

Exhibit No.:

Issues:

*Test Year, True-up,
Revenue, Municipal
Franchise Taxes and Bad
Debts*

Witness:

David G. Winter

Sponsoring Party:

MoPSC Staff

Type of Exhibit:

Direct Testimony

Case No.:

ER-97-81

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

DAVID G. WINTER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-97-81

*Jefferson City, Missouri
February 1997*

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MISSOURI
PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DAVID G. WINTER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-97-81

Q. Please state your name and business address.

A. David G. Winter, P.O. Box 360, Jefferson City, Missouri 65102.

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

A. I am a Regulatory Auditor for the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. I graduated from Southwest Missouri State University in 1973 with a Bachelor of Science degree in Accounting. After receiving an Honorable Discharge from the United States Army in 1977, I was employed by the firm of Williams-Keepers Certified Public Accountants. I began my employment with the Commission in 1979. I am a licensed Certified Public Accountant (CPA), a Certified Internal Auditor (CIA) and a Certified Government Financial Manager (CGFM).

Q. What has been the nature of your duties while in the employment of this Commission?

A. I have assisted, conducted and supervised audits and examinations of the books and records of public utility companies operating within the state of Missouri. I have participated in examinations of electric, natural gas, water, sewer and telecommunications

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1 companies. I have also been involved in cases concerning proposed rate increases, earnings
2 investigations, cases relating to mergers, acquisitions and certification applications.

3 Q. Concerning Case No. ER-97-81, have you examined and studied the books
4 and records of the Empire District Electric Company (Empire or Company)?

5 A. Yes, in conjunction with of other members of the Commission Staff (Staff).

6 Q. What test year has the Staff used in this case?

7 A. The Staff, as ordered by the Commission, has used a test year ending
8 September 30, 1996. The Staff updated certain material items (rate base, unit fuel prices, rate
9 case expense, payroll and rate of return/capital structure) through December 31, 1996, based
10 on actual information available during the Staff's audit. Updating specific material test year
11 amounts to reflect December 31, 1996 data enables the Staff to make its rate recommendation
12 based on the most recent auditable information available.

13 Q. What is a test year?

14 A. The test year is a twelve-month period used as the basis for the audit of any
15 rate filing or complaint case. This period serves as the starting point for analyses and review
16 of the utility's operations to set the reasonableness and appropriateness of the rate filing. The
17 test year forms the basis for any adjustments necessary to remove abnormalities that may have
18 occurred during the period and to reflect any increase or decrease to the accounts of the
19 utility. Adjustments are made to the test year level of revenues, expenses and investment to
20 determine the proper level of earnings. After the recommended rate of return is determined
21 which the utility is permitted to earn, a comparison of existing rates is made to see if any
22 additional revenues are necessary. If utility earnings are deficient, rates are increased.

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1 Sometimes, existing rates generate earnings in excess of authorized levels, which may show
2 the need for rate reductions. The test year is the vehicle used to evaluate and determine the
3 proper relationship between revenue, expenses and investment. This relationship is essential
4 to determine the appropriate level of earnings for the utility.

5 Q. Does the Staff propose a true-up audit this case?

6 A. Yes. The Staff proposes to true-up its revenue requirement calculation
7 through March 31, 1997, with possible isolated adjustments for the inclusion of Empire's
8 new State Line Unit 2 combustion turbine (SLCT2) and certain other events through May 31,
9 1997.

10 Q. What items through March 1997 would be reflected in the true-up audit under
11 the Staff's proposal?

12 A. The true-up audit would include all major items relating to revenue, expense,
13 capital structure and rate base occurring on or before March 31, 1997. The use of this
14 approach will maintain the appropriate relationship between revenues, expenses and rate base.
15 The Staff recommends the following items be included in the true-up audit process:

16
17 **RATE BASE:**
18

- 19 1. Plant in Service, including fully operational plant additions for which Empire
20 has received an invoice, approved and authorized payment, and recorded
21 payment in accounts payable system.
- 22 2. Depreciation reserve.
- 23 3. Deferred taxes.
- 24 4. True-up prices for fuel inventories for oil and coal.
- 25 5. Related cash working capital effects.
- 26
- 27

CAPITAL STRUCTURE:

1. Rate of Return - Embedded cost of capital components.
2. Capital Structure.

INCOME STATEMENT:

1. Revenues for customer growth.
2. Payroll - employee levels and current wage rates.
3. Fuel and purchase power expense to reflect fuel prices, purchase power prices and net system load (i.e., rerun production cost model).
4. Rate case expense.
5. Depreciation expense
6. Related income tax effects.

Additionally, the Staff's allocation factors will be trued-up through March 1997 to maintain the relationship of the allocators and related items at a consistent point in time. To be included in the true-up audit, standard monthly documentation must be available for all applicable items (i.e., monthly operating reports, Company ledgers and supporting invoices) which assure the Staff that the item has occurred or is in fact in service and booked and auditable at the date of true-up audit.

Q. What isolated adjustments beyond March 1997 does the Staff propose be eligible for inclusion in the true-up audit?

A. The most significant isolated adjustment for which reflection in the true-up audit may be appropriate is the SLCT2, planned to be operational and used for service by May 31, 1997. Empire has entered into a number of contracts with outside parties to assist in the construction of SLCT2. One of these contractors, Westinghouse Electric Corporation (Westinghouse) is responsible for the bulk of the total costs of constructing the SLCT2 combustion turbine for Empire under a fixed price "turnkey" construction agreement. The

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1 construction agreement provides for the design, construction, start-up and testing of SLCT2,
2 and provides for fixed progress payments to Westinghouse based on an agreed to payment
3 schedule that provides the Staff some assurances as to the final cost of the project. If the
4 Staff has deemed the SLCT2 to be in-service and used and useful by May 31, 1997, the Staff
5 intends to only recommend amounts paid (reflecting receipt of invoices, approved and
6 authorized payment, and recorded payment in Empire's accounts payable system) to
7 Westinghouse through May 31, 1997 for inclusion in rates for this proceeding. The Staff
8 recommends the following revenue requirement categories for the SLCT2 be reflected in the
9 true-up if the Staff's in-service criteria are met:

10
11 **RATE BASE:**
12

- 13 1. Plant in service.
14 2. Fuel inventories for SLCT2.
15

16
17 **INCOME STATEMENT:**
18

- 19 1. Fuel and purchase power expense to reflect addition of the SLCT2 to
20 Empire's system (i.e., rerun production cost model).
21 2. Depreciation expense.
22 3. Operations and maintenance other than fuel (SLCT2 only).
23

24 If SLCT2 is in-service at May 31, 1997, the Staff will also address as isolated
25 adjustments the following items: (1) decrease in the Company's demand capacity charges
26 effective June 1, 1997 because of the additional capacity available to Empire with the addition
27 of SLCT2; (2) the Company's letter agreement with Williams Natural Gas Company
28 concerning firm gas transportation service for the State Line 1 combustion turbine, if
29 finalized; (3) certain transmission line projects scheduled to be completed prior to or around

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1 the time the Company has projected SLCT2 to be in-service (these projects are discussed in
2 the direct testimony of Staff witness C. Bruce Deering of the Engineering section of the
3 Energy department); and (4) certain State Line Combustion Turbine Unit 1 costs that were
4 not allowed in Empire's previous rate case due to failure to meet required NOx emission
5 standards, if such standards are successfully met by May 1997.

6 Q. What is the Staff's proposal to recognize SLCT2 costs not included in the
7 Westinghouse fixed price construction contract in the true-up revenue requirement?

8 A. SLCT2 construction costs outside the Westinghouse fixed price construction
9 contract (i.e., work done by Empire or its subcontractors) would be included in the Staff's
10 true-up revenue requirement recommendation if: (1) the Staff's in-service criteria as discussed
11 in the direct testimony of Staff witness Deering is successfully completed; and
12 (2) documentation such as the construction work order and all available invoices, approved
13 and authorized for payment, and recorded payment in Empire's accounts payable system not
14 included in the SLCT2 construction work order is available to Staff five (5) working days
15 before the true-up hearing for inclusion in the true-up revenue requirement.

16 Q. What is the Staff's proposal to recognize the transmission project costs and
17 certain State Line Combustion Turbine Unit 1 costs that were not allowed in Empire's
18 previous rate case in the true-up revenue requirement?

19 A. The Staff would use the same criteria used to recognize SLCT2 costs not
20 included in the Westinghouse fixed price construction contract in the true-up revenue
21 requirement. For the transmission project and State Line Combustion Turbine Unit 1 costs
22 to be included in the Staff's true-up revenue requirement recommendation: (1) the Staff's

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1 in-service criteria as discussed the direct testimony of Staff witness Deering must be
2 successfully completed; and (2) documentation such as the transmission project's construction
3 work order and all available invoices, approved and authorized payment, and recorded
4 payment in Empire's accounts payable system not included in the transmission project
5 construction work order is available to Staff five (5) working days before the true-up hearing
6 for inclusion in the true-up revenue requirement.

7 Q. Are the Staff's true-up audit and isolated adjustment recommendations
8 consistent with the Commission's Order establishing test year dated December 13, 1996?

9 A. Yes. The test year order outlines the Commission's reasoning in rejecting the
10 various true-up audit proposals which extended through May 1997. In regard to the
11 Company's true-up proposal, the Order stated that the:

12 . . . Commission will decline to adopt the true-up proposal as
13 it does not allow sufficient time in which to fully consider the
14 issues in this case and to make an informed decision regarding
15 those issues in this case and to make an informed decision
16 regarding those issues by the operation-of-law date of July 28,
17 1997. The parties are also reminded that the Commission's
18 final Report and Order is generally issued at least 10 days
19 prior to the operation-of-law date, i.e., July 28, 1997. The
20 Commission would have no more than 4 weeks from the true-
21 up hearing in which to complete its deliberations and issue its
22 Report and Order. Four weeks is a grossly inadequate amount
23 of time for the Commission to properly perform its function in
24 a general proceeding . . .
25

26 The Commission thus ordered the:

27 . . . test year for use in this case as the twelve months ending
28 September 30, 1996, with isolated adjustments, including
29 consideration of State Line Unit II, through May 31, 1997.
30 All isolated adjustments will be known and measurable, used

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1 and useful, and in-service prior to the adjustment cutoff date.
2 In addition, the relationship between revenue, expense and
3 rate base will be maintained as accurately as possible in
4 calculating any isolated adjustments.
5

6 The Staff's true-up recommendation satisfies the Commission's concerns while
7 preserving a proper matching of major revenue requirement elements. In addition, adoption
8 of the Staff's true-up proposal allows for isolated adjustment elements for items/events
9 significantly affecting Empire's revenue requirement components that occur beyond the
10 March 1997 true-up date, but before the operation-of-law date.

11 Q. If the Commission adopts the Staff's true-up recommendation, what
12 procedurally will be required?

13 A. The Staff recognizes the possibility, that the Commission may hold true-up
14 hearings in May 1997 before the parties have final knowledge of the in-service status of the
15 SLCT2 combustion turbine. The Staff's true-up testimony, when filed, will identify the true-
16 up revenue requirement both with and without SLCT2 and other proposed isolated
17 adjustments. At the time the information is available, the Staff will notify the Commission
18 whether the SLCT2 should be considered in-service or not, based on the criteria set forth in
19 testimony. Thus, the Commission will have the necessary information available to it to set
20 the appropriate revenue requirement under either scenario. Besides the question of the in-
21 service status of the SLCT2, all other factors affecting the calculation of the true-up revenue
22 requirement should be known to the Commission at the time of the true-up hearings, if
23 hearings are held in May 1997.

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1 Q. Has the Staff included an estimate of the revenue requirement associated with
2 the true-up plus the SLCT2 and other isolated adjustments in its direct filing?

3 A. Yes. The Staff has included an increase in the revenue requirement of
4 \$8,285,000 in the Staff's direct filed case. This additional revenue requirement appears on
5 Accounting Schedule 1 as "True-Up Revenue Requirement." This amount reflects the
6 expected in-service of SLCT2 of May 31, 1997. Following its true-up audit, the Staff will
7 file True-Up Accounting Schedules that will contain actual true-up audit results.

8 Q. What are your primary areas of responsibility in this case?

9 A. I have three (3) principal areas of responsibility: revenues (customer growth),
10 municipal franchise taxes and bad debts.

11 Q. What Accounting Schedules are you sponsoring in Case No. ER-97-81?

12 A. I am sponsoring the following Accounting Schedules:

13 Accounting Schedule 1 Revenue Requirement

14 Accounting Schedule 9 Income Statement

15 Accounting Schedule 10 Adjustments to Income Statement

16 Q. With reference to Case No. ER-97-81, what Accounting adjustments are you
17 sponsoring in this case?

18 A. I am sponsoring the following Income Statement adjustments:

19 Revenues: S-1.1, S-1.2, S-1.3, S-1.4 & S-1.5

20 Bad Debts: S-15.2

21 Franchise Tax Expense: S-23.5

22 Q. Please discuss the accounting schedules you are sponsoring.

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1 A. Accounting Schedule 1 is the Staff's calculation of revenue requirement for
2 the rate of return range sponsored by Staff witness David P. Broadwater of the Commission's
3 Financial Analysis Department. The rates of return determined by Staff witness Broadwater
4 are applied to the Company's rate base, presented on Accounting Schedule 2, Rate Base, to
5 determine the net income requirement. Please refer to the direct testimony of Staff
6 Accounting witness Roy M. Boltz, Jr. for further information regarding the development of
7 rate base. The gross revenue requirement is then determined by adding the required income
8 taxes, calculated on Accounting Schedule 11, to the net income requirement. The testimony
9 of Staff Accounting witness James D. Schwieterman explains the calculation of income taxes
10 on Accounting Schedule 12. Accounting Schedule 9, Income Statement, contains the Staff's
11 adjusted Missouri jurisdictional revenues and expenses for the test year ended September 30,
12 1996. Accounting Schedule 10, Adjustments to Income Statement, contains a listing of the
13 specific adjustments that the Staff has made to the unadjusted test year income statement to
14 derive the Staff's adjusted net income. A brief explanation for each adjustment and the name
15 of the Staff witness sponsoring the adjustment is listed in Accounting Schedule 10.

16
17 **REVENUES**

18 Q. Has the Staff categorized revenues for purposes of this case?

19 A. Yes. The Staff has segregated revenues into five main categories:
20 jurisdictional and non-jurisdictional retail revenues associated with the sale of electricity, sales
21 for resale - non-system revenues, other revenues and revenues associated with the sale of
22 emission credits.

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1 Jurisdictional retail revenues have been annualized and represent only Missouri
2 jurisdictional electricity sales. Non-jurisdictional KWH system sales and sales for resale -
3 non-system revenues represent the Company's sales of electricity to other states, electric
4 companies and government agencies. Other revenues are revenues the Company collects that
5 are not associated with the actual sale of electricity.

6 Q. Please explain adjustment S-1.1.

7 A. Adjustment S-1.1 adjusts revenues to account for the rate level and rate design
8 changes implemented in November 15, 1995 as a result of a Stipulation and Agreement
9 reached in Empire's previous rate case, No. ER-95-279. Staff witness Janice Pyatte of the
10 Economic Analysis Department determined quantification of this adjustment. Please refer to
11 her direct testimony for an explanation of this adjustment.

12 Q. Please explain adjustment S-1.2.

13 A. Adjustment S-1.2 adjusts revenues for the normalization of weather and to
14 reflect 366 billing days within the test year. Staff witness Pyatte also determined
15 quantification of this adjustment. Please refer to Ms. Pyatte's direct testimony for an
16 explanation of this adjustment.

17 Q. Please explain adjustment S-1.3.

18 A. Adjustment S-1.3 annualizes revenues to reflect customer growth for the
19 revenue tariffs 25, 26, 41/43/45, 63 and 68 during the test year. Each of the aforementioned
20 revenue categories were adjusted by the Staff for: (1) rate changes from the Company' last
21 case; (2) normalized weather and days; and (3) other necessary annualizations.

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1 The customer growth adjustment annualizes revenues to reflect the revenues
2 that would have been received had the test year-end level of customers been served by the
3 Company for the entire test year. The Staff adjusted the average monthly customers each
4 month of the test year to the September 30, 1996 level. The differences between September
5 30, 1996 customers and customers billed in each month were multiplied by the average
6 adjusted kilowatt-hours (KWH) per customer in that month. The change in KWH each
7 month was multiplied by the average adjusted cost per KWH each month to obtain the
8 revenue adjustment. Refer to Schedule 2 of the direct testimony of Staff witness Pyatte
9 regarding the customer growth adjustments by tariff.

10 Q. As for adjustment S-1.3, does the Staff's test year monthly customer levels
11 reflect any customer movement between tariffs that took place during the test year?

12 A. Yes. The Staff's monthly customer levels reflect customer movement between
13 tariffs that occurred during the test year.

14 Q. What is adjustment S-1.4?

15 A. Adjustment S-1.4 eliminates Missouri unbilled revenues recorded on the
16 Company's books during the test year. The Staff's annualization of revenues reflects a full
17 year of revenue at the September 30, 1996 customer level, making it necessary to eliminate
18 the impact of unbilled revenue recorded during the test year. The Company's Missouri
19 operations experienced positive unbilled revenue in the amount of \$1,291,226 during the test
20 year, resulting in a negative revenue adjustment. Please refer to Ms. Pyatte's direct testimony
21 regarding the billing days adjustments.

FRANCHISE TAXES

Q. Please explain adjustments S-1.5 and S-23.5.

A. Adjustment S-1.5 eliminates Missouri municipal franchise taxes recorded on the Company's books during the test year as revenues. The Staff's annualized and normalized revenues are based on tariff rates that do not include municipal franchise taxes. To be consistent the Staff also eliminated, in adjustment S-20.4, test year Missouri municipal franchise taxes recorded as expense on the Company's books in Taxes Other Than Income Taxes. The Company collects the franchise taxes from its customers and then pays these amounts to the various municipalities. The net effect of this collection and remittance is zero, on the Company's income statement.

BAD DEBTS

A. Please explain adjustment S-15.2?

Q. Adjustment S-15.2 adjusts bad debt expense to reflect test year net write-offs. An analysis did by the Staff indicated that the test year net write-offs were at a reasonable level to be included in the cost of service. Therefore, test year net write-offs less the Company's test year monthly accrual resulted in adjustment S-15.2.

Q. Mr. Winter, does this conclude your direct testimony?

A. Yes, it does.

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) ER-97-81
File Tariffs Increasing Rates for Electric Service)
Provided to Customers in the Missouri Service)
Area of the Company.)

AFFIDAVIT OF DAVID G. WINTER

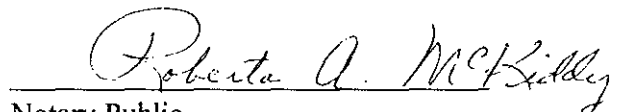
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David G. Winter, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Direct Testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the foregoing Direct Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



David G. Winter

Subscribed and sworn to before me this 12th day of February, 1997.



Notary Public

My Commission Expires: _____ ROBERTA A. MCKIDDY
Notary Public, State of Missouri
County of Cole
My Commission Expires 09/11/99