Exhibit No.:	
Issue:	Revenue Requirement
Witness:	Stephen M. Rackers
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Midwest Energy Users' Association
Case No.:	ER-2012-0345
Date Testimony Prepared:	November 30, 2012

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 for Electric Service Provided to Customers in the Missouri Service Area of the Company	**)**	**Case No. ER-2012-0345**

Direct Testimony and Schedule of

Stephen M. Rackers

Revenue Requirement

On behalf of

Midwest Energy Users' Association

November 30, 2012

BRUBAKER & ASSOCIATES, INC.

Project 9669

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 for Electric Service Provided to Customers in the Missouri Service Area of the Company	)	**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 are my direct testimony and schedule, which were 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 and schedule are true and correct and that they show the matters and things that they purport to show.

Stephen M. Rackers
Stephen M. Rackers

Subscribed and sworn to before me this 29th day of November, 2012.

MARIA E. DECKER
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis City
My Commission Expires: May 5, 2013
Commission # 09706793

Maria E. Decker
Notary Public

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<u>Direct Testimony of Stephen M. Rackers</u>

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<u>Direct Testimony of Stephen M. Rackers</u>

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q WHAT IS YOUR OCCUPATION?

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

Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A This information is included in Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A This testimony is presented on behalf of the Midwest Energy Users' Association ("MEUA"). These companies purchase substantial amounts of electricity from Empire District Electric Company ("Empire" or "Company") and the outcome of this proceeding will have an impact on their cost of electricity.

Q PLEASE SUMMARIZE THE ISSUES YOU ARE ADDRESSING IN YOUR TESTIMONY.

A I am recommending several adjustments to the Company's proposed revenue requirement. In total, they reduce Empire's proposed revenue requirement by approximately $11.8 million. Listed below is each adjustment with a short explanation discussing the adjustment and the approximate value of the issue:

1. Outside Services - I am recommending the disallowance of Empire's adjustment to increase test year operating expenses for additional consulting costs.
   Approximate Value - $1 million

2. Expiring Ice Storm Amortizations – I am recommending elimination of the ice storm amortizations which expire in 2012.
   Approximate Value - $3 million

3. Property Tax – I recommend a reduction to operating expense by including only the actual allocated portion of the property tax paid in 2012 in Empire's cost of service.
   Approximate Value - $0.5 million

4. Cash Working Capital – I am recommending a reduction to the billing lag component of the revenue lag Empire used to calculate its level of cash working capital included in rate base.
   Approximate Value - $0.5 million.

5. Off-system Sales – I recommend including an amount of OSS margin as a reduction to the net base fuel cost included in the cost of service.
   Approximate Net Value - $2 million

6. Bad Debts – I am recommending a level of bad debts expense, based on the five-year average of the actual write-offs experienced by Empire from April 2007 through March 2012. In addition, I oppose Empires adjustment to factor-up the revenue requirement for additional bad debts.
   Approximate Value - $0.2 million

7. Bank Fees – I am recommending a reduction to operating expense for the capitalization of the annual level of bank fees associated with securing Empire's short-term line of credit.
   Approximate Value - $0.4 million

8. Payroll Expense – I recommend the elimination of additional payroll expense and related taxes for unfilled employee positions, and certain bonus and incentive compensation included in operating expense by Empire.
   Approximate Value - $2.6 million

9. Prepayments – I recommend reducing rate base for the prepayments that reflect annual costs and are already included in cash working capital.
   Approximate Value - $0.5 million

10. Southwest Power Pool Cost Deferral – I recommend deferral of the costs Empire has included in its case to prepare for the implementation of the Southwest Power Pool Integrated Market Place.
    Approximate Value - $0.4 million

11. Employee Stock Ownership Plan – I recommend reducing Empire's taxable income for the calculation of income tax to recognize a deduction for the dividends paid on stock in the Employee Stock Ownership Plan.
    Approximate Value - $0.5 million

I will also address the Company's request to establish a tracker for transmission expenses and explain why a tracker should not be allowed. The fact that I do not address a particular issue should not be interpreted as approval or acceptance by MEUA of any position taken by Empire, unless I state otherwise in my testimony.

I have included a table of contents that lists each issue and the corresponding beginning page for that issue.

Q ARE ANY OTHER REVENUE REQUIREMENT WITNESSES APPEARING ON BEHALF OF MEUA?

A Yes. Michael Gorman provides testimony on cost of capital issues. His recommendations reduce Empire's revenue requirement by approximately $11.2 million. So in total, MEUA is recommending at least a $23 million reduction to Empire's original request to increase rates by $30.7 million.

Schedule SMR-1 attached to my testimony details the reduction to Empire's revenue requirement proposed by MEUA witnesses.

<u>Outside Services</u>

Q PLEASE EXPLAIN THIS ISSUE.

A Empire proposes to increase the test year level of outside services expense by approximately $1 million to reflect a three-year average, based on the 36 months ended March 31, 2012 plus an adjustment for accounting services.

Q WHAT IS EMPIRE'S JUSTIFICATION FOR THE ADDITIONAL $1 MILLION?

A Company witness Scott Keith provides a single question and answer that merely describes the calculation of the adjustment and mentions the normalization of integrated resource planning ("IRP") costs. While there is an indication that the test year does not include sufficient IRP costs and some accounting cost, the amount that was incurred for other outside services costs is not explained or justified. There is not even a statement saying that the level incurred in the past was appropriate or that it is indicative of the appropriate on-going level and there is certainly nothing supporting such a conclusion in the Company's testimony or workpapers.

In its workpapers, Empire provides a list of vendor names, dates, amounts and various other transaction codes. They also show an increase to the average for additional accounting costs. There is little or no explanation of what these vendors provided and whether the charges are one-time events or represent recurring fees.

Q DID YOU REQUEST ADDITIONAL DATA FROM EMPIRE REGARDING THESE EXPENSES?

A Yes. I submitted data requests in an attempt to determine whether Empire's adjustment was appropriate. Two of these data requests were objected to by Empire. The responses to the other four data requests update the expenditures for 2012 and provide additional detail regarding IRP costs. These data request responses do not justify the level of outside services requested by Empire.

Q WHAT IS YOUR RECOMMENDATION REGARDING EMPIRE'S ADJUSTMENT TO OUTSIDE SERVICES?

A As a result of the lack of information and justification, I recommend that the Commission eliminate Empire's proposed adjustment to increase the test year level of outside services expense, and reduce the Company's cost of service by approximately $1 million.

Expiring Ice Storm Amortizations

Q PLEASE EXPLAIN THIS ISSUE.

A In 2007, Empire experienced two ice storms within its service territory. A Non-unanimous Stipulation and Agreement in Case No. ER-2008-0093 states that for future ratemaking, the amortizations of the January 2007 storm and the December 2007 storm will begin in February of 2007 and January 2008, respectively. The term of the December storm was specified as lasting five years. Using a five-year term for both storms results in an expiration of both amortizations in 2012. Therefore, the test year should be reduced by the amortization expense associated with these two storms, since both will expire by the true-up cut-off date of December 31, 2012.

Q ARE THE AMORTIZATIONS OF THESE STORMS INCLUDED IN THE COST OF SERVICE?

A Yes. Empire has been amortizing the storm cost to distribution expense accounts. The amortization for the January 2007 storm expired in January 2012 and the December 2007 storm will expire in December 2012.

Q BASED ON THE STIPULATION IN ER-2009-0093 AND EMPIRE'S BOOKING, HOW SHOULD THESE AMORTIZATIONS BE TREATED IN THE CURRENT CASE?

A The expiration of the amortizations should be reflected in a reduction to the test year cost of service proposed by Empire. The amount of the reduction should reflect the level of amortization that occurred during the test year, approximately $3 million.

Property Tax

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

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

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

A No. I believe Empire has overstated the level of property taxes that should be reflected in the cost of service. The 2012 property taxes that will be paid in December of 2012 are based on the taxable investment that existed on January 1, 2012. By applying the estimated 2012 tax rate to the December 2012 trued-up investment amounts, Empire is attempting to include the taxes that will be paid in December of 2013.

Q WHY IS THIS LEVEL OF PROPERTY TAXES INAPPROPRIATE FOR THE CURRENT RATE CASE?

A First, the 2013 property taxes will not be paid until December 31, 2013, which is 12 months beyond the true-up cut-off date in this case. Second, Empire does not know the tax rate or the assessed value that will apply to the property in 2013. As a result, Empire's far reaching property tax proposal will not be known and measurable as of the true-up cut-off date.

Q WHAT LEVEL OF PROPERTY TAXES DO YOU PROPOSE?

A I am proposing the actual level of property taxes that Empire will pay in December 2012. To calculate my adjustment to Empire's cost of service, I am using the budgeted 2012 property tax as a placeholder. I recommend that this level be trued-up to the Missouri jurisdictional electric portion of the actual payment for 2012, net of any amount capitalized or associated with non-utility and future use property.

Q WHAT IS THE REVENUE REQUIREMENT EFFECT OF YOUR PROPOSAL?

A My proposal would reduce Empire's revenue requirement by approximately $0.5 million.

Cash Working Capital ("CWC")

Q PLEASE BRIEFLY EXPLAIN THE TERMS LEAD-LAG STUDY, REVENUE LAG, COLLECTION LAG AND EXPENSE LEAD.

A A lead-lag study analyzes the cash inflows and outflows of payments the Company receives from its customers for the service it provides and the disbursements it makes to provide that service. A lead-lag analysis compares the number of days that the utility is allowed to take or actually takes to make payments after receiving service from a provider (expense lead), with the number of days it takes the utility to receive payment for the service provided to customers (revenue lag). The revenue lag, net of the expense lead, divided by 365 days, is multiplied by the operating expenses and taxes incurred to provide service.

The revenue lag is comprised of three time components: usage lag, billing lag and collection lag. The usage lag reflects the period of time during which the customer receives service. The billing lag is the time period from the meter reading date through the billing statement date. The collection lag is the time period from the bill statement date through the date a customer pays the bill. My testimony will address the issue I have with the billing lag component of the revenue lag calculated by Empire. Although I am not proposing an adjustment, I will also address a concern I have with Empire's calculation of collection lag.

Q PLEASE EXPLAIN THE BILLING LAG ISSUE.

A Empire is proposing to include approximately a five-day billing lag in its calculation of CWC. Depending on the billing process and the measurement date for this component, I believe the billing lag should be no longer than one day. In this case I am recommending a zero-day billing lag. Given that Empire relies on automated meter reading, the customer billing date is usually the same day the meter is read.

Q IF THE BILLING STATEMENT DATE IS THE SAME DAY AS THE METER READING DATE, HOW DOES EMPIRE JUSTIFY A FIVE-DAY BILLING LAG?

A Empire's five-day billing lag reflects excessively long billing lags for bill corrections that Empire subsequently bills its customers. For example, if Customer A is billed in January for service, the billing lag for January would be zero days. If subsequent to January, Empire discovers in March that Customer A should have been billed an additional $5 for January, Empire proposes to reflect a billing lag for that $5 of approximately 60 days. However, the actual bill statement for March service reflects the same day as the customer's meter was read. The suggestion that one portion of Customer A's bill had a zero billing lag and another portion of the same bill had a 60-day billing lag is novel, to say the least.

Q DO YOU AGREE WITH EMPIRE'S PROPOSED METHOD OF DETERMINING THE BILLING LAG?

A No. To suggest that bill corrections from a previous bill cycle lengthens the billing lag is completely unfounded. This is an attempt by Empire to lengthen the revenue lag by expanding the billing lag and this proposal should be rejected by the Commission. The billing lag is a discrete time frame that simply reflects the processing of meter reading data to create customer bills. Once new charges are identified the same amount of time is incurred to create a customer bill.

Q HOW DID YOU DETERMINE A ZERO BILLING LAG?

A I believe the billing lag should reflect the time period associated with the normal billing practices for current usage. Billing data provided by Empire shows that normally the bill statement date for current usage is the same as the meter reading date. The bill statement date is also the date revenues are reflected in accounts receivable. Empire is basing the collection lag on an accounts receivable turn-over calculation, which reflects the timeliness of its collection process. Therefore, since the meter reading date, which is the end of the usage lag, is the same date as the billing statement date, which is the beginning of the collection lag, there is no time period reflecting a billing lag. Therefore, the billing lag is zero.

Q WHAT IS THE REVENUE REQUIREMENT EFFECT OF A ZERO BILLING LAG?

A The use of a zero billing lag reduces Empire's revenue requirement by approximately $0.5 million.

Q WHAT IS YOUR CONCERN REGARDING THE COLLECTION LAG?

A Empire is using an accounts receivable turn-over calculation to determine its collection lag, including an adjustment for the estimated effect of uncollectible accounts. I do not believe this calculation tracks the actual payment habits of individual customers. Based on my past experience I am aware that Ameren Missouri maintained a report that tracked the payments made by individual customers. This report was used by both the Company and the Staff to determine the collection lag in Ameren Missouri rate cases for over twenty years. I believe this report was superior to any other method of calculating the collection lag, because it measured the actual payment habits of customers without the use of estimates. I recommend to the Commission that it require each major electric and gas company in the state to develop a report that measures the collection lag based on the actual payment habits of all customers.

Off-System Sales ("OSS")

Q PLEASE EXPLAIN THIS ISSUE.

A Empire is proposing to eliminate all OSS revenues and expenses from the rates established in this general rate case. Under Empire's proposal, only the fuel and purchased power cost required to serve its retail customers would establish the net base fuel cost included in the rates determined in this case. Empire is proposing that the revenues net of expenses (margin) associated with OSS flow directly to the fuel adjustment clause ("FAC"), which captures the fuel and purchased power cost in excess of the amount recognized in the previous general rate case. Under Empire's proposal, the entire OSS margin would offset the fuel and purchased power changes captured by the FAC. I recommend that the net base fuel cost reflected in the rates established in this case include a component for OSS margins. Any change from the fuel and purchased power costs, net of OSS margins, included in the calculation of rates from this case will be captured in the FAC.

Q IN THE COST OF SERVICE RESULTING FROM THE GENERAL RATE CASE IN WHICH AN FAC WAS INITIALLY AUTHORIZED FOR EMPIRE, DID THE COMMISSION RECOGNIZE A LEVEL OF OSS MARGIN?

A Yes. When Empire was initially authorized to use an FAC in Case No. ER-2008-0093, the Commission recognized a level of OSS margin in the cost of service resulting from that case. In fact the OSS margin recognized, over

$6 million, was higher than the margins actually experienced in any of the previous five years from July 2002 through June of 2007.

Q ARE OSS MARGINS INCLUDED AS AN OFFSET TO THE FUEL AND PURCHASED POWER COST ESTABLISHED DURING A GENERAL RATE CASE FOR THE OTHER ELECTRIC UTILITIES IN MISSOURI THAT HAVE AN FAC?

A Yes. OSS margins are included as an offset to the fuel and purchased power costs in the most recent general rate cases for both Kansas City Power and Light Company's Greater Missouri Operations and Ameren Missouri. The fuel and purchased power cost, net of OSS margins reflected in retail rates is referred to as "net base fuel cost". The FACs for these Companies capture the change between the net base fuel costs established in the most recent general rate case and the fuel and purchased power, net of OSS margins actually experienced.

Q WHY IS IT APPROPRIATE TO INCLUDE A LEVEL OF OSS MARGIN IN NET BASE FUEL COST?

A As the Commission stated in Case No. ER-2008-0093:

> "Since the power Empire is able to sell is produced by generating plants paid for by ratepayers, profits (revenues less incurred fuel costs) from these off-system sales should be recognized as a reduction to the company's revenue requirement. For purposes of this case, the Commission must determine the amount of off-system sales margin to be included when calculating the amount of revenue Empire should be allowed to recover in rates."

In addition, the FAC should be designed to recover the amount of the difference between the fuel and purchased power net of OSS margins, included in net base fuel cost and the level actually experienced. Only the amount over or under the net base fuel cost would be subject to a 95% - 5% incentive, that allows recovery or refund of 95% of the difference and requires Empire to retain or adsorb 5%. Specific to OSS margins, customer's rates will reflect 100% of the OSS margins included in the net base fuel cost established in the most recent rate case, and 95% of the difference between the OSS margins included in the net base fuel cost and the actual level experienced, which is captured in the FAC. Empire should only retain or absorb 5% of the difference between the OSS margins included in net base fuel cost and the level actually experienced.

Q UNDER EMPIRE'S PROPOSAL, WILL THE COMPANY AUTOMATICALLY RETAIN 5% OF ALL OSS MARGINS?

A Yes. Contrary to the Commission's Order in Case No. ER-2008-0093 and the methodology used in general rate cases for the other utilities in Missouri with FACs, under its proposal Empire would retain 5% of all OSS margins. If OSS margins are only reflected as a reduction to the difference in the fuel and purchased power cost captured by the FAC, all the risk associated with not achieving the level of OSS margins included in retail rates will be removed and Empire will automatically retain 5% of all the profit associated with OSS. In other words, under Empire's proposal there would be a permanent sharing of all OSS margins between ratepayers (95%) and shareholders (5%). Based on the order in Case No. ER-2008-0093, this does not appear to be the intent of the Commission when it originally established Empire's FAC. In that case Empire, Staff and Office of Public Counsel all recommended that retail rates include a level of OSS margins and the Commission concurred.

Q WHAT LEVEL OF OSS MARGIN HAS EMPIRE HISTORICALLY EXPERIENCED?

A The table below shows the OSS Margins experienced during the five years ending June 30, 2007 that was presented in the order in Case No. ER-2008-0093.

12 Months Ended	Gross Profit (Margin)
June 30, 2003	$ 5,645,701
June 30, 2004	$ 2,023,298
June 30, 2005	$ 1,903,970
June 30, 2006	$ 3,798,127
June 30, 2007	$ 3,920,823

The following table shows the Missouri Jurisdictional OSS margins experienced during the five years ending in December 31, 2011, based on Empire's response to MEUA Data Request 40.

12 Months Ended	Gross Profit (Margin)
December 31, 2007	$ 4,862,436
December 31, 2008	$ 6,674,146
December 31, 2009	$ 2,058,195
December 31, 2010	$ 691,385
December 31, 2011	$ 1,558,585

Q WHAT LEVEL OF OSS MARGINS ARE YOU PROPOSING TO INCLUDE IN NET BASE FUEL COST IN THIS CASE?

A I recommend an OSS margin of $2 million be included in net base fuel cost in this case as a reduction to Empire's cost of service.

Q WHY IS THIS LEVEL OF OSS MARGIN APPROPRIATE?

A This level was achieved as recently as 2009, which was prior to Empire's 2010 capacity additions. On September 1, 2010 and December 31, 2010, Plum Point and Iatan 2 generating stations, respectively, began commercial operations. Through ownership and purchase power agreements, Empire acquired approximately 200 MWs of additional capacity.

Also, in 2011, Empire did not have full use of either Iatan 1 or 2, due to flooding on the Missouri River. In addition, according to Empire's 10K report to the Securities and Exchange Commission, the amount of off-system sales was reduced during 2011 due to excessive heat that required Empire to use its resources to serve its own load.

The above discussions demonstrate that the OSS margins in the most recent annual periods were constrained. As a result, an amount approximately equal to the actual OSS margin achieved in 2009 should be included in net base fuel cost in this case.

<u>Bad Debts</u>

Q PLEASE EXPLAIN THIS ISSUE.

A Empire is proposing to calculate bad debts expense by multiplying the adjusted revenues by an average write-off rate. The write-off rate reflects an average of the actual accounts written-off as a percentage of revenues for 60 months ended March 31, 2012. I recommend using an average of the actual write-offs Empire experienced during the five years ended March 31, 2012 to calculate the annualized level of bad debts expense.

In addition, Empire applied its write-off rate to the increase in revenue requirement it is requesting in this case. I believe this adjustment is inappropriate and overstates bad debt expense.

Q WHY IS IT MORE APPROPRIATE TO USE ACTUAL WRITE-OFFS RATHER THAN DEVELOP A FACTOR AS A PERCENTAGE OF REVENUES?

A I do not believe there is a strong relationship between revenues and write-offs. The table below shows the write-offs and the revenues during the five years ended March 31, 2012. As the table shows, revenues increased each year. However, write-offs increased and decreased significantly.

	Write-offs	Revenues
12 Mo Ended March 2012	$ 2,718,955	$ 416,550,240
12 Mo Ended March 2011	$ 1,859,716	$ 396,906,531
12 Mo Ended March 2010	$ 1,656,318	$ 355,381,831
12 Mo Ended March 2009	$ 1,813,949	$ 348,173,652
12 Mo Ended March 2008	$ 2,490,464	$ 344,400,505
Total Percentage Change		

Q METHODOLOGY ASIDE HAS EMPIRE CALCULATED ITS WRITE-OFF PERCENTAGE CORRECTLY?

A No. The write-off rate should be dollar weighted rather than taking an average of monthly percentages. The need for dollar weighting is shown in the following example for calculating the write-off percentage for an annual period.

	Simple Average				Dollar Weighted		
	Write-Offs	**Revenues**	**Write-Off %**		**Write-Offs**	**Revenues**	**Write-Off %**
Jan	$ 200	$ 10,000	2%	**Jan**	$ 200	$ 10,000	2%
Feb	$ 30	$ 1,000	3%	**Feb**	$ 30	$ 1,000	3%
Mar	$ 100	$ 10,000	1%	**Mar**	$ 100	$ 10,000	1%
Apr	$ 30	$ 1,000	3%	**Apr**	$ 30	$ 1,000	3%
May	$ 100	$ 10,000	1%	**May**	$ 100	$ 10,000	1%
Jun	$ 30	$ 1,000	3%	**Jun**	$ 30	$ 1,000	3%
Jul	$ 200	$ 10,000	2%	**Jul**	$ 200	$ 10,000	2%
Aug	$ 10	$ 1,000	1%	**Aug**	$ 10	$ 1,000	1%
Sep	$ 20	$ 1,000	2%	**Sep**	$ 20	$ 1,000	2%
Oct	$ 100	$ 10,000	1%	**Oct**	$ 100	$ 10,000	1%
Nov	$ 30	$ 1,000	3%	**Nov**	$ 30	$ 1,000	3%
Dec	$ 200	$ 10,000	2%	**Dec**	$ 200	$ 10,000	2%
		Average	**2%**	**Total**	**$1,050**	**$ 66,000**	**1.6%**

In the table above, the write-off rate for the year is 1.6%, based on the amount of revenues and write-offs actually experienced during the year. Using a simple average of the monthly write-off rate results in an incorrect write-off rate of 2%. When applied to $40 million of revenue this difference would result in a $160,000 overstatement of bad debt expense.

Q WHY IS EMPIRE'S ADDITIONAL ADJUSTMENT TO INCREASE BAD DEBT EXPENSE BY FACTORING-UP THE REVENUE REQUIREMENT IN THIS CASE BY THE WRITE-OFF RATE INAPPROPRIATE?

A As I have previously shown, there is not a strong relationship between the change in revenues and the change in write-offs. Therefore, it is inappropriate to simply assume that every dollar increase in revenues will result in a fixed percentage increase in the level of bad debts.

In addition, this adjustment goes far beyond the true-up date and operation of law date in this case. There is a several month lag between when the date revenues are recognized and an account is later written-off as a bad debt. As a result, no portion of the bad debts Empire seeks through this adjustment will be realized until well after the operation of law date and over six months beyond the true-up cut-off date in this case. The additional bad debts Empire is proposing to include in rates through this adjustment will not be fully realized, if at all, beyond June of 2014. The adjustment clearly violates the test year and true-up concepts of a rate case whereby all relevant factors are analyzed to a consistent point in time. Therefore, I propose that the Commission disallow Empire's proposed increase in bad debts expense relating to the increased revenue requirement of this case.

Q WHAT IS THE REVENUE REQUIREMENT VALUE OF YOUR TOTAL ADJUSTMENT TO EMPIRE'S PROPOSED BAD DEBTS EXPENSE?

A My recommendation for bad debts expense reduces Empire's revenue requirement by approximately $0.2 million.

<u>Bank Fees</u>

Q PLEASE EXPLAIN THIS ISSUE.

A Empire is proposing to include in operating and maintenance expense, the cost of obtaining its short-term debt line of credit. I recommend capitalization of this cost instead.

Q WHY IS CAPITALIZATION THE APPROPRIATE TREATMENT OF THESE COSTS?

A Short-term debt is generally recognized as a source of financing for construction. In addition, no short-term debt has been recognized in the capital structure in this case.

The Federal Energy Regulatory Commission ("FERC") formula for the calculation of the Allowance for Funds Used During Construction ("AFUDC") rate is based on short-term debt being used first to fund Construction Work In Progress ("CWIP"). For this reason, if the average balance of short-term debt is lower than the average balance of CWIP, generally no short-term debt is recognized in the capital structure used to set rates.

In the current case, the average balance of short-term debt is lower than the average balance of CWIP and no short-term debt has been included in the capital structure recommended by either Empire or MEUA. As a result, the cost of obtaining this lower cost of debt should follow the treatment of the debt and also be capitalized rather than recovered in rates as an expense.

Q IS THIS TREATMENT SIMILAR TO THE TREATMENT AFFORDED THE COST OF FINANCING LONG-TERM DEBT?

A Yes. The cost of obtaining long-term debt is factored into the cost of capital assigned to the long-term debt component of the weighted cost of capital. This cost is included in the cost of service through the application of the weighted cost of capital, which contains a component for long-term debt to the rate base. In the same way that the interest cost of short-term debt is treated as a construction cost, my recommendation also treats the cost of obtaining the short-term debt as an additional construction cost.

Q HAS THIS TREATMENT BEEN PROPOSED AND ADOPTED BY ANY OTHER UTILITY IN MISSOURI?

A Yes. Ameren Missouri is capitalizing its cost of obtaining short-term debt.

Q WHAT IS THE REVENUE REQUIREMENT VALUE OF THIS ADJUSTMENT?

A My recommendation to capitalize the cost of bank fees reduces Empire's revenue requirement by approximately $0.4 million.

Payroll

Q PLEASE EXPLAIN THIS ISSUE.

A Among other adjustments, Empire has included in its calculation of annualized payroll amounts for expected employee additions, cash bonuses, cash incentives and stock incentives. I am opposed to including the increase in payroll for expected employee increases, discretionary cash bonuses and stock incentives.

Q WHY DO YOU OPPOSE THE INCLUSION OF ESTIMATED EMPLOYEE ADDITIONS?

A Based on Empire's response to Staff Data Request 34, the actual number of employees had declined. Through July of 2012, employees have declined from the end of the test year and the average during the test year. These numbers do not support an increase in payroll due to changes in employee levels. I propose continued monitoring of the actual employee changes through the true-up cut-off date of December 31, 2012 for consideration of adjustments to the test year as part of the true-up process.

Q WHY ARE YOU PROPOSING TO EXCLUDE DISCRETIONARY CASH BONUSES AND STOCK INCENTIVES?

A Incentive payments should be based on goals that are known in advance to the employee and establish a basis for achieving and measuring actual performance. These goals should also have a direct connection to improvement in operating performance or quality of service to the ratepayer, rather than efforts to increase earnings, stock price or for participation in activities that provide no benefits to ratepayers.

In its Order in Case No. ER-2006-0315, the Commission accepted the above criteria and disallowed discretionary cash and stock incentive awards. In Case Nos. EC-87-114 and EC-87-115, the Commission found that, at a minimum, an acceptable management performance plan should contain goals that improve existing performance and the benefits of the plan should be ascertainable and reasonably related to the plan.

Q DOES THE BONUS AND INCENTIVE PAYMENTS YOU RECOMMEND ELIMINATING MEET THE COMMISSION'S CRITERIA?

A No. The cash payments I recommend eliminating are discretionary. As a result, there are no established goals and the employee does not know in advance what specific performance is required to achieve the incentive payment.

The stock incentives are awarded as a result of financial goals and employee retention. These awards improve stockholder value rather than operating performance and improved customer service.

Q HOW HAVE YOU CALCULATED THE AMOUNT OF INCENTIVE COMPENSATION YOU RECOMMEND ALLOWING?

A I recommend allowing only the officer and management performance incentives that were earned or charged to expense during the test year. Officer performance incentives for 2011 were not paid as a result of a dividend suspension and were replaced by a discretionary cash bonus. I have substituted the incentive performance awards that were earned, as provided in response to Staff Data Request 49.

Q WHAT IS THE REVENUE REQUIREMENT VALUE OF THIS ADJUSTMENT?

A My recommendation to eliminate these payroll costs reduce Empire's revenue requirement by approximately $2.6 million.

Prepayments

Q PLEASE EXPLAIN THIS ISSUE.

A Empire is seeking to include a 13-month average of all its prepayments in rate base. I am recommending that only a portion of the prepayments be included in rate base.

Q WHAT PORTION OF PREPAYMENTS SHOULD BE INCLUDED IN RATE BASE?

A Prepayments are included in rate base in recognition that shareholders have made an up-front investment in the working capital needed for utility operations. However, some of the prepayment accounts simply represent payments made in advance for annual expenses. The investment necessary to fund these annual expenses are also being measured in the calculation of CWC. Therefore, I recommend including only the prepayment balances that represent ongoing multi-year investments, which were identified by Empire in response to MEUA Data Request 41.

Q HOW ARE THE ANNUAL PREPAYMENT AMOUNTS MEASURED IN CWC?

A CWC represents the cash necessary to fund the day-to-day operations associated with the expenses of the utility. Several of the items included in annual prepayments are also specific line items in the CWC analysis, such as fuel and purchased power. Other items that are not identified in specific line items are lumped together in the CWC component labeled "Cash Vouchers". This amount represents all other operation and maintenance expenses. Therefore, the effect of providing the cash necessary to fund the annual operating expenses is included in CWC and should not again be included in rate base through prepayments. Including the costs in prepayments as well as CWC would allow a double return on these costs.

Q WHAT IS THE REVENUE REQUIREMENT VALUE OF THIS ADJUSTMENT?

A My recommendation to eliminate a portion of the prepayments balance reduces Empire's revenue requirement by approximately $0.5 million.

Southwest Power Pool ("SPP") Cost Deferral

Q PLEASE EXPLAIN THIS ISSUE.

A SPP is developing an Integrated Market Place ("IMP") that, according to the SPP website, will determine which generating units should run the next day for maximum cost-effectiveness, provide participants with greater access to reserve electricity, improve regional balancing of supply and demand and facilitate the integration of renewable resources. Empire has included an estimate of the cost to participate in the IMP in its cost of service in this case. I recommend deferring these costs for consideration of recovery in Empire's next rate case.

Q WHEN WILL THE IMP BE OPERATIONAL AND WHAT ARE THE COSTS?

A The planned operational date for the IMP is March 1, 2014. Empire has already begun updating its facilities and hiring personnel to prepare. According to the website, Empire needs to have systems operational for testing by May 15, 2013. The additional costs Empire is seeking in this case are for new software, software maintenance and payroll expenses.

Q WHY ARE YOU PROPOSING TO DEFER THESE COSTS?

A The IMP costs are being incurred today. However, the benefits of Empire's participation will not begin to be realized until March 1, 2014, at the earliest. My recommendation seeks to better match the potential recovery of the cost with the benefits, as stated by SPP, that Empire will receive in the future. Under Empire's proposal, the cost of the IMP will begin to be recovered in rates resulting for this case, effective no later than June 2013, while the benefits of the IMP will be realized no earlier than March 2014, barring any delays in the IMP operational date. I recommend deferral of these costs for consideration of recovery in the next general rate case when Empire is enjoying the benefits of the IMP.

Q WHAT IS THE REVENUE REQUIREMENT VALUE OF THIS ADJUSTMENT?

A My recommendation to eliminate these IMP implementation costs reduce Empire's revenue requirement by approximately $0.4 million.

Employee Stock Ownership Plan

Q PLEASE EXPLAIN THIS ISSUE.

A I recommend an adjustment to the calculation of income tax to reflect a deduction for dividends that are paid on Empire's common stock that is held in the Employee Stock Ownership Plan ("ESOP"). This tax deduction relates to an employee benefit program that is treated as jurisdictional for ratemaking. Therefore, the associated income tax savings should also be reflected in the calculation of income tax expense.

Q PLEASE DESCRIBE THE EMPLOYEE BENEFIT PROGRAM THAT YIELDS THE TAX DEDUCTIBLE DIVIDEND PAYMENTS.

A According to Empire's Securities and Exchange Commission 10-K Filing for 2011, the Employees 401(k) Plan and ESOP (the 401(k) Plan) allow participating employees to defer up to 25% of their annual compensation up to an Internal Revenue Service specified limit. Empire matches 50% of each employee's deferrals up to 3% of the employee's eligible compensation.

Q HAS EMPIRE TAKEN A TAX DEDUCTION ON ITS RETURN ASSOCIATED WITH THE DIVIDENDS ON THE STOCK HELD IN EMPLOYEE ESOP ACCOUNTS?

A Yes. According to Empire's response to MEUA Data Request 105, the Company has taken deductions on its 2009 through 2011 tax returns and estimates that it will take a deduction in 2012.

Q WHY IS IT APPROPRIATE TO REFLECT THIS DEDUCTION IN THE CALCULATION OF INCOME TAX IN DEVELOPING THE COST OF SERVICE IN THIS CASE?

A Ratepayers provide the cost of the ESOP in rates. Employees defer a portion of their salaries and Empire matches a portion of the employees' deferral with Company stock. Both the salaries and the Company match are included in the cost of service paid by customers. Therefore, ratepayers should receive the tax benefit.

Q HOW DID YOU CALCULATE THE AMOUNT OF THE ESOP INCOME TAX DEDUCTION?

A According to Empire's response to MEUA data request 105, the Company expects to take a tax deduction of $700,000 in 2012. This amount appears reasonable based on historical amounts and the reduction in Empire's dividend per share payout.

Q WHAT EFFECT DOES THIS TAX DEDUCTION HAVE ON EMPIRE'S REVENUE REQUIREMENT?

A The Missouri jurisdictional revenue requirement reduction associated with this tax deduction is approximately $0.4 million.

Transmission Tracker

Q PLEASE DESCRIBE THE COMPANY'S PROPOSAL TO ESTABLISH A TRANSMISSION TRACKER.

A Empire is proposing to establish a transmission tracker to track the actual level of the following expenses from the values for these expenses that were included in the rates established in this case:

- SPP Schedule 1-A Administration Charge and
- SPP Schedule 11 Base Plan Zonal Charge and Region-wide Charge.

After its new retail rates go into effect, the Company would track the difference between: (i) its actual amounts for these two expenses and (ii) the amounts for these two expenses that have been included in the rates established in this case. Actual amounts for these expenses that are in excess of the amount included in the rates resulting from this case would be treated as a regulatory asset (Account 182) and actual shortfalls for these expenses from the rate level would be treated as a regulatory liability (Account 254). A true-up of these expenses, as reflected in the accumulated regulatory asset and regulatory liability amounts for these expenses, would occur at the time of the Company's next general rate proceeding.

Q WHAT IS YOUR RESPONSE TO THE COMPANY'S PROPOSAL TO ESTABLISH A TRANSMISSION TRACKER?

A I recommend the Commission deny Empire's request to establish a transmission tracker. In general, the use of a tracker, either one that automatically adjusts rates between rate cases or a tracker that adjusts at the time of each new rate case, should be avoided. There are two important reasons to avoid such a mechanism.

First, the use of a tracker allows a utility to pursue single-issue ratemaking. Under single-issue ratemaking, a utility can receive additional revenue in rates due to either an increase in a tracked expense or decrease in tracked revenue without any consideration of whether that utility would simultaneously be receiving offsetting decreases in expenses or offsetting increases in revenues for those expenses and revenues that are not being tracked. Allowing a tracker can skew the relationship between revenues, expenses and rate base, potentially leading to a utility over-recovering its costs.

Second, the use of a tracker eliminates the inherent incentive a utility has to minimize expenses and maximize revenues between general rate proceedings, which over time works to keep electric rates lower than they otherwise would be. When a utility is allowed to track an expense, it can become indifferent with regard to minimizing that expense since it knows it will not need to file a new base rate case in order to recover any increases in that expense. Similarly, when a utility is allowed to track a revenue, it can become indifferent with regard to maximizing that revenue since it knows that it will not need to file a base rate case in order to recover any shortfall in that revenue.

Q ALTHOUGH THE COMMISSION HAS ALLOWED TRACKERS IN THE PAST, HAS IT EXPRESSED ITS DESIRE TO CONTROL THE PROLIFERATION OF THIS MECHANISM?

A Yes. In Ameren Missouri's Case No. ER-2008-0318, regarding a tracker for vegetation management, the Commission stated that:

> "Public Counsel's general concerns about the overuse of tracking mechanisms are valid. The Commission does not intend to allow the overuse of tracking mechanisms in this case, or in future rate cases."

In addition, in Ameren Missouri's Case No. ER-2010-0036, regarding a tracker for storm cost, the Commission stated:

> "The Commission is unwilling to implement another tracker. As the Commission has previously indicated, trackers should be used sparingly because they tend to limit a utility's incentive to prudently manage its costs. If all such costs can simply be passed on to ratepayers, there is a natural incentive for the company to simply incur the cost. If the company must consider whether it will be able to recover a cost, it is more likely to think before it spends and maximize any possible cost savings."

Q HAS THE COMMISSION ALREADY APPROVED NUMEROUS TRACKERS FOR EMPIRE?

A Yes. Empire currently has a tracker for vegetation management, pensions, other post-retirement benefits, Iatan expenses and Plum Point expenses. Empire also has an FAC which tracks fuel and purchase power costs, net of OSS.

Q WHAT IS THE MAJOR DRIVER OF THE INCREASE IN THE TRANSMISSION CHARGES EMPIRE PROPOSES TO TRACK?

A As discussed by company witness Bourne, construction of transmission plant is the major driver of the increase in the charges from SPP. Empire is requesting a tracker for the cost of new transmission plant. Empire should be aware of the planning and construction timetables associated with this new transmission plant through its participation in SPP. Empire should be able to time its rate case filings to address significant cost increases associated with these transmission plant additions.

Q ARE THERE OTHER ALTERNATIVES TO A TRACKER AVAILABLE TO THE COMPANY?

A Yes. If Empire foresees significant changes in transmission costs, it can file a rate case to capture this item in the cost of service. The Company may also file for an accounting authority order to defer significant changes in transmission costs for possible recovery as part of a future rate case.

Q PLEASE SUMMARIZE YOUR RECOMMENDATION.

A At this time, I am not proposing adjustments to the levels of transmission expenses and transmission revenues the Company is proposing to recover in rates in this case.

I view these amounts as placeholders pending the true-up process. I am recommending that through the true-up process, the Commission require the Company to annualize its transmission revenues and expenses based on actual values and rates at the end of the true-up period. In addition, for the reasons stated above, I am recommending that the Commission deny the Company's request for a transmission tracker.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.

Qualifications of Stephen M. Rackers

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

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

Q **PLEASE STATE YOUR OCCUPATION.**

A I am a Consultant in the field of public utility regulation with the firm of Brubaker & Associates, Inc. ("BAI"), energy, economic and regulatory consultants.

Q **PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EMPLOYMENT EXPERIENCE.**

A I graduated from the University of Missouri in 1978 with a Bachelor of Science Degree in Business Administration, with a major in Accounting. Subsequent to graduation I was employed by the Missouri Public Service Commission. I was employed with the Commission from June 1, 1978 until February 29, 2012.

I began my employment at the Missouri Public Service Commission as a Junior Auditor. During my employment at the Commission, I was promoted to higher auditing classifications. My final position at the Commission was an Auditor V, which I held for approximately 15 years.

As an Auditor V, I conducted audits and examinations of the accounts, books, records and reports of jurisdictional utilities. I also aided in the planning of audits and investigations, including staffing decisions, and in the development of staff positions in which the Auditing Department was assigned. I served as Lead Auditor and/or Case Supervisor as assigned. I assisted in the technical training of other auditors, which included the preparation of auditors' workpapers, oral and written testimony.

During my career at the Missouri Public Service Commission, I presented testimony in numerous electric, gas, telephone and water and sewer rate cases. In addition, I was involved in cases regarding service territory transfers. In the context of those cases listed above, I presented testimony on all conventional ratemaking principles related to a utility's revenue requirement.

In March of 2012, I joined the firm of Brubaker & Associates, Inc. as a Consultant. The firm Brubaker & Associates, Inc. provides consulting services in the field of energy procurement and public utility regulation to many clients including industrial and institutional customers, some utilities and, on occasion, state regulatory agencies.

More specifically, we provide analysis of energy procurement options based on consideration of prices and reliability as related to the needs of the client; prepare rate, feasibility, economic, and cost of service studies relating to energy and utility services; prepare depreciation and feasibility studies relating to utility service; assist in contract negotiations for utility services, and provide technical support to legislative activities.

In addition to our main office in St. Louis, the firm also has branch offices in Phoenix, Arizona and Corpus Christi, Texas.

Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS TO WHICH YOU BELONG.

A I am a licensed Certified Public Accountant ("CPA") in the state of Missouri.

Empire District Electric Company
Case No. ER-2012-0345

MEUA's Adjustment to Empire District Electric's Proposed Revenue Requirement

Line	Category of Adjustment	Amount of Reduction ($000)	Witness
1	Return on Equity	$ 9,155	Gorman
2	Capital Structure	$ 2,076	Gorman
3	Outside Services	$ 1,011	Rackers
4	Expiring Ice Storm Amortizations	$ 3,308	Rackers
5	Property Tax	$ 467	Rackers
6	Cash Working Capital	$ 469	Rackers
7	Off-system Sales	$ 2,000	Rackers
8	Bad Debts	$ 177	Rackers
9	Bank Fees	$ 442	Rackers
10	Payroll Expense	$ 2,618	Rackers
11	Prepayments	$ 466	Rackers
12	Southwest Power Pool Cost Deferral	$ 415	Rackers
13	ESOP	$ 379	Rackers
14	Total Reduction	$ 22,983	