FILED
May 7, 2015
Data Center
Missouri Public
Service Commission

Exhibit No.:	
Issues:	*Unamortized Balance of Joplin Tornado, ITC Over-Collection Cost of Removal Deferred Tax Amortization, State Flow-Through, and Transmission Revenues and Expense*
Witness:	*Kimberly K. Bolin.*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*ER-2014-0351*
Date Testimony Prepared:	*March 24, 2015*

MISSOURI PUBLIC SERVICE COMMISSION

REGULATORY REVIEW DIVISION
UTILITY SERVICES - AUDITING

SURREBUTTAL TESTIMONY

OF

KIMBERLY K. BOLIN

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2014-0351

Jefferson City, Missouri
March 2015

Staff Exhibit No. 216
Date 4-14-15 Reporter KF
File No ER-2014-0351

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THE EMPIRE DISTRICT ELECTRIC COMPANY

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SURREBUTTAL TESTIMONY

OF

KIMBERLY K. BOLIN

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2014-0351

Q. Please state your name and business address.

A. Kimberly K. Bolin, 200 Madison Street, Suite 440, Jefferson City, MO 65102.

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

A. I am employed by the Missouri Public Service Commission ("Commission") as a Utility Regulatory Auditor V.

Q. Are you the same Kimberly K. Bolin who has previously filed direct testimony, portions of the Commission Staff's ("Staff") Cost of Service Report and rebuttal testimony in this proceeding?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to The Empire District Electric Company's ("Empire" or "Company") rebuttal filing regarding the unamortized balance of the Joplin Tornado AAO. I will also respond to The Office of the Public Counsel's ("OPC") rebuttal testimony regarding the return to customers of the Iatan 2 Investment Tax Credit (ITC) over collection. In addition, I will respond to the Company's rebuttal filing regarding two income tax expense matters; cost of removal deferred tax amortization and state income tax flow-through.

Lastly, I address Empire witness, Aaron Doll's testimony regarding Southwest Power Pool (SPP) and off-system sales revenues

UNAMORTIZED BALANCE OF JOPLIN TORNADO AAO

Q. What is an accounting authority order (AAO)?

A. An AAO is an accounting mechanism that permits deferral of costs from one period to another. The items deferred are booked as an asset rather than an expense, thus improving the financial picture of the utility in question during the deferral period. During a subsequent rate case, the Commission determines what portion, if any, of the deferred amounts will be recovered in rates.

Q. Please describe the AAO that was granted to Empire regarding its 2011 tornado damage costs.

A. In Case No. EU-2011-0387, the Commission authorized Empire to defer incremental operation and maintenance (O&M) expenses incurred for the repair, restoration and rebuild activities associated with the May 22, 2011 tornado. The Company was also allowed to defer depreciation and carrying costs associated with the tornado-related capital expenditures. The Commission ordered the Company to begin amortizing the deferral over a ten-year period to start at the earlier of (1) the effective date of new rates implemented in its next general rate case (Case No. ER-2012-0345) or next rate complaint case; or (2) June 1, 2013.

Q. On page 8 of Company witness, W. Scott Keith's rebuttal testimony he states, "Empire has absorbed the financial impact of the storm for almost four years." Why is this statement incorrect?

A. Under the authority granted to Empire by the Commission, the Company did not charge any of the O&M expense or depreciation expense directly stemming from the tornado to its current expenses at the time of the extraordinary event. Empire was also allowed to accrue a carrying charge equal to its Allowance for Funds Used During Construction (AFUDC) rate on its tornado capital additions to offset the lack of a current return on its tornado-related capital additions. The AAO granted to Empire substantially mitigated many of the negative financial impacts Empire would have suffered due to the tornado.

Q. Does Staff's Cost of Service in this case include the amortization of the deferred tornado costs?

A. Yes.

Q. What is the unamortized AAO balance as of August 31, 2014?

A. The unamortized AAO balance, as of August 31, 2014 is $3,454,918.

Q. Does Staff agree with the Company's proposed inclusion of the unamortized balance of the tornado AAO in rate base?

A. No. Consistent with similar AAOs in prior cases, Staff recommends the Commission not include the AAO balance in rate base. This treatment was prescribed by the Commission in its Order in Case No. WR-95-145 involving St. Louis County Water Company's (SLCWC) unamortized flood deferrals (SLCWC is now part of Missouri-American Water Company). In the Commission's Order in Case No. WR-95-145, the Commission noted that including the unamortized balance in rate base would shield the shareholders from the risk of a natural disaster while imposing the risk entirely on the ratepayers. Allowing SLCWC to recover the cost through amortization without including the unamortized balance in rate base allowed both the ratepayers and the shareholders to share in the risk. This regulatory treatment applied to SLCWC in the past, which has been accepted by the Commission for other AAOs, should be adopted in this case as well.

AMORTIZATION OF INVESTMENT TAX CREDIT (ITC) OVER COLLECTION

Q. Company witness Keith states on page 13 of his rebuttal testimony, "Empire can agree to the process outlined by OPC witness Keri Roth, including the review of the excess ITC balance at the time of the next rate case." Is Staff also in agreement with this process?

A. In my rebuttal testimony Staff originally proposed a 16 month amortization for this item. However, if the Company is agreeable to OPC's proposal of a 24 month amortization, Staff will not object to that treatment.

STATE TAX FLOW THROUGH

Q. Please describe the state tax flow through issue in this particular rate proceeding.

A. Empire is asserting that the normalization treatment of tax timing differences provided to it by the Commission prior to August 1994 allowed the Company to book deferred taxes that were calculated using only the stand alone federal tax rate, and not the composite federal-state income tax rate usually used to record deferred taxes resulting from normalization of tax timing differences. The composite tax rate is a combination of the federal and state income rates. The current composite tax rate is 38.3886%, while the stand-alone tax rate is only the federal tax rate of 35%. Therefore, Empire claims when Staff uses the current composite federal-state income tax rate for the purpose of calculating deferred taxes to return to customers in this case, this overcompensates customers for the deferred taxes previously provided in rates in which a lower federal stand alone rate was used. Empire is proposing to increase its cost of service through an amortization to collect state deferred taxes that it did not record at the time of its previous rate proceedings to offset this alleged shortfall.

Q. What are "deferred taxes?"

A. "Deferred taxes" represent the income tax expense paid by customers in rates that is calculated based upon the impact of financial events and which is currently includable in "book" net income, but that is not includable in current "taxable income" as that amount is defined by federal and state taxing authorities. Deferred taxes result from use of the so-called "normalization" approach to recognize tax timing differences in setting customer rates. The usual ratemaking quantification of deferred taxes for ratemaking purposes is to calculate the amount based upon a "composite" income tax rate, reflecting both the current federal and state (Missouri) prescribed income tax rates.

Q. Is Empire claiming that its prior customer rates were in fact set using a tax normalization approach computed on a stand-alone federal income tax rate basis?

A. Yes. Company witness L. Jay Williams' rebuttal testimony on page 9 states that the Company under-recovered state income tax prior to August 1994 because the composite rate was not used.

Q. What evidence did Mr. Williams provide to support this contention?

A. None. Empire's position on this matter is based upon a claim that it was only authorized to book deferred taxes at a stand-alone federal rate due to a Commission order issued in 1956.

Q. If, in fact, Empire was only authorized to book deferred taxes using a federal stand-alone rate only from 1956 to 1994, does it necessarily mean that Empire's rates were set based upon a level of deferred tax expense calculated at a federal tax rate only?

A. No. I have reviewed several past Empire rate filings, including Case No. ER-90-138, an Empire rate increase filing within the period that Empire claims the Company's deferred taxes were calculated using the stand-alone federal tax rate. Staff's testimony in that case stated that Staff calculated deferred taxes using a composite federal-state income tax rate. Though this case was ultimately resolved through stipulation, Staff's position in that case illustrates that, at the very least, there was no agreement among parties in that proceeding that a stand-alone federal income tax rate should be used to calculate deferred taxes.

Q. Did you review any other cases to provide evidence of how deferred taxes were calculated for purposes of inclusion in rates for Empire in its previous rate cases?

A. Yes. I reviewed two case files for Empire's rate case Nos. ER-83-42 and ER-81-209. Both of these cases were stipulated in whole or in part, and I was unable to find any discussion in Commission orders or in stipulations and agreements, concerning the assumptions by which deferred taxes were calculated for inclusion in Empire's cost of service.

Q. If Staff cannot locate definitive evidence that demonstrates how Empire's rates were set in past rate proceedings regarding calculation of deferred taxes, what is the relevance of that to Empire's current position on this issue?

A. Even absent concerns regarding possible "retroactive ratemaking" due to setting current rates based on alleged past ratemaking omissions, unless Empire can provide definitive evidence that its prior rates were set for a period of time using calculations of deferred tax expense on a federal stand-alone basis, its request for recovery of an amortization in the current case should be rejected as unsupported. Empire has failed to provide any evidence supporting its position.

Q. Is the state flow through asset that Empire seeks to amortize a "regulatory asset?"

A. No, not in the usual sense of that term. This amount is not a regulatory asset in the sense that its booking was ever authorized by or approved by the Commission through an AAO or other means. The Company is attempting to validate this issue after the fact by recording a regulatory asset on the books without regulatory approval, then claiming the Company will need to write off this asset if regulatory approval for recovery of this asset is not given.

COST OF REMOVAL DEFERRED TAX AMORTIZATION

Q. How is Company witness Williams alleging that the cost of removal tax timing difference was treated for rate purposes in prior Empire rate proceedings?

A. Mr. Williams alleges that the tax deduction for cost of removal was inadvertently provided to customers twice in prior Empire rate proceedings prior to 2008, once by normalizing the cost of removal component included in Empire's authorized depreciation rates for tax purposes and again by simultaneously flowing through the amount of cost of removal actually incurred by the utility in the Company's income tax calculation. Empire is proposing to recoup this alleged under recovered accumulated deferred income tax through an amortization of approximate $615,000 per year, over the average remaining life of its plant assets when the amortization period begins.

Q. What is Staff's position regarding this proposed amortization?

A. Staff if opposed to this amortization's inclusion in rates for the following reasons:

1. Empire has not provided credible evidence that this alleged double-reflection of the cost of removal tax deduction in cost of service ever actually occurred, nor has Empire provided an accurate quantification of the amount of the alleged double recovery;
2. Empire's analysis of this issue ignores the point that the tax straight-line depreciation calculation does not necessarily provide for a deduction of cost of removal; and
3. Even assuming that this double-reflection of the cost of removal tax deduction in Empire's cost of service actually occurred, it is my understanding that prospective correction in rates of "errors" in setting a utility's prior rates may not be permissible from a legal prospective.

Q. What evidence, if any has Empire provided Staff in this proceeding to support its contention of double reflection of cost of removal deductions?

A. The Company provided Staff with copies of the Staff income tax accounting schedules from two Empire rate cases filed in the 1990s.

Q. Do these accounting schedules fully support Empire's assertions?

A. No. The accounting schedules show that Staff included a deduction for cost of removal in its income tax calculations on an individual basis and an amount for tax straight-line depreciation deduction in the tax calculation. However, these schedules do not show to what extent a cost of removal accrual was incorporated within Staff's tax straight-line depreciation deduction.

Q. What is "tax straight-line depreciation?"

A. A utility's tax depreciation deduction amount is split into two pieces for ratemaking purposes. "Tax straight-line depreciation" is the application of the utility's authorized book depreciation rates to the tax basis of their depreciable assets. "Excess depreciation" is the application of the allowed accelerated tax depreciation rates to the tax basis of the utility's depreciable assets. If cost of removal is included as part of the depreciation rates to calculate tax depreciation, it would be incorporated in the tax straight-line depreciation calculation.

Q. In this testimony, are you asserting that Staff's position in this matter is that no double reflection of a cost of removal tax deduction occurred in prior rate cases?

A. Yes. Mr. Williams' assertion that a double recovery of tax benefits of cost of removal occurred ignores the fact that the tax straight-line depreciation amount as measured over the life of a company's assets does not allow for recognition of cost of removal in the calculation. Therefore, the approach utilizing the tax straight-line depreciation deduction alone to recognize the tax benefits associated with cost of removal is problematic. The use of the tax depreciation model to calculate tax straight-line depreciation, as normally done in rate cases, ultimately prevents the recognition of any cost of removal in tax straight-line depreciation amounts.

Tax depreciation is based on "vintage accounting." "Vintage accounting" is accounting for a group of assets based upon the year the assets were placed in service, as opposed to accounting for each asset on an individual basis. Total tax depreciation is the result of the amount of a depreciation deduction allowed for each year, or vintage, of the Company's plant investment. Once the total tax depreciation deductions for a particular vintage over time equals the total dollar amount of the plant investment (as measured for tax purposes) made within that vintage, no further tax depreciation is allowed for that vintage of assets.

Q. Can you illustrate this point using a simple example?

A. Yes. Assume a plant asset has an original cost of $100 and an estimated cost of removal value of $20. (We will assume that there is zero expected salvage value for this asset.) The utility's depreciation rates should be set to recover a total of $120, the book basis of the asset plus the estimated cost of removal, over the asset's assumed life. However, if the asset has a longer life than originally assumed, the utility may collect an amount in excess of the $120 in depreciation expense for that associated asset in rates.

Then, assume that for tax purposes the depreciable basis of the same asset is $95. (The book basis and tax basis of assets will often be different.) Remembering that cost of removal is not part of the tax depreciation calculation (because no deduction for cost of removal is allowed until the cost is incurred), the tax depreciation treatment applied to this asset will result in a total tax depreciation deduction equal to $95, and no more. In this example, it can be seen that the use of a tax straight-line depreciation deduction to calculate income tax expense will not provide for a deduction amount for cost of removal, only for the amount of the tax basis of the asset.

Q. For the period of time for which Empire's cost of removal deferred tax asset was calculated, can Staff state affirmatively that for any portion of that period there was not even a theoretical possibility of a double reflection of the cost of removal deduction to the benefit of ratepayers?

A. Yes, for the approximate period of 2001 through 2004, the Commission ordered that cost of removal be included in Empire's cost of service as an element of expense on its income statement, and not as a component of Empire's depreciation expense. For at least this period of time, inclusion of cost of removal in Empire's income tax calculation for ratemaking purposes could not have occurred as part of a tax depreciation calculation.

Q. Assuming that Empire is correct in asserting that, in at least some past rate proceedings, cost of removal was reflected in income tax accounting schedules twice (once as a component of depreciation expense and again as a separate line item in the schedule), even then does this mean that customers necessarily received a proportionately greater tax benefit associated with cost of removal than merited by the amount of cost of removal they provided to Empire in rates?

A. No. Customers may not have received the full benefits of a tax deduction for the entire amount of cost of removal provided to the Company in rates for an additional reason.

The amount of tax straight-line depreciation reflected in a utility's income tax calculation for rate purposes is almost always less than the amount of book depreciation it is collecting in customer rates. This is because the "tax basis" of utility assets for depreciation purposes is almost always less than the book basis, because in the past the income tax code allowed for some elements of a company's book basis of assets to be charged to expense immediately rather than capitalized as plant in service. The full book value of the assets will not be reflected in a utility's tax straight-line depreciation calculation under these circumstances. Accordingly, a proportional amount of a cost of removal tax benefits associated with the difference in basis between a utility's assets for book and tax purposes also would not have been passed on to customers in rates as part of a tax straight-line depreciation deduction. This point is particularly applicable to Empire's rate levels set in the 1980s, prior to the time its income tax expense would have been calculated using the provisions of the Tax Reform Act of 1986, which had the impact of prospectively reducing the amount of differences between measurement of book basis and tax basis for purposes of depreciation of assets.

Q. Assuming again that the Company's contentions that customers have unduly benefited from prior rate treatment of cost of removal tax deductions are fully accurate (which Staff believes has not been demonstrated), does that mean that the proposed deferred tax asset amortization is appropriate and should be ordered by the Commission?

A. No. Empire is effectively claiming that its rates were improperly set in prior proceedings, due to the alleged double reflection of cost of removal tax deductions in its cost of service. Therefore, because Empire asserts its rates were set too low in past rate cases for this reason, Empire is now seeking to increase it rates through the proposed deferred tax asset amortization. Based upon discussions with Staff counsel, I have been advised that seeking to correct alleged errors made in setting a utility's prior rates in the context of setting new, prospective rates constitutes prohibited "retroactive ratemaking."

TRANSMISSION REVENUE AND EXPENSE (ACCOUNTS 447 AND 555)

Q. On page 2 of Empire witness Aaron J. Doll's rebuttal testimony, he claims that Staff has included revenue associated with real-time virtual sales of energy twice. Did Staff include this revenue twice in its calculation?

A. No. Staff eliminated the revenue associated with the real-time virtual sales. My understanding of the real-time virtual sales is that these sales are included in Staff's market price of purchased power. Attached, Schedule KKB-1 is Staff's calculation of SPP Integrated Marketplace sales.

Q. Also on page 2 of Mr. Doll's rebuttal testimony he addresses the off system sales-resale revenues included in Account 447 (Accounts 447113, 447124, 447133, and 447143) that Staff included in its cost of service. Mr. Doll states that these amounts should not be included in cost of service. Does Staff agree?

A. No. Staff still believes these revenues need to be included in the cost of service. The Company is still receiving these revenues. However, Staff's review of this account through December 2014 shows that the amount of revenue recorded in these accounts has decreased significantly since the end of the test year. Staff will review this account again in its true-up audit.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric)
Company for Authority to File Tariffs) Case No. ER-2014-0351
Increasing Rates for Electric Service Provided)
to Customers in the Company's Missouri)
Service Area)

AFFIDAVIT OF KIMBERLY K. BOLIN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Kimberly K. Bolin, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Surrebuttal Testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the foregoing Surrebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Kimberly K. Bolin
Kimberly K. Bolin

Subscribed and sworn to before me this 24th day of March, 2015.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 12, 2016
Commission Number: 12412070

D Suzie Mankin
Notary Public

The Empire District Electric Company
Case No. ER-2014-0351

Empire District Electric
SPP Ancillary Services Revenue

Description	Test Year	Staff's Annualized	Staff's Adjustment
DA Reg Up Cost	90,654.06	623,054.26	532,400.20
DA Reg Down Cost	4,361.97	34,534.28	30,172.31
DA Spin Reserve Cost	105,657.74	503,446.22	397,788.48
DA Supp Reserve Cost	1,717.71	12,058.05	10,340.34
DA Other PP Expense	342,634.56	1,759,574.66	1,416,940.10
RT NonAsset Energy Purchase	**233,412.31**	-	**(233,412.31)**
RT Reg Up Cost	67,612.29	330,147.62	262,535.33
RT Reg Down Cost	39,812.83	226,480.40	186,667.57
RT Spin Reserve Cost	63,638.11	366,468.46	302,830.35
RT Supp Reserve Cost	44,548.78	154,097.40	109,548.62
RT Other PP Expense	611,944.00	1,446,489.50	834,545.50
TCR Settlements	-	750.76	750.76
Auction Revenue Rights	-	-	-
Total	1,605,994.36	5,457,101.61	3,851,107.25

Adjustment to Acccount 447	3,851,107.25	
Jurisdicational Allocation	82.86%	
Adjustment to Acccount 447	3,191,027.46	Adj. No. Rev-5.2

Schedule KKB-1