

Exhibit No.:
Issues: *Infrastructure Remediation Costs;*
FAS 123 Accumulated
Deferred Income Taxes
Witness: *Paul R. Harrison*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
File No.: *ER-2011-0004*
Date Testimony Prepared: *April 28, 2011*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

PAUL R. HARRISON

THE EMPIRE DISTRICT ELECTRIC COMPANY

FILE NO. ER-2011-0004

Jefferson City, Missouri
April 2011

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1 asset associated with certain stock compensation costs should be included in rate base for
2 this case.

3 First, Empire alleges that Staff's remediation expense adjustment does not account for
4 a full year of costs associated with the repairs brought about by the Commission's current
5 inspection rule requirements. Staff disagrees with Empire's contention on this matter. Staff
6 included an annualized level of remediation costs in its cost of service up through November
7 30, 2010, the end of the test year update period for this rate case.

8 The second issue concerns Staff's position to exclude the deferred tax asset associated
9 with Empire's Financial Accounting Standard No. 123 (FAS 123) costs from rate base in this
10 case. The Staff disallowed from its case all of Empire's incentive compensation expense
11 associated with restricted stock bonuses, stock bonuses for directors' and officers', and stock
12 options; therefore, it is consistent and appropriate to also exclude an associated amount from
13 Empire's accumulated deferred income taxes rate base line item.

14 In this surrebuttal testimony, I will address Staff's position concerning both of these
15 issues.

16 **INFRASTRUCTURE REMEDIATION COSTS**

17 Q. Please describe how Staff adjusted Empire's "remediation" costs in Empire's
18 last rate case, File No. ER-2010-0130.

19 A. In its last rate case, File No. ER-2010-0130, Empire proposed to recover
20 certain "remediation" (or repair) costs through the vegetation/infrastructure tracker authorized
21 by the Commission in Case No. ER-2008-0093. These remediation costs were allegedly
22 incurred as a result of the Company performing preventive maintenance on its transmission
23 and distribution system during the inspection cycles mandated under the infrastructure

1 inspection rule first enacted in 2008. In the last case, Staff opposed inclusion of these costs in
2 the tracker because it did not believe this type of expense was truly solely attributable to the
3 new infrastructure inspections rule, but instead represented a type of repair expense that
4 utilities had always incurred. In that case, as an alternative to tracker inclusion, the Company
5 proposed an adjustment to include additional remediation costs in its case on the basis that the
6 mandated inspection requirements would result in an increase in its ongoing level of repair
7 costs to its equipment. Staff reviewed the costs in that case, and concluded that the
8 Company's belief appeared to be valid. Accordingly, Staff annualized these newly incurred
9 non-labor remediation costs and included an adjustment in the last case to increase this
10 expense by the amount of \$172,827.

11 Q. Please describe how Staff adjusted Empire's remediation costs in Empire's
12 current rate case.

13 A. In the current rate case, Staff analyzed Empire's remediation costs up through
14 November 30, 2010, the end of the test year update period for this case, and proposed an
15 adjustment to increase expense from the level recommended in Empire's last rate case in the
16 amount of \$154,824. The total annualized level of non-labor remediation costs that is included
17 in Staff's cost of service is \$327,651 (\$172,827 from the last case plus \$154,824 for the
18 current case).

19 Q. How did Empire propose to annualize its remediation costs in the current
20 rate case?

21 A. Empire multiplied the amount of its costs incurred from August 2010 to
22 January 2011 by two to arrive at an annualized amount for remediation costs of \$800,036.

1 Q. Do you agree with Empire's methodology in calculating its annualized level of
2 remediation costs?

3 A. No. Empire's methodology violates the test year concept by carrying the
4 remediation costs out through January 31, 2001 which is two months outside of the end of the
5 update period. In addition, this item was not identified by Empire as an item it was requesting
6 to be trued-up in its filing entitled "*Empire's Reply Regarding True-up Request*," dated
7 April 8, 2011. Moreover, a majority of Empire's rate recovery request for this item is
8 associated with its December 2010 and January 2011 level of remediation expenses. Carrying
9 this cost out through January 2011 and then multiplying these two months by two results in
10 \$444,310 of Empire's \$800,036 recommended annualized level of its remediation costs.
11 Additionally, Staff believes that Empire's recommended annualized level of remediation costs
12 includes the \$172,827 that was included in Empire's last rate case, and its rate request for that
13 item should be reduced by that amount.

14 Q. What does the Commission need to include in its Report and Order to
15 effectuate Staff's recommendation on the infrastructure remediation expense issue?

16 A. Staff recommends that the Commission reflect in rates Staff's adjusted level of
17 infrastructure remediation costs of \$327,651 based on Empire's incurred expenses for the
18 12-months ending November 30, 2010.

19 **FAS 123 DEFERRED TAX ASSET**

20 Q. Please describe FAS No. 123, *Accounting for Stock Issued to Employees*.

21 A. The following statement is quoted from FAS 123:

22 This Statement requires a public entity to measure the cost of
23 employee services received in exchange for an award of equity
24 instruments based on the grant-date fair value of the award

1 (with limited exceptions). That cost will be recognized over the
2 period during which an employee is required to provide service
3 in exchange for the award—the requisite service period (usually
4 the vesting period). No compensation cost is recognized for
5 equity instruments for which employees do not render the
6 requisite service. Employee share purchase plans will not result
7 in recognition of compensation cost if certain conditions are
8 met; those conditions are much the same as the related
9 conditions in Statement 123.

10 Q. Did Staff propose to disallow all of Empire’s incentive compensation expense
11 associated with stock issued to its employees?

12 A. Yes, as discussed in the Staff’s Cost of Service Report at pages 70 and 71.

13 Q. Why is Staff also proposing to disallow from rate base the deferred tax asset
14 associated with FAS 123 stock compensation costs?

15 A. This position is consistent with Staff’s position in this case of disallowing all
16 expenses associated with non-cash stock compensation. If an item is proposed for elimination
17 from expense, it follows that the income tax expense and rate base consequences of that cost
18 should also be removed from cost of service.

19 Q. What is Empire’s position concerning the deferred taxes associated with the
20 FAS 123 deferred stock compensation?

21 A. Empire witness Mr. Williams states on page 3, lines 11 through 13 of his
22 rebuttal testimony that “the FAS 123 deferred tax asset reflects the book/tax timing difference
23 of deferred compensation and should therefore be a part of deferred taxes included in rate
24 base as it has in the past.”

25 Q. Do you agree with Mr. Williams’ statement that this deferred tax has been
26 included in rate base as it has in the past?

27 A. No, not generally. In Empire’s last rate case, the deferred tax asset was
28 included in rate base because of an oversight on Staff’s part. However, it had not been

1 included in rate base in any of Empire's previous recent rate cases, and I am not aware of any
2 other utility in the state of Missouri where Staff has proposed to include this item in rate base.

3 Q. What is the revenue requirement impact of this issue in this case?

4 A. Staff believes this issue is valued at approximately \$83,976,
5 (Missouri Jurisdictional basis).

6 Q. What does the Commission need to include in its Report and Order to
7 effectuate Staff's recommendation on the FAS 123 deferred tax asset issue?

8 A. Staff recommends that the Commission reflect Staff's proposed disallowance
9 of the FAS 123 deferred tax asset associated with Empire's deferred stock compensation.

10 Q. Does this conclude your surrebuttal testimony?

11 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

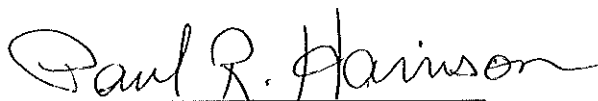
OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric)
Company of Joplin, Missouri for Authority to) File No. ER-2011-0004
File Tariffs Increasing Rates for Electric)
Service Provided to Customers in the Missouri)
Service Area of the Company)

AFFIDAVIT OF PAUL R. HARRISON

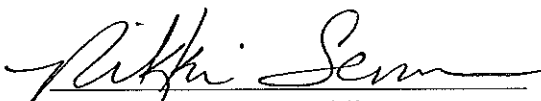
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Paul R. Harrison, 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 6 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.


Paul R. Harrison

Subscribed and sworn to before me this 28th day of April, 2011.

NIKKI SENN
Notary Public - Notary Seal
State of Missouri
Commissioned for Osage County
My Commission Expires: October 01, 2011
Commission Number: 07287016


Notary Public