Exhibit No.:
Issue: Accounting Authority Order
Witness: Mark L. Oligschlaeger
Sponsoring Party: MoPSC Staff
Case Nos.: EO-91-358 and EO-91-360

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

UTILICORP UNITED INC.
MISSOURI PUBLIC SERVICE DIVISION

CASE NOS. EO-91-358 AND EO-91-360

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

Jefferson City, Missouri
August, 1991

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UTILICORP UNITED INC.

MISSOURI PUBLIC SERVICE DIVISION

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Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Jefferson City, Missouri 65102.

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

A. I am the Manager of the Accounting Department of the Missouri Public Service Commission (Commission).

Q. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, Missouri, and received a Bachelor of Science degree in Business Administration, with a major in Accounting, in August, 1981. I joined the Commission in September, 1981, as a Regulatory Auditor. In November, 1981, I passed the Uniform Certified Public Accountant examination, and since February, 1989, I have been licensed in the state of Missouri as a CPA. In July, 1989, I was appointed to my present position within the Commission.

Q. What is the nature of your duties in your present position?

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A. Under the direction of the Director - Utility Services Division, I participate in the planning, coordination, supervision and review of all rate case work and other projects involving members of the Commission's Accounting Department. I am also responsible for various administrative functions associated with the Department.

Q. Have you previously filed testimony before this Commission?

A. Yes. A listing of cases in which I have previously filed testimony before this Commission is given in Schedule 1, attached to this rebuttal testimony.

Q. Did you participate in the planning, coordination, supervision and review of the Accounting Department's audit of Missouri Public Service (MoPub), a division of UtiliCorp United Inc., in Case Nos. EO-91-358 and EO-91-360?

A. Yes, I did.

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this rebuttal testimony is to address the direct testimony of MoPub witness James S. Brook filed in Case Nos. EO-91-358 and EO-91-360 in support of the Company's request to obtain accounting authority orders (accounting orders or AAOs) for certain expenditures. In this rebuttal testimony, I will set out certain criteria used by the Staff in this case and to be used in the future as guidelines for determining whether issuance of an accounting order is appropriate. The Staff's rebuttal testimony will demonstrate that the Company's applications in these cases do not meet the Staff's suggested criteria for issuances of accounting

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orders, and the Staff recommends that the applications be rejected by the Commission. In addition, I will discuss in a general sense how MoPub's applications for accounting orders violate fundamental tenets of traditional regulatory practice, and are a one-sided attempt to skew the regulatory process in MoPub's favor.

Staff witness Cary G. Featherstone will also be filing rebuttal testimony opposing the Company's applications in these cases.

Q. Does the Staff believe that accounting orders are an appropriate regulatory tool?

A. Yes. When based upon the appropriate criteria, and used in a limited manner, the Staff believes that accounting orders are a valid and useful regulatory tool, allowing utilities the flexibility to account for certain expenditures on their public financial statements in accordance with ratemaking practices. However, based upon recent experience, the Staff has concerns that utilities are requesting accounting orders for an increasingly broad variety of expenditures, which had never previously been the subject of AAOs, and which in the Staff's view are inappropriate for AAOs.

Q. How have accounting orders been used in the Missouri jurisdiction in the past?

A. Until recently, accounting orders were requested by utilities in Missouri on an infrequent basis, and were related to highly unique and unusual regulatory events or occurrences. For example, an accounting order was issued to allow Kansas City Power &

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Light Company (KCPL) to continue to accrue Allowance for Funds Used During Construction (AFDC) on its Iatan generating unit, after that unit was disallowed from rate base by the Commission in Case No. ER-80-48. KCPL and Union Electric Company (UE) sought accounting orders to determine the accounting treatment of the nuclear fuel leases associated with their Wolf Creek and Callaway generating units, respectively. Accounting orders were also issued by this Commission to allow KCPL and UE to accrue AFDC on the Wolf Creek and Callaway units for the period of time between the in-service dates for the units and the time rates went into effect reflecting the allowed cost of those units. Accounting orders were granted in that situation because the sheer size of the two companies' investments in the generating units made regulatory lag material and more detrimental to the utilities' financial position than that associated with any other rate base additions the Commission had dealt with previously, or since.

Most requests for accounting orders, then and now, seek in essence to allow utilities to capitalize on their books certain expenditures that would otherwise be required to be expensed during the period of incurrence under generally accepted accounting principles (GAAP). The utilities seek ratemaking treatment (amortization) of the deferred amounts in a later rate case. Deferred treatment has also been granted by this Commission in the past related to such extraordinary and material items as major ice and wind storms, and major power plant outages. The Commission, by allowing utilities to defer and amortize these extraordinary items to expense, allowed the utilities some recovery of extraordinary expense items, while not burdening either the utilities' financial statements or its customers with the full amount of expense in one accounting period. It should be noted that accounting orders were not always necessary for deferral of these types of extraordinary expense items, as in some instances the event occurred within a test year or a known and measurable period of a rate proceeding. The deferral and amortization request was dealt with directly within the context of the rate case, making accounting orders unnecessary in those cases.

Q. Why does the Staff now have concerns regarding utility applications for accounting orders?

A. The Staff's concern is not new although the Staff's efforts to set out in a formal manner the criteria for the issuance of an AAO is relatively new.

Schedule 2 to this rebuttal testimony is a listing of all accounting order applications submitted to the Commission by utilities in the last two years. Schedule 2 lists the case number, company name and the type of expenditure for which special accounting treatment was requested. Research performed by the Staff indicates that the number of accounting order requests within the last two years greatly exceeds the frequency with which such applications were made previously. In addition, there is a recent tendency by utilities to seek to use accounting orders to defer expenses for which there is no historical precedent for that treatment. These factors have led the Staff to conclude that specific criteria need to be established in a more formal manner, so that utilities are put on

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sufficient notice of the type of activities and expenditures for which accounting order status will be considered by the Commission.

Q. Did the Commission reject any of the applications for accounting orders listed in Schedule 2?

A. No. All of the applications listed in Schedule 2 were granted by the Commission.

Q. What criteria does the Staff suggest should be met before accounting orders are granted by the Commission?

A. The Staff would suggest that the following criteria be met before the Commission issues an accounting order in this case, or in future cases:

1. The costs must be associated with an extraordinary event, and have a material and substantial impact on the utility's earnings.

2. The extraordinary event has actually occurred, or is certain to occur in the very near future.

3. Except under limited circumstances, the utility should either have a rate case filed at the time of its application or be planning to file a rate case in the very near future.

4. Deferrals should not be granted if the utility is earning at or above its authorized rate of return at the time of application.

5. The expenditures in question must be reasonable and have been prudently incurred.

6. Any applicable offsets or cost savings associated with the extraordinary event must be reflected in the deferral.

I will explain each of these six conditions in turn.

Q. How does the Staff define "extraordinary event"?

A. The Staff would define "extraordinary event" as an item that is distinguished both by its unusual nature and by the infrequency of its occurrence. The event should possess a high degree of abnormality and be a type of event clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the utility. Further, the event should be of a type that would not reasonably be expected to recur in the foreseeable future.

This general definition is very close to that utilized by the Federal Energy Regulatory Commission (FERC) to denote extraordinary events, as well as the definition that is used for financial accounting purposes. Due to the general acceptance of this definition in the regulatory and accounting professions, the Staff believes that this represents a reasonable standard for definition of an "extraordinary event".

Q. What are some examples of extraordinary items?

A. Classic examples of extraordinary items would be the impacts of major wind and ice storms upon electric utility operations. In the past, the Commission has allowed deferral and amortization of such costs. As noted before, the Commission also allowed extraordinary treatment of certain aspects of the massive rate base additions to KCPL's and UE's operations respecting the Callaway and Wolf Creek nuclear generating units.

Q. Why should an item or event be considered extraordinary before it is eligible for AAO treatment?

A. The ratemaking process is premised upon normality and regularity as the basis for setting rates. Accounting and ratemaking rules and conventions are presumed to be capable of adequately reflecting the ongoing and normal changes to revenues, expenses and rate base which a utility will experience over time. Only infrequently do extraordinary events occur which justify changes to normal utility accounting and ratemaking practices and procedures. Only truly extraordinary items and events justify extraordinary accounting and ratemaking treatment, such as the deferral and amortization of items normally charged to expense as incurred.

Q. Do you consider MoPub's Sibley life extension and coal conversion projects and the increase in purchased power costs at issue in these applications to be extraordinary items, by the Staff's definition?

A. No. All of the above items should be considered part of MoPub's ongoing operations, which the normal ratemaking process is adequate to handle.

All of the items for which MoPub is requesting deferral treatment result from basic operating decisions made by MoPub in response to the need to build, maintain or purchase sufficient generating capacity to serve its customers with an adequate reserve. All electric utilities in this state are faced with the same fundamental issue of capacity planning that is basic to providing electric service to the public. MoPub is not at all unique in Missouri in considering and carrying out unit rehabilitation and coal conversion strategies, as well as making purchases of power in the interchange market. See the rebuttal testimony of Staff witness Featherstone for further discussion of the lack of uniqueness respecting MoPub's activities.

Q. If these items are determined by the Commission to be in the nature of non-extraordinary events, would deferral of their costs then be appropriate?

A. No. The result of deferring and allowing eventual rate recovery of normal and ongoing operational items of the type MoPub has requested would be "single-issue" ratemaking.

The Staff strives to use the ratemaking process to achieve a consistent and appropriate relationship between the major components of the revenue requirement calculation: revenues, expenses and rate base. The Staff utilizes normalization and annualization adjustments to set the levels of each of these three components at a normal level at a point in time, in order to set future rates. This process requires, for example, that one cannot increase rates to cover an increased level of normalized expenses without also examining the normalized level of revenues measured at the same point in time, to see if there is a revenue growth offset. If there is revenue growth, there must be a determination whether it offsets all or a part of the expense growth.

MoPub's proposal in these cases conflicts with this standard ratemaking convention. MoPub has selected two rate base additions and one expense increase in its applications in these cases, and has proposed to capture those costs for future recovery from customers, so the Company is guaranteed full recovery for these expenditures. The primary problem with this is that offsetting components of the revenue requirement process will not be given equivalent treatment; that is, deferral and capture for future reflection in rates to benefit customers. To the extent that each element of the revenue/expense/rate base relationship is not given equivalent and consistent treatment in the ratemaking process, then the ratemaking results will be skewed and flawed. MoPub's proposal in these cases fail this fundamental test of ratemaking equity.

Q. Please explain the condition that an extraordinary event should have a material impact on the utility's financial statements to be eligible for deferral treatment.

A. To qualify for treatment in an accounting order, an event should be both extraordinary in nature and have a significant and substantial impact on the company's earnings. Both elements are necessary. An event that would otherwise be thought of as extraordinary, but has an immaterial impact on a utility's earnings, should not be treated through an accounting order. Likewise, a recurring, ongoing event with a material impact on the company's earnings should not be treated through an AAO.

There are several reasons for maintaining a materiality standard for eligibility for issuance of an accounting order. One, events that have an immaterial impact on a utility's earnings cannot be considered truly extraordinary in any meaningful sense. Second, it is not an efficient use of the resources available to the utility, the Commission or its Staff to perform the investigation necessary on an accounting order application to which less than substantial sums of monies in relative terms are involved.

Q. To what level of corporate organization should this materiality test be applied?

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A. The Staff would propose that the materiality of an extraordinary event be measured against the Missouri jurisdictional financial results of the utility service affected (gas, electric, etc.). The Commission may in some instances additionally want to consider the effects of an extraordinary event on total company Missouri jurisdictional financial results, or total company financial results for a multi-state utility, before deciding to issue an accounting order.

Q. Please explain the second condition proposed by the Staff, which would require that the extraordinary event triggering the request have occurred, or be certain of occurring in the very near future, before an accounting order should be granted.

A. Proper ratemaking considers the relationship at an appropriate point in time among a utility's revenues, expenses and rate base. These three items should only be reflected in the ratemaking process at a point consistent with each other. The requests for deferrals submitted to the Commission through applications for accounting orders generally seek to isolate one component of the revenue/expense/investment relationship for deferral and amortization, upon the premise that the utility's rate levels are not/will not be sufficient to cover the component. This premise can only be adequately tested through examination of concurrent utility earnings at the time the asserted extraordinary event has occurred or is certain to occur in the near future.

For the coal conversion project and increase in purchased power costs in particular, MoPub has requested deferral treatment for

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events that are not scheduled to happen until well into the future. Once again, the premise behind the deferral request is that MoPub's rate levels will not be sufficient to cover these changes to MoPub's investment base and expenses. However, without concrete knowledge of what MoPub's revenue/expense/investment relationship will be at the point at which these events are scheduled to occur, there is no way of knowing whether MoPub's premise is correct. As noted in the rebuttal testimony of Staff witness Featherstone, MoPub has a consistent history since 1983, and continuing to the present time, of earning in excess of its authorized rate of return. There is, accordingly, the possibility that MoPub's rate levels at the time in question will still be sufficient to cover all or a part of these items without the need for a rate increase; thereby negating the justification for the deferral application. For this reason alone, the Commission should reject MoPub's request to defer expenditures for these items. There is no more theoretical justification for allowing deferral treatment for items not scheduled to occur for one or two years in the future than there is for setting rates based upon projections and estimates that far out in time.

Q. Why should a utility be required to have filed a rate case or be planning an imminent case before an accounting order is granted by the Commission?

A. This condition is necessary to prevent open-ended deferral of costs on a utility's books. Typically, an accounting order allows deferral of costs from a point in time requested by the utility to the date rates will be in effect resulting from the utility's next rate proceeding. The Staff's third proposed condition will limit the period of deferral to a fairly short period of time, and will not lead to a long-term distortion of financial statements that otherwise might occur.

There is another reason why the deferrals booked by utilities pursuant to accounting orders should be limited in this manner. Accounting orders in the past have properly reserved ultimate ratemaking treatment of the deferred costs to a future rate case. Thus, if a rate case is not filed soon after the accounting order is granted, costs may be deferred for a number of years. If ratemaking treatment of the cost is not ultimately allowed by the Commission, the company would be required to perform a "write-off" of the entire deferred amount at the time of the Commission's decision. If the company had been deferring costs for a considerable period of time, this immediate write-off would have more severe financial consequences than if the company had merely charged the original item to expense when incurred. The possibility of a write-off of a large magnitude will almost certainly cause utilities to argue that rate recovery of the deferred costs is required for that reason alone, regardless of the merits. Therefore, the Commission could expect to see arguments by utilities that the granting of accounting orders in and of itself dictates rate recovery of the amounts deferred, making a pretense of the "no ratemaking" clause of the original accounting order. In fact, MoPub itself made this type of argument concerning costs deferred pursuant to an accounting order in Case No. ER-90-101 before this Commission. For this reason, maintaining the integrity of the ratemaking and accounting order process would strongly suggest that deferrals made by utilities pursuant to accounting orders be limited by the requirement of a filed or imminent rate case.

Q. Should there be any exceptions to the rate case filing requirement?

A. Yes, in limited circumstances. If a utility undergoes an extraordinary event for which there is clear ratemaking precedent for deferral and amortization for the cost of that item, as opposed to immediate expensing, then an accounting order can be used to defer the cost of that event on the utility's books in the absence of a rate case. The event in question, however, should be clearly of the same or greater magnitude and materiality of the earlier event which triggered the rate case precedent. Further, this exception is not applicable if the utility in question is earning at or above its authorized rate of return at the time of the extraordinary event.

Q. Does MoPub currently have a rate case on file with the Commission?

A. No. In fact, MoPub asserts that a benefit of these applications for accounting orders is that granting the orders will allow MoPub to defer a rate case to the future. I will discuss later in this rebuttal testimony why it is a bad policy to "trade off" accounting orders for rate cases.

Q. Why should accounting orders be denied to utilities earning at or above their authorized rates of return?

A. A premise of utility regulation is that, until the point when a utility files for a rate increase, it must be presumed that it is covering all of its current costs through its ongoing rate levels. If a utility seeks deferral of an item through an accounting order, claiming the item is extraordinary or unique, but yet the utility is earning at or above its authorized rate of return, then the application for an accounting order should be rejected, all other considerations notwithstanding. This is because the current earnings of the utility are sufficient to recover the costs in question. To repeat, the premise behind an accounting order is that an extraordinary item has occurred, for which current rates have not been set, as a result of which the extraordinary item has a significant impact on the company's earnings. If a utility, after consideration of the alleged extraordinary item, is not earning materially below its authorized rate of return, then there is not any shortfall in rates and an accounting order should not be issued.

There is never a justification to defer costs to future customers when a utility is earning above its authorized rate of return. To do otherwise provides the utility in essence double-recovery of the costs from ratepayers. The double-recovery would result when a utility, having sufficient earnings to cover the extraordinary item in question, nonetheless is granted deferral treatment of the item with no reduction in rate levels. Under these circumstances, the utility will recover the deferred costs twice, once from current rate levels, and again from future customers who will pay in rates the amortization of the deferral, if allowed ratemaking treatment.

Q. Is MoPub currently earning in excess of its authorized rate of return?

A. Yes. This is explained in further detail in the rebuttal testimony of Staff witness Featherstone.

Q. Please explain your fifth condition, that the expenditures in question must be reasonable and incurred prudently.

A. The extraordinary item in question should not have been caused by unreasonable, improper, inappropriate or imprudent actions by a utility. However, though the reasonableness and prudency of the expenditures is a necessary pre-condition for issuance of an accounting order, it is not a sufficient justification in itself. Merely claiming that expenditures in question benefit ratepayers, represent the least-cost strategy or are otherwise beneficial is almost entirely irrelevant to the determination of whether an accounting order is appropriate. It should be noted that most of the support for the requests for deferral in Mr. Brook's direct testimony consists of general statements concerning the merit and prudency of the projects. To put it in its most simple terms, granting of an accounting order should not be thought of as a "reward" for reasonable and prudent conduct. Likewise, rejecting a utility's request for an accounting order should not be thought of in terms of a "punishment" or a "penalty". Granting an accounting order should merely depend upon whether certain criteria are met, particularly concerning the extraordinary nature of the item.

Q. Is the Staff taking issue with the reasonableness and prudency of the expenditures associated with the Sibley life extension and coal conversion projects, and the increase in purchased capacity costs?

A. The Staff did not undertake a specific "prudency" review of the items in this docket. The Staff reserves the right to fully explore the reasonableness and prudency of the expenditures at issue in these dockets in the context of future rate proceedings.

Q. Please explain your sixth condition, that savings or offsets should be considered in any deferral that is granted.

A. The sixth condition merely states that if an extraordinary event triggering the issuance of an accounting order has cost savings or offsets associated with it, then the amounts deferred should be accounted for net of any appropriate cost savings or offsets.

Q. Is the Staff's proposed criteria for issuances of accounting orders similar to those proposed by Staff witness Robert E. Schallenberg in Case No. ER-90-101 concerning the appropriateness of allowing deferred cost in rates?

A. Yes, the two sets of criteria are similar. However, the Staff has added to and modified the earlier list of criteria in light of our further experience with accounting orders in Case No. ER-90-101, and since the time of Case No. ER-90-101. Among the factors that triggered the issuance of this set of criteria is:

1. Utilities have requested accounting orders for events that are clearly related to their ongoing operations, and cannot be considered extraordinary.

2. Utilities have requested accounting orders for events for which the associated expenditures were clearly immaterial.

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3. Utilities have requested accounting orders at the same time the available evidence shows that they were earning in excess of their authorized rates of return.

Q. How does the fact that MoPub has earned in excess of its authorized rate of return for most of the 1980s relate to the Company's request for accounting orders in these cases?

A. The doctrine of retroactive ratemaking makes it clear that past excess earnings cannot be used to offset current earnings deficiencies as determined through the rate case process. Therefore, if the Sibley life extension and coal conversion projects, as well as the planned increase in purchased power costs, causes a revenue deficiency for MoPub in the future, then MoPub is fully entitled to normal rate recovery of the deficiencies. However, it is critical that the distinction be made that MoPub through these applications is not seeking normal ratemaking recovery of these items, it is instead seeking extraordinary treatment of these items to guarantee the utility shareholders against any earnings decline related to regulatory lag. In this context, it is extremely pertinent that MoPub is seeking special guarantees to protect itself against the risk of regulatory lag, when at the same time it has benefitted greatly over the last ten years from regulatory lag associated with excess earnings.

For the reasons set out above, the Staff would be opposed to granting these applications even if MoPub had not overearned continually since 1983. However, given that consistent history of overearning, it is particularly inappropriate to grant MoPub the requested deferral treatment of these expenditures.

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Q. Are MoPub's applications in these cases premised on elimination of the impact of regulatory lag in reflecting its Sibley rehabilitation and Western coal conversion projects, and the increase in its cost of purchased power in future rates?

A. Yes. Regulatory lag can be defined as the period of time that elapses between when an event and its related consequences occur and when the event and its related consequences are reflected in the utility's rates. Because current rate of return regulation is premised upon the thorough examination of past events to use as a guide in setting the level of rates necessary to cover ongoing future costs, a certain amount of regulatory lag is inherent and necessary in the context of the current regulatory process.

It is a mistake to view regulatory lag as being an inherent "problem", or something the regulatory process should attempt to eliminate or could eliminate entirely. There are several reasons for this. First, regulatory lag is not something that is inherently negative from the utility's standpoint. Utilities can benefit from regulatory lag, as well as suffer a detriment from it. The same is true of utility customers. In the same manner that it takes a certain period of time for a company to reflect the impact of increased costs or decreased revenues in its rates, it is equally true that it takes a certain period of time for customers to gain the benefit in rates of increased revenues and decreased costs. For example, the Staff's audit of Southwestern Bell Telephone Company that led to the complaint case filed in Case No. TC-89-14, et al., utilized a calendar year 1987 test year, but rates were ultimately

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not ordered to be reduced until the summer of 1989. Any attempt by utilities to use accounting orders to eliminate or mitigate the impact of "normal" regulatory lag on their earnings should be rejected, as similar opportunities are not available for elimination or mitigation of regulatory lag when it benefits utilities to the detriment of their customers.

In other contexts, MoPub has admitted that it has been a beneficiary of the phenomenon of regulatory lag through much of the 1980's. Refer to the rebuttal testimony of Staff witness Featherstone for a further explanation of this matter. There is a certain irony to the fact that MoPub, which has perhaps benefitted more from regulatory lag than any other utility in Missouri during the recent past, has in these applications demanded special regulatory treatment to eliminate regulatory lag that would be to its detriment.

Q. Does the Staff routinely take steps to minimize regulatory lag in the process of setting rates in the Missouri jurisdiction?

A. Yes. The Staff in its rate case audit process routinely utilizes annualization adjustments, pro forma adjustments in the context of "known and measurable" periods, and true-up audits (when appropriate) to minimize the amount of regulatory lag. The Staff believes that these measures are sufficient to mitigate the impact of normal regulatory lag, while still preserving appropriate ratemaking based upon auditable, known and measurable events. The Staff asserts that use of these techniques would minimize the impact of regulatory lag upon MoPub, provided that the Company files for rate relief on a timely basis.

Q. Has the Staff taken "special" measures to minimize or mitigate regulatory lag in past cases?

A. Yes, when the circumstances warranted. Beginning in the early 1980's, the Staff used forecasted fuel amounts to determine electric utility fuel expense, to minimize the impact of inflation on utility fuel costs. The Staff used a fully projected test year approach in the Southwestern Bell Telephone Company "divestiture" case, Case No. TR-83-253, because of the unique and unusual circumstances surrounding the divestiture of AT&T. MoPub itself has benefitted directly from the Staff's flexibility, when in Case No. ER-83-40 the Staff agreed to the use of a true-up mechanism to address the forecasted operation and maintenance expense levels associated with the Jeffrey Energy Center. Each of these special measures was taken in the context of a pending permanent general rate case and was fashioned to address a prospective situation.

The Staff utilized these approaches because they were believed to be appropriate under the circumstances, yet still maintained sound regulatory and ratemaking principles in the context of the rate case process. In these cases, the Staff does not believe that MoPub's proposals preserve sound regulatory and ratemaking principles. MoPub in these cases is concurrently seeking to eliminate the impact of regulatory lag entirely on certain aspects of its operations, while circumventing the rate case process completely. This is not appropriate nor acceptable in the Staff's view.

Q. Does regulatory lag have an effect on a utility's incentives to achieve efficiencies in its operations, under current regulation?

A. Yes. Regulatory lag is a powerful incentive for utilities to effectuate efficiencies and economies. The Commission should be very cognizant of this fact before accepting any proposals, generic or specific, to eliminate entirely the impact of regulatory lag. This incentive can be illustrated by considering a hypothetical regulatory scheme that is perfectly efficient in the sense that regulatory lag is eliminated in entirety; i.e., cost savings and increases are passed on to customers as they are incurred. Under this hypothetical model, utilities have no incentive to operate in a more efficient or economical manner, as the rewards associated with those efficiencies are passed on to customers immediately, with no gain to the utility. In the same manner, the utility has no incentive to attempt to minimize its expenses in producing the utility service, as any increased costs are passed on to customers immediately, with no detriment or penalty to the utility. Given the phenomenon of regulatory lag, utilities can accrue the benefits and rewards of more efficient operations for a period of time before passing the ongoing benefits on to customers, thereby encouraging more efficient operations. Likewise, the financial detriments associated with increased costs, and the utility's inability to immediately pass those costs on to customers, is a strong incentive for the utility to keep costs to a minimum. The incentives that currently exist in rate of return regulation as it is practiced in

Missouri are there largely because of the phenomenon of regulatory lag.

For these reasons, while the Staff agrees that regulatory lag should be sought to be limited to a reasonable degree, it is also the Staff's view that some regulatory lag is better than no regulatory lag at all. MoPub's proposals for accounting orders in these cases in essence request the Commission to eliminate entirely the impact of normal regulatory lag on certain future changes to its operations. MoPub's proposals should be rejected by the Commission for policy reasons.

Q. What is retroactive ratemaking?

A. Retroactive ratemaking, which is prohibited in Missouri, constitutes the setting of rates in order for a utility to recover the specific costs of past events incurred by the utility so as to make the utility's shareholders "whole", in contrast to setting rates to allow a utility to recover a normal ongoing level of cost.

Q. Does the Staff consider MoPub's applications for accounting orders in these cases to be akin to retroactive ratemaking?

A. Yes. The Staff believes that MoPub's applications in these cases amount in substance to seeking a guarantee that its shareholders will be made whole at the time of a future rate case for the regulatory lag impacts associated with the Sibley rehabilitation and coal conversion projects, and the scheduled increase in purchase power costs.

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Q. Aside from the legal requirements in Missouri, are there any other policy reasons why this type of guarantee to UtiliCorp's shareholders is inappropriate?

A. Yes. Guaranteeing shareholder investments in any fashion also provides a negative incentive for utility efficiency. As noted in Narragansett Electric Co. v. Burke, 415 A.2d 177 (R.I. 1980), which the Commission has cited as applicable case law in allowing deferral and amortization of extraordinary costs of power plant outages, the rule against retroactive ratemaking "also prevents the Company from employing future rates as a means of insuring the investments of its stockholders...If a utility's income were guaranteed, the Company would lose all incentive to operate in an efficient, cost-effective manner, thereby leading to higher operating costs and eventual rate increases."

Q. Is granting the Company's applications for accounting orders necessary to prevent the Company from incurring an onerous level of regulatory lag on the projects in question?

A. No. MoPub has presented absolutely no evidence that the amount of regulatory lag it would incur on these projects would be onerous if it had filed or does file for timely rate relief.

Q. MoPub asserts that the granting of its applications for accounting orders in this docket will allow it to forego a rate increase request it would otherwise undertake. Is this a valid reason for granting the Company's applications?

A. No, for three reasons. First, while rate cases have burdensome aspects in regard to both the utility and its regulators, they remain the best vehicles for rate determinations, precisely because all relevant factors can be considered. MoPub's proposals, in contrast, mandate the isolation of individual rate components for future ratemaking treatment, without proper consideration of all concurrent relevant factors. MoPub proposes that cost of service items causing increases to its revenue requirement be isolated and preserved for future recovery in a rate case through the deferral of said costs, while offsetting decreases to revenue requirement are ignored and are not "captured" in a similar manner for the benefit of MoPub's customers. The abandonment of sound regulatory practices and principles, and a skewing of the treatment afforded companies and their customers to favor the companies, is too high a price to pay for the false god of one less rate case.

Second, the increasing number of accounting order applications, and the ever-expanding scope of their subject matter, has made processing those applications increasingly burdensome for the Staff. If the number of applications continue to increase, the workload associated with them may become comparable to the current rate case workload.

Third, MoPub's proposal is an attempt to inappropriately shift some of the risks inherent in regulation from the utility to the utility's customers. Under the current regulatory process, the utility has always borne sole responsibility for the decision when to file a request to increase rates. The prohibition of retroactive ratemaking in this state, as well as the regulatory lag inherent in the ratemaking process, has meant that the utility took the risk of incurring a certain amount of deficient earnings, which it could not later recover, if it did not file a rate case in a timely fashion. MoPub in these cases is trying to shift the risk of not filing a rate case at the current time to its customers, by asking that it have its earnings associated solely with the items in question be guaranteed by the Commission in a future rate case, even though it chooses not to file a current rate case. MoPub's attempt to shift risks and responsibilities to its ratepayers in this fashion is inappropriate, and should be rejected by the Commission.

Q. Please summarize the reasons the Staff is opposed to MoPub's applications for accounting orders in these cases.

A. Based on the rationale discussed in this rebuttal testimony, as well as the rebuttal testimony of Staff witness Featherstone, the Staff is opposed to the accounting orders requested by MoPub in these cases for the following reasons:

- None of the costs for which deferral has been requested relate to extraordinary events.

- Most of the Sibley life extension program is already reflected in rates. The Sibley coal conversion project and increase in purchased capacity costs are events that will not happen until some time in the future, making a deferral request at this point inappropriate. The coal conversion project has been delayed once, and is currently being considered for further delay until April, 1994.

- Capacity purchase costs are ongoing expenses and should not be considered for deferral treatment. Further, there is uncertainty as to the overall level of fuel costs in the future relating to the coal conversion project.

- MoPub currently is earning at or in excess of its authorized rate of return.

- MoPub has derived the benefit of regulatory lag on excess earnings for a substantial period of time dating back to 1984, making its current request for

6/686a

guarantees against detrimental regulatory lag on these items to be particularly inappropriate.

Q. Does this conclude your rebuttal testimony?

A. Yes.

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BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of Missouri Public Service for the issuance of an accounting order relating to its electrical operations.)	Case No. EO-91-358
In the matter of the application of Missouri Public Service for the issuance of an accounting order relating to its purchase power commitments.)	Case No. EO-91-360

AFFIDAVIT OF MARK L. OLIGSCHLAESGER

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Mark L. Oligschlaeger, of lawful age, on his oath states: that he has participated in the preparation of the foregoing rebuttal testimony in question and answer form, consisting of 27 pages to be presented in the above case; that the answers in the foregoing rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Mark L. Oligschlaeger
Mark L. Oligschlaeger

Subscribed and sworn to before me this 16th day of August, 1991.

Judy Fritsch
Notary Public

JUDY FRITSCH
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP AUG. 15,1993

My Commission expires ______.

RATE CASE PROCEEDINGS

MARK L. OLIGSCHLAEGER

COMPANY	CASE NO.
Kansas City Power and Light Company	ER-82-66
Kansas City Power and Light Company	HR-82-67
Southwestern Bell Telephone Company	TR-82-199
Missouri Public Service Company	ER-83-40
Kansas City Power and Light Company	ER-83-49
Southwestern Bell Telephone Company	TR-83-253
Kansas City Power and Light Company	EO-84-4
Kansas City Power and Light Company	ER-85-128 & EO-85-185
KPL Gas Service Company	GR-86-76
Kansas City Power and Light Company	HO-86-139
Southwestern Bell Telephone Company	TC-89-14
Missouri-American Water Company	WR-91-211

ACCOUNTING ORDER APPLICATIONS (1989-1991)

CASE NO.	COMPANY	COST
GO-90-51	KPL Gas Service	Safety Expenditures
EO-90-114	MoPub	Plant Rehab Costs
GO-90-115	MoPub	Safety Expenditures
EO-90-126	KCPL	Coal Contract Buy-Out
EO-90-132	Sho-Me	Pension Costs
GO-90-215	United Cities	Safety Expenditures
EO-90-252	KCPL/St. Joseph	Transmission Line Lease Costs
EO-91-247	St. Joseph	'Mapping' System
EO-91-305	KCPL	Coal Contract Buy-Out
EO-91-358	MoPub	Plant Rehab Western Coal Conversion
EO-91-359	MoPub	Safety Expenditures
EO-91-360	MoPub	Purchased Power Cost Increase