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Issues: Prudence/State Line
Construction
Witness: Mark L. Oligschlaeger
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: ER-2001-299
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

MARK L. OLIGSCHLAEGER

Exhibit No. 66
Date 5/29/01 Case No. ER-2001-299
Reporter KRM

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

Jefferson City, Missouri
April 2001

****Denotes Highly Confidential Information****

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DIRECT TESTIMONY
OF
MARK L. OLIGSCHLAEGER
THE EMPIRE DISTRICT ELECTRIC COMPANY
CASE NO. ER-2001-299

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO
65102.

Q. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, MO, and received a Bachelor Science degree in Business Administration with a major in Accounting in 1981. I have been employed by the Missouri Public Service Commission (Commission) since September 1981 within the Accounting Department. In November 1981, I passed the Uniform Certified Public Accountant (CPA) examination and, since February 1989, have been licensed in the state of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

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

Q. With reference to Case No. ER-2001-299, have you examined the books and records of The Empire District Electric Company (Empire or Company)?

A. Yes, with the assistance of other members of the Commission Staff (Staff).

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1 Q. What is the purpose of your direct testimony?

2 A. The purpose of my direct testimony in this proceeding is to present
3 background information concerning the Staff's review of the Company's construction
4 costs for its new State Line Combined Cycle (SLCC) unit, which it seeks to reflect in
5 customer rates in this proceeding. In particular, I will present an historical overview of
6 past Staff and Commission reviews of major utility construction projects, and
7 demonstrate that the Staff's review of the SLCC project in this case is in accordance with
8 past Commission precedents.

9 Q. What is the SLCC unit?

10 A. The SLCC unit is a new generating unit being built by Empire that is
11 scheduled for completion and to provide power to customers by June 1, 2001. Empire
12 will own 60% of the capacity for the unit once it is completed, with Westar Generating,
13 Inc. (a subsidiary of Western Resources, Inc.) owning the other 40%. A more complete
14 description of the SLCC unit and the progress of its construction can be found in the
15 direct testimony of Staff Accounting witness Cary G. Featherstone and the direct
16 testimony of Staff witness David W. Elliott of the Engineering Section of the Electric
17 Department.

18 Q. Why is the Staff concerned with the construction costs of Empire's new
19 SLCC unit?

20 A. For several reasons.

21 First, the electric industry is a capital-intensive industry, in large part due
22 to the cost of constructing generating units to provide electric power to customers. The
23 costs of capital investment associated with a new power plant, such as the SLCC unit, can

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1 be material from a customer perspective if rate recovery is sought. In fact, the increase in
2 the Company's revenue requirement associated with the new SLCC unit is stated to be
3 one of the major factors driving this rate increase case.

4 Second, the SLCC unit is designed to be an "intermediate" unit, as
5 opposed to the "peaking" units Empire and other electric utilities have typically added to
6 their generating systems during the last decade or so when additional generating capacity
7 was needed. Intermediate generating units are larger than combustion turbines, the most
8 common type of peaking unit, and are also considerably more expensive than peaking
9 units from a capital cost perspective as well. The SLCC unit is one of the largest and
10 most expensive generating plant additions made by a Missouri electric utility in the last
11 decade, or more.

12 Q. What has been the general nature of the Staff's rate case reviews of major
13 construction projects, such as electric generating units?

14 A. The review typically looks at two different facets of the utility's decision-
15 making process regarding construction of new generating units. First, the Staff considers
16 whether the utility has justified the need for the generating unit in question and
17 demonstrated that construction of the unit was the cheapest alternative for providing
18 electric power to customers. Second, the Staff examines whether the costs incurred to
19 construct the generating unit were just and reasonable, and whether the utility (and its
20 contractors) prudently managed the construction process and, ultimately, the construction
21 costs to produce a generating unit capable of providing reliable power at the lowest
22 reasonable cost.

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1 Q. Has the Staff examined both of these areas in its audit and review of the
2 SLCC in this rate proceeding?

3 A. Yes. The Staff is not raising any issues concerning the prudence of the
4 decision making process that led to the construction of the SLCC unit. However, the
5 Staff does have concerns with the actual (and projected) cost of constructing this unit.

6 Q. In general, describe the approach the Staff has used in past rate
7 proceedings to examine the costs of major construction projects, such as generating units,
8 for which a company has sought rate base treatment.

9 A. As a starting point of its construction cost review, the Staff obtains the
10 budget document that is used by the utility for cost control purposes. In most instances,
11 this budget document is known as the "definitive estimate." Any increases in actual
12 construction costs above the levels set out in the definitive estimate are examined, with
13 the utility being expected to explain in detail the justification for the cost overruns. If the
14 utility cannot demonstrate that the additional costs were incurred for reasons beyond its
15 control, or were otherwise prudent, then the Staff recommends disallowance of these
16 additional costs.

17 For the SLCC unit project, the budget used by Empire for cost control
18 purposes was termed the "original cost estimate." The Staff believes this to be the
19 equivalent of the "definitive estimates" used for cost control purposes on earlier
20 generation construction projects.

21 Q. Has the Commission agreed in past rate proceedings to the Staff's general
22 approach to reviewing major construction expenditures outlined above?

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1 A. Yes. In Case Nos. EO-85-160 and EO-85-17, Union Electric Company
2 (Union Electric), the Commission stated "[t]he definitive estimate is the proper starting
3 point for an investigation of cost overruns and a determination as to whether costs
4 incurred on the project are reasonable." (Report and Order, pp. 39-40). Further, the
5 Commission quoted in that Report and Order:

6 In Case No. ER-77-118, Re: Kansas City Power & Light
7 Company, the Commission was of "the opinion that the
8 appropriate starting point for the calculation of any cost overrun
9 would be the target used by the Company in controlling cost. The
10 Commission is of the opinion, as in Case No. ER-77-118, that the
11 Company's definitive estimate is the appropriate starting point for
12 determining cost overruns. Kansas City Power & Light Company,
13 24 Mo. P. S. C. (N.S.), (1981).
14 (Ibid, p. 40).

15 Q. Can you provide examples of how the Commission has conducted rate
16 reviews of major generating projects in the past?

17 A. Yes. In Case Nos. EO-85-160 and EO-85-17, Union Electric, and Case
18 Nos. EO-85-185 and EO-85-224, Kansas City Power & Light Company (KCPL), the
19 Commission determined the appropriate rate treatment of Union Electric's Callaway
20 Generating Station and KCPL's Wolf Creek Generating Station, respectively. For each
21 of those nuclear generating units, the companies incurred significant cost overruns over
22 their definitive estimates. In both cases, the Commission examined the evidence
23 provided by the Staff, the utilities, the Office of the Public Counsel and other parties as to
24 why the cost overruns occurred. For those cost overruns the Commission determined the
25 companies incurred for reasons beyond their or their contractors' control, or were
26 otherwise prudently incurred, the Commission allowed the additional costs to be reflected
27 in rates. Otherwise, the Commission disallowed the cost overruns from customer rates.

1 Q. Please provide a more specific example of the Commission's treatment of
2 cost overruns in the two afore-mentioned nuclear cases.

3 A. Yes. For example, in the KCPL Wolf Creek case, the Commission
4 considered an overrun in direct man-hours in the "concrete" category. As stated in that
5 Report and Order, "the concrete category includes the direct labor necessary to complete
6 structures made of concrete. This category encompasses construction of form work,
7 placement of rebar and embeds, pouring and finishing of concrete, removal and clean up
8 of the forms and placement of post-pour embedded items such as plates and sleeves."
9 (Report and Order, p. 83).

10 KCPL's definitive estimate projected that 1,872,000 man-hours would be
11 expended in the concrete category. The final, actual total of concrete man-hours was
12 4,147,319. After reviewing the reasons additional man-hours above the level forecast in
13 the definitive estimate were incurred, the Staff recommended that the Commission
14 include the costs associated with 3,444,937 man-hours in the concrete category in
15 KCPL's rate base.

16 To derive its concrete man-hour estimate, the Staff made adjustments to
17 the Wolf Creek definitive estimate to account for such items as an increase in quantities
18 in the concrete category and the negative impact that certain required regulatory changes
19 had on construction productivity in this area. The Staff recommended inclusion of the
20 adjusted man-hours total in rates. Much of the difference between the Staff's
21 recommended man-hour level and actual man-hours in the concrete category related to
22 what the Staff called "late design," a failure of KCPL and its contractors to appropriately
23 coordinate the design phase and construction phase on the Wolf Creek project.

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1 Based upon the evidence submitted to it in that case, the Commission
2 concluded that the Staff's recommended man-hour allowance in the concrete area was
3 reasonable and should be adopted. (Report and Order, pp. 83-85).

4 Q. What is the amount of the original cost estimate Empire used for cost
5 control purposes in managing the SLCC unit project?

6 A. The original cost estimate for the SLCC unit project was approximately
7 ** _____ **. (All SLCC construction related amounts in this testimony are
8 provided on a total project basis.)

9 Q. Has Empire experienced any cost overruns on the SLCC unit project?

10 A. Yes. The current construction cost estimate for completing the SLCC unit
11 is approximately ** _____ **, meaning total cost overruns for this project are
12 expected to be approximately ** _____ **. The Staff considers this to be a material
13 and significant total cost overrun compared to the original cost estimate.

14 Q. In a rate proceeding, who has the burden of proving the prudence of
15 construction expenditures?

16 A. Based upon my understanding that current Missouri statutes require that
17 the burden of proof to show a proposed increased rate is just and reasonable is on the
18 public utility proposing the increased rate, the burden of proving the prudence of
19 construction expenditures is on the utility seeking to include them in consideration for
20 setting rates. Further, the Commission has indicated that when serious doubts are raised
21 in rate proceedings about the prudence of management actions the utilities have the
22 burden of proving that their management actions having a potential cost impact on their

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1 customers are prudent. (Report and Order, p. 65, Case Nos. E0-85-160 and EO-85-17,
2 Union Electric).

3 Q. Does the Staff believe that Empire has the burden of demonstrating both
4 that its management of the SLCC unit was prudent, and that all of the resulting costs that
5 it is incurring to complete the SLCC unit project were prudent?

6 A. Yes. The existence of significant and material cost overruns on the SLCC
7 project raises questions concerning whether the increased rates proposed by Empire
8 stemming from the SLCC unit are just and reasonable. The Staff asserts that the burden
9 is properly placed on Empire to justify the prudence of its management of the SLCC unit
10 construction project, and the reasonableness of its costs.

11 Q. Has Empire employed a number of contractors to assist it in the
12 construction of the new SLCC unit?

13 A. Yes, as is standard practice on major utility construction projects. For
14 example, Empire has employed Black & Veatch Engineering as the engineering firm to
15 engineer the project and to oversee construction management for the SLCC project.
16 Empire has also used other contractors and subcontractors for various construction tasks
17 on the SLCC unit project.

18 Q. Does it matter whether the cost overruns are directly attributable to
19 Empire or are attributable to it through construction project contractors, or
20 subcontractors?

21 A. From a customer's perspective, no.

1 First, Empire retains responsibility in general for successful completion of
2 the SLCC unit project on a timely and cost effective basis. That responsibility cannot be
3 delegated away to others working on the project.

4 Second, Empire was entirely responsible for selection of the contractors
5 used on the SLCC unit project, including evaluating of the various SLCC unit
6 construction bids for quality of workmanship and cost effectiveness.

7 Lastly, Empire negotiated contracts with its selected contractors on the
8 SLCC unit project outlining in detail the obligations and duties of both parties. The
9 Commission should expect that Empire include in any final contracts provisions
10 protecting itself (and, ultimately, its customers) from cost overruns caused by failure of
11 the contractors it selected to perform in a workmanlike and timely manner.

12 Q. Does the Staff believe that cost overruns associated with inadequate
13 contractor performance should be passed on in rates to customers?

14 A. No. For the reasons discussed above, any such cost overruns should be
15 the responsibility of Empire. The Commission itself has taken this position in the past.
16 For example, the Commission stated as part of its response to KCPL's request to include
17 cost overruns incurred at its Iatan Generating Station in rates in Case No. ER-81-42 as
18 follows, "[a]s to the above-ground piping account and the structural steel painting
19 account, the Commission is of the opinion that the contractor error, such as occurred,
20 cannot be tolerated and should not be borne by the ratepayer." (Emphasis added.)

21 Q. Relating to the cost overrun issues discussed above in Case No. ER-81-42,
22 KCPL, was there any subsequent relitigation of those issues?

1 A. Yes. Those specific cost overrun issues were relitigated twice. In Case
2 No. ER-82-66, the Commission again disallowed the amounts in dispute. In the
3 following rate case, Case No. ER-83-49, the Commission allowed the previously
4 disallowed cost overruns in rates, explaining, "[i]n the instant case, on the other hand, the
5 Company has come forward with sufficient evidence to rebut the allegation of inadequate
6 Company or contractor supervision." (Report and Order, p. 42).

7 Q. Based on past precedent, would either the Commission or the Staff require
8 that Empire or its contractors meet a standard of "perfection", i.e., no errors, before
9 considering that the costs incurred in a project such as Empire's SLCC unit project
10 should be included for rate setting purposes?

11 A. No. In fact, most budget estimates for generating plants contain a line
12 item for "contingencies", which is intended to account for the possibility that costs will
13 increase for unanticipated reasons above forecasted amounts over the course of a
14 construction project. It is my understanding that the "contingencies" line item can be
15 thought of, in part, as an allowance for a normal level of utility and/or contractor errors
16 and low productivity. Under no circumstances, however, should material utility and/or
17 contractor errors that cause significant cost overruns be allowed rate recovery.

18 Q. Has the Staff attempted to assess why cost overruns occurred on the SLCC
19 unit project?

20 A. Yes, the Staff has reviewed some information received from Empire
21 concerning why Empire incurred significant cost overruns. Presently the project is not
22 completed, however, and the Staff is continuing its investigation. The Staff will be

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1 unable to complete its investigation until the project is completed and the final costs of
2 the unit are known.

3 The information the Staff has reviewed up to the time of its direct
4 testimony filing indicates that a significant amount of the cost overruns are attributable to
5 the failure of a construction contractor to perform its assigned tasks in a timely,
6 workmanlike and cost effective manner. The failure of the contractor to perform
7 adequately was serious enough to lead Empire to terminate the contractor's participation
8 in the project. The Company then had to replace the terminated contractor with another
9 at a significantly increased cost. The Staff believes there is a substantial likelihood that
10 the cost overrun associated with this contractor was attributable to inadequate Company
11 or contractor supervision of this part of the construction project. This matter is also
12 addressed in the direct testimony of Staff witness Featherstone.

13 Q. Does the Staff believe that Empire has provided sufficient information to
14 the Staff at this point to justify including in rates of any of the cost overruns Empire has
15 incurred at its SLCC unit construction project?

16 A. No.

17 Q. Please summarize your testimony.

18 A. One of the primary drivers for Empire's rate increase request in this
19 proceeding is the Company's requested inclusion in rates of the construction costs for its
20 new SLCC generating unit. The Staff is reviewing the actual and projected remaining
21 costs of the SLCC unit to aid in ensuring that only just and reasonable charges are made
22 to customers flowing from this construction project. The Staff is conducting its review in

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1 a manner that is consistent with past Commission precedent regarding rate treatment of
2 the costs of major capital construction projects.

3 That there are already sizeable cost overruns on this uncompleted SLCC
4 unit project raises serious questions concerning whether Empire's customers should be
5 expected to pay for the overruns. The Staff believes that the Commission will have
6 concerns that the overruns may relate to imprudent management of the SLCC project by
7 Empire, or to contractor errors or inefficiencies. Thus, the Staff believes that the
8 Company should provide detailed information in its testimony in this proceeding
9 justifying why such overruns have occurred. Barring receipt of such information, and not
10 withstanding any other issues that may arise later in this case concerning such matters as
11 the in-service status of the SLCC unit, no amount of SLCC unit project cost overruns
12 should be considered for inclusion in rates in this proceeding.

13 Q. Does this conclude your direct testimony?

14 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of The Empire)
District Electric Company for a General Rate) Case No. ER-2001-299
Increase)

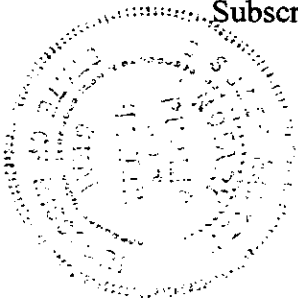
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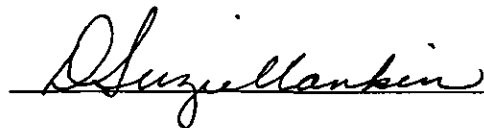
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Mark L. Oligschlaeger, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 12 pages to be presented in the above case; that the answers in the foregoing Direct 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

Subscribed and sworn to before me this 2nd day of April 2001.





D SUZIE MANKIN
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. JUNE 21, 2004

MARK L. OLIGSCHLAEGER

<u>COMPANY</u>	<u>CASE NO.</u>
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
Western Resources	GR-90-40 & GR-91-149
Missouri-American Water Company	WR-91-211
UtiliCorp United Inc. / Missouri Public Service	EO-91-358 & EO-91-360
Generic: Expanded Calling Scopes	TO-92-306
Generic: Energy Policy Act of 1992	EO-93-218
Western Resources, Inc./Southern Union Company	GM-94-40
St. Louis County Water Company	WR-95-145
Union Electric Company	EM-96-149
St. Louis County Water Company	WR-96-263
Missouri Gas Energy	GR-96-285
The Empire District Electric Company	ER-97-82
UtiliCorp United, Inc./Missouri Public Service	ER-97-394
Western Resources, Inc./Kansas City Power & Light Company	EM-97-515
United Water Missouri, Inc.	WA-98-187
Missouri-American Water Company	WM-2000-222

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<u>COMPANY</u>	<u>CASE NO.</u>
UtiliCorp United Inc. / St. Joseph Light & Power Company	EM-2000-292
UtiliCorp United Inc. / The Empire District Electric Company	EM-2000-369
Green Hills Telephone Corporation	TT-2001-115
IAMO Telephone Company	TT-2001-116
Ozark Telephone Company	TT-2001-117
Peace Valley Telephone Company, Inc.	TT-2001-118
Holway Telephone Company	TT-2001-119
KLM Telephone Company	TT-2001-120
Oregon Farmers Mutual Telephone Company	TT-2001-328
Ozark Telephone Company	TC-2001-402