

Exhibit No.
Issue: Depreciation, Pension Expense
Witness: Gregory A. Knapp
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Empire District
Case No. ER-2004-0570

**Before the Public Service Commission
Of the State of Missouri**

Surrebuttal Testimony

Of

Gregory A. Knapp

November 2004

**SURREBUTTAL TESTIMONY
OF
GREGORY A. KNAPP
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2004-0570**

1 **Q. Please state your name, position and business address.**

2 A. Gregory A. Knapp. I am Vice President – Finance and Chief Financial Officer
3 of The Empire District Electric Company (“Empire” or “Company”). My
4 business address is 602 Joplin Street, Joplin, Missouri.

5 **Q. Are you the same Gregory A. Knapp who caused to be filed rebuttal**
6 **testimony in this proceeding before the Missouri Public Service Commission**
7 **(“Commission”)?**

8 A. Yes.

9 **Q. Please state the purpose of your surrebuttal testimony?**

10 A. The purpose of this testimony is to respond, generally, to the rebuttal
11 testimony submitted by the other parties on the issue involving
12 pension expense and net cost of removal.

13 **Q. Please explain the Company’s position on pension expense.**

14 A. The Company agrees with Dr. Vogl’s FAS 87 methodology. However, if the
15 Commission decides not to adopt this method, at a minimum the following
16 language should be adopted which will support the Company’s efforts to remain
17 financially sound. The following language allows consistency between financial
18 reporting and the pension expense collected in rates.

1 The Parties agree that, effective _____, the rates established
2 in this case for The Empire District Electric Co. pension plan are
3 \$3 million which represents the continued amortization of the
4 Prepaid Pension Asset as ordered in Case No. ER-2002-424.
5

6 The Company shall also be authorized to record as a regulatory
7 asset/liability, as appropriate, the difference between the \$3
8 million used in setting rates and the level of FAS 87 pension
9 expense determined for book purposes.
10

11 In the subsequent rate case, this regulatory asset/liability will be
12 amortized over 5 years into rates and will be funded, following
13 such amortization, to the pension trust by the Company to the
14 extent that it has not already been funded.
15

16 The FAS 87 pension expense used for book purposes will be
17 determined using the following methodology: (a) Market Related
18 Value of assets, with smoothing of gains/losses implemented
19 prospectively over a five-year period, and (b) Amortization of
20 unrecognized gains or losses, only to the extent that they fall
21 outside of the 10% corridor described in FAS 87, over the
22 average future service of active plan participants.
23

24 **Q. Do you agree with Staff Witness Gibbs' rebuttal testimony that**
25 **Empire can simply ignore FAS 87, which governs pension**
26 **accounting, by invoking FAS 71 which speaks to the accounting**
27 **for certain types of regulation?**

28 A. No, I do not. The Company is required to follow accounting
29 principles generally accepted in the United States of America
30 (GAAP) for financial reporting. Financial reports prepared following
31 GAAP include reports read by stockholders, bondholders, and
32 prospective investors in the Company. FAS 87, which is GAAP,
33 specifies the accounting and reporting requirements the Company
34 must follow for its pension costs. FAS 71, which is also GAAP, is

1 unrelated and provides for the establishment of regulatory assets and
2 liabilities if certain conditions are met. FAS 71, paragraph 9, allows
3 the deferral of costs as long as it is probable, as defined in FAS 5, that
4 those costs will be recovered in future rates. The company is not
5 allowed to pick and choose which FAS to follow for pensions. FAS
6 87 must be followed.

7 **Q. What is the Company's position on the issue of Cost of Removal?**

8 A. Empire supports the position set out by Company witness Roff on the treatment
9 of net cost of removal. However, if the Commission does not accept this
10 approach, at a minimum the following language should be adopted.

11 Empire's rates include a provision for jurisdictional net cost of
12 removal of \$1,600,000 annually. Empire shall book for its
13 electric operations, actual levels of annual cost of removal as an
14 expense up to the amount listed above. Company is authorized to
15 record the difference between the rate case provision of
16 \$1,600,000 and the actual levels of annual net cost of removal as
17 a regulatory asset and/or liability. This regulatory asset and/or
18 liability is intended to track the difference between the provision
19 for net cost of removal provision included in rates in this case and
20 the Company's actual levels of annual net cost of removal after
21 the effective date of rates established in this case. This regulatory
22 asset and/or liability will be included in rate base in the
23 Company's next rate case and amortized over a five (5) year
24 period. The Company is authorized to make such additional
25 entries as are appropriate under FAS71 for this item. This
26 methodology will be reviewed in Empire's next rate case in
27 which its retail electric distribution rates are under review to
28 determine whether the methodology will be continued.
29

30 This language is consistent with the language which was adopted in
31 Case No. GR-2004-0209 involving Missouri Gas Energy.

32 **Q. Do you have any final remarks?**

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1 A. Yes. As the Company continues its tradition of reliable service to its customers, it
2 will need to continue to grow its infrastructure and meet upcoming baseload
3 needs. With that in mind, it is imperative that Empire go into this growth in sound
4 financial condition. The decisions of this Commission have a direct impact on the
5 Company's financial health. Including in rates pension expense and full net cost
6 of removal is a move in the right direction to establish and maintain the sound
7 financial health of the Company.

8 **Q. Does this conclude your testimony?**

9 A. Yes.