

Exhibit No. 135
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Witness: L. Jay Williams
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Sponsoring Party: Empire District
Case No. ER-2014-0351

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**Before the Public Service Commission
of the State of Missouri**

Surrebuttal Testimony

of

L. Jay Williams

March 2015



Empire Exhibit No. 135
Date 4-14-15 Reporter XF
File No. ER-2014-0351

L. JAY WILLIAMS
SURREBUTTAL TESTIMONY

SURREBUTTAL TESTIMONY
OF
L. JAY WILLIAMS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2014-0351

1 Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A. L. Jay Williams. My business address is 602 Joplin Street, Joplin, MO.

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

4 A. I am employed by The Empire District Electric Company ("Empire" or
5 "Company") as Regulatory Tax Manager.

6 Q. ARE YOU THE SAME L. JAY WILLIAMS THAT FILED REBUTTAL
7 TESTIMONY IN THIS CASE BEFORE THE MISSOURI PUBLIC
8 SERVICE COMMISSION ("COMMISSION")?

9 A. Yes.

10 Q. PLEASE BRIEFLY SUMMARIZE YOUR SURREBUTTAL TESTIMONY.

11 A. My surrebuttal testimony is to respond to the rebuttal testimony of Commission
12 Staff ("Staff") witness Kimberly K. Bolin related to the request by Empire to
13 recover flowed-through tax benefits of cost of removal and the under-recovery of
14 state income tax in its income tax cost of service computation in previous rate
15 cases. I will address how and why these benefits were flowed through/under-
16 recovered and what will likely be the result if the request for recovery of these
17 amounts is denied.

18 Q. DO YOU AGREE WITH STAFF THAT IT IS NOT "REASONABLE TO
19 EXPECT THE AMOUNT OF COST OF REMOVAL COLLECTED IN

1 **RATES BY A UTILITY WILL EVER BE EQUAL TO THE AMOUNT OF**
2 **COST OF REMOVAL ACTUALLY INCURRED BY A UTILITY”?**

3 A. No. The use of past history in depreciation studies in establishing the cost of
4 removal component of depreciation rates allows the Commission to “true-up” the
5 estimate of cost of removal used in the past determination of depreciation rates.

6 **Q. DO YOU AGREE WITH STAFF’S DEFINITIONS OF NORMALIZATION**
7 **AND FLOW THROUGH?**

8 A. Yes.

9 **Q. PLEASE EXPLAIN HOW THE COST OF REMOVAL TAX BENEFITS**
10 **WERE FLOWED THROUGH TO RATEPAYERS.**

11 A. Timing differences can be normalized in a tax calculation for ratemaking
12 purposes in either of two ways. One way is to simply ignore a tax timing
13 difference in the computation, thereby leaving the tax expense to be computed on
14 book income. The other way to normalize a timing difference is by deducting the
15 timing difference in determining the current tax expense and then by adding back
16 deferred tax expense equal to the current tax expense reduction created by the
17 timing difference. In the case of Empire, prior to 2008 the cost of removal
18 incurred was deducted in determining the current tax expense, but this deduction
19 was not added back or normalized through an increase in deferred tax expense. As
20 a result, the tax benefits of costs of removal incurred were flowed through to
21 ratepayers.

22 **Q. DO YOU AGREE WITH MS. BOLIN’S REBUTTAL TESTIMONY AT**
23 **PAGE 5 THAT IT IS NOT POSSIBLE TO DETERMINE HOW CERTAIN**
24 **ITEMS ARE TREATED FOR RATE PURPOSES BASED UPON A**

1 **REVIEW OF INCOME TAX ACCOUNTING SCHEDULES FROM**
2 **PREVIOUS CASES?**

3 A. No.

4 **Q. WHY NOT?**

5 A. In the 1994 and 1997 cases, the Staff's income tax accounting schedules clearly
6 show the subtraction of "Tax Depreciation – Excess" and "Cost of Removal" in
7 determining "Net Taxable Income". In both cases, deferred tax expense was
8 computed by multiplying only the "Tax Depreciation – Excess" by the composite
9 Federal and Missouri rate of 38.3886% in determining deferred income tax
10 expense. By not increasing deferred tax for the "Cost of Removal" that was
11 deducted in the determination of current tax expense, the tax benefits of the cost
12 of removal were flowed through to the ratepayers.

13 **Q. WAS STAFF'S FLOW THROUGH OF THE COST OF REMOVAL TAX**
14 **BENEFIT ISOLATED TO THESE TWO CASES?**

15 A. No. In Commission Case No. ER-2006-0314, a Kansas City Power & Light
16 Company rate case, Staff witness Steve Traxler stated: "Flow through treatment
17 (current year deduction) was used for all Missouri utilities unless the utility could
18 demonstrate the need for additional cash flow to meet interest coverage ratios."
19 This shows that flow through treatment was Staff's standard policy in all rate
20 cases and not isolated to the two Empire rate cases referenced above.

21 **Q. WHEN DID THE FLOW THROUGH OF THE COST OF REMOVAL IN**
22 **EMPIRE'S MISSOURI RATE CASES STOP?**

1 A. It stopped when Empire began recovering Regulatory Plan Amortization in 2008,
2 as that amortization was granted upon the demonstration by the utility of its need
3 “for additional cash flow to meet interest coverage ratios”.

4 **Q. DO YOU AGREE WITH MS. BOLIN’S SUGGESTION AT PAGE 6 OF**
5 **HER REBUTTAL TESTIMONY THAT THE SETTLEMENT OF PAST**
6 **EMPIRE RATE CASES PRECLUDES EMPIRE’S RECOVERY OF THE**
7 **REQUESTED AMOUNTS?**

8 A. No. It is readily apparent from Empire’s past rate case filings and the work-
9 papers provided in those filings that both Empire and Staff were aware of the flow
10 through of these tax benefits, and the settlement of these past cases does not
11 change the facts surrounding this issue.

12 **Q. DO YOU AGREE WITH MS. BOLIN’S STATEMENT AT PAGE 7 OF**
13 **HER REBUTTAL TESTIMONY THAT THE REGULATORY ASSET**
14 **RELATED TO THE RECOVERY OF THE FLOWED THROUGH COST**
15 **OF REMOVAL IS NOT A REGULATORY ASSET “IN THE USUAL**
16 **SENSE” OF THAT TERM?**

17 A. No. The regulatory asset related to the flow through of income tax deductions
18 was created by the regulatory actions of the Commission.

19 **Q. WHAT CREATED THE FLOW-THROUGH OF INCOME TAX**
20 **DEDUCTIONS RELATED TO STATE INCOME TAXES?**

21 A. The normalization requirements of the Internal Revenue Code consider the
22 recovery of anything less than the federal statutory rate to be a normalization
23 violation. In all of Empire’s Missouri rate cases prior to August 1994, deferred
24 income tax expense was only provided for the federal portion of income taxes, not

1 the state portion. The result was the flow through of the state portion of Empire's
2 tax deductions (benefits) to Empire's Missouri customers.

3 **Q. DO YOU AGREE WITH MS. BOLIN'S REBUTTTAL TESTIMONY AT**
4 **PAGE 8 WHERE SHE INDICATES THE FULL COMPOSITE FEDERAL**
5 **AND STATE RATE WAS RECOVERED IN PRIOR RATE CASES?**

6 A. No, I do not agree with this statement. The Commission's policy was to support
7 flow-through in earlier years, as stated in Staff witness Traxler's testimony in
8 Case No. ER-2006-0314, and the Commission's order provided in Empire's
9 response to DR 177 in Case No. ER-2012-0345. This Commission order
10 provided in DR177 in Case No. ER-2012-0345 prescribed the use of the federal
11 statutory rate only to record deferred income tax expense.

12 **Q. WHEN DID EMPIRE BEGIN USING THE COMPOSITE FEDERAL AND**
13 **STATE INCOME TAX RATE TO RECORD DEFERRED INCOME TAX**
14 **PROVISION?**

15 A. Empire began using the composite federal and state income tax rate to record
16 deferred income taxes in August, 1994.

17 **Q. WHY DID EMPIRE BEGIN TO USE THE COMBINED FEDERAL AND**
18 **STATE RATE IN AUGUST OF 1994?**

19 A. Empire started using the federal and state composite rate to be consistent with the
20 Commission Staff which was using this higher composite rate in its income tax
21 work-papers.


22 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

23 A. Yes, it does.

AFFIDAVIT OF L. JAY WILLIAMS

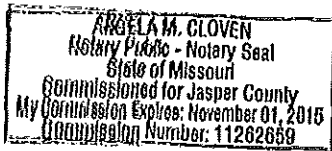
STATE OF MISSOURI)
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COUNTY OF JASPER)

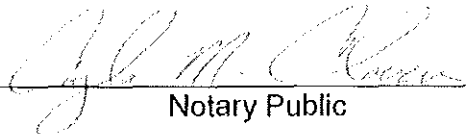
On the 20th day of March, 2015, before me appeared L. Jay Williams, to me personally known, who, being by me first duly sworn, states that he is Retulatory Tax Manager of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



L. Jay Williams

Subscribed and sworn to before me this 20th day of March, 2015.





Notary Public

My commission expires: 11/01/15