

**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)
Rates for Electric Service Provided)
To Customers in its Missouri)
Service Area)

CASE No. ER-2019-0374

STAFF FINDINGS OF FACT AND CONCLUSIONS OF LAW

COMES NOW the Staff of the Missouri Public Service Commission and for its *Findings of Fact and Conclusions of Law* in this matter hereby states:

FINDINGS OF FACT

1. The Empire District Electric Company is a Missouri certificated electrical corporation as defined by Subsection 386.020(15), RSMo (2016),¹ and is authorized to provide electrical service to portions of Missouri.
2. Staff is a party to this case pursuant to Section 386.071, RSMo, and Commission Rule 20 CSR 4240-2.010(10).
3. The Office of Public Counsel is a party to this case pursuant to Section 386.710(2), RSMo, and by Commission Rule 20 CSR 4240-2.010(10).
4. The Midwest Energy Consumers Group (MECG), Renew Missouri, the National Housing Trust (NHT), Empire District Retired Members and Spouses Association (EDRA), Natural Resources Defense Council (NRDC), Sierra Club, Missouri Division of Energy (DE), the Empire District Electric SERP Retirees, and the IBEW Local Union 1464 and 1474 all filed proper motions to intervene that were granted pursuant to Commission Rule 20 CSR 4240-2.075. DE later asked to be excused from further proceedings.²

¹ Unless otherwise stated, all statutory citations in this document are to the Revised Statutes of Missouri, as codified in the year 2016.

² *Missouri Division of Energy Motion to be Excused*, filed April 3, 2020, EFIS item 199.

5. Empire has indicated that it will be filing another request for a general rate increase sometime in 2020.³

Global Stipulation and Agreement

6. Empire, Staff, MCEG, Renew, NHT, EDRA, NRDC, and the SERP Retirees filed a Global Stipulation and Agreement on April 15, 2020. Only the Office of the Public Counsel opposed the Agreement.⁴

7. If the Commission approves the Global Stipulation and Agreement, it would resolve all outstanding issues in the case, with mechanisms in place to address any necessary areas in the next general rate case filed by Empire.⁵

8. The Agreement resolves the rate of return by applying a carrying cost of 7.3% on the balance created by the phase-in rate mechanism.⁶

Cost of Capital – Global Stipulation:

9. The *Global Stipulation* resolves the ROR issues by providing for a carrying cost rate of 7.3% on the balance created by the phase-in rate mechanism to be established pursuant to § 393.155.1, RSMo., with regard to plant-in-service and other rate-base-related items. The amortization period for what is captured by the phase-in mechanism will be determined in the next general base rate proceeding.

10. The carrying cost rate of 7.3% implies an ROE of 9.78%, using Staff's capital structure and cost of debt.

Cost of Capital – Return on Equity:

11. Three expert financial analysts provided testimony containing Return on Equity ("ROE") recommendations based upon established analytical methods. These methods, widely used in the business and investing worlds, fall into two broad categories. The first variety – the

³ Ex. 5, *Rebuttal Testimony of Sherri Richard*, P. 35.

⁴ *Global Stipulation and Agreement*.

⁵ *Global Stipulation and Agreement*.

⁶ *Global Stipulation and Agreement*, P. 2.

Discounted Cash Flow model (“DCF”) – calculates the cost of equity as the sum of the current dividend yield⁷ and a growth rate that represents the projected capital appreciation of the stock.⁸ 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)”⁹ -- reflecting the greater risk of the investment under consideration.¹⁰ The result is the return that an investor requires to invest in the more risky security; this value is equivalent to the ROE.

12. 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.¹¹ In the DCF method, it is the growth factor that is subject to manipulation; in the risk premium methods, it is the risk premium that is subject to manipulation. The choice of these values by the analyst is largely subjective, a matter of expert judgment.

13. 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 Analysis¹² with a proxy group of twenty companies.¹³ Mr. Hevert’s results ranged from 8.09% to 11.05%.¹⁴

14. 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.¹⁵ Mr. Chari’s results ranged from 4.63% to 8.14%.¹⁶

⁷ The expected next 12-months’ dividend divided by current share price. Staff’s *Cost of Service Report*, p. 14.

⁸ Id.

⁹ And varied by the application of Beta; see Staff’s *Cost of Service Report*, p. 17.

¹⁰ See Staff’s *Cost of Service Report*, pp. 16-17.

¹¹ Chari Rebuttal, p. 2: “Each methodology has certain inherent disadvantages that may bring in personal bias that lead to unreasonable estimates.”

¹² FERC has held that the Expected Earnings Analysis does not meet the Constitutional requirements applicable to ROE estimation. Chari Rebuttal, p. 2.

¹³ Hevert Direct, pp. 13-14.

¹⁴ Chari Rebuttal, p. 3.

¹⁵ Staff COS Report, pp. 13-14 and App. 2, Sch’s PC-7, PC-8..

¹⁶ Chari Rebuttal, p. 3.

15. David Murray, OPC's expert, used a Multi-Stage DCF, a CAPM, and a "Rule of Thumb" Risk Premium with five different proxy groups.¹⁷ Mr. Murray's results ranged from 5.35% to 6.75%.¹⁸

16. Mr. Chari criticized Mr. Hevert's ROE recommendation as "too high" and "implausible," noting that, at 9.95%, Mr. Hevert's recommendation was 56 basis points higher than the 2019 national average of authorized ROEs, 9.39%.¹⁹ 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%.²⁰ Mr. Chari pointed 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."²¹ Mr. Chari also noted 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.²² Based on FERC guidelines, Mr. Chari states, "Analysts' growth forecasts are simply inappropriate for exclusive use in the constant-growth DCF."²³ Mr. Hevert cited 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.²⁴

17. Mr. Chari also criticized Mr. Hevert's Market Risk Premiums ("MRPs") of 12.15% and 12.25%, used in his CAPM and ECAPM, as "too high."²⁵ Dr. Morin, for example, considers reasonable MRPs to fall between 5% and 8%.²⁶ 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

¹⁷ Murray Direct, p. 33 and Sch. DM-D-7.

¹⁸ Chari Rebuttal, p. 3.

¹⁹ Chari Rebuttal, pp. 6-7.

²⁰ Chari Rebuttal, p. 7.

²¹ *Id.* Mr. Chari cites widely-respected regulatory economist Roger Morin for this principle.

²² *Id.*, pp. 7-8. The growth rate used in the Constant Growth DCF is intended to predict growth in perpetuity.

²³ *Id.*, p. 8; citing FERC Opinion 569.

²⁴ *Id.*

²⁵ *Id.*, pp. 9, 11.

²⁶ *Id.*, p. 9.

high.²⁷ He demonstrated that, if calculated with appropriate inputs, Mr. Hevert's results would have been in line with Staff's.²⁸ Mr. Chari noted that the ECAPM and Bond Yield Plus Risk Premium methods used by Mr. Hevert are inherently unreliable.²⁹ Mr. Chari also criticized Mr. Hevert's upward adjustment for small size as inappropriate for Empire, a component of the Algonquin conglomerate.³⁰

18. Mr. Murray, OPC's expert, also disagreed with Mr. Hevert's recommendation, commenting that it should be "summarily dismissed" and "defies common sense."³¹ Like Mr. Chari, Mr. Murray criticized Mr. Hevert's DCF perpetual growth rate, suggesting that equity analysts actually use values "closer to 3%."³² Mr. Murray also criticized Mr. Hevert's MRPs, pointing out that their use resulted in projected returns "twice that of expectations from ... reputable sources[.]"³³ Mr. Murray characterizes Mr. Hevert's method of calculating MRPs as neither "rational U.S. GDP of about 4.0% per annum."³⁴ Mr. Murray also points out that, "Most equity analysts use market risk premiums that are approximately half of those assumed by Mr. Hevert."³⁵

19. The Commission finds that 9.25%, as recommended by both Mr. Chari and Mr. Murray, is the appropriate ROE for use in setting Empire's prospective rates.

Cost of Capital – Capital Structure:

20. The Company proposed a capital structure consisting of 53.07% equity and 46.93% debt.³⁶

21. Staff expert Peter Chari proposed a capital structure consisting of 52.43% equity and 47.57% debt.³⁷

²⁷ *Id.*

²⁸ *Id.*, p. 10 (chart).

²⁹ *Id.*, pp. 11-12.

³⁰ *Id.*, p. 12.

³¹ Murray Rebuttal, p. 10.

³² *Id.*, pp. 10-11.

³³ *Id.*, p. 17.

³⁴ *Id.*, p. 18.

³⁵ *Id.*, p. 19.

³⁶ Richard Surrebuttal Sch. SDR-2; Ex. 149, p. 2.

³⁷ Ex. 149.

22. OPC expert David Murray proposed a capital structure consisting of 46.00% equity and 54.00% debt.³⁸

23. Staff and OPC agree that a consolidated capital structure is appropriate for ratemaking purposes.³⁹

24. Staff does not agree with Mr. Murray's recommendation that the Commission use LUCo's adjusted capital structure for ratemaking.⁴⁰

25. 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,⁴¹ 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.⁴² Empire's consolidated capital structure is composed of 52.43% equity and 47.57% debt as of September, 30, 2019.⁴³ Liberty's capital structure is composed of 53.00% equity and 47.00% debt.⁴⁴ Because equity is more expensive than debt, LUCo's capital structure is less economical than Empire's.⁴⁵ Therefore, Staff accepts Empire's per books capital structure.⁴⁶

26. 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.

27. Mr. Murray's proposal, that LUCo's capital structure be used, does not comply with the Commission's *Order* and accordingly must be discarded.⁴⁷

³⁸ Murray Direct, p. 2, line 1, and p. 41, line 15.

³⁹ Chari Surrebuttal, p. 12. Staff inadvertently used a deconsolidated capital structure in its direct report. Ex. 149.

⁴⁰ Murray Surrebuttal, p. 9; Chari Rebuttal, p. 13.

⁴¹ 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 consolidated credit facility at LUCo. Staff's *Cost of Service Report*, p. 12.

⁴² 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.

⁴³ Ex. 149.

⁴⁴ Empire's Position Statement.

⁴⁵ Chari Rebuttal, p. 14.

⁴⁶ Staff's *Cost of Service Report*, p. 12.

⁴⁷ Chari Rebuttal, pp. 13-14.

28. Mr. Hevert's capital structure differs from Staff's because it is of the wrong vintage, March 31, 2019, rather than September 30, 2019.⁴⁸ The Commission should therefore also discard Mr. Hevert's recommended capital structure.

29. 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").⁴⁹ LUF is a subsidiary of APUC, responsible for raising debt for distribution to APUC and LUCo subsidiaries.⁵⁰ LUCo guarantees all the debt held by LUF.⁵¹ Mr. Murray argued that, because LUCo guarantees the debt held by LUF, LUCo should include it in its capital structure for ratemaking purposes.⁵² Consequently, Mr. Murray added the \$395 million to LUCo's long-term debt while subtracting the same amount from LUCo's equity.⁵³ 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, 2019.⁵⁴ 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.⁵⁵

30. 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.⁵⁶ LUF holds debt not just for LUCo but for all other subsidiaries of APUC, which include non-regulated entities.⁵⁷ Including the \$395 million in LUCo's capital structure incorrectly allocates the debt burden of the

⁴⁸ *Id.*, p. 13.

⁴⁹ Chari Rebuttal, p. 15.

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.*

entirety of APUC's entities to LUCo's regulated utilities, including Empire.⁵⁸ Staff contends, and the Commission finds, that the fact that LUCo guarantees LUF's debts does not mean that the debt should be included in the capital structure for ratemaking purposes.⁵⁹ 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.⁶⁰

31. The Commission finds that, as proposed by Staff, the appropriate capital structure for setting Empire's prospective rates consists of 52.43% equity and 47.57% debt.⁶¹

Cost of Capital – Cost of Debt:

32. The Company proposes a cost of debt of 4.85%.⁶²

33. Staff proposes a cost of debt of 4.57%, after adjusting its original recommendation in the light of a concern raised by Mr. Murray.⁶³

34. OPC proposes a cost of debt of 4.65%.⁶⁴

35. Staff rejected Mr. Murray's recommended cost of debt because it is based on his inappropriate choice of capital structure.⁶⁵

36. The Commission finds that 4.57% is the appropriate cost of debt to use in setting Empire's prospective rates.

Rate Design

37. The Global Stipulation and Agreement contemplates that tariffed rates will remain unchanged, so if the Commission approves the Agreement, or does not order a change to overall revenue requirement, no rate design arguments need be considered.⁶⁶

38. If the Commission does not approve the Agreement, it should order the Staff's

⁵⁸ Id.

⁵⁹ Id.

⁶⁰ *Id.*, p.16.

⁶¹ Ex. 149.

⁶² Empire's Position Statement.

⁶³ Chari Surrebuttal, pp. 13-14.

⁶⁴ OPC's Position Statement.

⁶⁵ Chari Rebuttal, pp. 16-17.

⁶⁶ *Global Stipulation and Agreement*, P. 2.

recommended class revenue allocation and rate design variations.⁶⁷

39. No Class Cost of Service Study provided in this case is reliable since there was a lack of quality data provided on which to base the studies.⁶⁸

40. If the Commission orders a reduction in Empire's revenue requirement, it should:

- Revert the Feed & Grain rate schedule to its pre-tax production tariffed revenue level;
- Retain the current level of revenue production, which is net of the current temporary tax reduction rider of the Residential, Contract Transmission and Lighting rate schedules;
- Adjust the Commercial Service/Small Heating, General Power/Total Electric Billing, and Large Power Service class revenue requirements in the case that imputed load shapes are relied upon for rate schedules on which few customers take service by:
 - Reducing class revenue requirements by level of temporary tax reduction;
 - Determine amount of additional reduction available after above-referenced reduction applied;
 - Further reduce Commercial Service/Small Heating and Large Power Service revenue requirements by 25% each of the amounts of additional reduction;
 - Further reduce General Power/Total Electric Billing revenue requirements by 50% of the amounts of additional reduction.⁶⁹

⁶⁷ Ex. 136, *Surrebuttal Testimony of Sarah L.K. Lange*, P. 13.

⁶⁸ Ex. 136, *Surrebuttal Testimony of Sarah L.K. Lange*, P.13.

⁶⁹ Ex. 104, *Staff Direct Report- Class Cost of Service*, P.2.

41. The proper rate designs for each class have been laid out carefully in *Staff's Initial Brief* and should be implemented if the Commission does not approve the *Agreement* and modifies the existing rate design.⁷⁰

42. Master-metered customers in multiple family dwellings that are “grandfathered” into service through a single meter should have the option of being served on the Commercial Service/Small Heating rate schedule.⁷¹

43. Empire should adopt time-variant rate structures once the sufficient metering and billing technology to support such is deployed.⁷²

44. The reduced revenues from the application of Empire’s Limited Large Customer Economic Development Rider should be allocated to all of Empire’s rate classes in accordance with Section 393.1640, RSMo.⁷³

SRLE

45. Empire is the first electric utility to seek a revenue stabilization mechanism under the auspices of Section 386.266.3, RSMo.⁷⁴

46. Empire proposed a Weather Normalization Rider to mitigate a basic misalignment between the structure of utility rates and the structure of utility costs, by adjusting customer bills on an individual basis for deviations from normal weather.⁷⁵

47. Staff proposed a sales reconciliation to levelized expectations (SRLE). The SRLE works by, on an annual basis, reconciling the revenues realized from sales in excess of 400 or 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

⁷⁰ Ex. 104, *Staff Direct Report- Class Cost of Service*, Pp. 14-23.

⁷¹ Ex. 104, *Staff Direct Report – Class Cost of Service*, P. 34.

⁷² Ex. 104, *Staff Direct Report – Class Cost of Service*, P. 23.

⁷³ Ex. 120, *Rebuttal Testimony of Robin Kliethermes – CCOS*, P. 9..

⁷⁴ Ex. 26, *Direct Testimony of Timothy S. Lyons*, p. 51.

⁷⁵ *Id.* p. 51, 55.

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.⁷⁶

48. Based on Empire's cumulative frequency distribution data, the level of usage per customer per month that is constant all year is 400 kWh for residential customers and 700 kWh for small business classes; therefore, these blocks can be reasonably assumed to be unaffected by weather or conservation.⁷⁷

49. The Global Stipulation and Agreement contains a modified version of Staff's SRLE.⁷⁸

50. The Commission previously approved a *Stipulation and Agreement* in a Ameren Missouri Gas rate case with a similar mechanism to the SRLE known as the VIRN.⁷⁹

51. It is likely impossible to design a rate stabilization mechanism (RSM) that guarantees 100% only impacts due to conservation and weather are captured.

52. The SRLE eliminates the throughput disincentive, regardless of whether Empire promulgates energy efficiency programs pursuant to MEEIA⁸⁰ or otherwise, for the Residential, CB, and SH rate schedules.⁸¹ 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, Staff states it would have recommended the SRLE instead of the TD.⁸²

53. In its *Responsive Brief*, Empire indicated that the Commission should not

⁷⁶ *Id.* p. 11-14.

⁷⁷ Ex. 104, *Staff Direct Report - Class Cost of Service*, p. 6 – 7.

⁷⁸ *Global Stipulation and Agreement*, Appendix C.

⁷⁹ Case No. GR-2019-0077, First Amended Non-unanimous Stipulation and Agreement, filed July 18, 2019.

⁸⁰ Section 393.1075, RSMo.

⁸¹ *Id.* p. 12.

⁸² Ex. 160, *Supplemental Testimony of Robin Kliethermes*, p. 3-4.

adopt the Weather Normalization Rider and instead should adopt Staff's proposed SRLE mechanism as set forth in the *Agreement*.⁸³

The sales reconciliation to levelized expectations (SRLE) as included in the Global Stipulation and Agreement is a proper method for addressing the weather conservation mechanism contemplated by Section 386.266.3, RSMo.⁸⁴

54. If the Commission does not approve the Agreement, the SRLE is still proper as recommended by Staff in its Direct Report, Rebuttal and Surrebuttal testimony.⁸⁵

55. The rules for rate case applications are adequate to provide a process for parties to receive necessary evidence and have a fair opportunity for a hearing to evaluate a rate stabilization mechanism.⁸⁶

FAC:

56. The Global Stipulation and Agreement proposes an appropriate FAC.⁸⁷

57. The fuel adjustment clause (FAC) provides a sufficient opportunity for the company to earn a fair return on equity while protecting customers by giving the company an incentive to be prudent in its decisions regarding fuel and third party energy purchases.⁸⁸

58. Empire has used an FAC since the Commission approved it in Case No. ER-2008-0093, and approved the 95%/5% sharing mechanism in that case.⁸⁹

59. Prudency reviews are a method of incentivizing a utility to maintain reasonable fuel costs.⁹⁰

60. The 95%/5% sharing mechanism has been approved in every successive Empire rate case either through Commission order or adoption of the parties' stipulation.⁹¹

⁸³ *Global Stipulation and Agreement*, P. 5.

⁸⁴ *Id.*

⁸⁵ Ex. 104, *Staff Direct Report- Class Cost of Service*; Ex. 121, *Rebuttal Testimony of Sarah L.K. Lange – CCOS*; Ex. 136, *Surrebuttal Testimony of Sarah L.K. Lange*.

⁸⁷ *Global Stipulation and Agreement*, Pp. 3-5

⁸⁷ *Global Stipulation and Agreement*, Pp. 3-5

⁸⁸ Case No. ER-2008-0093, *Report and Order*, P. 47 (Jul. 30, 2008).

⁸⁹ Case No. ER-2008-0093, *Report and Order*.

⁹⁰ Section 386.266.5(4), RSMo.

⁹¹ *Report and Order*, ER-2014-0351, P. 30 (June 24, 2015); *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 Agreement*, ER-2012-0345 (Feb 27, 2013); and *Order Approving Stipulation and Agreement*, ER-2016-0023 (Aug 10, 2016).

61. It is proper to approve no change to the base factor approved in Empire's last general rate case, Case No. ER-2016-0023, of \$0.02415/kWh.⁹²

62. If the Commission does not approve the *Agreement* it is proper to order a base factor of \$0.02333/kWh, instead.⁹³

63. Proper transmission costs to flow through the FAC are 34% for SPP, 50% for MISO and nothing for transmission revenues.⁹⁴

64. Revenue from the MJMEUC contracts should be excluded from the FAC along with a reduced portion of fuel expenses for the energy purchased by Empire specifically for the cities within the MJMEUC agreement.⁹⁵

65. Short term capacity costs should not flow through the FAC and Empire should remove provisions allowing the short-term capacity costs to flow through by June 1, 2021.⁹⁶

Customer Service

66. The requirements Empire has agreed to regarding customer service as part of the Global Stipulation and Agreement are the best way going forward to ensure Empire improves its customer service.⁹⁷

Credit Card Fees

67. Including credit card fees in the revenue requirement is not unduly burdensome to those customers who do not pay by credit card and will encourage credit card usage.⁹⁸

Rate Case Expense

68. Rate case expense included should be \$71,676, which has been normalized

⁹² *Global Stipulation and Agreement*, P. 3 (Apr 15, 2020), and Ex. 161: *Supplemental Testimony of Brooke Mastrogiannis*, P. 2 (May 6, 2020).

⁹³ Ex. 161: *Supplemental Testimony of Brooke Mastrogiannis*, P. 3 (May 6, 2020).

⁹⁴ *Statement of Positions*, P. 18 (Apr 17, 2020).

⁹⁵ *Global Stipulation and Agreement*, P. 4 (Apr 15, 2020) and *Statement of Positions*, P. 18 (Apr 17, 2020).

⁹⁶ *Global Stipulation and Agreement*, P. 3 (Apr 15, 2020) and *Statement of Positions*, P. 19 (Apr 17, 2020).

⁹⁷ *Id.* at 5-6.

⁹⁸ Ex. 101, *Staff Direct Report*, P. 103.

over a two-year period with the sharing mechanism original approved in KCPL's rate case applied.⁹⁹

69. Normalization of costs is appropriate as that reflects normal on-going operations.¹⁰⁰

Management Expense:

70. There is insufficient support for any additional adjustments to management expense.

AFUDC:

71. AFUDC should be handled consistent with the Uniform System of Accounts and no additional adjustments need to be made in this case to account for it.¹⁰¹

Cash Working Capital:

72. The appropriate lag time for cash working capital (CWC) is 39.38 days for income tax expense, based on the Internal Revenue Code.¹⁰²

Accumulated Deferred Income Tax:

73. 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."¹⁰³

74. Empire's current net operating losses balance should be included in its ADIT amount in rate base.¹⁰⁴

75. The FAS 123 deferred tax asset for stock-based compensation should not be

⁹⁹ *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).

¹⁰⁰ Ex. 140, *Surrebuttal/True Up Testimony of Angela Niemeier*, Pp. 8-9.

¹⁰¹ Uniform System of Accounts, 18 CFR Part 101

¹⁰² §6655 Internal Revenue Code, (requiring corporations to make quarterly income tax payments of at least 25% of the total annual payment)..

¹⁰³ ER-2014-0258, *Report and Order*, P. 18.

¹⁰⁴ Ex. 101, *Staff Direct Report*, P. 25.

included in rate base.¹⁰⁵

Tax Cuts and Jobs Act Revenue:

76. The Tax Cut and Jobs Act of 2017 (“TCJA”), effective January 1, 2018, reduced the federal income tax rate from 35 percent to 21 percent, thereby reducing Empire’s revenue requirement by \$17,837,022 on an annual basis.¹⁰⁶

77. 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 564.¹⁰⁷ That statute authorized the Commission to adjust the electric rates of an electrical corporation in light of the TCJA.

78. The Commission reduced Empire’s rates prospectively on August 30, 2018.¹⁰⁸

79. 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, 2018.¹⁰⁹

80. 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”).¹¹⁰

81. Income taxes are a cost of doing business and utility customers pay the cost of the utility’s income tax liability as part of their rates. However, during the eight-month-long “stub period” after the effective date of the TCJA, Empire collected more money from its customers for taxes than it actually owed to the IRS.¹¹¹

82. Staff proposed 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

¹⁰⁵ Ex. 131, *Surrebuttal/True-Up Direct Testimony of Keith D. Foster*, P.2.

¹⁰⁶ *Id.*, p. 13.

¹⁰⁷ 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.

¹⁰⁸ *Id.*, p. 14.

¹⁰⁹ *Id.*, p. 20.

¹¹⁰ *Id.*

¹¹¹ Staff’s Cost of Service Report, pp. 55-56.

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.¹¹²

83. Although initially resisted by Empire,¹¹³ Staff's position was ultimately accepted by all the signatories and embodied in the *Global Stipulation*.¹¹⁴

84. Staff supported rate recovery in this case of the stub period deferral as that is generally consistent with past ratemaking granted to extraordinary events by the Commission.¹¹⁵ As already discussed in Staff's direct filing,¹¹⁶ 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.¹¹⁷ 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.¹¹⁸ 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.¹¹⁹ 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.¹²⁰

¹¹² Oligschlaeger Surrebuttal, p. 1.

¹¹³ See Richard Rebuttal.

¹¹⁴ *Op. cit.*, § 3.b.

¹¹⁵ Oligschlaeger Surrebuttal, p. 2.

¹¹⁶ Staff's Cost of Service Report, pp. 55-56.

¹¹⁷ Oligschlaeger Surrebuttal, p. 2.

¹¹⁸ *Id.*

¹¹⁹ *Id.*

¹²⁰ *Id.*

85. 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.¹²¹ 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.¹²² 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.¹²³ 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.¹²⁴

86. 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, 2018.¹²⁵

87. 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.¹²⁶

88. OPC opposed Staff’s position and objected to the *Global Stipulation*.¹²⁷

89. OPC witness John Riley testified that the amortization proposed by Staff and accepted by the signatories was “arbitrary.”¹²⁸ Mr. Riley proposed that the deferral be used to offset and reduce Empire’s rate base. He further proposed that the deferral not be

¹²¹ *Id.*, p. 3.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ See Public Counsel’s Objection to Parts of the Global Stipulation and Agreement Filed April 15, 2020, filed on April 16, 2020.

¹²⁸ Riley Rebuttal, p. 2.

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."¹²⁹

90. 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.¹³⁰ 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.¹³¹ 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.¹³² Staff's position on this point is the most fair and equitable treatment of the impact of the TCJA for ratemaking purposes.¹³³

91. While Staff is proposing inclusion of the TCJA deferral in rates as a negative expense for customers, but not recognizing the deferral in rate base, OPC is instead proposing to include the entire amount in rate base as a long-term reduction.¹³⁴ 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.¹³⁵

¹²⁹ *Id.*, pp. 2-3.

¹³⁰ *Oligschlaeger Surrebuttal*, p. 6.

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.*

92. The Commission finds that amortization of the TCJA Stub Period deferral over five years is appropriate, with no rate base treatment.

Asbury

93. The Commission issued an order on January 28, 2020, stating that all issues regarding Asbury were properly considered in the next general rate case filing of Empire. It further ordered that any necessary considerations should be recommended by the parties for inclusion in an accounting authority order (AAO).¹³⁶

94. The Asbury plant retirement date is undetermined. The earliest any party has alleged that the plant could be considered retired is December 12, 2019.¹³⁷

¹³⁶ *Order Denying Public Counsel's Motion to Modify the Test Year and Order to File Suggestions for Inclusion in an Accounting Authority Order*, January 28, 2020.

¹³⁷ Ex. 299-18, *OPC Reply to Testimony Responding to Commission Questions of John A. Robinett*, P. 9.

95. It would be unjust and unreasonable to attempt to make isolated adjustments to the revenue requirement in this case due to the retirement of Asbury, as many of the components are not known and measurable at this time.

96. The Global Stipulation and Agreement accounts for an AAO to capture all financial impacts from Asbury's retirement, and tracks costs from January 1, 2020 forward to permit arguments for various retirement dates.¹³⁸

97. Due to the uncertainties surrounding the retirement of Asbury, if fuel inventories need be considered it is proper to use the most current information reported by Empire for the fuel inventories, as of the true-up period of January 31, 2020.¹³⁹

98. If operations and maintenance (O&M) expense need be considered, it is proper to use the appropriate normalized level of \$28,877,386 before jurisdictional allocations for Empire as a whole.¹⁴⁰

99. If generating unit maintenance needs to be considered, the appropriate average of years to be used to set maintenance expense for Riverton is 3 years, for the State Combined Cycle Unit, the Common Unit and State Line Unit 1 is 5 years.¹⁴¹

100. If depreciation expense and amortization expense needs to be considered, the appropriate amount of depreciation expense to allow is \$71,423,882 and amortization of electric plant is \$3,387,871 for Empire as a whole.¹⁴² The rates for accounts 371 and 373 should remain at the ordered rates of 4.67% and 3.33%, respectively.¹⁴³

¹³⁸ *Global Stipulation and Agreement*, Pp. 9-10.

¹³⁹ Ex. 138-C, *Surrebuttal/True-Up Testimony of Amanda McMellen*, P. 1-2.

¹⁴⁰ Ex. 124, *Staff True-Up Accounting Schedules*; Ex. 143, *Surrebuttal/True-Up Direct Testimony of Ashley Sarver*, P. 6-8.

¹⁴¹ Ex. 124, *Staff True-Up Accounting Schedules*.

¹⁴² Ex. 124, *Staff True-Up Accounting Schedules*.

¹⁴³ Ex. 124, *Staff True-Up Accounting Schedules*.

101. If property taxes needs to be considered, the appropriate amount of property tax expense is \$25,138,294 for Empire as a whole.¹⁴⁴

102. If common property needs to be considered, the appropriate amount for removal of common property from plant in service and accumulated depreciation is \$11,059,772.¹⁴⁵

Affiliate Transactions

103. While Affilaite Transactions are not specifically addressed within the *Global Stipulation and Agreement*, it resolves all revenue requirement issues by providing that there will be no changes to Empire's retail base rates, and thus, approval of the *Global Stipulation and Agreement* represents a resolution of all matters related to affiliate transactions in this matter.¹⁴⁶

Empire's June 2018 refinancing of first mortgage bonds

104. If the Commission need consider the matter of affiliate transactions, the interest rate charged to Empire by its affiliate LUCo to refinance its \$90 million in mortgage bonds made by executing a 15-year \$90 million unsecured promissory note is imprudent.¹⁴⁷

105. In June of 2018, Empire refinanced \$90 million of first mortgage bonds with its affiliates, LUSC and LUCo.¹⁴⁸

106. Empire signed a promissory note with LUCo, that carried a 4.53% interest rate, and was charged a \$450,000 fee associated with the refinancing.¹⁴⁹

107. LUCo did not incur a financing fee.¹⁵⁰

¹⁴⁴ Ex. 101, *Staff's Direct Report*, Pp. 78-79; Ex. 127, *Surrebuttal/True-Up Direct Testimony of Courtney Barron*, Pp. 1-3; Ex. 124, *Staff True-Up Accounting Schedules*.

¹⁴⁵ Ex. 101, *Staff's Direct Report*, P. 19; Ex. 127, *Surrebuttal/True-Up Direct Testimony of Courtney Barron*, Pp. 3-4; Ex. 124, *Staff True-Up Accounting Schedules*.

¹⁴⁶ *Global Stipulation and Agreement*.

¹⁴⁷ Ex. 106: *Rebuttal Testimony of Kimberly Bolin*, Pp. 11-13; Ex. 129: *Surrebuttal/True-Up Testimony of Kimberly K. Bolin*, Pp. 10-12.

¹⁴⁸ Ex. 220: *Schallenberg Direct*, P. 11.

¹⁴⁹ *Id.* at 12.

¹⁵⁰ *Id.*

108. 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.¹⁵¹

109. At the time the transaction was made, Empire did not solicit any bids for the refinancing of the \$90 million first mortgage bonds,¹⁵² and had the capability to get commercial financing with a lower interest rate.¹⁵³

110. The 4.53% interest rate charged to Empire by LUCo was likely higher than what it could have obtained for itself.

Empire's Transactions with Upstream Affiliates

111. Most of Empire's transactions with its affiliates Empire are for corporate support services;¹⁵⁴

112. These services are provided by Empire's affiliates on a shared basis where there is an opportunity to realize economies of scale or other efficiencies;¹⁵⁵ 67. Through the shared services model, Empire receives services vital to the day-to-day conduct of the utility;¹⁵⁶

113. These services are provided to Empire by upstream affiliates LUSC, LUC, and APUC.¹⁵⁷

¹⁵¹ Ex. 106; *Bolin Rebuttal*, Pp. 11-12.

¹⁵² Ex. 129; *Bolin Surrebuttal* P. 11.

¹⁵³ Ex. 220; *Schallenberg Direct* P. 11.

¹⁵⁴ Ex. 26; *Schwartz Surrebuttal* P. 5; Ex. 114; *Oligschlaeger Rebuttal* P. 6; citing Commission Rule 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 development activities.

¹⁵⁵ Ex. 24; *Schwartz Direct*, P. 3.

¹⁵⁶ Ex. 24 *Schwartz Direct*, P. 9.

¹⁵⁷ Ex. 24 P. 3.

114. LUSC, LUC, and APUC are “centralized service companies” pursuant to the Public Holding Company Act of 2005, and are required to transact with affiliates for services “at cost.”¹⁵⁸

115. Provision of corporate services to a number of affiliates on a centralized basis should be inherently more cost-effective than having each affiliate provide them for themselves;¹⁵⁹

116. Empire has seen noticeable cost reductions in recent years relating to treasury services, internal audits, and human resources, all of which are now provided on a centralized basis.¹⁶⁰

117. The upstream affiliate charges for these services are calculated at cost, with no profit margin included,¹⁶¹ and allocated to Empire, either directly or indirectly in accordance with a series of affiliate services agreements¹⁶² and with its Cost Allocation Manual (“CAM”).¹⁶³ Thus, as explained by Staff witness Mark L. Oligschlaeger, these transactions do not carry the same risk of impropriety as transactions with competitive affiliates seeking a profit.

¹⁵⁸ Ex. 24: *Schwartz Direct*, P. 3.

¹⁵⁹ Ex. 114, *Oligschlaeger Rebuttal*, P. 6; Of note, the Federal Energy Regulatory Commission (“FERC”) shares in this opinion. In FERC Order 667, one of several rulemaking orders implementing regulations facilitating the repeal of the Public Holding Company Act of 1935 and the enactment of the Public Utilities Holding Company Act of 2005, it stated, “Fundamentally, we agree with commenters such as American Transmission Company and Progress Energy that centralized provision of accounting, human resources, legal, tax and other such services benefits ratepayers through increased efficiency and economies of scale. Further, we recognize that it is frequently difficult to define the market value of the specialized services provided by centralized service companies. Accordingly, the Commission will apply a rebuttable presumption that costs incurred under “at cost” pricing of such services are reasonable.” *Repeal of the Public Utility Holding Company Act of 1935 and Enactment of the Public Utility Holding Company Act of 2005*, 70 FR 75592-01. As noted on page 93 of Staff’s Initial Brief, APUC, LUC, and LUSC are “centralized service companies” subject to the jurisdiction of FERC, and are required to transact with affiliates at cost.

¹⁶⁰ Ex. 24: *Schwartz Direct*, P. 10.

¹⁶¹ Ex. 114: *Oligschlaeger Rebuttal*, P. 6; Schedule RES-D-6 of Ex. 220: *Schallenberg Direct*, P. 7.

¹⁶² Ex. 25: *Schwartz Rebuttal*, P. 4.

¹⁶³ Ex 101: *Staff Direct Cost of Service Report*, P. 29.

118. Staff conducted a full audit of Empire in the course of this case, including a review of the costs allocated to it from upstream affiliates, and, with the exception of certain incentive compensation plans, has found those costs to be reasonable.¹⁶⁴

CONCLUSIONS OF LAW

1. In order to determine the appropriate revenue requirement for an investor-owned utility, you first must calculate the cost of service for that utility.¹⁶⁵ 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 Base¹⁶⁶

2. A determination of rate base and current net operating income based on existing rates are other crucial components of the ratemaking process.¹⁶⁷

3. Rate base and the rate of return are combined to determine the net operating income for the utility.¹⁶⁸

4. Adjustments for various elements of the case are made to the net operating

¹⁶⁴ Ex. 101: *Staff Direct Cost of Service Report*, Pp. 29-32.

¹⁶⁵ *Staff's Initial Brief*, P. 6; citing Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 3-4.

¹⁶⁶ *Staff's Initial Brief*, P. 6; citing Ex. 100, *Direct Testimony of Kimberly K. Bolin*, P. 4.

¹⁶⁷ *Staff's Initial Brief*, P. 6; citing Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 6-7.

¹⁶⁸ *Staff's Initial Brief*, P. 6; citing Ex. 100, *Direct Testimony of Kimberly K. Bolin*, Pp. 7-9.

income determined to be necessary and the return on equity is applied for the final determination of the necessary total income from rates.¹⁶⁹

5. The Public Service Commission has been granted rulemaking authority by Section 386.125, RSMo.

6. The Commission is authorized to perform any action authorized by Chapter 386, RSMo, pursuant to Section 386.240, RSMo.

7. Any rule authorized by the Commission is binding on a public utility under Section 386.240, RSMo.

8. The Commission has jurisdiction over electric utilities such as Empire District Electric Company pursuant to Section 386.250, RSMo.

9. An electric utility regulated in Missouri is required to keep all accounts according to the Uniform System of Accounts (USOA) pursuant to Commission Rule 20 CSR 4240-20.030.

Global Stipulation and Agreement:

10. Parties may file a Stipulation and Agreement at any time in a case and the Commission may resolve an entire case on the basis of a Stipulation and Agreement pursuant to Commission Rule 20 CSR 4240-2.115.1.

11. The settlement reached in this matter is such that, “the signatories do not stipulate to a specific capital structure, rate base, return on equity and overall rate of return.”¹⁷⁰

12. A phase-in rate mechanism is permitted by Section 393.155.1, RSMo.

Cost of Capital – Return on Equity:

¹⁶⁹ Staff's Initial Brief, P. 6; citing Ex. 100, Direct Testimony of Kimberly K. Bolin, Pp. 9-10.

¹⁷⁰ Staff's Initial Brief, P. 6; citing *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).

13. Capital is money.¹⁷¹ 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.¹⁷²

14. Capital has a cost and so rate case cost of capital issues are all about the rate of return (“ROR”).¹⁷³ 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.¹⁷⁴ In calculating the WACC, each category of capital is proportionately weighted by its cost and its quantity.¹⁷⁵ 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.

15. 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

¹⁷¹ *Investopedia*, accessed 04-21-20.

¹⁷² *Lexico (Oxford)*, accessed 04-21-20.

¹⁷³ 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.

¹⁷⁴ *Wikipedia*, accessed 04-21-20.

¹⁷⁵ *Investopedia*, accessed 04-21-20.

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.

16. The utility's shareholders have an absolute right to an opportunity to earn a reasonable return on the public use of their private property.¹⁷⁶ 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.¹⁷⁷ 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.¹⁷⁸ A ROR equal to the utility's WACC meets all of these requirements.¹⁷⁹

17. The Commission concludes that Staff's ROE, Capital Structure, and Cost of Debt recommendations are appropriate for use in setting Empire's prospective rates. Staff's recommendations meet all applicable constitutional and regulatory guidelines.

Rate Design:

18. Staff applied its Class Cost of Service Study to the necessary total income from rates determined in the ratemaking process to arrive at its recommended rates, if the Commission does not approve the terms of the Agreement.¹⁸⁰

19. Rate schedules used by an electric company should be compliant with the terms of 20 CSR 4240-20.105.

¹⁷⁶ *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41, 49 (Mo. banc 1979) ("**UCCM**").

¹⁷⁷ *Zinerman v. Burch*, 494 U.S. 113, 125, 110 S.Ct. 975, 983, 108 L.Ed.2d 100, ___ (1990) (internal quotation omitted).

¹⁷⁸ *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).

¹⁷⁹ Staff's *Cost of Capital Report*, p. 7.

¹⁸⁰ Staff's *Initial Brief*, P. 8; citing Ex. 104, *Staff Direct Report – Class Cost of Service*, Pp. 25-26.

20. Utilities are required to provide safe and adequate service.¹⁸¹ In determining the rates Empire may charge its customers, the Commission is required to determine that the proposed rates are just and reasonable.¹⁸²

SRLE

21. A mechanism such as the SRLE is permitted by Section 386.266.3, RSMo.

22. There are no statutory distinctions to be drafted between gas utilities and electric utilities to allow for disparate treatment.

23. The Commission can authorize the SRLE mechanism as the Commission has previously promulgated rules governing the applications for rate cases and authorized rate adjustment mechanisms under Section 386.266.3, RSMo.¹⁸³

FAC:

24. The Commission cannot revise Empire's FAC without inquiry into whether a revised tariff allows Empire reasonable opportunity to realize its ROR pursuant to Section 386.266, RSMo.¹⁸⁴

25. Commission Rule 20 CSR 4240-20.090 sets out the requirements for any Fuel and Purchased Power Rate Adjustment Mechanism such as an FAC.

26. The FAC statute is not ambiguous and there is no reason for the Commission to consider the PISA deferral in interpreting it.¹⁸⁵

¹⁸¹ Sections 393.130 and 393.140, RSMo.

¹⁸² Section 393.150.2, RSMo.

¹⁸³ *Staff's Initial Brief*, P. 37; citing 20 CSR 4240-3.030.

¹⁸⁴ *Staff's Responsive Brief*, Pp. 21-22

¹⁸⁵ *Staff's Responsive Brief*, P. 24

Customer Service

27. Commission Rule 20 CSR 4240-10.030 establishes the standards of quality to which all Missouri electric utilities are held.

28. Commission Rules 20 CSR 4240-10.040 and 13.020 establish the service and billing practices all electric utilities in Missouri must adhere to in serving Missouri's citizens.

Credit Card Fees

29. Including credit card fees in rate base is consistent with other expenses included in rate base.

Rate Case Expense

30. Sharing rate case expense is appropriate based on the Commission's prior order upheld by the Missouri Court of Appeals.¹⁸⁶

31. Pursuant to 20 CSR 4240-3.160.1(A) an electric utility is required to submit its depreciation study, database and property unit catalog when it files its request for a general rate increase unless it has submitted such things within the past five years and 20 CSR 4240-3.175 outlines the requirements for such studies.

32. It is proper to include the costs of the depreciation study in rate case expense as the company is required to conduct such a study by 20 CSR 4240-3.175.

Management Expense

33. No additional adjustments need be made in relation to management expense.

AFUDC

34. No additional adjustments need be made in relation to AFUDC.

¹⁸⁶ See *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).

Cash Working Capital

35. It is proper to assign a lag time for income tax consistent with the Internal Revenue Code.¹⁸⁷

Accruated Deferred Income Tax

36. Companies incur income tax and it is appropriate to include a reasonable portion in rates.

Tax Cuts and Jobs Act/Revenue

37. Section 393.137 permits adjustment of an electric company's rates consistent with the Tax Cuts and Jobs Act of 2017 (TCJA).¹⁸⁸

38. Events that are unanticipated and unexpected, outside of the direct control of the utility are appropriate for an AAO because such events are not included in rate on an ongoing basis.¹⁸⁹

39. An adjustment to the TCJA revenues to account for the difference that was actually billed to customer and what would have been billed to customers had the Act been in effect the entire year is proper.¹⁹⁰

Asbury

40. The Commission has already ruled multiple times that the Asbury retirement issue should not be addressed in this case but should be addressed in Empire's next general rate case.¹⁹¹

41. The Commission stated that it was proper to include any items related to Asbury's retirement in an AAO for consideration in the next general rate case.¹⁹²

¹⁸⁷ Section 6655 Internal Revenue Code, (requiring corporations to make quarterly income tax payments of at least 25% of the total annual payment).

¹⁸⁸ *Staff's Initial Brief*, P. 67.

¹⁸⁹ *Staff's Initial Brief*, P. 69; citing Ex. 141, *Surrebuttal Testimony of Mark Oligschlaeger*, P. 3.

¹⁹⁰ *Staff's Initial Brief*, Pp. 72-73.

¹⁹¹ *Staff's Initial Brief*, P. 74.

¹⁹² *Staff's Initial Brief*, P. 74.

42. 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 ratemaking.¹⁹³

43. 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).¹⁹⁴

44. The Commission has ruled that retiring a generating plant can count as an unusual event.¹⁹⁵

45. It is appropriate to include 18 burn days for fuel inventory for Asbury.¹⁹⁶

46. It is appropriate to include \$28,877,386 for operation and maintenance expense for Empire as a whole.¹⁹⁷

47. It is appropriate to include \$71,423,882 for depreciation expense and \$3,387,871 for amortization of electric plant for Empire as a whole.¹⁹⁸

48. It is appropriate to remove \$6,391,485 for unbilled revenues, and to remove \$9,923,350 for franchise tax revenues for Empire as a whole. It is appropriate to remove \$17,047,207 for FAC revenues for Empire as a whole.¹⁹⁹

49. It is appropriate to include \$25,138,294 for property tax expense for Empire as a whole.²⁰⁰

¹⁹³ *Staff's Initial Brief*, P. 78; *citing The Office of the Public Counsel and the Midwest Energy Consumers Group v. KCP&L Greater Missouri Operations Company*, Case No. EC-2019-0200.

¹⁹⁴ *Staff's Initial Brief*, P. 78; *citing The Office of the Public Counsel and the Midwest Energy Consumers Group v. KCP&L Greater Missouri Operations Company*, Case No. EC-2019-0200.

¹⁹⁵ *aff's Initial Brief*, P. 78; *citing The Office of the Public Counsel and the Midwest Energy Consumers Group v. KCP&L Greater Missouri Operations Company*, Case No. EC-2019-0200.

¹⁹⁶ *Staff's Initial Brief*, P. 82; *citing Ex. 138-C, McMellen Surrebuttal/True-up Testimony*, Pp. 1-2.

¹⁹⁷ *Staff's Initial Brief*, P. 82; *citing Ex. 124, Staff True-up Accounting Schedules; Ex. 143, Sarver Surrebuttal/True-up Testimony*, Pp. 6-8.

¹⁹⁸ *Staff's Initial Brief*, P. 83; *citing Ex. 124, Staff True-up Accounting Schedules.*

¹⁹⁹ *Staff's Initial Brief*, P. 83; *citing Ex. 101, Staff's Cost of Service Report*, Pp. 49-51; *Ex. 139, Newkirk Surrebuttal/True-up Testimony*, Pp. 1-2.

²⁰⁰ *Staff's Initial Brief*, P. 85; *citing 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.*

50. It is appropriate for removal of common property from plant in service and accumulated depreciation to include \$11,059,772 for Empire as a whole.²⁰¹

Affiliate Transactions

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

51. 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."²⁰²

52. "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*, 27 Mo. P.S.C. (N.S.) 183 (1985) and has been applied by it since that point."²⁰³

53. 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."²⁰⁴

²⁰¹ *Staff's Initial Brief*, P. 85; *citing* 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.

²⁰² *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)).

²⁰³ *Office of Public Counsel v. Missouri Public Service Com'n*, 409 S.W.3d 371, 376 (Mo. banc 2013).

²⁰⁴ *Office of Public Counsel v. Missouri Public Service Com'n*, 409 S.W.3d 371, 377 (Mo. banc 2013).

54. It is proper to remove \$450,000 for the origination fee associated with the refinancing of the \$90 million in mortgage bonds.²⁰⁵

Empire's June 2018 \$90 Million Refinancing

55. Empire had the capability to get commercial financing with a lower interest rate at the time it refinanced its \$90 million of first mortgage bonds with its affiliate. Thus, incurring this debt at a higher interest rate than necessary was imprudent, and harmed rate payers.

Empire's Transactions with Upstream Affiliates

56. Empire has met its burden of proof to show its transactions with upstream affiliates were prudently incurred.²⁰⁶

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

57. The Affiliate Transactions Rules are codified in 20 CSR 4240-20.015.

58. The intent of the Commission's Affiliate Transactions Rules is to prevent regulated utilities from subsidizing their non-regulated operations.²⁰⁷

59. To accomplish this, the rule prohibits a regulated electrical corporation from providing a financial advantage to an affiliated entity.²⁰⁸

²⁰⁵ Staff's Responsive Brief Pp. 44-45.

²⁰⁶ Staff's Initial Brief: P. 98.

²⁰⁷ 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).

²⁰⁸ 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

60. Empire did not solicit any bids for the refinancing of its \$90 million first mortgage bonds, and had the capability to obtain commercial financing with a lower interest rate than it secured from LUCo. Thus, the transaction resulted in a financial advantage to Empire's affiliate, in violation of Commission Rule 20 CSR 4240-20.015.

Empire's Transactions with Upstream Affiliates.

61. Empire has sufficiently demonstrated that its transactions with up stream affiliates, other than its \$90 million refinancing of first mortgage bonds, are consistent with the purpose of Commission Rule 20 CSR 4240-20.015.

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

62. The appropriate cost of debt related to Empire's June 2018 refinancing of first mortgage bonds is 2.15%, and should be reflected in Empire's embedded cost of debt.

63. Empire's revenue requirement should be reduced by the effect of the \$450,000 origination fee charged by LUCo to Empire for the refinancing.²⁰⁹

64. No separate amount for affiliate transactions need be included in Empire's revenue requirement.²¹⁰

Respectfully submitted,

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²⁰⁹ Staff's Responsive Brief P. 53.

²¹⁰ Staff's Initial Brief, P. 87.

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 18th day of May, 2020, to all counsel of record.

/s/ Whitney Payne