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Witness: Mark L. Oligschlaeger
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2006-0315

Jefferson City, Missouri
August 2006

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of The Empire District)
Electric Company of Joplin, Missouri for) Case No. ER-2006-0315
authority to file tariffs increasing rates for)
electric service provided to customers in)
the Missouri service area of the Company.)

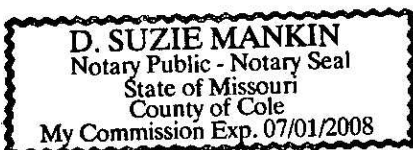
AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Mark Oligschlaeger, 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 12 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.

Mark L. Oligschlaeger
Mark L. Oligschlaeger

Subscribed and sworn to before me this 17th day of August, 2006.



D. Suzie Mankin

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1 should be treated as depreciation expense by Empire, so that the increase in rates/revenues
2 granted by the Commission would not be grossed up for income tax purposes. This is the
3 same approach taken by the Staff in testimony filed in the rate increase case of Kansas City
4 Power & Light Company (KCPL), Case No. ER-2006-0314. KCPL also has an experimental
5 regulatory plan relating in general to the construction of Iatan 2 and the provision for
6 additional amortizations to help maintain an investment grade status for KCPL over the
7 period commencing with the decision to construct the unit to the date the unit goes in service.

8 **REGULATORY PLAN AMORTIZATIONS**

9 Q. Please summarize Mr. Gipson's testimony on the regulatory plan amortization
10 issue.

11 A. Mr. Gipson states at page 1 of his rebuttal testimony, lines 13-15, that the
12 regulatory plan amortization process agreed to in the Stipulation And Agreement in Case No.
13 EO-2005-0263 (Regulatory Plan Stipulation) should have "no implication in this case."
14 Mr. Gipson goes on to explain this position at page 1, line 18 of his rebuttal testimony to
15 page 2, line 20 by asserting that the purpose of the Regulatory Plan Stipulation was to
16 address Iatan 2 generating unit construction costs, that "substantial" construction is not yet
17 underway for the Iatan 2 unit, and that the financial community will not react "favorably" to
18 regulatory plan amortizations intended as a "substitute for prudently incurred expense."

19 Q. Do you agree with Mr. Gipson's statement that the regulatory plan
20 amortizations should have "no implication in this case?"

21 A. No. The Regulatory Plan Stipulation, approved by the Commission on
22 August 2, 2005, contains the following statement at pages 12-13, "The Signatory Parties
23 agree to support an additional amortization amount added to Empire's electric cost of service

1 in any general rate case filed prior to the rate case that includes the Iatan 2 investment when
2 the projected cash flows resulting from Empire's Missouri jurisdictional electric operations,
3 as determined by the Commission, fail to meet or exceed the Missouri electric jurisdictional
4 portion of the financial ratio targets shown in Appendix D..."

5 Q. When did Empire file the instant rate increase application?

6 A. This case was filed on February 1, 2006.

7 Q. Do you agree with Mr. Gipson's characterization that the amortizations
8 authorized in the Regulatory Plan Stipulation are limited to address the direct impact of
9 Empire's Iatan 2 expenditures on its cash flow?

10 A. No. While I agree that the amortization provisions in the Regulatory Plan
11 Stipulation are in effect through the end of the construction period for the Iatan 2 unit, there
12 is nothing in the required amortization calculations that directly limits their scope to the
13 financial impact of Iatan 2 construction expenditures on Empire's cash flow, or that
14 precludes consideration of other potential impacts on the Company's cash flow within the
15 amortization calculations subsequent to Empire's decision to seek to participate and the
16 commencement of negotiations between KCPL and Empire. If the amortization calculations
17 show that Empire's cash flow metrics appear to be below levels considered to be consistent
18 with the middle of the bottom third of the Standard and Poor's BBB investment grade credit
19 rating, then rate amortizations will be included in Empire's rates in order to allow the
20 Company the opportunity to remain rated at that investment grade level. However, the
21 Regulatory Plan Stipulation And Agreement in no way requires a demonstration that cash
22 flow deficiencies be related to Iatan 2 construction activities or for that matter construction
23 activity in general. The regulatory plan amortizations are to cover the timeframe from the

1 date of the official acknowledgment that Empire aspires and is involved in negotiations with
2 KCPL to be one of the Iatan 2 partners to the in-service date of Iatan 2.

3 Q. In his rebuttal testimony at page 2, lines 9-10, Mr. Gipson states that no
4 substantial construction is underway at Iatan 2. When will construction activities begin for
5 the Iatan 2 project?

6 A. These activities have begun. According to the Company's response to Office
7 of the Public Counsel Data Request No. 0124 in this proceeding, Empire has booked over
8 \$300,000 of Iatan 2 construction costs as of June 30, 2006.

9 Q. What is your reaction to Mr. Gipson's statements at page 2, lines 13-20 of his
10 rebuttal testimony that regulatory plan amortizations should not be granted in lieu of rate
11 recovery of prudently incurred expenses?

12 A. Mr. Gipson's premise that all prudently incurred costs should be granted rate
13 recovery is incorrect. There are times where prudently incurred costs within a test year are
14 not allowed recovery in the rate process because the costs are subject to normalization
15 adjustments, because the costs are non-recurring, or for other reasons. To the extent that
16 these adjustments would contribute to a cash flow deficiency on Empire's part such that
17 certain of Empire's cash flow metrics would be below levels considered to be consistent with
18 the middle of the bottom third of the Standard and Poor's BBB investment grade credit
19 rating, then the amortization process established in the Regulatory Plan Stipulation and
20 Agreement would appropriately incorporate the impact of those adjustments in the
21 amortization calculations.

22 The Staff has made amortization calculations under both the IEC Continuation
23 and IEC Termination scenarios to determine whether the traditional revenue requirement

1 calculations under either scenario provide Empire with sufficient cash flow to avoid the need
2 for the amortization. The regulatory plan amortization calculations are based upon the
3 entirety of the Staff's revenue requirement calculations under both scenarios, reflecting its
4 adjusted levels of revenues, expense, rate base and rate of return for each scenario. The Staff
5 believes this approach to be in conformity with the intent of the Regulatory Plan Stipulation
6 and Agreement in how the amortization calculations would be applied to traditional cost of
7 service results.

8 Q. What points in Mr. Fetter's rebuttal testimony are you responding to?

9 A. Mr. Fetter's rebuttal testimony seems to be intended to support many of the
10 points made in Mr. Gipson's rebuttal. In particular, Mr. Fetter's rebuttal contains various
11 assertions as to the response of the "financial community" to the use of regulatory plan
12 amortizations as a substitute for recovery of prudently incurred expenses.

13 Q. Why does Mr. Fetter believe that the financial community would regard use of
14 regulatory plan amortizations in an unfavorable light in certain circumstances?

15 A. This is not clear, particularly when one considers that the Regulatory Plan
16 Stipulation provides for an alternative revenue requirement calculation for Empire, in
17 addition to the calculation performed in the traditional cost of service manner. The
18 Regulatory Plan calls for the higher revenue requirement amount to be used for Empire,
19 whether it is derived from the traditional ratemaking approach or from the amortization
20 calculation. In other words, use of the regulatory plan amortization mechanism can only
21 mean that a signatory party's recommendation would be that Empire should be granted a
22 higher revenue requirement under certain circumstances than under the traditional approach,

1 never a lower one. Why this type of mechanism would be regarded unfavorably by the
2 financial community is not readily apparent.

3 Q. Why then do both Mr. Gipson and Mr. Fetter appear to warn the Commission
4 not to use the regulatory plan amortizations in this proceeding?

5 A. Mr. Gipson's and Mr. Fetter's admonitions against use of the amortization
6 process in this case appear to be in the nature of veiled arguments against Commission
7 adoption of the IEC Continuation scenario. Since the IEC Continuation scenario will allow
8 Empire a lower recovery of fuel/purchased power expense than the IEC Termination
9 scenario, Mr. Gipson and Mr. Fetter make the point of stating that the regulatory plan
10 amortizations should not be used as a substitute for prudently incurred expenses.

11 Q. What is the nature of the dispute in this case regarding the IEC Continuation
12 and IEC Termination scenarios?

13 A. As discussed in my direct testimony in this proceeding, some of the signatory
14 parties to the Interim Energy Charge Stipulation And Agreement (IEC Stipulation) in Case
15 No. ER-2004-0570, Empire's most recent prior rate proceeding, have argued that Empire
16 agreed to limit its rate recovery of fuel/purchased power expense in rate proceedings through
17 March 2008 to the level granted it in permanent and interim rates in that rate proceeding
18 through base rates and the IEC, respectively. These parties are supporting a revenue
19 requirement based upon continuation of the IEC in this proceeding. Empire is disputing that
20 interpretation of the IEC Stipulation, and is seeking recovery of its current level of
21 fuel/purchased power expenses through base rates under the IEC Termination scenario.

22 Q. What is the relevance of the regulatory plan amortizations to the IEC
23 Continuation and IEC Termination scenarios before the Commission in this proceeding?

1 A. The Staff believes that there is no direct relevance. The dispute in this case
2 between the parties advocating the IEC Continuation scenario and the IEC
3 Termination scenario has to do with differing interpretations of the IEC Stipulation in Case
4 No. ER-2004-0570, a legal issue which the Commission has yet to decide. There is no
5 reason for the regulatory plan amortization to affect the Commission's decision on the IEC
6 Stipulation dispute. Once the Commission decides between the IEC Continuation and IEC
7 Termination scenarios for purposes of setting rates in this proceeding, then the Commission
8 will presumably determine the appropriate amount of the regulatory plan amortization to
9 include in rates, if any, based upon the adjusted revenues, expenses, rate base and rate of
10 return amounts associated with the revenue requirement scenario adopted by the
11 Commission. These other issues also should be decided by the Commission independent of
12 the availability of the regulatory plan amortizations.

13 Q. How do you respond to the implication in Mr. Gipson's rebuttal testimony at
14 page 2, line 14-17, that the Company's return on equity (ROE) should be increased in lieu of
15 ordering inclusion of regulatory plan amortizations in rates in this proceeding?

16 A. Increasing Empire's ROE in this manner would be a very cost-ineffective way
17 from a customer perspective of eliminating the need for regulatory plan amortizations in this
18 case, assuming for the sake of argument that elimination of the amortizations is a desirable
19 goal. This is because ROE allowances in rates are not tax-deductible and, therefore, require
20 customers currently to provide approximately \$1.62 in rates to the Company in order for
21 Empire to retain \$1.00 of ROE. For this reason, it would not be appropriate to increase
22 Empire's ROE in the case above the levels determined through traditional ratemaking
23 approaches.

1 Q. Are regulatory plan amortizations only at issue in this proceeding if the
2 Commission adopts the IEC Continuation scenario for purposes of setting rates?

3 A. No. As shown and discussed in my supplemental direct testimony in this
4 proceeding, the Staff believes inclusion of regulatory plan amortizations in rates is
5 appropriate in this case under either the IEC Continuation or IEC Termination scenarios. In
6 general, the deciding factor of whether regulatory plan amortization is applicable is whether
7 the revenue requirement found appropriate results in Empire maintaining the two relevant
8 financial ratios at the level specified in the Empire Regulatory Plan Stipulation.

9 Q. What issues are you addressing respecting Empire witness L. Jay Williams'
10 rebuttal testimony?

11 A. I am addressing Mr. Williams' contention on page 10, lines 2-13 of his
12 rebuttal testimony that the regulatory plan amortizations are not tax deductible expenses, and
13 that the amortizations would be considered taxable income by the Internal Revenue
14 Service (IRS).

15 Q. Do you agree with these statements by Mr. Williams?

16 A. No. At the time of my supplemental direct testimony in this proceeding, the
17 Staff was uncertain whether the IRS would consider the regulatory plan amortizations to be
18 taxable income. Now, the Staff believes that use of the appropriate approach outlined in this
19 testimony will not cause Empire to incur income tax liability associated with rate recovery of
20 regulatory plan amortizations.

21 Q. Did the Regulatory Plan Stipulation require that amortizations be grossed up
22 for taxes?

1 A. No. The Regulatory Plan Stipulation contains the following language,
2 “Additional taxes will be added to the amortization to the extent that the Commission finds
3 such taxes to be appropriate” (page 13). The Regulatory Plan Stipulation clearly leaves for
4 future rate proceedings all issues involving tax treatment of regulatory plan amortizations
5 allowed in rates.

6 Q. What are the primary factors that will determine whether the regulatory plan
7 amortizations should be grossed up for income taxes?

8 A. The Staff believes that the primary factor will be whether the amortizations
9 are considered to be akin to an additional allowance of ROE, or whether they are considered
10 to be more in the nature of depreciation/amortization expense.

11 As previously discussed, recovery of ROE amounts from customers in rates is
12 not considered tax-deductible by utilities, which requires a gross-up of all ROE amounts
13 included in the rate process for tax purposes. In contrast, depreciation/amortization expenses
14 are considered to be tax-deductible within the rate process, and are normally collected in
15 rates on a dollar-per-dollar basis from customers.

16 Q. In the context of the Regulatory Plan Stipulation, are amortizations considered
17 to be more like additional ROE allowances or more like additional depreciation/amortization
18 expenses?

19 A. Within the Regulatory Plan Stipulation, the Staff believes that regulatory plan
20 amortizations are clearly considered to be more like additional allowances of
21 depreciation/amortization expense than additional ROE allowances. First, these rate
22 allowances are referred to as “amortizations” in the Regulatory Plan Stipulation itself.
23 Amortizations are considered to be an expense under generally accepted accounting

1 principles (GAAP) and regulatory accounting conventions, and expenses are generally
2 considered fully deductible for income tax purposes. Second, the Regulatory Plan
3 Stipulation also requires that a rate base offset be booked by Empire related to any
4 amortization amounts collected in rates. This rate base offset treatment is also applied to
5 utility collections of depreciation and amortization expense in rates. In contrast, collections
6 of ROE allowances in rates have no associated rate base offset treatment under the traditional
7 rate process.

8 Q. Based upon these considerations, how does the Staff recommend that
9 regulatory plan amortizations be treated for tax purposes in this proceeding?

10 A. The Staff considers the regulatory plan amortizations to be a supplement to
11 book depreciation on Empire's existing plant. A straight line tax depreciation tax deduction
12 should be reflected consistent with the additional amortization amount in the Staff's cost of
13 service determination. This treatment is consistent with the ratemaking treatment used for
14 any increase in allowed book depreciation expense.

15 Q. Has the Staff used a similar approach in addressing rate amortizations for
16 other electric utilities?

17 A. Yes. As part of a settlement of an earnings investigation of KCPL in Case
18 No. EO-94-199, KCPL and the Staff agreed to an additional amortization of \$3.5 million
19 annually. In lieu of reducing rates by an additional \$3.5 million, KCPL was allowed to book
20 an additional amortization of \$3.5 million per year. This \$3.5 million amortization has been
21 treated as additional book depreciation with the accumulated balance being reflected as a
22 reduction to rate base. A corresponding straight line tax depreciation deduction has been
23 assumed in subsequent earnings investigations of KCPL.

1 Q. Is the Staff advocating the same approach for any other electric utility
2 currently operating under a regulatory plan?

3 A. Yes. This is the same approach advocated by the Staff in testimony filed in
4 the current rate increase case of KCPL, Case No. ER-2006-0314. Like Empire, KCPL also
5 has an experimental regulatory plan to help KCPL maintain its investment grade status.

6 Q. On pages 10, line 19 to page 11, line 2 of his rebuttal testimony, Mr. Williams
7 criticizes the Staff's recommended approach of using Empire's ongoing deferred tax benefits
8 to offset some or all of any income taxes associated with regulatory plan amortizations. Do
9 you agree with Mr. Williams' criticisms?

10 A. No. Mr. Williams states, "... I cannot see how future plant additions and any
11 associated tax benefits can be used to offset the additional income tax paid due to the
12 recovery of regulatory amortization in current rates. The two issues are not related in terms
13 of timing and may not even be related to the same plant investment." Mr. Williams'
14 comments on this matter miss the point. If regulatory plan amortizations are assumed to be
15 taxable, then there will be negative cash flow implications to Empire. The point of the
16 Staff's direct testimony was that Empire's ongoing level of deferred tax benefits from its
17 plant additions may provide cash flow benefits sufficient to offset all or part of any negative
18 cash flow implications associated with gross-up on taxes related to the regulatory plan
19 amortizations.

20 However, as stated previously, the Staff now does not believe that regulatory
21 plan amortizations will create an income tax liability for Empire if the amortizations are
22 treated in the manner recommended by the Staff. To the extent the Commission adopts the
23 Staff's recommendation in this case to treat the regulatory plan amortizations as

1 supplemental depreciation expense, and include a corresponding additional amount to the
2 straight line depreciation deduction, then the Staff's proposal in direct testimony to offset the
3 amortization tax liability with ongoing deferred tax benefit becomes moot.

4 Q. Does this conclude your surrebuttal testimony?

5 A. Yes, it does.