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Expense, Customer Growth
Witness: Kelly S. Walters
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Sponsoring Party: Empire District
Case No. ER-2004-0570
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**Before the Public Service Commission
of the State of Missouri**

Rebuttal Testimony

of

Kelly S. Walters

November 2004

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OF
KELLY S. WALTERS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

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REBUTTAL TESTIMONY
OF
KELLY S. WALTERS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE
THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2004-0570

1 **I. Introduction**

2 **Q. PLEASE STATE YOUR NAME.**

3 A. Kelly S. Walters.

4 **Q. ARE YOU THE SAME KELLY S. WALTERS THAT HAS PREVIOUSLY**
5 **FILED DIRECT TESTIMONY IN THIS CASE BEFORE THE MISSOURI**
6 **PUBLIC SERVICE COMMISSION ("COMMISSION") ON BEHALF OF**
7 **THE EMPIRE DISTRICT ELECTRIC COMPANY ("EMPIRE" OR**
8 **"COMPANY")?**

9 A. Yes.

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. I will address in this testimony issues involving the payroll adjustment or specifically
12 the Operation and Maintenance ("O&M") Expense Allocation Factor of the adjustment
13 and Outside Services issues raised by Commission Staff ("Staff") witness Sean
14 DeVore; Rate Case Expense issues raised by Staff witness Roberta McKiddy; and
15 Customer Growth issues raised by Staff witness Doyle Gibbs.

16 **O&M Expense Allocation Factor**

1 **Q. PLEASE EXPLAIN, IN GENERAL, THE PAYROLL ADJUSTMENT**
2 **COMPONENT KNOWN AS THE O&M EXPENSE ALLOCATION**
3 **FACTOR.**

4 A. This factor is designed to express the relationship between payroll for electric
5 (O&M) expense to total payroll. In Empire's situation, total payroll includes
6 amounts charged to expense, construction, and retirement for the Company's electric
7 and water operations, as well as the Company's non-utility functions.

8 **Q. HOW IS THE O&M EXPENSE ALLOCATION FACTOR USED IN THE**
9 **PAYROLL ADJUSTMENTS FOR PURPOSES OF SETTING RATES IN**
10 **THIS CASE?**

11 A. Payroll is calculated for total Company for the test period. The O&M expense
12 allocation factor is multiplied times total payroll to obtain total electric payroll
13 expense to be included in rates for the Missouri jurisdiction. In addition, the O&M
14 Expense Allocation Factor is applied to payroll-related adjustments such as 401(k),
15 health care costs, and other employee benefits.

16 **Q. PLEASE EXPLAIN WHY A CHANGE IN THE O&M EXPENSE**
17 **ALLOCATION FACTOR IS AN ISSUE IN THIS CASE?**

18 A. In the Company's original filing, the actual test year level electric O&M allocation
19 factor was used to calculate total electric payroll expense. Staff utilized a five-year
20 average in calculating this allocation factor, including expenses associated with the
21 State Line Combined Cycle construction. The inclusion of these construction
22 expenditures reduced the allocation factor, therefore decreasing electric O&M

1 expense. The results of Staff's adjustment reduced Empire's revenue requirement by
2 approximately \$280,000.

3 **Q. IN REGARD TO THE O&M EXPENSE ALLOCATION FACTOR AS**
4 **REFERENCED IN STAFF WITNESS SEAN DEVORE'S DIRECT**
5 **TESTIMONY, WHAT METHOD DID STAFF USE IN ITS CALCULATION?**

6 A. A five-year average of 70.51 percent was calculated by Staff from historical data
7 provided by Empire.

8 **Q. HOW DO YOU CHARACTERIZE THIS APPROACH?**

9 A. It is not appropriate. This five-year average includes the State Line Combined Cycle
10 construction year which skews the normal average. Empire rarely sees construction
11 projects of the magnitude of the State Line Combined Cycle unit. The most recent
12 occurrence prior to the State Line project was the Asbury coal unit which came on
13 line around 1970. Also, no large projects of this type are planned by Empire for the
14 near future.

15 **Q. WHAT DOES EMPIRE PROPOSE AS AN O&M EXPENSE ALLOCATION**
16 **FACTOR FOR THIS CASE?**

17 A. Empire filed an actual test year O&M expense allocation factor, but would support a
18 three-year average of 71.32%, which would exclude expenses associated with State
19 Line Combined Cycle construction. This three year time frame does however,
20 include the construction of the Company's two Aero units at the Energy Center. The
21 Company believes the inclusion of this type of construction is appropriate, as Empire
22 does plan construction of similar units in the near future.

23 **Outside Services**

1 **Q. WHAT ARE THE CIRCUMSTANCES SURROUNDING THE LEGAL FEES**
2 **FOR THE ENRON FUEL CONTRACT DISPUTE AS DISCUSSED IN THE**
3 **TESTIMONY OF STAFF WITNESS SEAN DEVORE?**

4 A. Empire terminated a fuel contract with Enron effective December 3, 2001 as a result
5 of, among other reasons, the drop in Enron's credit ratings. In October 2003, the
6 Company reached an agreement to settle the dispute for a payment of \$1,000,000.
7 This charge was accrued to fuel expense in the third quarter of 2003.

8 **Q. DO YOU AGREE WITH STAFF THAT LEGAL FEES FOR THE ENRON**
9 **FUEL CONTRACT DISPUTE SHOULD BE EXCLUDED FOR**
10 **RATEMAKING PURPOSES?**

11 A. No. Staff is disallowing legal fees for a single item, the Enron fuel contract dispute,
12 on the grounds that it is a nonrecurring event. This is not appropriate, the fees
13 should be allowed.

14 **Q. WHY SHOULD THE LEGAL FEES ASSOCIATED WITH THIS**
15 **CONTRACT DISPUTE BE ALLOWED?**

16 A. Specific legal disputes, by their nature, are nonrecurring events. Legal disputes
17 arise, however, during the normal course of business. Empire believes it should be
18 allowed to recover these normal costs of doing business.

19 **Q. HAVE EMPIRE'S LEGAL FEES INCREASED IN THE TEST YEAR?**

20 A. Not significantly. Total legal fees declined by 35.9% from 2001 to 2002, but
21 increased by 7.6% from 2002 to 2003. When compared, year by year, the fluctuation
22 varies greatly, which supports the statement that specific legal fees are nonrecurring
23 by nature, but occur generally on a regular basis.

1 **Rate Case Expense**

2 **Q. WHAT EXPENSES OF PROCESSING THIS RATE CASE DOES STAFF**
3 **SEEK TO DISALLOW?**

4 A. Staff seeks to disallow for ratemaking purposes the expenses incurred by Johannes
5 Pfeifenberger and James Vander Wiede.

6 **Q. HOW WERE THE SERVICES OF THESE INDIVIDUALS UTILIZED IN**
7 **THIS CASE?**

8 A. Mr. Pfeifenberger is providing strategic analysis of rate case issues, and Dr. Vander
9 Wiede is an expert witness in the area of Cost of Capital.

10 **Q. WHY HAS STAFF ELIMINATED THESE EXPENSES?**

11 A. Staff Witness Roberta McKiddy states in her direct testimony that Empire has not
12 provided adequate documentation to support the need for such services since the
13 Company has not previously utilized a consultant for rate case strategic analysis or a
14 second expert for Cost of Capital.

15 **Q. IS THERE COMMISSION PRECEDENT FOR ALLOWING TYPES OF**
16 **WITNESSES NOT PREVIOUSLY UTILIZED BY A COMPANY IN A RATE**
17 **CASE OR FOR ALLOWING MULTIPLE WITNESSES FOR A SINGLE**
18 **TOPIC?**

19 A. Yes, in Missouri Gas Energy's Case No. GR-2004-0209 a similar issue arose.

20 **Q. PLEASE EXPLAIN.**

21 A. In that case, rate case expense was a contested issue and the Commission made the
22 following statement in connection with that issue:

1 MGE is entitled to recover its reasonable and prudently incurred cost
2 of presenting this rate case to the Commission. Such costs are
3 routinely accepted as a cost of doing business for which the company
4 will be allowed to recover its costs in rates and no party disputes
5 MGE's right to recover its rate case expenses in this case.

6 The Commission, in the MGE case, allowed the expense for a witness whose
7 testimony the Public Counsel considered "inconsequential" and for a witness whose
8 fees Public Counsel considered too high. In so doing the Commission stated:

9 The Commission is hesitant to disallow expenses incurred by MGE in
10 prosecuting its rate case. The company is entitled to present its case
11 as it sees fit and the Commission will not lightly intrude into the
12 company's decisions about how best to present its case. However, the
13 Commission has a responsibility to ensure that the expenses that the
14 company submits to its ratepayers are reasonably and prudently
15 incurred. Otherwise, the company could take a cost-is-no-object
16 approach to its rate case presentation, secure in the knowledge that the
17 ratepayers would be required to pay for any cost that the company
18 might incur.

19 **Q. HAS EMPIRE TAKEN A COST-IS-NO-OBJECT APPROACH IN THIS**
20 **CASE?**

21 A. No. Empire engaged Mr. Pfeifenberger and Dr. Vander Wiede in the current case to
22 assist in the preparation and presentation of the facts and circumstances surrounding
23 Empire's need for rate relief.

1 **Q. WHAT IS EMPIRE'S GENERAL APPROACH FOR DETERMINING THE**
2 **NEED FOR CONSULTANTS IN A RATE CASE?**

3 A. Empire determines its need for outside assistance on a case by case basis. This
4 determination is based on the areas expected to be or those areas which become of
5 primary importance. As these areas develop, Empire determines the internal
6 resources available, and then, if necessary, looks outside for additional resources.
7 When time is of the essence, Empire usually hires consultants with whom it has had
8 prior experience.

9 **Q. WHEN TIME IS NOT OF THE ESSENCE, WHAT PROCESS DOES THE**
10 **COMPANY USE TO SELECT CONSULTANTS?**

11 A. When Empire knows a special study will be needed in a rate case, a request for
12 information is prepared and submitted to potential participants. This process was
13 utilized to solicit interest for the depreciation study and for the loss study, both of
14 which are parts of this case.

15 **Q. DO CONTROLS EXIST TO MONITOR THE COST INCURRED BY**
16 **CONSULTANTS?**

17 A. Yes. When consultants are employed, contact is maintained with each consultant by
18 personnel involved with the case. Each invoice is reviewed and approved by
19 management prior to the payment being processed.

20 **Customer Growth**

21 **Q. PLEASE DESCRIBE THE CUSTOMER GROWTH ADJUSTMENT MADE**
22 **BY STAFF?**

1 A. Staff calculated the customer growth adjustment by multiplying the test year average
2 annual as-billed weather-normalized revenue per customer for each tariff class by the
3 number of customers in the respective tariff class at June 30, 2004, the end of the
4 update period in this case. The difference between the product of this calculation and
5 the test year annual as-billed weather-normalized revenue is the adjustment for
6 customer growth for that tariff class.

7 **Q. WHAT IS THE IMPACT OF THIS ISSUE?**

8 A. One aspect of Staff's customer growth adjustment increased test year revenues by
9 \$1,030,431 thereby decreasing the Company's revenue requirement by that same
10 amount. A single component of the customer growth adjustment created this
11 adjustment and is discussed below. Company and Staff are currently working to
12 resolve this issue.

13 **Q. DO YOU AGREE WITH THIS ADJUSTMENT?**

14 A. No. The customer growth adjustment is incorrect for the CB and GP customers.
15 During the test year, there were twenty-three customers that moved from the General
16 Power (GP) rate class to the Commercial (CB) rate class. Likewise there were sixty-
17 six customers that moved from CB to GP. These customers are neither new nor did
18 they have significant changes in usage.

19 **Q. WHAT EFFECT DO THESE CUSTOMERS HAVE ON THE GROWTH**
20 **ADJUSTMENT?**

21 A. The average usage for CB customer is approximately 1,500 kWh whereas the GP
22 average usage is approximately 45,000 kWh. As a result, the customers making the
23 moves typically have a high average usage compared to other CB customers and a

1 low average usage compared to other GP customers. The result of the customer
2 switches in the growth adjustment would be an increase of forty-three customers to
3 GP. This would result in approximately 1,935,000 additional kWh per month prior
4 to the growth adjustment calculation. Likewise the CB rate class would be reduced
5 for these same customers but only 64,500 kWh per month before the growth
6 adjustment calculation. The outcome is a significant increase to the GP rate class
7 and small reduction to the CB rate class for growth that did not exist.

8 **Q. HOW SHOULD THE CUSTOMER CHANGES BE HANDLED IN THE**
9 **CUSTOMER GROWTH CALCULATION?**

10 A. The customers that made the rate class switches between CB and GP should be
11 identified due to the great discrepancy in the average usage within these two rates.
12 Those customers along with the kWh and revenues for those customers should be
13 eliminated from the customer growth calculation.

14 **Q. DID THE COMPANY PREPARE A CUSTOMER GROWTH**
15 **CALCULATION REFLECTING THESE CHANGES?**

16 A. Yes. In order to do the calculation, we used the customer growth schedule provided
17 by Staff Witness Doyle Gibbs in his work papers. We identified each of the
18 customers involved and removed the customers and kWh from the calculations. We
19 then used an average rate for the respective rate classes to remove the revenues.
20 When these adjusted amounts were applied to Staff's customer growth calculation,
21 the results were a reduction of the growth adjustment by 18,343,728 kWh and
22 \$1,030,431 in revenues. These customers were simply on the wrong rate and should
23 not cause growth on the system.

1 **Q. HAS STAFF MADE SIMILAR ADJUSTMENTS?**

2 A. Yes.

3 **Q. PLEASE EXPLAIN.**

4 A. Staff witness Janice Pyatte adjusted the GP and Large Power (LP) rates for customer
5 changes of three accounts. These customers were reclassified from GP to LP during the
6 test year. Janice removed the customers from the GP totals (customer count, kWh,
7 and revenues). The customers were not included in the GP average for computing
8 customer growth. The customers were considered LP customers for the entire test
9 year.

10 **Q. HOW HAVE SIMILAR CIRCUMSTANCES BEEN HANDLED IN PRIOR**
11 **CASES?**

12 A. During the previous Empire rate case, Case No.ER-2001-299, we discovered a large
13 amount of switches (over 150) which had taken place during the 6 month true-up
14 period between CB & GP. These customers were removed by Empire and Staff for
15 the true-up growth calculation. Although this level of detail has not always been
16 prepared, during the past few years an unusual number of rate changes have taken
17 place between these two groups.

18 Switches into and out of rate groups are usually between groups with like usage.
19 In these instances, the growth calculation will offset these switches. In the case
20 of a customer switch between CB, a rate group with average usage of 1,500 kwh
21 and GP, a rate group with average usage of 45,000 kwh, the customer growth
22 calculation can be misrepresented. Therefore, the usage and revenues were

1 removed. By removing these customers along with their corresponding kWh

2 and revenue, growth is better represented.

3 During the 2003 test year, the number of moves between these two rate groups

4 decreased (around 90), but is still a significant factor in the growth calculation.

5 Hopefully this problem will be resolved to a point of not being material in the future.

6 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

7 A. Yes.