Exhibit No.:	
Issues:	*O&M Expense, Plum Point, Iatan 2 & Iatan Common Trackers, Riverton 12 O&M Tracker Incentive Compensation*
Witness:	*Jermaine Green*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*ER-2014-0351*
Date Testimony Prepared:	*March 24, 2015*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION

UTILITY SERVICES - AUDITING

SURREBUTTAL TESTIMONY

OF

JERMAINE GREEN

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2014-0351

Jefferson City, Missouri
March 2015

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Q. Please state your name and business address.

A. Jermaine Green, Governor Office Building, P.O. Box 360, Jefferson City, Missouri 65102.

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

A. I am a Utility Regulatory Auditor with the Missouri Public Service Commission ("Commission").

Q. Are you the same Jermaine Green who has previously contributed to the Staff's Cost of Service Report ("Report") dated January 30, 2015 and Rebuttal Testimony in Case No. ER-2014-0351 for The Empire District Electric Company ("Empire" or "Company")?

A. Yes, I am.

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony addresses the rebuttal testimonies of Empire witnesses Kelly S. Walters, regarding the Company's incentive compensation expense; Blake Mertens, regarding operations and maintenance (O&M) expense; and Joan Land, concerning corrections to Staff's revenue requirement calculations.

EXECUTIVE SUMMARY

Q. Please briefly summarize your surrebuttal testimony pertaining to this rate case.

A. In this testimony, I will first address the issue of O&M expenses and Empire's proposed use of a price escalation adjustment in determining its normalized O&M expenses. It is Staff's position that actual expense totals should not be adjusted based on overall economic indexes that are not Company or expense-specific.

Next, I will explain Staff's position on the discontinuation of the Iatan 2, Iatan Common and Plum Point O&M expense tracker. Staff's position is that it is inappropriate to continue these O&M Trackers beyond the true-up cut-off date of December 31, 2014 in the current rate case.

I will also address in this testimony Staff's corrections regarding the O&M trackers as discussed by Empire witness Ms. Joan Land in her rebuttal testimony.

Additionally, I will address Staff's recommendation regarding the Company's proposed Riverton 12 O&M tracker. Staff recommends that a tracker mechanism be established for the O&M expense at this generating facility in this rate proceeding. However, Staff is proposing a different expense level be used as the base amount for this tracker than that advocated by Empire.

Lastly, I will address Staff's position regarding incentive compensation expenses for Empire. The incentive compensation adjustments proposed by Staff apply to three different forms of compensation offered by Empire: (1) the Management Incentive Compensation Plan ("MIP") for short-term executive incentive compensation; (2) long-term equity incentive compensation to executives, and (3) "Lightning Bolts" for short-term discretionary incentive compensation to non-management employees. Staff does not object to Empire's practice of offering its employees variable compensation based on the attainment of certain goals. However, Staff recommends that, for this expense to be allowed in rates, incentive compensation for all employees should be based on goals that provide a direct benefit to ratepayers, not goals which have a primary purpose of benefitting shareholders.

OPERATIONS AND MAINTENANCE (O&M) EXPENSE

Q. Why does Staff typically analyze five years of data for O&M expense for purposes of normalization?

A. Staff has used an averaging technique to set rates for generation O&M normalization purposes for many years in many different rate cases, and will likely continue to in the future. Staff believes the five year average is the most reasonable approach because it uses actual expense incurred and eliminates the impact of annual fluctuations in these expenses. In addition, for most of Empire's plants, the major turbine/boiler inspections, or overhauls, are scheduled on a five-year cycle. The two Iatan plants are on a six-year major inspection cycle, so Staff normalizes Iatan O&M expenses based on six years of actual expenditures.

Q. How do these major inspections impact O&M expenses?

A. Typically, these are the more expensive inspections, which significantly increase O&M expenses in the years major inspections occur. If rates were to be set based solely upon a year that a plant's major inspections occurred, the ongoing level of O&M expense would be overstated; if rates were to be set based upon a year that a plant's major inspections did not occur, the ongoing level of O&M expense would be understated. Use of a multi-year average to normalize these O&M expenses avoids both outcomes.

Q. Mr. Mertens implies in his testimony that changes in the Consumer Price Index (CPI) and Producer Price Index (PPI) from April 2009 to April 2014 should be used by Staff in determining its O&M adjustments. How do you respond?

A. It is not appropriate to adjust actual utility expenses for ratemaking purposes based on overall economic indexes that are not Company or utility-specific. According to the U.S. Bureau of Labor Statistics, the CPI is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Examples of this basket of goods consist of food & beverages, housing, apparel and transportation costs. Whereas, the PPI measures the average changes over time in the selling prices of domestic producers in goods and services.[1] Staff believes these general economic indicators are not specific to Empire's O&M expenses as these indicators are more reflective of the economic conditions in the United States as a whole and not Company-specific.

Q. Has the Commission previously included language in a Report and Order on the appropriateness of using economic indexes in adjusting O&M expense in a rate case?

A. Yes, it has. In the Report and Order issued in Case No. ER-93-41, St. Joseph Light & Power Company, the Commission stated its opinion relating to establishing a five (5) year historical maintenance expense level:

> However, the Commission finds no reasonable basis to adjust the maintenance expense based on the Consumer Price Index. The Consumer Price Index only reflects certain portions of national price increases and is not related to company-specific information. The Commission does not believe maintenance expense set upon a national Consumer Price Index is reasonable. Each company is different and expense adjustments should be set on an individual company's expenses and not upon statistical extrapolation based on an index which measures wide array of unrelated prices. 2 Mo.P.S.C.3d 259 (June 25, 1993).

<u>PLUM POINT, IATAN 2 AND IATAN COMMON O&M TRACKERS</u>

Q. Did Empire witness Mertens propose to continue the Company's current Plum Point, Iatan 2 and Iatan Common O&M Trackers in this case?

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[1] The U.S. Bureau of Labor Statistics.

A. Yes. In his rebuttal testimony at page 2, lines 12 to 13, Mr. Mertens states, "it is reasonable and equitable to continue the use of the tracker mechanisms for this case."

Q. Does Staff agree with Mr. Mertens that these particular trackers should continue?

A. No. Staff recommended in its Cost of Service Report that these trackers be discontinued after this case. As discussed at page 99, lines 9 to 12 of Staff's Report, if Kansas City Power & Light Company ("KCPL") (the majority owner of Iatan 2 and Iatan Common) is no longer seeking use of a tracker mechanism for the O&M expenses associated with these units in its current filed rate proceeding (Case No. ER-2014-0370), it stands to reason that Empire also no longer requires special ratemaking treatment in relation to its 12% ownership in Iatan 2 and Iatan Common. The same rationale applies to Empire in regard to its 7.52% ownership of Plum Point.

Q. In his Rebuttal testimony, Mr. Mertens discusses the significant costs Empire will incur from the expected five or six year maintenance milestones that has not yet taken place at these generating plants. What is Staff's position regarding this?

A. Staff agrees that the costs associated with these major outages can be significant at generation facilities. However, Staff believes a four year average of the actual known maintenance costs associated with these generating facilities is appropriate in this instance. The cost of major maintenance milestones for the Iatan 2, Iatan Common and Plum Point units can be taken into account for ratemaking purposes in future Empire rate proceedings when such costs are known and measureable.

Q. By proposing to discontinue these trackers, is Staff suggesting that Empire should no longer recover the costs related to these O&M expenses?

A. No. Staff has included a reasonable level of ongoing expense based on four years of actual historical data for each of these generating facilities. Furthermore, Staff is recommending that a net regulatory asset for the unamortized tracker balances of all three generating facilities accumulated pursuant to trackers authorized in previous rate cases be included in rate base and amortized to expense over five years.

Q. In her rebuttal testimony, Ms. Land discussed some corrections related to Staff's calculation of the O&M Trackers. Does Staff agree with these?

A. Yes. In Staff's direct filing, the O&M tracker balances used to calculate the current levels of amortization costs were not consistent with the balances established in the Nonunamimous Stipulation and Agreement in Case. No. ER-2012-0345 and the Global Agreement in Case No. ER-2011-0004, Empire's last two general rate proceedings in Missouri. Additionally, Staff calculated an income statement adjustment to the test year level of amortization expense which was inadvertently omitted in our direct filing.

RIVERTON 12 O&M TRACKER BASE COST

Q. What is Staff's recommendation concerning the Company's proposed Riverton 12 O&M Tracker?

A. After reviewing Empire's Long-term Maintenance Contract with Siemens Instrumentation, Controls and Electrical Group and consultation with the Company, Staff recommends that a tracker be established with a base amount of $2.7 million Missouri Jurisdictional.

Q. Please explain Staff's methodology in determining the amount for the tracker base.

A. Staff adopted the Company's methodology for determining the Riverton 12 tracker base, with the exception of excluding 2,475 equivalent operating hours (EOH) "anticipated" for the commissioning of the new Riverton 12 unit as a combined cycle generation unit. It is Staff's position that these hours represent a one-time cost and should not be included in ongoing expense levels or in a tracker mechanism. Instead, these costs should be treated as a capital item.

INCENTIVE COMPENSATION

Management Incentive Plan

Q. Please explain the executive compensation program at Empire.

A. The executive compensation program at Empire, known as the Management Incentive Compensation Plan ("MIP"), is comprised of three basic elements: (1) base salary; (2) annual (short-term) cash incentives based on threshold (minimum expected), target, and maximum performance measures; and (3) long-term incentive plans (LTIP).

Q. Out of the three elements mentioned above, what are the areas of disagreement between Staff and the Company?

A. The disagreements concern the annual (short-term) cash incentives for Empire executives and department heads as well as the long-term incentives. Staff did not adjust Empire executive's base salaries in its direct case.

Q. What is Empire's position in regards to its overall compensation methodology?

A. On page 4, lines 1 to 9, of Ms. Walters' rebuttal testimony, she states:

> As communicated by Hay Group, companies similar to Empire typically utilize the same approach as Empire by incorporating a mix of base salary, short-term, and long-term incentives into a total executive compensation package. This reflects a "best practices" approach used by companies both inside and outside the utility industry. Rather than relying solely on fixed compensation in the

> form of base salary, this best practices approach also includes a considerable measure of variable **(at risk)** compensation in the total compensation package. This approach is a key factor in ensuring the alignment of an executive's performance with the interests of customers and shareholders.[2]

Q. How does Staff respond to the above mentioned portion of Ms. Walters' rebuttal testimony?

A. Staff agrees with Ms. Walters' statement that larger utility companies in Missouri typically include a mix of base salary, short-term, and long-term incentives into their total executive compensation package. However, regarding these Missouri regulated utilities, Staff has also recommended the disallowance of incentive compensation components that are primarily intended to maximize shareholder wealth or do not provide a direct benefit to ratepayers. The position Staff is taking in this matter is no different than what it has recommended in past rate cases for Empire and other Missouri utilities.

Q. Is Staff opposed to the recovery of "at risk" executive incentive compensation?

A. No. Staff is not opposed to a portion of executive compensation being placed "at risk." If Empire shows that this approach is based upon goals and objectives that result in a ratepayer benefit, Staff would not oppose recovery of these costs in the cost of service.

Q. In her rebuttal testimony on page 4, Ms. Walters attempts to justify rate recovery for Empire's executive incentive compensation expenses on the grounds that Empire's total compensation package for its executives is lower than that of the peer group. Please respond.

A. Ms. Walters appears to be arguing that the Commission should place a different and more lenient ratemaking standard for incentive compensation on utilities that are perceived to pay less in compensation expenses than the industry or area norm. However, Staff believes

[2] Emphasis in original.

this argument misses the real point of this issue. Staff is not proposing its adjustments to Empire's incentive compensation expense on the grounds that Empire's incentive compensation is "excessive" or that it would cause Empire's total compensation package for executives to be "excessive;" rather, Staff's adjustments are based upon the belief that it is inappropriate to charge customers for costs primarily associated with shareholder benefit or which do not result in real improvement in utility performance. Whether a utility pays high or low total compensation levels should not affect this fundamental concern.

Q. Ms. Walters seems to imply that a company's compensation package should be judged in total, based upon the amount of total compensation, with no separate or distinctive criteria applied to variable incentive-type compensation. Do you agree?

A. No. Base salaries and incentive compensation are distinct types of employee compensation, and the Commission has historically applied specific criteria before allowing incentive compensation expense to be included in rates. The Commission's criteria have been based upon whether attainment of a Company's goals/targets would provide a benefit to its customers, and whether the goals/targets are designed to actually improve employee and company performance.

Q. Please explain Staff's calculation of allowable MIP in this case.

A. In order to determine the appropriate amount to include for the MIP in this case, Staff performed a review of all the incentive metrics used to measure each individual goal and disallowed all the actual payouts to Empire executives associated with performance measures tied to meeting financial goals; i.e. "earnings per share" targets. It is Staff's position that any incentive goals associated with enhancing the value of a utility's stock price and the achievement of these goals is a benefit to Empire's shareholders, and not Empire's ratepayers.

Q. On page 5 of her testimony, Ms. Walters' references specific adjustments that Staff made to disallow a portion of the executive incentive compensation and made the statement that these adjustments are unreasonable. Please comment.

A. Ms. Walters makes the statement that Staff's adjustments are unreasonable because awards are only payable to an executive officer if they perform above the "minimum" or "threshold" levels of performance. What Ms. Walters doesn't take into account is what each specific goal pertains to. Ms. Walters appears to take a position that Staff should not be looking at each individual goal for reasonableness because they are all a part of the total compensation package, and it should not matter what each specific goal is. Staff disagrees with this reasoning and believes that each individual goal should be scrutinized to determine if it has a direct benefit to ratepayers. Staff reviewed all of the specific goals for Empire's executives in this case and it is Staff's position to disallow only those awards given to executives and department heads that does not have a direct benefit to ratepayers.

As had been customary in past rate cases, Staff's policy is still to allow incentives related to customer service, reliability and safety, and environmental compliance, because these goals are associated with the provision of safe, adequate and reliable service to the ratepayers.

Q. Please describe Empire's long-term incentive plan (LTIP).

A. Empire's LTIP consists of stock options, dividend equivalent rights awarded in conjunction with each stock option grant, and performance-based restricted stock awards.

Q. Why does Staff propose to disallow the LTIP awards?

A. Staff proposes to disallow LTIP awards for the following reasons: (1) the awards are based on measures that primarily benefit shareholders, such as shareholder return (maximizing the dividends paid to shareholders) and stock price goals (the value of the stock increasing over time); (2) the granting of these stock options is not associated with any increase in duties or achievement of goals and is not tied to any specific level of employee performance; and (3) the stock options and performance-based restricted stock are equity-based compensation that do not result in cash outlays from the company and should not be recovered in cash through rates.

Q. Please explain your last point further.

A. When a stock option or performance-based restricted stock is granted to a management employee, no cash is exchanged. The stock-related grant gives the receiver of the grant an option (right) to purchase stock at a discount from its market value at a future date. No cash is paid out by Empire at the time of the grant/option or when the employee exercises the grant/option to acquire Company stock. When the grant/option is exercised, the grant/option holder pays cash to the Company and the Company issues stock. Empire does not pay out cash to the grant/option holder at either point.

Q. Has the Commission previously expressed its view on appropriate rate treatment of incentive plans?

A. Yes, in several instances. In the Report and Order issued in Case No. GR-96-285, Missouri Gas Energy (MGE), the Commission stated the following regarding the issue of incentive compensation plans that used shareholder-oriented financial measures:

> The Commission finds that the costs of MGE's incentive compensation program should not be included in MGE's revenue requirement because the incentive compensation program is driven at least primarily, if not solely, by the goal of shareholder wealth maximization, and it is not significantly driven by the interests of ratepayers. 5 Mo.P.S.C.3d 437,458 (January 22, 1997).

The Commission reiterated its position in its Report and Order in Case No. GR-2004-0209, MGE:

> The Commission agrees with Staff and Public Counsel that the financial incentive portions of the incentive compensation plan should not be recovered in rates. Those financial incentives seek to reward the company's employees for making their best efforts to improve the company's bottom line. Improvements to the company's bottom line chiefly benefit the company's shareholders, not its ratepayers. Indeed, some actions that might benefit a company's bottom line, such as a large rate increase, or the elimination of customer service personnel, might have an adverse effect on ratepayers.
>
> If the company wants to have an incentive compensation plan that rewards its employees for achieving financial goals that chiefly benefit shareholders, it is welcome to do so. However, the shareholders that benefit from that plan should pay the costs of that plan. The portion of the incentive compensation plan relating to the company's financial goals will be excluded from the company's cost of service revenue requirement.

The Commission also addressed this issue in its Report and Order in Case No. ER-2006-0315, Empire:

> The Commission finds that the Staff reasonably applied objective criteria for exclusion of certain incentive compensation. The Staff disallowed compensation related to charitable activities and activities related to the provision of services other than retail electric service.... We conclude that incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards, and stock options should not be recoverable in rates.

The Commission also reiterated its position on incentive compensation matters in its Report and Orders in Case Nos. ER-2006-0314 and ER-2007-0291, both KCPL rate cases.

<u>Non-Executive Salaried Compensation</u>

Q. In regards to the non-executive salaried employee incentive compensation issue, is it true, as referenced in Ms. Walters' rebuttal testimony at page 10, lines 1 to 4, that

"Staff excluded a portion of the non-executive salaried employees' incentive compensation similar to MIP?"

A. Yes, this is correct. Similarly to the MIP as discussed above, in order to determine the appropriate amount to include for the Department Head Cash Incentive Plan in this case, Staff performed a review of all the incentive metrics used to measure each individual goal and disallowed all the actual awards paid out to Empire's department heads associated with performance measures tied to enhancing the value of the utility's stock price; i.e., earnings per share.

<u>Lightning Bolts</u>

Q. Did Staff propose to disallow the expense associated with Empire's "Lightning Bolt" awards?

A. Yes. Staff disallowed the entire test year amount of Lightning Bolt expense.

Q. Ms. Walters states the Lightning Bolt Program provides cash awards to individuals who deliver results beyond those normally associated with their position. What is the reason for Staff's disallowance of Lightning Bolts?

A. Lightning Bolts do not have any pre-set goals or objectives attached to them that employees can "work toward," and are paid out at the senior management's discretion.

Q. What has been the Commission's past policy regarding incentives that do not have any goals attached to them?

A. The Commission stated its position on this matter in its Report and Order, page 49, in Case No. ER-2006-0315, Empire's 2006 rate case:

> The Commission finds that the Staff reasonably applied objective criteria for exclusion of certain incentive compensation. The Staff disallowed compensation related to charitable activities and activities related to the provision of services other than retail electric service. The Staff disallowed the Lightning Bolts incentive

compensation, as they did not relate to the provision of electric service and there were no performance criteria for receipt of the awards; they were given solely at the Company management's discretion.

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 The Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area	)))))	Case No. ER-2014-0351

AFFIDAVIT OF JERMAINE GREEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Jermaine Green, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the foregoing Surrebuttal 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.

J Green
Jermaine Green

Subscribed and sworn to before me this 24th day of March, 2015.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public