BEFORE THE CORPORATION COMMISSION

OF THE STATE OF KANSAS

IN THE MATTER OF THE APPLICATION OF THE EMPIRE DISTRICT ELECTRIC COMPANY FOR APPROVAL OF THE COMMISSION TO MAKE CERTAIN CHANGES IN ITS CHARGES FOR ELECTRIC SERVICE	]]]]]]	KCC Docket No. 10-EPDE-314-RTS

DIRECT TESTIMONY OF

ANDREA C. CRANE

RE: REVENUE REQUIREMENTS
AND COST OF CAPITAL

ON BEHALF OF

THE CITIZENS' UTILITY RATEPAYER BOARD

March 31, 2010

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I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is PO Box 810, Georgetown, Connecticut 06829. (Mailing address: 199 Ethan Allen Highway, Ridgefield, CT 06877).

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

A. I am President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various studies relating to utility rates and regulatory policy. I have held several positions of increasing responsibility since I joined The Columbia Group, Inc. in January 1989.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now Verizon) subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 300 regulatory proceedings in the states of Arizona, Arkansas, Connecticut, Delaware, Hawaii, Kansas, Kentucky, Maryland, New Jersey, New Mexico, New York, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Vermont, West Virginia and the District of Columbia. These proceedings involved electric, gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A list of dockets in which I have filed testimony is included in Appendix A.

Q. What is your educational background?

A. I received a Master of Business Administration degree, with a concentration in Finance, from Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in Chemistry from Temple University.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. On November 4, 2009, Empire District Electric Company ("Empire" or "Company") filed an Application with the Kansas Corporation Commission ("KCC" or "Commission") seeking a rate increase of approximately $5.20 million for its electric operations in Kansas. The requested increase would result in an overall increase of approximately 19.7% of pro forma operating revenues and of approximately 40.0% on base distribution revenues. The Columbia Group, Inc. was engaged by the State of Kansas, Citizens' Utility Ratepayer Board ("CURB") to review the Company's Application and to provide recommendations to the

KCC regarding the Company's cost of capital and revenue requirement claims.

Q. What are the most significant issues in this rate proceeding?

A. The most significant accounting issues driving Empire's rate increase request are 1) the Company's claim for a return on equity of 11.3%, 2) return requirements associated with investment in new generating facilities and environmental upgrades, 3) incremental operating expenses and depreciation expenses associated with incremental investment in additional generation and environmental facilities, and 4) post-test year salary and wage increases. In addition, the Company is requesting the establishment of a tracking mechanism to track its pension and Other Post-Employment Benefit ("OPEB") costs between base rate cases, as well as expansion of its existing pension tracker. The Company is also requesting authorization to transfer recovery of certain costs associated with consumables used in its environmental facilities from base distribution rates to its Energy Cost Adjustment ("ECA") mechanism.

Q. Please discuss the impact on the Company's revenue requirement of the incremental generating facilities and environmental upgrades included in the Company's rate base claim.

A. As described in the testimony of Mr. Gipson, Empire's rate base claim includes five major capital projects that have been added or will be added, since the Company's last base rate case. These include the Riverton 12 generating unit, new pollution control equipment at the

Asbury power plant, Iatan Unit I Air Quality Control Systems ("ACQS"), the Plum Point Generating Station, and Iatan Unit 2. The Riverton 12 generating station and the Asbury Selective Catalytic Reduction ("SCR") have been completed and were placed into service in April 2007 and February 2008 respectively. Empire is a 12% owner for Iatan Unit I and Iatan Unit 2. The Iatan Unit 1 ACQS went into service in April 2009 and Iatan Unit 2 is expected to be in-service sometime in the fall of 2010. The Plum Point Generating Facility, of which Empire is a 7.5% owner, is expected to come on-line during the summer of 2010.

The current filing includes return on investment, depreciation expense, and incremental operating costs associated with these facilities, as shown below:

Unit	Rate Base Claim ($000)	Return @ 8.80% ($000)	Operating Costs ($000)	Depreciation @ 2.02% ($000)
Riverton 12	$2,392	$210.5	N.A.	$48.3
Asbury SCR	$1,826	$160.7	$20.0	$36.9
Plum Point	$5,889	$518.2	$157.3	$119.0
Iatan 1 AQCS	$2,739	$241.0	$19.8	$55.3
Iatan 1 Common	$2,612	$229.9	$12.2	$52.8
Iatan 2	$12,786	$1,125.2	$218.0	$258.3
Total	$28,244	$2,485.5	$427.3	$570.6

Q. Are the new generating facilities being driven by growth in Kansas?

A. No, there are not. As noted in the testimony of Mr. Gibson at page 2, the Company's service territory encompasses 121 incorporated communities in 20 counties in a four-state area. The majority of the communities are very small, with only 29 containing a population in excess of 1,500. The largest town in the service territory is Joplin, Missouri. While Empire is proposing to add significant new generation as a result of this case, the need for additional generation is being driven largely by the Missouri portion of the service territory, and not by growth in sales in Kansas. As derived from the response to CURB-94, Kansas sales declined as a percentage of Missouri sales, from 6.62% in 2002 to 5.76% in 2009. Moreover, this decline has been consistent over this time period, as shown below:

2002	2003	2004	2005	2006	2007	2008	2009
6.62%	6.44%	6.27%	6.29%	6.13%	5.91%	5.80%	5.76%

The response to CURB-94 also demonstrates that while retail sales in Missouri increased over 13% between 2002 and 2009, sales in Kansas have been relatively flat over this period. While this data is not weather-normalized, one would expect that weather conditions have a similar impact on Missouri vs. Kansas sales, and thus a comparison of Missouri vs. Kansas sales during this period is relevant. The KCC should be mindful of the factors driving the need for additional generation as it evaluates the Company's request for recovery of the additional investment in generation facilities included in this case.

III. SUMMARY OF CONCLUSIONS

Q. What are your conclusions concerning the Company's revenue requirement and its need for rate relief?

A. Based on my analysis of the Company's filing and other documentation in this case, my conclusions are as follows:

1. The twelve months ending June 30, 2009, is an acceptable test year to use in this case to evaluate the reasonableness of the Company's claim.
2. The Commission should adopt a pro forma capital structure for Empire that consists of 47.43% common equity, 48.72% long-term debt, 3.85% trust preferred securities, and 3.99% short-term debt, as shown in Schedule ACC-2.
3. The Company has a pro forma cost of equity of 9.72%, as shown in Schedule 3.[1]
4. Based on my recommended capital structure and capital cost rates, I recommend that the Commission adopt an overall cost of capital of 8.32% for Empire, as shown in Schedule ACC-2.
5. Empire has test year pro forma rate base of $64,857,284, as shown in Schedule ACC-9.
6. The Company has pro forma operating income at present rates of $3,500,647, as shown in Schedule ACC-15.
7. Empire has a test year, pro forma, revenue requirement deficiency of $3,163,661, as

1 Schedules ACC-1, ACC-38, and ACC-39 are summary schedules, ACC-2 to ACC-8 are cost of capital schedules, ACC-9 to ACC-14 are rate base schedules, and ACC-15 to ACC-37 are operating income schedules.

shown on Schedule ACC-1. This is in contrast to the Company's claimed deficiency of $5,203,487.

8. Empire's request for establishment of an OBEP tracking mechanism and expansion of its pension tracker should be denied. If the KCC permits Empire to utilize any tracking mechanism for pension and/or OPEB costs, then it should adopt the mechanism recently approved for Kansas Gas Service and Westar Energy, Inc.

9. The Company's request to transfer recovery of ACQS consumables from distribution base rates to the ECA should be denied.

It should be noted that while my recommendations will reduce the Company's rate increase from the $5,203,487 requested by Empire to $3,163,661, CURB's recommendations still result in an increase of approximately 24% on base rates. Moreover, ratepayers may face an additional increase when the Company files the abbreviated rate case authorized in the Procedural Order and discussed later in this testimony. These rate increases are being imposed during a period when ratepayers are already facing challenging economic conditions, including loss of jobs, unprecedented levels of mortgage foreclosures, and severe reductions in the value of their investments. In evaluating the merits of the Company's filing, and the merits of the recommendations made by CURB and other parties in this case, the KCC should be mindful of the hardships currently facing Kansas ratepayers.

IV. COST OF CAPITAL AND CAPITAL STRUCTURE

Q. What is the cost of capital and capital structure that the Company is requesting in this case?

A. The Company's proposed capital structure was provided in its filing at Section 7. While the details of this capital structure are confidential, the proposed capital structure and cost rates result in an overall cost of capital of 8.80%.

Q. Are you recommending any adjustments to this capital structure or cost of capital?

A. Yes, I am recommending adjustments to the Company's capital structure and cost of equity.

A. Capital Structure

Q. How did Empire develop its pro forma capital structure?

A. According to the testimony of Mr. Sager at page 3, Empire's capital structure "is based upon a projected consolidated capital structure similar to the expected capital structure for Empire at the end of this rate case, with one adjustment." That adjustment was the exclusion of short-term debt in the capital structure. Mr. Sager goes on to state that "[i]n the past rate case, this exclusion was accepted since the balance of short-term debt was less than construction work in progress ("CWIP"). The balance in CWIP is expected to exceed the short-term debt balance until the Plum Point and Iatan II facilities are placed into service; therefore, short-term debt was eliminated from the capital structure."

Q. What capital structure did you utilize in determining the overall cost of capital for Empire?

A. I have used the most recent capital structure for Empire, as provided in the response to CURB-119. This capital structure consists of the following:

Common Equity	47.43%
Long Term Debt	48.72%
Trust Preferred Securities	3.85%
Short Term Debt	3.99%

Q. Are you recommending including short-term debt in Empire's capital structure for ratemaking purposes?

A. Short-term debt is an appropriate component of a utility's capital structure if it is regularly and consistently utilized for financing. Most utilities do utilize significant amounts of short-term debt, and I generally recommend that this debt be included in a utility's capital structure. As shown in the response to CURB-121, Empire has consistently used short-term debt throughout the past several years. Short-term debt has been consistently used by the Company as a financing mechanism and should be included in its capital structure for ratemaking purposes in this case.

Q. Is there another reason why short-term debt should be included in the Company's capital structure in this case?

A. Yes, there is. As discussed in the testimony of Mr. Sager, Empire has included an adjustment of $2,895,550 (total company) relating to bank fees associated with the Company's line of credit. There is no rationale for including these costs in utility rates if ratepayers are not receiving any of the benefits of this line of credit. Moreover, the only way that ratepayers would receive any benefit from this line of credit is if the Company's capital structure included the average balance of short-term debt and the weighted average short-term debt cost. The Company is attempting to make ratepayers pay for a credit facility without providing ratepayers with any resulting benefit. The Company cannot have it both ways, i.e., exclude short-term debt from the capital structure but include the costs of the line of credit in its revenue requirement. In developing my revenue requirement recommendation, I have not made any adjustment to the Company's claim associated with these banking fees. However, if the KCC adopts a capital structure that does not includes short-term debt, then the KCC should also eliminate all banking fees associated with the line of credit from the Company's revenue requirement.

The Company has also included certain line-of-credit fees in its rate base claim for prepayments in this case. Similarly, if such fees are included in prepayments, then it is only reasonable to reflect short-term debt as a component of the Company's capital structure.

Q. What level of short-term debt did you include in Empire's capital structure?

A. I utilized the most recent level of short-term debt, as provided in the response to CURB-119.

Q. What short-term debt rate did you use in your overall cost of capital calculation?

A. In the response to CURB-119, the Company reflected a short-term debt rate of 4.34%. This rate is very high relative to short-term debt costs filed by other utilities in recent cases. The Company did not provide the basis for its short-term debt rate in its response. To calculate my overall rate of return, I have used a short term debt rate of 1.45%, which is the actual annual test year cost rate included in the Company's original filing. If the Company provides additional information to support a different rate for short-term debt, I will review such documentation and revise my adjustment, if necessary.

Q. What is the resulting capital structure that you are recommending in this case?

A. Based on the most recent actual capital structure, I am recommending a capital structure for Empire that includes 47.43% common equity, 48.72% long-term debt, 3.85% trust preferred securities, and 3.99% short-term debt. My recommended capital structure is shown in Schedule ACC-2.

B. <u>Cost of Equity</u>

Q. What is the cost of equity that the Company is requesting in this case?

A. Empire is requesting a cost of equity of 11.3%.

Q. Are you recommending any adjustment to the Company's proposed cost of equity?

A. Yes, I am recommending an adjustment to the Company's proposed cost of equity. Specifically, I am recommending that the Commission adopt a cost of equity of 9.72% for Empire.

Q. How did you develop your cost of equity recommendation?

A. To develop a recommended cost of equity in this case, I utilized both the Discounted Cash Flow ("DCF") methodology as well as the Capital Asset Pricing Model ("CAPM"). It is my understanding that the Commission has traditionally relied upon the DCF methodology for determining cost of equity for a regulated utility and therefore I have given greater weight to my DCF result.

Q. Please describe the DCF methodology.

A. The DCF methodology is the most frequently used method to determine an appropriate return on equity for a regulated utility. The DCF methodology equates a utility's return on equity to the expected dividend yield plus expected future growth for comparable investments. Specifically, this methodology is based on the following formula:

$$\text{Return on Equity} = \frac{D_1}{P_0} + g$$

where "D_1" is the expected dividend, "P_0" is the current stock price, and "g" is the expected growth in dividends.

In order to ensure that the return on equity determined for a particular utility is representative of returns for comparable investments of similar risk, the DCF methodology examines returns for similar companies through the use of a "comparable" or "proxy" group. To minimize further controversy, I utilized the same companies in my comparable group as those used by Company Witness James H. Vander Weide in his testimony.

To determine an appropriate dividend yield for comparable companies - i.e., the expected dividend divided by the current price - I calculated the dividend yield of each of the comparable companies under two scenarios. First, I calculated the dividend yield using the average of the stock prices for each company over the past three months. The use of a dividend yield using a three-month average price mitigates the effect of stock price volatility for any given day. Based on the average stock prices over the past three months, and the current dividend for each company, I determined an average dividend yield for the comparable group of 4.87%, as shown in Schedule ACC-5. I also calculated the current dividend yield at February 22, 2010, which showed an average dividend yield for the comparable group of 4.95%, also shown in Schedule ACC-5. Finally, I examined the average dividend yields as reported in the March 2010 AUS Utility Reports, which showed an average dividend yield for electric companies of 4.5%. Based on all of this data, I recommend that a dividend yield of 4.95% be used in the DCF calculation. This dividend yield will be increased by one-half of my recommended growth rate, as determined below, to reflect the fact that the DCF model is prospective and dividend yields may grow over the next year. Increasing the dividend yield by one-half of the prospective growth rate is commonly referred to as the "half-year convention."

Q. How did you determine an appropriate growth rate?

A. The actual growth rate used in the DCF analysis is the dividend growth rate. In spite of the fact that the model is based on dividend growth, it is not uncommon for analysts to examine several growth factors, including growth in earnings, dividends, and book value.

Various growth rates for the companies within my comparable group are shown in Schedule ACC-6 and group averages are summarized below:

Past 5 Years – Earnings	4.7%
Past 5 Years – Dividends	2.5%
Past 5 Years - Book Value	4.1%
Past 10 Years – Earnings	3.2%
Past 10 Years – Dividends	(0.1%)
Past 10 Years - Book Value	2.4%
Estimated Next 5 Years - Earnings	5.5%
Estimated Next 5 Years - Dividends	5.9%
Estimated Next 5 Years - Book Value	4.5%

Q. Why do you believe that it is reasonable to examine historic growth rates as well as projected growth rates when evaluating a utility's cost of equity?

A. I believe that historic growth rates should be considered because security analysts have been notoriously optimistic in forecasting future growth in earnings. At least part of this problem in the past has been the fact that firms that traditionally sold securities were the same firms that provided investors with research on these securities, including forecasts of earnings growth. This resulted in a direct conflict of interest since it has traditionally been in the best interest of securities firms to provide optimistic earnings forecasts in the hope of selling more stock. Therefore, earnings growth forecasts should be analyzed cautiously by state regulatory commissions.

The continued unreliability of analysts' future forecasts has been confirmed with the recent economic problems faced by the financial community in late 2008 and 2009. Many firms, including Value Line, incorrectly forecasted steady growth for companies whose stock prices have now fallen dramatically, and in some cases for firms that have now required bailouts from other firms or the federal government. Although Value Line does not sell stock, its forecasts appear to be just as optimistic as many of the securities firm forecasts. The KCC needs only to examine actual results over the past 18 months to realize that earnings forecasts should be viewed with a healthy dose of skepticism.

Q. Based upon your review, what growth rate do you recommend the Commission utilize in the DCF calculation?

A. Based on my review of this data, I believe that a growth rate of no greater than 5.0% should be utilized. This recommended growth rate is greater than the five-year and ten-year historic growth rates in earnings, dividends, or book value. Moreover, my recommended growth rate is higher than the projected growth rate in book value, and is not significantly below the projected earnings growth rate.

Q. What are the results of your analysis?

A. My analysis indicates a cost of equity using the DCF methodology of 10.07%, as shown below:

Dividend Yield	4.95%
Growth in Dividend Yield (4.95% X (50% X 5.00%))	0.12%
Expected Growth	5.00%
Total	10.07%

Q. Did you also calculate a cost of equity based on the CAPM methodology?

A. Yes, I did.

Q. Please provide a brief description of the CAPM methodology.

A. The CAPM methodology is based on the following formula:

$$\text{Cost of Equity} = \text{Risk Free Rate} + \text{Beta (Risk Premium)}$$

or

$$\text{Cost of Equity} = R_f + B(R_m - R_f)$$

The CAPM methodology assumes that the cost of equity is equal to a risk-free rate plus some market-adjusted risk premium. The risk premium is adjusted by Beta, which is a measure of the extent to which an investor can diversify his market risk. The ability to diversify market risk is a measure of the extent to which a particular stock's price changes relative to changes in the overall stock market. Thus, a Beta of 1.00 means that changes in the price of a particular stock can be fully explained by changes in the overall market. A stock with a Beta of 0.60 will exhibit price changes that are only 60% as great as the price changes experienced by the overall market. Utility stocks have traditionally been less volatile than the overall market, i.e., their stock prices do not fluctuate as significantly as the market as a whole, and therefore their Betas have generally been less than 1.0.

Q. How did you calculate the cost of equity using the CAPM?

A. My CAPM analysis is shown in Schedule ACC-7. First, I used a risk-free rate of 4.44% for the yield on long-term U.S. Government bonds, which was the rate on March 22, 2010 per the Statistical Release by the Federal Reserve Board. Over the past year, this rate has ranged from 3.51% to 4.74%. In addition, I used the average Beta for my proxy group, based on the Beta for each company, as shown on Schedule ACC-8. This resulted in an average Beta of 0.71. Finally, since I am using a long-term U.S. Government bond rate as the risk-free rate, the risk premium that should be used is the historic risk premium of stocks over the rates for long-term government bonds. According to the *Ibbotson SBBI: 2008 Valuation Yearbook: Market Results for Stocks, Bonds, Bills, and Inflation, 1926-2007*, the risk premium of large company stocks relative to long-term risk-free rates using geometric mean returns is 4.9%, while the risk premium of small company stocks relative to long-term risk free rates using geometric mean returns is 7.0%. I used the average of these risk premiums, or 5.95%, in my CAPM recommendation.

Q. What is the difference between a geometric and an arithmetic mean return?

A. An arithmetic mean is a simple average of each year's percentage return. A geometric mean takes compounding into effect. As a result, the arithmetic mean overstates the historic return to investors. For example, suppose an investor starts with $100. In year 1, he makes 100% or $100. He now has $200. In year 2, he loses 50%, or $100. He is now back to $100.

The arithmetic mean of these transactions is 100% - 50% or 50%/ 2 = 25% per year. The geometric mean of these transactions is 0%. In this simple example, it is clear that the geometric mean more appropriately reflects the real return to the investor, who started with $100 and who still has $100 two years later. The use of the arithmetic mean would suggest that the investor should have $156.25 after two years ($100 X 1.25 X 1.25), when in fact the investor actually has considerably less. Therefore, a geometric mean return is a more appropriate measure of the real return to an investor, if it is used as I am using it here, i.e., to develop an historic relationship between long-term risk free rates and market risk premiums. Some utilities have criticized me in the past for using a geometric, rather than an arithmetic mean return, arguing that the arithmetic mean should be used when estimating future returns. However, in my case, I am not using the mean to develop an expected outcome, I am simply using the mean returns to develop an historic relationship. Therefore, the geometric mean is the appropriate measure, as illustrated in the above example.

Q. What is the Company's cost of equity using a CAPM approach?

A. Given a long-term risk-free rate of 4.44%, a Beta of 0.71, and a risk premium of 5.95%, the CAPM methodology produces a cost of equity of 8.66%, as shown on Schedule ACC-7.

Risk Free Rate + Beta (Risk Premium) = Cost of Equity

4.44% + (0.71 X 5.95%) = 8.66%

Q. Based on your analysis of the DCF and CAPM results, what cost of equity are you recommending in this case?

A. The DCF methodology and the CAPM methodology suggest that a return on equity of 8.66% to 10.07% would be appropriate. Since I recognize that the Commission has generally relied primarily upon the DCF, I have weighted my results with a 75% weighting for the DCF methodology and a 25% weighting for the CAPM methodology. This results in a cost of equity of 9.72%%, as shown below:

DCF Result	10.07% X 75% = 7.56%
CAPM	8.66% X 25% = 2.17%
Total	= 9.72%[2]

Q. Why is your recommendation substantially lower than the cost of equity recommended by Dr. Vander Weide?

A. Dr. Vander Weide based his 11.3% cost of equity recommendation on three methods, the DCF, the CAPM, and another risk premium approach. Dr. Vander Weide's results are overstated largely because he used inflated growth rates in the DCF analysis and inflated risk premiums in his other analyses.

Q. How does your cost of equity recommendation compare with the recommended cost of equity recently filed by the Missouri Public Service Commission Staff in Empire's pending rate case in that state?

A. In its recent report, the Missouri Staff recommended a cost of equity range of 8.90% to 9.90%, for a midpoint of 9.40%. Thus, my cost of equity recommendation of 9.72% is well above the midpoint of the range proposed by Missouri Staff in the Company's pending rate case.

C. Overall Cost of Capital

Q. What is the overall cost of capital that you are recommending for Empire?

A. I am recommending an overall cost of capital for Empire of 8.32%, based on the following capital structure and cost rates:

	Percentage	Cost	Weighted Cost
Common Equity	47.43%	9.72%	4.61%
Long-Term Debt	48.72%	6.79%	3.31%
Trust Preferred Securities	3.85%	8.86%	0.34%
Short-Term Debt	3.99%	1.45%	0.06%
Total	100.00%		8.32%

V. RATE BASE ISSUES

Q. What test year did the Company utilize to develop its rate base claim in this proceeding?

A. The Company selected the test year ending June 30, 2009. In addition, the Company has included costs associated with several new generating facilities and environmental projects that were not yet in-service by the end of the test year. As shown in Schedule BAM-6 to Mr. Mertens' testimony, the Company included post-test year plant associated with Iatan Unit 1 environmental upgrades, Iatan common facilities, Iatan Unit 2, and Plum Point in its rate base claim. To develop that claim, the Company started with its actual expenditures and

2 Total does not add due to rounding.

allowance for funds used during construction ("AFUDC") at June 30, 2009, the end of the test year in this case. Empire then projected the remaining costs to complete each project. The entire projected cost for each project was included in the Company's rate base claim.

As noted in the Procedural Order in this case issued on January 6, 2010, the parties have agreed to use a cutoff date of January 31, 2010 for post-test year plant. Thus, the parties agreed that this case will be based on "actual numbers, which will come from invoices received and paid for by Empire on or before January 31, 2010."[3] The parties also agreed that Empire will be permitted to file an abbreviated rate case, after the Plum Point and Iatan facilities are in-service, to reflect an additional prospective increase, if applicable, based on the difference between the amounts included in rates in this case and the total costs for the facilities.

The parties have also agreed to defer until the abbreviated case, any issues relating to the prudence of costs for the Iatan Unit 2 and Plum Point facilities. Accordingly, issues of prudence, or lack thereof, will not be addressed in this testimony.

Q. Are you recommending any adjustments to the Company's rate base claim?

A. Yes, I am recommending adjustments relating to a) utility plant in service for new generating facilities and environmental upgrades, b) utility plant related to various cottages that are owned by Empire, c) incremental materials and supplies relating to facilities that are not yet in service, and d) cash working capital.

A. Utility Plant in Service

Q. How much did the Company include in its rate base claim for post-test year plant additions?

A. As shown in Schedule BAM-6 to Mr. Mertens' testimony, Empire included \$28.2 million of expenditures and associated AFUDC in its Kansas-jurisdictional rate base relating to Iatan Unit 1 environmental projects, Iatan common plant, Iatan Unit 2 and Plum Point. These amounts represented the total costs, including AFUDC, through completion of each project. However, as noted above, the parties to this proceeding have agreed to limit rates resulting from this case to expenditures through January 31, 2010.

As shown in Schedule ACC-10, through January 31, 2010, the Company's actual expenditures for these four projects is \$3.269 million less on a Kansas-jurisdictional basis than the amount included in the Company's rate base claim. Therefore, at Schedule ACC-10, I have made an adjustment to reduce rate base by this amount. Additional expenditures will be reviewed in a future abbreviated rate case to be filed by Empire. In addition, in that case, the parties will also have the opportunity to propose disallowances based on prudence, including disallowance of costs expended through January 31, 2010.

Q. What is your second adjustment to the Company's utility plant in service claim?

A. In response to data request KCC-197, Empire stated that it owns several cabins that are made

3 Procedural Order, KCC Docket No. 10-EPDE-314-RTS, paragraph 5.

available to various individuals at the Company. According to this response, utility plant-in-service associated with these cabins totals $677,760 while accumulated depreciation on this plant totals $269,291. I am recommending that this plant be eliminated from the Company's rate base claim in this case. These cabins are obviously not necessary for the provision of safe and adequate utility service to Kansas ratepayers and they should not be included in regulated utility rates. Therefore, at Schedule ACC-11, I have made an adjustment to remove this plant-in-service and the associated depreciation reserve from rate base. It should be noted that it is likely that there are also operating costs associated with these cabins embedded in the Company's revenue requirement claim. At this time, I do not have a quantification of these expenses and therefore I have limited my adjustment to the plant-in-service and associated depreciation reserve. However, the KCC should ensure that all costs associated with these cabins, including any operating costs, be eliminated from the rates established in this case.

B. Materials and Supplies

Q. How did the Company determine its claim for material and supplies?

A. The Company's claim is based on a thirteen-month average balance for materials and supplies. Materials and supplies include fuel as well as other materials used in the provision of utility service. In addition to including a thirteen-month average balance in rate base, Empire made additional adjustments to its "Fuel" and "Other Materials" balances to reflect increases anticipated for Plum Point and Iatan Unit 2.

Q. Are you recommending any adjustment to the Company's claim for materials and supplies?

A. Yes, I am recommending that the Commission eliminate the incremental Fuel and Other Materials costs related to Plum Point and Iatan Unit 2 from rate base at this time. Neither of these facilities is operational and it is premature to include speculative inventory items relating to these facilities in rate base. The Company's claim for Other Material costs is especially troublesome, since it is based solely on an assumption that the Other Materials inventory currently utilized at Iatan I will be replicated at Iatan Unit 2 and Plum Point. With regard to Fuel inventory, the Company's pro forma adjustments are based on projected balances through December 2011, well after the test year in this case. Given that these generating facilities are not yet operational, that the Company's claims are speculative, and that these requested adjustments extend up to 18 months beyond the test year in this case, I recommend that the Commission eliminate these adjustments relating to Plum Point and Iatan 2. My adjustment relating to Materials and Supplies – Fuel is shown in Schedule ACC-12. My adjustment relating to Materials and Supplies – Other Materials is shown in Schedule ACC-13.

C. <u>Cash Working Capital</u>

Q. What is cash working capital?

A. Cash working capital is the amount of cash that is required by a utility in order to cover cash outflows between the time that revenues are received from customers and the time that expenses must be paid. In some cases, utilities incur costs prior to receiving the associated revenues from ratepayers, and these companies have a positive cash working capital requirement. In other cases, utilities receive revenues in advance of expenses being incurred, and these companies have a negative cash working capital requirement.

Q. Please describe the Company's cash working capital claim in this case.

Empire has included a cash working capital claim of $890,923. Empire included a negative cash working capital claim in each of its last two base rate case filings. However, during the discovery phase of 05-EPDE-980-RTS, Empire stated that its cash working capital claim "should have been based on the recently completed Missouri Case in ER-2004-0570," resulting in an increase in cash working capital from the negative ($135,188) filed in its last Kansas case to $181,613, a difference of $316,801. The Company indicated that this increase was due to an increase in the revenue lag, from 35.04 days to 38.15 days, and a decrease in the purchased power expense lag from 34.93 days to 14.40 days. CURB opposed the Company's claim, on the basis that adjustments to the lead/lag study that may have been made in Missouri were not necessarily applicable to Kansas.

In its current filing, Empire did provide a lead/lag study in support of its cash working capital claim. In this filing, Empire has further increased the revenue lag, from the 35.04 days filed in its last case to 48.88 days, an increase of almost 40%. In addition, the Company has included a purchased power expense lag of 8.94 days, significantly less than the 34.93

days filed in its last case.

Q. Did Empire provide sufficient justification for these new revenue and expense lags?

A. No, it did not. While the Company did provide a lead/lag study, I believe that there are serious issues with regard to the Company's study. First, the revenue lag is based on system-wide operations, and not on payment patterns in Kansas. As noted above, the Company attempted to revise its claim in the last case, based on longer revenue lags found in the Missouri jurisdiction. There is no reason why Kansas ratepayers should pay higher costs due to payment patterns in Missouri. It is entirely possible that payment practices differ between jurisdictions, resulting in differences in average revenue lag days.

In addition, in the current case, the Company did not review 12 months of invoices to determine its expense lags, but rather relied upon two summer months and two winter months of data. As a result, expense lags changed significantly. For example, the expense lags associated with coal, gas, and oil decreased from 18.93, 36.03, and 28.37 days in the last case to 6.45, 7.14, and 8.94 days in this case.[4] In fact, Empire's entire cash working capital claim can be attributed to the expense lags associated with fuel and purchased power costs, for which the Company is already being compensated on a dollar-for-dollar basis through the ECA. These three items alone account for a cash working capital claim of over $1.0 million, more than the entire claim included in the Company's filing. Therefore, all other components result in a negative cash working capital requirement. Since fuel and purchased power costs are generally more volatile during the year than many other expense components, basing a lead/lag study on only four months of the year is likely to have skewed the study results.

Q. What do you recommend?

A. The Company has not provided sufficient documentation in this case to justify its significant claim for cash working capital, especially when one considers that past filings included a negative cash working capital requirement. The use of a Company-wide revenue lag, and the fact that that only 4 months of expense payment patterns were used in the calculation of the expense lag, raise serious questions about the Company's claim. Therefore, I recommend that the Company's cash working capital claim in this case be rejected. Instead, I am recommending that no cash working capital requirement be included in rate base. My adjustment is shown in Schedule ACC-14.

D. <u>Summary of Rate Base Issues</u>

Q. What is the impact of all of your rate base adjustments?

A. My recommended adjustments reduce the Company's rate base claim from $69,181,819, as reflected in its filing, to $64,857,284, as summarized on Schedule ACC-9.

4 See the response to CURB-69

VI. OPERATING INCOME ISSUES

A. Pro Forma Revenue

Q. How did the Company determine its pro forma revenue claim in this case?

A. Empire began with its actual test year revenues. The Company then made adjustments to annualize revenues for changes in customers, to normalize sales for weather variations, to remove unbilled revenues, to remove revenues that flow through the Energy Cost Adjustment ("ECA"), and to remove certain water revenues. It should be noted that in normalizing its sales for the effects of weather, Empire used a thirty-year period for normal weather. This is consistent with CURB's recommendation that a thirty-year normal should be used.

Q. Are you recommending any adjustment to the Company's pro forma revenue claim?

A. I am recommending one adjustment to the Company's revenue claim. Empire has included an adjustment to reduce its pro forma revenue by $54,277 to reflect a net reduction in customers. The Company claims that this adjustment is based on annualizing customers at June 30, 2009. While the number of customers at June 30, 2009 may have been lower than the average number of customers during the test year, it does not follow that revenues should be based on actual customers at June 30, 2009. A more accurate approach is to determine if, on average, customer sales are growing. Given the fact that Empire has included two new generating facilities in its utility plant-in-service claim, it is unreasonable for the KCC to include a reduction to pro forma sales while at the same time requiring ratepayers to pay higher rates resulting from new generation resources.

The Company's filing includes a 40% increase in base distribution rates, much of which is being driven by this new generation. Even though CURB is recommending a significant reduction to the Company's claim, our revenue requirement still reflects an increase in base rates of approximately 24%. While some of this generation will replace an expiring purchased power contract with Westar Energy, the Plum Point and Iatan Unit 2 generating units still represent a net increase of 38 MWs of capacity to Empire.

It is unconscionable to raise rates by 24% in order to pay for new capacity, while at the same time arguing that revenues are declining due to lower retail sales. Accordingly, I recommend that the Commission reject the Company's customer annualization adjustment. My adjustment is shown in Schedule ACC-16.

B. Salaries and Wage Expense

Q. How did the Company develop its salary and wage claim in this case?

A. As shown in the Company's workpapers, Empire began by annualizing its regular payroll based on rates in effect at August 30, 2009. The Company then made various adjustments relating to vacant positions, overtime costs, various incentive programs, and other items to determine a total annualized payroll. In addition, it included a 3% payroll increase. It then compared the expense portion of its pro forma annualized payroll to the actual test-year payroll expense to quantify its adjustment.

Q. Are you recommending any adjustment to the Company's payroll expense claim?

A. Yes, I am recommending two adjustments. Specifically, I am recommending adjustments relating to post-test year increases and to vacant positions.

Q. Please describe your recommended adjustment relating to the Company's claim for post-test year increases.

A. Empire has included an adjustment of $1,209,950 (total Company), which reflects a 3% increase to the August 30, 2009, annualized salaries and wages. While I am not opposed to the Company's annualization of salary and wages at August 30, 2009, this additional adjustment will result in a post-test year increase on top of any increases resulting from the August annualization. Empire's claim does not begin, therefore, with its actual test year level of payroll. The Company has already reflected an increase by annualizing its pay rates as of August, several months beyond the end of the test year. Applying another 3% increase to costs that have already been annualized will result in a level of salaries and wages that are based on August 30, 2010, rates, more than 12 months beyond the end of the test year in this case. Therefore, the additional 3% increase included by Empire is neither necessary nor appropriate, and should be rejected by the KCC. My adjustment is shown in Schedule ACC-17. In quantifying my adjustment, I have reduced the total Company adjustment by the percentage of payroll costs that are capitalized and by amounts allocated to other jurisdictions.

Q. Please describe your second adjustment.

A. I am recommending that the Commission deny Empire's claim for vacant positions. The Company included payroll costs of $582,515(total Company) for vacant positions in its filing. This claim included 12 vacant positions, as shown in the response to CURB-78.

Q. What is the basis for your recommended adjustment?

A. It is normal and customary for companies to have unfilled positions at any given time, as a result of terminations, transfers, and retirements. If utility rates are set based on a full complement of employees, and if these employee positions remain vacant, then ratepayers will have paid rates that are higher than necessary to the benefit of shareholders. Therefore, when setting rates, I recommend that the Commission consider the fact that, at any given time, a certain number of positions are likely to be vacant.

Q. Have any of these positions included in the Company's original filing since been filled?

A. Yes, it appears that some of these positions have been filled while others remain vacant. Moreover, additional vacancies have occurred since the Company filed its testimony in this case. The important point is that it is not unusual to have vacant positions at any point in time and the KCC should recognize this fact in setting utility rates in this case.

Q. What do you recommend?

A. I am recommending an adjustment to eliminate costs for the positions that were vacant as of August 30, 2009, which is the time period used by the Company in determining its salary and wage claim. This results in a total Company adjustment of $582,515. My adjustment is reduced by the percentage of salaries and wages that is capitalized and is then allocated to the Kansas jurisdiction, as shown in Schedule ACC-18.

Q. Is your adjustment intended to eliminate the specific positions shown as open positions in the Company's response to CURB-78?

A. No, it is not. My adjustment is not intended to eliminate the specific employee positions or to suggest that a particular position is not necessary. My adjustment simply recognizes that vacant positions continually arise, either because of the creation of new positions or because of employees leaving the Company, and that this fact should be considered by the KCC in setting rates.

C. <u>Incentive Compensation Expense</u>

Q. Please describe the Company's incentive compensation programs.

A. Empire has included costs of approximately $1.75 million (total Company) in its claim relating to several incentive compensation programs. While the Company claims that the specific details of these programs and costs are confidential, the majority of these costs are earmarked for directors and officers. Programs available to officers and executives include a cash bonus program, a stock option program, and a restricted stock bonus program. With regard to the annual cash incentive plan, awards are based on a series of metrics developed from corporate goals and approved by the Compensation Committee of the Board of

Directors. Metrics may include expense control, regulatory performance, completion of projects, financial performance, and customer services. A total target cash incentive amount is identified for each executive officer.

The Company also has a Department Head Cash Incentive Plan, which is similar to the plan for executive officers, as well as a Salaried Employee Cash Incentive Plan. The latter plan allocates a cash pool to each department. This cash pool is then allocated among salaried employees by individual managers. There does not appear to be a specific set of approved metrics for allocation of these awards to individuals. Finally, the Company has a discretionary "Lighting Bolt" program that awards individuals "who have delivered results which are beyond those normally associated with their position."

Q. How much of the Company's incentive compensation claim is allocated to officers and directors?

A. It appears from the Company's workpapers that approximately 73% of the Company's incentive compensation claim relates to programs that exclusively benefit officers and executives.

Q. What was the total compensation for the Named Executive Officers ("NEOs") as specified in the most recent Proxy Statement?

Q. According to the most recent Proxy Statement, total compensation for the NEOs ranged from $359,994 for Kelly S. Walters (Vice President – Regulatory and Services) to $1,267,151 for

William L. Gipson (President and Chief Executive Officer). Base salaries ranged from $173,000 for Kelly Walters to $350,000 for Mr. Gipson. Thus, it appears that officers are well compensated through their base salaries.

Q. Have incentive compensation awards generally been increasing?

A. Yes, they have. According to the response to CURB-15, the details of which are confidential, officer incentive compensation increased by approximately 77% from 2005 to 2009. During this same period, incentive compensation for other employees has risen by approximately 29%.

Q. What level of payroll increases have employees received over this period?

A. In addition to increases in incentive compensation, employees have received very respectable payroll increases over this period. As shown in the response to CURB-5, annual increases for salaried employees have averaged 3.33%.

Q. Doesn't the Company use a compensation consulting firm to benchmark its compensation?

A. Yes, it does. According to its Proxy Statement, Empire engaged the Hay Group in 2009 to review its compensation practices. A similar review was conducted in 2008. Unfortunately, such reviews tend to escalate increases in compensation, especially for highly-paid officers. These studies compare the subject company's compensation to compensation in a broad range of other firms. Since most companies do not want to find themselves in the lower half of the benchmark group, companies that typically fall below the average raise their compensation – and hence the average of the benchmark companies increases. This sets off a chain of events that results in ever-increasing compensation levels. Thus, the KCC should be particularly wary of any compensation plans that are justified by means of comparison to benchmark studies.

Q. Do you believe that the incentive compensation program costs claimed by Empire should be passed through to ratepayers?

A. No, I do not. I have several concerns about these types of programs, many of which are based, at least in part, on a utility's ability to achieve certain earnings goals. First, it should be noted that 77% of the overall cost of these plans involve incentive compensation awards for a small group of officers and executives. In addition to these awards, the Company's revenue requirement claim also includes substantial base salaries for officers. I am not recommending any disallowance relating to the test-year cost of officer and executive salaries. Thus, my revenue requirement recommendation already reflects a generous allowance for officers and executives. If the Company wants to further reward officers and executives it can do so, but these additional costs should be borne by shareholders, not ratepayers.

I also have concerns regarding incentive compensation costs for other salaried employees, as there is no specific criteria for these awards.

Q. What do you recommend?

A. I recommend that the KCC deny the Company's request for recovery of incentive compensation costs. Approximately 77% of these costs relate to incentive awards for a small number of officers and executives. Moreover, employees are consistently receiving payroll increases that are clearly reasonable relative to market conditions. If the Company wants to reward officers and salaried employees based on financial results, in whole or in part, then shareholders should be willing to absorb these costs. This recommendation will require the Board of Directors to establish incentive compensation plans that shareholders are willing to finance. As long as ratepayers are required to pay the costs of these incentive plans, then there is no incentive for management to control these costs. This is especially true since the officers and executives of the Company are primary beneficiaries of such plans. Therefore, I recommend that the Company's claim for incentive compensation costs be denied. My adjustment is shown in Schedule ACC-19.

D. <u>Payroll Tax Expense</u>

Q. What adjustment have you made to the Company's payroll tax expense claim?

A. Since I am recommending a reduction to the Company's payroll costs associated with post-test year salary and wage increases, vacant positions, and incentive compensation costs, it is necessary to make a corresponding adjustment to eliminate certain payroll taxes. At Schedule ACC-20, I have made an adjustment to eliminate payroll taxes associated with my recommended payroll and incentive compensation adjustments, using the statutory payroll tax rate of 7.65%.

E. Supplemental Executive Retirement Plan ("SERP") Expense

Q. What are SERP costs?

A. These benefits are provided to certain officers whose retirement benefits would otherwise have been reduced as a result of certain changes made to the tax code. According to the Company's response to CURB-18, the SERP plan is "a non-qualified retirement plan covering key employees that provides benefits they would have received under the company's other retirement plans, except for compensation and benefit limitations imposed by certain sections of the Internal Revenue Code." These costs relate to supplemental retirement benefits for key executives that are in addition to the normal retirement programs provided by the Company. These programs generally exceed various limits imposed on retirement programs by the IRS and therefore are referred to as "non-qualified" plans.

Q. What are the test year SERP costs that the Company has included in its claim?

A. As shown in the response to CURB-18, the Company is projecting total company SERP costs of $328,194. Approximately 78% of these costs are expensed and the remainder are capitalized.

Q. Do you believe that these costs should be included in utility rates?

A. No, I do not. As noted above, the officers of the Company are already well-compensated. Moreover, employees that receive SERP benefits are also included in the normal retirement plans of the Company, so ratepayers are already paying retirement costs for these employees. If Empire wants to provide further retirement benefits to select employees, then shareholders, not ratepayers, should fund these excess benefits. Therefore, I recommend that the Commission disallow the Company's claim for SERP costs. My adjustment is shown in Schedule ACC-21.

F. <u>Medical Benefits Expense</u>

Q. How did the Company determine its medical benefits expense claim in this case?

A. Empire is self-insured for its health care costs. The health insurance plans are funded through contributions by both Empire and its employees, and actual costs depend on the number and magnitude of claims made during the year. In its filing, the Company included an increase of $420,000 over the actual test-year cost. This increase was based on an estimated renewal premium and on an estimated trend for cost increases.

Q. Did the Company discuss why the proposed increase over the test-year level of funding was reasonable?

A. No, it did not. Empire did not discuss why it believes that the level of funding in the test year was insufficient. Since the Company is self-insured for these costs, its medical expense costs ultimately depend on the actual claims made against the fund. Empire does not know what the actual claims will be on a prospective basis. The actual amount of claims paid will not only be impacted by the general level of health care costs, but it will also be impacted by the degree to which employees seek medical care and the severity of the illnesses experienced by employees. For these reasons, the Company's post-test year claim does not represent a known and measurable change to the test year.

Q. What do you recommend?

A. Based on the lack of any supporting documentation from Empire, and on the fact that the Company's adjustment does not reflect a known and measurable change to the test year, I am recommending that the Commission deny Empire's pro forma adjustment relating to medical benefit costs. My adjustment is shown in Schedule ACC-22.

G. Bad Debt Expense

Q. How did Empire determine its claim for bad debt expense?

A. Empire's claim is based on an uncollectible rate of 0.58%, which it applied to both its pro forma revenue at present rates as well as to its requested rate increase.

Q. Are you recommending any adjustment to the Company's claim for bad debt expense?

A. I am not recommending any adjustment to the uncollectible rate of 0.58%. However, the actual level of bad debt expense included in rates should depend upon the level of the rate increase that is ultimately awarded by the KCC. Therefore, at Schedule ACC-23, I have made an adjustment to remove the Company's claim for bad debt expense associated with its proposed rate increase. In addition, I have included the uncollectible factor of 0.58% in the revenue multiplier that I used to gross-up the required increase in operating income based on the recommendations contained in my testimony (see Schedule ACC-38). This will ensure that the uncollectible expense included in utility rates is synchronized with the overall level of revenues awarded by the KCC.

H. Operating and Maintenance Expense – New Facilities

Q. Please describe the operating and maintenance (O&M) adjustments included by Empire in its filing relating to its new generation and environmental facilities.

A. In its filing, Empire included $7,558,394 (total Company) of adjustments to "normalize maintenance for plant additions." As discussed in the testimony of Mr. Mertens, this included adjustments of $3,858,276 for Iatan Unit 2; $2,783,975 for Plum Point; $350,007 for Iatan Unit 1 AQCS; $212,136 for Iatan Common; and of $354,000 for the Asbury SCR.

Q. Are you recommending any adjustments to the Company's claim?

A. Yes, at this time, I am recommending that the Commission decline to include in rates the Company's O&M adjustments relating to Iatan Unit 2 and Plum Point . As noted earlier, these facilities are not yet in-service. While the parties agreed to reflect in rates certain capital costs incurred through January 31, 2010, relating to these facilities, it would be premature to include operating costs for these facilities in rates at this time. The Company's claim is based on Iatan Unit 2 costs that are budgeted costs for the 2011 calendar year, well beyond the test year in this case. The Plum Point costs are also budgeted costs that do not meet the known and measurable standard for inclusion in utility rates. Therefore, I recommend that the Commission deny including operating and maintenance costs associated with both of these units in rates at this time. Even if the Commission adopts all of CURB's recommendations, Kansas ratepayers will still face a 24% base rate increase as a result of this case. There is no rationale for increasing rates even more for speculative operating costs for plant that are not yet in-service. Accordingly, at Schedule ACC-24, I have made an adjustment to remove the Iatan Unit 2 and Plum Point operating costs from the Company's revenue requirement.

I. Distribution Maintenance Expense

Q. What level of distribution maintenance costs has the Company claimed in this case?

A. Empire has claimed distribution maintenance costs of $14,920,988, which is the actual cost incurred in the test year. The largest maintenance expenditure relates to maintenance of overhead lines, which typically accounts for well over 70% of distribution maintenance costs.

Q. Do distribution maintenance costs generally vary from year-to-year?

A. Yes, distribution maintenance costs can vary significantly from year-to-year, generally as a result of varying amounts of vegetative management that is undertaken by a utility. As shown in the Company's filing at Section 8, Schedule C, page 2, the Company incurred distribution maintenance costs of $8.7 million in 2006, $16.4 million in 2007, and $12.2 million in 2008. As noted, test year costs were $14.9 million while costs for the twelve months preceding the test year were $11.8 million. Obviously, these costs are subject to annual fluctuations from year-to-year, due to the level of maintenance programs, as well as the specific programs, undertaken by the Company.

Q. What do you recommend?

A. Given the fluctuation in these costs from year-to-year, I recommend that the KCC set rates based on average distribution maintenance costs over a three-year period (2006-2008). My adjustment is shown in Schedule ACC-25.

Q. Why didn't you use the time period 2007 to 2009 to determine your three-year average?

A. There are two reasons why I did not use the most recent calendar year in my average. First, I simply did not have information on calendar year 2009 costs when I prepared my adjustment. More importantly, Empire received permission to implement a vegetative management tracker in Missouri as part of its 2008 rate case. It appears from the Company's response to CURB-38 that the Company has accelerated spending on vegetative management now that it is virtually guaranteed recovery of these costs in Missouri. The use of the 2006-2008 time frame eliminates any impact that the adoption of this tracker had on the level of vegetative management expenditures undertaken by Empire.

J. Storm Damage Amortization Expense

Q. Please summarize the Company's claim for amortization of storm damage costs.

A. As described in the testimony of Michael Palmer, Empire has included amortization costs associated with several storms in its filing. First, the Company included a five-year amortization of costs resulting from ice storms in January 2007 and December 2007. In January, 2008, Empire filed a request for an Accounting Order relating to these ice storms. In its Application for an Accounting Order, Empire requested a five-year amortization for these costs. On June 24, 2008, the KCC granted the Company's request for an Accounting Order, but ordered that the Company recover these costs over a period of ten years, with carrying costs. In this case, Empire has included an annual amortization expense adjustment of $124,032 relating to these storms.

Second, Empire is requesting recovery of costs relating to a wind storm that occurred in May 2009. It is my understanding that the Company has not filed an Application for an Accounting Order with regard to this storm. Instead, Empire is requesting recovery of these costs, over five years, as part of this base rate case.

Q. Are you recommending any adjustment to the Company's claim?

A. I am not recommending any adjustment to the Company's claim associated with the two ice storms, since it appears that the Company's claim is consistent with the Accounting Order issued by the KCC. With regard to the May 2009 wind storm, Empire should have filed an Application for an Accounting Order so that the appropriate cost deferral could be evaluated by the KCC. Nevertheless, given the KCC's decision with regard to the earlier ice storms, I have included recovery of the May 2009 storm damage costs in my revenue requirement. However, I recommend that the Company recover these costs over a period of ten years, instead of the five years proposed by Empire. This is consistent with the recovery period authorized by the KCC for the costs associated with the earlier ice storms. In addition, since the Company did not promptly request an Accounting Order for these costs, I recommend no recovery of carrying costs. My adjustment is shown in Schedule ACC-26.

K. Regulatory Commission Expense

Q. Please describe the Company's claim for regulatory commission costs.

A. Empire is requesting recovery of total rate case costs for the current case of $400,000, which it is proposing to amortize over three years. Thus, Empire is requesting recovery of $133,333 annually.

Q. Are you recommending any adjustment to the Company's claim?

A. I am not recommending any adjustment to the proposed amortization period, but I am recommending an adjustment to the level of rate case costs claimed by Empire. According to the response to CURB-41, the Company incurred costs of $230,833 in KCC Docket No. 05-EPDE-980-RTS and of $211,470 in KCC Docket No. 02-EPDE-488-RTS. Therefore, I believe that the Company's claim for rate case costs of $400,000 for the present docket is overstated and is not supported by the record in this case.

Q. How much has the Company spent to date with regard to this rate case?

A. According to the response to KCC-201, to date the Company has only incurred costs of $43,751.

Q. What level of rate case costs do you recommend be reflected in rates?

A. Given the actual level of rate case costs incurred in each of the past two cases, and the fact that the Company has only spent $43,751 to date, I am recommending recovery of $250,000 for rate case costs. Consistent with the Company's proposal, I have amortized these pro forma rate case costs over 3 years. My adjustment is shown in Schedule ACC-27.

L. Software Contract Payment

Q. Please describe the payment received by Empire in the test year that is the subject of this adjustment.

A. As discussed on page 8 of Ms. Long's testimony, a software maintenance contract between Empire and Tomorrow Now was terminated during the test year. As a result of terminating the contract early, Tomorrow Now was required to pay Empire a fee of $254,247.

Q. Did Empire include this payment in its test year revenues?

A. No, it did not. In its filing, Empire included an adjustment to remove the entire payment from its test year results. Therefore, Empire proposed to have shareholders retain this payment instead of passing this benefit along to ratepayers.

Q. What do you recommend?

A. Since ratepayers were responsible for paying the expenses associated with this maintenance contract, I recommend that they also benefit from the early termination payment made by Tomorrow Now. There is no rationale for flowing this benefit through to shareholders. However, it would also be unreasonable to flow through the entire benefit to ratepayers in one year. Accordingly, at Schedule ACC-28, I have made an adjustment to reflect a three-year amortization period, without carrying costs, for this early termination payment. This period is consistent with the time period used by the Company for amortization of its rate case costs, and therefore I believe it is a reasonable period to use for amortization of the early termination payment.

M. <u>Gain on Sale of Property</u>

Q. Did the Company sell any utility property since its last rate case?

A. Yes, according to the response to CURB-127, Empire sold land along the Spring River in Riverton, Kansas during the test year. Empire did not reflect any proceeds from this sale in its claim in this case.

Q. How should sale proceeds be handled for ratemaking purposes?

A. Since this land was previously in rate base, and since ratepayers previously paid a return to shareholders on this land, then ratepayers should get the benefit of any net sale proceeds. It would be unreasonable to require ratepayers to pay a return on this land year after year, and then to allocate the benefit of any sale proceeds to shareholders. Accordingly, I have made an adjustment to include the net gain from this sale in the Company's revenue requirement.

Q. How did you quantify your adjustment?

A. To quantify my adjustment, I relied upon the Company's response to CURB-60. In that response, Empire indicated that the land had an original cost of $22,521. Empire sold the land for $544,061. In addition, the Company incurred removal costs of $17,454. Thus, the Company realized a net gain of $504,086. I am recommending that the Commission order the Company to return the gain to ratepayers, without carrying costs, over a three-year period. I am recommending a three-year period to be consistent with the Company's proposed amortization period for rate case costs. My adjustment is shown in Schedule ACC-29.

N. Miscellaneous Expense

Q. Do you recommend disallowance of other test-year expenses included in the Company's filing?

A. Yes, I do. A review of the Company's responses to data requests indicates that there are a host of expenses included in the Company's claim that should not be borne by ratepayers. These include dues and donations, lobbying costs, entertainment costs, and advertising expenditures.

For example, according to the response to CURB-48, the Company has included $104,806 for employee membership dues for a variety of Chambers of Commerce and other organizations that engage in lobbying activities. In addition to explicit lobbying, many of these organizations also engage in other activities that should not be charged to ratepayers, such as public affairs, media relations, and other advocacy initiatives.

Q. Are lobbying costs an appropriate expense to include in a regulated utility's cost of service?

A. No, they are not. Lobbying expenses are not necessary for the provision of safe and adequate utility service. Ratepayers have the ability to lobby on their own through the legislative process. Moreover, lobbying activities have no functional relationship to the provision of safe and adequate regulated utility service. If the Company were to immediately cease contributing to these types of efforts, utility service would in no way be disrupted. For all these reasons, I recommend that the Commission disallow any costs associated with lobbying activities.

Q. How did you quantify your adjustment?

A. I am recommending that the Commission disallow 15% of the Company's membership dues identified in the response to CURB-48 on the basis that such costs constitute lobbying activities or should not otherwise be charged to cost of service. I recognize that the specific level of lobbying/public affairs/media activity varies from organization to organization.

However, based on my review of these organizations and on recommendations in other utility rate proceedings, I believe that a 15% disallowance is a reasonable overall recommendation. My adjustment is shown in Schedule ACC-30.

Q. Are you recommending any adjustment to the Company's meals and entertainment expense claim?

A. Yes, I am. According to the response to CURB-51, the Company has included in its filing approximately $73,000 for meals and entertainment expenses that are not deductible on the Company's income tax return. These are costs that the IRS has determined are not appropriate deductions for federal tax purposes. If these costs are not deemed to be reasonable business expenses by the IRS, it seems reasonable to conclude that they are not reasonable business expenses to include in a regulated utility's cost of service. Accordingly, at Schedule ACC-30, I have also made an adjustment to eliminate these costs from the Company's revenue requirement.

Q. Did the Company provide any additional information about these costs?

A. No. In CURB-126, we asked the Company to provide a breakdown of the costs shown in the response to CURB-51 between "meals" and "entertainment". Empire stated that did not separately track meals vs. entertainment. However, it is clear that the Company has included in its claim costs that should not be borne by ratepayers, such as tickets for the Kansas City Chiefs, as shown in the response to KCC-134. I find it difficult to conceive of a business purpose that would support ratepayers paying for tickets to sporting events. Clearly, these are costs that should be borne by the Company's shareholders, and not its ratepayers. While there may be certain meals and entertainment costs that should be borne by ratepayers, there are also clearly costs included in this category which should be entirely excluded from the Company's revenue requirement. Therefore, my recommendation to use the IRS criteria provides a reasonable balance between shareholders and ratepayers and should be adopted by the KCC.

Q. Are you also recommending any adjustments to the Company's claim for advertising costs?

A. Given limited CURB resources, I am not making a specific adjustment to the Company's claim for advertising costs. Since only about 5% of advertising costs are allocated to the Kansas jurisdiction, and since many of the individual invoices are relatively small, I could not justify undertaking a detailed review of each invoice to determine which costs should be borne by ratepayers. However, a cursory review of the response to KCC-47 indicates that there are certainly advertising costs included in the Company's claim that do not benefit ratepayers. For example, this response includes sponsorship of Missouri Southern Athletics, a congratulatory ad in response to an award presented by a business journal, other costs relating to name recognition and institutional advertising, and promotional costs. None of these costs are appropriate to recover from ratepayers. Therefore, the KCC should consider my recommended miscellaneous cost adjustment as the minimum adjustment that should be made in this case and recognize that there are additional costs embedded in the Company's claim that should not be funded by ratepayers.

O. Property Tax Expense

Q. How did Empire develop its pro forma property tax expense claim?

A. Empire calculated its pro forma property tax expense by applying a pro forma tax rate of 0.888% to its utility plant-in-service claim of $1,936,833,062, as shown in Section 8, Schedule B, page 2 of its filing.

Q. Are you recommending any adjustment to the Company's claim?

A. Yes, I am recommending two adjustments, relating to both the property tax rate and to the utility plant-in-service balance used in the calculation. First, based on my review of the Company's historic property tax expense and its utility plant-in-service balances, it appears that the pro forma tax rate of 0.888% used by the Company is excessive. Using plant balances at December 31, 2008 and the actual property tax expense incurred in the test year, I calculate a pro forma property tax rate of 0.76%. I then applied this rate to the Company's pro forma utility plant-in-service claim, to determine the pro forma property tax expense assuming the lower tax rate. This adjustment is shown in Schedule ACC-31.

Second, since I am recommending an adjustment to the Company's utility plant-in-service claim, it is necessary to make a further adjustment to reduce property taxes associated with my plant adjustment. As shown in Schedule ACC-32, I applied my pro forma property tax rate of 0.76% to my recommended plant adjustment to quantify the property taxes associated with the plant that I recommend be disallowed.

P. Interest on Customer Deposits

Q. How did the Company treat customer deposits in its filing?

A. As CURB recommended in the last case, Empire has reflected customer deposits as a rate base deduction. Therefore, it is necessary to make a corresponding adjustment to reflect interest on customer deposits "above-the-line". The Company is required to pay interest on its customer deposits. However, interest payments are typically recorded "below-the-line". Since ratepayers are receiving the benefit of a rate base reduction associated with customer deposits, it is appropriate for the KCC to include interest on customer deposits in the Company's revenue requirement.

Q. How did Empire quantify its claim for interest on customer deposits?

A. Empire based its claim on the level of customer deposits included in rate base, and on an interest rate of 1.0%.

Q. Are you recommending any adjustment to the Company's claim?

A. I am not recommending any adjustment to the customer deposit balance used in the Company's calculation. However, I am recommending that the Commission reduce the 1.0% interest rate on customer deposits to 0.5%. This is the rate that is currently authorized by the

KCC for interest on customer deposits. Therefore, it is appropriate to use this interest rate in calculating the Company's pro forma interest expense. My adjustment is shown in Schedule ACC-33.

Q. <u>Depreciation Expense</u>

Q. Have you made any adjustment to the Company's claim for pro forma depreciation expense?

A. Yes, I have made one adjustment. Since I am recommending a reduction to the Company's utility plant-in-service claim, it is necessary to make a corresponding reduction to its depreciation expense claim. At Schedule ACC-34, I have made an adjustment to eliminate depreciation on the utility plant that I recommend be excluded from rate base. To quantify my adjustment, I utilized a composite depreciation rate for production plant of 2.02%. Since the vast majority of my utility plant-in-adjustment relates to new generating facilities, I believe that the composite rate for production plant is a reasonable proxy to utilize in quantifying the associated depreciation expense impact.

Q. Did the Company actually include depreciation expense on its post-test year plant additions in its filing?

A. Yes, it did. In the response to CURB-122, the Company suggested that it did not include depreciation expense in its filing for Plum Point, Iatan Unit 2, or Iatan Common plant. However, the Company's claim for depreciation expense, which is shown in its filing at

Section 10, Schedule B, is based on production plant of $1,023,281,260, which is the post-test year plant claim shown in Section 4, Schedule A, of the filing. Therefore, it certainly appears that depreciation expense on this plant has been included in the filing. If so, then it is necessary to make an adjustment to remove depreciation expense on the plant that I recommend be eliminated from rate base, as I have done at Schedule ACC-34.

R. Interest Synchronization and Taxes

Q. Have you adjusted the pro forma interest expense for income tax purposes?

A. Yes, I made this adjustment at Schedule ACC-35. It is consistent (synchronized) with my recommended rate base, capital structure, and cost of capital recommendations. I am recommending a lower rate base and a higher debt ratio than the rate base and debt ratio that the Company included in its filing. My recommendations result in lower pro forma interest expense for the Company. This lower interest expense, which is an income tax deduction for state and federal tax purposes, will result in an increase to the Company's income tax liability under my recommendations. Therefore, my recommendations result in an interest synchronization adjustment that reflects a higher income tax burden for the Company, and a decrease to pro forma income at present rates.

Q. What income tax factor have you used to quantify your adjustments?

A. As shown on Schedule ACC-36, I have a composite income tax factor of 39.78%, which includes a state income tax rate of 7.35% and a federal income tax rate of 35%. These are the state and federal income tax rates contained in the Company's filing.

Q. What revenue multiplier have you used in your revenue requirement?

A. My recommendations result in a revenue multiplier of 1.67020, as shown on Schedule ACC-37. This revenue multiplier reflects an uncollectible rate of 0.58%, in addition to the state and federal income tax rates discussed above.

VII. REVENUE REQUIREMENT SUMMARY

Q. What is the result of the recommendations contained in your testimony?

A. My adjustments result in a revenue requirement deficiency at present rates of $3,163,661, as summarized on Schedule ACC-1. This recommendation reflects revenue requirement adjustments of $2,039,826 to the revenue requirement increase of $5,203,487 requested by Empire.

Q. Have you developed a pro forma income statement?

A. Yes, Schedule ACC-37 contains a pro forma income statement, showing utility operating income under several scenarios, including the Company's claimed operating income at present rates, my recommended operating income at present rates, and operating income under my proposed rate increase. My recommendations will result in an overall return on rate base of 8.32%.

Q. Have you quantified the revenue requirement impact of each of your recommendations?

A. Yes, at Schedule ACC-38, I have quantified the impact on Empire's revenue requirement of the rate of return, rate base, revenue and expense recommendations contained in this testimony.

VIII. <u>ENERGY COST ADJUSTMENT CLAUSE</u>

Q. Please discuss the Company's requested modification to the ECA.

A. As discussed in the testimony of Mr. Mertens at page 13, the Company is requesting authorization to transfer recovery of consumables used in the AQCS processes from base distribution rates to the ECA mechanism. These include the costs of ammonia used by an SCR, the costs of limestone used by scrubbers, and the cost of powder activated carbon used in mercury removal processes. The Company has included $2,165,183 (total Company) relating to these costs in its revenue requirement claim, but requests that recovery be transferred to the ECA.

Q. Do you recommend that the Company's proposal be accepted?

A. No, I do not. The Company's proposal is another attempt to shift risk from the Company's shareholders to its ratepayers. In spite of objections from CURB, the Company was successful in obtaining KCC approval to implement an ECA as part of its last base rate case. The ECA mechanism results in single-issue ratemaking. It also removes an important incentive for the utility to minimize costs, since Empire is virtually guaranteed recovery on a dollar-for-dollar basis of costs passed through the ECA. Moreover, with an ECA, a utility can seek to increase rates even if it is earning well above its authorized rate of return. Perhaps most importantly, an ECA mechanism results in rate uncertainty for ratepayers and shifts risk from shareholders to ratepayers.

Q. Given the problems you just identified with ECA mechanisms, what do you recommend?

A. I recommend that the KCC reject the Company's proposal to expand the ECA mechanism to include new categories of costs. The AQCS consumable costs that the Company proposes to include in its ECA are not direct fuel costs. In fact, these costs do not relate directly to generation at all, but rather relate to the environmental processes that have been imposed on the generation of electricity. Thus, there is a fundamental difference between fuel costs, which are currently recovered through the ECA, and the AQCS consumables that are the subject of the Company's current proposal.

Moreover, the ECA has already transferred a substantial portion of utility risk from shareholders to ratepayers. As shown in Section 8, Schedule C of the Company's filing, over 52% of the Company's test year operating and maintenance costs related to fuel and purchased power, costs for which the Company is now guaranteed recovery on a dollar-for-dollar basis. All risk associated with fluctuations in these costs has now been transferred from utility shareholders to utility ratepayers. The KCC should resist attempts by the Company to shift additional risk to ratepayers and reject the Company's request to recover the cost of AQCS consumables through the ECA.

IX. TRACKER MECHANISMS

Q. Please summarize the Company's request with regard to tracking mechanisms for pension and OPEB costs.

A. As discussed in the testimony of Laurie Delano, the Company is requesting authorization to implement a tracker mechanism for OPEB costs. Under the Company's proposal, the Company would defer the difference between the OBEP amount collected in rates and the actual annual costs booked under Generally Accepted Accounting Principles ("GAAP") pursuant to Accounting Standards Codification ("ASC") 715-60, formerly Financial Accounting Standard ("FAS") 106. Empire proposes that the resulting regulatory asset or liability would be included in rate base in a future rate case and amortized over five years, with inclusion of the unamortized balance in rate base. A similar mechanism was implemented for pension costs pursuant to a Stipulation in the Company's last base rate case between KCC Staff and the Empire. CURB was not a party to that Stipulation.

In addition, with regard to the pension costs that were addressed in the prior Stipulation, Empire is now seeking a clarification with regard to the ratemaking treatment for certain pension fund contributions. Specifically, the Company is proposing to expand the situations whereby pension fund contributions in excess of the annual pension expense would be deferred and amortized in the next case over a five-year period, with rate base treatment.

Q. Please summarize the tracking mechanism approved in the Company's last base rate case for pension costs.

A. In that case, KCC Staff and Empire entered into a Stipulation that permitted the Company to defer the difference between the amount of pension costs included in rates and the annual pension costs booked under GAAP pursuant to FAS 87. The Stipulation provided that these deferrals would then be amortized over a period of five years, with rate base treatment, in the Company's next base rate case. In addition, the Stipulation permitted the Company to record a regulatory asset for pension contributions made to the pension fund that were in excess of the annual FAS 87 expense, provided that such contributions were required: 1) if the minimum required contribution was greater than the FAS 87 expense; 2) to avoid Pension Benefit Guaranty Corporation ("PBGC") variable premiums; and 3) to avoid the write-off of an existing prepaid pension asset. The Stipulation provided that the resulting regulatory asset would be amortized over five years, with rate base treatment, in the Company's next base rate case. The Company had originally requested that these mechanisms would apply to both pension and OPEB costs. In that case, CURB opposed the establishment of any tracking mechanism and CURB was not a signatory to the Stipulation. The Stipulation limited these tracking mechanisms to pension costs. In approving the Stipulation, the KCC noted that the tracking mechanism was opposed by CURB. The Commission also noted that "the Agreement has limited use of the tracking mechanism to FAS 87 costs and specifically excludes (OPEB), but the Agreement specifically states this tracker will not apply to FAS 106 costs."[5]

Q. Have there been further developments with regard to recovery of pension and OPEB costs since the KCC approved the Stipulation in Empire's last base rate case?

A. Yes, since the last base rate case, there has been a major development with regard to these costs. On March 29, 2007, the KCC initiated a generic docket (KCC Docket No. 07-GIMX-1041-GIV) to examine the appropriate ratemaking treatment for pension and OPEB costs. This docket was initiated in response to a request by several utility companies, including Empire. Specifically, the utilities requested KCC authorization to:

> Establish a regulatory asset or regulatory liability to track the difference between the amounts recognized in rates and the pension and OPEB costs recorded for financial reporting purposes pursuant to Generally Accepted Accounting Principles ("GAAP"), and
>
> Recognize for ratemaking purposes the companies' contributions to their pension and OPEB plans in excess of costs recorded for financial reporting purposes.

On March 18, 2009, Staff filed its Report and Recommendations in the generic proceeding. Staff recommended that the KCC permit the utilities to establish a regulatory asset or liability for the difference between pension and OPEB costs recovered in rates and

5 Order in KCC Docket No. 05-EPDE-980-RTS, paragraph 18.

amounts recorded for financial reporting purposes. KCC Staff also recommended that the utilities be required to fund the amount of pension and OBEP costs recovered annually in rates. The KCC Staff recommended than any deferrals be amortized over a five-year period without carrying costs. Moreover, the KCC Staff recommended that the KCC reject the utilities' request to establish a regulatory asset for the difference between the annual amount of pension and OBEP contributions and the amounts booked pursuant to GAAP.

On April 17, 2007, CURB filed Initial Comments in the generic docket. I assisted CURB with the preparation of those comments. CURB recommended that the KCC deny the utilities' requests to establish regulatory assets or liabilities relating to pension and OBEP costs. As noted in CURB's comments, "[p]ermitting the establishment of a regulatory asset or regulatory liability would constitute single-issue ratemaking, would provide a disincentive for the companies to control these costs, would weaken regulatory oversight, would shift risk from the companies completely to ratepayers, and has not been justified by Staff." However, CURB also recommended that if the KCC adopted Staff's recommendation to permit a regulatory asset or liability to be established for the difference between amounts collected in rates and the amounts booked pursuant to GAAP, then it should also adopt Staff's recommendation to require the utilities to fund the amount collected in rates. In addition, CURB argued that if such a mechanism was adopted, the KCC should also adopt Staff's recommendation that the KCC reject the utilities' request to include any regulatory asset or liability in rate base. A copy of the Initial Comments and Reply Comments filed by CURB are included in Appendix C.

Staff, CURB, and the utilities had several discussions to determine if resolution of these issues was possible. As a result of those discussions, Applications for Accounting Orders were subsequently filed by Kansas Gas Service ("KGS") and by Westar Energy, Inc. and Kansas Gas and Electric Company (collectively "Westar"), on August 13, 2009 and August 14, 2009 respectively. These utilities requested authorization to implement a tracking mechanism for the difference between the pension and OPEB costs included in rates and the costs booked pursuant to GAAP, but agreed that any resulting regulatory asset or liability would not accrue carrying costs and that the associated unamortized balances would not be included in rate base in the companies' next rate proceeding. Both utilities also agreed to fund the amount of pension and OPEB costs reflected in rates, to the extent such funding was deductible for federal income tax purposes. Both KGS and Westar also agreed to establish a regulatory liability for any amounts not funded due to IRS limitations with regard to tax deductibility.

In addition, in their Applications for Accounting Orders, both parties requested authorization to establish a second regulatory asset if the amounts actually funded exceeded the annual costs booked pursuant to GAAP. However, KGS and Westar agreed that this second regulatory asset would not accrue carrying costs or be included in rate base in a future case, but would only be used to meet the funding requirements for its first tracker. On September 11, 2009, the KCC issued orders approving the Applications for Accounting Orders submitted by KGS and Westar. On January 12, 2010, CURB, Staff, Westar, and KGS filed a Stipulation and Agreement proposing that the KCC adopt the terms and conditions outlined in the KGS and Westar Accounting Orders on a permanent basis. The Stipulation and Agreement is also included in Appendix C of my testimony.

Q. How does Empire's proposed tracking mechanism vary from the mechanism adopted for KGS and Westar?

A. Empire's proposed mechanism differs in three significant ways. First, the Company's proposal does not require any specific level of funding in order to record a regulatory asset for the difference between pension and OPEB amounts collected in rates and amounts booked pursuant to GAAP. Second, Empire's proposal includes rate base treatment for the regulatory asset or liability resulting from the difference between pension and OPEB amounts collected in rates and amounts booked pursuant to GAAP. Third, Empire's proposal provides for ratemaking recovery of a second regulatory asset related to the difference between amounts funded and the annual pension and OPEB costs booked pursuant to GAAP, and for rate base treatment of this second regulatory asset.

Q. What is your recommendation with regard to Empire's proposal in this case?

A. I continue to oppose pension and OPEB tracker mechanisms, for the reasons expressed in the Initial Comments and Reply Comments filed by CURB in KCC Docket No. 07-GIMX-1041-GIV. However, if the KCC determines that some tracking mechanism is appropriate, then it should adopt the mechanisms approved for KGS and Westar. These mechanisms have substantial ratepayer safeguards that are not found in Empire's proposal. First, the KGS and

Westar mechanisms require that utilities actually fund amounts collected in rates in order to record a regulatory asset for differences between pension and OPEB amounts collected in rates and amounts booked pursuant to GAAP. This is an important safeguard and will ensure that amounts collected from ratepayers for pension and OPEB costs are actually used for that purpose. Second, the KGS and Westar mechanisms do not include rate base treatment for the regulatory asset or liability resulting from the difference between pension and OPEB amounts collected in rates and amounts booked pursuant to GAAP. Since the funding requirement will match the amount collected in rates, the regulatory asset or liability generated will have no cash impact on the Company and therefore there is no rationale for including any such regulatory asset or liability in rate base. Third, the KGS and Westar mechanisms do permit the recording of a second regulatory asset relating to excess contributions, but this regulatory asset has no ratemaking implications and therefore receives no rate base treatment or carrying costs. This provision allows the companies to apply "excess" contributions to meet their regulatory funding requirements in future years, but avoids the possibility of utilities basing funding decisions on discretionary criteria that may not benefit ratepayers. These are three important differences between Empire's proposal and the mechanisms approved for KGS and Westar. Therefore, if the KCC adopts a pension and OPEB tracking mechanism for Empire, it should adopt the same mechanism as that adopted for KGS and Westar. Given the KCC's generic investigation, which was initiated by the utilities including Empire, it would be reasonable to implement uniform tracking mechanisms to all Kansas utilities.

Q. Does this conclude your testimony?

A. Yes, it does.

VERIFICATION

STATE OF CONNECTICUT)

COUNTY OF FAIRFIELD) ss:

Andrea C. Crane, being duly sworn upon her oath, deposes and states that she is a consultant for the Citizens' Utility Ratepayer Board, that she has read and is familiar with the foregoing testimony, and that the statements made herein are true to the best of her knowledge, information and belief

Andrea C. Crane

Andrea C. Crane

Subscribed and sworn before me this 26TH of March, 2010.

Notary Public Marjorie M. Lenix

My Commission Expires: December 31, 2013