

House Committee on Energy and Environment

January 26, 2015

Utility Ratemaking in Kansas

Justin Grady,

Chief of Accounting and Financial Analysis



Agenda

- 1. Overview of the Ratemaking Process in Kansas**
 - a. Legal Process**
 - b. Role of KCC Staff and Other Parties**
- 2. Types of Cases**
- 3. Styles of Ratemaking**
 - a. Rate Base/Rate of Return**
 - b. DSC/TIER**
- 4. Review of a Rate Case**
- 5. Rate Design/Class Cost of Service**

Overview of Ratemaking Process

- Fundamentally a Legal Process

- Utility regulation and Ratemaking is governed by Kansas Statutes, Administrative Rules and Regulations, and Civil Court proceedings (through appeals of KCC Orders)
- Therefore, KCC Ratemaking is largely a legal process designed to produce “substantial competent evidence” that is necessary to decide a “just and reasonable” rate. (pleadings, motions, briefs, discovery, hearings, Orders, etc.)
- Generally, due process rights are set out in procedural schedules (see example of current procedural schedules next slide)
- Commission has 240 days to issue an Order so procedural schedule defines the due dates within statutory time frame
- Commission issues Orders that can be appealed to a civil court

Examples of Current KCPL and Westar Rate Case Procedural Schedules

Westar—Docket No. 15-WSEE-115-RTS

KCPL— Docket No. 15-KCPE-116-RTS

	<u>KCP&L Schedule</u>	<u>Westar Schedule</u>
Open rate case docket for pre-audit	Sept. 19, 2014	Sept. 19, 2014
Filing date	Jan. 2, 2015	March 2, 2015
Actual La Cygne Cost Update due	March 31, 2015	May 31, 2015
Update Data due	April 10, 2015	June 8, 2015
Staff/Intervenor Testimony due	May 11, 2015	July 9, 2015
Public hearing	May 18, 2015	July 21, 2015

Examples of Current KCPL and Westar Rate Case Procedural Schedules

KCP&L Schedule

Westar Schedule

Cross-Answering Testimony due	May 26, 2015	July 22, 2015
Rebuttal Testimony due	June 1, 2015	July 29, 2015
Settlement discussions	June 4-15, 2015	August 3-7, 2015
Deadline to submit settlement agreement	June 16, 2015	August 11, 2015
Discovery cutoff	June 16, 2015	August 11, 2015
End of public comment period	June 16, 2015	August 11, 2015
List of contested issues due	June 16, 2015	August 11, 2015
In-service confirmation filing	June 16, 2015	June 16, 2015
Prehearing Conference	June 17, 2015	August 12, 2015
Evidentiary Hearing	June 22-26, 2015	August 17-21, 2015
Staff & Intervenor Response to In-service confirmation due	July 10, 2015	July 10, 2015
Initial Company Brief	July 17, 2015	Sept. 11, 2015
Initial Staff/Intervenor Brief	July 28, 2015	Sept. 22, 2015
Hearing on In-service (if necessary)	July 31, 2015	July 31, 2015
Reply Briefs	August 4, 2015	Sept. 29, 2015
Order date	Sept. 10, 2015 ⁴⁸	Oct. 28, 2015
Effective date of rates	Oct. 1, 2015	Oct. 28, 2015
Abbreviated case filing	Aug. 29, 2016 (or sooner)	N/A

Overview of Ratemaking Process

- Role of KCC Staff and Other Parties
 - The KCC Staff represents the “public generally,” which means we strive to balance the interests between the utility company, its shareholders, and ratepayers
 - Citizen’s Utility Ratepayer Board
 - Advocates on behalf of residential and small commercial ratepayers
 - Other parties – such as large industrial customers, or other utility companies – represent their respective interests

Types of Cases with Rate Implications

- Rate Cases
- Fuel Clause Review
(Purchased Gas Adjustments and Energy Cost Adjustments)
- Mergers & Acquisitions
- Accounting Authority Order
- Certificate
- Complaint
- Contract
- General Investigations
- Fuel Purchase and Hedging Review
- Kansas Universal Service Fund Audits (KUSF)
- Review of Surcharges and Riders
 - Property Tax Surcharge (66-117(f))
 - Transmission Delivery Charge (66-1237)
 - Environmental Cost Recovery Rider
 - Bad Debt Cost of Gas
 - Energy Efficiency Rider
 - Transmission Formula Rates
 - Southern Pioneer DSC-FBR
 - Gas Safety Reliability Surcharge (66-2202)

Styles of Ratemaking

Rate Base/Rate of Return

- **Revenue Requirement = (RB*ROR) + O&M + A&G+ Depreciation + Taxes**

*= (Rate Base * Rate of Return) + Operating and Maintenance Expenses + Administrative and General Expenses + Depreciation Expense + Income and Other Taxes Expenses*

- Primarily used for large Investor Owned Utilities
- Rate Base represents all utility capital investment 'used and required to be used' to provide utility service to consumers
- Rate of Return consists of Weighted Average Cost of Capital (*Cost of Debt * Proportion of Debt in Cap. Structure*) + (*Cost of Equity* Proportion of Equity in Capital Structure*) **Example WACC= (5% * 50%) + (9% * 50%)= 7%**
- Cost of Equity (required shareholder return) is usually the most contentious issue in the case due to significant impact to both customers and shareholders, and disagreements about models used to estimate
- A Just and Reasonable rate requires a an opportunity to earn a fair return but no guarantee

Example of Revenue Requirement Calculation from KCPL's current case

Revenue Requirement - Sch 1

Kansas City Power & Light Company
2015 RATE CASE - Direct Filing
Kansas Jurisdiction
TY 6/30/14; K&M 3/31/15

Revenue Requirement - Schedule 1

Line No.	Description	Amount
1	Net Orig Cost of Rate Base (Sch 2)	\$ 2,087,480,330
2	Rate of Return	7.9432%
3	Net Operating Income Requirement	165,812,738
4	Net Income Available (Sch 9)	131,792,200
5	Additional NOIBT Needed	34,020,538
6	Additional Current Tax Required	22,258,277
7	Gross Revenue Requirement	<u>\$ 56,278,815</u>
% increase: Excluding ECA and EE		10.52%

Example of Adjustments to Expenses

Summary of Adjustments

Section 3 (ii)

Kansas City Power & Light Company
2015 RATE CASE - Direct Filing
Kansas Jurisdiction
TY 6/30/14; K&M 3/31/15

Summary of Adjustments

Line No.	Adj No.	Description	Witness	Increase (Decrease)			
	A	B		D	E	F	G
				Adjust to 3-31-16 - Update Date			
				Total Adjustments	Allocated Adj	100% MO & Whole Adj (2)	100% KS Adj
				Inor (Deor)	Inor (Deor)	Inor (Deor)	Inor (Deor)
1		JURISDICTIONAL COST OF SERVICE					
2		OPERATING REVENUE					
3	R-1	Remove Gross Receipts Tax revenue (MO only)	n/a	(50,318,095)		(50,318,095)	
4	R-20	Normalize KS Retail revenues (KS only)	Lutz/Bass	(20,330,986)			(20,330,986)
5	R-21	Adjust KS forfeited discounts for R-20 (KS Only)	Klote	22,718			22,718
6	R-82	Transmission Delivery Charge Adjustment	Klote	(8,549,865)	(8,549,865)		
7	CS-26	ECA revenue	Klote	(7,344,678)	(7,344,678)		
8				(96,520,906)	(15,894,543)	(60,318,095)	(20,308,268)
9		OPERATING EXPENSES					
10	CS-4	Reflect KCREC test year bad debt expense in KCP&L's COS	Klote	7,726,079		5,475,472	2,250,607
11	CS-9	Reflect KCREC test year bank commitment fees in KCP&L's COS	Klote	1,172,779	1,172,779		
12	CS-10	Reflect test year interest on customer deposits in COS	Klote	148,993		146,885	2,108
13	CS-11	Reverse prior period and non-recurring test year amounts	Klote	(4,875,718)	(4,875,718)		
14	CS-20a	Normalize bad debt expense related to test year revenue	Klote	79,249			79,249
15	CS-20b	Normalize bad debt expense related to jurisdictional "Ask" (KS only)	Klote	300,176			300,176
16	CS-26	ECA costs	Klote	(17,561,018)	(17,561,018)		
17	CS-35	Eliminate Wolf Creek Mid-Cycle Outage	Klote	(4,634,778)	(4,634,778)		
18	CS-36	Annualize Wolf Creek refueling outage amortization	n/a	(314,116)		(314,116)	
19	CS-37	Adjust Nuclear decommissioning expense	Glizer	0			
20	CS-43	Annualize Vegetation Management Costs	Klote	1,832,363	1,832,363		
21	CS-44	Economic Relief Pilot Program (ERPP)	Klote	400,000			400,000
22	CS-49	Miscellaneous O&M	Klote	385,947	385,947		
23	CS-50	Annualize salary and wage expense for changes in staffing levels and base pay rates	Klote	1,461,827	1,471,395	(2,946)	(6,622)
24	CS-51	Normalize incentive compensation costs	Klote	(5,204,220)	(5,204,220)		
25	CS-52	Normalize 401(k) costs	Klote	2,484	2,484		
26	CS-60	Annualize other benefit costs	Klote	3,151,178	3,151,178		
27	CS-61	Annualize OPEB expense	Klote	(689,644)	(689,644)		
28	CS-65	Annualize Pension expense (Includes SERP)	Klote	2,951,042	2,951,042		
29	CS-70	Annualize Insurance premiums	Klote	828,107	828,107		
30	CS-71	Normalize injuries and damages expense	Klote	163,928	163,928		
31	CS-76	Annualize interest on customer deposits	Klote	7,220		7,430	(210)
32	CS-77	Annualize Customer Accounts expense for credit card payment costs	Klote	(26,851)	(26,851)		
33	CS-78	Annualize KCREC bank fees related to sale of receivables	Klote	(206,642)	(206,642)		
34	CS-80	Amortize KS Rate Case expenses	Klote	(1,579,503)			(1,579,503)
35	CS-82	Transmission Delivery Charge Adjustment	Klote	(48,141,681)	(48,067,623)	(54,969)	(19,090)
36	CS-85	Annualize regulatory assessments	Klote	(67,686)		(67,686)	
37	CS-87	IT Roadmap O&M	Klote	3,515,615	3,515,615		
38	CS-89	Meter Replacement O&M	Klote	540,000	540,000		
39	CS-92	Adjust dues, donations and contributions	Klote	910,978	910,978		

Example of Adjustments to Expenses

Kansas City Power & Light Company 2015 RATE CASE - Direct Filing Kansas Jurisdiction TY 6/30/14; K&M 3/31/15

Summary of Adjustments

Line No.	Adj No.	Description	Witness	Increase (Decrease)			
	A	B		D	E	F	G
				Adjust to 3-31-16 - Update Date			
				Total Adjustments	Allocated Adj's	100% MO & Whol Adj's (2)	100% KS Adj's
				Inor (Deor)	Inor (Deor)	Inor (Deor)	Inor (Deor)
40	CS-96	Amortize Merger transition costs (KS only)	Klote	(1,777,778)			(1,777,778)
41	CS-99	Flood Reimbursement Amortization	Klote	320,857	320,857		
42	CS-100	Amortize DSM/EE regulatory assets	Klote	(1,894,515)			(1,894,515)
43	CS-101	Amortize Talent Assessment severance and outplacement regulatory asset	Klote	(3,513)			(3,513)
44	CS-107	Transource Account Review Amortization	Klote	(21,453)			(21,453)
45	CS-109	Adjust Lease expense - Corporate Headquarters	Klote	(134,898)	(377,058)		242,160
46	CS-114	Amortization of La Cynne Obsolete Inventory	Klote	197,099	197,099		
47	CS-115	Amortize Legal fee reimbursement	Klote	340,497			340,497
48	CS-117	Common-use Billings	Klote	(2,546,143)	(2,546,143)		
49	CS-120	Annualize depr exp based on jurisdictional depr rates applied to jurisdictional plant-in-service at indicated period - unit trains & transportation equipment	Klote	0	0		
50				(63,233,829)	(66,735,912)	5,190,070	(1,687,987)
Depreciation Expense							
51	CS-120	Annualize depreciation expense based on jurisdictional depreciation rates applied to jurisdictional plant-in-service at indicated period	Klote	5,259,711	5,259,711		
52				5,259,711	5,259,711	0	0
Amortization Expense							
53	CS-113	Amortization of La Cynne Reg Asset - Depr Deferral	Klote	110,053			110,053
54	CS-118	Amortize Meter Replacement Unrecovered Reserve	Klote	1,068,624			1,068,624
55	CS-121	Annualize plant amortization expense based on jurisdictional amortization rates applied to unamortized jurisdictional plant-in-service at indicated period	Klote	11,487,900	11,487,900		
56				12,666,577	11,487,900	0	1,178,677
Taxes Other than Income							
57	R-1	Remove Gross Receipts Tax expense (MO only)	n/a	(58,977,490)		(58,977,490)	
58	CS-18	Reverse test year Kansas City, Missouri Earnings tax (MO only)	n/a	53,173		53,173	
59	CS-53	Annualize FICA payroll tax expense	Klote	(256,531)	(256,531)		
60	CS-125	Adjust property tax expense	Klote	(3,644,994)	(3,644,994)		
61				(62,825,842)	(3,901,525)	(58,924,317)	0
Income Tax Expense							
63	CS-125	Reflect adjustments to Schedule 9, Allocation of Current and Deferred Income Taxes	Klote	6,866,348	6,317,799	548,549	
64				6,866,348	6,317,799	548,549	0
65		Total Electric Oper. Expenses		(101,267,035)	(47,572,028)	(53,185,698)	(509,310)
66		Net Electric Operating Income		4,746,128	31,677,484	(7,132,397)	(19,798,958)

Styles of Ratemaking

DSC/TIER

- Debt Service Coverage (DSC) & Times Interest Earned Ratio (TIER)
- Primarily used for Co-ops (*Southern Pioneer is exception*)
- Although most Co-op rates are deregulated, transmission services are not. *Mid-Kansas and Sunflower TFRs and Several Local Access Charges for transmission service over 34.5 kV system.*
- Under DSC & TIER, revenue requirement equals the total of:
 - O&M + A&G + Depreciation
 - Debt Service Requirements (TIER uses interest only while DSC uses principal and interest)
 - “Coverage” allowance in excess of the actual debt service payments required

Staff Review of a Rate Case

- KCC Staff's role in reviewing a rate case:
 - Evaluate and analyze utility rate case applications for adherence to accepted regulatory theory.
 - Accumulate and evaluate evidence obtained from the utility (discovery process).
 - Determine differences between utility's application and established policies and ratemaking concepts
 - There are few issues that are black and white
 - Provide pre-filed testimony to Commissioners presenting evidence in support of Staff's position
 - The Goal is a Revenue Requirement (and ultimately rates) that allows the utility to meet its financial obligations and provide reliable service, while at the same time protecting captive ratepayers from overpaying for a service that is essential to modern day life.

CCOS / Rate Design

Rate Design is the development of prices customers will pay for retail service. There are two stages:

- Allocate the Revenue Requirement among the different classes of customers. This determines how much revenue needs to be collected from each class. The process to determine this allocation is called a “class cost of service” study.
- Construct customer rates for each class and sub-class that generates the required class revenue
- This phase of a proceeding is often very contentious amongst larger customers in different classes.