

# Exhibit No. 317

**Exhibit No.:** \_\_\_\_\_  
**Issue(s):** Hedging Transactions in the FAC/  
Rate Base Adjustment for Loss on Business Property/  
Tax Credits in Rate Base & Income Tax Calculations/  
Tax Credit Calculations in the EMS Run  
**Witness/Type of Exhibit:** Riley/Surrebuttal  
**Sponsoring Party:** Public Counsel  
**Case No.:** ER-2022-0129 and ER-2022-0130

**SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

Submitted on Behalf of the Office of the Public Counsel

**EVERGY METRO, INC. D/B/A  
EVERGY MISSOURI METRO  
AND  
EVERGY MISSOURI WEST, INC. D/B/A  
EVERGY MISSOURI WEST**

CASE NOS. ER-2022-0129 AND ER-2022-0130

August 16, 2022

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**SURREBUTTAL TESTIMONY**  
**OF**  
**JOHN S. RILEY**  
**EVERGY METRO, INC D/B/A EVERGY MISSOURI METRO**  
**CASE NO. ER-2022-0129**  
**EVERGY MISSOURI WEST, INC D/B/A EVERY MISSOURI WEST**  
**CASE NO. ER-2022-0130**

1 **Q. Are you the same John S. Riley that filed direct and rebuttal testimony in these cases on**  
2 **behalf of the Office of the Public Counsel (“OPC”)?**

3 A. Yes.

4 **Q. Why are you filing surrebuttal testimony in these cases?**

5 A. To respond to Evergy rebuttal witness James Meitner concerning the Company’s request to  
6 reintroduce hedging into the FAC. I also will make corrections to some calculations I had  
7 included in direct testimony that Company witness Ms. Melissa Hardesty pointed out were  
8 inaccurate. Ms. Hardesty has also raised an argument that net operating losses (“NOL”) prior  
9 to the Tax Cuts and Jobs Act (“TCJA”) should not be adjusted by taxable income after that  
10 legislations passage (before and after Jan. 2018). I will illustrate how that premise is not true.  
11 Ms. Hardesty also argues against my deduction to rate base for the Company’s balance of  
12 general business credits. I will provide the Commission with my logic for a rate base  
13 reduction or extensive income tax expense deduction.

14 **HEDGING TRANSACTIONS EXCLUSION FROM THE FAC**

15 **Q. Could you summarize the OPC’s position on the Company’s wish to resume hedging**  
16 **and include the results in the FAC?**

17 A. The OPC is not opposed to the resumption of hedging natural gas purchases. Our concern  
18 lies in the fact that the Company does not have a long enough track record to provide the  
19 ratepayers the assurance that inclusion in the FAC will not result in the same consistent

1 transaction losses that we argued against in 2016. Abiding by the Stipulation and Agreement<sup>1</sup>  
2 and posting these transactions in regulatory liability and asset accounts until at least the next  
3 general rate case will allow every stakeholder the opportunity to judge the effectiveness of the  
4 new policy and build a track record before FAC inclusion. Including hedging transaction in  
5 the FAC should not be taken lightly.

6 **Q. Company witness James Meitner claims that the Company's poor historical track**  
7 **record of hedging should not be used to judge the current policy. Is that a legitimate**  
8 **argument?**

9 A. There are two key points that should come into focus. First, what else does the Commission  
10 have to determine whether the current policy will be better than the old one? There is no  
11 current track record to judge the effectiveness of the policy and hence nothing to rebut the  
12 Company's poor historical track record. Second, how is this policy better than the previous  
13 system given that the Company admits that the markets and products are still the same as  
14 before? Building a new track record over several different seasons is the only way to satisfy  
15 these points.

16 **Q. Mr. Meitner states that purchase power hedging is necessary to Evergy Missouri West**  
17 **due to a high amount of capacity exposed to natural gas and floating price exposure. Do**  
18 **you agree?**

19 A. I would say that is an accurate statement; however, if Evergy West would produce more of  
20 the power it needs to satisfy customers instead of buying it on the open market, its risk and  
21 exposure to floating prices would be substantially lower. The Company has brought this on  
22 themselves through its imprudent resource planning.

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<sup>1</sup> Please refer to Riley Direct page 3 and Stipulation & Agreement signed in ER-2016-0156 & 0285

1 **Q. Mr. Meitner maintains that hedging activities flowing through the FAC is timelier and**  
2 **a better match with both customers and the costs incurred than waiting for a general**  
3 **rate case. What is the advantage of waiting for a general rate case?**

4 A. The advantage for at least one rate case cycle is to be diligent in knowing what costs should  
5 be considered for inclusion in the FAC and how both Evergy Missouri Metro and West will  
6 execute its hedging policy. FAC cases are every six months and the time to review costs is  
7 condensed. Reviewing the execution of a new hedging policy should best be done with a  
8 general rate case. The Company agreed to tracking and reporting and will provide the  
9 Commission semi-annual portfolio reports on all recent and anticipated hedging activities<sup>2</sup>and  
10 that reporting and review for at least one rate case cycle should provide the stakeholders the  
11 information and the ability to iron out differences with the Company on fuel costs that should  
12 be included in the FAC.

13 Let's keep in mind that the Company's past hedging produced excessive losses. Allowing the  
14 stakeholders to view the results of the Companies' new approach to hedging before  
15 committing to FAC inclusion is a prudent decision.

16 **RATE BASE ADJUSTMENT FOR LOSS ON SALE OF BUSINESS PROPERTY**

17 **Q. What was the error in your calculations that Ms. Hardesty pointed out in her rebuttal**  
18 **testimony?**

19 A. I had made the argument that the loss on the sale of business property should offset the NOL  
20 balance that the Company has included in rate base. My error was that I did not convert the  
21 actual loss reported on the tax return to a tax adjusted balance.

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<sup>2</sup> Notice to resume fuel hedging, Case No. ER-2016-0285, paragraph 5

1 **Q. How do you convert a net operating loss?**

2 A. Originally, a net operating loss is a tax loss created by having less income than expenses on  
3 the Company tax return. For example, if a company has \$1,000 in revenues and \$1,200 in  
4 expenses, then the company has a NOL of \$200 (\$1,000 less \$1,200). To create a deferred  
5 tax asset (*i.e.* NOL), the \$200 is multiplied by the 23.84% composite corporate tax rate to  
6 produce a deferred tax asset of \$47.68. This is the calculation I need to do with the Evergy  
7 Metro's \$183 million and Evergy West's \$111 million NOL balances.

8 **Q. What would be the converted balances for Evergy Metro and Evergy West?**

9 A. The Metro tax converted losses since 2017 that should be considered against an NOL balance  
10 is \$43.6 million. The Evergy West losses to offset NOL are \$26.46 million.

11 **Q. These tax converted losses no longer surpass the NOL balances that the Company has**  
12 **included in the Metro and West rate bases. Should the remaining NOL balances be**  
13 **included in rate base as a reduction to ADIT?**

14 A. No. The Commission should not follow its Staff's and Company's misguided position on this  
15 issue. Ms. Hardesty illustrated in her rebuttal testimony that the NOL balances are pre TCJA.  
16 This is significant because, as Ms. Hardesty pointed out, the Company entered into a non-  
17 unanimous stipulation and agreement in the 2018 general rate cases where EDIT and NOL  
18 amortization was specified.<sup>3</sup> The paragraph is quoted below but the entire Stipulation and  
19 Agreement is attached as Schedule JSR-S-01

20 12. EXCESS ACCUMULATED DEFERED INCOME TAX ("EDIT")  
21 AMORTIZATIONS: Amortization expense associated with the excess  
22 accumulated deferred income taxes will be recorded by the Company  
23 using the following periods :

- 24
  - Protected-ARAM

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<sup>3</sup> The OPC was not a signatory to this Stipulation & Agreement.

- 1                   ▪ Nonprotected-10 yr.
- 2                   ▪ NOL-ARAM
- 3                   ▪ Misc.- 10 yr.

4                   I believe that this section of the agreement quoted above and specifically the NOL – ARAM  
5                   amortization is a violation of the normalization rules of the IRS.

6                   **Q.    Would you explain the violation?**

7                   A.    Below is a copy of § 168(i)(9) “Normalization Rules”

8                   **§ 168(i)(9)**

9  
10                  **(9) Normalization rules**

11                  **(A) In general** In order to use a normalization method of accounting with respect to any  
12                  public utility property for purposes of subsection (f)(2)—

13                  **(i)**

14                  the taxpayer must, in computing its tax expense for purposes of establishing its cost  
15                  of service for ratemaking purposes and reflecting operating results in its regulated  
16                  books of account, use a method of depreciation with respect to such property that is  
17                  the same as, and a depreciation period for such property that is no shorter than, the  
18                  method and period used to compute its depreciation expense for such purposes; and

19                  **(ii)**

20                  if the amount allowable as a deduction under this section with respect to such property  
21                  (respecting all elections made by the taxpayer under this section) differs from the  
22                  amount that would be allowable as a deduction under section 167 using the method  
23                  (including the period, first and last year convention, and salvage value) used to  
24                  compute regulated tax expense under clause (i), the taxpayer must make adjustments  
25                  to a reserve to reflect the deferral of taxes resulting from such difference.

26                  **(B) Use of inconsistent estimates and projections, etc.**

27                  **(i) In general**

28                  One way in which the requirements of subparagraph (A) are not met is if the taxpayer,  
29                  for ratemaking purposes, uses a procedure or adjustment which is inconsistent with  
30                  the requirements of subparagraph (A).

31                  **(ii) Use of inconsistent estimates and projections**

32                  The procedures and adjustments which are to be treated as inconsistent for purposes  
33                  of clause (i) shall include any procedure or adjustment for ratemaking purposes which  
34                  uses an estimate or projection of the taxpayer’s tax expense, depreciation expense, or



1 reserve for deferred taxes under subparagraph (A)(ii) unless such estimate or  
2 projection is also used, for ratemaking purposes, with respect to the other 2 such items  
3 and with respect to the rate base.

4 **(iii) Regulatory authority**

5 The Secretary may by regulations prescribe procedures and adjustments (in addition  
6 to those specified in clause (ii)) which are to be treated as inconsistent for purposes of  
7 clause (i).

8 **(C) Public utility property which does not meet normalization rules**

9 In the case of any public utility property to which this section does not apply by reason  
10 of subsection (f)(2), the allowance for depreciation under section 167(a) shall be an  
11 amount computed using the method and period referred to in subparagraph (A)(i).

12 Referencing (9)(A)(i) and the depreciation of property, an NOL is not property nor is it an  
13 amortizable (depreciable) tax item and is not subject to a change in tax rates. Clearly this  
14 provision in the Stipulation and Agreement is a violation of the subparagraph (A). The  
15 Company has tried to skirt the issue by claiming that the NOL and the Excess ADIT were not  
16 “merged.” That doesn’t hold water. Amortizing an NOL on the same books and records with  
17 excess ADIT from the same timeframe interferes with the true balance that should be deducted  
18 each year. I therefore believe that amortizing an NOL is a violation of the normalization rules.

19 **Q. What explanations has the Company provided for its amortization of an NOL?**

20 A. The Company offered an explanation that “[i]n the 2018 rate case, the Commission ordered  
21 that the excess deferred taxes related to net operating losses existing at that time should be  
22 flowed back to the ratepayers using the IRS’s average rate assumption method (“ARAM”).”<sup>4</sup>  
23 The Company also explains that NOL created prior to TCJA were computed at higher rates  
24 and argues that “[w]hen the rate changes were passed, the tax benefits available on future  
25 returns is less and financial accounting rules require us to restate the tax benefits at the new  
26 rates.” As a result, Evergy argues that “[t]he difference between the old rates and the new rates  
27 is considered ‘excess or deficient deferred income taxes’ and is flowed back to ratepayers

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<sup>4</sup> Quote from the answer to OPC data request 1317 (Schedule JSR-S-02).

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1 (similar to the excess deferred taxes on plant related or other deferred taxes).”<sup>5</sup> Ms. Hardesty  
2 also argued that “offsetting a net operating loss generated in years 2010-2017, with business  
3 losses incurred in 2018-2020 is not the correct way to compute these numbers” and that “[t]he  
4 business losses in later years were used to offset taxable income in those years and should not  
5 be carried back to offset NOL generated in prior years.”<sup>6</sup>

6 **Q. Are these legitimate reasons to amortize an NOL?**

7 A. No. To state that the Commission “ordered” that the NOL should be flowed back using  
8 ARAM maybe technically correct, but is in conflict with the normalization rules mentioned  
9 above. Also, as stated before, an NOL is not subject to a given tax rate. Losses are created  
10 by excess expenses over income, not by the fact that in 2017 there was a 35% tax rate and  
11 there was a 21% rate in 2018. Great Plains Energy used \$173 million of pre-TCJA NOL to  
12 offset its 2018 taxable income. Evergy, Inc. applied \$549 million of pre-TCJA to its 2018  
13 taxable income. It also applied \$736 million to its 2019 taxable income and \$440 million to  
14 the 2020 tax return, all pre-TCJA.

15 **Q. What amount of NOL should be allowed in Evergy Metro or West’s rate base?**

16 A. Judging from the fact that the NOL deduction did not completely offset the taxable income  
17 for tax year 2020, it appears that the consolidated corporation has nearly exhausted its NOL  
18 balance,<sup>7</sup> so the question may be moot. The amortization of the excess NOL was a mistake  
19 and the balance should be offset by the taxable income of 2018, 2019, 2020, or 2021. As I  
20 stated before, the Companies have been improperly amortizing the NOL instead of a straight  
21 reduction to net income and, given the fact that the Corporation has been exhausting its NOL

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<sup>5</sup> Also quoted from data request 1317

<sup>6</sup> Hardesty, rebuttal, pg. 3, lines 20-23

<sup>7</sup> The NOL deduction only offset approximately 73% of the taxable income on the 2020 tax return when offsetting 80% was allowed.

1 balance since 2018,<sup>8</sup> there should be very little deferred tax assets left for the 2022 income  
2 tax returns. Any NOL balance should be removed from rate base for both Companies.

3 **Q. As far as the IRS code, is the Commission allowed to eliminate the NOL balances from**  
4 **rate base?**

5 A. Yes it is. The IRS has stated numerous times that it provides utility commissions wide  
6 discretion concerning deferred tax inclusion in rate base. Eliminating a pre-TCJA NOL  
7 balance should fall under that grant of discretion. Also, keep in mind that the amortization  
8 was a mistake so it is the responsibility of the Company to justify a recalculated NOL balance  
9 and prove that the balance would even survive another tax filing much less through to the next  
10 rate case. Given that the Company is relying on an amortization of the NOL instead of direct  
11 association with taxable income, this is not something Evergy has accomplished.

12 **TAX CREDITS REDUCTION TO RATE BASE AND INCOME TAX CALCULATIONS**

13 **Q. Company witness Ms. Hardesty makes the argument that income tax credit**  
14 **carryforwards should be viewed as a possible rate base addition rather than your**  
15 **contention that it is a rate base reduction. Could you please frame your argument for**  
16 **rate base reduction again?**

17 A. First, let's clear up some misinformation from the Company testimony. Ms. Hardesty makes  
18 the claim "If anything, the deferred tax assets related to the tax credit carryforward would be  
19 an increase to rate base since **the customers have gotten the benefit of the tax credits in**  
20 **setting rates**, but the Company has not received these tax benefits from the government yet."<sup>9</sup>  
21 I wanted to illuminate that error since I have pointed out in rebuttal testimony that Staff has  
22 applied only limited amounts of general business credits to the income tax expense built into  
23 the prior Company rate cases. The customers have received little in the way of benefits from

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<sup>8</sup> Great Plains and Evergy have combined to use \$1.458 billion in NOL since the enactment of TCJA

<sup>9</sup> Hardesty rebuttal, page 5 lines 8-11 (Emphasis added.)

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1 the accumulation of business credits even though these credits have been funded through rates,  
2 yet Evergy, Inc. has enjoyed these benefits from the government by reducing its income tax  
3 liability by 75% for the 2020 and 2021 tax years. Let's play the Hardesty contention  
4 backwards. The *Company* has gotten the benefit of the tax credit in setting rates due to Staff's  
5 inability to apply them in a general rate case, thereby allowing the full amount of income tax  
6 expense in rates instead of a much lower credit reduced level that the Company has actually  
7 paid to the Federal Government.

8 **Q. Why has Staff not been able to apply the credits to the income tax built into rates?**

9 A. Prior to 2018, Evergy was either creating NOL or applying NOL to taxable income on a  
10 consolidated basis. The business credits couldn't be used due to the fact that there wasn't any  
11 income to apply the credits to.<sup>10</sup> Credits have therefore just been accumulating for years and  
12 waiting to be spent down. Now with TCJA, the consolidated Company is in a taxable  
13 situation. It can now lower its taxable income liability with the stockpiled general business  
14 credits.

15 **Q. Why the rate base reduction?**

16 A. These GBC have been accumulating and waiting to be used. They aren't amortized and they  
17 haven't expired. They are a deferred tax asset to the Company very similar to NOL but the  
18 ratepayer has been funding these credits through the cost of service and they have been  
19 accumulating due to the application of the NOLs to taxable income. It is true that GBC aren't  
20 exactly an interest free loan to the Company, but this balance has been building every year  
21 courtesy of the ratepayer, and has allowed the Company to apply them in 2020 and 2021.  
22 These tax savings are not reflected in past rate cases. These customer provided credits should  
23 somehow be reflected as a reduction. The ratepayer has paid in advance for the credit just  
24 like the ratepayer paid the deferred income taxes in advance. Honestly, the proper application

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<sup>10</sup> When calculating taxable income and income tax liability, if there is a positive net income, NOLs are applied first. Prior to 2020, there was no taxable income to apply tax credits.

1 of these credits is to reduce the income tax expense within the cost of service, but if the  
2 Commission leaves income taxes unadjusted then a reduction in rate base to reflect the  
3 customer funding of Evergy Metro tax reduction should be considered.

4 **Q. What would you expect the deferred balance to be?**

5 A. The most current information that the Company has provided the Commission is a GBC  
6 balance at 2021 year end of \$162 million<sup>11</sup>. Even though the Company has extended the  
7 filing date of the 2022 consolidated federal and state tax returns, that doesn't mean the  
8 information concerning GBC isn't already known and measurable. The Company could  
9 update the 2022 GBC balance now.

10 **Q. Could you summarize this adjustment?**

11 A. Prior to the test year in ER-2018-0145, Great Plains Energy reported a taxable loss on its 2017  
12 federal tax return and applied an NOL to its 2016 return. It would be hard to argue that Staff  
13 should have applied GBC to the test year in the 2018 rate case where every indication said  
14 GBC won't be applied, however, due to NOL depletion and the TCJA, GBC was applied to  
15 reduce the Company's tax liability in 2020, 2021, and probably 2022. These credits are  
16 available to Evergy Missouri Metro courtesy of the IRS and financed by the ratepayers. As  
17 such, the credits should be reflected in Evergy's rates.

18 **GBC AND REVENUE REQUIREMENT CALCULATIONS**

19 **Q. You mentioned in rebuttal testimony that you believe there is an error in the income tax**  
20 **calculations performed in the Staff EMS run. Have you worked with Staff on resolving**  
21 **your concerns?**

22 A. Yes. I had my concerns with the EMS calculations in the last Ameren general rate case  
23 however, the case was stipulated and the tax issue was not revisited. I had an opportunity to

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<sup>11</sup> Evergy Metro 2021 FERC Form No. 1

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1 work through the application of GBC to the income tax liability and found the EMS  
2 calculations and ending revenue requirement to be in line with my review. It would appear  
3 that my concerns were brought on by my expectations in the presentation rather than the  
4 internal calculations.

5 The application of GBC and the corresponding adjustment to the tax offset in the Cash  
6 Working Capital changes the mid-point revenue requirement to a negative \$32,495,578 prior  
7 to any other OPC adjustments or true-up adjustments.

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

9 A. Yes, it does.

