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Case No. ER-2012-0345
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**Before the Public Service Commission
of the State of Missouri**

Interim Surrebuttal Testimony

of

Kelly S. Walters

August 2012

Empire Exhibit No. 3
Date 9-10-12 Reporter KF
File No. ER-2012-0345

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OF
KELLY S. WALTERS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2012-0345

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INTERIM SURREBUTTAL TESTIMONY
OF
KELLY S. WALTERS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2012-0345

1 **INTRODUCTION**

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

3 A. My name is Kelly S. Walters and my business address is 602 South Joplin Avenue,
4 Joplin, Missouri.

5 **POSITION**

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

7 A. I am presently employed by The Empire District Electric Company (“Empire” or
8 “Company”) as Vice President-Chief Operating Officer-Electric. I have held this
9 position since February of 2011.

10 **Q. ARE YOU THE SAME KELLY S. WALTERS THAT EARLIER**
11 **PREPARED AND FILED DIRECT TESTIMONY IN THIS RATE CASE**
12 **BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION**
13 **(“COMMISSION”) ON BEHALF OF EMPIRE?**

14 A. Yes.

15 **PURPOSE**

16 **Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

17 A. My surrebuttal testimony will discuss several issues related to Empire’s request for
18 an interim increase in its rates. These issues have been raised by the Commission

1 Staff ("Staff") and the Midwest Energy Users' Association ("MEUA") in their
2 respective Interim rebuttal testimonies in this rate case. Specifically, I will address
3 the following:

- 4 • The interim rate issues raised by the Staff in connection with the Accounting
5 Authority Order granted in Case No. EU-2011-0387;
- 6 • How Empire's interim request contrasts with an interim request made by Ameren
7 Missouri;
- 8 • The positions taken by Staff and MEUA regarding interim relief and accumulated
9 deferred income taxes;
- 10 • The Staff's characterization of Empire's interim relief and its relationship to unsold
11 power and the tornado;
- 12 • The Staff's contention that Empire has recovered all of its costs since the tornado;
- 13 • The Staff's comments concerning single-issue ratemaking and Empire's interim
14 request;
- 15 • The Staff's comments concerning austerity measures taken as a result of the
16 tornado;
- 17 • The Staff's comments regarding Empire's fuel adjustment mechanism and interim
18 relief; and
- 19 • The Staff's comments regarding the impact the tornado had on Empire's past and
20 near-term sales, revenue levels and customer levels.
- 21 • The Staff's comments relative to dividend payout ratio

22 **Q. HAVE YOU REVIEWED THE INTERIM REBUTTAL TESTIMONIES**
23 **FILED BY THE STAFF AND MEUA AND THE POSITIONS TAKEN BY**

1 **STAFF AND MEUA?**

2 A. Yes. I have reviewed all of the Interim rebuttal testimony filed by the parties to
3 this case.

4 **ACCOUNTING AUTHORITY ORDER**

5 **Q. DO YOU AGREE WITH STAFF WITNESS OLIGSCHLAEGER'S**
6 **STATEMENT BEGINNING AT PAGE 11, LINE 6 OF HIS INTERIM**
7 **REBUTTAL TESTIMONY REGARDING EMPIRE HAVING RECEIVED**
8 **THE BENEFIT OF AN ACCOUNTING AUTHORITY ORDER ("AAO") IN**
9 **CASE NO. EU-2011-0387?**

10 A. I believe Mr. Oligschlaeger's statement on this point is somewhat misleading. The
11 AAO issued by the Commission does protect Empire's earnings to some extent, but
12 it does not allow the Company a reasonable opportunity to earn its authorized
13 return, does not eliminate the need for interim relief by establishing just and
14 reasonable rates, nor in any way does it prohibit interim relief.

15 **Q. PLEASE EXPLAIN.**

16 A. The order in Case No. EU-2011-0387 did not establish new rates for Empire. It
17 simply granted Empire the authority to defer actual incremental operation and
18 maintenance expenses associated with the tornado, to defer the depreciation
19 associated with the incremental investment required to rebuild the electrical system
20 destroyed by the tornado and to accrue carrying costs on the incremental tornado
21 investment at a rate equal to Empire's Allowance for Funds Used During
22 Construction ("AFUDC"). While the first two components of the deferral
23 protected Empire's earnings to some extent, the third component, recording

1 carrying costs at the AFUDC rate, does not fully reflect the Company's long-term
2 carrying cost, which is equal to a full before income tax rate of return on rate base.
3 In addition, the AAO did not address the decline in earnings that would occur
4 between rate cases due to the significant loss of customers served due to the
5 tornado.

6 **Q. WHAT HAS EMPIRE'S AFUDC RATE BEEN DURING 2011 AND 2012?**

7 A. Empire's AFUDC rate for 2011 was 5.19 percent and has ranged from 3.37 percent
8 in first quarter of 2012, to 1.82 percent during the second quarter of 2012.

9 **Q. HOW DOES EMPIRE'S AFUDC RATE COMPARE TO THE COMPANY'S**
10 **MOST RECENTLY COMMISSION-AUTHORIZED RETURN ON RATE**
11 **BASE?**

A. Empire's AFUDC rate is substantially lower and does not adequately compensate
the Company for its investment in the facilities used to rebuild the system after the
tornado. More specifically, the last authorized rate of return as discussed in the
Direct Testimony of Company Witness Rob Sager was 8.91%. This carrying cost
shortfall can never be recaptured by Empire and will adversely impact the
Company's earnings until Empire's tornado-related investments are reflected in the
Company's rates.

12 **AMEREN'S INTERIM RATE REQUEST**

13 **Q. DO YOU AGREE WITH STAFF WITNESS OLIGSCHLAEGER'S**
14 **CONTENTION AT PAGE 13, LINES 12 THROUGH 20 OF HIS INTERIM**
15 **REBUTTAL TESTIMONY, THAT EMPIRE'S INTERIM RATE REQUEST**
16 **HAS LESS MERIT THAN AMEREN MISSOURI'S INTERIM REQUEST IN**

1 **CASE NO. ER-2010-0036?**

2 A. I am not familiar with all the details surrounding the Ameren Missouri case.
3 However, Empire's interim request is directly related to a catastrophic event, the
4 tornado, not the normal or routine plant additions that have taken place since the
5 end of the test year in Empire's last rate case, which I believe was the underlying
6 basis of the Ameren Missouri request. The tornado related investment that Empire
7 was required to make was significant and immediate and could not be timed or
8 planned for as is normally the situation with routine plant additions and
9 retirements.

10 **ACCUMULATED DEFERRED INCOME TAXES**

11 **Q. IS STAFF WITNESS OLIGSCHLAEGER'S OBSERVATION CORRECT**
12 **THAT EMPIRE DID NOT INCLUDE A COMPONENT RELATED TO THE**
13 **ACCUMULATED DEFERRED INCOME TAXES IN ITS CALCULATION**
14 **OF THE LEVEL OF INTERIM RELIEF REQUESTED?**

15 A. Yes. However, the accumulated deferred income taxes ("ADIT") associated with
16 the tornado investment has been included as a component of Empire's permanent
17 rate case. Empire views its rate filing as a single filing with two components, a
18 request for a permanent overall rate increase of \$30.7 million with an interim
19 component of \$6.2 million.

20 **DEPRECIATION RESERVE**

21 **Q. IS STAFF WITNESS OLIGSCHLAEGER'S OBSERVATION CORRECT**
22 **THAT EMPIRE DID NOT INCLUDE A COMPONENT FOR PLANT-**
23 **RELATED DEPRECIATION RESERVE IN ITS CALCULATION OF THE**

1 **LEVEL OF INTERIM RELIEF REQUESTED?**

2 A. Yes. However, this item is, again, a component of Empire's permanent rate case.
3 If the plant-related depreciation reserve is included as a component of Empire's
4 interim rate increase request, the interim request would be reduced by
5 approximately \$68,000 or 1 percent of Empire's overall interim request.

6 **REVENUE-UNSOLD POWER**

7 **Q. DOES EMPIRE'S INTERIM REQUEST CONCERN REVENUE FROM**
8 **UNSOLD POWER AS STAFF WITNESS OLIGSCHLAEGER CONTENDS**
9 **AT PAGES 14 AND 15 OF HIS INTERIM REBUTTAL TESTIMONY?**

10 A. No. The portion of Empire's interim request related to the lower number of
11 customers, sales and revenue due to the tornado has to do with adjusting Empire's
12 rates on a going-forward basis in order to accurately reflect its current customer
13 numbers. It is not related to the actual reduction in customer levels and un-
14 generated sales that took place in the past. The ongoing customer levels are factors
15 that will need to be addressed in the permanent rate levels established in this case,
16 as Staff witness Oligschlaeger indicates at page 16 of his Interim Rebuttal
17 Testimony. In addition, Staff witness Lange outlines his preliminary view of the
18 ongoing reduction in kilowatt-hour sales due to the tornado at pages 6 and 7 of his
19 Interim Rebuttal Testimony. At first glance, Staff's reduction in ongoing kilowatt-
20 hours and customer levels appear to be in line with those set out in Empire's
21 interim request.

22 **POST-TORNADO COST RECOVERY**

23 **Q. DO YOU AGREE WITH STAFF WITNESS OLIGSCHLAEGER'S**

1 **STATEMENT AT PAGE 16 OF HIS INTERIM REBUTTAL TESTIMONY**
2 **THAT EMPIRE HAS RECOVERED ALL OF ITS COSTS SINCE THE**
3 **TORNADO?**

4 A. No. Empire's opportunity to earn a fair rate of return has been impaired since the
5 tornado struck Joplin in May 2011. The continuing impacts of the tornado (lower
6 customer levels and deferred tornado related costs) have yet to be reflected in
7 Empire's rates and will continue to exist and grow, respectively, until they are
8 reflected in rates. If Empire's interim request is granted, the accumulation of costs
9 under the AAO will stop, ultimately reducing the level of tornado related costs paid
10 by Empire's customers in the future. While mitigating the impact of the tornado to
11 some degree, the tornado AAO authorized by the Commission does not enable
12 Empire to defer and recover all of the damage it has suffered as a result of the
13 tornado.

14 **SINGLE ISSUE RATEMAKING**

15 **Q. DO YOU AGREE WITH STAFF WITNESS OLIGSCHLAEGER'S**
16 **STATEMENT AT PAGE 16 OF HIS INTERIM REBUTTAL TESTIMONY**
17 **THAT EMPIRE'S REQUEST FOR INTERIM RELIEF DOES NOT TAKE**
18 **INTO ACCOUNT ALL OF THE RELEVANT FACTORS THAT THE**
19 **COMMISSION SHOULD CONSIDER IN SETTING PERMANENT RATES?**

20 A. I do not know which factors the Commission will determine to be relevant in
21 setting permanent rates for Empire but certainly ROE is low which does consider
22 all relevant factors. The relevant factors for interim, subject-to-refund relief and
23 the relevant factors for permanent relief may not be identical. In considering

1 Empire's request for interim rate relief, the Commission will need to take into
2 account all factors which it believes are relevant to the interim request. In making
3 its interim filing, Empire took into account all factors which the Company believes
4 are relevant to the interim request and tried to restrict the interim portion of its
5 overall rate increase request of \$30.7 million to cost components directly related to
6 the tornado that occurred in Joplin in May 2011. In addition to the tornado there
7 are a variety of other factors driving Empire's permanent rate increase. Some of
8 these factors, such as the increases in Southwest Power Pool transmission charges,
9 are already occurring and lowering Empire's potential to earn a reasonable rate of
10 return.

11 **Q. DO YOU AGREE WITH STAFF WITNESS OLIGSCHLAEGER'S**
12 **STATEMENT AT PAGE 17 OF HIS INTERIM REBUTTAL TESTIMONY**
13 **THAT EMPIRE'S REQUEST FOR INTERIM RATE RELIEF IS SINGLE**
14 **ISSUE RATEMAKING?**

15 A. No, although I believe this is a legal issue. Empire's interim request is merely a
16 component of Empire's permanent rate increase request. In the event that the
17 Commission finds that Empire's permanent rates should be increased less than the
18 level of interim rate relief granted by the Commission, Empire would refund the
19 difference to its customers with interest. Further, in making its interim request,
20 Empire has taken into account all factors which the Company believes are relevant
21 to the interim request and has proposed what the Company believes are just and
22 reasonable interim rates. In setting interim rates for Empire, the Commission will
23 need to take into consideration all factors which the Commission deems relevant.

1 **TORNADO RELATED AUSTERITY MEASURES**

2 **Q. DID EMPIRE TAKE STEPS TO REDUCE COSTS IN RESPONSE TO THE**
3 **TORNADO?**

4 A. Yes. While Empire did not institute what Staff witness Oligschlaeger refers to as a
5 “formal austerity plan” (page 18, Interim Rebuttal Testimony) in response to the
6 tornado, Empire did take immediate steps to eliminate the shareholder dividend for
7 two quarters, substantially eliminated the executive officers’ incentive pay for
8 2011, and instituted a fifty percent reduction in incentive pay for all of its
9 department heads in 2011. In addition, some construction projects were delayed as
10 a result of the work being performed to restore service immediately following the
11 tornado. Steps beyond those, however, would have made no sense.

12 **Q. WHY?**

13 A. It would have been extremely imprudent for Empire to have attempted to reduce
14 costs by cutting services at a time when our customers needed those services the
15 most. For example, had we eliminated call center staff or reduced the number of
16 linemen available to rebuild our system, the public outcry would have been
17 enormous. I am confident that no one would have recommended that course of
18 action.

19 **Q. HOW WOULD YOU CHARACTERIZE THE CIRCUMSTANCES EMPIRE**
20 **FACED IN CONNECTION WITH THE TORNADO THAT STRUCK**
21 **JOPLIN ON MAY 22, 2011?**

22 A. They were extraordinary circumstances.

23 **Q. PLEASE EXPLAIN.**

1 A. The May 22, 2011, tornado was clearly an extraordinary event under any definition
2 of that term. In fact, the Staff has described it as “a catastrophic natural disaster”.
3 As explained in Empire’s direct testimony, prior to the tornado, for a variety of
4 reasons, Empire was experiencing a low level of retained earnings. The tornado
5 made that situation much worse. It severely impacted Empire’s operations,
6 including the total destruction of a significant part of Empire’s facilities in and
7 around Joplin and the physical loss of thousands of customers. The costs incurred
8 by Empire in connection with the tornado and the revenue losses the Company
9 experienced as a result of the significantly lower number of customers served
10 created at that time a set of circumstances that could be fairly characterized as
11 “extraordinary”, “extreme” and of an “emergency” nature. Fortunately, Empire
12 and its shareholders were able to make financial and other sacrifices in order that
13 its customers were able to continue to receive safe and reliable service. Empire’s
14 rates, however, no longer could be considered to be just and reasonable. That is
15 because the costs incurred in connection with the tornado and the losses in terms of
16 customers served were not at that time and have yet to be reflected in Empire’s
17 ongoing cost of service and revenue requirement. Consequently, the granting of
18 interim rate relief to begin to mitigate the financial impacts from this extraordinary
19 event is warranted and reasonable and in no way circumvents the Commission’s
20 standards of practice and procedure, including the Commission’s audit and hearing
21 processes.

22 **TORNADO IMPACT AND FUEL ADJUSTMENT MECHANISM**

23 **Q. DID THE OVER-COLLECTION OF ENERGY COSTS IN EMPIRE’S FUEL**

1 **ADJUSTMENT CLAUSE (“FAC”) MITIGATE THE IMPACT OF THE**
2 **TORNADO ON EMPIRE’S OPERATIONS, AS IMPLIED BY STAFF**
3 **WITNESS MANTLE AT PAGE 6 OF HER INTERIM REBUTTAL**
4 **TESTIMONY?**

5 A. No. The FAC ultimately allows Empire to recover the actual cost of energy. When
6 an over-collection of energy costs is returned to the customer through the FAC, it is
7 returned to the customer with interest. The FAC is not used or designed to be used
8 as some sort of profit center for Empire that can be used during extraordinary
9 circumstances.

10 **SALES AND REVENUE IMPACT OF THE TORNADO**

11 **Q. DO YOU AGREE WITH STAFF WITNESS LANGE’S CONTENTION AT**
12 **PAGE 3 OF HIS INTERIM REBUTTAL TESTIMONY THAT EMPIRE’S**
13 **OVERALL SALES AND REVENUE DID NOT DECLINE UNTIL THE**
14 **WINTER MONTHS AFTER THE TORNADO?**

15 A. No. It is undisputed that Empire lost several thousand customers as a result of the
16 tornado. While the hotter than normal weather and influx of temporary rescue and
17 assistance workers mitigated some of the impact in terms of the electric sales
18 Empire lost due to the destruction of the Company’s customer base in Joplin in the
19 summer of 2011, there is no doubt that Empire’s electric sales in Joplin were
20 adversely impacted by the tornado. The loss of customers was in the thousands and
21 had those customers been able to take electric service in the summer of 2011 and
22 the winter of 2012, Empire’s electric sales would have been significantly higher.

23 **Q. IS EMPIRE’S INTERIM RATE REQUEST RELATED TO THE SALES**

1 **AND REVENUE EMPIRE LOST DUE TO THE TORNADO IN THE**
2 **SUMMER OF 2011 AND THE WINTER OF 2012 AS IMPLIED BY STAFF**
3 **WITNESS OLIGSCHLAEGER AND MEUA WITNESS RACKERS IN**
4 **THEIR INTERIM REBUTTAL TESTIMONIES AT PAGE 14 AND PAGE 5,**
5 **RESPECTIVELY?**

6 A. No. Empire's requested rate increase, interim and permanent, adjusts rates on a
7 going-forward basis, and does not attempt to recover past sales and revenue
8 reductions related to the tornado. As Staff witness Lange's graph illustrates at page
9 6 of his Interim Rebuttal Testimony, Empire's ongoing weather normalized sales
10 are lower than the level established in Empire's last rate case, Case No. ER-2011-
11 0004. This is primarily due to the reduction in the number of customers Empire
12 serves, as Staff witness Lange points out in his Interim Rebuttal Testimony at pages
13 6 and 7. This ongoing decline in normalized revenue is a component of Empire's
14 interim request, not the un-generated revenue losses related to the tornado that
15 occurred between late May 2011 and March of 2012, the end of Empire's test year
16 in this case.

17 **DIVIDENDS PER SHARE**

18 **Q. HOW DO YOU RESPOND TO STAFF WITNESS ATKINSON'S**
19 **CONCLUSIONS AT PAGE 4 OF HER INTERIM REBUTTAL**
20 **TESTIMONY CONCERNING WHAT WOULD HAVE HAPPENED IF**
21 **EMPIRE HAD BEEN PAYING AN ANNUAL DIVIDEND PER SHARE OF**
22 **\$1.00 AS OPPOSED TO \$1.28 FOR THE PERIOD 1993 THROUGH 2010?**

23 A. I disagree with her payout ratio analysis.

1 **Q. WHY?**

2 A. Her analysis appears to be based on the premise that if Empire had lowered the
3 dividend to \$1.00 a share then the share price would have remained the same. I
4 believe this assumption is incorrect As a result, Ms. Atkinson fails to make an
5 adjustment in her earnings per share analysis to reflect the fact that Empire would
6 have had to issue more shares to fund on-going capital expenditures which included
7 the construction of the State Line Plant, Energy Center 3 & 4, Riverton 12, Iatan 2,
8 Plum Point, and environmental upgrades at Asbury and Iatan 1.

9 **Q. HOW MANY SHARES OF COMMON STOCK HAS EMPIRE ISSUED**
10 **SINCE 1993?**

11 A. Empire had 13.6 million shares of stock outstanding at year-end 1993. The
12 Company has 42.2 million shares outstanding now. Therefore, Empire has issued
13 approximately 28.4 million new shares over that period of time.

14 **Q. DOES THIS CONCLUDE YOUR INTERIM SURREBUTTAL**
15 **TESTIMONY?**

16 A. Yes.

