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**MISSOURI PUBLIC SERVICE COMMISSION**

**REGULATORY REVIEW**

**UTILITY SERVICES - AUDITING**

**REBUTTAL TESTIMONY**

**OF**

**MARK L. OLIGSCHLAEGER**

**KANSAS CITY POWER & LIGHT COMPANY**

**CASE NO. ER-2014-0370**

*Jefferson City, Missouri*  
*May 2015*

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OF  
MARK L. OLIGSCHLAEGER**

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **MARK L. OLIGSCHLAEGER**

4 **KANSAS CITY POWER & LIGHT COMPANY**

5 **CASE NO. ER-2014-0370**

6 Q. Please state your name and business address.

7 A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

8 Q. Please describe your educational background and work experience.

9 A. I attended Rockhurst College in Kansas City, Missouri, and received a  
10 Bachelor of Science degree in Business Administration, with a major in Accounting, in 1981.  
11 I have been employed by the Missouri Public Service Commission (“Commission”) since  
12 September 1981 within the Auditing Unit.

13 Q. What is your current position with the Commission?

14 A. In April 2011, I assumed the position of Manager of the Auditing Unit, Utility  
15 Services Department, Regulatory Review Division, of the Commission.

16 Q. Are you a Certified Public Accountant (CPA)?

17 A. Yes, I am. In November 1981, I passed the Uniform Certified Public  
18 Accountant examination and, since February 1989, have been licensed in the state of Missouri  
19 as a CPA.

20 Q. Have you previously filed testimony before this Commission?

21 A. Yes, numerous times. A listing of the cases in which I have previously filed  
22 testimony before this Commission, and the issues I have addressed in testimony in cases from  
23 1990 to current, is attached as Schedule MLO-r1 to this rebuttal testimony.

1 Q. What knowledge, skills, experience, training and education do you have in the  
2 areas of which you are testifying as an expert witness?

3 A. I have been employed by this Commission as a Regulatory Auditor for over  
4 30 years and have submitted testimony on ratemaking matters numerous times before the  
5 Commission. I have also been responsible for the supervision of other Commission  
6 employees in rate cases and other regulatory proceedings many times. I have received  
7 continuous training at in-house and outside seminars on technical ratemaking matters since  
8 I began my employment at the Commission.

9 Q. Have you participated in the Commission Staff's ("Staff") review of the  
10 application filed by Kansas City Power & Light Company (KCPL) in Case No. ER-2014-  
11 0370?

12 A. Yes, I have, with the assistance of other members of Staff.

13 **EXECUTIVE SUMMARY**

14 Q. Please summarize your rebuttal testimony in this proceeding.

15 A. In this testimony, I address from a policy perspective the proposals made by  
16 KCPL requesting Commission authorization for certain special regulatory mechanisms, called  
17 "trackers," to be implemented to account for KCPL's property tax expense, vegetation  
18 management expense and cyber-security costs. In each instance, the Staff recommends that  
19 the Company's request be denied.

20 Q. Are other Staff witnesses addressing KCPL's proposed trackers?

21 A. Yes. Staff witnesses Karen Lyons, Randy S. Gross and Daniel I. Beck all  
22 address aspects of KCPL's property tax, vegetation management and cyber-security tracker  
23 proposals in their rebuttal testimony.

1     **TRACKER PROPOSALS**

2           Q.     What is a “tracker”?

3           A.     The term “tracker” refers to rate mechanisms under which the amount of  
4 a particular cost of service item actually incurred by a utility is “tracked” and compared to  
5 the amount of that item currently included in a utility’s rate levels. Any over-recovery or  
6 under-recovery of the item in rates compared to the actual expenditures made by a utility  
7 is then booked to a regulatory asset or regulatory liability account, and would be eligible to  
8 be included in the utility’s rates set in its next general rate proceeding through an amortization  
9 to expense.

10          Q.     Should use of trackers be a common occurrence in Missouri rate regulation  
11 of utilities?

12          A.     No. Rates are normally set in Missouri to allow a utility an opportunity to  
13 recover its cost of service, measured as a whole, on an ongoing basis from the utility’s  
14 customers. However, under this approach, with rare exceptions, neither utilities nor utility  
15 customers are allowed to be reimbursed through the rate case process for any prior under or  
16 over-recovery of costs experienced by the utility in rates, either measured for its cost of  
17 service as a whole or for individual cost of service components. For this reason, use of  
18 trackers in order to provide reimbursement in rates to utilities or customers of any over or  
19 under-recovery of individual rate component items is rare and should be dependent on unique  
20 and unusual circumstances.

21          Q.     Under what criteria might Staff consider the use of trackers is justified?

22          A.     Use of trackers may be justified under the following circumstances: (1) when  
23 the applicable costs demonstrate significant fluctuation and up-and-down volatility over time,  
24 and for which accurate estimation is difficult; (2) new costs for which there is little or no

1 historical experience, and for which accurate estimation is accordingly difficult; and (3) costs  
2 imposed upon utilities by Commission rule. In addition, the costs should be material  
3 in nature.

4 Q. Why are trackers sometimes justified by significantly fluctuating and volatile  
5 costs?

6 A. If a utility's cost levels for a particular rate item over time demonstrate  
7 significant up-and-down volatility, it can be appropriate to implement a tracker mechanism  
8 for this type of item to reduce the amount of risk associated with a material inaccuracy in  
9 estimating the particular cost for purposes of setting the utility's rates.

10 Q. What is an example of a tracker being authorized by the Commission for a  
11 volatile cost in the past?

12 A. All major utilities operating in Missouri, including KCPL, have tracker  
13 mechanisms in place at the present time for their pension and other post-employment benefit  
14 (OPEB) expenses. (OPEBs are generally retiree medical benefits.) Annual pension and  
15 OPEB expense amounts have at times in the past subject to significant annual volatility,  
16 primarily because pension and OPEB funding amounts are impacted by investment outcomes  
17 in equity and debt markets which, of course, can swing upward or downward based upon  
18 trends in the general economy.

19 Q. Are there other unusual aspects to pension and OPEB expense that justify  
20 using tracking mechanisms?

21 A. Yes. In Missouri, utilities place amounts intended for later payment to retired  
22 employees for pensions and OPEBs into external trust funds to help ensure that such funds are

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1 available when due to utility employees.<sup>1</sup> Staff believes it is good policy for utilities to keep  
2 as current as possible on funding of pension and OPEB amounts. In this respect, Staff  
3 believes that authorizing tracker mechanisms for these expense items encourages utilities to  
4 stay current on pension and OPEB funding levels, by ensuring that utilities are ultimately  
5 made whole for their contributions, even in the event such contributions exceed the amount of  
6 pension and OPEB expense allowances currently included in their rate levels. Of course, if  
7 pension or funding amounts turn out to be less than the amounts for these items currently  
8 included in a utility's rate level, use of trackers also ensure that the funding/rate differential  
9 would ultimately be flowed back to its customers.

10 Q. Does Staff continue to recommend that KCPL be authorized to have pension  
11 and OPEB trackers?

12 A. Yes. Staff believes continued authorization of these trackers remains  
13 appropriate for KCPL and other utilities that offer pension and OPEB benefits to their  
14 employees.

15 Q. Are there other instances where trackers may be justified?

16 A. In rare circumstances, utilities will incur significant new expenses for which  
17 they have little or no past history to aid in determining an appropriate ongoing level for these  
18 expenses for setting rates. In those circumstances, it may be appropriate to authorize a tracker  
19 to protect both the utility and its customers from over- or under-recovery in rates of these  
20 expenses due to erroneous estimates.

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<sup>1</sup> Federal law requires prefunding of pension amounts. In Missouri, under state law OPEB amounts must be prefunded by utilities in order to be eligible for rate recovery of this item on an accrual basis in advance of actual payment to retirees.

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1 Q. Has Staff agreed to use of a tracker for this reason?

2 A. Yes. When KCPL's Iatan II generating station went into service in 2010, Staff  
3 agreed to a tracker applicable to the O&M expenses associated with this power plant, given  
4 the lack of prior history for these expenses. However, Staff's agreement to use this tracker  
5 was only intended to cover the initial years of operation of the Iatan II unit, until an adequate  
6 history of the unit's O&M expenses existed. In the current rate case, KCPL has  
7 recommended that this tracker no longer be used, and Staff agrees.

8 Q. Are there any other instances where the Commission has used trackers?

9 A. In some circumstances, the Commission has established within the rules it  
10 promulgates provisions for tracking and recovery of incremental costs caused by utility  
11 compliance with new rules. This was the case with the Commission rules requiring certain  
12 actions be taken by electric utilities regarding vegetation management and infrastructure  
13 inspection activities that became effective in 2008.

14 Q. Did the Commission impose conditions in the rules for using those trackers?

15 A. Yes. Under the language in the rules, the trackers were only available where  
16 costs a utility incurs as a result of the rule exceeded the costs included in that utility's current  
17 rates at the time the rules went into effect.

18 Q. Are cost deferrals resulting from use of trackers any different than cost  
19 deferrals resulting from use of accounting authority orders?

20 A. Yes. In Missouri, when someone refers to an "accounting authority order,"  
21 also known as an AAO, it is understood that person is referring to a Commission order that  
22 allow a utility to defer certain costs on its balance sheet for potential recovery of the deferred  
23 costs in rates through amortizations to expense in general rate proceedings. This is similar to

1 how deferrals resulting from trackers may be treated in general rate proceedings. However,  
2 the nature of the costs to which AAOs are normally granted, and the nature of the costs to  
3 which tracking treatment is normally granted, are quite different.

4 Q. Would you explain the major differences in how AAOs and trackers have been  
5 used in Missouri?

6 A. Typically, AAOs have been used to allow utilities to capture certain  
7 unanticipated and “extraordinary” costs that are not included in their ongoing rate levels. The  
8 term “extraordinary costs” has been defined as costs associated with an event that is unusual,  
9 unique and non-recurring in nature. The classic example of an extraordinary event is the  
10 occurrence of a natural disaster, such as a wind or ice storm, or major flood that affects a  
11 utility’s service territory.

12 In contrast, trackers have been used in Missouri to track certain costs that are ongoing  
13 to a utility, and for which some allowance has been built into the company’s existing rate  
14 levels. For this reason, while costs subject to trackers exhibit some highly usual or unique  
15 attributes which justify the use of a tracker, these costs are not “extraordinary” in the sense  
16 that this term is commonly applied to costs covered by AAOs.

17 Q. If use of trackers has not been limited to truly extraordinary costs, then why  
18 not track all or most costs?

19 A. There are at least two reasons. First, excessive use of trackers would tend to  
20 unreasonably skew ratemaking results either in favor of the utility or in favor of its customers.  
21 Secondly, broad use of trackers would inevitably dull the incentives a utility has to operate  
22 efficiently and productively under the rate regulation approach employed in Missouri.

1 Q. Why would the widespread use of trackers tend to unreasonably skew the  
2 ratemaking results for a utility?

3 A. With certain exceptions, the policy in Missouri has been to set a utility's rates  
4 based upon measurement of "all relevant factors," taking into accounts levels of revenues,  
5 expenses, rate base and rate of return that are calculated at or about the same point in time.  
6 Use of an "all relevant factors" approach is necessary in order to ensure that a utility's rate  
7 levels are based upon an accurate measurement of its cost of service at a particular point  
8 in time.

9 When trackers are used as part of setting rates, certain cost factors inevitably receive  
10 different and inconsistent treatment compared to other cost factors. For example, if a utility  
11 tracks expenses that tend to increase in amount over time, but does not track cost of service  
12 factors that may reduce its cost of service (factors such as revenue growth, or increases in the  
13 rate base offsets for accumulated depreciation or deferred taxes), the utility will have the  
14 potential of receiving retroactive dollar-for-dollar recovery of certain cost increases in its  
15 customer rates through the operation of its trackers, while pocketing for itself any beneficial  
16 changes in other cost of service components that occur over the same period. In this manner,  
17 inappropriate use of trackers can lead to skewed and unfair ratemaking results.

18 Q. How do trackers affect a utility's incentives to operate efficiently?

19 A. An inevitable byproduct of the Missouri ratemaking approach is "regulatory  
20 lag." "Regulatory lag" is simply the passage of time between when a utility experiences a  
21 change in its cost of service, and when that change is reflected in its rate levels. While  
22 regulatory lag is often portrayed by utilities as a phenomenon that is entirely negative or  
23 harmful, the existence of regulatory lag does provide utilities with incentive to be as efficient

1 and cost-effective over time as they can. Excessive use of trackers can serve to eliminate or  
2 weaken these beneficial incentives.

3 Q. Would you explain your point further?

4 A. The operation of regulatory lag as part of the normal ratemaking process  
5 exposes a utility to the prospect of lower earnings if its cost of service increases between  
6 general rate proceedings, but it also allows the utility to experience higher earnings after a  
7 general rate proceeding, if it is able to reduce its cost of service. This “penalty/reward” aspect  
8 of current Missouri ratemaking policy would be damaged by use of trackers if applied to  
9 normal cost of service items. A company that experiences an increase in an expense that is  
10 being tracked will experience no reduction in earnings related to that increased cost (because  
11 the cost increase will be captured on its balance sheet and not on its income statement) and,  
12 therefore, will have less incentive to attempt to minimize any such cost increase. On the other  
13 hand, a company that experiences a reduction in an expense that is being tracked will  
14 experience no increase to its ongoing earnings levels as a result of the decreased cost (again,  
15 because the cost decrease will be captured on its balance sheet and not on its income  
16 statement) and, therefore, would therefore have less incentive to produce the lower cost levels  
17 in the first place.

18 Q. For what cost of service items is KCPL seeking to track?

19 A. KCPL is seeking authority to implement trackers for property tax expenses,  
20 vegetation management expenses, and cyber-security expenses as part of this rate increase  
21 application. I briefly address each of these requests, and explain why they do not meet  
22 appropriate criteria for when to use a tracker.

1 Q. Is it generally appropriate to track property taxes?

2 A. No. Property taxes are an ongoing cost of service item that is incurred on a  
3 routine annual basis by all major utilities. They have been a component of utility cost of  
4 service in all general rate cases I have been involved with for over 30 years. These costs are  
5 incurred according to a regular schedule and a set process of which utilities are intimately  
6 familiar. Moreover, increases in property tax expense incurred by utilities are usually  
7 associated with increases to their plant-in-service balances included in rate base, and can be  
8 planned for inclusion in rates in the same manner that other revenue requirement changes  
9 associated with plant additions are included.

10 Q. KCPL witnesses Mr. Tim M. Rush and Mr. Darrin R. Ives emphasize in their  
11 direct testimony that property taxes are “almost entirely” outside of utility’s control, as part of  
12 their justification for requesting tracker treatment of this item. Does Staff have a response to  
13 this claim?

14 A. Simply being partially or totally out of a utility’s direct control is not a  
15 sufficient justification to track a particular cost. In any event, KCPL’s witnesses who address  
16 this issue under-emphasize KCPL’s ability to take steps to control the level of the property  
17 taxes it pays over time. To cite a pertinent example, I am aware of at least two utilities that  
18 appealed property assessment decisions made by taxing authorities, and achieved reductions  
19 in the amount of property taxes paid as a result. These two utilities are Missouri Gas Energy  
20 (rate treatment of property tax refunds at issue in Case No. GR-2006-0422), and Union  
21 Electric Company d/b/a Ameren Missouri (rate treatment of property tax refunds at issue in  
22 Case No. ER-2012-0166). It is hard to imagine why a utility that received authority to track  
23 property tax expense amounts would choose to undergo the work and expense of appealing

1 property tax increases when it would be insulated from financial harm associated with the  
2 increase through operation of the tracker in the first place.

3 Q. Should vegetation management expenses be tracked?

4 A. Generally, "No," and not under KCPL's current circumstances. Again,  
5 vegetation management expenses are a normal and ongoing cost of all electric utilities. While  
6 the Commission promulgated rules in the 2007-2008 that established a minimum amount of  
7 vegetation management activity required of utilities, to my knowledge KCPL has been in  
8 compliance with these rules for a number of years, and these compliance costs are not at all a  
9 new phenomenon to KCPL.

10 Q. KCPL claims that its request to track vegetation management expense is driven  
11 in part by expected increases in its annual amount of expense due to insect infestation  
12 concerns and its operational desire to accelerate its vegetation management activities above  
13 the minimum level required under current Commission rules. Does Staff agree?

14 A. No. Many different factors will presumably influence a utility's vegetation  
15 management expense levels over time, and the simple fact of a changing or increasing level  
16 of expense does not justify tracker treatment. Further, if KCPL believes that a potential  
17 decision to accelerate its vegetation management activities beyond the minimum level  
18 required under Commission rules is justified on a cost-benefit basis, it should be willing to  
19 make that decision without requiring a tracker for vegetation management costs. In that  
20 manner, to the extent that KCPL's accelerated vegetation management activities produce  
21 financial benefits to it down the road, both the costs and the associated benefits can be  
22 captured within the ratemaking process on an equal and balanced basis.

1           Please refer to the rebuttal testimony of Staff witness Beck for a further discussion of  
2 KCPL’s purported justifications for tracker treatment of vegetation management costs.

3           Q.     Should cyber-security costs generally be tracked?

4           A.     No.  Activities to safeguard utility assets from malicious attack are not a new  
5 concern to utilities, and costs associated with these activities are not new to KCPL.  While  
6 Staff is aware that the National Electric Reliability Council (NERC) is seeking to implement  
7 updated cyber-security requirements on electric utilities through issuance of “Version 5” of its  
8 rules in 2016, earlier versions of these rules existed and were followed by KCPL and other  
9 electric utilities without trackers.

10          Q.     Notwithstanding Staff’s view that cyber-security costs should not be tracked,  
11 does Staff have any other concerns with KCPL’s proposed cyber-security tracker?

12          A.     Yes.  KCPL’s request for this tracker at this time is premature.  To my  
13 understanding, NERC’s proposed Version 5 rules will not be effective until April 1, 2016 and  
14 there is no final estimate of what the financial impact of the incremental costs on KCPL to  
15 comply with these requirements.  (Please refer to the rebuttal testimony of Staff witness Gross  
16 for further discussion of these points.)  At page 33 of his rebuttal testimony, KCPL witness  
17 Mr. Rush admits that the compliance costs associated with the new standards are “undefined,”  
18 and that KCPL is now “working diligently to develop a cost plan.”  Therefore, at this time  
19 KCPL cannot justify its tracker request by citing to reasonably certain and material  
20 compliance cost estimates for its cyber-security activities.

21          Q.     Has Staff observed any attribute common to each of KCPL’s proposed  
22 trackers?

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1           A.     Yes. KCPL has either experienced recent cost increases for each of these costs  
2 it seeks to track, or their cost is expected to increase in the near future.

3           Q.     Have any of the relevant factors in KCPL's cost of service reduced in recent  
4 years?

5           A.     Yes. In his rebuttal testimony, Staff witness Cary G. Featherstone cites recent  
6 reductions in KCPL's interest payments on long-term debt, and expense reductions associated  
7 with recent programs to reduce KCPL's employee levels. In addition, Staff filed an  
8 application in October 2014 to seek deferral treatment of a recent and ongoing expense  
9 reduction in the amount of U.S. Department of Energy (DOE) fees KCPL was required to pay  
10 related to spent nuclear fuel storage.

11          Q.     Has KCPL sought accounting authority for any of its costs that have declined  
12 or are declining?

13          A.     No.

14          Q.     What is your understanding of the underlying reason for why KCPL is  
15 requesting trackers at this time?

16          A.     Based upon a review of KCPL's direct testimony filed in this proceeding  
17 pertinent to its tracker requests, it is clear to me that these requests are premised as a whole  
18 upon claims that KCPL's recent earnings are unreasonably low, and its claim that the current  
19 Missouri ratemaking process cannot provide KCPL with a realistic opportunity to actually  
20 earn at or near the authorized return set by the Commission without approval of these tracker  
21 requests.

22          Q.     Are general concerns regarding KCPL's recent earnings history and the nature  
23 of the Missouri ratemaking process relevant when considering whether to authorize trackers?

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1           A.     In Staff’s opinion, “No.” As I previously testified, any request to track  
2 individual cost of service items should be considered on the basis of whether there are highly  
3 unusual considerations present that would make this this type of special accounting treatment  
4 justified. Generic complaints regarding the current Missouri rate process are not an adequate  
5 justification.

6           Q.     At page 7 of his rebuttal testimony, KCPL witness Mr. Rush states that,  
7 without enactment of various rate proposals in this case, including the tracker requests,  
8 “KCPL will not have a reasonable opportunity to earn its authorized return on equity now or  
9 in the foreseeable future.” What is Staff’s response?

10          A.     There is no merit to this claim as it relates to KCPL’s proposed trackers. Other  
11 Missouri electric utilities apparently have a reasonable opportunity to earn near or at their  
12 authorized returns on equity (ROE), because several of them have recently been earning at or  
13 above their authorized ROEs. As the Commission is aware, the declassified earnings results  
14 of Ameren Missouri show that it has consistently earned above its authorized return on equity  
15 since mid-year 2012. KPCL witness Mr. Ives himself discusses in his rebuttal testimony the  
16 fact that KCPL’s affiliate KCP&L Greater Missouri Operations Company (“GMO”), which is  
17 also rate regulated by this Commission, earned at or above its authorized ROE in 2013.

18          Q.     Does any electric utility in Missouri have a property tax expense tracker?

19          A.     No. No electric utility other than KCPL has even requested this type of  
20 tracker.

21          Q.     Does any electric utility in Missouri have a vegetation management tracker?

22          A.     While Ameren Missouri and The Empire District Electric Company have had  
23 such trackers since the vegetation management rule went into effect in 2008, this tracker is

1 being eliminated for Ameren Missouri by the Commission in its recent Report and Order in  
2 Case ER-2014-0258. In addition, Empire has agreed to the elimination of its vegetation  
3 management tracker in the Unanimous Stipulation and Agreement filed on April 8, 2015, in  
4 its pending Missouri general electric rate increase case, Case No. ER-2015-0351.

5 Q. Does any electric utility in Missouri have a cyber-security tracker?

6 A. No, and other than KCPL none of them has requested one.

7 Q. Must the Commission grant authority for KCPL to implement property tax,  
8 vegetation management or cyber-security cost trackers in this case to provide KCPL with a  
9 reasonable opportunity to earn the ROE the Commission authorizes it to earn in this case?

10 A. No. As I testified, other Missouri electric utilities have been able to earn at or  
11 near the ROEs the Commission authorized them to earn, without having property tax or  
12 cyber-security cost trackers. Staff likewise asserts that denying KCPL's request for a  
13 vegetation management tracker would not materially harm KCPL's ability to earn its  
14 authorized ROE.

15 **SUMMARY/CONCLUSION**

16 Q. Would you summarize your rebuttal testimony?

17 A. I recommend that the Commission reject KCPL's request to implement  
18 trackers for its property tax expenses, vegetation management expenses, and cyber-security  
19 costs. None of these items meet appropriate criteria for approval of this special accounting  
20 treatment.

21 Q. Does this conclude your rebuttal testimony?

22 A. Yes, it does.

