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Witness: L. Jay Williams
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Sponsoring Party: Empire District Electric
Docket No: ER-2012-0345
Date Testimony Prepared: January 2013

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

Rebuttal Testimony

Of

L. Jay Williams

January 2013



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L. JAY WILLIAMS
ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
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OF
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THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
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1 **INTRODUCTION**

2

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

4 A. L. Jay Williams. My business address is 602 S. Joplin Avenue, Joplin, MO.

5 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

6 A. I am employed by The Empire District Electric Company (“Empire” or
7 “Company”) as Regulatory Tax Manager.

8 **Q. ARE YOU THE SAME L. JAY WILLIAMS WHO PREVIOUSLY FILED**
9 **DIRECT TESTIMONY IN THIS CASE ON BEHALF OF EMPIRE?**

10 A. Yes.

11 **PURPOSE**

12 **Q. PLEASE BRIEFLY SUMMARIZE YOUR REBUTTAL TESTIMONY.**

13 A. My rebuttal testimony concerns errors in the property tax computation made by
14 the Staff of the Missouri Public Service Commission (“Staff”), a revision in
15 deferred taxes included in rate base for deferred taxes related to the Missouri
16 AAO for deferred tornado costs, the recovery of deferred tax benefits related to
17 the Advanced Coal Credit given to customers in our current rates, and Staff’s
18 proposal to give the tax benefits related to the Company’s ESOP plan to
19 ratepayers.

20

1 **STAFF PROPERTY TAX COMPUTATION**

2 **Q. PLEASE DESCRIBE THE PROPERTY TAX COMPUTATION PROCESS**
3 **USED BY STAFF IN THIS CASE.**

4 A. Staff uses a 5-year simple average to determine the ratio of property taxes
5 expensed to taxable plant. For each of the five years preceding the test year, Staff
6 computed this ratio. The ratios were then summed and divided by five. The
7 resulting average ratio was applied to the taxable plant for the test period to
8 determine the proper level of property tax expense to be recovered in the case.

9 **Q. WHAT ERRORS DID YOU DISCOVER IN THE STAFF'S**
10 **COMPUTATION?**

11 A. Staff used amounts of property tax expense for each year which for four of the
12 years did not agree with the Company's books and records. Staff's property tax
13 expense for 2007 agreed to the Company's records and Staff's property tax
14 expense for the year 2011 was immaterially different from the expense levels
15 reflected on the Company's books and records. Staff's property tax expense
16 levels for each of the years 2008 to 2010 reflected tax expense that ranged from
17 approximately \$145,000 to \$725,000 less than the Company's actual booked
18 expense.

19 **Q. WHAT IS REPRESENTED BY THE ACTUAL BOOKED EXPENSE?**

20 A. The actual tax payments charged to operations.

21 **Q. WHAT WAS THE SOURCE OF THE EXPENSE USED BY STAFF?**

22 A. I have not been able to determine the source of property tax expenses used in the
23 Staff calculation.

1 **Q. WERE THERE ANY OTHER ERRORS IN THE STAFF'S**
2 **COMPUTATION?**

3 A. Yes. There is another.

4 **Q. PLEASE EXPLAIN THAT ERROR.**

5 A. Staff property tax calculation intended to add a PILOT (Payment in Lieu of
6 Taxes), related to our Plum Point Plant located in Arkansas, to the expected
7 adjustment for property tax expense in its schedule. However, the PILOT annual
8 payment (\$84,388) was omitted from Staff's total.

9 **Q. WHAT IS THE MAGNITUDE OF BOTH ERRORS IN STAFF'S**
10 **PROPERTY TAX EXPENSE LEVELS IN THIS CASE?**

11 A. The Staff has understated Empire's property tax expense levels by approximately
12 \$480,000.

13 **Q. DO YOU AGREE WITH THE PROPERTY TAX EXPENSE LEVELS**
14 **BEING ADVOCATED BY MISSOURI ENERGY USERS ASSOCIATION**
15 **("MEUA") WITNESS RACKERS?**

16 A. No.

17 **Q. WHY?**

18 A. MEUA proposes to establish ongoing property tax levels essentially based upon
19 the Company's investment in facilities at January 1, 2012. Empire's investment
20 in plant has increased between January 1, 2012 and December 31, 2012, the end
21 of the true up period in this case. MEUA's approach would essentially understate
22 the level of property taxes Empire is facing in the rate effective period 2013, and

1 simply increase the regulatory lag associated with the recovery of a reasonable
2 level of property tax expenses.

3 **DEFERRED TAX RELATED TO THE AAO**

4 **Q. WHAT ADJUSTMENT IS MADE BY STAFF IN THIS AREA?**

5 A. Staff has increased the deferred taxes used to reduce rate base by an amount
6 described to be “Tornado Related AAO”.

7 **Q. DO YOU KNOW WHY STAFF PROPOSED THIS ADJUSTMENT**
8 **REDUCING RATE BASE?**

9 A. No, I do not. The deferred taxes related to the AAO amount are already included
10 in a miscellaneous deferred tax asset account. Staff’s adjustment appears to make
11 this rate base deduction twice.

12 **ADVANCED COAL INVESTMENT TAX CREDIT RECOVERY**

13 **Q. PLEASE EXPLAIN THIS ISSUE.**

14 A. In Missouri Case No. ER-2011-0004, estimates of the amount of Advanced Coal
15 ITC tax benefits to be returned to customers in rates beginning in 2011 were made
16 and the benefits were used to reduce rates. Ultimately, no Advanced Coal ITC
17 was utilized by Empire on its tax return in 2011, in large part due to the Company
18 receiving favorable treatment from the IRS for monies received in connection
19 with the future generation reductions at the Company’s Ozark Beach generation
20 facility (SWPA Payment) which reduced Empire’s ability to use the investment
21 tax credits. Therefore, customers were provided the benefit of the Advanced Coal
22 ITC in advance of Empire utilizing them on the corporate tax return. This is

1 considered a violation under the IRS code if not remedied properly in the next rate
2 case.

3 **Q. DOES THE IRS PROVIDE GUIDANCE AS TO HOW TO REMEDY THIS**
4 **SITUATION?**

5 A. Yes. Estimates used to determine benefits to taxpayers are to be corrected in the
6 first year that new rates are put into place.

7 **Q. WHAT IS THE AMOUNT THAT NEEDS TO BE RETURNED TO THE**
8 **COMPANY FROM RATEPAYERS?**

9 A. Assuming the ITC benefits would have been provided to the ratepayers for a 2-
10 year period before the rates from this case are in place, I estimate the amount to
11 be returned to the Company in this case at approximately \$266,150 (\$163,978
12 grossed up for tax).

13 **Q. HOW WOULD YOU PROPOSE MAKING THE ADJUSTMENT IN**
14 **RATES?**

15 A. Because the recapture of the ITC benefits is to be made over a one year period of
16 time, I suggest that a tracker mechanism be implemented, and the Company's
17 revenue requirement in this case be increased by approximately \$266,000 to
18 recapture the impact of the premature pass through of ITC benefits to the
19 customers that occurred in the last case.

20 **Q. WHAT IS THE POTENTIAL CONSEQUENCE OF NOT FOLLOWING**
21 **THE IRS REGULATIONS IN THIS AREA?**

22 A. This would be considered a normalization violation. As such, the benefits related
23 to ITC and the use of accelerated depreciation would be put at risk. If these two

1 features were lost, it would result in a significant increase in cash outlays related
2 to income taxes and an increase in rate base.

3
4

STAFF AND MEUA ESOP TAX DEDUCTION

5 **Q. CAN YOU EXPLAIN THE SOURCE OF THE EMPLOYEE STOCK**
6 **OPTION PLAN (“ESOP”) TAX DEDUCTION?**

7 A. Yes. This deduction is allowed when ESOP plans elect to give their participants
8 the right to receive dividends currently from company stock held in the plan.

9 **Q. CAN YOU EXPLAIN WHY THIS TAX BENEFIT SHOULD NOT BE**
10 **GIVEN TO RATEPAYERS?**

11 A. Yes. The deduction comes from the participants’ holdings as a shareholder not
12 from company contributions to the plan. In fact, although the Company
13 contributes stock for the benefit of the participants, the employee participants as
14 shareholders have the right to convert their holdings of the Company’s stock into
15 other forms of investment. For example, if all employee participants chose to
16 divest their holdings of Company stock in the plan there would be no tax benefit
17 available to the Company. Therefore, the tax benefit associated with an ESOP
18 should not be required to be returned to ratepayers.

19 **Q. HAS THIS SAME ESOP TAX DEDUCTION ISSUE RECENTLY BEEN**
20 **ADDRESSED BY THE COMMISSION?**

21 A. Yes. The Commission addressed this same issue in a recent Ameren rate case,
22 Case No. ER-2012-0166.

23 **Q. HOW DID THE COMMISSION RULE ON THIS ISSUE IN CASE NO. ER-**
24 **2012-0166?**

1 A. The Commission rejected the adjustment proposed by other parties to the case and
2 indicated the ratepayers did not have any right to the ESOP tax deduction. The
3 Commission's decision in ER-2012-0166 was as follows:

4 "Ameren Missouri ratepayers are not entitled to claim a share of the tax benefits
5 resulting from Ameren Corporation's decision to pay a dividend to Ameren
6 Missouri employees who also happen to be shareholders under Ameren
7 Corporation's ESOP. No portion of the income tax benefit realized on dividend
8 paid on Ameren Corporation shares held in Employee Stock Ownership Plan
9 ("ESOP") accounts should be a reduction to Ameren Missouri's revenue
10 requirement."

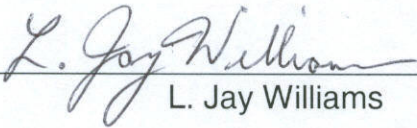
11 **Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?**

12 A. Yes it does.

AFFIDAVIT OF L. JAY WILLIAMS

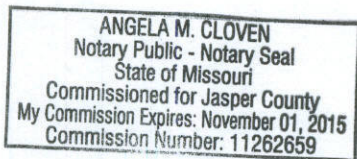
STATE OF MISSOURI)
) **ss**
COUNTY OF JASPER)

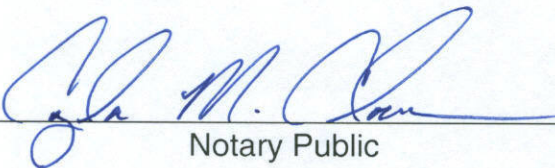
On the 14th day of January, 2013, before me appeared L. Jay Williams, to me personally known, who, being by me first duly sworn, states that he is Retulatory Tax Manager of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



L. Jay Williams

Subscribed and sworn to before me this 14th day of January, 2013.





Notary Public

My commission expires 11/01/15