

Exhibit No.:
Issues: *Bad Debt Factor-Up*
Forfeited Discounts
Witness: *Amanda C McMellen*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
File No.: *ER-2011-0004*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

AMANDA C. MCMELLEN

THE EMPIRE DISTRICT ELECTRIC COMPANY

FILE NO. ER-2011-0004

Jefferson City, Missouri
April 2011

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TABLE OF CONTENTS
REBUTTAL TESTIMONY
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EXECUTIVE SUMMARY..... 1
BAD DEBT EXPENSE..... 2
FORFEITED DISCOUNTS..... 6

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **AMANDA C. MCMELLEN**

4 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

5 **FILE NO. ER-2011-0004**

6 Q. Please state your name and business address.

7 A. Amanda C McMellen, Governor Office Building, P.O. Box 360,
8 Jefferson City, Missouri 65102.

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

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

12 Q. Are you the same Amanda C McMellen who has previously contributed to the
13 Staff's Cost of Service Report in File No. ER-2011-0004 dated February 23, 2011 for
14 The Empire District Electric Company (Empire or Company)?

15 A. Yes, I am.

16 Q. What is the purpose of your rebuttal testimony?

17 A. The purpose of my testimony is to respond to the direct testimony
18 of Empire witness Jayna R. Long and The Office of the Public Counsel (OPC) witness Shawn
19 Lafferty with regard to bad debt expense and forfeited discounts (late payment fees).

20 **EXECUTIVE SUMMARY**

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

22 A. In this testimony, I respond to Empire's request to recover a level of bad debt
23 expense in excess of the experienced level calculated in this case. I explain Staff's

1 recommendation that Empire not be allowed to recover bad debt expense at a level which
2 includes the full impact of the revenue requirement increase in this rate case. Empire's
3 request to include an adjustment for bad debt expense associated with a revenue requirement
4 increase (or decrease) is commonly referred to as bad debt "factor up" or "gross up."

5 The Company's rationale for making this request is based on the assumption that any
6 increase in revenue requirement granted by the Commission will cause bad debt expense to
7 also increase in direct proportion. However, the Company has not provided evidence to
8 support its theory that a direct correlation exists between the level of rates and the level of
9 bad debts.

10 While Staff does not recommend adoption of Empire's bad debt "factor up" request, it
11 is Staff's position that if the Commission grants Empire's request to "factor up" bad debt
12 expense proportionately with an increase in revenue requirement, then it would also be
13 appropriate to "factor up" forfeited discounts for the same reason. If the Commission
14 concludes that it is reasonable and appropriate to "factor up" bad debt expense for purposes of
15 setting rates, on the premise that Empire will experience a higher level of bad debts as a result
16 of a rate increase, then it is reasonable and appropriate to conclude that Empire will also
17 experience a higher level of late payment revenue resulting from those higher rates.

18 **BAD DEBT EXPENSE**

19 Q. Do Staff and Empire differ regarding the level of bad debt expense to reflect in
20 Empire's rates?

21 A. Yes. There is a difference in methodology between Staff and Empire in
22 calculating the ongoing level of total bad debt expense. Empire adjusted bad debt expense to
23 include an additional portion related in direct proportion to the amount of its requested

1 revenue increase in this case, which is referred to as a bad debt “factor up” or “gross up.”

2 Staff’s recommendation is based only on experienced (actual) levels of bad debt.

3 Q. Does Staff believe that it is reasonable to assume that there will be bad debts
4 associated with the revenue requirement increase granted in this rate case?

5 A. In principle, the Staff believes that it may be reasonable to assume that bad
6 debts could increase to some extent as a result of an increase in Empire’s revenue
7 requirement. However, the Staff does not agree with the position that any increase in a
8 company’s revenue requirement should necessarily cause bad debt expense to also directly
9 increase proportionally, on a dollar-for-dollar basis. Empire has not produced any evidence in
10 support of this alleged direct correlation, in its testimony or workpapers. Review of the
11 records shows that there have been times that, even as revenues go up, bad debts have actually
12 declined. In other instances, the Staff has observed bad debts going up while
13 revenues decreased.

14 Q. What is a bad debt “factor up” or “gross up” and what is the rationale behind
15 its use?

16 A. The usual justification for use of the bad debt “factor up” is the belief that it is
17 necessary to properly match the level of bad debt expense established in a rate case with the
18 amount of revenue requirement increase that will be determined by the Commission in that
19 case. This additional amount of bad debt expense, if the “factor up” is granted, will be
20 calculated and added to the annualized and normalized level of bad debt expense found
21 reasonable for inclusion in the utility’s revenue requirement. The amount of any ordered bad
22 debt “factor up” will be derived by applying the bad debt expense ratio to the expected
23 revenue requirement increase to be granted by the Commission.

1 Empire's use of a bad debt "factor up" is based on the assumption that any amount of
2 increased revenues resulting from this rate case will or should directly cause bad debt expense
3 to increase proportionally as well, all things being equal. In other words, the Company
4 believes it is reasonable to assume that if some ratepayers are not able to pay their current
5 utility bills when they are due, these same customers would not be able to pay their bills when
6 the utility bills go up as a result of a rate increase. However, Staff has found that this theory
7 does not always hold true in reality. In other words, use of bad debt "factor up" assumes it is
8 a certainty that with each rate increase bad debts will go up by the same percentage. This is
9 not a realistic view. In order for the Empire's proposed use of a bad debt "factor-up" to be
10 justified, a substantial amount of analysis would be needed to demonstrate a direct correlation
11 between revenue levels and bad debt levels.

12 Q. Does Empire's requested bad debt "factor up" work in the same way as an
13 income tax "factor up"?

14 A. Yes. The income tax factor assumes that for every dollar of increase in
15 earnings to a utility resulting from a rate case there will be a direct and absolute proportional
16 increase in income taxes. This is a well-known and established relationship, and in this case
17 both Company and the Staff have applied an income tax "factor up" to the additional revenue
18 requirement calculation to determine the proper level of rate increase recommended in this
19 case. If the Commission authorizes a rate increase in this proceeding, then a corresponding
20 income tax amount will have to be added to the additional revenue requirement amount or the
21 Company may not be able to recover the authorized amount of increase in revenue
22 requirement. Unlike the case with income taxes, Staff has observed no evidence that a direct
23 relationship exists between increased rates and increased bad debt expense.

1 Q. How did Staff review Empire’s historical relationship of bad debt expense to
2 sales revenue?

3 A. Staff employed various methods of data analysis in its review. None of the
4 analyzed methods produced any substantive evidence to support the direct relationship that
5 must exist between the two items to justify inclusion of a full bad debt “gross up” in this case.

6 Q. Do Staff and OPC also differ on the level of bad debt expense to include in
7 this case?

8 A. Yes. There is a difference in methodology between Staff and OPC regarding
9 the ongoing level of bad debt expense to include in rates. OPC believes use of a three-year
10 average of actual net write-offs is a more appropriate method of calculating bad debt expense
11 in this case. Staff based its’ recommendation on a five-year average of the effective
12 uncollectible rate to apply to Staff’s level of annualized revenues in this case.

13 Q. What is an effective uncollectible rate?

14 A. An effective uncollectible rate is the ratio of actual net write-offs as compared
15 to total electric retail revenues.

16 Q. Does Staff believe that using an effective uncollectible rate is appropriate?

17 A. Yes. Staff believes that there is a relationship between revenues and actual
18 net-write-offs, though not a direct relationship. Therefore, it is more appropriate to use an
19 effective uncollectible rate to calculate an ongoing level of bad debt expense which is more in
20 line with the weather-normalized jurisdictional revenue levels calculated in this case, as
21 opposed to OPC’s proposed use of actual write-off amounts to determine its bad debts
22 recommendation.

1 **FORFEITED DISCOUNTS**

2 Q. What are “forfeited discounts”?

3 A. Forfeited discounts, also known as “late payment fees,” are fees
4 that Empire charges its customers for failing to pay their bills on time or when they are due.
5 The charges are assessed on the remainder of the unpaid bill.

6 Q. What is the issue(s) between the Staff and the Company regarding forfeited
7 discounts?

8 A. The issue is whether to “factor up” forfeited discounts for the revenue
9 requirement increase in this case.

10 Q. Did the Company propose to “gross up” forfeited discount (late payment fees)
11 consistent with its requested bad debt gross up for revenue requirements increases?

12 A. No.

13 Q. Is it consistent to treat forfeited discounts in the same manner as bad debt
14 expense levels with respect to the “factor up” issue?

15 A. Yes. The Staff’s position is that if the Commission decides to grant Empire’s
16 request to increase bad debt expense proportionate to any increase in revenue requirement,
17 then it is the best regulatory practice to “gross up” forfeited discounts for the same reason.
18 If the Commission concludes that Empire will experience a proportionately higher level of
19 bad debt as a result of a rate increase, then it would follow that Empire will also experience
20 a proportionally higher level of late payment revenue.

21 Q. Does this conclude your rebuttal testimony?

22 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

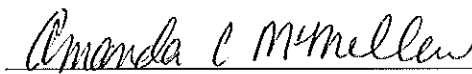
In the Matter of The Empire District Electric)
Company of Joplin, Missouri for Authority)
to File Tariffs Increasing Rates for Electric)
Service Provided to Customers in the)
Missouri Service Area of the Company

File No. ER-2011-0004

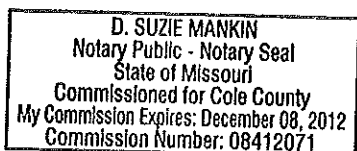
AFFIDAVIT OF AMANDA C. MCMELLEN

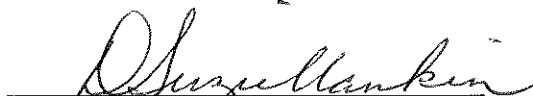
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Amanda C. McMellen, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 6 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.


Amanda C. McMellen

Subscribed and sworn to before me this 14th day of April, 2011.




Notary Public