

Board of Public Utilities
Prepared Testimony of
Darrell Dorsey
September, 2010

Q: Please state your name and your business address.

A: My name is Darrell Dorsey, 312 E. 65th Street, Kansas City, Kansas.

Q: What is your position at the BPU?

A: I am the Manager of Electric Production and Supply.

Q: Did you previously provide testimony in this matter.

A: Yes, I testified during the rate hearing on May 3 and 4, 2010, and also filed a certified copy of a summary of my testimony.

Q. What is the purpose of the testimony you are now providing?

A: The purpose of my testimony is two-fold, first, to address issues raised by interveners in this proceeding, and second, to provide updates on matters to which I previously testified.

Q. You testified as to the responsibility of your position for numerous departments and activities within the Utility. Do you have anything that you wish to add to this testimony with regard to rising costs faced by the Utility?

A. One of my responsibilities is to evaluate the impact of rising costs on the operations of the departments and activities that I manage.

Operating costs for all businesses continue to rise, unfortunately, including for the BPU. Procurement of goods and services, materials and supplies, fuels for vehicles and facilities, all are escalating over time. In the power sector, electric utilities are also faced with new environmental regulations requiring the addition of expensive pollution control equipment and the need to replace aging infrastructure. Implementation of new technologies that improve the quality and reliability of service come at a cost, but are necessary to avoid further problems caused by operating obsolete equipment. Older generation units become less reliable as they age and require more maintenance, while procurement of power from other utilities to make up any generation shortages is now predominately based on high, and very volatile, natural gas prices.

Q. It has been suggested by representatives of the large power group that you could defer capital projects and lower the CIP over the study period in order to reduce the revenue requirements of the electric utility and thereby lower the amount of the requested rate increases. What is your response to this suggestion?

A. As I testified during the May 3 and May 4 hearings, and as indicated in the filed summary of my testimony, there have been numerous deferrals and delays of projects over the past several years.

Every year staff makes difficult decisions regarding the scope and scheduling of work. Lack of funding results in the need to accept greater risk in prioritizing projects, deferring as much work as required to stay within available funding limits. There are capital projects that have potential to be deferred on the basis of low perceived risks and impacts resulting from failure to perform the work. However, the projects that get included in our planning are those that we either know must be done or at a minimum have a very high probability of being needed within the planning period. Our decisions regarding the timing of execution of those projects is predominately based on sound judgment regarding risks and as well as the benefits of the mitigating those risks.

The proposed electric rate increases include funding for the electric system capital improvement projects. These projects are all in the five year Capital Improvement Plan (CIP). All of the projects are needed and many have already been deferred in earlier planning and budgeting efforts. The CIP represents BPU's attempt to balance the demands for more reliable, efficient and sustainable energy system, with financial limitations. The CIP is evaluated on an ongoing basis and the amount of funding shown in a particular year for a particular category in the Cost of Service Study was BPU's best estimate at the time the CIP information was provided for the Cost of Service Study. Management recognizes that plans change based on revenues on hand, political environments and needs, and the likelihood a major unanticipated cost, but management does not recommend deferral of any of these capital projects solely for the sake of reducing the cost of the projects in the CIP and in the rate study period. Quite to the contrary, BPU management notes that every deferral bears its own risks of detrimental impacts and unintended consequences.

Q. The Electric Cost of Service Study was prepared based on the five year CIP as in place at the time of preparation and based on the 2010 budget. Subsequent to that time, the BPU Board has approved a 7% increase to electric base rates for 2010, commencing July 1, 2010, a month later than had been projected in the Cost of Service Study, resulting in a lowering of projected revenues. Also, as discussed in the testimony of representatives of BPU and Black & Veatch, the shifting of fixed capacity costs associated with fuel and purchased power from the ERC as

originally proposed by BPU staff, back into base rates, required the BPU to adjust its revenue requirements to compensate for the fixed capacity costs that will now continue to be recovered from base rates. Please describe any changes to the CIP for the departments and activities which you manage from the CIP figures from the figures which were included in the Electric Cost of Service Study

A. As stated in my earlier testimony in May, we made many adjustments to the CIP pushing work out of 2010 to later years expecting that revenues would be inadequate to complete all the required work in 2010 Those CIP adjustments are already reflected in the Cost of Service results. Since the Cost of Service Study was released, we have further recommended pushing CT5 out yet another year. This would not be done simply to reduce the rate increase. It would be done as the result of our normal CIP reviews and planning updates giving us clear indicators that pushing the CT5 project out yet another year is acceptable, just as we have done for the last several years.

Q. Please describe considerations that the BPU takes into account in planning for its power supply needs.

A. There is little certainty in the power industry today. To the contrary, there is significant volatility in many areas resulting in subsequent volatility and uncertainty in all composite planning results. The BPU not only considers sensitivity analysis in planning for future capacity additions, but also evaluates numerous alternative plans that represent a much wider spectrum of possible future outcomes.

In running planning models, BPU frequently compares the various alternative cases to a 'do nothing' case, in which no new resources are added and the regional market is used to make up for all capacity and energy deficiencies. The do nothing scenario historically results in higher overall production costs and is flawed further by the fact that the BPU cannot legitimately plan on utilizing the regional markets in that fashion.

Projected cash reserve levels and related financial metrics represent a minimal plan threshold that is prudent for the BPU based on a limited set of criteria. These targets do not begin to cover the overall risk matrix that the Utility faces. The forecasts provided are not high, they are low, representing efforts already taken to reduce the plan to that minimal level where the corresponding risk potential created by cost reduction efforts are perceived as acceptable. Not all needs can be determined with precision, not all risks can be determined with precision and not all potential outcomes can be foreseen.

We do not manipulate our participation in the energy markets by incurring speculative financial risks in hope of increasing our margins. Rather, our transactions are based on meeting the actual needs of the utility. Utility plans are therefore based on our standard practices, projecting only anticipated market sales and purchases based on the needs of the utility, the planned availability of supply resources and projected market performance.

Lack of accurate data is a common in utility planning creating the need to use reasonable methodologies to approximate the required data. This does not justify making arbitrary adjustments to the results of the planning effort, simply to drive the results towards an even less well defined, arbitrary metric.

Q. One suggested deferral was that the BPU move the possible construction of another Combustion Turbine, CT5, outside of the study period. What is your response to this suggestion?

A. The rate increases include the funding required to install another Combustion Turbine. BPU must continuously plan for the addition of new generation equipment, both to meet future loads and to replace the older generation equipment that will be retired in future years. Extensive planning in recent years has led to a base plan that calls for the addition of another Combustion Turbine at the Nearman station. There are actually three primary alternatives in that plan, all of which lead to about the same cost of service over the planning period. Originally intended to be installed and operational by 2011, the economic slowdown and changing conditions has allowed BPU to push that date out to 2014. Should economic recovery return the utility to previous conditions and growth projections, the utility will rapidly become capacity deficient and the combustion turbine project would then very likely need to be accelerated rather than delayed. Though BPU continues to evaluate alternatives that could further delay this project, the only alternative that can be relied upon to satisfy a wide range of planning scenarios at this time is the actual installation of new equipment. This is the minimal acceptable plan and for that reason, this new generator continues to remain an integral component of the recovery plan. As I mentioned earlier in this testimony, we are now recommending pushing the CT5 project out another year based on current planning results, but it remains in the 5 year plan.

Q. Do you recommend removing the funding for CT5 outside of the study period ending in 2014.

A. No. We have not been able to build new baseload capacity and today only have one new unit – CT4 at 75Mw. Three of our oldest coal fired units are already in long term cold storage and can not cost effectively be returned to service. Our other three coal fired units and the three Quindaro combustion turbines are all old and will start coming up for retirements as they continue to age to the point of no longer being cost effective to operate. However, we can not retire capacity without having something to replace it, which at this stage of our planning, will be CT5.

Furthermore, if the BPU removed the funding for CT5 during the study period, BPU would have to add funding for other ways to satisfy its capacity needs, including such things as repairs to CT1 which couldn't be retired, buying capacity and energy from other utilities or generating more energy from our gas turbine fleet at high, volatile gas and oil pricing. The net effect would not result in any significant reductions in required expenses to satisfy capacity requirements. In the long run, it would only drive the cost of energy up even further.

Q. What are your views, as a BPU Manager, of the BPU's staffing needs, and what challenges have you faced in meeting your staffing needs?

A. The rate increases include funding to fill vacant positions as they develop. In past years BPU has held many vacancies open for longer periods of time as a means of holding down personnel cost. This was done in addition to staffing reductions and wage freezes. With increased vacancy rates caused primarily by retirements in an aging work force, staffing levels have dropped not only to all new lows, but to inadequate levels that jeopardize BPU's ability to function and provide the safe, reliable, efficient service that complies with all regulatory criteria required by law, fulfills our financial obligations and provides the quality of service expected from the BPU customers. BPU must recover its work force to minimal acceptable levels.

Electric Production and Supply has been reducing staffing levels, reorganizing and right sizing departments, and modifying staffing mix for over 15 years. We have also made specific efforts to maximize attrition savings each year by holding off on filling vacancies wherever possible. Unfortunately, staffing has now dropped to low thresholds that significantly increase the probability of critical work not being completed in a timely, efficient and effective manner. There is also clear need for additional staff in the near future in various areas of the operation such as environmental compliance, power market operations, NERC regulatory compliance, plant operations and maintenance staffing additions resulting from the addition of new environmental equipment and processes, and increasing engineering and technical staff to support the ever increasing complexity of capital projects and new technology.

Q. Please provide your views, as a BPU manager, of the BPU's financial condition and failure to meet financial guidelines, how this has impacted your ability to complete multi-year projects and the recovery plan which the BPU staff has proposed.

A. The rate increase includes the funding required to meet mandatory financial guidelines. The BPU does not have money building up on the side to fund major capital projects. Instead, the BPU uses low interest bonds, which then only require rates that support the payments on those bonds.

In recent years, BPU has depleted cash reserves to dangerously low levels and with this decline in BPU's financial position, the Bond rating agencies have reduced BPU's ratings, put BPU on negative watch and are looking for the BPU to take such actions as required to reestablish acceptable financial reserves. Without the ability to issue the low interest bonds, the BPU cannot continue to implement required projects and it is for that reason that the five year recovery plan includes the gradual replenishment of reserve funds to a minimum level required by policy and adequate to protect the BPU in the volatile and unpredictable economy that it now operates in.

The timing of the bond issues is critical to supporting the corresponding project work. These major, multi-year projects required dependable revenue streams for efficient implementation. Unfortunately, there has been significant volatility in commodity markets, construction and equipment markets, making it rather difficult to accurately estimate project costs. This requires the availability of additional cash resources to offset errors in estimates, and/or, the ability to adjust project bonds by way of multiple issuances or utilization of interim financing mechanisms that allow for unforeseeable cost escalations during the execution of the work.

The extensive effort on the part of the BPU to develop a five year recovery plan that meets the needs of the utility while minimizing the impact on the customers will bring the utility back up to the minimum required operating level. This recovery plan has been streamlined to make smaller adjustments from year to year over the planning period to reduce the impacts on the customers while achieving the longer term goals and requirements. It allows for a continuation of BPU's high quality of service to the community while maintaining the flexibility to make adjustments to the plan should the national economic recovery pick up to a point of bringing greater benefit to the utility. Should that occur, a portion of the future rate increases may well be deferred or eliminated all together, but in the mean time, a plan will be in place that assures the lights will stay on.

- Q. Please discuss the Environmental Surcharge Rider (ESC) and its proposed initial application to a mandated environmental project.
- A. The rate increases include the funding required to install new Low NOx burner systems on two of the utility's coal fired generators. The new equipment is required to meet new regulations that have now been made into law and must be met in a timely fashion. This equipment essentially reduces the BPU's impact on ground level ozone, a serious problem here in the Kansas City metropolitan region. The improvement in Air Quality will benefit not only the BPU customers, but everyone in the region.
- Q. What do you anticipate in the way of future environmental mandates?

A. There are numerous regulatory changes in the works, yet the full extent of future regulatory requirements, compliance measures required, related cost impacts and timing of implementation are not known. Some of the programs under various stages of development include:

Regional Haze State Implementation Plan

316a Thermal Discharge Limits

316b Intake Fish Protection

Mercury Monitoring and Removal

Hazardous Air Pollutant Limits

Ash Disposal Regulations

Interstate Transport Rule

National Ambient Air Quality Standard Revisions

Green House Gas and Carbon Regulations

There are more, but suffice it to say that these programs have been in the works for years, it may take years for them to come to fruition and as they do, there is serious potential for hundreds of millions of dollars in increased capital requirements and increased annual operating expenses. The impact of these programs have not been included in the current plan, they may force the early retirement of existing generation assets and will require future additional bond funding as well as significant increase in rates to support increased annual operating costs.

The ESC Rider will provide a mechanism for the BPU to respond promptly to construct and install major environmental capital projects which are mandated by the government and to be able to promptly recover the costs of projects, on the basis of the actual costs incurred by the BPU to construct and install such projects.

Q. Is there anything else to which you wish to testify in this matter?

A. The financial health of the utility was already declining prior to the national economic crisis. The BPU was working with revenue shortages through spending down reserves, maximizing debt, drawing down surplus coal inventories to reduce new coal deliveries, reducing staffing further, freezing wages and taking advantage of well maintained assets that allowed for deferrals of work and related expenses with minimal operational risks. Although economic recovery may generally benefit the utility relative to the recent 'bad times' even a full recovery to prior conditions will not accomplish the required minimal financial metrics without implementation of the full plan. The overall plan is a moderate one that still bears a risk of providing inadequate coverage of the utility needs depending on many unpredictable future outcomes, and any arbitrary reductions to the plan, stand to create greater risk than benefit.