Exhibit No. 106

Staff – Exhibit 106
Kimberly Bolin
Rebuttal Testimony
File No. ER-2021-0312

Exhibit No.:
Issue(s): Business Risk, Paygo, AROs, Transmission Tracker
Witness: Kimberly K. Bolin
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MISSOURI PUBLIC SERVICE COMMISSION

FINANCIAL & BUSINESS ANALYSIS DIVISION

AUDITING DEPARTMENT

REBUTTAL TESTIMONY

OF

KIMBERLY K. BOLIN

THE EMPIRE DISTRICT ELECTRIC COMPANY, d/b/a Liberty

CASE NO. ER-2021-0312

Jefferson City, Missouri
December 2021

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Q. Please state your name and business address.

A. My name is Kimberly K. Bolin. My business address is P. O. Box 360, Suite 440, Jefferson City, MO 65102.

Q. Are you the same Kimberly K. Bolin that contributed to the Missouri Public Service Commission Staff's ("Staff") Costs of Service Report ("COS Report") that was filed on October 29, 2021 in this case?

A. Yes, I am.

<u>EXECUTIVE SUMMARY</u>

Q. What is the purpose of your rebuttal testimony?

A. In this testimony, I address The Empire District Electric Company, d/b/a Liberty ("Empire" or "Company") witness John J. Reed's direct testimony concerning business risk. I also address Office of the Public Counsel ("OPC") witness John S. Riley's direct testimony concerning Paygo revenues. I address both Empire and OPC direct testimony concerning the inclusion of Asset Retirement Obligations ("ARO") in rate base. Finally, I address Empire witness Aaron J. Doll's alternative proposal of a tracker for transmission revenues and expenses if the Commission does not allow 100 percent of the transmission revenues and expenses to flow through the Fuel Adjustment Clause ("FAC").

BUSINESS RISK

Q. What is regulatory lag?

A. "Regulatory lag" is the lapse in time between when a utility experiences a financial change and when that change can be reflected in its rate levels. Regulatory lag can be either detrimental or beneficial to a utility's earnings, and under either scenario, the existence of this phenomenon serves as an important incentive on the utility to be as cost-conscious and efficient over time as possible, in order to maintain its earnings levels.

Q. Does regulatory lag motivate a utility to act efficiently?

A. Yes. Regulators rely on regulatory lag as an important tool to provide an incentive to a utility to act efficiently. An excessive use of tracking mechanisms and rate riders reduces the incentive for the utility to seek out cost reductions because the utility is insulated from changes in costs and thereby may be able to maintain the utility's profits even when its costs increase. The more that utilities are insulated from the impacts of increase costs through riders and surcharges, the more business risk is shifted to utility customers. If a utility experiences an increase in expense that is being tracked separately from typical costs authorized by the Commission, its financial results will not be adversely impacted because the impacts are captured on the balance sheet for deferral treatment, with likely recovery. In this instance, the utility has less incentive to attempt to minimize any such costs increase for the tracked item. In addition, if a utility experiences a reduction in an expense that is being tracked, the financial result will not increase earnings because of the decreased cost level. Once again, the utility will have less incentive to seek out ways to reduce costs. Utilities may even be dis-incentivized to reduce costs if the benefits of those lower costs are quickly flowed to customers through special regulatory mechanism outside of a general rate case.

Q. Generally speaking, what is "business risk" for a regulated utility?

A. "Business risk" refers to the uncertainty linked to the operating cash flows of the utility. Business risk is multi-faceted and includes factors affecting revenues, expenses, and investment costs that could reduce a utility's profit level. In general, a utility with a certificated service area that has the ability to request changes in rates to cover changes in costs and to provide an opportunity to earn a fair return on investment has far less risk than a business or industry that does not have such safeguards. For example, local and regionally owned grocery stores must compete with other nearby nationwide discount retailers for a customer's purchase of groceries. Most price sensitive consumers will shop at the store that has the same products but at lower prices. Likewise, if two nearby gas stations have different pricing for gasoline, most price sensitive consumers who need to purchase gasoline will opt to fill their vehicles at the filing station with the lowest price. On the other hand, a regulated utility's customers are captive customers that have, for the most part, no practical choice other than to accept utility service and utility rates in the area in which they live or do business. Thus, most utility customers are captive to one utility service provider in the area where they live.

Q. On page 64 of Empire witness John J. Reed's direct testimony he cites four factors affecting Empire's business risk. What are the four factors he cites?

A. Mr. Reed cites the four factors as follows: (1) test year convention; (2) rate base convention; (3) revenue decoupling; and (4) capital cost recovery.

Q. The first business risk factor, Mr. Reed cites is the test year convention. He claims that 47 % of the utilities in his proxy group utilize a fully or partial future test year. Has Missouri traditionally used a "historic test year?"

A. Yes. In Missouri, utility rates have traditionally been set using a historic test year approach. Under this method, rate analysis begins with selection of a test year consisting of twelve months of actual financial information, and for which the data is available for review and analysis at the beginning of the rate case audit. During this audit, the test year data is reviewed to determine what adjustments should be proposed in order to convert the historical financial data into representative ongoing expense and revenue levels to include in prospective rate levels. In every rate case, a number of "annualization" and "normalization" adjustments are proposed for this purpose. Annualization adjustments are proposed to reflect the most current trends evident for an individual expense or revenue item in setting utility rates. Normalization adjustments are proposed to eliminate abnormally high or low individual revenue and expense amounts incurred within the test year in order to reflect only normal and ongoing levels of costs in setting prospective utility rates.

However, historic test year ratemaking in Missouri is not limited to reliance on information contained within the twelve-month test year selected for the case. In all major cases, financial information from a subsequent "test year update period" is used and, in almost all cases, an even later "true-up" period is authorized as well to allow use of the most updated expense, revenue, and rate base data possible in setting utility rates; this practice has been referred to as a "modified" historic test year approach. Under Missouri's modified historic test year approach, rate base items are generally set equal to the update period or true-up period ending level, again to reflect that the most current information available is utilized to set customer rates while ensuring that actual expenditures made were prudently incurred and in-service.

To summarize, use of a modified historic test year approach in Missouri has included a number of features intended to reasonably ensure that utility rates are set to reflect the most current trends in the company's revenue, expense, and capital results. However, in almost all cases, ratemaking allowances have been restricted to those qualifying under the "known and measurable" cost standard. The "known and measurable" standard requires that only the costs associated with events that have actually occurred or are certain to occur, and for which the financial impact can be accurately quantified, should be reflected in utility rates. If adhered to, the known and measurable standard precludes the use of budgeted, projected, or forecasted information in setting utility rates.

The Staff's position is that adherence to the known and measurable standard in setting rates is an important customer protection.

Q. In this case, has Empire chosen to forgo use of a true-up period to set its rates?

A. Yes. At the very least, this position seems to reflect that Empire does not view regulatory lag as being a major concern to it in this particular proceeding.

Q. The second business risk factor Mr. Reed briefly discusses is rate base convention. Does this factor affect Empire's risk negatively?

A. No. As Mr. Reed cites, Empire recommends and the Commission has universally adopted use in past cases of a year-end rate base. This approach provides a more timely cost recovery of capital investments than for other utilities in other jurisdictions, which may use an average rate base.

Q. On page 64 of Mr. Reed's direct testimony he states that 46 % of the utilities in his proxy group have revenue decoupling mechanisms or weather normalization adjustment clauses. Does Missouri offer a revenue decoupling options for electric utilities?

A. Yes. However, Empire is currently unable to utilize the mechanism because Empire elected to utilize the Plant in Service Account ("PISA") mechanism. Per Section 386.266(3) RSMo,[1] if a utility elects to use PISA then the utility is not allowed to use a revenue adjustment rate (i.e., a revenue decoupling mechanism).

Q. Does Empire witness Mr. Reed assert that Empire is more risky than its peers even with the implementation of PISA?

A. Yes Mr. Reed asserts on pages 65 through 66 that Empire's implementation of PISA does not make Empire less risky than its peers. Mr. Reed argues that despite the implementation of PISA, Empire has a greater risk relative to his proxy group in terms of regulatory treatment because Empire is unable to include Construction Work in Progress (CWIP) in rate base. Mr. Reed's other concerns about PISA is that PISA does not provide immediate cash flow for new construction and that there is no tracking mechanism to recover certain capital investments for generation capacity or generic infrastructure replacement that are placed into service between rate cases.

Q. Does Staff agree with this reasoning?

A. No. It is Staff's position that because Empire has implemented the PISA recovery mechanism Empire's business risk has certainly been reduced in absolute terms compared to past rate cases, and has also very likely been reduced in relative terms compared to other electric utilities that have not been granted the benefit of major new regulatory lag mitigation measures in the time since Empire began using PISA. The PISA recovery mechanism

[1] Subject to the requirements of this section, any gas or electrical corporation may make an application to the commission to approve rate schedules authorizing periodic rate adjustments outside of general rate proceedings to adjust rates of customers in eligible customer classes to account for the impact on utility revenues of increases or decreases in residential and commercial customer usage due to variations in either weather, conservation, or both. No electrical corporation shall make an application to the commission under this subsection if such corporation has provided notice to the commission under subsection 5 of section 393.1400.

has reduced the impact of regulatory lag that exists by enabling Empire to defer and later recover significant amounts of investment related costs associated with eligible PISA investment.

Q. Should the Commission consider this reduced business risk in determining a reasonable and appropriate rate of return for Empire?

A. Yes. Staff is not aware of any policy or statutory impediment to the Commission doing so in relation to the impact of the recent incorporation of the PISA mechanism into Empire's ratemaking.

Q. Have you assessed other aspects of Empire's business risk or conducted any comparison of Empire with any of its peers?

A. No. Any questions regarding those matters should be referred to Staff witness Peter Chari. My testimony will address Mr. Reed's statements only from an accounting perspective. My rebuttal testimony focuses on my review of PISA. I also provide a brief discussion of various other trackers and riders that are available to Empire.

Q. What is the impact of the PISA mechanism in this case?

A. For the period covering August 2020 through June 30, 2021, Empire deferred $12,597,366 of investment related costs associated with eligible PISA investment. During this same period, Empire completed $811,392,988 in total investment of which $712,072,493 was PISA eligible. Approximately 88% of Empire's plant investment was eligible for the prescribed 85% recovery of PISA investment related costs. The table below summarizes the "return of" and "return on" the eligible PISA investment ending June 30, 2021.[2]

[2] Per Staff's Cost of Service Report filed on October 29, 2021 in Case No. ER-2021-0312.

PISA Depreciation Expense	$ 3,860,686
PISA Debt Cost on Plant	$ 3,165,641
PISA Equity Return on Plant	$ 5,372,762
PISA Carrying Cost on Regulatory Asset	$ 73,512
PISA Equity Return on Regulatory Asset	$ 124,765
Total Deferral June 30, 2021	$12,597,366
Amortization over 20 years	$ 629,868
Return on Deferral[3]	$ 852,842
Tax Factor Up	$ 196,519
Total Revenue Requirement Impact	$ 1,679,299

Q. On page 65 of Mr. Reed's direct testimony he cites that 73% of the operating groups in his proxy are able to include CWIP in rate base in between rate cases. What is CWIP?

A. In general, CWIP represents the costs of construction associated with projects that are not yet in-service and therefore not capable of providing electric utility service to customers during construction. The Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts prescribes the following accounting treatment in Account 107 for these costs:

> A. This account shall include the total of the balances of work orders for electric plant in process of construction.
>
> B. Work orders shall be cleared from this account as soon as practicable after completion of the job. Further, if a project, such as a hydroelectric project, a steam station or a transmission line, is designed to consist of two or more units or circuits which any be placed in service at different dates, any expenditures which are common to and which will be used in the operation of the project as a whole shall be included in electric plant in service upon the completion and readiness for service of the first unit. Any expenditures which are identified exclusively with units of property not yet in service shall be included in this account.
>
> C. Expenditures on research, development, and demonstration projects for construction of utility facilities are to be included in a separate subdivision in this account. Records must be maintained to show separately each project along with complete detail of the nature and

[3] Using Staff's Midpoint Rate of Return filed in its Staff's Cost of Service Report.

> purpose of the research, development, and demonstration project together with the related costs.

Q. Have the citizens of Missouri passed a referendum prohibiting CWIP in current rates?

A. Yes. In November 1976, Missouri passed a referendum prohibiting electric utilities from including CWIP in customers' current rates. This law is commonly referred to as "Proposition 1" and, in effect, does not allow electric utilities to receive cost recovery of CWIP until such time that the plant or capital investment is fully operational and used for service.[4] The intention of this law was to protect customers from being forced to pay for capital investment that is not capable of providing utility service and therefore would not provide an actual benefit to customers.

Q. In light of Proposition 1, do Missouri electric utilities ever recover CWIP in rates?

A. Yes. While amounts booked to CWIP are not included in permanent rates in Missouri, the accumulated CWIP balances are included in rate base when the construction is completed and the amounts formerly booked to CWIP are transferred to plant in service accounts and placed into service. Once plant is completed and customers start to benefit from the system improvement, the related costs are included in the rate structure of the utility through a rate request. While the costs of the newly completed plant are "deferred" during the time of construction in Missouri, utilities are made whole for this cost over time through the accrual of an allowance for funds used during construction ("AFUDC"). AFUDC represents a deferred

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[4] Section 393.135 RSMo (2016) Charges based on nonoperational property of electrical corporation prohibited. Any charges made of demanded by an electrical corporation for service, or in connection therewith, which is based on the costs of construction in progress upon any existing or new facility of the electrical corporation, or any other cost associated with owning, operating, maintaining, or financing any property before it is fully operational and used for service, is unjust and unreasonable, and is prohibited.

"return" mechanism recognizing the investors' cost of money during the duration of the construction project. The plant construction costs and the related AFUDC are included in the final plant costs that are ultimately included in rate base as part of a general rate case once it is fully operational and used for service.

Q. Would Staff be supportive of a utility's attempt to recover CWIP in customer rates before plant is placed in service?

A. No. Beyond the fact that legal counsel advises the recovery of CWIP in current utility rates is not permitted, as determined by Missouri voters in 1976, allowing CWIP recovery in rates would produce unfair results for customers because:

1. It is not appropriate to charge customers for investment costs for an item such as an electric generating facility that is not capable of providing utility service during the time the plant is being constructed. Customers should not have to pay for plant that is not capable of providing utility service. Only when customers start benefitting from use of the completed plant should rate recovery start;

2. Including CWIP in current rates prior to provides the utility an incentive to complete plant that is determined to not be needed in providing utility service, increasing the likelihood that a utility would construct unnecessary investment;

3. CWIP in rates can create intergenerational inequities. Intergenerational inequity means that if CWIP were collected in current rates, the utility would get the benefit of collecting the construction costs for investment that is not yet in service today while at the same time the customers would be receiving no benefits until a later time, if ever.

4. Including CWIP in current rates shifts the risk from the utility to its customers by requiring customers to pay for plant that may never be completed. Utilities are required to plan and build sufficient facilities to meet existing customer needs, receiving a financial return for accepting this risk. By shifting the risk of construction projects to utility customers, there is not typically a corresponding

reduction in the utility's expected and requested rate of return. Thus, utility customers will likely pay more in rates for having to accept this additional risk.

Q. Are there other measures adopted by the Commission for Empire that have had the impact of materially reducing its regulatory lag?

A. Yes. Frequently, utilities such as Empire request from the Commission what is referred to as deferral accounting treatment of certain costs. Often circumstances warrant costs that ordinarily would be charged currently to expense instead be deferred to balance sheet accounts. Deferral authority, when granted by the Commission, allows the utility the opportunity to recover such costs in later rate cases, thus mitigating regulatory lag.

Q. What kinds of costs does the Commission typically allow deferral treatment?

A. There are situation that may occur during the normal operations of the utility where events happen causing costs to rise above normal levels and above what is currently in rates. Most of the time in these situations whatever is causing the abnormally high costs is out of the control of the utility. Storms, such as the Joplin tornado that occurred in 2011, are examples of this phenomenon. In that particular situation, Empire was required to immediately repair damage to the transmission and distribution infrastructure to restore power as soon as possible. Empire was granted an Accounting Authority Order ("AAO") to recover repair and restoration costs in future rate cases related to the tornado.

Q. Above you cite the tornado AAO. Are there any other deferrals that Empire has been authorized to use by this Commission that are currently in rates?

A. Yes. The following is a listing of the approaches that Empire has employed to mitigate regulatory lag impacts:

1. Fuel Adjustment Clause ("FAC") Rider;
2. Pension and Other Post Retirement Employee Benefits ("OPEBs") Tracker
3. Various Trackers – Regulatory Asset and Liability Deferrals and Amortizations
    a. Vegetation Management Tracker Regulatory Asset
    b. Iatan and Plum Point Carrying Costs Regulatory Asset
    c. Riverton 12 Long-Term Maintenance Regulatory Asset

Q. Has Empire filed a notice of intent to seek a financing order that authorizes the issuance of securitized utility tariff bonds regarding the extraordinary costs incurred during the anomalous weather event of February 2021, sometimes referred to as Winter Storm Uri?

A. Yes. Empire filed a notice of intent in Case No. EO-2022-0040 to seek securitized utility bonds for the extraordinary Winter Storm Uri costs.

PAYGO

Q. What is "Paygo?"

A. "Paygo" is additional contributions of cash by the wind farm tax equity partners ultimately paid to Empire based on actual production in excess of a threshold amount of Megawatt hours (MWhs). If the threshold production level is exceeded, then the tax equity partner must begin making paygo payments.

Q. On page 6 of OPC witness John S. Riley's direct testimony he recommends the Commission include $4 million in Paygo payments in Empire's annual revenue requirement, and track the difference between Empire's actual paygo revenues against that $4 million per year, and address the difference when designing Empire's rates in its next general rate case. Does Staff agree with this recommendation?

A. Yes and no. Staff has proposed to include the paygo revenues in the FAC; however if the Commission decides that the Paygo revenues should not be included in the FAC, then the revenues should be included in the revenue requirement, and ongoing levels tracked against the amount included in the revenue requirement. If the Commission decides to include the paygo revenues in the FAC, the customers will automatically receive the benefits of the paygo revenues and a tracker will not be needed.

<u>ASSET RETIREMENT OBLIGATION</u>

Q. What is an ARO?

A. An ARO is an obligation, legal or non-legal, associated with the retirement of a tangible, long-lived asset for the cost of returning a piece of property to its original condition. Retirement obligations can be recognized either when the asset is placed in service or during the operational life when its removal obligation is incurred.

Q. What is an asset retirement cost ("ARC")?

A. An ARC is the offsetting asset that Empire booked in its records when Empire recognized the ARO.

Q. Did Empire include the ARO and the ARC in its rate base?

A. Yes. Empire included the ARC in plant in service in the amount of $22,880,541, but also included an offsetting liability for the ARO in the amount of $23,593,959.[5]

Q. Is Empire requesting to amortize the ARC?

A. Yes. Empire has proposed to amortize the ARC in the amount of $22,880,541 (Missouri jurisdictional) over 30 years, which results in an annual amortization of $762,845.

Q. Has Staff included this amortization in its cost of service?

A. No. AROs represent one component of costs that are considered in determining the cost of removal component of utility depreciation rates. Cost of removal is allowed to be collected in rates on an ongoing basis in order for the utilities to recover over time the estimated

[5] Both amounts are Missouri jurisdictional.

costs of "removing" assets once they are retired and no longer needed to provide service to customers. Allowing rate treatment of AROs would result in double recovery in rates by the utility of certain costs related to retirement of assets.

<u>TRANSMISSION TRACKER</u>

Q. On page 29 of Empire witness Aaron J. Doll's direct testimony he proposes that if the Commission does not allow transmission expense and revenues to flow through the FAC at 100%, then in the alternative, he recommends a tracker be authorized for transmission revenues and transmission expenses that are not allowed to flow through the FAC. Does Staff recommend the Commission grant a tracker for transmission expense and revenues as an alternative to including 100 % of the transmission revenues and expenses in the FAC?

A. No.

Q. In the past, has the Commission denied requests for a tracker for transmission costs?

A. Yes. In Case Nos. ER-2012-0174 and ER-2014-0370, the Commission denied Kansas City Power & Light Company ("KCPL") and KCPL Greater Missouri Operations Company (now Evergy Metro and Evergy Missouri West, respectively) requests for a tracker for transmission costs.

The Commission stated on page 54 in its Report and Order in Case No. ER-2014-0370:

> The evidence presented in this case showed that KCPL's transmission costs, while having increased in recent years, are normal, ordinary and recurring operation costs. These recurring costs are not abnormal or significantly different from the ordinary and typical activities of the company, so they are not extraordinary, and therefore, not subject to deferral under the USoA.

Q. Did Staff include a normalized level of transmission expenses and revenues included in its cost of service?

A. Yes. In this case, Staff examined transmission revenues and expenses incurred since October 2015, and determined that the twelve months ending June 30, 2021 level of expenses and revenues incurred represented a normalized level.[6]

Q. Does this conclude your rebuttal testimony?

A. Yes.

[6] Staff Cost of Service Report, page 86 in Case No. ER-2021-0312.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Request of The Empire District Electric Company d/b/a Liberty for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in its Missouri Service Area	)))))	Case No. ER-2021-0312

AFFIDAVIT OF KIMBERLY K. BOLIN

STATE OF MISSOURI	)	
	)	ss.
COUNTY OF COLE	)	

COMES NOW KIMBERLY K. BOLIN, and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing *Rebuttal Testimony of Kimberly K. Bolin;* and that the same is true and correct according to her best knowledge and belief.

Further the Affiant sayeth not.

Kimberly K. Bolin
KIMBERLY K. BOLIN

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 15th day of December, 2021.

DIANNA L. VAUGHT
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: July 18, 2023
Commission Number: 15207377

Dianna L. Vaught
Notary Public