

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

In the Matter of the Propriety of the)
Rate Schedules for Electric Service of) File No. ER-2018-0228
The Empire District Electric Company)

RESPONSE TO SHOW CAUSE MOTION AND ORDER

COMES NOW The Empire District Electric Company ("EDE"), and, in response to the Motion to Open Rate Case and to Require Company to Show Cause ("Show Cause Motion") filed by the Staff of the Commission ("Staff") on February 16, 2018, and the *Order Opening Rate Case, Directing Notice, Establishing Time to Intervene, and Requiring Company to Show Cause Why Its Rates Should Not be Adjusted* ("Show Cause Order") issued herein by the Missouri Public Service Commission ("Commission") on February 21, 2018, respectfully states as follows:

EDE participated in the working docket regarding "the effect on Missouri utilities and ratepayers of a tax reform now being enacted by the Congress of the United States," File No. AW-2018-0174. EDE filed its Response to Order in File No. AW-2018-0174 on January 31, 2018, stating that EDE believes cost savings from the Tax Cuts and Jobs Acts of 2017 (the "Act") should, and ultimately will, be passed on to utility customers, noting challenges facing all parties and the Commission, and responding to the questions set forth by Staff and the Commission. The positions of EDE, as set forth in its Response to Order in File No. AW-2018-0174, remain unchanged.

When the Commission closed the working docket, Staff filed its Show Cause Motion herein, and the Commission issued its Show Cause Order. The Show Cause Order contains five directives to EDE. Set forth below are EDE's responses to these five directives. Before turning to the Company's responses to these specific questions, it should be noted that the Company is willing to discuss the impacts of the Act on EDE's cost of service with Staff and other interested stakeholders, in an effort to reach a fair and reasonable outcome for EDE and its customers.

Directive 1: Empire shall show cause, if any, why the Commission should not order it to promptly file tariffs reducing its rates for every class and category of electric service to reflect the percentage reduction in its federal-state effective income tax rate.

EDE's Response:

Currently, EDE's customers are paying the Commission-authorized and legally established rates – no more and no less. In order to effectuate a change (including a reduction) in the Company's rates for every class and category of electric service, there would need to be a rate case or a complaint case. *See* Sections 386.390 and 393.150, RSMo. Although a complaint case alleging that EDE is over-earning may be authorized by statute, the Commission does not have the power to order EDE to file tariffs to reduce rates to reflect the singular effect of the Act.

In either a rate case or a complaint case, the Commission would be required to consider all relevant factors when effectuating a rate change based on the effect of tax reform. Missouri law generally requires that utility rates only be adjusted based on the Commission's consideration of "all relevant factors." Unless an exemption is specifically authorized by statute, all relevant cost and revenue changes must be properly considered before rates may be adjusted.¹ This is partially because "there are always increases and off-setting decreases in other costs that are not reflected in current rates."² As such, rates may not be adjusted to reflect a change in tax law, or any other single factor, in isolation. This limitation applies whether the utility is facing a cost increase (as is typically the case) or a cost decrease (as is the case with the Act).

In addition to the statutory limitations and the prohibition against single-issue ratemaking, it would be difficult, if not impossible, to determine the impact of the change in federal corporate tax rates on Missouri retail rates without consideration of all relevant factors. A utility's cost of service is

¹ *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo banc 1979).

² *In the Matter of the Application of Missouri-American Water Company*, Report and Order, p. 18, MoPSC File No. WU-2017-0351 (December 20, 2017).

a multifaceted process which requires in depth analysis of data to ultimately outline the costs a utility must incur to provide safe and reliable service to its customers.

EDE looks forward to working with Staff, the Office of the Public Counsel, and other interested stakeholders to ensure that EDE's customers receive the appropriate benefit of cost savings resulting from the Act. At the very latest, a rate case will be initiated by Empire in approximately 17 months (due to the rate case requirement associated with a FAC), with a historical test year reflecting the Act's cost savings for EDE.

Directive 2: Empire shall quantify and track all impacts of the Tax Cuts and Jobs Act of 2017 potentially affecting electric service rates from January 1, 2018, going forward.

EDE's Response:

EDE has the ability to evaluate, quantify, and calculate the impacts of the Act potentially affecting the Company's cost of service. As noted above, EDE's customers are paying the Commission-authorized and legally established rates – no more and no less, and any change in the Company's rates would need to be effectuated through a rate case, where these amounts can be appropriately evaluated and an appropriate outcome determined.

Directive 3: Empire shall quantify and track its excess protected and unprotected ADIT for possible future flow back to ratepayers, and shall advise the Commission how best such flow-back may be accomplished.

EDE's Response:

Empire has no objection to quantifying and tracking its excess ADIT for possible future flow back to customers. EDE is generally in agreement with the process outlined in paragraphs 11(a)-(c) of the Stipulation and Agreement entered into in MAWC's current rate case, File No. WR-2017-0285. It should be noted that EDE will need to acquire new software, estimated at a cost of \$129,000-\$165,000, to follow the ARAM method.

Directive 4: Empire shall advise the Commission as to its position on whether the impact of the Tax Cuts and Jobs Act of 2017 is like the gross receipts tax analyzed in *Hotel Continental* and the natural gas commodity costs considered in *Midwest Gas Users' Association*, such that the Commission may order a reduction in utility rates without considering all relevant factors in an extended general rate case.

EDE's Response:

The impact of the Act is distinguishable from the gross receipts tax analyzed in *State ex rel. Hotel Continental v. Burton et al.*, 334 S.W.2d 75 (Mo. 1960), and the natural gas costs addressed in *State ex rel. Midwest Gas Users Ass'n. v. Public Service Commission*, 976 S.W.2d 470 (Mo.App. W.D. 1998). These two cases do not provide authority for the Commission to adjust EDE's rates without considering all relevant factors concerning expenses and revenues in the context of a rate case.

In the *Hotel Continental* case, the Missouri Supreme Court addressed the lawfulness of a surcharge for a municipal gross receipts tax and affirmed the Commission's authorization of the tax adjustment clause. In *Hotel Continental*, the Commission had determined that the municipal gross receipts tax was not to be included in operating expense. In contrast, income taxes were not excluded from EDE's operating expenses in the Company's last rate case. Also, the tax adjustment clause at issue in *Hotel Continental* had been authorized by the Commission in a general rate case.

The *Hotel Continental* holding was very specific, with the court finding that "the only items of operating expense which are directly related to the company's gross revenues are the gross receipts tax and the state sales tax." The court continued by stating that other tax items "do not lend themselves to such segregated handling." The court in *State ex rel. Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979) ("*UCCM*"), overturned the Commission's authorization of a fuel adjustment clause prior to the enactment of the statute specifically authorizing the same. The *UCCM* court did an excellent job of explaining the

specificity and limitations of the *Hotel Continental* holding. The court explained, in part, as follows:

The court was very careful in Hotel Continental to limit its holding to the specific type of clause before it, a TAC. . . . That is to say the tax was a *direct* charge, exactly proportionate to the customer's bill, the amount of which was directly determined by the amount of that bill. Effectively, the tax was imposed on the amount of the customer's bill, and hence its amount was governed by the other amounts charged the customer. Any change in other factors could not change this direct relationship, and thus any change in the tax rate could properly be taken into consideration under the TAC without regard to changes in other costs and without disturbing the statutory scheme that changes in rates of return not occur without considering all cost factors and without public awareness and understanding of rates proposed to be charged.

585 S.W.2d at 51-52.

The Commission in the rate proceeding underlying *Midwest Gas* determined that the gas utility's wholesale natural gas costs should be periodically reconciled through Purchased Gas Adjustment ("PGA") and Actual Cost Adjustment ("ACA") clauses. The *Midwest Gas* court concluded that the Commission had appropriately determined that the "unique nature of gas fuel costs" justified a rate treatment that differed from other costs of service, similar to the findings with regard to the tax adjustment clause in *Hotel Continental*. 976 S.W.2d at 480. Like the tax adjustment clause addressed in *Hotel Continental*, PGA/ACA clauses address a cost that, because of its nature, is not factored into the determination of a utility's base rates.

Adjusting EDE's rates for the impact of the Act outside of a rate case is distinguishable from how the gross receipts tax was handled in *Hotel Continental* and the natural gas commodity costs were handled in *Midwest Gas*. The type of cost is disguisable, and the Commission, in a general rate case proceeding, has not put in place a tax rate adjustment mechanism or tracker for EDE. As such, there is no basis for making a change in EDE's rates for electric service should the Company's income tax rate go up or down, other than in the context of a future general rate case

or complaint proceeding. As noted above, however, EDE looks forward to, and is open to discussing the impacts of the Act on EDE's cost of service with Staff and other interested stakeholders, in an effort to reach a fair and reasonable outcome for EDE and its customers.

Directive 5: Empire shall identify and quantify all other impacts of the Tax Cuts and Jobs Act of 2017 on its electric rates not otherwise addressed in this order.

EDE's Response:

The Act is relatively new, and the changes to the federal tax code are comprehensive and complex. Due to the complexity of the Act and the relatively short time from its issuance, EDE is still in the process of evaluating the full implications of the Act. In addition to the direct impact of the Act (the reduction in the federal tax rate paid by EDE), there may be indirect impacts on the Company and its cost of service that remain to be identified and quantified.

WHEREFORE, EDE respectfully submits this Response, demonstrating cause as to why the Commission should not order the Company to promptly file tariffs reducing its rates for every class and category of electric service to reflect the percentage reduction in its federal-state effective income tax rate. EDE requests such relief as is just and proper under the circumstances.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that the above and foregoing document was filed in EFIS on this 19th day of March, 2018, with notice of the same being sent to all counsel of record.

Diana C. Carter