

# EXHIBIT

Exhibit No.:  
Issue(s): Patch Construction Costs  
Witness: Ted Robertson  
Type of Exhibit: Surrebuttal  
Sponsoring Party: Public Counsel  
Case Number: ER-2004-0570  
Date Testimony Prepared: November 24, 2004

## SURREBUTTAL TESTIMONY

OF

**TED ROBERTSON**

FILED

DEC 28 2004

Missouri Public  
Service Commission

Submitted on Behalf of  
the Office of the Public Counsel

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

**Case No. ER-2004-0570**

November 24, 2004

Exhibit No. 98  
Case No(s) ER-2004-0570  
Date 2-06-05 Rptr. 45

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

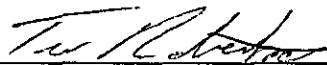
In the Matter of the tariff filing of The	)	
Empire District Electric Company	)	
to implement a general rate increase for	)	Case No. ER-2004-0570
retail electric service provided to customers	)	
in its Missouri service area.	)	

**AFFIDAVIT OF TED ROBERTSON**

STATE OF MISSOURI    )  
                                  )   ss  
COUNTY OF COLE     )

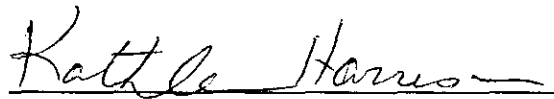
Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony consisting of pages 1 through 12.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

  
\_\_\_\_\_  
Ted Robertson, C.P.A.  
Public Utility Accountant III

Subscribed and sworn to me this 24<sup>th</sup> day of November 2004.

KATHLEEN HARRISON  
Notary Public - State of Missouri  
County of Cole  
My Commission Expires Jan. 31, 2006

  
\_\_\_\_\_  
Kathleen Harrison  
Notary Public

My commission expires January 31, 2006.

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**SURREBUTTAL TESTIMONY**  
**OF**  
**TED ROBERTSON**  
**EMPIRE DISTRICT ELECTRIC COMPANY**  
**CASE NO. ER-2004-0570**

**INTRODUCTION**

1

2

3

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

4

A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

5

6

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED  
DIRECT AND REBUTTAL TESTIMONY IN THIS CASE?

7

8

A. Yes.

9

10

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

11

A. The purpose of this testimony is to address the rebuttal testimony of Mr. Brad P.  
Beecher regarding cost overruns on the Energy Center 3 & 4 project.

12

13

14

15

**PATCH CONSTRUCTION COSTS**

16

17

Q. WHAT IS THE ISSUE?

1 A. The issue concerns whether ratepayers should be required to reimburse Company  
2 for cost overruns associated with a construction company's failure to perform on  
3 its contract. The Company incurred the cost overruns due to an imprudent  
4 abandonment of a performance bond provision contained in the original contract  
5 with Patch. The abandonment of the performance bond shifted the risk from the  
6 contractor/bonding company to the Company and it now wants the ratepayers to  
7 reimburse it for the resulting costs.

8  
9 Q. HAS THE COMPANY TAKEN A POSITION REGARDING WHETHER OR  
10 NOT A PERFORMANCE BOND SIGNIFICANTLY REDUCED THE RISK  
11 ASSOCIATED WITH THE CONSTRUCTION PROJECT?

12 A. Yes. Company witness Beecher has acknowledged that the performance bond  
13 would have protected Empire from the additional liability that it suffered.  
14 Beginning on page 31, line 22, of Mr. Beecher's Deposition Transcript, dated 11-  
15 10-04, it states:

16

17 Q. Since Empire required Patch to get a performance bond in  
18 the contract, would you agree that Empire did believe that a  
19 performance bond was important to ensure Empire's  
20 exposure to financial risk was minimized?

21

22 A. **I agree that performance bonds help minimize risk, and**  
23 **that we thought one was appropriate for this scope of**  
24 **project.**

25

26 (Emphasis added by OPC.)

27

And continuing on page 51, line 14, it states:

Q. Bear with me. I think we're getting pretty close to the end here. I may consolidate a little. Why didn't you believe that Amendment 01 did not provide the same protections as a performance bond?

A. **A performance bond correctly would have made sure the scope of work was performed at the cost they bid. Without the performance bond, that guarantee or cap was not there.**

(Emphasis added by OPC.)

Furthermore, beginning on page 113, line 5, it states:

Q. If Patch had obtained a performance bond as originally required in the Patch contract, would Empire have been protected from paying any amounts in excess of the \$12 million assigned to the Patch Construction responsibilities?

A. In theory, **we would have been protected** if Patch had not -- had been -- had not been fraudulent with the performance bond company and represented their scope of work as it really was. I think there's always the potential that the performance bond company says, Patch you didn't represent correctly and maybe they would have argued about that. Performance bonds are just -- they just won't necessarily agree to every dollar you spend above a scope. They're going to do their own due diligence and make sure that nothing was misrepresented when the policy was placed. **So to the extent that Patch would have achieved a performance bond without misrepresenting any of the facts, then probably they would have protected above that number, the \$12 million number.**

(Emphasis added by OPC.)

Q. HAS THE PUBLIC COUNSEL UPDATED THE LEVEL OF THE COST  
OVERRUNS AMOUNT THAT IT RECOMMENDS THE COMMISSION  
DISALLOW?

A. Yes. Earlier responses to OPC data requests stated that the cost overruns amount  
was \$3,648,717; however, Company's response to OPC Data Request No. 1091  
states that the total cost overruns was actually \$4,052,535. The difference being  
that the \$3.6 million represents only a partial billing of the cost overruns Empire  
actually incurred and sought to recover from Patch. Company stated in the  
response that it did not bill Patch for the remaining costs (the difference) because  
it did not think payment was forthcoming.

Q. IS THE PUBLIC COUNSEL RECOMMENDING THAT THE TOTAL  
\$4,052,535 BE DISALLOWED?

A. No. During the project Company included various change orders to the project  
scope, the cost of which we are not opposing. Excluding the approved change  
order costs identified in Company's response to OPC Data Request No. 1091  
(\$166,787) leaves a remaining cost overrun of \$3,885,758 that represents the  
Public Counsel's recommended adjustment for this portion of the issue.

1 Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE COMPANY'S  
2 POSITION?

3 A. Company's position is that the cost overruns it incurred for a portion of the Energy  
4 Center 3 & 4 project ("Energy Center") should be allowed in the determination of  
5 rates on a going forward basis. In Mr. Beecher's rebuttal testimony he describes  
6 the Energy Center 3 & 4 project coming in at the approximate total budgeted cost.  
7 He calls the project's total budget the "definitive estimate," and states that the total  
8 budgeted amount for a project is the "standard" by which costs should or should  
9 not be allowed in rates. He indicates that the "standard" is one which the MPSC  
10 Staff has relied on in past Company cases and as such the cost overruns in  
11 question should be allowed in the determination of rates.

12  
13 Q. DOES THE PUBLIC COUNSEL AGREE WITH MR. BEECHER'S POSITION?

14 A. No. The issue is not whether the budget was met, improved upon or exceeded  
15 with respect to the project's total cost. The issue is whether the Company can  
16 recover from its ratepayers project costs it incurred, but which it would not have  
17 incurred had it not abandoned the performance bond required in the original  
18 contract with Patch Construction Company. Company's apparently tight planning  
19 schedule and its failure to enforce the terms of that original contract with Patch  
20 are what ultimately led to it becoming liable for the additional costs it incurred. It  
21 is my belief that this issue has little or nothing to do with the level of the Energy  
22 Center 3 & 4 project budget or its associated cost estimates.

1 Q. DOES MISSOURI HAVE A "BUDGETED COST STANDARD"

2 RATEMAKING POLICY?

3 A. No. To my knowledge, no such "standard" exists. Furthermore, it is my  
4 experience that it is rare for a construction project to be completed at its exact  
5 budgeted cost. In most situations, budgets include best guess estimates, and as  
6 such the end result is subject to a significant degree of variation from what is  
7 planned. Empire recognized that fact when it included an amount for nonspecific  
8 contingencies of approximately 10% into the Energy Center project's total budget.  
9 Mr. Beecher's Deposition Transcript, page 107, lines 17-19, states:

10

11 Q. And can you tell me exactly how much was put into that  
12 budget for contingencies?

13

14 A. My memory is 10 percent or \$5 million.

15

16

17 The administration of a budget should not be rigid. Changed conditions call for  
18 changes in plans. The budget must receive respect, but it does not have to be so  
19 revered that it prevents a manager from taking prudent actions. Therefore, it  
20 would be bad policy for the Commission to set rates based on a budget "standard"  
21 for ratemaking purposes. To do so would require the Commission to accept only  
22 the representations of Empire's management as to the level, reasonableness and  
23 prudence of the costs.

24

1 Q. WHAT IS A BUDGET AND WHY DOES NO RATEMAKING STANDARD  
2 FOR COST INCLUSION EXIST THAT RELIES SOLELY ON ITS  
3 DEVELOPMENT?

4 A. A budget is a quantitative expression of a plan of action and an aid to  
5 coordination and implementation. Budgets are a major feature of a company's  
6 control systems. They, 1) compel planning, 2) provide performance criteria, and  
7 3) promote communication and coordination. The focus of any budget is on the  
8 planning function, however, budgets serve the additional functions such as  
9 evaluating performance, coordinating activities, implementing plans, and  
10 communicating, motivating and authorizing actions. Budgets are one of the most  
11 widely used type of accounting systems. They include both expected results and  
12 historical or actual results; however, the forced planning is by far the greatest  
13 contribution of budgeting to management. The inherent planning process helps  
14 management to eliminate or avoid "management by crises" type actions.

15  
16 In essence, a budget is nothing more than a planning tool to be utilized by  
17 management in the development and operation of a company. To use a utility's  
18 budget as a shield against a disallowance would setup incentives to inflate  
19 budgetary estimates. Budgets are, or should be, subject to continuous monitoring  
20 and updating as dictated by an ever-changing business environment and  
21 circumstances. The inherent inconsistencies that will occur because of the  
22 constant need for modification and adjustment would, in my opinion, make it

1 impossible to develop a ratemaking cost standard that relied solely upon an initial  
2 budget (equivalent to Mr. Beecher's use of the term "definitive estimate" budget)  
3 for its base.  
4

5 Q. SHOULD THE COMMISSION'S DECISION ON THIS ISSUE BE IMPACTED  
6 BY THE FACT THAT THE FINAL COST OF THE CONSTRUCTION  
7 PROJECT WAS VERY NEAR TO THE TOTAL AMOUNT BUDGETED?

8 A. No. First, it must be remembered that the Company included in its total budget a  
9 10% contingency amount; thus, it was able to meet its budgeted amount only with  
10 the help of this additional contingency "padding." In addition, had the Company  
11 not eliminated the construction company's performance bond the total amount  
12 expended for the project would have been approximately \$3,885,748 less than the  
13 amount actually expended (i.e. \$4,052,535 total cost overrun less approved  
14 change orders \$166,787). Company actually utilized approximately 78% of the  
15 original 10% contingency amount for the cost overruns associated with the Patch  
16 contract. The cost overruns at issue were not included in the costs it envisioned  
17 when it developed the contingency portion of the total budget. The cost overruns  
18 amount that resulted from the elimination of the performance bond would not  
19 have been considered a part of the original budget contingency because those  
20 costs, were they to occur (and they did), would have been viewed as the liability  
21 of the construction company and/or its performance bond agency.  
22

1 Q. WHOSE RESPONSIBILITY IS IT TO MANAGE THE INVESTMENT NEEDS  
2 OF THE UTILITY?

3 A. That responsibility lies with Empire's management. Planning and implementation  
4 of the Company's construction projects are a fundamental responsibility of Empire's  
5 management. Only management has complete access to the data and resources  
6 necessary to fulfill these responsibilities, and as such, management should be able to  
7 implement a construction program that minimizes the likelihood of not meeting its  
8 operational needs.

9  
10 Q. DID MR BEECHER ACCEPT RESPONSIBILITY FOR ABANDONING THE  
11 PERFORMANCE BOND REQUIREMENT OF THE ORIGINAL PATCH  
12 CONTRACT?

13 A. Yes. Beginning on page 50, line 14, of Mr. Beecher's Deposition Transcript, it  
14 states:

15

16 Q. Who made the ultimate decision to waive the performance  
17 bond requirement?

18

19 A. I signed Amendment 01, and ultimately, I suppose I'm the  
20 primary officer responsible for this project.

21

22

23 Q. SHOULD RATEPAYERS BE REQUIRED TO PROVIDE EMPIRE WITH  
24 RECOVERY OF CONSTRUCTION EXPENDITURES EVEN WHEN THE  
25 COMPANY'S MANAGEMENT CHOOSES NOT TO FULFILL ITS

1            CONSTRUCTION            PLANNING            AND            IMPLEMENTATION  
2            RESPONSIBILITIES?

3        A.    No, ratepayers should not be required to fund such a recovery. This issue concerns  
4            whether the managers of Empire failed to plan for the needs of the operation in a  
5            timely manner and whether or not Company resulted to a "management by crises"  
6            policy rather than following through on the construction project in prudent business-  
7            like manner that would have appropriately protected it and its ratepayers. This issue  
8            is not about whether or not the Company met or exceeded its budget for the project.

9  
10          Company has admitted that is needed to have a certain amount of new energy  
11          sources online before June 1, 2003 (Beecher Rebuttal Testimony, page 22, lines 7-  
12          8). When Patch did not provide a performance bond within 21 days of the contract  
13          signing (as required by the contract), Empire's management allowed itself to be  
14          stalled by Patch for months rather than enforce the terms of the contract.  
15          Management's failure to enforce Company's rights per the contract ultimately led to  
16          Empire's abandonment of the performance bond requirement and its eventual cost  
17          overruns liability. Empire took an inappropriate gamble with shareholders assets to  
18          cover its planning failures and lost. In my opinion, ratepayers should not be held  
19          liable for cost recovery associated with such imprudent actions by the Company.

SUMMARY

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS  
ISSUE.

A. The cost overruns would not have become the Company's liability had the additional risk of the performance bond abandonment not been imprudently taken-on by Empire; therefore, I recommend that ratepayers not be required to reimburse the Company for those costs. The cost overruns belong to shareholders due to the fact that their appointed managers imprudently incurred them by failing to plan appropriately for needed investment for operations. Mr. Beecher's testimony (Rebuttal, page 22, lines 7-8) states that Empire needed at least one of the new units on line to meet the 12% minimum Southwest Power Pool capacity margin requirement before June 1, 2003. That leads me to believe that the Company was "rushed" to complete the energy project in order to meet its SPP requirements; therefore, it did not follow through on its contractual protections as it should have done. Company's failure to timely plan for its future investment needs led it to make "hurried" decisions which created a significant unnecessary liability. There can be no doubt that the Company's liability for the cost overruns was the result of those imprudent actions so Public Counsel's recommendation is that the \$3,885,748 not be included in the calculation of rates determined in this case.

1 Had Empire appropriately planned its investment needs on a timely basis and  
2 forced the construction contractor to meet the requirements of the signed contract,  
3 it is not unreasonable to believe that the \$3,885,758 cost overrun would have  
4 never become a liability to Empire. However, since the management of the  
5 Company did abandon the performance bond requirement of the contract  
6 (approximately 5 months after it was entered into), it is the Public Counsel's belief  
7 that that imprudent action put the Company, and its shareholders, into a position  
8 of increased risk. The increased risk acquiesced to by Empires managers created  
9 a potential liability that eventually became a reality.

10  
11 It is the Public Counsel's belief that the "definitive estimate" standard espoused by  
12 Mr. Beecher does not exist. A budget (initial, preliminary or final) is merely a  
13 planning tool and not a ratemaking standard upon which a cost is allowed or  
14 disallowed. His attempt to convince this Commission otherwise (that such a  
15 standard does exist) merely obfuscates the real issues beginning with the  
16 Company's planning processes and its willing elimination of the performance  
17 bond criteria of the construction contract Patch and Company had entered into  
18 The end result was the accumulation of the cost overruns liability and its  
19 consequences.

20  
21 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

22 A. Yes, it does.