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Issues:

Performance
Measurements; History
of Rate of Return
Adjustments

Witness:

Deborah Ann Bernsen

Sponsoring Party:

MoPSC Staff

Type of Exhibit:

Rebuttal Testimony

Case No.:

ER-2006-0314

Date Testimony Prepared:

September 8, 2006

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

DEBORAH ANN BERNSEN

KANSAS CITY POWER & LIGHT COMPANY

CASE NO. ER-2006-0314

Jefferson City, Missouri
September 2006

~~STAFF~~ Exhibit No. 105
Case No(s) ER-2006-0314
Date 10-16-06 Rptr XF

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

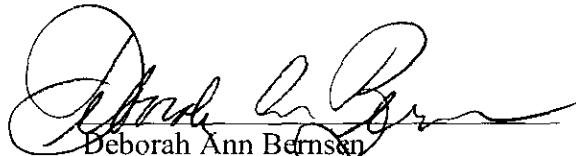
In the Matter of the Application of Kansas City)
Power & Light Company for Approval to Make)
Certain Changes in its Charges for Electric Service)
to Begin the Implementation of Its Regulatory Plan.)

Case No. ER-2006-0314

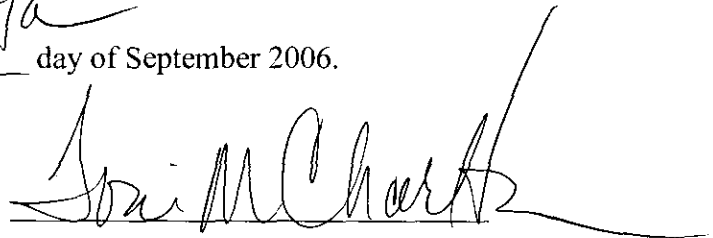
AFFIDAVIT OF DEBORAH ANN BERNSEN

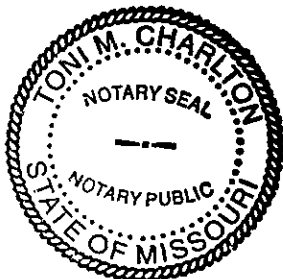
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Deborah Ann Bernsen, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.


Deborah Ann Bernsen

Subscribed and sworn to before me this 7th day of September 2006.





TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

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DEBORAH ANN BERNSEN
KANSAS CITY POWER & LIGHT COMPANY
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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **DEBORAH ANN BERNSEN**

4 **KANSAS CITY POWER & LIGHT COMPANY**

5 **CASE NO. ER-2006-0314**

6 Q. Please state your name and address.

7 A. My name is Deborah Ann Bernsen. My address is P.O. Box 360, Jefferson
8 City, Missouri, 65102.

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

10 A. I am employed as a Utility Management Analyst III for the Missouri Public
11 Service Commission (Commission or PSC).

12 Q. Please describe your educational training and professional background.

13 A. I graduated from the University of Missouri-Columbia in 1975 with a
14 Bachelor of Science degree in Business Administration. I completed a Masters degree in
15 Public Administration in 1990 from the same university. I have passed all four parts of the
16 Certified Internal Auditor (CIA) examination and received the CIA designation in November
17 2004.

18 Q. Please describe your duties while employed by the Commission.

19 A. I have been employed by the Commission since 1976 when I began a graduate
20 internship with the agency. I subsequently entered the Consumer Services Department of the
21 PSC as a Consumer Services Specialist responding to consumer complaints and inquiries. I
22 entered the Management Services Department in 1978 as a Management Analyst and since
23 that time have had responsibility for conducting and directing reviews of management
24 operating and control systems at utility companies under the Commission's jurisdiction. The

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1 name of the Management Services Department was changed to the Engineering and
2 Management Services Department (EMSD) in February 2000. I was the Staff's
3 representative and a member of the Consumer Interest Working Group within the Missouri
4 Public Service Commission's Retail Electric Competition Task Force in 1999. I was also the
5 Chair of the National Association of Regulatory Utility Commissioners (NARUC) Staff
6 Subcommittee on Competition and Performance Analysis (SSCPA) for approximately six
7 years.

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

9 A. Yes. Please see Schedule 1, attached to this testimony for a list of cases in
10 which I have previously filed testimony and the issues that I addressed.

11 Q. What is the purpose of your testimony?

12 A. The purpose of my testimony is to address the recommendation made in the
13 direct testimony of Kansas City Power & Light Company (KCPL or Company) witness
14 Robert J. Camfield regarding the award of a rate of return adjustment to the Company in
15 recognition of its asserted management efficiency. This rebuttal testimony will address the
16 appropriateness of utilizing rate of return adjustments to recognize company performance.

17 Q. Have you previously filed testimony addressing these types of adjustments to
18 the rate of return?

19 A. Yes. I previously submitted testimony on these issues in the 1980s and more
20 recently in a Missouri Gas Energy case where the issue was brought before the Commission.

21 **EXECUTIVE SUMMARY**

22 Q. In summary, what is the point of your rebuttal testimony?

23 A. My rebuttal testimony responds to the direct testimony of Company witness
24 Robert J. Camfield. Mr. Camfield requests that the Commission award a rate of return

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1 adjustment upward in response to what Mr. Camfield asserts is good Company performance.
2 Mr. Camfield presents four different methods utilizing metrics in an attempt to prove the
3 effectiveness of the Company's performance.

4 The major focus of my rebuttal testimony is that rate of return adjustments are not an
5 effective nor appropriate way to recognize Company performance, whatever it may be. The
6 testimony will briefly discuss the difficulty with determining a Company's effectiveness and
7 efficiency utilizing metrics and ratios. The history in Missouri cases regarding these types of
8 adjustments and the Commission's statements regarding their appropriateness is presented. I
9 will also relate some of the process difficulties involved with the use of these adjustments
10 regardless of the testimony of Mr. Camfield.

11 **PERFORMANCE MEASUREMENT TECHNIQUES**

12 Q. Have you reviewed the direct testimony of Robert J. Camfield?

13 A. Yes.

14 Q. And do you believe that Mr. Camfield's methods of looking at Company
15 performance provides any assurance that the Company is being managed in an effective and
16 efficient manner?

17 A. No. Mr. Camfield's testimony utilizes four different types of metrics over a
18 period of ten years. While such metrics are useful in looking at performance and provide
19 management a tool, the Staff does not believe they provide valid information from which to
20 make a definitive statement about the effectiveness of overall Company performance. The
21 problems associated with the use of these metrics become more pronounced and
22 disconcerting when the Company is attempting to utilize these metrics to rationalize a
23 reward.

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HISTORY OF RATE OF RETURN ADJUSTMENTS IN MISSOURI

Q. Has the Commission utilized adjustments to any utilities' rate of return on account of management efficiency in the past?

A. Yes. The Commission utilized both upward and downward adjustments to the rate of return in several cases in the early 1980s. The first instance where an adjustment was applied was in Case Nos. ER-82-39 and WR-82-50, Missouri Public Service Company. The Commission reduced that utility's rate of return on water rate base from 10.47% to 9.47% due to what it determined as Company management inefficiency and negligence in completing needed operational improvements.

In Case No. ER-83-42, the Commission granted The Empire District Electric Company a forty basis point upward adjustment to the company's return on equity (ROE). The Report and Order in this proceeding cited a number of issues the Commission believed prompted the adjustment, including excellent customer relations, cooperation in implementing recommendations of Staff audits as well as a low embedded cost of long-term debt and cost of preferred stock.

In Case No. ER-83-49, Kansas City Power & Light Company, the Commission again granted a forty basis point upward adjustment to the Company's return on equity. The company provided testimony that cited a number of what it alleged were diverse cost savings and income increasing programs. The Commission in its Report and Order stated that it appeared from the evidence in the case that the company had engaged in substantial efforts designed at improving its management efficiency based upon the submitted testimony. On this basis, the Commission awarded an upward adjustment.

Q. What did the Commission subsequently determine regarding these upward adjustments?

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1 A. In the April 23, 1986, Report and Order in Case Nos. EO-85-185 and
2 EO-85-224, Kansas City Power & Light Company, the Commission noted that it had
3 reevaluated the practice of utilizing adjustments to the return on equity and determined that it
4 was not necessary nor appropriate to upwardly adjust the return on equity on account of
5 management efficiency. The Order went on to state that adequate encouragement of
6 management efficiency is given through the recovery of all prudently incurred costs.

7 Q. Did the Commission provide any additional direction to companies of how it
8 anticipated to recognize good or poor utility management efficiency in lieu of using these
9 adjustments?

10 A. Yes. In the June 20, 1989, Report and Order in Case No. TC-89-14, et al.
11 Southwestern Bell Telephone Company (SWB), pages 70 – 72, the Commission stated:

12 The Commission has determined that it is not appropriate to adjust the
13 rate of return SWB will be authorized to earn for management
14 decisions. Now the Commission has determined that where it has
15 made adjustments to ROE in other cases, these types of adjustments
16 can rarely be supported by sufficient evidence to warrant a decision.
17 The difficulty of deciding how much value a certain management
18 decision has in terms of ROE makes the determination almost
19 impossible. The evidence in this case provides no real guide to the
20 Commission on how to value the various allegations of inefficient
21 management. The more appropriate method for making adjustments to
22 a public utility's revenue requirement is where specific dollar
23 adjustments can be addressed, not by adjusting the ROE.

24 The Commission did go on to state on page 72 of that Order:

25 As a regulated company, SWB has an obligation to ratepayers to
26 reduce prices where appropriate as well as to provide quality service.

27 The Staff believes that the Commission provided specific guidance as to how these
28 issues were to be addressed in the future. First, that specific dollar adjustments should be
29 used to make adjustments to the utility's revenue requirement. And second, that the utility
30 has the basic obligation to reduce prices where appropriate and provide quality service.

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1 The Commission recently reaffirmed its earlier statements regarding the use of these
2 adjustments. In Case No. GR-2004-0209, Missouri Gas Energy (MGE) requested a 25 basis
3 point adjustment to its rate of return to recognize what it believed was high management
4 efficiency. The Commission responded in its Report and Order and reaffirmed its beliefs
5 regarding the inappropriateness of utilizing a rate of return adjustment.

6 As the Commission found in 1986, and as was demonstrated in this
7 case, a rate of return adder is inappropriate in concept and unworkable
8 in practice. Conceptually, the Commission must determine a just and
9 reasonable rate of return for the utility that it regulates. To then tack
10 an additional percentage to the rate of return as a reward for efficiency
11 means that the company would be receiving a rate of return that is
12 higher than the just and reasonable rate. In essence, the Commission
13 would be making a gift to the company from the ratepayer's pocket.
14 Obviously, that is not acceptable.

15 **UTILIZATION OF ADJUSTMENTS**

16 Q. Does the Staff support the concept of using adjustments to the rate of return or
17 the return on equity to reward a utility company for what it may allege is high quality
18 customer service, safe and adequate service or management efficiency?

19 A. No. The Staff agrees with the Commission's earlier assessments regarding the
20 inappropriateness of these adjustments. There are several additional reasons the Staff does
21 not agree with the need for an upward adjustment to the rate of return in rate case
22 proceedings. The Staff believes that such adjustments are not appropriate on the grounds that
23 these types of adjustments do not effectively recognize performance. There are a number of
24 problems inherent with the use of rate of return adjustments of this nature.

25 Q. Why does the Staff not support the utilization of an adjustment to the rate of
26 return or return on equity?

27 A. First, and most importantly, the Staff believes that the Company has a
28 responsibility for providing safe and adequate service at a reasonable cost to the customer

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1 without reward for what is required by law. This is the basic function of company
2 management, and meeting this goal does not represent nor should it be thought of as
3 representing a superior or extraordinary effort on management's part. KCPL, as all regulated
4 utilities, should continually strive to achieve the best service possible within resource
5 constraints. Central to the process of managing is the effective and efficient use of resources
6 within an ever changing environment. These efforts should not be considered as beyond the
7 normal functions of management. The customers should not be required to pay extra or a
8 premium for safe and adequate service. The application of a rate of return adjustment to
9 reward the Company for carrying out the basic functions it has the responsibility to perform
10 does not result in just and reasonable rates.

11 Q. Are there other difficulties associated with such adjustments?

12 A. Yes. The rationale for these adjustments is not just to reward past conduct but
13 to induce conduct that leads to positive results that otherwise would not occur. The previous
14 awarding of these allowances did not include any method to track the actual effect of such
15 awards on company operations. Did the adjustments actually motivate the company to strive
16 for even better performance and did the company actually achieve higher levels of
17 productivity and effectiveness? What would an expected level of performance and then a
18 level of improvement be? Is there a way to determine a link between performance and these
19 incentives? What if a company's performance indicates a decline in performance as
20 measured by the indicators? Should an adjustment downward be utilized to address a lack of
21 improved performance or decreased performance? These are questions that the Staff believes
22 should be answered before such an adjustment should be utilized.

23 Should such an approach address the situation of a company that does not continually
24 reach higher levels of performance and what levels should these be? The Commission

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1 recognized some of these questions and cited them in the Southwestern Bell Report and
2 Order in Case No. TC-89-14 that was quoted earlier in this testimony.

3 Q. Did Mr. Camfield also address some of these difficulties?

4 A. Yes, to a limited extent. Mr. Camfield recommended that the Commission
5 apply some criteria in determining the level for the allowance. On page 27 of his direct
6 testimony, he states:

7 ...We recommend that the Commission apply a rational principle and
8 criterion in the determining the appropriate level of a performance
9 allowance inclusion within the rate of return. In brief, the Commission
10 should ensure that the net benefits to electricity consumers, as obtained
11 by the allowance, are sufficient to cover the allowance itself...

12 He directs the Commission in their determination to ensure that consumers would at
13 least break even when they were forced to pay for this award within rates. However, he
14 offers no method of accomplishing this or tracking the effect of this award he is
15 recommending.

16 Q. Does the Company have any incentive to manage its operations in an effective
17 manner?

18 A. Certainly. The effective and efficient performance of the Company will allow
19 it to operate at a lower cost, anticipate and respond to externalities, and provide improved
20 customer service.

21 Utility managers are compensated at higher levels than non-managers to recognize
22 their greater responsibilities of ensuring company achievement of goals and objectives. In
23 addition, incentives to individual employees are provided in the various incentive
24 compensation and performance objective or goal related programs in place at most utilities.
25 These programs provide employees with the opportunity to earn financial rewards by

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1 achieving annually set performance objectives or goals in specific areas that contribute to the
2 company's successful performance.

3 Q. Has the Commission reviewed these types of programs and rewards associated
4 with the achievement of these incentive compensation program objectives within rate cases?

5 A. Yes. The Staff has usually allowed the inclusion of rewards associated with
6 the achievement of objectives except for those linked to financial indicators, which only
7 directly benefit shareholders and not ratepayers. The Staff has maintained that goals
8 respecting these financial indicators produce benefits that primarily accrue to shareholders
9 and not to customers. Therefore, it is not appropriate that the costs of those awards be
10 included in rates that would be paid by customers. Staff witness V. William Harris addresses
11 the issue of incentive compensation at KCPL within his direct testimony.

12 **REQUEST FOR AN ADJUSTMENT**

13 Q. Did the Company make a compelling case in its direct testimony for the
14 application of a rate of return adjustment?

15 A. No. While Mr. Camfield sponsors a request for a rate of return adjustment,
16 other Company witnesses seem less committed to seeking this particular adjustment.
17 William H. Downey, the President and Chief Executive Officer of the Company, stated the
18 following on page 6 of his direct testimony:

19 KCPL is not requesting any additional return on equity as a result of
20 its performance. However, KCPL respectfully requests that before
21 recommending a return on equity for KCPL in this proceeding the
22 Commission Staff and other parties to this case consider all relevant
23 factors, including KCPL's construction program, its off-system sales
24 risk, and its performance.

25 In addition, Terry Bassham, the Chief Financial Officer of KCPL, also refers to
26 Mr. Camfield's testimony in his own direct testimony on the rate relief requested. He

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1 believes that Mr. Camfield's testimony illustrates that the Company's performance "results in
2 lower prices, higher levels of productivity, resource utilization and service." On this basis,
3 he is requesting that the Commission "give consideration to this performance when
4 establishing a rate of return in this case."

5 Chris Giles, Vice President of Regulatory Affairs for KCPL, in his direct testimony
6 also references Mr. Camfield's testimony and asks that the Commission give consideration to
7 the Company's current performance when recommending a rate of return in this proceeding.

8 While Mr. Camfield believes it is appropriate to request a specific adjustment, other
9 Company executive witnesses are asking the Commission to consider the performance
10 information when recommending a rate of return.

11 Q. Please summarize your rebuttal testimony.

12 A. The Staff does not support the use of an adjustment to the rate of return or
13 return on equity based upon the Company's alleged high performance.

14 Q. Does this complete your rebuttal testimony?

15 A. Yes, it does.

TESTIMONY SUMMARY

DEBORAH ANN BERNSEN

| DATE FILED | ISSUES | CASE NUMBER | FILING TYPE | COMPANY NAME |
|------------|---|-------------------------------|----------------------|---|
| 10/07/1983 | Management Efficiency | TR83253 | Rebuttal | Southwestern Bell Telephone Company |
| 1983 | Customer Service | GR83225 | Direct | Gas Service Company |
| 07/03/1985 | Management Efficiency; Rate of Return Adjustment | ER85128 & EO85185 | Direct | Kansas City Power & Light |
| 11/17/1989 | Capital Deployment | TR89196 | Rebuttal | Contel of Missouri, Inc. |
| 10/07/1992 | Affiliated Transactions | WR92207 & SR92208 | Surrebuttal | Missouri Cities Water Company |
| 05/02/2000 | Customer Service | EM2000292 | Rebuttal | Utilicorp United Inc./St. Joseph Light and Power |
| 06/26/2001 | Customer Service | WM2001309 | Rebuttal | Missouri-American Water Company, et al |
| 12/06/2001 | Customer Service Call Center Reporting | EC2002265 | Direct | UtiliCorp United Inc. d/b/a Missouri Public Service |
| 12/06/2001 | Call Center Reporting | ER2001672 | Direct | UtiliCorp United Inc. d/b/a Missouri Public Service |
| 06/24/2002 | Alternative Regulation Plan - Quality of Service | EC20021 | Surrebuttal | Union Electric Company d/b/a AmerenUE |
| 03/17/2003 | Quality of Service | GM20030238 | Rebuttal | Southern Union Company d/b/a Missouri Gas Energy |
| 10/03/2003 | Customer Service | WR20030500 & WC20040168 | Direct | Missouri-American Water Company |
| 05/2004 | Customer Service; Rate of Return Adjustment | GR20040209 | Direct & Rebuttal | Missouri Gas Energy |