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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

TRUE-UP DIRECT TESTIMONY

OF

MARK L. OLIGSCHLAEGER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2006-0315

Jefferson City, Missouri
September 2006

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Q. Please state your name and business address.

A. Mark L. Oligschlaeger, P. O. Box 360, Jefferson City, MO 65102.

Q. Are you the same Mark L. Oligschlaeger who has previously filed direct testimony, supplemental direct testimony, rebuttal and surrebuttal testimony in this proceeding for the Staff?

A. Yes, I am.

Q. What is the purpose of your true-up direct testimony?

A. The purpose of this testimony is to report the results of the Staff's true-up audit of The Empire District Electric Company (Empire or Company) in this proceeding.

EXECUTIVE SUMMARY

Q. Please briefly summarize your true-up direct testimony.

A. The Staff has performed a true-up audit of Empire's electric operations in conformity with the Commission's April 11, 2006, "Order Concerning Test Year and True-up and Adopting Procedural Schedule." In this testimony, I discuss the results of this audit in general, and in particular the Staff's positions and adjustments concerning renewable energy credit revenues, rate case expense, and allocation of administrative and general costs and net general plant in service. I also present the Staff's updated Regulatory Plan amortization calculation results, reflecting the changes made to the Staff's case per the true-up audit. I also

discuss a new approach Staff has used to determine the amount of long-term debt attributable to Empire's electric operations in the context of the Regulatory Plan amortization calculations, and the Staff's current position on the Regulatory Plan amortization tax gross-up issue.

TRUE-UP AUDIT

Q. Please describe the true-up audit of Empire's electric operations performed by the Staff in this proceeding.

A. Per the Commission's April 11, 2006 Order authorizing a true-up in this proceeding, the Staff has updated its case to reflect known and measurable events affecting significant elements of Empire's electric revenue requirement for the period April through June 2006. The revenue requirement areas updated by the Staff are the following:

Rate Base: Plant in Service, Depreciation Reserve, Deferred Taxes, Fuel Inventories, Cash Working Capital (annualized amounts only), Materials and Supplies, Prepayments, Customer Advances, Customer Contributions, Customer Deposits, Cash Working Capital Income Tax and Interest Offsets, Allocation Factors.

Income Statement: Revenues from Customer Growth, Off-System Sales Margin, Uncollectibles, Payroll (Employee Levels and Wage Rates), Fuel and Purchased Power Expense (Fuel and Purchased Power Prices, System Loads), Rate Case Expense, Commission Assessment, Depreciation Expense, Property Taxes (if applicable and appropriate), Income Tax (Effect of Trued-up Items), Allocation Factors.

Rate of Return: Rate of Return Calculation (excluding Return on Equity), Capital Structure.

Q. How did the Staff conduct its true-up audit?

1 A. The Staff updated its analysis in almost all of the areas listed above using the
2 same methods and approach it used in its initial filing in this proceeding. Where the Staff has
3 deviated from the approach it used in its initial filings due to new circumstances or the
4 existence of new costs not examined in the Staff's direct case, these instances will be
5 addressed in this testimony.

6 Q. What capital structure is the Staff using as of June 30, 2006?

7 A. The Staff is using Empire's actual capital structure as of June 30, 2006, which
8 consists of 50.80% common equity, 5.39% trust preferred stock and 43.81% long-term debt.

9 Q. What is the Staff's true-up rate of return recommendation in this case?

10 A. After updating the long-term debt rate and capital structure percentages, the
11 Staff's rate of return recommendation at true-up is 8.41%, reflecting a mid-range return on
12 equity of 9.55%.

13 Q. What revenue components were updated by the Staff in its true-up audit?

14 A. The Staff updated its revenue adjustments to reflect customer growth for the
15 period April – June 2006 for the following customer classes: residential, commercial, small
16 heating, total electric buildings, and general power.

17 Q. What components of fuel/purchased power expense were updated by the Staff
18 in its true-up audit?

19 A. The Staff has updated its calculated natural gas prices, coal prices, purchased
20 power prices, and freight/transportation costs associated with delivery of coal, natural gas
21 and petroleum coke. The result of this update, when the Staff incorporated this updated
22 information in its fuel expense model, was an increase in the Staff's recommended level of
23 fuel/purchased power variable costs from $159,420,692 to $161,981,643.

1 Q. Why did the Staff's recommended level of fuel/purchased power expense
2 increase as a result of the true-up?
3 A. Part of this increase relates to serving the increased customer loads reflected in
4 the Staff's true-up revenues calculation. Also, replacing April-June 2005 fuel and
5 purchased power price data with the same months for 2006 in Staff's adjustment
6 calculations resulted in an overall increase to natural gas and purchased power prices. In
7 addition, the price to transport coal and petroleum coke by truck increased in the true-up
8 period due to very high gasoline price levels at June 30, 2006.
9 Q. What trued-up natural gas price is the Staff recommending that the
10 Commission use to set rates in this case?
11 A. The Staff's overall recommended price for natural gas in this proceeding is
12 $6.39 per MMBtu. This result is derived from Empire's known and measurable hedged
13 contracts to purchase natural gas as of June 30, 2006, applicable to the months July 2006
14 through December 2007, valued at $6.007/MMBtu; and the weighted average actual price
15 paid by Empire for spot natural gas for the twelve months ended June 2006, valued at
16 $8.109/MMBtu. The Staff combined these two gas costs at an 80% weighting for hedged
17 gas costs to 20% for spot gas costs to determine the overall price of $6.39 per MMBtu. This
18 methodology is consistent with that used to determine the Staff's recommended natural gas
19 price in its initial direct filing.
20 Q. What is Staff adjustment S-100.1?
21 A. This adjustment includes, in Empire's annualized revenues amounts it has
22 received from sale of "renewable energy credits" during the test year, update period and
23 true-up period.

1 Q. What are renewable energy credits (RECs)?
2 A. RECs are credits issued under the Center for Resource Solution's "green-e"
3 program to certify that one megawatt-hour of electricity has been generated by a facility
4 engaged in the production of renewable energy, such as wind, solar, or biomass. Since a
5 number of governmental entities in this country require electric utilities to generate or
6 obtain a certain percentage of energy from renewable resources, RECs are tradable and can
7 be bought and sold.
8 Q. Has Empire received revenues from sale of RECs in the test year, update
9 period and true-up period?
10 A. Yes. Because Empire currently purchases the entire generation output of the
11 Elk River Wind Farm per a long-term agreement, Empire receives all of the RECs
12 associated with the Elk River Wind Farm's energy output. Empire has chosen to sell its
13 RECs since it began taking energy from the Elk River Wind Farm in late 2005.
14 Q. Does Empire have a requirement to generate or obtain power from renewable
15 sources in any jurisdiction in which it operates?
16 A. No, not to the Staff's knowledge.
17 Q. How much revenue has Empire received from its sale of RECs since late 2005?
18 A. Approximately $337,000 on a total Company basis.
19 Q. Should the revenues Empire receives from sale of RECs be reflected in the
20 Missouri ratemaking process?
21 A. Yes, because Missouri customers will be paying the costs of the wind power
22 obtained by Empire from the Elk River Wind Farm as a result of this case. For this reason,

1 Missouri customers are likewise entitled to any revenue benefits received by Empire as a
2 result of its contract with the Elk River Wind Farm.

3 Q. Please describe adjustment S-100.1.

4 A. This adjustment reflects in Empire's revenues all proceeds from sale of RECs
5 from December 2005 to June 2006. Because REC revenues received within the test year
6 were booked below-the-line by Empire, this adjustment includes those revenues as well as
7 amounts received by Empire after the end of the test year but prior to the cut-off date for the
8 true-up.

9 Q. Why is the Staff proposing this adjustment for REC revenues in its true-up
10 direct testimony, instead of its initial direct testimony in this proceeding?

11 A. The Staff was not aware of Empire's sale of its RECs until June 2006, just
12 prior to its initial direct filing. On June 23, 2006, the Staff filed a *Notice* with the
13 Commission to notify it of this issue, and to state that the Staff would address proper
14 ratemaking treatment of REC revenues in subsequent testimony filings.

15 Q. How did the Staff update Empire's rate case expense in the true-up audit?

16 A. The Staff has reflected Empire's actual rate case expenses incurred through
17 September 21, 2006, in its case, as well as, including an estimate of the costs Empire will
18 incur during the true-up and briefing phases of this case. As discussed in the initial direct
19 testimony of Staff witness Paula Mapeka in this proceeding, the Staff is proposing to
20 normalize Empire's rate case expense incurred during this proceeding over a two-year period.

21 Q. Has Empire experienced any significant changes to its corporate structure
22 during the true-up period that will affect its corporate allocations on a going-forward basis?

1 A. Yes. On June 1, 2006, Empire completed its acquisition of Aquila United,
2 Inc.'s Missouri natural gas properties, and formed a new subsidiary to operate its new gas
3 business.

4 Q. What impact will Empire's new natural gas properties have on its electric
5 operations?

6 A. While there should be few direct impacts on Empire's electric operations from
7 its acquisition of natural gas properties, one direct impact will be a reduction in the percentage
8 of administrative and general (A&G) costs otherwise allocable to Empire's electric
9 operations.

10 Q. Why will the natural gas acquisition affect the allocation of A&G costs to
11 Empire's electric operations?

12 A. A&G costs represent corporate overhead costs, or the type of costs a company
13 incurs that are not directly assignable to any of its distinct lines of business (executive
14 salaries, corporate office facility and supplies costs, etc.). Therefore, A&G costs are generally
15 allocated among a utility's lines of business, so that all lines of business bear a reasonable
16 proportion of a utility's overhead costs. Typically, as a utility expands through mergers and
17 acquisitions, there will be a reduction in the amount of A&G costs allocated to its existing
18 divisions/subsidiaries as the new additions will be charged a proportionate share of the
19 existing A&G cost levels. In this proceeding, the Staff believes it is appropriate to re-
20 calculate Empire's A&G allocation factors to reflect the known and measurable natural gas
21 acquisition event that occurred during the true-up period.

22 Q. What is the relative size of Empire's new gas properties compared to its other
23 properties?

1 A. Empire has provided the Staff with a "Massachusetts Formula" analysis of the
2 amounts of revenue, plant in service and payroll costs experienced by Aquila United, Inc.'s
3 former Missouri gas properties in calendar year 2005, compared to these same items for
4 Empire's pre-existing electric, water and non-regulated operations for the same period of
5 time. This analysis showed that Empire's gas properties are currently estimated to make up
6 approximately 9.37% of Empire's total Company operations. That means, all other things
7 being equal, that the gas acquisition should mean a reduction in the percentage of A&G costs
8 allocated to Empire's electric operations of close to 10%.

9 Q. Is the Company using the 9.37% percentage above to allocate overhead costs
10 to its new gas properties?

11 A. Yes. The Massachusetts Formula is a commonly used procedure in the
12 regulated utility industry for allocation of common/overhead costs. The 9.37% percentage
13 referenced in my testimony above is currently being used by Empire to allocate a portion of
14 its A&G costs to its gas properties.

15 Q. How did the Staff calculate its adjustment to reflect the reduction in the A&G
16 expense allocations to Empire's electric operations resulting from the gas acquisition?

17 A. The Staff re-calculated the allocation factors for selected A&G accounts to
18 take into account the reduced A&G allocation to Empire's electric operations resulting from
19 the gas acquisition, using the Massachusetts Formula analysis performed by Empire. The
20 accounts to which the new allocation factors were applied included A&G salaries, office
21 supplies, outside services, rents and maintenance of general plant.

1 The calculation of the new A&G allocators is shown in Schedule 1 of this testimony.
2 Use of these allocation factors has the impact of reducing Empire's electric A&G expense by
3 over $700,000 (Missouri jurisdictional) on an annual basis.

4 Q. Is it possible that the Company could experience additional costs in these A&G
5 accounts as a result of the gas acquisition that might in part offset savings in electric A&G
6 allocations?

7 A. Yes, that is possible. To the extent the Company incurred any such additional
8 costs by June 30, 2006, (the true-up cut-off) and the costs were in an area updated by the Staff
9 in the true-up (such as payroll costs), then the additional costs would be reflected in the
10 Staff's true-up revenue requirement.

11 Q. Why didn't the Staff reflect new A&G allocations for all of the A&G expense
12 accounts listed in Accounting Schedule 9, Income Statement?

13 A. Certain A&G accounts, such as Employee Pensions and Benefits, Property
14 Insurance, Injuries and Damages, and Miscellaneous Expenses (largely advertising-related)
15 will likely be charged additional costs due to the gas acquisition. Without further analysis, at
16 this time it is impossible to determine the extent to which any increased costs in those
17 accounts will offset or even outweigh the reduction in allocated expenses to Empire's electric
18 operations that would otherwise occur in those accounts. Therefore, to be conservative, the
19 Staff has not changed the electric A&G allocation factor that applies to those accounts.

20 Q. Are there any other expected savings to Empire's electric business resulting
21 from the gas acquisition?

22 A. Yes. Empire's electric operations will receive a lower allocation of its general
23 plant in service (for example, its corporate office building), as a result of the gas acquisition.

1 General plant is the plant investment that is not specifically associated with any of Empire's
2 lines of businesses.

3 Q. How did the Staff calculate the appropriate allocation factors for general plan
4 in service and general plant depreciation reserve as of June 30, 2006?

5 A. These calculations can also be found in Schedule 1 of this testimony. The total
6 reduction in the amount of net plant in service allocated to the Missouri jurisdictional electric
7 operations of Empire due to the new allocation factors is in excess of $2 million.

8 Q. Is the issue of A&G allocations a continuing subject of discussion between the
9 Company and the Staff?

10 A. Yes, it is. The Staff will obtain additional information from the Company after
11 this testimony is filed to gain a more complete understanding of Empire's plans for allocating
12 A&G costs to its business lines in the future. Based upon this information, it is possible that
13 the Staff may modify its position on this issue if appropriate.

14 Q. What were the overall results of the Staff's true-up audit?

15 A. For the Staff's Interim Energy Charge (IEC) Termination scenario, the Staff's
16 recommended revenue requirement after the true-up audit is $15,929,828. When taking into
17 account the reduction in IEC revenues assumed in this scenario, the net rate increase to
18 Empire's customers under this scenario is $7,120,178.

19 For the IEC Continuation scenario, the Staff's recommended revenue requirement is
20 ($15,258,967).

21 Q. Is the Staff filing True-up Accounting Schedules along with its true-up
22 testimony?

1 A. Yes. As with its initial direct filing, the filed accounting schedules support the
2 Staff's IEC Termination revenue requirement. The only differences between the Staff's
3 adjustment amounts for the IEC Termination and IEC Continuation scenarios are depicted on
4 Schedule 2 of this testimony, which is in a similar format to that of Schedule 3 attached to my
5 direct testimony.

6 **REGULATORY PLAN AMORTIZATIONS**

7 Q. Has the Staff updated its calculations for the Regulatory Plan amortizations
8 authorized in the Stipulation And Agreement for Case No. EO-2005-0263?
9 A. Yes, it did. The updated amortization calculation for the IEC Termination
10 scenario is shown as Schedule 3 in this testimony, while the updated calculation for the IEC
11 Continuation scenario is shown as Schedule 4 in this testimony.
12 Q. Are these amortization calculations different than the earlier calculations
13 attached to your supplemental direct testimony?
14 A. Yes. These calculations reflect the Staff's updated true-up revenue
15 requirement.
16 Q. Is the Staff proposing any changes to the methodology used to calculate the
17 Regulatory Plan amortizations at this time?
18 A. Yes, in the area of capital structure allocation and in the amount of additional
19 book depreciation required to meet the rating agency metrics. Both of these changes in
20 approach are discussed below.
21 Q. Why does the Staff believe a change in approach is needed in the capital
22 structure allocation area?

1 A. In the amortization calculations it sponsored in supplemental direct testimony,
2 the Staff derived the long-term debt component used in the ratio analysis by taking Empire's
3 total Company capital structure, determining the portion of that capital structure supported by
4 long-term debt, and then applying a Missouri jurisdictional plant allocation factor to that long-
5 term debt amount. At that time, this approach was believed to have provided an accurate
6 quantification of the amount of Empire's long-term debt associated with its electric
7 operations.

8 Since that time, as previously mentioned, Empire has acquired significant natural gas
9 operations. To ensure that Empire's debt associated with its new gas and existing non-
10 regulated operations is not included in the calculation of an amortization intended to cover
11 only Empire's Missouri jurisdictional electric operations, the Staff has determined that
12 another approach to determining the amount of debt attributable to Empire's electric business
13 is more appropriate than the one previously employed by the Staff.

14 Q. Please describe the Staff's new approach.

15 A. The Staff analyzed Empire's Electric Balance Sheet as of June 30, 2006, and
16 determined the amount of Empire's net investment in its electric operations (assets less
17 liabilities) not reflected in its rate base for ratemaking purposes. (This amount includes such
18 items as Construction Work in Progress and net Regulatory Assets.) The Staff then combined
19 this amount with the amount of the Staff's recommended electric rate base (from Accounting
20 Schedule 2), and applied the current percentage of long-term debt in Empire's capital
21 structure to the combined rate base/balance sheet net investment amount to determine the
22 amount of long-term debt attributable to Empire's electric operations used in the Regulatory
23 Plan calculation.

1 Q. Is this general approach to determining the amount of long-term debt
2 attributable to electric operations also being used by the Staff in the current KCPL rate
3 proceeding, Case No. ER-2006-0314?
4 A. Yes, it is my understanding that the same general approach will be used by the
5 Staff in the calculation of the Regulatory Plan amortization for KCPL in that rate proceeding
6 as well.
7 Q. Why has the Staff's approach changed regarding the amount of additional book
8 depreciation provided to allow the Company an opportunity to maintain its investment grade
9 credit ratings?
10 A. In prior testimony in this proceeding, the Staff recommended that the
11 Commission order that any Regulatory Plan amortizations included in rates be treated as book
12 depreciation by Empire, and that a tax straight-line depreciation deduction equal to the
13 amount of the amortizations be reflected in the ratemaking process as well.
14 The Staff has made updated calculations to determine the amount of additional book
15 depreciation required by Empire to address the full cash flow requirements of the credit rating
16 agency metrics, as measured in the Regulatory Plan amortization calculation (attached as
17 Appendix D-3 to the Regulatory Plan Stipulation And Agreement from Case No.
18 EO-2005-0263). Consistent with any increase in book depreciation, Empire will recognize a
19 corresponding increase in the tax straight-line depreciation deduction used in calculating
20 deferred income taxes. The impact on deferred tax expense has also been considered in the
21 Regulatory Plan amortization calculations, consistent with the increased book depreciation
22 and increased tax straight-line depreciation deduction resulting from the amortization amounts

1 granted in rates. This impact on deferred tax expense was not considered in the Staff's prior
2 Regulatory Plan amortization calculations.

3 The net result of the Staff's proposed increase in book depreciation recovery through
4 the Regulatory Plan amortization mechanism addresses the agreement to provide Empire the
5 opportunity to obtain the necessary after-tax cash flow required to meet the two Regulatory
6 Plan credit metrics.

7 Q. Are the other parties to this case in agreement with the Staff's approach to this
8 issue outlined in this testimony?

9 A. The Staff believes there is a "settlement in principle" on the issue of the
10 Regulatory Plan amortization gross-up among the parties to this proceeding consistent with
11 the position set forth in this testimony. At this time, the parties are endeavoring to agree on
12 language for a stipulation and agreement on this matter for submission to the Commission.
13 This matter is quite complex.

14 Q. What do the Staff's current Regulatory Plan amortization calculations show?

15 A. For the IEC Termination scenario, the Staff's calculated amount is
16 $20,745,271; and for the IEC Continuation scenario, the Staff's calculated amount is
17 $43,009,776.

18 Q. Taking into account both the Staff's traditional revenue requirement and the
19 Regulatory Plan amortization revenue requirement, what is the total Staff recommended
20 revenue requirement for Empire in this case under both scenarios?

21 A. The Staff's total revenue requirement recommendation under the IEC
22 Termination scenario is $27,865,449 [$7,120,178 + $20,745,271], and for the IEC
23 Continuation scenario it is $27,750,809 [(15,258,967) + $43,009,776].

1 Q. Why has the amount of the calculated Regulatory Plan amortizations increased
2 significantly from those attached to your earlier supplemental direct testimony?
3 A. Most of the increase relates to Empire's greater average debt level for the
4 twelve months ended June 30, 2006, compared to its average debt level for the twelve months
5 ended March 31, 2006, the debt amount for which the earlier amortization calculations were
6 based. All other things being equal, higher debt levels will drive the Company's Regulatory
7 Plan financial ratios lower, and thereby increase the amount of the necessary amortizations to
8 maintain Empire at investment grade credit ratings.
9 Q. Does this conclude your true-up testimony?
10 A. Yes, it does.