

Exhibit No.:	_____
Issue(s):	Stub Period Tax Regulatory Liability/ Cash Working Capital Adjustment/ Deferred Tax Balance and Regulatory Asset/Liability Accounts/ Proposed Revenue increase due to TCJA
Witness/Type of Exhibit:	Riley/Direct
Sponsoring Party:	Public Counsel
Case No.:	ER-2019-0374

DIRECT TESTIMONY

OF

JOHN S. RILEY

Submitted on Behalf of the Office of the Public Counsel

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2019-0374

January 15, 2015

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


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

AFFIDAVIT OF JOHN S. RILEY

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

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

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




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

Subscribed and sworn to me this 15th day of January 2020.



JERENA A. BUCKMAN
My Commission Expires
August 23, 2021
Cole County
Commission #13754037



Jerene A. Buckman
Notary Public

My Commission expires August 23, 2021.

TABLE OF CONTENTS

Testimony	Page
Stub Period Tax Regulatory Liability	2
Cash Working Capital Adjustment	4
Deferred Tax Balance and Regulatory Asset/Liability Accounts	7
Proposed Revenue increase due to TCJA	7

DIRECT TESTIMONY
OF
JOHN S. RILEY
THE EMPIRE DISTRICT ELECTRIC COMPANY
CASE NO. ER-2019-0374

1 **Q. What is your name and what is your business address?**

2 A. John S. Riley, PO Box 2230, Jefferson City, Missouri 65102.

3 **Q. By whom are you employed and in what capacity?**

4 A. I am employed by the Missouri Office of the Public Counsel (“OPC”) as a Public Utility
5 Accountant III.

6 **Q. What is your educational background?**

7 A. I earned a B.S. in Business Administration with a major in Accounting from Missouri State
8 University.

9 **Q. What is your professional work experience?**

10 A. I was employed by the OPC from 1987 to 1990 as a Public Utility Accountant. In this capacity
11 I participated in rate cases and other regulatory proceedings before the Public Service
12 Commission (“Commission”). From 1994 to 2000 I was employed as an auditor with the
13 Missouri Department of Revenue. From 2000 until 2013 I was employed as an Accounting
14 Specialist with the Office of the State Court Administrator. In 2013, I accepted a position as
15 the Court Administrator for the 19th Judicial Circuit where I was employed until April, 2016
16 when I joined the OPC as a Public Utility Accountant III. From 2014 through 2017 I also
17 prepared income tax returns at a local accounting firm for individuals and small businesses.

1 **Q. Are you a Certified Public Accountant?**

2 A. Yes, I have a CPA license from the State of Missouri. I am also a member of the Institute of
3 Internal Auditors (“IIA”).

4 **Q. Have you previously filed testimony before the Missouri Public Service Commission?**

5 A. Yes, I have. A listing of my Case filings is attached as JSR-D-1.

6 **Q. What is the purpose of your direct testimony?**

7 A. I make four recommendations to the Commission that affect Empire’s revenue requirement.
8 The first is to request the Commission follow through with section 393.137.3 of the Missouri
9 Statutes and amortize over 12 months the regulatory liability (Stub Period) that it directed
10 Empire to establish in the *Report & Order* issued in Case No. ER-2018-0366 and include the
11 resulting annual amount as a reduction to Empire’s revenue requirement since Empire is not
12 paying any income taxes to the Internal Revenue Services (IRS) and the Missouri Department
13 of Revenue. The second is to reduce Empire’s cash working capital expense total based on
14 my calculation of the income tax expense lag. The third is to reduce Empire’s rate base by
15 excluding certain offsets to the deferred income tax balance and the regulatory asset and
16 liability accounts that Empire included on its books and records. The fourth, and final
17 recommendation, is to not increase Empire’s revenue requirement due to the 2017 Tax Cuts
18 and Jobs Act reduction of Empire’s Federal and State taxes.

19 **Stub Period Tax Regulatory Liability**

20 **Q. What did the Commission order in Case No. ER-2018-0366 with regard to Empire’s**
21 **2017 Tax Cuts and Jobs Act (TCJA) stub period beginning January 1 and ending**
22 **August 30, 2018?**

23 A. The Commission ordered the following:

1 4. The Empire District Electric Company shall record a
2 regulatory liability for the financial impact of the Tax Cut and Jobs
3 Act of 2017 on the electrical corporation for the period of January 1,
4 2018, through August 30, 2018. Recovery of the amounts deferred
5 through the regulatory liability shall be determined in Empire's next
6 general rate proceeding.

7 **Q. What is the financial impact to which this ordered paragraph is directed?**

8 A. This regulatory liability represents the financial impact on Empire of the TCJA reduction of
9 the corporate federal income tax rate from 34% to 21% between the date the change in tax
10 took effect (January 1, 2018) to the date that the Commission ordered Empire to adjust its
11 permanent rates for the tax rate change (August 30, 2018). This period from January 1, 2018,
12 to August 30, 2018 is commonly known as the "stub period."

13 **Q. What is the amount of Empire's stub period 2017 TCJA regulatory liability the**
14 **Commission established in Case No. ER-2018-0366?**

15 A. With no objections to the Commission's final calculation, the amount was \$11,728,453.¹

16 **Q. Has Empire indicated its opinion regarding your recommendation?**

17 A. Yes. The Company has indicated that it does not agree with my recommendation. The
18 Company asserts that because it did not earn its allowed rate of return during the "Stub
19 Period," it would not be equitable to credit this regulatory liability to
20 customers.

21 **Q. Why is your position correct, Empire's argument notwithstanding?**

22 A. The Company's position is not sound. The whole point of the Commission ordering Empire
23 to create the regulatory liability for the impacts of the 2017 TCJA from January 1 to August
24 30, 2018, was that the 40% reduction in the Federal Income Tax rate would cause Empire to

¹ R&O, Case No. ER-2018-0366, Page 21, lines 3-5.

1 over-earn by \$11,728,453. The last sentence of § 393.137.3, RSMo., reads, “The [stub period]
2 amounts deferred under this subsection **shall** be included in the revenue requirement used to
3 set the electrical corporation's rates in its subsequent general rate proceeding through an
4 amortization over a period determined by the commission.” (emphasis added). Moreover, the
5 financial surveillance reports Empire submitted for the 12-month period ending September
6 30, 2018 — just one month after the stub period ended — indicate that Empire’s costs and
7 revenues were such that it was exceeding its authorized ROE by a substantial amount.²
8 Finally, the Revenue Requirement Schedule workpaper³ Empire provided for this general rate
9 case indicates that Empire’s test year ROR was 10.23%,⁴ which is well above the 7.5%
10 established in Empire’s last rate case.

11 **Q. Over what period should the Commission amortize the \$11,728,453 recorded for**
12 **Empire’s “stub period” regulatory liability?**

13 A. If this regulatory liability were used to offset an established asset, then an amortization
14 timeframe would be established. Offsetting the prepaid pension asset would eliminate any
15 adjustments to the rate design or trying to nail down a monthly credit amount. The prepaid
16 pension balance should be reduced by \$11,728,453.

17 **Cash Working Capital Adjustment**

18 **Q. Would you generally explain what Cash Working Capital (“CWC”) is, and how it**
19 **affects a company’s revenue requirement?**

20 A. CWC is the net amount of funds required to finance the day-to-day operations of a regulated
21 utility. The CWC amount is generally derived by a lead/lag study. The study compares the
22 net difference between the revenue lag and expense lag, which will be a positive number for

² Confidential FAC Surveillance Monitoring Report for the 12 months ended – September, 2018.

³ Attached as Schedule JSR-D-2.

⁴ ER-2016-0023 Report & Order acknowledged a 9.5 to 9.9% range for a Return on Equity “(ROE)” which would establish a ROR of approximately 7.55%

1 some expense items and a negative number for others. The revenue lag represents how
2 quickly the utility receives payment from its customers after they receive service. The longer
3 the revenue lag, the more cash the utility needs from its investors to fund its day-to-day
4 operations. The expense lag represents the number of days between the time the utility
5 receives goods and services and the time when the utility disperses funds for those goods and
6 services. The longer the expense lag, the less cash the utility needs from its investors to fund
7 its day-to-day operations. When all of these individual calculation are added together; the
8 summation is included in rate base and ultimately figured into the revenue requirement.

9 **Q. Are there any conditions you would like to point out to the Commission prior to your**
10 **discussion concerning Cash Working Capital components?**

11 A. Yes. I am proposing an adjustment to the Company's CWC, but I want to make it clear that
12 I am not proposing any reduction to the actual expense that exist in the determination of the
13 cost of service. I am adjusting how the account balance flows through the calculation of CWC
14 and not the actual expense itself.

15 **Q. Did you perform a lead/lag study for this rate case?**

16 A. No. I did not take issue with Company witness Mr. Timothy Lyons' CWC formulas so
17 producing another study would be unnecessary. I simply made adjustments to his study to
18 determine revenue requirement regarding this issue.

19 **Q. What is your adjustment to the Company's Cash Working Capital computations?**

20 A. Company witness Timothy S. Lyons developed a lead/lag study to be used in the calculation
21 of various inputs to the CWC balance. Mr. Lyons has used a revenue lag of 42.13 days for
22 every line in his summary. This is his calculation of when the Company will receive the funds
23 from customers (revenues collected). Each line has a different expense lag which is dependent
24 on when the expense in question is paid to the vendor. In Schedule TSL 12, page 4 of 6, there

1 is a table that Mr. Lyons developed to support the hypothetical payment of federal and state
2 income tax in four installments. The expense (payment) lag works out to a negative 37 days.
3 This Lead/Lag day summary is then a positive 5.13 days (42.13 less 37). Mr. Lyons
4 calculations indicate that the Company has a shortfall of \$131,812. I say shortfall meaning
5 that the Company must provide funding prior to customer collections so that the shortfall
6 would be an addition to the CWC total. This positive number of days indicates that the
7 Company contends that it is required to pay income tax before that money is generated
8 through billing revenues from its customers. I used the term “hypothetical payments” because
9 *if* the Company actually paid quarterly income taxes, then the results that Mr. Lyons has
10 produced might be accurate. However, the Company has not paid income tax in the last four
11 years, so the calculation exercise is not representative of how the Company actually spends
12 its income tax expense.

13 **Q. How did you calculate the CWC amount for income tax expense?**

14 A. I only changed one component of Mr. Lyons CWC income tax calculation. Since the
15 Company has not submitted federal income tax in at least four years, I adjusted the expense
16 lag of (37.00) days to (365) days, or one full year. Using a payment period of an entire year
17 indicates that the company receives the money from its customers but the expense is never
18 paid.

19 **Q. What was the new product from Mr. Lyons adjusted multiplication factors?**

20 A. Instead of a positive \$131,812 included in CWC, the outcome should be a negative
21 \$8,295,946. The line item calculation can be reviewed on Schedule JSR-D-3. This amount
22 will be adjusted when the Commission has set a revenue requirement and the Staff’s Exhibit
23 Modeling Systems (EMS) run can isolate the amount of income tax expense that will be
24 included in the Cost of Service.

1 **Deferred Tax Balance and Regulatory Asset/Liability Accounts**

2 **Q. What adjustments are you proposing to the Company’s overall Accumulated Deferred**
3 **Income Tax Balance (“ADIT”) that should be included in rate base?**

4 A. The Company has reduced its ADIT balance by a net operating loss (“NOL”) of \$2,621,928.
5 The entry should be removed and the ADIT balance increased by that amount.

6 **Q. What is your argument for disallowing an NOL reduction to ADIT?**

7 A. All utilities are afforded income tax expense in their cost of service whether income taxes are
8 due or if there is a loss on the tax return due to tax benefits. Staff includes the expense as if
9 there are no tax advantages taken. To include an NOL and reduce the ADIT would be to
10 disregard the benefit of income tax expense in rates. To put it another way, including an NOL
11 would be double dipping on a regulatory benefit as well as the cost principle.

12 **Q. Are there any other adjustments you would make to ADIT or regulatory asset/liability**
13 **accounts at this time?**

14 A. The Company has made several reversing entries to eliminate some balances within the
15 regulatory asset/liability sections of the general ledger. As of this testimony, I have made
16 inquiries with the Company about these balances but have not received replies. Depending
17 on Staff’s revenue requirement testimony, I may have additional adjustments in rebuttal
18 testimony.

19 **Proposed Revenue increase due to TCJA**

20 **Q. What has the Company proposed in its revenue requirement to offset some of the effects**
21 **of the lower federal income tax rates?**

1 A. In a nutshell, Empire argues that between the Stub period liability account and the permanent
2 reduction in rates that began in September 2018, the income tax reduction caused the
3 Company to under earn by \$3,985,465. Empire seeks to increase revenue requirement by that
4 amount to make up for the shortfall.

5 **Q. Do you agree with this assertion?**

6 A. No, for several reasons. First, the Company's measurement period was 15 months instead of
7 12. The extra three months could explain the "shortfall." Secondly, revenue requirement in
8 Missouri is a rate base rate of return calculation. A revenue requirement is determined and
9 current revenues and expenses are calculated to determine a rate increase or decrease. Income
10 taxes are one of the few expenses in a rate case that are fluid and the true expense is not known
11 until the revenue requirement is established. And finally, to request the inclusion of additional
12 revenue to make the Company whole due to a past, *perceived* shortfall would be retroactive
13 ratemaking.

14 **Q. Does this conclude your direct testimony?**

15 A. Yes, it does.

John S. Riley, CPA
Summary of Case Participation

ST LOUIS COUNTY WATER COMPANY	CASE NO. WR-88-5
SOUTHWESTERN BELL TELEPHONE COMPANY	CASE NO. TC-89-21
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2016-0023
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2016-0156
KANSAS CITY POWER & LIGHT COMPANY	CASE NO. ER-2016-0285
AMEREN MISSOURI	CASE NO. ER-2016-0179
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2017-0065
LACLEDE GAS COMPANY	CASE NO. GR-2017-0215
MISSOURI AMERICAN WATER COMPANY	CASE NO. WU-2017-0351
MISSOURI AMERICAN WATER COMPANY	CASE NO. WR-2017-0285
LIBERTY (MIDSTATE NATURAL GAS)	CASE NO. GR-2018-0013
KANSAS CITY POWER AND LIGHT	CASE NO. ER-2018-0145
KCP&L GREATER MISSOURI OPERATIONS COMPANY	CASE NO. ER-2018-0146
EMPIRE DISTRICT ELECTRIC PRUDENCE REVIEW	CASE NO. EO-2018-0244
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2018-0228
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. ER-2018-0366
EMPIRE DISTRICT ELECTRIC COMPANY	CASE NO. EO-2018-0092
AMEREN GAS COMPANY	CASE NO. GR-2018-0227
MISSOURI AMERICAN WATER COMPANY	CASE NO. WO-2018-0373
LIBERTY UTILITIES EMPIRE ELECTRIC CO	CASE NO. EA-2019-0010
SUMMIT NATURAL GAS OF MISSOURI, INC	CASE NO. GR-2018-0230
SPIRE NATURAL GAS, EAST/WEST ISRS	CASE NO. GO-2019-0115
MISSOURI AMERICAN WATER COMPANY	CASE NO. WO-2019-0184
AMEREN GAS	CASE NO. GR-2019-0077
UNION ELECTRIC COMPANY	CASE NO. ER-2019-0335



The Empire District Electric Company
 Missouri Jurisdiction
 Docket No. ER-2019-0374
 Schedule 1 Revenue Requirement

ROR 10.23%

Line No.	Description (a)	Reference (b)	3/31/2019 Test Year End (c)	Pro Forma Adjustments (d)	Adjusted Test Year End (e) = (c) + (d)
1	Rate Base	Schedules 2 & 3	1,301,068,347	156,292,122	1,457,360,469
2	Revenues	Schedules 4 & 5	538,554,855	(409,586)	538,145,269
3	Expenses	Schedules 4 & 5	395,553,192	50,492,361	446,045,553
4	Operating Income (Loss) Before Taxes	(Line 2 - Line 3)	143,001,663	(50,901,947)	92,099,716
5	Income Taxes	Schedule 4	9,911,046	(6,854,196)	3,056,850
6	Operating Income (Loss) After Taxes	(Line 4 - Line 5)	133,090,617	(44,047,751)	89,042,866
7	Current Rate of Return	(Line 6 / Line 1)	10.23%		6.11%
8	Rate of Return Requested	Schedule 6	7.50%	7.50%	7.50%
9	Required Net Operating Income	(Line 1 x Line 8)	97,522,879	11,715,032	109,237,911
10	Income Deficiency	(Line 9 - Line 6)	(35,567,738)	55,762,783	20,195,045
11	Gross Revenue Conversion factor	Schedule 7	1.313027	1.313027	1.313027
12	Revenue Deficiency	(Line 10 x Line 11)	(46,701,398)	73,218,036	26,516,638
13	Revenue Deficiency %	(Line 12 / Line 2)	-8.67%		4.93%
14	Revenue Requirement	(Line 2 + Line 12)	491,853,457	72,808,450	564,661,907



The Empire District Electric Company
 Missouri Jurisdiction
 Docket No. ER-2019-0374
 RB ADJ 12 Cash Working Capital

COMPANY CASH WORKING CAPITAL WORKPAPER CALCULATIONS

Line	Description	Reference	Revenue Requirement Amount	Average Daily Amount	Revenue Lag	Ref.	Expense Lead	Ref.	Net (Lead)/Lag Days	Working Capital Requirement
1	Purchased Fuel and Power Expenses		\$ 140,548,512	385,064	42.13	A	(31.13)	B	11.00	\$ 4,235,709
2	<u>Operation and Maintenance Expenses</u>									
3	O&M, Labor	O&M by FERC for Labor	32,381,159	88,716	42.13	A	(12.00)	C	30.13	2,672,998
4	401-K	Note 1	20,782,671	56,939	42.13	A	(12.00)	C	30.13	1,715,567
5	Post Retirement Benefits	Note 2	139,238	381	42.13	A	(5.66)	C	36.47	13,912
6	Medical, Vision, and Dental Expenses	Note 3	5,817,290	15,938	42.13	A	(16.29)	C	25.84	411,832
7	Life Insurance / AD&D	Note 4	274,470	752	42.13	A	(16.34)	C	25.79	19,393
8	Intercompany Transfers	Note 5	15,103,105	41,378	42.13	A	(35.13)	C	7.00	289,649
9	PSC Assessment	Note 6	1,084,117	2,970	42.13	A	17.23	C	59.36	176,310
10	O&M, Other Non-Labor	Note 7	118,830,054	325,562	42.13	A	(29.21)	C	12.92	4,206,258
11	Total O&M Expenses									9,505,920
12	<u>Taxes Other Than Income Taxes</u>									
13	Property Taxes	Note 8	25,261,712	69,210	42.13	A	(195.13)	E	(153.00)	(10,589,156)
14	Payroll Taxes	Note 9	2,661,110	7,291	42.13	A	(11.17)	E	30.96	225,720
15	Total Taxes Other Than Income Taxes									(10,363,435)
16	Federal and State Income Taxes	Note 10	9,378,451	25,694	42.13	A	(37.00)	D	5.13	131,812
17	Interest Payments	Note 11	33,957,956	93,035	42.13	A	(91.26)	F	(49.13)	(4,570,834)
18	Total									\$ (1,060,829)



The Empire District Electric Company
 Missouri Jurisdiction
 Docket No. ER-2019-0374
 RB ADJ 12 Cash Working Capital

Federal and State Income Taxes - Expense Lead Adjusted

Line	Description	Reference	Revenue Requirement Amount	Average Daily Amount	Revenue Lag	Ref.	Expense Lead	Ref.	Net (Lead)/Lag Days	Working Capital Requirement
1	Purchased Fuel and Power Expenses		\$ 140,548,512	385,064	42.13	A	(31.13)	B	11.00	\$ 4,235,709
2	<u>Operation and Maintenance Expenses</u>									
3	O&M, Labor	O&M by FERC for Labor	32,381,159	88,716	42.13	A	(12.00)	C	30.13	2,672,998
4	401-K	Note 1	20,782,671	56,939	42.13	A	(12.00)	C	30.13	1,715,567
5	Post Retirement Benefits	Note 2	139,238	381	42.13	A	(5.66)	C	36.47	13,912
6	Medical, Vision, and Dental Expenses	Note 3	5,817,290	15,938	42.13	A	(16.29)	C	25.84	411,832
7	Life Insurance / AD&D	Note 4	274,470	752	42.13	A	(16.34)	C	25.79	19,393
8	Intercompany Transfers	Note 5	15,103,105	41,378	42.13	A	(35.13)	C	7.00	289,649
9	PSC Assessment	Note 6	1,084,117	2,970	42.13	A	17.23	C	59.36	176,310
10	O&M, Other Non-Labor	Note 7	118,830,054	325,562	42.13	A	(29.21)	C	12.92	4,206,258
11	Total O&M Expenses									9,505,920
12	<u>Taxes Other Than Income Taxes</u>									
13	Property Taxes	Note 8	25,261,712	69,210	42.13	A	(195.13)	E	(153.00)	(10,589,156)
14	Payroll Taxes	Note 9	2,661,110	7,291	42.13	A	(11.17)	E	30.96	225,720
15	Total Taxes Other Than Income Taxes									(10,363,435)
16	Federal and State Income Taxes	Note 10	9,378,451	25,694	42.13	A	(365.00)	D	(322.87)	(8,295,946)
17	Interest Payments	Note 11	33,957,956	93,035	42.13	A	(91.26)	F	(49.13)	(4,570,834)
18	Total			-						\$ (9,488,587)