

Exhibit No.:
Issues: Revenue Requirement,
Transmission Tracker
Witness: Stephen M. Rackers
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Midwest Energy Users' Association
Case No.: ER-2012-0345
Date Testimony Prepared: February 4, 2013

**BEFORE THE PUBLIC SERVICE
COMMISSION OF THE STATE OF MISSOURI**

In the Matter of The Empire District)
Electric Company of Joplin,)
Missouri Tariffs Increasing Rates) **Case No. ER-2012-0345**
for Electric Service Provided to)
Customers in the Missouri Service)
Area of the Company)

Surrebuttal Testimony of
Stephen M. Rackers

On behalf of
Midwest Energy Users' Association

February 4, 2013



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Case No. ER-2012-0345

STATE OF MISSOURI)
)
) SS
 COUNTY OF ST. LOUIS)

Affidavit of Stephen M. Rackers

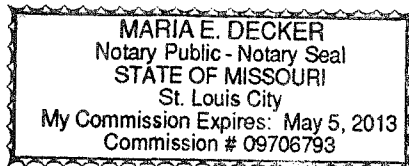
Stephen M. Rackers, being first duly sworn, on his oath states:

1. My name is Stephen M. Rackers. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 16690 Swingley Ridge Road, Suite 140, Chesterfield, Missouri 63017. We have been retained by Midwest Energy Users' Association in this proceeding on their behalf.
2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony which was prepared in written form for introduction into evidence in the Missouri Public Commission Case No. ER-2012-0345.
3. I hereby swear and affirm that the testimony is true and correct and that it shows the matters and things that it purports to show.

Stephen M. Rackers

 Stephen M. Rackers

Subscribed and sworn to before me this 3rd day of February, 2013.



Maria E. Decker

 Notary Public

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Surrebuttal Testimony of Stephen M. Rackers

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Stephen M. Rackers. My business address is 16690 Swingley Ridge Road,
3 Suite 140, Chesterfield, MO 63017.

4 **Q WHAT IS YOUR OCCUPATION?**

5 A I am a consultant in the field of public utility regulation of Brubaker & Associates, Inc.,
6 energy, economic and regulatory consultants.

7 **Q ARE YOU THE SAME STEPHEN M. RACKERS WHO FILED DIRECT TESTIMONY**
8 **EARLIER IN THIS PROCEEDING?**

9 A Yes.

10 **Q WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

11 A I will address the Empire District Electric Company (“Empire” or “Company”) rebuttal
12 testimonies of Witnesses W. Scott Keith, regarding outside services, transmission
13 tracker and off-system sales (“OSS”); L. Jay Williams, regarding the Employee Stock
14 Ownership Plan (“ESOP”) income tax deduction and property tax; Blake A. Mertens,

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1 regarding Southwest Power Pool (“SPP”) Integrated Marketplace costs;
2 Kelly S. Walters, regarding incentive compensation; Robert W. Sager, regarding
3 short-term banking fees; and Joan E. Land, regarding prepayments and the billing lag
4 used in the calculation of cash working capital (“CWC”).

5 **Outside Services**

6 **Q PLEASE EXPLAIN THIS ISSUE.**

7 A Empire proposes to increase the test year level of outside services expense by
8 approximately \$1 million to reflect a three-year average, based on the 36 months
9 ended March 31, 2012.

10 **Q WHAT IS EMPIRE’S JUSTIFICATION FOR ITS ADJUSTMENT?**

11 A In his rebuttal testimony, Company witness Scott Keith states that the level of test
12 year outside services is abnormally low and does not include Integrated Resource
13 Planning (“IRP”) costs. Mr. Keith justifies his abnormally low claim by comparing the
14 test year to the prior two 12-month periods. He also claims that the use of a
15 multi-year average is a common place method of establishing a normalized level of
16 expense.

17 **Q DO YOU AGREE WITH MR. KEITH’S CLAIMS REGARDING AN ABNORMAL**
18 **LEVEL OF OUTSIDE SERVICES AND MULTI-YEAR AVERAGING?**

19 A No. Empire hires outside vendors to perform a variety of work for the Company, for
20 example, accounting services and engineering services. The same vendors are not
21 necessarily hired each year and the same services are not necessarily required each
22 year. Some of the services are recurring and others may reflect one-time projects.

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1 Simply lumping dollars together over several years and taking an average does not
2 justify a normal ongoing level of expense. Comparing the amount experienced in the
3 test year to prior periods does not justify a claim of abnormal. The prior years may be
4 abnormal as a result of including nonrecurring costs or costs which benefit more than
5 one year, and should be spread over several periods.

6 Also, multi-year averaging is an acceptable normalization technique when
7 dealing with a homogeneous group of expenses. For example, I used a multi-year
8 average to determine my recommendation for a normal level of bad debts, by
9 considering only data that is used to calculate monthly net write-offs. However, as
10 previously discussed, outside services cost can hardly be considered a
11 homogeneous group of expenses. Lumping varied costs together for several years
12 and calculating an average may not result in a normal ongoing level of expense.

13 To the best of my knowledge, the Company has not provided a detailed
14 analysis of the costs included in the test year and prior years. Without such an
15 analysis, Empire has not justified its claim of abnormality or an adjustment to the test
16 year level of outside services expense.

17 **Q IS MR. KEITH CORRECT REGARDING HIS CLAIM THAT YOU HAVE NOT**
18 **NORMALIZED IRP COSTS ACCURATELY?**

19 **A** No. Based on Empire's response to MEUA Data Request 111, the estimated cost of
20 the current IRP is \$605,093. Since an IRP analysis is performed only once every
21 three years, only one-third of this cost should be included in the ongoing cost of
22 service. The \$1.4 million test year level of outside services is more than enough to
23 account for the annual IRP cost of \$201,698 and does not justify Empire's adjustment
24 to increase the test year level by over \$1 million.

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1 **Employee Stock Ownership Plan (“ESOP”)**

2 **Q PLEASE EXPLAIN THIS ISSUE.**

3 A In my direct testimony, I recommended an adjustment to the calculation of income tax
4 to reflect a deduction for dividends that are paid on Empire’s common stock that is
5 held in the ESOP. Company witness Williams correctly states that the Commission
6 did not accept this adjustment in its Report and Order in the Ameren Missouri
7 Case No. ER-2012-0166, and I am no longer recommending that the adjustment be
8 reflected in Empire’s cost of service in this case.

9 **Property Tax**

10 **Q WHAT IS THE BASIS OF THE LEVEL OF PROPERTY TAXES EMPIRE HAS**
11 **INCLUDED IN THE COST OF SERVICE?**

12 A Empire has applied its estimated 2012 property tax rate to the taxable investment
13 amounts estimated through the December 31, 2012 true-up cut-off date.

14 **Q WILL THIS CALCULATION RESULT IN THE APPROPRIATE LEVEL OF**
15 **PROPERTY TAXES FOR THIS CASE?**

16 A No. I believe Empire has overstated the level of property taxes that should be
17 reflected in the cost of service. The 2012 property taxes that were paid in
18 December 2012 were based on taxable investment that was in service on
19 January 1, 2012. By applying the estimated 2012 tax rate to trued-up amounts,
20 Empire is essentially including the taxes that will be paid in December 2013. The
21 2013 property taxes will not be paid until December 31, 2013, which is 12 months
22 beyond the true-up cut-off date in this case. In addition, Empire does not know the
23 tax rate or the assessment rate that will be applied to property in 2013. As a result,

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1 Empire's property tax proposal is not known and measurable as of the
2 December 31, 2012 true-up cut-off date.

3 **Q. HAS THE COMMISSION RECENTLY REJECTED A SIMILAR PROPOSED**
4 **ADJUSTMENT?**

5 A. Yes. In Case No. ER-2012-0166, the same case that Mr. Williams cites as
6 authoritative for the determination of the ESOP issue, the Commission rejected
7 Ameren Missouri's adjustment to use prior year tax rates as estimates for future
8 payments that occurred beyond the true-up cut-off date.

9 **Q WHAT LEVEL OF PROPERTY TAXES DO YOU PROPOSE?**

10 A As accepted by the Commission in Case No. ER-2012-0166, I am proposing to use
11 the December 2012 actual property tax payment. In the Ameren Missouri case, even
12 though the true-up cut-off date was July 31, 2012, the Commission ordered the use of
13 the actual December 31, 2011 property tax payment. In the Empire case, the most
14 recent actual property tax payment coincides exactly with the end of the true-up cut-
15 off date of December 31, 2012.

16 **Cash Working Capital ("CWC")**

17 **Q PLEASE BRIEFLY EXPLAIN THE CWC ISSUE IN THIS CASE.**

18 A Empire originally proposed to include a billing lag of over five days in its calculation of
19 CWC. The Company has since agreed to use a billing lag of 4.14 days.

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1 **Q DO YOU BELIEVE A BILLING LAG OF 4.14 DAYS IS EXCESSIVE?**

2 A Yes. Although meters are physically read, the rest of the billing process is automated
3 and meter readings are uploaded to the billing system the same day the meter is
4 read. However, these readings are not necessarily billed after being uploaded to the
5 billing system. Rather, the reading information is held until all the meters in a cycle
6 are read. This delay in sending out bills increases the billing lag and the amount of
7 CWC required by Empire.

8 **Q WHAT EXPLANATION DID THE COMPANY PROVIDE FOR THIS DELAY IN**
9 **BILLING?**

10 A The major justification provided was that this process allowed the customer to receive
11 their bill on the same day each month.

12 **Q DO YOU BELIEVE ALLOWING A CUSTOMER TO RECEIVE THEIR BILL ON THE**
13 **SAME DAY EACH MONTH IS ADEQUATE JUSTIFICATION FOR THE DELAY IN**
14 **BILLING?**

15 A No. If a customer's meter is read on approximately the same day each month and
16 billing was not delayed, that customer should receive their bill on approximately the
17 same day each month. This concern is not adequate justification for the delay in
18 billing.

19 **Q WHAT IS YOUR RECOMMENDATION FOR THE BILLING LAG IN THIS CASE?**

20 A I continue to recommend a zero billing lag. The meter reading date, which is the
21 same date the reading is uploaded to the billing system, is the last day of the usage

1 lag. If the bill was not delayed, it would be sent out the following day which would be
2 the start of the collection lag. Therefore, the billing lag should be zero.

3 **Off-system Sales (“OSS”)**

4 **Q PLEASE EXPLAIN THIS ISSUE.**

5 A Empire is proposing to eliminate all OSS revenues and expenses from base rates.
6 Under Empire’s proposal, only the fuel and purchased power cost necessary to meet
7 the needs of its customers will be reflected in net base fuel cost. The revenue and
8 expenses for all OSS will flow directly to the fuel adjustment clause (“FAC”) and offset
9 the fuel and purchased power in excess of the net base fuel cost included in base
10 rates. I recommend that the net fuel cost included in base rates reflect an annual
11 reduction for OSS margins. Any change from the fuel and purchased power costs,
12 net of OSS margins recognized in net base fuel cost, will be captured in the FAC.

13 **Q. WHY IS THIS RECOGNITION FOR OSS INAPPROPRIATE?**

14 A. As I explained in my direct testimony, under Empire’s proposal the Company
15 automatically retains 5% of all OSS margins rather than the difference between the
16 amount included in base rates and the actual amount experienced. If OSS margins
17 are only reflected as a reduction to the difference in the fuel and purchased power
18 cost flowing through the FAC, all the risk associated with not achieving the level of
19 OSS margins included in base rates will be removed and Empire will automatically
20 retain 5% of all the profit associated with OSS. In other words, under Empire’s
21 proposal there would be a permanent sharing of all OSS margins between ratepayers
22 (95%) and shareholders (5%). It also effectively eliminates an incentive for Empire to
23 be aggressive in pursuing OSS and offsetting the fuel and purchased power charged

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1 to customers. Based on the Commission's Report and Order in
2 Case No. ER-2008-0098, when the FAC was established for Empire, this does not
3 appear to be the intent of the Commission.

4 **Q. WHAT IS YOUR RESPONSE TO MR. KEITH'S REBUTTAL TESTIMONY**
5 **REGARDING LOW OSS PRICES AND RELATED LOW NATURAL GAS PRICES?**

6 A. Both OSS and natural gas prices have been depressed, but as recent as 2011
7 Empire experienced \$1.5 million of net OSS margin. In addition, the United States
8 Energy Information Administration ("EIA") estimates that the average price of natural
9 gas will increase from \$2.75 per million BTU in 2012 to \$3.74 in 2013 and \$3.90 in
10 2014, the period when rates from this case will be in effect. These prices are almost
11 equal to the \$4 per million BTU average price experienced in 2011. These estimates
12 refute Mr. Keith's statements that the OSS prices, which reflect the recent low natural
13 gas prices, will continue during the period rates from this case are in effect.

14 **Bank Fees**

15 **Q PLEASE EXPLAIN THIS ISSUE.**

16 A Empire is proposing to include in operating and maintenance ("O&M") expense, the
17 cost of obtaining its short-term debt line of credit. I recommend capitalization of this
18 cost.

19 **Q WHY IS CAPITALIZATION THE APPROPRIATE TREATMENT OF THESE**
20 **COSTS?**

21 A Short-term debt is generally recognized as a source of financing for construction.
22 Since the average balance of short-term debt is lower than the average balance of

1 construction work in progress, no short-term debt has been included in the capital
2 structure recommended by either Staff, Empire or MEUA. My recommendation
3 simply treats the cost of obtaining short-term debt in the same manner as the interest
4 paid on that debt, by capitalizing both items.

5 **Q HOW DO YOU RESPOND TO MR. SAGER'S CLAIM THAT YOUR**
6 **RECOMMENDATION TO CAPITALIZE THE COST OF OBTAINING SHORT-TERM**
7 **DEBT IS AN ATTEMPT TO DELAY RECOVERY OF PRUDENTLY INCURRED**
8 **COSTS?**

9 A Mr. Sager's claim is incorrect. My recommendation reflects consistent treatment for
10 both the interest cost and the procurement cost associated with short-term debt.
11 Since the short-term debt supports Empire's construction program, as Mr. Sager
12 admits in his rebuttal testimony, the cost to obtain this financing is a proper
13 construction cost.

14 My recommendation reflects proper cost classification between capital and
15 O&M. Capitalizing any cost, be it interest, bank fees or construction labor, recognizes
16 that it is part of a utility's construction program. The plant resulting from the
17 Company's construction program is recovered through depreciation and a return is
18 provided on the investment through the inclusion in rate base.

19 **Incentive Compensation**

20 **Q PLEASE EXPLAIN THIS ISSUE.**

21 A I recommend disallowing discretionary cash payments and stock incentive awards
22 based on financial goals. As discussed in my direct testimony, I believe these

1 adjustments reflect prior Commission's Report and Orders regarding the disallowance
2 of such incentives.

3 **Q WHAT IS YOUR RESPONSE TO MS. WALTERS' REBUTTAL TESTIMONY**
4 **REGARDING THESE TYPES OF INCENTIVE PAYMENTS?**

5 A I do not believe Ms. Walters' testimony provides any new arguments for including
6 these incentives in the cost of service. As a result, I see no justification for a
7 departure from past Commission rulings regarding the disallowance of discretionary
8 cash incentives and stock incentive awards based on financial goals.

9 **Prepayments**

10 **Q PLEASE EXPLAIN THIS ISSUE.**

11 A Empire is seeking to include a 13-month average of all its prepayments in rate base.
12 Including an amount in prepayments reflects the shareholder payment for an item in
13 advance of being reimbursed by customers.

14 A significant portion of the prepayments simply reflects monthly expenses that
15 are paid in advance. In my direct testimony, I recommended eliminating this portion
16 of the prepayments balance since the related expense dollars are also included in the
17 calculation of CWC. This prevents a double counting of the working capital
18 associated with these expenses.

19 **Q HAS THE COMPANY PROVIDED ADDITIONAL INFORMATION WHICH**
20 **CHANGES YOUR CALCULATION OF THIS ADJUSTMENT?**

21 A Yes. As Ms. Land states in her testimony, the advance payment was not reflected in
22 the calculation of the expense lag for the prepayments related to annual expenses.

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1 However, the expense dollars are included in the CWC annual amounts for fuel
2 purchased power and cash vouchers. Therefore, a double counting continues to
3 exist for these expenses since the item is reflected in both CWC and prepayments.

4 **Q HAVE YOU REVISED THE CALCULATION OF YOUR ADJUSTMENT TO**
5 **ELIMINATE THIS DOUBLE COUNTING?**

6 A Yes. The advance payment for these items is reflected in the prepayments balance
7 included in rate base, so there is no need to again reflect this advance payment in the
8 calculation of CWC. As a result, I assigned a zero revenue and expense lag to the
9 advance payment portion of fuel, purchased power and cash vouchers. This
10 eliminates any CWC associated with these expenses and prevents a double counting
11 of the associated amounts included in prepayments. After revising my prepayment
12 calculation the adjustment value was reduced from approximately \$500,000 to
13 \$200,000.

14 **Q. WHAT IS YOUR RESPONSE TO MS. LAND'S STATEMENTS ABOUT THE NEED**
15 **FOR INCLUDING THESE MONTHLY EXPENSES IN BOTH PREPAYMENTS AND**
16 **CWC AS A WAY TO "FILL IN THE GAP" BETWEEN THE TIME FUNDS ARE**
17 **REQUIRED IN PROVIDING SERVICE AND REVENUES ARE RECEIVED?**

18 A. Her approach leads to the very double counting that my adjustment is designed to
19 eliminate. Including the advance payment in the calculation of the CWC expense lag,
20 or including the item as a component of prepayments provides the working capital
21 associated with items paid in advance. However, including the item in both rate base
22 components reflects a double counting of the working capital associated with this
23 expense.

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1 **Southwest Power Pool (“SPP”) Cost Deferral**

2 **Q PLEASE EXPLAIN THIS ISSUE.**

3 A SPP is developing an Integrated Market Place (“IMP”) that is designed to increase the
4 efficiency of generation resources for participants. Although the planned operational
5 date for the IMP is March 1, 2014, Empire seeks to begin charging ratepayers for the
6 cost of the system when rates from this case become effective on June 3, 2013. I am
7 recommending a deferral of these costs until the IMP is operational and any customer
8 benefits are realized.

9 **Q WHY ARE YOU PROPOSING TO DEFER THESE COSTS?**

10 A The IMP costs are being incurred today. However, any benefits of Empire’s
11 participation will not be realized until March 1, 2014, at the earliest. My
12 recommendation seeks to better match the recovery of the cost with the benefits that
13 Empire will receive in the future. Under Empire’s proposal, the cost of the IMP will
14 begin to be recovered in rates resulting for this case, effective no later than
15 June 3, 2013, while any benefits of the IMP will be realized no earlier than
16 March 1, 2014.

17 **Q. WHAT IS YOUR RESPONSE TO THE STATEMENTS MADE BY MR. MERTENS IN**
18 **HIS REBUTTAL TESTIMONY REGARDING THESE COSTS?**

19 A. Mr. Mertens states that the software is currently performing the dual role of aiding the
20 Company’s supply management group to perform its current function as well as
21 prepare for the IMP. I am not opposed to splitting the cost between these two
22 functions and deferring only the portion related to preparation for the IMP. However,
23 Mr. Mertens’ rebuttal provides no indication that the new employees are engaged in

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1 any function other than preparing Empire for the IMP. Therefore, I continue to
2 recommend 100% deferral off the employee cost and partial deferral off software
3 costs as a means to better match the cost of Empire's participation in the IMP with the
4 benefits of that participation.

5 **Transmission Tracker**

6 **Q PLEASE DESCRIBE THIS ISSUE**

7 A Empire originally proposed to establish a Transmission Tracker to track the difference
8 between the actual level of certain SPP transmission costs and the amount of these
9 expenses included in base rates. Empire has now changed its proposal and seeks to
10 include these costs in the FAC.

11 **Q WHY HAS EMPIRE CHANGED ITS PROPOSAL TO RECOVER THESE COSTS?**

12 A As stated by Mr. Keith in his rebuttal testimony, Empire is following the Commissions'
13 authorization in Case No. ER-2012-0166 to allow Ameren Missouri to include these
14 costs in the FAC.

15 **Q. IS EMPIRE IN THE SAME SITUATION AS AMEREM MISSOURI WITH REGARD** 16 **TO THESE TRANSMISSION COSTS?**

17 A. No. As Mr. Keith states in his rebuttal testimony, transmission cost is a new
18 component for Empire's FAC. In Ameren Missouri's case, transmission costs were
19 previously included in its FAC and the Commission's order continued that
20 authorization.

1 Q HAS THE COMMISSION PROVIDED GUIDANCE FOR HOW TO TREAT
2 REGIONAL TRANSMISSION COSTS THAT WERE NOT PREVIOUSLY A
3 COMPONENT OF A UTILITIES FAC?

4 A Yes. In Case No. ER-2012-0174, the Commission denied Kansas City Power & Light
5 Company's ("KCPL") request for a transmission tracker for regional transmission
6 costs. In that case, the Commission stated that KCPL already had the authority to
7 defer the cost associated with SPP transmission cost under the Uniform System of
8 Accounts ("USoA").

9 According to the USoA, costs representing more than five percent of the
10 utility's income, computed before the cost, may be deferred for consideration in a
11 future rate case. Therefore, if Empire's SPP transmission costs meet the five percent
12 threshold for materiality, it needs no authority from the Commission to defer these
13 costs. If Empire does not meet the threshold it may still seek an Accounting Authority
14 Order ("AAO") to defer these costs.

15 Q IN THE RECENT KCPL – GREATER MISSOURI OPERATIONS ("GMO")
16 CASE NO. ER-2012-0175, DID THE COMMISSION ALLOW SPP TRANSMISSION
17 COSTS IN GMO'S FAC?

18 A No. Case Nos. ER-2012-0174 and ER-2012-0175 were consolidated and the same
19 Commission ruling discussed above was applicable to both KCPL and GMO.

20 Q HAS THE COMMISSION ALREADY APPROVED NUMEROUS TRACKERS FOR
21 EMPIRE?

22 A Yes. Empire currently has a tracker for vegetation management, pensions, other
23 post-retirement benefits, latan O&M expenses and Plum Point O&M expenses.

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1 Empire also has an FAC which tracks fuel and purchase power costs, net of OSS. I
2 recommend that the Commission not grant Empire the authority to establish another
3 tracker or include SPP transmission costs in the FAC. Instead, I recommend the
4 Commission follow its ruling in the KCPL and GMO rate cases, which recognizes the
5 authority the Company already has to defer costs under the USoA or to seek an AAO
6 to address recovery of SPP transmission costs.

7 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

8 **A** Yes, it does.

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