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Issue: Income Tax
Witness: L. Jay Williams
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Empire District
Case No. ER-2016-0023

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

Surrebuttal Testimony

of

L. Jay Williams

May 2016



SERVICES YOU COUNT ON

Empire Exhibit No. 27
Date 6-2-16 Reporter KKF
File No. ER-2016-0023



SURREBUTTAL TESTIMONY
OF
L. JAY WILLIAMS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2016-0023

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 Amanda C. McMellen 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 thereby matching the amount collected from customers with the amount actually
7 incurred by the utility.

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

10 A. Yes, Empire and Staff appear to be using these terms in the same manner.

11 **Q. PLEASE EXPLAIN HOW THE COST OF REMOVAL TAX BENEFITS**
12 **WERE FLOWED THROUGH TO CUSTOMERS.**

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

24 **Q. HOW DID CUSTOMERS BENEFIT?**

1 A. The rates customers paid during that period were less as a result of the tax benefit
2 related to flowing through the cost of removal. **Q. DO YOU AGREE WITH**
3 **MS. MCMELLEN'S REBUTTAL TESTIMONY AT PAGE 4 THAT IT IS**
4 **NOT POSSIBLE TO DETERMINE HOW CERTAIN ITEMS ARE**
5 **TREATED FOR RATE PURPOSES BASED UPON A REVIEW OF**
6 **INCOME TAX ACCOUNTING SCHEDULES FROM PREVIOUS CASES?**

7 A. No.

8 **Q. WHY DO YOU DISAGREE WITH MS. MCMELLEN'S STATEMENT?**

9 A. In Empire's 1994 and 1997 rate cases, the Staff's income tax accounting
10 schedules clearly show the subtraction of "Tax Depreciation – Excess" and "Cost
11 of Removal" in determining "Net Taxable Income". In both cases, deferred tax
12 expense was computed by multiplying only the "Tax Depreciation – Excess" by
13 the composite Federal and Missouri rate of 38.3886% in determining deferred
14 income tax expense. By not increasing deferred tax expense for the "Cost of
15 Removal" that was deducted in the determination of current tax expense, the tax
16 benefits of the cost of removal incurred were flowed through to the customers, as
17 evidenced by Staff's income tax accounting schedules. **Q. WAS STAFF'S**
18 **FLOW THROUGH OF THE COST OF REMOVAL TAX BENEFIT**
19 **ISOLATED TO THESE TWO CASES?**

20 A. No. In Commission Case No. ER-2006-0314, a Kansas City Power & Light
21 Company rate case, Staff witness Steve Traxler stated: "Flow through treatment
22 (current year deduction) was used for all Missouri utilities unless the utility could
23 demonstrate the need for additional cash flow to meet interest coverage ratios."

1 This demonstrates that flow through treatment was Staff's standard policy in all
2 rate cases and not isolated to the two Empire rate cases referenced above.

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

5 A. This flow through process stopped when Empire began recovering Regulatory
6 Plan Amortization in 2008, as that amortization was granted upon the
7 demonstration by the utility of its need "for additional cash flow to meet interest
8 coverage ratios".

9 **Q. DO YOU AGREE WITH MS. MCMELLEN'S SUGGESTION AT PAGE 4**
10 **OF HER REBUTTAL TESTIMONY THAT THE SETTLEMENT OF PAST**
11 **EMPIRE RATE CASES PRECLUDES EMPIRE'S RECOVERY OF THE**
12 **REQUESTED AMOUNTS?**

13 A. No. It is readily apparent from Empire's past rate case filings and the work-
14 papers provided in those filings that both Empire and Staff were aware of the flow
15 through of these tax benefits and were not waiving their respective arguments on
16 the issue.

17 **Q. DO YOU AGREE WITH MS. MCMELLEN'S STATEMENT AT PAGE 5**
18 **OF HER REBUTTAL TESTIMONY THAT THE REGULATORY ASSET**
19 **RELATED TO THE RECOVERY OF THE FLOWED THROUGH COST**
20 **OF REMOVAL IS NOT A REGULATORY ASSET "IN THE USUAL**
21 **SENSE" OF THAT TERM?**

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

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

3 A. The normalization requirements of the Internal Revenue Code consider the
4 recovery of anything less than the federal statutory rate to be a normalization
5 violation. In all of Empire's Missouri rate cases prior to August 1994, deferred
6 income tax expense was only provided for the federal portion of income taxes, not
7 the state portion. The result was the flow through of the state portion of Empire's
8 tax deductions (benefits) to Empire's Missouri customers.

9 **Q. DO YOU AGREE WITH MS. MCMELLEN'S REBUTTTAL TESTIMONY**
10 **AT PAGE 6 WHERE SHE INDICATES THE FULL COMPOSITE**
11 **FEDERAL AND STATE RATE WAS RECOVERED IN PRIOR RATE**
12 **CASES?**

13 A. No, I do not agree with this statement, and I am not aware of any support for this
14 statement by Staff witness McMellen. The Commission's policy was to support
15 flow-through in earlier years, as stated in Staff witness Traxler's testimony in
16 Case No. ER-2006-0314, and in the Commission's order provided in Empire's
17 response to DR 177 in Case No. ER-2012-0345. This Commission order
18 provided in response to DR177 in Case No. ER-2012-0345 prescribed the use of
19 the federal statutory rate only to record deferred income tax expense.

20 **Q. WHEN DID EMPIRE BEGIN USING THE COMPOSITE FEDERAL AND**
21 **STATE INCOME TAX RATE TO PROVIDE FOR DEFERRED INCOME**
22 **TAX EXPENSE?**

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

L. JAY WILLIAMS
SURREBUTTAL TESTIMONY

1 Q. WHY DID EMPIRE BEGIN TO USE THE COMBINED FEDERAL AND
2 STATE RATE IN AUGUST OF 1994?

3 A. Empire started using the federal and state composite rate when we became aware
4 that Commission Staff were using the composite rate.

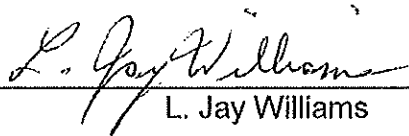
5 Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

6 A. Yes, it does.

AFFIDAVIT OF L. JAY WILLIAMS

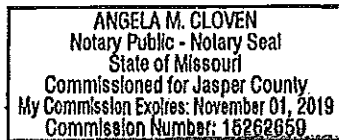
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COUNTY OF JASPER)

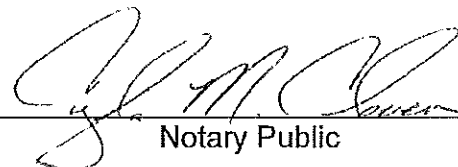
On the 13th day of May, 2016, before me appeared L. Jay Williams, to me personally known, who, being by me first duly sworn, states that he is Regulatory Tax Manager of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



L. Jay Williams

Subscribed and sworn to before me this 13th day of May, 2016.





Notary Public

My commission expires: 11/01/19.