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Witness: Mark L. Oligschlaeger
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

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Missouri Public
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THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

Jefferson City, Missouri
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1 I will also briefly comment on some of the statements made by the Empire
2 rebuttal witnesses attempting to contrast past Commission decisions concerning
3 construction costs to issues involving the SLCC unit.

4 Q. On page 16 of his rebuttal testimony, Empire witness Beecher states that
5 “[n]one of the variances from the original estimate are the result of Empire making an
6 improper or imprudent decision”. Does the Staff agree that this is a crucial point in
7 assigning responsibility between shareholders and ratepayers for cost overruns for the
8 SLCC unit project for rate purposes?

9 A. No. Staff witness Cary G. Featherstone does address Empire’s decision-
10 making as it involved Fru-Con Construction Corporation (Fru-Con), a major contractor
11 on the SLCC unit project, in his surrebuttal testimony. However, regardless of each of
12 Empire’s decisions with respect to Fru-Con and the SLCC unit project, the Staff believes
13 that the cost overruns associated with Fru-Con’s scope of work on the SLCC unit project
14 were incurred imprudently, and should not be assigned to Empire’s customers for rate
15 purposes.

16 Q. Is it a requirement that the Commission find that Empire specifically acted
17 in an imprudent manner before disallowing the cost overrun amounts at issue for SLCC
18 in this case?

19 A. No, not in the Staff’s opinion. The Staff believes that the prudence
20 standard should apply both to Empire and to its contractors on the SLCC unit project.
21 This is because the risk of inadequate performance on a construction project causing cost
22 overruns is properly placed on the utility, not its ratepayers. Further, this point should
23 hold whether the inadequate performance was associated with the utility itself or its

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1 contractors. Otherwise, the result would be that customers would be protected from
2 detrimental cost impacts of imprudent actions or decisions made by regulated utilities,
3 but would be expected to pay in rates the adverse consequences of imprudent actions or
4 decisions made by construction project contractors that are hired by regulated utilities
5 and, in fact, are accountable only to the regulated utilities. Such a result is illogical.

6 Q. Why should customers not be responsible for cost overruns associated
7 with inadequate performance by contractors on major construction projects?

8 A. It is entirely the responsibility of the utility to manage the construction
9 project so that the generating plant is capable at providing a reliable supply of power at
10 the least reasonable cost. Part of this overall responsibility consists of selecting qualified
11 contractors and sub-contractors to assist in the design and the construction of the
12 production facility, as well as entering into contractual agreements with the contractors
13 and sub-contractors to define each parties' scope of work and responsibilities for the
14 project, and setting forth penalty provisions to enforce sanctions if a party to a contract
15 does not live up to its responsibilities under the contract. Including penalty provisions in
16 contracts is obviously intended to attempt to shield Empire, and ultimately its customers,
17 from detrimental impacts of inadequate performance by contractors. To the extent that
18 Empire or other utilities fail to enter into contracts that serve to protect their and their
19 customers' interests, or if Empire or other utilities fail to enforce the provisions in those
20 contracts, it would be inappropriate to pass on the additional costs associated with those
21 actions on to customers, who as a body have no responsibility for management of
22 construction projects.

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1 Q. Did Empire enter into such contracts with its major contractors on the
2 SLCC unit project?

3 A. Yes, it did. For example, the Company's contract with Fru-Con contained
4 provisions allowing Empire to terminate Fru-Con for "default" or "convenience". It is
5 my understanding that a termination for "default" would result from Fru-Con's inability
6 or unwillingness to live up to its responsibilities under the contract, and that Fru-Con
7 would be liable to Empire for all costs that it incurred for work that was within the scope
8 of the Fru-Con/Empire contract. In contrast, it is my understanding that a termination for
9 "convenience" would merely require that Empire decide that it no longer needed Fru-
10 Con's services on the SLCC unit project. Such a decision would not require that Fru-Con
11 had in any way materially violated the terms of the contract. In the event of a termination
12 for "convenience", Fru-Con would be entitled to compensation from Empire for
13 cancellation costs as set out in the contract, plus an additional fee of 8% of substantiated
14 and unbilled costs to that point.

15 Q. Did Empire ultimately terminate Fru-Con for "default" on the SLCC unit
16 project?

17 A. Empire notified Fru-Con that it was in "default" under the contract in
18 April 2000. The direct testimony of Staff witness Cary G. Featherstone contains a
19 narrative of the events that led to Fru-Con's termination. The Staff believes that it is very
20 clear from Empire's correspondence with Fru-Con in March and April 2000 that Empire
21 intended its termination to be for "default" under the Fru-Con contract, not for
22 "convenience". Empire's decision to terminate Fru-Con is fully supported by the rebuttal
23 testimony filed by Company witness Wilson in this proceeding. In that testimony,

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1 Mr. Wilson describes the myriad of problems Empire encountered with Fru-Con's
2 assigned work on the SLCC unit project, and Mr. Wilson's perception that Fru-Con's
3 continued participation in the project could have potentially resulted in unacceptable
4 detrimental financial consequences to Empire, associated with increased construction
5 costs and delays in the project schedule.

6 The Staff generally concurs with Empire witness Wilson's
7 characterization of Fru-Con's performance on the SLCC unit project.

8 Q. Did Empire attempt to assign responsibility for cost overruns associated
9 with Fru-Con's performance on the SLCC unit project to Fru-Con following its
10 termination?

11 A. As referenced in the surrebuttal testimony of Staff witness Featherstone,
12 Empire apparently initially assumed that it would receive recovery of the detrimental cost
13 impacts of Fru-Con's performance under the SLCC unit contract from Fru-Con itself.
14 However, Empire ultimately decided to enter into a settlement with Fru-Con, and pay it
15 for the work it performed up to the time of termination on the SLCC unit project. The
16 Staff believes this settlement was more indicative of the payment arrangements one might
17 expect under a termination for "convenience".

18 Q. Why did Empire agree to give up its rights under the contract with Fru-
19 Con associated with a termination for "default"?

20 A. Based upon the testimony of the Empire witnesses on this issue, Empire
21 apparently believed it might not prevail in arbitration or judicial review of its claim
22 against Fru-Con when Fru-Con challenged its termination for "default" made pursuant to
23 the Fru-Con/Empire contract.

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1 Q. Does Empire's agreement to a settlement with Fru-Con form the basis for
2 a legitimate claim that the cost overruns associated with Fru-Con's work on the SLCC
3 unit project should be paid for by Empire's customers?

4 A. No. The Staff believes that there can be no serious dispute of the
5 following points as they involve Empire and Fru-Con:

- 6 1. Fru-Con's work on the SLCC unit project was not in conformance
7 with the terms of its contract with Empire, and was unacceptable and
8 imprudent by any reasonable standard; and
- 9 2. Fru-Con's work on the SLCC unit project through April 2000, and
10 Empire's decision to terminate Fru-Con, caused cost overruns on the
11 project that would not have occurred if Fru-Con had met its
12 contractual responsibilities on the SLCC unit project in an appropriate
13 manner.

14 Given these points, it is irrelevant whether Empire subsequent decision to
15 absolve Fru-Con of its responsibilities under the contract for termination for "default"
16 was good or bad, prudent or unwise. Those cost overruns, by their very nature, should
17 not be assigned to customers under reasonable regulatory principles.

18 Q. Please explain.

19 A. It is a fundamental axiom of utility regulation that customers, who do not
20 have choices in utility service providers, should not pay for costs that are unnecessary to
21 provision of utility service, or that were incurred imprudently by the utility supplier. This
22 axiom is based upon a belief that the existence of competitive markets serves to protect
23 consumers from unnecessary costs, or necessary but excessive costs associated with

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1 production of the competitive project. Regulation serves as the mechanism to replace the
2 competitive market and protect customers from unnecessary and/or excessive cost levels
3 when the product offered is of an essential nature to consumers and a natural monopoly.

4 The cost overruns on the SLCC unit project were by no stretch of the
5 imagination inherent and/or unavoidable. They resulted either from a deliberate approach
6 by Fru-Con not to meet its responsibilities to Empire on the SLCC unit project, or an
7 inability of Fru-Con to successfully perform the work. The decision by Empire not to
8 seek reimbursement for cost overruns from Fru-Con, and instead to seek recovery from
9 its ratepayers for these costs, was a voluntary choice of the Company, as well. The costs
10 at issue here are therefore not akin to "Acts of God" or natural disasters; they are instead
11 the product of the failure of Fru-Con to live up to their contractual obligations for the
12 SLCC unit project, and Empire's decision not to seek full reimbursement from Fru-Con
13 for the detrimental impact. The costs at issue here also cannot be considered to be part of
14 a "normal" construction process, where mistakes might happen, things may not proceed
15 strictly according to plan and some unanticipated costs may be incurred. These "normal"
16 types of events can be considered in the budgeting process for a construction project
17 through a "contingency" amount. In contrast, the failure of a contractor to perform in an
18 acceptable manner to the degree displayed by Fru-Con on the SLCC unit project is, from
19 the Staff's experience, highly unusual.

20 For all of these reasons, the Fru-Con cost overruns at issue in this
21 proceeding are inappropriate for inclusion in customer rates.

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1 Q. Your testimony so far has addressed only cost overruns associated with
2 Fru-Con. Does this imply that the Staff is recommending rate recovery of the remaining
3 SLCC unit cost overruns?

4 A. No, not at this time. The Staff may recommend rate recovery of some or
5 all of the remaining SLCC unit cost overruns at such time that Empire adequately
6 explains the causes for and justifies the existence of the other cost overruns. This point is
7 explained in the surrebuttal testimony of Staff witness Featherstone.

8 Q. Do Empire witnesses in their surrebuttal testimony use
9 “industry comparisons” in an attempt to justify inclusion of SLCC unit cost overruns in
10 rates?

11 A. Yes. Company witness Beecher offers a comparison of projected costs of
12 other combined cycle units to the current projected cost of Empire’s SLCC unit project.
13 Empire witness Rolph compares the current SLCC unit cost projection (on a \$/kw basis)
14 to a similar measurement of combined-cycle costs for other units. Both witnesses claim
15 that these industry comparisons show the SLCC unit project in a favorable light.

16 Q. Has the Commission rejected the use of industry comparisons in past
17 construction cost cases to attempt to justify inclusion of cost overruns in customer rates?

18 A. Yes, as conceded by Empire witness Beecher on page 5 of his rebuttal
19 testimony. Nonetheless, Mr. Beecher states that such analyses can be used as a “tool” by
20 the Commission to determine if SLCC unit costs are just and reasonable.

21 Q. Does the Staff agree with this statement?

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1 A. No. The Staff does not believe that data from industry comparisons
2 constitute a legitimate means of determining whether construction costs should be
3 reflected in rates.

4 Q. Why has the Commission rejected the use of industry comparisons in
5 reviewing rate recovery of cost overruns in past rate proceedings?

6 A. In both the Union Electric Company (now AmerenUE) and Kansas City
7 Power & Light Company (KCPL) nuclear generating rate cases in the 1980s, those
8 companies attempted to justify the amount of cost overruns experienced at those
9 generating units by making favorable comparisons between the total cost of their units to
10 the costs experienced at other nuclear generating units around the country. The
11 Commission rejected these comparisons. At page 12 of its Report and Order in Case
12 Nos. EO-85-160 and EO-85-17, Union Electric Company (UE), the Commission stated as
13 follows:

14 The Commission determines that no industry
15 standard of prudence has been established by UE. Over
16 100 nuclear plants have been cancelled since 1972. Some
17 have been fraught with problems while others have been
18 relatively successful. Mr. Schnell's schedule showing
19 nuclear plant costs, excluding AFUDC, range from \$1,121
20 per kilowatt to \$3,491 per kilowatt. The average plant does
21 not exist. No evidence was produced to show prudent
22 management at any of the plants used in the schedules
23 showing industry averages. The Commission concludes
24 that industry averages do not create an industry standard of
25 prudence.
26

27 Q. Does the above quote from the Commission also apply to the industry
28 comparisons discussed by Mr. Beecher and Ms. Rolph?

29 A. Yes. No evidence has been introduced in this proceeding as to what a
30 comparable "average" combined cycle unit should cost, as a relevant comparison to the

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1 specific projected costs of the SLCC unit project. This fact is particularly relevant in that
2 Company witness Rolph in her rebuttal testimony discusses at pages 5-6 some factors
3 that lead to different capital cost levels for combined cycle units. Furthermore, there has
4 been no evidence introduced in this proceeding concerning the prudence, or the lack
5 thereof, of the construction management and construction costs of the other combined
6 cycle units cited by Mr. Beecher and Ms. Rolph. Even if it could be considered relevant
7 to the Commission's consideration of the cost overruns incurred at the SLCC unit project,
8 the bare bones industry comparison information provided by the Empire witnesses in
9 their rebuttal testimony is wholly inadequate to providing the basis for any type of
10 intelligent comparison between the facts and circumstances that led to the level of costs
11 incurred at the SLCC unit project, and the facts and circumstances underlying the level of
12 costs at the other combined cycle units.

13 Q. Are there circumstances in which a demonstration that the construction
14 costs of a generating unit are less than an industry average would be an appropriate
15 response to an allegation of imprudence?

16 A. I believe not. If it were satisfactorily shown that a utility has been
17 imprudent in its management of some aspect of power plant construction, that fact would
18 not somehow be negated by a favorable overall comparison of that unit's costs to an
19 industry average. Seen in its best light, the utility's argument would seem to be that its
20 imprudence in some aspect of the unit construction was offset by superior performance in
21 another aspect or aspects of that construction. Even if that were a relevant point, in this
22 proceeding Empire has certainly not pointed to any factors within its control that have

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1 allegedly caused it to "outperform" the industry average in the construction costs for the
2 SLCC unit.

3 Q. Please comment on Ms. Rolph's specific industry comparison.

4 A. In her rebuttal testimony, Company witness Rolph presents an expected
5 range of "all-in" capital costs for a combined cycle unit coming on-line in the summer of
6 2001 of \$480 - \$560 per kw, and compares that to a forecasted cost of the SLCC unit of
7 \$520 per kw. She further presents an alleged \$90/kW advantage for SLCC compared to
8 combined cycle units coming on-line in the six months following the expected in-service
9 date for the SLCC unit.

10 There has been no support provided by Ms. Rolph in her testimony, or in
11 workpapers that are normally provided concurrently with testimony, to support any of the
12 estimates referenced in Ms. Rolph's testimony. Accordingly, Ms. Rolph's conclusions
13 concerning the costs of the SLCC unit are both irrelevant concerning the prudence of the
14 costs, and totally unsubstantiated.

15 Q. Please comment on Mr. Beecher's use of industry comparisons in his
16 rebuttal testimony.

17 A. Empire witness Beecher presents cost data concerning 17 combined cycle
18 units scheduled to come on-line between 2000 and 2004. Mr. Beecher explains that the
19 data concerning these units was obtained through a review of "press releases" issued by
20 the plant owners. He asserts that the SLCC unit's cost compares favorably with the other
21 17 units.

22 As discussed before, it is not clear from the information provided by
23 Mr. Beecher how comparable these other combined cycle projects are to the SLCC unit.

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1 In particular, the Staff questions why SLCC should be compared to plants coming on-line
2 as late as 2004. Both Empire witnesses Beecher and Rolph go into some detail as to the
3 current rapidly escalating cost environment for combined cycle units. If this is accurate,
4 it stands to reason that the SLCC project would cost less than similar plants coming on-
5 line in 2002, 2003 and 2004. Under the terms of Mr. Beecher's analysis, what is not
6 clear is why Empire should be given "credit" for the fact that its load growth required the
7 addition of new generating capacity in 2001, compared to other constructors who plan to
8 add generating capacity in later years, or why that "credit" should be thought to somehow
9 offsets the additional costs associated with inadequate performance by Empire and/or its
10 contractors on the SLCC unit site.

11 Mr. Beecher also did not provide workpapers or source documents to the
12 Staff to support the industry comparison conclusions he reaches in his rebuttal testimony.

13 Q. On pages 9-10 of his rebuttal testimony, Mr. Beecher attempts to contrast
14 Empire's alleged aggressiveness with contractors on the SLCC unit project with the lack
15 of aggressiveness of KCPL with its contractors concerning the Wolf Creek generating
16 unit, which the Commission criticized in its Report and Order in Case Nos. EO-85-185
17 and EO-85-224. Is Mr. Beecher's point valid?

18 A. No. Concerning the Wolf Creek project, KCPL was not the managing
19 construction partner; Kansas Gas & Electric Company was. Therefore, KCPL's role in
20 the Wolf Creek project was roughly analogous to that on the SLCC unit project of Westar
21 Generating, Inc., the owner of 40% of SLCC's capacity. KCPL and Empire are not
22 directly comparable in their roles in the construction of Wolf Creek and SLCC,
23 respectively.

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1 Q. Is Empire's "aggressiveness" on the SLCC unit project the crux of this
2 issue in any case, in the Staff's opinion?

3 A. No. Again, Empire's management of Fru-Con on the SLCC unit project is
4 addressed in Staff witness Featherstone's surrebuttal testimony. In the hypothetical
5 situation where a utility company is entirely blameless in contractor error or imprudence
6 that resulted in material cost overruns, the Staff's position is that the cost of such errors
7 or imprudence should be recovered from the party at fault. In the event that is not
8 possible, or the utility voluntarily decides to forego recovery of the additional costs from
9 its contractor, then the utility's shareholders should bear the additional costs associated
10 with the errors or imprudence. A regulated utility's customers should only reimburse a
11 utility in rates for prudent expenditures that are necessary to the provision of utility
12 service.

13 Q. Is there a settlement of SLCC unit project cost overrun issues between
14 Empire, the Staff and the Office of the Public Counsel?

15 A. Yes, tentatively. The parties expect that a stipulation and agreement
16 resolving these issues will be filed by these parties shortly. The content of this tentative
17 settlement is discussed in the surrebuttal testimony of Staff witness Featherstone.

18 Q. Does this conclude your surrebuttal testimony?

19 A. Yes, it does.

