BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of The Empire District	)	
Electric Company's Request for	)	
Authority to File Tariffs Increasing	)	**Case No. ER-2019-0374**
Rates for Electric Service Provided	)	
To Customers in its Missouri Service Area	)	

STAFF'S INITIAL BRIEF

Respectfully submitted,

WHITNEY PAYNE, Mo Bar No. 64078
Senior Staff Counsel

KEVIN THOMPSON, Mo Bar No. 36288
Chief Staff Counsel

JEFF KEEVIL, Mo Bar No. 33825
Deputy Staff Counsel

NICOLE MERS, Mo Bar No. 66766
Deputy Staff Counsel

MARK JOHNSON, Mo Bar No. 64940
Deputy Staff Counsel

KAREN BRETZ, Mo Bar No. 70632
Senior Staff Counsel

JAMIE MYERS, Mo Bar No. 68291
Associate Staff Counsel

TRAVIS PRINGLE, Mo Bar No. 71128
Legal Staff Counsel

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INTRODUCTION

The Empire District Electric Company (Empire Electric or Empire or Company) filed tariff sheets with the Missouri Public Service Commission requesting a general rate increase on August 14, 2019. Staff, in response to this filing, conducted a full audit of Empire's books and filed two reports along with rebuttal and surrebuttal testimony reflecting its findings. The intervening parties to this matter conducted their own investigations and filed testimony as well. The approved test year for this case is the 12 months ending March 31, 2019, updated to September 30, 2019 and trued-up to January 31, 2020.

The standard for rate cases before the Commission is to hold an evidentiary hearing after all pre-filed testimony is complete at which the parties may cross-examine opposing witnesses regarding the issues included in pre-filed testimony and submit evidence into the record. However, the evidentiary hearing in this matter, set for April 14-17 and 20-22, was suspended by the Commission following a request on behalf of all parties to instead consider the outstanding issues in this case on pre-filed exhibits and the submission of three rounds of briefing, an Initial Brief, a Responsive Brief and a Reply Brief. The parties have submitted evidence and corresponding evidentiary lists to identify the necessary materials to be considered by the Commission when it issues its final order in this proceeding.

The unique procedure requested in this matter is because in the midst of the progression of this rate case, a global pandemic of the Covid-19 virus occurred, which forced actions by several countries around the globe, unprecedented in the past century. Of the local actions taken by Missouri's government, one of those was to close the Governor's Office Building to all personnel not obligated to be present in the building. That action contributed

to the parties' requests to suspend the evidentiary hearing and has caused this case to be an example of a unique approach to the standard rate case process.

The parties filed a *Global Stipulation and Agreement* (Global Agreement or Agreement or Non-Unanimous Stipulation or Stipulation) on April 15, 2020, which encompasses all parties except for the Office of the Public Counsel (OPC). The *Agreement* includes consideration of the concerns of all parties to this matter, as well as the current pandemic and its effect on the citizens of Missouri, even where not outlined explicitly. Explained in more detail below, that *Agreement* is the most proper way to settle this proceeding and Staff recommends that the Commission accept the *Agreement* in its entirety as a resolution of all the issues in the case.

LEGAL STANDARD

The Commission is charged by statute with setting just and reasonable rates[1] after due consideration of all relevant factors.[2] The United States Supreme Court in the *Hope* case established that the rate making process involves a balancing of the investor and consumer interests.[3] Missouri's courts have upheld that principle in their rulings, balancing the interests of the stakeholders with the public interest.[4] The opinion of a qualified expert may amount to substantial and competent evidence for the purposes of arriving at a conclusion in a case.[5] To that end, the Commission may adopt or reject any or all of any witnesses' testimony.[6]

[1] Sections 393.130 and 393.140, RSMo.
[2] *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 49 (Mo. banc. 1979).
[3] *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944).
[4] *See* ***State ex rel. Union Electric Co. v. Public Service Commission***, 765 S.W.2d 618, 622 (Mo. App. W.D. 1988).
[5] ***State ex rel. General Tel. Co. of Midwest v. Public Service Commission***, 537 S.W.2d 655, 663 (1976).
[6] **Associated Nat'l Gas**, 37 S.W.3d 287, 294, (quoting ***State ex rel. Associated Nat'l Gas Co. v. Public Service Comm'n***, 706 S.W.2d 870, 880 (Mo. App. W.D. 1998)).

RATEMAKING

In order to determine the appropriate revenue requirement for an investor-owned utility, you first must calculate the cost of service for that utility.[7] The cost of service formula for a regulated, investor-owned utility is:

Cost of Service = Cost of Providing Utility Service

or

COS = O + (V – D)R where,

COS = Cost of Service

O = Operating Costs (Fuel, Payroll, Maintenance, etc.), Depreciation and Taxes

V = Gross Valuation of Property Required for Providing Service (including plant and additions or subtractions of other rate base items)

D = Accumulated Depreciation Representing Recovery of Gross Depreciable Plant Investment

V – D = Rate Base (Gross Property Investment less Accumulated Depreciation = Net Property Investment)

(V – D)R = Return Allowed on Rate Base[8]

Once this is determined, Staff also conducts a cost of capital analysis to determine the appropriate rate of return to recommend for the utility.[9] This is further explained in the section of the brief regarding Capital Structure below. The other components of a proper audit include the determination of rate base and the utility's current net operating income based on existing rates.[10] The recommended rate base and recommended rate of return are combined to determine the net operating income recommended for the utility to receive in this present case.[11] Staff then makes

[7] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 3-4.
[8] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, P. 4.
[9] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, P. 6.
[10] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 6-7.
[11] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 7-9.

several adjustments to account for various factors and Staff applies the recommended return on equity to arrive at its final recommendation.[12] Once Staff arrives at the final recommendation it applies that amount to the results of its Class Cost of Service Study to arrive at an appropriate rate design by examining each of the utility's rate classes.[13] The specific recommendations that Staff supports are outlined in the delineated sections below.

STIPULATION AND AGREEMENT

All of the parties to this matter, except OPC, have either signed onto or not opposed an Agreement in an effort to settle all issues in this matter. The Agreement is the result of a just and reasonable accounting of the costs to provide electric service balanced with a reasonable return on investment for the shareholders of Empire Electric, in accordance with the legal standard. Approving the Agreement will maintain the current rates and capital structure previously approved in Empire's last rate case. Empire has indicated that it will file additional tariffs to request a rate case before the close of 2020, therefore, maintaining the status quo now will provide Missouri's citizens with consistency and structure in a very turbulent and uncertain time in history and prevent multiple changes in the course of a single year.

The Agreement is reflective of negotiations and compromises between the signatories in order to reach a settlement to which all signatories could affix their names. Those positions taken in the Agreement may not be supported by the pre-filed testimony of the parties to the extent that the positions were modified for the sake of the Agreement. This type of

[12] Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 9-10.
[13] Ex. 104, *Staff's Direct Report - Class Cost of Service*, Pp. 25-26.

agreement is often referred to as a black-box settlement. The nature of this type of agreement in a rate case is such that the collective parties arrive at a revenue requirement amount after a series of negotiations composed of the dollar values of many components important to the signatories of the Agreement. In an Order issued in a Missouri American case, the Commission described a black box settlement in a rate case as one in which "the signatories do not stipulate to a specific capital structure, rate base, return on equity and overall rate of return."[14] Even the net operating income is not set by the parties in such an agreement. Therefore the specific dollar amounts attributed to each component of this rate case may not be considered by each party to be the same. In addition, the terms of a stipulation and agreement regarding non-revenue requirement issues such as movement on rate design, commitments to take action, or to report to parties on a specific concern, may also influence a party's decision to enter into the agreement. This is due to each party holding certain issues as more or less substantive than the other parties, but coming to an agreement on the overall revenue requirement for the sake of settling the case. The Commission previously found that a proposed increase in steam heating revenues and electric revenues was "just and reasonable" in the case of a black box settlement, stating, "Parties regularly engage in settlement negotiations, sometimes, as in this case, resolving their disputes with 'black box' settlements."[15] Staff has provided Supplemental Testimony in tandem with the filing of this Initial Brief which should provide specific support for the positions contained in the Agreement to the extent Staff is able.

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[14] *In the Matter of Missouri-American Water Company for a Certificate of Convenience and Necessity Authorizing it to Install, Own, Acquire, Construct, Operate, Control, Manage, and Maintain Water and Sewer Systems in Christian and Taney Counties, Missouri,* Case No. WA-2012-0066 (Order Approving Unanimous Stipulation and Agreement July 21, 2012).
[15] *Id.*

Portions of this Supplemental Testimony may be referenced in additional sections of this Initial Brief.

ISSUES TO BE DECIDED BY THE COMMISSION

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. However, pursuant to the filing of the OPC regarding its positions in the case, should the Commission not approve the Agreement, it is charged with considering certain elements of the following issues:

- Rate of Return
- Rate Design
- Weather Normalization Rider or Sales Reconciliation to Levelized Expectations mechanism
- Fuel Adjustment Clause
- Customer Service
- Credit Card Fees
- Rate Case Expense
- Management Expense
- Allowance for Funds Used During Construction
- Cash Working Capital
- Accumulated Deferred Income Tax
- Tax Cuts and Job Acts
- Tax Cuts and Jobs Acts Revenue
- Asbury
- Fuel Inventories

- Operation and Maintenance Normalization
- Depreciation and Amortization Expense
- Retail Revenue
- Property Taxes
- Common Property Removed from Plant and Accumulated Depreciation
- Affiliate Transactions
- Jurisdictional Allocation Factors
- Payroll and Overtime
- Employee Benefits
- Outside Services
- Commission Ordered Conditions in Case No. EM-2016-0213

Whitney Payne

Rate of Return—Return on Equity, Capital Structure, and Cost of Debt

Issues and Staff's Position:

The Cost of Capital issues presented, and Staff's positions on those issues, are as follows:

a. Return on Common Equity – what return on common equity should be used for determining rate of return?

Staff's Position: Staff recommends, based upon its expert analysis, a return on common equity ("ROE") range of 9.05% to 9.80%, with a point estimate of 9.25%.[16]

[16] Ex. 101: Staff's *Cost of Service Report,* Pp. 16-18.

b. Capital structure – what capital structure should be used for determining rate of return?

Staff's Position: The appropriate capital structure for determining the allowed ROR is Empire District Electric Company's ("Empire") consolidated capital structure, as of September 30, 2019, of 52.43% common equity and 47.57% long-term debt.[17] As stipulated by Condition 5 of the *Stipulation and Agreement* of the merger case, No. EM-2016-0213, Staff finds Empire's capital structure more economical tha Liberty Utilities Company ("LUCo").[18]

c. Cost of debt – what cost of debt should be used for determining rate of return?

Staff's Position: The correct cost of debt to be used for setting Empire's authorized ROR is Empire's consolidated embedded cost of debt of 4.57%, as of September 30, 2019.[19] The embedded cost of debt includes 2.15% cost of debt, as adjusted by Staff in compliance with the Commission's Affiliate Transactions Rules for $90 million 'Related Party Note.[20]

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the Global Stipulation and Agreement as a full resolution of all issues, Staff outlines its argument prior to entering into the Agreement.

[17] Ex. 130:Chari Surrebuttal, P. 12.
[18] Ex. 101: Staff's *Cost of Service Report,* P. 12.
[19] Ex. 130:Chari Surrebuttal, P. 14.
[20] Ex. 130:Chari Surrebuttal, P. 13.

Introduction:

Capital is money.[21] A business, such as a public utility, needs money – capital -- to finance its assets and its operations. Businesses, including public utilities, obtain capital from investors. Equity capital is raised by selling shares; debt capital is raised by selling bonds. Necessarily, capital has a cost. For debt capital, the cost is the interest and principal paid to bondholders. For equity capital, the cost is the dividends paid to shareholders. Both bondholders and shareholders are investors who provide capital to businesses and expect a corresponding return on their investment; a "return" being the profit received from an investment.[22]

Capital has a cost and so rate case cost of capital issues are all about the rate of return ("ROR").[23] The ROR is identical to the Weighted Average Cost of Capital ("WACC"), that is, the amount of money that the utility company must pay on average to all its security holders to finance its assets and operations.[24] In calculating the WACC, each category of capital is proportionately weighted by its cost and its quantity.[25] Therefore, the contested cost of capital issues are always these:

--*Return on Equity ("ROE"):* The ROE is the cost of the common equity component of capital;

--*Capital Structure:* The Capital Structure reflects the quantity of each type of capital – equity and debt -- as a percentage of the whole;

--*Cost of Debt:* The cost of the debt component of capital.

[21] *Investopedia,* accessed 04-21-20.
[22] *Lexico (Oxford),* accessed 04-21-20.
[23] A "rate of return" ("ROR") is the net gain or loss of an investment over a specified time period, expressed as a percentage of the investment's initial cost. *Investopedia,* accessed 04-21-20.
[24] *Wikipedia,* accessed 04-21-20.
[25] *Investopedia,* accessed 04-21-20.

As reflected in Staff's *Position Statement* and testimony filings, Staff's expert financial analyst, Peter Chari, recommends an authorized ROR of 7.02%, based on a WACC including a capital structure of 52.43% common equity and 47.57% long-term debt, an authorized ROE of 9.25%, and a cost of debt of 4.57%.

Of course, a public utility is significantly different from other businesses in that, although it is private property, it is nonetheless subject to pervasive government regulation to promote the public interest. This includes government price setting via the rate case process. In exchange, the utility enjoys a monopoly service area within which it is the only provider of a commodity that everyone has to have. This is a situation in which the regulator is constrained by important statutory and constitutional considerations, and Staff's expert, Peter Chari, has made his recommendations with those constraints in mind.

The utility's shareholders have an absolute right to an opportunity to earn a reasonable return on the public use of their private property.[26] This return, however, cannot be either too great or too little, or it will violate the constitutional rights of the customers or the shareholders, respectively.[27] It should be commensurate with the return available on other investments of similar risk; as well as sufficient to attract necessary capital and maintain the company's financial integrity. [28] A ROR equal to the utility's WACC meets all of these requirements.[29]

[26] ***State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission,*** 585 S.W.2d 41, 49 (Mo. banc 1979) (***"UCCM"***).
[27] ***Zinermon v. Burch,*** 494 U.S. 113, 125, 110 S.Ct. 975, 983, 108 L.Ed.2d 100, ___ (1990) (internal quotation omitted).
[28] ***Federal Power Commission v. Hope Natural Gas Company***, 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); ***Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia***, 262 U.S. 679, *43 S.Ct. 675, 67 L.Ed. 1176* (1923).
[29] Ex. 101:Staff's *Cost of Capital Report,* P. 7.

Three expert financial presented recommendations for the contested issues, as set out below:[30]

	Murray OPC	Chari Staff	Hevert Empire
ROE Range	**9.25% 8.50% - 9.25%**	**9.25% 9.05% - 9.80%**	**9.95% 9.80% -10.60%**
Cost of Debt	**4.65%**	**4.57%**	**4.85%**
Capital Structure --Equity --Debt:	**46.00% 54.00%**	**52.43% 47.57%**	**53.07% 46.93%**
ROR	**6.77%**	**7.02%**	**7.56%**

Return on Common Equity

The art and science of developing a ROE recommendation depends on expert judgment and the use of certain well-known analytical methods. Three expert analysts testified in this case and each used essentially the same methods and the same data. Their results differ due to the different judgmental decisions they made.

The analytical methods, long-established and widely used in the business and investing worlds, fall into two broad categories. The first variety – the Discounted Cash Flow model

[30] Chart information derived from each party's *Position Statement* and from Murray Direct, P. 2, line 1, and P. 41, line 15; Richard Surrebuttal Sch. SDR-2; Ex. 149, P. 2;

(“DCF”) – calculates the cost of equity as the sum of the current dividend yield[31] and a growth rate that represents the projected capital appreciation of the stock.[32] The other variety of analytical method, which includes the Capital Asset Pricing Model (“CAPM”) and the Risk Premium model, takes a current risk-free rate and adds a premium – in the CAPM, referred to as a “Market Risk Premium (MRP)”[33] -- reflecting the greater risk of the investment under consideration.[34] The result is the return that an investor requires to invest in the more risky security; this value is equivalent to the ROE. Both types of analysis are used to judge the performance of companies and investments and to guide acquisition decisions. In order to meet the Constitutional requirement that the return allowed by the Commission be commensurate to those realized from other investments of similar risk, ROE analysts apply these methods to proxy groups of similar companies rather than to the subject utility itself.

While both types of methodology are market-based – the current market value used in the DCF and the current risk-free rate used in the various risk premium methods – both methods are also vulnerable to unconscious bias and purposeful manipulation by the analyst in order to achieve a pre-determined result.[35] In the DCF method, it is the growth factor that is subject to manipulation;[36] in the risk premium methods, it is the risk premium that is subject to manipulation.[37] The choice of these values by the analyst is largely subjective, a matter of expert judgment.[38]

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[31] The expected next 12-months' dividend divided by current share price. Ex. 101: Staff’s *Cost of Service Report,* P. 14.
[32] *Id.*
[33] And varied by the application of Beta; *see* Staff’s *Cost of Service Report,* P. 17.
[34] *See* Ex. 101: Staff’s *Cost of Service Report,* Pp. 16-17.
[35] Ex. 108: Chari Rebuttal, P. 2: “Each methodology has certain inherent disadvantages that may bring in personal bias that lead to unreasonable estimates.”
[36] Manipulation is possible by selecting a high or low growth factor.
[37] Manipulation is possible by selecting a large or small risk premium/market risk premium.
[38] Although, the fact is that these analytical methods can be applied directly to the subject company and this is commonly done by business, financial and investment professionals.

Perhaps because of the non-objective and thus unreliable nature of ROE recommendations, this Commission has long looked for guidance to the ROE awards made by other commissions. For a period of several years, the Commission employed an analytical method of its own in which the ROE was set within a range – termed the "Zone of Reasonableness" – extending 100 basis points above and below the national average of recent ROE awards. For all its limitations, this method provided a greater degree of objectivity because it was not subject to manipulation by expert analysts working for parties with particular agendas.[39]

Robert Hevert, the Company's expert, used a Constant Growth DCF, a CAPM and ECAPM, a Bond Yield Plus Risk Premium, and an Expected Earnings Analysis[40] with a proxy group of twenty companies.[41] Mr. Hevert's results ranged from 8.09% to 11.05%.[42] Staff expert Peter Chari used a Constant Growth DCF, a CAPM, and a comparison with other commission-awarded ROEs with two proxy groups, one consisting of fifteen electric utilities and other consisting of five natural gas utilities.[43] Mr. Chari's results ranged from 4.63% to 8.14%.[44] David Murray, OPC's expert, used a Multi-Stage DCF, a CAPM, and a "Rule of Thumb" Risk Premium with five different proxy groups.[45] Mr. Murray's results ranged from 5.35% to 6.75%.[46]

Mr. Chari criticized Mr. Hevert's ROE recommendation as "too high" and "implausible," noting that, at 9.95%, Mr. Hevert's recommendation 56 basis points higher than the 2019

[39] What are those agendas? The point of investing is to make money, so the Company expert can be counted on to champion a high ROR. The consumer advocate, conversely, generally recommends a low ROR.
[40] FERC has held that the Expected Earnings Analysis does not meet the Constitutional requirements applicable to ROE estimation. Ex. 108: Chari Rebuttal, P. 2.
[41] Ex. 36: Hevert Direct, Pp. 13-14.
[42] Ex. 108: Chari Rebuttal, P. 3.
[43] Ex. 101: Staff COS Report, pp. 13-14 and App. 2, Sch's PC-7, PC-8.
[44] Ex. 108: Chari Rebuttal, P. 3.
[45] Ex. 210: Murray Direct, P. 33 and Sch. DM-D-7.
[46] Ex. 108: Chari Rebuttal, P. 3.

national average of authorized ROEs, 9.39%.[47] Mr. Chari traces the flaws in Mr. Hevert's DCF analysis to the growth rate that he used in his Constant Growth DCF, 5.80%, which is 170 basis points higher than the estimated long-term growth rate for the United States economy of 4.1%.[48] As Mr. Chari points out, "Assuming that utilities will grow at a higher rate than the overall economy is unrealistic, because it runs counter to basic economic principles: in the long run, companies will grow at a rate consistent with the long-term growth rate of the overall economy."[49] Mr. Chari also notes that Mr. Hevert inappropriately used analysts' short-term growth projections in his Constant Growth DCF model, a methodology that requires a *long-term* growth rate.[50] Based on FERC guidelines, Mr. Chari states, "Analysts' growth forecasts are simply inappropriate for exclusive use in the constant-growth DCF."[51] In an evident attempt at analytical sleight-of-hand, Mr. Hevert cites research supporting the superiority of analysts' growth rates without noting that the research does not apply to their *exclusive use* in a Constant Growth DCF.[52]

Mr. Chari also criticizes Mr. Hevert's Market Risk Premiums ("MRPs") of 12.15% and 12.25%, used in his CAPM and ECAPM, as "too high."[53] Dr. Morin, for example, considers reasonable MRPs to fall between 5% and 8%.[54] Mr. Chari explains that a flaw in Mr. Hevert's methodology was his inclusion of companies that do not pay dividends, thus skewing his results too high.[55] He demonstrated that, if calculated with appropriate in puts, Mr. Hevert's results would have been in line with Staff's.[56] Mr. Chari noted that

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[47] Ex. 108: Chari Rebuttal, Pp. 6-7.
[48] Ex. 108: Chari Rebuttal, P. 7.
[49] *Id.* Mr. Chari cites widely-respected regulatory economist Roger Morin for this principle.
[50] *Id.,* Pp. 7-8. The growth rate used in the Constant Growth DCF is intended to predict growth in perpetuity.
[51] *Id.,* P. 8; citing FERC Opinion 569.
[52] *Id.*
[53] *Id.,* Pp. 9, 11.
[54] *Id.,* P. 9.
[55] *Id.*
[56] *Id.,* P. 10 (chart).

the ECAPM and Bond Yield Plus Risk Premium methods used by Mr. Hevert are inherently unreliable.[57] Mr. Chari also criticized Mr. Hevert's upward adjustment for small size as inappropriate for Empire, a component of the Algonquin conglomerate.[58]

Mr. Murray, OPC's expert, also disagreed with Mr. Hevert's recommendation, commenting that it should be "summarily dismissed" and "defies common sense."[59]

Like Mr. Chari, Mr. Murray criticized Mr. Hevert's DCF perpetual growth rate, suggesting that equity analysts actually use values "closer to 3%."[60] Mr. Murray also criticized Mr. Hevert's MRPs, pointing out that their use resulted in projected returns "twice that of expectations from … reputable sources[.]"[61] Mr. Murray characterizes Mr. Hevert's method of calculating MRPs as neither "rational" nor "reasonable."[62] Mr. Hevert's MRPs imply a growth rate that is *triple* projected growth in the U.S. GDP of about 4.0%per annum.[63] Mr. Murray also points out that, "Most equity analysts use market risk premiums that are approximately half of those assumed by Mr. Hevert."[64]

Earlier, Staff noted that the methods used by cost-of-capital analysts are subject to manipulation in order to produce higher or lower results. That is exactly what is observed in this case in Mr. Hevert's testimony. Mr. Hevert has calculated an inappropriately high ROE by using an irrationally high growth rate and an inflated market risk premium. Mr. Chari and Mr. Murray, on the other hand, agree on the figure of 9.25%. That is the figure the Commission should adopt.

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[57] *Id.,* Pp. 11-12.
[58] *Id.,* P. 12.
[59] Ex. 211: Murray Rebuttal, P. 10.
[60] *Id.,* Pp. 10-11.
[61] *Id.,* P. 17.
[62] *Id.*
[63] *Id.,* P. 18.
[64] *Id.,* P. 19.

Capital Structure:

The capital structure is simply the proportion of each variety of financing – equity and debt -- used by a corporation to finance its assets and operations. The expert analysts have offered three different proposals:

	Murray OPC	**Chari Staff**	**Hevert Empire**
Capital Structure --Equity --Debt:	**46.00% 54.00%**	**52.43% 47.57%**	**53.07% 46.93%**

Staff agrees with OPC that a consolidated capital structure is appropriate for ratemaking purposes.[65] However, Staff does not agree with Mr. Murray's recommendation that the Commission use LUCo's adjusted capital structure for ratemaking.[66]

In its *Order Approving Stipulations and Agreements and Authorizing Merger Transaction* issued in Case No. EM-2016-0213 on September 7, 2016, the Commission ordered the parties to comply with the stipulation in which Empire agreed that, if its per books capital structure is different from the per books capital structure of the entity on which it relies for financing,[67] then Empire would be required to provide evidence in subsequent rate cases as to why its per book capital structure is the most economical for purposes of determining its revenue requirement.[68] Empire's consolidated capital structure is composed

[65] Ex. 130: Chari Surrebuttal, P. 12. Staff inadvertently used a deconsolidated capital structure in its direct report. Ex. 149.
[66] Ex. 212: Murray Surrebuttal, P. 9; Ex. 108: Chari Rebuttal, P. 13.
[67] LUCo is the primary debt issuer for the entire LUCo family. All existing Empire debt was retained by Empire when the merger happened. New debt and refinancing of maturing debt will occur on the LUCo bond platform. Liquidity is to be provided via a single consoldiated credit facility at LUCo. Ex. 101: Staff's *Cost of Service Report,* P. 12.
[68] Ex. 101: Staff's *Cost of Service Report,* P. 12; *In the Matter of The Empire District Electric Company, Liberty Utilities (Central) Co. And Liberty Sub Corp. Concerning an Agreement and Plan of Merger and Certain Related Transactions,* Case No. EM-2016-0213 (*Order Approving Stipulations and Agreements and Authorizing Merger Transaction,* Appendix to Attachment A, Paragraph A.5), issued September 7, 2016, effective October 7, 2016.

of 52.43% equity and 47.57% debt as of September, 30, 2019.[69] Liberty's capital structure is composed of 53.00% equity and 47.00% debt.[70] Because equity is more expensive than debt, LUCo's capital structure is less economical than Empire's.[71] Therefore, Staff accepts Empire's per books capital structure.[72]

The *Order* of September 7, 2016, is binding on the Company and all the signatory parties. That *Order* requires the use of Empire's per books capital structure as explained above. Mr. Murray's proposal, that LUCo's capital structure be used, does not comply with the Commission's *Order* and accordingly must be discarded.[73] Mr. Hevert's capital structure differs from Staff's because it is of the wrong vintage, March 31, 2019, rather than September 30, 2019.[74] The Commission should therefore also discard Mr. Hevert's recommended capital structure.

On its face, Mr. Murray's recommended capital structure appears to be more economical because it includes less equity. However, that appearance is due to an improper adjustment made by Mr. Murray. Mr. Murray argues that LUCo's capital structure under reports its debt burden by $395 million, which is the debt held by Liberty Utilities Financing ("LUF").[75] LUF is a subsidiary of APUC, responsible for raising debt for distribution to APUC and LUCo subsidiaries.[76] LUCo guarantees all the debt held by LUF.[77] Mr. Murray argues that, because LUCo guarantees the debt held by LUF, LUCo should include it in its capital structure for ratemaking purposes.[78] Consequently, Mr. Murray added

[69] Ex. 149.
[70] Empire's *Position Statement.*
[71] Ex. 108: Chari Rebuttal, P. 14.
[72] Ex. 101: Staff's *Cost of Service Report,* P. 12.
[73] Ex. 108: Chari Rebuttal, Pp. 13-14.
[74] *Id.,* P. 13.
[75] Ex. 108: Chari Rebuttal, p. 15.
[76] *Id.*
[77] *Id.*
[78] *Id.*

the $395 million to LUCo's long-term debt while subtracting the same amount from LUCo's equity.[79] The result of Mr. Murray's adjustment was that LUCo's capital structure changed to 54.00% long-term debt and 46.00% common equity, as of September 30, 2019.[80] The adjustment made LUCo's capital structure appear more economical than Empire's and consequently, the appropriate capital structure for use in setting Empire's ROR, according to Mr. Murray.[81]

However, Mr. Murray's adjustment is improper. Mr. Murray's inclusion of the $395 million debt in LUCo's capital structure for ratemaking purposes is based on an erroneous assumption that the $395 million debt is entirely used for LUCo's regulated operations.[82] LUF holds debt not just for LUCo but also for all other regulated utility subsidiaries of APUC. Including the $395 million in LUCo's capital structure incorrectly allocates the debt burden of the entirety of APUC's entities to LUCo's regulated utilities, including Empire.[83] Staff does not agree that the fact that LUCo guarantees LUF's debts means that the debt should be included in the capital structure for ratemaking purposes.[84] That would be unfair for both LUCo and Empire because it would use a capital structure that is not representative of the capital they use in their operations.[85]

Commission Questions for Staff:

1. LUCo provides shared corporate support functions and services to all of its various affiliates, both regulated and unregulated, on a centralized basis. In evaluating whether the use of Empire's Capital Structure is more "economical"

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[79] *Id.*
[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*
[84] *Id.*
[85] *Id.,* P.16.

than LUCo's, why is it appropriate to remove the debt associated with LUCo's unregulated affiliates from its capital structure, but not make a companion adjustment to reduce a portion of equity that is used to serve unregulated affiliates?

Staff did not adjust LUCo's capital structure for either the debt or equity components.[86]

2. What percentage of LUCo's total debt is attributable to unregulated affiliate debt? What percentage of LUCo's equity is attributable to equity in unregulated affiliates? What would be LUCo's capital structure if an equivalent percentage of LUCo's debt to and equity in unregulated utilities were removed?

Staff did not attempt to separate LUCo's capital structure into unregulated and regulated sections. It is not Staff's standard practice to try to separate capital structure into regulated or unregulated portions.[87]

Cost of Debt:

The cost of debt is the final input necessary to calculate the ROR.

	Murray OPC	Chari Staff	Hevert Empire
Cost of Debt	**4.65%**	**4.57%**	**4.85%**

[86] Ex. 130: Chari Supplemental Testimony, P. 1.
[87] *Id.,* P.2.

The cost of debt is characterized as "embedded" because it can be calculated from the indentures. Staff proposes a cost of debt of 4.57% after adjusting its original recommendation in the light of a concern raised by Mr. Murray.[88] Staff rejects Mr. Murray's recommended cost of debt because it is based on his inappropriate choice of capital structure.[89]

Conclusion:

The use of appropriate inputs, as recommended by Staff, results in a just and reasonable ROR for Empire of 7.02%. These inputs include a capital structure of 52.43% common equity and 47.57% long-term debt, an authorized ROE of 9.25%, and a cost of debt of 4.57%. As explained by Staff in detail above, the recommendations offered by Mr. Hevert and Mr. Murray should be discarded because they have been manipulated to skew either high or low, depending on the goals of the respective party.

Kevin A. Thompson

Rate Design, Other Tariff and Data Issues

Staff considers the resolution of rate design in the *Global Stipulation* reasonable in the context of the interplay of issues resolved therein. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument as presented in testimony prior to entering into the Agreement.

a. How should any revenue requirement increase or decrease be allocated to each rate class?

[88] Ex. 130: Chari Surrebuttal, Pp. 13-14.
[89] Ex. 108: Chari Rebuttal, Pp. 16-17.

Typically Staff assumes a Class Cost of Service ("CCOS") study is accurate to around 5% plus or minus of each studied class's revenue requirement, however in this case, that is not a reasonable assumption.[90] No CCOS Study submitted in this case is reliable for ratemaking purposes.[91] Given (1) the magnitude of overall revenue requirement change contemplated in this case, (2) the results of Staff's CCOS study in File No. ER-2016-0023, (3) the likely future investment in metering systems, (4) the intent to phase out the overly simplistic PFM rate schedule and transition all customers to modern time-variant rate designs, and (5) an overall goal of minimizing customer impacts associated with unnecessary bill swings from case to case, Staff maintains its class revenue responsibility and rate design variations as a reasonable outcome in this case, especially since, due to the lack of quality data, there is no typically-reliable CCOS from any party.[92]

Introduction:

The overarching goal of cost allocation is equitable division of costs among customers.[93] Staff performed a CCOS study in this case in order to provide the Commission Staff's recommendation on the appropriate revenue responsibility for each customer class.[94] Empire and MECG each submitted CCOS Studies.[95] As noted in the rebuttal testimonies of Staff witnesses Michael Stahlman and Robin Kliethermes, Staff had several concerns with the quality of Empire's data that was used in the CCOS Studies filed in this case.[96] Also, as discussed in Staff's CCOS Report, Empire

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[90] Ex. 136, Surrebuttal Testimony of Sarah L.K. Lange, P. 13.
[91] *Id.*
[92] *Id.*
[93] *See* Electric Cost Allocation for a New Era, A Manual, Schedule SLKL-d2, page 20-276. Appendix 3 of Ex. 104.
[94] *See* Ex. 104, Staff Direct Report – Class Cost of Service.
[95] Empire CCOS- Ex.26, Direct Testimony of Timothy S. Lyons.; MECG CCOS- Ex. 650, Direct Testimony of Kavita Maini.
[96] *See* Ex. 123, Rebuttal Testimony of Michael L. Stahlman- CCOS.; Ex. 120, Rebuttal Testimony of Robin Kliethermes – CCOS; Ex. 136, Surrebuttal Testimony of Sarah L.K. Lange.

has rate switching and rate misalignment issues involving its CB and SH rate schedules, its GP and TEB rate schedules, and the PFM and GP/TEB rate schedules.[97]

In short, no CCOS study submitted in this case is of the quality typically used for ratemaking purposes.[98] Given this, if the Commission does not approve the *Global Stipulation and Agreement*, the Commission must decide which of the recommended revenue allocations and rate designs are most appropriate under the circumstances. Staff recommends the Commission order Empire to adopt Staff's recommended class revenue allocations and rate design variations. Staff's recommendations are most appropriate when one considers: (1) the magnitude of overall revenue requirement change contemplated in this case, (2) the results of Staff's CCOS study in File No. ER-2016-0023, (3) the likely future investment in metering systems, (4) the intent to phase out the overly simplistic PFM rate schedule and transition all customers to modern time-variant rate designs, and (5) an overall goal of minimizing customer impacts associated with unnecessary bill swings from case to case.[99]

Staff's CCOS Study Results and Recommendations:

In the event that the Commission orders a reduction in Empire's revenue requirement, Staff recommends that the Feed & Grain rate schedule revert to its pre-tax reduction tariffed revenue level. Staff recommends that the Residential, Contract Transmission, and Lighting rate schedules retain the current level of revenue production which is net of the current temporary tax reduction rider, and that the CB/SH, GP/TEB, and LPS class revenue requirements be adjusted by the following process, in the event

[97] Ex. 121, Rebuttal Testimony of Sarah L.K. Lange- CCOS, p 21; Ex. 136, Surrebuttal Testimony of Sarah L.K. Lange, P.13.
[98] Ex. 136, Surrebuttal Testimony of Sarah L.K. Lange, P. 13.
[99] Ex. 136, Surrebuttal Testimony of Sarah L.K. Lange, P. 13.

that imputed load shapes are relied upon for rate schedules on which few customers take service:[100]

1. Reduce class revenue requirements by the level of the temporary tax reduction;
2. Determine the amount of additional reduction available after the above-referenced reductions have been applied, (approximately $18.5 million at Staff's recommended revenue requirement);
3. Further reduce the CB/SH and LPS revenue requirements by 25% each of the amount identified in step 2;
4. Further reduce the GP/TEB revenue requirements by 50% of the amount identified in step 2.[101]

If it is preferred to use customer-specific loads for the classes with few customers, then the LPS reduction should be reduced to 23% of the Step 2 amount, and Praxair should be reduced by 2% of the Step 2 amount.[102]

To the extent that the Commission decides changes are necessary to any class's revenue requirement, net of the tax rider, Staff recommends the following rate designs.

> Residential rate design: In the event the Commission orders a reduction to the Residential class that is of equal magnitude to the temporary tax rider's value, Staff recommends that the reduction to the class revenue requirement be applied as an equal amount to each energy rate element. This results in

[100] The provided class names refer to the indicated rate schedules: "Residential"- Residential Service; "CB/SH" – Commercial Service and Small Heating Service; "GP/TEB"- General Power Service and Total Electric Building Service; "LPS" - Large Power Service; "Feed & Grain" – Feed Mill and Grain Elevator Service, Schedule PFM; Contract Transmission - Special Transmission Service; and Lighting – Schedules SPL, PL, LS, MS, and other derivative schedules.
[101] Ex. 104, Staff Direct Report – Class Cost of Service, P. 2.
[102] Ex. 121, Rebuttal Testimony of Sarah L.K. Lange - CCOS, P. 18.

customer effective rates being held constant to those currently experienced by customers pursuant to the temporary tax rider.

In the event that decreases to the non-customer portion of the residential revenue requirement are ordered that are in excess of the magnitude of the temporary tax rider's value, Staff recommends the decrease to the residential revenue requirement be implemented by first setting the charges for usage in excess of 600 kWh to the "current effective" rates that result from applying the temporary tax reduction to the current tariffed rates. The additional decrease would then be applied as the same percentage decrease to the charges applicable to 0-600 kWh of usage for each season, effectively creating a summer incline and reducing the winter decline. This approach would reduce the impact experienced by customers and facilitate a transition to time-variant rates in a future proceeding.[103]

In the event the reduction applicable to residential energy charge recovery does not exceed the approximate $8.5 million currently generated by the application of the temporary tax reduction to the residential class, then the tail block charges should be set equal to the current tariff tail block charges, with the decrease applied as an equal percentage reduction to the charges for usage from 0-600 kWh per month, by season.[104]

Residential Customer Charge: Staff recommends the customer charge be maintained at $13.00. This will mitigate potential rate shock in the next rate

[103] Ex. 121, Rebuttal Testimony of Sarah L.K. Lange - CCOS, P. 22.
[104] Ex. 104, Staff Direct Report – Class Cost of Service, P.15.

proceeding associated with the expected inclusion of AMI meter costs in Empire's revenue requirement.[105]

CB/SH Alignment and Rate Design:[106] [107] For implementing any overall reduction in the revenue requirement of the realigned CB and SH schedules, collectively the CB/SH class, Staff recommends a multistep process that includes isolating the cost of energy to serve load within the energy charge from further adjustment. After isolating the energy costs, for the CB/SH class, Staff recommends the decrease be applied to the charges for usage within each rate schedule applicable to the first 700 kWh of usage each month, maintaining the consistency of these rate elements across the two rate schedules. At Staff's recommended level of class revenue responsibility, one third of the percentage reduction applied to the energy-isolated first blocks should be applied to the CB energy-isolated winter tail block, and one half of the percentage reduction applied to the energy-isolated CB winter tail block should be applied to the energy-isolated SH winter tail block. The adjustment of winter tail blocks is only

[105] Ex. 104, Staff Direct Report – Class Cost of Service Pp. 14-15.

[106] If there is no change in the revenue requirement (net of the tax rider) of the non-residential classes, then the consolidation of the GP and TEB rate schedules and the partial consolidation and alignment of the CB & SH rate schedules cannot be effectuated at this time. In the event of a change in the revenue requirement of either the GP or TEB rate schedule in this case, these schedules should be consolidated in that there is not at this time an apparent cost-related distinction between the service of customers on these rate schedules. Due to the seasonality of Empire's demand charges and the hours use rate structure of these rate schedules, it is reasonable to merge these rate schedules at this time. The overall decrease expected in this case will mitigate any customer impacts that may preclude merger of these schedules under ordinary circumstances. The consolidation of Empire's rate schedules is an interim step in the modernization of Empire's rate structures. Time-variant charges, potentially including a coincident demand charge, better reflect any differences in cost causation between customers served on these rate schedules. Ex. 104, Staff Direct Report – Class Cost of Service, p. 18.

[107] Regarding the alignment of the CB and SH rate schedules, the values of the customer charge, all summer energy blocks, and first non-summer blocks should be aligned, resulting in partial consolidation of these rate schedules, in the event there is a change in the revenue requirement of either class, net of the tax r*Id*er. The assumed distinction for the SH and CB rate schedules is that space heating customers will use significantly more energy in the non-summer months, and will have a higher load factor than similarly-sized CB customers. Under this assumption, it is not unreasonable to discount the tail block for non-summer usage of SH customers so they do not over-contribute to the cost of maintaining the transmission and distribution system; and it is also assumed that more usage will occur off-peak, thus a discount for off peak usage's lower energy cost and reduced impact on generating capacity is warranted. The alignment of rate elements within these rate schedules is an interim step in the modernization of Empire's rate structures. Any discrepancy in cost of service is better recognized with time-variant charges, potentially including a coincident demand charge. Ex. 104, Staff Direct Report – Class Cost of Service, P. 16.

appropriate if the failure to apply this step would result in inverted rate designs.[108]

GP/TEB Consolidation and Rate Design:[109] For implementing any overall reductions in the revenue requirement of the consolidated GP/TEB schedule, Staff recommends a multistep process that includes isolating the cost of energy to serve load within the energy charge from further adjustment. After isolating the energy costs, Staff recommends the decrease be applied as an equal percentage to the charges for usage net of energy and each other charge as tariffed.[110]

LP Rate Design: For implementing any overall reductions in the revenue requirement of the LP rate schedule, Staff recommends a multistep process that includes isolating the cost of energy to serve load within the energy charge from further adjustment. After isolating the energy costs, Staff recommends the decrease be applied as an equal percentage to the charges for usage net of energy and each other charge as tariffed.[111] [112]

PFM Rate Design: Staff recommends that the Feed & Grain rate schedule revert to its pre-tax reduction tariffed revenue level.[113] Staff generally recommends that non-residential revenue requirement changes from the revenues produced by existing rates be implemented as an equal percentage adjustment to all rate elements as isolated for the voltage-adjusted cost of

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[108] Ex. 104, Staff Direct Report – Class Cost of Service, P. 17.
[109] *See* footnote 106.
[110] Ex. 104, Staff Direct Report – Class Cost of Service, P. 19.
[111] *Id.*
[112] Unfortunately, the hours use rate design fails to recognize the relationship between the time of energy consumption and the value of the energy consumed. Instead, it relies on simplified assumptions of the relationship between the coincidence of customer load and load factor. The relationship of the LP tail block charge to the cost of acquiring the energy through the SPP integrated market should be reviewed as part of any final rate design. Ex. 121, Rebuttal Testimony of Sarah L.K. Lange - CCOS, P. 18.
[113] Ex 104, Staff Direct Report – Class Cost of Service, Pp. 1 & 20.

energy obtained to serve load.[114] Staff recommends the Feed Mill rate schedule be consolidated into the GP/TEB schedule in a future rate proceeding.

Given the relatively small number of customers taking service on this schedule, Staff encourages Empire to work one-on-one with customers to understand the impacts of this transition. If a well-designed time-variant rate is in place for the consolidated GP/TEB class at the time of transition, customer impacts should be minimal and may result in overall bill reductions for customers that utilize energy primarily in times of low capacity and energy costs.[115]

Contract Transmission and Special Contract – Praxair rate design: Staff recommends the existing relationship of on-peak, off-peak, and shoulder rates be realigned to reflect the relationship observed in the simple averages of the test period market energy prices used to determine the cost of energy to serve load in Staff's production modeling. The energy-isolated recovery from each rate element should next be reduced by the class-applicable energy-isolated equal percentage adjustment. The energy prices by time and season should then be added back into the rate.[116] Staff suggests, based on observed trends in market prices, that in Empire's next rate proceeding, it present a proposal to better capture the seasonality of rates, such as through shifting the summer season to begin in mid-May as opposed to mid-June, and through implementing shoulder month pricing and peak winter month pricing.[117]

[114] *Id.*, P. 3.
[115] *Id.*, P. 20.
[116] *Id.*, P. 22.
[117] *Id.*, P. 23.

Other Tariff and Data Issues

Staff considers the resolution of the following issues as provided in the *Global Stipulation and Agreement* reasonable in the context of the interplay of the issues resolved therein. However, should the Commission decide otherwise, Staff recommends the following:

Multiple-family Dwellings

Staff recommends the Commission's order include that "grandfathered" multiple-family customers taking service through single meter be given the option of being served on the CB/SH rate schedule. Currently, multiple-family dwellings within a single building that are served from one meter instead of separately metered are served on the Residential tariff.[118] The customer's bill is calculated by multiplying each customer charge and kWh block by the number of dwelling units.[119] Unless a customer obtains a variance from the Commission, multiple-family dwellings, such as apartment buildings, have been required to be separately metered after June 1, 1981, according to Commission Rule 20 CSR 4240-20.050.2. However, there are buildings that were built prior to June 1, 1981, that are grandfathered and continue to be metered from one meter point. Staff suggests Empire modify its tariff to allow such master-metered customers to be served on the CB tariff instead of the Residential tariff.[120]

Low-Income Pilot Program

Staff recommends continuation of Empire's Low-Income Pilot Program. Consistent with the *Global Stipulation and Agreement*, the Low-Income Pilot Program will remain in

[118] *Id.*, P. 34.
[119] *Id.*
[120] *Id.*

place with no changes made in this case and Empire will track all costs until its next general rate case.[121] Empire, Staff, and OPC will meet at least twice prior to the filing of Empire's next rate case to discuss the Company's Low-Income Pilot Program and whether or not modifications are warranted.[122]

Future Time-Variant Rate Structures

When sufficient metering and billing technology has been deployed, Staff recommends that Empire adopt time-variant rate structures as discussed in the Staff Report on Distributed Energy Resources, filed April 5, 2018, in File No. EW 2017-0245, concerning residential and utility-wide rate design.[123] In the more immediate future, pending Empire's deployment of AMI and broad-scale billing technology, which are necessary for more broadly-deployed time of use ("ToU"), Staff recommends Empire work towards a more seasonally appropriate incorporation of a "shoulder" season.[124] Empire has consistently high demands and usage in the months of December, January, and February and it is most appropriate to charge out the usage in these months at a higher rate than is charged for usage in October, April or similar months.[125] Staff recommends Empire should also begin retaining determinants associated with creation of a coincident peak demand charge to facilitate study of this charge type as a potential element of a more modern rate structure in the future.[126]

Economic Development Rider

Staff recommends that the reduced level of revenues arising from the application of Empire's Limited Large Customer Economic Development Rider ("LLCEDR")

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[121] *See* Global Stipulation and Agreement, filed April 15, 2020.
[122] *See Id.*
[123] Ex. 104, Staff Direct Report- Class Cost of Service*,* P. 23.
[124] *Id.*
[125] *Id.*
[126] *Id.*

discounted rates be allocated to all of Empire's customer rate classes in accordance with Section 393.1640, RSMo, which states that the increase shall be implemented through the application of a uniform percentage adjustment to the revenue requirement responsibility of all customer rate classes.[127] Further, Staff recommends that the reduced level of revenues be recoverable from all customers through a separate line item on the customer's bill.[128]

Jamie Myers

WNR and SRLE Adjustment Mechanisms

a. ***Should the Commission approve, reject, or approve with modifications Empire's proposed Weather Normalization Rider?***

The Commission should reject Empire's proposed Weather Normalization Rider (WNR). Staff has several issues with the WNR, including its structure (based on billed amount instead of rate based), application (individual customer instead of customer group), practicality (monthly vs annual) and potential legal implications.[129] Furthermore, the proposed WNR is impossible to implement[130] and does not correspond to the weather normalization process used in rate cases to determine normal weather.[131] This position is consistent with the *Global Agreement*. All parties, except for OPC, have agreed that Staff's Sales Reconciliation to Levelized Expectations mechanism (SRLE), as modified by the *Global Agreement*, is the appropriate implementation of Section 386.266.3, RSMo. The Commission should reject the WNR and approve the SRLE as described in the non-unanimous stipulation and agreement.

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[127] Ex. 120, Rebuttal Testimony of Robin Kliethermes – CCOS, P. 9.
[128] *Id.*
[129] Ex. 123, Rebuttal Testimony of Michael L. Stahlman, P. 2-3.
[130] *Id.*, P. 3, ll. 12-18.
[131] *Id.*, P. 2, ll. 9-15.

The structure of the WNR is needlessly complex and unworkable.[132] For example, the WNR is unclear as to what portion of its rates are included in base rates, and if revenues from mechanisms such as the FAC are included.[133] The WNR also suffers from its linear assumptions based on the assumed base load usage and the ratio of actual heating degree days (HDD) or cooling degree days (CDD) to normal HDD or CDD.[134] This renders the WNR unable to correct for changes in customer usage because of fuel switching or newer energy efficient equipment, among others.[135] The WNR also assumes a linear slope response, as opposed to the SRLE's more dynamic process that accounts for breakpoints and seasonal affects.[136] Finally, the structure of the WNR works against customers pursuing energy efficiency, as its design would actually result in a customer who engaged in conservation efforts repaying the company for that customer's reductions in usage from year to year, as adjusted for the number of heating and cooling degree days.[137]

The WNR's application to individual customers as opposed to customer classes raises concerns on multiple fronts. By operating the WNR on an individual level instead of a class level, Empire created a disconnect between the weather normalization process in the case and the process utilized in the WNR.[138] As an example, the weather normalization process in this case has temperature breakpoints where a class' response to weather changes.[139] The proposed WNR has no such breakpoints; it assumes a strictly linear response.[140] Additionally, the weather normalization process in this case is based

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[132] *Id*, P. 3, ll. 12-18.
[133] *Id.,* P. 2-3.
[134] *Id.* P.4.
[135] *Id.*
[136] *Id.*
[137] Ex. 136,Surrebuttal Testimony of Sarah L.K. Lange, P. 5.
[138]Ex. 123, Rebuttal Testimony of Michael L. Stahlman, P. 2.
[139] *Id.*
[140] *Id.*

on a whole customer class's response to weather, while the proposed WNR adjustment is specific to individual customers.[141] Another complicating factor is the large number of estimated bills in this case.[142] However, Empire's WNR relies on each customer's actual usage to estimate the normal usage.[143] Empire's proposed WNR is customer specific and not a rate developed based on usage for an entire class; thus missing key months' data can have a large impact on a customer's base load usage estimate.[144] An additional concern is the proposal on how to calculate the "base load factor" for customers without any billing history.[145] The proposed tariff states "if a customer has no billing history for shoulder months, then the average daily electric usage for shoulder months for the rate schedule under which the customer is served will be used."[146] This means a customer's calculated usage may bear no resemblance to their actual usage.[147] Finally, as the proposed WNR adjusts, on an individual basis, usage from the prior billing period, it may constitute prohibited retroactive ratemaking.[148] The individual customer adjustment to future bills based on an individual's prior bill also is a violation of the filed rate doctrine.[149] Under Empire's approach, an individual customer will not know what effective rate that customer will have to pay for usage in the next billing cycle, as that month's charge will be calculated based on a prior billing cycle's usage.[150] Without a filed, published rate, or ability to calculate the usage that rate is based on before that usage occurs, customers cannot make decisions to react or plan for that charge.[151]

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[141] *Id.*
[142] *Id.* P.4.
[143] *Id.*
[144] *Id.*
[145] *Id.* P.5.
[146] Proposed Tariff Sheet P.S.C. Mo. No. 5 Sec. 4 Original Sheet No. 25a.
[147] Ex. 123, Rebuttal Testimony of Michael L. Stahlman, P. 5.
[148] ***Lightfoot v. City of Springfield,*** 361 Mo. 659, 669, 236 S.W.2d 348, 353 (Mo.1951).
[149] ***State ex rel. AG Processing, Inc. v. Public Service Com'n ex rel. State*** Missouri Court of Appeals, Western District, 311 S.W.3d 361 (Mo. 2010).
[150] *Id.*
[151] *The filed rate doctrine's rule against retroactive ratemaking has an underlying policy of predictability, meaning that if a utility is*

The WNR is impractical and unclear. Aside from previously noted issues with the "base load factor" calculation, the calculation raises other questions due to its muddled nature. The proposed tariff states that a customer's base load usage will be the two year average of the lowest month's usage in a shoulder period.[152] Since there are two shoulder periods in a calendar year, this means that the base load usage will be determined as the average of four months.[153] However, even these two shoulder periods have HDD and CDD for each month.[154] For there to be no HDD or CDD, every day in that month would need an average temperature of 65 degrees, an unfortunately unlikely event for Missouri.[155] This means that Empire is not capturing the "base usage", and raises questions on how this interplay would factor into a customer's bill in a shoulder period—what will Empire assume a customer's billed usage should have been for a shoulder month with both HDD and CDD, and how does this factor into future base load factors?[156] Finally, Empire's WNR, as well the weather adjustment normalization rider (WNAR) used for certain gas utilities, are incompatible with the establishment of a throughput disincentive (TD), either through an approved Missouri Energy Efficiency Investment Act (MEEIA) plan or other utility sponsored energy efficiency programs.[157] However, the modified SRLE, as explained in detail later in this brief, is compatible with a TD, which, among other reasons outlined later, make it the preferred option.

Fortunately, much of the debate regarding the appropriate Section 386.266.3 mechanism to adjust for impacts due to conservation and weather is rendered moot by

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bound by the rates which it properly filed with the appropriate regulatory agency, then its customers will know prior to purchase what rates are being charged, and can therefore make economic or business plans or adjustments in response; in other words, the approved tariffs are to provide *advance notice to customers of prospective charges, allowing the customers to plan accordingly.311 S.W.3d 361*

[152] Ex. 123, Rebuttal Testimony of Michael L. Stahlman, P. 4.

[153] *Id.*

[154] *Id.*

[155] *Id.*

[156] *Id.*

[157] Ex. 160, Supplemental Testimony of Robin Kliethermes, P. 3.

the existence of the non-unanimous stipulation and agreement. If the Commission finds the answer to the threshold question of, should Empire implement this type of rate adjusting mechanism, is yes, then the most reasonable course of action is to authorize the SRLE as modified by the non-unanimous stipulation and agreement, supported by all the parties, except OPC. Even Empire has disavowed its WNR in favor of the modified SRLE that appropriately balances the interests of the stakeholders, the Company and the ratepayers. The record supports rejecting the WNR and ordering the modified SRLE.

b. ***Is it lawful for the Commission authorize Empire to implement a Sales Reconciliation to Levelized Expectations ("SRLE") mechanism, such as those Staff and Empire are proposing in this case?***

Consistent with the *Global Stipulation*, the Commission can authorize the SRLE mechanism, as the Commission has previously promulgated rules governing applications for rate cases.[158] As a general rate case is the only avenue for a utility to request a SRLE mechanism,[159] these application requirements also govern the SRLE request. The Commission has already utilized this process to authorize rate adjustment mechanisms under Section 386.266.3. No specific, standalone rules regarding applications under Section 386.266.3 was deemed necessary in those prior cases, and no such rules were in place for gas applications, similar to electric applications. In Case No. GR-2019-0077, *In the Matter of Union Electric Company d/b/a Ameren Missouri's Tariffs to Increase Its Annual Revenues for Natural Gas Service*, the parties, including OPC, stipulated to the creation of a Volume Indifference Reconciliation to Normal Rider (VIRN) under the auspices of Section 386.266.3.[160] The VIRN and

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[158] 20 CSR 4240-3.030.
[159] 386.266(5) RSMo.
[160] See Case No. GR-2019-0077, First Amended Non-unanimous Stipulation and Agreement, filed

the SRLE have a consistent design and interpretation of "conservation".[161] The Commission approved this stipulation on August 21, 2019.[162] In Case No. GR-2017-0215, *In the Matter of the Laclede Gas Company's Request to Increase Its Revenues for Gas Service* and GR-2017-0216, *In the Matter of the Laclede Gas Company d/b/a Missouri Gas Energy's Request to Increase Its Revenues for Gas Service*, the Commission authorized a Section 386.266.3 compliant weather normalization adjustment rider filed utilizing the rate case application process.[163] Case No. 2018-0013, *In the Matter of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities' Tariff Revisions Designed to Implement a General Rate Increase For Natural Gas Service in the Missouri Service Areas of the Company*, was resolved when OPC, and the other parties, filed a unanimous stipulation and agreement that included a WNAR.[164] The Commission approved the stipulation and agreement on June 6, 2018.[165] There are no statutory distinctions to be drawn between gas utilities and electric utilities to allow for disparate treatment. At this time, OPC has not filed any motions in the aforementioned gas cases or opened complaint cases regarding, under OPC's current interpretation, the unlawful propagation of mechanisms accounting for weather and conservation mechanisms. This includes the Ameren Gas VIRN, which, as noted, is structured almost identically to the SRLE. The rules regarding rate case applications are currently adequate to provide a process for parties receiving the necessary evidence and fair opportunity for hearing to evaluate a rate stabilization mechanism. The Commission can lawfully authorize the

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July 18, 2019.

[161] Ex. 160, Supplemental Testimony of Robin Kliethermes, P. 4.

[162] See Case No. GR-2019-0077, Order Approving Stipulations and Agreements, and Compliance Tariff, effective September 1, 2019.

[163] See Case No. GR-2017-0215 and GR-2017-0216, Amended Report and Order, issued March 7, 2018.

[164] See Case No. 2018-0013, Unanimous Stipulation and Agreement, filed May 24, 2018.

[165] See Case No. 2018-0013, Order Approving Stipulation and Agreement.

SRLE, much like rate stabilization mechanisms the Commission lawfully authorized in prior cases.

b. ***Should the Commission adopt Staff's Sales Reconciliation to Levelized Expectations Proposal ("SRLE") or approve the SRLE with modifications as suggested by the Company?***

The Commission should adopt the modified SRLE outlined in the non-unanimous stipulation and agreement. The modified SRLE sprang from, and is still supported by, the Staff's testimony regarding its SRLE. The modified SRLE does not suffer from any of the issues plaguing the WNR, and fairly balances the needs of the Company with the ratepayers' right to just and reasonable rates. However, if the terms of non-unanimous stipulation and agreement are not accepted as the resolution to the case, Staff recommends adoption of its original SRLE, as described in testimony.

Staff began its development of the SRLE by reviewing Empire's cumulative frequency distribution data to determine a level of usage per customer per month that is constant all year, and therefore, can be reasonably assumed to be unaffected by weather or conservation.[166] Staff determined this level of usage to be 400 kWh for residential customers.[167] The selection of the 400kWh level represents balancing the opportunity for additional revenues associated with customer growth (and retaining customer risk associated with customer losses) with covering the changes in gross usage associated with the impacts of weather and conservation pursuant to the statute.[168] Staff repeated the analysis for the small business classes. Staff reviewed the number of customers

[166] Ex. 104: Staff Class Cost of Service Report, P. 6 – 7.
[167] *Id.* P. 7.
[168] Ex. 136: Surrebuttal Testimony of Sarah L.K. Lange, P. 2.

taking service on the CB and SH rate schedules per level of usage, as CB stand-alone, SH stand-alone, and with the classes combined.[169] The maximum level of consistent usage was 700 kWh per customer per month under all three approaches.[170] For residential customers, the SRLE works by, on an annual basis, reconciling the revenues realized from sales in excess of 400 kWh per customer per month, less the FAC base factor and any other applicable riders or rates charged or credited on a per-kWh basis to the revenues that were assumed to be realized in aggregate from those sales, less the FAC base factor and any other applicable riders or rates charged or credited on a per-kWh basis.[171] This aggregate amount will be trued-up against actual sales on an annual basis.[172] So if an atypically mild winter is experienced in the same annual period as an atypically warm summer, the resulting SRLE adjustment will net these offsetting impacts.[173] Similarly, Staff's CB/SH reconciles, on an annual basis, the revenues realized from sales in excess of 700 kWh per customer per month, less the FAC base factor and any other applicable riders or rates charged or credited on a per-kWh basis, to the revenues that were assumed to be realized in aggregate from those sales, less the FAC base factor and any other applicable riders or rates charged or credited on a per-kWh basis. [174]

Reconciling on annual basis is preferable to Empire's WNR's monthly basis. Customers and the utility benefit from fewer filings and rate changes.[175] As the rate design of residential rate schedules continues to modernize and shift towards incenting

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[169] Ex. 104: Staff Class Cost of Service Report, P. 8.
[170] *Id.*
[171] *Id.* P. 11-12.
[172] *Id.* P. 12.
[173] *Id.*
[174] *Id.* P. 14.
[175] *Id.* P. 16.

behaviors that will reduce overall system costs, avoiding discouragement of those incentives by frequent shifts of total experienced rates due to changes in FAC and other rider rates, and is accomplished by the modified SRLE's annual approach.[176] Annual reconciliation under the SRLE has a secondary effect of smoothing some of the revenue and customer bill volatility that the FAC introduces through its operation within the integrated market paradigm that arose shortly after the FACs were implemented for Missouri electric utilities.[177]

The modified SRLE supports the encouragement of energy efficiency as well. The SRLE eliminates the throughput disincentive, regardless of whether Empire promulgates energy efficiency programs pursuant to MEEIA[178] or otherwise, for the Residential, CB, and SH rate schedules.[179] Currently, the "TD" adjustment found in the mechanisms of other utilities involves a complicated and complex analysis, which the SRLE would simplify and improve upon. As explained in the supplemental testimony of Staff expert Robin Kliethermes;

> The accuracy of the MEEIA TD design is contingent on the accuracy of the underlying data and assumptions, which are then aggregated for class level

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[176] *Id.*

[177] For example, if winter weather is colder than normal, it is likely that Empire's sales will be up, and Empire will collect more revenue than under normalized conditions. However, Empire will have likely experienced higher Total Energy Costs under the FAC, due to procurement of more energy and at a higher cost from the integrated market than would have occurred under normalized conditions. In some but not all circumstances these additional costs of energy to serve load may be offset by the net proceeds of sales from Empire's generation fleet. However, given Empire's capacity position, it is likely that the additional revenues net of fuel of selling additional energy at a higher price will not fully offset the additional costs of obtaining more energy at a higher price to serve its load. So, in the short term, each Empire customer who used more energy in the colder month will pay a bigger bill in the cold month because they used more energy, and Empire will receive more non-FAC revenue than it would under normalized conditions. Then, a few months later, all Empire customers will see an increase in the FAC portion of their bill because Empire paid more for the energy it bought to serve those customers, offset by any additional profit Empire made selling energy into the market, and Empire will receive the FAC revenue. The reverse of this is also applicable to milder-than-normal conditions, when customers will pay lower bills, and Empire will receive lower revenues, through both base rates and the FAC rider. Thus, as currently implemented the FAC exacerbates revenue and bill volatility associated with changes in energy consumption due to weather – but it spreads it out over time. Spreading out the SRLE over an annual period allows for an offset of FAC-induced volatility as it relates to changes in the FAC associated with weather-related energy price volatility.

[178] Section 393.1075, RSMo.

[179] *Id.* P. 12.

Residential impact, and remaining total company impact. At a minimum, the following information or assumptions are necessary for a properly designed TD:

- An estimation of the timing of when each measure was actually used or installed. For example, were 12 lightbulbs simultaneously installed on the date of purchase?
- The impact of each energy efficiency measure in an average or series of typical installations. For example, it is fairly easy to determine the level of kWh savings per hour of operation of Lightbulb A versus Lightbulb B. It is less easy to determine a representative average kWh savings of Air Handler A versus Air Handler B. The HVAC professional may know with relative certainty that B is 20% more efficient than A, but the TD analyst must know what number to take 20% off of.
- It is not easy to determine the number of hours a particular customer operates a particular device, or the circumstances associated with its operation that could lead to changes in its usage. Even if we know lightbulb A consumes 100 kWh less than lightbulb B if operated for a month of 720 consecutive hours, we do not know how many hours the lightbulbs under the program will be on, or when they are installed, or what type of lightbulb it is replacing, if any. Another example, an old dryer was being limped along and functioned relatively poorly, but upon purchase of the new dryer, the customer begins washing towels and sheets more frequently.
- The rate impact of applicable changes in usage as it relates to non-flat rate designs may be skewed. Even within a class, the avoided sale of a kWh for

customer A may come at a different price than the avoided sale of a kWh for customer B. To accomplish TD calculations in a timely manner and with consistency, these rates are locked down – which may lead to absurd results or obvious but incurable inaccuracies.

- The outputs of the above 4 assumptions must then be summed up over all energy efficiency measures installed within the time period of the MEEIA Cycle which magnifies the errors and inaccuracies of each assumption. If the assumptions were right, then the result would be that the dollar value of the change to the utilities' revenues would allow the utilities to be in the same position – revenue wise –as though MEEIA savings never happened. This end point of the TD is the starting point of the SRLE.

A laborious and contentious process of rate case annualizations and rebasing is necessary during the compliance phase of each rate case to back out these impacts. The SRLE avoids all of the above. At the time the TD was recommended in other utilities' MEEIA Cycle 2 cases, the SRLE was not legislatively authorized. If the SRLE had been legislatively authorized, it is reasonable that Staff would have recommended the SRLE instead of the TD.[180]

As the modified SRLE avoids the pitfalls of Empire's WNR, and provides additional benefits in the form of smoothing FAC volatility and demystifying and improving the accuracy of the TD, the Commission should authorize Empire to utilize the mechanism as outlined in the non-unanimous Stipulation and Agreement.

Nicole Mers

[180] Ex. 160, Supplemental Testimony of Robin Kliethermes, P. 3-4.

FAC

Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

a. What is the appropriate incentive mechanism in Empire's FAC for sharing between Empire and its retail customers the difference between its actual and base net fuel costs?

Staff[181] and Empire[182] request that the Commission order continuation of the 95% / 5% FAC sharing mechanism, which the Commission has consistently ordered. The Office of Public Counsel advocates for an 85% / 15% sharing ratio.[183]

Under the 95% / 5% sharing ratio, actual FAC costs are compared to estimated FAC costs following a FAC Accumulation Period. If estimated costs exceed actual costs, 95% of the difference is returned to customers. If actual costs exceed estimated costs, 95% of the difference is recovered from customers. Since passage of the FAC statute, § 386.266, RSMo,[184] the Commission has considered various sharing percentages from various parties – including Staff – and determined that a 95% / 5% sharing mechanism creates sufficient incentive for utilities to manage their FAC costs while also

[181] *Statement of Positions*, P. 16 (Apr 17, 2020).
[182] *Statement of Positions of the Empire District Electric Company*, P. 10 (Apr 17, 2020).
[183] *Public Counsel's Positions on Jointly Listed Issues*, P. 7-8 (Apr 17, 2020).
[184] Section 386.266.1, RSMo states:
Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation. The commission may, in accordance with existing law, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities.

acknowledging the FAC's purpose of allowing utilities to recover their prudently incurred FAC costs.[185]

The Commission approved Empire's FAC in Case No. ER-2008-0093, establishing a 95% / 5% ratio sharing mechanism. The Commission found that allowing Empire to pass 95% of its prudently incurred fuel and purchased power costs, above those included in its base rates, through a FAC was appropriate. The Commission stated:

> This incentive clause will give Empire a sufficient opportunity to earn a fair return on equity as required by Section 386.266 and the Hope and Bluefield decisions. At the same time, it will protect Empire's customers by giving the company an incentive to be prudent in its decisions by not allowing all costs to simply be passed through to customers.[186]

In all Empire general rate cases since then, the Commission has ordered a 95% / 5% sharing ratio either through a report and order[187] or by adopting the parties' stipulations.[188] Through its review in this case, and previous reviews in Empire prudence review cases, Staff found no reason to recommend changing the sharing mechanism at this time. It is Staff's opinion that Empire is managing its fuel and purchased power costs effectively. For all these reasons, Staff continues to recommend the current 95% / 5% sharing mechanism.[189]

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[185] For a listing of FAC sharing proposals other than 95% / 5%, *see* Ex.112: *Rebuttal Testimony of Brooke Mastrogiannis*, Sch. BM-r1 (Mar 3, 2020).
[186] *Report and Order*, ER-2008-093, P. 47 (Jul 30, 2008).
[187] *Report and Order*, ER-2014-0351, P. 30 (June 24, 2015).
[188] *Order Approving Unanimous Stipulation and Agreement*, ER-2010-0130 (May 19, 2010); *Order Approving Global Agreement*, ER-2011-0004 (June 1, 2011); *Order Approving Stipulation and Agreemen*t, ER-2012-0345 (Feb 27, 2013); and *Order Approving Stipulation and Agreement*, ER-2016-0023 (Aug 10, 2016).
[189] Ex. 112: *Rebuttal Testimony of Brooke Mastrogiannis*, P. 3 (Mar 3, 2020).

b. What is the appropriate base factor?

Consistent with the *Global Stipulation and Agreement*, Staff supports no change to the current base factor of $0.02415/kWh.[190] The Commission approved this base factor in Empire's last general rate case, ER-2016-0023, and the components of the base factor in ER-2016-0023 and Staff's proposal in this case are generally the same.[191] They include variable fuel and purchased power costs and 50% of MISO costs and 34% of SPP transmission costs. These costs do not include fixed labor or administrative costs, such as SPP Schedule 1-A and SPP Schedule 12 costs. OPC states that Staff should recalculate the base factor removing Asbury fuel costs and revenues.[192]

During settlement negotiations Staff reviewed Empire's last seven Fuel Adjustment Rate ("FAR") filings filed since Empire's prior general rate case, to compare actual costs to the net base. Staff found that Empire under-recovered in four Accumulation Periods ("APs") and over-recovered in the other three. Because there is no consistent under- or over-recovery, it appears that the base factor is balanced. For these reasons, Staff supports the *Global Stipulation and Agreement* with no change to the current base factor. However, if the Commission does not approve the Global Agreement, Staff recommends that the Commission order Staff's trued-up base factor of $0.02333/kWh.[193]

c. What costs and revenues should flow through Empire's FAC, including, but not necessarily limited to, the following?

i. What is the appropriate percentage of transmission costs for the FAC?

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[190] *Global Stipulation and Agreement,* P. 3 (Apr 15, 2020), and Ex. 161: *Supplemental Testimony of Brooke Mastrogiannis*, P. 2 (May 6, 2020).
[191] Specific components for Staff's base factor calculation in this rate case are addressed and defined in Ex. 101: *Staff Class Cost of Service Report*, P. 38-39 (Jan 29, 2020). Also, to see the difference in components between the Global Agreement FAC base factor compared to Staff's trued-up FAC base factor, *see* Ex. 161: *Supplemental Testimony of Brooke Mastrogiannis*, Sch. BM-sup-1 (May 6, 2020).
[192] *Public Counsel's Positions on Jointly Listed Issues*, P. 9 (Apr 17, 2020).
[193] Ex. 161: *Supplemental Testimony of Brooke Mastrogiannis*, P. 3 (May 6, 2020).

Consistent with the *Global Stipulation and Agreement*, Staff's position is that there should be no change to the FAC base factor, therefore there should be no change to the percentage of transmission costs included in the FAC.[194] They should remain the same as they are now, which is 34% for SPP costs, 50% for MISO transmission costs, and nothing for transmission revenues.[195] OPC's position is generally the same, excluding SPP costs related to Asbury.[196]

Staff's position is consistent with Missouri law and prior Commission rulings which allow only transportation costs related to purchased power to flow through the FAC. Section 386.266.1, RSMo states that the purpose of a FAC is to "reflect increases and decreases in [a utility's] prudently incurred fuel and purchased-power costs, including transportation." Interpreting this clause, the Commission stated that it limits the costs that can be flowed through the FAC for recovery between rate cases. It allows for recovery of transportation costs, which has been determined to include transmission costs, but such transmission costs are limited to those connected to purchased power costs.[197]
The Commission has repeatedly stated in prior report and orders that these transmission costs are limited to two types:

1) Costs to transmit electric power [the utility] did not generate to its own load (true purchased power) and
2) Costs to transmit excess electric power it is selling to third parties to locations outside of its RTO (off-system sales).[198]

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[194] *Global Stipulation and Agreement,* P. 3 (Apr 15, 2020).
[195] *Statement of Positions*, P. 18 (Apr 17, 2020).
[196] *Public Counsel's Positions on Jointly Listed Issues*, P. 8 (Apr 17, 2020).
[197] *Report and Order*, ER-2014-0258, P. 114-115 (Apr 29, 2015).
[198] *Report and Order*, ER-2014-0258, P. 115 (Apr 29, 2015) and *Report and Order*, ER-2014-0351, P. 28 (June 24, 2015).

Staff proposes that only transmission costs associated with "true" purchased power and off-system sales be recovered in Empire's FAC, consistent with statutory and Commission authority. Therefore, not all purchased power and third party sales should be included in the FAC.[199]

Further, Staff's position is that it is not appropriate to include transmission revenues in the FAC. This is consistent with Commission treatment in past Empire rate cases, along with Evergy Missouri West and Evergy Missouri Metro rate cases.[200]

ii. What, if any, portion of the MJMEUC contract should be included or excluded from the FAC? Should the Company provide any additional reporting requirements within its FAC monthly reporting in regards to MJMEUC?

Consistent with the *Global Stipulation and Agreement*, Staff's position is that revenue from Missouri Joint Municipal Electric Utility Commission ("MJMEUC") contracts should be excluded from the FAC, along with a reduced portion of fuel expenses for the energy purchased by Liberty-Empire specifically for the cities within the MJMEUC agreement.[201] OPC's position is that MJMEUC income should be treated as any contract for the sale of power and should be included in the FAC.[202]

Revenue from the MJMEUC contracts should not flow through the FAC because the definition of Off-System Sales Revenue ("OSSR") in Empire's FAC tariff explicitly excludes revenue from full and partial requirement sales to municipalities. A MJMEUC contract is a "full and partial requirement sales to municipalities" contract.

[199] Ex.112: *Rebuttal Testimony of Brooke Mastrogiannis*, P. 4 (Mar 3, 2020).
[200] Ex. 112: *Rebuttal Testimony of Brooke Mastrogiannis*, P. 4 (Mar 3, 2020) and Ex.137: *Surrebuttal/True-Up Testimony of Brooke Mastrogiannis*, P. 5 (Mar 27, 2020).
[201] *Global Stipulation and Agreement,* P. 4 (Apr 15, 2020) and *Statement of Positions*, P. 18 (Apr 17, 2020).
[202] *Public Counsel's Positions on Jointly Listed Issues*, P. 9 (Apr 17, 2020).

Staff's position is that MJMEUC revenues will offset lost revenues from the current municipal customer contracts, and Empire should retain this revenue until allocations are reexamined in its next general rate case. Empire proposed to include the revenues in the FAC if there was an established Accounting Authority Order ("AAO") to account for the jurisdictional allocations between rate cases. [203] However, Staff is opposed to establishing this AAO.[204] Staff recommends that Empire file additional reporting with its FAC monthly reports and Fuel Adjustment Rate filing workpapers. Empire's monthly FAC submissions should include a detailed listing of all the costs incurred due to the MJMEUC contracts and the revenues that Empire receives from MJMEUC including, but not limited to, revenue for energy generated, revenue for capacity, and reimbursement of fuel, variable O&M, and start-up costs. This additional reporting will demonstrate that the energy purchased from Liberty-Empire related to the MJMEUC agreement will be billed to the cities (Staff understands these cities to be Monett and Mr. Vernon, Missouri.) via MJMEUC and will reduce a portion of the fuel expenses allocated and billed to Liberty-Empire's retail customers. This reduced portion of fuel expense will clearly illustrate that the energy purchased for these specific cities via MJMEUC is not flowing through the FAC in order to be collected from all Liberty-Empire retail customers.[205]

iii. Should any short-term capacity costs flow through the FAC from the effective date of this rate case?

Consistent with the *Global Stipulation and Agreement*, Staff's position is that short-term capacity costs should not flow through the FAC from the effective date of this

[203] Ex. 20: *Rebuttal Testimony of Aaron J. Doll*, P. 8 (Apr 17, 2020).
[204] Ex.106: *Rebuttal Testimony of Kimberly K. Bolin*, P. 7-9 (Mar 3, 2020).
[205] Ex.137: *Surrebuttal/True-Up Testimony of Brooke Mastrogiannis*, P. 4 (Mar 27, 2020).

rate case. In addition, Empire should remove the provisions allowing short-term capacity costs to flow through the FAC until June 1, 2021.[206] OPC is in agreement.[207]

Karen Bretz

Customer Service

a. Is Empire providing satisfactory customer service?

Empire's customer service, particularly at its contact center and in its billing practices, is below expectations. As will be explained, Staff is also concerned about the above average number of bills Empire issues based on estimated usage. Staff found that Empire's customer service deterioration began in 2017 shortly after Empire merged with Liberty Utilities (Central) Co. and Liberty Sub Corp., although it was not until 2018 that unsatisfactory performance became a concern. Call center performance issues and the high number of estimated billings is attributable to staff turnover, and turnover is common during mergers. Despite the level of concerns with Empire's previous service, Staff believes that Empire is taking appropriate actions to address contact center performance and the high number of estimated billings for the future.[208] The *Global Agreement* filed by the parties and not objected to by all parties except OPC, includes several provisions agreed to by the parties to preserve good customer service for the future.[209]

Consistent with a 2004 stipulation, Empire has submitted monthly contact center data (staff levels, call volumes, average speed of answer, and abandoned call rates) and regularly met with Staff to discuss customer service.[210] Meeting with Staff regarding

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[206] *Global Stipulation and Agreement,* P. 3 (Apr 15, 2020) and *Statement of Positions*, P. 19 (Apr 17, 2020).
[207] *Public Counsel's Positions on Jointly Listed Issues*, P. 9 (Apr 17, 2020).
[208] Ex. 101: *Staff Cost of Service Report*, P. 101-102 (Jan 15, 2020).
[209] *Global Stipulation and Agreement*, P. 5-6 (Apr 15, 2020).
[210] *Stipulation and Agreement as to Certain Issues*, ER-2004-0570, P. 4 (Dec 22, 2004).

contact center quality was also a provision in the stipulation in the Empire-Liberty merger.[211] Despite this, Empire's call center performance is underwhelming. For example, Empire's statistics indicate an abandoned call rate of 4% and an average answer speed of 44 seconds in September 2019, in contrast to its goals of 5% abandoned calls and 30 second answer speed. Empire is taking remedial actions, including adding additional customer service representative positions plus a supervisor and creating a Digital Customer Experience Team to respond to customer service inquiries received through Facebook and Twitter.[212]

The number of complaints the Commission's Consumer Services Department received from Empire customers increased 120% between 2015 and 2018. Many of these complaints since 2018 are related to estimated or high billing.[213] Dissatisfaction with estimated bills was a dominant topic of customer testimony at the February 2020 local public hearings held in Bolivar, Joplin, and Branson. Testimony included the following:

> MS REED: I know when I moved to Ozark, I was gone for two weeks, and then I came back; I had everything turned off; I was in a bottom apartment; there was no usage, everything turned off, everything unplugged. My bills were normally 50, 60 bucks a month.
> I came back and got a bill for 220. I had to call back in, because at this point I had already known that they don't read meters half the time. And the lady finally admitted, "Yeah, we just estimate. This is what your neighbors, you know, used. How do you want to pay that?"
> It's like, "No. Come read my meter."
> She's like, "Well this is probably close to yours."
> "No, I haven't been here for almost three weeks in a month. Everything is turned off and unplugged. It's not mine. Come read it."
> Finally, they showed up, they read it, and I got a $30 bills, which is what was owed.

[211] *Staff Stipulation and Agreement*, EM-2016-0213, P. 10 (Aug 4, 2016).
[212] Ex. 101: *Staff Cost of Service Report*, P. 101-102 (Jan 15, 2020).
[213] Ex. 126: *Surrebuttal Testimony of Gary Bangert*, P. 2 (Mar 27, 2020).

So there's something that needs to be reviewed. I think people, morality-wise, would feel better, even with the rate increase, with using a company that would go out of their way to actually check their bills and not be pulling teeth to have to get someone to come out and read what you're using.[214]

And:

> MR. BARD: Come to find out, a couple days ago, I sat down with a gentleman that actually works for Liberty. My bill had been estimated eight times last year. So, you know, to me, when an estimation happens, whether you come out and read my meter in July during the peak time, what's that tell you for the rest of the year?
>
> MS. PAYNE: Mr. Bard, was there any kind of indication on your bill that it had been estimated?
>
> MR. BARD: Yes.
> JUDGE CLARK: So your bills did say they had been estimated?
> MR. BARD: Well, when they finally came out and reconciled it, yeah.
> MS. PAYNE: Okay. But the bills that you would receive that you later learned had been estimated didn't indicate that that was estimated?
> MR. BARD: No, not until October -- October, when there was finally a nice, long list of all the estimates.[215]

Also:

> JUDGE CLARK: So you had an estimated bill and you contacted the Company, and I guess they either sent out a meter-reader or did a meter reading of some kind, and then you said it went down by a fairly large percentage. Would you care to estimate that percentage?
> MS. MCCARTHY: I wouldn't know exactly the percentage unless I had a calculator readily available, but I will say that it went down from about $400 to about 238. And so that was the combined bill. So I had already paid the water bill, because they didn't have to send out a meter-reader for that, and so that was not on the next bill that came out when they did the cancel/re-bill because I already paid it.
> So the electricity portion, though, went down from I think -- I wish I brought my bill. But I think it went down from about 350 -- because the water was about 50-ish, went down from about 350 to 238. So significantly. And it justified, you know, that family living there, whereas before I was like, this cannot be possible.[216]

[214] *Local Public Hearing, Bolivar, MO*, P. 40-42 (Feb 3, 2020).
[215] *Local Public Hearing, Joplin, MO*, P. 36-38 (Feb 3, 2020).
[216] *Local Public Hearing, Branson, MO*, P. 50-51 (Feb 4, 2020).

Commission rules permit utilities to render bills based on estimated usage for specific reasons, such as extreme weather conditions, emergencies, labor agreements, or work stoppages[217] and "[w]hen the utility is unable to obtain a meter reading for reasons beyond the utility's reasonable control."[218] These events do not explain the high number of estimated bills. Staff notes a correlation between the number of estimated billings and the number of meter readers. Actual meter reading staffing was not at authorized staffing levels when Empire reports frequently estimating meter readings.[219] Empire's authorized meter reading staff (Empire and contract personnel combined) has been 25 since January 2017.[220]

For example, Empire estimated a monthly average of 677 bills from January 2017 to October 2017. From November 2017 to December 2018 a monthly average of 12,630 bills were estimated – an approximately 1,766% increase – and contract meter reading staffing level averaged 23.4 persons per month.[221] The number of estimated bills returned to a more normal level between January 2019 and June 2019. But then they dramatically increased from July 2019 to December 2019 to an average of about 13,097 estimated bills per month, as the number of meter readers dropped to as low as 22. The number of estimated bills sharply decreased to 5668 in January 2020 and 1179 in February 2020, when there were 27 meter readers. From this, it appears that Empire's efforts to maintain meter reader staffing levels has a direct bearing on the number of

[217] 20 CSR 4240-13.020(2)(A)2.
[218] 20 CSR 4240-13.020(2)(A)3.
[219] Ex. 126: *Surrebuttal Testimony of Gary Bangert*, P. 5 (Mar 27, 2020).
[220] Ex. 126: *Surrebuttal Testimony of Gary Bangert*, P. 4-5 (Mar 27, 2020).
[221] Ex. 126: *Surrebuttal Testimony of Gary Bangert*, P. 3-5 (Mar 27, 2020) and Ex. 155: *Supplemental Testimony of Gary P. Bangert*, P. 5 (May 6, 2020).

estimated readings. Maintaining adequate meter reading staffing levels is a controllable factor that is essential for minimizing the number of estimated bills.[222]

Related to the estimated bill issues, Staff found that Empire

- Does not consistently include a clear notation on customers' bills indicating that they are based on estimated usage, in violation of 20 CSR 4240-13.020(2)(C)5;[223]
- Was not communicating required information to customers receiving estimated bills for three consecutive billing periods, in violation of 20 CSR 4240-13.020(3);[224] and
- Was not consistently offering customers an appropriate amount of time to pay account balances resulting from underestimated usage, in violation of 20 CSR 4240-13.025(1)(C),[225]

Additionally, through the informal complaint process, Staff became aware that Empire exceeded the maximum allowable number of days in a billing period on several occasions, in violation of 20 CSR 4240-13.015(1)(C).[226]

i. If not, what should the Commission order to ensure better customer service?

Regarding call center performance, the Commission should order Empire to establish a deadline for meeting its contact center performance goals and communicate its progress to Staff in its monthly reports and periodic meetings. Developing a deadline

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[222] Ex. 126: *Surrebuttal Testimony of Gary Bangert*, P. 4-5 (Mar 27, 2020).
[223] 20 CSR 4240-13.020(2)(C)5 states: "A utility shall clearly and conspicuously note on the bills that it is based on estimated usage[.]"
[224] 20 CSR 4240-13.020(3) states: "If a utility is unable to provide an actual meter reading for three (3) consecutive billing periods, the utility shall advise the customer by first class mail or personal delivery that the bills being rendered are estimated, that estimation may not reflect the actual usage, and the customer may read and report their electric, gas, sewer, or water usage to the utility on a regular basis."
[225] 20 CSR 4240-13.025(1)(C) states: In the event of an undercharge, the utility shall offer the customer the option to pay the adjusted bill over a period at least double the period covered by the adjusted bill."
[226] 20 CSR 4240-13.025(1)(C) states: Billing period means a normal usage period of not less than twenty-six (26) nor more than thirty-five (35) days for a monthly billed customer … except for initial, corrected, or final bills[.]"

to achieve contact center goals should help ensure that satisfactory performance occurs in a timely manner. Staff will monitor Empire's actions and progress toward restoring contact center performance to pre-merger levels.[227]

Based on the parties' *Global Agreement*, regarding estimated billing practices, maintaining adequate meter reading staff levels, and correcting practices related to several rule violations, the Commission should order Empire to do the following for years 2020, 2021 and 2022:

- Incorporate data into its monthly reports to Commission Staff;
- Initiate quarterly reports to the Commission Staff and OPC regarding the number of estimated meter readings;
- Initiate quarterly reports to the Commission Staff and OPC regarding the number of estimated meter readings exceeding three consecutive estimates;
- Initiate quarterly reports to the Commission Staff and OPC regarding the number of bills with a billing period outside of 26 to 35 days; and
- Initiate quarterly reports to the Commission Staff and OPC regarding the Company and contract meter reader staffing levels;
- Evaluate the authorized meter reader staffing level and take action to maintain adequate meter reader staffing levels in order to minimize the number of estimated bills.
- Company will meet with Staff and OPC to discuss bill redesign possibilities for the future.

[227] Ex. 101: *Staff Cost of Service Report*, P. 102 (Jan 15, 2020).

- Ensure that all customers who receive estimated bills for three consecutive months receive the appropriate communication regarding estimated bills and their option to report usage as required by Service and Billing Practices, Rule 20 CSR 4240-13.020(3).
- Ensure that all customers who receive an adjusted bill due to underestimated usage are offered the appropriate amount of time to pay the amount due on past actual usage as required by Service and Billing Practices, Rule 20 CSR 4240-13.025(1)(C).
- Evaluate meter reading practices and take action to ensure that billing periods stay within the required 26 to 35 days, unless permitted by those exceptions listed in the Commission's rules.
- File notice within this case by September 1, 2020, containing an explanation of the actions the Company has taken to implement the above recommendations related to billing and bill estimates.[228]

Karen Bretz

Credit Card Fees

Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

[228] *Global Stipulation and Agreement*, P. 5-6 (Apr 15, 2020).

a. Should Empire's credit card fees be included in Empire's revenue requirement?

Staff's[229] and Empire's[230] position is that the transaction fees associated with processing customer credit card payments should be included in the revenue requirement. The Office of Public Counsel's position is that they should not.[231]

Currently, each customer paying an Empire utility bill with a credit card is charged a convenience fee. Residential customers pay a $2.25 fee, while commercial customers pay $13.00. ** ____ ** and report to Empire that ease of bill paying is a priority, which includes having no fees for credit card payments. Empire proposes to eliminate credit card convenience fees and to recover the costs associated with processing credit card payments in its cost of service, similar to the way it recovers bank fees.[232]

b. If so, what level of fees should be included?

Staff's position is that $1,308,320 (before the jurisdictional allocation factor is applied) should be included,[233] while Empire's position is that $1,297,266 (after the jurisdictional allocation factor is applied) should be included.[234] After the jurisdictional allocation factor is applied, Staff's position is $1,165,283. Staff is in agreement with Empire's first adjustment of separating the number of credit card fee transactions during the test year between residential and commercial customers and multiplying the $2.25 fee to the number of residential customer credit card transactions and multiplying the $13.00 fee to the number of commercial customer credit card transactions. However, Staff used the number of credit card fees processed during the test year (twelve months ending

[229] *Statement of Positions*, P. 19 (Apr 17, 2020).
[230] *Statement of Positions of the Empire District Electric Company*, P. 12 (Apr 17, 2020).
[231] *Public Counsel's Positions on Jointly Listed Issues*, 10 (Apr 17, 2020).
[232] Ex. 101: *Staff Cost of Service Report*, P. 103 (Jan 15, 2020).
[233] *Statement of Positions*, P. 19 (Apr 17, 2020).
[234] *Statement of Positions of the Empire District Electric Company*, P. 12 (Apr 17, 2020).

March 31, 2019) while Empire used the number of customer credit card fees processed for the twelve months ending January 31, 2020.

Empire cannot predict the number of customers that will pay using a credit card if no convenience fee is directly charged, but based on the high level of current participation, Staff and Empire anticipate that the number will increase if there is no convenience fee. This will reduce resources needed for processing mail payments, customer walk-ins and phone calls, as well as collections. Staff agrees that there is a potential savings in these areas if the convenience fee is eliminated. However, at this time Empire is unable to estimate this savings.[235]

The Commission has approved at least one request to include credit card processing fees in the cost of service.[236] If the Commission approves this, Staff recommends that Empire be ordered to track performance and savings from this initiative. Staff further recommends that Empire be required to monitor and track the number of customers using credit cards. Staff also encourages the Commission to order Empire to describe how it will inform customers that there is no fee to make their electric utility payments by credit card.

Karen Bretz

Rate Case Expense

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the

[235] Ex. 101: *Staff Cost of Service Report*, P. 104 (Jan 15, 2020).

[236] *Amended Report and Order*, In the Matter of Laclede Gas Company's Request to Increase Its Revenue for Gas Service, Case Nos. GR-2017-0215 and GR-2017-0216, 70 (Mar 7, 2018).

Global Stipulation and Agreement as a full resolution of all issues, Staff outlines its argument prior to entering into the Agreement.

The Commission has in previous cases recognized the need for investor-owned utilities to recover a reasonable amount of their rate case expense through rates and has issued orders accordingly with this recognition. The Commission has also recognized the importance of only allowing the recovery of "prudently" incurred rate case expenses.[237] While the Global Stipulation and Agreement does not specifically address rate case expense, the Agreement considers a reasonable amount of prudently incurred rate case expense. However, OPC has disputed the Agreement to the extent that rate case expense is considered as part of the Agreement.[238] Should the Commission not agree with the other parties that the Global Stipulation and Agreement is not a full resolution of all of the issues in this case, Staff argues as outlined below in regards to Rate Case Expense.

a. How much of Empire's rate case expenses should be included in Empire's revenue requirement?

Staff in this case has taken the position that the appropriate amount of Rate Case Expense to be borne by the ratepayers annually is $71,676. Staff's annual expense amount is calculated based upon a two year normalization. Staff' rate case expense amount includes the normalized cost of the depreciation study from the prior rate case, and the normalized cost of the line loss study included.[239] It is proper to include the costs of the depreciation study because Commission rules require the study to be

[237] ***In the Matter of Application for a Rate Increase Request for Liberty Utilities (Missouri Water), LLC d/b/a Liberty Utilities***, *Report and Order,* Case No. WR-2018-0170.
[238] *Public' Counsel's Positions on Jointly Listed Issues,* filed April 17, 2020.
[239] Ex. 101, *Staff's Direct Report*, P. 73; Niemeier Surrebuttal Pp. 8-.

conducted every five (5) years.[240] It is proper to include the costs of the line loss study because Commission rules require investor-owned electric utilities to factor transmission losses into their planning.[241] Staff in Supplemental Testimony provided an outline of the items and their corresponding amounts that were included in Staff's trued-up account for rate case expense.[242]

b. Should Empire's prudent rate case expenses be normalized or amortized, and over what period of time?

Staff in this case has taken the position that the prudent amount of rate case expense ordered by the Commission should be normalized over a 2 year period. Generally, Staff recommends normalizing the rate case expense for larger utilities, and the Commission has upheld this practice for Empire previously.[243] Normalization adjustments are performed to reflect normal on-going operations. Most expenses and revenues included in the cost of service are normalized. In this case, Empire does not file for a rate case every year, thus Empire will not incur this expense every year, so a normalized level of expense is calculated to determine the annual level of rate case expense that should be included in the cost of service. Rate case expense is no different than any other expense a utility incurs, thus it should treated as other expenses. In fact, rate case expense can be more controlled than other expenses, because the utility can decide when to file for a rate case.

[240] 20 CSR 4240-3.160.1(A).
[241] 20 CSR 4240-22.045.
[242] Ex. 156, *Supplemental Testimony of Kimberly K. Bolin*, P. 4.
[243] *Order Approving Stipulation and Agreement*, Case No. ER-2016-0023 (in which parties agreed to apply sharing mechanism derived from Case No. ER-2014-0370).

c. ***Should Empire's prudent rate case expenses be shared between Empire's shareholder and Empire's retail customers? If so, how?***

Staff in this case has taken the position that it is appropriate for Empire to share its prudent rate case expense between its shareholders and what is included in base rates. The expense should be shared on a 50/50 basis between Empire's shareholders and Empire's retail customers.[244] As pointed out in Staff's Direct Cost of Service Report, there is a high probability that some of the recommendations advanced by the utility in the rate case process will be found by the Commission to not be in the public interest.[245] In Case No. ER-2014-0370, a request for general rate increase by Kansas City Power & Light Company (KCP&L), the Commission found it was proper for the expenses of the company's litigation of the rate increase to be shared between the shareholders and the customers, as a rate increase benefits both parties in different manners.[246] The Western District Court of Appeals has upheld the Commission's use of the sharing mechanism when the facts of the case show it is proper to implement.[247] The facts of this case, just as the facts of Empire's previous general rate case and the KCP&L case cited, also support a sharing mechanism for the rate case expense.

Whitney Payne

Management Expense

a. ***Should any of Empire's management expenses not be included in Empire's revenue requirement?***

[244] Ex. 101, *Staff's Direct Report*, Pp. 73-76; Bolin Surrebuttal Pp. 5-7.
[245] Ex. 101, *Staff's Direct Report*, P. 74.
[246] ***In Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service v. Missouri Public Service Commission***, 509 S.W.3d 757, 778 (2016).
[247] ***In Matter of Kansas City Power & Light Company's Request for Authority to Implement a General Rate Increase for Electric Service v. Missouri Public Service Commission***, 509 S.W.3d 757, 778 (2016).

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. Staff did not take a position on this issue or address it in testimony at any point in this matter. OPC has identified this as an issue which must be decided by the Commission. Staff reserves the right to address this issue in the Responsive and Reply Briefs to the extent it is addressed by the other parties.

The Commission has inquired why Staff did not take a position on this issue, which is responded to in the *Staff Response to Commission Questions* responding to all Commission inquiries and the supplemental testimony of Kimberly K. Bolin filed in tandem with this Initial Brief. In short, Staff made its own adjustments for its recommended amount of management expenses to be included in this case in its direct filing.[248] Staff does not necessarily oppose OPC's recommendation for further adjustments, but does not agree with some of the assumptions OPC relied upon to reach its recommendation so Staff did not take an independent position on the matter.[249]

Whitney Payne

Allowance for Funds Used During Construction

a. ***What metric should be used for Empire's carrying cost rate for funds it uses during construction that are capitalized?***

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. Staff did not take a position on this issue or address it in testimony at any point in this matter. OPC has identified this as an issue which must be decided by the Commission. Staff reserves the right to address this issue in the Responsive and Reply

[248] Ex. 101, *Staff Direct Report*, P. 32.
[249] Ex. 156, *Supplemental Testimony of Kimberly K. Bolin,* P. 4.

Briefs to the extent it is addressed by the other parties. Staff accounted for that amount in its negotiations of the Global Agreement and did not agree with the further adjustments argued by OPC.

Whitney Payne

Cash Working Capital

a. ***What is the appropriate expense lag days for measuring Empire's income tax lag for purposes of cash working capital?***

Staff supports the Global Stipulation and Agreement as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the Global Stipulation and Agreement as a full resolution of all issues, Staff has taken the position in this case that an income tax expense lag of 39.38 days based on the Internal Revenue Code requirement for filing and paying corporate income taxes on a quarterly basis.[250] Staff made adjustments in its direct case to account for differences it identified between Empire's lag calculation for income tax and Staff's.[251] Staff's lag number is derived from the test year period of April 1, 2018 through March 31, 2019 and is based on the exact quarterly corporate income tax return amount plus the estimated amount of tax due dates for that period.[252] Staff generally uses the 15th day when accounting for the due date, however, two quarterly dates fell on weekends so the actual due date Staff applied for those was the 17th day instead of the standard 15th day. Empire's direct-filed number

[250] §6655 Internal Revenue Code, (requiring corporations to make quarterly income tax payments of at least 25% of the total annual payment).
[251] Ex. 101, *Staff's Direct Report*, P. 20.
[252] Ex. 101, *Staff's Direct Report*, P. 20.

differed from Staff's but in later testimony, the Company accepted Staff's calculation.[253] Staff's calculation assumes an exact even distribution of 25% of the estimated total tax Empire would expect to pay for the year in each of its required quarterly installments, also reflected in Staff's number.[254]

OPC attempts to apply its position that the lag should be 365 days or one year to Staff's calculation and claims that the resulting adjustment equals approximately $14,000,000.[255] However, Staff cannot agree that a lag of 365 days is appropriate and OPC has provided insufficient work product to support such claims in its testimony.

Whitney Payne

Accumulated Deferred Income Tax

Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

Accumulated Deferred Income Tax ("ADIT") "represents assets or liabilities for cumulative amounts of deferred income taxes resulting from differences between book accounting and income-tax accounting."[256] This allows Empire to claim accelerated depreciation in calculating its taxes,[257] which in turn would increase its ADIT.[258]

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[253] Ex. 29, *Surrebuttal and True-Up Direct Testimony of Timothy S. Lyons*, P. 2.
[254] Ex. 101, *Staff Direct Report*, P. 20.
[255] *Public' Counsel's Positions on Jointly Listed Issues*, filed April 17, 2020.
[256] ER-2014-0258, *Report and Order*, Pp 18.
[257] *Id.*
[258] Ex. 5, *Rebuttal Testimony of Sheri Richard*, Pp. 8:17-18.

Due to the use of accelerated depreciation in calculating its taxes, "the amount of depreciation expense used as a deduction for income tax purposed by Empire is considerably higher than the amount of depreciation expense used for ratemaking purposes."[259] In effect, because Empire pays less in taxes over the short-term, it is able to keep more cash. This "cost-free cash" is available to Empire between the time the ADIT is acquired and the time the increased taxes will come due. Now, because ratepayers should not be required to pay for this "cost-free cash," "Empire's rate base is reduced by the ADIT balance to avoid having customers pay a return on funds that are provided cost-free to the Company."[260]

a. Should Empire's booked accumulated federal income tax include a reduction for net operating loss?

Yes. It is Staff's position that Empire's booked accumulated federal income tax include a reduction for net operating loss ("NOL").

As described above, an ADIT is meant to offset tax liability and generate "cost-free cash." However, "when bonus depreciation and other tax deductions grow so large as to push the company's taxable income into the negative, the available tax deduction cannot offset any tax liability and no 'free' cash is generated."[261] In this situation, Empire must record an offsetting deferred tax asset for NOL. As Empire witness Sheri Richard points out in her rebuttal testimony:

> The IRS has issued numerous private letter rulings which provide that an NOL deferred tax asset resulting from accelerated tax depreciation should be

[259] Ex. 101, *Staff Direct Report*, Pp. 24:28-30.
[260] *Id*, Pp. 25:3-4.
[261] ER-2014-0258, *Report and Order*, Pp. 18.

offset against a Plant deferred tax liability also resulting from accelerated tax depreciation for ratemaking purposes.[262]

Staff witness Keith Foster further elaborates that "[g]enerally, deferred income taxes associated with all book-tax timing differences created through the ratemaking process should be reflected in rate base."[263] And, as pointed out by Empire witness Ms. Richard, "In the computation of tax expense recovered from customers through a normalized revenue requirement, accelerated depreciation is excluded, as are other book-to-tax differences which will eventually be taxable or deductible."[264]

Staff and Empire agree that this is an appropriate treatment. Empire goes on to stress that "ADIT created by bonus depreciation did not reduce current income tax payments and did not provide the company with a no-cost source of capital."[265]

Staff continues to recommend that Empire's booked accumulated federal income tax include a reduction for net operating loss ("NOL").

b. Should FAS 123 deferred tax asset for stock-based compensation be included in ADIT balances for rate base?

No. The FAS 123 deferred tax asset for stock-based compensation should not be included in rate base "since [Staff] is not including any stock-based compensation in normalized payroll levels."[266] Thus, the deferred tax impact of stock-based compensation should not be included in Staff's case as well.[267]

Travis Pringle

[262] Ex. 5, Pp. 8-9, Ln. 24 and Ln. 1-3, citing Staff Ex. 101, Pp. 36:20-22.
[263] Ex. 101, Pp. 25:4-6.
[264] Ex. 5, Pp. 8:3-6.
[265] Ex. 5, Pp. 9:4-5.
[266] Ex. 131, *Surrebuttal/True-up Direct Testimony of Keith D. Foster*, Pp. 2:6-7.
[267] *Id*, at Ln. 8.

<u>Tax Cut and Jobs Act of 2017 federal income tax rate reduction from 35% to 21% impact for the period January 1 to August 30, 2018</u>

a. *How should the Commission treat the 2017 TCJA regulatory liability the Commission established in Case No. ER-2018-0366 when setting rates for Empire in this case?*

Staff's Position: Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. Staff recommends that the *Global Stipulation* be approved, which contains provisions requiring an amortization of this regulatory liability of $5,000 on a monthly basis until Empire's next rate case, during which the amortization period for this item will be re-examined. *See* Section 3.b of the *Global Stipulation.*[268] To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

What is this issue about?

The Commission opened Case No. ER-2018-0366 on June 6, 2018, to adjust Empire's electric rates pursuant to § 393.137, RSMo., passed during the 2018 session as part of Senate Bill 564.[269] That statute authorized the Commission to adjust the electric rates of an electrical corporation in light of the recently enacted federal Tax Cut and Jobs Act of 2017 ("TCJA"). The TCJA reduced the federal income tax rate from 35 percent to 21 percent, reducing Empire's revenue requirement by $17,837,022 on an annual

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[268] "An amortization of the balance of the stub period amortization of $11,728,453, in the amount of $5,000 monthly, is included in the revenue requirement for this case. The amortization balance, and the appropriate amortization period, will be reevaluated in the next general rate case." *Global Stipulation,* § 3.b.

[269] *In the Matter of a Proceeding Under Section 393.137 (SB 564) to Adjust the Electric Rates of The Empire District Electric Company,* Case No. ER-2018-0366, (*Report & Order,* eff. Aug. 25, 2018) P. 4.

basis.[270] Empire's rates were reduced prospectively on August 30, 2018.[271] However Empire earned some $11,728,453 in excess revenues during the "stub period" between the effective date of the TCJA on January 1, 2018, and the date of its rate adjustment, August 30, 2018.[272] In Case No. ER-2018-0366, the Commission ordered Empire to defer its stub period overearnings to a regulatory liability via an Accounting Authority Order ("AAO").[273]

Since income taxes are a cost of doing business, utility customers pay the cost of the utility's income tax liability as part of their rates. However, for eight months after the effective date of the TCJA, Empire collected more money from its customers for taxes than it would actually ever owe.[274] It is Staff's position that the deferral of tax benefits ordered by the Commission that accrued to Empire as a result of the TCJA, from the effective date of the law to the date Empire's rates were reduced to reflect the TCJA (i.e., January 1, 2018, to August 30, 2018, or the "stub period"), should be passed on in rates to Empire's customers through a five-year expense amortization, with no rate base offset for the unamortized amount.[275] Although initially resisted by Empire,[276] Staff's position calling for an amortization of the stub period regulatory liability was ultimately accepted by all the signatories and embodied in the *Global Stipulation.*[277]

Why is the treatment of this issue embodied in the Global Stipulation appropriate?

Staff supports rate recovery in this case of the stub period deferral as that is generally consistent with past ratemaking granted to extraordinary events by the

[270] *Id.,* P. 13.
[271] *Id.,* P. 14.
[272] *Id.,* p. 20.
[273] *Id.*
[274] *Staff's Cost of Service Report,* pp. 55-56.
[275] Oligschlaeger Surrebuttal, p. 1.
[276] *See* Richard Rebuttal.
[277] *Op. cit.,* § 3.b.

Commission.[278] As already discussed in Staff's direct filing,[279] the Commission found enactment of the TCJA to be an extraordinary event in both Case No. ER-2018-0366 and similar cases involving other major utilities.[280] There is a long history and practice in this jurisdiction of granting deferral requests to capture as regulatory assets some or all of the financial impact of extraordinary events on the utility's balance sheet, and subsequently providing the utility with the opportunity to recover such costs in subsequent general rate proceedings. [281] In most cases, this rate recovery has been approved by the Commission through a multi-year amortization of the regulatory asset, with no rate base treatment.[282] This is what Staff recommended in this case for the stub period deferral, with one difference -- while amortization of regulatory assets increase expense and, therefore, increase customer rates, amortization of a regulatory liability amount, such as Empire's TCJA deferral, results in negative amortization expense that benefits customers by reducing overall expense recovery.[283]

There are no fundamental differences between the passage of the TCJA and the other types of extraordinary events that have been allowed rate recovery by the Commission in the past.[284] Most of the extraordinary events recognized by the Commission in the past as deserving rate recovery were in the nature of natural disasters ("acts of God"), such as floods or storms.[285] These types of events are unanticipated and unexpected, and outside of the direct control of the utility, and for that reason costs associated with such events are not included in rates on an ongoing basis.[286]

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[278] Oligschlaeger Surrebuttal, p. 2.
[279] *Staff's Cost of Service Report,* pp. 55-56.
[280] Oligschlaeger Surrebuttal, p. 2.
[281] *Id.*
[282] *Id.*
[283] *Id.*
[284] *Id.,* p. 3.
[285] *Id.*
[286] *Id.*

When incurred, these costs must be deferred as regulatory assets in order to provide utilities with a reasonable opportunity to recover all or a portion of the repair and remediation costs in rates.[287]

Similarly, the enactment of the TCJA was an event outside of Empire's control, could not be accurately forecasted in advance, and the impact of this law on Empire's income tax expense could not be, and was not, reflected in Empire's customer rates as of January 1, 2018.[288] However, instead of imposing an unexpected financial cost on the utilities, as natural disasters do, the TCJA provided Empire and other utilities with a financial windfall until such time that the benefits could be reflected in customer rates.[289]

OPC also opposed Staff's position and objected to the *Global Stipulation.*[290] OPC witness John Riley testified that the amortization proposed by Staff and accepted by the signatories was "arbitrary."[291] Mr. Riley proposed that the deferral be used to offset and reduce Empire's rate base:

> The $11.7 million represents interest free money to Empire. The Commission usually adjusts a company's rate base for its use of interest free money from its retail customers. Empire will have benefitted from the use of this interest free money for more than a year and a half by the time this case is concluded. Any unamortized balance should be a rate base offset until exhausted.[292]

He further proposed that the deferral not be amortized at all, but simply be cancelled out by being set off against a regulatory asset in Empire's rate base because this would be "cleaner."[293]

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[287] *Id.*
[288] *Id.*
[289] *Id.*
[290] *See Public Counsel's Objection to Parts of the Global Stipulation and Agreement Filed April 15, 2020,* filed on April 16, 2020.
[291] Riley Rebuttal, p. 2.
[292] *Id.*
[293] *Id.,* pp. 2-3.

Staff's proposal to amortize the deferral over a reasonable period of time is consistent with prior rate treatment of many extraordinary deferrals granted by the Commission in that it effectively "shares" the financial impact of the extraordinary event in question between the utility and its customers.[294] In the case of an "act of God," including an amortization of the costs to repair and restore a utility system in rates, but excluding the unamortized amount from rate base, serves to share the financial burden and risk of unanticipated natural disasters between utility shareholders and customers.[295] In the same manner, passing on to customers the dollar value of the TCJA tax benefits in rates over time through an amortization, but excluding the unamortized amount from rate base, effectively shares the benefit of unanticipated windfalls such as the TCJA between a utility and its customers.[296] Staff's position on this point is the most fair and equitable treatment of the impact of the TCJA for ratemaking purposes.[297]

While Staff's position in its direct case is to propose inclusion of the TCJA deferral in rates as a negative expense for customers, but not recognize the deferral in rate base, OPC is instead proposing to include the entire amount in rate base as a long-term reduction.[298] Given that the stub period represents a tax benefit received by Empire over a relatively short period of time (January – August, 2018); Staff's position of recognizing that benefit over a finite five-year period is more appropriate than including this amount in rates as a long-term reduction to rate base.[299]

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[294] Oligschlaeger Surrebuttal, P. 6.
[295] *Id.*
[296] *Id.*
[297] *Id.*
[298] *Id.*
[299] *Id.*

Conclusion

Staff's proposed treatment of this issue, embodied in the *Global Stipulation,* flows Empire's stub period over-collection back to the ratepayers, in accordance with the traditional treatment of such extraordinary matters. OPC has not articulated any compelling reason to deviate from established practice and instead adopt an unprecedented treatment. For these reasons, Staff urges the Commission to uphold the *Global Stipulation's* disposition of this issue.

Kevin A. Thompson

Tax Cut and Job Acts Revenue

a. ***What is the appropriate amount of tax cut and job act revenue to remove from test year revenues?***

First it should be remembered that Staff recommends that the *Global Stipulation* be approved in its entirety, which would eliminate the need for a decision on these as well as numerous other issues. In its statement of position The Office of the Public Counsel (OPC) listed sub-issues (a) and (b) under Tax Cut and Jobs Act Revenue as issues it was contesting, yet failed to set forth any position on the issues; therefore, Staff is unsure what it is, if anything, that OPC is contesting. Staff's adjustments for both (a) and (b) are appropriate regardless of the Commission's ultimate decision regarding the treatment of the Asbury generating unit. The appropriate amount of tax cut and job act revenue to remove from test year revenues is $7,760,076.[300] This is due to the fact that test year revenues were overstated by the difference between the amount that was actually billed

[300] See Ex. 101, Staff's Cost of Service Report, P. 49 and Ex. 102 and 124, Staff Accounting Schedules.

to customers during the test year and the amount that would have been billed if the federal tax rate reduction had been in effect throughout the entire test year.[301]

b. ***Should revenues associated with the tax cut and jobs act stub period be removed from revenue?***

Yes. As with (a) above, Staff's adjustment is appropriate regardless of the Commission's ultimate decision regarding the treatment of the Asbury generating unit. Empire recorded an accrual amount for the tax cut and jobs act stub period. This should be removed from the test year. The amount recorded was $11,728,453.[302]

Jeffrey Keevil

Asbury

(a) Is it lawful to require Empire's customers to pay for Asbury costs through new rates?

(b) Is it reasonable to require Empire's customers to pay for Asbury costs through new rates?

(c) If it is unlawful and/or unreasonable to include the costs of the retired Asbury plant in rates, what amount should be removed from Empire's cost of service?

This brief will address the three sub-issues under Asbury together, given their intricate relationship. Staff would first note that the wording of these sub-issues themselves is somewhat skewed, apparently in an effort to sway the Commission before even reaching the response. Staff's response is that its recommended resolution of the

[301] Ex. 101, Staff's Cost of Service Report, P. 49.
[302] See Ex. 101, Staff's Cost of Service Report, P. 49 and Ex. 102 and 124, Staff Accounting Schedules.

Asbury issue(s) is both lawful and reasonable; in fact, the most reasonable under the circumstances presented. More specifically, Staff recommends that an accounting authority order be issued to capture all financial impacts from Asbury's retirement from January 1, 2020 forward consistent with the terms of paragraphs 24 -26 of the Global Stipulation. Further, any fuel related costs or market related charges or revenues incurred at Asbury or related to Asbury after January 1, 2020 shall not be eligible for inclusion in the FAC. As noted in paragraph 26 of the Global Stipulation, support of the Global Stipulation is in no way agreement as to the retirement date of Asbury.

The Commission will recall that it has already ruled on multiple occasions in this case that the Asbury retirement issue should not be addressed in this case but should be addressed in Empire's next general rate case, and gave the parties the opportunity to submit a list of items related to Asbury's retirement to be included in an accounting authority order ("AAO") for this case. For example, in the Commission's *Order Denying Public Counsel's Motion to Modify the Test Year, and Order to File Suggestions for Inclusion in an Accounting Authority Order* issued January 28, 2020, the Commission stated that "After considering the positions of the parties and examining the current procedural schedule, the Commission determines that OPC's motion to modify the test year should be denied. Asbury's retirement is best addressed in Empire's next rate proceeding. The parties will be ordered to submit a list of items to be included in an AAO to address the impacts resulting from Asbury's retirement." Similarly, in its *Order Denying [Public Counsel's] Motion for Reconsideration* issued February 19, 2020, the Commission stated "OPC continues to assert that failing to modify the test year to allow for adjustments for the retirement of the Asbury power plant violates the fundamental goal of ratemaking. After considering OPC's motion, reply, and the

responses of Empire and Staff, the Commission will deny the motion. The Commission will not modify the test year, nor allow isolated adjustments for Asbury's retirement to be addressed in this general rate proceeding. The Commission will address the impacts of Asbury's retirement in Empire's next rate proceeding, which Empire states it will file upon the conclusion of this proceeding." Finally, during the Procedural Conference held in this matter onFebruary 28, 2020, the RLJ stated

> . . . And the commission's order [issued February 19, 2020] stated that the Commission will not modified [*sic*] the test year nor allow isolated adjustments in this general rate proceeding, which I think the Commission considered to be fairly straight forward. And I understand that some of the parties are not happy with the answer they received, but that is the answer the Commission gave.
>
> . . . This is a unique situation where Empire will be filing a rate case immediately after this one, and so the Commission made the determination that Asbury's retirement is best handled in that proceeding.
>
> . . . If you go back and look at the agenda as to what the chairman said, I would recommend that the parties do that. What he indicated in regard to Asbury's retirement was he did not want this issue to be a distraction. And I think the feeling right now with the Commission is that this has become a distraction in a way that is exactly what the Commission did not want to have happen.[303]

[303] Tr. Vol. 6: p. 37:21 through p. 38:23.

Consistent with the foregoing, the Global Stipulation filed herein on April 15, 2020, provides as follows in paragraphs number 24-26:

Establishment of an AAO Regarding the Asbury Power Plant

24. The Signatories request that the Commission issue an order authorizing the establishment of an Accounting Authority Order ("AAO") with regard to the retirement of the Asbury power plant.

25. The Signatories request that the Asbury AAO direct the Company to establish a regulatory asset/liability, beginning January 1, 2020, to reflect the impact of the closure of Asbury and require the Company to separately track and quantify the changes from the base amounts, as reflected in **Appendix D**, of the following categories of rate base and expense:

a. Rate of return on Asbury Plant,

b. Accumulated Depreciation,

c. Accumulated and Excess Deferred Income Tax,

d. Fuel inventories assigned to the Asbury Plant,

e. Depreciation expense,

f. All Non-fuel/ non-labor operating and maintenance expenses,

g. All labor charges for maintaining and operating the Asbury Plant,

h. Property taxes assigned to the Asbury Plant,

i. Any costs associated with the retirement of the Asbury Plant, including dismantlement and decommissioning - Non-Empire labor excluded.

26. *There is no agreement on ratemaking or the treatment to be given to any deferred amounts in a future rate case. There also is not agreement with the Company's stated retirement date of March 2, 2020*, and the list of

> plant items that may be repurposed or otherwise remain in use. In future proceedings, Empire retains the right to request recovery of both a return of and on its investment in Asbury, as well as present arguments on all other issues related to the impact of the closure of the Asbury power plant on the Company's cost of service, while the other parties retain their respective rights to oppose the Company's positions. The signatories acknowledge that the purpose of an AAO is to defer a final decision on current costs until a future rate case and that, in that future rate case, the signatories and the Commission are not bound by the terms of the AAO in setting new rates. (Emphasis added)

Paragraph 25 set forth above also includes a footnote which provides "All plant at the Asbury station will be assumed to be retired solely for purposes of calculating the deferrals for return and depreciation, except for any plant operationally needed and continuously in-service at Asbury after retirement of the station as a whole. If, pursuant to a plan adopted by Empire, some Asbury plant previously retired is "re-purposed" for another use, Empire may contact the signatories to discuss appropriate adjustments to the return and depreciation deferrals once the re-purposed plant is in-service."[304]

In other words, the Global Stipulation provides that an accounting authority order be issued to capture all financial impacts from Asbury's retirement from January 1, 2020 forward, consistent with the Commission's prior pronouncements in this case on the Asbury retirement issue, and to address those impacts in a future rate case.

[304] Footnote 3.

In addition to being consistent with the Commission's prior orders in this case, the AAO resolution provided by the Global Stipulation and supported by Staff is also consistent with other Commission orders addressing AAOs. Recently, on October 17, 2019, the Commission issued its Report and Order in Case No. EC-2019-0200, *The Office of the Public Counsel and the Midwest Energy Consumers Group v. KCP&L Greater Missouri Operations Company*, a case in which *OPC sought an AAO* to address KCP&L GMO's retirement of its Sibley units. In its Report and Order in that case, as part of its Conclusions of Law the Commission concluded that

> E. The Commission has authority to defer extraordinary costs of a utility for consideration in a later period. In doing so, it is not engaging in single-issue rate making.
>
> F. The purpose of an Accounting Authority Order (AAO) is to defer a final decision on current extraordinary costs until a rate case is in order. In that subsequent rate case, the Commission is not bound by the terms of the AAO in setting new rates.
>
> G. In a 1991 decision involving a request for an AAO, the Commission held that an AAO was appropriate where "events occur during a period which are *extraordinary, unusual and unique, and not recurring*." This has sometimes been described as "the Sibley Standard." (Emphasis added)

There, the Commission went on to decide that

> The USOA definition of extraordinary items for which an AAO may be appropriate clearly applies to both items of profit and loss, as does the Commission's "Sibley standard" for considering whether an AAO should be issued. Therefore, the question before the Commission is whether GMO's

> decision to close the Sibley units is "extraordinary, unusual and unique, and not recurring."
>
> In describing the factors that should be taken into account when deciding whether a given item of profit or loss should be considered "extraordinary", the USOA definition refers to significant events and transactions that are "abnormal and significantly different from the ordinary and typical activities *of the company*." (Emphasis in Order). Thus, the focus of the standard is on the abnormality and significance of the event and transaction on the company, not on the industry as a whole. That is a reasonable focus as the Commission is expected to determine whether the event is extraordinary and a justification for an AAO for a single utility, not for the industry as a whole.
>
> Clearly, ***it is unusual for GMO to retire a generating unit*** as it has not done so in the past thirty years. More importantly, it is unusual and unique for a utility to retire a generating unit with twenty years of remaining anticipated service life, and twenty years of unrecovered depreciation expense. It is also significant that the Sibley plant was retired just after GMO's last rate case was resolved and in fact before those new rates went into effect. (Emphasis added).

As Staff witness Mr. Mark L. Oligschlaeger testified in his supplemental testimony filed herein on May 6, 2020, the Commission has held in many prior cases that the standard to be applied to consideration of AAO requests is: a) whether the underlying event giving rise to the cost in question was "extraordinary" in nature; and b) whether the

costs associated with the event were material;[305] the Commission has consistently defined an extraordinary event as one that is unusual, unique and non-recurring.[306] As further testified by Mr. Oligschlaeger, for reasons very similar to the reasons the Commission found the retirement of the Sibley units to be extraordinary and warrant an AAO, Staff considers the retirement of Asbury to be an extraordinary event, as well as material.[307]

Further supporting the appropriateness of an AAO in this instance is the current uncertainty as to the appropriate date for which to consider the Asbury unit to have been retired. OPC would appear to argue for December 12, 2019, while Empire would argue March 1, 2020. The supplemental testimony filed May 6, 2020, by both Mr. Oligschlaeger and Mr. Charles T. Poston,[308] as well as the Global Stipulation itself, address this uncertainty. The following question and answer are taken from the supplemental testimony of Mr. Poston:

> Q. In the Global Stipulation and Agreement there is a provision that states, "Any fuel related costs or market related charges or revenue incurred at Asbury or related to Asbury after January 1, 2020 shall not be eligible for inclusion in the FAC." Does this provision indicate that Staff supports a retirement date of January 1, 2020 for the Asbury Plant?
>
> A. No. This provision is not indicative that Staff supports a retirement date of January 1, 2020 for the Asbury Plant, or any other date at this time. As stated in the footnote associated with that provision, "Use of

[305] The Commission has consistently defined material in this context as meaning the extraordinary event should have a financial impact at least equal to 5% of the utility's annual net income. See Ex. 162, Oligschlaeger supplemental testimony filed May 6, 2020.
[306] Ex. 162, Oligschlaeger supplemental testimony filed May 6, 2020, p. 6.
[307] Ex. 162, Oligschlaeger supplemental testimony filed May 6, 2020, pp. 6-7.
[308] Ex. 163, Poston supplemental testimony filed May 6, 2020.

January 1, 2020 in this settlement provision does not represent an agreement regarding the retirement date of the plant."[309]

As testified by Mr. Oligschlaeger, since there is some doubt as to the appropriate retirement date for Asbury, "Beginning the deferral on January 1, 2020 allows parties to argue different positions in Empire's next rate case as to when the retirement actually occurred, preserves accounting of the amounts for consideration regardless of the retirement date ultimately ordered by the Commission in a future case, and permits parties to recommend an amount of the deferral be recovered based upon that determination."[310]

In conclusion of this issue, Staff's recommendation that an accounting authority order be issued to capture all financial impacts from Asbury's retirement from January 1, 2020 forward consistent with the terms of paragraphs 24 -26 of the Global Stipulation is both lawful and reasonable and should be adopted by the Commission.

Jeffrey Keevil

Fuel Inventories

a. ***What is the appropriate number of burn days to use for Asbury fuel inventory?***

The appropriate number of burn days for the Asbury fuel inventory is 18 days. Staff determined this number of days based on information provided by the Company in

[309] Ex. 163, Poston supplemental testimony filed May 6, 2020, P. 3.
[310] Ex. 162, Oligschlaeger supplemental testimony filed May 6, 2020, P. 9.

response to Staff Data Request Nos. 0044 and 0210 which was the most current information available to the Staff at the time of the surrebuttal/true-up filing.[311]

Jeffrey Keevil

Operation and Maintenance Normalization

a. ***What is the appropriate level of operation and maintenance expense to be included in the cost of service?***

Before Jurisdictional Allocations are applied the appropriate normalized level for operation and maintenance expense to be included in cost of service is $28,877,386.[312]

Jeffrey Keevil

Depreciation and Amortization Expense

a. ***What is the appropriate level of depreciation and amortization expense of plant to include in the cost of service?***

The appropriate amount of depreciation expense to allow is $71,423,882 and the appropriate amount of amortization of electric plant is $3,387,871.[313]

Jeffrey Keevil

Retail Revenue

a. ***What is the appropriate amount to remove from retail revenue for unbilled revenue, franchise tax revenue, and FAC revenue?***

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[311] Ex. 138-C, McMellen Surrebuttal/True-up Testimony, Pp. 1-2.
[312] Ex. 124, Staff True-up Accounting Schedules; Ex. 143, Sarver Surrebuttal/True-up Testimony, Pp. 6-8.
[313] Ex. 124, Staff True-up Accounting Schedules.

The appropriate amount to remove for unbilled revenues is $6,391,485. The appropriate amount to remove for franchise tax revenues is $9,923,350. The appropriate amount to remove for FAC revenues is $17,047,207. These amounts represent the total amounts recorded in the general ledger for test year. Since these accounts are only pass-through accounts, the purpose of Staff's adjustment is to zero out each account as to have no effect on the cost of service.[314]

b. ***What is the level of billing determinants per rate schedule that should be used to calculate retail rate revenue in this case?***

Staff considers the resolution of this issue as provided in the *Global Stipulation* reasonable in the context of the interplay of issues resolved therein. However, in the event the resolution of this case involves a change in Empire's revenue requirement, Staff's position is as follows: Staff's true-up billing determinants as provided below and in the true-up workpapers of Michelle Bocklage and Byron Murray, and filed on April 17 in this matter as additional evidence (Exhibits 147 and 151 respectively) should be used to calculate retail rate revenue in this case. The level of retail revenue is provided in Staff's true-up accounting schedules (Exhibit 124).

[314] Ex. 101, Staff's Cost of Service Report, Pp. 49-51; Ex. 139, Newkirk Surrebuttal/True-up Testimony, Pp. 1-2.

Final Billing Determinants	Total	Summer	Winter	Final Billing Determinants	Total	Summer	Winter
Residential				**Large Power Class**			
Customers	1,584,876	528,292	1,056,584	Customers	480	240	240
First 600 kWh	804,199,567	272,826,945	531,372,622	Billing Demand	1,562,697	560,784	1,001,913
Over 600 kWh	874,037,676	265,133,807	608,903,870	Facilities Demand	1,649,224		
Total kWh	1,678,237,243	537,960,751	1,140,276,492	First 350 Hrs. Use	531,680,256	191,870,888	339,809,368
Commercial				All Additional kWh	265,232,977	96,899,199	168,333,778
Customers	218,280	72,760	145,520	Total kWh	796,913,233	288,770,087	508,143,146
First 700 kWh	94,469,871	31,463,636	63,006,235	**Feed Mill & Grain Elevator Service**			
Over 700 kWh	226,970,566	88,572,087	138,398,480	Customers	120	40	80
Total kWh	321,440,438	120,035,722	201,404,715	First 700 kWh	59,626	21,083	38,543
Small Heating				Over 700 kWh	401,700	125,900	275,800
Customers	36,252	12,084	24,168	Total kWh	461,326	146,983	314,343
First 700 kWh	17,861,680	6,564,188	11,297,492	**Special Transmission Contract: Praxair**			
Over 700 kWh	65,507,120	21,767,525	43,739,595	Customers	12	4	8
Total kWh	83,368,801	28,331,714	55,037,087	Billed Demand kW	98,482	32,853	65,629
Total Electric Building				Facility Demand kW	98,965	32,950	66,015
Customers	11,268	3,756	7,512	On-Peak Period	25,570,840	4,727,202	20,843,638
kW Billing Demand	1,273,270	393,446	879,824	Shoulder Period	6,618,083	6,618,083	-
kW Facilities Demand	1,738,838	578,697	1,160,141	Off-Peak Period	36,500,690	12,151,333	24,349,357
First 150 Hrs Use	177,729,956	54,887,161	122,842,795	Total Usage	68,689,613	23,496,618	45,192,995
Next 200 Hrs Use	143,745,032	51,687,632	92,057,400	**Lighting**			
All Additional kWh	32,381,761	13,551,066	18,830,696	Miscellaneous Service			
Total kWh	353,856,749	120,125,859	233,730,890	Total Usage	150,222	53,418	96,804
General Power				Muncipal Street Lights			
Customers	21,516	7,172	14,344	Total Usage	18,032,613	5,352,415	12,680,198
kW Billing Demand	3,022,039	1,072,561	1,949,478	Private Lighting			
kW Facilities Demand	3,111,880	1,125,724	1,986,156	Total Usage	12,859,554	4,312,125	8,547,429
First 150 Hrs Use	369,887,968	133,114,935	236,773,032	Special Lighting			
Next 200 Hrs Use	353,224,637	131,908,842	221,315,794	Total Usage	857,151	314,163	542,988
All Additional kWh	143,582,466	55,589,840	87,992,626				
Total kWh	866,695,070	320,613,618	546,081,452				

c. Should the billing adjustments and the retail revenues be trued up to January 31, 2020 in the cost of service?

Staff considers the resolution of this issue as provided in the *Global Stipulation* reasonable in the context of the interplay of issues resolved therein. However, in the event the resolution of this case involves a change in Empire's revenue requirement, Staff's position is as follows: The billing adjustments should be trued up to January 31, 2020; however, the adjustments to retail revenue for unbilled revenue,

franchise tax revenue and FAC revenue should not be trued up and left at test year amounts.[315]

Jeffrey Keevil

Property Taxes

a. ***What is the appropriate amount of property taxes to include in the cost of service?***

The appropriate amount of property tax expense is $25,138,294. Staff determined this annualized level by applying Empire's tax rate to plant in service balances as of December 31, 2019 which are the most current known and measurable balances used in the property tax assessment process.[316]

Jeffrey Keevil

Common Property Removed from Plant and Accumulated Depreciation

a. ***What is the appropriate method and amount for removal of common property from plant in service and accumulated depreciation?***

To determine Staff's plant in service and accumulated depreciation adjustments, Staff applied the Company's Mass rate percentage to its January 31, 2020 plant in service and accumulated depreciation balances for general plant accounts 389 through 398. The appropriate amount for removal of common property from plant in service and accumulated depreciation is $11,059,772.[317]

Jeffrey Keevil

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[315] See Ex. 139, Newkirk Surrebuttal/True-up Testimony, P. 2.
[316] See Ex. 101, Staff's Cost of Service Report, Pp. 78-79; Ex. 127, Barron Surrebuttal/True-up Testimony, Pp. 1-3; Ex. 124, Staff True-up Accounting Schedules.
[317] See Ex. 101, Staff's Cost of Service Report, P. 19; Ex. 127, Barron Surrebuttal/True-up Testimony, Pp. 3-4; Ex. 124, Staff True-up Accounting Schedules.

Affiliate Transactions

Issues and Staff's Position

As an initial matter, Staff states that it supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, in OPC's objection to the Agreement, it identified issues specifically relating to Empire's transactions with its affiliate companies as issues which must be decided by the Commission. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument on these issues as presented in its testimony, and taken prior to entering into the *Agreement*.

a. ***Are Empire's transactions with its affiliates imprudent?***

Staff's Position: Staff recommends, based upon its expert analysis, that the vast majority of Empire's transactions with its affiliates reflected in its revenue requirement for this case were prudently incurred. However, the interest rate charged to Empire by LUCo associated with the June 2018 $90 million refinancing of Empire's first mortgage bonds is imprudent.

b. ***Do Empire's transactions with its affiliates comply with Commission Rule 20 CSR 4240-20.015 (Affiliate Transactions)?***

Staff's Position: While Empire's Cost Allocation Manual ("CAM") has yet to be approved by the Commission, it is Staff's recommendation that Empire has sufficiently demonstrated that, except for its June 2018 $90 million refinancing through LUCo, its affiliate transactions with its upstream affiliates are consistent with the intent of, and substantially comply with, the Commission's Affiliate Transactions Rules. However,

Empire's $90 million refinancing of first mortgage bonds through LUCo likely violated the Commission's Affiliate Transaction Rules.

c. ***What amount should be included in Empire's revenue requirement for its transactions with its affiliates?***

Staff's Position: This issue is reasonably resolved by the approval of the *Global Stipulation and Agreement* filed in this matter on April 15, 2020. However, if the Commission chooses not to resolve this matter by approving the *Agreement*, Staff's recommended amount of affiliate transactions to be included in Empire's revenue requirement is included in the various expense items in this case that make up Staff's recommended revenue requirement for Empire. In regard to Empire's June 2018 $90 million refinancing, Staff recommends that the appropriate cost of debt for this promissory note is 2.15%, and is reflected in its recommended cost of debt used to determine Empire's rate of return. Therefore, Staff recommends no separate amount for affiliate transactions be included in Empire's revenue requirement.

Introduction:

Affiliate transactions are exchanges of goods and services between a regulated utility and another entity sharing common ownership with the utility.[318] Because affiliated transactions are often made between a regulated entity and an unregulated entity, affiliated transactions are a concern to regulators because of the potential of subsidization of the unregulated operations or affiliates by a regulated entity's customers. This can be done either through paying excessive prices or receiving insufficient revenues for goods

[318] Ex. 114: Rebuttal Testimony of Mark L. Oligschlaeger, P.1.

and services from these affiliates.[319] The risk of such subsidization arises in these affiliated transactions because such exchanges of goods and services are not conducted at "arms-length;" that is, they are not conducted by two independent third parties each looking out for its best interest.[320]

To guard against potential subsidization of unregulated affiliates, approximately twenty (20) years ago, the Commission promulgated rules regulating the affiliate transactions of electric, gas, and steam heating utilities.[321] The intent of these rules is detailed in the purpose statement for each. For 20 CSR 4240-20.015 (the Commission's Affiliate Transactions Rule pertaining to Electric Utilities), it states the following:

> *This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations. In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and record-keeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in section 386.754, RSMo Supp. 1998, by the General Assembly of Missouri). The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.*

Shortly after the Commission issued orders of rulemaking directing the promulgation of the Affiliate Transaction rules, several Missouri utilities contested the validity of the rules by challenging the authority of the Commission to promulgate them, and the procedure by which they were promulgated.[322] The Missouri Supreme Court affirmed the Commission's authority to do so, stating, "…this Court holds that the PSC had authority

[319] Ex. 114: Oligschlaeger Rebuttal, p.2.
[320] *Id.*
[321] *See* Commission Rules 20 CSR 4240-20.015; 20 CSR 4240-40-015; 20 CSR 4240-80.015; and corresponding orders of rulemaking found in Commission Case Nos. EX-99-442, GX-99-444, and HX-99-443.
[322] ***State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm'n of State***, 103 S.W.3d 753, 756 (Mo. 2003).

to promulgate the rules and that promulgation of the rules satisfied all relevant rulemaking procedures. Thus, the order of rulemaking was lawful and reasonable."[323]

Under the Commission's rule, to ensure the customers of a regulated utility are not subsidizing nonregulated operations, regulated electric utilities are required to adhere to certain standards,[324] evidentiary standards,[325] and record keeping requirements,[326] and to ensure certain records are maintained by its affiliates[327] and proper access to those records is provided.[328] Regulated electric utilities are also required to maintain a cost allocation manual ("CAM") detailing a utility's criteria, guidelines, and procedures it will follow to be in compliance with the rule.[329]

Empire's CAM:

While Empire utilizes a CAM to allocate costs to and from affiliates, its CAM has yet to be approved by the Commission. Empire, and its subsidiary The Empire District Gas Company ("EDG"), first sought Commission approval of a CAM with its August 23, 2011, filing (Case No. AO-2012-0062). However, this CAM was neither approved nor rejected by the Commission.[330] As detailed in Staff's Direct Cost of Service Report,[331] Empire's most recent electric rate case, Case No. ER-2016-0023, was settled among the parties. The settlement contained a provision that within two weeks of the filing of the Stipulation and Agreement, Empire, Staff, and OPC would jointly propose a procedural schedule in Empire's CAM docket, Case No. AO-2012-0062.[332]

[323] *State ex rel. Atmos* at 765.
[324] *See* 20 CSR 4240-20.015(2).
[325] *See* 20 CSR 4240-20.015(3).
[326] *See* 20 CSR 4240-20.015(4).
[327] *See* 20 CSR 4240-20.015(5)
[328] *See* 20 CSR 4240-20.015(6).
[329] *See* 20 CSR 4240-20.015(2)(E) and 20 CSR 4240-20.015(3)(D).
[330] Ex. 25: Rebuttal Testimony of Jill Schwartz, P. 2-3.
[331] *See* Ex. 101: Staff's Direct Cost of Service Report, Pp. 27-28.
[332] *See* pg. 11 of 12 of Attachment a to the Commission's August 10, 2016, *Order Approving Stipulation and Agreement* in Case No.

However, after the conclusion of Case No. ER-2016-0023, in Case No. EM-2016-0213, the Commission approved the sale of all of the common stock of Empire to Liberty Utilities (Central) Co. and Liberty Sub Corp., subsidiaries of Algonquin Power & Utilities Corporation ("APUC"). On October 19, 2016, in Case No. AO-2012-0062, Empire, Staff, and OPC, via a Unanimous Stipulation and Agreement and Joint Request to Suspend Procedural Schedule agreed, in part, as follows:

> 7. In Case No. EM-2016-0213, the Commission on September 7, 2016 authorized the applicants to perform in accordance with the terms of an Agreement and Plan of Merger dated February 9, 2016, pursuant to which LU Central and Liberty Sub Corp. will acquire all of the stock of Empire (the "Transaction") and then merge Empire with Liberty Sub Corp., with Empire emerging as the surviving corporation. Following the merger, Liberty Sub Corp. will cease to exist and Empire will be a wholly-owned subsidiary of LU Central. It is anticipated that these transactions will close in January of 2017. It is further anticipated that the relationship between EDE and its affiliates, including its wholly owned subsidiary EDG, will change if the Transaction is closed as contemplated. As such, the Signatories believe it would be an inefficient use of resources to continue contesting the contents of one or more CAMs for the current affiliate arrangement, which pre-dates the Joint Application of The Empire District Electric Company, Liberty Utilities Co., and Liberty Sub Corp. for approval of an Agreement and Plan of Merger and the Order Approving Stipulations and Agreements and Authorizing Merger Transaction, which the Commission issued on September 7, 2016, effective October 7, 2016. Good cause exists for EDE and EDG to operate without Commission approved CAMs until their respective CAMs are approved in the proceedings initiated pursuant to paragraphs 8 and 9 below.
>
> 8. If the Transaction discussed above is closed, EDE shall initiate a new proceeding by filing a proposed CAM and seeking Commission approval thereof, within six (6) months of said closing.[333]

* * *

ER-2016-0023, EFIS Item No. 179.

[333] *See* Pp. 2-3 of the *Unanimous Stipulation and Agreement* filed by The Empire District Electric Company, The Empire District Gas Company, Staff, and the OPC on October 10, 2016, in Case No. AO-2012-0062, EFIS Item No. 91.

> 11. Neither the Staff nor OPC will file a complaint against EDE and/or EDG *or provide support for any claim or allegation* against EDE and/or EDG on the basis that EDE and/or EDG is or *has been* non-compliant with the Commission's affiliate transactions rules because EDE and/or EDG are conducting and/or have conducted affiliate transactions without Commission approved CAMs.[334]

The acquisition closed on January 1, 2017, and the Commission closed Case No. AO-2012-0062 on July 5, 2017.[335] On June 30, 2017, Empire; EDG; Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty Midstates"); and Liberty Utilities (Missouri Water), LLC ("Liberty Water") filed an *Application for Approval of CAM, Conditional Request for Variance, and, if Necessary, Request for Waiver* in Case No. AO-2016-0360. This proceeding is currently stayed by the Commission.[336] As detailed in Staff's Direct Cost of Service Report,[337] the CAM attached to the parties' Application, and currently utilized by Empire, is applicable to APUC and its subsidiaries, and includes an Appendix 9, which contains additional terms and conditions specifically applicable to Empire, EDG, and Liberty Midstates. While the Commission has yet to approve the CAM filed in Case No. AO-2017-0360, since January 1, 2017, the various services directly or indirectly provided to Empire by APUC and its subsidiaries have been allocated based on the allocation procedures described within that CAM. As explained in the Direct Testimony of Jill Schwartz, Empire's CAM outlines the services provided by various entities within the APUC family of businesses and the methods used to distribute the costs for those services. Costs allocated include both direct charges to specific

[334] *See Id.* at P. 3.
[335] *See* the Commission's *Notice Closing File*, issued July 5, 2017, in Case No. AO-2012-0062, EFIS Item No. 95.
[336] As detailed on P. 28 of Ex. 101: Staff's Direct Cost of Service Report, on June 27, 2018, Staff filed a motion to open a working docket, File No. AW-2018-0394, for a review and consideration of rewriting and writing of existing and new Affiliate Transaction Rules. Numerous comments were received concerning the draft affiliate transaction rules, and on July 17, 2019, the Commission ordered Staff to file a new draft rule for its consideration; Staff did so on September 16, 2019. Consequently, on December 30, 2019, the parties to Case. No. AO-2017-0360 filed a Status Report and Joint Motion to Stay Proceeding until completion of the workshop docket and a formal rulemaking respecting the Affiliate Transaction Rules. The Commission, in its January 10, 2020, Order Staying Proceeding, granted the parties' joint request.
[337] *See* Ex. 101: Staff's Direct Cost of Service Report, P. 28.

entities and the allocation of indirect costs for services that benefit the entire organization. Specifically, the CAM outlines the methods of direct charge and cost allocations between (1) APUC and its unregulated businesses and the regulated businesses; (2) LUC and Liberty Power/Liberty Utilities; (3) LUC and the regulated utility subsidiaries of LUCo; (4) LUSC and Liberty Power/Liberty Utilities; (5) LUSC and the regulated utility subsidiaries of LUCo; and (6) regional allocations.[338] Ms. Schwartz further testifies that the Empire CAM is based on the National Association of Regulatory Utility Commissions ("NARUC") Guidelines for Cost Allocations and Affiliate Transactions, and the fundamental premise of those guidelines and the CAM is to direct charge costs as much as possible and to use reasonable allocation factors where allocation of indirect costs is necessary and direct charging is not possible.[339]

Ms. Schwartz also states the Missouri-specific portion of the APUC CAM must be read and followed in conjunction with the entire APUC CAM. The APUC CAM applies to subsidiaries of APUC, including the Missouri Regulated Utilities, while the Missouri-specific Appendix applies to APUC and its affiliates other than the Missouri Regulated Utilities only to the extent required by the Commission's affiliate transaction rules or as specifically stated in the Appendix.[340]

Empire's Affiliate Transactions:

Empire, as is the case with all of Missouri's regulated electric utilities, engages in multiple transactions with its affiliates for the provision of goods and services. Empire is part of a multi-layered corporate structure. It is directly owned by Liberty Utilities Co. ("LUCo"), which in turn is owned by a string of affiliated companies, and ultimately by

338 Ex. 24: Direct Testimony of Jill Schwartz, P.4.
339 *Id.*
340 *Id.*

Algonquin Power & Utilities Corp ("APUC"). As detailed in the Direct Testimony of Empire Witness Jill Schwartz, while Liberty Utilities entities operate on a decentralized basis, emphasizing the importance of local management and local control of day-today business operations, some services are provided on a shared basis where there is an opportunity to realize economies of scale or other efficiencies; i.e., a shared services model. These services are provided to Empire by upstream affiliates Liberty Utilities Service Corp. ("LUSC"), Liberty Utilities (Canada) Corp. ("LUC"), and APUC,[341] and charged to affiliates based upon the methodology prescribed in Empire's CAM. Pursuant to the Public Utility Holding Company Act of 2005, Section 1270, Section 309 of the Federal Power Act and 18 CFR 366.23, LUSC, LUC, and APUC are required to file Annual Reports of Centralized Service Companies (known as a FERC Form 60s) with the Federal Energy Regulatory Commission ("FERC").[342] These annual reports are annual regulatory support documents required under 18 CFR 369.1 for all "centralized service companies."[343] As "centralized service companies," LUSC, LUC, and APUC provide various corporate support services[344] to Empire and its other affiliates that are required to be made "at cost."[345] Empire receives a variety of corporate, administrative and support services from these upstream affiliated entities. By far the largest number of affiliate transactions

[341] Ex. 24: Direct Testimony of Jill Schwartz, P. 3.
[342] The 2018 FERC Form 60, Annual Report of Centralized Service Companies, for APUC, LUC, and LUSC are attached to Ex. 220, the Direct Testimony of Robert E. Schallenberg, as Schedules res-d-7, res-d-8, and res-d-9.
[343] 18 CFR 367.1(a)(7) of the FERC regulations defines a centralized service company as "a service company that provides services such as administrative, managerial, financial, accounting, recordkeeping, legal or engineering services, which are sold, furnished, or otherwise provided (typically for a charge) to other companies in the same holding company system. Centralized service companies are different from other service companies that only provide a discrete good or service."
[344] 20 CSR 4240-20.015(1)(D) defines "corporate support" as joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and design.
[345] 18 CFR 367.1(a)(11) defines cost as "the amount of money actually paid for property or services. When the consideration given is other than cash in a purchase and sale transaction, as distinguished from a transaction involving the issuance of common stock in a merger, the value of such consideration must be determined on a cash basis.";
18 CFR 367.2(c) states "to the extent that the term service company is used in this Uniform System of Accounts, it applies only to centralized service companies.
18 CFR 367.25 states, in part, "a service must be deemed at cost and fair allocation of costs requires an accurate accounting for the elements that makes up the aggregate expense of conducting the business of the service company.

entered into by Empire, both by volume of transactions and dollar value, is its receipt of support services from various affiliates.[346] Empire reported in its 2018 Affiliate Transaction Report, that goods and services charged to it by upstream affiliates were at actual cost, and did not include markups.[347]

Are Empire's transactions with its affiliates imprudent?

OPC witness Robert E. Schallenberg contends that *none* of the costs associated with Empire's transactions with its affiliates have been shown to be prudent in the course of this case, and therefore, they should *all* be excluded from recovery.[348] However, Staff recommends that the vast majority of Empire's transactions with its affiliates made during the test year and true-up period for this case were prudently incurred. That being said, Empire's June 2018 $90 million refinancing of First Mortgage Bonds was imprudent, and as such, Staff recommends an appropriate cost of debt for this promissory note to be 2.15%, and has reflected this adjustment in its recommended cost of debt used to determine Empire's rate of return. [349]

In order to disallow a utility's recovery of costs from its ratepayers, the Commission must find both that "(1) the utility acted imprudently, [and] (2) such imprudence resulted in harm to the utility's ratepayers."[350] "While the burden of proof rests on the [utility], the PSC's practice has been to apply a 'presumption of prudence' in determining whether a utility properly incurred its expenditures. The presumption of prudence is not a creature of statute or regulation. It first was recognized by the PSC in *Matter of Union Electric,*

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[346] Ex. 114: Oligschlaeger Rebuttal P. 3.
[347] *See* p. 7 of 9 of Schedule res-d-6 of the Direct Testimony of Robert E. Schallenberg.
[348] Ex. 220: Schallenberg Direct, p. 19-20. Mr. Schallenberg estimates these costs equate to approximately $100 million.
[349] Ex. 129: Surrebuttal Testimony of Staff Witness Kimberly K. Bolin Pp. 11-12.
[350] ***State ex rel. KCP&L Greater Missouri Operations Co. v. Missouri Pub. Serv. Comm'n***, 408 S.W.3d 153, 163 (Mo. Ct. App. 2013)(Citing ***State ex rel. Ass'd Nat. Gas Co. v. Pub. Serv. Com'n of State of Mo.***, 954 S.W.2d 520, 529(Mo. App., W.D. 1997)).

27 Mo. P.S.C. (N.S.) 183 (1985) and has been applied by it since that point."[351] However, while a presumption of prudence is appropriate when dealing with arm's length transactions, it is not appropriate when dealing with affiliate transactions because of the substantially greater risk and incentive of self-dealing. "This greater risk inherent in affiliate transactions arises because agreements between a public utility and its affiliates are not "made at arm's length or on an open market. They are between corporations, one of which is controlled by the other. As such they are subject to suspicion and therefore present dangerous potentialities.""[352] The affiliate rules' stated purpose is to "prevent regulated utilities from subsidizing their non-regulated operations ... and provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities." 4240–40.015. A presumption that costs of transactions between affiliates were prudent is inconsistent with these rules.[353]

While Mr. Schallenberg references the Missouri Supreme Court opinion in *Office of Public Counsel v. Missouri Public Service Com'n*, 409 S.W.3d 371 (Mo. banc 2013) in his direct testimony, specifically that it finding that a presumption of prudence is inappropriate when dealing with transactions that are not arms-length,[354] he offers little more than broad allegations of non-compliance with the Commission's affiliate transactions rule as support for finding Empire's transactions with affiliates imprudent. Though Mr. Schallenberg is correct in his general recitation of the Court's finding, as noted in both the rebuttal testimony of Jill Schwartz[355] and that of Mark L. Oligschlaeger,[356] aside from noting Empire's $90 million refinancing of first

[351] ***Office of Public Counsel v.. Missouri Public Service Com'n**, 409 S.W.3d 371, 376 (Mo. banc 2013).*
[352] ***Office of Public Counsel v. Missouri Public Service Com'n***, 409 S.W.3d 371, 377 (Mo. banc 2013).
[353] ***Office of Public Counsel v. Missouri Public Service Com'n***, 409 S.W.3d 371, 378 (Mo. banc 2013).
[354] Ex. 220: Schallenberg Direct P. 1.
[355] Ex. 25: Rebuttal of Schwartz, P.2.
[356] Ex. 114: Oligschlaeger rebuttal, P. 10.

mortgage bonds, he offers no specific examples of transactions that do not comply with the affiliate transaction rules, much less describe the harm to ratepayers. Mr. Schallenberg offered no other testimony in this matter. As an initial matter, as will be discussed in the following section of Staff's brief, it is Staff's position that Empire is in substantial compliance with the Commission's Affiliate Transaction Rules. Further, as noted earlier, Empire operates as part of a shared services model[357] in accordance with a series of affiliate service agreements[358] As such, most affiliate transactions entered into by Empire are for corporate support services necessary to support the operation of the utility, such as corporate governance, financial services, regulatory strategy, human resources, information technology, accounting services, legal services, et cetera.[359] Ms. Schwartz, in her direct testimony, explains that the shared services model serves an important role in the administration and operations of Liberty; that Empire receives services vital to the day-to-day conduct of the utility. She goes on to state that the services provided by APUC are necessary for all affiliates, including Empire, to have access to capital markets for funding of capital projects and operations, and that the allocation of shared services from upstream affiliates maximize economies of scale and expertise while limiting redundancies.[360]

As pointed out in the Rebuttal Testimony of Staff Witness Mark L. Oligschlaeger, the provision of corporate services to a number of affiliates on a centralized basis, as is done for Empire by its upstream affiliates, should be inherently more cost-effective than having each affiliate, including regulated utilities, provide the services for themselves.[361]

[357] Ex. 24: Direct Testimony of Empire Witness Jill Schwartz, P. 3.
[358] Ex. 25: Schwartz Rebuttal, P. 4.
[359] Ex. 114: Rebuttal Testimony of Staff Witness Mark L. Oligschlaeger p. 3; Ex. 24: Schwartz Direct, Pp. 4-6.
[360] Ex. 24: Schwartz Direct, P. 10.
[361] Ex. 114: Oligschlaeger Rebuttal, P. 6

In addition, the upstream affiliate charges for these services are calculated at cost, with no profit margin included,[362] and allocated to Empire, either directly or indirectly in accordance with a series of affiliate service agreements[363] and with its CAM.[364] As noted above, Empire's upstream affiliates that it transacts with function as "centralized service companies" pursuant to FERC regulation, and are required to transact with affiliate companies "at cost;" therefore, Empire's transactions with them inherently do not present the same "dangerous potentialities" as transactions with affiliates that include charging of a profit margin to the buyer of the goods and services, and discussed in *Office of Public Counsel v. Missouri Public Service Com'n*, 409 S.W.3d 371, (Mo. banc 2013). Further, Ms. Schwartz indicated in her testimony that, while Empire's operating expenses have slightly increased for various reasons since its most recent rate case,[365] Empire has seen noticeable cost reductions relating to treasury services, internal audits, and human resources, all of which are now provided on a centralized basis.[366]

Finally, in the course of its audit in this case, Staff performed a full review of the costs allocated from upstream affiliates to Empire and, in its Direct Cost of Service Report, proposed an adjustment to properly assign a portion of common costs to Empire's non-regulated operations.[367] However, as stated by Staff Witness Keith Foster in his Surrebuttal/True-Up testimony, Staff has agreed that Empire had already addressed the allocated costs to its non-regulated operations, and Staff's adjustment was removed from Staff's case as part of its true-up.[368] Therefore, it is Staff's position that Empire has met

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[362] Ex. 114: Oligschlaeger Rebuttal, P. 6; Schedule RES-D-6 of Ex. 220: Schallenberg Direct, P. 7.
[363] Ex. 25: Schwartz Rebuttal, P. 4.
[364] Ex. 101: Staff Direct Cost of Service Report, P. 29.
[365] Ex. 24: Schwartz Direct, P. 10
[366] *Id.* at P. 11.
[367] Ex. 101: Staff Direct Cost of Service Report, P. 32
[368] Staff erroneously indicated in its filed position that it had made an adjustment to Empire's allocation of costs to its non-regulated operations. Staff apologizes for any confusion this may have caused.

its burden to show that nearly all of its transactions for services with its upstream affiliates are prudently incurred.

Prudency of Empire's June 2018 $90 million Refinancing

While Empire has shown that the vast majority of its transactions with upstream affiliates are prudently incurred, it is Staff's position that the interest rate being charged Empire by Liberty Utilities Corp. (LUCo) associated with the June 2018 $90 million refinancing of Empire's first mortgage bonds, as discussed on pages 11 through 15 of the direct testimony of OPC witness Robert E. Schallenberg, is imprudent.[369] While LUCo claims to have charged a market-based interest rate to Empire, LUCo obtained the money for this refinancing at a lower interest rate than the 4.53% it is charging Empire.[370] LUCo obtained the funds to loan Empire the $90 million by accessing its credit facility, and obtained the money at a significantly lower interest rate than 4.53% While Empire witness Mark T. Timpe states that LUCo bears the risk of any increases in long-term interest rates until such time as it issues its own long-term debt to refinance its short-term borrowings which provides interim funding for the loan to Empire,[371] as explained by Staff witness Kimberly Bolin, the $90 million refinancing was issued approximately one and a half years ago; since that time, LUCo has not issued its own long-term debt to refinanced the lending.[372] Empire solicited no bids for the refinancing of the $90 million first mortgage bond; instead, LUCo claims it based the rate for this note upon the most recent competitively bid private debt placement by a LUCo affiliate, Liberty Utilities; Finance GP1. However, the fact remains that LUCo charges Empire a rate higher than it

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[369] Ex. 106: Rebuttal Testimony of Staff Witness Kimberly K. Bolin, P. 12.
[370] Ex. 129: Surrebuttal Testimony of Staff Witness Kimberly K. Bolin, P. 11.
[371] Ex. 43: Rebuttal Testimony of Mark T. Timpe, P. 4.
[372] Ex. 129: Bolin Surrebuttal P. 10.

actually incurs,[373] constituting harm to Empire's rate payers. Staff agrees with OPC witness David Murray that an average cost of the short term debt LUCo used to finance this borrowing should be used as LUCo is actually utilizing short term debt to fund this financing, and has been doing so for over a year and a half. However, Staff recommends updating this average cost of the LUCo short term debt for the period of 12 months ending January 31, 2020, and thus, recommends an appropriate cost of debt of 2.15%.[374]

Do Empire's transactions with its affiliates comply with Commission Rule 20 CSR 4240-20.015 (Affiliate Transactions)?

Though Empire's Cost Allocation Manual (CAM) has yet to be approved by the Commission, it is Staff recommendation that the Commission find that Empire's affiliate transactions substantially comply with the Commission's Affiliate Transaction Rules. As discussed earlier, the large majority of costs allocated to Empire from affiliates are for the provision of shared corporate support functions,[375] as defined by the Commission's Affiliate Transactions Rules.[376] The intent of the Commission's Affiliate Transactions Rules is to prevent regulated utilities from subsidizing their non-regulated operations.[377] To accomplish this, in part, the rule prohibits a regulated electrical corporation from providing a financial advantage to an affiliated entity.[378] The rule also prohibits regulated

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[373] *Id.*
[374] Ex. 129: Bolin Surrebuttal P. 10.
[375] Ex. 26: Surrebuttal of Empire Witness Jill Schwartz, P. 5; Ex. 114: Rebuttal Testimony of Mark L. Oligschlaeger, P. 6.
[376] *See* Commission Rule 20 CSR 4240-20.015(1)(D) Corporate support means joint corporate oversight, governance, support systems and personnel, involving payroll, shareholder services, financial reporting, human resources, employee records, pension management, legal services, and research and development activities.
[377] *See* the PURPOSE statement of Commission Rule 20 CSR 4240-20.015; ***Office of Public Counsel v. Missouri Public Service Com'n,*** 409 S.W.3d 371, 378 (Mo. banc 2013).
[378] 20 CSR 4240-20.015(2)(A) provides that "A regulated electrical corporation shall not provide a financial advantage to an affiliate entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if –

1. It compensates an affiliate entity for goods or services above the lesser of –
    A. The fair market price; or
    B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or
2. It transfers information, assets, goods or services of any kind to an affiliate entity below the greater of –
    A. The fair market price; or

electric utilities from providing any preferential service, information or treatment to affiliate entities over other entities; however, for the purposes of furnishing corporate support services, this prohibition does not apply.[379] The Commission incorporated this exemption in the rule, specifically to allow for greater flexibility to obtain economies of scale in these areas.[380] OPC Witness Robert E. Schallenberg, in his direct testimony, notes that the rule essentially prohibits a utility from subsidizing its affiliates, or its non-regulated operations by paying either more than it would cost the utility to do the activity itself or what it would pay to an independent third party vendor.[381] Mr. Schallenberg also states, painting with a broad brush, that, because Empire did not competitively bid the goods or services it used to serve its customers, or demonstrate that competitive bidding was neither necessary nor appropriate for these affiliate transactions, it has no ability to determine fair market price, or the fully distributed cost for it to produce the good or service for itself.[382] Staff agrees that Empire did not competitively bid for these services, but Mr. Schallenberg ignores facts that demonstrate that bidding for these goods and services was neither necessary nor appropriate.

Empire transacts with its upstream affiliates for centralized services at cost, with no profit margin included.[383] Further, the "centralized service companies with which it transacts are required by FERC regulation to transact with affiliates "at cost."[384]

B. The fully distributed cost to the regulated electrical corporation.

[379] *See* 20 CSR 4240-20.015(2)(B).

[380] *See* the Commission's *Order of Rulemaking* issued on January 1, 2000, in Case No. EX-99-442, EFIS Item No. 71.

[381] Ex. 220: Schallenberg Direct p.11.

[382] Ex. 220: Schallenberg Direct P. 6.

[383] Ex. 114: Oligschlaeger Rebuttal, P. 6.; Schedule RES-D-6 of Ex. 220: Schallenberg Direct, P. 7.

[384] Further, as noted earlier in this brief, 18 CFR 367.1(a)(11) defines cost as "the amount of money actually paid for property or services. When the consideration given is other than cash in a purchase and sale transaction, as distinguished from a transaction involving the issuance of common stock in a merger, the value of such consideration must be determined on a cash basis.";

18 CFR 367.2(c) states "to the extent that the term service company is used in this Uniform System of Accounts, it applies only to centralized service companies.

18 CFR 367.25 states, in part, "a service must be deemed at cost and fair allocation of costs requires an accurate accounting for the elements that makes up the aggregate expense of conducting the business of the service company.

Thus, allocations from Empire's service company affiliates do not involve the same perverse incentives for abuse as transactions between a regulated affiliate with a non-regulated, profit-seeking affiliate.[385] Staff's expert witness, Mark L. Oligschlaeger testified, given that the provision of corporate services to a number of affiliates on a centralized basis, as is done for Empire by its upstream affiliates, should be inherently more cost-effective than having each affiliate, including regulated utilities, provide the services for themselves, soliciting bids for such services was unnecessary.[386] Mr. Oligschlaeger goes on to state that given the inherent cost advantages and efficiencies associated with service company structures, Staff views the prospect of mass competitive bidding by Empire for upstream affiliate services as very likely to be non-productive and not cost effective, and sees good cause for Empire to not primarily rely on competitive bidding to determine the reasonableness of obtaining services from its upstream affiliates. Further, as discussed earlier, Staff performed a review of the costs allocated from Empire's upstream affiliates in this case, and found them to be reasonable. Consequently, under these circumstances, it is Staff's recommendation that Empire has sufficiently demonstrated that the large majority of its transactions with upstream affiliates for the provision of centralized services are consistent with the intent of the asymmetric pricing standards contained within the Affiliate Transaction Rules,[387] and the nonregulated affiliates with which Empire transacts are not subsidized by its ratepayers.

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[385] Ex. 114: Oligschlaeger Rebuttal Pp. 5-6
[386] Ex. 114: Oligschlaeger Rebuttal P. 6-7
[387] 20 CSR 4240-20.015(2)(A) provides that "A regulated electrical corporation shall not provide a financial advantage to an affiliate entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if –
It compensates an affiliate entity for goods or services above the lesser of –
The fair market price; or
The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or
It transfers information, assets, goods or services of any kind to an affiliate entity below the greater of –
The fair market price; or
The fully distributed cost to the regulated electrical corporation.

Empire's June 2018 $90 million Refinancing Compliance with the Affiliate Transaction Rules

In regard to the $90 million refinancing described earlier in this brief, it is Staff's position that it constitutes a violation of the Commission's Affiliate Transaction Rules.[388] Empire signed a promissory note with LUCo that had a 4.53% interest rate. LUCo obtained the funds to loan Empire the $90 million by accessing its short term credit facility, at a significantly lower interest rate than what it eventually charged Empire.[389] At the time the transaction was made, Empire did not solicit any bids for the refinancing of the $90 million first mortgage bond,[390] and had the capability to get commercial financing with a lower interest rate.[391] Thus, as the interest rate charged to Empire was likely higher than what it could have obtained for itself, Empire compensated LUCo above the lesser of cost or fair market price,[392] and therefore the transaction resulted in a financial advantage to LUCo pursuant to the rule. Staff recommends an appropriate cost of debt for this promissory note to be 2.15%, and has reflected this adjustment in its recommended cost of debt used to determine Empire's rate of return.[393]

What amount should be included in Empire's revenue requirement for its transactions with its affiliates?

Staff did not compile a listing of the amounts of affiliate transactions included in Empire's cost of service. The costs associated with affiliate transactions are recorded in most of the accounts for Empire and therefore were reviewed as part of an individual

[388] Ex. 106: Rebuttal Testimony of Staff Witness Kimberly K. Bolin, Pp.11-12.
[389] Ex. 106: Bolin Rebuttal, P. 11.
[390] Ex. 129: Bolin Surrebuttal P. 11.
[391] Ex. 220: Schallenberg Direct P. 11.
[392] *See* 20 CSR 4240-20.015(2)(A).
[393] Ex. 129: Surrebuttal Testimony of Staff Witness Kimberly K. Bolin, Pp. 11-12.

auditor's assignments in the course of Staff's case. However, it is Staff's position that all issues relating to Empire's transactions with affiliates are reasonably resolved by the *Global Stipulation* filed in this matter on April 15, 2020. However, if the *Global Stipulation* is not approved by the Commission, Staff's recommended amount for affiliate transactions to be included in Empire's revenue requirement is included in Staff's positions on various expense items in this case. Therefore, Staff recommends no separate amount for affiliate transactions be included in Empire's revenue requirement. In regard to Empire's $90 million refinancing of first mortgage bonds, Staff recommends an appropriate cost of debt for this promissory note to be 2.15%, and has reflected its adjustment in the cost of debt used to determine Empire's rate of return.

Mark Johnson

Jurisdictional Allocation Factors

b. ***What is the appropriate jurisdictional allocation factors to be used in the cost of service?***

As an initial matter, as has been discussed throughout this brief, Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, to the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

The jurisdictional allocations utilized by Staff are the appropriate factors to be used to calculate Empire's cost of service. For Empire, jurisdiction allocation factors are used to allocate demand-related and energy-related costs between each of the retail jurisdictions served by Empire; i.e., Missouri, Arkansas, Oklahoma, and Kansas, as well

as the wholesale jurisdiction in Missouri and Kansas.[394] As explained in Staff's Direct Report, fixed costs, such as the capital costs associated with generation and transmission plant, are allocated on the basis of demand; variable costs, such as fuel, are more appropriately allocated on the basis of energy consumption.[395] In this case, Staff utilized a "Demand Allocation Factor" and an "Energy Allocation Factor" in determining Staff's recommended cost of service for Empire.

Demand Allocation Factor

As explained by Staff witness Alan J. Bax in Staff's Direct Report, demand refers to the rate at which electric energy is delivered to a system to match the requirements of its customers, either at an instant in time or averaged over a specified time interval. Since generation units and transmission lines are planned, designed, and constructed to meet a utility's anticipated system peak demands,[396] plus required reserves, the contribution of each of Empire's three jurisdictions coincident[397] to the system peak demand is the appropriate basis on which to allocate these facilities.[398] For this case, Staff utilized a Twelve Coincident Peak ("12 CP") methodology to determine demand allocation factors for Empire. This methodology is appropriate for an electric utility, such as Empire, that experiences similar system peak demands in both summer and winter months.[399] As explained by Mr. Bax, Staff determined the demand allocation factor for each jurisdiction using the following process:

a. Identify Empire's peak hourly load in each month for the test year, April 2018 through March 2019, and sum the hourly peak loads.

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[394] Ex. 101: Staff Direct Cost of Service Report, Pp. 32-33.
[395] *Id.* at 32.
[396] System Peak Demand is the largest electrical requirement ("load") that occurs within a specified period of time (e.g., hour, day, month, season, and year) on a utility's system.
[397] Coincident peak refers to the load, generally kWs or MWs, in each of the jurisdictions that coincides with Empire's overall system peak recorded for the time period in the corresponding analysis.
[398] Ex. 101: Staff Direct Cost of Service Report, P. 33.
[399] *Id.* at 33.

b. Sum the particular jurisdiction's corresponding loads for the hours identified in a. above.
c. Divide b. by a. above.

This methodology resulted in the following allocation factors for each of Empire's jurisdictions:

Retail Operations:

Missouri:	.8393
Non-Missouri:[400]	.1065
Wholesale Operations:[401]	.0542[402]

Energy Allocation Factor

Variable expenses, such as fuel, are allocated to the jurisdictions based on energy consumption. The energy allocation factor, for each individual jurisdiction, is the ratio of the normalized annual kilowatt-hour ("kWh") usage of each particular jurisdiction to the total normalized Empire kWh usage. Mr. Bax determined the following energy allocation factors for each jurisdiction:

Retail Operations:

Missouri:	.8240
Non-Missouri:	.1109
Wholesale Operations:	.0651[403]

In her rebuttal testimony, Empire witness Sheri Richard criticizes Staff's calculation of its Energy Allocation Factor, contending that Staff annualized the Missouri and Arkansas retail energy and the Wholesales customer energy, while failing to annualize the Kansas and Oklahoma retail amounts.[404] Mr. Bax, however, refutes this contention in his surrebuttal testimony,[405] showing that Staff did not, in fact, utilize any annualized

[400] Staff's Non-Missouri Retail Jurisdiction for both its Demand Allocation Factor and its Energy Allocation Factor is comprised of Empire's retail operations in Arkansas, Oklahoma, and Kansas.
[401] Staff's Wholesale Operations Jurisdiction for both its Demand Allocation Factor and its Energy Allocation Factor is comprised of Empire's wholesale operations in Arkansas, Oklahoma, and Kansas.
[402] *Id.*
[403] *Id.*
[404] Ex. 5: Richard Rebuttal P. 39.
[405] Ex. 128: Bax Surrebuttal, P. 2.

values in calculating its recommended allocation factors. He explains that the energy allocation factor for each jurisdiction is the ratio of the *normalized* annual kWh usage of a particular jurisdiction to the total normalized Empire kWh usage. Staff did, however, adjust the kWh usage data for anticipated growth, annualizations, and non-normal weather. What Ms. Richard describes as the annualized retail energy kWhs for the state of Arkansas is actually the determination of Staff's Non-Missouri Retail energy allocation factor,[406] as illustrated above.

OPC, in its statement of positions in this case, states that any allocation factors for affiliate transactions should be based on the costs and values of the goods or services provided.[407] However, as stated above, jurisdictional allocations factors, as developed by Staff in this proceeding, do not relate to affiliate transactions. These factors are created at the Empire level to allocate Empire's demand-related and energy-related costs between each of the retail jurisdictions served by Empire: Missouri, Arkansas, Oklahoma, and Kansas, as well as the wholesale jurisdictions in Missouri and Kansas.[408] As such, the Commission should disregard OPC's position in setting appropriate jurisdictional allocation factors for Empire.

Conclusion

Staff's methodology for calculating the jurisdictional allocation factors used in determining its cost of service recommendation have not changed nor been disputed by Empire Electric in rate case filings over at least the last ten years. Even though now owned by Liberty Utilities, Empire still serves the same four states as it did before the acquisition and, therefore, Staff is not aware of any reason there would be any significant

[406] Ex. 128: Bax Surrebuttal, P. 2.
[407] *See Public Counsel's Positions on Jointly Listed Issues*, filed on April 17, 2020, in Case No. ER-2019-0374, EFIS Item No. 430.
[408] Ex. 101: Staff Direct Cost of Service Report, Pp. 32-33.

difference, if any, in how costs are jurisdictionally allocated to Missouri operations under the new ownership structure. Therefore, to the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues in this matter, Staff recommends the Commission order its calculation of jurisdictional allocation factors as the appropriate factors to be used to calculate Empire's cost of service.

Mark Johnson

Payroll and Overtime

c. ***What is the appropriate test year amount of payroll expense?***

d. ***What is the appropriate test year amount for overtime expense?***

As Staff recommendation for overtime expense is included as a component of its overall recommendation on payroll expense, this brief will address both sub-issues under Payroll and Overtime together. However, as stated throughout this brief, Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter, including the matters discussed within this section of Staff's brief. However, to the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*.

Staff recommends the appropriate test year amount for total payroll and overtime expense to be included in Empire's cost of service, is $40,750,944. In the course of its review of Empire's books and records in this proceeding, Staff made adjustments to Empire's test year payroll expense to reflect annualized levels of payroll, payroll taxes, and 401(k) benefit costs as of January 31, 2020, as detailed in Staff's Direct Cost of Service Report and True-Up testimony[409] To calculate a reasonable level of overtime

[409] Ex. 125: Arabian Surrebuttal/True-Up testimony, P.3; Ex. 101: Staff Direct Report, P. 62.

expense to include in payroll expense, Staff multiplied an overtime percentage computed for union and nonunion employees based upon a two-year average of overtime hours actually incurred by the current rate paid for overtime as of January 31, 2020, accounting for short term fluctuations. Staff then divided that product by Staff's pro forma base payroll amount.[410]

While Empire witness Sheri Richard, in her rebuttal testimony, criticized Staff's calculation as being incorrect,[411] Staff witness Kimberly K. Bolin testified that, in fact, Staff's test year total payroll includes all the components of payroll expense (regular payroll, overtime payroll and incentive compensation).[412] Further, she explains in the same testimony that Staff calculated regular payroll and overtime separately from incentive compensation. Staff independently calculated an annualized level of incentive compensation to include in the cost of service, and therefore made an adjustment to add this number into the cost of service.[413] Therefore, Staff made adjustments to remove all incentive compensation that occurred in the test year. Staff then made a further adjustment adding the appropriate amount of incentive compensation back into the cost of service.[414]

OPC alleges in its statement of positions that the amount of payroll and overtime expense included in Empire's cost of service should not include any amount related to affiliate transactions.[415] However, as detailed in the *Affiliate Transactions* section of this brief, Staff recommends that the vast majority of Empire's transactions with its affiliates

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[410] *Id.*
[411] Ex. 5: Richard Rebuttal P. 25.
[412] Ex. 129: Bolin Surrebuttal P. 4.
[413] Ex. 129: Bolin Surrebuttal, P. 4.
[414] *Id.*
[415] *See Public Counsel's Positions on Jointly Listed Issues*, filed on April 17, 2020, in Case No. ER-2019-0374, EFIS Item No. 430.

sufficiently comply with the Commission's Affiliate Transactions Rule,[416] including those related to payroll and overtime expense. Thus, Staff recommends no adjustment to remove amounts related to affiliate transactions are necessary.

In conclusion, should the Commission choose not to adopt the *Global Stipulation and Agreement*, resolving all issues, Staff recommends the appropriate test year amount for total payroll and overtime expense to be included in Empire's cost of service, is $40,750,944.

Mark Johnson

Employee Benefits

Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, to the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*. Empire itself has no employees; Liberty Utilities Service Corporation ("LUSC") serves as the employer for most of the U.S.-based utility employees, who are then assigned to specific utilities.[417] Those employees are offered Dental, Vision, Healthcare, and Life Insurance benefits. Empire books these expenses in Account 926. To determine the appropriate level of employee benefits to include in Empire's cost of service, Staff normalized each expense by examining the individual costs over a three - year period. Averaging over a three-year period accounts for potential fluctuations in expense from year to year. Based upon this methodology, Staff recommends the appropriate level of employee benefits included in

[416] *See* 20 CSR 4240-20.015.
[417] Ex. 101: Staff Direct Cost of Service Report, P. 30.

the cost of service is $7,506,683 Total Company.[418] In its statement of positions in this case, OPC states that the amount of outside services included in Empire's cost of service should not include any amount related to affiliate transactions.[419] As detailed in the *Affiliate Transactions* section of this brief, Staff recommends that the vast majority of Empire's transactions with its affiliates sufficiently comply with the Commission's Affiliate Transactions Rule,[420] including those related to employee benefits. Thus, Staff recommends no adjustment to remove amounts related to affiliate transactions are necessary.

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Outside Services

e. ***What is the appropriate amount of outside services to include in the cost of service?***

Staff supports the *Global Stipulation and Agreement* as a full resolution of all of the issues in this matter. However, OPC has identified this as an issue which must be decided by the Commission. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its argument prior to entering into the *Agreement*. As detailed in Staff's Direct Cost of Service Report, Empire is provided various services, such as legal and auditing, by several outside contractors. In the process of its audit, Staff reviewed Empire's outside services expense booked to Accounts 923045 and 923947 for the test year and update period. As further detailed in Staff's Direct Report, Staff normalized the amounts of

[418] *Id.* at P.63.
[419] *See Public Counsel's Positions on Jointly Listed Issues*, filed on April 17, 2020, in Case No. ER-2019-0374, EFIS Item No. 430.
[420] *See* 20 CSR 4240-20.015.

outside services on a going forward basis by calculating a five-year average of incurred costs for booked in these accounts. Based upon this methodology, Staff recommends the appropriate amount of outside service expense is $2,326,254.[421]

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Case No. EM-2016-0213 Commission-Ordered Conditions

In Case No. EM-2016-0213, the Commission approved the sale of all of the common stock of Empire to Liberty Utilities (Central) Co. and Liberty Sub Corp.,[422] subsidiaries of Algonquin Power & Utilities. In its *Order Approving Stipulations and Agreements and Authorizing Merger Transaction*,[423] the Commission approved, and ordered the parties to comply with, multiple stipulations and agreements; one of the many was a *Stipulation and Agreement* between the applicants and the Office of Public Counsel which included as Appendix A, and incorporated therein, a separate stipulation and agreement between the Applicants and Staff.[424] Appendix A to the *Stipulation and Agreement* resolved all matters between Staff and the Applicants, and recommended the Commission approve the sale of all of the common stock of Empire, subject to multiple conditions and representations contained in the stipulation. Compliance with several of these conditions is now at issue in this matter. However, as has been discussed throughout this brief, Staff supports the *Global Stipulation and Agreement* as a full resolution of all issues in this matter, including, for purposes of this rate case, compliance

[421] Ex. 101: Staff Direct Cost of Service Report, P. 82
[422] Liberty Sub Corp. was a special purpose corporation formed for the sole purpose of merging with and into Empire, with Empire emerging as the surviving corporation.
[423] *See Stipulation and Agreement*, filed on August 23, 2016, in Case No. EM-2016-0213, EFIS Item No. 105.
[424] The stipulation and agreement included as Attachment A was first filed with the Commission in on August 4, 2016; *see* Case No. EM-2016-0213, EFIS Item 78. OPC objected to the stipulation and agreement between Staff and the Applicants on August 11, 2016; *see Office of the Public Counsel Objection to Non-Unanimous Stipulation and Agreement*, filed in Case No. EM-2016-0213, EFIS Item 91.

with the stipulation conditions discussed below. To the extent that the Commission does not approve the *Global Stipulation and Agreement* as a full resolution of all issues, Staff outlines its position on these issues as taken prior to entering into the *Agreement*.

f. ***Has Empire complied with Condition A.4 the Commission imposed in Case No. EM-2016-0213?***

   i. ***If not, what relief should the Commission grant?***

No. Condition A.4. contained in Appendix A to the *Stipulation and Agreement* approved by the Commission in Case No. EM-2016-0213 states:

> Empire shall not seek an increase to the cost of capital as a result of this Transaction or Empire's ongoing affiliation with Algonquin Power & Utilities Corp. and its affiliates other than Empire after the Transaction. Any net increase in the cost of capital Empire seeks shall be supported by documentation that: (a) the increases are a result of factors not associated with the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates; (b) the increases are not a result of changes in business, market, economic or other conditions caused by the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates; and (c) the increases are not a result of changes in the risk profile of Empire caused by the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates. The provisions of this section are intended to recognize the Commission's authority to consider, in appropriate proceedings, whether this Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates has resulted in capital cost increases for Empire. Nothing in this agreement shall restrict the Commission from disallowing such capital cost increases from recovery in Empire's rates.

In June 2018, Empire signed a promissory note with LUCo to refinance $90 million of first mortgage bonds that carried a 4.53% interest rate. As detailed in the *Affiliate Transaction* section of this brief, LUCo obtained the funds to loan Empire the $90 million by accessing its credit facility, itself incurring a significantly lower interest rate

as what it charged Empire.[425] At the time the transaction was made, Empire did not solicit any bids for the refinancing of the $90 million first mortgage bond,[426] and had the capability to get commercial financing with a lower interest rate.[427] Thus, as the interest rate charged to Empire was likely higher than what it could have obtained for itself, the transaction resulted in an improper financial advantage to LUCo. As Empire has reflected this higher cost of debt in its cost of capital, it has therefore sought an increase to the cost of capital as a result of its ongoing affiliation with Algonquin Power & Utilities Corp. and its affiliates other than Empire.

Staff recommends an appropriate cost of debt for this promissory note to be 2.15%, and has reflected this adjustment in its recommended cost of debt used to determine Empire's rate of return.[428]

g. ***Has Empire complied with Condition A.5 the Commission imposed in Case No. EM-2016-0213?***

ii. ***If not, what relief should the Commission grant?***

Yes. This condition states:

> If Empire's per books capital structure is different from that of the entity or entities in which Empire relies for its financing needs, Empire shall be required to provide evidence in subsequent rate cases as to why Empire's per book capital structure is the most economical for purposes of determining a fair and reasonable allowed rate of return for purposes of determining Empire's revenue requirement.

As detailed in the *Capital Structure* section of this brief, Empire's book capital structure remains more economical than LUCo's book capital structure.

[425] Ex. 106: Bolin Rebuttal, P. 11.
[426] Ex. 129: Bolin Surrebuttal P. 11.
[427] Ex. 220: Schallenberg Direct P. 11.
[428] Ex. 129: Bolin Surrebuttal, Pp. 11-12.

Empire's consolidated capital structure is composed of 52.43% equity and 47.57% debt as of September, 30, 2019.[429] LUCo's capital structure is composed of 53.00% equity and 47.00% debt.[430] Because equity is more expensive than debt, LUCo's capital structure is less economical than Empire's.[431] Therefore, although Staff accepts that a consolidated capital structure is the appropriate capital structure for setting Empire's ROR, Staff still maintains that Empire's capital structure is more economical than LUCo's capital structure.[432]

h. ***Has Empire complied with Condition A.6 the Commission imposed in Case No. EM-2016-0213?***

iii. ***If not, what relief should the Commission grant?***

No. Condition A.6. states as follows:

> The Joint Applicants will not obtain Empire financing services from an affiliate, unless such services comply with Missouri's Affiliate Transaction Rules.

As detailed in the earlier in this brief, Empire's $90 million refinancing of first mortgage bonds with LUCo at an interest rate of 4.53% constitutes a violation of the Commission's Affiliate Transaction Rules.[433] Empire signed a promissory note with LUCo that had a 4.53% interest rate. LUCo obtained the funds to loan Empire the $90 million by accessing its short term credit facility, at a significantly lower interest rate than what it would eventually charge Empire.[434] At the time the transaction was made, Empire did not solicit any bids for the refinancing of the $90 million first mortgage bond,[435] and had

[429] Ex. 149.
[430] Empire's *Position Statement.*
[431] Ex. 108: Chari Rebuttal, P. 14.
[432] Ex. 130: Chari Surrebuttal, P. 14.
[433] Ex. 106: Bolin, Pp.11-12.
[434] Ex. 106: Bolin Rebuttal, P. 11.
[435] Ex. 129: Bolin Surrebuttal P. 11.

the capability to get commercial financing with a lower interest rate.[436] Thus, as the interest rate charged to Empire was likely higher than what it could have obtained for itself, Empire compensated LUCo above the lesser of cost or fair market price,[437] and the transaction resulted in an improper financial advantage to LUCo.

Staff recommends an appropriate cost of debt for this promissory note to be 2.15%, and has reflected this adjustment in its recommended cost of debt used to determine Empire's rate of return.[438]

i. ***Has Empire complied with Condition G.3 the Commission imposed in Case No. EM-2016-0213?***

iv. ***If not, what relief should the Commission grant?***

Yes. Condition G.3. reads:

> Empire shall provide Staff and OPC access to and copies of, if requested by Staff or OPC, the complete Liberty Utilities Co, LU Central and Empire Board of Directors' meeting minutes, including all agendas and related information distributed in advance of the meeting, presentations and handouts, provided that privileged information shall continue to be subject to protection from disclosure and Empire shall continue to have the right to object to the provision of such information on relevancy grounds.

Staff issued Data Request No. 0009 on August 16, 2019, requesting the following:

> Please provide for review of the minutes of the Board of Directors and Board Commission, such as audit, compensation and pension, and any other corporate level meetings of Liberty Utilities and/or Empire District Electric Company for the period January 2016 to current. Provide materials and handouts such as presentations and slides given to the members at each meeting. Please update on an ongoing basis as additional information becomes available.[439]

[436] Ex. 220: Schallenberg Direct, P. 11.
[437] *See* 20 CSR 4240-20.015(2)(A).
[438] Ex. 129: Bolin Surrebuttal, Pp. 11-12.
[439] Ex. 153.

While Counsel for Empire objected to Staff's request, subject to that objection, Staff was provided access to Board of Director documents responsive to its request at the Liberty Utilities office in Jefferson City, Missouri.[440] Therefore, at least in regard to access and provision of copies of Board of Directors' meeting minutes to Staff, Empire has complied with this condition.

Mark Johnson

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by electronic mail, or First Class United States Postal Mail, postage prepaid, on this 6th day of May, 2020, to all counsel of record.

/s/ Whitney Payne

[440] Ex. 153.