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

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| In the Matter of the Petition of The Empire District Electric Company d/b/a Liberty to Obtain a Financing Order that Authorizes the Issuance of Securitized Utility Tariff Bonds for Qualified Extraordinary Costs | ) ) ) ) ) | Case No. EO-2022-0040 |
| In the Matter of the Petition of The Empire District Electric Company d/b/a Liberty to Obtain a Financing Order that Authorizes the Issuance of Securitized Utility Tariff Bonds for Energy Transition Costs Related to the Asbury Plant | ) ) ) ) ) | Case No. EO-2022-0193 |

## MOTION FOR RECONSIDERATION OR CLARIFICATION AND/OR APPLICATION FOR REHEARING

**COMES NOW** The Empire District Electric Company, a Liberty company ("Liberty" or "Company") and, pursuant to RSMo. §386.500, submits its *Motion for Reconsideration or Clarification and/or Application for Rehearing* concerning the *Report and Order* issued by the Missouri Public Service Commission ("Commission") in the above-captioned matter on August 18, 2022.

The *Report and Order* (the "Order") is unlawful, unreasonable, unjust, arbitrary, and an abuse of discretion for one or more or all of the reasons hereinafter set forth. For the reasons stated in the following paragraphs, the decision of the Commission should be reconsidered or reheard, and the Order should be amended or superseded to address and correct the matters of error raised by the Company.

The Commission's careful consideration of this rehearing application is especially important given that the Order is the first time that the Commission has applied the securitization statute that the Missouri legislature enacted in 2021. *See* RSMo. §393.1700. What the Commission does here not only has a serious effect on Liberty and its customers but also sets a

precedent for how the Commission will implement §393.1700 and what costs other Missouri utilities will be allowed to securitize. Liberty has identified a number of errors—including an objective error as to the "ADIT offset," Order, p. 52—in the Commission's approach to the new statute, which in total result in an improper reduction of the amount to be securitized here of more than $72 million. If the Commission permits those errors to stand, then the incentive for Liberty to issue securitized bonds, which has very significant advantages for customers, is greatly reduced. *See* RSMo. §393.1700.3(5) (permitting a utility to choose to "abandon[] the issuance of securitized utility tariff bonds under the financing order"). And the incentive for other utilities to seek authorization to proceed under the securitization statute is likewise greatly reduced. That seriously increases the risk that the benefits that the legislature intended to confer on customers (and others) through enactment of the securitization statute will be lost.

## I. The Commission's Calculation of the ADIT Offset Amount Is Contrary to Law and Unreasonable

The Order addresses accumulated deferred income taxes ("ADIT") only briefly and conclusorily. The Order adopts the calculation of Staff's witness, which results in a "net present value of Liberty's ADIT offset of $17,134,363." Order, p. 52 (Finding of Fact 107); *see id.* at 54. And the Order agrees with that witness that "Liberty's calculation of the net present value of its ADIT offset effectively and inappropriately discounted the ADIT twice by discounting the yearly amounts related to the remaining balance of ADIT, and then discounting the sum of the yearly amounts again." Order, p. 52. The Order recognizes that the exact amount of the ADIT offset will vary depending on the Commission's resolution of other issues affecting the starting point of the Asbury Energy Transition Cost Balance, the bond interest rate, and other inputs. Order, p. 52 (Findings of Fact 106, 110). By adopting the Staff calculation methodology, however, the Order deprives Liberty of the ability to securitize a substantial portion of energy transition costs that the

Commission agrees are otherwise fully appropriate for securitization under §393.1700—approximately $14.1 million, by the Company's estimation.

The excessive ADIT offset the Order adopts reflects taxes that the Company will owe, and that customers have previously funded in rates, but that the Order effectively gives back to customers. *The Order deprives the Company of the source of revenue for paying taxes that will be owed as customers pay principal on the securitized bonds*.

That outcome is objectively wrong. The securitization statute does not shift the obligation to fund the payment of taxes as a cost of electric service from customers to the Company. But by deducting the full amount of Liberty's ADIT balance (discounted to present value), rather than deducting the *tax benefits* associated with that balance (discounted to present value), the Order does just that, contrary to the clear language of the securitization statute. That statute permits deduction only of the present value of the tax benefits associated with ADIT, namely, the deferral of the obligation to pay taxes. The statute provides step-by-step instructions for arriving at that value, which reflects the time value of that deferral, measured by the interest rate on the bonds. Staff's erroneous calculation plainly deviates from that statutory directive. The Order also reaches an unreasonable, unjust, and arbitrary result that amounts to an abuse of the Commission's discretion and will have seriously harmful consequences.

**A. Statutory Violation**

The flaw in the Order's treatment of ADIT is made manifest by the end result. Absent securitization, the amounts the Company has collected in rates, reflected in the ADIT balance, would be available as a source of funds to pay taxes. In contrast, the Order takes that ADIT balance away, meaning the Company would not recover its tax expense in full. That difference is due to the Order's erroneous decision to offset from the securitization principal the full amount of the

ADIT balance, discounted to present value. In effect, that decision returns to customers the full amount of taxes that the Company will pay in the future.

The securitization statute directs the Commission to reduce the amount of energy transition costs to be securitized "by applicable *tax benefits* of accumulated . . . deferred income taxes." RSMo. §393.1700.1(7)(a) (emphasis added); *see* RSMo. §393.1700.2(3)(c)(m) (stating that ADIT "shall be excluded from rate base in future general rate cases and the *net tax benefits* relating to amounts that will be recovered through the issuance of securitized utility tariff bonds shall be credited to retail customers by reducing the amount of such securitized utility tariff bonds that would otherwise be issued") (emphasis added).

There is no question that the "tax benefits" associated with the ADIT balance are distinct from, and less than, the accumulated amount of that balance.[1] ADIT arises because of a timing difference between when the Company collects revenue necessary to cover tax costs and when the Company uses that revenue to pay taxes. ADIT balances occur if, for a period of time after an asset goes into service, the depreciation or amortization expense for determining the revenue requirement for customers is smaller than the corresponding depreciation or amortization expense used for calculating taxable income. The result is that customers pay more to the Company during

[1] In an effort to explain how ADIT works as fully and straightforwardly as possible, the Company respectfully submits along with this rehearing request an affidavit from Bradley M. Seltzer, a tax attorney and former Global and U.S. Tax Leader for Energy and Natural Resources at Deloitte who is a recognized expert in how ADIT works. *See* **Exhibit A** (Seltzer affidavit). Even an otherwise highly qualified accountant likely would not have occasion to fully master ADIT-related issues, but Mr. Seltzer has done so. In submitting the affidavit, the Company does not in any way suggest that the nature of the Commission's error with respect to the ADIT offset is not already apparent from the securitization statute's language, the ADIT-related material in the existing record, and past decisions of Missouri courts and of this Commission discussing ADIT. Rather, the Company submits the affidavit to further aid the Commission's understanding of the nature of the error here and to underscore the importance of this issue to the Company and to all Missouri utilities.

that period for the Company to use in paying taxes than the Company actually pays in taxes, and an ADIT balance accumulates. *See Missouri-Am. Water Co. v. Missouri Pub. Serv. Comm'n*, 602 S.W.3d 252, 255 (Mo. Ct. App. 2020) (ADIT represents the "difference between what is being paid by customers attributable to [the utility's] tax liability, and the amount actually being paid by [the utility] for taxes given the effect of accelerated depreciation").

But an ADIT balance with respect to a given asset is always temporary, and it always reflects an amount that the Company still will owe in taxes in the future. Over time, such an ADIT balance unwinds as the depreciation or amortization expense used for determining the revenue requirement for customers exceeds the depreciation or amortization expense used for calculating taxable income. When ratemaking depreciation/amortization expense exceeds tax depreciation/amortization expense, the Company collects less revenue than it needs to pay its taxes, which reduces the ADIT balance; eventually, the asset is fully depreciated or amortized. At that point, the total amount of revenue collected from customers to pay tax equals the total amount of taxes paid by the Company, and the ADIT balance declines to zero. *See, e.g.*, *State ex rel. Util. Consumers Council of Missouri, Inc. v. Pub. Serv. Comm'n*, 606 S.W.2d 222, 224 (Mo. Ct. App. 1980) ("*UCC*").

For the period that it exists, an ADIT balance is, in effect, a "cost-free addition to capital," *UCC*, 606 S.W.2d at 224, because the Company can access the funds at no cost until such point as they are paid in taxes. The net benefit of ADIT is the time value of money—the ability to hold funds that a utility has collected in rates for purposes of paying a tax before the tax is due.

In traditional ratemaking, a utility gives customers the benefits of the ADIT balance by crediting them with an amount equal to the authorized rate of return multiplied by the ADIT balance. *See* Order, p. 34 (Finding of Fact 54) ("Customers do not receive the recorded amount of

the ADIT liability, instead, they benefit because ADIT liability reduces rate base and customers are charged *a lower revenue requirement reflecting the lower cost of capital*" (emphasis added)); *UCC*, 606 S.W.2d at 224 ("The [ADIT] reserve therefore inures to the benefit of the ratepayers in that the rates do not reflect any cost for the use of the money."); *see also State ex rel. KCP & L Greater Missouri Operations Co. v. Missouri Pub. Serv. Comm'n*, 408 S.W.3d 153, 166 (Mo. Ct. App. 2013) (same). In this way, the benefit of holding ADIT is passed onto customers. Table 1 below shows how this ratemaking adjustment is implemented. The table uses, as an illustration, the $93.6 million investment balance and $22.3 million ADIT balance used by Staff recovered over 13 years:[2]

**Table 1**
**Tax Benefit of ADIT - Traditional Ratemaking**

| Year | Investment Balance | Revenue (taxable income) | Tax Liability | ADIT Balance | Authorized Return | Tax Benefit |
|---|---|---|---|---|---|---|
| (A) | (B) | (C) | (D) | (E) | (F) | (G) = (E)*(F) |
| **0** | 93,567,922 | | | (22,306,686) | | |
| 1 | 86,370,390 | 7,197,532 | 1,715,899 | (20,590,787) | 6.77% | (1,393,996) |
| 2 | 79,172,857 | 7,197,532 | 1,715,899 | (18,874,888) | 6.77% | (1,277,830) |
| 13 | (0) | 7,197,532 | 1,715,899 | - | 6.77% | - |
| Total | | 93,567,922 | 22,306,686 | | | (9,060,976) |

In the securitization context, the benefits of ADIT are measured in an analogous way. The Company must record as taxable income the principal payments on the bonds received from customers. *See* Order, p. 33 (Finding of Fact 53); Ex. 103, Bolin Surreb., p. 5, lines 2-9; IRS Revenue Procedure 2005-62. As the Company incurs a tax liability on that income, the ADIT balance is unwound. Once the bonds are fully repaid, the ADIT balance reduces to zero. The

[2] The Company disagrees with the investment and ADIT balances used by Staff. As noted, the actual amount of the investment and ADIT balances will depend on the Commission's resolution of other issues raised in this application. The total tax benefit shown in Table 1 is nominal (not present valued). As discussed below, the securitization statute requires the Commission to use the present value of the ADIT tax benefits as an offset.

benefit of the ADIT balance is the utility's possession of the cash previously collected in rates to cover the cost of taxes before the Company incurs those tax liabilities.

The securitization statute makes clear that customers will be credited with the benefit of ADIT in the same way as under traditional ratemaking—by multiplying the ADIT balance by the applicable financing cost, which is the bond interest rate instead of the authorized rate of return. Table 2 below shows how this operates, using the same $93.6 million investment balance and $22.3 million ADIT balance recovered over 13 years:

| Table 2 | | | | | | |
|---|---|---|---|---|---|---|
| **Tax Benefit of ADIT - Securitization** | | | | | | |
| **Year** | **Investment Balance** | **Revenue (taxable income)** | **Tax Liability** | **ADIT Balance** | **Authorized Return** | **Tax Benefit** |
| (A) | (B) | (C) | (D) | (E) | (F) | (G) = (E)*(F) |
| **0** | 93,567,922 | | | (22,306,686) | | |
| 1 | 86,370,390 | 7,197,532 | 1,715,899 | (20,590,787) | 2.47% | (508,592) |
| 2 | 79,172,857 | 7,197,532 | 1,715,899 | (18,874,888) | 2.47% | (466,210) |
| 13 | (0) | 7,197,532 | 1,715,899 | - | 2.47% | - |
| Total | | 93,567,922 | 22,306,686 | | | (3,305,851) |

The securitization statute requires one further step to implement the ratemaking adjustment. Instead of providing that benefit as an ongoing credit on customer bills equal to the ADIT balance times the bond interest rate (which would be the precise analog to traditional ratemaking), the securitization statute gives customers that benefit up front by reducing the securitization amount by the present value of that stream of future benefits. *See* RSMo. §393.1700.2(3)(c)(m) ("the net *tax benefits*" of ADIT "relating to amounts that will be recovered through the issuance of securitized utility tariff bonds shall be credited to retail customers by reducing the amount of such securitized utility tariff bonds that would otherwise be issued") (emphasis added). That is illustrated in Table 3 below, which is the same as Table 2 except for the addition of a final column showing the net present value calculation.

| Table 3 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Tax Benefit of ADIT - Securitization - with NPV | | | | | | | |
| Year | Investment Balance | Revenue (taxable income) | Tax Liability | ADIT Balance | Authorized Return | Tax Benefit | NPV |
| (A) | (B) | (C) | (D) | (E) | (F) | (G) = (E)*(F) | (H) |
| | | | | | | | |
| | | | | | | | |
| **0** | 93,567,922 | | | (22,306,686) | | | |
| 1 | 86,370,390 | 7,197,532 | 1,715,899 | (20,590,787) | 2.47% | (508,592) | (496,333) |
| 2 | 79,172,857 | 7,197,532 | 1,715,899 | (18,874,888) | 2.47% | (466,210) | (444,005) |
| 13 | (0) | 7,197,532 | 1,715,899 | - | 2.47% | - | 0 |
| Total | | 93,567,922 | 22,306,686 | | | (3,305,851) | (2,989,284) |

The securitization statute contains detailed, step-by-step instructions for implementing that ratemaking adjustment. Specifically, the statute states that the net present value of the tax benefits that reduces the securitization amount is to be "calculated using [1] a discount rate equal to the expected interest rate of the securitized utility tariff bonds, for the estimated accumulated and excess deferred income taxes at the time of securitization including [2] timing differences created by the issuance of securitized utility tariff bonds amortized over the period of the bonds [3] multiplied by the expected interest rate on such securitized utility tariff bonds." RSMo. §393.1700.2(3)(c)(m).

That statutory language directs the calculation to proceed through the following steps:

1. Use a "discount rate equal to the expected interest rate of the securitized utility tariff bonds." RSMo. §393.1700.2(3)(c)(m). That means that the ADIT balance in a particular year must be multiplied by the bond interest rate, yielding an amount representing the tax benefits *for that year*. In traditional ratemaking, the multiplier instead would be the allowed rate of return.

2. Consider "timing differences created by the issuance of securitized utility tariff bonds amortized over the period of the bonds." RSMo. §393.1700.2(3)(c)(m). That means that the ADIT balance is unwound over the period the bonds are amortized, because that is the period over which the utility incurs tax liability. The statute recognizes that this time period may be different from the time period that would be relevant in traditional ratemaking. An ADIT balance is unwound in traditional ratemaking over the period the asset is depreciated or amortized, which could be different from the period the bonds are amortized. For each of the 13 years the bonds will be outstanding, the ADIT benefit is the *remaining* ADIT balance times the bond interest rate (see step 1).

3. Determine, and credit customers with, the "present value" of ADIT benefits, which represents the ADIT offset. RSMo. §393.1700.2(3)(c)(m). The amount equals the sum of the ADIT benefits for each of the 13 years the bonds will be outstanding (steps 1 and 2), discounted to present value determined by applying "the expected interest rate on such securitized utility tariff bonds." *Id.*

Table 4 shows this three-step procedure. The table is identical to the previous table, except that it labels each of the three steps:

**Table 4**
**Tax Benefit of ADIT - Securitization - with NPV**

| | | | | Step 1 | | | |
|---|---|---|---|---|---|---|---|
| **Year** | **Investment Balance** | **Revenue (taxable income)** | **Tax Liability** | **ADIT Balance** | **Authorized Return** | **Tax Benefit** | **NPV** |
| (A) | (B) | (C) | (D) | (E) | (F) | (G) = (E)*(F) | (H) |
| **0** | 93,567,922 | | | (22,306,686) | | | |
| 1 | 86,370,390 | 7,197,532 | 1,715,899 | (20,590,787) | 2.47% | (508,592) | (496,333) |
| 2 | 79,172,857 | 7,197,532 | 1,715,899 | (18,874,888) | 2.47% | (466,210) | (444,005) |
| 13 | (0) | 7,197,532 | 1,715,899 | - | 2.47% | - | 0 |
| Total | | 93,567,922 | 22,306,686 | | | (3,305,851) | (2,989,284) |
| | | | | | Step 2 | | Step 3 |

Staff's calculation, as adopted by the Commission, entirely *skips* the critical statutory steps of calculating the *tax benefits* of the ADIT balance (steps 1 and 2). Instead, as shown in Table 5, Staff's calculation simply takes the full amount of the ADIT balance, which is not equivalent to the tax benefits of that balance, and discounts the full amount to present value using the interest rate of the securitized bonds (step 3). *See, e.g.*, Tr. Vol. 3, p. 241 (Bolin); Tr. Vol. 2, p. 59 (Staff counsel describing Staff's calculation). That is why the amount that Staff's calculation yields is far too large, producing a result that is unfair to the Company and irreconcilable with the statute.

| Table 5 | | | | | | | |
|---|---|---|---|---|---|---|---|
| Staff Position | | | | | | | |
| | | | | Step 1 (OMITTED) | | | |
| Year | Investment Balance | Revenue (taxable income) | Tax Liability | ADIT Balance | Authorized Return | Tax Benefit | NPV |
| (A) | (B) | (C) | (D) | (E) | (F) | (G) = (E)*(F) | (H) |
| 0 | 93,567,922 | | | | | | |
| 1 | 86,370,390 | 7,197,532 | 1,715,899 | | | | 1,649,903 |
| 2 | 79,172,857 | 7,197,532 | 1,715,899 | | | | 1,586,445 |
| 13 | (0) | 7,197,532 | 1,715,899 | | | | 1,030,524 |
| Total | | 93,567,922 | 22,306,686 | | | | 17,134,363 |
| | | | | Step 2 (OMITTED) | | | Step 3 |

With that understanding of ADIT in mind, it is clear that Staff's witness's criticism of the Company's calculation, which faults the Company for supposedly "discount[ing] the ADIT twice by discounting the yearly amounts related to the remaining balance of ADIT, and then discounting the sum of the yearly amounts again," Order, p. 52, is objectively incorrect. The Company's calculation does *exactly what the statute provides*: it first determines the tax benefits of the ADIT balance and then discounts those benefits to present value. *See* Ex. 8, Emery Surreb., pp. 14-15.

As shown in Tables 1 and 2, steps 1 and 2 track the traditional ratemaking approach. Multiplying the ADIT balance by the bond interest rate for each of the thirteen years the bonds will be outstanding determines the amount of revenue to be credited to customers for each year to reflect the tax benefits of the ADIT balance—precisely the same as crediting customers the ADIT balance times the authorized rate of return in conventional ratemaking. The only difference between steps 1 and 2 and traditional ratemaking is that the bond interest rate is used instead of the authorized rate of return. As shown in Table 3, step 3 is needed to translate that stream of future credits into a present value that reduces the securitization amount. In other words, step 3 determines the present value of the total tax benefits by using the bond interest rate to discount back to present value each of the thirteen annual amounts of the tax benefits of the ADIT balance. The total present value is the "ADIT offset." Order, p. 52; *see* RSMo. §393.1700.2(3)(c)(m).

The Company's methodology does not discount the ADIT balance twice, as the Order finds. Order, p. 52. Steps 1 and 2 use the bond interest rate to quantify the ADIT benefit; Step 3 uses the bond interest rate to discount that benefit to present value. Step 3 is the first and only time discounting takes place. Using the same interest rate for two different purposes does not constitute discounting twice.

The proper calculation of the "ADIT offset," Order, p. 52, is not a matter for the Commission's discretion; it is a matter of statutory command, combined with basic mathematics. And in accepting Staff's erroneous calculation, the Commission has committed an indisputable error. Notably, the Commission did not purport to interpret the securitization statute to require the return to customers of the *full amount* of the ADIT balance (discounted to present value)—nor could the Commission have done so, because the plain language of the statute does not allow for any such interpretation. *See, e.g.*, *Truman Med. Ctr., Inc. v. Progressive Cas. Ins. Co.*, 597 S.W.3d 362, 367 (Mo. App. W.D. 2020) (the "primary rule of statutory interpretation is to give effect to the legislative intent as reflected in the plain language of the statute at issue"). The Commission's error therefore reflects a grave misapplication of the securitization statute, as well as a fundamental misunderstanding what an ADIT balance is and what role it plays in the Company's finances.

The result of the error is that the Order permits the Company to securitize far less than the amount of its otherwise-approved Asbury-related energy transition costs. And that means that the Company is effectively being forced to return to customers amounts that customers have paid for taxes that the Company will *continue to owe in taxes*. *See, e.g.*, Tr. Vol. 3, p. 232 (Bolin agreeing that "those taxes will eventually be paid"). That outcome is far worse for the Company than the outcome under conventional ratemaking, in which the utility recovers from customers the full amount of its tax liabilities.

The securitization statute is not written to require that absurd result—and there is no possible way to interpret it to provide for such an absurdity. To the contrary, statutory interpretations that yield such absurd results are not permissible. *See, e.g.*, *Townsend v. Jefferson Cnty. Sheriff's Dep't*, 602 S.W.3d 262, 265 (Mo. Ct. App. 2020), *reh'g and/or transfer denied* (June 18, 2020).

**B. Unreasonableness**

In addition to violating the statute, the Commission's treatment of the ADIT offset is unreasonable, unjust, arbitrary, and an abuse of discretion, for a number of reasons.

First, the Commission purports to be crediting customers with "net tax benefits relating to amounts that will be recovered through the issuance of securitized utility tariff bonds," RSMo. §393.1700.2(3)(c)m, while evincing no recognition that the Order fails to do so. Instead, as explained above, the Order credits customers with the full amount in the ADIT balance (discounted to present value)—that is, the full amount collected by the Company in order to make tax payments—and that amount does not represent "net tax benefits." The Commission's order therefore makes an arbitrary, unreasonable, and unjust mistake about how to perform a tax-benefit calculation. *Cf., e.g.*, *Spire Missouri, Inc. v. Pub. Serv. Comm'n*, 618 S.W.3d 225, 236 (Mo. 2021); *State ex rel. Missouri Power & Light Co. v. Pub. Serv. Comm'n of State of Mo.*, 669 S.W.2d 941, 945 (Mo. Ct. App. 1984).

Second, the Commission's conclusion is not supported by the evidence in the record and the Commission's explanation of that conclusion is not adequate. *See State ex rel. Monsanto Co. v. PSC*, 716 S.W.2d 791, 795 (Mo. banc 1986) ("Findings of fact that are completely conclusory, providing no insights into how controlling issues were resolved are inadequate."). In assessing whether there is sufficient evidence in the record to support a conclusion, the question is not simply whether there is *any* evidence in the record that points in the direction of the Commission's result.

Rather, the question is whether there is "competent and substantial evidence upon the *whole* record." *State ex rel. Pub. Couns. v. Missouri Pub. Serv. Comm'n*, 289 S.W.3d 240, 251 (Mo. Ct. App. 2009); *see also, e.g.*, *Spire*, 618 S.W.3d at 236 ("Viewed in isolation, there was evidence to support the PSC's decision in this respect, but this Court's review does not use this approach. . . . Instead, the PSC's decision must be supported by competent and substantial evidence on the whole record, including the evidence the PSC rejected.").

Here, the testimony of Staff witness Bolin, on which the Commission relied (without explaining her testimony in the body of the Order itself), is not sufficient to sustain the Commission's result in light of the whole record. Notably, witness Bolin's testimony on the Company's supposed ADIT double-discounting—which is the sole basis provided in the Order for deciding that the Company's ADIT offset calculation is incorrect—is entirely conclusory. Bolin's testimony mechanically states that Liberty multiplied by the securitization yield at two different points in the offset calculation, but does not even attempt to explain why doing so is inconsistent with what the statute requires or is otherwise improper as a matter of regulatory policy. *See* Ex. 102, Bolin Reb., p. 11, lines 10-14, *cited in* Order, p. 52 n.139; Tr. Vol. 3, p. 246 (Bolin); *see also id.* at p. 230 (Bolin describes herself as "*somewhat* of a tax authority" because she has "worked tax issues . . . on other rate cases") (emphasis added); *id.* at p. 234 (Bolin states that she is "*somewhat* familiar" with tax normalization rules) (emphasis added).

In contrast, witness Emery's testimony clearly and cogently explains why Bolin's accusation of double-discounting is just wrong in light of the statutory requirement that only the *tax benefits* of ADIT be deducted from the amount to be securitized. *See* Ex. 8, Emery Surreb., pp. 14-15. As witness Emery stated, "[i]t appears that Ms. Bolin believes that Liberty is discounting ADIT twice because the Company removed the ADIT applicable to securitization and

multiplied it by the securitization yield and then adjusted it again to obtain the [net present value]. However, this approach is correct, because it reflects the anticipated cash in-flows associated with the *benefits* of ADIT. This aligns with the approach taken in calculating an annual revenue requirement where Liberty customers *receive the benefit of the requested rate of return and not the full amount of the ADIT, which is the amount paid to the IRS*." *Id.* (emphasis added). The Commission failed entirely to grapple with witness Emery's explanation or to provide any reasoning for why that explanation is wrong. Indeed, given the objectively incorrect nature of witness Bolin's critique, no reasoned basis for rejecting witness Emery's explanation exists.

Third, the Commission's decision punishes the Company by forcing it to effectively return to customers amounts that it has collected from customers to pay a tax bill that the Company will continue to owe. The Company estimates that the amount at issue is nearly $14.1 million—the difference between the Company's correct calculation of the ADIT offset and the Commission's erroneous conclusion that the ADIT offset is $17,134,363 (representing an amount equal to the entire ADIT balance discounted to present value)—though the precise amount will be a function of the Commission's resolution of other issues and the bond interest rate. Applying the Commission's enormous offset number to prevent the Company from securitizing nearly $14.1 million in energy transition costs that the Commission has otherwise found fully recoverable and securitizable is a severe, arbitrary, and unjust penalty. And it is likewise arbitrary and unjust to force the Company to return to customers the full amount of the ADIT balance, even though the Company will later owe that amount in taxes—which is exactly why the amount was collected from customers in the first place. In particular, the Commission's mistake arbitrarily and unjustly penalizes the Company for seeking recovery of its costs under the securitization statute rather than

under some other authority, even though nothing about securitization itself or the statute authorizing securitization here warrants that result.

Finally, the consequences of the Commission's error on the ADIT offset are severe for utilities in Missouri more generally. As noted above, this is the first Commission decision about ADIT under the new securitization statute, which the legislature enacted in 2021 as a way to allow utilities to recover costs in a manner that is less expensive and burdensome for customers than traditional ratemaking approaches. If the Commission does not rehear the Order and correct the error, then the Order will create serious disincentives for *all* utilities—each of which carries an ADIT balance for a particular asset for a period of time after that asset goes into service—to use the securitization statute with respect to qualified costs. That will, in turn, deprive customers of the benefits that the legislature intended the securitization statute to confer on the public.

The Company urges the Commission to reconsider, clarify, and/or rehear the Order as it relates to the ADIT offset and to order that the offset should be calculated pursuant to the methodology recommended by the Company, consistent with the securitization statute.

## II. The Order's Application of Liberty's 95/5 Fuel Adjustment Clause to Fuel and Purchased Power Costs From Winter Storm Uri Is Arbitrary and Contrary to the Terms of the Securitization Statute

The Order addresses sub-issues 2.A-D as a single topic and limits Liberty's recovery, through securitization, of fuel and power purchase costs from Winter Storm Uri to only 95% of Liberty's incurred costs. The Order does not find that any of those costs were imprudent; on the contrary, it states that "prudence is not relevant" to the recovery of these costs. Order, p. 21. In other words, the Order reasons that 5% of these costs should be disallowed even assuming that 100% of the costs were prudently incurred.

The Commission reached that result by applying to the securitization process what it deemed the 95/5 "sharing mechanism" or "sharing provision" that applies under the Fuel

Adjustment Clause ("FAC") from Liberty's tariff. And the Commission based its decision to apply the 95/5 mechanism here on two theories: (1) that Liberty should not be permitted to recover more than it would through "traditional methods of rate making," which the Commission asserts would exclude 5% under the FAC, and (2) that disallowing Liberty's recovery of 5% of its fuel and purchased power costs is "just and reasonable." Order, p. 21.

The Commission's decision deprives the Company of the ability to securitize $9,670,110 in costs. That decision is legally erroneous as well as unreasonable, unjust, and arbitrary. The decision rests on a misapplication of the principles underlying the FAC and a misreading of the securitization statute. The decision ultimately results in an arbitrary and systematic denial of costs prudently incurred for the benefit of ratepayers.

### A. In the Securitization Context, the 95/5 "Sharing Provision" Results in an Arbitrary Denial of Costs

It is a fundamental principle of public utilities law that "a public utility is entitled to recover from ratepayers all its costs (plus a reasonable return on its investments)," usually through ratemaking. *Spire Missouri*, 618 S.W.3d at 232. A utility is not legally entitled to recover imprudently incurred costs. But the utility must be given a reasonable opportunity to recover in full costs that were prudently incurred in order to provide service to customers. *See, e.g.*, *State ex rel. Associated Nat. Gas Co. v. Pub. Serv. Comm'n of Missouri*, 706 S.W.2d 870, 873 (Mo. Ct. App. 1985) (noting "the ratemaking function must provide sufficient income to cover the utility's operating expenses and debt service"); *see also, e.g.*, *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) (recognizing that it is important "that there be enough revenue not only for operating expenses but also for the capital costs of the business").

Under ordinary circumstances, the 95/5 mechanism contained within Liberty's FAC, which is derived from language found in RSMo. §386.266.1 permitting "incentives to improve the

efficiency and cost-effectiveness of [a utility's] fuel and purchased-power procurement activities," preserves the Company's ability to recover in full its fuel and purchased power costs. The FAC functions to reconcile differences between estimated and actual fuel costs. Rates are initially calculated using a base cost, which is a forecast of future fuel and purchased power costs. The base costs then are adjusted up or down twice yearly based on the difference between the base fuel costs and actually incurred fuel costs. *See* File No. ER-2019-0374 (*Amended Report and Order*, issued July 23, 2020), p. 60. Because actual costs may be higher *or lower* than the base costs, the fact that 5% of the differential in costs is not reconciled through the FAC process does not result in a *per se* disallowance of costs. Those ups and downs tend to net out over time, with the utility and ratepayers approximately breaking even. In 2020, the Commission noted that, over the previous 11 years, Liberty had collected (by various estimates) over 99.5% of FAC costs allocated to customers. *See id.* at p. 64. As a result, the utility continues to retain the opportunity to recover its costs under the normal operation of the 95/5 tariff provision, even as its 5% stake provides an incentive to manage fuel costs efficiently. Order, p. 17; *see* RSMo. §386.266.1; Tr. Vol. 3, p. 289, lines 18-25.

As the Order acknowledges, consistent with the incentive-based rationale behind an FAC, "extraordinary costs are not to be passed through the company's FAC." Order, p. 19; *see* 20 CSR 4240-20.090(8)(A)2.A(XI). By definition, an "extraordinary cost" represents a fuel and purchased power cost that is greater than the base cost forecast. The Company has no opportunity to offset extraordinary costs with equally substantial cost under-runs compared to forecast. Extending the 95/5 mechanism to "extraordinary costs" thus would systematically deprive the Company of the opportunity to fully recover its prudently incurred costs. In other words, applying a 95/5 mechanism to "extraordinary costs" will *always* result in a partial disallowance of recovery of such

costs incurred for the benefit of ratepayers, however prudently incurred. That outcome is contrary to the operation of the FAC and to basic principles of ratemaking.

For that reason, under traditional ratemaking, "extraordinary costs" are not subject to the FAC and instead are tracked in an AAO and reviewed in the utility's next rate case. The Order cites no precedent, and the Company is not aware of any, in which the Commission denied recovery of fuel and purchased power costs recorded in an AAO absent a finding that such costs were imprudently incurred.

The Order's suggestion that it is just and reasonable to disallow 5% of the Winter Storm Uri extraordinary fuel costs, even assuming those costs were prudently incurred, is arbitrary. Under the FAC, the potential 5% disallowance is counterbalanced by the possibility of actual fuel and purchased power costs being lower than the base cost forecast—but no similar opportunity exists with respect to extraordinary costs like those at issue here. Instead, extending the 95/5 mechanism to these costs imposes an arbitrary partial disallowance of an entire category of prudently incurred costs without even the possibility for recovery, which is contrary to the most basic principles of justness and reasonableness in the utility context. *See Hope Nat. Gas Co.*, 320 U.S. at 603.

The Order's reliance on *Spire Missouri, Inc. v. Pub. Serv. Comm'n*, 618 S.W.3d 225 (Mo. 2021), to conclude that utilities do not have a general right to recover prudently incurred costs is misplaced. Order, p. 20. The issue in that case was the Commission's disallowance of costs incurred by a utility in connection with the development of ratemaking proposals that benefitted shareholders. *Spire*, 618 S.W.3d at 229, 233. The Commission assumed that those costs were prudent, in the sense that the utility reasonably managed the amount spent on those activities. The Commission nevertheless concluded that it was just and reasonable to disallow those costs,

because they were solely for shareholder benefit. *See id.* In affirming that conclusion, the Missouri Supreme Court ruled that the Commission did not err in refusing to permit recovery of expenses that "served only to benefit shareholders and minimize shareholder risk with no accompanying benefit (or potential benefit) to ratepayers," because requiring ratepayers to pay costs solely for the benefit of shareholders would not be "just and reasonable." *Id.* at 233. Nothing in *Spire* upsets the general rule that a utility must be permitted at least the opportunity to recover operating expenses prudently incurred *for the benefit of ratepayers*. *Id.*; *see Hope Nat. Gas Co.*, 320 U.S. at 603.

In contrast to the costs at issue in *Spire*, the fuel and purchased power costs at issue here were unquestionably incurred for the benefit of customers. The Order specifically finds that "Liberty incurred [its] extraordinary fuel costs for its Missouri customers during Winter Storm Uri." Order, p. 17. And the Order concludes that Liberty's fuel and purchased power costs, *as a category of costs*, are recoverable through securitization. Order, pp. 12-14, 31-33. But the Order simply imposes a categorical 5% disallowance on that category of costs. Neither *Spire* nor any other authority supports the proposition that it is "just and reasonable" for the Commission to propose a blanket partial disallowance on recovery of a category of costs prudently incurred for the benefit of ratepayers.

### B. The Commission's Decision To Import A 95/5 "Sharing Provision" Into The Securitization Statute Is Flawed On Additional Grounds

The Order's imposition of a 95/5 "sharing provision" in this context is also fatally flawed for a number of additional reasons.

First, Liberty's FAC, as it exists for purposes of ratemaking, is a creature of a statute that is very different than the statute at issue here. RSMo. §386.266.1 authorizes the Commission to "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." No similar language exists in the securitization statute to authorize the Commission to adopt rules such as a 95/5 sharing mechanism. The legislature knew how to authorize a sharing mechanism in the securitization statute if it wanted to, but it chose not to do so.

The legislature's decision not to include language authorizing a cost-sharing mechanism similar to the 95/5 mechanism in the securitization statute is consistent with the purpose of that statute as a whole. Contrary to the Commission's conclusion (Order, p. 17), the purpose of a cost-sharing mechanism—to create incentives for efficient cost management—does not hold in the context of extraordinary costs, which by definition arise from extraordinary events that are extremely hard to predict and plan for and that will naturally lead to higher-than-expected costs no matter how well a utility manages its costs in normal circumstances. And because there is no corresponding opportunity for the utility to *profit* from a sharing mechanism for extraordinary costs, applying a 95/5 rule to extraordinary costs results in a systematic and arbitrary cost disallowance for the utility—which is not a balanced incentive feature.

Second, the Commission's reliance on the notion that the securitization statute "direct[s]" the Commission to calculate the Company's recovery by "compar[ing] the results of the securitization to the results of a recovery of those costs using traditional (non-securitization) method," Order, p. 20; *see id.* at p. 21, is misplaced. Even if the statute called for that comparison, the Order does not conclude that, under traditional ratemaking, 5% of prudently incurred extraordinary costs booked in an AAO would be disallowed. As noted, the 95/5 mechanism applies only to the FAC, which would not apply to the Winter Storm Uri costs. In addition, the provision cited by the Order does not support the Commission's conclusion. The comparison

language on which the Commission relied is found in Section 393.1700.2(3)(c)(b), which states that a financing order shall include "[a] finding that the proposed issuance of securitized utility tariff bonds and the imposition and collection of a securitized utility tariff charge are just and reasonable and in the public interest and are expected to provide quantifiable net present value benefits to customers as compared to recovery of the components of securitized utility tariff costs that would have been incurred absent the issuance of securitized utility tariff bonds." That provision is *separate* from the immediately preceding provision calling on the Commission to make a determination of whether it is just and reasonable for the utility to "recover[]" a certain "amount" of those costs. RSMo. §393.1700.2(3)(c)(a). The mandated comparison therefore cannot be understood to go to the amount; it goes only to the question whether *securitization*, and the associated bond issuance and customer charges, is just and reasonable. In other words, the statute does not make the comparison a *measure* of how much the Company should recover. Rather, the comparison is a mechanical one that is required only insofar as it provides confirmation that securitization is more beneficial to customers than alternatives would be—and here, there is no dispute that securitization is more beneficial. *See* Order, pp. 77-78.

Finally, the Commission's application of a 95/5 "sharing provision" is unjust, reasonable, and arbitrary not only for the reason that the 5% disallowance is itself arbitrary (*see* p. 15, *supra*) but also for various other reasons, which individually and in combination are fatal to the Commission's conclusion. The Commission has imported into the securitization context a mechanism authorized by a different statute and implemented through a specific tariff that has no reasonable application under the different circumstances presented here. The Commission has suggested that the Company could somehow be incentivized *post hoc* to lower its fuel and purchased power costs incurred in connection with a truly extraordinary and unpredictable storm,

which is an irrational conclusion. *See* https://www.smithsonianmag.com/smart-news/how-winter-storm-uri-has-impacted-us-180977055/ (Winter Storm Uri was "extreme" event with unprecedented effects on provision of power to customers in many parts of the country). The Commission's decision *acknowledges* that under customary methods of ratemaking extraordinary costs like these would *not* be subject to the 95/5 tariff provision under the FAC because such costs would not pass through the FAC—but then immediately and contradictorily uses the procedures under the FAC as the basis for a comparison to what would happen under those customary methods, stating vaguely only that in that hypothetical world "Liberty would recover its Winter Storm Uri related fuel and purchased power costs by *starting with* its FAC." Order, p. 21 (emphasis added). In the end, the decision undermines the securitization statute by telling Liberty and other utilities that they will *never* recover the full amount of their extraordinary fuel and purchased power costs under that statute.

## III. Certain of the Commission's Determinations with Respect to Carrying Charges Are Contrary to Law and Unreasonable

### A. The Commission's Exclusion of Carrying Charges for Asbury for the Period Between Plant Retirement and June 2022 Is Contrary to Law and Unreasonable

In the Order, the Commission rejects Liberty's argument that carrying charges as to the Asbury plant "should be recovered for the period after the property was retired through the issuance of the securitized bonds." Order, p. 70. The Commission acknowledges that "the securitization statute specifically includes carrying costs within the definition of energy transition costs that can be recovered through securitization," but states that "nothing i[n] the statute . . . *mandates* that they be included for recovery." *Id.* at pp. 71-72 (emphasis added). The Commission then concludes that it is not just and reasonable for Liberty to "recover its full carrying costs on a generation facility that has not been used and useful since its effective retirement" and that "a more limited recovery of carrying costs for the period after the Asbury plant was removed from Liberty's rates, beginning in June 2022[,] is just and reasonable." *Id.* at p. 72.

That conclusion, which deprives Liberty of a substantial amount in carrying charges, violates the securitization statute. That statute cannot be read to permit a finding that recovery of carrying charges as to a retired plant is not just and reasonable *merely because* that plant is retired.[3] Any such finding is contrary to the plain language and underlying purpose of the securitization statute relating to securitization of energy transition costs. The Commission's conclusion is also unreasonable, unjust, arbitrary, and an abuse of discretion. Among other things, the Commission has permitted carrying charges from June 2022 through bond issuance (projected to be December 2022), without justifying why carrying charges are permissible for that particular period but not

[3] Liberty also seeks rehearing of the Commission's conclusion about the date of the Asbury plant's retirement, but discusses that issue separately below. *See* p. 39, *infra*. This section assumes, purely for purposes of argument, that the Commission's selection of the retirement date was correct.

for the earlier period from plant retirement through May 2022. After all, the plant could have been no more used and usable in the later period than it was in the earlier one.

**1. Statutory violation**

The legislature enacted the securitization statute in 2021 in order to permit utilities to obtain "a financing order to finance energy transition costs" or qualified extraordinary costs "through an issuance of securitized utility tariff bonds." RSMo. §393.1700.2(1). The statute defines "energy transition costs" as costs that arise "with respect to a retired or abandoned or to be retired or abandoned electric generating facility . . . where such early retirement or abandonment is deemed reasonable and prudent by the commission." RSMo. §393.1700.1(7)(a). And the statute specifically states that such costs include (among other things) "accrued carrying charges." *Id.* When this Commission issues a financing order, that order "shall include . . . [t]he amount of . . . costs to be financed using securitized utility tariff bonds and a finding that recovery of such costs is just and reasonable and in the public interest." RSMo. §393.1700.2(3)(c)(a).

Those provisions relating to the recovery and financing of carrying charges must be read together so that they work in harmony and all parts of the statute are given full effect. *See, e.g.*, *Anderson ex rel. Anderson v. Ken Kauffman & Sons Excavating, L.L.C.*, 248 S.W.3d 101, 107 (Mo. Ct. App. 2008) ("[a] provision in a statute must be read in harmony with the entire section") (citation omitted); *id.* at 108; *State ex rel. Evans v. Brown Builders Elec. Co.*, 254 S.W.3d 31, 35 (Mo.banc 2008). The ultimate aim is "to ascertain the intent of the legislature from the language used." *Anderson,* 248 S.W.3d at 106 (citing *United Pharmacal Co. of Mo., Inc. v. Mo. Bd. of Pharmacy,* 208 S.W.3d 907, 909 (Mo. banc 2006)); *see Williams v. Nat'l Cas. Co.,* 132 S.W.3d 244, 249 (Mo. banc 2004) ("All canons of statutory construction are subordinate to the requirement that the court ascertain and apply a statute in a manner consistent with the legislative intent.").

Here, it is clear that the legislature expected that carrying charges can be recovered with respect to a retired plant, even though such a plant is *by definition* no longer used and useful. The legislature can be presumed to have been aware of case law in this state, predating the 2021 enactment of the securitization statute, discussing in the context of a general rate case whether a property must be used and useful in order for a return to be appropriate. *See* Order, p. 71 (citing a 1988 decision). But the legislature nevertheless included carrying charges in the securitization statute as among the costs that a utility can recover.

To be sure, the statute does ask this Commission to determine whether "recovery of such costs is just and reasonable and in the public interest." RSMo. §393.1700.2(3)(c)(a). It cannot be the case, however, that carrying charges are not just and reasonable *merely because of the fact* that they relate to a retired plant. If the Commission were to take that approach across the board as a matter of principle, the result would be that a utility could *never* securitize carrying charges for a retired asset. Such a self-defeating interpretation would place the provision asking for a "just and reasonable" determination in irreconcilable tension with the provision defining "energy transition costs" as costs that can be recovered in connection with a retired plant, rather than reading those provisions in harmony with each other. It also would render the statutory reference to carrying charges, and to energy transition costs more generally, entirely superfluous. The legislature could not have intended such a "meaningless act." *Anderson*, 248 S.W.3d at 109 (citing *Missouri ex rel. Bouchard v. Grady*, 86 S.W.3d 121, 123 (Mo. App. E.D. 2002)).

Read as a whole, the securitization statute reflects a different legislative intent: to recognize that where a utility saves customers money by prudently retiring an uneconomic asset, the utility should not be penalized for doing so. *See* Ex. 16, Graves Dir., pp. 4, 46-47; Ex. 17, Graves Surreb., Sched. FCG-2, pp. 6-16; Ex. 17, Graves Surreb., pp. 3-19. To be sure, that does

not mean that recovery of carrying charges always will be just and reasonable; there may conceivably be reasons why claimed carrying charges might be flawed under the circumstances in a particular case. But none of those reasons exist here, where the Commission specifically found that the retirement of the Asbury plant was prudent, *see* Order, pp. 47-48, and made no suggestion that the carrying charges at issue were in any way unusual or questionable. The Commission's only reason for denial of the carrying charges for an extended period of time after retirement was the *fact* of retirement, and that is the one reason for denial that is plainly impermissible under the securitization statute.

The Commission's citation of *State ex rel. Union Elec. Co. v. Pub. Serv. Comm'n of State of Mo.*, 765 S.W.2d 618, 622 (Mo. App. W.D. 1988), *cited in* Order, p. 71, does not change that analysis. That case obviously does not involve interpretation of the securitization statute, which the legislature enacted many years after the case was decided; as noted, the fundamental purpose of the securitization statute is to encourage utilities to retire and replace uneconomic and environmentally challenged utility assets, which means allowing a carrying cost on retired assets as a cost of service to the utility. The case is also distinguishable on additional grounds. The utility in that case sought cancellation costs for a facility that it had begun construction on but had never completed. *Union Electric*, 765 S.W.2d at 620-23. Thus, the facility in that case was *never* used and useful at any point in time. That is a very different circumstance than the one presented here, where the question is a determination of recovery "in the context of existing assets that were used for many years, that were long deemed used and useful and that were generating customers benefits, but which have been retired once they became uneconomic due to changing economic circumstances." Ex. 17, Graves Surreb., Sched. FCG-2, p. 7.

### 2. Unreasonableness

The Commission's conclusion as to the carrying charges associated with the Asbury plant is also unreasonable, unjust, arbitrary, and an abuse of discretion. *See generally* Ex. 1, Reed Surreb., p. 24 ("Liberty has committed capital to funding the deferred fuel cost collections and the regulatory asset associated with Asbury that are the subject of this securitization application, and that commitment of capital warrants a reasonable return on capital until such time as Liberty's capital is paid off by the proceeds from securitization.").

First, the Order does not explain why carrying charges as to the period from plant retirement through May 2022 are unjust and unreasonable on the ground that the retired plant was not used and useful, but carrying charges as to the period from June 2022 through bond issuance are just and reasonable even though the plant was not used and useful at that time either. That distinction is arbitrary and unjust. The retired plant certainly is not more used and useful at a *later* date than it was at an *earlier* one. And the Commission's decision as to the later period demonstrates that the mere fact that a plant is retired is not, standing on its own, sufficient reason to deem recovery of carrying charges impermissible.

Second, the Order does not explain why June 2022 is the correct moment in time at which to draw a line between carrying charges that are recoverable and those that are not. That line-drawing is also arbitrary and unjust. Staff originally suggested that particular dividing line, on the ground that the carrying charges for Asbury were collected in rates from the date of plant retirement through May 2022. *See, e.g.*, Tr. Vol. 3, pp. 214-16 (McMellen); Tr. Vol. 2, p. 61 (Staff counsel stating that "Asbury was included in rates all the way up through May of 2022"). But that rationale for the Commission's recoverability determination is a red herring, and the Order—which rests instead on the distinct idea that a retired plan is not used and useful—ultimately does not rely

on Staff's rationale in any meaningful way. *But see* Order, p. 72 (referring in passing to "the period after the Asbury plant was removed from Liberty's rates, beginning in June 2022").

Nor could the Order reasonably do so. At Staff's urging, the Commission has *deducted* the amount of previously collected carrying charges from the amount of plant that the Company can securitize, by treating those carrying charges as part of an AAO liability balance. That deduction effectively forces the Company to *write off* carrying charges for the entire period from plant retirement through May 2022. *See* Tr. Vol. 2, p. 216 (McMellen) (agreeing that in Staff's view the return for Asbury that was built into rates up through May 2022 is "included in the Asbury liability" and therefore should be deducted from the amount to be securitized). Accordingly, the notion that the Company has already collected carrying charges through May 2022 cannot possibly serve as a justification for an effective disallowance of carrying charges for the period of time covered by the AAO. Because the Order appears to reflect reasoning that is constructed to adopt the date that Staff suggested, but without adopting Staff's (erroneous) rationale for choosing that date, the Order is arbitrary and unreasonable.

Indeed, had the Commission adopted Staff's rationale, then the outcome could not have been to prohibit recovery of carrying charges prior to June 2022. The Commission could have adopted the Company's primary recommendation, which was to allow the Company to keep the carrying charges it had collected in rates from plant retirement through May 2022, by removing the previously collected carrying charges from the AAO liability so that the Company could securitize the full amount of undepreciated plant consistent with the securitization statute.[4] Or the

[4] The Company requested in this proceeding that the amount of the carrying charges for that period not effectively be deducted from the amount to be securitized by treating those charges as part of an AAO liability balance. *See, e.g.*, *Response to Commission Order*, pp. 3-4, EFIS Item No. 179 (filed August 9, 2022).

Commission could have adopted the Company's alternative recommendation, which was to order the Company to refund the carrying charges collected for the period up through May 2022 and to add that same amount of carrying charges to the regulatory asset to be securitized. *See* Ex. 8, Emery Surreb., pp. 20-21. That alternative approach would give effect to the statutory directive to include "accrued carrying charges" in the amount to be securitized. The carrying charges collected in rates represent the "accrued" carrying charges which, if refunded, would be securitized. The Order, however, follows neither path and instead denies the Company recovery of those carrying charges away entirely. That outcome is inconsistent with the securitization statute.

Third, the Order penalizes the Company millions of dollars despite the fact that the Company behaved prudently and protected customers by retiring a plant that is now uneconomic to operate. The Commission's determination that a significant (but arbitrary) amount of carrying charges as to a retired plant is unrecoverable precisely *because* the plant is retired discourages that kind of prudent decision making by the Company and by other utilities and therefore will deprive customers of better and less costly alternatives. *See* Ex. 16, Graves Dir., p.4; *see also, e.g.*, *id.* at p. 51 ("Utility regulators and courts have long concluded that a utility may include prudent investments no longer being used to provide service in its rate base as long as the regulator reasonably balances consumers' interest in fair rates against investors' interest in maintaining financial integrity."); *see also State ex rel. Missouri Off. of Pub. Couns. v. Pub. Serv. Comm'n of State*, 293 S.W.3d 63, 76 (Mo. Ct. App. 2009) (utility may continue amortizing cost of software no longer in use); *Town of Norwood, Mass. v. FERC,* 80 F.3d 526, 531 (D.C. Cir. 1996) (noting that a "utility may include prudent but canceled investments in its rate base as long as the Commission reasonably balances consumers' interest in fair rates against investors' interest in

maintaining financial integrity and access to capital markets) (internal quotation marks omitted); p. 25, *supra* (distinguishing 1988 decision addressing the "used and useful" concept on which the Order relies).

For all of those reasons, the Commission should rehear the carrying charges issue discussed above and determine that the Company is entitled to recover carrying charges on Asbury from the date of retirement to the date when the bonds are issued. At a minimum, the Commission should clarify that the Company is entitled to seek recovery in a future proceeding of the carrying charges associated with the Asbury plant that are tracked in the AAO, without being prejudiced by any determination made in this proceeding.

### B. The Commission's Rejection of the WACC as the Rate of Return to Be Applied to Carrying Charges Is Contrary to Law and Unreasonable

As discussed above, the securitization statute specifically provides for recovery of carrying charges. The statute defines "qualified extraordinary costs" as costs for the "purchase of fuel or power, inclusive of carrying charges, during anomalous weather events." RSMo. §393.1700.1(13). And the statute defines "energy transition costs," which are costs relating to retired or abandoned facilities, as including "accrued carrying charges." RSMo. §393.1700.1(7)(a).

Here, the Commission ruled that carrying charges both as to Winter Storm Uri and as to Asbury should be calculated at Liberty's long-term debt rate of 4.65 percent rather than at the Company's weighted average cost of capital ("WACC"). Both rulings are legally erroneous. Both rulings also are unreasonable, unjust, and arbitrary.

#### 1. Winter Storm Uri

As to carrying charges related to Winter Storm Uri, the Commission stated that "[t]he Winter Storm Uri costs are operating costs, not capital improvements or replacements to existing plant and equipment. It is inappropriate for Liberty to be allowed a profit on expenditures for the

purchase of energy, as it would if carrying costs were calculated using its WACC." Order, p. 35. The Commission concluded that "Staff's proposal to calculate carrying costs for Winter Storm Uri related costs at Liberty's long-term debt rate of 4.65 percent is most appropriate because the costs to be securitized are not capital costs and there is no reason Liberty should be allowed to earn a profit on those costs." *Id.* at p. 36.

The Order's conclusion is contrary to the securitization statute and is arbitrary, unjust, and unreasonable. The phrase "carrying charges," as used in RSMo. §393.17001.(7)(a), should be interpreted in accordance with its ordinary meaning: a "cost associated with holding" an asset. *See* https://www.investopedia.com/terms/c/carryingcharge.asp; *see also Matter of Amend. of Commission's Rule Regarding Applications for Certificates of Convenience & Necessity*, 618 S.W.3d 520, 528 (Mo. 2021), *reh'g denied* (Apr. 6, 2021). The statute therefore directs the Commission to permit securitization of an amount that reflects the Company's cost of financing the Winter Storm Uri costs.

The Order's observation that the Winter Storm Uri costs are not capital costs is misplaced. The relevant question is not whether the underlying costs, as to which application of carrying charges is necessary, are capital or operating costs, but rather the *time period* over which they are financed, which in turn determines how they are financed. In some cases, costs that will be recovered quickly may be expected to be financed at short-term debt rates. That is not the case here. The Winter Storm Uri costs were incurred in early 2021. Since then, the balance has been a component of Liberty's balance sheet, and Liberty has not been able to deploy the capital elsewhere, where it could have earned its authorized return. That state of affairs has been the expectation since the time that those costs were incurred. *See* Ex. 1, Reed Surreb., p. 22. As such, those costs were necessarily financed with long-term capital, and the cost to Liberty is based on

its authorized rate of return. Indeed, the Order itself acknowledges that these are long-term costs by authorizing a carrying cost based on the long-term debt rate rather than on a short-term debt rate.

The Order errs in allowing only a *portion* of the cost of financing long-term capital, namely, the cost of debt. The record shows without contradiction that the Company's long-term capital is financed with a combination of debt and equity. *See* Ex. 1, Reed Surreb., p. 22 ("[T]he Company "relies on a balanced mix of debt and equity to fund intermediate term and longer-term investments, operations, and emergencies, like Storm Uri. Short term sources of funding provide utilities with access to capital between long-term financings. They are one of a utility's sources of capital, not the entire source of capital."); *see also* Ex. 8, Emery Surreb., p. 19. The actual carrying cost of Winter Storm Uri costs, like any other long-term financing, is therefore the Company's WACC. The long-term financing of those costs solely with long-term debt would undermine the Company's compliance with its authorized capital structure. *See* Ex. 1, Reed Surreb., p. 22 (referring to the Company's "balanced mix of debt and equity"); Ex. 8, Emery Surreb., p.19.

The statutory language therefore clearly dictates use of the WACC here. But to the extent the relevant statutory language were to be deemed ambiguous, understanding "carrying charges" to refer to something other than the WACC is also inconsistent with the legislature's purpose in enacting the securitization statute. *See Anderson*, 248 S.W.3d at 106. The legislature intended to encourage utilities to use the securitization procedure so as to ensure greater benefits to customers than would be available in other kinds of cost-recovery proceedings. The Commission's ruling discourages use of securitization, since absent securitization the Company would "recover the

carrying costs it incurred between now and the time of the recovery, which would be calculated at its authorized WACC." Ex. 8, Emery Surreb., p. 12; *see* Ex. 1, Reed Surreb., pp. 22-23.

In addition to running afoul of the "carrying charges" language in the securitization statute, the Commission's interpretation is arbitrary, unjust, and unreasonable. Using the WACC here is most consistent with principles regarding "fair return of capital deployed on behalf of customers." Ex. 8, Emery Surreb., p. 20 (citing Ex. 1, Reed Surreb., pp. 21-22). Using the WACC also accords with the way that the Company actually funds emergencies like Winter Storm Uri—which means that using the long-term debt rate instead is unreasonable and gives rise to an arbitrary penalty. The Commission has previously used the WACC in calculating carrying charges for deferred storm expense balances that are analogous to the extraordinary costs related to Winter Storm Uri. In Case No. ER-2019-0374, the Commission approved the Company's recovery of deferred costs associated with the Joplin tornado using the WACC, by approving inclusion of the unamortized balance of storm costs in the Company's rate base. *See* Ex. 8, Emery Surreb., p. 20; Ex. 1, Reed Surreb., p. 23. The Order provides no explanation for its failure to follow the same approach. In addition, the Commission's ruling creates an unjust and harmful disincentive to utilities' use of the securitization statute to recover and securitize extraordinary costs like the ones at issue here.

For all of those reasons, the Order should be corrected to permit the Company to securitize the costs it actually incurred to finance the Winter Storm Uri costs, which requires a calculation of those costs using the WACC.

**2. Asbury**

As to carrying charges related to Asbury, the Commission pointed to the same 1988 decision discussed above in connection with the period of time for which the Commission allowed recovery of Asbury carrying charges (*see* p. 25, *supra*): *State ex rel. Union Elec. Co. v. Pub. Serv. Comm'n of State of Mo.* 765 S.W.2d 618 (Mo. App. W.D. 1988), which ruled that cancellation

costs as to construction of a facility that was never completed were not just and reasonable because the facility was not "used and useful." *Id.* at 622; *see* Order, pp. 71-72. The Commission noted that "the securitization statute specifically includes carrying costs within the definition of energy transition costs that can be recovered through securitization." *Id.* at p. 71. Nevertheless, the Commission concluded that "full recovery" of those charges is not "just and reasonable" because "Liberty is seeking to recover its full carrying costs on a generation facility that has not been used and useful since its effective retirement in December 2019." *Id.* at p. 72. For that reason, the Commission stated, it is "just and reasonable to allow Liberty to recover those carrying costs at its 4.65 percent cost of long-term debt rather than at [the] WACC." *Id.*

That decision is both legally erroneous and unreasonable for many of the same reasons discussed above in connection with the Commission's ruling on the period of time for which Asbury carrying charges are recoverable (p. 23, *supra*), and Liberty incorporates those reasons here by reference. The securitization statute cannot be interpreted to permit a finding that recovery of costs is unjust and unreasonable *precisely because* a plant is retired—and yet that is the only basis for the Commission's ruling that Liberty should recover carrying charges at the 4.65% cost of long-term debt rather than at the higher WACC. The "used and useful" concept has no application under the securitization statute, which the legislature intended to permit recovery of charges *specifically* with respect to assets that are not used or useful by definition. *See* p. 25, *supra*. And the statutory authorization of recovery of carrying costs should be interpreted to correspond to the costs the Company incurs to finance the assets in question, which is the WACC.

In addition, even if the Commission's determination that Liberty should not make a full recovery of its carrying charges were otherwise supportable, the decision to cut back Liberty's recovery by choosing a lower percentage rate is unreasonable. That decision is an arbitrary one

because there is no rationale for reducing the Company's recovery by the specific amount the Commission chose: the differential between application of the long-term debt rate and the WACC. The decision is not supported by the evidence in the record, since that evidence showed that using the WACC to calculate the carrying charges for the capital costs at issue is consistent with the Company's capital structure and with fundamental principles of fair return. *See* Ex. 1, Reed Surreb., pp. 22-24; Ex. 8, Emery Surreb., p. 20. The decision is arbitrary because Asbury is clearly a capital investment as to which carrying charges would typically be calculated using the WACC, *see* Order, pp. 35-36, was used and useful for many years, and (as the Commission found) was prudently retired. And the decision is arbitrary and unjust because the precedent set by the Commission in choosing the long-term debt rate will serve to discourage Liberty and other utilities from retiring plants that are uneconomic or have problematic environmental impacts, which in turn harms the public. *See* p. 29, *supra*; Ex. 1, Reed Surreb., pp. 21-22. In contrast, securitization of the carrying charges using the WACC has significant benefits for customers. *See* Ex. 8, Emery Surreb., p. 20.

The decision is also legally erroneous and unreasonable for many of the same reasons discussed above in connection with the Commission's ruling on use of the long-term debt rate to calculate costs for Winter Storm Uri (p. 30, *supra*), and Liberty incorporates those reasons here by reference as well. Most notably, because the statute directs the Commission to permit securitization of an amount that reflects the Company's cost of financing, *see* p. 31, *supra*, the Commission's decision to use a different rate in its carrying-charge calculation, under the rubric of a "just and reasonable" determination, puts the portion of the statute calling for such a determination into serious tension with the statutory language stating that "accrued carrying charges" are part of the energy transition costs that a utility can recover and securitize. That

conclusion is underscored in the context of energy transition costs, because as to those costs the securitization statute uses the term "*accrued* carrying charges," RSMo. §393.1700.1(7)(a), and the Asbury carrying charges were in fact accrued in an AAO.

## IV. Even Setting Aside the Errors Described Above with Respect to Asbury, the Commission's Finding of the Total Amount of Asbury Costs That Are Securitizable Contains a Calculation Error

Even apart from the various issues discussed above with respect to Asbury, Liberty believes that there is a calculation error in the amount of energy transition costs related to the retirement of Asbury that the Commission has authorized Liberty to securitize. The Commission found this amount to be $81,241,471. Order, p. 16.

Without adjusting for the other matters raised in this application for rehearing (as to which Liberty reserves all of its rights), and taking the Order as issued, Liberty believes that the total amount of energy transition costs related to the retirement of Asbury that the Commission has authorized Liberty to securitize is actually $82,921,331, and that the Order lists a lower total amount only as a result of an error in adding up all of the separate amounts that the order authorizes.

Liberty's calculation is based on the following categories, amounts, and references:

| DESCRIPTION | AMOUNT | ORDER REFERENCE/SOURCE |
|---|---:|---|
| Net Retired Asbury Plant | $159,414,474 | Order, p. 41 (that amount reflects that there are no carrying costs on the $1,673,601 associated with abandoned environmental capital projects, Order, pp. 65-67) |
| Asbury Environmental Regulatory Assets | $1,643,357 | Order, p. 50 |
| Asbury Fuel Inventories | $1,532,832 | Order, p. 51 |
| Asbury Excess ADIT | ($12,313,459) | Order, pp. 53, 54 |
| Asbury AAO Liability | ($78,691,414) | Order, p. 56 |
| Asbury ADIT (NPV Value utilizing 13 years) | ($17,134,363) | Order, pp. 52, 54 |
| Additional Asbury Decommissioning Costs (Phase 2) | $3,541,054 | Order, pp. 56, 58 |

| Additional Asbury Decommissioning Costs (Phase 3) | $1,500,522 | Order, p. 58 (the specific balance is not identified in the Order; however, this amount is identified on page 1 of Staff's *Response to Commission Order of August 10*, filed on August 12, 2022) |
|---|---:|---|
| Additional Asbury Asset Retirement Obligation Costs – Asbestos/CCR | $21,282,684 | Order, p. 59 |
| **Total Asbury Energy Transition Costs** | $80,775,687 | |
| | | |
| Asbury Carrying Costs | $2,145,644 | Order, p. 72 (the specific balance is not identified in the Order; this balance is derived by using the ordered 4.65% carrying cost rate for the period of June – December 2022, under the following calculation: (80,775,687 – 1,673,601) * (4.65/12*7 months) = 2,145,644) |
| | | |
| **Total Asbury Costs to be Securitized** | **$82,921,331** | |

As shown by the above, the amounts for individual issues do not add up to the $81,241,471 cited by the Order. The difference between the amount identified in the Order and the sum above ($82,921,331) is approximately $1.7 million.

Accordingly, the amount of energy transition costs related to the retirement of Asbury that the Commission has authorized Liberty to securitize is unlawful and/or unreasonable and the Commission should reconsider or grant rehearing as to this issue, regardless of how it rules on the other issues contained in this application for rehearing.

## V. Additional Issues

### A. Carrying Costs for Abandoned Environmental Capital Projects (Issue 3.P)

The Commission found that Liberty could include in its securitization balance costs related to two Asbury environmental projects that were abandoned when the plant was closed. Order, pp.

65-67. However, the Commission decided that those costs "would not be includible in Liberty's ratebase and thus it may not recover a return on those investments." *Id*., p. 67.

The Commission's decision to not permit a return on those investments is based on a statement in *State ex rel. Union Electric Co. v. Public Service Commission of State of Missouri.*, 765 S.W.2d 618 (Mo. App. W.D. 1988), that "[t]he utility property upon which a rate of return can be earned must be utilized to provide service to its customers. That is, it must be used and useful." *Id.* at 622; *see* Order, pp. 66-67.

The Commission's reliance on *Union Electric* is erroneous. That decision does not address the securitization statute, and the court's determination was made within the context of a traditional general rate case. The securitization statute was enacted to provide a process of recovery separate and apart from a general rate case. And, as discussed above in connection with the carrying charges argument covered in Part II.A of this rehearing request, *see* p. 16, *supra*, that statute necessarily contemplates that the investments associated with energy transition costs will concern a "retired or abandoned" "electric generating facility"—a facility that is by definition no longer "used and useful." RSMo. §393.1700.1(7)(a). The statute nevertheless requires inclusion of "accrued carrying charges" as part of "energy transition costs." *Id.* Thus, the "used and useful" concept as applied in general ratemaking does not carry over to decisions about energy transition costs made pursuant to the securitization statute.

Accordingly, the Commission should reconsider or grant rehearing as to this issue and, thereafter, issue its order providing for carrying costs as to the abandoned environmental capital projects.

### B. Retirement Date of Asbury for Purposes of Calculating Depreciation Expense to Be Included in the Asbury AAO Liability (Issue 3.S)

The Commission erred in its determination of when Asbury should be deemed retired, and that error rendered incorrect the Commission's calculation of depreciation expense to be included in the Asbury AAO liability. The Commission's decision in this regard is legally erroneous because it cannot be reconciled with the Commission's own regulations. The decision is also unreasonable because it is contrary to undisputed facts in the record.

The Commission described its decision to use the Staff's calculation of depreciation expense associated with the Asbury plant as follows: "Asbury was *effectively retired* in December 2019, when it ceased producing electricity. Therefore, Staff's calculation of depreciation, which includes the months of January and February 2020, is appropriate and is adopted." Order, p. 70 (emphasis added). The Commission appears to rely on the finding that "Asbury's last day of generating power was December 12, 2019, when its [useable] coal supply was exhausted." *Id.*, p. 69.

That is not the appropriate test for determining when a plant is retired. The Uniform System of Accounts ("USOA"), as adopted by the Commission in 20 CSR 4240-20.030(1), defines "property retired" and states that the term, "as applied to electric plant, means property which has been removed, sold, abandoned, destroyed, or which for any cause has been withdrawn from service." Part 101, Definitions; No. 28. The USOA nowhere mentions the concept of a plant being "effectively" retired.

Here, under the applicable definition of retirement, Asbury was retired on March 1, 2020, and not before, because prior to that date it was not "removed, sold, abandoned, destroyed, or . . . for any cause . . . withdrawn from service." Part 101, Definitions; No. 28. It is true that Asbury last generated electricity in December of 2019. But it stood ready to do so after that date as well.

As Liberty witness Doll explained, in testimony that is uncontradicted in the record, at all times up until March 1, 2020, "Asbury was staffed and available to operate if economic fuel could have been procured in that timeframe." Ex. 4, Doll Surreb., p. 5. Moreover, "[t]he Company continued to monitor conditions, forward market prices, and evaluate economical fuel procurement options. If market conditions and forward market prices created an opportunity for Liberty to procure fuel at a price allowing Asbury to operate economically, fuel would have been purchased and the unit would have been offered to the market." *Id.*; *see id.* ("[s]imply because forward indications didn't warrant additional purchases and the Company did not believe it would be prudent to take additional coal deliveries and risk raising customers costs for unburned coal does not" indicate that the facility was retired at that time).

Consistent with that testimony, the record reflects that although in August 2019 Liberty notified the Southwest Power Pool ("SPP") of Asbury's coming retirement, Asbury was not officially de-designated as a network resource until March 1, 2020. Ex. 3, Doll Dir., p. 15. That was the earliest possible retirement date for Asbury per the SPP guidelines that were in place at the time. *See id.* And that is the earliest date on which Asbury could be deemed "removed" or "withdrawn from service." Part 101, Definitions; No. 28.

The Commission's decision as to the appropriate date of retirement for Asbury therefore cannot stand. The decision is both unlawful and unreasonable.

### C. Designated Staff Representatives; Conditions to Be Included in the Financing Order (Issues 6 and 7)

Finally, Liberty seeks a clarification as to the part of the Order identifying the written certifications required in connection with the submission of the issuance advice letter. The Order states that "*Liberty and the lead underwriters for the securitized utility tariff bonds shall provide a written certificate to the Commission* certifying, and setting forth all calculations and

assumptions used to support such calculations and certificate," as to four items. Order, p. 85 and pp. 123-124 (Ordering para. 7) (emphasis added). The items that must be certified to are (i) compliance with the Financing Order; (ii) compliance with all other legal requirements; (iii) "that the issuance of the securitized utility tariff bonds and the imposition of the securitized utility tariff charges are expected to provide quantifiable net present value benefits to customers as compared to recovery . . . absent the issuance of securitized utility tariff bonds," and (iv) "that the structuring, marketing, and pricing of the securitized utility tariff bonds will result in the lowest securitized utility tariff charges consistent with market conditions at the time the securitized utility tariff bonds are priced and the terms of this Financing Order." *Id.* The certificates are "a condition precedent to the submission of the issuance advice letter to the Commission." *Id.* at p. 85.

It is Liberty's expectation that the four items identified by the Commission would be addressed by a combination of certificates provided by Liberty and the lead underwriters. Liberty would provide a written certificate concerning all four items. However, the lead underwriters would provide a certificate only as to item (iv), regarding whether the structuring and pricing of the bonds results in the lowest securitized utility charges consistent with market conditions at the time of bond pricing and with the Order itself. (*See* Ex. 19, Niehaus Dir. (EO-2022-0193), Sched. KN-4, p. 39 of 87 (para. 69)).

In contrast, requiring the lead underwriters to certify as to all four items could create an untenable situation. The lead underwriters are not qualified to speak to legal issues such as compliance with the Commission's Order or with other applicable legal requirements. Nor are they qualified to certify as to the calculation of quantifiable net present benefits as compared to recovery of costs absent issuance of the bonds, since the latter question involves complex calculations based on information that is not in the lead underwriters' possession.

Nothing in the securitization statute requires the lead underwriters to provide any certification at all, let alone as to those items that are outside of their experience and knowledge. That is not surprising, given that underwriters would not commonly provide a certificate related to compliance with the financing order, compliance with state statutory requirements, or calculation of quantifiable net present value benefits.

In addition, nothing in the record suggests that the lead underwriters should be required to provide that broad set of certificates. Requiring certification by the lead underwriters only as to whether "the structuring and pricing of the securitized utility tariff bonds will result in the lowest securitized utility tariff charges consistent with market conditions" and the terms of the Order would be consistent with the evidence before the Commission, because that is the only certification that anyone told the Commission would in fact be provided by the lead underwriters. (*See* Ex. 19, Niehaus Dir. (EO-2022-0193), Sched. KN-4, p. 39 of 87 (para. 69)).

Liberty interprets the Order to permit a combination of certificates from the Company and the underwriters to satisfy Ordering Paragraph 7. Out of an abundance of caution, Liberty expresses that understanding now. Liberty respectfully suggests that, for the complete avoidance of doubt, the Commission confirm that Liberty's interpretation of the identified certification requirements is correct or, in the alternative, reconsider or rehear the matter and issue a decision making clear that the lead underwriters are required to provide a certificate only as to item (iv) noted above.

**WHEREFORE**, The Empire District Electric Company d/b/a Liberty respectfully submits this *Motion for Reconsideration or Clarification and/or Application for Rehearing* for the Commission's consideration and requests that the Commission issue such orders as it should find to be reasonable and just.

Respectfully submitted,

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**CERTIFICATE OF SERVICE**

I hereby certify that the above document was filed in EFIS on this 27th day of August, 2022, and sent by electronic transmission to all counsel of record.

/s/ Dean L. Cooper

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

| | | |
|---|---|---|
| In the Matter of the Petition of The Empire District Electric Company d/b/a Liberty to Obtain a Financing Order that Authorizes the Issuance of Securitized Utility Tariff Bonds for Qualified Extraordinary Costs | ) | Case No. EO-2022-0040 |
| In the Matter of the Petition of The Empire District Electric Company d/b/a Liberty to Obtain a Financing Order that Authorizes the Issuance of Securitized Utility Tariff Bonds for Energy Transition Costs Related to the Asbury Plant | ) | Case No. EO-2022-0193 |

# AFFIDAVIT OF BRADLEY M. SELTZER

1. My name is Bradley M. Seltzer. Under penalty of perjury, I declare that the below is true and correct to the best of knowledge and belief.

2. I am an equity partner in the law firm of Eversheds Sutherland (U.S.) LLP. I specialize in the taxation of, and tax issues relating to, regulated public utilities, including the treatment of taxes for ratemaking purposes. Throughout my career I have provided tax advice primarily to regulated electric, gas, telephone, and water industry clients. I began my career at Sutherland, Asbill & Brennan in 1978, was later promoted to partner, joined Deloitte as a partner in 1997 and until 2016 served as Deloitte's Global and U.S. Tax Leader for Energy and Natural Resources. In 2016, I rejoined Sutherland as a partner shortly before its merger into what is now Eversheds Sutherland.

3. I have testified regarding tax, tax accounting and regulatory tax matters before state regulatory commissions in California, Missouri, Texas, Oklahoma, Arizona and before the Federal Energy Regulatory Commission. In addition, I have assisted company-sponsored witnesses in preparation of their testimony in proceedings before the North Carolina, Alaska, Louisiana, Indiana and Texas commissions. I am also the Former Chair of the ABA Section of Taxation, Committee on Regulated Public Utilities and then served as the Former Chair of the ABA Section of Taxation's Normalization and Industry Specialization Subcommittee. A copy of my professional biography is attached to this affidavit.

4. This affidavit is offered in support of The Empire Electric District Company's Motion for Reconsideration or Clarification and/or Application for Rehearing ("Motion") in File No. EO-2022-0193.

**Summary of Conclusions**

5. In this Affidavit, I explain that the Order that is the subject of the Motion adopts an erroneous calculation of the net present value of the tax benefit of the Company's accumulated deferred income taxes ("ADIT") and thereby erroneously reduces the amount of securitized proceeds. The Order effectively and impermissibly converts a portion of the ADIT balance from a temporary timing difference into a permanent difference. The net effect of this error is to give back to customers money the Company still owes in taxes—that is, it deprives the Company of the designated source of revenue for paying the taxes that will be owed as customers pay principal on the bonds. The Order will discourage beneficial securitization transactions by requiring the utility to bear tax costs that it would otherwise recover in conventional ratemaking.

6. In support of the conclusions summarized above, this Affidavit specifically addresses the following issues: (a) how ADIT properly arise and reverse; (b) the impact of the proposed securitization transaction on ADIT; and (c) the proper calculation of the net present value of the tax benefits of ADIT under RSMo. §393.1700 that serves to reduce the amount of the securitization proceeds.

**Accumulated Deferred Income Taxes**

7. ADIT arise primarily from timing differences attributable to the use of a different method of computing depreciation expense as an element of cost of service (typically straight-line) than the depreciation method used in computing taxable income (typically accelerated depreciation). The taxes deferred by reason of accelerated depreciation are temporary in nature and will become due as the tax timing differences reverse, namely when depreciation expense for ratemaking purposes exceeds the deduction for depreciation on the income tax return. The deferred taxes, computed at the statutory tax rate, represent an interest-free loan from the federal government that is repaid over time as tax depreciation exceeds ratemaking depreciation. In other words, an ADIT balance represents money the Company has collected from customers as a source of funds to pay future taxes.

8. Under traditional cost of service ratemaking, and consistent with the Federal income tax rules for normalizing accelerated depreciation deductions, until the interest-free loan is fully repaid, the tax benefit of the deferred income tax liability represented by the ADIT balance is provided to customers by reducing the revenue requirement by an amount equal to the ADIT

balance multiplied by the utility's authorized rate of return, in the Company's case, 6.77%.

9. In the instant securitization situation, the tax benefit of the ADIT balance is amortized over the 13-year life of the bonds as the customers pay principal on the bonds (which is taxable to the Company) and the taxes become due. In other words, the ADIT balance serves as the Company's source of funds for the payment of taxes. If, as here, the amount of the net present value of the tax benefits of the ADIT balance is overstated, the reduction of the securitized amount will also be overstated, leaving a shortfall in the Company's source of funds to pay taxes on the taxable receipts from customers. Stated differently, any such shortfall essentially represents the impermissible conversion of what is intended to be a temporary timing difference into a permanent difference that will never be recovered from customers.

**Securitization**

10. When the cost of assets is securitized, the principal amount is recovered from customers over the life of the bonds. This is analogous to recovering the asset balance over a depreciation or amortization period in conventional ratemaking. Securitization does not change the Company's obligation to pay taxes or the Company's need to access the ADIT balance as a source of funds to pay such taxes.

11. Without securitization, under traditional cost of service ratemaking, the ADIT balance would have reversed over the period the remaining investment balance is recovered in rates, as the depreciation timing differences reversed. While the time period may be different, the securitization transaction effectively should achieve the same result by spreading the reversal of ADIT on a straight-line basis over the 13-year life of the bonds. As the revenue is received from customers for the amortization of the principal amount of the bonds, it generates taxable income to the Company.[1] The ADIT balance serves as the Company's source of funds for the payment of taxes due as revenue is received for securitized bond payments. That amount of tax owed over the life of the bond on a nominal basis is equal to the amount of the ADIT balance. The ADIT balance will reduce to zero over the life of the bonds as the bond amortization creates periodic tax liabilities.

12. Just as in traditional ratemaking, if the ADIT balance is inadequate to meet the future tax liability that will be incurred as customers pay the cost of the Asbury plant (whether securitized or not), the Company will have insufficient revenue to cover those tax costs. For that reason, the tax

[1] IRS Revenue Procedure 2005-62.

benefit of the ADIT balance is not the balance itself, but just the avoided financing cost of the balance, which is the balance multiplied by the applicable financing cost.[2]

**Calculation of the Proper Reduction of the Bond Proceeds**

13. The required calculation methodology of the amount of the reduction of the bond proceeds by reason of the tax benefit of the ADIT balance is set forth in the Missouri Securitization statute as follows:

> The accumulated deferred income taxes, including excess deferred income taxes, shall be excluded from rate base in future general rate cases and the net tax benefits relating to amounts that will be recovered through the issuance of securitized utility tariff bonds shall be credited to retail customers by reducing the amount of such securitized utility tariff bonds that would otherwise be issued.

RSMo. § 393.1700.2(3)(c)(m).

14. As the Missouri securitization statute further specifies, the net present value of the tax benefits of ADIT is to be deducted from the issuance amount of the bonds. Thus, the critical calculation set forth in the statute is of the net tax benefit that is to reduce the issuance amount of the bonds:

> The customer credit shall include the net present value of the tax benefits, calculated using a discount rate equal to the expected interest rate of the securitized utility tariff bonds, for the estimated accumulated and excess deferred income taxes at the time of securitization including timing differences created by the issuance of securitized utility tariff bonds amortized over the period of the bonds multiplied by the expected interest rate on such securitized utility tariff bonds.

RSMo. §393.1700.2(3)(c)(m).

15. In RSMo. §393.1700.2(3)(c)(m), the securitization statute envisions a 3-step process for determining the net tax benefit that will reduce the amount of the securitized proceeds. First, it substitutes the bond interest rate for the authorized rate of return in computing the discount rate, *i.e.,* the ADIT balance is multiplied by the bond rate (2.47%) rather than the authorized rate of return (6.77%). Second, the amortization period substitutes the life of the bonds for the period of time over which the remaining balance of the retired assets would be recovered in conventional ratemaking. Third, the net present value of the ADIT benefits is computed using the interest rate

[2] The accelerated recovery of ADIT and the conversion of a portion of the ADIT from a temporary timing benefit to a permanent benefit would also, if uncorrected, bring into play the normalization provisions of the Internal Revenue Code. Those provisions, if violated, subject the Company to the loss of accelerated depreciation on all of its public utility property subject to MoPSC jurisdiction. *See* I.R.C. § 168(i)(9) and Treas. Reg. § 1.167(l)-1(h)(2). The loss of the right to claim accelerated depreciation on the Company's remaining Missouri public utility property would be extremely detrimental to customers.

on the securitized bonds.

16. When these three steps are applied in the instant case, the ADIT balance amortizes at an annual rate equal to the balance multiplied by the bond interest rate for each of the thirteen years the bonds are outstanding. Then, to arrive at the present value of the tax benefit of the ADIT balance over the thirteen annual revenue requirements, the future values of the annual impacts of ADIT on the revenue requirements are discounted back at the bond interest rate to the date of securitization.

17. Contrary to the conclusion of the Order, **this calculation does not discount the ADIT balance twice by the bond interest rate**. Multiplying the ADIT balance by the bond interest rate to determine the annual tax benefit of the ADIT is not equivalent to discounting that balance to present value. Rather, multiplying the ADIT balance by the bond interest rate calculates the benefit to customers. For each year the bonds are outstanding, the benefit equates to the amount of avoided financing costs funded by the outstanding ADIT balance. That amount is recalculated each year based on the declining ADIT balance. In steps 1 and 2, the bond interest rate is used only to calculate the financing cost benefit, *i.e.*, the tax benefit. In the third step, the statute requires the use of the bond interest rate again, but for a different purpose: to discount the tax benefit derived from ADIT over the term of the bonds to present value. **Step 3 is the first and only time discounting takes place.** Using the same interest rate for two different purposes does not constitute discounting twice.

18. Witness Bolin's testimony, on which the Order relies, erroneously calculates the present value of the full ADIT balance for purposes of the reduction to the authorized securitization proceeds. But, as noted above, the statute expressly states that the reduction is not in the amount of the ADIT, but rather is in the amount of the tax benefit of the ADIT. Thus, the overstatement of the reduction prevents the Company from securitizing the full amount of the approved transition costs. Effectively, the Company will be returning to customers the amounts that they have previously paid for the Company's taxes, even though the Company will continue to owe those taxes in the future.

Under penalty of perjury, on this 27th day of August, 2022, I declare that the foregoing is true and correct to the best of my knowledge and belief.

//S// Bradley M. Seltzer
Bradley M. Seltzer