

Exhibit No.: _____
Issue(s): Income Tax Calculations within CWC/
Renewable Energy Credits/
Purchase Price Reductions/
Witness/Type of Exhibit: Riley/Rebuttal
Sponsoring Party: Public Counsel
Case No.: ER-2021-0312

REBUTTAL TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

**THE EMPIRE DISTRICT ELECTRIC COMPANY
D/B/A LIBERTY**

FILE NO. ER-2021-0312

Denotes Highly Confidential Information that has been redacted

December 20, 2021

PUBLIC

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

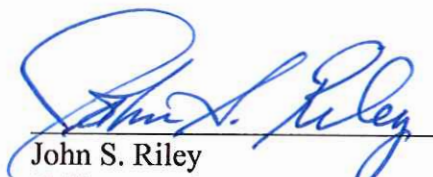
In the Matter of the Request of The)
Empire District Electric Company d/b/a)
Liberty for Authority to File Tariffs) Case No. ER-2021-0312
Increasing Rates for Electric Service)
Provided to Customers in its Missouri)
Service Area)

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

John S. Riley, of lawful age and being first duly sworn, deposes and states:

1. My name is John S. Riley. I am a Utility Regulatory Supervisor for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.




John S. Riley
Utility Regulatory Supervisor

Subscribed and sworn to me this 20th day of December 2021.



TIFFANY HILDEBRAND
My Commission Expires
August 8, 2023
Cole County
Commission #16837121



Tiffany Hildebrand
Notary Public

My Commission expires August 8, 2023.

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REBUTTAL TESTIMONY

OF

JOHN S. RILEY

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2021-0312

1 **Q. Are you the same John S. Riley who prepared and prefiled direct testimony in this case**
2 **on behalf of the Office of the Public Counsel?**

3 A. Yes.

4 **Q. Why are you testifying in rebuttal?**

5 A. Staff has failed to recognize that Empire or its parent company have not paid Federal and State
6 income tax for several years, and that it should not be expected to pay any taxes for the period
7 that these rates will be in effect from this rate case. This lack of acknowledgement has resulted
8 in Staff overstating the Federal and State Tax offsets in Cash Working Capital (“CWC”).

9 Empire is seeking to include Renewable Energy Credits (“RECs”) purchased through the
10 wind projects in its rate base and to also pass the costs through its FAC. Allowing Empire to
11 account for RECs in this manner would be a disincentive to maximizing the sale price of these
12 credits.

13 The overall cost of the wind projects that is included in rate base should be reduced to reflect
14 a high Production Tax Credit (“PTC”) total prior to Empire’s purchase, as well as Liberty
15 Utilities Company (“LUCo”) generation sales to the Southwest Power Pool (“SPP”) prior to
16 Empire’s ownership.

1 **INCOME TAX CALCULATIONS WITHIN CWC**

2 **Q. What is Cash Working Capital?**

3 A. Staff often defines it as follows:

4 Cash Working Capital (CWC) is a rate base component that represents
5 a measurement of the amount of funds, on average, required for the
6 **payment** of a utility's day-to-day expenses, as well as an identification
7 of whether a utility's customers or its shareholders are responsible for
8 providing these funds in the aggregate. (Emphasis Added)

9 In a CWC calculation, both a revenue lag and an expense lag are measured. The "lag" is the
10 amount of time that it takes revenues to come in from the customer or the time it takes for the
11 utility to pay out an expense. In Staff's CWC schedule 08, the revenue lag is 45.04 days and
12 the expense lag is 39.38 days. This translates to Staff's interpretation that Empire was
13 "funding" this unpaid expense for a little more than five and a half days prior to the ratepayers
14 providing the funds for payment.

15 **Q. With the recent decision in Case No. GR-2021-0108 concerning the length of the expense**
16 **lag for unpaid income taxes, why would Staff not include a 365 day expense lag for the**
17 **calculation of income taxes to be included as an offset to rate base?**

18 A. I do not know, but the rationale for a 365 day expense lag in the above mentioned case was
19 due to no tax being submitted with the tax returns, and Liberty Utilities (America) LUCo has
20 been required to submit income tax payments with past tax returns. Staff applied the IRS
21 mandated quarterly payment time frame when calculating its test year CWC tax amounts.

1 **Q. Do income tax payments of any kind trigger the quarterly payment lag that Staff has**
2 **historically applied in Empire’s income tax CWC calculations?**

3 A. No. As I stated in direct testimony; the American based parent company of Empire, Liberty
4 Utilities (America) a.k.a. LUCo, is not the ultimate owner of Empire. The foreign ownership
5 by Algonquin is the source of the mandated tax payments. Empire does not have a stand-
6 alone tax liability to cause Staff to apply the IRS-required quarterly payment expense lag.

7 **Q. What has Staff included in its original accounting schedules for the income tax amounts**
8 **and expense lag that it applied in its CWC calculations?**

9 A. Currently, Staff has included \$23,887,182 in federal income tax and \$4,241,871 for Missouri
10 state income tax in its determination of Empire’s cost-of-service. The CWC revenue lag is
11 45.04 days. The expense lag is 39.38 days, which is consistent with the quarterly payment
12 lag in-line with the requirement set out by the IRS. This creates a positive net lag factor which
13 translates to an increase in CWC requirement of \$370,419 for federal income tax and a
14 positive \$65,779 for Missouri state income tax.¹

| TAX OFFSET FROM RATE BASE | | | | | | |
|---------------------------|------------|-------|-------|------|----------|------------|
| \$ | 23,887,182 | 45.04 | 39.38 | 5.66 | 0.015507 | \$ 370,419 |
| \$ | 4,424,871 | 45.04 | 39.38 | 5.66 | 0.015507 | \$ 65,779 |

15

¹ A positive lag indicates that the Company is providing funds to pay the day to day expense which in this case is impossible due to no income tax liability for Empire during the test year.

1 **Q. Are you taking issue with any of Staff's income tax calculations?**

2 A. No. The income tax calculations themselves are initiated on accounting schedule 11 and the
3 summary of the income taxes on line 43 and 44 are transferred to the CWC accounting
4 schedule 08, line 32 and 33. The only adjustment that I expect will be made is when the
5 Commission makes its final determinations and the Staff will recalculate these income tax
6 totals. That will adjust the final income tax requirement and CWC requirement.

7 **Q. What is your calculation of the CWC income tax requirement using Staff's current tax**
8 **amounts?**

9 A. Using the \$23,887,182 for federal income tax and \$4,424,871 for state and applying the
10 adjusted factor² of -.87660, the reduction in rate base due to these tax offsets is a total of
11 \$24,818,423. Staff had included a positive \$436,198, a \$25,254,621 difference.

TAX OFFSET FROM RATE BASE

\$ 23,887,182 45.04 365 -319.96 -0.8766 (20,939,569)

\$ 4,424,871 45.04 365 -319.96 -0.8766 (3,878,854)

\$(24,818,423)

12

13 **Q. As a hypothetical, assume that the Commission rejects your argument of a zero tax**
14 **liability. What should the Commission do with these CWC calculations?**

15 A. Even if one accepts the premise that taxes were paid and, therefore, a liability should be
16 calculated, the liability is nowhere close to the \$28 million that Staff has built into its case.

² (45.04 - 365)/365 = -.8766027

1 One cannot blindly throw a tax liability in the pot and come out with what Staff has calculated
2 as a CWC offset. The confidential 2019 LUCo federal and Missouri state income tax returns
3 are included as Schedule JSR-R-01C³. LUCo’s federal tax liability was for the calculated
4 Base Erosion and Anti-Abuse Tax (“BEAT”) amount due to the foreign parent company.
5 There was no Missouri state tax liability. If the Commission is going to accept that some tax
6 is in play, then it should be no more than the tax calculated on the return. But to entertain this
7 scenario is to disregard the lack of taxable income and the immediate deductions at hand.

8 **Q. What are those deductions?**

9 A. Besides the Net Operating Loss Carryforward (“NOL”) that will eliminate any taxable net
10 income for years, you do not have to be a CPA or an expert in taxation to understand that
11 \$600 million of depreciable assets of Empire are about to be included on the next consolidated
12 groups’ state and federal tax returns. Empire will also enjoy the availability of 1% of the
13 Production Tax Credits generated by the wind projects.

14 It is a safe assumption that neither LUCo nor Empire will be paying any state or federal
15 income taxes before Empire’s next rate case, other than the amount caused by their foreign
16 ownership. Regardless, Staff has calculated a tax amount (\$28 million) and included it in its
17 determination of Empire’s revenue requirement for rates generated from this case. Empire
18 will pay no tax. This is the same lack of tax liability circumstance that occurred in Case No.
19 GR-2021-0108, and a 365 day expense lag should be used to calculate the CWC for the
20 income tax rate base deduction.

³ Only the pertinent pages of the tax returns were presented. The front page which shows no taxable income on line 30. The NOL carryforward page and the Schedule J that shows line 2, no income tax and line 3 where the **
** BEAT amount is displayed

1 If the Commission chooses to disregard Empire’s lack of income tax liability and accepts the
2 BEAT amount as an amount that should be allocated to APUC’s subsidiaries, then separate
3 calculations should be made for Empire’s portion of the BEAT amount included on the tax
4 return, and for the unappropriated remaining portion of the Staff calculated taxes in Empire’s
5 cost-of-service.

6 **RENEWABLE ENERGY CREDITS**

7 **Q. Empire has proposed that renewable energy credits (“RECs”) be included in a new asset**
8 **account listing as account 158⁴. What is your response?**

9 A. The cost of these credits should be excluded from consideration as either an asset or as a cost
10 that flows through Empire’s FAC. It is my understanding that Empire is required by the tax
11 equity arrangement to purchase RECs from the wind holding companies and may resell them
12 on the open market. To propose to record the REC purchases as an asset would indicate that
13 Empire is seeking rate base treatment, including a rate of return on the balance. Apparently
14 Empire doesn’t expect to flow these purchases through very quickly, and would like to profit
15 handsomely while they languish on its books. The Commission should steer clear of
16 recognizing the cost of these RECs in rate base. The cost of these purchases should also be
17 excluded from Empire’s FAC as well.

⁴ Answers to OPC data requests 8065 and 8065.1 are included as Schedule JSR-R-02. The answers indicate the rate base and FAC treatment the Company proposes for the RECs in question.

1 **Q. Are there other rationales for why the Commission should not include any of these RECs**
2 **in Empire’s rate base and flow them through its FAC?**

3 A. Yes. Rate base is for recovery of and on investments, or their equivalent, while FACs are for
4 recovery of expenses. RECs are not investment attributes. Furthermore, it is my
5 understanding that RECs generated through the Company’s wind PPAs are not assigned a
6 cost, so only the revenue from them that is recognized in Empire’s FAC is when Empire
7 actually sells such a REC. Having Empire’s ratepaying customers compensate Empire the
8 \$.20/per REC cost is a disincentive for Empire to maximize the revenues from the RECs. Any
9 consideration of the RECs in Empire’s FAC only should be when they are sold, and then only
10 if they are sold for more than \$.20/per REC.

11 **PURCHASE PRICE REDUCTIONS**

12 **Q. Mr. Mooney has stated in testimony that Empire has negotiated some reductions in the**
13 **purchase price of the wind projects. What are they?**

14 A. Mr. Mooney states on Page 10 of his direct testimony that there were negotiated price
15 reductions. To quote:

16 **Q. Was Empire able to negotiate any contract provisions to**
17 **reduce the costs of the Wind Projects?**

18 A. Yes. As provided in Section 2.3(d) of the Purchase and Sale
19 Agreements, any electricity production delivered to the Southwest
20 Power Pool’s Integrated Marketplace prior to Empire’s acquisition of
21 the Wind Projects results in a reduction to the purchase price,
22 estimated at *** _____ ***

23 Mr. Mooney’s testimony is misleading. As his answer is worded, one would think that the
24 purchase price would be reduced by the sale of electricity in the SPP. However, 2.3(d) deals
25 only with Production Tax Credits generated prior to the ultimate purchase of each project.

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Q. Do you have any issues with this section?

A. Yes. First of all the adjustment is based on only 75% of the generated PTCs. Let us remember that Empire’s American parent company, LUCo, acquired Tenaska’s interest in Kings Point and North Fork Ridge. If the price adjustment is not based on the entire amount of the generated PTCs, then LUCo has made a profit on a transaction with a subsidiary. Hardly an arm’s-length transaction.

Q. Let’s turn our attention to the LUCo ownership and transfer to Empire. How should the power production sales to the SPP from the North Fork Ridge and Kings Point wind projects prior to the transfer to Empire be treated in context of Empire’s purchase price?

A. Any revenues generated by these projects, whether that be sales of electricity or the creation of PTCs, should be a reduction in the project price paid by Empire.

Q. Why?

A. As I stated in direct testimony, cost prior to transfer are capitalized, and so revenues should be capitalized too. The owner of these two projects was Empire’s parent company. Accounting standards dictate a certain treatment of revenues prior to the owner taking

1 possession. The Deloitte accounting firm provides a good description of the proper
2 accounting for these revenues in one of its publications:

3 It is also important to understand how to account for revenues
4 generated before commercial operations. For instance, once project
5 construction is substantially complete, the related assets generally
6 must be commissioned before commercial operations commence.
7 As part of standard tests during the commissioning process,
8 electricity will be generated. Once the tests are completed, the asset
9 is shut down and certified and control is transferred from the
10 manufacturer to the owner/operator upon the latter's signature of
11 acceptance. All revenues produced before the owner/operator's
12 acceptance of the project assets are considered test revenue. Test
13 revenue is treated as a reduction of construction work-in-process in
14 accordance with ASC 970-10-20, which states that "[r]evenue-
15 producing activities engaged in during the holding or development
16 period . . . reduce the cost of developing the property for its intended
17 use, as distinguished from activities designed to generate a profit or
18 a return from the use of the property.⁵

19 This is an affiliate transaction. Any revenues generated while LUCo is the general
20 contractor should be treated as a reduction in the cost of the project, and should be reflected
21 in the price paid by Empire.

22 **Q. Can you provide an adjustment amount that should be considered a reduction in the**
23 **rate base inclusion of the wind projects?**

24 A. Not at this time. Revenues and generation figures provided by Empire included in
25 workpapers and answers to OPC data requests have been estimates. I expect more clarity
26 before surrebuttal and will present my calculations at that time.

⁵ Deloitte, Power and Utilities Accounting, Financial Reporting, and Tax Research Guide, July 2018, page 209.

1 **Q. Does this conclude your rebuttal testimony?**

2 A. Yes it does.