

Exhibit No.:
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Experimental Regulatory Plan Amortization
Witness: Ted Robertson
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Case Number: ER-2006-00315
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REBUTTAL TESTIMONY
OF
TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

THE EMPIRE DISTRICT ELECTRIC COMPANY
Case No. ER-2006-0315

July 28, 2006

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

In the Matter of the Empire District Electric)
Company of Joplin, Missouri for Authority)
to File Tariffs Increasing Rates for Electric)
Service Provided to Customers in the)
Missouri Service Area of the Company)


Case No. ER-2006-0315

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 30.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Ted Robertson, C.P.A.
Public Utility Accountant III

Subscribed and sworn to me this 28th day of July 2006.



JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036



Jerene Buckman
Notary Public

My commission expires August 10, 2009.

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**REBUTTAL TESTIMONY
OF
TED ROBERTSON**

**EMPIRE DISTRICT ELECTRIC COMPANY
CASE NO. ER-2006-0315**

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 2230, Jefferson City, Missouri 65102.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED
DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this rebuttal testimony is to address the positions taken by the Empire District Electric Company ("EDE" or "Company") witnesses, Mr. Michael E. Palmer and Mr. William L. Gipson, regarding the development and implementation of a storm damage expense tracker mechanism, and the amortization requirement identified in the Stipulation & Agreement of the Experimental Regulatory Plan, Empire Case No. EO-2005-0263, respectively. In addition, I will also address the supplemental direct testimony of MPSC Staff witness, Mr. Mark Oligschlaeger, concerning the amortization requirement identified in the Stipulation & Agreement of the Experimental Regulatory Plan, Empire Case No. EO-2005-0263.

1 **II. STORM DAMAGE EXPENSE**

2 Q. WHAT IS THE ISSUE?

3 A. Empire has requested authorization to implement a storm damage tracker
4 mechanism to recover expenses related to the restoration of its system in the
5 event of a natural disaster.

6
7 Q. IS THE PUBLIC COUNSEL OPPOSED TO EMPIRE'S REQUEST?

8 A. Yes. Company's witness, Mr. Michael E. Palmer, states that he believes the
9 requested approach will help lessen the potential financial burden of a natural
10 disaster for both customers and shareholders; however, Public Counsel believes
11 the proposed expense tracker to be a gross violation of regulated utility
12 ratemaking concepts and procedures. It is my belief that if the proposal were
13 authorized incentives inherent in the ratemaking process would be eliminated and
14 the only beneficiaries of the proposal would be Empire's shareholders. The
15 incentives eliminated would result from management's effective release of its
16 responsibility to manage the expenses while shareholders would benefit from the
17 guaranteed recovery of all expenses incurred while at the same time earning a
18 higher rate of return that compensates them for risk above a risk-free rate of
19 return. In addition, I have been informed by legal counsel that implementation of
20 the tracker, as proposed by Empire, would likely result in a violation of rules and
21 statutes prohibiting what is commonly described in regulated ratemaking as
22 "retroactive ratemaking."

1 Q. PLEASE EXPLAIN HOW THE PROPOSED EXPENSE TRACKER WOULD
2 WORK.

3 A. The expense tracker is described beginning on page 8, line 21, of Mr. Palmer's
4 direct testimony:

5
6 Empire proposes using the test year storm expense as the base for
7 storm damage expenses in the cost of service. Each year actual
8 storm damage expenses will be compared to the storm damage
9 expenses included in the test year. The difference between the
10 actual expense and the base expense, test year, will be captured as
11 a regulatory asset or liability. If the actual storm damage expenses
12 during a calendar year are more than the test year expenses,
13 Empire will record the difference as a regulatory asset. If the
14 actual storm damage expenses are less than the test year expense
15 levels, the difference will be used to reduce the regulatory asset or
16 recorded as a regulatory liability. The resulting regulatory asset or
17 liability will be included in the calculation of rate base and the
18 balance amortized in the next rate case.
19
20

21 In essence, the regulatory asset or liability would capture expense incurred above
22 or below a base year amount already included in rates. The expense afforded
23 tracker treatment would then be subject to rate base treatment and amortization in
24 Company's next rate case.
25

26 Q. WHAT IS THE BASE SUPPORT FOR MR. PALMER'S REQUEST?

27 A. Mr. Palmer's request appears to be based on the generally catastrophic nature and
28 volatility of costs associated with natural disasters. To support his position he has
29 attached an Edison Electric Institute ("EEI") report, "After the Disaster, Utility

1 Restoration Cost," to his direct testimony. The EEI Report purports to show,
2 primarily, the substantial costs incurred by utilities to repair their systems after a
3 disaster strikes, the overall economic impact on an area hit by a disaster, the
4 financial impact that the repair costs have on utilities, and the inconsistent
5 ratemaking treatment and recovery of the costs.

6
7 Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE EEI REPORT
8 APPROPRIATELY DESCRIBES THE REGULATED RATEMAKING OF
9 STORM COSTS IN THE STATE OF MISSOURI OR FOR EMPIRE
10 SPECIFICALLY?

11 A. No, it does not. The EEI Report shows the results of a survey of storm costs for
12 some of its member companies. However, the results summarized in the EEI
13 Report are primarily impacted by utilities operating in the Southeast portion of
14 the United States (i.e., mostly Florida) and the effects of various large hurricanes
15 that they have experienced. For example, in the current year dollars utilized in
16 the EEI Report, of the 55 event items identified on page 4 approximately 74% of
17 the restoration costs shown are identified as being directly, or partially, hurricane
18 related. Clearly, the summary for the average cost of a major storm, identified on
19 page 3 as \$48.7 million, is skewed towards areas of the country wherein
20 hurricanes and tropical storms are predominant and in no way relate to actual
21 storm costs incurred by Empire within its service area.
22

1 Q. DID EMPIRE PARTICIPATE IN THE EEI SURVEY?

2 A. No. Company response to OPC Data Request No. 1010 states:

3
4 Fourteen companies participated in this survey, Empire did not
5 participate.
6
7

8 Q. HAS EMPIRE EXPERIENCED ANY HURRICANE RELATED STORM
9 RESTORATION COSTS WITHIN ITS MISSOURI SERVICE AREA?

10 A. No. Company response to OPC Data Request No. 1010 states:

11
12 We do not have hurricanes in Empire's jurisdiction.
13
14

15 Q. HAS EMPIRE DEVELOPED A STORM DAMAGE FINANCIAL
16 THRESHOLD THAT IS LARGE ENOUGH TO JEOPARDIZE ITS
17 FINANCIAL HEALTH?

18 A. No. Company response to OPC Data Request No. 1017 states:

19
20 Empire has not designated a dollar amount that is "large enough to
21 jeopardize the Company's financial health."
22
23

24 Q. HAS EMPIRE EXPERIENCED STORM DAMAGE COST VOLATILITY
25 SIMILAR TO HURRICANES WITHIN ITS SERVICE AREA?

1 A. No. Empire has not experienced any storm damage cost that is representative of
2 the extremely large losses which resulted from the hurricanes identified in the
3 EEI Report. Company response to OPC Data Request No. 1010 states that the
4 average yearly storm cost for the period 1998-2005 was, 1) retirements \$174,380,
5 2) construction \$1,093,616, and 3) expense \$195,656. In addition, for the period
6 1997 through February 2006, the Company's responses to MPSC Staff Data
7 Request No. 65.1 and OPC Data Request No. 1018 identify that the average
8 annual yearly storm expense approximates a slightly lower value of \$174,654.
9 That \$174,654 represents approximately 0.052% of the total test year revenues, at
10 the proposed rates, Company requested in its initial rate case filing (source:
11 Section C, Schedule 1, Empire Comparative & Summary Schedules). Clearly, the
12 level of storm damage expense that Empire has actually experienced does not
13 compare to the level of volatility identified for the hurricane-related costs as
14 shown in the EEI Report.

15
16 Q. WHAT LEVEL OF STORM DAMAGE COSTS OCCURRING IN EMPIRE'S
17 SERVICE AREA WERE ACTUALLY INCLUDED IN RATES DURING THE
18 PERIOD 1997-2005?

19 A. It is my understanding that all retirement and construction costs (i.e., capital
20 costs), net of insurance proceeds, are included in rates. Company's response to
21 OPC Data Request No. 1020 states:
22

The proposed tracker is not designed to address storm related capital costs, only the expenses. Empire is not aware of any rate case where the Company has been denied the opportunity to include the recovery of capital costs associated with storm damage in its rates.

As for storm damage expense, OPC Data Request No. 1019 requested the amounts actually included in rates. Company's response states:

Case	Total Co Storm Damage as Filed	Included in Order
ER-95-279	*	Not Specified
ER-97-81	*	Not Specified
ER-01-299	63,788	Not Specified
ER-02-424	251,322	Not Specified
ER-04-0570	379,504	Not Specified

Thus, because the issue was apparently included as part of a settlement in the cases identified, it cannot be determined that the specific expenses were included or excluded from the new rates. However, I am personally unaware of any adjustments proposed in the cases that disallow any of the storm damage expenses not reimbursed by insurance proceeds. Given that the average annual expense approximates \$174,654 to \$195,656, depending on the time periods reviewed, it is highly likely, in my opinion, that Empire has been unable to recover in rates a level of storm damage expense equal to or greater than the amounts it has actually incurred. In fact, as long as the earnings level achieved by Empire is positive, revenues are adequate to provide recovery of any and all expenses it incurs.

1
2 Q. MR. PALMER STATES ON PAGE NINE OF HIS DIRECT TESTIMONY
3 THAT AUTHORIZATION OF THE STORM TRACKER MECHANISM WILL
4 ENSURE THAT THE STORM RELATED EXPENSES ARE FULLY
5 RECOVERED. IS THAT AN APPROPRIATE OR REASONABLE GOAL FOR
6 THE STORM EXPENSES?

7 A. No, it is an inconsistent and unjustifiable departure from traditional regulated rate
8 of return ratemaking. Mr. Palmer states that Empire believes it is in the best
9 interest of the customers and stockholders to utilize this method for recovery of
10 storm expenses, and that the mechanism will ensure that the storm-related
11 expenses are fully recovered while maintaining rate stability for the customer as
12 the costs associated with storm damage are spread over more than one year. I
13 believe his proposal, if authorized, eliminates important incentives for the
14 minimization of the expenses between rate cases.

15
16 Q. PLEASE CONTINUE.

17 A. One reason expenses are fixed between rate cases is to provide incentive to a
18 utility's managers to manage those expenses. If the managers of the utility are
19 able to maintain or even decrease the expenses, shareholders, and ultimately
20 ratepayers, will benefit from their actions.

1 Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THE REGULATED
2 RATEMAKING PROCESS PROVIDES A UTILITY INCENTIVE TO
3 OPERATE MORE EFFICIENTLY?

4 A. Yes. One example that comes to mind is a utility's tree trimming program. If a
5 utility is diligent in its tree trimming activities, when major storms do occur, it is
6 likely that any damage, and its associated costs, will be less than if a utility does
7 not manage an effective tree trimming program. Both shareholders and
8 ratepayers benefit from an effective tree trimming program because, should
9 damage costs come in less than the amount included in rates, all else being equal,
10 shareholders will earn a higher return on their investment while ratepayers may
11 obtain the benefits of the lower costs in the utility's next general rate case. The
12 opposite is true if an effective tree trimming program is not maintained. If the
13 damages incurred exceeds the damage cost included in rates, both parties are at
14 risk. Shareholders risk not earning an appropriate return because the additional
15 costs are not included in rates while ratepayers risk having to compensate
16 shareholders for the higher damage costs at a later date.

17
18 Q. DOES MR. PALMER'S PROPOSAL HAVE THE EFFECT OF ELIMINATING
19 THE INCENTIVE YOU DESCRIBED IN THE PREVIOUS Q&A?

20 A. Yes. In the case of a tree trimming program, management may decide, once its
21 costs are included in rates, to cutback on or reduce the program in order to benefit
22 from the higher earnings that would naturally result. They might do this knowing

1 that if a major storm does occur, the recovery of any additional storm expenses
2 (i.e., expenses that exceed the amount included in rates) will be guaranteed under
3 Mr. Palmer's proposal. Thus, ratepayers will be left "holding the bag" for
4 reimbursement of the additional storm expenses while the risk to shareholders is
5 completely eliminated.

6
7 Public Counsel believes that the regulatory process is a surrogate for competition
8 and regulatory lag is a well-established and traditional incentive for utilities to
9 minimize all costs between rate cases. Guaranteed recovery of any cost or
10 expense is not competition and does not accomplish the inherent incentive of
11 regulatory ratemaking. In fact, it effectively undermines the process since it
12 relieves management of its expense containment responsibilities.

13
14 Q. IF OPERATIONAL COSTS OTHERWISE EXCEED MANAGERMENTS
15 CONTROL, AND JEOPARDIZE THE UTILITY ACHIEVING ITS
16 AUTHORIZED RATE OF RETURN, ARE OTHER OPTIONS AVAILABLE
17 TO CORRECT THE SITUATION?

18 A. Yes. If management decides that the utility's current cost structure is not
19 allowing it to earn its authorized rate of return, they are free, at any time, to file
20 for a base rate increase. Furthermore, in the case of an unexpected catastrophic
21 natural event, such as a major storm, management can request Commission

1 authorization of an Accounting Authority Order ("AAO") to defer the costs for
2 future ratemaking resolution.
3

4 Q. DOES MR. PALMER BELIEVE THE AAO MECHANISM TO BE AN
5 APPROPRIATE VEHICLE FOR THE RECOVERY OF CATASTROPHIC
6 STORM DAMAGE EXPENSES?

7 A. His testimony indicates that he does not. On page 8, lines 11-12, of his direct
8 testimony, Mr. Palmer levels the criticism that lengthy delays occur due to the
9 AAO deferred costs approval process becoming "politicized." Thus, implying,
10 that the regulatory ratemaking process is not efficient or effective. I believe what
11 Mr. Palmer has characterized as politicizing is actually nothing more than the
12 regulatory forum's airing of the issues by all represented parties. If the utility's
13 positions "whither on the vine" or take a certain amount of time to resolve due to
14 the application of close public scrutiny, I do not believe any rationale person
15 could justifiably denounce the methodology or its end result. In my opinion, in
16 this instance, Mr. Palmer's criticism of the regulatory process is unfounded and
17 without merit due to its lack defined examples for which the criticism is valid.
18

19 Q. DID PUBLIC COUNSEL REQUEST COMPANY TO PROVIDE EXAMPLES
20 OF THE AAO APPROVAL PROCESS BECOMING POLITICIZED?

1 A. Yes. OPC Data Request No. 1014 requested identification of all known
2 examples, by actual Empire case number, wherein Company believed the
3 approval process became politicized. Empire's response stated it was:

4
5 Unaware of any at the present time.
6
7

8 Empire's response clearly indicates that Mr. Palmer's criticism of the AAO
9 process is not a relevant factor within the Missouri jurisdiction of Company's
10 service area.
11

12 Q. HAS EMPIRE EVER BEEN GRANTED AN ACCOUNTING AUTHORITY
13 ORDER FOR ITS MISSOURI JURISDICTION?

14 A. Yes. OPC Data Request No. 1016 requested Company to identify and describe
15 all Accounting Authority Orders granted Empire during the period 1990-2005.
16 Empire's response states:

17
18 An AAO was granted to Empire in 1994. (case EO-94-149). This
19 AAO was related to flooding costs at Iatan and Riverton. The
20 company began amortizing these costs (\$263,187) in March of
21 1994. The company continued the amortization of these costs until
22 fully amortized in December 1997.
23
24

25 Q. WERE ANY OF EMPIRE'S AAO COSTS DENIED RECOVERY IN RATES?

26 A. No. Company's response to OPC Data Request No. 1016 states:

We are not aware of any costs that were denied rate recovery.

Q. IS MR. PALMER ADVOCATING THAT EMPIRE BE GUARANTEED
RECOVERY OF ALL STORM EXPENSES IT INCURS?

A. His direct testimony states that he does; however, his response to OPC Data
Request No. 1007 appears to hedge a bit on that position:

While as a general rule a utility should be allowed to recover its
prudently incurred expenses, I am not aware of any regulatory
jurisdiction that guarantees a utility recovery of all expenses **and
that is not what my proposal is advocating.** The proposal I
made is related only to the recovery of storm costs and the
potential of spreading storm costs over a period greater than a
single year. I am generally aware of several instances in which the
Missouri Public Service Commission has authorized the deferral
and recovery of costs of such events or projects as ice storm,
power plant retro fits and demand-side management program costs.
In general, the concept I am proposing to use for storm damage is
similar to the AAO treatment afforded utilities in Missouri to deal
with major storm damage.

(Bolding by OPC.)

Q. IS MR. PALMER'S PROPOSAL SIMILAR TO THE AAO PROCESS
UTILIZED IN THE STATE OF MISSOURI?

A. No. I believe that the storm damage expense tracker, as proposed by Mr. Palmer,
is merely a process to capture and defer expenses actually incurred in one year for
automatic recovery in future years. An AAO would also capture and defer the

1 expenses, if they met certain parameters for deferral, but the important difference
2 between the AAO and Mr. Palmer's proposal is that the AAO deferred expenses
3 would not be automatically guaranteed recovery in future years. Company would
4 first have to go through a process whereby the expenses are audited and reviewed
5 for prudence before the Commission would allow their recovery in rates.

6
7 Q. DO YOU CONSIDER MR. PALMER'S PROPOSAL, IF AUTHORIZED BY
8 THE COMMISSION, TO BE RETROACTIVE RATEMAKING?

9 A. Yes. Retroactive ratemaking is the recovery in current rates of an expense or
10 liability which occurred or accrued in a prior period (see *St. ex rel. Utility*
11 *Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41,
12 47-49 (Mo. Banc 1979). Even though Mr. Palmer denies, as shown in the data
13 request response in the prior Q&A, that he is advocating a guaranteed recovery of
14 all of Empire's expenses, he makes no such claim regarding the storm damage
15 expenses his wishes to defer and recover in rates. He cannot because guaranteed
16 recovery of the storm damage expenses is exactly what his proposal is designed
17 to achieve. It is my understanding that his proposal violates the retroactive
18 ratemaking prohibition because he is requesting the Commission to authorize, in
19 the current case, rate base treatment and amortization of expenses that will not be
20 incurred until sometime in the future. Further, it is my belief that Palmer's
21 proposal is merely nothing more than a thinly veiled attempt by the Company to
22 reduce shareholder's risk at the expense of ratepayer's.

1 Q. MR PALMER ALLEGES ON PAGE NINE OF HIS DIRECT TESTIMONY
2 THAT THE FAS 87 TRACKING MECHANISM APPROVED BY THE
3 COMMISSION IN EMPIRE CASE NO. ER-2004-0570 IS SIMILAR TO THE
4 ONE HE PROPOSES FOR STORM EXPENSES. IS HIS ASSERTION
5 APPROPRIATE OR REASONABLE?

6 A. No. Mr. Palmer's allegation that the storm expense tracker he proposes is similar
7 to the FAS 87 tracking mechanism is only accurate inasmuch as it relates to the
8 structure of the proposed tracker mechanism (i.e., the mechanics or processes and
9 procedures developed and implemented for the tracking and reporting of the
10 expenses). In its response to OPC Data Request No. 1008, Company states:

11
12 Mr. Palmer's testimony is a comparison of the mechanics of the
13 proposed tracking process itself.
14
15

16 However, thereafter, little or no similarities exist between Mr. Palmer's storm
17 cost proposal and Empire's current FAS 87 tracking mechanism. For example,
18 the rationale behind the authorization and utilization of a FAS 87 tracking
19 mechanism bears little, if any, resemblance to the rationale he uses to support the
20 recovery of storm damage expenses. The FAS 87 tracker was setup to facilitate
21 wide differences in expense verses funding levels associated with the
22 complexities of various accounting and governmental supported requirements.
23 That is, statistical anomalies and estimates, along with financial market
24 conditions and various Federal legal requirements, more likely than not create

1 differences between the actual amount of employee benefit expense calculated
2 and booked verses the actual funding amount the utility is required to submit to
3 the FAS 87 investment vehicle. Since the calculated "accounting" expense
4 amount is often not funded in its entirety, the FAS 87 tracker was setup to
5 recognize that difference even though it is not included in the development of
6 regulated rates (i.e., not until the actual funding of the investment vehicle occurs).

7
8 Q. WHY IS THE FAS 87 TRACKER NECESSARY?

9 A. The FAS 87 tracker mechanism is necessary to mitigate any concerns of the
10 utility's outside auditors, and the financial community at large, that the utility is
11 satisfying the requirements of the Generally Accepted Accounting Procedures
12 ("GAAP") governing these types of costs. It is not a reserve or depository-like
13 account whereby the utility is allowed to book for future automatic recovery
14 expenses incurred in a prior year. If the costs booked in the FAS 87 tracker are
15 not funded, according the rules and regulations of the relevant accounting
16 standards and Federal law, they will not be allowed in the development of
17 regulated rates in the state of Missouri.

18
19 Another reason for the utilization of the FAS 87 tracker is that the development
20 and tracking of the associated expense is related to employee retirement benefit
21 costs, and these types of costs are considered one of the most complicated and
22 strictly governed areas of regulated ratemaking. The retirement benefit costs are

1 not simply incurred and expensed as are storm damage expenses. The are annual
2 in nature; occurring each and every year, and not just occasionally as do major
3 storms. Further, the costs are often dictated by third parties which include
4 Federal government rules and regulations and business operations and conditions
5 within the market which Empire operates. These costs are, in fact, regulated by a
6 extremely large and complex volume of rules, procedures and laws, both within
7 the accounting profession and the Federal government. It is quite clear that any
8 storm damage expenses incurred by Empire do not rise to or achieve the same
9 level of scrutiny and regulation.

10
11 Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS
12 ISSUE.

13 A. Public Counsel has proposed that a "normal" level of storm damage expense be
14 included in the development of rates for the current case; thus, there is no need to
15 utilize a deferred expense accounting process such as that proposed by Empire
16 because the expenses actually being incurred are not significantly volatile or
17 extraordinary. Extraordinary events, whether a company is able to plan for them
18 or not, are a risk of doing business. The Commission and the Public Counsel has
19 for many years been willing to work with and assist utilities in the development
20 of plans for utilities to recover prudently incurred costs associated with
21 catastrophic storm damages. In the event that such costs are determined to be
22 extraordinary, OPC concurs that AAO deferral for possible future recovery

1 should be permitted in order to provide a utility with the incentive to do what is
2 necessary to help prevent disruption of or restore safe and adequate service.

3
4 Mr. Palmer's proposal; however, is intended only to insulate stockholders from all
5 risks associated with a storm event and that is inconsistent with the fundamental
6 ratemaking concept that the development of a utilities' cost of capital requires it to
7 bear some risk in order to have the opportunity to earn returns in excess of the
8 returns provided by risk-free investments (interestingly, Mr. Palmer's proposal
9 contains no reduction in Empire's return on equity for the reduction in risk that
10 would be achieved if his proposal is authorized by the Commission). In addition,
11 Commission authorization of the Company's request would only benefit
12 shareholders because, as identified by Mr. Palmer, it would essentially guarantee
13 Empire full recovery of any and all future storm damage expenses it may incur
14 and that could lead to less incentive for management to manage the costs. Lastly,
15 it is my opinion that if the Commission were to authorize the Company's request
16 it would lead to the creation of a process whereby the final result would be
17 retroactive ratemaking treatment of the expenses which, it is my understanding, is
18 illegal in the state of Missouri.

19
20 **III. EXPERIMENTAL REGULATORY PLAN AMORTIZATION**

21 Q. WHAT IS THE ISSUE?

1 A. The Stipulation & Agreement for the Experimental Regulatory Plan, Empire Case
2 No. EO-2005-0263, required Company to develop an amortization to meet
3 financial ratio targets in any rate case subsequent to its effective date. However,
4 Company did not create or provide the calculation in its initial rate filing. On
5 page 10, lines 8-17, of the direct testimony, of Mr. William L. Gipson, President
6 and Chief Executive Officer of Empire District Electric Company, he states:

7
8 Q. ARE YOU REQUESTING ANY AMORTIZATION TO
9 MEET FINANCIAL RATIO TARGETS AS PROVIDED
10 FOR IN CASE NO. EO-2005-0263?

11
12 A. **Not in the initial rate filing.** Empire is currently working
13 with the parties involved in the regulatory plan on how to
14 best meet the future capacity requirements. At this point,
15 these plans may include a new purchased power contract.
16 According to Standard & Poor's *Utilities & Perspectives*,
17 May 12, 2003, "Standard & Poor's Ratings Services views
18 electric utility purchased-power agreements ("PPA") as
19 debt-like in nature...". From the point a commitment on
20 the new contract is made, the rating agencies may adjust
21 their financial ratio calculations to accommodate the new
22 power contract. If Empire finalizes the details of the new
23 contract within the true-up period, we recommend that this
24 be taken into account as a true-up adjustment.

25
26 (Emphasis by OPC.)
27
28

29 Q. DOES THE PUBLIC COUNSEL BELIEVE THAT COMPANY SHOULD
30 HAVE PROVIDED THE AMORTIZATION CALCULATION IN ITS INITIAL
31 FILING?

32 A. Yes. Company's failure to provide the amortization calculation in its initial filing
33 has created the situation wherein valuable audit time has been lost. The factors

1 and data that go into the amortization's calculation are varied and of sufficient
2 complexity and volume to warrant a thorough review. At this late date much of
3 the data and information has yet to be verified and interpreted as to the relevance
4 of its inclusion in the calculation.

5
6 Q. HAS COMPANY RECENTLY PROVIDED ITS AMORTIZATION
7 CALCULATION TO THE CASE PARTIES?

8 A. Yes. On or about July 7, 2006, Company provided the Public Counsel its version
9 of the amortization calculation via an e-mail addressed to me. The e-mail also
10 identified that the amortization, and its support, is included in Empire's response
11 to MPSC Data Request No. 301.

12
13 Q. HAS THE MPSC STAFF DEVELOPED ITS OWN CALCULATIONS OF THE
14 AMORTIZATION?

15 A. Yes. Utilizing its filed EMS runs (i.e., adjusted), Staff has developed its own
16 versions of the amortization based on the scenarios of with and without the
17 continuation of the interim energy charge. The Staff's amortizations are discussed
18 in the supplemental direct testimony of Mr. Mark L. Oligschlaeger.

19
20 Q. DO THE STAFF AND COMPANY'S AMORTIZATION AMOUNTS DIFFER?

21 A. Yes. While both parties have utilized the calculation format setout in Appendix
22 D of the Stipulation & Agreement, Company bases its calculation on its 2006 rate

1 case filing and Staff bases its calculations on its own adjusted rate case filings.

2 The end result is that the parties amortizations differ significantly.

3
4 Q. WHAT PROBLEMS DO THE DIFFERENT AMORTIZATIONS CREATE?

5 A. Most of the differences in the calculations result from the parties utilization of the
6 different Company and Staff rate case filings. The positions that the parties have
7 taken on the various revenue requirement issues, as shown in the respective
8 filings, create differences which will likely be resolved either through a
9 negotiated settlement or via Commission order. However, there is additional
10 information included in the amortization calculations, of both parties (that is not
11 necessarily included in their individual rate case filings), which needs further
12 review. For example, Public Counsel is primarily concerned with two specific
13 area of costs included in the amortization calculations, 1) the off-balance sheet
14 obligations, and 2) the gross up of the amortization for income taxes.

15
16 Q. WHAT ARE THE ISSUES WITH THE OFF-BALANCE SHEET
17 OBLIGATIONS?

18 A. The issues are, 1) what is an off-balance sheet obligation, and 2) what is the
19 valuation of an obligation if it is to be included in the amortization calculation?

20
21 Q. DO THE OFF-BALANCE SHEET OBLIGATIONS INCLUDED IN THE
22 COMPANY AND STAFF CALCULATIONS DIFFER?

1 A. Yes. Company and Staff have both included off-balance sheet obligations
2 (including related depreciation and interest amounts), for operating leases and
3 purchase power agreements, in their respective calculations; however, the
4 balances which they have included differ by extremely large amounts.

5
6 Beginning on page 9, line 14, of Mr. Oligschlaeger's supplemental direct
7 testimony, he states:

8
9 Q. Has Empire valued the amount of its off-balance sheet
10 obligations that should be treated as debt for purposes of
11 the benchmark ratios?

12
13 A. Yes. The Company provided to the Staff an analysis of the
14 estimated total debt valuation for the Elk River Windfarm
15 operating lease agreement, as well as its other and less
16 material off-balance sheet items.

17
18 Q. Does the Staff concur with these estimates concerning
19 Empire's off-balance sheet obligations?

20
21 A. No, not without further investigation. Available
22 documentation from S&P indicates that there is an apparent
23 discrepancy between Empire's estimates of the debt
24 equivalent valuation of its off-balance sheet obligations,
25 and S&P's assumptions concerning these amounts.
26
27

28 Q. WHAT OFF-BALANCE SHEET OBLIGATIONS SHOULD BE INCLUDED IN
29 THE AMORTIZATION CALCULATION?

30 A. The off-balance sheet obligations to include are those that conform with rating
31 agency methods for balance sheet restatements. It's my understanding that they

1 consist primarily of operating leases and tolling agreements, purchased power
2 debt-equivalents and accounts receivables sold along with related interest and
3 depreciation expense associated with the obligations. For example, in Appendix
4 D, Process Illustration: Adjustment of Amortization Amounts, attached to the
5 Stipulation & Agreement of Empire Case No. 2005-0263, it states:

6
7 Empire made adjustments to this base financial information to
8 include certain off balance sheet items. These adjustments were to
9 conform with rating agency methods for balance sheet re-
10 statement. Empire identified these accounting adjustments, such
11 as the equivalent debt treatment of operating leases and capacity
12 contracts. The equivalent debt treatment of these off balance sheet
13 items was determined by calculating the net present value of the
14 future stream of lease or contract payments, discounted at 10%.
15 The base financial information was then adjusted by the equivalent
16 debt balances and the interest expense associated with the
17 equivalent debt balances. From this adjusted information, Empire
18 then calculated the three guideline ratios defined in Appendix C
19 for total regulated company and as allocated to the Missouri
20 jurisdiction.
21
22

23 Q. SHOULD AN OFF-BALANCE SHEET OBLIGATION THAT IS NOT
24 ACTUALLY IN-FORCE, OR ENTERED INTO, WITHIN THE BOUNDRIES
25 OF THE COMMISSION ORDERED TEST YEAR (INLCUDING THE UPDATE
26 FOR KNOWN AND MEASUREABLE PERIOD) BE INCLUDED IN THE
27 AMORTIZATION CALCULATION?

28 A. No.

29 Q. HOW SHOULD THE OFF-BALANCE SHEET OBLIGATIONS THAT ARE
30 INCLUDED IN THE AMORTIZATION CALCULATION BE VALUED?

1 A. The obligations, once determined, are to be discounted back to their individual
2 present value using a 10% discount rate. Once the present values are know, a
3 portion is treated as the debt-equivalent, based on the application of a risk factor
4 of either 10-20%, 30%, or 50%.

5
6 Q. HAVE THE PARTIES AGREED ON THE RISK FACTORS TO APPLY TO
7 THE INDIVIDUAL OFF-BALANCE SHEET OBLIGATIONS?

8 A. No.
9

10 Q. WHAT RISK FACTOR WOULD PUBLIC COUNSEL RECOMMEND BE
11 APPLIED TO THE INDIVIDUAL OFF-BALANCE SHEET OBLIGATIONS?

12 A. It is the Public Counsel's belief that the lowest risk factor available within the
13 rating agency methodology should be utilized to determine the debt-equivalent
14 value of each off-balance sheet obligation included in the calculation of the
15 amortization. Thus, Public Counsel recommends that the risk factor to apply be
16 no more than 10%.

17
18 Q. WOULD UTILIZATION OF THE LOWEST RISK FACTOR BE A
19 VIOLATION OF THE TERMS OF THE EXPERIMENTAL REGULATORY
20 PLAN STIPULATION AND AGREEMENT?

21 A. No. In the Stipulation & Agreement, the parties agreed to utilize a rating agency
22 methodology for determining the debt-equivalent value of the off-balance sheet

1 obligations. The Standard & Poor's Rating Services Utility Financial Ratio
2 Definitions, updated January 13, 2005 (as described in Appendix C of the
3 Experimental Regulatory Plan Stipulation & Agreement and Company's response
4 to MPSC Data Request No. 301), identifies a range of 10-20%, 30%, or 50% as
5 the risk factors to be applied to off-balance sheet obligations to determine their
6 debt-equivalent value.

7
8 Furthermore, to my knowledge, Standard & Poor's methodology does not
9 explicitly identify which risk factor should apply to which contract based on the
10 specific risk of the individual contract; therefore, it is Public Counsel's belief that
11 the application of a specific risk factor to an individual contract should be based
12 on the actual risks associated with the contract. Since Empire is a regulated
13 public utility operating within the state of Missouri, Public Counsel believes that
14 the risk it will default on any individual off-balance sheet obligation is almost
15 nonexistent. Therefore, the lowest risk factor available in the rating agency
16 methodology should be utilized to determine the debt-equivalent value of
17 each off-balance sheet obligation. It is Public Counsel's belief that application of
18 the lowest risk factor to the off-balance sheet obligations does not violate the
19 methodology terms agreed to in the Experimental Regulatory Plan Stipulation &
20 Agreement.

21 Q. WHAT IS THE ISSUE WITH THE INCOME TAX GROSS-UP OF THE
22 AMORTIZATION?

1 A. The issue is whether or not the amortization should be adjusted (increased) for
2 income taxes that may become due and payable on the amount.

3
4 Q. DO COMPANY AND THE MPSC STAFF SUPPORT A GROSS-UP OF THE
5 AMORTIZATION FOR INCOME TAXES?

6 A. Both parties show the gross-up in their respective amortization calculations;
7 however, the MPSC Staff opposes its inclusion. Beginning on page 11, line 12,
8 of Mr. Oligschlaeger's supplemental direct testimony, he states:

9
10 Q. What is the Staff's position on including a gross-up for
11 income taxes in the amount of regulatory plan
12 amortizations allowed in rates?

13
14 A. The Staff opposes including a gross-up of income taxes as
15 part of the amortization amount to be included in rates,
16 absent a showing that such amortizations will be
17 considered taxable by federal and state taxing authorities. If
18 that showing can be made, the Staff would still oppose
19 inclusion of income tax effects in the amortization amounts
20 granted in rates unless the utility can demonstrate that it
21 will not derive sufficient benefits in deferred taxes from its
22 ongoing plant in service additions to offset any additional
23 tax liability associated with the regulatory plan
24 amortizations.

25
26
27 Q. HOW IS THE INCOME TAX GROSS-UP TO BE TREATED ACCORDING
28 TO THE TERMS OF THE STIPULATION AND AGREEMENT IN CASE NO.
29 EO-2005-0263?

1 A. The issue has not yet been resolved. On page 2, of Appendix D, attached to the
2 Stipulation & Agreement, it states:

3
4 The Signatory Parties have not agreed to a methodology to
5 determine the tax impacts relate to additional FFO.
6
7

8 However, on page 13, of the Stipulation & Agreement, the signatory parties also
9 included the following language:

10
11 Additional taxes will be added to the amortization to the extent
12 that the Commission finds such taxes to be appropriate.
13
14

15 Q. WHAT POSITION DOES PUBLIC COUNSEL TAKE ON THE ISSUE OF THE
16 INCOME TAX GROSS-UP?

17 A. For the same reasons articulated by Mr. Oligschlaeger in his supplemental direct
18 testimony, Public Counsel opposes including the gross-up of income taxes on the
19 amortization amount to be included in rates. Our position is also based on the
20 fact that the terms of the Experimental Regulatory Plan Stipulation & Agreement
21 identify the amortization as an expense item, and expenses are never subject to
22 income tax gross-up.

23 Q. DOES THE STIPULATION AND AGREEMENT ALLOW A PARTY TO
24 REQUEST THAT THE AMORTIZATION BE DIRECTED TOWARDS

1 SPECIFIC PLANT ACCOUNTS OR REFLECTED IN DEPRECIATION
2 RATES?

3 A. Yes. On page 15 of the Experimental Regulatory Plan Stipulation & Agreement,
4 it states:

5
6 This paragraph does not preclude a party from requesting that this
7 amortization be directed toward specific plant accounts or from
8 requesting additional changes in depreciation rates that may result
9 from depreciation studies.
10
11

12 Q. IS IT THE PUBLIC COUNSEL'S POSITION THAT THE AMORTIZATION
13 SHOULD BE UTILIZED TO OFFSET SPECIFIC PLANT ACCOUNTS
14 AND/OR TREATED AS ADDITIONAL DEPRECIATION EXPENSE?

15 A Yes. It is the Public Counsel's belief that the other side of the accounting entry
16 for the amortization (expense) should be directed towards an offset of specific
17 plant accounts. This means that the amortization should be booked as a debit to
18 either amortization or depreciation expense with a resulting credit to plant in
19 service accumulated depreciation. The amortization booked in the accumulated
20 depreciation account can then be further subdivided or allocated to specific plant
21 in service accounts as appropriate.
22

23 In effect, the terms of the Stipulation & Agreement state that the amortization
24 represents an expense which is to be treated as a reduction of current plant in
25 service. In the regulated utility ratemaking process, plant in service, which is a

1 component of the utility's rate base, usually receives a "return of" and "return on"
2 its investment cost. This means that the utility is allowed to earn a "return on" the
3 investment while also receiving a "return of" of its cost. The amortization, being
4 a reduction in the value of plant in service, represents a "return of" the plant
5 investment to the utility. This implies indirectly, if not directly, that the
6 amortization is in fact additional depreciation expense whether or not it is
7 actually included in the development of the depreciation rates ultimately
8 authorized in the current case. Since it is similar to, if not actually, additional
9 depreciation expense, and there is no income tax gross-up required on expenses,
10 there should be no gross-up for income tax on the amortization.

11
12 Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THE
13 AMORTIZATION.

14 A. It is the Public Counsel's belief that an amortization will be required in order to
15 satisfy the terms of the Experimental Regulatory Plan of Empire Case No. 2005-
16 0263; however, at the moment, there is some confusion regarding what off-
17 balance sheet obligations should be included in the calculation. Furthermore,
18 once the appropriate off-balance sheet obligations are identified for inclusion,
19 agreement regarding each obligation's debt-equivalent valuation has not been
20 reached by the parties. Both Company and Staff's amortization calculations
21 include some identical off-balance sheet obligations, but the values that they have
22 assigned to those obligations differ significantly. It is my belief that imputed debt

1 valuations utilized have raised more questions than they have resolved; thus,
2 additional information will have to be gathered and reviewed before the questions
3 are resolved to the satisfaction of the parties, and that will take time.

4
5 Lastly, it is the Public Counsel's belief that once the amortization is determined,
6 the amount should not be grossed-up for income taxes. The Stipulation &
7 Agreement of Case No. EO-2005-0263 states that the signatory parties did not
8 reach an agreement to determine the related tax impacts, if any, to the
9 amortization. Thus, any possible tax implications are not yet known and
10 measurable and, depending on the future actions of the various taxing authorities,
11 they may never materialize. Public Counsel believes it would be unreasonable to
12 force ratepayers to fund the additional cost associated with the income tax gross-
13 up since it is likely that it will never exist.

14
15 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

16 A. Yes, it does.