

Board of Public Utilities
Prepared Testimony of
Lori Austin
September, 2010

Q: Please state your name and your business address.

A: My name is Lori Austin, 540 Minnesota Avenue, Kansas City, KS 66101.

Q: What is your position at the BPU?

A: I am the Manager of Accounting and Finance/Chief Financial Officer.

Q: Have you previously provided testimony in this matter?

A: Yes, I provided testimony in the initial public hearing for the Kansas City Board of Public Utilities (BPU) on May 3 and 4, 2010 and also filed written testimony.

Q: What is the purpose of your testimony?

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: Have you had the opportunity to review the testimony and report of Michael Gorman and Robert Stephens filed on behalf of the Industrial Group on August 16, 2010?

A: Yes, I have.

Q: Do you have any concerns regarding Mr. Gorman's statements presented in his testimony?

A: Yes I do. In the testimony for Michael Gorman, in the summarization of findings and recommendations, Mr. Gorman states his interpretation of the history of rate processes and approvals and states that in the past there have been many rate hearings in which the Board has rejected staff's plan as being too expensive and directed staff to evaluate other options that will lower cost. Mr. Gorman has incorrectly stated this process. In all previous rate cases BPU's staff along with interveners have made joint recommendations and modified the initial recommendations before a final plan was presented to the Board. The Board has approved the rate plan that staff has recommended.

Q: Have these reductions in the prior rate requests had an impact on BPU's current financial condition?

A: Yes, in the prior rate cases when staff proposed a reduction in the rate adjustment there were adequate cash reserves to use so that the utility still met both the operating and capital plans. In the last four rate cases, staff previously set rates based on a single upcoming budget year with minimum budget expectations that ultimately did not raise enough revenue to meet the operating and capital needs of the utility. Over the last four plus years, the BPU has used reserves to fund annual operating and maintenance expenditures and a very minimal capital plan. The BPU currently does not have adequate reserves to meet the required cash reserve financial policies. (Exhibit LA-1) The BPU has deferred many much needed capital projects that are required to meet the high quality and reliable utility service our customers expect.

Q: Are the credit metrics of the utility weak due to only the economic condition of its service territory?

A: No, there are multiple reasons for the decline, the economic condition is just one reason. The decline of electric and water sales also has been caused from unusually cool and wet weather in both 2008 and 2009 which resulted in record low temperatures and above average rainfall in the Spring and Summer months of each year, which are the main revenue months for the utility. In addition, the increased costs of goods, such as wire, cable, and transformers has attributed to the depletion of cash. As stated above with the reduction of prior rate requests, the revenue generated has not been enough to meet our capital and operating expenses thus causing BPU to use cash reserves. The use of cash reserves has caused the BPU to fall below the financial targets for Days Cash on Hand of 60 days and the reduction in revenue has dropped our debt coverage ratio below 1 (one) times coverage excluding PILOT, substantially below the target of 1.6 times.

Q: Does the BPU's rate plan fully restore its financial health as stated by Mr. Gorman?

A: No, the plan is designed to reach minimum levels of target metrics and does not allow for any financial contingencies such as ice and wind storms, higher pension costs to fund the financial obligation of the pension fund, unscheduled forced power plant outages requiring the purchasing of power on the market and increased health care costs. For example if health care costs rise with current federal legislation, the BPU could see an estimated 5% addition to the labor burden to cover current and retired employees. The BPU must be able to cash finance for contingencies. There are risks

with every plan and with any of the above mentioned risks it provides for a higher chance the utility will not meet or exceed the financial goals.

Q: Does Table 2 in Mr. Gorman's testimony accurately reflect BPU's revenue increase amounts to be achieved in each rate year?

A: No, the electric revenue increase for 2010 identifies that BPU would receive \$7.6 million. BPU's rate increase for 2010 was put in effect July 1, 2010. This allowed for 6 months of revenue (\$3.8 million) in 2010, not a full year. So Mr. Gorman's table overstates the proposed revenue that would be generated in 2010 by \$3.8 million.

Q: Do you have any concerns with the adjustments Mr. Gorman made to the revenue requirements?

A: Yes, I do. Over the last 4 years, the BPU has been operating the utility at historically unprecedented low spending levels. The management staffs are concerned that this level of service cannot be sustained as it will jeopardize reliability, service and safety of employees. Mr. Gorman has reduced the non-environmental CIP to arbitrary levels and provides no basis for the reductions other than to reduce the rate increase amount. Historical CIP costs over the last 4 years are not reflective of the needs of the utility. The utility has sacrificed the CIP program to an uncomfortable level in order to conserve cash and maintain some level of reserves for the utility.

Q: Do you agree with Mr. Gorman's analysis with regard to the financial integrity and bond/credit rating of the BPU?

A: No, I do not. Mr. Gorman has misstated the BPU's representation to the credit analysts. He stated BPU staff identified to the rating agencies that a new coal-fired unit and other large investments in generating resources was the reason to increase the CIP program. He has also stated that his updated analyses show "a new generating unit is not needed, at least over the next four to five years. Therefore the credit concerns and negative rating outlooks related to the substantial increases in CIP to add new generating capacity are no longer a valid concern for BPU bond ratings."

Of the three credit rating reports provided to Mr. Gorman, there is no mention of BPU pursuing the construction of a new coal-fired unit and it is not part of the CIP program. In fact, the rating agency reports state, "BPU has looked at building a 235 MW coal-fired plant and those plans were put on hold due to political uncertainties for permitting, recent reduction in demand and cost escalations. The BPU faces challenges related to securing its future base load requirements and expects to construct a new 25-75 MW

simple cycle gas fired generation unit to be in service in 2014." The credit concerns related to the CIP identified in the rating reports are for potential environmental compliance costs.

Q: Do you agree with Mr. Gorman's assessment that BPU's proposed CIP is unreasonable?

A: No, I do not. Mr. Gorman identifies and has only focused on two projects, the CT5 and Advanced Metering Infrastructure (AMR-AMI), out of many projects in the BPU's CIP plan. The proposed reductions in the funding of the CIP plan are arbitrary and provide no basis for the reduction. The reductions only represent a way to reduce the rate increase by deferring capital dollars.

With regard to CT5, Mr. Gorman states it should be removed because BPU's studies show that this generating resource is not needed to meet native load requirements until 2014. If the plan was to have the generating resource in place by 2014, the construction would need to begin by 2012 so the costs should be included in the CIP plan. As documented in Darrell Dorsey's testimony and also communicated to the rating agencies, the BPU must plan for the addition of new generation in order to meet future loads and to replace older generation equipment. The original planning has led to the addition of a Combustion Turbine at the Nearman station which would have been operational in 2011. As evidenced in the past 2 years the need to begin the construction of the Combustion Turbine has been delayed in part to the economic slowdown. The current recommendation is to push it out another year to be operational in 2015, but it still would remain part of the 5 year CIP plan. The need for additional generation is a continuous process along with evaluating other alternatives. As the economy and growth projections recover, the need for additional generation will accelerate and the BPU must be able to plan and meet the needs of the community.

The other project identified is AMR-AMI. Mr. Gorman calls this "a highly discretionary investment" and states this program should be deferred due to the BPU being unable to receive federal funding. He also states that other utilities in the region are deferring these investments due to lack of federal funding. In reality, there are several utilities within our region (Kansas City Power & Light, Westar, WaterOne, City of Olathe Water and Kansas City Missouri Water Works) that are moving forward with an AMR-AMI system. As identified in William A. Johnson's testimony, BPU's analysis has determined it to be economically beneficial and the project will provide our customers and BPU with operational and energy usage savings.

Q: What was the reason staff recommended a multi-year plan versus a one year plan.

A: In order to maintain the BPU's credit rating and be removed from negative watch the BPU needed to develop a plan that would build back the credit metrics for debt service coverage and liquidity. BPU staff could have looked at restoring the minimum credit metrics back in one year in which the required increase would have been a double-digit increase. In order to minimize the burden to BPU's customers, the decision was made to implement a multi-year increase that would demonstrate restoring the minimum credit metrics gradually over a four-year period. This would allow for smaller increases for each year and also allow BPU to fund capital projects that require several years to construct.

As part of the annual budget process, the BPU prepares a 5 year Capital Plan which uses the guidance of the 20 year Electric and Water master plan. The CIP plan included in the Cost of Service study is inclusive of many projects that have been deferred over the last few years due to lack of funding sources. The 4 year revenue requirement plan in the Cost of Service study is what is needed to maintain service, reliability and safety expected by our customers as well as meet the financial metrics of the utility to minimize costs with regard to debt financings.

Q. Why was a 4 year multi-year approach used to meet overall goals and financial targets?

A. The items below summarize the reasons for the multi-year approach as well as address the BPU's credit concerns and goals of the Utility.

- In order to meet the concerns of the rating agencies and to work toward removal of the negative outlook on the Utility's debt, approval of the multiple year base rate adjustments is needed to provide firm financial guidance to the rating agencies and to investors in any debt the Utility will issue in the next four years.
- The Utility should be allowed to meet its Board directed debt service coverage and operating reserve targets over the next four years. Approval of the proposed base rate increases for electric and water utilities will achieve this goal. In addition, approval of the proposed changes to the electric ERC and the proposed ESC will provide further support in achieving the Board directed financial goals and address future funding concerns of the rating agencies.
- Approval of the multiple year base rate adjustments will demonstrate to the rating agencies the commitment of the BPU to meet its financial

obligations and goals. In addition, it will allow BPU to plan its capital and operating budgets over a multiple year period to maintain the systems and provide for timely renewals and replacements to its infrastructure. Currently budgets cannot be reliably set for more than a year at a time under existing rates and revenues.

- Approval of multiple year base rate adjustments will also give clarity to customers in planning and budgeting their electric and water utility costs. This clarity is particularly needed for our large users which, like BPU, plan and operate based on approval of their annual operating and capital budgets. The series of base rate increases is needed to reduce the bill impact on our residential and smaller general service customers from large one time rate adjustments.

Q: Mr. Gorman discusses the PILOT level in his testimony. Does the BPU have control of the Payment-in-Lieu of Tax (PILOT) percentage?

A: No, the PILOT is a percentage of revenue that is determined by the Unified Government of Wyandotte County/Kansas City Kansas each year. The revenue generated from the PILOT is passed on to the Unified Government. The BPU does not have any control as to the percentage level of the PILOT. The PILOT payment made to the Unified Government of Wyandotte County/Kansas City, KS, has increased to 12.8% from 9.9% of revenue and has provided some burden to BPU ratepayers. The PILOT contribution is expected to be reduced to 11.9% for 2011 and 9.9% in 2012.

Q. In your direct testimony, you testified as to the BPU's credit ratings, the fact that Fitch and Moody's had changed the utility from a stable outlook to a negative watch, and the key credit concerns and challenges that the rating agencies expressed in their recent rating reports. Those concerns included the debt service coverage ratios and dwindling reserves and days cash on hand. Since your direct testimony was filed, the BPU's 2009 Comprehensive Annual Financial Report (CAFR) has been released, and Quarterly Unaudited Financial Statement Reports for the Periods ending March 31, 2010 and June 30, 2010 have been presented to the Board. Please describe the debt service coverage ratios and reserve and days cash on hand data presented in these documents.

A. The 2009 financial results indicate that the debt service coverage was .76 times without PILOT and 36 days cash on hand for the combined utilities. As of June 30, 2010 the utility's debt service coverage reported .85 times without PILOT and day cash on hand was 35 days. In other words, for the debt service coverage, the BPU has less than one dollar to pay every dollar of debt service. The utility's liquidity has weakened over the

2003-2009 time period as 2009 days cash on hand declined to 36 days from 113 days in 2003. This is below the utility's stated policy reserve target of 60 days cash on hand. Since 2007, BPU has continually been forced to delay and cancel capital projects as an effort to conserve cash and meet the utility's day to day obligations.

As I previously testified, in the credit report in which Fitch placed the BPU on negative credit watch, Fitch also noted "If planned rate increases are delayed due to concerns about customer costs and result in lower financial metrics, a downgrade to 'A' may be warranted." If the BPU's credit rating were to be lowered to an A and A3 level the impact would be that for every \$10 million of bonds issued and repaid over a 25-year term, the result would be increased debt service cost of approximately \$820,000 over the life of the bond.

Q: In your direct testimony, you testified as to the revenue requirements of the BPU. Have there been any changes in the assumptions which should be used to determine the BPU's revenue requirements since your direct testimony was filed on May 4, 2010.

A: Yes. As of September 7, 2010, the following represent changes in the assumptions made to the Electric and Water revenue requirements:

1) The non-labor escalation was reduced from 4% to 3%. The BPU felt a drop was appropriate to recognize inflation levels after 2008 which was the percentage used in the initial revenue requirement. In the original revenue requirement study the operating and maintenance expenses were derived from a percentage escalation as well as adjustments in electric production with regard to specific scheduled plant outages and maintenance events. The proposed reduction of 3% is calculated across all operating and maintenance expenses including scheduled plant outages.

2) The BPU proposal is to slow the rebuild of attrition and reduce the number of positions filled to 635 from the proposed 681. As of June 30, 2010, the BPU had 595 employees with several more retirements anticipated in the 3rd and 4th quarter of 2010. The BPU realizes the build up to 681 is not realistic in the study period based on the current level of employees. Management staff considers the pace at which employees are retiring or leaving the utility and has determined that there is a potential for a reduction in service levels to our customers and workplace safety concerns for employees.

3) The revenue requirements have also been adjusted to reflect the delay of the issuance of revenue bonds. The original proposal identified a bond issuance in mid-year of 2010. With the delay in the decision for the rate proposal the bond issuance has been moved to an issuance date of January 2011. This will defer the bond payment that was identified in 2010.

4) For the electric revenue requirements, BPU has compromised with the Customer Group to add back into base rates \$2.6 million of known capacity charges that were originally removed from base rates and were anticipated to be collected in the Energy Rate Component (ERC) rider. The \$2.6 million is the current known level of capacity charges that BPU is required to collect for. There is the potential for additional capacity charges in the future with regard to SPP markets. These are unknown at this time, but if they arise they are anticipated to be collected through the ERC.

5) Delay the Electric's Combustion Turbine No. 5 (CT5) project one year. The original plan was to begin work on the CT5 project in 2011. After the completion of Electric Production's planning analysis, the recommendation is to begin the engineering on the project in 2012. The CT5 project still would remain in the plan and be partially funded in the proposed rate plan.

6) In addition, the BPU staff has considered the timing of construction and CIP expenditures and whether any adjustments can be made to the revenue requirements relating to the CIP budget for the electric utility. Until such time as the BPU staff and Black & Veatch analysis is completed, as discussed below in my testimony, it would be premature to provide specific information as to revised revenue requirements.

Q: You previously testified as to the recommendations for rate design and rate application changes, and provided highlights of such recommendations. Have there been any changes to the recommendations for the electric rate design and rate application manual and any additional recommendations?

A: Yes. The revised and additional rate design recommendations include:

- o Adjusting the ERC Purchase Power definition to remove currently known long-term purchase power capacity charges assessed under long-term contracts.

- Restore the peak period to its current timeframe, 10 a.m. to 8 p.m. until further evaluation as discussed in my testimony and that of Black & Veatch.

Q: Has BPU compromised with the Customer Group to adjust the ERC Rider definition to remove the currently known long-term purchase power capacity charges assessed under long term contracts?

A: Yes, the current level of purchase power capacity charges is \$2.6 million that will be removed from the ERC rider and applied back into base rates. The impact is that customers will see an overall rate increase that is lower than originally proposed. Also, BPU has had to adjust its revenue requirements to compensate for the additional \$2.6 million that must be recovered from base rates.

Q: Did BPU do additional analysis for the Billing Demand periods and the winter ratchet percentage?

A: Yes.

Q: What was the proposed Billing Demand measurement time period in the original rate filing?

A: BPU originally proposed to expand the summer month's measurement period so that it would run from 10:00am to 11:00pm, that is, add 3 additional hours.

Q: What is the current Billing Demand measurement time?

A: The current Billing Demand measurement time is 10:00am to 8:00pm.

Q: Why did BPU propose changing the Billing Demand measurement time?

A: Based on Black & Veatch's statistical analysis of the costs during the summer hours the proposed time change would match BPU's actual high costs periods during the summer.

Q: What Billing Demand measurement time period are you recommending?

A: BPU has recommended not expanding the summer month's measurement period and leaving the measurement time period from 10:00am to 8:00pm until additional study and further evaluation.

Q: Are there other issues related to the Billing demand as it related to the LPS rate?

A: Yes, the utility is proposing the continued use of a 70% ratchet for winter demand billing.

- Q Did the utility look into adjusting or changing the ratchet in this rate proceeding?
- A: Yes, Black and Veatch reviewed the hourly Demand for the Top 20 BPU customers according to kWh consumption. Research indicated that adjusting the 70% ratchet would have very little impact to these customers since these customers have consistent month to month Demand requirements. Essentially, their winter Demand requirements are very similar to their summer Demand requirements.
- Q: In the testimony of Robert R. Stephens, he stated he has concerns with the change of the summer month definition and the expansion of the winter period. He states "the expansion of the winter period increases the ratchet applicability and, thus, makes the factor more important." Did Black and Veatch provide analysis with regard to the impact of the change in the summer and winter definitions along with the ratchet factor?
- A: Yes, Black and Veatch performed a detailed statistical analysis of the Top 20 BPU customers in which there were detailed billing determinants and determined the winter demand requirements are very similar to the summer demand requirements. The analysis shows the optimum summer periods are from May through August.
- Q: Has BPU staff directed Black and Veatch to revise the revenue requirements and cost of service?
- A: Yes, BPU staff has directed Black and Veatch to revise the revenue requirements based on the 6 assumptions identified above and to adjust the cost of service and rate design to encompass the allocation of meter costs for the AMR/AMI project and also to update the rate class percentages after the implementation of the July 1, 2010 across the board 7% electric and 8% water increases. BPU staff has also instructed Black and Veatch to level out the multi year increase for the Large Power Service rate class in order to minimize the larger increase originally proposed in 2010 and 2011.
- Q. Has this process been completed yet?
- A. No, not yet. The BPU Staff has directed Black & Veatch to revise schedules and update the Cost of Service Study models for each of the electric and water utilities. Until Black & Veatch has completed its revisions and provided the BPU with an analysis of revised revenue requirements, cost of service and rates for its electric utility and for its water utility and the BPU Staff has had the opportunity to review and approve the revisions; it would be premature to make final rate recommendations to the Board. Furthermore, final rate schedules cannot be prepared until the BPU Staff has completed its review of the revisions. Accordingly, the BPU Staff has requested a three day extension of time, or until September 10, 2010, to file rate recommendation testimony.

Q: Have any changes been made in the recommended Electric Environmental Surcharge Rider (ESC)?

A: The BPU continues to recommend a new rider to provide for the recovery of the Utility's capital investment in projects not recovered in base rates that are required to meet Federal, state, reliability council, or local environmental regulations. The dollar amount and timing of these capital intensive projects cannot be accurately forecast prior to the environmental regulations being mandated.

As stated in my previous testimony, the ESC will be applied to all electricity billed to retail customers excluding sales to contract customers where recovery of a surcharge is not permitted under the terms of the contract. The surcharge is intended to recover only the annual cash expenditures of the Utility, whether in direct expenditures or in the form of debt service payments for the environmental projects.

The BPU has made a few modifications to the proposed ESC, following discussions with the Industrial Group; these modifications are consistent with how the BPU staff had expected the proposed ESC rider to be applied. Application of the surcharge will be limited to major environmental projects, defined as projects in excess of \$10 million, which are primarily bond financed. If a portion of a bond-financed mandated project is cash funded, such cash financed costs in an amount not to exceed 25% of the total project cost will also be recovered through the ESC and may be amortized over more than one year to limit the impact on rates. The allocation of the ESC between customer classes will be made on a production capacity allocation factor basis, which in effect results in a demand basis allocation for customer classes with a demand as well as energy component in the rate schedule. As BPU staff has testified, the initial application of the ESC rider will provide \$40 million in funding for the Low Nox Burners and Over Fire Air projects at the Nearman and Quindaro 2 power plants. Notice of any proposed future application of the ESC Rider will be published at least 120 days before the date that the recommendation is presented to the Board, and any future application of the ESC Rider will require Board approval.

Other than the percentage of the amount of cash-financing of a material environmental project which can be recovered under the ESC rider (BPU staff recommends a 25% limit, the large power group had suggested a 5% limit), the revised ESC is in accord with the approach which Mr. Gorman suggested in his filed testimony, and in fact had been discussed with Mr. Gorman prior to the

filing of his testimony. Attached is the revised version of the ESC Rider (Exhibit LA-2).

Q: In summary, what are the revised recommendations for the revenue increase?

A: The cost of service study for the electric and water utility were performed to provide a recommendation that would fund the electric and water utility's revenue requirements. After further review and discussion with the interveners the following are the changes to revenue requirements (other than possible changes to the CIP, if any, which will be described in my testimony on final rate recommendations):

- Reduce the non-labor escalation from 4% to 3%.
- Slow the rebuild of attrition and reduce the number of positions filled to 635 from the proposed 681.
- Delay the issuance of the proposed July 2010 bonds to January 2011.
- Agreed with the Customer Group to add back into base rates \$2.6 million of known capacity charges that were originally removed from base rates and were anticipated to be collected in the Energy Rate Component (ERC) rider.
- Delay the Electric's Combustion Turbine No. 5 (CT5) project for one year from the original start date of 2011.

The following are changes recommended to rate design:

- Adjust the ERC Purchase Power definition to remove currently known purchase power capacity charges assessed under long-term contracts. Currently \$2.6 million. Any additional capacity charges that are unknown at this time will be included in the ERC calculation until the next rate hearing when a new level of long-term purchase power capacity is calculated.
- Restore the peak period to its current timeframe, 10 a.m. to 8 p.m. until further analysis and evaluation.
- Levelize the multi year increase for the Large Power Service rate class over the 2011 to 2013 time period.
- Revise the wording of the ESC to include:
 - Allocation between customer classes based on demand and energy component
 - Dollar limits (\$10 million) per project.

- Percentage (25%) of cash financed environmental project to be amortized over a lesser period of time than the bond financing.
- Publication notice of 120 days and board approval for future applications.

Q. Is it possible for levels of rate increases to be lowered in future years below the level(s) approved by the BPU Board in this rate proceeding?

A. The BPU's goal is to have the lowest increase as possible while maintaining reliable service, taking into account the financial metrics that must be satisfied. As part of the ongoing process of reviewing operating and capital expenditures, the BPU staff will conduct an additional review each year and analyze the financial metrics of the utility to ensure a plan that produces the lowest possible rate proposal. If the BPU meets or exceeds the financial metrics set out in the plan, BPU staff will recommend a downward adjustment to the future years proposed rate increase.

Q. Is there any issue in this rate proceedings that you recommend holding open for further study?

A. Yes, BPU staff recommends holding open the issue of making a change to the on-peak period for the Billing Demand measurement time. The current Billing Demand measurement time is 10:00am to 8:00pm. The BPU staff had originally proposed changing the end time from 8pm to 11:00pm. After receiving and reviewing testimony, the BPU staff has determined that additional study of this issue should be undertaken, through such tools as the pilot time-of-use rate program that will be implemented, and data received from the AMR-AMI project. The additional analysis of the longer periods will include possible customer impacts and the associated critical capacity cost hours. BPU staff expects to bring this matter back to the Board for a final determination after the additional study has been completed.

Q: Does this conclude your written testimony?

A: No, I will be filing additional testimony, as will Black & Veatch, on or before September 10, 2010, to set out the final rate recommendations once the analysis described in my testimony has been completed.