EXHIBIT

Exhibit No.: ____________

Issue(s): Experimental Regulatory Plan Amortization

Witness: Ted Robertson

Type of Exhibit: Surrebuttal

Sponsoring Party: Public Counsel

Case Number: ER-2006-00315

Date Testimony Prepared: August 18, 2006

SURREBUTTAL TESTIMONY

OF

TED ROBERTSON

FILED

SEP 2 9 2006

Missouri Public Service Commission

Submitted on Behalf of
the Office of the Public Counsel

THE EMPIRE DISTRICT ELECTRIC COMPANY

Case No. ER-2006-0315

August 18, 2006

Public counsel Exhibit No. 80

Case No(s). ER-2006-0315

Date 9-05-06 Rptr PF

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SURREBUTTAL 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 AND REBUTTAL TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this surrebuttal testimony is to address the rebuttal testimony of the Empire District Electric Company ("EDE" or "Company") witnesses, Mr. William L. Gipson, Mr. Steven M. Fetter, and Mr. L. Jay Williams, regarding the amortization requirement identified in the Stipulation & Agreement for the Experimental Regulatory Plan, Empire Case No. EO-2005-0263.

II. EXPERIMENTAL REGULATORY PLAN AMORTIZATION

Q. DOES MR. GIPSON BELIEVE THAT AN AMORTIZATION SHOULD BE INCLUDED IN THE INSTANT CASE?

A. According to his testimony, it would appear that he does not. On page 1, lines 13-15, of his rebuttal testimony, he states:

> Specifically, I will discuss my understanding of the purpose of the amortization addressed in Empire's Regulatory Plan, which resulted from Commission Case No. EO-2005-0263, **and why it should have no implication in this case.**
>
> (Emphasis added by OPC)

In addition, in its response to OPC Data Request No. 1025, which requested if an amortization is required in the current rate case, Company stated it was not.

Q. ACCORDING TO MR. GIPSON, WHY WAS THE AMORTIZATION MECHANISM CREATED?

A. On page 2, lines 13-14, of his rebuttal testimony, he states:

> As I stated in my supplemental direct testimony, the amortization mechanism was designed to maintain certain S&P ratios during the construction of Iatan 2.

Q. ACCORDING TO MR. GIPSON, IS THE IATAN 2 CONSTRUCTION UNDERWAY?

A. On page 2, line 9, of his rebuttal testimony, he states:

> No substantial construction is underway to my knowledge.

Q. IS HIS UNDERSTANDING OF THE CONSTRUCTION COSTS ACTUALLY INCURRED CORRECT?

A. I believe that it is not. Regarding the level of charges actually incurred to-date, Company's response to OPC Data Request No. 1024 states:

> We have received one invoice from KCPL for the initial billing for Iatan Unit 2. The invoice was for $4,739,041.48. Detail for this invoice may be found at KCPL.

The response also states that as of June 2006 Empire's costs booked to the Iatan 2 Project total $308,436.91.

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE LEVEL OF CONSTRUCTION COSTS IDENTIFIED IN THE PREVIOUS Q&A ARE SUBSTANTIAL?

A. Yes. In relation to the total projected cost of the Iatan 2 Project these costs may seem de minimis, but I seriously doubt anyone would view millions of dollars as being insubstantial. In any event, the amount of construction costs actually incurred to-date is not the deciding factor upon which a determination to include an amortization is to be based. The Commission's Order in Empire Case EO-2005- 0263 approved a Stipulation and Agreement that provides Empire the opportunity to maintain its debt at investment grade rating <u>during the period associated with construction of the Iatan 2 generating facility</u>. That is, the period associated with the construction, as defined in the Order. It does not state that the amortization opportunity will not begin until some threshold level of construction costs is actually incurred.

Q. WHAT IS THE PERIOD ASSOCIATED WITH THE CONSTRUCTION OF THE IATAN 2 PROJECT?

A. The Stipulation and Agreement defines the duration of the Regulatory Plan Term as the approximate five year period beginning with the effective date of a Commission order that approved the Stipulation and Agreement and ending with the effective date of the initial rates that reflect inclusion of the Iatan 2 investment. The effective date of the Commission's Order Approving Stipulation And Agreement, Case No. EO-2005-0263, was August 12, 2005; therefore, the financial ratios, and any other associated agreements identified in the Stipulation and Agreement, should be analyzed to determine if an amortization is necessary at this time.

Q. IN YOUR REBUTTAL TESTIMONY YOU DISCUSSED VARIOUS VALUATION DISCREPANCIES IN THE AMORTIZATIONS PROVIDED BY THE COMPANY AND MPSC STAFF. HAVE THE INCONSISTENCIES IN THE VALUES ASSOCIATED WITH THE OFF-BALANCE SHEET OBLIGATIONS BEEN RESOLVED?

A. No. It appears that the method used by Standard & Poor's to develop the debt-equivalent values for these items is known, at least to some degree, only by Standard & Poor's personnel. In response to OPC Data Request No. 1029, which requested information on how the application of a risk factor to purchased power contracts is determined, Empire stated:

> 1. We do not know the specific criteria used to make the determination of the risk factor, and 2. We do not know the specific methodologies used by S&P and therefore we cannot comment on their application.

Q. HAS PUBLIC COUNSEL DETERMINED THE AMORTIZATION THAT SHOULD BE INCLUDED IN THE INSTANT CASE?

A. Yes. Utilizing the Interim Energy Charge ("IEC") Continuation Scenario for the amortization included in the supplemental direct testimony of MPSC Staff witness, Mr. Mark L. Oligschlaeger, as a base template, Public Counsel has calculated the amortization based upon the end of the known and measurable period ordered by the Commission, i.e., March 31, 2006. The OPC's amortization calculation is attached to this surrebuttal testimony as Schedule TJR-1.

Q. WHY DID THE PUBLIC COUNSEL UTILIZE THE MPSC STAFF'S AMORTIZATION CALCULATION AS A BASE TEMPLATE?

A. Because, it is my understanding that Staff's amortization calculation, excluding the off-balance sheet obligations, includes Empire's revenue requirement, capital structure/costs, and other relevant costs, as of March 31, 2006, which is the end of the known and measurable period authorized by the Commission for the instant case.

Q. WHAT CHANGES DID OPC MAKE TO THE STAFF'S IEC CONTINUATION AMORTIZATION?

A. The only amounts OPC changed were those directly related to the off-balance sheet obligations, i.e., the operating lease and purchase power debt-equivalents, and the operating lease depreciation adjustment. I changed these inputs to the calculation so that they would represent the debt-equivalent value and depreciation adjustment that existed at March 31, 2006 based on my interpretation of the Company's responses to OPC Data Request Nos. 1023, 1025, 1027, 1028, 1029, and MPSC Staff Data Request No. 3. I made no changes to any of the other inputs shown on Mr. Oligschlaeger's IEC Continuation Scenario amortization.

Q. IS IT LIKELY THAT ANY OF THE OTHER INPUTED VALUES SHOWN ON THE STAFF'S AMORTIZATION CALCULATION ARE SUBJECT TO FURTHER MODIFICATION?

A. Yes. It is likely that some of the costs Staff has included in its amortization calculation will change depending on how the Commission rules on the various positions and issues taken by the individual parties in the rate case (e.g., rate of return); however, I believe that the Staff's calculation of the amortization numbers, except for the off-balance sheet obligation amounts that I believe are based to some degree on calendar year amounts and a higher than necessary risk factor, represent a reasonable starting point in determining the amortization to include in the instant rate case.

Q. PLEASE DESCRIBE HOW THE PUBLIC COUNSEL CALCULATED THE OFF-BALANCE SHEET OBLIGATION DEBT-EQUIVALENT VALUES IT INCLUDED IN ITS DETERMINATION OF THE AMORTIZATION.

A. Public Counsel included in its determination of the off-balance sheet obligations operating lease costs for Empire's Unit Trains along with two purchased power contracts, 1) the Western Resources, Inc., Jeffrey Energy Center, and 2) the Elk River Windfarm. The first step in the determination of the debt-equivalent values for these obligations was the calculation of the individual discounted present value of all three obligations as of March 31, 2006. Based on my understanding of the Standard & Poor's methodology, I determined the debt-equivalent value for the Unit Train leases to be their actual March 31, 2006 discounted present value. I then calculated and included an operating lease depreciation adjustment which is also based on the Standard & Poor's methodology for calculating depreciation adjustments. Finally, the March 31, 2006 discounted present values of the two purchased power contracts were further adjusted by a risk factor ratio to arrive at their debt-equivalent values.

Q. WHAT RISK FACTOR RATIO DID PUBLIC COUNSEL USE TO DETERMINE THE DEBT-EQUIVALENT VALUE OF THE PURCHASED POWER CONTRACTS?

A. I utilized a risk factor ratio of 10%. I believe this risk factor to be appropriate because it is based on Standard & Poor's methodology for calculating debt-equivalent values. Furthermore, it represents what I believe are the actual risks of default or non-payment associated with the contracts.

Q. DO YOU BELIEVE IT LIKELY THAT EMPIRE WILL DEFAULT ON THE PURCHASED POWER CONTRACTS?

A. No. As I stated in my rebuttal testimony, Empire is a regulated public utility operating within the state of Missouri; therefore, Public Counsel believes that the risk it will default on any individual purchased power contract is almost nonexistent. Thus, I believe, the lowest risk factor available in the rating agency's methodology should be utilized to the determine the debt-equivalent value for each of Empire's purchased power contracts.

Q. HAS EMPIRE EVER DEFAULTED ON A OPERATING LEASE OR PURCHASED POWER CONTRACT?

A. Not to my knowledge. In its response to OPC Data Request No. 1023, which requested a listing of all known operating leases and purchased power contracts on which Empire (i.e., the regulated utility) has defaulted, Company stated:

> ...please be advised the Empire has not defaulted on any contracts in the last 10 years.

In fact, no evidence has been presented, in the instant case, that Empire has ever defaulted on any of its operating leases or purchased power contracts.

Q. DID PUBLIC COUNSEL ALSO EXCLUDE ONE OF EMPIRE'S CURRENT PURCHASED POWER CONTRACTS IN ITS DETERMINATION OF THE AMORTIZATION'S PURCHASED POWER DEBT-EQUIVALENT VALUATION?

A. Yes. Company's response to OPC Data Request No. 1027 identified that Empire has an off-balance sheet obligation related to its Plum Point power purchase; however, Ms. Kelly Walters, Empire's Vice President - Regulatory and General Services, informed me during a phone call on August 11, 2006 that the Plum Point contract was not entered into until April 2006. Since the contract was not "in-force" until after the end of the test year known and measurable period authorized by the Commission, I excluded it from the calculation of the amortization.

Q. ON PAGE 2 OF HIS SURREBUTTAL TESTIMONY, MR. FETTER DISCUSSES HIS CONCERN THAT THE AMORTIZATION NOT BE VIEWED AS SUBSTITUTE FOR TIMELY RECOVERY OF FUEL AND PURCHASED POWER EXPENSES. IS HIS CONCERN RELEVANT?

A. No. Public Counsel believes his concern to be baseless. It is not relevant because the amortization mechanism was specifically set up to allow Empire to maintain its debt at investment grade rating during the period associated with construction of the Iatan 2 Project. It does so by including the debt-equivalent costs associated with operating leases and purchased power agreements. There is no adjustment to disallow costs that are prudently incurred and there is no mention at all of any recovery or non-recovery of fuel costs in its development.

Q. ON PAGE 10, LINES 2-13, OF HIS SURREBUTTAL TESTIMONY, MR L. JAY WILLIAMS STATES THAT THE AMORTIZATION IS NOT A TAX DEDUCTIBLE EXPENSE; THUS, IT SHOULD BE GROSSED-UP FOR INCOME TAXES. DO YOU AGREE?

A. No. Mr. Williams' statement that the revenue that comes with the amortization would be considered taxable income by the IRS is unfounded. He has provided absolutely no testimony or evidence that would verify the accuracy or reasonableness of that statement. The Stipulation & Agreement in Case No. EO-

2005-0263 clearly states that the signatory parties did not reach an agreement to determine the related tax impacts, if any, to the amortization. Any possible tax gross-up implications are not yet known and measurable and, depending on the future actions of the various taxing authorities, they may never materialize.

Q. DOES THE PUBLIC COUNSEL BELIEVE THE AMORTIZATION TO BE A TAX DEDUCTIBLE EXPENSE?

A. Yes. The terms of the Stipulation & Agreement state that the amortization represents an expense which is to be treated as a reduction of current plant in service. Thus, Public Counsel believes the amortization to be additional depreciation on Empire's existing plant and that the additional depreciation requires a straight line tax depreciation deduction be reflected in the determination of the Company's cost of service in the instant case. This position is consistent with the ratemaking treatment afforded any increase in depreciation expense.

Q. DOES PUBLIC COUNSEL KNOW OF ANY OTHER MISSOURI CASE WHEREIN AN AMORTIZATION SIMILAR TO THE ONE PROPOSED IN THIS CASE HAS BEEN TREATED AS ADDITIONAL DEPRECIATION?

A. Yes. In Kansas City Power & Light, Case No. EO-94-199, Company and the MPSC Staff agreed to an amortization which has been treated as additional book depreciation with the accumulated balance being utilized as a reduction to rate base. In addition, it is my understanding, that for income tax purposes a depreciation deduction has been assumed in subsequent earnings and/or revenue investigations of KCPL.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

Office of the Public Counsel
Calculation of Amortization to meet Financial Ratio Targets
IEC Continuation Scenario

			Total Company	Juris Alloc
1				
2				
3				
4			Total	Juris
5			Company	Alloc
6				
7	Rate Base	Staff Acct. Schedule 2*		617,577,674
8	Jurisdictional Allocation for Capital			0.82
9				
10	Total Capital	Murray Schedule 9	772,078,472	633,104,347
11	Equity	Murray Schedule 9	384,040,776	314,913,436
12	Trust Preferred	Murray Schedule 9	48,434,238	39,716,075
13	Long-term Debt	Murray Schedule 9	339,603,458	278,474,836
14	Cost of Debt	Murray Schedule 20	7.02%	7.02%
15	Interest Expense	L12 * L13 (+$4,250,000 (TOPRs))	28,090,163	23,033,933
16				
17	Electric Sales Revenue	Staff Acct. Schedule 9*, L.1-3, + Rate Decrease		289,813,503
18	Other Electric Operating Revenue	Staff Acct. Schedule 9, L.4-5		4,250,093
19	Water Revenue			
20	Operating Revenue	L16 + L17		294,063,596
21				
22	Operating and Maintenance Expense	Staff Acct. Schedule 9, L.94 (less cust. deposits)		199,821,131
23	Depreciation	Staff Acct. Schedule 9, L.95 + L99		32,373,757
24	Amortization			
25	Interest on Customer Deposits	Staff Acct. Schedule 10, Adj. S-70.3		529,813
26	Taxes Other than Income Taxes	Staff Acct. Schedule 9, L.100		10,883,580
27	Federal and State Income Taxes	Staff Acct. Schedule 9, L.111 (plus IEC revenues		10,362,867
28	Gains on Disposition of Plant	and rate decr. impact)		
29	Total Water Operating Expenses			
30	Total Electric/Water Operating Exp	Sum of L. 21-28		253,971,148
31				
32	Operating Income - Electric	L19 - L29		40,092,448
33	Operating Income - Water			
34	less: Interest Expense	L14		-23,033,933
35	Depreciation	L22		32,373,757
36	Amortization			
37	Deferred Taxes	Staff Acct. Schedule 9, L110		2,323,761
38	Funds from Operations (FFO)	Sum of L31-36		51,756,033
39				
40				
41				
42				
43	Additional Financial Information Needed for Calculation of Ratios			
44	Capitalized Lease Obligations	EDE Accounts 227 + 243	443,765	363,887
45	Short-term Debt Balance	EDE Form 10-Q, p. 6	46,000,000	37,720,000
46	Short-term Debt Interest	EDE Accounts 417.891 + 431.400	625,992	513,313
47	Cash Interest Paid	Information Supplied by EDE	24,275,961	19,906,288
48	AFUDC Debt (capitalized interest)	EDE Form 10-Q, p. 4	606,000	496,920
49				
50	Adjustments Made by Rating Agencies for Off-Balance Sheet Obligations			
51	Debt Adj for Off-Balance Sheet Obligs			
52	Operating Lease Debt Equivalent	OPC DR 1025 & Robertson W/P	2,033,085	1,667,130
53	Purchase Power Debt Equivalent	OPC DRs 1025/1028&Robertson W/P	18,119,915	14,858,330
54	Total OSB Debt Adjustment	L52 + l53	20,153,000	16,525,460
55				
56	Operating Lease Deprec Adjustment	OPC DR 1025 & Robertson W/P	555,336	455,375
57				

58	Interest Adjustments for Off-Balance Sheet Obligations			
59	Present Value of Operating Leases	L52 * 10%	203,309	166,713
60	Purchase Power Debt Equivalent	L53 * 10%	1,811,992	1,485,833
61	Total OSB Interest Adjustment	L59 + L60	2,015,300	1,652,546
62				
63	Ratio Calculations			
64	Adjusted Interest Expense	L14 + L46 + L61	30,731,455	25,199,793
65	Adjusted Total Debt 3/31/06	L11 + L12 + L44 + L45 +L54	454,634,461	372,800,258
66	Adjusted Total Debt 3/31/05	Same as L65, but for prior year	412,861,000	338,546,020
67	Adjusted Total Capital	L9 + L44 + L45 + L54	838,675,237	687,713,695
68				
69	Adj. FFO Interest Coverage	(L37 + L47 + L48 + L61)/(L14 + L48 + L61)		2.93
70	Adj. FFO as a % of Average Total Debt	(L37 + L56)/(avg. of L65 + L66)		0.1468
71	Adj. Total Debt to Total Capital	L65/L67		0.5421
72				
73	Changes Required to Meet Ratio Targets			
74	Adj. FFO Interest Coverage Target			3.20
75	FFO Adjustment to Meet Target	(L74 - L69) * L64		6,779,502
76	Interest Adjustment to Meet Target	L37 * (1/L74 - 1) - 1/L69 - 1)		-3,277,658
77				
78	Adj. FFO as a % of Average Total Debt			0.195
79	FFO Adjustment to Meet Target	(L78 - L70) * (Avg of L65 + L66)		17,144,854
80	Debt Adjustment to Meet Target	L37 * (1/L78 - 1/L70)		-87,155,493
81				
82	Adj. Total Debt to Total Capital Target			56.50%
83	Debt Adjustment to Meet Target	(L82 - L71) * L67		15,757,979
84	Total Capital Adjustment to Meet Target	L65/L82 - L67		-27,890,229
85				
86	Amortization and Revenue Needed to Meet Targeted Ratios			
87	FFO Adj Needed to Meet Target Ratios	Maximum of L75, L79 or zero		17,144,854
88	Effective Income Tax Rate			0.3839
89	Income Tax Effect	L87 * L88/(1 - L88)		-10,683,184
90	Total Amortization Req for FFO Adj	L87 - L89		27,828,038
91				
92	* All references to Staff Accounting Schedules tie to schedules supporting amounts reflected in the			
93	Preliminary Reconciliation filed 7/7/06.			

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 surrebuttal testimony consisting of pages 1 through 12 and Schedule TJR-1.

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 18th day of August 2006.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

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

Jerene Buckman
Notary Public

My commission expires August 10, 2009.