(V - D) R = Return Allowed on Net Property Investment

But determining the revenue requirement does not end the analysis, because the utility must collect that amount from its customers, and all customers need not receive identical treatment. Rate design is how a utility distributes its revenue requirement among its various classes of customer. Customers vary as to the costs attributable to their service. Accordingly, their rates should reflect their costs, respectively. Just and reasonable rates may account for such differences among customers.

### Conclusions<sup>14</sup>

A utility has the burden of proving that increased rates are just and reasonable<sup>15</sup> by a preponderance of the evidence.<sup>16</sup> In this order, the Commission grants the signatory parties' unopposed request to enter all pre-filed testimony and affidavits prepared by the parties into the record. The record thus contains substantial and competent evidence. The Commission has compared the substantial and competent evidence on

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<sup>14</sup> Section 386.420.2, RSMo 2000 requires a report of the Commission's conclusions.

<sup>15</sup> Section 393.150.2, RSMo 2000.

<sup>16</sup> *State Board of Nursing v. Berry*, 32 S.W.3d 638, 641 (Mo. App. 2000).



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the whole record with the Agreement as to both rate adjustment and rate design. The Commission independently finds and concludes that Empire has met its burden of proof that the rates proposed in the Agreement are just and reasonable rates. Additionally, upon review of the record and the Agreement, the Commission independently finds and concludes that the Agreement's proposed terms support safe and adequate service.

**THE COMMISSION ORDERS THAT:**

1. The non-unanimous Global Agreement filed on May 27, 2011 is approved. The signatory parties shall comply with the terms of the Global Agreement. A copy of the Agreement shall be attached to this order as "Attachment A."

2. The tariff sheets submitted under Tariff File No. YE-2011-0154, on September 28, 2010, by The Empire District Electric Company ("Empire"), for the purpose of increasing rates for electric service, is rejected. The specific tariff sheets rejected are:

**P.S.C. MO. No. 5**

Sec. A, 26th, Revised Sheet No. 1; Canceling Sec. A, 25th, Revised Sheet No. 1  
Sec. 1, 16th, Revised Sheet No. 1; Canceling Sec. 1, 15th, Revised Sheet No. 1  
Sec. 2, 15th, Revised Sheet No. 1; Canceling Sec. 2, 14th, Revised Sheet No. 1  
Sec. 2, 15th, Revised Sheet No. 2; Canceling Sec. 2, 14th, Revised Sheet No. 2  
Sec. 2, 15th, Revised Sheet No. 3; Canceling Sec. 2, 14th, Revised Sheet No. 3  
Sec. 2, 16th, Revised Sheet No. 4; Canceling Sec. 2, 15th, Revised Sheet No. 4  
Sec. 2, 15th, Revised Sheet No. 6; Canceling Sec. 2, 14th, Revised Sheet No. 6  
Sec. 2, 15th, Revised Sheet No. 7; Canceling Sec. 2, 14th, Revised Sheet No. 7  
Sec. 2, 11th, Revised Sheet No. 9; Canceling Sec. 2, 10th, Revised Sheet No. 9  
Sec. 2, 8th, Revised Sheet No. 9b; Canceling Sec. 2, 7th, Revised Sheet No. 9b  
Sec. 2, 10th, Revised Sheet No. 13; Canceling Sec. 2, 9th, Revised Sheet No. 13  
Sec. 3, 7th, Revised Sheet No. 1a; Canceling Sec. 3, 6th, Revised Sheet No. 1a  
Sec. 3, 15th, Revised Sheet No. 3; Canceling Sec. 3, 14th, Revised Sheet No. 3  
Sec. 3, 15th, Revised Sheet No. 4; Canceling Sec. 3, 14th, Revised Sheet No. 4  
Sec. 4, 1st, Revised Sheet No. 8a.1; Canceling Sec. 4, Original Sheet No. 8a.1  
Sec. 4, 4th, Revised Sheet No. 8c; Canceling Sec. 4, 3rd Revised Sheet No. 8c  
Sec. 4, 2nd, Revised Sheet No. 8d; Canceling Sec. 4, 1st Revised Sheet No. 8d  
Sec. 4, 1st, Revised Sheet No. 8f; Canceling Sec. 4, Original Sheet No. 8f  
Sec. 4, 1st, Revised Sheet No. 8g; Canceling Sec. 4, Original Sheet No. 8g  
Sec. 4, 1st, Revised Sheet No. 8h; Canceling Sec. 4, Original Sheet No. 8h  
Sec. 4, 1st, Revised Sheet No. 8j; Canceling Sec. 4, Original Sheet No. 8j  
Sec. 4, 6th, Revised Sheet No. 9; Canceling Sec. 4, 5th Revised Sheet No. 9  
Sec. 4, 4th, Revised Sheet No. 10; Canceling Sec. 4, 3rd Revised Sheet No. 10  
Sec. 4, 5th, Revised Sheet No. 11; Canceling Sec. 4, 4th Revised Sheet No. 11  
Sec. 5, 7th, Revised Sheet No. A; Canceling Sec. 5, 6th Revised Sheet No. A  
Sec. 5, 5th, Revised Sheet No. 1; Canceling Sec. 5, 4th Revised Sheet No. 1  
Sec. 5, 6th, Revised Sheet No. 2; Canceling Sec. 5, 5th Revised Sheet No. 2  
Sec. 5, 3rd, Revised Sheet No. 2a; Canceling Sec. 5, 2nd Revised Sheet No. 2a  
Sec. 5, 6th, Revised Sheet No. 3; Canceling Sec. 5, 5th Revised Sheet No. 3  
Sec. 5, 5th, Revised Sheet No. 4; Canceling Sec. 5, 4th Revised Sheet No. 4

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Sec. 5, 4th, Revised Sheet No. 5; Canceling Sec. 5, 3rd Revised Sheet No. 5  
Sec. 5, 4th, Revised Sheet No. 6; Canceling Sec. 5, 3rd Revised Sheet No. 6  
Sec. 5, 5th, Revised Sheet No. 7; Canceling Sec. 5, 4th Revised Sheet No. 7  
Sec. 5, 5th, Revised Sheet No. 8; Canceling Sec. 5, 4th Revised Sheet No. 8  
Sec. 5, 6th, Revised Sheet No. 9; Canceling Sec. 5, 5th Revised Sheet No. 9  
Sec. 5, 7th, Revised Sheet No. 10; Canceling Sec. 5, 6th Revised Sheet No. 10  
Sec. 5, 6th, Revised Sheet No. 11; Canceling Sec. 5, 5th Revised Sheet No. 11  
Sec. 5, 3rd, Revised Sheet No. 11a; Canceling Sec. 5, 2nd Revised Sheet No. 11a  
Sec. 5, 8th, Revised Sheet No. 12; Canceling Sec. 5, 7th Revised Sheet No. 12  
Sec. 5, 6th, Revised Sheet No. 13; Canceling Sec. 5, 5th Revised Sheet No. 13  
Sec. 5, 5th, Revised Sheet No. 14; Canceling Sec. 5, 4th Revised Sheet No. 14  
Sec. 5, 5th, Revised Sheet No. 15; Canceling Sec. 5, 4th Revised Sheet No. 15  
Sec. 5, 5th, Revised Sheet No. 16; Canceling Sec. 5, 4th Revised Sheet No. 16  
Sec. 5, 5th, Revised Sheet No. 17; Canceling Sec. 5, 4th Revised Sheet No. 17  
Sec. 5, 2nd, Revised Sheet No. 17a; Canceling Sec. 5, 1st Revised Sheet No. 17a  
Sec. 5, 2nd, Revised Sheet No. 17b; Canceling Sec. 5, 1st Revised Sheet No. 17b  
Sec. 5, 2nd, Revised Sheet No. 17c; Canceling Sec. 5, 1st Revised Sheet No. 17c  
Sec. 5, 2nd, Revised Sheet No. 17d; Canceling Sec. 5, 1st Revised Sheet No. 17d  
Sec. 5, 2nd, Revised Sheet No. 17e; Canceling Sec. 5, 1st Revised Sheet No. 17e  
Sec. 5, 2nd, Revised Sheet No. 17f; Canceling Sec. 5, 1st Revised Sheet No. 17f  
Sec. 5, 6th, Revised Sheet No. 18; Canceling Sec. 5, 5th Revised Sheet No. 18  
Sec. 5, 5th, Revised Sheet No. 19; Canceling Sec. 5, 4th Revised Sheet No. 19  
Sec. 5, 4th, Revised Sheet No. 20; Canceling Sec. 5, 3rd Revised Sheet No. 20  
Sec. 5, 4th, Revised Sheet No. 21; Canceling Sec. 5, 3rd Revised Sheet No. 21  
Sec. 5, 6th, Revised Sheet No. 22; Canceling Sec. 5, 5th Revised Sheet No. 22  
Sec. 5, 6th, Revised Sheet No. 23; Canceling Sec. 5, 5th Revised Sheet No. 23  
Sec. 5, 3rd, Revised Sheet No. 23a; Canceling Sec. 5, 2nd Revised Sheet No. 23a  
Sec. 5, 6th, Revised Sheet No. 24; Canceling Sec. 5, 5th Revised Sheet No. 24  
Sec. 5, 6th, Revised Sheet No. 25; Canceling Sec. 5, 5th Revised Sheet No. 25  
Sec. 5, 7th, Revised Sheet No. 26; Canceling Sec. 5, 6th Revised Sheet No. 26  
Sec. 5, 6th, Revised Sheet No. 27; Canceling Sec. 5, 5th Revised Sheet No. 27  
Sec. 5, 6th, Revised Sheet No. 28; Canceling Sec. 5, 5th Revised Sheet No. 28  
Sec. 5, 6th, Revised Sheet No. 29; Canceling Sec. 5, 5th Revised Sheet No. 29  
Sec. 5, 4th, Revised Sheet No. 30; Canceling Sec. 5, 3rd Revised Sheet No. 30  
Sec. 5, 4th, Revised Sheet No. 31; Canceling Sec. 5, 3rd Revised Sheet No. 31  
Sec. 5, 2nd, Revised Sheet No. 32; Canceling Sec. 5, 1st Revised Sheet No. 32  
Sec. 5, 2nd, Revised Sheet No. 33; Canceling Sec. 5, 1st Revised Sheet No. 33  
Sec. 5, 2nd, Revised Sheet No. 34; Canceling Sec. 5, 1st Revised Sheet No. 34  
Sec. 5, 2nd, Revised Sheet No. 35; Canceling Sec. 5, 1st Revised Sheet No. 35  
Sec. 5, 3rd, Revised Sheet No. 36; Canceling Sec. 5, 2nd Revised Sheet No. 36  
Sec. 5, 3rd, Revised Sheet No. 37; Canceling Sec. 5, 2nd Revised Sheet No. 37  
Sec. 5, 3rd, Revised Sheet No. 38; Canceling Sec. 5, 2nd Revised Sheet No. 38  
  
Sec. 5, 3rd, Revised Sheet No. 39; Canceling Sec. 5, 2nd Revised Sheet No. 39  
Sec. 5, 3rd, Revised Sheet No. 40; Canceling Sec. 5, 2nd Revised Sheet No. 40  
Sec. 5, 2nd, Revised Sheet No. 41; Canceling Sec. 5, 1st Revised Sheet No. 41

3. The prefiled testimony, including all exhibits, appendices, schedules, etc. attached thereto, as well as all reports of all witnesses,

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that are already filed in the Commission's Electronic Filing and Information System ("EFIS") are hereby admitted into evidence. A notation in EFIS for the issuance of this order shall stand in lieu of a notation in EFIS for any exhibit's entry into the record.

4. Empire shall file new tariff sheets consistent with this order and the specimen tariff sheets attached to the Global Agreement no later than June 3, 2011, bearing an effective date of June 15, 2011.

5. The Commission's Staff may either join Empire with filing its compliance tariff sheets, or file a separate recommendation regarding their approval no later than June 6, 2011.

6. This order shall become effective on June 6, 2011, except for paragraphs 4 and 5 that shall become effective immediately upon this order's issuance.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.  
Stearley, Senior Regulatory Law Judge

**\*NOTE:** Attachments to this order have not been published. If needed, these documents are available in the official case files of the Public Service Commission.

**In the Matter of Union Electric Company, d/b/a Ameren Missouri's  
Tariff to Increase Its Annual Revenues for Electric Service**

*File No. ER-2011-0028  
Decided June 1, 2011*

**Evidence, practice and procedure §8.** By Commission rule, non-unanimous stipulations and agreements to which no party objects within seven days may be treated as if they were unanimous.

**ORDER APPROVING STIPULATIONS AND AGREEMENTS**

During the course of the hearing of this case, various parties have filed nonunanimous stipulations and agreements to resolve certain issues that would otherwise have been presented to the Commission for resolution. Specifically, on May 3, Staff, Ameren Missouri, Public Counsel, the Missouri Industrial Energy Consumers (MIEC), the Missouri Energy Group (MEG), and the Missouri Retailers Association (MRA) filed a First Nonunanimous Stipulation and Agreement – Miscellaneous

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Revenue Requirement Items. On May 5, Ameren Missouri and the MIEC filed a Nonunanimous Stipulation and Agreement Regarding Tax Issues. On May 6, Staff, Ameren Missouri, and MIEC filed a Third Nonunanimous Stipulation and Agreement. Each of the submitted stipulations and agreements would resolve multiple issues regarding Ameren Missouri's request for a rate increase.

Each described stipulation and agreement is nonunanimous in that none was signed by all parties. However, Commission rule 4 CSR 240-2.115(2) provides that other parties have seven days in which to object to a nonunanimous stipulation and agreement. If no party files a timely objection to a stipulation and agreement, the Commission may treat it as a unanimous stipulation and agreement. More than seven days have now passed since each described stipulation and agreement was filed and no party has objected. Therefore, the Commission will treat each of these stipulations and agreements as a unanimous stipulation and agreement.

Two other nonunanimous stipulations and agreements were also filed. One, filed on May 12, would have resolved certain class cost of service and rate design issues. The other, filed on May 18, embodied an agreement regarding the evaluation of Ameren Missouri's low-income weatherization program. Both nonunanimous stipulations and agreements were objected to by a non-signatory party. Under Commission Rule 4 CSR 240.2-115(2)(D) both stipulations and agreements are treated as mere position statements of the signatory parties. As a result, those stipulations and agreements cannot be approved.

After reviewing the stipulations and agreements and having questioned the parties at an on-the-record proceeding held on May 20, the Commission independently finds and concludes that each described stipulation and agreement to which no objections was raised is a reasonable resolution of the issues addressed by that stipulation and agreement and that each such stipulation and agreement should be approved.

### **THE COMMISSION ORDERS THAT:**

1. The First Nonunanimous Stipulation and Agreement – Miscellaneous Revenue Requirement Issues, filed on May 3, 2011, is approved as a resolution of the issues addressed in that stipulation and agreement. A copy of the stipulation and agreement is attached to this order.

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2. The Nonunanimous Stipulation and Agreement Regarding Tax Issues, filed on May 5, 2011, is approved as a resolution of the issues addressed in that stipulation and agreement. A copy of the stipulation and agreement is attached to this order.

3. The Third Nonunanimous Stipulation and Agreement, filed on May 6, 2011, is approved as a resolution of the issues addressed in that stipulation and agreement. A copy of the stipulation and agreement is attached to this order.

4. This order shall become effective on June 1, 2011.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.  
Woodruff, Chief Regulatory Law Judge

\*NOTE: The Stipulation & Agreement in this case has not been published. If needed, this document is available in the official case files of the Public Service Commission.

\*NOTE: See pages 40, 562, & 662 for other orders in this case.

**In the Matter of the Application of Southern Union Company, d/b/a Missouri Gas Energy, for a Certificate of Public Convenience and Necessity Authorizing It to Construct, Install, Own, Operate, Control, Manage and Maintain a Natural Gas Distribution System to Provide Gas Service in Lawrence County, Missouri as a Further Expansion of Its Existing Certified Area**

*File No. GA-2011-0367*

*Decided June 10, 2011*

**Gas §3.** The Commission may impose such conditions on a certificate of convenience and necessity as it deems reasonable and necessary. Nothing in the order granting this certificate was a finding by the Commission of the reasonableness or prudence of expenditures involved in serving the customers in the new service area listed in the certificate.

**ORDER GRANTING CERTIFICATE  
OF PUBLIC CONVENIENCE AND NECESSITY**

**Syllabus:**

This order grants Southern Union Company, d/b/a Missouri Gas Energy ("MGE"), a certificate of convenience and necessity to provide natural gas service in a portion of Lawrence County, Missouri.

**Procedural History:**

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On May 6, 2011<sup>1</sup>, Southern Union Company, d/b/a Missouri Gas Energy (“MGE”), applied with the Missouri Public Service Commission, pursuant to Section 393.170, RSMo, requesting that the Commission grant it authority to “construct, install, own, operate, control, manage and maintain a system for the provision of natural gas service to the public pursuant to its approved rates, rules and regulations, in Lawrence County, Missouri. MGE asks for a certificate to serve Section 1, Township 26 North, Range 25 West, in Lawrence County, Missouri. MGE states that a developer has requested MGE to provide natural gas service to a new four-plex to be located within that section.

The Commission issued notice of the application on May 10, and allowed potential intervenors until May 30 to request intervention. The Commission received no intervention requests.

On June 2, the Staff of the Commission filed its Recommendation. Staff believes that granting the application would be in the public interest because: 1) MGE is willing and able to serve the new area under current tariff provisions; 2) MGE’s service to the new customers would not jeopardize MGE’s current customers; 3) no intervenors objected; 4) MGE anticipates using the customary state highway, railroad, and county rights of way, 5) the requested service area has projected growth, and 6) no new franchises are required. Staff recommends that the Commission grant the application.

**Findings of Fact:**

The Commission has reviewed the verified pleadings, which are admitted into evidence, and from those pleadings finds as follows:

MGE is a Delaware corporation in good standing, and has a certificate to do business in Missouri. MGE is a “gas corporation” and provides natural gas service in the Missouri counties of Andrew, Barry, Barton, Bates, Buchanan, Carroll, Cass, Cedar, Christina, Clay, Clinton, Dade, DeKalb, Greene, Henry, Howard, Jackson, Jasper, Johnson, Lafayette, Lawrence, McDonald, Moniteau, Pettis, Platte, Ray, Saline, Stone, and Vernon..

MGE’s new proposed service area is within Section 1, in Township 26 North, Range 25 West, in Lawrence County. To serve the new area, MGE will apply the same rates and regulations it applies to customers under its current tariff. Other than a certificate from the Commission, the only remaining permission MGE requires to serve this

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<sup>1</sup> Calendar references are to 2011 unless otherwise noted.

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area is from state highway, railroad and county road authorities for rights-of-way. No Commission-regulated gas company supplies natural gas to this area.

The Commission will grant MGE the certificate. The proposed service is in the public interest. The Commission will order MGE to file revised tariff sheets describing the new service area.

**Conclusions of Law:**

MGE is a "gas corporation" and a "public utility" as defined in Subsections 386.020(18) and (43), RSMo Supp. 2010. It is subject to the Commission's jurisdiction under to Chapters 386 and 393, RSMo 2000.

A gas corporation may not exercise any right under a franchise unless the Commission gives it a certificate. Also, the Commission may impose such conditions on the certificate as it deems reasonable and necessary.<sup>2</sup>

The Commission concludes that the proposed service area is both necessary and convenient for the public service. Furthermore, the Commission will authorize MGE to construct, install, own, operate, control, manage and maintain a natural gas distribution system as described in its application. The Commission also concludes that it is reasonable and necessary for MGE to file revised tariff sheets that reflect this new service.

**THE COMMISSION ORDERS THAT:**

1. Southern Union Company, d/b/a Missouri Gas Energy, is granted a certificate of public convenience and necessity to construct, install, own, operate, control, manage and maintain a natural gas distribution system in Section 1, Township 26 North, Range 25 West, Lawrence County, Missouri.

2. The certificate of convenience and necessity referenced in ordered paragraph 1 shall become effective on June 20, 2011.

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<sup>2</sup> Subsection 393.170.3, RSMo 2000.

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3. Southern Union Company, d/b/a Missouri Gas Energy, shall file with the Commission tariff sheets describing the new service area and gas supply line no later than July 10, 2011.

4. Southern Union Company, d/b/a Missouri Gas Energy, shall not serve the new service area granted in this order before it files the tariff sheets described in ordered paragraph 3.

5. Nothing in this order shall be considered a finding by the Commission of the reasonableness or prudence of the expenditures herein involved, nor of the value for ratemaking purposes of the properties herein involved, nor as an acquiescence in the value placed on said property.

6. The Commission reserves the right to consider the ratemaking treatment to be afforded the properties herein involved, and the resulting cost of capital, in any later proceeding.

7. This order shall become effective on June 20, 2011.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.  
Pridgin, Senior Regulatory Law Judge

**In the Matter of the Application of Kansas City Power & Light Company for Permission and Approval and a Certificate of Public Convenience And Necessity Authorizing It to Acquire, Construct Install, Own, Operate, Maintain, and Otherwise Control and Manage Electrical Production and Related Facilities in the Smart Grid Project Area of Jackson County, Missouri**

*File No. EA-2011-0368*

*Decided June 10, 2011*

**Electric §3.** In granting the utility a certificate of convenience and necessity, the Commission approved the overall project to install small solar production facilities within a defined area. Additional approval was not required after the utility determined the exact placement of those facilities.

**ORDER GRANTING CERTIFICATE OF CONVENIENCE AND  
NECESSITY**



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On May 6, 2011, Kansas City Power & Light Company (KCPL) applied to the Commission for a certificate of public convenience and necessity granting it authority to construct and operate multiple small solar energy electrical production facilities located in the SmartGrid Demonstration Area in Kansas City, Missouri. KCPL asks the Commission to approve its application by June 15 so that the project can be part of a public demonstration event to be held this summer.

KCPL's application explains that the solar facilities will be located primarily on the rooftops of schools, commercial facilities, and residences within the Demonstration Area. The solar facilities will be small, ranging in size from 100 kW for facilities installed on schools, down to 15 kW for facilities installed at customer residences and 5 kW for a facility to be installed at a KCPL substation. In total, the solar production facilities will have a nameplate capacity of approximately 180 kW. The contractors installing the solar facilities will obtain any necessary local building permits. The project will be financed using KCPL's general funds and the United States Department of Energy will reimburse KCPL for half of the cost of the Project.

In response to KCPL's application, the Commission established May 23 as the deadline for submission of intervention requests and directed its Staff to file a recommendation by May 27. The Missouri Department of Natural Resources (MDNR) applied to intervene on May 23, and the Commission granted its application to intervene on May 24. No other party has applied to intervene.

Staff and MDNR filed their recommendations on May 27. MDNR advises the Commission to approve KCPL's application as a visible demonstration of distributed solar technology. MDNR believes that placement of rooftop solar units on a diverse selection of buildings in the SmartGrid Demonstration Area will serve the public interest by increasing the public's exposure to this renewable energy alternative.

Staff also advises the Commission to approve KCPL's application. However, Staff is concerned that KCPL's Application does not specify the exact locations where the rooftop solar facilities will be installed. In an amendment to its application filed on May 27, KCPL was able to specify the installation location of two solar facilities, 100 kW to be installed at a school and 5kW to be installed at a KCPL substation. However, KCPL has not yet determined the exact location of the other 75 kW it plans to install.

Staff believes the Missouri Court of Appeals' recent decisions regarding the construction of the South Harper electrical generating plant

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requires the utility to specify the location of the generation to be built before the Commission can grant a certificate of convenience and necessity. The first South Harper decision,<sup>1</sup> declares that section 393.170.1, RSMo 2000 requires an electric utility to obtain a certificate of convenience and necessity from the Commission before constructing an electrical generating facility within its service territory. That decision also declares that section 393.170.3, RSMo 2000 requires the Commission to determine contemporaneously with the application whether construction of the electrical generating facility is necessary or convenient for the public service.<sup>2</sup> Because of that decision, Staff advises the Commission to issue a certificate only for the 105 kW facilities for which KCPL has specifically identified an installation site.

After reviewing the applicable decisions and statutes, as well as the facts described in KCPL's application, the Commission concludes that Staff's interpretation is overly restrictive. The purpose of the statutory requirement is to ensure that the public interest is protected. In the South Harper case the public interest concerned placement of a natural gas-fired turbine electrical generating plant that could potentially disrupt a residential neighborhood without regard to local zoning requirements. In this case, the public interest concerns placement of solar arrays on a few buildings, subject to local building permits and in a way that does not implicate local zoning requirements.

If Staff's interpretation of the requirements of the statute and the court decision were correct, then KCPL would have to come back before the Commission with a new application for a certificate of convenience and necessity each time it identifies a new structure on which it wishes to install a small solar production facility. That would be a waste of resources for both the utility and for the Commission. Instead, the Commission finds that by specifying the parameters of the area in which it intends to install the described small solar production facilities, KCPL has provided the Commission with sufficient information to satisfy the requirements of the statute.

Section 393.170.1, RSMo 2000 provides that no electrical corporation may begin construction of electric plant until it has obtained the permission and approval of the Commission. Subsection 3 of that statute says the Commission may grant such approval when it determines, after due hearing, that such construction is necessary or

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<sup>1</sup> *Stopaquila.org v. Aquila, Inc.*, 180 S.W. 3d 24 (Mo Ap. W.D. 2005).

<sup>2</sup> *Id.* at 34.

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convenient for the public service. In this case no party has requested a hearing and the Commission will decide the case based on the submitted pleadings.

Based on KCPL's verified application and the recommendations of Staff and MDNR, the Commission finds that KCPL's plan to install small solar production facilities within the SmartGrid Demonstration Project Area is necessary and convenient for the public service. The Commission will grant KCPL a certificate of public convenience and necessity for that purpose.

KCPL also requests a waiver of Commission Rule 4 CSR 240-4.020(2), which would require KCPL to file notice of a potential contested case sixty days before filing its application for certificate of public convenience and necessity. The Commission will grant that requested waiver.

In granting KCPL a certificate of convenience and necessity, the Commission is approving the overall project to install small solar production facilities within the SmartGrid Demonstration Project area. Additional Commission approval is not required after KCPL determines precisely on which buildings to install those small solar facilities. However, the Commission will direct KCPL to file a list of the specific locations at which small solar production facilities have been installed after that information is available.

**THE COMMISSION ORDERS THAT:**

1. Kansas City Power & Light Company is granted a certificate of convenience and necessity to acquire, construct, install, own, operate, maintain and otherwise control and manage a group of distributed solar electrical production facilities with an additive nameplate capacity of approximately 180 kW and related facilities located in the SmartGrid Project Area in Kansas City, Missouri.

2. Kansas City Power & Light Company is granted a waiver from the requirements of Commission Rule 4 CSR 240-4.020(2).

3. Nothing in this order shall be considered a finding by the Commission of the reasonableness of the expenditures herein involved, nor of the value for ratemaking purposes of the properties herein involved, nor as an acquiescence in the value placed on said property.

4. The Commission reserves the right to consider the ratemaking treatment to be afforded the expenditures and properties herein involved, and the resulting cost of capital, in any later proceeding.

5. This order shall become effective on June 15, 2011.

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Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.  
Woodruff, Chief Regulatory Law Judge

**In the Matter of the Joint Application of Aqua Missouri, Inc. and the  
City of Taos, Missouri, for Authority to Acquire Certain Assets of  
Aqua Missouri, Inc., and in Connection Therewith, Certain Other  
Related Transactions**

*File No. SO-2011-0331  
Decided June 15, 2011*

**Certificates §45.** The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff.

**Water §4.** The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff.

**ORDER GRANTING APPLICATION WITH CONDITIONS**

The Missouri Public Service Commission is approving the application subject to conditions recommended by Staff.

On April 7, 2011, Aqua Missouri, Inc. and the City of Taos, Missouri filed the application seeking authority for the City of Taos, Missouri to acquire the sewer system of Aqua Missouri, Inc.

By order dated April 8, 2011, the Commission provided for notice of the application to affected political subdivisions and others. In that same order, the Commission set a deadline for applications to intervene. As of the date of this order, the Commission has received no application to intervene. Staff filed its recommendation on June 10, 2011, favoring the application subject to certain conditions. Because the applicants sought expedited treatment,<sup>1</sup> the Commission will dispense with the time for responses to the recommendation.

No law requires an evidentiary hearing,<sup>2</sup> and no person has sought one,<sup>3</sup> so this action is not a contested case and the Commission need not separately state its findings of fact.

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<sup>1</sup> Motion filed on May 31, 2011; granted by order dated June 3, 2011.

<sup>2</sup> Section 536.010(4), RSMo Supp. 2010.

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The Commission has jurisdiction to rule on the application under the following provision:

No [sewer company] shall hereafter sell . . . its . . . works or system . . . without having first secured from the commission an order authorizing it so to do. [<sup>4</sup>]

The Commission will only deny the application if approval would be detrimental to the public interest.<sup>5</sup> The public interest will suffer no detriment from the sale, according to the verified filings, with the conditions set forth below. Therefore, the Commission will approve the application subject to those conditions.

**THE COMMISSION ORDERS THAT:**

1. The application for authority to transfer assets (“transfer”) from Aqua Missouri, Inc. (“Aqua”) to the City of Taos, Missouri is approved subject to the following conditions.

2. Unless the transfer of assets is complete, no later than 30 days after the effective date of this order and at the end of each subsequent 30-day period, Aqua shall file a status report stating whether the transfer is complete, is proceeding, or will not occur.

3. Within three business days after the transfer is complete, Aqua shall file notice of the transfer, including evidence that the transfer has occurred, so that the Commission may cancel Aqua’s certificate of convenience and necessity and sewer tariff on file for the area being served by the assets transferred.

4. This order shall become effective on June 25, 2011.

5. This file shall remain open for notice of the transfer, and the cancellation of any associated tariff, and certificate of convenience and necessity.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.  
Daniel Jordan, Senior Regulatory Law Judge

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<sup>3</sup> *State ex rel. Rex Deffenderfer Ent., Inc. v. Public Serv. Comm’n*, 776 S.W.2d 494, 496 (Mo. App., W.D. 1989).

<sup>4</sup> Section 393.190.1, RSMo 2000.

<sup>5</sup> *State ex rel. City of St. Louis v. Public Serv. Comm’n of Missouri*, 73 S.W.2d 393, 400 (Mo. 1934).

## ASSESSMENT ORDER FOR FISCAL YEAR 2012

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### **In the Matter of the Assessment Against the Public Utilities in the State of Missouri for the Expenses of the Commission for the Fiscal Year Commencing July 1, 2011**

*Case No. AO-2011-0395*

*Decided June 22, 2011*

**Public Utilities §1.** The Commission estimated its fiscal year 2012 Assessment to be \$16,574,239.

### **ASSESSMENT ORDER FOR FISCAL YEAR 2012**

Pursuant to 386.370, RSMo 2000, the Commission estimates the expenses to be incurred by it during the fiscal year commencing July 1, 2011. These expenses are reasonably attributable to the regulation of public utilities as provided in Chapters 386, 392 and 393, RSMo and amount to \$18,813,763. Within that total, the Commission estimates the expenses directly attributable to the regulation of the six groups of public utilities: electrical, gas, heating, water, sewer and telephone, which total for all groups \$11,094,488. In addition to the separately identified costs for each utility group, the Commission estimates the amount of expenses that could not be attributed directly to any utility group of \$7,719,275.

The Commission estimates that the amount of Federal Gas Safety reimbursement will be \$540,852. The unexpended balance in the Public Service Commission Fund in the hands of the State Treasurer on July 1, 2011, is estimated to be \$1,698,672. The Commission deducts these amounts and estimates its Fiscal Year 2012 Assessment to be \$16,574,239. The unexpended sum is allocated as a deduction from the estimated expenses of each utilities group listed above, in proportion to the group's gross intrastate operating revenue as a percentage of all groups' gross intrastate operating revenue for the calendar year of 2010, as provided by law. The reimbursement from the federal gas safety program is deducted from the estimated expenses attributed to the gas utility group.

The Commission allocates to each utility group its directly attributable estimated expenses. Additional common, administrative and other costs not directly attributable to any particular utility group are assessed according to the group's proportion of the total gross intrastate operating revenue of all utilities groups. Those amounts are set out with

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more specificity in documents located on the Commission's web page at <http://www.psc.mo.gov>.

The Commission fixes the amount so allocated to each such group of public utilities, net of said estimated unexpended fund balance and federal reimbursement as follows:

Electric .....	\$ 8,428,925
Gas .....	\$ 4,129,396
Steam/Heating .....	\$ 96,862
Water .....	\$ 1,324,045
Sewer .....	\$ 594,222
Telephone.....	\$ 2,000,789
Total.....	\$ 16,574,239

This year, pursuant to HB7, Section 7.185, 2011 Session, the Commission has been charged with collecting an assessment for the Office of Public Counsel which totals \$1,024,131 and is included in the total assessment amount of \$16,574,239.

The Commission allocates a proportionate share of the \$16,574,239 to each industry group as indicated above. The amount allocated to each industry group is allotted to the companies within that group. This allotment is accomplished according to the percentage of each individual company's gross intrastate operating revenues compared to the total gross intrastate operating revenues for that group. The amount allotted to a company is the amount assessed to that company.

The Budget and Fiscal Services Department of the Commission is hereby directed to calculate the amount of such assessment against each public utility, and the Commission's Executive Director shall render a statement of such assessment to each public utility on or before July 1, 2011. The assessment shall be due and payable on or before July 15, 2011, or at the option of each public utility, it may be paid in equal quarterly installments on or before July 15, 2011, October 15, 2011, January 15, 2012, and April 15, 2012. The Budget and Fiscal Services Department shall deliver checks to the Director of Revenue the day they are received.

All checks shall be made payable to the Director of Revenue, State of Missouri; however, these checks must be sent to:

Missouri Public Service Commission  
Budget and Fiscal Services Department  
P.O. Box 360  
Jefferson City, MO, 65102-0360

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**IT IS ORDERED THAT:**

1. The assessment for fiscal year 2012 shall be as set forth herein.
2. The Budget and Fiscal Services Department of the Commission shall calculate the amount of such assessment against each public utility.
3. On behalf of the Commission, the Commission's Executive Director shall render a statement of such assessment to each public utility on or before July 1, 2011.
4. Each public utility shall pay its assessment as set forth herein.
5. The Budget and Fiscal Services Department shall deliver checks to the Director of Revenue the day they are received.
6. This order shall become effective on July 1, 2011.

Gunn, Chm., Clayton, Davis  
Jarrett, and Kenney, CC., concur.

Woodruff, Chief Regulatory Law Judge

**In the Matter of Union Electric Company, d/b/a Ameren Missouri's  
Tariff to Increase Its Annual Revenues for Electric Service\***

*File No. ER-2011-0028  
Decided July 13, 2011*

**Rates §22.** No one benefits when a utility is deprived of the ability to charge its customers a just and reasonable rate. Public sentiment is only part of the equation the Commission must consider when fulfilling its responsibility to establish just and reasonable rates.

**Electric §33.** The Commission continued a tracking mechanism for costs related to vegetation management to encourage the utility to continue to improve reliability.

**Rates §20.** The purpose of normalization is to determine a reasonable expectation of what costs a utility is likely to experience in the future so that rates can be set to allow the utility a reasonable opportunity to recover those costs.

**Evidence, practice and procedure §4.** Utility expenditures are presumed to be prudently incurred until some party presents sufficient evidence to establish a serious doubt as to prudence. Thereafter the burden shifts to the utility to prove that its expenditures were prudent.



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**Electric §22.** The throughput disincentive discourages investment by utilities in energy efficiency measures.

**Electric §37.** Ameren Missouri was not allowed to include any amount of the cost to rebuild the upper reservoir of the Taum Sauk plant in its rate base.

**Electric §29.** The Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investor's dollar in the capital market.

**Electric §29.** The principles and methods involved in valuing physical assets are different than the principles and methods involved in estimating a utility's cost of equity. Therefore, valuation analyses cannot be used to support the reasonableness of a return on equity recommendation.

**Rates §101.** Any fuel adjustment clause the Commission allows a utility to implement must be reasonably designed to allow the company a sufficient opportunity to earn a fair return on equity.

**Electric §43.** The Commission's rule allows Ameren Missouri to use an AAO to defer recovery of its costs as an alternative to recovering those costs through a Renewable Energy Standard Rate Adjustment Mechanism (RESRAM).

**Public Utilities §7.** The Commission does not have authority to dictate to the company whether it must use internal workforce rather than outside contractors to perform the work of the company.

**Rates §119.** It is important that each customer class carry its own weight by paying rates sufficient to cover the cost to serve that class. That also encourages cost effective utilization of electricity by sending appropriate price signals.

**Rates §89.** The Commission does not like declining block rates, but insufficient evidence was presented to justify changing those rates.

**REPORT AND ORDER**

**APPEARANCES**

**Thomas M. Byrne**, Managing Assoc. General Counsel, and **Wendy K. Tatro**, Asst. General Counsel, Ameren Services Company, P.O. Box 66149, 1901 Chouteau Ave., St. Louis, Missouri 63103;

**James B. Lowery**, Attorney at Law, and **Michael Tripp**, Smith Lewis, LLP, P.O. Box 918, Suite 200, City Centre Building, 111 South Ninth St. Columbia, Missouri 65205-0918; and

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**Russ Mitten**, Attorney at Law, Brydon, Swearingen & England, 312 E. Capital Ave., Jefferson City, Missouri 65102.

**Mark A. Whitt**, Attorney at Law, Carpenter Lipps & Leland LLP, 280 Plaza, Suite 1300, 280 North High Street, Columbus, Ohio 43215.

For Union Electric Company, d/b/a Ameren Missouri.

**Kevin Thompson**, Chief Staff Counsel, **Steven Dotthiem**, Chief Deputy Counsel, **Nathan Williams**, Deputy Counsel, **Jennifer Hernandez**, Legal Counsel, **Sarah Kliethermes**, Legal Counsel, **Jaime Ott**, Legal Counsel, **Meghan McClowery**, Legal Counsel, and **Annette Slack**, Legal Counsel, P.O. Box 360, 200 Madison Street, Jefferson City, Missouri 65102

For the Staff of the Missouri Public Service Commission.

**Lewis R. Mills, Jr.**, Public Counsel, P.O. Box 2230, 200 Madison Street, Suite 650, Jefferson City, Missouri 65102

For the Office of the Public Counsel and the Public.

**Jennifer Frazier**, Assistant Attorney General, P.O. Box 899, Jefferson City, Missouri 65102

For the Missouri Department of Natural Resources.

**David Woodsmall**, Attorney at Law, Finnegan, Conrad & Peterson, L.C., 428 East Capitol, Suite 300, Jefferson City, Missouri 65101

For the Midwest Energy Users' Association.

**Diana Vuylsteke**, Attorney at Law, **Mark Leadlove**, Attorney at Law, **Brent Roam**, Attorney at Law, **Edward F. Downey**, Attorney at Law, and **Carol Iles**, Attorney at Law, Bryan Cave, LLP, 211 N. Broadway, Suite 3600, St. Louis, Missouri 63102

For Missouri Industrial Energy Consumers.

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**Lisa C. Langeneckert**, Attorney at Law, Sandberg, Phoenix & Von Gontard, P.C., 515 N. 6<sup>th</sup> Street, St. Louis, Missouri 63101.

For Missouri Energy Group.

**John B. Coffman**, Attorney at Law, John B. Coffman, LLC, 871 Tuxedo Blvd, St. Louis, Missouri 63119-2044.

For AARP and the Consumers Council of Missouri.

**Sherrie A. Schroder**, Attorney at Law, Hammond and Shinnars, P.C. 7730 Carondelet Ave., Suite 200, St. Louis, Missouri 63105.

For International Brotherhood of Electrical Workers Locals 2, 309, 649, 702, 1439, 1455, AFL-CIO and International Brotherhood of Operating Engineers Local 148, AFL-CIO.

**Leland B. Curtis**, Attorney at Law, Curtis, Oetting, Heinz, Garrett & O'Keefe, 130 S. Bemiston, Suite 200, St. Louis, Missouri 63105.

For the St. Louis County Municipal League, the Cities of O'Fallon, Creve Coeur, University City, Olivette, St. Ann, Kirkwood, Bellefontaine Neighbors, Florissant, Richmond Heights, Twin Oaks, Ballwin, Brentwood, Riverview, St. John, and Sunset Hills (The Municipal Group).

**Thomas R. Schwarz**, Blitz, Bardgett & Deutsch, L.C. 308 East High Street, Suite 301, Jefferson City, Missouri 65101.

For the Missouri Retailers Association.

**CHIEF REGULATORY LAW JUDGE: Morris L. Woodruff**

The Missouri Public Service Commission, having considered all the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position, or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

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**Summary**

This order allows Ameren Missouri to increase the revenue it may collect from its Missouri customers by approximately \$172 million based on the data contained in the Revised True-up Reconciliation filed by the Missouri Public Service Commission Staff on May 16, 2011.

**Procedural History**

On September 3, 2010, Union Electric Company, d/b/a Ameren Missouri filed tariff sheets designed to implement a general rate increase for electric service. The tariff would have increased Ameren Missouri's annual electric revenues by approximately \$263 million. The tariff revisions carried an effective date of October 3, 2010.

By order issued on September 7, 2010, the Commission suspended Ameren Missouri's general rate increase tariff until July 31, 2011, the maximum amount of time allowed by the controlling statute.<sup>1</sup> In the same order, the Commission directed that notice of Ameren Missouri's tariff filing be provided to interested parties and the public. The Commission also established October 4, 2010, as the deadline for submission of applications to intervene. The following parties filed applications and were allowed to intervene: The International Brotherhood of Electrical Workers Locals 2, 309, 649, 702, 1439, and 1455, AFL-CIO and International Union of Operating Engineers Local 148 AFL-CIO (collectively the Unions); The Missouri Industrial Energy Consumers (MIEC);<sup>2</sup> The Missouri Energy Group (MEG);<sup>3</sup> The Missouri Department of Natural Resources (MDNR); Missouri-American Water Company; The Consumers Council of Missouri; AARP; The Missouri Retailers Association; The Natural Resources Defense Council; the Missouri Coalition for the Environment, d/b/a Renew Missouri; the Cities of O'Fallon, Creve Coeur, University City, Olivette, St. Ann, Kirkwood, Belfontaine Neighbors, Florissant, Richmond Heights, Ballwin, Brentwood, St. John, Sunset Hills, the Village of Twin Oaks, the Village of Riverview, and the St. Louis County Municipal League (the Municipal

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<sup>1</sup> Section 393.150, RSMo 2000.

<sup>2</sup> The following members of MIEC were allowed to intervene as individual entities and as an association: Anheuser-Busch Companies, Inc.; BioKyowa, Inc.; The Boeing Company; Doe Run; Enbridge; Explorer Pipeline; General Motors Corporation; GKN Aerospace; Hussmann Corporation; JW Aluminum; Monsanto; Precoat Metals; Proctor & Gamble Company; Nestlé Purina PetCare; Noranda Aluminum; Saint Gobain; Solutia; and U.S. Silica Company.

<sup>3</sup> The members of MEG are Barnes-Jewish Hospital; Buzzi Unicem USA, Inc.; and SSM HealthCare.

Group); the Midwest Energy Users' Association (MEUA);<sup>4</sup> and Charter Communications, Inc.

On November 10, 2010, the Commission established the test year for this case as the 12-month period ending March 31, 2010, true-up as of February 28, 2011. In its November 10 order, the Commission established a procedural schedule leading to an evidentiary hearing regarding Ameren Missouri's general rate increase tariff.

In February and March 2011, the Commission conducted fourteen local public hearings at various sites around Ameren Missouri's service area. At those hearings, the Commission heard comments from Ameren Missouri's customers and the public regarding Ameren Missouri's request for a rate increase.

In compliance with the established procedural schedule, the parties prefiled direct, rebuttal, and surrebuttal testimony. The evidentiary hearing began on April 26, 2011, and continued through May 20. The parties indicated they had no contested true-up issues and the Commission cancelled the scheduled true-up hearing. The parties filed post-hearing briefs on June 1, 2011, with reply briefs following on June 13. Based on the revised true-up reconciliation filed by Staff on May 16, Ameren Missouri has reduced its rate increase request to \$211,183,446.

#### **Admission of True-Up Document into Evidence**

A true-up hearing was originally scheduled for May 23 and 24. On May 16, Gary Weiss filed true-up direct testimony consisting of many pages of accounting schedules detailing true-up numbers. There were no true-up issues and on May 20, the Commission cancelled the true-up hearing. Through an oversight, Mr. Weiss's true-up testimony was never admitted into evidence. However, the accounting schedules attached to that testimony are cited in the briefs and in this report and order. Therefore, the Commission will admit the True-Up Direct Testimony of Gary S. Weiss into evidence and will assign that document exhibit number 174.

#### **The Partial Stipulations and Agreements**

During the course of the evidentiary hearing, various parties filed three nonunanimous partial stipulations and agreements resolving issues that would otherwise have been the subject of testimony at the hearing. No party opposed those partial stipulations and agreements. As permitted by its regulations, the Commission treated the unopposed

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<sup>4</sup> The only member of MEUA for this case is Wal-Mart Stores, Inc.

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partial stipulations and agreements as unanimous.<sup>5</sup> After considering the stipulations and agreements, the Commission approved them as a resolution of the issues addressed in those agreements.<sup>6</sup> The issues resolved in those stipulations and agreements will not be further addressed in this report and order, except as they may relate to any unresolved issues.

On May 12, 2011, Public Counsel, MIEC, AARP, the Consumers Council of Missouri, the Missouri Retailers, MEUA, and MEG filed a non-unanimous stipulation and agreement that would have resolved various class cost of service and rate design issues. The Municipal Group opposed that non-unanimous stipulation and agreement. Similarly, on May 18, Ameren Missouri and MDNR filed a non-unanimous stipulation and agreement regarding evaluation of the low-income weatherization program. Public Counsel opposed that stipulation and agreement. As provided in the Commission's rules, the Commission will consider those stipulations and agreements to be merely a position of the signatory parties to which no party is bound.<sup>7</sup> The issues that were the subject of those stipulations and agreements will be determined in this report and order.

### Overview

Ameren Missouri is an investor-owned integrated electric utility providing retail electric service to large portions of Missouri, including the St. Louis Metropolitan area. Ameren Missouri has approximately 1.2 million retail electric customers in Missouri, more than 1 million of whom are residential customers.<sup>8</sup> Ameren Missouri also operates a natural gas utility in Missouri but the rates it charges for natural gas are not at issue in this case.

Ameren Missouri began the rate case process when it filed its tariff on September 3, 2010. In doing so, Ameren Missouri asserted it was entitled to increase its retail rates by \$263 million per year, an increase of approximately 11 percent.<sup>9</sup> Ameren Missouri attributed approximately \$200 million of the proposed increase to energy infrastructure investments, environmental controls and other reliability costs to meet customers' expectations for more reliable and cleaner

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<sup>5</sup> Commission Rule 4 CSR 240-2.115(C).

<sup>6</sup> The Commission issued its *Order Approving Stipulations and Agreements* on June 1, 2011.

<sup>7</sup> Commission Rule 4 CSR 240-2.115(2)(D).

<sup>8</sup> Baxter Direct, Ex. 100, Page 4, Lines 19-20.

<sup>9</sup> Baxter Direct, Ex. 100, Page 5, Lines 16-17.

energy.<sup>10</sup> The company attributed another \$70 million of that increase to the rebasing of fuel costs that would otherwise be passed through to customers by operation of the company's existing fuel adjustment clause.<sup>11</sup>

Ameren Missouri set out its rationale for increasing its rates in the direct testimony it filed along with its tariff on September 3, 2010. In addition to its filed testimony, Ameren Missouri provided work papers and other detailed information and records to the Staff of the Commission, Public Counsel, and to the intervening parties. Those parties then had the opportunity to review Ameren Missouri's testimony and records to determine whether the requested rate increase was justified.

Where the parties disagreed, they prefiled written testimony to raise those issues to the attention of the Commission. All parties were given an opportunity to prefile three rounds of testimony – direct, rebuttal, and surrebuttal. The process of filing testimony and responding to the testimony filed by other parties revealed areas of agreement that resolved some issues and areas of disagreement that revealed new issues. On April 21, the parties filed a list of the issues they asked the Commission to resolve. The Commission will address those issues in the order submitted by the parties.

#### **Conclusions of Law Regarding Jurisdiction**

A. Ameren Missouri is a public utility, and an electrical corporation, as those terms are defined in Section 386.020(43) and (15), RSMo (Supp. 2010). As such, Ameren Missouri is subject to the Commission's jurisdiction pursuant to Chapters 386 and 393, RSMo.

B. Section 393.140(11), RSMo 2000, gives the Commission authority to regulate the rates Ameren Missouri may charge its customers for electricity. When Ameren Missouri filed a tariff designed to increase its rates, the Commission exercised its authority under Section 393.150, RSMo 2000, to suspend the effective date of that tariff for 120 days beyond the effective date of the tariff, plus an additional six months.

#### **Conclusions of Law Regarding the Determination of Just and Reasonable Rates**

A. In determining the rates Ameren Missouri may charge its customers, the Commission is required to determine that the proposed

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<sup>10</sup> Baxter Direct, Ex. 100, Page 5, Lines 20-22.

<sup>11</sup> Baxter Direct, Ex. 100, Page 6, Lines 19-23.

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rates are just and reasonable.<sup>12</sup> Ameren Missouri has the burden of proving its proposed rates are just and reasonable.<sup>13</sup>

B. In determining whether the rates proposed by Ameren Missouri are just and reasonable, the Commission must balance the interests of the investor and the consumer.<sup>14</sup> In discussing the need for a regulatory body to institute just and reasonable rates, the United States Supreme Court has held as follows:

Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.<sup>15</sup>

In the same case, the Supreme Court provided the following guidance on what is a just and reasonable rate:

What annual rate will constitute just compensation depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts. A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be

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<sup>12</sup> Section 393.150.2, RSMo 2000.

<sup>13</sup> *Id.*

<sup>14</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603, (1944).

<sup>15</sup> *Bluefield Water Works & Improvement Co. v. Public Service Commission of the State of West Virginia*, 262 U.S. 679, 690 (1923).



reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.<sup>16</sup>

The Supreme Court has further indicated:

'[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.<sup>17</sup>

C. In undertaking the balancing required by the Constitution, the Commission is not bound to apply any particular formula or combination of formulas. Instead, the Supreme Court has said:

Agencies to whom this legislative power has been delegated are free, within the ambit of their statutory authority, to make the pragmatic adjustments which may be called for by particular circumstances.<sup>18</sup>

Furthermore, in quoting the United States Supreme Court in *Hope Natural Gas*, the Missouri Court of Appeals said:

[T]he Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function, moreover, involves the making of 'pragmatic adjustments.' ... Under the statutory standard of 'just and reasonable' it is the result reached, not the method employed which is controlling. It is not theory but the impact of the rate order which

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<sup>16</sup> *Id.* at 692-93.

<sup>17</sup> *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (citations omitted).

<sup>18</sup> *Federal Power Commission v. Natural Gas Pipeline Co.* 315 U.S. 575, 586 (1942).

counts.<sup>19</sup>

### **The Rate Making Process**

The rates Ameren Missouri will be allowed to charge its customers are based on a determination of the company's revenue requirement. Ameren Missouri's revenue requirement is calculated by adding the company's operating expenses, its depreciation on plant in rate base, taxes, and its rate of return multiplied by its rate base. The revenue requirement can be expressed as the following formula:

$$\text{Revenue Requirement} = E + D + T + R(V-AD+A)$$

Where: E = Operating expense requirement

D = Depreciation on plant in rate base

T = Taxes including income tax related to return

R = Return requirement

(V-AD+A) = Rate base

For the rate base calculation:

V = Gross Plant

AD = Accumulated depreciation

A = Other rate base items

All parties accept the basic formula. Disagreements arise over the amounts that should be included in the formula.

### **The Issues**

#### **1. Overview and Policy:**

**A. What "cost of service" and/or regulatory policy considerations, if any, should guide the Commission's decision of the issues in this case?**

**B. Can the Commission consider and rely on the testimony of ratepayers at local public hearings in determining just and reasonable rates? If so, how should the Commission take this testimony into account, if at all?**

Although this was identified as an issue by the parties, there is no actual overview and policy issue that will require resolution by the Commission. Rather, some of the parties ask the Commission to explain how it views its role as a regulator and in particular, explain how it deals with the testimony it receives from ratepayers at local public hearings. The Commission will accept this invitation to explain its role.

As its name implies, the Public Service Commission was created and exists primarily to serve the public. In a case decided just a few

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<sup>19</sup> *State ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n*, 706 S.W. 2d 870, 873 (Mo. App. W.D. 1985).

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years after this Commission was created, the Missouri Supreme Court stated that the spirit of the act establishing the Public Service Commission is to protect the public. In the words of the court, “[t]he protection given the utility is incidental.”<sup>20</sup>

Some parties suggest that if the Commission is to serve the public interest, it must bow to the popular will expressed at the various local public hearings and eliminate or reduce as far as possible any rate increase requested by the utility. However, that is not the law under which the Commission operates. Furthermore, a Commission policy that destroyed the profitability of the utility would ultimately harm the public the Commission is obligated to serve.

As the Commission indicated in a previous section of this Report and Order, it is required to balance the interests of the ratepayers and the utility’s shareholders to establish rates that are just and reasonable. Many witnesses who testify at local public hearings offer heartfelt and frequently heartbreaking accounts of how they are suffering from the economy in general and high utility rates in particular. As the Commission heard frequently at those hearings, many customers want the Commission to “just say no” to any proposed rate increase.

The Commission hears the public’s testimony and takes it into account when deciding this or any other utility rate case. However, the Commission cannot simply “just say no” to a rate increase. The utility is entitled to charge rates sufficient to cover its costs and to yield a reasonable return on its investment. That is why the Commission took and considered extensive testimony offered by multiple parties before making the difficult decisions that are set forth and explained in this report and order.

Even if the Commission had the legal authority to “just say no” to a rate increase, doing so could cause great harm to the public. No one benefits when a utility is deprived of the ability to charge its customers a just and reasonable rate. Customers may initially be happy when the rates they pay are kept low, but as a utility’s income is reduced beyond a reasonable level, it must begin to cut corners to reduce its expenses. When that happens, the reliability of the service offered by the utility will suffer. While ratepayers do not like to pay increased rates, they also do not like to sit in the cold and dark when the power goes out.

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<sup>20</sup> *State ex rel. Electric Co. of Missouri v. Atkinson et al.*, 275 Mo. 325, 204 S.W. 897, 899 (Mo banc 1918).

The Commission can and does consider all the testimony offered in this case, including the testimony offered by the public at the local public hearings. However, public sentiment is only part of the equation the Commission must consider when fulfilling its responsibility to establish just and reasonable rates.

**2. Storm Costs/Vegetation-Infrastructure Trackers**

**A. Vegetation-Infrastructure:**

**(1) Should the Commission authorize Ameren Missouri to continue the current tracking mechanism for vegetation management and infrastructure inspections?**

**Findings of Fact:**

**Introduction:**

1. Ameren Missouri's vegetation management and infrastructure inspection expense is closely associated with two Commission rules. Following extensive storm related service outages in 2006, the Commission promulgated new rules designed to compel Missouri's electric utilities to do a better job of maintaining their electric distribution systems. Those rules, entitled Electrical Corporation Infrastructure Standards<sup>21</sup> and Electrical Corporation Vegetation Management Standards and Reporting Requirements,<sup>22</sup> became effective on June 30, 2008.

2. The rules establish specific standards requiring electric utilities to inspect and replace old and damaged infrastructure, such as poles and transformers. In addition, electric utilities are required to more aggressively trim tree branches and other vegetation that encroaches on transmission lines. In promulgating the stricter standards, the Commission anticipated utilities would have to spend more money to comply. Therefore, both rules include provisions that allow a utility the means to recover the extra costs it incurs to comply with the requirements of the rule.

3. In ER-2008-0318, the Commission allowed Ameren Missouri to recover a set amount in its base rates for vegetation management and infrastructure inspection costs. However, since the rules were new, the Commission found that Ameren Missouri had too little experience to reasonably know how much it would need to spend to comply with the vegetation management and infrastructure inspection rules. Because of that uncertainty, the Commission established a two-way tracking

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<sup>21</sup> Commission Rule 4 CSR 240-23.020.

<sup>22</sup> Commission Rule 4 CSR 240-23.030.

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mechanism to allow Ameren Missouri to track its vegetation management and infrastructure costs.

4. The order required Ameren Missouri to track actual expenditures around the base level. In any year in which Ameren Missouri spent below that base level, a regulatory liability would be created. In any year in which Ameren Missouri's spending exceeded the base level, a regulatory asset would be created. The regulatory assets and liabilities would then be netted against each other and would be considered in Ameren Missouri's future rate case. The tracking mechanism contained a 10 percent cap so if Ameren Missouri's expenditures exceeded the base level by more than 10 percent it could not defer those costs under the tracking mechanism, but would need to apply for an additional accounting authority order. The Commission's order indicated that the tracking mechanism would operate until new rates were established in Ameren Missouri's next rate case.<sup>23</sup>

5. The Commission renewed the tracking mechanism in Ameren Missouri's next rate case, ER-2010-0036, finding that Ameren Missouri's costs to comply with the vegetation management and infrastructure inspection rules were still uncertain as the company had not yet completed a full four/six year vegetation management cycle on its entire system.<sup>24</sup>

6. Ameren Missouri asks that the tracker be continued. Staff does not oppose the continuation of the tracker, but MIEC contends the tracker is no longer necessary and urges the Commission to end it.

**Specific Findings of Fact:**

7. Ameren Missouri has now been operating under the Commission's vegetation management and infrastructure inspection rules for several years. However, Ameren Missouri will not complete its first four-year cycle for vegetation management work on urban circuits under the requirements of the new rules until December 31, 2011. It will not complete the six-year cycle of work on rural circuits until December 31, 2013.<sup>25</sup>

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<sup>23</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Pages 48-49.

<sup>24</sup> *In the Matter of Union Electric Company, d/b/a Ameren UE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, File No. ER-2010-0036, May 28, 2010.

<sup>25</sup> Wakeman Rebuttal, Ex. 105, Page 9, Lines 19-21.

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8. Ameren Missouri's actual expenditures for vegetation management and infrastructure inspection have not been extremely volatile over the last two rate cases, but they have consistently increased. Furthermore, Ameren Missouri has consistently spent more than the base amount allowed in rates.<sup>26</sup> For example, the base amount allowed in rates in the last rate case was \$50.4 million for vegetation management and \$7.6 million for infrastructure inspections. For the twelve months ending in February 2011, the company actually spent \$52.2 million on vegetation management and \$7.7 million on infrastructure inspections.<sup>27</sup>

9. In a stipulation and agreement that has been approved by the Commission, the parties have agreed that the vegetation management and infrastructure actual expenses through the February 28, 2011 true-up of \$52.2 million and \$7.7 million will be established as the base amount allowed in rates for this case.<sup>28</sup>

**Conclusions of Law:**

A. Commission Rule 4 CSR 240-23.020 establishes standards requiring electrical corporations, including Ameren Missouri, to inspect its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.020(3)(A) establishes a four-year cycle for inspection of urban infrastructure and a six-year cycle for inspection of rural infrastructure.

B. Commission Rule 4 CSR 240-23.020(4) establishes a procedure by which an electric utility may recover expenses it incurs because of the rule. Specifically, that section states as follows:

In the event an electrical corporation incurs expenses as a result of this rule in excess of the costs included in current rates, the corporation may submit a request to the commission for accounting authorization to defer recognition and possible recovery of these excess expenses until the effective date of rates resulting from its next general rate case, filed after the effective date of this rule, using a tracking mechanism to record the difference between the actually incurred

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<sup>26</sup> Meyer Surrebuttal, Ex. 401, Chart at Page 13.

<sup>27</sup> Wakeman Rebuttal, Ex. 105, Page 9, Lines 7-10.

<sup>28</sup> First Nonunanimous Stipulation and Agreement – Miscellaneous Revenue Requirement Items, paragraph 20, filed on May 3, 2011, and approved by order of the Commission on June 1, 2011.

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expenses as a result of this rule and the amount included in the corporation's rates ... .

C. Commission Rule 4 CSR 240-23.030 establishes standards requiring electrical corporations, including Ameren Missouri, to trim trees and otherwise manage the growth of vegetation around its transmission and distribution facilities as necessary to provide safe and adequate service to its customers. Specifically, 4 CSR 240-23.030(9) establishes a four-year cycle for vegetation management of urban infrastructure and a six-year cycle for vegetation management of rural infrastructure. The vegetation management rule also includes a provision that would allow Ameren Missouri to ask the Commission for authority to accumulate and recover its cost of compliance in its next rate case.<sup>29</sup>

**Decision:**

Ameren Missouri's system reliability has improved since the new rules went into effect and the Commission believes that vegetation management and infrastructure inspection is very important to that improved reliability. The Commission wants to encourage Ameren Missouri to continue to spend the money needed to improve reliability. Although Ameren Missouri now has more experience in complying with the rules, it still has not completed a single cycle on inspections for its urban or rural circuits. The Commission finds that because of that remaining uncertainty the tracker is still needed. However, as the Commission has indicated in previous rate cases, it does not intend for this tracker to become permanent. For this case, the Commission will renew the existing vegetation management and infrastructure inspection tracker.

Ameren Missouri shall establish a tracking mechanism to track future vegetation management and infrastructure costs. That tracking mechanism shall include a base level of \$59.9 million (\$52.2 million vegetation management + \$7.7 million infrastructure = \$59.9 million). Actual expenditures shall be tracked around that base level with the creation of a regulatory liability in any year where Ameren Missouri spends less than the base amount and a regulatory asset in any year where Ameren Missouri spends more than the base amount. The assets and liabilities shall be netted against each other and shall be considered

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<sup>29</sup> Commission Rule 4 CSR 240-23.030(10).

in Ameren Missouri's next rate case. The tracking mechanism shall contain a ten percent cap so expenditures exceeding the base level by more than ten percent shall not be deferred under the tracking mechanism. If Ameren Missouri's vegetation management and infrastructure inspection costs exceed the ten percent cap, it may request additional accounting authority from the Commission in a separate proceeding. The tracking mechanism shall operate until the Commission establishes new rates in Ameren Missouri's next rate case.

**B. Normalized Level of Non-Labor Storm Costs:**

**(1) How should the Commission calculate Ameren Missouri's normalized, non-labor storm costs to be included in the revenue requirement for ratemaking purposes?**

**(2) Should the difference between the amount of non-labor storm costs that Ameren Missouri incurred during the true-up period and the normalized level of non-labor storm costs included in the revenue requirement for ratemaking purposes be amortized over five (5) years or should that difference be included in the normalized costs used for ratemaking purposes?**

**Findings of Fact:**

**Introduction:**

10. For time to time, Ameren Missouri experiences the effects of severe storms in its service territory. Those can be severe windstorms, usually in the spring or summer, or severe ice storms in the winter. Of course, such storms are unpredictable and do not occur in any recognizable pattern. As a result, storm costs can vary greatly from year to year.

11. For example, Ameren Missouri incurred \$6 million in non-labor related storm restoration costs in the nine months ending December 31, 2007, \$4.8 million in 2008, \$9 million in 2009, but only \$38,000 in 2010. However, the company then incurred \$8.1 million in such costs in February 2011.<sup>30</sup>

12. In the past, the Commission has dealt with storm costs by allowing the utility to recover an amount in rates based on a historic average of the storm costs incurred. For costs that exceed the average level of costs recovered through rates, the utility is generally allowed to accumulate and defer those costs through an accounting authority order, an AAO. The accumulated and deferred costs are then considered in the utility's next rate case. Generally, the Commission allows the utility

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<sup>30</sup> Ex. 151.



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to recover those costs amortized over a five-year period.<sup>31</sup> Using those practices, the Commission has allowed Ameren Missouri to recover every single dollar expended for storms since April 1, 2007.<sup>32</sup>

**Specific Findings of Fact:**

13. Ameren Missouri proposes to set the amount of storm costs it will be allowed to recover prospectively in rates by compiling a 47-month (April 2007 through February 2011) average of storm costs to obtain an average annual storm cost amount of \$7,096,592. Ameren Missouri would then use this normalized amount as the amount it would recover in rates.<sup>33</sup>

14. Staff used the same 47-month period used by Ameren Missouri to calculate a normalized average annual storm cost. However, before calculating the average annual storm cost, Staff removed \$8.8 million of storm costs that the Commission has previously allowed Ameren Missouri to recover by amortization.<sup>34</sup> Using its adjusted figures, Staff calculated an average annual storm cost of \$4.8 million and proposes to allow Ameren Missouri to recover that amount in its rates.

15. MIEC also proposed to allow Ameren Missouri to recover in rates an amount based on its normalized annual storm costs. However, MIEC proposed to calculate that annual storm cost on only 23 months of costs, beginning with the start of the test year and running through the end of the true-up period (April 2009 through February 2011). On that basis, MIEC proposed to allow Ameren Missouri to recover \$4.9 million.<sup>35</sup>

16. The purpose of a normalization is to determine a reasonable expectation of what costs a utility is likely to experience in the future so that rates can be set to allow the utility a reasonable opportunity to recover those costs. For that reason, a normalization over a nearly four-year period is likely to be a better predictor of the future than is a normalization over approximately two years. That is particularly true were, as here, the company experienced a very low level of storm costs during one year of the studied period.<sup>36</sup>

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<sup>31</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, File No. ER-2010-0036, Report and Order, May 28, 2010, Page 66.

<sup>32</sup> Transcript, Page 391, Lines 1-14, *see also*, Meyer Surrebuttal, Ex. 401, Page 24, Lines 1-6.

<sup>33</sup> Barnes Rebuttal, Ex. 103, Page 14, Lines 8-16.

<sup>34</sup> Cassidy Surrebuttal, Ex. 207, Page 8, Lines 7-16. \$4,857,000 was removed for the amortization in ER-2008-0318 and \$3,977,675 for the amortization in ER-2010-0036.

<sup>35</sup> Meyer Surrebuttal, Ex. 401, Page 23, Lines 20-22.

<sup>36</sup> Ex. 151.

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17. Of course, the average over a shorter period may be a better predictor than a longer period if for some reason the costs experienced are trending in a certain direction. MIEC defended its use of the shorter period by arguing that Ameren Missouri's recent increases in vegetation management spending should have the effect of decreasing the damages that result from storms.<sup>37</sup> However, MIEC did not attempt to quantify any such effect and its argument is little more than speculation. The Commission finds that MIEC's calculation of average annual storm costs based on 23 months of experience is not as reliable as the same calculation over 47 months of experience.

18. Staff calculates average annual storm costs over the same 47 months of experience as Ameren Missouri, but it would exclude from that average a portion of the actual costs Ameren Missouri incurred because the Commission previously allowed the company to recover those costs by amortization.

19. As previously indicated, the purpose of a normalization is to attempt to predict the amount of expenses the company is likely to incur in the future. Staff's calculation removes from consideration a portion of the costs the company actually incurred because of past Commission decisions about how the company would be allowed to recover those costs. No matter how those costs were recovered in the past, they were still incurred. By the logic of a normalization, they are thus likely to be incurred again in the future. Therefore, the normalized amount of storm costs proposed by Staff is not a reliable indicator of the actual storm costs Ameren Missouri is likely to incur in the future.

20. The Commission finds that Ameren Missouri's calculation of average annual storm costs based on a straight 47-month average of storm costs experienced in the past is the most reliable indicator of expected future storm costs and will use that average to set future rates in this case.

21. The Commission must decide one more question. Ameren Missouri proposes that it be allowed to recover \$1,037,146 through an amortization. That amount represents the difference between \$8,133,738, the actual storm costs for the twelve months ending on the true-up date of February 28, 2011, and \$7,096,592, the 47-month average storm costs as calculated by Ameren Missouri.<sup>38</sup>

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<sup>37</sup> Transcript, Page 392, Lines 9-21.

<sup>38</sup> Barnes Rebuttal, Ex. 103, Page 15, Lines 11-22.

22. Ameren Missouri does not explain why the 47-month average of storm costs should be the basis for determining the amount it should be allowed to amortize and that number makes no sense. Even if the 47-month average is used in this case to determine rates going forward, it bears no relationship to the amount of money Ameren Missouri was allowed to recover in rates during the period the cost was incurred. That number was set in Ameren Missouri's last rate case.

23. In Ameren Missouri's last rate case, the Commission allowed Ameren Missouri to recover \$6.4 million in its cost of service for storm restoration costs.<sup>39</sup> Based on that amount as well as the amount Ameren Missouri was allowed to recover in the next previous rate case, ER-2008-0318, MIEC's witness, Greg Meyer, correctly calculated that from the beginning of the test year in this case (April 1, 2009) through the end of the true-up period (February 28, 2011), Ameren Missouri has recovered \$10.8 million in rates for repairs from major storms. During that same time, Ameren Missouri has incurred \$9.4 million in storm costs, including the costs for the February 2011 storm preparations for which Ameren Missouri seeks an additional amortization.

24/25. Based on those calculations, it is apparent that there is no basis for allowing Ameren Missouri to amortize \$1,037,146 for storm costs relating to its preparation for the February 2011 ice storm.

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

Ameren Missouri shall recover \$7,096,592 in its rates for non-labor storm costs. Ameren Missouri shall not amortize an additional \$1,037,146 for storm costs relating to its preparation for the February 2011 ice storm.

**3. Sioux Scrubbers: Should the Commission allow in rate base \$31 million in cost increases (\$18 million in construction costs and \$13 million in AFUDC) that were incurred as a result of Ameren Missouri's decision to temporarily suspend construction of the Sioux Plant Wet Flue Gas Desulfurization Project due to the Company's concerns about conditions in the financial markets during the period commencing in late 2008 and continuing into early 2009?**

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<sup>39</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, File No. ER-2010-0036, Report and Order, May 28, 2010, Page 68.

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**Findings of Fact:**

**Introduction:**

1. Ameren Missouri seeks to add to its rate base the cost of constructing wet flue gas desulfurization units at both generating units at the company's coal-fired Sioux Plant. The wet flue gas desulfurization units are referred to as "scrubbers" by the witnesses and will be referred to as such in this report and order.

2. As their name implies, the scrubbers are designed to scrub sulfur dioxide gas (SO<sub>2</sub>) from flue gases produced by burning coal. The wet scrubbers installed at the Sioux Plant remove SO<sub>2</sub> by passing the flue gas through a spray of limestone slurry solution in the scrubber reaction vessel. A chemical reaction between the limestone, air, water, and SO<sub>2</sub> converts the SO<sub>2</sub> to calcium sulfate that is removed from the scrubber and pumped in slurry form to an on-site landfill for final disposal. The scrubbers are designed to remove in excess of 95 percent of the SO<sub>2</sub> generated by the plant.<sup>40</sup>

3. Ameren Missouri installed the scrubbers at the Sioux Plant to comply with various Federal clean air rules. No party has questioned the overall prudence of the decision to install the scrubbers and that decision need not be addressed in this report and order.

4. Staff undertook an audit of the project to install the scrubbers and reported the results of that audit on February 8, 2011, as part of its direct testimony. For purposes of the audit, Ameren Missouri reported \$521.8 million in charges incurred for the scrubbers project through September 30, 2010.<sup>41</sup> Staff's audit recommended that \$31.6 million of those costs be excluded from rate base because of Ameren Missouri's decision to slowdown construction in November 2008.<sup>42</sup>

5. Ameren Missouri challenges Staff's recommendation to disallow its costs, but does not challenge the amount of the disallowance. In other words, Staff and Ameren Missouri agree that the amount in dispute is \$31.8 million.

6. Although the amount in dispute is \$31.8 million, that is the amount that Staff proposes be excluded from the company's rate base. That exclusion would reduce Ameren Missouri's revenue requirement in this case by approximately \$4.6 million,<sup>43</sup> and would continue to reduce

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<sup>40</sup> Birk Direct, Ex. 106, Page 3, Lines 8-19.

<sup>41</sup> Staff's Construction Audit and Prudence Review, Ex. 200, Page 1, Lines 20-21.

<sup>42</sup> Staff's Construction Audit and Prudence Review, Ex. 200, Page 2, Lines 14-16.

<sup>43</sup> Reconciliation, Ex. 230.

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Ameren Missouri's revenue requirement in future rate cases as the property is depreciated.

7. Staff asserts that a disallowance is necessary because of Ameren Missouri's decision to "slow down construction and ultimately shift the in-service dates to fall 2010 from fall 2009 because of this delay."<sup>44</sup>

**Specific Findings of Fact:**

8. In the fall of 2008, this country and the rest of the world was facing a financial crisis. On September 6, 2008, the United States government took over Fannie Mae and Freddie Mac. Nine days later Bank of America acquired Merrill Lynch and Lehman Brothers filed for bankruptcy. The largest bank failure in history occurred on September 26, 2008, when regulators seized Washington Mutual. The stock market plummeted throughout October and November of 2008. Because of these volatile financial conditions a credit freeze developed.<sup>45</sup>

9. During the credit freeze, the banking sector severely restricted the channels of credit that are needed by consumers and businesses for normal working capital and expansion needs. Banks chose to hold on to any capital they had to decrease their own leverage rather than lend money to even large, credit worthy businesses.<sup>46</sup>

10. The electric utility industry is heavily capital-intensive. Therefore, electric utilities, including Ameren Missouri, must be concerned about their current liquidity and their ability to obtain necessary capital through their credit facilities.<sup>47</sup>

11. Liquidity is the ability to meet expected and unexpected demands for cash at an acceptable cost at the time when needed. Electric utilities, as well as other companies, use credit facilities as a means of borrowing the cash they need to maintain liquidity.<sup>48</sup>

12. A bank credit facility is a committed revolving bank credit line under which a company can borrow on a short-term basis, typically 30 days. Such credit facilities are syndicated by a group of bank lenders that lend by funding borrowing requests under the credit facility on a pro-rata basis.<sup>49</sup>

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<sup>44</sup> Staff's Construction Audit and Prudence Review, Ex. 200, Page 42, Lines 18-19.

<sup>45</sup> Birdsong Rebuttal, Ex. 109, Pages 7 and 8.

<sup>46</sup> Birdsong Rebuttal, Ex. 109, Page 9, Lines 4-13.

<sup>47</sup> Birdsong Rebuttal, Ex. 109, Page 11, Lines 11-14.

<sup>48</sup> Birdsong Rebuttal, Ex. 109, Page 11, Lines 11-15.

<sup>49</sup> O'Bryan Direct, Ex. 147, Page 8, Lines 18-23.

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13. In 2008, Ameren Missouri had access to a credit facility under which it could borrow up to \$500 million. At the end of October 2008, Ameren Missouri had approximately \$380 million of its own credit facility available. In addition, Ameren Missouri had access to part of the credit facility of its corporate parent, Ameren Corporation. In total, at that time, Ameren Missouri had access to credit facilities totaling 1.45 billion.<sup>50</sup>

14. Ameren Missouri's credit facility was supported by a syndicate of 18 banks. \$171 million of the total was offered by Lehman Brothers Bank and \$121 million of that was no longer available after Lehman Brothers went broke. Wachovia had \$156 million, Citibank had \$167 million, and National City had \$45 million. That means \$529 million of the available credit facility was held by banks that were rumored to be in financial distress.<sup>51</sup>

15. At that time, Ameren Missouri was operating with negative free cash flow, meaning its capital expenditures were larger than the net cash flows provided by rate revenues. As a result, credit was vital to the continuation of Ameren Missouri's operations.<sup>52</sup>

16. Very bad things happen to a utility that runs out of cash liquidity. As cash becomes short, the company will actually need more cash because suppliers will demand more payments and may require advanced payments before products are supplied. If payments are not made, the suppliers may cut off their supplies and services, such as coal and natural gas supplies, making it difficult for the utility to continue to provide electric service to its customers.<sup>53</sup>

17. Faced with a perceived liquidity problem in October 2008, Ameren Missouri, along with Ameren Corp. and the Illinois affiliates, began looking for ways to reduce capital expenditures, primarily by focusing on reductions in larger projects that could be made quickly, had minimal impact on employees, did not impact safety, would not result in the violation of any law or regulation, did not impact the actual delivery of utility service to customers, and involved heavy use of contractors.<sup>54</sup>

18. Following its review, Ameren Missouri deferred all 2009 planned generating plant outages and plant upgrades, reduced expenditures on

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<sup>50</sup> Transcript, Page 515, Lines 17-25.

<sup>51</sup> Transcript, Page 516, Lines 4-21, *see also*, Birdsong Rebuttal, Ex. 109, Page 12, Lines 9-22.

<sup>52</sup> Birdsong Rebuttal, Ex. 109, Page 12, Lines 4-8.

<sup>53</sup> Transcript, Pages 517-518, Lines 8-25, 1-9.

<sup>54</sup> Birdsong Rebuttal, Ex. 109, Page 15, Lines 16-20.

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the undergrounding portion of the Power On initiative, deferred some fleet acquisitions, and deferred certain Energy Delivery Technical Services capital projects. Along with the other deferred projects, Ameren Missouri decided to delay the Sioux scrubber project. In total, Ameren Missouri planned to reduce its capital expenditures by approximately \$420 million through 2009.<sup>55</sup>

19. At the time, Ameren Missouri was spending \$17 million per month on the Sioux scrubber project. It planned to reduce its cash expenditures for that project to \$2 million per month.<sup>56</sup>

20. By late January, 2009, Ameren Missouri decided that its liquidity situation had improved enough to allow it to again ramp up its spending on the Sioux scrubber project.<sup>57</sup>

21. The delay of the Sioux scrubber project had at least one unforeseen benefit for Ameren Missouri and its ratepayers. Ameren's installation of scrubbers at its unregulated generating plants at Duck Creek and Coffeen in Illinois, which were completed while the Sioux project was delayed, experienced quality issues with the flake glass lining system that was originally planned for the Sioux scrubbers. Because of the delay, Ameren Missouri was able to draw on that experience in Illinois to install a Stebbins glass tile lining at Sioux, thereby improving long-term reliability and decreasing maintenance costs.<sup>58</sup>

22. Exhibit 155, which Ameren Missouri filed at the request of a Commissioner, demonstrates that it would have cost \$3.47 million dollars to replace a flake glass liner at the Sioux scrubber if the Stebbins tile lining had not been used. The exhibit also demonstrates that the cumulative present worth of the revenue requirements to replace the flake glass lining range up to \$33.3 million depending upon various assumptions.

23. Staff's recommendation to disallow \$31.8 million of costs incurred because of the delay in completing the Sioux scrubber project is based on Staff's determination that Ameren Missouri had sufficient credit available to it under its credit facilities to avoid having to delay the project.<sup>59</sup> Staff supported that recommendation by citing Ameren's

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<sup>55</sup> Birdsong Rebuttal, Ex. 109, Page 16, Lines 2-9.

<sup>56</sup> Transcript, Page 443, Lines 10-12.

<sup>57</sup> Birdsong Rebuttal, Ex. 109, Page 18, Lines 1-5.

<sup>58</sup> Birk Rebuttal, Ex. 107, Page 20, Lines 2-9.

<sup>59</sup> Staff's Construction Audit and Prudence Review, Ex. 200, Page 42, Lines 7-11.

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issuance of common equity in September 2009 and Ameren Missouri's issuance of First Mortgage Bonds in March 2009 to show Ameren Missouri's ability to raise additional capital if it had chosen to do so.<sup>60</sup>

24. Staff never performed a liquidity analysis to determine whether Ameren Missouri had sufficient cash liquidity to avoid slowing down work on the Sioux scrubber project. Indeed, on cross-examination, Staff's witness conceded that she had no idea whether Ameren Missouri had sufficient liquidity in 2008 to continue construction and meet its daily operational needs.<sup>61</sup>

25. Staff's analysis focused only on whether Ameren Missouri had access to sufficient cash and credit to continue work on the Sioux scrubber project and did not look at any other expenditures the company would also need to make at the time.<sup>62</sup>

26. Ameren Missouri's issuance of additional bonds in March 2009 does not demonstrate that the company could have easily issued such bonds in November 2008, when it made the decision to slow down work on the Sioux scrubbers. By January 2009, the financial crisis had begun to ease and Ameren Missouri had taken other steps, including a reduction in its dividends, to improve its liquidity. Indeed, by that time, Ameren Missouri had made the decision to ramp up the pace of work on the scrubbers.<sup>63</sup>

27. In October 2008, Ameren Missouri had discussions with Staff regarding the possibility of an additional bond issue by Ameren Missouri to try to improve its liquidity position. Staff told the company it would oppose that request and Ameren Missouri chose not to seek the required financing authority from the Commission at that time.<sup>64</sup> Both Staff and Ameren Missouri spent a great deal of hearing and briefing time arguing about the details of that dispute, but most of those details are classified as proprietary or highly confidential so they cannot be disclosed in this report and order. The Commission will not take the unusual step of issuing a highly confidential or proprietary version of this report and order to discuss the details of that disagreement because it is of very little relevance to the Commission's decision. As Ameren Missouri's witness indicated, around the time of that meeting, Ameren Missouri's

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<sup>60</sup> Staff's Construction Audit and Prudence Review, Ex. 200, Page 42, Lines 11-15.

<sup>61</sup> Transcript, Pages 608-609, Lines 19-25, 1-2.

<sup>62</sup> Transcript, Page 604, Lines 7-20.

<sup>63</sup> Birdsong Rebuttal, Ex. 109, Page 18, Lines 1-18.

<sup>64</sup> Murray Surrebuttal, Ex.220, Page 28, Lines 3-15.



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management had already decided to slow down spending on the Sioux scrubber project and “there was never, ever any indication that by approving this financing we would not have to slow down projects, including the Sioux scrubber.”<sup>65</sup>

**Conclusions of Law:**

A. The Commission established its standard for determining the prudence of a utility’s expenditures in a 1985 decision regarding Union Electric’s construction of the Callaway nuclear plant. In that decision, the Commission held that a utility’s expenditures are presumed to be prudently incurred, but, if some other participant in the proceeding creates a serious doubt as to the prudence of the expenditure, then the utility has the burden of dispelling those doubts and proving the questioned expenditure to have been prudent.<sup>66</sup>

B. The 1985 Union Electric decision also established the standard by which the prudence of a utility’s decision would be evaluated when it said:

In reviewing UE’s management of the Callaway project, the Commission will not rely on hindsight. The Commission will assess management decisions at the time they were made and ask the question, ‘Given all the surrounding circumstances existing at the time, did management use due diligence to address all relevant factors and information known or available to it when it assessed the situation?’<sup>67</sup>

C. The Commission’s use of that prudence standard is consistent with judicial precedent<sup>68</sup> and has been accepted and applied by

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<sup>65</sup> Transcript, Page 503, Lines 5-7.

<sup>66</sup> *In the matter of the determination of in-service criteria for the Union Electric Company’s Callaway Nuclear Plant and Callaway rate base and related issues. And In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.* 27 Mo. P.S.C. (N.S.) 183, 193 (1985).

<sup>67</sup> *In the matter of the determination of in-service criteria for the Union Electric Company’s Callaway Nuclear Plant and Callaway rate base and related issues. And In the matter of Union Electric Company of St. Louis, Missouri, for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.* 27 Mo. P.S.C. (N.S.) 183, 194 (1985).

<sup>68</sup> “Good faith is to be presumed on the part of the managers of a business. In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay.” *West Ohio Gas Co. v. Pub. Util. Com’n of Ohio*, 294 U.S. 63, 72, 55 S.Ct. 316, 321 (1935)

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reviewing courts.<sup>69</sup>

D. In order to disallow a utility's recovery of costs from its ratepayers, a regulatory agency must find both that the utility acted imprudently and that such imprudence resulted in harm to the utility's ratepayers.<sup>70</sup>

E. Applying the prudence standard as it has been defined by the Commission, the first step is to determine whether any party has raised a serious doubt about the prudence of Ameren Missouri's decision to slow down the Sioux scrubber project to preserve cash in the face of the global economic crisis of 2008. That raises the question of what is a "serious doubt?"

F. In its reply brief, Staff suggests that the presumption of prudence is only a matter of convenience designed to focus attention on those items that are subject to challenge by any party on grounds that are reasonable on their face.<sup>71</sup> If as Staff suggests, the presumption of prudence is only a matter of convenience, then it could be overcome by a simple statement by a party that it wants to challenge a particular decision on some reasonable basis without presenting a shred of evidence to show that the utility did anything wrong.

G. Staff's suggestion is not correct, the presumption of prudence is not just a matter of convenience. The United States Supreme Court in the *West Ohio Gas* case indicated that the presumption of prudence is real and is not overcome absent a showing of inefficiency or improvidence.<sup>72</sup> That is what "serious doubt" means. By statute, the utility has the burden of proving that its proposed rates are just and reasonable. However, before the presumption of prudence is overcome, the challenging party must present sufficient evidence to create a serious doubt about a decision of the utility. Staff failed to create a serious doubt in this case.

**Decision:**

Staff's recommendation to disallow \$31.8 million of costs incurred because of the delay in completing the Sioux scrubber project is based on Staff's determination that Ameren Missouri had sufficient credit

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<sup>69</sup> For example see, *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Com'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997).

<sup>70</sup> *State ex rel. Assoc. Natural Gas Co. v. Public Serv. Com'n*, 954 S.W.2d 520 (Mo. App. W.D. 1997).

<sup>71</sup> Staff's Reply Brief, Page 4.

<sup>72</sup> *West Ohio Gas Co. v. Pub. Util. Com'n of Ohio*, 294 U.S. 63, 72, 55 S.Ct. 316, 321 (1935)

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available to it under its credit facilities to avoid having to delay the project. But Staff never undertook any sort of liquidity analysis to determine whether Ameren Missouri actually had reliable access to sufficient cash to continue to pay \$17 million per month for the Sioux scrubber project while also meeting all its other needs and contingencies. Instead, Staff seems to have naively assumed that if Ameren Missouri had \$31.8 million in available cash or credit in November 2008 it should have used those funds to continue forward with the Sioux scrubber project without taking into account the very real uncertainties facing the company because of the financial crisis.

Even assuming that Staff was able to raise a serious doubt about the prudence of Ameren Missouri's decision to slow down work on the Sioux scrubbers at the height of the global financial crisis, Ameren Missouri presented more than enough evidence to dispel those doubts and to prove that the questioned expenditure was prudent. Ameren Missouri demonstrated that measured by what it knew at the time, without the benefit of hindsight, it was justifiably concerned that it faced the potentially cataclysmic danger of running out of liquidity. Under those circumstances, the decision to slow down the Sioux scrubber project for a few months was a prudent act.

Furthermore, there is little indication that Ameren Missouri's customers were actually harmed by Ameren Missouri's decision to slow down work on the Sioux scrubber project. Certain costs did increase because of the delay as Staff indicates, but the delay also gave the company an opportunity to learn from mistakes made in the construction of similar scrubbers at other power plants. In particular, Ameren Missouri learned from experience that the flake glass lining proposed for use in the Sioux scrubber was not optimal and instead installed a Stebbins glass tile lining that saved the company and its ratepayers up to \$33.3 million, offsetting the additional costs associated with the delay.

In summary, Staff failed to raise a serious doubt about the prudence of Ameren Missouri's decision to slow down work on the Sioux scrubber project. Even if it is assumed that Staff was able to raise a serious doubt about the prudence of those expenditures, Ameren Missouri dispelled those doubts and proved that those expenditures were prudent. Finally, savings that were made possible by the delay offset any costs to ratepayers that resulted from Ameren Missouri's decision to slow down the Sioux scrubber project. On those bases, the Commission will reject Staff's proposed \$31.8 million disallowance.

**4. Energy Efficiency/Demand Side Management (DSM):**

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**A. Is Ameren Missouri in compliance with the Missouri Energy Efficiency Investment Act (MEEIA) regardless of whether or not proposed rules under the law are effective?**

**(1) What DSM programs should Ameren Missouri continue and/or implement, and at what annual expenditure level; and**

**(2) Should Ameren Missouri continue to ramp up its demand side management programs to pursue all cost-effective demand side savings?**

**B. Does Ameren Missouri's request for demand-side management programs' cost recovery in this case comply with MEEIA requirements?**

**(1) Should the Commission approve a cost recovery mechanism for Ameren Missouri DSM programs as part of this case? If so,**

**(a) Over what period should DSM program costs incurred after December 31, 2010, be amortized?**

**(b) Should the mechanism include an adjustment of kWh billing determinants?**

**(c) How much should the Commission reduce the billing determinants?**

**(d) If billing units are adjusted for demand side savings, how should the NBFC rates be calculated?**

**Findings of Fact:**

**Introduction:**

1. Energy Efficiency and Demand Side Management (DSM) programs are designed to encourage an electric utility's customers to reduce their use of electricity. In recent years, Ameren Missouri has undertaken a number of residential and business energy efficiency and DSM programs. The particular programs are listed and described in the direct testimony of MDNR's witness Laura Wolfe<sup>73</sup>

2. Ameren Missouri has not submitted those programs to the Commission for approval under the Missouri Energy Efficiency Investment Act.<sup>74</sup>

3. Ameren Missouri has spent significant amounts of money to support those energy efficiency and DSM programs in recent years. Those expenditures rose from \$13.5 million in 2008 and 2009, to \$23 million in 2010, to an anticipated spending level of \$33 million in 2011.<sup>75</sup>

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<sup>73</sup> Wolfe Direct, Ex.800, Pages 3-4.

<sup>74</sup> Section 393.1075, RSMo (Supp. 2010).

<sup>75</sup> Mark Surrebuttal, Ex. 111, Page 4, Lines 4-6.

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All parties agree that those energy efficiency and DSM initiatives have been effective in reducing energy usage and would like to see them continue. However, Ameren Missouri's electric energy efficiency programs offered under the existing tariffs end on September 30, 2011,<sup>76</sup> and Ameren Missouri may significantly reduce its energy efficiency expenditures in the future.<sup>77</sup>

4. Ameren Missouri indicates it would like to continue its current slate of programs at current funding levels, but is willing to do so only if the Commission approves its proposals to establish a mechanism to allow it to recover the revenue it will lose because of reduced sales of electricity as customers reduce their use of electricity as a result of the energy efficiency programs.<sup>78</sup>

5. Ameren Missouri describes the problem of declining sales as the throughput disincentive and the issue is about how the Commission should address that disincentive.

**Specific Findings of Fact:**

6. The throughput disincentive results from the traditional regulated utility business model in which a utility earns revenues by selling electricity. Under that model, the more electricity it sells, the more revenue the utility earns to cover its fixed costs and to provide a profit for its shareholders.<sup>79</sup> Energy efficiency programs are designed to reduce electricity sales. Thus, by implementing energy efficiency programs, the utility is knowingly causing financial harm to itself. Understandably, utility companies are reluctant to reduce their earnings, resulting in a strong incentive for the company to spend as little as possible on energy efficiency programs.<sup>80</sup>

7. The throughput disincentive has a real effect on Ameren Missouri's earnings. Ameren Missouri estimated that if it were to continue to spend \$25 million per year on energy efficiency over the next two years without a rate case, it would lose about \$53 million in additional revenue.<sup>81</sup>

8. Advocates for energy efficiency are of course aware of this disincentive and search for the means to realign the utility's interests to more closely match the goal of increasing energy efficiency to reduce the

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<sup>76</sup> Laurent Surrebuttal, Ex. 113, Page 4, Lines 12-15.

<sup>77</sup> Mark Rebuttal, Ex. 110, Page 8, Lines 7-12.

<sup>78</sup> Laurent Surrebuttal, Ex. 113, Page 4, Lines 16-21.

<sup>79</sup> Davis Rebuttal, Ex. 115, Page 1, Lines 20-23.

<sup>80</sup> Davis Rebuttal, Ex. 115, Page 3, Lines 11-13.

<sup>81</sup> Davis Rebuttal, Ex. 115, Page 5, Lines 1-5.

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use of electricity. In Missouri, the Missouri Energy Efficiency Investment Act (MEEIA) makes that realignment the policy of this state.<sup>82</sup>

9. Ameren Missouri asks the Commission to address the throughput disincentive in this case by implementing an adjustment to decrease the billing units used to set rates in anticipation of reduced sales resulting from energy efficiency programs.<sup>83</sup> However, Ameren Missouri did not propose its billing unit adjustment plan until it filed the rebuttal testimony of William Davis on March 25, 2011.

10. Ameren Missouri's proposed billing unit adjustment is a new and novel idea that to the knowledge of the Ameren Missouri witness who proposed it, has never been tried anywhere else in the country.<sup>84</sup> Because Ameren Missouri did not file its "new and novel idea until its rebuttal testimony, the other parties had a very limited amount of time to evaluate that idea before filing their surrebuttal testimony two weeks later.

11. The proposed billing rate unit adjustment would have the effect of increasing rates by allowing the company to recover its revenue requirement over a smaller number of units. For example if the revenue requirement is \$100 and the normalized, annualized billing unit is 1,000 kWh, then the rate would be \$0.10 per kWh (\$100 divided by 1,000 kWh) and the company would collect its \$100 revenue requirement after selling 1,000 kWh of electricity. If in the same example the billing units were reduced to 800 kWh, the resulting rate would be \$0.125 per kWh and the company would collect \$125 when it sells 1,000 kWh of electricity.<sup>85</sup> Staying with the example, Ameren Missouri's justification for this adjustment is that because of energy efficiency programs it anticipates selling only 800 kWh, meaning it will in fact collect only its \$100 revenue requirement.

12. Despite Ameren Missouri's protests to the contrary, the proposed billing units adjustment is a mechanism that attempts to compensate the company for lost revenue. It just tries to accomplish that compensation before the revenue is lost, which is a distinction without meaning. As Ameren Missouri's witness, William Davis, indicated in the following exchange at the hearing:

Q. Isn't the whole purpose of the billing unit adjustment to recover future lost sales revenue?

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<sup>82</sup> Section 393.0175, RSMo (Supp. 2010).

<sup>83</sup> Davis Rebuttal, Ex. 115, Pages 6-7.

<sup>84</sup> Transcript, Page 1911, Lines 1-12.

<sup>85</sup> Mantle Supplemental Testimony, Ex. 247, Page 2, Lines 8-20.

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A. Associated with fixed costs, yes, and a reduction in sales associated with our energy efficiency programs.<sup>86</sup>

13. As a lost revenue recovery mechanism, Ameren Missouri's proposed lost revenue mechanism must comply with the requirements of the Commission's rule regarding Demand-Side Programs Investment Mechanisms.<sup>87</sup> The Commission will discuss the application of that rule in its Conclusions of Law regarding this issue.

14. Most significantly, the proposed billing units adjustment does not eliminate the throughput disincentive. It would guarantee the company a greater recovery, but the company would continue to benefit from increases in energy sales and suffer a loss of income when sales drop just as it would without the adjustment.<sup>88</sup> In other words, despite the use of the billing units adjustment, Ameren Missouri would still have just as much incentive to maximize its sales of electricity and minimize energy efficiency programs.

15. William Davis, Ameren Missouri's witness who proposed the billing units adjustment, admitted on the stand that his plan did not decrease the company incentive to increase sales. His only defense was to indicate that he was not aware of any plans by Ameren Missouri to implement any programs to increase its sales.<sup>89</sup>

16. In effect, Ameren Missouri's proposed billing units adjustment relies on the willingness of the Commission and ratepayers to hand the company extra money while trusting to the good intentions of the company to avoid acting in compliance with its throughput incentive by maximizing sales while minimizing energy efficiency efforts.

17. The Commission finds that Ameren Missouri's proposed billing units adjustment is a hastily proposed and ill-conceived lost revenue recovery mechanism that the Commission is not willing to adopt in its present form.

18. Aside from consideration of the proposed billing units adjustment, there is one other matter related to energy efficiency and DSM programs that the Commission needs to address. Currently, between rate cases, Ameren Missouri is allowed to book its direct costs incurred while implementing energy efficiency and DSM programs to a regulatory asset. In the rate case, the amount in the regulatory asset is

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<sup>86</sup> Transcript, Page 1878, Lines 5-9.

<sup>87</sup> 4 CSR 240-20.093, See Also, Rogers Supplemental Testimony, Ex. 246, Page 2, Lines 21-25.

<sup>88</sup> Rogers Surrebuttal, Ex. 222, Page 14, Lines 6-10.

<sup>89</sup> Transcript, Page 1878, Lines 10-21.

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added to the company's rate base and is amortized over a six-year period. That procedure was established by a stipulation and agreement in Ameren Missouri's last rate case.<sup>90</sup>

19. Ameren Missouri initially proposed that the amortization period be decreased from six years to three.<sup>91</sup> Subsequently, Ameren Missouri dropped its proposal to decrease the amortization period to concentrate on dealing with the throughput disincentive.<sup>92</sup> MDNR continues to support at least a decreased amortization period and suggests that such expenses should be expensed and recovered immediately instead of amortized.<sup>93</sup> MIEC goes the other direction and argues the amortization period should be increased to ten years.<sup>94</sup>

20. MIEC's argument for a ten-year amortization period is that demand-side resources are to be treated comparably with supply-side resources. A utility recovers its supply-side costs through depreciation over the useful life of the asset. For a demand-side asset, the equivalent asset is a "regulatory asset" that is recovered through an amortization. Ameren Missouri would recover the cost of supply-side assets that are displaced by demand-side resources through depreciation over twelve years. On that basis, MIEC's witness argues Ameren Missouri should recover the cost of its demand-side resources over at least a ten-year period.<sup>95</sup>

21. As Ameren Missouri's witness explained, there is no objective basis for the six-year amortization period currently in use. It was simply the product of negotiations in Ameren Missouri's last rate case.<sup>96</sup> Similarly, there is no objective basis to return to a ten-year amortization period other than it was used before the six-year amortization period was instituted. MIEC comparison of the amortization period to the depreciation period of displaced supply-side resources is not convincing. The real reason to stay with a six-year amortization period is to continue to allow Ameren Missouri a reasonable incentive to make demand-side expenditures.

22. A lengthy amortization period for Ameren Missouri's DSM costs would provide a strong disincentive for the utility to incur those costs and

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<sup>90</sup> Davis Direct, Ex. 114, Pages 3-4, Lines 19-24, 1-5.

<sup>91</sup> Davis Direct, Ex. 114, Page 5, Lines 10-13.

<sup>92</sup> Transcript, Page 1867, Lines 15-22.

<sup>93</sup> Wolfe Direct, Ex. 800, Page 11, Lines 13-16.

<sup>94</sup> Brubaker Direct, Ex. 403, Page 14, Lines 12-18.

<sup>95</sup> Brubaker Direct, Ex. 403, Pages 11-14.

<sup>96</sup> Davis Direct, Ex. 114, Page 4, Lines 10-12.



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would be inconsistent with the policy established by MEEIA that favor timely recovery cost recovery for utilities. The Commission does not want to send that signal and will not alter the current six-year amortization period.

**Conclusions of Law:**

A. The Missouri Energy Efficiency Investment Act (MEEIA) provides in part as follows:

3. It shall be the policy of the state to value demand-side investments equal to traditional investments in supply and delivery infrastructure and allow recovery of all reasonable and prudent costs of delivering cost-effective demand-side programs. In support of this policy the commission shall:

- (1) Provide timely cost recovery for utilities;
- (2) Ensure that utility financial incentives are aligned with helping customers use energy more efficiently and in a manner that sustains or enhances utility customers' incentives to use energy more efficiently; and
- (3) Provide timely earnings opportunities associated with cost-effective measurable and verifiable efficiency savings.<sup>97</sup>

In this section, the legislature has set out the policy considerations that must guide the Commission in reaching its decision on this issue.

B. The Commission has established rules to implement MEEIA. 4 CSR 240-20.093 establishes specific requirements for the creation of Demand-Side Programs Investment Mechanisms. 4 CSR 240-20.094 establishes procedures for filing and processing applications for approval, modification, and discontinuance of electric utility demand-side programs.

C. Section 4 of MEEIA requires the Commission to permit electric corporations to implement "commission approved demand-side programs." That section also provides "[R]ecovery for such programs shall not be permitted unless the programs are approved by the commission, ..." Ameren Missouri has not submitted an application pursuant to MEEIA or the MEEIA rules for approval of any of its demand-side programs.<sup>98</sup>

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<sup>97</sup> 393.1075.3, RSMo (Supp. 2010).

<sup>98</sup> Rogers Surrebuttal, Ex. 222, Page 6, Lines 36-37.

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D. Commission Rule 4 CSR 240-20.093(1)(Y) defines lost revenue as:

the net reduction in utility retail revenue, ... that occurs when utility demand-side programs approved by the commission in accordance with 4 CSR 240-20.094 cause a drop in net system retail kWh delivered to jurisdictional customers below the level used to set the electricity rates.

By that definition, lost revenue would include only revenue losses that exceed net gains in sales from other sources. That definition is inconsistent with Ameren Missouri's billing units adjustment proposal that would allow the company to recover for any potential lost revenue, even if its net revenue was rising from another source.

E. The rule's definition of lost revenue goes on to say:

Lost revenues are only those net revenues lost due to energy and demand savings from utility demand-side programs approved by the commission in accordance with 4 CSR 240-094 Demand-Side Programs and measured and verified through EM&V. (evaluation, measurement and verification)

That definition once again allows recovery only for demand-side programs approved by the Commission. It also means that recovery is not allowed until the program has been evaluated to "estimate and/or verify the estimated actual energy and demand savings, utility lost revenue, cost-effectiveness, and other effects from demand-side programs."<sup>99</sup>

Ameren Missouri's billing units adjustment proposal would not comply with either aspect of the definition and could allow Ameren Missouri to recover revenue in the future that is in excess of the rule's definition of lost revenue.

F. Section 393.1075.13 of MEEIA requires that "[c]harges attributable to demand-side programs under this section shall be clearly shown as a separate line item on bills to the electrical corporation's customers." Ameren Missouri's billing units adjustment proposal would raise customer rates without disclosing that increase to customers and would therefore be inconsistent with MEEIA.

G. Ameren Missouri has indicated its intention to significantly reduce its spending on energy efficiency and DSM programs if the

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<sup>99</sup> 4 CSR 240-20.093(1)(V), the definition of evaluation, measurement, and verification.

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Commission does not approve its billing units adjustment proposal. Some parties suggest that the Commission simply order Ameren Missouri to continue spending for those programs at their current levels. However, the Commission, while it has the power to regulate Ameren Missouri, does not have the power to take over management of the utility.<sup>100</sup> MEEIA does not contain any language that requires utilities, or allows the Commission to require utilities, to spend any particular level of dollars on energy efficiency, or to achieve any particular amount of MWh savings through energy efficiency. Therefore, the Commission cannot order Ameren Missouri to continue spending money on energy efficiency and DSM programs.

H. Ameren Missouri indicates that it wants to continue to offer energy efficiency and DSM programs. Once Ameren Missouri files an application for approval of its programs under MEEIA, perhaps a cost recovery mechanism satisfactory to Ameren Missouri and its ratepayers can be worked out. But the Commission cannot bridge that gap between this rate case and the company's MEEIA application by approving a cost recovery mechanism that is wholly inconsistent with MEEIA and the implementing regulations. Therefore, the Commission must reject Ameren Missouri's billing units adjustment proposal.

**Decision:**

For the reasons set forth in its findings of fact and conclusions of law, the Commission rejects Ameren Missouri's billing units adjustment proposal. The Commission also directs that DSM program costs incurred after December 31, 2010, shall continue to be amortized over a period of six years.

**C. Should a portion of the low-income weatherization program funds be utilized to engage an independent third party to evaluate the program?**

**Findings of Fact:**

**Introduction:**

1. Ameren Missouri currently funds a low-income weatherization program at a rate of \$1.2 million per year. MDNR asked that the company continue to fund the program at that level.<sup>101</sup> Ameren Missouri agreed.<sup>102</sup>

2. Following the evidentiary hearing, on May 18, 2011, Ameren Missouri and MDNR filed a nonunanimous stipulation and agreement by

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<sup>100</sup> *State ex rel. Harline v. Public Serv. Com'n*, 343 S.W.2d 177,182 (Mo. App. 1960).

<sup>101</sup> Wolfe Direct, Ex. 800, Page 5, Lines 1-2.

<sup>102</sup> Laurent Rebuttal, Ex. 112, Page 8, Lines 6-8.

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which the company agreed to continue funding the low-income weatherization program at \$1.2 million per year. The signatories also agreed that Ameren Missouri would contract with an independent third party contractor to conduct both a process and impact evaluation of the low-income weatherization program every two years. The independent evaluation was to be funded by withholding up to \$60,000 per year from Ameren Missouri's payment to the program.

3. Public Counsel filed a written objection to the nonunanimous stipulation and agreement on May 25. Public Counsel objected that the recurring evaluation would consume money that would otherwise be used to provide weatherization services.

4. Because the nonunanimous stipulation and agreement was objected to, it becomes just a joint position of the signatory parties.

**Specific Findings of Fact:**

5. As Ameren Missouri's witness indicates, the low-income weatherization program should have more transparent reporting and should be evaluated as are other energy efficiency programs.<sup>103</sup>

6. The impact evaluation contemplated by Ameren Missouri and MDNR's joint position would determine the energy and demand savings of the program. Process evaluation would assess the effectiveness of the program implementation processes.<sup>104</sup>

6. Setting aside \$60,000 per year to evaluate a multi-million dollar program is reasonable and prudent.

**Conclusions of Law:**

A. Commission Rule 4 CSR 240-2.115(2)(D) provides that a nonunanimous stipulation and agreement to which an objection is made is to be treated as a joint position of the signatory parties, except that no party is bound by the agreement.

B. The approach the Commission must take when considering a nonunanimous stipulation and agreement to which an objection is made is further described in a 1982 decision of the Missouri Court of Appeals. In *State ex rel. Fischer v. Public Service Commission*,<sup>105</sup> the Court held that when considering a nonunanimous stipulation and agreement the Commission must recognize all statutory requirements, including the right to be heard and to introduce evidence. Furthermore, the Commission's decision must be in writing and must include adequate findings of fact.

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<sup>103</sup> Laurent Rebuttal, Ex. 112, Page 8, Lines 8-10.

<sup>104</sup> Laurent Rebuttal, Ex. 112, Page 4, FN 1.

<sup>105</sup> 645 S.W.2d 39 (Mo. App. W.D. 1982)

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**Decision:**

Ameren Missouri shall continue its annual payments of \$1,200,000 to the Environmental Improvement and Energy Resources Authority ("EIERA") for the purposes of funding weatherization of homes owned by qualified low-income Ameren Missouri electric customers ("Low Income Weatherization Program"), less an amount set aside for evaluation of the Low Income Weatherization Program.

Ameren Missouri shall contract with an independent third party contractor to conduct both a process and impact evaluation ("evaluation") of the Low Income Weatherization program in Ameren Missouri's service territory as follows:

A. The first evaluation under this agreement will be completed by April 30, 2012.

B. The first evaluation will cover the time period of January 1, 2010 through December 31, 2011.

C. Evaluations will be conducted every two years thereafter.

The evaluation is to be funded from Ameren Missouri's withholding from Ameren Missouri's annual payment to EIERA of a maximum amount of \$60,000 annually. This is intended to provide \$120,000 as the maximum funding for each evaluation. In the event an evaluation costs less than \$120,000, the remaining funds will serve to reduce the next annual \$60,000 withholding.

**5. Taum Sauk: What amount, if any, of Ameren Missouri's investment related to the reconstruction of Taum Sauk should be included in rate base for ratemaking purposes?**

**Findings of Fact:**

**Introduction:**

1. The Taum Sauk plant is a pumped storage facility located in Reynolds County, Missouri. It consists of an upper reservoir located on the top of a mountain, a shaft and tunnel conduit, two 220-megawatt pump-turbine units, and a lower reservoir. When the cost of electricity to run the pumps is low, water is pumped from the lower reservoir to the upper reservoir. When demand for electricity and the resulting price of that electricity is high, the water in the upper reservoir is allowed to drain down through the tunnel conduit to turn the turbines to generate electricity. When the price of electricity again drops, the water is pumped back up and the cycle is repeated.<sup>106</sup>

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<sup>106</sup> Birk Direct, Ex. 106, Page 23, Lines 3-22.

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2. In the early morning of December 14, 2005, a portion of the parapet wall and the northwest corner of the dike around the upper reservoir breached, causing an uncontrolled, rapid release of water down the mountain. The flood swept through Johnson's Shut-ins State Park and Campground, devastating the park and washing away the home of the park superintendent. Fortunately, no one was killed.<sup>107</sup>

3. The Commission's Staff investigated the failure of the upper reservoir and issued a report in 2007. That report concluded:

[t]he Upper Reservoir at the Taum Sauk Pumped Storage Project breached on the early morning of December 14, 2005, because the reservoir overtopped when more water was pumped into the Upper Reservoir than it could hold. The overtopping occurred because (1) the plant was customarily operated with an insufficient margin of safety, (2) the water level sensors were unreliable because they had broken free from their anchoring system, and (3) the emergency back-up sensors, intended to prevent the exact chain of events that in fact occurred, had been improperly set too high. The breach was entirely avoidable in that the Company knew for over two months that the water level sensors were unreliable, as they had broken free from their anchoring system, but unaccountably failed to make repairs. The failure was a management failure in that Ameren had organized the operation of its plants and the performance of maintenance, repair and improvement activities at its plants in such a way that overall direction was lacking and crucial information was not shared.<sup>108</sup>

Based on its findings, Staff recommended:

[t]hat any and all costs, direct and indirect, associated with the Taum Sauk incident be excluded from rates on an ongoing basis. This includes, but is not limited to, the exclusion of rebuilding costs and treating

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<sup>107</sup> Birk Direct, Ex. 106, Page 24, Lines 17-23.

<sup>108</sup> *In the Matter of an Investigation Into an Incident in December 2005 at the Taum Sauk Pumped Storage Project Owned and Operated by the Union Electric Company, doing business as AmerenUE*, Case No. ES-2007-0474, Staff's Initial Incident Report, October 24, 2007, Pages 4-5.

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the facility as though its capacity is available for dispatch modeling.<sup>109</sup>

4. Ameren Missouri has accepted full responsibility for the failure of the upper reservoir.<sup>110</sup> Up until now, the company's ratepayers have not been asked to pay any of the cost of cleaning up after the breach or the cost of rebuilding the upper reservoir.

5. Ameren Missouri has now rebuilt the upper reservoir and the Taum Sauk unit is once again producing electricity. In this case, it is asking the Commission to include \$89 million in its rate base for construction of "enhancements" to the upper reservoir because of the rebuild.<sup>111</sup> The \$89 million figure was derived by subtracting the \$400 million in insurance proceeds received by Ameren Missouri from the \$489 million total cost to rebuild the upper reservoir.<sup>112</sup>

6. Although Ameren Missouri's proposal would allow it to recover all rebuilding costs not covered by insurance, it has absorbed approximately \$94 million in insurance deductibles, fines, lost energy and capacity, and other expenses resulting from the collapse for which it has not sought recovery from ratepayers.<sup>113</sup>

**Specific Findings of Fact:**

7. The Commission's Staff conducted an audit of Ameren Missouri's rebuild of the Taum Sauk upper reservoir and reported the results of that audit in this case.<sup>114</sup> Staff did not recommend any disallowances as the result of its audit. That means that except for Ameren Missouri's responsibility for the breach of the reservoir in 2005, no party has questioned the specific costs of the rebuild project and those costs are not otherwise at issue. Instead, the question before the Commission is whether Ameren Missouri should be allowed to recover

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<sup>109</sup> *In the Matter of an Investigation Into an Incident in December 2005 at the Taum Sauk Pumped Storage Project Owned and Operated by the Union Electric Company, doing business as AmerenUE*, Case No. ES-2007-0474, Staff's Initial Incident Report, October 24, 2007, Pages 82.

<sup>110</sup> Transcript, Page 209, Lines 11-14.

<sup>111</sup> The inclusion of \$89 million in rate base does not mean that Ameren Missouri's revenue requirement would increase by that amount in this case. Ameren Missouri would include that amount in its rate base, which it will recover through depreciation over the life of the property. The impact on revenue requirement for this case would be approximately \$10.4 million if Ameren Missouri is allowed to include the entire \$89 million in rate base.

<sup>112</sup> Transcript, Page 881, Lines 10-13.

<sup>113</sup> Birk Direct, Ex. 106, Page 39, lines 1-15, *see also*, Transcript, Page 432.

<sup>114</sup> Staff's Construction Audit and Prudence Review of Taum Sauk Project for Costs Reported as of October 31, 2010. Ex. 203.

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all, or any part of those cost due to its imprudence in causing the failure of the upper reservoir in 2005.

8. Following the failure of the upper reservoir, Ameren Missouri was sued by the State of Missouri in the Circuit Court of Reynolds County. That lawsuit resulted in the entry of a Consent Judgment.<sup>115</sup> Signed by Ameren Missouri and by Missouri's Attorney General on behalf of the State of Missouri, including the Missouri Department of Natural Resources, the Missouri Clean Water Commission, and the Missouri Conservation Commission, that Consent Judgment required Ameren Missouri to pay damages and to rebuild the upper reservoir.

9. The Commission was not a party to the Consent Agreement and is not bound by its terms.

10. The Consent Agreement includes the following provision under the heading "Ratepayer Protection":

AmerenUE acknowledges that it will not attempt to recover from ratepayers in any rate increase any in-kind or monetary payments to the State Parties required by this Consent Judgment or construction cost incurred in the reconstruction of the Upper Reservoir Dam (expressly excluding, however, "allowed costs," which shall mean only enhancements, costs incurred due to circumstances or conditions that are currently not reasonably foreseeable and costs that would have been incurred absent the Occurrence as allowed by law), and further acknowledges the audit powers of the Missouri Public Service Commission to ensure that no such recovery is pursued. In the event that Ameren intends to seek recovery for allowed costs, it shall notify the State Parties in writing at least seven (7) business days in advance of its initial application for the recovery of these costs. If AmerenUE fails to provide the required notice, it shall forfeit whatever legal right it has to seek such recovery. (Emphasis added)<sup>116</sup>

11. Ameren Missouri provided the notice to the State Parties required by the provision on August 16, 2010.<sup>117</sup> None of the named state parties has objected to Ameren Missouri's attempt to recover the described costs.

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<sup>115</sup> Ex. 157.

<sup>116</sup> Ex. 157.

<sup>117</sup> Ex. 158.



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12. The Missouri Department of Natural Resources is a party to this case, but has not opposed Ameren Missouri's attempt to recover the costs. MDNR is represented by the Missouri Attorney General's office. When asked about the State's position regarding the attempt to recover the costs, counsel for MDNR stated that she was authorized to say that "the Attorney General's office did review Ameren's request for reimbursement after this case was filed and we have no evidence to believe that the request is inconsistent with or in violation of the consent judgment on record in Reynolds County."<sup>118</sup>

13. Ameren Missouri asserts that the costs it seeks to recover are "allowed costs" under two provisions of the Consent Judgment. First it claims those costs paid for "enhancements", and second it claims those costs would have been incurred even if the reservoir had not collapsed. The Commission will address the second argument first.

14. Ameren Missouri contends all \$89 million in rebuild costs not covered by insurance should be recoverable because it would have had to rebuild the upper reservoir soon even if it had not collapsed in 2005.

15. Paul Rizzo, a civil engineer, offered testimony in that regard on behalf of Ameren Missouri. Ameren Missouri hired him after the collapse of the upper reservoir to perform a forensic investigation and root cause analysis regarding the collapse. He concluded that the reservoir collapsed due to over-pumping associated with faulty instrument control systems coupled with substandard construction and inadequate design.<sup>119</sup> Subsequently, his firm served as construction manager for the rebuild of the upper reservoir.<sup>120</sup>

16. The Taum Sauk plant is regulated by the FERC and has been subject to a major independent dam safety inspection every five years beginning in 1985. The old Taum Sauk plant passed its last inspection in 2003.<sup>121</sup>

17. Beginning in 2003, the FERC began using a new, more rigorous dam safety inspection process known as the Potential Failure Modes Analysis (PFMA) Program. Taum Sauk would have been inspected under that more rigorous process in 2008.<sup>122</sup>

18. Rizzo testified that if Taum Sauk had been inspected under the PFMA program, that inspection would have revealed that the old dam

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<sup>118</sup> Transcript, Page 2124, Lines 10-15.

<sup>119</sup> Rizzo Direct, Ex. 117, Page 2, Lines 22-25.

<sup>120</sup> Transcript, Page 770, Lines 17-22.

<sup>121</sup> Rizzo Direct, Ex. 117, Page 17, Lines 22-26.

<sup>122</sup> Rizzo Direct, Ex. 117, Page 18, Lines 1-14.

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used the parapet wall for water retention in violation of modern safety standards,<sup>123</sup> the dam did not meet modern seismic standards and could not withstand a significant earthquake,<sup>124</sup> and due to excessive leakage from the old reservoir, there were significant voids under the concrete foundation.<sup>125</sup> Most fundamentally, the foundation of the old upper reservoir was completely inadequate. In part that inadequacy was due to deficiencies in the way the dam was originally designed and in part because the construction of the dam did not follow the design requirements.<sup>126</sup>

19. In Rizzo's opinion, after seeing the results of the PFMA inspection, the FERC would have required a complete rebuild of the facility, like the rebuild that Ameren Missouri actually did, to fully address the safety risks he identified.<sup>127</sup>

20. Ameren Missouri argues that because the FERC would have required it to rebuild the dam in a few years anyway, all the reconstruction costs are "costs that would have been incurred absent the occurrence" and thus qualify as "allowed costs" under the Consent Agreement. The Commission does not accept that argument.

21. First, Paul Rizzo appears to be a very good civil engineer and he offered very credible evidence about the condition of the old dam, why it collapsed, and why it should have failed a FERC inspection in 2008. Of course, those problems were also present in 2003 when the Taum Sauk reservoir passed a FERC inspection. At least some of the deficiencies should have been apparent to an inspector even without the enhanced inspection required by the new PFMA process. For example, an inspector should have been able to tell that the parapet walls were being used to retain water without an extensive inspection.

22. The problem is that Rizzo is a civil engineer, not a FERC bureaucrat. While he can say with great credibility that the old reservoir should have failed a FERC inspection in 2008, he cannot say with certainty what FERC would have done with the results of that inspection. As a result, the Commission cannot conclude that the upper reservoir would have had to be rebuilt even if it had not collapsed and therefore cannot conclude that the costs are "allowed costs" because they "would have been incurred absent the Occurrence."

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<sup>123</sup> Rizzo Direct, Ex. 117, Pages 19-20.

<sup>124</sup> Rizzo Direct, Ex. 117, Pages 29-30.

<sup>125</sup> Rizzo Direct, Ex. 117, Pages 30-32.

<sup>126</sup> Rizzo Direct, Ex. 117, Pages 20-29.

<sup>127</sup> Rizzo Direct, Ex. 117, Page 32, Lines 11-25.

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23. The second reason the Commission will not accept the “reservoir would have had to be rebuilt anyway” argument has nothing to do with the language of the Consent Judgment. Rizzo’s testimony reveals that the upper reservoir was very poorly constructed even by 1963 standards. In particular, the foundation was deficient because smaller soil particles, known as “fines” were allowed to remain in the rockfill mass comprising the dam. The people responsible for construction of the dam knew about the “fines” problem at the time, but did not fix the problem.<sup>128</sup> Furthermore, the design called for foundation rock to be cleaned of organic material, top soil, residual soil, and weathered rock with a bulldozer such that no more than 2 inches of such material was left in place. However, as much as 18 inches of low strength material, including top soil and vegetation was left in place under the foundation.<sup>129</sup> Union Electric Company, Ameren Missouri’s parent company, was ultimately responsible for the construction of the upper reservoir.

24. Essentially then, Ameren Missouri’s “the reservoir would have had to be rebuilt anyway” argument is that not only did the company operate the reservoir recklessly and imprudently in 2005, it also constructed it poorly fifty years ago. That is not a reasonable basis to allow the company to pass the uninsured portion of the costs of the rebuild on to its ratepayers.

25. Moving on to the other argument about the meaning of the Consent Judgment’s exception, the Consent Judgment does not define the term “enhancement” in its definition of allowed costs. Furthermore, “enhancement” is not a term in general use within the field of utility regulation.

26. Ameren Missouri and Staff further divide the concept of “enhancements” into discrete enhancements and non-discrete enhancements. Discrete enhancements are features in the new reservoir that were not present at all in the old. Ameren Missouri identified those discrete enhancements as an overflow release structure, a drainage and inspection gallery, a continuous upstream grout curtain, a cementitious floor, a crest concrete roadway and guardrail, crest-to-gallery and foundation drains, and new instrumentation.<sup>130</sup> Staff’s audit report set

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<sup>128</sup> Rizzo Direct, Ex. 117, Pages 27-29.

<sup>129</sup> Rizzo Direct, Ex. 117, Page 21, Lines 9-13.

<sup>130</sup> Birk Direct, Ex. 106, Page 32, Lines 10-13.

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the cost of the discrete enhancements identified by Ameren Missouri at \$67 million.<sup>131</sup>

27. The non-discrete enhancement identified by Ameren Missouri is chiefly the new and improved foundation of the dam. The new foundation is constructed of roller compacted concrete rather than dumped rock-fill and now meets seismic standards.<sup>132</sup> As a result, the remaining service life of the reservoir has been extended by at least 80 years.<sup>133</sup>

28. Staff's audit valued the non-discrete enhancements at an amount in excess of the amount needed to allow Ameren Missouri to recover all rebuild costs not otherwise covered by insurance.<sup>134</sup>

29. The non-discrete enhancements clearly improve the reservoir. But are they "enhancements" within the meaning of the Consent Judgment? The Commission finds that they are not.

30. If the Consent Judgment's allowed cost exception for "enhancements" is broad enough to include non-discrete enhancement such as an improved foundation, then the exception swallows the rule and renders the Consent Judgment's restriction on recovery of rebuilding costs meaningless. Under that interpretation, the Consent Judgment might as well say that Ameren Missouri can recover all building costs not covered by insurance because that would be the result. That cannot have been the intent of the parties to the Consent Judgment, it is not good public policy, and the Commission will not accept it.

31. That leaves the \$67 million that Staff and Ameren Missouri identified as discrete enhancements. In principle, those are additions to the new reservoir that were not present in the old reservoir.

32. However, the Commission finds that even the discrete enhancements described by Ameren Missouri and accepted by Staff do not match a reasonable interpretation of the meaning of an enhancement under the Consent Agreement.

33. When Ameren Missouri, then Union Electric, constructed the Taum Sauk plant in the early 1960's they constructed a reservoir that was designed to comply with the state of the art as it existed at that time.<sup>135</sup> The newly constructed reservoir is designed in compliance with

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<sup>131</sup> Staffs' Construction Audit and Prudence Review of Taum Sauk Project for Costs Reported as of October 31, 2010, Ex. 203, Page 17, Chart at Line 6.

<sup>132</sup> Birk Direct, Ex. 106, Page 35, Liens 19-22.

<sup>133</sup> Transcript, Page 768, Lines 17-23.

<sup>134</sup> Transcript, Pages 880-881.

<sup>135</sup> As previously discussed, Ameren Missouri, then Union Electric, did not construct the

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current dam safety requirements. All the new dam safety features that Ameren Missouri and Staff describe as enhancements are required by those current dam safety requirements.<sup>136</sup> Thus, while those new features are certainly enhancements compared to the original dam, which was designed by 1963 standards, they are not enhancements compared to today's industry standards, as Ameren Missouri's expert witness, Paul Rizzo testified.<sup>137</sup>

34. If "enhancement" within the meaning of the Consent Judgment is taken to mean just an improvement over the 1963 dam, then again the restriction in the Consent Judgment is essentially meaningless and Ameren Missouri would be invited to recover all its reconstruction costs not covered by insurance. Clearly that was not the intent of the Consent Judgment.

35. The Commission interprets the Consent Judgment to allow Ameren Missouri to recover for "enhancements" measured against today's dam safety standards, not against the much weaker dam safety standards of 1963. Viewed in that manner Ameren Missouri has not described any enhancements for which it can recover construction costs from its ratepayers under the Consent Judgment.

36. An interpretation of the Consent Judgment is not the only reason to disallow Ameren Missouri's recovery of any amount for the rebuild of the Taum Sauk reservoir. Remember, the Commission was not a party to the Consent Judgment and is not bound by its terms. Even if the parties to the Consent Judgment intended to allow Ameren Missouri to recover these costs, the Commission is not bound to follow that intent.

37. As previously indicated, when Staff reviewed the circumstances of the collapse of the reservoir, it concluded that Ameren Missouri's imprudence and recklessness had caused the collapse.<sup>138</sup> At that time, Staff recommended that Ameren Missouri not be allowed to recover any costs related to the rebuilding of Taum Sauk without any exception.<sup>139</sup>

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dam in compliance with even 1963 standards.

<sup>136</sup> Transcript, Page 812, Lines 5-19.

<sup>137</sup> Transcript, Page 814, Lines 1-8.

<sup>138</sup> *In the Matter of an Investigation Into an Incident in December 2005 at the Taum Sauk Pumped Storage Project Owned and Operated by the Union Electric Company, doing business as AmerenUE*, Case No. ES-2007-0474, Staff's Initial Incident Report, October 24, 2007, Pages 71-72, See also, Kind Direct, Ex. 300, Page 5, Lines 6-19.

<sup>139</sup> *In the Matter of an Investigation Into an Incident in December 2005 at the Taum Sauk Pumped Storage Project Owned and Operated by the Union Electric Company, doing business as AmerenUE*, Case No. ES-2007-0474, Staff's Initial Incident Report, October 24, 2007, Pages 82.

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38. Similarly, after the collapse, Ameren Missouri took full responsibility and promised to protect its ratepayers from the consequence of that collapse.<sup>140</sup> The Commission intends to hold Ameren Missouri to that promise.

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

Ameren Missouri shall not include any amount of the cost to rebuild the upper reservoir of the Taum Sauk plant in its rate base.

**6. Municipal Lighting: What is the appropriate ratemaking treatment for Ameren Missouri's street lighting classes in this case?**

**Findings of Fact:**

**Introduction:**

1. This issue concerns Ameren Missouri's street lighting class, which is comprised mostly of various municipalities who purchase electricity from Ameren Missouri to light the streets of their communities. A group of municipalities in St. Louis County intervened in this case and they are identified collectively as the Municipal Group. The Municipal Group was also a party to Ameren Missouri's last rate case, ER-2010-0036.

2. In that case, the Commission was concerned that no one could tell whether the rates being paid by the lighting class were just and reasonable because no class cost of service study had examined the lighting class for at least thirty years. Because of its concern, the Commission exempted the lighting class from the rate increase that resulted from that order.<sup>141</sup> As the result of a stipulation and agreement in that case, Ameren Missouri agreed to undertake a cost of service study for all rates affecting the lighting class in its next rate case.<sup>142</sup>

3. Ameren Missouri's cost of service study in this case indicates the lighting class as a whole is paying approximately \$7 million less than the cost to serve that class. To bring the lighting class fully to its cost of service would require a rate increase of 22.41 percent beyond the overall

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<sup>140</sup> Kind Direct, Ex. 300, Pages 3-4. Lines 14-23, 1-17.

<sup>141</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, File No. ER-2010-0036, Report and Order, May 28, 2010, Page 100.

<sup>142</sup> Difani Direct, Ex. 119, Page 3, Lines 1-15.

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rate increase that will result from this report and order.<sup>143</sup> No party has challenged the validity of Ameren Missouri's cost of service study.

**Specific Findings of Fact:**

4. The lighting class is divided into three classifications: Street and Outdoor Area Lighting – Company Owned (5M), Street and Outdoor Area Lighting – Customer Owned (6M), and Municipal Street Lighting – Incandescent (7M). The 5M classification is the largest, providing 89.6 percent of Ameren Missouri's total revenue from the lighting class.<sup>144</sup>

5. After conducting its overall class cost of service study, Ameren Missouri undertook a further study to divide the overall revenue requirement to be collected from the lighting class among the three classifications within the lighting class. Again, no party challenged the validity of that study. Instead, the disagreement arose within the 5M classification.

6. The disagreement concerns charges for company-owned distribution facilities. For company-owned distribution facilities, such as poles and spans, installed before September 1988, the municipality is billed a relatively small monthly amount. After September 1988, Ameren Missouri changed its billing policy and charged a relatively large one-time, upfront fee to the municipality when it installed the new pole and span. The municipality then did not have to pay the continuing monthly charge for that pole and span.<sup>145</sup>

7. Not surprisingly, the municipalities that had been paying the monthly "pole and span" charge for 22 years or more compared their monthly payments to the upfront charge and started asking whether they had not fully paid for the pole and span by this time. Ameren Missouri agreed that the system should be simplified and proposed to eliminate the "pole and span" charge and instead collect that revenue from the 5M classification as a whole.<sup>146</sup>

8. The Municipal Group argues that the pre-1988 installation charges should be entirely removed and the revenue those charges collect should not be collected from the lighting class in general or from

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<sup>143</sup> Ex. 551. In a subsequent section of this order, the Commission determines that the lighting class will receive a revenue neutral increase of 4 percent beyond the overall rate increase that will result from this order.

<sup>144</sup> Eastman Direct, Ex. 750, Page 5, Lines 6-7.

<sup>145</sup> Difani Direct, Ex. 119, Page 8, Lines 7-15.

<sup>146</sup> Difani Direct, Ex. 119, Pages 8-9, Lines 18-23, 1-6.

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the 5M classification in particular, arguing that after 22 years those municipalities have surely paid for those poles.<sup>147</sup>

9. The Municipal Group's argument misunderstands the nature of the monthly pre-1988 installation charge (also known as the pole and span charge) and the revenue it collects for Ameren Missouri. As determined in the company's class cost of service study, it costs Ameren Missouri a certain amount of money to provide electric service to the lighting class. Similarly, it costs a certain amount of money to provide services to each of the three classifications within the lighting class. Ameren Missouri has created a number of charges by which it collects that money from those classifications and the lighting class as a whole. Many years ago, Ameren Missouri decided to collect part of the cost of serving the lighting class through the pole and span charge.

10. Payment of the pole and span charge, even for a very long time, does not mean the customer will eventually own the pole and span, just as the payment of the upfront charge after 1988 does not mean the municipality owns the pole and span. The pole and span charge is simply the device the company used to collect a portion of its cost to serve its municipal lighting customers.

11. The situation is analogous to a city government that collects part of the revenue it needs from parking meters. For various reasons, a city may decide that its parking meter rates are too high and should be reduced. However, if the city is to continue to collect the revenue it needs to operate, it may need to increase its sales tax rate to collect the revenue lost when parking meter rates are reduced.

12. Even if the company eliminates a particular charge, the amount of revenue Ameren Missouri needs to serve the lighting class in general and the 5M classification in particular does not change. If Ameren Missouri is to continue to recover its cost of service after eliminating the pole and span charge, it must increase some other charge to make up the difference.

13. The Municipal Group's suggestion that the revenue lost when the pole and span charge is eliminated not be recovered from the lighting class would mean that Ameren Missouri would have to recover the revenue from some other rate class that the class cost of service studies establish is not responsible for those costs. Such a result would be patently unfair. If the pole and span charge is eliminated, the revenue lost must be collected from the lighting class and the 5M classification in

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<sup>147</sup> Eastman Direct, Ex. 750, Page 9, Lines 16-22.



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some other manner. The question remains, should the pole and span charge be eliminated as Ameren Missouri proposes?

14. The Municipal Group explains that the elimination of the pole and span charge and the collection of that revenue from the entire 5M rate classification would have a disparate impact on newer and older municipalities. Older cities that installed most of their street lighting years ago and as a result have been paying the pole and span charges for pre-1988 poles would no longer pay that charge and could see their rates go down with the elimination of the pole and span charge. On the other hand, newly developing cities that have installed street lighting since 1998 and thus have paid an upfront charge rather than the pole and span charge, would not benefit from the elimination of the pole and span charge and would see their overall rates increase substantially.<sup>148</sup>

15. Staff suggests that this result is unfair to the newer municipalities and contends the pole and span charge should not be eliminated.<sup>149</sup> However, the same facts imply that the current arrangement is unfair to the older municipalities that have been paying the pole and span charge. Their subsidization of the newer municipalities will only grow as they continue to pay the pole and span charges and the accumulated revenue Ameren Missouri collects from that charge outstrips the revenue collected through the up-front charges paid by the newer municipalities.

16. The pole and span charge needs to be eliminated, but the rate shock that would cause the newer municipalities that paid up-front charges should also be avoided. Therefore, a gradual elimination of the charge is appropriate.

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

Based on its findings of fact and conclusions of law, the Commission decides that Ameren Missouri should eliminate the pole and span charge gradually. To avoid the rate shock that would result from the complete elimination of the charge, the Commission directs Ameren Missouri to initially reduce the monthly pole and span charge by half. The reduced revenue resulting from this reduction in the pole and span charge shall be collected from the entire 5M classification within the

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<sup>148</sup> Eastman Direct, Ex. 750, Pages 6-7.

<sup>149</sup> Scheperle Surrebuttal, Ex. 228, Page 3, Lines 8-13.

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lighting class. The Commission will consider the total elimination of the pole and span charge in Ameren Missouri's next rate case.

**7. Cost of Capital: What return on equity should be used to determine Ameren Missouri's revenue requirement in this case?**

**Findings of Fact:**

**Introduction:**

1. This issue concerns the rate of return Ameren Missouri will be authorized to earn on its rate base. Rate base includes things like generating plants, electric meters, wires and poles, and the trucks driven by Ameren Missouri's repair crews. In order to determine a rate of return, the Commission must determine Ameren Missouri's cost of obtaining the capital it needs.

2. The relative mixture of sources Ameren Missouri uses to obtain the capital it needs is its capital structure. Ameren Missouri's True-Up Accounting Schedules described Ameren Missouri's actual capital structure as of February 28, 2011 as:

Long-Term Debt	46.702%
Short-Term Debt	00.000%
Preferred Stock	01.063%
Common Equity	52.235% <sup>150</sup>

No party has raised an issue regarding capital structure so the Commission will not further address this matter.

3. Similarly, no party has raised an issue regarding Ameren Missouri's calculation of the cost of its long-term debt and preferred stock.

4. Determining an appropriate return on equity is the most difficult part of determining a rate of return. The cost of long-term debt and the cost of preferred stock are relatively easy to determine because their rate of return is specified within the instruments that create them. In contrast, in determining a return on equity, the Commission must consider the expectations and requirements of investors when they choose to invest their money in Ameren Missouri rather than in some other investment opportunity. As a result, the Commission cannot simply find a rate of return on equity that is unassailably scientifically, mathematically, or legally correct. Such a "correct" rate does not exist. Instead, the Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investors' dollar in the capital market, without permitting an excessive

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<sup>150</sup> Weiss True-Up Direct, Schedule GSW-TE18-43.

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rate of return on equity that would drive up rates for Ameren Missouri's ratepayers. In order to obtain guidance about the appropriate rate of return on equity, the Commission considers the testimony of expert witnesses.

5. Four financial analysts offered recommendations regarding an appropriate return on equity in this case. Robert B. Hevert testified on behalf of Ameren Missouri. Hevert is President of Concentric Energy Advisors, Inc. of Marlborough, Massachusetts. He holds a Bachelor of Science degree in Finance from the University of Delaware and a Master of Business Administration degree from the University of Massachusetts.<sup>151</sup> He recommends the Commission allow Ameren Missouri a return on equity of 10.70 percent, within a range of 10.40 percent to 11.25 percent.<sup>152</sup>

6. Billie Sue LaConte testified on behalf of the Missouri Energy Group. LaConte is a consultant in the field of public utility economics and regulation and is a member of the Drazen Consulting Group, Inc.<sup>153</sup> LaConte has a Bachelor of Arts in mathematics from Boston University, and a Master of Business Administration degree in finance from the John M. Olin School of Business, Washington University.<sup>154</sup> She recommends the Commission allow Ameren Missouri a return on equity within a range of 9.7 percent to 10.6 percent.<sup>155</sup>

7. Michael Gorman testified on behalf of MIEC. Gorman is a consultant in the field of public utility regulation and is a managing principal of Brubaker & Associates.<sup>156</sup> He holds a Bachelor of Science degree in Electrical Engineering from Southern Illinois University and a Masters Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield.<sup>157</sup> Gorman recommends the Commission allow Ameren Missouri a return on equity of 9.90 percent, within a recommended range of 9.80 percent to 10.00 percent.<sup>158</sup>

8. Finally, David Murray testified on behalf of Staff. Murray is the Acting Utility Regulatory Manager of the Financial Analysis Department for the Commission. He holds a Bachelor of Science degree in Business

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<sup>151</sup> Hevert Direct, Ex. 121, Page 1, Lines 16-18.

<sup>152</sup> Hevert Surrebuttal, Ex. 123, Page 7, Lines 15-18.

<sup>153</sup> LaConte Direct, Ex. 450, Page 1, Lines 5-6.

<sup>154</sup> LaConte Direct, Ex. 450, Appendix A, Page 2, Lines 1-3.

<sup>155</sup> LaConte Surrebuttal, Ex. 452, Page 6, Lines 17-18.

<sup>156</sup> Gorman Direct, Ex. 407, Page 1, Lines 6-7.

<sup>157</sup> Gorman Direct, Ex. 407, Appendix A, Page 1, Lines 9-12.

<sup>158</sup> Gorman Surrebuttal, Ex. 409, Page 18, Line 10.

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Administration from the University of Missouri – Columbia, and a Masters in Business Administration from Lincoln University. Murray has been employed by the Commission since 2000 and has offered testimony in many cases before the Commission.<sup>159</sup> Murray recommends a return on equity within a range of 8.25 percent to 9.25 percent, with a recommended midpoint of 8.75 percent.<sup>160</sup>

**Specific Findings of Fact:**

9. A utility's cost of common equity is the return investors require on an investment in that company.<sup>161</sup> To comply with standards established by the United States Supreme Court, the Commission must authorize a return on equity sufficient to maintain financial integrity, attract capital under reasonable terms, and be commensurate with returns investors could earn by investing in other enterprises of comparable risk.<sup>162</sup>

10. Financial analysts use variations on three generally accepted methods to estimate a company's fair rate of return on equity. The Discounted Cash Flow (DCF) method assumes the current market price of a firm's stock is equal to the discounted value of all expected future cash flows. The Risk Premium method assumes that all the investor's required return on an equity investment is equal to the interest rate on a long-term bond plus an additional equity risk premium to compensate the investor for the risks of investing in equities compared to bonds. The Capital Asset Pricing Method (CAPM) assumes the investor's required rate of return on equity is equal to a risk-free rate of interest plus the product of a company-specific risk factor, beta, and the expected risk premium on the market portfolio. No one method is any more "correct" than any other method in all circumstances. Analysts balance their use of all three methods to reach a recommended return on equity.

11. Before examining the analyst's use of these various methods to arrive at a recommended return on equity, it is important to look at another number. For 2010, the average return on equity awarded to integrated electric utilities by state commissions in this country was 10.30 percent. Among states neighboring Missouri, the average authorized return on equity over the same period was 10.23 percent.<sup>163</sup>

12. The Commission mentions the average allowed return on equity

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<sup>159</sup> Staff Report – Revenue Requirement/Cost of Service, Ex. 201, Appendix 1, Page 49.

<sup>160</sup> Staff Report – Revenue Requirement/Cost of Service, Ex. 201, Page 4, Lines 11-12.

<sup>161</sup> Gorman Direct, Ex. 407, Page 8, Lines 7-9.

<sup>162</sup> Gorman Direct, Ex. 407, Page 9, Lines 3-7.

<sup>163</sup> Hevert Surrebuttal, Ex. 123, Page 6, Lines 10-17.

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not because the Commission should, or would slavishly follow the national average in awarding a return on equity to Ameren Missouri. However, Ameren Missouri must compete with other utilities all over the country for the same capital. Therefore, the average allowed return on equity provides a reasonableness test for the recommendations offered by the return on equity experts.

13. The 8.75 percent return on equity recommendation offered by Staff's witness is substantially below both the national average awarded return on equity and the recommendations offered by the other expert witnesses. If the Commission were to authorize the return on equity recommended by Staff, it would apparently be the lowest "non-penalty" return on equity authorized in the United States in the last thirty years.<sup>164</sup>

14. In developing his recommendation for Staff, Murray gave primary weight to his multi-stage DCF analysis.<sup>165</sup> Murray's multi-stage DCF analysis results in a low recommended return on equity because the third stage of his analysis relies on a low long-term growth estimate of 3 to 4 percent, with a midpoint of 3.5 percent, to derive an estimated cost of equity ranging from 8.4 percent to 9.15 percent, with a midpoint of 8.775 percent.<sup>166</sup>

15. Murray initially based his long-term growth rate on a 2003 study published in Mergent *Public Utility and Transportation Manual*. Because Murray could not replicate Mergent's data, he decided to perform his own study to estimate long-term growth rates based on historical growth rates for a set of electric utilities during the period between 1968 and 1999. That study showed an average annual growth rate of 3.59 percent.<sup>167</sup>

16. Murray admittedly did not use "rigid selection criteria" in determining which utilities to include in his study and it appears that the selection of data to study was based more on the ready availability of that information to Staff than to any rational basis for that selection.<sup>168</sup>

17. In contrast to the very low long-term growth rate used by Murray, Ameren Missouri's witness, Robert Hevert, used a long-term growth rate of 5.75 percent, based on the real GDP growth rate of 3.28 percent from 1929 through 2009, plus an inflation rate of 2.40 percent.<sup>169</sup>

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<sup>164</sup> Hevert Rebuttal, Ex. 122, Page 16, Footnote 19.

<sup>165</sup> Staff Report – Revenue Requirement/Cost of Service, Page 19, Lines 14-15.

<sup>166</sup> Staff Report – Revenue Requirement/Cost of Service, Page 20, Lines 1-10.

<sup>167</sup> Staff Report – Revenue Requirement/Cost of Service, Page 23, Lines 5-13.

<sup>168</sup> Staff Report – Revenue Requirement/Cost of Service, Page 22-23, Lines 5-26, 1-4.

<sup>169</sup> Hevert Direct, Ex. 121, Page 29, Lines 3-5.

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In his multi-stage DCF analysis, Michael Gorman used a long-term growth rate of 4.7 percent based on consensus economists' projected 10-year GDP growth rate as published in Blue Chip Economic Indicators.<sup>170</sup> Billie LaConte performed a two-stage DCF analysis, but used an average long-term growth rate of 5.57 percent based on the average 5-year growth rate for her proxy group of companies.<sup>171</sup> In sum, the long-term growth rates used by the other return on equity witnesses are substantially higher than the rate used by Murray.

18. In support of his use of a very low long-term growth rate, Murray points to a 2009 research report by Goldman Sachs that uses a 2.5 percent perpetual growth rate in its DCF analysis. Murray argues that such a low growth rate is consistent with what investors use in practice.<sup>172</sup> However, Murray conceded that the 2.5 percent growth rate used by Goldman Sachs in its report is a real growth rate in that it does not take into account inflation.<sup>173</sup> Analysis of growth rates for purposes of estimating the cost of equity usually looks at nominal growth rates. If a forecast of long-term inflation were added to Goldman Sachs' real growth rate to estimate a nominal growth rate, then Staff's forecasted growth rate would be more in line with the forecasts offered by the other experts.<sup>174</sup>

19. In an effort to support his low recommended return on equity, Murray points to various valuation analyses regarding Ameren Missouri done by financial analysts for purposes other than the establishment of rates. Murray reports that in general, experts in the field of asset valuation consistently apply a much lower cost of equity to cash flows generated from regulated utility operations as compared to the estimates of cost of equity from rate of return witnesses in the utility ratemaking process.<sup>175</sup> Murray's clear implication is that aside from him, all other rate of return witnesses are getting it wrong.<sup>176</sup>

20. Murray's reliance on valuation analyses to support the reasonableness of his return on equity recommendation is misplaced. Murray acknowledged that he has no experience in asset valuation.<sup>177</sup> In his surrebuttal testimony, Robert Hevert explained in great detail why

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<sup>170</sup> Gorman Direct, Ex. 407, Page 23, Lines 14-18.

<sup>171</sup> LaConte Direct, Ex. 450, Page 11, Lines 1-4.

<sup>172</sup> Staff Report – Revenue Requirement/Cost of Service, Page 23-24, Lines 26-27, 1-13.

<sup>173</sup> Transcript, Page 1177, Lines 3-6.

<sup>174</sup> Hevert Rebuttal, Ex. 122, Pages 46-47, Lines 23-29, 1-2.

<sup>175</sup> Murray Rebuttal, Ex. 219, Page 13, Lines 3-9.

<sup>176</sup> Transcript, Page 1185, Lines 5-21.

<sup>177</sup> Transcript, Pages 1181-1182.

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the valuation analyses cited by Staff are different than the analysis necessary to evaluate a reasonable return on equity in the rate making process.<sup>178</sup> The Commission is persuaded by that explanation and accepts Mr. Hevert's explanation without repeating his arguments. In sum, as MEG's witness, Billie Sue LaConte, who has done asset valuation work in the past, indicated, the principles and methods involved in valuing physical assets are different than the principles and methods involved in estimating a utility's cost of equity.<sup>179</sup>

21. The Commission finds that Staff's recommended return on equity of 8.75 percent is not a reasonable return on equity for Ameren Missouri.

22. Aside from Staff's outlying recommendation, the return on equity recommendations of the other expert witnesses are fairly close together. LaConte and Gorman both recommend a return on equity near 10.0 percent. Hevert for Ameren Missouri recommends a return on equity of 10.7 percent, but no less than 10.4 percent.

23. Hevert's recommended return on equity is higher than the other recommendations in large part because he over-estimates future long-term growth in his various DCF analyses, making them too high to be reasonable estimates of long-term sustainable growth.<sup>180</sup> When Hevert's long-term growth rates are adjusted to use more sustainable growth estimates based on published analyst's projections, his multi-stage DCF analysis produces a rate of return more in line with the estimates of LaConte and Gorman.<sup>181</sup>

24. MEG's witness Billie LaConte recommends an ROE within a range of 9.7 percent to 10.6 percent. In her direct testimony she recommended an ROE of 10.2 percent<sup>182</sup>, but in her surrebuttal testimony she recommended the allowed ROE be set at the lower end of her range between 9.7 and 10.0 percent.<sup>183</sup>

25. LaConte lowered her recommended ROE based on her CAPM and ECAPM studies that indicated very low numbers, a full point or more below her DCF analyses, which the Commission has usually found to be more reliable. LaConte did not explain why she decided to place greater reliance on her CAPM and ECAPM studies in her surrebuttal

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<sup>178</sup> Hevert Surrebuttal, Ex. 123, Pages 13-33.

<sup>179</sup> Transcript, Page 1215, Lines 15-21.

<sup>180</sup> Gorman Rebuttal, Ex. 408, Pages 8-9, Lines 20-23, 1-3.

<sup>181</sup> Gorman Surrebuttal, Ex. 409, Page 22, Lines 1-13.

<sup>182</sup> LaConte Direct, Ex. 450, Page 18, Lines 16-17.

<sup>183</sup> LaConte Surrebuttal, Ex. 452, Page 8, Lines 10-11.

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recommendation than she had in her direct testimony and the Commission finds no justification for doing so. At any rate, LaConte testified that any percentage within her range of 9.7 to 10.6 percent would be reasonable.<sup>184</sup>

26. MIEC's witness, Michael Gorman, recommended a return of 9.9 percent, within a range of 9.8 to 10.0 percent. He also over relies on his unreasonably low Sustainable Growth DCF analysis to pull down the average of his more reasonable Constant Growth DCF and Multi-Stage DCF analyses.<sup>185</sup> If Gorman were to rely more heavily on his Constant Growth DCF result of 10.47 percent and his Multi-Stage Growth DCF of 10.16 percent, his analyses would indicate an allowed ROE near 10.2 percent.

27. An allowed ROE of 10.2 percent would still be below the national average allowed ROE of 10.3 percent.

**Conclusions of Law:**

A. In assessing the Commission's ability to use different methodologies to determine just and reasonable rates, the Missouri Court of Appeals has said:

Because ratemaking is not an exact science, the utilization of different formulas is sometimes necessary. ... The Supreme Court of Arkansas, in dealing with this issue, stated that there is no 'judicial mandate requiring the Commission to take the same approach to every rate application or even to consecutive applications by the same utility, when the commission in its expertise, determines that its previous methods are unsound or inappropriate to the particular application' (quoting *Southwestern Bell Telephone Company v. Arkansas Public Service Commission*, 593 S.W. 2d 434 (Ark 1980)).<sup>186</sup>

Furthermore,

Not only can the Commission select its methodology in determining rates and make pragmatic adjustments called for by particular circumstances, but it also may adopt or reject any or all of any witnesses' testimony.<sup>187</sup>

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<sup>184</sup> Transcript, Pages 1215-1216, Lines 22-25, 1-6.

<sup>185</sup> Gorman Surrebuttal, Ex. 409, Page 18, Table 1.

<sup>186</sup> *State ex rel. Assoc. Natural Gas Co. v. Public Service Commission*, 706 S.W. 2d 870, 880 (Mo. App. W.D. 1985).

<sup>187</sup> *State ex rel. Assoc. Natural Gas Co. v. Public Service Commission*, 706 S.W. 2d 870,



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B. In another case, the Court of Appeals recognized that the establishment of an appropriate rate of return is not a “precise science”:

While rate of return is the result of a straight forward mathematic calculation, the inputs, particularly regarding the cost of common equity, are not a matter of ‘precise science,’ because inferences must be made about the cost of equity, which involves an estimation of investor expectations. In other words, some amount of speculation is inherent in any ratemaking decision to the extent that it is based on capital structure, because such decisions are forward-looking and rely, in part, on the accuracy of financial and market forecasts.<sup>188</sup>

C. In its brief, Staff suggests that the Commission adopt what it describes as a new paradigm to determine an appropriate authorized return on equity for Ameren Missouri. Staff contends that the United States Supreme Court’s *Bluefield* decision establishes a sort of zone of reasonableness. According to the Supreme Court, rates that are insufficient to yield a reasonable return on the company’s investment are confiscatory and would deprive the utility of its property in violation of the Fourteenth Amendment. Staff contends the rate that would be unconstitutionally confiscatory sets the lower bound of the zone of reasonableness. The *Bluefield* decision also states that the utility is not entitled to profits that would be realized or anticipated in highly profitable enterprises or speculative ventures. Staff claims that such a rate would be the upper bound of the zone of reasonableness.

D. Staff claims that through the testimony of David Murray it has attempted to establish the lower bound of this zone of reasonableness, in other words, the level below which the authorized rate would be unconstitutionally confiscatory. Staff claims that the rate proposed by Murray is the lowest reasonable rate at the edge of confiscation and suggests that the Commission must set Ameren Missouri’s rates at that level unless it has a valid regulatory reason to award the company a higher rate. Staff contends there is no valid reason to set a rate higher than the lowest reasonable rate that it indicates is at the very edge of confiscation.

E. Staff’s “new paradigm” adds nothing to the Commission’s consideration of an appropriate return on equity. Of course, the

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880 (Mo. App. W.D. 1985).

<sup>188</sup> *State ex rel. Missouri Gas Energy v. Public Service Commission*, 186 S.W.3d 376, 383 (Mo App. W.D. 2005).

Commission is trying to find the lowest reasonable rate that protects the interests of ratepayers and shareholders. That is what it has always done. In claiming that the rate proposed by its witness is the lowest reasonable rate, Staff simply begs the question of whether the rate proposed by its witness is reasonable. It is certainly the lowest rate proposed, but that does not make it a reasonable rate. Indeed, the Commission has found as a matter of fact that the rate proposed by Staff is not reasonable. Nothing is to be gained by trying to determine the edge of confiscation when under either the old or the new paradigm, the Commission is simply obligated to determine a reasonable rate for the utility.

**Decision:**

Based on the evidence in the record, on its analysis of the expert testimony offered by the parties, and on its balancing of the interests of the company's ratepayers and shareholders, as fully explained in its findings of fact and conclusions of law, the Commission finds that 10.2 percent is a fair and reasonable return on equity for Ameren Missouri. The Commission finds that this rate of return will allow Ameren Missouri to compete in the capital market for the funds needed to maintain its financial health.

**8. Fuel Adjustment Clause Issues:**

**A. Should the Commission authorize Ameren Missouri to continue its current Fuel Adjustment Clause (FAC) or should the Commission discontinue or order modifications to the FAC?**

**Findings of Fact:**

**Introduction:**

1. In a previous Ameren Missouri rate case, ER-2008-0318, the Commission allowed Ameren Missouri to implement a fuel adjustment clause.<sup>189</sup> The approved fuel adjustment clause includes an incentive mechanism that requires Ameren Missouri to pass through to its customers 95 percent of any deviation in fuel and purchased power costs from the base level. The other 5 percent of any deviation is retained or absorbed by Ameren Missouri.<sup>190</sup>
2. In this case, Ameren Missouri proposed that the Commission allow it to continue to use its existing fuel adjustment clause.<sup>191</sup> AARP

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<sup>189</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Pages 69-70.

<sup>190</sup> *Id.* at Page 76.

<sup>191</sup> Barnes Direct, Ex. 102, Page 4, Lines 11-13.

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and Consumers Council urge the Commission to discontinue that fuel adjustment clause. Staff did not oppose the continuation of the fuel adjustment clause, but advises the Commission to change the sharing mechanism to create an 85/15 split, with Ameren Missouri retaining or absorbing 15 percent of any deviation from the base level of fuel and purchased power costs. Public Counsel supports Staff's position. The Commission will address the proposed modification of the sharing mechanism in the next section of this report and order.

**Specific Findings of Fact:**

3. In a previous Ameren Missouri rate case, ER-2008-0318, the Commission found that Ameren Missouri should be allowed to establish a fuel adjustment clause because its fuels costs were substantial, beyond the control of the company's management, and volatile in amount. The Commission also found that Ameren Missouri needed a fuel adjustment clause to have a sufficient opportunity to earn a fair return on equity and to be able to compete for capital with other utilities that have a fuel adjustment clause.<sup>192</sup> In the same rate case, the Commission found that a 95/5 sharing mechanism would give Ameren Missouri a sufficient opportunity to earn a fair return on equity, while protecting customers by preserving the company's incentive to be prudent.<sup>193</sup>

4. Nothing has changed in the years since the Commission established Ameren Missouri's fuel adjustment clause to cause the Commission to change that decision. The Commission again finds that Ameren Missouri's fuel and purchased power costs are substantial, \$888 million in the test year, comprising 49 percent of the company's total operations and maintenance expense.<sup>194</sup> Furthermore, the revenue the company receives from off-system sales, which is also tracked through the fuel adjustment clause, is also substantial.<sup>195</sup> These fuel and purchased power costs continue to be dictated by national and international markets, and thus are outside the control of Ameren Missouri's management.<sup>196</sup> Finally, these costs and revenues continue to be volatile. For example, the price Ameren Missouri was able to

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<sup>192</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Pages 69-70.

<sup>193</sup> *Id.*, at Page 76.

<sup>194</sup> Barnes Direct, Ex. 102, Page 6, Lines 19-22.

<sup>195</sup> Barnes Direct, Ex. 102, Page 6, Lines 22-24.

<sup>196</sup> Barnes Direct, Ex. 102, Page 6, Lines 24-27.

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obtain in the market for off-system electricity sales decreased 45 percent from 2008 to 2009 before partially recovering during the trued-up test year.<sup>197</sup>

5. Furthermore, the Commission finds that Ameren Missouri still needs a fuel adjustment clause to help alleviate the effects of regulatory lag as net fuel costs continue to rise. Ameren Missouri's regulatory lag problems have not improved since its last rate case. In recent years, the company has been unable to earn its allowed rate of return,<sup>198</sup> and in large part, that problem is due to fuel-related issues. Even with the fuel adjustment clause in place, Ameren Missouri's return on equity for the year ending December 2009, was only 7.27 percent. Ameren Missouri's retail operating income for the test year would have been approximately \$30 million lower if the fuel adjustment clause had not been in effect, further reducing the company's ability to earn its allowed return.<sup>199</sup> In addition, Ameren Missouri still must compete in the capital markets with other utilities and the vast majority of those utilities have fuel adjustment clauses.<sup>200</sup>

**Conclusions of Law:**

A. Section 386.266.1, RSMo (Supp. 2010), the statute that allows the Commission to establish a fuel adjustment clause provides as follows:

Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

Subsection 4 of that statute sets out some of the provisions that must be included in a fuel adjustment clause as follows:

The commission shall have the power to approve,

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<sup>197</sup> Barnes Direct, Ex. 102, Page 7, Lines 2-4.

<sup>198</sup> Weiss Direct, Ex. 130, Pages 33-34, Lines 12-23, 1-4.

<sup>199</sup> Barnes Direct, Ex. 102, Pages 7-8, Lines 22-23, 1-6.

<sup>200</sup> Transcript, Page 1516, Lines 22-24.

modify, or reject adjustment mechanisms submitted under subsections 1 to 3 of this section only after providing the opportunity for a full hearing in a general rate proceeding, including a general rate proceeding initiated by complaint. The commission may approve such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation, provided that it finds that the adjustment mechanism set forth in the schedules:

(1) *Is reasonably designed to provide the utility with a sufficient opportunity to earn a fair return on equity;*

(2) Includes provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest at the utility's short-term borrowing rate, through subsequent rate adjustments or refunds;

(3) In the case of an adjustment mechanism submitted under subsections 1 and 2 of this section, includes provisions requiring that the utility file a general rate case with the effective date of new rates to be no later than four years after the effective date of the commission order implementing the adjustment mechanism. ...

(4) In the case of an adjustment mechanism submitted under subsections 1 or 2 of this section, includes provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently incurred costs plus interest at the utility's short-term borrowing rate. (emphasis added)

Subsection 4(1) is emphasized because that is the key requirement of the statute. Any fuel adjustment clause the Commission allows Ameren Missouri to implement must be reasonably designed to allow the company a sufficient opportunity to earn a fair return on equity.

B. Subsection 7 of the fuel adjustment clause statute provides the Commission with further guidance, stating the Commission may:

take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any

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other changes in business risk experienced by the corporation.

Finally, subsection 9 of that statute requires the Commission to promulgate rules to “govern the structure, content and operation of such rate adjustments, and the procedure for the submission, frequency, examination, hearing and approval of such rate adjustments.” In compliance with the requirements of the statute, the Commission promulgated Commission Rule 4 CSR 240-3.161, which establishes in detail the procedures for submission, approval, and implementation of a fuel adjustment clause.

C. Specifically, Commission Rule 4 CSR 240-3.161(3) establishes minimum filing requirements for an electric utility that wishes to continue its fuel adjustment clause in a rate case subsequent to the rate case in which the fuel adjustment clause was established. Ameren Missouri has met those filing requirements.

**Decision:**

Ameren Missouri still needs to have a fuel adjustment clause in place to help alleviate the effects of regulatory lag if it is to have a reasonable opportunity to earn a fair return on its investments. The Commission concludes that Ameren Missouri should be allowed to continue to implement the previously approved fuel adjustment clause.

**B. Should the sharing percentage in Ameren Missouri's FAC be changed from 95/5 percent to 85/15 percent?**

**Findings of Fact:**

**Introduction:**

6. While Staff did not oppose the continuation of Ameren Missouri's fuel adjustment clause, it advised the Commission to modify the sharing mechanism within the fuel adjustment clause to increase the percentage of costs and income absorbed or retained by Ameren Missouri from 5 percent to 15 percent. Public Counsel supports that proposed modification.

7. Staff offered four reasons why the sharing percentage should be changed. First, Staff initially gave Ameren Missouri credit for asking that its net base fuel costs be rebased in this rate case. Staff explained that the request to rebase those costs showed that Ameren Missouri has a proper incentive to avoid forfeiting the 5 percent share it would lose under the fuel adjustment clause if its net base fuel costs were not rebased.<sup>201</sup> However, later in the case, Staff turned that positive factor

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<sup>201</sup> Staff Report - Revenue Requirement / Cost of Service, Ex. 201, Page 112, Lines 2-9.

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into a negative by claiming that Ameren Missouri's willingness to agree to a level of off-system sales revenue that the company indicated was likely to be too low, showed that the company did not have a proper incentive to get it right.<sup>202</sup> Second, Staff claims that the results of a recent prudence audit of Ameren Missouri's fuel adjustment clause in File No. EO-2010-0255 justify imposing a larger sharing percentage on Ameren Missouri.<sup>203</sup> Third, Staff asserts that a larger sharing percentage might have provided Ameren Missouri a greater incentive to avoid the miscalculation of an input into its FAC rate that it identified in the true-up of the first recovery period of its fuel adjustment clause.<sup>204</sup> Fourth, and finally, Staff claims that because Ameren Missouri's off-system sales are down since it implemented a fuel adjustment clause, perhaps it does not have sufficient incentive to maximize off-system sales.<sup>205</sup>

8. In addition to Staff's concerns, Public Counsel points out that one of the incentives Ameren Missouri has used in past cases to justify use of the 95/5 sharing mechanism has gone away. Ameren Missouri is no longer involved in a coal pool purchasing arrangement with its unregulated merchant generation plants in Illinois and thus no longer shares the unregulated affiliates' profit motive to minimize its coal costs.<sup>206</sup> The Commission will address each of Staff and Public Counsel's concerns in turn.

**Specific Findings of Fact:**

9. In her rebuttal testimony, Ameren Missouri's witness, Lynn Barnes, testified that she believes the net base fuel costs used in calculating rates for this case are likely to be lower than actual future costs because the three-year historical average used to calculate those costs includes power prices that are higher than Ameren Missouri is likely to experience in the future. As a result, Ameren Missouri believes it will likely need to absorb more net fuel costs under the existing 95/5 sharing mechanism.<sup>207</sup> Staff turned that argument against Ameren Missouri by claiming that if the company had a sufficient incentive under the 95/5 sharing mechanism it would have fought harder to establish a proper determination of net base fuel costs.<sup>208</sup>

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<sup>202</sup> Mantle Surrebuttal, Ex. 218, Page 12, Lines 5-7.

<sup>203</sup> Staff Report – Revenue Requirement / Cost of Service, Ex. 201, Page 113, Lines 15-20.

<sup>204</sup> Staff Report – Revenue Requirement / Cost of Service, Ex. 201, Page 114, Lines 7-10.

<sup>205</sup> Staff Report – Revenue Requirement / Cost of Service, Ex. 201, Page 115, Lines 5-7.

<sup>206</sup> Kind Rebuttal, Ex. 302, Page 15, Lines 16-23.

<sup>207</sup> Barnes Rebuttal, Ex. 103, Page 8, Lines 1-13.

<sup>208</sup> Mantle Surrebuttal, Ex. 218, Page 12, Lines 5-7.

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10. The fuel cost issues about which Staff expressed a concern were settled for this case by a stipulation and agreement signed by Staff and approved by the Commission.<sup>209</sup> Ameren Missouri's witnesses indicated that the off-system sales component of those fuel costs were based on a three-year historical average of actual off-system sales rather than a projection of future sales that the company believes would better reflect the amount of sales it is likely to make in the future. Nevertheless, Ameren Missouri accepted the use of the historical average sales as part of the settlement.

11. Staff argues that Ameren Missouri's willingness to accept what it believes to be a flawed basis for the calculation demonstrates that it does not have a sufficient incentive to "get it right." The Commission finds that Ameren Missouri's pragmatic acceptance of the use of historical average sales in the calculation of future off-system sales simply reflects the company's acceptance of the position the Commission clearly stated in previous Ameren Missouri rate case.

12. This issue was presented to the Commission in File Number ER-2007-0002. In that case, certain parties argued the Commission should establish the amount allowed for off-system sales based on Ameren Missouri's future budgets. In refusing to allow for the use of future budgeted amounts, the Commission stated:

[s]ince the Commission uses historical expenses and revenues to set rates, it would be fundamentally unfair to reach forward to grab a single budget item to reduce AmerenUE's cost of service, while ignoring other anticipated costs that might increase that cost of service.<sup>210</sup>

Far from evidencing a lack of incentive to "get it right", Ameren Missouri's decision to settle the fuel cost issue simply illustrates the company's willingness to comply with a position clearly stated in a recent Commission decision.

13. Staff's second argument asserts that an 85/15 sharing mechanism is appropriate because the Commission made a finding that Ameren Missouri acted imprudently in its review of the company's first

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<sup>209</sup> Third Non-Unanimous Stipulation and Agreement, filed May 6, 2011, and approved by the Commission on June 1, 2011.

<sup>210</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area*, Case No. ER-2007-0002, Report and Order, May 22, 2007, Page 32.



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prudence review in file number EO-2010-0255.<sup>211</sup> The Commission did find that Ameren Missouri acted imprudently in that prudence review. However, the imprudence that the Commission found was related to Ameren Missouri's failure to flow revenue received from certain contracts through the fuel adjustment clause. Ameren Missouri had entered into those contracts in an attempt to replace a portion of the revenue it lost when production and the use of electricity was reduced at the Noranda aluminum smelter because of a January 2009 ice storm. Despite disagreeing with Ameren Missouri regarding the proper interpretation of a provision of the fuel adjustment clause tariff, the Commission did not find that Ameren Missouri had acted imprudently in deciding to enter into those replacement contracts. In short, the Commission's decision in EO-2010-0255 does not support the argument that Ameren Missouri needs a larger financial incentive within the fuel adjustment clause.

14. Staff's third argument is that a larger sharing percentage within the fuel adjustment clause might have provided Ameren Missouri with a greater incentive to avoid the miscalculation of an input into its fuel adjustment clause rate that was identified in the recent true-up of the first recovery period under that fuel adjustment clause. In that case, ER-2010-0274, a mutual mistake by Staff and Ameren Missouri about the proper calculation of an input resulted in Ameren Missouri collecting less money than it should have collected under the fuel adjustment clause. Extensive testimony was received regarding the details of that mistake, but that evidence did not show that giving Ameren Missouri a greater financial incentive by increasing the sharing percentage of the fuel adjustment clause would have made the mistake less likely to have occurred.

15. Staff's fourth argument asserts that a recent decline in Ameren Missouri's off-system sales might be attributable to a reduction in the company's incentive to make those sales. Staff points out that Ameren Missouri's total off-system sales decreased in four of the five accumulation periods since the Commission first approved Ameren Missouri's fuel adjustment clause.<sup>212</sup> However, the reduction in off-system sales that Staff notes is entirely explained by an increase in retail sales during the same period.<sup>213</sup> More retail sales means less power is

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<sup>211</sup> *In the Matter of the First Prudence Review of Costs Subject to the Commission-Approved Fuel Adjustment Clause of Union Electric Company, d/b/a Ameren Missouri*, EO-2010-0255, Report and Order, April 27, 2011.

<sup>212</sup> Staff Report, Revenue Requirement/Cost of Service, Ex. 201, Page 115, Lines 1-4.

<sup>213</sup> Haro Rebuttal, Ex. 125, Page 19, Lines 1-8.

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available to sell off-system. In addition, during this period Ameren Missouri experience several major planned generator outages that reduce the amount of electricity available for off-system sales.<sup>214</sup> Ultimately, under cross-examination, Staff's witness conceded that she was not contending that Ameren Missouri lacks sufficient incentive to make off-system sales.<sup>215</sup>

16. The final argument offered to support the contention that Ameren Missouri needs additional incentives to minimize its fuel costs was initially offered by Public Counsel's witness, Ryan Kind. He pointed out that the pool arrangement for purchasing coal that Ameren Missouri formerly had with its unregulated affiliated generating company in Illinois has ended.<sup>216</sup> In its report and order that initially established the 95/5 sharing mechanism for Ameren Missouri's fuel adjustment clause, the Commission noted that Ameren's strong incentive to minimize coal costs for its unregulated operations would also benefit Ameren Missouri. The Commission cited that incentive as a justification for believing that a 95/5 sharing mechanism would provide the company with a sufficient incentive to minimize its fuel costs.<sup>217</sup>

17. Ameren Missouri is no longer in a coal pool arrangement with its Illinois affiliates because FERC rule changes have forbidden the practice and because it was no longer financially beneficial to Ameren Missouri to be involved in the coal pool.<sup>218</sup> Thus, one incentive to minimize one aspect of the company's fuel costs has been eliminated. However, that was only one incentive, and its elimination does not have a significant impact on Ameren Missouri's remaining overall incentive to minimize its fuel purchasing costs.

18. No other electric utility in Missouri buys coal under a coal purchasing pool arrangement and the Commission has allowed those utilities to implement their fuel adjustment clauses using a 95/5 sharing mechanism. Indeed, no other electric utility in the country buys its coal under a coal purchasing arrangement since such arrangements are no longer allowed by FERC rules, yet 90 percent of electric utilities operate

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<sup>214</sup> Haro Rebuttal, Ex. 125, Pages 19-21.

<sup>215</sup> Transcript, Pages 1605-1606, Lines 23-25, 1.

<sup>216</sup> Kind Rebuttal, Ex. 302, Page 15, Lines 13-23.

<sup>217</sup> *In the Matter of Union Electric Company, d/b/a Ameren UE's Tariffs to Increase its Annual Revenues for Electric Service*, Report and Order, Case No. ER-2008-0318, January 27, 2009, Page 73

<sup>218</sup> Transcript, Page 1460, Lines 3-20.

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using fuel adjustment clauses and the vast majority of those have no percentage sharing mechanism of any kind.<sup>219</sup>

19. Furthermore, changing the sharing percentage without a good reason to do so would lead investors to question the future of Ameren Missouri's fuel adjustment clause. In the words of Gary Rygh, a managing director at Barclays Capital, Inc.:

If the Commission were willing to significantly degrade the existing FAC and pass-through mechanism apart from findings in the established review processes, and despite the lack of credible evidence that Ameren Missouri in fact is mismanaging its net fuel costs, investors would view such a change as capricious and designed to inflict significant harm on the Company.<sup>220</sup>

Because of investors concerns, ratepayers would be burdened with excessive costs each time Ameren Missouri accesses the capital markets.<sup>221</sup>

20. Most significantly, a change in the sharing mechanism to require Ameren Missouri to absorb 15 percent of net fuel cost changes instead of the current 5 percent would impose a significant financial burden on the company. If the proposed 85/15 sharing mechanism had been in place since the fuel adjustment clause was put into effect instead of the actual 95/5 sharing mechanism, Ameren Missouri would have been required to absorb an additional \$22 million in net fuel costs.<sup>222</sup> That would be a heavy burden on a company that is already having difficulty earning its allowed rate of return.

**Conclusions of Law:**

There are no additional conclusions of law for this sub-issue.

**Decision:**

Staff's stated reasons for experimenting with adjusting the sharing mechanism of Ameren Missouri's fuel adjustment clause to implement an 85/15 split do not withstand scrutiny. Imposing a significant financial burden on the company simply to experiment with an alternative sharing percentage would be unfair to the company. The Commission finds that there is no reason to change the sharing percentages in the fuel adjustment clause under which Ameren Missouri has operated for the past several years. The Commission will retain the

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<sup>219</sup> Rygh Rebuttal, Ex. 126, Page 16, Lines 14-15.

<sup>220</sup> Rygh Rebuttal, Ex. 126, Page 16, Lines 3-8.

<sup>221</sup> Rygh Rebuttal, Ex. 126, Page 17, Lines 3-4.

<sup>222</sup> Transcript, Page 1583, Lines 3-10.

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current 95/5 sharing mechanism included in Ameren Missouri's fuel adjustment clause.

**C. Should the length of the recovery periods for the FAC be reduced from twelve (12) months to eight (8) months?**

**Findings of Fact:**

**Introduction:**

21. Ameren Missouri's current FAC tariff provides that the company accumulates fuel costs during accumulation periods that are four months long. Two months after the end of the accumulation period, Ameren Missouri files tariff sheets to change its fuel and purchased power adjustment (FPA) that have a 60-day effective date. The Commission must act to approve or reject that change within 60 days. Once the change in the FPA goes into effect, Ameren Missouri collects the difference between the actual total energy costs and the base energy cost over a recovery period of 12 months.<sup>223</sup>

22. The current process for cost recovery under the fuel adjustment clause means that Ameren Missouri must wait up to 22 months before fully recovering its net fuel costs.

23. Staff proposes to reduce that lag period by four months by shortening the cost recovery period from 12 months to 8 months. That change would allow Ameren Missouri to recover its net fuel costs more quickly.

24. Not surprisingly, Ameren Missouri supports the proposed reduction in the recovery period. MIEC however opposes that change, arguing that the 12-month recovery period moderates the adjustment by spreading any recovery or refund over a full calendar year. MIEC contends spreading the recovery or refund over a full year avoids concentrating the reconciliation in a shortened period where some classes could have a disproportionate share of usage and thereby incur a disproportionate share of the recovery costs or collect a disproportionate share of any refund.<sup>224</sup>

**Specific Findings of Fact:**

25. Changing the 12-month recovery period to an 8-month recovery period will not change the total amount of net fuel costs that Ameren Missouri will be able to recover from its customers. The change will however allow the company to recover those costs more quickly and thereby improve Ameren Missouri's cash flow.<sup>225</sup>

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<sup>223</sup> Staff Report, Revenue Requirement/Cost of Service, Ex. 201, Page 117, Lines 13-21.

<sup>224</sup> Brubaker Rebuttal, Ex. 405, Page 14, Lines 11-18.

<sup>225</sup> Transcript, Page 1737, Lines 15-21.

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26. Improving cash flow is important to Ameren Missouri because it has been suffering from the effects of regulatory lag and as a result has failed to earn its allowed return on its investment over the past several years.<sup>226</sup>

27. Moving from a 12-month recovery period to an 8 month recovery period will improve Ameren Missouri's cash flow, but also has the effect of increasing the volatility of the fuel adjustment clause. In other words, the necessary adjustments will tend to be larger, either up or down, and customers will pay the adjusted rates sooner.<sup>227</sup>

28. MIEC suggests that changing the recovery period from 12 months to 8 months could have the effect of concentrating the reconciliation into a shortened period where some classes could have a disproportionate share of usage. For example, the residential class, which uses a lot of electricity in the summer for air conditioning, could pay a disproportionate share during an 8-month recovery period that includes the summer months. However, a chart presented by Ameren Missouri's witness, Lynn Barnes, demonstrates that there are only minimal differences in class percentages of kilowatt-hour sales regardless of whether a 12-month or 8-month recovery period is used.<sup>228</sup> Thus, concerns about concentration of the reconciliation are unfounded.

**Conclusions of Law:**

There are no additional conclusions of law for this sub-issue.

**Decision:**

The decision on this sub-issue comes down to a weighing of the need to increase Ameren Missouri's cash flows against the desire to reduce the volatility of recovery of net fuel costs under the fuel adjustment clause. There is nothing legally correct or preordained about either a 12-month or an 8-month recovery period, the recovery period could just as easily be set at 6, 9, or 18 months, or at some point in between. On balance, the Commission concludes that improved cash flows for Ameren Missouri outweigh concerns about an increase in volatility in recovery under the fuel adjustment clause. The recovery period shall be changed to 8 months.

**D. Should the Company have the ability to adjust the FPAC rate for errors in calculations that may have occurred since the FAC Rider was granted to Ameren Missouri?**

**Findings of Fact:**

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<sup>226</sup> Weiss Direct, Ex. 130, Pages 33-34, Lines 12-23, 1-4.

<sup>227</sup> Transcript, Pages 1570-1571, Lines 20-25, 1-20.

<sup>228</sup> Barnes Surrebuttal, Ex. 104, Pages 2-3, Lines 4-18, 1-4.

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**Introduction:**

29. In addition to the broad issues regarding the fuel adjustment clause tariff that have previously been discussed, Ameren Missouri has submitted specific proposed language for that tariff.<sup>229</sup> The exemplar tariff proposed by Ameren Missouri would add the following clause to the section regarding true-up of the FAC:

The true-up adjustment shall be the difference between the revenue billed and the revenues authorized for collection during the Recovery Period, *plus amounts necessary to correct over- or under-collections due to errors made in calculating adjustments to the FPA<sub>C</sub> rate that impacted the Recovery Period.* (new language is in *italics.*)

30. Staff objects to the inclusion of the new language proposed by Ameren Missouri because under the formula used to calculate the FAC adjustment, each succeeding FPA<sub>C</sub> is linked to all previous FPA<sub>C</sub>s. Staff is concerned that the additional language proposed by Ameren Missouri would allow the company to claim an adjustment during any true-up for any perceived discrepancy in calculating the FPAs that have occurred since March 1, 2009, when Ameren Missouri's fuel adjustment clause first went into effect. Staff is concerned that this provision would complicate the true-up process and would deny finality to Commission decisions regarding the true-up.<sup>230</sup>

**Specific Findings of Fact:**

31. This disagreement between Staff and Ameren Missouri is related to a dispute pending before the Commission in a current Ameren Missouri true-up, File Number ER-2010-0274. In that case, Ameren Missouri sought to adjust its true-up amounts to collect a sum of money that it had failed to collect due to an error in calculating the FPA<sub>C</sub>. The Commission had not yet decided that case at the time this case was heard, but on June 29, 2011, issued a Report and Order that allowed Ameren Missouri to collect the amount necessary to correct the identified error.<sup>231</sup>

32. The tariff language proposed by Ameren Missouri would not be limited to the particular error that the Commission found could be

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<sup>229</sup> Barnes Rebuttal, Ex. 103, Schedule LMB-ER4.

<sup>230</sup> Roos Surrebuttal, Ex. 225, Pages 4-5, Lines 17-24, 1-3.

<sup>231</sup> *In the Matter of the First True-Up Filing Under the Commission-Approved Fuel Adjustment Clause of Union Electric Company, d/b/a Ameren Missouri*, File No. ER-2010-0274, Report and Order, June 29, 2011.

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corrected in File Number ER-2010-0274 and would instead provide Ameren Missouri with broad authority to correct other errors that might be identified in the future.

**Conclusions of Law:**

There are no additional conclusions of law for this sub-issue.

**Decision:**

The Commission has found in favor of Ameren Missouri's position in File Number ER-2010-0274, eliminating the immediate need for the language proposed by the company. The Commission is persuaded by Staff's concern that the proposed language would affect the finality of future true-up decisions and would prefer to continue to decide these matter on a case-by-case basis rather than allow Ameren Missouri's tariff to set a standard for all future cases. Therefore, the Commission will decide this issue in favor of Staff and directs Ameren Missouri to strike the disputed language from the tariff.

**E. What is the appropriate tariff language to reflect any modifications or clarifications to Ameren Missouri's FAC?**

**Findings of Fact:**

33. This sub-issue is about the choice of one word. In the fuel adjustment portion of the Ameren Missouri's tariff, which is known as a rider, Sheet 98.6 refers to prudence reviews of FAC costs and requires that costs be returned to ratepayers if the Commission determines that the costs were imprudently incurred "or incurred in violation of the terms of this *tariff*" (emphasis added).<sup>232</sup> Staff would change the word "tariff" in the quoted section to "rider",<sup>233</sup> reasoning that using the word "tariff" in that manner could be interpreted as a expansion of the true-up to include all other aspects of Ameren Missouri's broader tariff.<sup>234</sup>

**Conclusions of Law:**

There are no additional conclusions of law for this sub-issue.

**Decision:**

The Commission agrees with Staff that the prudence review is limited to matters addressed in this fuel adjustment rider rather than in Ameren Missouri's broader tariff. Therefore, the language proposed by Staff is more precise and shall be adopted.

**9. LED Lighting: Should the Commission order Ameren Missouri, not later than twelve (12) months following the effective date of the Report & Order in this case, to complete its evaluation of**

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<sup>232</sup> Barnes Rebuttal, Ex. 103, Schedule LMB-ER4.

<sup>233</sup> Roos Surrebuttal, Ex. 225.

<sup>234</sup> Transcript, Page 1411, Lines 3-7.

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**LED SAL systems, and, based on the results of that evaluation, either file a proposed LED lighting tariff(s) or indicate why such tariff(s) should not be filed?**

**Findings of Fact:**

**Introduction:**

1. Staff believes that Light Emitting Diode (LED) Street and Area Lighting (SAL) systems are the most energy efficient SAL fixtures currently available and would like Ameren Missouri to take steps to make this form of technology available to its customers.<sup>235</sup> To that end, Staff asks the Commission to order Ameren Missouri to complete its evaluation of LED SAL systems and within the next year file a proposed LED lighting tariff or provide the Commission with an update on when it will file a proposed LED lighting tariff.<sup>236</sup>

2. Ameren Missouri is not as enthusiastic about the future of LED lighting. While it intends to continue studying the LED alternative, it does not want the Commission to order it to file an LED tariff at this time.<sup>237</sup>

**Specific Findings of Fact:**

3. Ameren Missouri currently has approximately 212,800 SAL systems for 1,568 public street and municipal lighting customers in its service territory. Those lights use a total of 137,000 MWh. Most of the existing street lighting in Ameren Missouri's service area uses high-pressure sodium or mercury vapor lamps.<sup>238</sup>

4. Light Emitting Diodes are composed of a semiconducting chip complete with a junction for electrons to move across. As the electrons move across the junction, they release photons, creating light at very high efficiencies.<sup>239</sup>

5. LED street lighting has certain advantages over other street lighting alternatives including improved efficiency, longer lamp life, improved night visibility, reduced maintenance costs, no mercury, lead, or other known disposal hazards, and it permits the use of programmable controls.<sup>240</sup>

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<sup>235</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Page 34, Lines 1-11.

<sup>236</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Pages 32-33, Lines 11-22, 1-3.

<sup>237</sup> Shoff Rebuttal, Ex. 149, Page 4, Lines 1-6.

<sup>238</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Page 33, Lines 5-19.

<sup>239</sup> Shoff Rebuttal, Ex. 149, Page 4, Lines 8-12.

<sup>240</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Page 34, Lines 1-11.



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6. LED street lighting technology is still under development and technical problems remain. At the moment, energy savings benefits do not exceed the cost of the technology.<sup>241</sup>

7. Ameren Missouri is currently working with the Electric Power Research Institute (EPRI) to test and evaluate the potential of currently available LED lighting as part of a national demonstration project. The project started in 2009 and will end sometime in the fourth quarter of 2011.<sup>242</sup>

8. In the recent Kansas City Power & Light rate case, ER-2010-0355, the Commission approved a stipulation and agreement in which the signatories invited the Commission to host a workshop regarding LED street lighting issues.<sup>243</sup>

9. If Ameren Missouri were to offer company-owned LED street lighting under its tariff, it would have to maintain an inventory of LED lighting equipment for which there may be limited demand at a cost to the company and ultimately its ratepayers.<sup>244</sup>

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

The Commission agrees with Staff that LED street lighting is an exciting technology that should be examined and implemented if appropriate. Staff does not ask the Commission to order Ameren Missouri to immediately file an LED tariff and the Commission will not do so. Instead, Staff asks the Commission to order Ameren Missouri to continue examining the potential of LED lighting and to either file a tariff within one year, or file a status report indicating when it will be able to file such a tariff. Staff's request is reasonable and the Commission will direct Ameren Missouri to either file an LED street lighting tariff by July 31, 2012, or to provide a status report to Staff by that date, indicating when it will be able to file such a tariff.

The Commission emphasizes that Ameren Missouri does not have to file a tariff until it is appropriate to do so. If its further study of the potential of LED street lighting reveals that such lighting will not be a benefit to its customers, Ameren Missouri may inform the Staff of that conclusion in its status report.

**10. Solar Rebates Accounting Authority Order (AAO):**

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<sup>241</sup> Shoff Rebuttal, Ex. 149, Page 7, Lines 14-16.

<sup>242</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Page 35, Lines 10-17.

<sup>243</sup> Transcript, Pages 2148-2149.

<sup>244</sup> Cooper Rebuttal, Ex. 134, Page 15, Lines 5-21.

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**A. What is the appropriate method – RESRAM or an Accounting Authority Order (AAO) – for Ameren Missouri to recover the costs it incurs for compliance with the Missouri Renewable Energy Standard (RES) after the true-up date in this case (February 28, 2011)?**

**Findings of Fact:**

**Introduction:**

1. As explained in more detail in the Conclusions of Law for this issue, Missouri's Renewable Energy Standard law, Section 393.1020, et seq., RSMo (Supp. 2010), requires electric utilities to incur certain costs related to the adoption of renewable energy technology. Ameren Missouri asks the Commission to grant it an accounting authority order to defer the cost of solar rebates, the cost to purchase renewable energy or renewable energy credits and other related costs incurred after February 28, 2011, the true-up date for this case, until the effective date of new rates in the company's next rate case.<sup>245</sup>

2. Staff does not object to Ameren Missouri's request to defer these costs for later recovery, but contends the company should be required to use a different device known as a Renewable Energy Standard Rate Adjustment Mechanism (RESRAM) for that purpose rather than an Accounting Authority Order (AAO).<sup>246</sup>

**Specific Findings of Fact:**

3. This is a legal rather than a factual issue and there are no other relevant facts.

**Conclusions of Law:**

A. Missouri's Renewable Energy Standard (RES) law, found at Sections 393.1020, 1025, and 1030, RSMo (Supp. 2010), require electric utilities, such as Ameren Missouri, to incur certain costs to comply with the requirements of the law.

B. Commission Rule 4 CSR 240-20.100(6) allows an electric utility to file an application and rate schedules to establish a Renewable Energy Standard Rate Adjustment Mechanism (RESRAM) that would allow the utility to recover prudently incurred costs relating to compliance with RES requirements. The regulation allows such an application to be filed either within or outside a general rate proceeding. If it had wished to do so, Ameren Missouri could have applied for a RESRAM in this case.

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<sup>245</sup> Weiss Direct, Ex. 130, Page 36, Lines 6-10.

<sup>246</sup> Taylor Rebuttal, Ex. 229, Page 3, Lines 1-9.

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C. However, Commission Rule 4 CSR 240.20.100(6)(D) specifically offers the electric utility an alternative to the use of a RESRAM. That section of the regulation states:

Alternatively, an electric utility may recover RES compliance costs without the RESRAM procedure through rates established in a general rate proceeding. In the interim between general rate proceedings the electric utility may defer the costs in a regulatory asset account, and monthly calculate a carrying charge on the balance in that regulatory asset account equal to its short-term cost of borrowing. All questions pertaining to rate recovery of the RES compliance costs in a subsequent general rate proceeding will be reserved to that proceeding, including the prudence of the costs for which rate recovery is sought and the period of time over which any costs allowed rate recovery will be amortized. Any rate recovery granted to RES compliance costs under this alternative approach will be fully subject to the retail rate impact requirements set forth in section (5) of this rule.

This section of the regulation describes exactly the alternative approach that Ameren Missouri has chosen to pursue in this rate case.

D. Ameren Missouri's decision to request an AAO in this case instead of the RESRAM that Staff would prefer it to have is in full compliance with the provisions of the Commission's rule.

E. In its reply brief, Staff sets forth an argument that Ameren Missouri's use of an AAO will allow it to recover a greater amount of carrying costs than if it were required to use a RESRAM.<sup>247</sup> Staff's argument is not supported by any testimony or other evidence in the record, and furthermore it is irrelevant. The Commission's rule specifically allows Ameren Missouri to use an AAO to defer recovery of its costs as an alternative to recovering those costs through a RESRAM. Presumably, Ameren Missouri chose to use the recovery method that was most favorable to it, as it is allowed to do by the regulation. If Staff does not like the alternative allowed by the regulation, it can ask the Commission to change the regulation, but for purposes of this case, the Commission is bound by that regulation and cannot deny Ameren Missouri the use of its chosen alternative.

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<sup>247</sup> Staff's Reply Brief, Pages 64-65.

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**Decision:**

Ameren Missouri may defer its RES compliance costs through an Accounting Authority Order as permitted by Commission Rule 4 CSR 240-20.100(6)(D).

**B. If the Commission determines that an AAO is appropriate, should the Company be authorized in this case to implement an AAO to recover the costs it incurred for compliance with the RES before the true-up date in this case?**

**C. What amount of solar rebate costs should Ameren Missouri be allowed to include in the revenue requirement used to set rates in this case?**

**Findings of Fact:**

**Introduction:**

1. This issue concerns the amount of RES compliance costs that Ameren Missouri should be allowed to recover in this case and means by which it should be allowed to recover those costs.

2. The renewable energy portfolio requirements of the RES law are still rather new and Ameren Missouri has not yet incurred many of the costs that it may ultimately have under that law. For purposes of this case, the only RES compliance costs in question are the cost of solar rebates paid by Ameren Missouri to its customers who have installed or expanded solar electric systems on the customer's premises.

3. Staff and Ameren Missouri agree that those solar rebate costs should be treated as an expense item and immediately recovered as an on-going operations and maintenance cost.<sup>248</sup> MIEC contends the solar rebate costs should be amortized over a period of ten years.<sup>249</sup>

4. Although they agree that the solar rebate costs should be expensed rather than amortized, Staff and Ameren Missouri disagree about the amount that Ameren Missouri should be allowed to recover.

**Specific Findings of Fact:**

5. MIEC's witness, Maurice Brubaker, argues that the company's expense of paying the solar rebates should be amortized over ten years to reflect the minimum ten year expected life of the installed solar equipment.<sup>250</sup> He reasons that the company and its ratepayers will benefit from the equipment for at least ten years and therefore the costs that make that benefit possible should be recovered over ten years.

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<sup>248</sup> Weiss Rebuttal, Ex. 131, Page 16, Lines 2-6.

<sup>249</sup> Brubaker Direct, Ex. 403, Page 20, Lines 8-9.

<sup>250</sup> Brubaker Direct, Ex. 403, Pages 19-20.

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6. Ameren Missouri does not own or operate the solar equipment for which it is required to pay a rebate. That equipment is the property of the customer who has sole control and responsibility for them and will primarily benefit from the use of the equipment.<sup>251</sup> Thus, to Ameren Missouri, payment of the solar rebates is simply an expense imposed upon it by the statute. For that reason, a long amortization period as proposed by MIEC is inappropriate.

7. The other half of this issue concerns the amount that Ameren Missouri should be allowed to recover for past solar rebate payments and how much should be included in rates as a going-forward expense.

8. In the 2010 calendar year, Ameren Missouri incurred \$487,782 in solar rebate costs. Staff would allow Ameren Missouri to include that amount in rates on a going forward basis.<sup>252</sup> During the twelve months ending on the true-up date of February 28, 2011, Ameren Missouri incurred \$885,266 in solar rebate costs. Ameren Missouri asks the Commission to include that amount in rates on a going forward basis.<sup>253</sup>

9. The fact that solar rebate costs are substantially higher for the twelve months ending at the February 28, 2011 true-up date than they were for the 2010 calendar year indicates that such costs are increasing. For that reason, Ameren Missouri's actual expenses through the true-up period are a better indicator of the amount of expenses the company will likely incur going forward and forward looking rates should be based on that amount.

10. Another aspect of this issue concerns whether Ameren Missouri should be permitted to accumulate in its AAO the solar rebates paid from the beginning of the program until the new rates become effective in this case.

11. The treatment of its solar rebate expenses proposed by Ameren Missouri is appropriate because the company started to incur those expenses after the company's last rate case and therefore those expenses were not reflected in the rates established in that case. The recovery of those costs and the others deferred in the AAO will then be decided in the next rate case.<sup>254</sup>

12. Staff suggests that those costs should not be accumulated in the AAO but should instead be recovered in this rate case. But Staff does

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<sup>251</sup> Weiss Rebuttal, Ex. 131, Page 17, Liens 6-7.

<sup>252</sup> Transcript, Page 2192, Lines 1-4.

<sup>253</sup> Weiss True-Up Direct, Ex. 174, Schedule GSW-TE18-110.

<sup>254</sup> Weiss Rebuttal, Ex. 131, Page 16, Lines 13-23.

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not offer a specific recommendation about how that recovery should be accomplished.

13. The Commission finds that Ameren Missouri shall accumulate the amount it has paid for solar rebates from the beginning of the program until new rates become effective in this case. The recovery of those costs and future costs deferred in the AAO will be decided in Ameren Missouri's next rate case.

**Conclusions of Law**

A. Ameren Missouri has paid rebates to its customer who have installed or expanded solar power equipment pursuant to Section 393.1030.3, RSMo (Supp. 2010), which requires electric utilities to: "make available to its retail customers a standard rebate offer of at least two dollars per installed watt for new or expanded solar electric systems sited on customers' premises, up to a maximum of twenty-five kilowatts per system, that become operational after 2009."

B. Staff argues that Ameren Missouri's solar rebate expenses for the 2010 calendar year should be used to establish the company's rates going forward because Commission Rule 4 CSR 240-20.100(5)(A) requires that the retail rate impact for purposes of determining whether the 1 percent cap has been exceeded is to be "calculated on an incremental basis for each planning year ...". However, the regulations requirement for the use of a planning year to calculate retail rate impact does not mean that the Commission must also use a planning year to determine an appropriate amount of expense to include in rates on a going forward basis.

**Decision:**

Ameren Missouri shall include \$885,266 in its rates for ongoing solar rebate expenses. Ameren Missouri shall accumulate in an AAO the amount it has paid for solar rebates from the beginning of the program until new rates become effective in this case. The recovery of those costs and future costs deferred in the AAO will be decided in Ameren Missouri's next rate case.

**11. Union Issues:**

**A. Does the Commission have the authority to order Ameren Missouri to do the following:**

**(1) Institute or expand its training programs within specified time periods as a means of investing in its employee infrastructure?**

**(2) Hire specific additional personnel within specified time periods as a means of investing in its employee infrastructure?**

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**(3) Submit to a tracker for its energy delivery distribution system?**

**(4) Submit to a tracker to address the need and efforts to replace the aging workforce?**

**(5) Expend a substantial portion of the rate increase from this proceeding on investing and re-investing in its regular employee base in general, including hiring, training and utilizing its internal workforce to maintain its normal and sustained workload?**

**(6) Use a portion of the rate increase from this proceeding to replace equipment, wires and cable which have out lived their anticipated life?**

**B. If the Commission does have the authority, should it order Ameren Missouri to take one or more of the steps listed above?**

**Findings of Fact:**

**Introduction:**

1. The various unions that represent some of Ameren Missouri's employees appeared at the hearing to support the company's request for a rate increase. However, they asked the Commission to order Ameren Missouri to spend more money on employee training and to take specific steps to increase its internal workforce so that it will use fewer outside contractors and to replace an aging workforce. The Unions also ask the Commission to order Ameren Missouri to spend more money to replace aging infrastructure. Ameren Missouri contends it is currently providing safe and adequate service and argues the Commission has no authority to manage the day-to-day affairs of the company.

**Findings of Fact:**

2. Michael Walter is the Business Manager of International Brotherhood of Electrical Workers Local 1439, AFL-CIO.<sup>255</sup> He testified that he is concerned about Ameren Missouri's ability to deal with an aging infrastructure and an aging workforce.<sup>256</sup> In particular, he is concerned that Ameren Missouri has not spent enough on training new workers and as a result has over-relied on outside contractors to perform normal and sustained work.<sup>257</sup> In particular, Walter is concerned that Ameren Missouri's trained work force is aging and he sees a need for increased training of new workers capable of stepping in when the

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<sup>255</sup> Walter Direct, Ex. 650, Page 3, Lines 3-4.

<sup>256</sup> Walter Direct, Ex. 650, Page 3, Lines 25-26.

<sup>257</sup> Walter Direct, Ex. 650, Pages 5-8.

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current workforce retires.<sup>258</sup> He asks the Commission to require Ameren Missouri to spend a portion of its rate increase to improve training and increase the portion of the workload performed by its internal workforce.<sup>259</sup>

3. In response to the concerns expressed by the Unions, Commissioner Davis asked Ameren Missouri's witnesses if the company could use extra money for training of its work force. The witness replied that additional money could be used to institute a heavy underground apprentice program.<sup>260</sup> Heavy underground training involves industrial type routing of underground electric lines in the downtown area.<sup>261</sup> The witness testified that \$1,250,000 would be needed for that purpose and explained that that amount would buy needed equipment and would be sufficient to hire nine new journeymen, a supervisor, and a trainer.<sup>262</sup>

4. The Commission finds that the evidence presented by the union witnesses does not demonstrate that Ameren Missouri has failed to supply safe and adequate service to the public. Furthermore, for reasons fully explained in its Conclusions of Law, the Commission does not have the authority to dictate the manner in which Ameren Missouri conducts its business. Therefore, the Commission will not attempt to dictate to the company regarding its use of outside contractors.

5. However, the union witnesses and Ameren Missouri agree that there is a need for improved training. On that basis, the Commission finds that there is a need for additional training to meet the need for skilled heavy underground workers.

6. Therefore, the Commission will add \$1.25 million to Ameren Missouri's cost of service to fund increased training staff.

7. The Commission wants to ensure that all parties are satisfied that the additional training money authorized by this order is well spent. Therefore, the Commission will create a Training Advisory Group initially including Ameren Missouri, the Unions, Staff, and Public Counsel. Other entities may also participate if they wish to do so. The Training Advisory Group will provide input to Ameren Missouri on the design, implementation, and evaluation of the company's additional training programs authorized under this and previous rate case orders. If the Training Advisory Group is unable to reach agreement on any issue

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<sup>258</sup> Walter Direct, Ex. 650, Page 4.

<sup>259</sup> Walter Direct, Ex.650, Pages 7, Lines 28-43.

<sup>260</sup> Transcript, Page 2306, Lines 3-17.

<sup>261</sup> Transcript, Page 2278, Lines 15-18.

<sup>262</sup> Transcript, Page 2307-2308.



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related to the training programs, any member may petition the Commission for further direction.

8. The Unions also ask the Commission to require the company to compile information about its aging electric distribution system and its aging workforce and to submit periodic reports to the Commission's Staff. The Unions did not present any detailed evidence about the information that would be contained in such reports, nor did they demonstrate any need for such reports. The Commission's Staff is able to obtain any information it may want or need from the company without the need and expense of creating any additional reporting requirements.

**Conclusions of Law:**

A. The Commission has the authority to regulate Ameren Missouri, including the authority to ensure that the utility provides safe and adequate service. However, the Commission does not have authority to manage the company. In the words of the Missouri Court of Appeals,

The powers of regulation delegated to the Commission are comprehensive and extend to every conceivable source of corporate malfeasance. Those powers do not, however, clothe the Commission with the general power of management incident to ownership. The utility retains the lawful right to manage its own affairs and conduct its business as it may choose, as long as it performs its legal duty, complies with lawful regulation, and does no harm to public welfare.<sup>263</sup>

Therefore, the Commission does not have the authority to dictate to the company whether it must use internal workforce rather than outside contractors to perform the work of the company, nor does the Commission have the authority to direct the company to spend a portion of the rate increase to replace specific items of equipment.

**Decision:**

The evidence presented by the union does not demonstrate that Ameren Missouri has failed to provide safe and adequate service and the Commission will not dictate to the company whether it must use its internal workforce or outside contractors to perform the company's work. However, the Commission will add \$1,250,000 to Ameren Missouri's cost of service to fund increased training for heavy underground work.

**12. Property Tax:**

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<sup>263</sup> *State ex rel. Harline v. Public Serv. Com'n*, 343 S.W.2d 177, 182 (Mo. App. 1960)

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**A. What amount of property tax expense relating to the Sioux Scrubbers and the Taum Sauk additions the Company seeks to put in rate base in this case should the Commission include in Ameren Missouri's revenue requirement for ratemaking purposes?**

**Findings of Fact:**

**Introduction:**

1. Ameren Missouri pays property taxes on property it owns in Missouri, Illinois, and Iowa.<sup>264</sup> In a stipulation and agreement that the Commission approved in this case, the parties agreed that Ameren Missouri's revenue requirement in this case would include at least \$119 million for payment of such property taxes, based on the amount of property taxes the company paid in 2010.<sup>265</sup> That stipulation and agreement however excluded from the settlement additional property taxes related to the Sioux scrubber and Taum Sauk plant additions. Ameren Missouri and Staff propose to allow the company to include an additional \$10 million in its revenue requirement for those additional property taxes. MIEC proposes to disallow \$2.5 million of additional property taxes associated with the Taum Sauk rebuild and \$7.5 million associated with the addition of the Sioux Scrubbers.<sup>266</sup> That is the basis for this issue.

2. The Sioux scrubber and the Taum Sauk plant additions went into service in 2010. That means they became subject to the state of Missouri's property tax assessment in 2011. Property tax on property owned on January 1 must be paid by December 31 of the same year.<sup>267</sup> That means Ameren Missouri will not pay the additional property tax associated with the Sioux scrubber and the Taum Sauk plant additions until December 31, 2011, ten months after the close of the true-up period for this case.

3. At this point Ameren Missouri cannot know the exact amount of additional taxes it will owe for the Sioux scrubber and the Taum Sauk plant additions because it has not yet received tax bills from the various county assessors. It will not receive those tax bills until September, October, and November.<sup>268</sup>

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<sup>264</sup> Transcript, Page 1285, Lines 23-25.

<sup>265</sup> First Nonunanimous Stipulation and Agreement – Miscellaneous Revenue Requirement Items, filed May 3, 2011.

<sup>266</sup> Meyer Direct, Ex. 400, Page 16, Lines 1-6.

<sup>267</sup> Weiss Rebuttal, Ex. 131, Page 2, Lines 18-23.

<sup>268</sup> Transcript, Page 1306, Lines 5-10.

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4. Before the Sioux scrubber and the Taum Sauk additions were put in service they were subject to property tax as construction work in progress. For regulatory accounting purposes, property taxes on construction work in progress is removed from the company's expenses and instead treated as a capital item that the company recovers through depreciation over the life of the plant.<sup>269</sup> Since the Sioux scrubber and the Taum Sauk additions were still treated as construction work in progress for purposes of the 2010 tax assessments, they were not included in the company's \$119 million property tax bill for 2010 for regulatory purposes. Thus, the Sioux scrubber and the Taum Sauk additions will be entirely new taxed items for purposes of determining the amount of Ameren Missouri's property tax bill that can be recovered as an expense.

5. Generally accepted accounting principles (GAAP) require Ameren Missouri to begin accruing its 2011 tax liabilities on its books at the beginning of the year. Thus, by December 31, 2011, the company will have expensed its entire 2011 tax payments.<sup>270</sup>

6. The amount Ameren Missouri expenses for taxes under the GAAP requirements is based on plant investment on January 1. Average tax rates from 2010, adjusted for estimated changes in tax rates for 2011, are applied to the plant investment amount to determine estimated total taxes for 2011. Ameren Missouri's Manager of Regulatory Accounting, Gary Weiss, testified that that amount is usually fairly accurate.<sup>271</sup> That is the same method that Staff and Ameren Missouri used to calculate 2011 taxes for this case.<sup>272</sup>

7. As a general principle, expenses must be known and measurable before a utility will be allowed to recover those expenses in rates. That does not mean an expense must be known precisely to be included in rates. For example, on this very issue, the parties agreed that Ameren Missouri's tax expenses to be included in going forward rates would be based on the company's 2010 tax bill, even though it is apparent that those taxes may change in future years.

8. MIEC questioned Ameren Missouri's witness, Gary Weiss, about a document from his work papers pertaining to the Sioux scrubber. That document contained the following disclaimer: "We cannot determine with accuracy the anticipated 2011 property taxes pertaining to the Sioux

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<sup>269</sup> Transcript, Page 1321, Lines 13-20.

<sup>270</sup> Transcript, Page 1319, Lines 17-19.

<sup>271</sup> Transcript, Page 1323, Lines 7-18.

<sup>272</sup> Weiss Rebuttal, Ex. 131, Lines 15-22.

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scrubber since the accounts involved are state assessed property.”<sup>273</sup> MIEC contends that this disclaimer is an admission by Ameren Missouri that the 2011 property taxes in question are not known and measurable, and thus not recoverable.

9. However, Weiss explained that the document that includes the disclaimer was created in early 2010. Ameren Missouri property tax department added the disclaimer at a time when the company did not yet have the 2010 assessment and tax rates. He testified that the company now has the January 1, 2011 assessment and actual taxes paid in 2010. As a result, he is now confident in the company’s estimate of 2011 taxes.<sup>274</sup> The Commission finds that the disclaimer on the document is not dispositive of this issue.

10. In considering what expense should be treated as known and measurable, it is important to keep in mind the underlying purpose of the Commission’s ratemaking process. The Commission is not setting rates designed to allow the company to recover past expenses. Rather, the Commission is using historical cost data based on a test year to determine a just and reasonable going-forward rate that will afford the company a reasonable opportunity to recover its costs and earn a profit.

11. It is known that Ameren Missouri will pay additional property tax now that the Sioux scrubbers and the Taum Sauk additions are in service and have been assessed for tax purposes. Ameren Missouri is already accruing those taxes on its books and has reasonably determined the amount accrued based on the known value of the property and adjusted 2010 tax rates. For purposes of determining a reasonable rate, the Commission finds that the additional taxes Ameren Missouri will pay for the Sioux scrubbers and the Taum Sauk additions are known and measurable. The additional \$10 million in property tax expenses associated with those additions shall be included in the company’s revenue requirement.

**Conclusions of Law:**

A. Missouri Retailers Association argues that Ameren Missouri’s property taxes attributable to the Taum Sauk additions are not known and measurable because the local taxing authority may have to decrease its tax levy based on the increased valuation of the property under Section 137.073.2, RSMo 2000. However, that statute provides that a levy rollback is not required when the increased valuation results

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<sup>273</sup> Ex. 415.

<sup>274</sup> Transcript, Page 1324, Lines 5-16.

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from “new construction and improvements.” Thus, the levy rollback provision would not apply to the Taum Sauk addition.<sup>275</sup>

**Decision:**

The additional \$10 million in property tax expenses associated with the Sioux scrubbers and the Taum Sauk additions shall be included in the company’s revenue requirement.

**B. Should the Commission order Ameren Missouri to return to its customers any reductions that the Company receives in its 2010 property taxes?**

**Findings of Fact:**

12. Ameren Missouri has appealed a portion of its 2010 state property taxes to the State Tax Commission. The company has paid the full amount of those taxes, but \$28,883,742 of that payment is being held in escrow pending the results of the appeal.<sup>276</sup> If Ameren Missouri prevails on its appeal, its 2010 taxes, as well as future tax bills could be reduced by an unknown amount. No hearing date has yet been set on the tax appeal.<sup>277</sup>

13. Ameren Missouri has agreed to track any possible tax refunds. Staff asks the Commission to order Ameren Missouri in this case to credit any tax refund it ultimately receives to its ratepayers. Ameren Missouri contends the Commission should not issue such an order in this case and should instead simply allow the company to track the refund and wait until a future case to determine how any refund received should be handled.

**Specific Findings of Fact:**

14. The only question before the Commission at this time is whether to order Ameren Missouri in this case to return any tax refund it may receive to its customers. There is no disagreement about Ameren Missouri’s duty to track that refund. If Ameren Missouri does receive a tax refund, then the Commission would certainly expect that the company would return that refund to its customers who are ultimately paying the tax bill. It is hard to imagine any circumstance in which such a refund would not be ordered. However, such an order must wait until a future rate case in which that decision will be presented to the Commission.

15. Any such order the Commission could issue in this case would be ineffective, as this Commission cannot bind a future Commission. At this

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<sup>275</sup> Transcript, Page 1293, Lines 12-21.

<sup>276</sup> Staff Report – Revenue Requirement / Cost of Service, Ex. 201, Page 91, Lines 10-13.

<sup>277</sup> Transcript, Page 1315, Lines 13-15.

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time, the Commission can only order Ameren Missouri to track any possible refund. A decision about how any such tax refund is to be handled must be left to a future rate case.

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

Ameren Missouri shall track any state tax refund it receives because of its appeal of its 2010 assessment. The Commission will decide in a future rate case how any such refunds are to be handled.

**13. Rate Design/Class Cost of Service**

**A. Class Cost of Service:**

(1) Which of the proposed class cost of service methodologies – the 4 NCP-A&E methodology, the Base Intermediate-Peak methodology, or the 4P-P&A methodology – should the Commission use in this case to allocate Ameren Missouri's investment and costs among the Company's various rate classes?

(2) What methodology should the Commission use in this case to allocate Ameren Missouri's fixed production plant investment and operation and maintenance costs?

**B. Rate Design:**

(1) To what extent should the Commission rely on the results of a class cost of service study in apportioning revenue responsibility among Ameren Missouri's customer classes in this case?

(2) What amount of increase or decrease in the revenue responsibilities of Ameren Missouri's customer classes should the Commission order in this case?

**Findings of Fact:**

**Introduction:**

1. After the Commission determines the amount of rate increase that is necessary, it must decide how that rate increase will be spread among Ameren Missouri's customer classes. The basic principle guiding that decision is that the customer class that causes a cost should pay that cost.

2. During the course of the hearing, Public Counsel, MIEC, AARP, the Consumers Council, MEUA, MEG, and the Missouri Retailers Association filed a nonunanimous stipulation and agreement that reached an agreement on how the rate increase should be allocated to the customer classes. Ameren Missouri and Staff did not sign the

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stipulation and agreement but do not oppose the compromise agreement. The Municipal Group, however, does oppose that stipulation and agreement.

3. Because of that opposition, the Commission cannot approve the stipulation and agreement. Nevertheless, all signatory parties testified that they continue to support the compromise described in the stipulation and agreement. That stipulation and agreement continues to represent the position of the signatory parties and the Commission can consider that position as it decides this issue.

4. Ameren Missouri has seven customer classes.<sup>278</sup> The Residential class is comprised of residential households. The Small General Service and Large General Service classes are comprised of commercial operations of various sizes. The first three classes receive electric service at a low secondary voltage level. The Small Primary Service and the Large Primary Service are larger industrial operations that receive their electric service at a high voltage level. The Large Transmission Service class takes service at a transmission voltage level. Noranda Aluminum is the only member of the Large Transmission Service class. The seventh customer class is the Lighting Service class, which includes area and street lighting.

**Specific Findings of Fact:**

5. To evaluate how best to allocate costs among these customer classes, four parties prepared and presented class cost of service studies. The studies presented by Ameren Missouri and MIEC used versions of the Average and Excess Demand Allocation method (A&E). Staff used a Base, Intermediate, Peak (BIP) method, and Public Counsel used a Peak and Average Demand Allocation method.

6. The following chart compares the results of each of the class cost of service studies, indicating the percent change in class revenues required to equalize class rates of return, as well as the dollar amounts needed to bring a class to its indicated cost of service. A negative number means the class is paying more than its indicated share of costs. A positive number means the class is paying less than its indicated share. All dollar figures are in millions.

Study	Residential	Small General Service	Large General Service	Large Primary Service	Large Transmission Service	Lighting

<sup>278</sup> Cooper Direct, Ex. 133, Page 4, Lines 4-18.

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Staff <sup>279</sup>	13.21% \$144.6	-1.78% \$(5.0)	-8.52% (\$60.4)	-6.42% (\$11.5)	-1.64% \$(2.3)	21.02% \$6.6
Ameren Missouri <sup>280</sup>	6.95% \$76.0	-8.77% (\$24.6)	-8.94% (\$63.7)	-1.42% (\$2.6)	5.60% \$7.8	22.41% \$7.0
OPC <sup>281</sup>	3.12% \$34.1	-11.22% (\$31.4)	-5.69% (\$40.4)	6.34% \$11.3	18.85% \$26.3	
MIEC <sup>282</sup>	9.7% \$106.0	-7.3% (\$20.5)	-10.4% (\$74.3)	-6.7% (\$12.2)	-5.0% (\$6.9)	24.9% \$7.7

For example, Staff's study indicated the Residential class is currently paying \$144.6 million less than Ameren Missouri's cost to serve that class. In contrast, according to Staff's study, the Large General Service class is currently paying \$60.4 million more than Ameren Missouri's cost to serve that class. Although the exact numbers vary among the various studies, all the studies agree that the Residential class is currently paying substantially less than its cost of service and that the other classes are currently paying more than their cost of service.

7. The studies presented by Staff, Ameren Missouri and MIEC show that the Large Transmission Class is currently paying rates that are near its current cost of service. Public Counsel's study however shows the Large Transmission Class as paying 18.83 percent less than its cost of service. However, Public Counsel's study uses an Average and Peak allocation method that the Commission has rejected as unreliable in previous cases.<sup>283</sup>

8. Noranda Aluminum, which is the sole member of the Large Transmission Class, runs its aluminum smelter at a constant rate, 24 hours a day, 7 days a week. Therefore, its usage of electricity does not vary significantly by hour or by season. Thus, while it uses a lot of electricity, that usage does not cause demand on the system to hit peaks for which the utility must build or acquire additional capacity. Another customer class, for example, the residential class, will contribute to the

<sup>279</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Page 3, Table 1.

<sup>280</sup> Ex. 551.

<sup>281</sup> Kind Direct, Ex. 301, Attachment A.

<sup>282</sup> Brubaker Direct, Ex. 404, Schedule MEB-COS-5.

<sup>283</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its Annual Revenues for Electric Service*, File Number ER-2010-0036, Report and Order, May 28, 2010, Page 85.



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average amount of electricity used on the system, but it will also contribute a great deal to the peaks on system usage, as residential usage will tend to vary a great deal from season to season, day to day, and hour to hour.

9. To recognize that pattern of usage, the Average and Excess method used by Ameren Missouri and MIEC in their studies separately allocates energy cost based on the average usage of the system by the various customer classes. It then allocates the excess of the system peaks to the various customer classes by a measure of that class' contribution to the peak. In other words, the average and excess costs are each allocated to the customer classes once.

10. The Peak and Average method, in contrast, initially allocates average costs to each class, but then, instead of allocating just the excess of the peak usage period to the various cost causing classes, the method reallocates the entire peak usage to the classes that contribute to the peak. Thus, the classes that contribute a large amount to the average usage of the system but add little to the peak, have their average usage allocated to them a second time. Thus, the Peak and Average method double counts the average system usage, and for that reason is unreliable.<sup>284</sup> In particular, it tends to overstate the class revenue responsibility of the Large Transmission Class and therefore Public Counsel's finding that that class is significantly under contributing is especially unreliable.

11. In general, it is important that each customer class carry its own weight by paying rates sufficient to cover the cost to serve that class. That is a matter of simple fairness in that one customer class should not be required to subsidize another. Requiring each customer class to cover its actual cost of service also encourages cost effective utilization of electricity by customers by sending correct price signals to those customers.<sup>285</sup> However, the Commission is not required to precisely set rates to match the indicated class cost of service. Instead, the Commission has a great deal of discretion to set just and reasonable rates, and can take into account other factors, such as public acceptance, rate stability, and revenue stability in setting rates.

12. Ameren Missouri proposed that any rate increase should be allotted equally to each customer class. In other words, each class would receive the system average percentage increase.<sup>286</sup> That would

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<sup>284</sup> Brubaker Rebuttal, Ex. 405, Pages 4-6.

<sup>285</sup> Cooper Direct, Ex. 133, Page 17, Lines 1-12.

<sup>286</sup> Cooper Direct, Ex. 133, Page 19, Lines 1-2.

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leave the existing disparities revealed in the class cost of service studies unchanged.

13. Staff proposed that small adjustments be made to shift revenue responsibility from the classes that are paying more than their share to those that are paying too little. Specifically, Staff recommends that the Residential and Lighting classes receive the system average percentage increase plus one percent. The Large General Service / Small Primary Service classes would receive no increase for the first \$30 million in increased rates and the system average thereafter. Finally, Staff would have the Commission give the Small General Service and Large Transmission Service classes the system average increase.<sup>287</sup>

14. MIEC proposed that the Residential and Lighting classes receive a revenue-neutral increase with the other classes receiving decreases to bring each class closer to its actual cost of service.<sup>288</sup>

15. Finally, Public Counsel recommended that the Commission make no adjustment to the residential class but proposed revenue neutral shifts sufficient to move each other class' revenues half-way toward that class' cost of service.<sup>289</sup>

16. The stipulation and agreement to which the Municipal Group objected would shift revenue responsibility to the Residential and Lighting classes in the following manner:

Rate Class	Current Revenues	Revenue Increase	Percent Change
Residential	\$1,099,447,000	\$21,989,000	+2.00%
Small Gen. Service	\$278,880,000	(\$4,957,000)	-1.78%
Large Gen. Service / Small Primary	\$710,244,000	(\$12,624,000)	-1.78%
Large Primary	\$178,643,000	(\$3,175,000)	-1.78%
Large Transmission	\$139,472,000	(\$2,479,000)	-1.78%
MSD	\$64,000	----	0.00%
Lighting	\$31,171,000	\$1,247,000	+4.00%

In other words, the Residential class' rates would increase by 2 percent

<sup>287</sup> Staff Report -Class Cost-of-Service and Rate Design, Ex. 204, Page 1, Lines 2-20.

<sup>288</sup> Brubaker Direct, Ex. 404, Schedule MEB-COS-6.

<sup>289</sup> Kind Direct, Ex. 301, Page 7, Lines 6-22.

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on a revenue-neutral basis and the Lighting class' rates would increase by 4 percent on a revenue-neutral basis. All other classes would see their rates decline by 1.78 percent on a revenue-neutral basis.

17. The stipulation and agreement, now the joint position of the signatory parties, further provides that any overall increase granted to Ameren Missouri as a result of this rate case would be implemented on an equal percent, across-the-board basis and added to the described revenue-neutral adjustments to determine each class' total increase relative to current rates.

18. The stipulation and agreement, now the joint position, also provides that no class should receive an overall rate decrease if any other class is receiving an overall rate increase. In such a circumstance, the class receiving that decrease would be held at its current rates with the avoided decrease spread equally among the remaining classes receiving revenue-neutral decreases.

19. The reallocation of revenue responsibility the signatories agreed to in the stipulation and agreement, now their joint position, bears some resemblance to the results of all the submitted class cost of service studies. Most notably, all the submitted studies indicate that the residential class is paying substantially less than its actual revenue responsibility. The stipulated position would bring that revenue class closer to its actual cost of service.

20. The party that objected to the stipulation and agreement, the Municipal Group, represents the members of the Lighting class, which would receive a 4 percent revenue-neutral increase under the stipulation and agreement. Understandably, the Municipal Group would prefer a system average across-the-board increase as proposed by Ameren Missouri. However, there are circumstances that justify a larger than average increase for the Lighting class.

21. In Ameren Missouri's last rate case, ER-2010-0036, the Municipal Group complained that neither Ameren Missouri, nor any other party had performed a class cost of service study that would determine the reasonableness of the rate charged to the Lighting class. For many years, Ameren Missouri and the other parties to its rate cases had ignored the Lighting class in their studies because of its insignificant size compared to Ameren Missouri's over-all customer base. As a result, the Commission found that the Lighting class had been given rates that "may or may not bear any resemblance to the cost to serve that class."<sup>290</sup> On

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<sup>290</sup> *In the Matter of Union Electric Company, d/b/a AmerenUE's Tariffs to Increase its*

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that basis, the Commission exempted the Lighting class from the rate increase that resulted from that Report and Order and directed Ameren Missouri to include the Lighting class in its next class cost of service study.

22. Ameren Missouri and the other parties included the Lighting class in their class cost of service studies for this case and those studies indicate that the Lighting class is not currently paying its full cost of service. According to Staff's study, the Lighting class' rates would have to be increased 21.02 percent to bring in sufficient revenue from that class to cover the cost to serve that class. Ameren Missouri's study sets the necessary increase at 22.41 percent, and MIEC's study was even higher at 24.9 percent. Considering the results of those studies, the 4 percent revenue-neutral increase allotted to the Lighting class by the stipulation and agreement / joint position is quite reasonable.

**Conclusions of Law:**

A. Commission Rule 4 CSR 240-2.115(2)(D) provides that a nonunanimous stipulation and agreement to which an objection is made is to be treated as a joint position of the signatory parties, except that no party is bound by the agreement.

B. The approach the Commission must take when considering a nonunanimous stipulation and agreement to which an objection is made is further described in a 1982 decision of the Missouri Court of Appeals. In *State ex rel. Fischer v. Public Service Commission*,<sup>291</sup> the Court held that when considering a nonunanimous stipulation and agreement the Commission must recognize all statutory requirements, including the right to be heard and to introduce evidence. Furthermore, the Commission's decision must be in writing and must include adequate findings of fact.

**Decision:**

The Commission accepts the joint position advocated by the parties representing the vast majority of Ameren Missouri's customers and accepted by Ameren Missouri and Staff. The Commission's acceptance of that joint position will result in a reasonable adjustment of rates to bring all parties closer to their actual cost of service.

**(3) What is the appropriate monthly residential customer charge that should be set for Ameren Missouri in this case?**

**Findings of Fact:**

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*Annual Revenues for Electric Service*, File Number ER-2010-0036, Report and Order, May 28, 2010, Page 99.

<sup>291</sup> 645 S.W.2d 39 (Mo. App. W.D. 1982)

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**Introduction:**

23. The monthly residential customer charge is the portion of the customer's bill that is independent of the amount of electricity used in the month. It is the amount the customer must pay just to remain a customer of Ameren Missouri. In general, consumer groups prefer a low customer charge reasoning that customers want to be able to lower their costs if they use less electricity. The utility, including Ameren Missouri, prefers a higher customer charge because the customer charge allows the company to recover its fixed costs with more certainty regardless of how much electricity the customer uses in a month. Currently Ameren Missouri's monthly residential customer charge is set at \$8.00.

**Specific Findings of Fact:**

24. The various class cost of service studies examine the amount of charges that should appropriately be collected from customers through the fixed monthly customer charge. Ameren Missouri indicates its study would support a residential customer charge of approximately \$18. However, Ameren Missouri's witness recommended that the customer charge be increased only to \$10.<sup>292</sup>

25. Staff's witness indicated his class cost of service study would support a monthly customer charge of \$9.67, but he recommended the customer charge be increased to only \$9.00 to avoid a large impact on residential customers.<sup>293</sup>

26. The nonunanimous stipulation and agreement on class cost of service issues provides that the residential customer charge would remain at \$8.00, with the remaining revenue assigned to the residential class to be allocated to volumetric charges.

27. Although the Municipal Group objected to the stipulation and agreement, the stipulation and agreement still represents the joint position of the signatory parties. Despite their earlier positions advocating an increase in the customer charge, neither Ameren Missouri nor Staff raised any objection to the stipulation and agreement. Furthermore, although the Municipal Group objected to the stipulation and agreement as a whole, it expressed no opposition to the agreement to leave the residential customer charge at \$8.00.

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

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<sup>292</sup> Cooper Rebuttal, Ex. 134, Page 11, Lines 1-7.

<sup>293</sup> Staff Report – Rate Design and Class Cost of Service, Ex. 204, Pages 19-20, Lines 33-36, 1-3.

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The current residential customer charge of \$8.00 per month is reasonable and shall be continued.

**(4) Should AmerenMO be required to eliminate declining block rates for the residential winter energy charge? If so, should the declining block rates be eliminated in a revenue neutral manner?**

**Findings of Fact:**

**Introduction:**

28. Ameren Missouri's current residential rate design includes a declining block element for the winter billing season only. That means that during the winter the rate paid for electricity goes down as more electricity is used. That declining block design benefits customer who use a lot of electricity in the winter, chiefly customers who use electricity for space heating in their home. That design also benefits the electric utility in that it makes electricity more competitive with other fuel sources for space heating and allows the company to sell more electricity during off-peak times.

**Specific Findings of Fact:**

29. A stipulation and agreement approved in Ameren Missouri's last rate case, ER-2010-0036, required Ameren Missouri to conduct a study addressing the elimination of declining block rates for residential service in a revenue neutral manner and to file the results of that study in this, its next rate case. Ameren Missouri conducted that study and reported the results in the direct testimony of Wilbon Cooper.<sup>294</sup>

30. Ameren Missouri reports that the elimination of the declining block rate would increase the electric bill for customers who use electricity for space heating by roughly five percent above the overall average rate increase that would otherwise result from this case.<sup>295</sup> If the declining block rate design were eliminated and Ameren Missouri were allowed to increase its overall rates by 10.8 percent, monthly winter bills would decrease by \$1.78 per month at 700 kWh, increase by \$53.85 per month at 4,000 kWh, and increase by \$157.05 per month at 10,000 kWh from current rate levels. For comparison, if the same overall rate increase were allowed and the declining block rate were retained, the monthly winter bills would increase \$6.20 per month at 700 kWh, \$17.88 per month at 4,000 kWh, and \$38.88 per month at 10,000 kWh.<sup>296</sup>

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<sup>294</sup> Cooper Direct, Ex. 133, Pages 25-26.

<sup>295</sup> Cooper Direct, Ex. 133, Page 25, Lines 20-23.

<sup>296</sup> Cooper Direct, Ex. 133, Page 26, Lines 2-7.

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31. The Missouri Department of Natural Resources asks the Commission to eliminate the declining block rates to encourage energy efficiency and conservation, arguing that declining block rates do not send a signal to encourage reduced usage.<sup>297</sup>

32. Customers who use less than approximately 1,400 kWh per month would see their monthly bill decrease if the declining block rate was eliminated. Those who use more than 1,400 kWh per month would see their monthly bill increase.<sup>298</sup> An average residential customer uses approximately 1,000 to 1,100 kWh per month.<sup>299</sup> As a result, the customers who would see increased monthly bill would chiefly be those who use electricity for space heating.<sup>300</sup>

33. There is no evidence in the record to indicate how a phase-in of the elimination of declining block rates could be accomplished.<sup>301</sup>

**Conclusions of Law:**

There are no additional conclusions of law for this issue.

**Decision:**

The Commission does not like declining block rates. They do not send a proper price signal and tend to encourage the excessive consumption of electricity. In addition, declining block rates may force residential customers who conserve electricity to subsidize their neighbors who use excessive amounts.

In the last case a stipulation and agreement required Ameren Missouri to study the elimination of declining block rates. Not surprisingly, Ameren Missouri's study concluded that elimination of the declining block rate would cost the company money and would result in increased rates for the customers who currently benefit from the rate. MDNR is the only party that responded to Ameren Missouri's study, but that response dealt only in generalities and provided very little detailed information to assist the Commission in actually evaluating the merits of the elimination of the winter declining block rate.

Unfortunately, there is just not enough evidence in this record to justify a modification of the current rate design. The only thing that is clear is that the elimination of the declining block rate would have an unfortunate impact on the rates of those customers who use electricity for space heating. If any party wants to try again to eliminate the winter

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<sup>297</sup> Wolfe Rebuttal, Ex. 801, Page 16, Lines 16-21.

<sup>298</sup> Transcript, Page 2385, Lines 13-21.

<sup>299</sup> Transcript, Page 2386, Lines 5-6.

<sup>300</sup> Transcript, Page 2393, Lines 2-6.

<sup>301</sup> Transcript, Page 2402, Lines 13-18.

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declining block rate in Ameren Missouri's next rate case, they will need to provide the Commission with more information to justify that change.

**THE COMMISSION ORDERS THAT:**

1. The tariff sheets filed by Union Electric Company, d/b/a Ameren Missouri on September 3, 2010, and assigned tariff number YE-2011-0116, are rejected.

2. Union Electric Company, d/b/a Ameren Missouri is authorized to file a tariff sufficient to recover revenues as determined by the Commission in this order. Ameren Missouri shall file its compliance tariff no later than July 18, 2011.

3. Governor Nixon has signed into law Missouri Senate Bill 48, which changes the procedure for parties appealing orders from the Missouri Public Service Commission. The new law took effect on July 1, 2011.

Please refer to SB 48 to become familiar with the new appellate process. An unofficial copy of the truly agreed to and finally passed SB 48 may be found at:

[http://www.senate.mo.gov/11info/BTS\\_Web/BillText.aspx?SessionType=R&BillID=4065300](http://www.senate.mo.gov/11info/BTS_Web/BillText.aspx?SessionType=R&BillID=4065300)

Please refer to the Supreme Court Rules for further guidance. The Commission is preparing its version of Form 8, which is required by Supreme Court Rule 81.08(a).

4. This report and order shall become effective on July 23, 2011.

Gunn, Chm., and Jarrett, C., concur;  
Clayton, C., concurs with separate concurring opinion attached;  
Davis and Kenney, CC., concur with separate concurring opinions to follow.

\*NOTE: See pages 40, 549 and 663 for other orders in this case.

\*NOTE: At the time of publication, no opinion of Commissioner R. Kenney has been filed.

**CONCURRING OPINION OF COMMISSIONER ROBERT M. CLAYTON III**

This Commissioner concurs in the Commission's Report and Order granting a rate increase to Ameren Missouri. Rate increases are never welcome by any stakeholders and involve difficult, complex decisions on the part of policy makers. This utility is the largest electric provider in the state with the greatest number of customers, which means that many fellow citizens will feel the impact of an increase in



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their monthly electric bills. That impact was not taken lightly by this Commissioner and it is my hope through this statement to set out the reasons why I am supporting the decision. There are two primary reasons supporting my vote in favor of the rate increase and both involve needed capital investments in the utility's infrastructure.

First, the bulk of the increase is to support the investments made at the Sioux Plant in which wet flue gas desulfurization units, or "scrubbers", were installed, thereby improving the environmental performance of the facility. These investments, which will benefit the entire region, remove sulfur dioxide from the flue gases, as well as removing oxidized mercury, sulfur trioxide, particulate, hydrogen chloride and hydrogen fluoride. Investments, totaling approximately \$574 million and involving hundreds of high-paying jobs, have been added to rate base. The investments will continue the operation of a relatively efficient and low cost facility while reducing its environmental impact. These are the types of investments which should be supported by the Commission as necessary and prudent. The Commission was unanimous in including the \$31 million dollars of contested investments in rates. This environmental investment makes up the largest portion of the total rate increase.

Secondly, this Commissioner believes the Commission acted appropriately in disallowing and rejecting the additional investments made in the Taum Sauk pump-storage, hydro facility. Roughly \$89 million has been completely excluded from utility rates. This Commissioner participated in the prior investigation and litigation over the utility's errors and omissions associated with the Taum Sauk disaster in December 2006. It is not an overstatement to recognize the miracle of no deaths occurring from the man-made disaster that could and should have been avoided. While the utility has taken responsibility by paying millions in penalties to government agencies and millions in damages to injured parties, it is concerning that this request for passing on these investments to rate payers is brought to this Commission. The facility is an impressive engineering marvel and its performance is an important part of the utility's generation fleet. However, we should all be mindful of its power and the impact should the facility's safety equipment fail, as in 2006. Rate payers should not be burdened with this investment which came about entirely and solely because of mistakes made by the utility.

Lastly, this Commissioner must note some dissatisfaction with other aspects of the order. While my support stems from the two issues mentioned above, the Commission could have done better in addressing

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other issues. For example, the Commission could have taken the opportunity to reevaluate the utility's Fuel Adjustment Clause, which inappropriately shifts too much of a burden of risk on the rate payers with an inequitable 95% to 5% division of cost. The Commission could have taken a stronger stand on Demand Side Management opportunities to empower customers to reduce their energy costs. The Commission could have taken a closer look at various costs that are being passed along to customers, which would have slightly lowered the impact of the rate increase. However, the total impact of these items is outweighed by the exclusion of Taum Sauk and support of environmental improvements at Sioux.

For the foregoing reasons, this Commissioner concurs.

**CONCURRENCE OF COMMISSIONER JEFF DAVIS**

I respectfully concur with my colleagues in the reasoning and decision in the above-referenced case, but wish to differ with my colleagues with respect to the Taum Sauk enhancements. Further, although the testimony of the Consumer Council of Missouri President, Joan Bray, really does not reflect on any of the issues in this case, there needs to be some mention of the discrepancy between the position taken by President Bray at a local public hearing in St. Louis and the differing response of John Coffman, her legal counsel, in response to questions on that issue.

**The Commission's denial of all Taum Sauk expenses is not only plain error, it's bad public policy that discourages investment in Missouri.**

The videotapes of the Commission deliberations on this issue will show that there were a number of Commissioners who were willing to award Ameren UE all or part of the enhancements made at the Taum Sauk Upper Reservoir. Ameren UE may not have been entitled to all of the \$89,179,539 they requested, but they were entitled to some financial consideration on this issue. For instance, how can you say that a \$19,839 gallery vehicle used to check equipment is not an enhancement? Are we to assume that Ameren would have never bought a vehicle to drive around to the top of the dam or underneath it?

The truth is we had at least one commissioner who made up his mind not to give Ameren anything on this issue because Ameren had promised to hold the ratepayers harmless for Taum Sauk. Ameren did hold the ratepayers harmless for Taum Sauk and they now have a new, improved pump storage unit with greater capacity and a longer life

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expectancy. Recovery of prudent incurred costs for capital investment should never be an all or nothing proposition. Ameren should at least be compensated for the net present value of those enhancements.

Further, the decision on this issue is one of the reasons why investors question Missouri's climate for investment. All earnings are not created equal. This was an \$89 million capital investment that we denied in its totality. It may only amount to approximately \$7 million annually that gradually depreciates down to zero, but over 30, 40 or 60 years, that sum amounts to hundreds of millions of dollars. This isn't an example of greedy Wall Street investment, it's a prime example of why utility investors ask the question "Do you get it?" and some Commissioners get offended.

The bottom line is the Commission chose the path of popularity with the masses over doing what was right and the company should not be punished for adding those benefits. I voted for the order because in the end we achieved a result that was within the nebula of reasonableness and, had I not supported the order, there would have been an even more unconscionable result. Once again, let me repeat: this is no way to attract investment capital to Missouri. Despite the very high standard of review imposed by Missouri courts on PSG cases, I sincerely hope the courts take a look at this issue and send it back because there is ample reason to do so.

**Consumers Council of Missouri's Misleading Statements Injure the Public.**

No discussion of this case would be complete without a discussion concerning the Consumers Council of Missouri.

As President of the Consumers Council, former Democratic Senator Joan Bray has never been shy about giving pious ethics lectures to this Commissioner and the Commission in general. This case was no exception as she appeared at one of the local public hearings in St. Louis to testify that, in her opinion, Ameren Missouri should not be entitled to any rate increase. Then, when John Coffman, the attorney for Consumers Council, appeared in front of this Commission to give his opening statement to this Commission, he recognized that even if the Commission adopted every one of his positions in this case, Ameren Missouri was entitled to approximately \$72 million.

\$72 million is a long way from zero and it's time the Consumers Council of Missouri be held accountable for making misleading statements to the public. To add to the hypocrisy, a January 8, 2012 story in the St. Louis Post-Dispatch indicates the Consumers Council of

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Missouri actually helped craft a ballot initiative that includes a utility rate increase necessary as part of requiring Ameren Missouri to buy more renewable energy. Will the Consumers Council of Missouri President Bray show up at the next Ameren Missouri hearing and urge the Commission to reject Ameren Missouri's rate request in its entirety? This Commission can only wait and wonder.

A review of the record in this case and of Consumer Council's subsequent conduct raises a serious question as to whether the group is really making a thoughtful effort to help shape Missouri energy policy or its leaders have their own ideological agenda. This Commission has a hard enough time helping people understand the process and the law without this type of demagoguery. In conclusion, if the board members of the Consumer Council of Missouri want to be taken seriously by this Commission or anyone else in mainstream Missouri, their actions need to match their words and vice versa.

**\*NOTE:** This case was appealed to the Missouri Court of Appeals (WD) and affirmed. See 369 SW 3d 807 (Mo. App. W.D. 2012)

**In the Matter of Union Electric Company, d/b/a Ameren Missouri's  
Tariff to Increase Its Annual Revenues for Electric Service**

*File No. ER-2011-0028*

*Decided July 27, 2011*

**Evidence, practice and procedure §24.** The Commission denied applications for rehearing regarding its decision in a rate case.

**ORDER DENYING APPLICATIONS FOR REHEARING, DENYING  
RECONSIDERATION, CLARIFYING A PORTION OF THE  
COMMISSION'S REPORT AND ORDER, CORRECTING THE REPORT  
AND ORDER NUNC PRO TUNC**

On July 13, 2011, the Commission issued a report and order regarding Union Electric Company d/b/a Ameren Missouri's tariffs to increase its rates for electric service. That report and order became effective on July 23. On Friday, July 22, Ameren Missouri, the Missouri Industrial Energy Consumers (MIEC), and the Office of the Public Counsel filed timely applications for rehearing. Ameren Missouri also

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asked the Commission to reconsider a portion of its report and order, to clarify a portion of the report and order, and to correct a typographical error and a misstatement of fact within the report and order.

Section 386.500.1, RSMo (2000), indicates the Commission shall grant an application for rehearing if "in its judgment sufficient reason therefor be made to appear." The applications for rehearing merely restate positions the Commission has previously rejected in its report and order. In the judgment of the Commission, Ameren Missouri, MIEC, and Public Counsel have not shown sufficient reason to rehear the report and order. The Commission will deny their applications for rehearing.

In addition to its application for rehearing, Ameren Missouri asks the Commission to reconsider its decision addressing the company's energy efficiency programs. Ameren Missouri does not challenge the legality of the Commission's decision, but again asks the Commission to approve a billing unit adjustment mechanism to encourage the company to continue its existing energy efficiency programs. As the Commission explained in its report and order, it encourages Ameren Missouri to continue to offer its energy efficiency programs. However, again as explained in its report and order, the Commission will not approve the billing unit adjustment mechanism proposed by Ameren Missouri. The Commission will not reconsider this aspect of its report and order.

Ameren Missouri also asks the Commission to clarify a portion of its report and order regarding Renewable Energy Standard (RES) compliance costs. As the Commission indicated in its report and order, that issue concerns several kinds of RES compliance costs that Ameren Missouri will incur while the rates established in this case are in effect. However, most of the discussion in the report and order was about solar rebate costs, which was the only type of RES compliance cost the company actually incurred during the test year and true-up period. The Commission will clarify its report and order to make it clear that the amount the Commission allowed in the company's revenue requirement is for all RES compliance costs, not just solar rebate costs. Furthermore, the Commission clarifies that the Accounting Authority Order authorized in the report and order is designed to capture all RES compliance costs, not just the cost of solar rebates.

Finally, Ameren Missouri asks the Commission to correct two errors within the report and order. The first is a typographical error that on page 71 of the report and order refers to analyst's projections. Ameren Missouri indicates the singular possessive "analyst's" should be

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changed to the plural possessive “analysts”. Second, Ameren Missouri points out that on page 54, the Commission incorrectly refers to Union Electric Company as Ameren Missouri’s parent company. In fact, Ameren Missouri is a fictitious name under which Union Electric Company does business.

Ameren Missouri is correct, and the Commission will correct both identified errors *nunc pro tunc*. Neither correction changes the meaning or effect of the Commission’s report and order.

**THE COMMISSION ORDERS THAT:**

1. Union Electric Company d/b/a Ameren Missouri’s Application for Rehearing is denied.
2. Union Electric Company d/b/a Ameren Missouri’s Request of Reconsideration is denied.
3. Union Electric Company d/b/a Ameren Missouri’s Motion for Clarification is granted as explained in the body of this order.
4. Union Electric Company d/b/a Ameren Missouri’s Motion for Correction of Report and Order *Nunc Pro Tunc* is granted as explained in the body of this order.
5. The Office of the Public Counsel’s Application for Rehearing is denied.
6. Missouri Industrial Energy Consumers’ Application for Rehearing is denied.
7. This order shall become effective immediately upon issuance.

Gunn, Chm., Clayton, Davis, Jarrett,  
and Kenney, CC., concur.

Woodruff, Chief Regulatory Law Judge

\*NOTE: See pages 40, 549, and 562 for other orders in this case.

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**The Staff of the Missouri Public Service Commission, Complainant,  
v. Laclede Gas Company, Respondent.**

*File No. GC-2011-0098*

*Decided: July 27, 2011*

**Evidence, Practice and Procedures §22.** Utility's counter-claim that challenged the good-faith basis of Staff's position did not potentially affect the individual interest of Staff's legal representative to justify the intervention of that individual as a party to the counter-claim.

**ORDER REGARDING SHEMWELL'S  
APPLICATION TO INTERVENE**

The Commission's Staff filed its second amended complaint against Laclede Gas Company on November 22, 2010. Laclede answered that complaint on December 10 and at the same time asserted a counter-claim against Staff alleging that in various Laclede ACA cases, Staff has made recommendations, asserted disallowances, and sought discovery that directly conflict with the Commission's affiliate transaction rules and the company's Cost Allocation Manual. Laclede asserts that Staff does not have a good faith, non-frivolous argument for its positions and therefore is in violation of Commission Rule 4 CSR 240-2.080.

Lera Shemwell, an attorney for the Commission's Staff, signed Staff's second amended complaint, as did two other attorneys for Staff, Annette Slack, and Kevin Thompson. On July 8, 2011, Shemwell withdrew as counsel for Staff in this case. On July 11, she filed an application to intervene as a party arguing that Laclede's counter-claim alleges that she, as one of the attorneys who signed the complaint, acted unethically, thereby subjecting her to possible disciplinary action before the Missouri Bar. Shemwell asks to be permitted to intervene to protect her individual professional interests.

Commission Rule 4 CSR 240-2.075(1) requires that applications to intervene be filed within thirty days after the Commission gives notice of the case unless a different date is set by the Commission. That thirty-day intervention window has long since passed and the evidentiary hearing on Staff's complaint and Laclede's counter-claim is set to begin on August 10. Shemwell recognizes that her application to intervene is late, but along with that application, she filed a motion requesting leave to intervene out of time.

Laclede responded to Shemwell's application to intervene on July 21. Laclede asks the Commission to deny Shemwell's application to

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intervene as unnecessary, explaining that its counter-claim does not make any specific allegations against Shemwell that would reasonably put her at risk of an ethics complaint before the Missouri Bar. Laclede instead states that its counter-claim seeks to establish that the Commission's Staff, as opposed to Staff's Legal Counsel, does not have a good faith basis for the positions it has taken in various complaint and actual cost adjustment (ACA) cases affecting Laclede.

Shemwell replied to Laclede's response on July 25. Shemwell repeats her assertion that she has a right to intervene to defend her reputation and professional standing. She also suggests that any confusion regarding her intervention into the case could be alleviated if the hearing on Laclede's counter-claim is bifurcated from the hearing on Staff's complaint.

Commission rule 4 CSR 240-2.075(4), the rule regarding intervention, provides that the Commission may grant intervention upon a finding that the intervenor has an interest that is different than that of the general public, and that may be adversely affected by a final order arising from the case, or upon a finding that granting intervention will serve the public interest. Furthermore, the rule authorizes the Commission to grant late applications to intervene upon a showing of good cause.

The Commission finds that Shemwell's interest in this case is certainly different than that of the general public. The question of whether her interest may be adversely affected by a final order arising from this case is less clear. Laclede claims that Shemwell is "virtually unexposed to any allegation of professional misconduct" that would possibly subject her to an ethics complaint because of this case. The Commission agrees that the risk to Shemwell's professional standing is very slight. Laclede's counter-claim does not make any specific allegations against Shemwell and she did not sign most of the documents to which Laclede raised specific concerns. Furthermore, no one has indicated any intention to pursue an ethics complaint against her no matter how Staff's complaint and Laclede's counter-claim are decided. As a result, the Commission concludes that Shemwell's individual interest will not be adversely affected by any ruling in this case. Therefore, in accordance with Commission Rule 4 CSR 240-2.075(4), the Commission will deny her application to intervene.

### **THE COMMISSION ORDERS THAT:**

1. Lera Shemwell's Application to Intervene is denied.
2. This order shall become effective immediately upon



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issuance.

Davis, Jarrett, and Kenney CC., concur.  
Gunn, Chm., dissents with separate dissenting opinion to follow.  
Clayton, C., dissents.

Woodruff, Chief Regulatory Law Judge

\*NOTE: See page 126 for another order in this case.

**DISSENTING OPINION OF CHAIRMAN KEVIN D. GUNN**

Words matter. That simple and straightforward phrase is at the heart of the Commission decision, from which I respectfully dissent.

This case has not been an easy one for the Commission. It has touched on some basic philosophical differences among Commissioners. When this happens, it is imperative that the parties involved plead their case in a manner commensurate with their obligations as attorneys and good faith participants in the regulatory process.

Unfortunately, Laclede Gas Company's (Laclede's) conduct in this case falls short of this ideal. They have filed incendiary pleadings, ignored Commission orders and personally attacked the integrity of both staff and Commissioners. This uncivil conduct would be inappropriate in a court of law and is certainly not appropriate for matters before the Public Service Commission. In one pleading, Laclede unfairly attacked a staff attorney, Lera Shemwell. In the motion before us, she simply asked that she be allowed to defend herself. I believe the majority's decision not to allow Ms. Shemwell to intervene was based on a belief that the attacks on Ms. Shemwell were not consequential to the case, were not to be believed by the Commission and created a procedural and precedential issue as to how staff interacts in a case. All of these are fair points, but they miss the fundamental truth of this motion: words matter. To not allow Ms. Shemwell to defend herself and to allow Laclede's personal attacks to go unchallenged, we are allowing this conduct to continue, if not tacitly condoning it now and in the future. As a fair tribunal, we should demand more that civility from those that practice before us and we should demand it each and every time.

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Secondarily, Ms. Shemwell rightfully recognized the potential ethical issues that arise out of the pleadings. While I believe that Ms. Shemwell in no way acted unethically, and despite Laclede's denials, the allegations made in the petition do impact the perception that the Public Service Commission staff somehow did not uphold the highest ethical standards. Ms. Shemwell should have been given a fair opportunity to defend herself and to clear up any doubt about her conduct.

Therefore, I would have allowed Ms. Shemwell to intervene in the case for the limited purpose of protecting her interests and respectfully dissent from the Commission's decision in this matter.

**DIGEST OF REPORTS**

**OF THE**

**PUBLIC SERVICE COMMISSION**

**OF THE**

**STATE OF MISSOURI**



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## ACCOUNTING

### III. PARTICULAR ITEMS

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Under Section 211(b) of the Tax Reform Act of 1986, all credits for tax years open under the statute of limitations at the time a final determination is rendered by a state utility regulatory commission inconsistent with normalization requirements are recaptured. – Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company-20 MPSC 3d 153.

The Commission intended to avoid a normalization error. Thus, the Commission clarified its Report and Order to say that if the advanced coal tax credits are allocated to GMO, it will lower the cost of service for GMO and also lower rates. – Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company-20 MPSC 3d 197.

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- §43. Gas
- §44. Heating
- §45. Water
- §46. Telecommunications
- §46.1. Certificate of local exchange service authority
- §46.2. Certificate of interexchange service authority
- §46.3. Certificate of basic local exchange service authority
- §47. Sewers

#### **VII. OPERATION UNDER TERMS OF THE CERTIFICATE**

- §48. Operations under terms of the certificate generally
- §49. Beginning operation
- §50. Duration of certificate right
- §51. Modification and amendment of certificate generally

#### **VIII. TRANSFER, MORTGAGE OR LEASE**

- §52. Transfer, mortgage or lease generally
- §53. Consolidation or merger
- §54. Dissolution
- §55. Transferability of rights
- §55.1. Change of supplier
- §55.2. Territorial agreement
- §56. Partial transfer
- §57. Transfer of abandoned or forfeited rights
- §58. Mortgage of certificate rights
- §59. Sale of certificate rights

#### **IX. REVOCATION, CANCELLATION AND FORFEITURE**

- §60. Revocation, cancellation and forfeiture generally
- §61. Acts or omissions justifying revocation or forfeiture
- §62. Necessity of action by the Commission
- §63. Penalties

## **CERTIFICATES**

### **VI. CERTIFICATE OR PERMIT FOR PARTICULAR UTILITIES**

#### **§45. Water**

The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff. – U.S. Water Company-20 MPSC 3d 27.

The Commission grants public utility's application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility's certificate and tariff. – Aqua Missouri, Inc.-20 MPSC 3d 569.

## **DEPRECIATION**

### **I. IN GENERAL**

- §1. Generally**
- §2. Right to allowance for depreciation**
- §3. Reports, records and statements**
- §4. Obligation of the utility**

### **II. JURISDICTION AND POWERS**

- §5. Jurisdiction and powers generally**
- §6. Jurisdiction and powers of the State Commission**
- §7. Jurisdiction and powers of the Federal Commission**
- §8. Jurisdiction and powers of local authorities**

### **III. BASIS FOR CALCULATION**

- §9. Generally**
- §10. Cost or value**
- §11. Property subject to depreciation**
- §12. Methods of calculation**
- §13. Depreciation rates to be allowed**
- §14. Rates or charges for service**

### **IV. FACTORS AFFECTING ANNUAL ALLOWANCE**

- §15. Factors affecting annual allowance generally**
- §16. Life of enterprise**
- §17. Life of property**
- §18. Past depreciation**

- §19. Charges to maintenance and other accounts
- §20. Particular methods and theories
- §21. Experience
- §22. Life of property and salvage
- §23. Sinking fund and straight line
- §24. Combination of methods

#### V. RESERVES

- §25. Necessity
- §26. Separation between plant units
- §27. Amount
- §28. Ownership of fund
- §29. Investment and use
- §30. Earnings on reserve

#### VI. DEPRECIATION OF PARTICULAR UTILITIES

- §31. Electric and power
- §32. Gas
- §33. Heating
- §34. Telecommunications
- §35. Water

### DEPRECIATION

No headnotes in this volume involved the question of depreciation.

### DISCRIMINATION

#### I. IN GENERAL

- §1. Generally
- §2. Obligation of the utility
- §3. Recovery of damages for discrimination
- §4. Recovery of discriminatory undercharge
- §5. Reports, records and statements

#### II. JURISDICTION AND POWERS

- §6. Jurisdiction and powers of the State Commission
- §7. Jurisdiction and powers of the Federal Commissions

§8. Jurisdiction and powers of the local authorities

**III. RATES**

- §9. Competitor's right to equal treatment
- §10. Free service
- §11. Inequality of rates
- §12. Methods of eliminating discrimination
- §13. Optional rates
- §14. Rebates
- §15. Service charge, meter rental or minimum charge
- §16. Special rates
- §17. Rates between localities
- §18. Concessions

**IV. RATES BETWEEN CLASSES**

- §19. Bases for classification and differences
- §20. Right of the utility to classify
- §21. Reasonableness of classification

**V. RATES AND CHARGES OF PARTICULAR UTILITIES**

- §22. Electric and power
- §23. Gas
- §24. Heating
- §25. Telecommunications
- §26. Sewer
- §27. Water

**VI. SERVICE IN GENERAL**

- §28. Service generally
- §29. Abandonment and discontinuance
- §30. Discrimination against competitor
- §31. Equipment, meters and instruments
- §32. Extensions
- §33. Preference during shortage of supply
- §34. Preferences to particular classes or persons

**VII. SERVICE BY PARTICULAR UTILITIES**

- §35. Electric and power
- §36. Gas
- §37. Heating
- §38. Sewer

- §39. Telecommunications
- §40. Water

## **DISCRIMINATION**

No headnotes in this volume involved the question of discrimination.

## **ELECTRIC**

### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §4. Transfer, lease and sale
- §4.1. Change of suppliers
- §5. Charters and franchise
- §6. Territorial agreements

### **II. JURISDICTION AND POWERS**

- §7. Jurisdiction and powers generally
- §8. Jurisdiction and powers of Federal Commissions
- §9. Jurisdiction and powers of the State Commission
- §10. Jurisdiction and powers of the local authorities
- §11. Territorial agreements
- §12. Unregulated service agreements

### **III. OPERATIONS**

- §13. Operations generally
- §14. Rules and regulations
- §15. Cooperatives
- §16. Public corporations
- §17. Abandonment and discontinuance
- §18. Depreciation
- §19. Discrimination
- §20. Rates
- §21. Refunds
- §22. Revenue
- §23. Return
- §24. Services generally

- §25. Competition
- §26. Valuation
- §27. Accounting
- §28. Apportionment
- §29. Rate of return
- §30. Construction
- §31. Equipment
- §32. Safety
- §33. Maintenance
- §34. Additions and betterments
- §35. Extensions
- §36. Local service
- §37. Liability for damage
- §38. Financing practices
- §39. Costs and expenses
- §40. Reports, records and statements
- §41. Billing practices
- §42. Planning and management
- §43. Accounting Authority orders
- §44. Safety
- §45. Decommissioning costs

#### IV. RELATIONS BETWEEN CONNECTING COMPANIES

- §46. Relations between connecting companies generally
- §47. Physical connection
- §48. Contracts
- §48.1 Qualifying facilities
- §49. Records and statements

### ELECTRIC

#### I. IN GENERAL

##### §3. Certificate of convenience and necessity

The Commission approves an application to construct a facility for producing electricity powered by landfill gas. – KC&PL Greater Missouri Operations Company-20 MPSC 3d 142.

In granting the utility a certificate of convenience and necessity, the Commission approved the overall project to install small solar production facilities within a defined area. Additional approval was not required after the utility determined the exact placement of those facilities. – Kansas City Power & Light Company-20 MPSC 3d 565.

#### **§ 4.1. Change of suppliers**

In determining whether a change of supplier will be granted, the Commission questions whether such change is for a reason other than a rate differential and in the public interest, which may be determined by answering ten questions: (1) whether the needs of the customer can be adequately met by the current supplier; (2) health or safety issue with regard to the amount or quality of power; (3) alternative the customer has considered; (4) whether there has been damage to the customer's equipment as a result of a problem with the current supplier; (5) the effect that the loss of the customer would have on the present supplier; (6) whether a change of supplier would result in duplicative services or facilities; (7) the overall burden on the customer caused by inadequate service; (8) efforts made by the present supplier to solve or mitigate the problems; (9) the impact the Commission's decision may have on economic development; and, (10) the effect the granting of authority might have on any territorial agreements or on the negotiation thereof. – Union Electric Company-20 MPSC 3d 99.

The Commission may order a change of suppliers for property served by a cooperative or a municipally owned or operated electric power system on the basis that the change is in the public interest for a reason other than a rate differential. The cost the cooperative must incur to repair and replace the infrastructure for the properties in question outweighs the revenue the sales from the infrastructure would generate, and the public utility and property owners agreeing to the change, are all factors supporting that the change would be in the public interest. – Osage Valley Electric Cooperative-20 MPSC 3d 146.

### **II. JURISDICTION AND POWERS**

#### **§9. Jurisdiction and powers of the State Commission**

Commissioner Terry M. Jarrett dissented from the Commission's decision to transmit administrative rules to the Secretary of State regarding Section 393.1075, RSMo, the Missouri Energy Efficiency Investment Act. Commissioner Jarrett states that some of the proposed rules are unlawful because they exceed the Commission's statutory authority. The enabling legislation did not authorize the Commission to establish energy and demand savings goals or impose penalties for failure to meet those goals. – Missouri Energy Efficiency Investment Act-20 MPSC 3d 24.

### **III. OPERATIONS**

#### **§14. Rules and regulations**

The Commission purported to withdraw two rule provisions that had previously been rejected by the Joint Committee on Administrative Rules (JCAR). – Electric Utility Renewable Energy Standard Requirements-20 MPSC 3d 122.

#### **§20. Rates**

The Commission approved a non-unanimous Global Agreement resolving a tariff issue concerning Empire District Electric Company's jurisdictional gross annual



electric revenues by \$18,650,000. Empire had previously attempted to set rates that would increase its annual gross revenues by approximately \$36.5 million. The Commission found that Empire had met its burden of proof by a preponderance of the evidence that the rates set forth in the Global Agreement were just and reasonable. – The Empire District Electric Company-20 MPSC 3d 553.

**§22. Revenue**

The throughput disincentive discourages investment by utilities in energy efficiency measures. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

**§29. Rate of return**

The Commission must use its judgment to establish a rate of return on equity attractive enough to investors to allow the utility to fairly compete for the investor's dollar in the capital market. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

The principles and methods involved in valuing physical assets are different than the principles and methods involved in estimating a utility's cost of equity. Therefore, valuation analyses cannot be used to support the reasonableness of a return on equity recommendation. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

**§30. Construction**

The Commission approves an application to construct a facility for producing electricity powered by landfill gas. – KCP&L Greater Missouri Operations Company-20 MPSC 3d 142.

**§33. Maintenance**

The Commission continued a tracking mechanism for costs related to vegetation management to encourage the utility to continue to improve reliability. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

**§37. Liability for damage**

Ameren Missouri was not allowed to include any amount of the cost to rebuild the upper reservoir of the Taum Sauk plant in its rate base. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

**§39. Costs and expenses**

Off-system contracts for the sale of electricity were not long-term full and partial requirements sales within the meaning of the utility's tariff and could not be excluded from the utilities off-system sales for purposes of calculating the balances in its fuel adjustment clause. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 353.

**§42. Planning and management**

Commissioner Davis advocated the Commission's IRP rule require the Commission acknowledge the reasonableness of an electric utility's resource plan as part of the IRP process. – Chapter 22 Electric Utility Resource Planning Rules-20 MPSC 3d 37.

**§43. Accounting Authority orders**

The Commission's rule allows Ameren Missouri to use an AAO to defer recovery of its costs as an alternative to recovering those costs through a Renewable Energy Standard Rate Adjustment Mechanism (RESRAM). – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

**EVIDENCE, PRACTICE AND PROCEDURE****I. IN GENERAL**

- §1. Generally
- §2. Jurisdiction and powers
- §3. Judicial notice; matters outside the record
- §4. Presumption and burden of proof
- §5. Admissibility
- §6. Weight, effect and sufficiency
- §7. Competency
- §8. Stipulation

**II. PARTICULAR KINDS OF EVIDENCE**

- §9. Particular kinds of evidence generally
- §10. Admissions
- §11. Best and secondary evidence
- §12. Depositions
- §13. Documentary evidence
- §14. Evidence by Commission witnesses
- §15. Opinions and conclusions; evidence by experts
- §16. Petitions, questionnaires and resolutions
- §17. Photographs
- §19. Records and books of utilities
- §20. Reports by utilities
- §21. Views

**III. PRACTICE AND PROCEDURE**

- §22. Parties
- §23. Notice and hearing
- §24. Procedures, evidence and proof
- §25. Pleadings and exhibits

- §26. Burden of proof
- §27. Finality and conclusiveness
- §28. Arbitration
- §29. Discovery
- §30. Settlement procedures
- §31. Mediator
- §32. Confidential evidence
- §33. Defaults

## **EVIDENCE, PRACTICE AND PROCEDURE**

### **I. IN GENERAL**

#### **§4. Presumption and burden of proof**

Utility expenditures are presumed to be prudently incurred until some party presents sufficient evidence to establish a serious doubt as to prudence. Thereafter the burden shifts to the utility to prove that its expenditures were prudent. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

#### **§5. Admissibility**

The Commission denied a motion by the utility to strike Staff evidence presented for the first time in surrebuttal testimony to justify a disallowance. The Commission found that the utility was not prejudiced by presenting the evidence in surrebuttal rather than in earlier testimony because the utility had three months before the hearing to prepare for cross-examination and did not request to supplement its own testimony to address that issue. – Atmos Energy Corporation-20 MPSC 3d 347.

#### **§8. Stipulation**

The Commission has the legal authority to accept a stipulation to resolve a case. The Commission need not make findings of fact or conclusions of law in an order accepting or approving a stipulation. – Union Electric Company, d/b/a Ameren UE-20 MPSC 3d 12.

By Commission rule, non-unanimous stipulations and agreements to which no party objects within seven days may be treated as if they were unanimous. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 560.

### **II. PARTICULAR KINDS OF EVIDENCE**

#### **§9. Particular kinds of evidence generally**

Private letter rulings are entitled to evidentiary weight, are relied upon by courts as an instructive tool, and are helpful in ascertaining doctrines applied by the Internal

Revenue Service. – Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company-20 MPSC 3d 153.

### **III. PRACTICE AND PROCEDURE**

#### **§22. Parties**

The applications to intervene of the Natural Resource Defense Council and the Missouri Coalition for the Environment, d/b/a Renew Missouri were found to comply with the applicable regulation and were granted. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 40.

Utility's counter-claim that challenged the good-faith basis of Staff's position did not potentially affect the individual interest of Staff's legal representative to justify the intervention of that individual as a party to the counter-claim. – Laclede Gas Company-20 MPSC 3d 675.

#### **§23. Notice and hearing**

Even in a contested case, if no party requests a hearing, the Commission may rule on the application without convening a hearing. – RDG Development, LLC-20 MPSC 3d 33.

#### **§24. Procedures, evidence and proof**

When disposing of a matter on the pleadings the facts alleged in the challenged pleading are accepted as true. If those assumed facts are insufficient as a matter of law a judgment on the pleadings is appropriate. – Laclede Gas Company, Laclede Energy Resources, and The Laclede Group-20 MPSC 3d 93.

The Commission granted Laclede's motion to dismiss count I of Staff's complaint where that count merely alleged the Commission's jurisdiction over Laclede while not asserting a claim that Laclede had violated any provision of law or tariff. – Laclede Gas Company-20 MPSC 3d 126.

The Commission granted summary determination in favor of Staff's complaint against Laclede for violating a stipulation and agreement by which Laclede agreed not to object to the production of documents on the basis that such documents were in the possession of its corporate parent rather than itself. – Laclede Gas Company-20 MPSC 3d 129.

Because no party adequately supported KCP&L's number for fuel expense as filed in its true-up testimony, the Commission found that KCP&L's true-up testimony on the dollar amount was less reliable than the dollar amount presented by Staff. – Kansas City Power & Light Company-20 MPSC 3d 339.

The Commission denied applications for rehearing regarding its decision in a rate case. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 673.

**§26. Burden of proof**

The complainant bears the burden of proof to show the utility has engaged in unjust or unreasonable actions. – Laclede Gas Company-20 MPSC 3d 29.

The Commission presumes a utility's costs were prudently incurred. Utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures are prudent. Any party can challenge the presumption of prudence by creating a serious doubt as to the prudence of an expenditure. Once a serious doubt is raised, the burden shifts to the utility to dispel those doubts and prove prudence. – Kansas City Power & Light Company-20 MPSC 3d 200.

The Commission presumes that a utility's costs were prudently incurred. Any party can rebut that presumption by creating a "serious doubt" as to the prudence of an expenditure. The serious doubt is created upon identifying an imprudent action based on industry standards and the circumstances at the time the decision was made, and proof of increased costs due to that decision. Once a serious doubt has been raised, the burden shifts back to the utility to dispel those doubts and prove the expenditure was prudent. – KCP&L Greater Missouri Operations Company-20 MPSC 3d 378.

**§27. Finality and conclusiveness**

The Office of Public Counsel filed a motion for rehearing alleging that the filing by another party of a motion for extension of time regarding a previous stipulation and agreement created a new live issue to which Public Counsel was entitled to respond. In denying the request for rehearing, the Commission stated that Public Counsel waived any right to a hearing when it did not timely oppose the stipulation and agreement and did not request a stay of the Commission's report and order. The Commission noted that it opened a separate case solely for the purpose of allowing Public Counsel to address that issue. – Lake Region Water & Sewer Company-20 MPSC 3d 1.

Law of the case bars the Commission from re-trying a matter on which Court of Appeals reversed Commission's decision. – KCP&L Greater Missouri Operations Company-20 MPSC 3d 85.

**§28. Arbitration**

In arbitration of telecommunications interconnection agreement, post-decision practice is subject to federal statutes and the Missouri regulations made pursuant to federal regulations, to the exclusion of State statutes and regulations made under State statutes. – Southwestern Bell Telephone Company d/b/a AT&T Missouri-20 MPSC 3d 118.

**§29. Discovery**

The Commission granted a motion by its staff to compel a utility to provide documents regarding transactions between the utility and its marketing affiliate

because the information was relevant or may lead to the discovery of admissible evidence. – Atmos Energy Corporation-20 MPSC 3d 52.

**§32. Confidential evidence**

The Commission may appoint a special master to review attorney-client privilege claims for objections to discovery requests. – Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company-20 MPSC 3d 111. – Kansas City Power & Light Company and KCP&L Greater Missouri Operations Company-20 MPSC 3d 111.

**EXPENSE**

**I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Financing practices
- §4. Apportionment
- §5. Valuation
- §6. Accounting

**II. JURISDICTION AND POWERS**

- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of the Federal Commissions
- §9. Jurisdiction and powers of local authorities

**III. EXPENSES OF PARTICULAR UTILITIES**

- §10. Electric and power
- §11. Gas
- §12. Heating
- §13. Telecommunications
- §14. Water
- §15. Sewer

**IV. ASCERTAINMENT OF EXPENSES**

- §16. Ascertainment of expenses generally
- §17. Extraordinary and unusual expenses
- §18. Comparisons in absence of evidence
- §19. Future expenses
- §20. Methods of estimating
- §21. Intercorporate costs or dealings

**V. REASONABLENESS OF EXPENSE**

- §22. Reasonableness generally
- §23. Comparisons to test reasonableness
- §24. Test year and true up

**VI. PARTICULAR KIND OF EXPENSE**

- §25. Particular kinds of expenses generally
- §26. Accidents and damages
- §27. Additions and betterments
- §28. Advertising, promotion and publicity
- §29. Appraisal expense
- §30. Auditing and bookkeeping
- §31. Burglary loss
- §32. Casualty losses and expenses
- §33. Capital amortization
- §34. Collection fees
- §35. Construction
- §36. Consolidation expense
- §37. Depreciation
- §38. Deficits under rate schedules
- §39. Donations
- §40. Dues
- §41. Employee's pension and welfare
- §42. Expenses relating to property not owned
- §43. Expenses and losses of subsidiaries or other departments
- §44. Expenses of non-utility business
- §45. Expenses relating to unused property
- §46. Expenses of rate proceedings
- §47. Extensions
- §48. Financing costs and interest
- §49. Franchise and license expense
- §50. Insurance and surety premiums
- §51. Legal expense
- §52. Loss from unprofitable business
- §53. Losses in distribution
- §54. Maintenance and depreciation; repairs and replacements
- §55. Management, administration and financing fees
- §56. Materials and supplies
- §57. Purchases under contract
- §58. Office expense
- §59. Officers' expenses
- §60. Political and lobbying expenditures
- §61. Payments to affiliated interests

- §62. Rentals
- §63. Research
- §64. Salaries and wages
- §65. Savings in operation
- §66. Securities redemption or amortization
- §67. Taxes
- §68. Uncollectible accounts
- §69. Administrative expense
- §70. Engineering and superintendence expense
- §71. Interest expense
- §72. Preliminary and organization expense
- §73. Expenses incurred in acquisition of property
- §74. Demand charges
- §75. Expenses incidental to refunds for overcharges
- §76. Matching revenue/expense/rate base
- §77. Adjustments to test year levels
- §78. Isolated adjustments

## **EXPENSE**

### **V. REASONABLENESS OF EXPENSE**

#### **§22. Reasonableness generally**

A party must provide evidence that the utility's actions caused higher costs than if prudent decisions had been made. This includes evidence as to the amount that the expenditures would have been had the utility acted in a prudent manner. – Kansas City Power & Light Company-20 MPSC 3d 200.

## **GAS**

### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §4. Abandonment or discontinuance
- §5. Liability for damages
- §6. Transfer, lease and sale



**II. JURISDICTION AND POWERS**

- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of the Federal Commissions
- §9. Jurisdiction and powers of local authorities

**III. CONSTRUCTION AND EQUIPMENT**

- §10. Construction and equipment generally
- §11. Leakage, shrinkage and waste
- §12. Location
- §13. Additions and betterments
- §14. Extensions
- §15. Maintenance
- §16. Safety

**IV. OPERATION**

- §17. Operation generally
- §17.1. Purchased Gas Adjustment (PGA)
- §17.2. Purchased Gas-incentive mechanism
- §18. Rates
- §19. Revenue
- §20. Return
- §21. Service
- §22. Weatherization
- §23. Valuation
- §24. Accounting
- §25. Apportionment
- §26. Restriction of service
- §27. Depreciation
- §28. Discrimination
- §29. Costs and expenses
- §30. Reports, records and statements
- §31. Interstate operation
- §32. Financing practices
- §33. Billing practices
- §34. Accounting Authority orders
- §35. Safety

**V. JOINT OPERATIONS**

- §36. Joint operations generally
- §37. Division of revenue
- §38. Division of expenses
- §39. Contracts

- §40. Transportation
- §41. Pipelines

**VI. PARTICULAR KIND OF EXPENSES**

- §42. Particular kinds of expenses generally
- §43. Accidents and damages
- §44. Additions and betterments
- §45. Advertising, promotion and publicity
- §46. Appraisal expense
- §47. Auditing and bookkeeping
- §48. Burglary loss
- §49. Casualty losses and expenses
- §50. Capital amortization
- §51. Collection fees
- §52. Construction
- §53. Consolidation expense
- §54. Depreciation
- §55. Deficits under rate schedules
- §56. Donations
- §57. Dues
- §58. Employee's pension and welfare
- §59. Expenses relating to property not owned
- §60. Expenses and losses of subsidiaries or other departments
- §61. Expenses of non-utility business
- §62. Expenses relating to unused property
- §63. Expenses of rate proceedings
- §64. Extensions
- §65. Financing costs and interest
- §66. Franchise and license expense
- §67. Insurance and surety premiums
- §68. Legal expense
- §69. Loss from unprofitable business
- §70. Losses in distribution
- §71. Maintenance and depreciation; repairs and replacements
- §72. Management, administration and financing fees
- §73. Materials and supplies
- §74. Purchases under contract
- §75. Office expense
- §76. Officers' expenses
- §77. Political and lobbying expenditures
- §78. Payments to affiliated interests
- §79. Rentals
- §80. Research
- §81. Salaries and wages

- §82. **Savings in operation**
- §83. **Securities redemption or amortization**
- §84. **Taxes**
- §85. **Uncollectible accounts**
- §86. **Administrative expense**
- §87. **Engineering and superintendence expense**
- §88. **Interest expense**
- §89. **Preliminary and organization expense**
- §90. **Expenses incurred in acquisition of property**
- §91. **Demand charges**
- §92. **Expenses incidental to refunds for overcharges**

## **GAS**

### **I. IN GENERAL**

#### **§3. Certificate of convenience and necessity**

The Commission may impose such conditions on a certificate of convenience and necessity as it deems reasonable and necessary. Nothing in the order granting this certificate was a finding by the Commission of the reasonableness or prudence of expenditures involved in serving the customers in the new service area listed in the certificate. – Southern Union Company, d/b/a Missouri Gas Energy-20 MPSC 3d 562.

### **IV. OPERATION**

#### **§18. Rates**

The Commission approved a Stipulation and Agreement authorizing an increase of \$9 million in AmerenUE's retail base rate, which includes \$700,000 in annual funding, increasing to \$850,000 over the next three years, for natural gas energy efficient programs. – Union Electric Company, d/b/a Ameren UE-20 MPSC 3d 114.

#### **§33. Billing practices**

Laclede Gas Company was not in violation of the law when it began sending electronic bills to Complainant and, therefore within the law by sending an electronic notice of disconnection. – Laclede Gas Company-20 MPSC 3d 43.

### **V. JOINT OPERATIONS**

#### **§36. Joint operations generally**

Alleging the existence of circumstances that are expressly allowed by the affiliate transactions rule does not allege a violation of that rule and does not state a claim upon which relief can be granted. – Laclede Gas Company, Laclede Energy Resources, and The Laclede Group-20 MPSC 3d 93.

## **MANUFACTURED HOUSING**

### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the manufacturers and dealers
- §3. Jurisdiction and powers of Federal authorities
- §4. Jurisdiction and powers of the State Commission
- §5. Reports, records and statements

### **II. WHEN A PERMIT IS REQUIRED**

- §6. When a permit is required generally
- §7. Operations and construction

### **III. GRANT OR REFUSAL OF A PERMIT**

- §8. Grant or refusal generally
- §9. Restrictions or conditions
- §10. Who may possess
- §11. Public safety

### **IV. OPERATION, TRANSFER, REVOCATION OR CANCELLATION**

- §12. Operations under the permit generally
- §13. Duration of the permit
- §14. Modification and amendment of the permit generally
- §15. Transfer, mortgage or lease generally
- §16. Revocation, cancellation and forfeiture generally
- §17. Acts or omissions justifying revocation or forfeiture
- §18. Necessity of action by the Commission
- §19. Penalties

## **MANUFACTURED HOUSING**

### **I. IN GENERAL**

#### **§4. Jurisdiction and powers of the State Commission**

Under Section 700.100.2, RSMO, the Commission may consider a complaint charging a registered manufactured housing dealer with failure to arrange for proper initial setup of any modular home. – 5 Star Homes and Development Community, Inc.-20 MPSC 3d 88.

#### **IV. OPERATION, TRANSFER, REVOCATION OR CANCELLATION**

##### **§17. Acts or omissions justifying revocation or forfeiture**

Under Commission rule 4 CSR 240-123.095(11), failure to pay a re-inspection fee constitutes grounds for the denial, suspension or revocation, or placing on probation of a dealer's certificate of registration. – 5 Star Homes and Development Company, Inc.-20 MPSC 3d 88.

Under Section 700.100.2(6) RSMo, failure to arrange for proper initial setup of a modular home constitutes grounds for suspension, revocation or placing on probation of a manufacturer's dealer registration. – 5 Star Homes and Development Company, Inc.-20 MPSC 3d 88.

##### **§19. Penalties**

Under Section 700.115.2 RSMo, whoever violated any provision of Chapter 700, RSMo, shall be liable to the state of Missouri for a civil penalty in an amount which shall not exceed \$1,000 for each violation. – 5 Star Homes and Development Company, Inc.-20 MPSC 3d 88.

### **PUBLIC UTILITIES**

#### **I. IN GENERAL**

- §1. Generally**
- §2. Nature of**
- §3. Functions and powers**
- §4. Termination of status**
- §5. Obligation of the utility**

#### **II. JURISDICTION AND POWERS**

- §6. Jurisdiction and powers generally**
- §7. Jurisdiction and powers of the State Commission**
- §8. Jurisdiction and powers of the Federal Commissions**
- §9. Jurisdiction and powers of local authorities**

#### **III. FACTORS AFFECTING PUBLIC UTILITY CHARACTER**

- §10. Tests in general**
- §11. Franchises**
- §12. Charters**
- §13. Acquisition of public utility property**
- §14. Compensation or profit**

- §15. Eminent domain
- §16. Property sold or leased to a public utility
- §17. Restrictions on service, extent of use
- §18. Size of business
- §19. Solicitation of business
- §20. Submission to regulation
- §21. Sale of surplus
- §22. Use of streets or public places

#### **IV. PARTICULAR ORGANIZATIONS-PUBLIC UTILITY CHARACTER**

- §23. Particular organizations generally
- §24. Municipal plants
- §25. Municipal districts
- §26. Mutual companies; cooperatives
- §27. Corporations
- §28. Foreign corporations or companies
- §29. Unincorporated companies
- §30. State or federally owned or operated utility
- §31. Trustees

### **PUBLIC UTILITIES**

#### **I. IN GENERAL**

##### **§1. Generally**

The Commission estimated its fiscal year 2012 Assessment to be \$16,574,239. – Assessment Against Public Utilities-20 MPSC 3d 571.

#### **II. JURISDICTION AND POWERS**

##### **§7. Jurisdiction and powers of the State Commission**

The Commission does not have authority to dictate to the company whether it must use internal workforce rather than outside contractors to perform the work of the company. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 574.

### III. FACTORS AFFECTING PUBLIC UTILITY CHARACTER

#### §19. Solicitation of business

This file is established as a repository for documents and comments regarding Missouri's regulated utilities' procurement of goods and services from diverse suppliers. – Utilities' Efforts to Procure Goods and Services from Diverse Suppliers-20 MPSC 3d 337.

## RATES

### I. JURISDICTION AND POWERS

- §1. Jurisdiction and powers generally
- §2. Jurisdiction and powers of Federal Commissions
- §3. Jurisdiction and powers of the State Commission
- §4. Jurisdiction and powers of the courts
- §5. Jurisdiction and powers of local authorities
- §6. Limitations on jurisdiction and power
- §7. Obligation of the utility

### II. REASONABLENESS-FACTORS AFFECTING REASONABLENESS

- §8. Reasonableness generally
- §9. Right of utility to accept less than a reasonable rate
- §10. Ability to pay
- §11. Breach of contract
- §12. Capitalization and security prices
- §13. Character of the service
- §14. Temporary or emergency
- §15. Classification of customers
- §16. Comparisons
- §17. Competition
- §18. Consolidation or sale
- §19. Contract or franchise rate
- §20. Costs and expenses
- §21. Discrimination, partiality, or unfairness
- §22. Economic conditions
- §23. Efficiency of operation and management
- §24. Exemptions
- §25. Former rates; extent of change
- §26. Future prospects
- §27. Intercorporate relations
- §28. Large consumption

- §29. Liability of utility
- §30. Location
- §31. Maintenance of service
- §32. Ownership of facilities
- §33. Losses or profits
- §34. Effects on patronage and use of the service
- §35. Patron's profit from use of service
- §36. Public or industrial use
- §37. Refund and/or reduction
- §38. Reliance on rates by patrons
- §39. Restriction of service
- §40. Revenues
- §41. Return
- §42. Seasonal or irregular use
- §43. Substitute service
- §44. Taxes
- §45. Uniformity
- §46. Value of service
- §47. Value of cost of the property
- §48. Violation of law or orders
- §49. Voluntary rates
- §50. What the traffic will bear
- §51. Wishes of the utility or patrons

### **III. CONTRACTS AND FRANCHISES**

- §52. Contracts and franchises generally
- §53. Validity of rate contract
- §54. Filing and Commission approval
- §55. Changing or terminating-contract rates
- §56. Franchise or public contract rates
- §57. Rates after expiration of franchise
- §58. Effect of filing new rates
- §59. Changes by action of the Commission
- §60. Changes or termination of franchise or public contract rate
- §61. Restoration after change

### **IV. SCHEDULES, FORMALITIES AND PROCEDURE RELATING TO**

- §62. Initiation of rates and rate changes
- §63. Proper rates when existing rates are declared illegal
- §64. Reduction of rates
- §65. Refunds



- §66. Filing of schedules reports and records
- §67. Publication and notice
- §68. Establishment of rate base
- §69. Approval or rejection by the Commission
- §70. Legality pending Commission action
- §71. Suspension
- §72. Effective date
- §73. Period for which effective
- §74. Retroactive rates
- §75. Deviation from schedules
- §76. Form and contents
- §77. Billing methods and practices
- §78. Optional rate schedules
- §79. Test or trial rates

#### **V. KINDS AND FORMS OF RATES AND CHARGES**

- §80. Kinds and forms of rates and charges in general
- §81. Surcharges
- §82. Uniformity of structure
- §83. Cost elements involved
- §84. Load, diversity and other factors
- §85. Flat rates and charges
- §86. Mileage charges
- §87. Zone rates
- §88. Transition from flat to meter
- §89. Straight, block or step-generally
- §90. Contract or franchise requirement
- §91. Two-part rate combinations
- §92. Charter, contract, statutory, or franchise restrictions
- §93. Demand charge
- §94. Initial charge
- §95. Meter rental
- §96. Minimum bill or charge
- §97. Maximum charge or rate
- §98. Wholesale rates
- §99. Charge when service not used; discontinuance
- §100. Variable rates based on costs-generally
- §101. Fuel clauses
- §102. Installation, connection and disconnection charges
- §103. Charges to short time users

#### **VI. RATES AND CHARGES OF PARTICULAR UTILITIES**

- §104. Electric and power

- §105. Demand, load and related factors
- §106. Special charges; amount and computation
- §107. Kinds and classes of service
- §108. Gas
- §109. Heating
- §110. Telecommunications
- §111. Water
- §112. Sewers
- §113. Joint Municipal Utility Commissions

#### **VII. EMERGENCY AND TEMPORARY RATES**

- §114. Emergency and temporary rates generally
- §115. What constitutes an emergency
- §116. Prices
- §117. Burden of proof to show emergencies

#### **VIII. RATE DESIGN, CLASS COST OF SERVICE**

- §118. Method of allocating costs
- §119. Rate design, class cost of service for electric utilities
- §120. Rate design, class cost of service for gas utilities
- §121. Rate design, class cost of service for water utilities
- §122. Rate design, class cost of service for sewer utilities
- §123. Rate design, class cost of service for telecommunications utilities
- §124. Rate design, class cost of service for heating utilities

### **RATES**

#### **I. JURISDICTION AND POWERS**

##### **§3. Jurisdiction and powers of the State Commission**

The Commission has described a “zone of reasonableness” extending from 100 basis points above to 100 basis points below the recent national average of awarded return on equity (“ROE”) to help the Commission evaluate ROE recommendations. The Commission has wide latitude in setting an ROE within the zone of reasonableness. If the total effect of the rate order is not unjust or unreasonable, judicial inquiry is at an end. – KCP&L Greater Missouri Operations Company-20 MPSC 3d 378.

The Commission may phase in a rate increase that is primarily due to an unusually large increase in the utility’s rate base. Because the rate base increased more

than 100% as a result of this rate case, there is an unusually large increase in rate base. – KCP&L Greater Missouri Operations Company-20 MPSC 3d 545.

## **II. REASONABLENESS-FACTORS AFFECTING REASONABLENESS**

### **§20. Costs and expenses**

The purpose of normalization is to determine a reasonable expectation of what costs a utility is likely to experience in the future so that rates can be set to allow the utility a reasonable opportunity to recover those costs. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

### **§22. Economic conditions**

No one benefits when a utility is deprived of the ability to charge its customers a just and reasonable rate. Public sentiment is only part of the equation the Commission must consider when fulfilling its responsibility to establish just and reasonable rates. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

## **V. KINDS AND FORMS OF RATES AND CHARGES**

### **§89. Straight, block or step-generally**

The Commission does not like declining block rates, but insufficient evidence was presented to justify changing those rates. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

### **§101. Fuel clauses**

The Commission is not obligated to interpret the language of a fuel adjustment tariff in a manner that protects the utility's ability to earn a fair return on equity. Rather such tariffs are to be interpreted in the same manner as any other tariff. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 353.

The Commission approved a stipulation and agreement to clarify the amount of interest owed by the utility pursuant to the decision announced in the report and order. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 543.

Any fuel adjustment clause the Commission allows a utility to implement must be reasonably designed to allow the company a sufficient opportunity to earn a fair return on equity. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

## **VIII. RATE DESIGN, CLASS COST OF SERVICE**

### **§119. Rate design, class cost of service for electric utilities**

It is important that each customer class carry its own weight by paying rates sufficient to cover the cost to serve that class. That also encourages cost effective

utilization of electricity by sending appropriate price signals. – Union Electric Company, d/b/a Ameren Missouri-20 MPSC 3d 573.

## **SECURITY ISSUES**

### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Authorization by a corporation
- §4. Conversion, redemption and purchase by a corporation
- §5. Decrease of capitalization
- §6. Sinking funds
- §7. Dividends
- §8. Revocation and suspension of Commission authorization
- §9. Fees and expenses
- §10. Purchase by utility
- §11. Accounting practices

### **II. JURISDICTION AND POWERS**

- §12. Jurisdiction and powers in general
- §13. Jurisdiction and powers of Federal Commissions
- §14. Jurisdiction and powers of the State Commission
- §15. Jurisdiction and powers of local authorities

### **III. NECESSITY OF AUTHORIZATION BY THE COMMISSION**

- §16. Necessity of authorization by the Commission generally
- §17. Installment contracts
- §18. Refunding or exchange of securities
- §19. Securities covering utility and nonutility property
- §20. Securities covering properties outside the State

### **IV. FACTORS AFFECTING AUTHORIZATION**

- §21. Factors affecting authorization generally
- §21.1. Effect on bond rating
- §22. Equity capital
- §23. Charters
- §24. Competition
- §25. Compliance with the terms of a mortgage or lease
- §26. Definite plans and purposes

- §27. Financial conditions and prospects
- §28. Use of proceeds
- §29. Dividends and dividend restrictions
- §30. Improper practices and irregularities
- §31. Intercorporate relations
- §32. Necessity of issuance
- §33. Revenue
- §34. Rates and rate base
- §35. Size of the company
- §36. Title of property
- §37. Amount
- §38. Kind of security
- §39. Restrictions imposed by the security

#### **V. PURPOSES AND SUBJECTS OF CAPITALIZATION**

- §40. Purposes and subjects of capitalization generally
- §41. Additions and betterments
- §42. Appreciation or full plant value
- §43. Compensation for services and stockholders' contributions
- §44. Deficits and losses
- §45. Depreciation funds and requirements
- §46. Financing costs
- §47. Intangible property
- §48. Going value and good will
- §49. Stock dividends
- §50. Loans to affiliated interests
- §51. Overhead
- §52. Profits
- §53. Refunding, exchange and conversion
- §54. Reimbursement of treasury
- §55. Renewals, replacements and reconstruction
- §56. Working capital

#### **VI. KINDS AND PROPORTIONS**

- §57. Bonds or stock
- §58. Common or preferred stock
- §59. Stock without par value
- §60. Short term notes
- §61. Proportions of stock, bonds and other security
- §62. Proportion of debt to net plant

**VII. SALE PRICE AND INTEREST RATES**

- §63. Sale price and interest rates generally
- §64. Bonds
- §65. Notes
- §66. Stock
- §67. Preferred stock
- §68. No par value stock

**VIII. FINANCING METHODS AND PRACTICES**

- §69. Financing methods and practices generally
- §70. Leases
- §71. Financing expense
- §72. Payment for securities
- §73. Prospectuses and advertising
- §74. Subscriptions and allotments
- §75. Stipulation as to rate base

**IX. PARTICULAR UTILITIES**

- §76. Telecommunications
- §77. Electric and power
- §78. Gas
- §79. Sewer
- §80. Water
- §81. Miscellaneous

**SECURITY ISSUES**

No headnotes in this volume involved the question of security.

**SERVICE****I. IN GENERAL**

- §1. Generally
- §2. What constitutes adequate service
- §3. Obligation of the utility
- §4. Abandonment, discontinuance and refusal of service
- §5. Contract, charter, franchise and ordinance provisions

- §6. Restoration or continuation of service
- §7. Substitution of service
- §7.1. Change of supplier
- §8. Discrimination

## **II. JURISDICTION AND POWERS**

- §9. Jurisdiction and powers generally
- §10. Jurisdiction and powers of the Federal Commissions
- §11. Jurisdiction and powers of the State Commission
- §12. Jurisdiction and powers over service outside of the state
- §13. Jurisdiction and powers of the courts
- §14. Jurisdiction and powers of local authorities
- §15. Limitations on jurisdiction
- §16. Enforcement of duty to serve

## **III. DUTY TO SERVE**

- §17. Duty to serve in general
- §18. Duty to render adequate service
- §19. Extent of profession of service
- §20. Duty to serve as affected by contract
- §21. Duty to serve as affected by charter, franchise or ordinance
- §22. Duty to serve persons who are not patrons
- §23. Reasons for failure or refusal to serve
- §24. Duty to serve as affected by inadequate revenue

## **IV. OPERATIONS**

- §25. Operations generally
- §26. Extensions
- §27. Trial or experimental operation
- §28. Consent of local authorities
- §29. Service area
- §30. Rate of return
- §31. Rules and regulations
- §32. Use and ownership of property
- §33. Hours of service
- §34. Restriction on service
- §35. Management and operation
- §36. Maintenance
- §37. Equipment
- §38. Standard service
- §39. Noncontinuous service

**V. SERVICE BY PARTICULAR UTILITIES**

- §40. Gas
- §41. Electric and power
- §42. Heating
- §43. Water
- §44. Sewer
- §45. Telecommunications

**VI. CONNECTIONS, INSTRUMENTS AND EQUIPMENT**

- §46. Connections, instruments and equipment in general
- §47. Duty to install, own and maintain
- §48. Protection, location and liability for damage
- §49. Restriction and control of connections, instruments and equipment

**SERVICE**

No headnotes in this volume involved the question of service.

**SEWER****I. IN GENERAL**

- §1. Generally
- §2. Certificate of convenience and necessity
- §3. Obligation of the utility
- §4. Transfer, lease and sale

**II. JURISDICTION AND POWERS**

- §5. Jurisdiction and powers generally
- §6. Jurisdiction and powers of the Federal Commissions
- §7. Jurisdiction and powers of the State Commission
- §8. Jurisdiction and powers of local authorities
- §9. Territorial agreements

**III. OPERATIONS**

- §10. Operation generally
- §11. Construction and equipment
- §12. Maintenance



- §13. **Additions and betterments**
- §14. **Rates and revenues**
- §15. **Return**
- §16. **Costs and expenses**
- §17. **Service**
- §18. **Depreciation**
- §19. **Discrimination**
- §20. **Apportionment**
- §21. **Accounting**
- §22. **Valuation**
- §23. **Extensions**
- §24. **Abandonment or discontinuance**
- §25. **Reports, records and statements**
- §26. **Financing practices**
- §27. **Security issues**
- §28. **Rules and regulations**
- §29. **Billing practices**
- §30. **Eminent domain**
- §31. **Accounting Authority orders**

## SEWER

### I. **IN GENERAL**

#### §2. **Certificate of convenience and necessity**

In making determinations to grant certificates of convenience and necessity, the Commission has used the following criteria: there must be a need for the service; the applicant must be qualified to provide the proposed service; the applicant must have the financial ability to provide the service; the applicant's proposal must be economically feasible; the service must promote the public interest. – Holtgrewe Farms Sewer Company, LLC-20 MPSC 3d 19.

In making its determination of whether there is a need for the service, the term does not mean "essential" or "absolutely indispensable" but rather that the inconvenience to the public occasioned by the lack of the proposed service is great enough to amount to a necessity. – Holtgrewe Farms Sewer Company, LLC-20 MPSC 3d 19.

### II. **JURISDICTION AND POWERS**

#### §7. **Jurisdiction and powers of the State Commission**

The Commission has expressed its policy regarding jurisdiction over homeowners associations. Through these cases, the Commission has established a policy of not

asserting jurisdiction over a system if certain criteria are met. Those criteria, known as the "Rocky Ridge Criteria", are reflected in the following factors:

- (a) The Association was organized as a not-for-profit corporation for the benefit of the property owners.
- (b) All customers currently served by the subject utility assets are members of the Association.
- (c) Only members of the Association will be served by the subject utility assets.
- (d) The Association's action regarding utility matters will be under the control of the members that are also the customers served by the subject utility assets.
- (e) The Association owns the subject assets and thus has control over such assets. – RDG Development, LLC-20 MPSC 3d 33.

### **III. OPERATIONS**

#### **§13. Additions and betterments**

Timber Creek was not entitled to recover expenses associated with drilling an exploratory pilot gas well or other exploration for alternative energy sources because the drilling venture's potential return was too speculative and ultimately provided no benefit to customers. – Timber Creek Sewer Company-20 MPSC 3d 161.

#### **§14. Rates and revenues**

Timber Creek was not entitled to implement a \$.50 per month per customer surcharge to establish an emergency repair fund where factual evidence demonstrated that the company was able to fund unplanned events and repairs without financial hardship. – Timber Creek Sewer Company-20 MPSC 3d 161.

#### **§16. Costs and expenses**

The Commission determined that Timber Creek, a small sewer company with four employees, had met its burden of proof in establishing that the salaries authorized for its well-qualified employees were just and reasonable amounts to be recovered from rates as compensation. This determination was based on four Relevant Salary Determination Factors and commensurate with experience and a cost of living adjustment. The Commission reasoned that the increase in salaries would help ensure the retention of quality and experienced employees.

Likewise, Timber Creek sufficiently proved that \$36,170 was a just and reasonable amount to be recovered in rates for rate case expense for costs associated with adjudicating this rate increase request. An additional \$18,175 rate case expense recovery requested for an earlier rate case was denied because it would constitute unlawful retroactive ratemaking by permitting recovery of past losses. Recovery for the alleged under-recovery of Commission assessments from prior years was denied for similar reasons. – Timber Creek Sewer Company-20 MPSC 3d 161.

## **STEAM**

### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §4. Transfer, lease and sale
- §4.1. Change of suppliers
- §5. Charters and franchise
- §6. Territorial agreements

### **II. JURISDICTION AND POWERS**

- §7. Jurisdiction and powers generally
- §8. Jurisdiction and powers of Federal Commissions
- §9. Jurisdiction and powers of the State Commission
- §10. Jurisdiction and powers of the local authorities
- §11. Territorial agreements
- §12. Unregulated service agreements

### **III. OPERATIONS**

- §13. Operations generally
- §14. Rules and regulations
- §15. Cooperatives
- §16. Public corporations
- §17. Abandonment and discontinuance
- §18. Depreciation
- §19. Discrimination
- §20. Rates
- §21. Refunds
- §22. Revenue
- §23. Return
- §24. Services generally
- §25. Competition
- §26. Valuation
- §27. Accounting
- §28. Apportionment
- §29. Rate of return
- §30. Construction
- §31. Equipment
- §32. Safety
- §33. Maintenance

- §34. Additions and betterments
- §35. Extensions
- §36. Local service
- §37. Liability for damage
- §38. Financing practices
- §39. Costs and expenses
- §40. Reports, records and statements
- §41. Billing practices
- §42. Planning and management
- §43. Accounting Authority orders
- §44. Safety
- §45. Decommissioning costs

#### **IV. RELATIONS BETWEEN CONNECTING COMPANIES**

- §46. Relations between connecting companies generally
- §47. Physical connection
- §48. Contracts
- §49. Records and statements

### **STEAM**

No headnotes in this volume involved the question of steam.

### **TELECOMMUNICATIONS**

#### **I. IN GENERAL**

- §1. Generally
- §2. Obligation of the utility
- §3. Certificate of convenience and necessity
- §3.1. Certificate of local exchange service authority
- §3.2. Certificate of interexchange service authority
- §3.3. Certificate of basic local exchange service authority
- §4. Transfer, lease and sale

#### **II. JURISDICTION AND POWERS**

- §5. Jurisdiction and powers of local authorities
- §6. Jurisdiction and powers of Federal Commissions
- §7. Jurisdiction and powers of the State Commission

**III. OPERATIONS**

- §8. Operations generally
- §9. Public corporations
- §10. Abandonment or discontinuance
- §11. Depreciation
- §12. Discrimination
- §13. Costs and expenses
- §13.1. Yellow Pages
- §14. Rates
- §14.1 Universal Service Fund
- §15. Establishment of a rate base
- §16. Revenue
- §17. Valuation
- §18. Accounting
- §19. Financing practices
- §20. Return
- §21. Construction
- §22. Maintenance
- §23. Rules and regulations
- §24. Equipment
- §25. Additions and betterments
- §26. Service generally
- §27. Invasion of adjacent service area
- §28. Extensions
- §29. Local service
- §30. Calling scope
- §31. Long distance service
- §32. Reports, records and statements
- §33. Billing practices
- §34. Pricing policies
- §35. Accounting Authority orders

**IV. RELATIONS BETWEEN CONNECTING COMPANIES**

- §36. Relations between connecting companies generally
- §37. Physical connection
- §38. Contracts
- §39. Division of revenue, expenses, etc.

**V. ALTERNATIVE REGULATION AND COMPETITION**

- §40. Classification of company or service as noncompetitive, transitionally, or competitive
- §41. Incentive regulation plans
- §42. Rate bands

- §43. Waiver of statutes and rules
- §44. Network modernization
- §45. Local exchange competition
- §46. Interconnection Agreements
- §46.1 Interconnection Agreements-Arbitrated
- §47. Price Cap

## TELECOMMUNICATIONS

### III. OPERATIONS

#### §14. Rates

As required by Section 392.245.13, RSMo, the Commission calculated the weighted, statewide average rate of nonwireless basic local telecommunications services and determined that no legislative changes were recommended to the state legislature. – Weighted Statewide Average Rate of Nonwireless Basic Local Telecommunication Services-20 MPSC 3d 125.

#### §26. Service generally

The Commission opened an investigation into the quality of service provided by telecommunications companies following deregulation. – Wireline Telecommunications Services-20 MPSC 3d 5.

The Commission accepted a Staff investigative report that concluded that deregulated local exchange telecommunications companies continue to provide an acceptable quality of service to their customers. – Wireline Telecommunications Services-20 MPSC 3d 147.

### V. ALTERNATIVE REGULATION AND COMPETITION

#### §46. Interconnection Agreements

Missouri statute subjects interconnected voice over internet protocol traffic to the same charges as telecommunications services with an exception for information service providers.

Missouri may govern access to dark fiber. – Southwestern Bell Telephone Company, d/b/a AT&T Missouri-20 MPSC 3d 60.

#### §46.1. Interconnection Agreements-Arbitrated

In arbitration of telecommunications interconnection agreement, post-decision practice is subject to federal statutes and the Missouri regulations made pursuant to federal regulations, to the exclusion of State statutes and regulations made under State

statutes. – Southwestern Bell Telephone Company, d/b/a AT&T Missouri -20 MPSC 3d 118.

## VALUATION

### I. IN GENERAL

- §1. Generally
- §2. Constitutional limitations
- §3. Necessity for
- §4. Obligation of the utility

### II. JURISDICTION AND POWERS

- §5. Jurisdiction and powers generally
- §6. Jurisdiction and powers of the State Commission
- §7. Jurisdiction and powers of the Federal Commissions
- §8. Jurisdiction and powers of local authorities

### III. METHODS OR THEORIES OF VALUATION

- §9. Methods or theories generally
- §10. Purpose of valuation as a factor
- §11. Rule, formula or judgment as a guide
- §12. Permanent and tentative valuation

### IV. ASCERTAINMENT OF VALUE

- §13. Ascertainment of value generally
- §14. For rate making purposes
- §15. Purchase or sale price
- §16. For issuing securities

### V. FACTORS AFFECTING VALUE OR COST

- §17. Factors affecting value or cost generally
- §18. Contributions from customers
- §19. Appreciation
- §20. Apportionment of investment or costs
- §21. Experimental or testing cost
- §22. Financing costs
- §23. Intercorporate relationships
- §24. Organization and promotion costs
- §25. Discounts on securities

- §26. Property not used or useful
- §27. Overheads in general
- §28. Direct labor
- §29. Material overheads
- §30. Accidents and damages
- §31. Engineering and superintendence
- §32. Preliminary and design
- §33. Interest during construction
- §34. Insurance during construction
- §35. Taxes during construction
- §36. Contingencies and omissions
- §37. Contractor's profit and loss
- §38. Administrative expense
- §39. Legal expense
- §40. Promotion expense
- §41. Miscellaneous

#### **VI. VALUATION OF TANGIBLE PROPERTY**

- §42. Buildings and structures
- §43. Equipment and facilities
- §44. Land
- §45. Materials and supplies
- §46. Second-hand property
- §47. Property not used and useful

#### **VII. VALUATION OF INTANGIBLE PROPERTY**

- §48. Good will
- §49. Going value
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## **WATER**

### **I. IN GENERAL**

#### **§2. Certificate of convenience and necessity**

In making determinations to grant certificates of convenience and necessity, the Commission has used the following criteria: there must be a need for the service; the applicant must be qualified to provide the proposed service; the applicant must have the financial ability to provide the service; the applicant's proposal must be

economically feasible; the service must promote the public interest. – Holtgrewe Farms Walter Company, LLC-20 MPSC 3d 14.

In making its determination of whether there is a need for the service, the term does not mean “essential” or “absolutely indispensable” but rather that the inconvenience to the public occasioned by the lack of the proposed service is great enough to amount to a necessity. – Holtgrewe Farms Walter Company, LLC-20 MPSC 3d 14.

**§4. Transfer, lease and sale**

The Commission grants public utility’s application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility’s certificate and tariff. – U.S. Water Company-20 MPSC 3d 27.

After approving the transfer of assets from Loma Linda Water Company to Missouri-American Water Company, the Commission cancelled the certificate granted to Loma Linda. – Missouri American Water Company and Loma Linda Water Company-20 MPSC 3d 377.

The Commission grants public utility’s application to sell works and system to city, conditioned on notice of that transfer, for cancelation of public utility’s certificate and tariff. – Aqua Missouri, Inc.-20 MPSC 3d 569.

**III. OPERATIONS**

**§27. Reports, records and statements**

The Commission granted union’s request to make Missouri-American Water Company’s officer salaries public information to be published in its 2009 Annual Report. The Commission reasoned that the public interest would be served by requiring disclosure of the salaries, given the utility’s monopoly status. This was true even though the utility had previously provided all requested information in its 2009 Annual Report and had committed no violation. – Missouri-American Water Company-20 MPSC 3d 342.