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Issue: Regulatory Mechanisms
Witness: H. Edwin Overcast
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Case No.: ER-2014-0370
Date Testimony Prepared: June 5, 2015

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO.: ER-2014-0370

SURREBUTTAL TESTIMONY

OF

H. EDWIN OVERCAST

ON BEHALF OF

KANSAS CITY POWER & LIGHT COMPANY

Kansas City, Missouri
June 2015

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Case No. ER-2014-0370

Introduction

Q. Please state your name and business address.

A. My name is H. Edwin Overcast, Director, Management Consulting, POB 2946, McDonough, GA 30253.

Q. On whose behalf are you submitting this testimony?

A. I am submitting this surrebuttal testimony ("Surrebuttal Testimony") before the Missouri Public Service Commission ("Commission") on behalf of Kansas City Power & Light Company ("KCP&L" or the "Company").

Q. What is the purpose of your Surrebuttal Testimony?

A. The purpose of my Surrebuttal Testimony is to address the fundamental inequities in the testimony of the Missouri Public Service Commission Staff ("Staff"), the Office of the Public Counsel ("OPC") and the Midwest Energy Consumers' Group ("MECG") as it relates to the proposed 100% fuel clause (as opposed to the 95/5 convention) and certain trackers proposed by KCP&L.

The Test Year Basis for the Fuel Adjustment Clause ("FAC") and Trackers

Q. Please discuss the fundamental inequities related to determining the revenue requirements in this case.

A. The single largest inequity is the use of a historic test year with known and measurable changes through a date certain as described by Staff witness Featherstone with no reasonable recognition for certain specific and limited categories of costs that are fully expected to increase significantly during the period when rates are effective in comparison to the levels experienced during the test year as updated. Witness Featherstone goes to great length to document all of the savings achieved by KCP&L. It is certainly true that utilities work hard to manage their costs and to be more efficient. There is no reason to discuss the aggregate dollars of saving achieved by KCP&L in historic periods. Nevertheless, three facts are extremely important in discussing witness Featherstone's analysis.

First, the same savings are no longer available to KCP&L because they will be included in total in the determination of the revenue requirements coming from this case and cannot be replicated in a new Rate Year. New savings will need to be found, and based on the law of diminishing returns will be harder to find as KCP&L becomes more efficient. Cost savings, subject to management control cannot be relied upon like an infinite well. As a utility becomes more efficient the number of and dollar savings of potential new savings decrease and the potential for efficiency gains becomes more risky and less likely to satisfy the requirement that full payback of costs to implement the program can be recovered between rate cases. If the costs are not recoverable between rate cases, there is no contribution to earnings from the efficiency gains and shareholders never recover their investment.

Second, despite all of those dramatic cost saving events, KCP&L was unable to earn its Commission-authorized return. No party has argued that any of the expenses for KCP&L have been imprudent so the only reasonable assumption must be that the forecast of the Rate Year costs using the historical test year customary in Missouri must have been very much in error relative to the reasonable cost levels for Rate Effective Period and beyond.

Third, the concept of annual rate cases to chase inadequate earnings because of a failure of the test year to adequately forecast future costs results in negative outcomes for all stakeholders including higher rates for customers because of regulatory costs and potentially higher capital costs. Plus if the Commission is concerned about the frequency and expense of rate cases, it is entirely inconsistent to deny the utility regulatory mechanisms that would reduce the need for continuous rate cases.

Q. Witness Featherstone explains in detail that there is no inherent bias in the Staff's estimates of Rate Year costs because of all the adjustments made to the test year. Please comment on those assertions.

A. First, normalizing and annualizing expenses does not solve the issue related the fact that historical costs cannot be a good prediction of a future period if for no other reason than rising prices and wages during the Rate Year are not reflected. Other regulators allow companies with historic test periods to make proforma adjustments to revenue requirements beyond normalizing and annualizing as well such as the higher wage costs based on existing contracts or for general inflation. The proforma adjustments are added to the revenue requirement in order to provide a closer match to the expected costs in the Rate Year. In those jurisdictions that allow proforma adjustments a utility may be permitted, for example, to estimate the expected increase in property tax for the rate year knowing that this cost rises by some regular amount each year. (Instead KCP&L made the modest proposal for a tracker in keeping with the desire not to profit from nor lose based on a cost largely beyond its control.) Proforma adjustments may be made for other changes such as labor rates agreed to in a contract for a period beyond the test year but within the rate year. Also, not all proforma adjustments apply only to costs or to increasing costs. The use of proforma adjustments helps to improve the accuracy of the forecast. An even better opportunity of matching is provided by a well-designed future test year estimate.

Second, the Staff's view, as expressed by witness Featherstone, is at best a third option to estimating test year expenses but unfortunately one that fails for systemic reasons such as the mismatch of historic costs with costs in the Rate Year as discussed below to provide an accurate matching of costs and revenues in the Rate Year. The approach essentially provides no opportunity to earn the Commission authorized return except under extreme and low probability weather conditions when volumetric rate revenues increase well above the normalized revenue levels. This cannot fairly be characterized as a realistic or reasonable opportunity for KCP&L to achieve its Commission-authorized return.

Q. Please explain the systemic nature of a historic test year failure to adequately reflect costs in the Rate Year.

A. Actual historic data proves that the historic test year is biased and cannot reasonably predict the actual costs in the Rate Year as claimed by witness Featherstone. The essential mandated requirement for the approved test year is that it provides a reasonable opportunity for cost and revenues to match and a reasonable opportunity for the utility to earn the authorized return. Table 1 below is taken from data collected by the United States Bureau of Labor Statistics (BLS). The BLS collects data relevant to the issue of whether the normalized and annualized payroll and other adjustments four months in advance of the beginning of the rate year is a good estimate of total compensation for the rate year.

Table 1
Employment Cost Index Total Compensation for Utilities
12 Months Ended Percent Changes Reported by BLS

Year	March	June	September	December
2010	5.2	5.5	5.9	4.9
2011	3.5	3.3	3.1	3.5
2012	3.0	3.6	3.2	3.4
2013	2.9	1.8	0.7	1.0
2014	1.4	1.5	2.9	2.4
Average	3.2	3.1	3.2	3.0

This table shows that in no quarter over the last five years has the 12 months ended employment cost index for utilities changed by less than a positive increase of three percent. It is fair to say that to reasonably reflect payroll cost increases over the 16 months (four months from the update and 12 months of the Rate Year), payroll would need to be adjusted up for the market by the four months plus another six months to the midpoint of the test year or a number close to three percent.

Q. Are payroll and other compensation the only costs that exhibit an upward trend?

A. No. Other costs are subject to the same inflationary pressures. For example, the Producer Price Index (PPI) measures the average change in selling prices received by domestic producers of goods and services over time. It would be indicative of the level of costs to be passed through for the services by KCP&L based on the treatment of all similarly situated utilities. It would also be indicative of the potential volatility of transmission prices paid by KCP&L based on an electric transmission PPI. Table 2 below provides the PPI for both transmission and distribution services as developed by the BLS.

Table 2
Annual Percentage Change in Prices for Electric Distribution and Transmission Reported by the BLS

Year	Transmission Annual Change from Prior Year	Distribution Annual Change from Prior Year
2010	1.038188	1.022709
2011	1.059025	1.025268
2012	1.01454	1.010456
2013	1.080414	1.013304
2014	1.07885	1.03647
Average	1.054	1.022

This table provides important information for assessing the adequacy of the historic test year as a forecast of the Rate Year cost of service. Since utilities are regulated on a cost of service basis, this shows how these costs have changed over time. Table 2 shows that transmission costs are both volatile and unpredictable based on a variety of factors as I discussed in my rebuttal testimony. On this basis alone, it is reasonable to include these costs in the Fuel and Purchased Power Adjustment Clause. Table 2 also shows that the overall cost of distribution increases at about two percent per year based on prudently incurred costs. Thus, the regulatory historic test year that Staff witness Featherstone and OPC and MECG support as well cannot be representative of actual costs in the rate year. It is simply an inadequate forecast of the revenue requirement for the Rate Year.

Q. How is an increase in costs of over two percent between the test year and the Rate Year as shown by Table 2 a significant amount?

A. This two plus percent increase that one would expect year over year includes efficiency improvements across the whole industry. This means the increase is after all of the kinds of efforts Staff witness Featherstone discusses related to KCP&L. Second, a two percent increase in overall prices may not seem like a lot but absent fuel costs pass through and any trackers, the residual impact is a significant impact on earnings[1].

Q. If costs are increasing as shown above how will the FAC and proposed tracker mechanisms provide KCP&L a reasonable opportunity to earn the authorized return?

A. By themselves, the FAC and the trackers will not provide that opportunity to earn the authorized return. KCP&L will also need to continue to manage the costs over which it has control and increase productivity[2], to the degree it can, to overcome the impact of regulatory lag as it relates to the remainder of its costs. Essentially, regulatory lag continues to be an effective incentive for a significant portion of costs in rates that management has some control and ability to create economic efficiency in these costs. Importantly, regulatory lag as an incentive is based on a portion of costs that KCP&L has some control over in terms of increasing productivity. Productivity increases are

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[1] This would be about $20 million as a percent of non-fuel O&M at $1 billion.
[2] The measure of production efficiency defined as the ratio inputs to outputs.

important because the source of reduced costs from an economic perspective is productivity.

Q. Do the various proposals of Staff, OPC and MECG provide for a balancing of the interests of KCP&L and their consumers as they relate to the trackers and the FAC?

A. No. The opposition to the riders and the FAC should be seen for what they are—an effort to disallow recovery of prudent costs that these parties believe are likely to be higher than those costs during the test year. That is, the opposition is based on a concern that allowing these mechanisms to operate will result in higher rates for customers and the ability for KCP&L to have an opportunity to earn the authorized return at the expense of their constituents. Finding the proper balance between customers and shareholders cannot be achieved with the current historic test year as discussed above. KCP&L has proposed a just and reasonable FAC RAM that takes into account both the costs and benefits of the SPP IM and balances the interests of shareholders and customers through the dollar for dollar matching of the covered expenses over which KCP&L has little or no control. The proposed alternative of no FAC denies KCP&L recovery of costs that increase and provides investors an unearned reward if costs decline related to the covered expenses included in the FAC. Approval of the proposed 100% FAC (as opposed to the 95/5 convention) balances the interests of all parties and is a necessary condition for having just and reasonable rates. The trackers, while not extensive, are also consistent with just and reasonable rates. Moreover, the use of these modest trackers results in a better matching of costs and revenues in the Rate Year.

Q. Are these proposed regulatory mechanisms extraordinary or unusual regulatory tools?

A. Not at all. These proposals are modest compared to other regulatory jurisdictions that permit full future test years, decoupling proposals, and other RAMs for far more than just fuel costs. Relative to other utilities, KCP&L has limited its requests for regulatory mechanisms and regulatory changes that provide a reasonable opportunity to earn the authorized return. It is in the public interest to allow the utilities a reasonable opportunity to earn the authorized return on equity to provide long run lower costs for customers.

Q. Should the transmission costs approved under the SPP OATT be removed from the FAC as proposed by witness Dauphinais?

A. No. Energy or kWhs cannot be delivered across the KCP&L service territory without incurring these SPP transmission costs. Since each kWh must be delivered to the load nodes that connect the system to either transmission or distribution substations for ultimate delivery to retail customers, these costs are effectively the cost of delivered power from the market. The costs are netted as a result of the purchase and sale nature of the transaction so that the retail costs reflect only the deliveries for retail related Missouri Commission jurisdictional costs that are properly part of the FAC as proposed. In addition, those costs are reduced by the net cost of off-system sales through inclusion in the FAC. The FAC becomes a critical component of timely price signals and efficient matching of costs and revenues during the Rate Year and beyond. As I have explained in rebuttal the FAC is both economically efficient and an effective mechanism to provide a reasonable opportunity to earn the allowed return.

Q. Do you agree with witness Dauphinais' proposed removal of the SPP administrative costs and FERC and NERC (North American Electric Reliability Corporation) fees from the FAC?

A. No. As I discussed in my rebuttal testimony these administrative costs are part of the costs associated with the market for energy and capacity.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Kansas City Power & Light Company's Request for Authority to Implement A General Rate Increase for Electric Service	)))	Case No. ER-2014-0370

AFFIDAVIT OF H. EDWIN OVERCAST

STATE OF GEORGIA)
) **ss**
COUNTY OF HENRY)

H. Edwin Overcast, being first duly sworn on his oath, states:

1. My name is H. Edwin Overcast and my business address is Black & Veatch Corporation, POB 2946, McDonough, GA 30253. I have been retained to serve as an expert witness to provide testimony on behalf of Kansas City Power & Light Company.

2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony on behalf of Kansas City Power & Light Company consisting of ten (10) pages, having been prepared in written form for introduction into evidence in the above-captioned docket.

3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

H E Overcast
H. Edwin Overcast

Subscribed and sworn before me this 2 day of June, 2015.

Jasmine C Browne
Notary Public

My commission expires: 12/11/2018

JASMINE C BROWNE
NOTARY PUBLIC
MY COMMISSION EXPIRES DECEMBER 11, 2018
HENRY COUNTY