

Exhibit No.:  
Issue: Construction Accounting  
Witness: Ronald A. Klotz  
Type of Exhibit: Direct Testimony  
Sponsoring Party: Kansas City Power & Light Company  
Case No.: EU-2014-0255  
Date Testimony Prepared: June 12, 2014

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: EU-2014-0255**

**DIRECT TESTIMONY**

**OF**

**RONALD A. KLOTE**

**ON BEHALF OF**

**KANSAS CITY POWER & LIGHT COMPANY**

**Kansas City, Missouri  
June 2014**

**DIRECT TESTIMONY**

**OF**

**RONALD A. KLOTE**

**Case No. EU-2014-0255**

1   **Q:   Please state your name and business address.**

2   A:   My name is Ronald A. Klot. My business address is 1200 Main, Kansas City, Missouri  
3       64105.

4   **Q:   By whom and in what capacity are you employed?**

5   A:   I am employed by Kansas City Power & Light Company (“KCP&L” or “Company”) as  
6       Senior Manager, Regulatory Affairs.

7   **Q:   On whose behalf are you testifying?**

8   A:   I am testifying on behalf of KCP&L.

9   **Q:   What are your responsibilities?**

10  A:   My responsibilities include the preparation and review of accounting exhibits and  
11       schedules associated with Company regulatory filings. I also have responsibility for the  
12       completion and filing of certain regulatory reports to the Federal Energy Regulatory  
13       Commission, Department of Energy, and state regulatory commissions, among others.

14  **Q:   Please describe your education, experience and employment history.**

15  A:   In 1992, I received a Bachelor of Science Degree in Accountancy from the University of  
16       Missouri-Columbia. I am a Certified Public Accountant holding a certificate in the State  
17       of Missouri. In 1992, I joined Arthur Andersen, LLP holding various positions of  
18       increasing responsibilities in the auditing division. I conducted and led various auditing  
19       engagements of company financial statements. In 1995, I joined Water District No. 1 of

1 Johnson County as a Senior Accountant. This position involved operational and financial  
2 analysis of water operations. In 1998, I joined Overland Consulting, Inc. as a Senior  
3 Consultant. This position involved special accounting and auditing projects in the  
4 electric, gas, telecommunications and cable industries. In 2002, I joined Aquila, Inc.  
5 (“Aquila”) holding various positions within the Regulatory department until 2004 when I  
6 became Director of Regulatory Accounting Services. This position was primarily  
7 responsible for the planning and preparation of all accounting adjustments associated  
8 with regulatory filings in the electric jurisdictions. As a result of the acquisition of  
9 Aquila by Great Plains Energy Incorporated (“GPE”), I began my employment with  
10 KCP&L as Senior Manager, Regulatory Accounting in July 2008. In April 2013, I joined  
11 the Regulatory Affairs department as a Senior Manager still in charge of Regulatory  
12 Accounting responsibilities.

13 **Q: Have you previously testified in a proceeding before the Missouri Public Service**  
14 **Commission (“Commission” or “MPSC”) or before any other utility regulatory**  
15 **agency?**

16 A: Yes. I have testified before the MPSC, Kansas Corporation Commission, California  
17 Public Utilities Commission, and the Public Utilities Commission of Colorado.

18 **Q: What is the purpose of your Direct Testimony?**

19 A: The purpose of my Direct Testimony is (i) to provide background concerning the La  
20 Cygne Generating Station (“La Cygne”) and the environmental project that gives rise to  
21 this request; (ii) to explain why KCP&L seeks an order from the Commission to allow  
22 KCP&L to treat the La Cygne environmental project under “Construction Accounting”,  
23 from the project’s in-service date until the effective date of the rates approved in

1 KCP&L's rate case in which the La Cygne environmental project is included in rates, and  
2 (iii) to define the specific principles KCP&L is requesting that the Commission determine  
3 in this proceeding.

4 **Q: What is La Cygne?**

5 A: La Cygne is comprised of two coal-fired generating units. Unit 1 has a net generating  
6 capacity of 736 MWs. Unit 2 has a net generating capacity of 682 MWs. KCP&L owns  
7 50% of La Cygne. Kansas Gas and Electric Company ("KG&E"), a wholly owned  
8 subsidiary of Westar Energy, Inc. ("Westar"), owns the other 50%. Pursuant to the two  
9 companies' ownership agreement, KCP&L is responsible for operating both La Cygne  
10 units.

11 **Q: What are the environmental requirements that have given rise to the current**  
12 **environmental plant additions at La Cygne?**

13 A: KCP&L executed an agreement with the Kansas Department of Health and Environment  
14 ("KDHE"), which ultimately became part of the Kansas Regional Haze Rule State  
15 Implementation Plan ("SIP") submitted by KDHE to the EPA for approval. That  
16 agreement requires KCP&L to have in place best available retrofit technology ("BART")  
17 environmental equipment on La Cygne Units 1 and 2 on or before June 1, 2015 or the  
18 units will not be in compliance, requiring them to be shut down until the equipment is  
19 installed.

20 **Q: What environmental control equipment is necessary to satisfy the BART**  
21 **requirements for the La Cygne units?**

22 A: Generally speaking, to satisfy the requirements of BART at La Cygne, KCP&L is  
23 installing wet scrubbers, baghouses, and a dual flue chimney for both Units 1 and 2, and a

selective catalytic reduction (“SCR”), low-nitrogen oxide (“low NOx”) burners, and an over-fire air (“OFA”) system for Unit 2.

**Q: What is the current scheduled in-service date associated with this project?**

A: The current plan has a scheduled in-service date that will meet the June 1, 2015 deadline as described above.

**Q: What impact does that in-service date have on this request?**

A: There are very specific guidelines the Company must follow in accounting for construction projects. As provided for in Accounts 419.1 and 432 of the Uniform System of Accounts, Allowance For Funds Used During Construction (“AFUDC”), as computed in accordance with the formula prescribed in Electric Plant Instruction 3(17)<sup>1</sup> in the Federal Energy Regulatory Commission Rules, would cease to accrue on the date that the La Cygne Environmental Project achieves its in-service criteria, unless the Commission authorizes an alternative accounting treatment. AFUDC allows the Company to earn a deferred return on funds expended for plant additions during the construction phase of the project. But, the accounting requirements specify that AFUDC must cease at the date the plant additions are put into service which creates a lag on the Company since these plant additions are not yet included in rates. In addition, absent alternative Commission-authorized accounting treatment, on the in-service date, depreciation expense related to the project would begin to accrue on KCP&L’s books. Both of these events occur prior to when the Company is allowed to establish the plant additions in rates and thus creates an earnings lag.

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<sup>1</sup> 18 CFR part 101.

1 **Q: Please explain the lag between when a plant addition goes into service and when the**  
2 **increase in revenue requirement is reflected in the Company's rates to its**  
3 **customers.**

4 A: Given that both the construction and the ratemaking processes typically take a significant  
5 amount of time and effort to complete, in all likelihood, there will be span of time  
6 between when the plant addition is deemed in service and when the Company will be  
7 granted an increase in rates to cover the associated cost. This period of lag between the  
8 time the plant addition is placed in service and the time the Company begins to recover  
9 the associated costs in rates is driven largely by work associated with the regulatory  
10 process, which includes but is not limited to 1) audit work to verify that the plant addition  
11 meets appropriate in-service criteria, 2) audit work to verify costs associated with the  
12 plant addition, 3) preparation of regulatory filings (testimony, etc.), 4) the possible need  
13 to hold hearings, 5) deliberation by the Commission and preparation of a Commission  
14 order, 6) calculation of new rates, and 7) preparation, review and approval of revised  
15 tariff sheets. In the case of the La Cygne environmental project, KCP&L estimates that  
16 the period of time between the in-service date and the commencement of rate recovery  
17 will be no less than four (4) months which is very significant and would have a  
18 detrimental impact on the Company's earnings.

19 **Q: Is there typically time between when a plant addition goes into service and when it is**  
20 **collected in rates?**

21 A: Yes.

1 **Q: What is different about the La Cygne environmental plant addition compared to**  
2 **other more typical plant additions that justifies the use of Construction Accounting**  
3 **in this instance?**

4 A: Quite simply, the magnitude of the La Cygne environmental plant addition distinguishes  
5 this project from more typical plant additions. The KCP&L-MO share of the La Cygne  
6 environmental project amounts to approximately \$336 million in rate base prior to the  
7 impacts of AFUDC. For context, this amounts to approximately 16% of Missouri  
8 jurisdictional rate base used to set rates in KCP&L's most recent general rate proceeding  
9 in Missouri. It should also be noted that the La Cygne environmental project 1) will not  
10 provide access to new customers or new revenue streams that could be used to help  
11 defray the costs associated with the project and 2) is necessary to meet governmentally  
12 mandated environmental standards. This construction project includes installation of wet  
13 scrubbers, baghouses, and a dual flue chimney for both Units 1 and 2, and a selective  
14 catalytic reduction ("SCR"), low-nitrogen oxide ("low NOx") burners, and an over-fire  
15 air ("OFA") system for Unit 2. This is a very significant investment in environmental  
16 equipment that is impactful on the earnings of the Company. Any gap between the date  
17 the investment goes into service and the date the investment is collected in rates will  
18 create significant regulatory lag on the Company's earnings.

19 **Q: Discuss the financial impact of the lag.**

20 A: Absent the use of construction accounting treatment, when the La Cygne environmental  
21 project goes in-service, KCP&L estimates that carrying costs and depreciation expense  
22 associated with the La Cygne environmental project will reduce KCP&L's earnings by  
23 approximately \$1.8 million per month until new rates which include the cost of the La

1       Cygne environmental project take effect. While this negative earnings impact is  
2       significant in and of itself, this impact will be amplified by the fact that when the La  
3       Cygne environmental project goes in-service, KCP&L will have a general rate case on  
4       file and already be in an earnings-deficient situation. Use of construction accounting,  
5       however, would ease this financial situation somewhat.

6   **Q:   How would you define Construction Accounting as it relates to your current**  
7   **request?**

8   A:   The authorization of Construction Accounting in this proceeding can be best described by  
9       separating it into two separate buckets of deferrals that will be recorded in Regulatory  
10      Asset Account 182.3. First, Construction Accounting would provide for a deferral  
11      mechanism to record to Regulatory Asset Account 182.3 the Missouri jurisdictional  
12      carrying costs calculated on the La Cygne environmental plant addition from the date the  
13      plant addition is placed in service to the date the plant addition is included in rates.  
14      Secondly, Construction Accounting would provide for a deferral mechanism to record to  
15      Regulatory Asset Account 182.3 the Missouri jurisdictional monthly depreciation  
16      expense recorded for the La Cygne environmental plant addition from the date the project  
17      is placed in service to the date the plant addition is included in rates. Both of these  
18      amounts would be accumulated in Regulatory Asset Account 182.3 and treatment of  
19      these costs would be decided in the Company's next general rate case.

20   **Q:   What rate would be used to calculate the Missouri jurisdictional share of carrying**  
21   **costs associated with the La Cygne plant investment?**

22   A:   The carrying cost rate that is requested in this application and that will be applied to the  
23      plant additions once they are in service to the date the plant additions are reflected in



1 rates will be a rate that is calculated similar to the rates typically charged to construction  
2 projects as described in Electric Plant Instruction 3(17)<sup>2</sup> in the Federal Energy Regulatory  
3 Commission Rules. This deferred carrying charge as calculated and described above  
4 would be booked to account 182.3 and offset in interest charge account 431.

5 **Q: Has the Commission authorized the use of similar accounting treatment in the past?**

6 A: Yes, it has. Pursuant to the terms of the Non-Unanimous Stipulation and Agreement  
7 approved by the Commission on June 10, 2009, in Case No. ER-2009-0089, KCPL was  
8 authorized to defer depreciation expense and carrying costs for the Iatan Unit 1 AQCS  
9 and Iatan Common Plant that was not included in KCPL's rate base in that case. In its  
10 next rate case, Case No. ER-2010-0355, KCP&L included in rate base Vintage 1  
11 depreciation expense and carrying costs deferred from May 1, 2009 to December 31,  
12 2010, the true-up in that case. Thereafter, KCP&L continued to defer depreciation  
13 expense and carrying costs as Vintage 2 in regulatory asset account 182426 as incurred  
14 subsequent to the December 2010 true-up through the effective date of rates of May 4,  
15 2011 in Case No. ER-2010-0355. In addition, the Regulatory Plan Stipulation and  
16 Agreement in Case No. EO-2005-0329, approved by the Commission on July 28, 2005  
17 ("Regulatory Plan S&A"), provided that KCP&L could use Construction Accounting  
18 during the period from the Iatan 2 commercial in-service date (August 26, 2010) through  
19 the effective date of new rates in the 2010 Case (May 4, 2011). Construction Accounting  
20 impacts, including depreciation, carrying costs, operations and maintenance ("O&M")  
21 expenses, and fuel and revenue impacts were accumulated in a regulatory asset account.  
22 In Case No. ER-2010-0355, KCP&L included in rate base Vintage 1 construction  
23 accounting costs thru December 31, 2010, the true-up in that case. KCP&L continued to

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<sup>2</sup> 18 CFR part 101.

1 defer expenses as Vintage 2 in regulatory asset account 182502 as incurred subsequent to  
2 the December 2010 true-up through the effective date of rates of May 4, 2011 in Case  
3 No. ER-2010-0355.

4 **Q: Has the Commission approved this type of accounting deferral for other companies?**

5 A: Yes. While this list is not an exhaustive list, the Commission allowed a similar deferral  
6 for the Iatan 1, 2 and Common costs associated with the ownership percentage for the  
7 KCP&L Greater Missouri Operation Companies as well as for The Empire District  
8 Electric Company. In addition, the Commission approved a similar accounting deferral  
9 in Case No. EO-2010-0262 for The Empire District Electric Company relating to their  
10 Plum Point Power Generating Unit, as well as, in Case No. ER-2010-0036 for Union  
11 Electric Company d/b/a AmerenUE relating to their Sioux generating station.

12 **Q: In the cases you mentioned above, did the Commission's authorization for the use of**  
13 **construction accounting result from settlement agreements among the parties to**  
14 **those cases?**

15 A: Yes. Consequently, I do not cite those cases as precedent that the Commission must  
16 follow in this case, but simply to make the Commission aware that KCP&L's request for  
17 authorization to use construction accounting treatment is not unprecedented. In fact, in  
18 recent years utilities in the state of Missouri that have had major electric generation  
19 projects have been granted utilization of construction accounting associated with the  
20 completion of those projects as described above.

1 **Q: Has the Missouri General Assembly passed legislation regarding recovery, outside**  
2 **of a general rate proceeding, of costs incurred to comply with environmental**  
3 **requirements?**

4 A: Yes. Counsel advises that in 2005 the Missouri General Assembly passed section  
5 386.266, subsection 2 of which authorizes the Commission to approve rate schedules  
6 enabling rate adjustments to be made outside a general rate case for increases or  
7 decreases in prudently incurred costs to comply with any federal, state, or local  
8 environmental law, regulation or rule. Section 386.266 also authorized the Commission  
9 to promulgate rules to implement its provisions.

10 **Q: Has the Commission promulgated a rule regarding electric utility recovery, outside**  
11 **of a general rate proceeding, of costs incurred to comply with environmental**  
12 **requirements?**

13 A: Yes. It can be found at 4 CSR 240-20.091.

14 **Q: Why has KCP&L not used that rule to recover costs of the La Cygne environmental**  
15 **project?**

16 A: Although the La Cygne environmental project has inarguably been undertaken to comply  
17 with federal and state environmental laws and regulations and therefore represents the  
18 type of costs that would qualify for treatment under section 386.266.2, the Company has  
19 not elected to make use of the Commission's environmental cost recovery rule applicable  
20 to electric utilities because the 2.5% cap (which is found in both the law and the rule  
21 implementing the law) is too low to allow recovery of all of the costs incurred for the  
22 project. Consequently, KCP&L has elected to request authorization to use Construction

Accounting, consistent with other recent similar major electric plant generation construction projects in Missouri similar to LaCygne, to mitigate regulatory lag.

**Q: Are there other types of mechanisms utilized by other industries which provide protections against regulatory lag on plant additions that are placed in service?**

A: Yes. Counsel advises that in 2003 the Missouri General Assembly passed legislation, which was signed into law by the governor, providing for an Infrastructure System Replacement Surcharge (“ISRS”) mechanism which allows certain gas and water utilities in the state to recover costs associated with certain non-revenue producing facilities replacements, at least some of which are governmentally mandated, without the necessity of filing a full-blown general rate proceeding. The ISRS mechanism mitigates regulatory lag for qualifying plant additions (generally non-revenue producing infrastructure replacement) made by companies eligible to use the mechanism. I am unaware of a comparable mechanism that may be used by KCP&L in Missouri. Consequently, KCP&L has elected to request authorization to use construction accounting to mitigate regulatory lag in connection with the La Cygne environmental project.

**Q: Please discuss the accounting entries that would be made to accomplish the accounting deferral KCP&L requests.**

A: Once the La Cygne environmental project is completed and has passed its in-service criteria, an accounting deferral entry equal to the Company’s Missouri jurisdictional monthly depreciation expense associated with the La Cygne environmental project plant additions would be recorded to regulatory asset account 182.3 until the plant additions are included in rates. In addition, the Company’s Missouri jurisdictional share of carrying costs computed on the La Cygne plant additions would be recorded to the regulatory asset

1 account 182.3 on a monthly basis from the date the plant additions are placed in-service  
2 to the date the plant additions are included in rates. Amortization of the accumulated  
3 deferred balance would be requested in the Company's next general rate case that would  
4 span the remaining life of the plant additions.

5 **Q: Please provide a summary of the Company's request in this proceeding.**

6 A: The Company is asking this Commission to authorize KCP&L to use Construction  
7 Accounting associated with its La Cygne environmental plant additions similar to past  
8 accounting treatment of major plant additions to generating stations in the state of  
9 Missouri. Construction Accounting can be broken into two separate buckets. First,  
10 Construction Accounting would include the accounting deferral of Missouri jurisdictional  
11 carrying costs calculated on the La Cygne environmental plant additions from the time  
12 the La Cygne environmental project is placed into service until the date rates become  
13 effective in the Company's next general rate case. Secondly, the Company requests that  
14 an accounting deferral be approved to record all Missouri jurisdiction monthly  
15 depreciation expense on the La Cygne environmental project from the date the La Cygne  
16 environmental plant addition is placed in-service until the date rates become effective in  
17 the Company's next general rate case.

18 **Q: Does this conclude your testimony?**

19 A: Yes, it does.

