

**Exhibit No.:**

**Issue(s):** ADIT Balances/Hedging Policy

**Witness/Type of Exhibit:** Riley/Surrebuttal

**Sponsoring Party:** Public Counsel

**Case No.:** ER-2024-0261

## **SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

Submitted on Behalf of the Office of the Public Counsel

**THE EMPIRE DISTRICT ELECTRIC COMPANY  
D/B/A LIBERTY**

FILE NO. ER-2024-0261

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Denotes Confidential Information that has been redacted.

Confidential information is either information Empire designated to be confidential in response to discovery or in information it provides through filings/submissions with the Commission (Rule 20 CSR 4240- 2.135(9))

September 17, 2025

**PUBLIC**

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**SURREBUTTAL TESTIMONY**

**OF**

**JOHN S. RILEY**

**The Empire District Electric Company**

**d/b/a Liberty**

**CASE NO. ER-2024-0261**

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

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

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

A. Yes.

**Q. What are you surrebutting?**

A. I will specifically be responding to Empire witness Mr. Michael McCuen concerning a carry-forward NOL account balance that Empire included in its rate base which I identified in my direct testimony and the Company's contention that it deserves a regulatory asset for paying a deferred tax liability off faster than it intended. I will also be responding to Company witness Mr. Aaron J. Doll's contention that the OPC opposes utility hedging natural gas and that during Storm Uri, "Empire's hedges reduced customer costs by approximately \$50 million during the event."<sup>1</sup>

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<sup>1</sup> Case No. ER-2024-0261, Empire witness Aaron J. Doll rebuttal testimony, p. 14, lines 20 and 21.

**COMPANY REDUCTIONS TO ADIT BALANCES SHOULD BE EXCLUDED**

**Q. What is Empire’s argument for why its NOL carry-forward balance should be included in its rate base as a deferred tax asset?**

**A.** Empire witness Mr. McCuen argues that Empire’s NOL carryforward balance of approximately \$26 million should be included in Empire’s rate base as a deferred tax asset because that balance is the sum of the unused parts of the NOLs from each tax year where that NOL was created but Empire was unable to use the full NOL which, in turn, means that Empire was prevented from taking advantage of the cost-free capital associated with that unused NOL.

**Q. What is your response to Mr. McCuen’s rationale?**

**A.** The inability of a company from using its ADIT (cost free capital) is the IRS reasoning for including NOL carryforwards in rate base.<sup>2</sup> My contention to exclude any NOL in rate base

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<sup>2</sup> Quotes similar to the following can be found in most Private Letter Rulings (“PLR”) concerning NOLs. This one is PLR-119381-16

On its regulatory books of account, Taxpayer “normalizes” the differences between regulatory depreciation and tax depreciation. This means that, where accelerated depreciation reduces taxable income, the taxes that a taxpayer would have paid if regulatory depreciation (instead of accelerated tax depreciation) were claimed constitute “cost-free capital” to the taxpayer. A taxpayer that normalizes these differences, like Taxpayer, maintains a reserve account showing the amount of tax liability that is deferred as a result of the accelerated depreciation. This reserve is the accumulated deferred income tax (ADIT) account. Taxpayer maintains an ADIT account. In addition, Taxpayer maintains an offsetting series of entries – a “deferred tax asset” and a “deferred tax expense” – that reflect that portion of those ‘tax losses’ which, while due to accelerated depreciation, did not actually defer tax because of the existence of a NOLC.

1 is based on three facts. The first is that the IRS only mandates recognizing NOL that is created  
2 by accelerated depreciation.<sup>3</sup> Secondly, the entire NOL in question was paid back to the  
3 Company by way of the securitization of Storm Uri losses. Third, the Company, Empire  
4 specifically, has shown a taxable profit the last two years since the creation of the NOL and  
5 has exhausted the accelerated depreciation created portion of the NOL. Together, these three  
6 facts eliminate any IRS mandated NOL or any other portion of the original tax loss.

7 **Q. What caused Empire's NOL carryforward balance?**

8 A. The NOL in question originated in 2021, primarily caused by Storm Uri. The Liberty Utilities  
9 (America) Co. & Subs consolidated federal tax return indicates that the Empire District  
10 Electric Company subsidiary sustained a \$\*\* \_\_\_\_\_ \*\* (JSR-S-01C, page 1).<sup>4</sup>  
11 Interestingly enough, the Commission granted the Company a \$208,676,955 securitization  
12 amount to compensate them for Storm Uri losses.<sup>5</sup>

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<sup>3</sup> Additional quotation concerning accelerated depreciation. This is a portion of IRS Notice 2019-33 concerning Normalization requirements  
SECTION 2. BACKGROUND

In general, normalization is a system of accounting used by regulated public utilities to reconcile the tax treatment of accelerated depreciation of public utility assets with their regulatory treatment. Under normalization, a utility receives the tax benefit of accelerated depreciation in the early years of an asset's regulatory useful life and passes that benefit through to ratepayers ratably over the regulatory useful life of the asset in the form of reduced rates.

<sup>4</sup> Liberty generated Pro Forma income tax return that only contains Empire specific tax information. Liberty has designated it to be CONFIDENTIAL.

<sup>5</sup> Please refer back to my Confidential JSR-R-1 C in rebuttal where Company indicated a storm cost asset of \$208,676,955 was securitized.

1 **Q. Would you elaborate on the IRS mandate that losses associated with accelerated**  
2 **depreciation be recognized?**

3 A. This is one of the aspects of what is known as the Normalization rules. A brief explanation  
4 of the rule is that the IRS intent is to not allow accelerated depreciation benefits to be reversed  
5 and flowed back to ratepayers sooner than Congress intended. The key point there is  
6 “accelerated depreciation”. Any other timing difference can be flowed back to ratepayers by  
7 whatever rate the Commission deems appropriate. I have quoted two IRS private letter rulings  
8 below that point out the accelerated depreciation issue.

9 **PLR-148311-13 page 2. (2014436038)**

10 **Taxpayer, for normalization purposes, calculates the portion of**  
11 **the NOLC attributable to accelerated depreciation using a “with or**  
12 **without” methodology, meaning that an NOLC is attributable**  
13 **to accelerated depreciation to the extent of the lesser of the**  
14 **accelerated depreciation or the NOLC.**

15 **LTR 202426004**

16 **The entire DTA balance is deemed to be attributable to**  
17 **accelerated depreciation, as determined using the “with or**  
18 **without” approach, pursuant to which an NOL is treated as being**  
19 **created first by accelerated tax depreciation deductions and only**  
20 **to the extent the NOL is larger than the accelerated tax**  
21 **depreciation deductions is it considered to have been created by**  
22 **other tax deductions.**

23 **Q. How much of Empire’s 2021 tax loss was generated by accelerated depreciation?**

24 A. Schedule JSR-S-01C, page 2, is a copy of the page of the tax return that displays the temporary  
25 difference between income statement amounts and expenses used on the tax return. The  
26 highlighted line indicates that accelerated depreciation was used to calculated taxable income.

1 The portion of the tax loss directly related to accelerated depreciation was an expense amount  
2 of \$\*\* \_\_\_\_\_ \*\*.

3 **Q. What would this \$\*\* \_\_\_\_\_ \*\* amount be if one were to convert it to a deferred tax**  
4 **asset and applied it to rate base?**

5 A. Using a combined tax rate of 23.84% as a multiplier, the deferred tax asset would be \$\*\*  
6 \_\_\_\_\_ \*\*.

7 **Q. Should this \$\*\* \_\_\_\_\_ \*\* be included in Empire's rate base as a deferred tax asset**  
8 **which reduces the rate base balance?**

9 A. No. As the second quote above points out, the "NOL is treated as being first created by  
10 accelerated depreciation deductions and only to the extent the NOL is larger than the  
11 accelerated tax depreciation deductions is it considered to have been created by other tax  
12 deductions." (emphasis added) Accepting the plain language of the quote, the portion of the  
13 entire original tax loss that is attributable to accelerated depreciation would be the first \$\*\*  
14 \_\_\_\_\_ \*\*. The Empire District Electric Company pro forma 2022 and 2023 corporate  
15 income tax returns indicate that the \$\*\* \_\_\_\_\_ \*\* million has been completely consumed by  
16 taxable income. (confidential Schedule JSR-S-02). None of the \$\*\* \_\_\_\_\_ \*\* DTA  
17 should be included in Empire's rate base.

18 **Q. How should the Commission treat the difference between Empire's 2021 net operating**  
19 **loss of \$\*\* \_\_\_\_\_ \*\* shown on line 30 of page one of Schedule JSR-S-01C and the**  
20 **\$\*\* \_\_\_\_\_ \*\* related to accelerated depreciation shown on line 31, column b of page**  
21 **3 of that same schedule?**

22 A. The remaining portion of the NOL is not depreciation related and does not fall under the IRS  
23 normalization rules. The Commission is not bound by IRS code and does not need to

1 recognize it in rate base. As I have mention before, that in Case No. EO-2022-0040, Empire  
2 was allowed to securitize more Storm Uri costs than the entire subsidiaries' tax loss for the  
3 year \$208 million vs. \$\*\* \_\_\_\_\_ \*\*. The Company was reimbursed for its extra  
4 expenses (losses) and was allowed to keep the tax deduction, worth \$ 49.5 million, as well.  
5 Let's not forget that the Commission has also allowed Empire to collect income tax on the  
6 securitization charges through the tariff as well. Empire ratepayers deserve an outcome where  
7 the Commission will not allow another layer of unjust rate increases, which the Commission  
8 would be doing by including a deferred tax asset in rate base that was already reimbursed  
9 through securitization, and for which ratepayers are paying back through securitization  
10 charges that include interest and income taxes.

11 **Q. What does Empire's witness Michael McCuen say in his rebuttal testimony about**  
12 **Empire's Excess Deferred income tax ("EADIT") balance?**

13 A. The Company was amortizing an EADIT balance over three years through rates. Apparently,  
14 the amortized balance will be in rates longer than the originally anticipated three years. Mr.  
15 McCuen has explained that the balance in question is not "protected" ADIT so there is no  
16 normalization violation, but the Company wants to recapture the "overpayment" and collect  
17 a return on the "overpayment" by including it as a rate base asset.

18 **Q. What is your response?**

19 A. I disagree with Empire's proposal. The Company still has an overall EADIT balance to  
20 amortize, but, through rates, Empire paid (amortized) a portion of that balance faster than  
21 what the parties in Case No. ER-2021-0312 agreed to include in the cost of service to which  
22 they agreed, and the Commission adopted and ordered. In short, the Company wants to be  
23 compensated for their mistakes.



1 **Q. What do you suggest that the Commission do about this error?**

2 A. It's unprotected EADIT which means the Commission can set the amortization rate at the  
3 pace they so choose. Errors were made, but at least we don't have to fix an IRS problem. I  
4 suggest the Company recalculate the balance and recalculate the amortization rate.

5 **Q. Are there any other ADIT balances that you wish to contest at this time?**

6 A. No. Staff has indicated that it will have an updated rate base in true-up. I will review any  
7 adjustments then and make any comments at that time.

8 **AARON DOLL MISREPRESENTS PUBLIC COUNSEL'S HEDGING ARGUMENT**

9 **Q. What does Empire witness Mr. Aaron J. Doll says in his rebuttal testimony about Public**  
10 **Counsel witness Dr. Geoffe Marke's testimony that Empire's hedging practices are**  
11 **"bad hedging practices"?**

12 A. Mr. Doll seems to mischaracterize Dr. Geoffe Marke's testimony as an attack on all utility  
13 hedging practices. Mr. Doll testifies, **"OPC has long opposed utility hedging, most notably**  
14 **in 2016-2017, an effort that led Kansas City Power & Light and KCP&L Greater**  
15 **Missouri Operations (now Evergy) to suspend their programs 'until there is a need in**  
16 **the marketplace to hedge again.' That is hindsight bias, not prudent risk management."**<sup>6</sup>

17 Mr. Doll displays selective memory. Most of Dr. Marke's comments on Liberty hedging, as  
18 well as his quote of Commissioner Rupp were directly related to testimony filed in a FAC  
19 prudence review case, Case No. EO-2017-0065, where the OPC challenged Empire's poor

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<sup>6</sup> Empire witness Doll rebuttal testimony, p. 14, ll. 10-13.

1 hedging practices. However, that was not the first time Empire's hedging was called out for  
2 being imprudent. There was no hindsight regarding Empire's poor hedging practices. I filed  
3 testimony in the general rate case, ER-2016-0023 pointing out that Empire's hedging strategy  
4 didn't keep up with current and future expectations of the natural gas market. Several  
5 testimony schedules in the 2016 and 2017 cases demonstrated Empire's excessive hedging  
6 losses. At the time, evidence was provided that showed 38.5% of Empire's natural gas costs  
7 during the prudence review period were directly related to hedging losses.<sup>7</sup>

8 Let's be clear. Public Counsel argued against KCPL's hedging practices because KCPL's  
9 natural gas costs were high when the gas market prices were low and not volatile. Public  
10 Counsel didn't argue against Ameren Missouri's hedging, and it did not argue against Spire's  
11 natural gas hedging practices either. Both of those utilities displayed flexibility in their  
12 hedging strategies and protection of their ratepayers. Empire, on the other hand, was  
13 inflexible and failed to respond to the market. As a result, Empire incurred over \$100 million  
14 in losses.<sup>8</sup>

15 **Q. What is your response to Mr. Doll's testimony that "Empire's hedges reduced customer**  
16 **costs by approximately \$50 million during [Winter Storm Uri]."?<sup>9</sup>**

17 **A.** I believe I've read that claim before in Empire's securitization case, but I haven't seen it  
18 substantiated. Empire's pro forma 2021 federal income tax return only listed \$\*\* \_\_\_\_\_  
19 \*\* as hedging income, and it has been the past practice of the Company to not include physical

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<sup>7</sup> Case No. Eo-2017-0065, Direct testimony of John S. Riley, page 20 line 19. "When in actuality, Empire's hedging losses which were passed to the customers through the FAC represent 38.5% of actual natural gas fuel costs" Schedule JSR-D-5, Natural Gas Costs

<sup>8</sup> Direct testimony Dr. Geoff Marke, page 19-20

<sup>9</sup> ER-Doll rebuttal, page 14 line 20,21

1 forward contracts in its hedging gains and losses,<sup>10</sup> so I'm not sure how that number was  
2 calculated. The only thing I'm sure of is the Company received over \$208 million in bond  
3 proceeds for Storm Uri losses. It could have saved their customers over \$50 million if the  
4 \$208 million was reduced by the \$49.5 million in tax savings it received from the "losses,"  
5 but that didn't happen.

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

7 **A. Yes.**

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<sup>10</sup> Paragraph 33 from the Amended Report & Order, EO-2017-0065

Empire's hedging strategy includes physical forward purchasing of gas supplies as one of many elements of its overall hedging strategy. However, for accounting purposes, physical forward contracts for the purchase of natural gas are treated as a normal purchase used in the ordinary course of business and are not included in calculations to determine hedging gains and losses

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

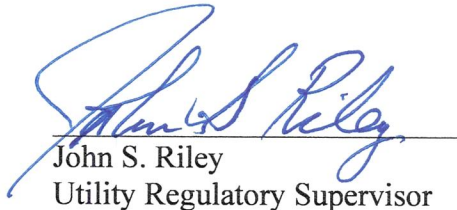
In the Matter of the Request of The	)	
Empire District Electric Company d/b/a	)	
Liberty for Authority to File Tariffs	)	<u>Case No. ER-2024-0261</u>
Increasing Rates for Electric Service	)	
Provided to Customers in Its Missouri	)	
Service Area	)	

**AFFIDAVIT OF JOHN S. RILEY**

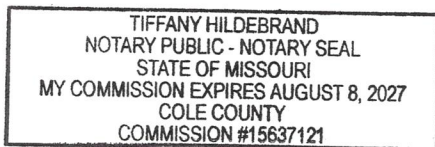
**STATE OF MISSOURI**    )  
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**COUNTY OF COLE**        )

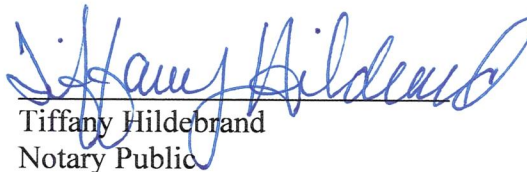
John S. Riley, of lawful age and being first duly sworn, deposes and states:

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

  
\_\_\_\_\_  
John S. Riley  
Utility Regulatory Supervisor

Subscribed and sworn to me this 12<sup>th</sup> day of September 2025.



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

My Commission expires August 8, 2027.