

**Exhibit No.:** \_\_\_\_\_  
**Issue(s):** NOL Rate Base Deduction  
CWC Adjustment for Income Tax  
**Witness/Type of Exhibit:** Riley/Surrebuttal  
**Sponsoring Party:** Public Counsel  
**Case No.:** ER-2019-0374

**SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

Filed on Behalf of the Office of the Public Counsel

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

CASE NO. ER-2019-0374

March 27, 2020

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

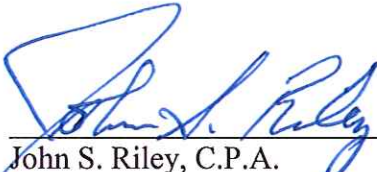
In the Matter of The Empire District            )  
Electric Company's Request for Authority    )  
to File Tariffs Increasing Rates for Electric ) Case No. ER-2019-0374  
Service Provided to Customers in its        )  
Missouri Service Area                            )

**AFFIDAVIT OF JOHN S. RILEY**

STATE OF MISSOURI    )  
  ) ss  
COUNTY OF COLE     )

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

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

  
\_\_\_\_\_  
John S. Riley, C.P.A.  
Public Utility Accountant III

Subscribed and sworn to me this 27<sup>th</sup> day of March 2020.



TIFFANY HILDEBRAND  
My Commission Expires  
August 8, 2023  
Cole County  
Commission #15637121

  
\_\_\_\_\_  
Tiffany Hildebrand  
Notary Public

My Commission expires August 8, 2023.

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**SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

**CASE NO. ER-2019-0374**

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

3 A. Yes.

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

5 A. To refute Empire witness Ms. Sheri Richard's argument that a net operating loss ("NOL")  
6 should be a reduction to the accumulated deferred income tax balance ("ADIT"). I also  
7 explain how Mr. Timothy Lyons has confused income tax liability with the collection of  
8 income tax expense in the revenue requirement. Understanding the difference will explain  
9 how the cash working capital ("CWC") calculation of income taxes should be a reduction to  
10 rate base.

11 **DISALLOW NOL RATE BASE DEDUCTION**

12 **Q. Can you summarize Ms. Richard's argument for reducing ADIT by the amount of the**  
13 **NOL?**

14 A. Ms. Richard uses the logic that the use of accelerated depreciation for tax purposes increases  
15 the ADIT balance and that same tax advantage depreciation also is the reason for the NOL.  
16 Because the tax advantage depreciation is reason for both events then the two events should

1 offset each other. Ms. Richard states: “For ADIT purposes, NOLs constitute a deferred  
2 tax asset which reduces overall ADIT. The IRS has issued numerous private letter  
3 rulings which provide that an NOL deferred tax asset resulting from accelerated  
4 depreciation should be offset against a Plant deferred tax liability also resulting from  
5 accelerated tax depreciation for ratemaking purposes.”<sup>1</sup>

6 **Q. How do you respond to that quote?**

7 A. First of all, an NOL is a tax return item. It is only created by completing an income tax return.<sup>2</sup>  
8 Given that fact, the first observation is that there is no tax return to substantiate the basis of  
9 the NOL.

10 **Q. Why do you say that there is no tax return to substantiate the NOL?**

11 A. For income tax purposes, since January 2, 2017, Empire has been a subsidiary of Liberty  
12 Utilities (America) Co. and is included in the consolidated income tax return filed by the  
13 parent. Where did Empire procure a subsidiary specific NOL? Furthermore, how has it  
14 proved that the NOL is directly tied to accelerated depreciation? When Empire was absorbed  
15 by Liberty Utilities, its income tax NOL carryforward of more than \$53 million dollars<sup>3</sup> was  
16 also absorbed, and was no longer subsidiary specific. Having Empire propose to reduce its  
17 ADIT by a \$2,621,928 NOL when the parent company has control of the corporation’s tax  
18 umbrella is an improper attempt to prop up rate base.

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<sup>1</sup> Richard rebuttal, bottom page 8 and top of page 9.

<sup>2</sup> Case No. WO-2018-0373, Report & Order, Finding of Fact No. 12 “An NOL is a tax return adjustment and not a regulatory item.”

<sup>3</sup> Liberty Utilities 2017 consolidated federal income tax return, statement 42.

1 **Q. How has the Commission’s Staff dealt with this Empire adjustment to its books in Staff’s**  
2 **schedules and workpapers?**

3 A. Staff allowed the adjustment in its workpapers, with a note stating, “Excluded \$2,621,928  
4 and \$852,431 because Company excludes.”<sup>4</sup> Staff did not question Empire’s adjustment  
5 and accepted it.

6 **Q. Could you please summarize your adjustment?**

7 A. Yes. The Commission should reject Empire and Staff’s use of an NOL balance of  
8 \$2,621,928 as a reduction to Empire’s overall balance of ADIT when determining Empire’s  
9 cost of service. As I explained in my direct testimony, “To include an NOL and reduce the  
10 ADIT would be to disregard the benefit of income tax expense in rates. To put it another  
11 way, including an NOL would be double dipping on a regulatory benefit as well as the cost  
12 principle.” The result is that a higher ADIT balance (higher by \$2,621,928) than those of  
13 Empire and Staff should be used to offset Empire’s rate base.

14 **CWC ADJUSTMENT FOR NONPAYMENT OF INCOME TAXES**

15 **Q. Company witness Mr. Timothy S. Lyons argues in his rebuttal testimony that Empire**  
16 **based its income tax calculations on payment dates established in IRS rules. Is this**  
17 **the correct lead/lag to calculate the income tax impact on CWC?**

18 A. The short answer is “no.” I stated in my direct testimony that I did not disagree with Mr.  
19 Lyons’ formula, but only took issue with his expense lag for income tax payments. It  
20 appears that Mr. Lyons based his calculations on amounts and information provided by the  
21 Company. It’s not Mr. Lyons’ responsibility to verify the accuracy of that information. If

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<sup>4</sup> Staff witness Foster ADIT excel workpapers.

1 the Company actually owed income taxes then the IRS would require Liberty Utilities  
2 (America) to make payments on “the 15<sup>th</sup> day of the 4<sup>th</sup>, 6<sup>th</sup>, 9<sup>th</sup>, and 12<sup>th</sup> months of the  
3 corporation’s year.”<sup>5</sup> Apparently, Empire never pointed out to Mr. Lyons that it hasn’t  
4 paid income tax for at least four (4) years. The lack of any income tax payment is the basis  
5 of the negative 365 days’ expense lag adjustment. The lack of payments makes the IRS  
6 payment schedule moot.

7 **Q. Mr. Lyons states: “Second, if the Commission determines in this rate case proceeding  
8 that the Company has no income tax expense, then the Company’s lead days would  
9 be applied to a “zero” expense resulting in no cash working capital requirement.”<sup>6</sup> Is  
10 he correct?**

11 A. No. A regulated utility always has an income tax expense. In fact, Staff has currently  
12 established just over \$17.6 million as the income tax expense to include in Empire’s  
13 revenue requirement for setting its rates in this case.<sup>7</sup>

14 **Q. How do you interpret his statement?**

15 A. I think Mr. Lyons is trying to imply that if Empire does not pay income tax, then it has no  
16 income tax expense and, therefore, has a zero cash working capital requirement.

17 **Q. You have testified that Empire has not paid income taxes for four years, should the  
18 CWC tax calculation just be zeroed out as Mr. Lyons suggests?**

19 A. No. Just deleting the CWC tax calculation does not recognize the fact that Empire’s  
20 customers will pay for \$17.6 million of income taxes in rates, but Empire will pay \$0

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<sup>5</sup> Lyons rebuttal, page 4, lines 8 and 9.

<sup>6</sup> Lyons rebuttal, page 4, lines 13 -15.

<sup>7</sup> Approximate taxes calculated on the mid-range revenue requirement in Staff’s rebuttal accounting schedules.

1 dollars to the federal and state governments for income taxes. This is a cost to Empire's  
2 customers and interest-free money to Empire. There are two sides to the calculation, but  
3 Empire wants the Commission to recognize only one side.

4 **Q. So your contention is that Empire enjoys the use of \$17.6 million dollars from its**  
5 **customers without ever having to actually pay any income taxes and, therefore, the**  
6 **expense lag should represent the entire year?**

7 A. Exactly. There are several expenses within the CWC calculations that have negative lags  
8 (collecting the funds from customers before the cost is to be paid): Pensions, city tax,  
9 vacation pay and property taxes are some of these expenses. But the characteristic that  
10 separates those expenses from income taxes is that those costs eventually get paid  
11 sometime within the year. Income taxes are not paid. Hence my contention is that income  
12 tax expense—here \$17.6 million—is free money to Empire, and Empire has an entire year  
13 of expense lag.

14 **Q. What has Staff included in its CWC calculations for income tax?**

15 A. Staff has included a positive \$132,658 for income tax within the total CWC amount.

16 **Q. What is your most recent calculation of Empire's income tax CWC?**

17 A. Using the Staff mid-range income tax amounts from its original accounting schedules, the  
18 CWC amount for income tax is a negative \$15,575,504. See attached Schedule JSR-S-01

19 **Q. Why do you and Staff differ?**

20 A. It appears that Staff has assumed that Empire will actually make payments to the taxing  
21 authorities and has made its calculations based on that assumption.



Surrebuttal Testimony of  
John S. Riley  
Case No. ER-2019-0374

1 **Q. Do you expect Empire to have an income tax liability prior to its next rate case filing?**

2 A. No.

3 **Q. Does this conclude your surrebuttal testimony?**

4 A. Yes.

**OPC Recalculation of income tax expense for CWC ER-2019-0374**

<b>Company</b>	<b>TAX OFFSET FROM RATE BASE:</b>	<b>Annual Amount</b>	<b>Daily Average</b>	<b>Revenue Lag</b>	<b>Expense Lag</b>	<b>Lead/Lag Days</b>	
calculations	INCOME TAX OFFSET	\$ 10,996,093.00	\$ 30,126.00	42.13	(37.00)	5.130	\$ 154,546.38
<b>OPC</b>	<b>TAX OFFSET FROM RATE BASE:</b>						
Calculations	INCOME TAX OFFSET	\$ 17,607,888.00	\$ 48,240.79	42.13	(365.00)	(322.870)	<u>\$ (15,575,503.56)</u>
<b>Staff</b>	<b>TAX OFFSET FROM RATE BASE:</b>						
	INCOME TAX OFFSET	\$ 17,607,888.00	\$ 48,240.79	42.13	(39.38)	2.75	<u>\$ 132,662.17</u>
<b>Adjustment from Company</b>							<u><u>\$ (15,730,049.94)</u></u>