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Cash Working Capital; Plant Operating and
Maintenance Expense; SPP Integrated
Marketplace Costs
Witness: Blake A. Mertens
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Case No. ER-2012-0345
Date Testimony Prepared: January 2013

Before the Missouri Public Service Commission

Rebuttal Testimony

of

Blake A. Mertens

January 2013

****Denotes Highly Confidential****

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BLAKE A. MERTENS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2012-0345

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REBUTTAL TESTIMONY
OF
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THE EMPIRE DISTRICT ELECTRIC COMPANY
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MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2012-0345

1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. Blake A. Mertens. My business address is 602 South Joplin Avenue, Joplin,
4 Missouri.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. The Empire District Electric Company (“Empire” or “Company”), I am - Vice
7 President Energy Supply.

8 **Q. ARE YOU THE SAME BLAKE A MERTENS WHO FILED DIRECT**
9 **TESTIMONY IN THIS CASE?**

10 A. Yes, I am.

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

12 A. I will rebut the testimony presented in Staff’s Cost of Service Report for three
13 different items: (1) proposed disallowance of Iatan from rate base; (2) proposed
14 disallowance of two accounts from cash working capital included in rate base due to
15 a mischaracterization of the accounts; (3) plant operating and maintenance expense.

16 As it relates to Staff’s proposed Iatan disallowance, I will present the steps Empire
17 has taken to prudently manage its capital investments in the Iatan Power Station,
18 including Iatan 1, Iatan 2, and Iatan Common Property (Iatan Common), and how
19 Empire’s efforts in this area make it essential that Empire’s prudence should be
20 judged on its actions, and not the actions of Kansas City Power and Light
21 (“KCPL”). I will also rebut the testimony of MEUA witness Stephen Rackers and

1 his proposed deferral of costs that Empire is incurring to prepare for participation in
2 the next day markets.

3 **IATAN POWER STATION:**

4 **Q. PLEASE BRIEFLY DESCRIBE EMPIRE’S OWNERSHIP INTEREST IN**
5 **THE IATAN POWER STATION.**

6 A. Empire owns a 12 percent interest in Iatan Unit 1 and Iatan Common Facilities.
7 The provisions of this ownership interest are defined in the Iatan Station Ownership
8 Agreement dated July 31, 1978 (“Unit 1 Agreement”). Similarly, Empire owns 12
9 percent of Iatan Unit 2 and associated Iatan Common Facilities. The provisions of
10 this ownership interest are defined in the Iatan Unit 2 and Common Facilities
11 Ownership Agreement dated May 19, 2006 (“Unit 2 Agreement”). Empire owns 3
12 percent of the Iatan Site property that is not directly a portion of Iatan Unit 1, Unit
13 2, or Common Facilities.

14 **Q. WHAT SPECIAL EFFORTS DID EMPIRE, OR OTHERS, MAKE TO**
15 **ASSURE IATAN UNIT 2 BECAME A REALITY?**

16 A. As I mention above, Empire and KCPL have a long history of joint plant ownership
17 beginning in the late-1970s with the addition of Iatan Unit 1. Both Empire and
18 KCPL worked with the Staff, the Office of Public Counsel, the Missouri
19 Department of Natural Resources, and various industrial customers to present to the
20 Missouri Public Service Commission (“Commission”) regulatory plans that called
21 for the addition of Iatan Unit 2. Subsequently, both Empire’s and KCPL’s
22 Regulatory Plans were approved by the Commission. Because of the relatively
23 small number of customers served in Kansas, Arkansas and Oklahoma, and the

1 regulatory cost associated with pursuing a regulatory plan, Empire did not pursue
2 similar regulatory plans in these other regulatory jurisdictions.

3 **Q. WERE THE TERMS CONTAINED IN THE IATAN 2 OWNERSHIP**
4 **AGREEMENT NEGOTIATED BETWEEN KCPL AND THE OTHER**
5 **OWNERS, INCLUDING EMPIRE?**

6 A. Yes. Extensive negotiations occurred relating to the terms contained in the Iatan 2
7 Ownership Agreement.

8 **Q. DID THE IATAN 2 OWNERSHIP AGREEMENT INCLUDE PROVISIONS**
9 **WHICH WOULD ALLOW EMPIRE, AS A NON-OPERATOR OWNER, TO**
10 **PROTECT THE INTERESTS OF EMPIRE AND ITS CUSTOMERS?**

11 A. Yes, but only to a degree. There are several provisions included in the Iatan
12 Ownership Agreement that Empire insisted upon to allow the Company to take
13 steps to protect the interests of Empire and its customers. Those provisions
14 included a requirement that KCPL use “good utility practice” in constructing and
15 operating Iatan 2 (Article V, par. 5.3(f)). It included a provision that established a
16 management committee, in which Empire was a member, “to determine and
17 administer policies and take all other action relating to the management, operation
18 and maintenance of Iatan 2” (Article V, par. 5.1 and 5.2). It further included
19 provisions requiring KCPL to provide Empire access to information relating to the
20 cost of construction (Article VI, par. 6.5), including notification by KCPL to the
21 other owners of all significant events material to the construction and/or operation
22 of Iatan 2.

23 **Q. WAS KCPL IN CHARGE OF CONSTRUCTING IATAN 2?**

1 A. Yes. The Unit 2 Agreement authorized KCPL to act as the exclusive Operator to
2 perform all functions as may be required for the actual design, permitting,
3 development, procurement, construction, operation and maintenance of the Iatan
4 Unit 2 Facility, the Common Facilities, and the Iatan Station Site. It is typical in
5 jointly owned electric generation plants for the owner with the largest ownership
6 share to be the owner in charge of construction and operation of the plant. This is
7 what occurred in this case. However, KCPL, as Operating Agent / Operator, was
8 subject to the direction of the Management Committee. The Management
9 Committee consists of representatives of the respective Owners who have voting
10 rights equal to their undivided ownership interest in the facility.

11 **Q. PLEASE EXPLAIN THE SIGNIFICANCE OF THESE MANAGEMENT**
12 **COMMITTEE PROVISIONS.**

13 A. To do this one must understand the Ownership Interests of all the parties. The
14 following two tables outline said ownership interests:

15 **Iatan Unit 1 Ownership Interests**

	<u>KCPL</u>	<u>Aquila</u>	<u>Empire</u>
16 Site Property	92.5%	4.5%	3.0%
17 Common Facilities	70.0%	18.0%	12.0%
18 Unit 1	70.0%	18.0%	12.0%

20
21 **Iatan Unit 2 Ownership Interests**

	<u>KCPL</u>	<u>Aquila</u>	<u>Empire</u>	<u>MJMEUC</u>	<u>KEPCO</u>
22 Common Facilities	61.45%	18.0%	12.0%	6.58%	1.97%
23 Unit 2	54.71%	18.0%	12.0%	11.76%	3.53%

25

1 As can be seen in the table above, Great Plains Energy Incorporated which includes
2 KCPL and Aquila, owns almost 90 percent of Unit 1, approximately 73 percent of
3 Unit 2, and over 79 percent of Common Facilities. Since the voting provisions of
4 the agreements only require a simple majority of ownership interest to carry a vote,
5 KCPL, in essence, has complete decision making authority for both units and all
6 facilities. Consequently, there is little a minority owner like Empire can do to
7 control KCPL's actions as Operator.

8 **Q. WHAT STEPS DID EMPIRE TAKE TO PRUDENTLY MANAGE ITS**
9 **INTERESTS AND COSTS ASSOCIATED WITH THE IATAN PROJECTS?**

10 A. Empire took extensive action to prudently manage its interests and associated costs.
11 These actions included but were not limited to:

- 12 1. Implementation of a project management team to oversee Empire's
13 interests in this and other projects included in Empire's Regulatory Plan.
- 14 2. Implementation of an internal cost control system to track costs
15 associated with the Iatan projects.
- 16 3. Actively participated in monthly joint owner's meetings related to the
17 projects.
- 18 4. Performed internal and construction audits of project contracts,
19 processes, and controls.
- 20 5. Placed an on-site representative to follow day-to-day activities and
21 provide prompt updates to project management.
- 22 6. Implementation of a Request for Information process to formally ask for
23 explanation of decisions, processes, and disputed invoices.

- 1 7. Implementation of a Request for Documentation process to obtain
2 omitted invoice and cost information in joint-owner billings.
- 3 8. Challenged, via the arbitration process allowed for in the Unit 2
4 Agreement, KCPL’s decision to solely take the benefits of the Advanced
5 Coal Tax Credit.
- 6 9. Challenged, via the arbitration process allowed for in the Unit 2
7 Agreement, KCPL’s decision to invoice Empire for legal fees associated
8 with Schiff-Hardin.
- 9 10. Participation in KCPL’s Comprehensive Energy Plan quarterly meetings
10 and KCPL’s rate case proceedings.

11 These steps allowed Empire to effectively manage its interests in the Iatan projects.

12 **IMPLEMENTATION OF A PROJECT MANAGEMENT TEAM**

13 **Q. GIVEN EMPIRE WAS INVOLVED IN THE IATAN AND OTHER LARGE**
14 **GENERATION PROJECTS REQUIRING SIGNIFICANT CAPITAL**
15 **INVESTMENT, WHAT DID EMPIRE DO TO MANAGE THESE**
16 **PROJECTS?**

17 A. Empire senior management recognized the Iatan 2, Plum Point, and Asbury
18 Selective Catalytic Reduction (“SCR”) projects were going to take direct
19 management attention in order to prudently assure their implementation. After
20 signing the Iatan 2 and Plum Point Ownership Agreements, Empire formed a group
21 of professionals referred to as the Strategic Projects Group. This group consisted of
22 the Manager of Strategic Projects (titled later changed to “Associate Director of

1 Strategic Projects”), a Cost Control Specialist, and an Operations & Planning
2 Analyst (title later changed to “Renewables and Strategic Initiatives Manager”).

3 **Q. WHO FILLED THESE POSITIONS?**

4 A. At that time I was the Associate Director of Strategic Projects and filled one of the
5 first two positions. The other of the first two positions listed above was filled by a
6 professional within the Company. Both of us had just been involved with the
7 construction of Riverton Unit 12, and had spent over 2-years on-site at the Riverton
8 plant managing day-to-day demolition and construction, managing and negotiating
9 project contracts, implementing cost control systems, commissioning the unit, and
10 supporting regulatory functions associated with the project. The third position was
11 filled by an individual that has extensive experience negotiating contracts, and more
12 specifically, purchase power agreements with wind farm developers.

13 **Q. WERE OTHER EMPIRE PERSONNEL INVOLVED?**

14 A. Yes. In addition to the Strategic Projects Group, Empire’s Vice-President of
15 Energy Supply was intimately involved with this group of projects. The then Vice-
16 President of Energy Supply had over 30-years of operating and construction
17 experience mainly with coal-fired generation. The assembly of these individuals
18 created an experienced and robust team to manage Empire’s interests in the Iatan
19 and Plum Point projects.

20 **Q. HOW WOULD YOU DESCRIBE THE MANNER IN WHICH THIS GROUP**
21 **HAS MANAGED THESE PROJECTS?**

22 A. Within the limits of Empire’s ability to act on these projects, I would say the group
23 performed very successfully. For example, the Riverton Unit 12, Asbury SCR, and

1 Plum Point projects have been brought on-line as scheduled and within budget and
2 Empire has not been cited for any material imprudence with respect to these
3 projects, representing over \$160 million in investments by Empire, by any of the
4 regulatory agencies under which it operates. Moreover, as part of the MPSC's Staff
5 audit and testimony in Empire's last Missouri rate case (ER-2011-0004) related to
6 Plum Point, the Commission Staff witness Mr. Chuck Hyneman stated that "the
7 ability of Staff to get quality auditable information, and the consistent full
8 cooperation professionalism and cooperativeness of Empire personnel in
9 conjunction with based on Staff's experience in previous rate case and construction
10 audits with Empire were significant factors in affecting the audit scope for Plum
11 Point." Similar statements were repeatedly made in the Staff's Plum Point Audit.

12 A portion of Mr. Hyneman's statement refers to the recently completed audits by
13 the Staff of Empire's Riverton Unit 12 and Asbury SCR projects. This is further
14 evidence of Empire's proven track record of cooperation and professionalism as it
15 relates to construction projects. Virtually no disallowances have been
16 recommended for the Plum Point, Riverton Unit 12, and Asbury SCR projects, and
17 the same Empire construction management team was in place for these three
18 projects that was in place for the Iatan Projects.

19 **IMPLEMENTATION OF EMPIRE INTERNAL COST CONTROL SYSTEM**

20 **Q. HOW HAS EMPIRE TRACKED AND MANAGED COSTS ASSOCIATED**
21 **WITH THE IATAN PROJECTS?**

22 A. Similar to the cost control systems we set up for the Riverton Unit 12, Asbury SCR,
23 and Plum Point projects, Empire set up a cost control system for Iatan 1 AQCS and

1 Iatan 2 projects. This system allowed Empire to track costs it had been charged,
2 track the adequacy of documentation provided with invoices, allow for the review
3 of invoices provided and their adherence to vendor/supplier/contractor contract
4 terms, and ultimately approve payment of invoices after adjustments had been made
5 for improper billings or clerical mistakes had been corrected.

6 **Q. HOW WOULD YOU DESCRIBE THE RESULTS OF EMPIRE'S COST**
7 **CONTROL SYSTEM?**

8 A. They were successful. Empire was able to identify costs totaling about **_____
9 _____** to date in total project costs that were deemed improperly billed to
10 Empire as a result of our review process. Empire's share of that amount is about
11 **_____**, which Empire has received reimbursement for or reduced its billings
12 as a result of our review process. In my opinion, Empire's cost control system has
13 allowed Empire to as effectively as possible manage the costs associated with
14 Empire's share of the Iatan projects as well as the other construction projects
15 previously discussed.

16 **REQUEST FOR INFORMATION AND DOCUMENTATION PROCESSES.**

17 **Q. HOW WAS EMPIRE ABLE TO OBTAIN COST DATA TO DETERMINE IF**
18 **IT WAS BEING APPROPRIATELY INVOICED FOR ITS SHARE OF**
19 **IATAN PROJECT COSTS?**

20 A. We diligently and aggressively requested back-up documentation from KCPL to
21 support every invoice we received. In the initial Iatan billings Empire received
22 from KCPL on the project, not a great deal of back-up documentation was provided.
23 We recognized that in order to substantiate the billings, Empire would need

1 documentation for every item being charged. That does not mean we were able to
2 scrutinize every single invoice or time sheet charged to the project, but rather that
3 we more thoroughly audited those invoices that were of greater significance to the
4 Iatan project.

5 **Q. WHAT PROCESSES WERE UTILIZED TO OBTAIN COST DATA?**

6 A. Initially much of the back-up information requests were made by email or phone
7 call requests. As the review and data transfer processes became more refined, we
8 initiated, in cooperation with KCPL, Request for Documentation and Request for
9 Information processes to ask specific questions about missing documentation,
10 potential clerical errors, potential improper billings, and other miscellaneous
11 information. These processes and the associated responses from KCPL allowed us
12 to request adjustments to Empire's billings if required.

13 **Q. WERE THESE PROCESSES SUCCESSFUL?**

14 A. In my opinion, yes. There was a large amount of back-up documentation associated
15 with these billings, with over 37,000 cost detail transactions having been received
16 for the Iatan projects alone. The processes we implemented, along with our overall
17 cost control system, allowed for systematic processing of the information without
18 overwhelming our staff. Our project management staff was able to effectively and
19 relatively quickly identify billing issues, ask KCPL management to clarify any
20 issues through a documented process, and, as stated in previous sections of my
21 testimony, receive approximately **_____** in reimbursements on the project.

22 **ACTIVE PARTICIPATION IN JOINT OWNERS MEETINGS**

1 **Q. HOW DID EMPIRE KEEP APPRISED OF PROGRESS ON THE IATAN**
2 **PROJECTS?**

3 A. Joint-owner's meetings were held on a monthly basis and sometimes more often
4 when budget or schedule changes were taking place. During these meetings project
5 safety, construction progress, contractor performance schedule, and budgets were
6 among the items discussed. While the meetings were led by KCPL's project
7 management team, review of the minutes from these meetings will show that
8 Empire's project management was quite active during these meetings. Empire
9 management consistently questioned progress, schedule, management decisions,
10 budget updates, budget variances, and many other parameters of the project.

11 **ON-SITE OWNER REPRESENTATIVE**

12 **Q. DID EMPIRE USE ANY OTHER MEANS TO STAY APPRISED OF THE**
13 **IATAN PROJECTS?**

14 A. Initially, the monthly project meetings and sporadic site visits by Empire's Strategic
15 Project Group, the monthly-joint owners meetings and the information provided in
16 them, and review of the monthly project reports of Burns & McDonnell, ALSTOM,
17 Kiewit, and other contractors, were the main avenues by which Empire was
18 informed of project progress. However, Empire ultimately decided to put someone
19 at the site full-time. Provisions within the Iatan Unit 2 Ownership Agreement
20 allowed us to place a Site Representative at the site to monitor activities.

21 **Q. WHEN DID EMPIRE PLACE SOMEONE FULL TIME AT THE IATAN**
22 **SITE?**

23 A. In June of 2008, Empire placed a full-time joint owner Site Representative at Iatan.

1 **Q. WHO DID EMPIRE PLACE AT THE SITE?**

2 A. Mr. John Minturn was hired as an independent contractor to be Empire's on-site
3 representative. Mr. Minturn had served as a site construction manager for Sega,
4 Inc., on Empire's Riverton Unit 12 construction project. In addition to that, Mr.
5 Minturn has over 25 years of construction experience, much of which was in the
6 utility industry. I've attached Mr. Minturn's resume as BAM Schedule 1.

7 **Q. WHAT WERE HIS RESPONSIBILITIES?**

8 A. Per the Unit 2 Ownership Agreement, Empire's Site Representative did not have the
9 authority to direct contractor work or the Operator's operations. However, Mr.
10 Minturn regularly attended project planning meetings, schedule meetings, and
11 monitored project progress. Mr. Minturn provided regular updates to Empire
12 management. But Mr. Minturn did not participate in budget reforecast, "Risk and
13 Opportunity", or other project budgeting meetings led by KCPL project
14 management due to KCPL management's insistence that he not; he also did not
15 participate in KCPL management meetings or meetings between KCPL and its
16 contractors when discussing commercial terms. In essence, Mr. Minturn was
17 Empire's eyes and ears on the site so we knew what was taking place in a timely
18 manner.

19 **AUDITS PERFORMED**

20 **Q. DID EMPIRE PERFORM ANY AUDITS ON THE IATAN PROJECTS?**

21 A. Yes. In addition to reviewing the Ernst and Young audits directed by KCPL project
22 management, Empire completed audits on its own accord to assure not only KCPL
23 processes were sound, but also our own internal systems and processes were

1 adequate. Empire conducted an audit of a key contractor / contract on the project,
2 that of Pullman Power, who was contracted to construct the chimney on the project.
3 This audit was completed by an independent contractor, McDonald and Associates.
4 In addition, Empire's internal auditing department audited the processes and cost
5 control systems implemented by Empire's Strategic Projects Group for this project.

6 **Q. IS EMPIRE'S INTERNAL AUDITING DEPARTMENT AN INDEPENDENT**
7 **GROUP?**

8 A. Yes. Our Internal Audit group reports to the Audit Committee of the Board of
9 Directors. Empire has purposely structured this to assure their findings are not
10 influenced by any other departments within Empire or senior management.

11 **Q. WERE THERE ANY KEY FINDINGS IN THE AUDITS EMPIRE'S**
12 **INTERNAL AUDITING DEPARTMENT CONDUCTED?**

13 A. A copy of an internal audit report dated September 30, 2010 is attached for
14 reference as BAM Schedule 2. A key finding of this audit, which can be found on
15 the last page of the report, states as follows:

16 **“We believe a system to provide an organized, knowledgeable, and**
17 **substantial review of Iatan II expenses has been designed and utilized by the**
18 **Strategic Projects team during the construction process.”**

19 These findings further substantiate the effectiveness and prudence of Empire's
20 processes associated with these projects.

21 **ADVANCED COAL TAX CREDIT ARBITRATION**

22 **Q. IN ADDITION TO THE APPROXIMATELY **_____** EMPIRE WAS**
23 **ABLE TO OBTAIN REIMBURSEMENT FOR THROUGH DIRECT**

1 **PROJECT BILLINGS, WERE THERE ANY OTHER ACTIONS EMPIRE’S**
2 **MANAGEMENT TOOK TO REDUCE IATAN PROJECT COSTS?**

3 A. Yes. Empire was awarded about \$17.7 million in advanced coal tax credits
4 associated with Iatan 2 to the benefit of its customers as a result of an arbitration
5 proceeding initiated by Empire management.

6 **Q. CAN YOU PLEASE EXPLAIN THESE ADVANCED COAL TAX CREDITS**
7 **AND THE ARBITRATION PROCEEDING?**

8 A. These matters are discussed in considerable detail in a recent Report and Order
9 issued by the Missouri Public Service Commission on Case Nos. ER-2010-0355
10 and ER-2010-0356. The order directed KCPL and GMO to apply to the IRS to
11 Revise the Memorandum of Understanding Regarding the Advanced Coal Tax
12 Credits for Iatan. A copy of that order is attached as BAM Schedule 3 to my
13 rebuttal testimony.

14 Again, Empire was awarded about \$17.7 million as direct result of its prudent and
15 diligent management of its interests in the Iatan 2 project. These tax credits will
16 directly offset the cost Empire’s ratepayers will pay for the Iatan 2 investment.

17 **SCHIFF HARDIN ARBITRATION**

18 **Q. PLEASE DESCRIBE SCHIFF HARDIN’S ROLE IN THE IATAN**
19 **PROJECTS.**

20 A. It is my understanding that Schiff Hardin LLC provided legal services to KCPL for
21 the Iatan projects.

22 **Q. DID EMPIRE ENTER INTO A DEMAND FOR ARBITRATION**
23 **CONCERNING SCHIFF HARDIN MATTERS?**

1 A. Yes.

2 **Q. WHY?**

3 A. KCP&L entered into an agreement with Schiff Hardin LLC to provide legal
4 services. Provisions within the agreement between KCP&L and Schiff Hardin state
5 the legal services “are intended for the sole benefit of KCP&L”; however, KCP&L
6 invoiced Empire for Schiff Hardin expenses based upon Empire’s ownership share
7 of Iatan. Despite being charged for Schiff Hardin’s services, Empire was not given
8 full access to Schiff Hardin reports, work product, and legal counsel.

9 **Q. WHAT WERE THE RESULTS OF THIS ARBITRATION?**

10 A. The arbitration proceeding was settled in the fall of 2011. The settlement allowed
11 for a ** _____

12 _____
13 _____ ** Again, the result of the

14 settlement is a direct consequence of prudent and diligent management by Empire
15 of its interests in the Iatan projects and yet another example of the steps Empire
16 took to assure that the Company and its customers are paying only their proper
17 share of Iatan costs.

18 **Q. HAVE YOU REVIEWED THIS COMMISSION’S RATE CASE ORDER IN**
19 **CASE NO. ER-2010-0355 WHICH DECIDED, AMONG OTHER ISSUES,**
20 **CLAIMS BY STAFF, OPC AND OTHER INTERVENORS THAT KCPL**
21 **WAS IMPRUDENT IN ITS MANAGEMENT OF THE CONSTRUCTION**
22 **OF IATAN 1 AQCS AND IATAN 2?**

23 A. Yes. I have reviewed the Commission’s decision.

1 **Q. WHAT WAS THE COMMISSION'S DECISION WITH RESPECT TO**
2 **WHETHER KCPL WAS PRUDENT IN ITS MANAGEMENT OF THE**
3 **CONSTRUCTION OF IATAN 1 AQCS AND IATAN 2?**

4 A. In Case No. ER-20120-0355, it is my understanding that the Commission excluded
5 from rate base two of the R&O packages relating to Iatan 1 AQCS: (1) relocation of
6 the construction management campus (\$456,608 total plant); and (2) resurfacing of
7 the construction area after a safety incident related to a JLG turnover (\$1,155,000
8 total plant). Similarly, in that same case, it is also my understanding that, with
9 respect to Iatan 2, the Commission concluded KCPL was imprudent in its
10 management of the construction of that plant relating to four items: (1) relocation of
11 the construction management campus (\$1,107,119 total plant); (2) the engagement
12 of Welding Services, Inc. (\$12,714,596 total plant); (3) KCPL's removal and re-
13 addition of an auxiliary boiler to the Iatan 2 Project (\$5,346,049 total plant); and
14 resurfacing of the construction area after a safety incident related to a JLG turnover
15 (\$2,345,000 total plant).

16 **Q. DID EMPIRE QUESTION KCPL ABOUT THE ISSUES THAT LED TO**
17 **DISALLOWANCES IN KCPL'S CASE WHEN EMPIRE BECAME AWARE**
18 **OF THEM?**

19 A. Yes. We made repeated inquiries at Joint Owner meetings and via Requests for
20 Information about the JLG incident that led to the resurfacing of the construction
21 area as well as about the construction campus relocation. The Joint Owner meeting
22 minutes in April and May of 2009 show that KCPL presented information on the
23 Welding Services, Inc. engagement. Empire asked numerous questions in these

1 meetings about this engagement. In addition we submitted a Request for
2 Information, RFI #40 dated May 8, 2009, attached hereto as BAM Schedule 4,
3 requesting additional information on this issue. Similarly, the September of 2009
4 Joint Owner meeting minutes show that Empire management asked for continued
5 updates on the Auxiliary Boiler issue in future Joint Owner meetings.

6 **Q. WHAT IS STAFF'S POSITION IN THIS CASE AS IT RELATES TO**
7 **THESE DISALLOWANCES AND EMPIRE'S PRUDENCE?**

8 A. On page 55 of Staff's Cost of Service Report and in its accounting schedules they
9 are recommending imputing Empire's share of these disallowances.

10 **Q. DO YOU BELIEVE KCPL'S IMPRUDENCE WITH RESPECT TO THESE**
11 **TWO ISSUES SHOULD BE IMPUTED TO EMPIRE?**

12 A. No.

13 **Q. CAN YOU EXPLAIN WHY KCPL'S IMPRUDENCE WITH RESPECT TO**
14 **THESE TWO ISSUES SHOULD NOT BE IMPUTED TO EMPIRE?**

15 A. I can list at least three reasons why the costs found imprudent in the KCPL case
16 should not be imputed to Empire.

17 First, Empire and the rest of the Joint Owners were not asked to vote via the
18 Management Committee whether contracts or change orders associated with these
19 issues should be executed. Upon being made aware of these issues, Empire
20 management specifically stated it had concerns with the Welding Services, Inc.,
21 change order, since this scope of work and schedule risk was already within the
22 ALSTOM contract. Similarly, Empire personnel were not allowed to make
23 decision on the original design and therefore had no input as to whether additional

1 Auxiliary Boilers would be required nor were we part of the construction
2 management decision as to where the construction campus should be located. We
3 were also not part of the negotiations with ALSTOM that lead to the resurfacing of
4 the construction area and were not asked to approve via the Management
5 Committee this change order.

6 Second, KCPL's own prudence expert indicated that it was KCPL who acted
7 imprudently with respect to some of these issues, which were clearly outside the
8 control of Empire's management, and Empire was given no reasonable opportunity
9 to object to the actions of KCPL beyond what Empire was able to do in the Joint
10 Owner meetings.

11 Finally, Empire believes its actions to be prudent associated with these issues. We
12 made KCPL management aware of our concerns both during Joint Owner meetings
13 and during informal conversations. Ultimately, KCPL determined it was best to
14 move forward with the contract issuance or change orders which its own prudence
15 expert found were imprudent. Ultimately there was nothing Empire and the other
16 Joint Owners could do to stop KCPL from acting the way it did.

17 **SUMMARY RELATED TO PROPOSED IATAN DISALLOWANCE**

18 **Q. PLEASE SUMMARIZE YOUR IATAN PROJECT REBUTTAL**
19 **TESTIMONY.**

20 A. While the Commission has previously disallowed a portion of Iatan project cost in a
21 recent KCPL rate case, KCPL Case No. ER-2010-0355, it is Empire's position that
22 it effectively managed its portion of the Iatan projects, and in so doing was able to
23 save its customers in excess of **_____** in project costs to-date, which is

1 more than the level of the KCPL disallowance simply being imputed to Empire.
2 Empire's prudence should be judged upon its actions, and not those of KCPL.
3 Empire is a 12% (twelve percent) owner of Iatan 2, but has been actively involved
4 in the construction project. Empire's involvement was further demonstrated in its
5 vigorous attempt to secure its share of the Iatan 2 Advanced Tax Coal Investment
6 Credit." In the final consideration it is clear that Empire dutifully managed its share
7 of the Iatan projects in accordance with the Ownership Agreements to ensure our
8 share of project costs were proper. We were able to put into place an experienced
9 and robust management team that took actions and implemented processes that
10 utilized the information provided to us by KCPL, whether through the cost control
11 system KCPL implemented, project reports or additional questioning of our own, to
12 ensure prudent management of costs billed to Empire.

13 **IATAN AND PLUM POINT PREPAYMENTS**

14 **Q. DID STAFF PROPOSE AN ADJUSTMENT RELATED TO**
15 **PREPAYMENTS?**

16 A. Yes. In its Cost of Service Report on page 62, Staff proposes to include
17 "prepayments in rate base at the 13-month average level ending June
18 2012." However, Staff proposes to exclude "two accounts added during the test
19 year for Working Funds Iatan (165350) and Working Funds Plum Point (165351)
20 that were excluded in the Staff's average. These are cash accounts, not actual
21 investment in utility assets, and are therefore excluded from rate base."

22 **Q. DO YOU AGREE WITH THESE EXCLUSIONS?**

23 A. No. I do not agree that the two accounts should be excluded from rate base.

1 **Q. WHY DO YOU NOT AGREE THAT THESE ACCOUNTS SHOULD BE**
2 **EXCLUDED FROM RATE BASE?**

3 A. These accounts represent working capital funds that are required as part of the Plum
4 Point and Iatan Ownership agreements. These amounts were previously included in
5 135 or Working Capital accounts and were re-categorized to these 165 or Prepaid
6 accounts for accounting reasons, the accounting reason being that KCPL and Plum
7 Point Energy Associates, the “holders” of these accounts, are not banks and thus
8 require different categorization than other working capital funds that are held by
9 banks. Regardless of this accounting technicality, these are still working capital
10 accounts that are only drawn upon if Empire is in default (i.e. cannot make required
11 payments) of the ownership agreements for these two plants. These are not
12 “Prepaid” funds that are normally drawn upon to pay ongoing, annual expenses at
13 the plants.

14 **Q. ARE WORKING CAPITAL FUNDS NORMALLY INCLUDED AS PART**
15 **OF RATE BASE?**

16 A. Yes. In fact on page 56 of Staff’s Cost of Service Report Staff states as follows:
17 “Cash Working Capital (“CWC”) is the amount of funding necessary for a utility to
18 pay the day-to-day expenses incurred in providing utility services to its customers.
19 When a utility expends funds in order to pay an expense necessary for the provision
20 of service before its customers provide any corresponding payment, the utility’s
21 shareholders are the source of the funds. This shareholder funding represents a
22 portion of each shareholders’ total investment in the utility, for which the
23 shareholders are compensated by the inclusion of these funds in rate base. By

1 including these funds in rate base, the shareholders earn a return on the CWC-
2 related funding they have invested.”

3 These cash working capital funds at Iatan and Plum Point should be subject to the
4 same rate base treatment as other cash working capital funds.

5 **PLANT OPERATING AND MAINTENANCE EXPENSE**

6 **Q. DOES STAFF PROPOSE AN ADJUSTMENT TO TEST YEAR PLANT**
7 **OPERATING AND MAINTENANCE EXPENSE IN ITS COST OF**
8 **SERVICE REPORT?**

9 A. Yes. On pages 108 – 110 of its Report, Staff recommends using five- or six-year
10 annualized averages to normalize annual plant expenses at Empire’s Iatan 1,
11 Asbury, Ozark Beach, Riverton, State Line Combined Cycle, State Line 1, and
12 Energy Center generating facilities. In the aggregate adjustments related to
13 expenses at these plants equates to a negative adjustment of \$558,747.

14 **Q. DO YOU AGREE WITH STAFF’S METHODOLOGY AND**
15 **ADJUSTMENT?**

16 A. No, I do not.

17 **Q. WHY NOT?**

18 A. In my direct testimony in this case I anticipated that Staff would utilize its historical
19 adjustment methodology (i.e. five- and six-year averages) to calculate its
20 adjustment. In that testimony, I presented various reasons why I did not agree with
21 this methodology under current circumstances. Instead of restating that testimony
22 here, I refer you to pages 3 through 7 of my direct testimony.

1 **Q. ARE THERE ANY POINTS YOU WOULD LIKE TO EXPOUND UPON**
2 **FROM YOUR DIRECT TESTIMONY?**

3 A. Yes. In my direct testimony on page 5, I detail that the Consumer Price Index (CPI)
4 and Producer Price Index (PPI) have grown at a compound annual growth rate of
5 2.34% and 4.13%, respectively, between the periods of March 2007 and March
6 2012. On pages 5 through 6 of Staff's Cost of Service Report, Staff itself shows
7 that the CPI and PPI have grown 11.58% and 19.66% in the aggregate between
8 early 2007 and the end of 2011. These aggregate growths rates equate to 2.22% and
9 3.65% compound annual growth rates, respectively, and average 2.94% annually.

10 **Q. WHY IS THIS RELEVANT?**

11 A. As stated in my direct testimony, if one uses a historical five year average to set a
12 level of expense, from a value of money perspective that average effectively sets
13 costs at a level 2.5 years in the past (i.e. ignores 2.5 years of escalation). For
14 Empire's level of expenses at these plants, that is nearly \$1 million dollars of under-
15 recovery of expenses that Empire currently incurs to meet the needs of its customers
16 at its generating plants.

17 **Q. IS EMPIRE CHANGING ITS RECOMMENDED ADJUSTMENT FOR**
18 **OPERATING AND MAINTENANCE EXPENSES AT THESE PLANTS?**

19 A. No. Empire is still recommending a positive adjustment of \$1,253,384 for plant
20 O&M expenses above test year levels. This adjustment reflects 2012 budgeted
21 amounts.

22 **Q. DOES STAFF AGREE WITH USING BUDGETED AMOUNTS?**

1 A. No. On page 3 of its Cost of Service Report, Staff states the concern that “Empire’s
2 direct filing included many expenses and rate base items that were calculated based
3 on budgeted or projected information, instead of relying on test year or normalized
4 levels.”

5 **Q. HOW DO YOU RESPOND TO STAFF’S CONCERN?**

6 A. Using 2012 budgeted amounts for the Ozark Beach, Asbury, Riverton, Stateline,
7 State Line Combined Cycle (adjusted for ownership shares), and Energy Center
8 plant O&M expenses is not an issue in this instance because twelve-month ending
9 November 30, 2012 expense is \$12,470,567 versus the 2012 budgeted amount of
10 \$12,224,392. Again, the budgeted amount is the amount Empire based its
11 adjustment on. Since this case allows for a true-up of the test year through
12 December 31, 2012, using 2012 actual expenses should not be significantly
13 different than budgeted amounts once December actuals are added to the year to
14 date values through November.

15 **SPP INTEGRATED MARKETPLACE**

16 **Q. DO ANY WITNESSES TAKE ISSUE WITH EMPIRE’S PROPOSED**
17 **ADJUSTMENTS FOR SPP INTEGRATED MARKETPLACE?**

18 A. Yes. MEUA witness Stephen M. Rackers, on pages 23-24 of his direct testimony
19 recommends deferring costs incurred by Empire to prepare and participate in the
20 integrated marketplace.

21 **Q. DO YOU AGREE WITH THIS PROPOSED DEFERRAL?**

22 A. No. Empire is incurring these costs today to prepare for the integrated marketplace
23 as well as participate in the current market and they should not be deferred. In

1 addition, the software we have added to plant-in-service as of December 31, 2012 is
2 used and useful as required by Missouri statute. While some of this software is
3 required for future integrated or “next-day” market participation, much of it is being
4 used today by our supply management group in SPP’s existing marketplace. Please
5 refer to Schedule BAM 5 for functions the software is providing today.

6 **Q. DO YOU HAVE ANY CHANGES YOU WOULD LIKE TO MAKE TO**
7 **YOUR PROPOSED ADJUSTMENTS THAT YOU STATED IN YOUR**
8 **DIRECT TESTIMONY?**

9 A. Yes. As to the estimated \$90,000 maintenance fee that I proposed related to the
10 ongoing expenses for the software, I no longer propose this adjustment because we
11 were able to negotiate a contract for the software that did not increase our ongoing
12 maintenance fee. Additionally, I would propose actual software plant in-service
13 amounts of \$457,981.58 as of December 31, 2012 versus the \$900,000 I estimated
14 for this software in my direct testimony. Finally, with regards to the costs
15 associated with the two additional personnel added to manage Empire’s
16 participation in the SPP marketplace, these positions will be included in total
17 company end of year staffing levels in the calculation used to normalize or true-up
18 payroll expense as these two positions have been filled during the 2012 calendar
19 year.

20 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

21 A. Yes, it does.

