

Exhibit No.:
Issue: Property Taxes
Witness: Roy M. Boltz, Jr.
Sponsoring Party: MoPSC Staff
Type of Exhibit: True-up Surrebuttal Testimony
Case No.: ER-2001-299
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MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

TRUE-UP SURREBUTTAL TESTIMONY

OF
ROY M. BOLTZ, JR.

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Missouri Public
Service Commission

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

Jefferson City, Missouri
August 2001

1 **TRUE-UP SURREBUTTAL TESTIMONY**

2 **OF**

3 **ROY M. BOLTZ, JR.**

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5 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

6 Q. Please state your name and business address.

7 A. Roy M. Boltz, Jr., P.O. Box 360, Jefferson City, Missouri 65102.

8 Q. By whom are you employed and in what capacity?

9 A. I am a Regulatory Auditor with the Missouri Public Service Commission
10 (Commission).

11 Q. Are you the same Roy M. Boltz, Jr. who has previously filed direct,
12 surrebuttal and true-up direct testimony in this case?

13 A. Yes, I am.

14 Q. What is the purpose of this true-up surrebuttal testimony?

15 A. The purpose of this testimony is to respond to portions of the true-up
16 rebuttal testimony filed by The Empire District Electric Company (Empire or Company)
17 witness David W. Gibson regarding property taxes.

18 Q. At page 1 of Mr. Gibson's true-up rebuttal testimony, he indicated that
19 Empire disagrees with the Staff's amount of property tax expense included in the test
20 year true-up audit. Do you agree with Mr. Gibson's criticism that the Staff's property tax
21 annualization ignores proper matching of property tax expense to plant in service?

22 A. No. The Staff calculated property taxes based upon the actual property tax
23 payments at December 31, 2000, the end of the Staff's test year. This payment of tax is

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1 based on the value of the property owned as of January 1, 2000, which is the date
2 property is assessed for taxing purposes. This relationship reflects how tax payments are
3 actually determined by the taxing authorities.

4 Q. Why is the January 1 assessment date important?

5 A. The state and local taxing authorities use January 1 as the assessment date
6 to determine the appraised value of the property which forms the basis of the property tax
7 liability owed the state and political subdivisions for the calendar year. Any plant
8 additions or property that are completed and booked to plant in service during the period
9 of January 2 through December 31 of any given calendar year will not be assessed for
10 property tax purposes until January 1 of the following year. In essence, the property tax
11 liability associated with this plant is not due to the state and local taxing authorities until
12 November-December of the subsequent year. Thus, unless the property was in-service on
13 January 1, the taxes will not be owed until November-December of the following year.

14 As an example, any plant additions that Empire added to its plant in
15 service on January 2, 2001, will not be assessed by the taxing authorities until January 1,
16 2002, and property taxes thereon will not be due until November-December of 2002.

17 Q. Mr. Gibson states at page 2, lines 3 through 6 of his true-up rebuttal
18 testimony that "The failure of the Staff to provide an updated amount of property tax in
19 the cost of service to reflect this substantial property addition is, in my view, a clear
20 violation of the matching principle whereby revenues are based or "matched" with their
21 associated rate base and expenses." Do you agree?

22 A. No. Mr. Gibson is attempting to persuade the Commission that the Staff's
23 calculation of property taxes is in some way a "mismatch" with Staff's normalizations

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1 and annualizations throughout the rest of its case. This is simply not true. The Staff has
2 calculated the property tax annualization based upon how the taxing authorities assess
3 and how Empire ultimately pays these taxes. Because of the unique nature of how
4 property taxes are determined, the typical normalization and annualization process used
5 by both the Company and the Staff for other expense items is not appropriate for property
6 tax expense.

7 The previous example of plant additions included in plant in service on
8 January 2, 2001, is an illustration of the unique nature of property taxes. Unlike a payroll
9 or revenue annualization, which the Staff attempts to include through an end of the test
10 year, the end of an update to the test year period, or the end of a true-up period, the
11 January 2, 2001 plant in service balances will not be included in the Company's booked
12 property tax expenses until January through December of 2002. Indeed, Empire will not
13 accrue a property tax expense for any of the plant additions (including the State Line
14 Combined Cycle (SLCC) unit) through June 30, 2001, the end of the Staff's true-up
15 period, until January of 2002. This accrual will only be an estimate because the
16 Company will not know the actual amount of property tax payments until late in 2002,
17 when the tax bills are distributed by the taxing authorities, usually in November or
18 December of that year.

19 Q. Would it be appropriate to include an accrual/estimate of property taxes to
20 be paid in 2002 in this rate case?

21 A. No. No other expense item is being considered for inclusion in this case
22 by the Staff or even Empire itself to go out to anytime in 2002. It is important to note
23 that the property taxes that Empire will pay on or about December 31, 2001, represents

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1 the level of plant at January 1, 2001 which is the exact time period which the Staff used
2 to calculate its property tax annualization in this case.

3 Q. Does Empire's proposal to include a level of property tax expense based
4 upon plant in service as of June 30, 2001 violate the test year and update of the test year
5 concept?

6 A. Yes. Empire's proposed level of property tax expense violates the test
7 year and the true-up audit period in this case. This proposal does not represent a
8 complete "package" of adjustments that appropriately reflects a consistent revenue-
9 expense-rate base relationship at a point in time. As indicated previously, the property
10 tax expense level proposed by Empire represents an estimated amount that the Company
11 will not begin accruing on its books and records until January of 2002, and Empire will
12 not know the exact amount payable for those property taxes until late in 2002. The actual
13 property taxes themselves will not be paid until on or about December 31, 2002.
14 Mr. Gibson has only considered one item of expense while not considering other items
15 such as additional revenues from customer growth during 2002, property insurance,
16 payroll annualizations, plant additions and retirements, depreciation reserve and possibly
17 other items.

18 Q. Why is it important to maintain the proper relationship of the individual
19 components that make up the revenue requirement?

20 A. It is very important that all elements of the revenue requirement be
21 considered at a consistent point in time because events occur that result in constant
22 changes in revenues, expenses and rate base that cause changes to the overall revenue
23 requirements. Reflecting changes for only one element of the revenue requirement, in

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1 this case property taxes, without consideration of other offsetting changes in other
2 revenue requirement components, will likely lead to setting a distorted level of rates.

3 Q. Has the Commission recognized the importance of maintaining the proper
4 relationship between revenues, expenses and rate base in setting rates previously?

5 A. Yes. In its March 13, 1996 Suspension Order and Notice for Missouri Gas
6 Energy, the Commission stated, "The Commission will not consider a true-up of isolated
7 adjustments, but will examine only a "package" of adjustments designed to maintain the
8 proper revenue-expense-rate base match at a proper point in time. *Re: Kansas City*
9 *Power & Light Company, 26 Mo. P.S.C. (N.S.) 104, 110 (1983).*" Similar language has
10 been used in many other rate proceedings by the Commission.

11 Q. Is Empire aware of the importance the Commission places on maintaining
12 the proper relationship between revenues, expenses and rate base in setting rates?

13 A. Yes. In Case No. ER-97-81, The Empire District Electric Company, the
14 Commission in its test year order rejected various true-up proposals and thus ordered:

15 . . . test year for use in this case as the twelve months
16 ending September 30, 1996, with isolated adjustments,
17 including consideration of State Line Unit II, through
18 May 31, 1997. All isolated adjustments will be known and
19 measurable, used and useful, and in-service prior to the
20 adjustment cutoff date. In addition, the relationship
21 between revenue, expense, and rate base will be maintained
22 as accurately as possible in calculating any isolated
23 adjustments.

24 Q. Is the Company's proposed level of property tax expense "known and
25 measurable"?

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1 A. No. Empire's proposed level of property tax expense is not a known and
2 measurable expense, which can or should be included in the cost of service in this
3 proceeding.

4 Q. What does the term "known and measurable" mean?

5 A. A "known and measurable" expense is an expense that is 1) "known,"
6 meaning that the amount did or definitely will be an actually incurred cost and
7 2) "measurable," meaning that the rate impact of the change (for example, property tax
8 expense) can be calculated with a high degree of accuracy. The significance of this term
9 is that historically the Commission has only reflected in rates those revenue requirement
10 changes that were known and measurable at the time the rate decision was made.
11 Certainly, property taxes that are not "known and measurable" until 2002 do not
12 constitute a proper or appropriate inclusion into the cost of service in this case.

13 Q. If the Company does not "know" what the actual amounts of property tax
14 expense will be until late in a given year, how does Empire determine the level which it
15 books to expense on a monthly basis?

16 A. Each year the Company will attempt to estimate the appropriate expense
17 level it believes will be incurred in that given year. It may change its estimate from time
18 to time during the course of the year but, ultimately, when the actual property tax
19 payment amount becomes known, Empire must book a "true-up" amount to make the
20 actual property tax payment equal the level recorded for the year on its books and
21 records. These "true-up" amounts are generally booked late in the year, usually in
22 November or December. The actual amounts of property taxes associated with the
23 June 30, 2001 plant levels (as well as any level of property tax on plant in service levels

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1 during 2001) will be estimated and booked as an expense beginning January 2002 and
2 will not actually be known until November/December of that year. The property tax
3 "true-up" adjustment to correct the earlier property tax estimates will not be until late
4 in 2002, as it relates to 2001 additions. Thus, Empire's proposal regarding property taxes
5 in this case would result in a "mismatch" of the "relationship between revenue, expense
6 and ratebase."

7 Q. Is there a difference between the amounts charged to expense for property
8 taxes for any given year and the property tax payments for that year?

9 A. Property taxes assessed on plant in service are expensed. Every year at the
10 January 1 assessment date, there is also an amount of property taxes which is assessed on
11 Empire's construction activities that is capitalized. The amount of property tax expensed
12 are different than the total payment amounts because of the portion that is capitalized on
13 the utilities books. In other words, the amount of property taxes expensed will be lower
14 than the total property taxes paid because of the capitalized portion of property taxes.

15 Q. Mr. Gibson states at page 2, lines 9 through 10 of his true-up rebuttal
16 testimony that Staff "has ignored the property taxes that will be paid as a direct result of
17 this plant being built." Do you agree?

18 A. No. The Staff has not ignored the property taxes associated with the new
19 SLCC plant. Those property taxes were appropriately capitalized and are included in the
20 plant balances that Staff has recommended during the true-up audit through June 30,
21 2001. Those property taxes were added to the applicable plant account balances which
22 the Staff has included in its June 30, 2001 true-up revenue requirement. Empire will

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1 recover those property taxes in rates over the life of the asset through depreciation
2 expense and a return component through rate base treatment.

3 Q. On page 4, line 21 of Mr. Gibson's true-up rebuttal testimony he states,
4 "As can be seen from the preceding table, property taxes have increased since 1996."
5 Do you wish to comment on this?

6 A. Yes. The preceding table he references is found on page 3 of his true-up
7 rebuttal testimony. In that table, the line Electric represents the amounts that were
8 expensed during the indicated period. The amount shown as being expensed for 1997
9 related to Empire's electric operations decreased from the previous year 1996 and the
10 amount for 2000 decreased from the previous year 1999 as well. Thus, it can be seen that
11 the amounts of electric property tax expense for the Company both can increase and
12 decrease over time which does not support the argument that property taxes can be
13 accurately estimated for plant additions in future periods.

14 Q. On page 4, lines 12 through 19 of Mr. Gibson's true-up rebuttal testimony,
15 he describes how he calculated the level of property tax expense that he is proposing. Do
16 you agree with his calculation?

17 A. I agree that his mathematics are correct, but that calculation is not based
18 on how property taxes are actually assessed. The December 31, 2000 or January 1, 2001
19 plant balances are used to assess the property, not the June 30, 2001 plant balances. The
20 June 30, 2001 plant balances will never be used for assessment purposes since that is not
21 how the taxing authorities assess for property taxes. The June 30, 2001 balances will be
22 included in the December 31, 2001 balances (or January 1, 2002 balances) for assessment
23 purposes. The property tax payment amount will not be known until approximately

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1 November or December 2002 and the payment will not be actually due until
2 December 31, 2002.

3 Q. Has this issue, or a similar issue, previously been tried before the
4 Commission?

5 A. Yes, several times. In Case No. GR-96-285, Missouri Gas Energy (MGE)
6 contended that the most current known and measurable plant balances should be used to
7 calculate an ongoing level of property tax expense. Thus, MGE used a May 30, 1996
8 plant balance in the annualization of property tax expense. The Staff's position was that
9 the last actual property tax assessment should be used to determine property taxes for
10 revenue requirement purposes. The Commission found in favor of the Staff's position on
11 this issue. The Commission stated in its ruling that:

12 The Commission finds Staff witness Featherstone's persuasive where he
13 states:

14 MGE will not accrue a property tax expense for any of the
15 plant additions through May 31, 1996 identified in the
16 Rebuttal Testimony of Mr. Kelly until January of 1997.
17 This accrual will only be an estimate for which the
18 Company will not know the actual amount of property tax
19 payments until late in 1997, when the tax bills are
20 distributed by the taxing authorities, usually in November
21 or December of that year. (Ex. 73, p. 4)

22 The Commission finds that MGE's proposal would require
23 waiting until the end of 1997 to account for an item of
24 expense for inclusion in this case because this would be a
25 violation of the test year, updated test year or true-up
26 concepts. Staff's recommendation will be adopted.

27 In Case No. WR-2000-844, St. Louis County Water Company, that utility
28 also argued that its property tax expenses should be based on the level of plant in service
29 to be reflected in rates. The Commission in that case ruled:

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1 The Commission traditionally, and properly, allows
2 recovery of cost increases that are projected to occur after
3 the end of the test year (including any adjustment periods)
4 only if those costs are known and measurable. A cost
5 increase is "known" if it is certain to occur, and it is
6 "measurable" if the Commission is able to determine the
7 amount of the increase with reasonable precision. The
8 Company's projected property tax increases are neither
9 known nor measurable. While it is probable that the
10 Company will experience an increase in property tax
11 expense at the end of the year, it is by no means certain.
12 Even more damaging to the Company's proposal is the fact
13 that its best estimate of the amount of any increase is based
14 on an assumption that finds no support in the record.
15 Company's proposed property tax calculation assumes that
16 the tax rates for 2000 will be the same as the tax rates for
17 1999. Because any increase in the Company's property tax
18 expense is not known and measurable, the Commission will
19 not adopt the Company's proposal. Staff's proposal to use
20 a known amount (the last amount actually paid), while
21 probably not a perfectly accurate representation of the
22 property taxes that will be paid in the future, at least avoids
23 the speculation inherent in Company's proposal.

24 Q. Was the Staff aware that property tax expense on the SLCC plant going to
25 be a true-up issue in this case?

26 A. No. At the Company's request, the Staff made a correction during the
27 prehearing conference held during the week of April 16, 2001 for test year property tax
28 expense, but no mention was ever made that property taxes related to the SLCC plant was
29 going to be an issue. It was not listed as an issue under State Line Power Plant in the
30 Company's Statement of Position on List of Issues filed May 15, 2001 nor was it listed in
31 the Revised List Of Issues filed June 4, 2001. The Staff first learned that it was an issue
32 on Friday, August 10, one workday prior to the Company's true-up rebuttal testimony
33 being filed. While the Staff has not formally challenged the Company's true-up rebuttal
34 testimony on the issue of property taxes, the Staff believes this issue could have and

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1 should have been presented to the Commission during the initial hearings for this
2 proceeding in May-June 2001.

3 Q. Does this conclude your true-up surrebuttal testimony?

4 A. Yes, it does.

