

Exhibit No.: _____

Issues(s): Accounting Order

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Sponsoring Party: Public Counsel

Case No.: EC-2019-0200

DIRECT TESTIMONY

OF

ROBERT E. SCHALLENBERG

**Submitted on Behalf of
the Office of the Public Counsel**

Case No. EC-2019-0200

**** Denotes Confidential Information ****

April 23, 2019

DIRECT TESTIMONY

OF

ROBERT E. SCHALLENGER

CASE NO. EC-2019-0200

Q. Please state your name and business address.

A. My name is Robert E. Schallenberg. My business address is Post Office Box 2230, Jefferson City, Missouri, 65102.

Q. By whom are you employed and in what capacity?

A. I am the Director of Policy at the Office of the Public Counsel (“OPC”).

Q. Please describe your educational background, professional credentials, and work experience.

A. I have worked in Missouri utility regulation both at the state and federal level for forty-two years. I also worked in Kansas on utility regulation for eight months. My educational background, professional credentials, and work experience are contained in Schedule RES-D-1 and Schedule RES-D-2.

Q. Do you have specific experience relative to this matter?

A. Yes. When I began my career in November 1976, my initial assignments consisted of interim rates, electric fuel clauses, and rate case audits as my primary assignments. I was involved in the rate cases when the issue of how Sibley 3 rehabilitation costs were to be treated with an accounting authority order was determined, EO-91-358/EO-91-360. These

cases are used to establish the criteria to evaluate subsequent accounting authority order cases. I have been involved with accounting orders allowing the utility to defer expenses to be considered in future rate cases. Another common regulatory mechanism is a rate case tracker where an amount is included in the cost of service to establish customer rates and actual costs are tracked for comparison to the amount included in rates. As actual costs exceed, or are less than, the amount included in customer rates, the difference is recorded for its ultimate treatment in the next rate case. I recall accounting authority orders (AAO) for major infrastructure additions (e.g. Wolf Creek and Callaway), programs (e.g. gas service line replacement) and Commission rule or order mandating utility action (e.g. cold weather rule). Construction accounting is another way to defer costs for consideration in future rate cases as was used in KCP&L's Comprehensive Energy Plan (CEP). OPC's request in this case is consistent with the principles of prior AAOs and trackers to modify regulatory accounting to support future rate case deliberations.

Q. What is the purpose of your direct testimony?

A. The purpose of my direct testimony is to support OPC's request for an accounting order (AO) to reflect all of the costs associated with the generation units at Kansas City Power & Light Greater Missouri Operations (GMO)'s Sibley station that customers are currently paying in base rates to operate the station despite the fact that the station was effectively removed from service on November 13, 2018. This retirement was before new rates took effect in December 6, 2018, but after the true-up date in that case. By year end, GMO had recorded an approximately \$160 million regulatory asset regarding future recovery of alleged Sibley 3 retirement costs. OPC's AO is needed because the full picture of the Sibley station retirement costs including Sibley 3 will be essential for the Commission to

determine whether the totality of these costs is unrecovered or over- recovered when this issue is presented to the Commission in a future rate case

Q. What is an AO and what purpose does it serve?

A. An AO is a Commission order directing a utility to account for a specific activity, event, item, program, or transaction in a manner different from that required by the Uniform System of Accounts (USOA) absent the order. The purpose of an accounting order is to capture data for a specific cost objective. This information will then be available to assist in the determination of a potential issue in a future rate case. The cost objective in this case is the aggregation of recovery of any of the financial impacts regarding the Sibley Generation Station retirement to provide for consideration of cost over or under recovery in GMO's next general rate case. The AO is needed now to provide a full picture of the Sibley retirement when GMO seeks recovery of approximately \$160 million of alleged unrecovered plant investment caused by the accelerated retirement of Sibley 3.

Q. What is the ratemaking impact of such an accounting order?

A. There is no ratemaking impact in an accounting order.¹ Customer rates are unchanged whether the Commission approves the accounting order or not. Customer rates will only be impacted when the Commission decides the issue in the next rate case based on information that would not be available without the AO. Orders of this nature generally state that no ratemaking decisions have been made in an AO. The impact of an AO is to preserve cost information to be considered in the next rate case.

Q. Why do you believe that the Commission should order an AO in this case?

¹ See *Report and Order*, EU-2014-0077 (Aug. 29, 2014).

A. I believe there are five separate reasons why this AO should be granted:

- 1) GMO has already established a \$159.9 million regulatory asset in relation to the retirement of the Sibley generating units, which shows GMO is accounting for alleged costs but not for savings.
- 2) The aggregate financial impact of the retirement of the Sibley generating units exceeds at least 5% of GMO's reported net income;
- 3) GMO does not regularly retire generating plants, and has not done so in at least three decades;
- 4) The Sibley station was retired far before the end of its projected remaining life; and
- 5) Despite being retired, the costs associated with the Sibley units are still included in base rates and those costs are currently being collected from GMO's customers.

I am of the opinion that all the relevant criteria for the AO request are satisfied, and that the need for the AO to ensure the entire scope of recovered and unrecovered Sibley retirement costs will be available for determination of this matter in the future is well established.

Q. Regarding the first reason you stated, did GMO indicate to the OPC or Missouri Energy Consumer Group (MECG) that they would seek to recover unrecovered plant investment related to the Sibley Generation Station retirement?

A. No. MECG's data request 1-41 specifically asked GMO:

At the time of retirement of Sibley Unit 1, Sibley Unit 2, Sibley Unit 3 and Sibley Common Facilities, if those separate units of investment are not fully depreciated, will GMO establish a regulatory asset for the unrecovered investment at: (1) time of retirement or (2) some future period in time? If no, please explain in detail. If GMO indicates that it will seek a regulatory asset in the future, please indicate the approximate date.

GMO responded:

GMO objects to this data request as it seeks information that is not relevant and not reasonably calculated to lead to the discovery of admissible evidence regarding whether the retirement of Sibley Station and its units is unusual, abnormal, and significantly different from the ordinary and typical operations of the Company where it would be appropriate for the

Commission to impose deferral accounting, and the quantification of any such deferral if ordered by the Commission. Additionally, GMO objects to data requests 1.36, 1.39, and 1.41 as they call for speculation.

GMO also provided the same objection and response to the following questions:

- 1) Data Request 1-39, which asked whether “GMO anticipate[s] seeking recovery of any unrecovered investment in Sibley Unit 1, Sibley Unit 2, Sibley Unit 3 and / or Sibley common costs in a future rate case?”, and
- 2) Data Request 1-36, which wanted to know “(a) [w]ill the Commission’s issuance of an Accounting Authority Order in this case affect GMO’s decision to retire either Sibley Unit 1, Sibley Unit 2 or Sibley Unit 3? (b) [i]f yes, please describe in detail GMO’s plans regarding each unit in response to the Commission’s decision to grant an Accounting Authority Order.”

Further GMO indicated affirmatively in its response to the following MCEG data request 1-40:

Does GMO believe that it can establish a regulatory asset, with Commission approval, for any unrecovered investment in Sibley Unit 1, Sibley Unit 2, Sibley Unit 3 and / or Sibley common facilities?

As of the timing of this testimony, GMO has not requested Commission approval for the establishment of a regulatory asset for any unrecovered investment in Sibley Unit 1, Sibley Unit 2, Sibley Unit 3 and / or Sibley common facilities retirement.

Q. Did you find any uncertainty or speculation as to whether GMO would establish a regulatory asset related to the Sibley Station retirement?

A. No. Contrary to the data request responses GMO provided, it has already established a regulatory asset related to the Sibley generating station’s retirement. Page 41 of Evergy’s (GMO’s parent company) 2018 10 K filed with the Security and Exchange Commission (SEC) includes a statement that:

Evergy's regulatory assets increased by \$243.4 million primarily due to the reclassification of retired generating plant of \$159.9 million related to GMO's Sibley No. 3 Unit from property, plant and equipment, net to a regulatory asset upon the retirement of the unit in 2018.

This Evergy 2018 10K filing was made on February 22, 2019. On page 34 of this filing, it was further noted that the utility's philosophy regarding regulatory assets and liabilities was as follows:

Regulatory Assets and Liabilities

Evergy has recorded assets and liabilities on its consolidated balance sheets resulting from the effects of the ratemaking process, which would not otherwise be recorded under GAAP. **Regulatory assets represent incurred costs that are probable of recovery from future revenues.** Regulatory liabilities represent future reductions in revenues or refunds to customers. **Management regularly assesses whether regulatory assets and liabilities are probable of future recovery or refund** by considering factors such as decisions by the MPSC, KCC or FERC in Evergy's rate case filings; decisions in other regulatory proceedings, including decisions related to other companies that establish precedent on matters applicable to Evergy; and changes in laws and regulations. If recovery or refund of regulatory assets or liabilities is not approved by regulators or is no longer deemed probable, these regulatory assets or liabilities are recognized in the current period results of operations. Evergy's continued ability to meet the criteria for recording regulatory assets and liabilities may be affected in the future by restructuring and deregulation in the electric industry or changes in accounting rules. In the event that the criteria no longer applied to all or a portion of Evergy's operations, the related regulatory assets and liabilities would be written off unless an appropriate regulatory recovery mechanism were provided. Additionally, these factors could result in an impairment on utility plant assets. See Note 5 to the consolidated financial statements for additional information.

Evergy, Inc. 2018 10K page 34 (emphasis added). Note 5 to the Evergy 2018 10 K consolidated financial statements, pages 95 thru 101, are contained in Schedule RES-D-3. Included in Note 5 is this statement regarding regulatory assets and liabilities:

Regulatory Assets and Liabilities

The Evergy Companies have recorded assets and liabilities on their consolidated balance sheets resulting from the effects of the ratemaking process, which would not otherwise be recorded if they were not regulated. **Regulatory assets represent incurred costs that are probable of recovery from future revenues.** Regulatory liabilities represent future reductions in revenues or refunds to customers. **Management regularly assesses whether regulatory assets and liabilities are probable of future recovery or refund** by considering factors such as decisions by the MPSC, KCC or FERC in Westar Energy's, KCP&L's and GMO's rate case filings; decisions in other regulatory proceedings, including decisions related to other companies that establish precedent on matters applicable to the Evergy Companies; and changes in laws and regulations. If recovery or refund of regulatory assets or liabilities is not approved by regulators or is no longer deemed probable, these regulatory assets or liabilities are recognized in the current period results of operations. The Evergy Companies continued ability to meet the criteria for recording regulatory assets and liabilities may be affected in the future by restructuring and deregulation in the electric industry or changes in accounting rules. In the event that the criteria no longer applied to any or all of the Evergy Companies' operations, the related regulatory assets and liabilities would be written off unless an appropriate regulatory recovery mechanism were provided. Additionally, these factors could result in an impairment on utility plant assets.

(emphasis added).

Q. What conclusions do you draw from this information?

- A. This information shows the basis for the Company, including GMO, to recognize regulatory assets and liabilities. These assets and liabilities are created based on Management assessment and discretion. Commission approval is not needed. Such was the process for the \$160 million Sibley 3 retirement that will be the subject of future rate proceedings as GMO works to recover the \$160 million from GMO's customers. OPC has no such authority to record potential liabilities to offer a complete picture of the matter in hand. However, the Commission has the authority to order GMO to complete the picture by deferring the monies collected from a plant and its costs placed in their rates and retired

before those rates became effective. I would recommend the Commission use its authority in this case.

Q. Moving to the second reason that you cite for why the Commission should grant the requested AO in this case, why does the fact that the aggregate financial impact of the retirement of the Sibley generating units exceed at least 5% of GMO's reported net income matter?

A. When reviewing requests for deferral accounting, or accounting authority orders, the Commission has often relied on the USOA. The USOA provides basic accounting instructions for utilities to report in their annual reports, and includes instructions on accounting for what it deems "extraordinary" events. This "extraordinary" standard is the same standard that I use to support OPC's request for an AO, and the fact that the aggregate financial impact of the retirement of the Sibley generating units exceed at least 5% of GMO's reported net income explains why the retirement of the Sibley generating units should be considered extraordinary.

Q. What do you mean by "extraordinary"?

A. I am referring to the USOA's instructions as to deferral accounting. The Commission adopted the USOA's standards via 4 CSR 240-20.030. USOA Instruction 7 spells out when a utility should defer certain costs or revenues associated with extraordinary items. Restated, the USOA says:

It is the intent that net income shall reflect all items of profit and loss during the period with the exception of prior period adjustments as described in paragraph 7.1 and long-term debt as described in paragraph 17 below. Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual s nature and infrequent

occurrence shall be considered extraordinary items. Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable [sic] future. (In determining significance, items should be considered individually and not in the aggregate. However, the effects of a series of related transactions arising from a single specific and identifiable event or plan of action should be considered in the aggregate. To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary. (See accounts 434 and 435.)

Thus, the USOA has determined that an event is extraordinary if its financial impacts are 5% or more than the entity's income.

Q. Does GMO retiring Sibley meet the USOA's five percent threshold?

A. Yes, by a wide margin. I employed a two-step analysis of the test to determine whether the Sibley retirement meets the USOA's threshold 5% test for extraordinary. First, I developed an estimate of the amount of money customers are either paying in base rates or are otherwise paying through surcharges associated with the operation of the Sibley Generation Station that GMO retired ignoring the fact that this facility was included in customer rates. The criteria used to perform the 5% test was to identify the items that are in base rates and impacted by the Sibley retirement. To transform these number to recognize their income impact, a state and federal income tax of rate of 25.4482542% was applied to develop the income effect of these numbers. The total income effect of these financial items is over ** [REDACTED] **. ² Table 1 below shows each item used and the amount associated with the item.

² This value does not include deferred income taxes, fuel inventories, cash working capital, or property taxes, as these numbers were not readily available to me.

Table 1: Aggregate Customer Payments to Operate the Sibley Station

Non-Labor O & M	\$12,414,468
Labor	\$14,706,742
Depreciation Expense	\$10,362,079
Increase in Fuel Expense	** [REDACTED] **
Total Pre-Income Tax Effect	** [REDACTED] **
Total Income Effect	** [REDACTED] **

By dividing the ** [REDACTED] ** Total Income Effect found in Table 1 by 5%, the result shows GMO would need income in excess of ** [REDACTED] ** for this AO value to not be considered “extraordinary” under the USOA.

Once I had determined the proper amount of net income that GMO would need to meet the USOA’s 5% threshold, I examined the net income/losses GMO had reported in the annual reports it submits to the Commission and the Federal Energy Regulatory Commission (FERC) for 2017 and 2016. I could not examine net income from 2018 because this annual report is not yet available, as GMO has asked for an extension for filing its 2018 annual report. GMO’s 2016 net income was \$60.8 million. In 2017, GMO reported a loss. Therefore, the money customers are paying in base rates and other surcharges associated with costs that GMO is no longer incurring because of retirement of the Sibley generation facility exceeds 5% of GMO’s net income for the past two annual report years. Consequently, the AO exceeds the 5% income test.

Q. On what information did you rely in developing your numbers?

A. In Schedule RES-D-3 I have included all of the documentation regarding of the source of the dollar amount used for each item.

Q. You also previously listed the fact that GMO has not retired a generating facility in over three decades as a reason for why this AO should be granted; do you consider GMO's history regarding plant retirements to also mean that this retirement should be considered extraordinary?

A. Yes. Despite having worked for the Public Service Commission for over forty years, I do not recall the last time GMO or one of its predecessor companies shut down a major generating facility. In fact, GMO indicated in its response to MCEG data request 1-34 that; "[n]o generating units were retired within the past 30 years". The response also indicates GMO's last retirement was Edmond Street around 1987, and that Ralph Green Units 1 and 2 were retired in November 1982. I have included this data request and response as Schedule RES-D-3 for ease of reference.

The long time frame for GMO not retiring a generating plant is somewhat predictable given that generating plants are not retired until they are no longer needed for system reliability and are uneconomic to operate compared to other generating sources. This is why one often sees significant investment in rehabilitation, retro-fits, and environmental upgrades before actual retirements. This trend is also likely to extend into the future as rehabilitation has been more economic and reliable than relying on the market or building new generation. The Sibley generating facility was a dominant generating unit station of GMO's fleet which makes its retirement an extraordinary change to GMO's system.

Q. Could you please explain why you claim that the Sibley Station was retired far before the end of its projected remaining life?

A. Certainly. The principle unit at the Sibley Generation Station is Sibley 3. The current GMO depreciation rates for Sibley 3 are based on a 2040 retirement date.

Q. Why is GMO's decision to retire the Sibley Station far before the end of its projected remaining life relevant?

A. The retirement of Sibley 3 in 2018, despite GMO's previous indication that the plant should last until 2040, is another reason why the decision should be considered extraordinary. This is especially true considering the inadequate level of information the Company has supplied to support that decision. The data supporting this over twenty year advancement of Sibley 3's retirement would be expected to address this significant change in the service life of Sibley 3, which would have far-reaching effects. For example, GMO's \$160 million regulatory asset must necessarily be impacted by the depreciation reserve deficiency caused by retiring a sizable unit twenty-two years in advance of the 2040 retirement date used to establish the units' depreciation rates.

In other words, it is extraordinary that a unit's planned retirement was advanced twenty-two years without a catastrophic change to normal factors, extensive reliability concerns, or cost analysis justifying early retirement. The retirement is made even more extraordinary by the fact that action has resulted in GMO representing nearly \$160 million in future costs.

Q. Has OPC previously raised concerns about GMO's modeling regarding the retirement of the Sibley Station?

A. Yes. As a regulated electrical utility, GMO is required to submit a triennial Integrated Resource Plan (IRP) to the Commission. The planning period for this IRP is 20 years. Based on past submitted IRPs, the retirement of Sibley 3 was not considered in the evaluation of GMO's system until 2017 because GMO considered it beyond the twenty year planning horizon. Schedule RES-D-4 contains OPC 2017 and 2018 GMO Integrated Resource Plan comments.

Q. What did those comments say?

A. The comments addressed the risks associated with the Sibley 3 retirement, based in part, on the fact that GMO has an increasing customer base load.

Q. Your earlier table shows the costs associated with the Sibley units that are still in base rates. Why should this be considered extraordinary?

A. It is extraordinary for GMO to include in customer rates a significant amount of costs to operate a facility that was retired before the rates went into effect. Rate cases are done to give utilities a return on and of their investments to serve their customers, but GMO's customers are paying GMO for a now non-existent investment that is not even serving them.

Q. Would you please summarize your testimony?

A. The retirement of the entire GMO's Sibley Generation Station is an extraordinary event with significant financial implications that will not be known until the next GMO rate case. GMO has already claimed that it still needs approximately \$160 million from its customers from the Sibley Station retirement, specifically Sibley 3's retirement, but there are other

facts surrounding GMO's regulatory asset that are being omitted. Specifically, GMO is omitting facts concerning the cost savings it will receive in the Sibley retirement that will benefit GMO's financials to the detriment of its customers. OPC recognizes this flaw in GMO's regulatory position and has requested an AO, which will allow the costs savings to at least be considered as an offset to the \$160 million asset GMO intends to recover from its customers. This is the best possible way for the Commission to be able to determine the actual amounts that GMO should eventually be allowed to recover from its customers. By allowing the total Sibley Station retirement economic consequences to be known, the real financial impacts can be used to analyze the retirements' effects on Missouri Energy Efficiency Investment Act (MEEIA), GMO's Fuel Adjustment Clause (FAC), and economic value of new generation to satisfy GMO's growing load requirements.

Q. Does this conclude your direct testimony on this matter?

A. Yes.