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

The Office of the Public Counsel's Initial Brief

Respectfully submitted,

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**** Denotes Redacted Highly Confidential Information****

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TABLE OF CONTENTS

Introduction……………………………………………………………………………..3

PUBLIC COUNSEL'S ARGUMENTS FOR ITS POSITIONS…………………………….8

1. Rate of Return—Return on Equity, Capital Structure, and Cost of Debt……………8
2. Rate Design, Other Tariff and Data Issues…………………………………………....23
3. Jurisdictional Allocation Factors……………………………………………………26
4. WNR and SRLE Adjustment Mechanisms…………………………………………26
5. FAC……………………………………………………………………………………29
6. Credit Card Fees……………………………………………………………………....42
7. Rate Case Expense…………………………………………………………………....43
8. Management Expense…………………………………………………………………44
9. Allowance for Funds Used During Construction……………………………………..45
10. Cash Working Capital………………………………………………………………...47
11. Accumulated Deferred Income Tax…………………………………………………..47
12. Tax Cut and Jobs Act of 2017 federal income tax rate reduction from 35% to 21% Impact for the period January 1 to August 30, 2018…………………….........48
13. Asbury…………………………………………………………………………………48
14. Fuel Inventories………………………………………………………………………55
16. Operation and Maintenance Normalization…………………………………….....55
18. Affiliate Transactions……………………………………………………………......56
22. Customer Service……………………………………………………………….....68
28. Depreciation and Amortization………………………………………………………74
33. Retail Revenue………………………………………………………………………..74
35. Tax Cut and Job Acts Revenue………………………………………………………74
38. Payroll and Overtime…………………………………………………………………75
40. Employee Benefits……………………………………………………………………75
41. Property Taxes………………………………………………………………………..75
43. Outside Services……………………………………………………………...…75
44. Common Property Removed from Plant and Accumulated Depreciation………...75
46. Case No. EM-2016-0213 Commission-ordered Conditions………………………76

CONCLUSION………………………………………………………………………81

COMES NOW the Office of the Public Counsel and for its Initial Brief states:

Introduction

This is Empire's first general electric rate case since Algonquin Power & Utilities Corporation, with Commission approval in case number EM-2016-0213, indirectly acquired Empire. In that case the Commission imposed sixty-seven conditions to the acquisition—an acquisition which makes Empire but one of a large group of affiliates. In Case No. EM-2016-0213, through testimony, as part of their showing for the standard for Commission authorization to acquire Empire—that the acquisition would not be "detrimental to the public interest"—witnesses for the applicants explained how after the acquisition Empire would be operated. In that testimony they represented that Empire would continue to operate post-acquisition as pre-acquisition, thus providing at least the same quality of service, because Empire's employees and experienced management team were to remain in place. Post-acquisition Empire does not operate independently. Empire has no employees, and has significant service quality issues. Employees of Empire affiliates operate and manage Empire, and since the acquisition, the costs of Empire's transactions with its affiliates have increased twenty-fold.

When it initiated this case on August 14, 2019, Empire filed its analysis of its annual cost-of-service based on historical information from the twelve months ended March 31, 2019, and its analysis of its annual cost of service based on not only that historical information, but also its estimates of the impacts of future events through January 31, 2020.[1] However, § 393.135, RSMo, passed by voter initiative petition in 1976, requires that before an electric utility may recover costs of property, that property must be "fully operational and used for service."

[1] Ex. 4C, Empire witness Richard, corrected direct testimony, p. 4.

When setting general rates the Commission must consider "all relevant factors."[2] To that end, the Commission uses a test year—twelve consecutive months of historical information. The purpose of the test year is to gather historical information as a basis for projecting a utility's future annual cost-of-service when the rates based on that cost-of-service will be in effect.[3] The purpose of update and true-up periods is to have historical information as current as practicable for evaluating a utility's future annual cost-of-service, but still allow sufficient time for the parties and Commission to weigh and evaluate that information before the Commission sets new rates.[4]

As the Commission explained in the *Report and Order* that it issued on April 29, 2015, in a recent Ameren Missouri general electric rate case, Case No. ER-2014-0258, "Rate making is designed to be forward looking. ***The goal is to choose a representative test year to estimate what costs will be when rates are in effect***, not to make adjustments for past earning levels."[5] (Emphasis added). In the *Report and Order* it issued on September 2, 2015, in a Kansas City Power & Light Company's general electric rate case, Case No. ER-2014-0370, the Commission explained:

> The Commission also established the true-up period to . . . to reflect any significant and material impacts on KCPL's revenue requirement. The use of a true-up audit and hearing in ratemaking is a compromise between the use of a historical test year and the use of a projected or future test year. It involves adjustment of the historical test year figures for known and measurable subsequent or future changes. However, the true-up is generally limited to only those accounts necessarily affected by some significant known and measurable change, such as a new labor contract, a new tax rate, or the completion of a new capital asset. The true-up is a device employed to reduce regulatory lag, which is "the lapse of time between a change in revenue

[2] § 393.270(4), RSMo., *State ex rel. Missouri Water Co. v. Public Service Com.,* 308 S.W.2d 704 718-19 (Mo. banc 1957), ; *State ex rel. Utility Consumers Council, Inc. v. Public Service Com.,* 585 S.W.2d 41, 49 (Mo. banc 1979).
[3] *State ex rel. Missouri Power & Light Co. v. Public Service Com.*, 669 S.W.2d 941, 943-45 (Mo. App. 1984)
[4] See, e.g., *State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882*, 888 (Mo. App. 1981) ("However, the Commission in this case did use a modified version of the projected year model by utilizing a test year which was adjusted to take into account known and measurable future changes. That concept was implemented by the holding of what the Commission denominates as 'a true-up hearing.'")

[5] 25 MoPSC3d 70, 100-101.

requirement and the reflection of that change in rates."[6] (Footnotes in original omitted).

In this case the Commission ordered, and its Staff used, the twelve months ended March 31, 2019, as the test year for historical information to develop its evaluation of Empire's future annual cost-of-service, but Staff also considered historical information first through September 30, 2019, (update period cutoff) and then through January 31, 2020 (true-up period cutoff) for evaluating Empire's future annual cost-of-service. Other parties, including Empire, also updated their evaluations of Empire's future annual cost-of-service, based on historical information through the update and true-up periods.

Ultimately, through its order, the Commission must lawfully exercise its discretionary powers; and its order must be "supported by competent and substantial evidence upon the whole record and . . . reasonable, or, as is sometimes conversely stated, [the order must not be] arbitrary or capricious or . . . against the overwhelming weight of the evidence." *State ex rel. Chi., R. I. & P. R. Co. v. Pub. Serv. Com.*, 312 S.W.2d 791, 796 (Mo. banc 1958). More recently, in 2013, the Missouri Supreme Court held that competent and substantial evidence upon the whole record for including the costs of a utility's transactions with its affiliates in its cost-of-service used for setting rates requires evidence those costs were prudent, *i.e.*, the evidence must show not only what cost the utility incurred, but also that it prudently incurred the cost.[7]

Public Counsel identified a number of issues with Empire in its position statements. As it said there, from a revenue requirement perspective two stand out starkly: (1) Empire's insistence on treating Asbury as one of its electricity supply-side resources ***after*** Empire intentionally shutoff

[6] 25 MoPSC3d 368, 375.
[7] *Office of the Public Counsel v Mo.PSC*, 409 S.W.3d 371 (Mo. banc 2013).

Asbury's fuel supply so that it last produced electricity on December 12, 2019 (primarily Issue 13)—an event reducing Empire's future annual cost-of-service (revenue requirement) by between $32.9 and $43.5 million,[8] and (2) the absence of evidence that Empire's affiliate transactions are prudent, evidence that Empire has the burden of producing (Issue 18)—a failure of evidentiary support for some $100 million of Empire's trued-up, updated test year costs.[9] If a new labor contract, a new tax rate, or the completion of a new capital asset is a significant known and measurable change to be addressed in a true-up, then the shutdown of Asbury must be a true-up item. As Public Counsel explained in its position statements, and as it argues in this brief, Public Counsel does not see how, when setting rates in this case, the Commission can lawfully and reasonably not address the impacts on Empire's future annual cost-of-service from Empire shutting Asbury down, or how the Commission can include Empire's $100 million of affiliate transactions in Empire's future annual cost-of-service.

From a customer service perspective one issue—Empire's history of estimating its customers' bills over more than the past two-years—also stands out (Issue 22). It is noteworthy that Empire witness Sheri Richard testified, "There are two aspects of utility service that are of paramount interest to customers– the quality of the utility service they receive and the cost of that service."[10] Empire's lack of effective action to remedy its ballooning number of estimated billings immediately following APUC's acquisition of Empire in mid-2017 and continuing at least until

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[8] Case No. ER-2019-0374 Final Reconciliation page 5, lines 161, 167, and 169, filed April 10, 2020. Low range sum of lines 161 and 167. High range sum of lines161, 167, and 169.
[9] Ex. 229C, Empire's 2019 Affiliate Transactions Report, Ex. 220C, Public Counsel witness Schallenberg, direct testimony, Sch. RES-D-6C.
[10] Ex. 5, Empire witness Sheri Richard, rebuttal testimony, p. 27.

early 2020,[11] calls into question whether Empire is sensitive to what it identifies as the paramount interests of its customers.

Public Counsel first learned of the potential magnitude of this customer service issue through public comments submitted in this case and testimony at the public hearings the Commission held in this case at Bolivar, Joplin, and Branson, Missouri. Later Public Counsel learned the extent of the estimated billings from Empire's responses to Staff and Public Counsel data requests directed to it. Similarly, Public Counsel first learned that Empire shut Asbury down on December 12, 2019, by reviewing Empire's Commission rule 20 CSR 4240-3.190 and fuel adjustment clause submissions to the Commission.[12] In like vein, Empire refused to provide Public Counsel with copies of information that Public Counsel requested,[13] despite Empire witness Sheri Richard's following testimony:

> The Company agrees to provide Staff and OPC access to and copies of, if requested by Staff or OPC, the complete Liberty Utilities Co, LU Central and Empire Board of Directors' meeting minutes, including all agendas and related information distributed in advance of the meeting, presentations and handouts, provided that privileged information shall continue to be subject to protection from disclosure and Liberty-Empire shall continue to have the right to object to the provision of such information on relevancy grounds. Empire agrees to provide access to and copies of the relevant, non-privileged documents.[14]

[11] Ex. 207NP, Public Counsel witness Geoff Marke, revenue requirement rebuttal testimony, Sch. GM-R-3, Empire response to Staff data request no. 255.
[12] Ex. 219C, Public Counsel witness John Robinett, surrebuttal/true-up direct testimony, Schs. JAR-S-1C and JAR-S-2C; and Exs. 261C, February 2020 Fuel Report submitted by Empire on 03-31-2020 BEGR-2020-1067, and 262C, Electric Net Fuel and Purchased Power Report submitted by Empire on 03-31-2020 BFMR-2020-1070.
[13] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 6, and 36-37.
[14] Ex. 4C, Empire witness Sheri Richard, corrected direct testimony, p. 49.

PUBLIC COUNSEL'S ARGUMENTS FOR ITS POSITIONS

1. Rate of Return—Return on Equity, Capital Structure, and Cost of Debt[15]

a. Return on Common Equity – what return on common equity should be used for determining rate of return?

The Commission should award Empire an allowed return on equity (ROE) of 9.25% if the Commission adopts Public Counsel's recommended capital structure. If the Commission adopts Empire's recommended capital structure, Empire should be awarded an allowed ROE of 8.5%.

Public Counsel witness David Murray performed a cost of equity (COE) analysis on a broad electric utility industry proxy group and several subsets of that broad proxy group to determine a rational and reasonable COE estimate. Mr. Murray applied two methodologies, a discounted cash flow ("DCF") method and the Capital Asset Pricing Model ("CAPM"),[16] commonly used by investors to evaluate a fair value for utility stocks. Mr. Murray decided to apply the multi-stage version of the DCF to his electric utility proxy group because he determined utility industry equity investment analysts use this version in practice.[17] Mr. Murray's DCF analysis specifically discounted his proxy groups' expected dividends, which is the intent of the standard DCF used to estimate the utility industry's COE for purposes of assessing a fair and reasonable allowed ROE in utility ratemaking proceedings. Therefore, he used equity analysts' discrete annual dividends per share (DPS) estimates for the first stage, then he estimated the transitionary growth rate in DPS for each company during the second stage in order for all

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[15] Public Counsel's witness on these issues is David Murray (including Public Counsel's failure to comply with Commission order adjustment to ROE (Issue 46); except that Public Counsel's witness Geoff Marke testifies to a service quality adjustment to ROE (Issue 22)).
[16] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 19, ll. 6-10.
[17] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 29, l. 23 – 30, l. 9.

companies to achieve an average industry dividend payout ratio (DPS/EPS) in the final stage. Mr. Murray's approach and assumptions are similar to those of analyses that equity investment analysts actually use and, thus, that upon which investors rely. Consequently, Mr. Murray's COE results of approximately 6.5%[18] are in the ballpark of the 5% to 6% COE estimates utility equity analysts actually use.[19]

Mr. Murray also applied the CAPM to his broad proxy group, and broke out the results for several subsets of this group in order to determine more refined COE estimates for pure-play regulated utilities. Because Mr. Murray used equity risk premiums consistent with the consensus that equity investment analysts use, his CAPM estimates fell within the range of COE estimates equity investment analysts actually used. Mr. Murray's CAPM analysis implied COE estimates in the range of 5.35% to 6.1%.[20]

Staff arrived at a 7.34% to 8.14% COE estimate using the constant-growth version of the DCF. Staff's higher COE estimates are attributed to its use of much higher perpetual growth rates (4.2% to 5%),[21] than Public Counsel's use of perpetual growth rates of 2.85% to 3%.[22] Public Counsel's assumed perpetual growth rates are consistent with those utility equity analysts use in making stock recommendations.[23] Staff's CAPM results were in the range of 4.63% to 5.43% range.[24] The lower COE estimate is due to the use of a low-end equity risk premium of 4.5%.

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[18] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 35, ll. 4-8.
[19] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 30, ll. 8-9.
[20] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 38, ll. 20-22.
[21] Staff Cost of Service Report, p. 16, ll. 15-19.
[22] Ex. 210C, Public Counsel witness David Murray, direct testimony, Schedule DM-D-6.
[23] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 32, ll. 15-18.
[24] Ex. 101, Staff Cost of Service Report, p. 17, ll. 17-20.

The higher COE estimate of 5.43% used a 6% equity risk premium, which is consistent with the equity risk premiums Public Counsel used.

Empire's ROR witness, Robert Hevert, estimates a COE of 9.8% to 10.6%. Mr. Hevert used three methodologies—a constant-growth DCF, CAPM (a standard version and an "empirical" version), and a bond-yield-plus-risk-premium approach. Mr. Hevert's constant-growth DCF estimates had a mean of approximately 9%, with a mean low of 8.09% and a mean high of 10.04%.[25] Mr. Hevert's standard CAPM results range from 8.66% to 9.76%, and his ECAPM results range from 10.19% to 11.05%. His bond-yield-plus-risk-premium results range from 9.9% to 10.06%.[26] Because Mr. Hevert's average constant-growth DCF results are around 9%, it is clear that Mr. Hevert decided to give more weight to his higher CAPM and bond-yield-plus-risk-premium results. Regardless, it is clear that Mr. Hevert is the outlier (not only among the ROR witnesses in this case, but also among utility equity analysts providing professional stock recommendations) in his opinion that the electric utility industry could have a COE anywhere near the double-digits, let alone in the double digits. Mr. Hevert is only able to achieve these high COE results by using assumptions that are not corroborated by the investment community. Mr. Hevert's intentional inflation of his COE estimates may be driven by a desire for this Commission to award a ROE slightly above recent country-wide average allowed utility ROEs. To that end, as Public Counsel witness Murray testifies, the market data and investor expectations support lowering those allowed ROEs from current levels.[27] While an allowed ROE of 9.25% is still a significant

[25] Ex. 36, Empire witness Robert Hevert, direct testimony, p. 21, Table 2.
[26] Ex. 36, Empire witness Robert Hevert, direct testimony, p. 22, Table 3.
[27] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 32, ll. 10-12, and 25, l. 17 – 26, l. 13

premium over Empire's COE, at least it would reduce that premium to a level more consistent with the spreads between ROEs and COEs when the electric utility industry's average COE was higher.

Public Counsel witness David Murray's analysis of the regulated electric utility industry's cost of capital revealed that regulated electric utility companies have been realizing costs of debt capital that haven't been realized in approximately 70 years.[28] This extremely low cost of debt capital explains the all-time high price-to-next-twelve-month (P/NTM) earnings per share (EPS) levels achieved at the beginning of 2020.[29] The high P/NTM EPS ratios are not explained by regulated electric utility industry's higher long-term growth rates, but rather the lower discount rates (i.e. costs of equity) applied to equity investors' expected dividends from their utility investments.[30] In fact, the cost-of-equity (COE) is so low that Mr. Murray recognizes that investors do not even expect utility commissions to authorize ROEs based on the industry's COE. Investors have become accustomed to utility commissions authorizing ROEs that are higher than utility's actual COE. However, investors factor in the expectation that commissions will eventually reduce allowed ROEs as the actual COE continues to fall, causing the margin between allowed ROEs and COEs to widen. In fact, some investors have commented on the "stickiness" of allowed ROEs, even as long-term interest rates continue to decline and cause utility P/NTM EPS ratios to increase.[31]

Based on this insight, it is not surprising that Mr. Murray's COE analysis using models and assumptions consistent with those upon which investors rely, produced cost of equity estimates

[28] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 13, ll. 1-8.
[29] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 3, ll. 3-7.
[30] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 28, ll. 3-20.
[31] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 25, l. 25 – 26, l. 13.

between 5.35% to 7.27%.[32] After Mr. Murray refined his broader proxy group in order to limit the group to pure-play regulated utility companies, he determined his COE analysis supported an estimate of 5.5% to 6.5%. Mr. Murray relied on his multi-stage DCF estimate for the upper-end of his range[33] and the CAPM estimates for the lower-end of his range.[34] Mr. Murray's COE estimate was based on capital market data for October 2019 through December 2019. As Mr. Murray noted in his rebuttal testimony, utility bond yields and dividend yields continued to decline through February 2020 causing utility P/E ratios to reach all-time highs.[35] Again, this was due to a decline in the cost of equity rather than higher growth expectations. The continued decline in the COE provided even more justification for the Commission to award an ROE below the approximate 9.5% it deemed fair and reasonable during periods of lower P/E ratios and higher interest rates.[36]

Mr. Murray continued to monitor and consider capital market conditions subsequent to the true-up period, which captured the market sell-off during March as a result of the COVID-19 pandemic and a dispute between Saudi Arabia and Russia on decreasing oil production. Because of major disruptions in the capital markets during the third week of March that impacted even low-risk utility security investments, Mr. Murray considered it prudent to recognize the capital cost increases by increasing the allowed ROE he recommends to the Commission for Empire to 9.5% in his surrebuttal testimony.[37] Because of the capital market uncertainty and concerns about how these events may impact Empire's access to capital through its parent companies, specifically the

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[32] Ex. 210C, Public Counsel witness David Murray, direct testimony, Sch. DM-D-6 through DMD-D-9.
[33] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 35, ll. 4-8.
[34] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 38, ll. 20-22.
[35] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 3, ll. 3-8.
[36] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 4, ll. 16-22.
[37] Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, pp. 1, l. 15— 2, l. 4.

LUCo debt platform, Public Counsel issued several data requests seeking information about the potential impact such events may have on LUCo's capital expenditure and financing plans for Empire. Empire objected to the requests for this information because these events occurred after the true-up period.[38]

The basis for the Empire's objection implies that Mr. Murray should not have considered capital market conditions after January 31, 2020. Although Empire did not consider the impact of capital market uncertainty relevant to the Commission setting rates for Empire, Mr. Murray continued to monitor and analyze capital market conditions after filing his surrebuttal testimony in this case. The United States Federal Reserve Bank ("Fed") and the United States Treasury Department ("Treasury") have taken extraordinary steps to support domestic capital markets this year.[39] These actions, which include supporting the investment grade corporate bond market, had a direct impact on utility bond and stock prices. Mr. Murray observed that not only had broader investment-grade bond indices showed bond yields had declined back to levels either below or similar to levels at the end of 2019, but that the bonds of Missouri's major electric utility companies (Ameren Missouri and Kansas City Power & Light Company) had returned to such levels, and in the case of one of Ameren Missouri's bonds, a new record low.[40] Analyzing the bond yield information in conjunction with utility stock P/E levels,[41] Mr. Murray determined utility capital market conditions once again supported his original conclusion that Empire should be awarded a 9.25% ROE, which provides consideration for the secular decline in utility capital costs over the last decade.

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[38] Ex. 213, Public Counsel witness David Murray, supplemental surrebuttal testimony, Sch. DM-1.
[39] Ex. 213, Public Counsel witness David Murray, supplemental surrebuttal testimony, pp. 6, l. 9 – 7, l. 3.
[40] Ex. 213, Public Counsel witness David Murray, supplemental surrebuttal testimony, Table, p. 4.
[41] Ex. 213, Public Counsel witness David Murray, supplemental surrebuttal testimony, pp. 5 – 9.

Empire's witness Hevert recommends the Commission set Empire's rates based on a ROE of 9.95% based on his opinion that his ROE recommendation is consistent with the electric utility industry's COE. Mr. Hevert claims this is a conservative estimate of the electric utility industry's COE because some of his models imply an industry COE of around 11%.[42] The fact that Mr. Hevert believes it is reasonable to conclude his double-digit COE estimates are reliable in a capital market environment which is allowing for long-term utility debt costs of around 3% to 4% is incredible. If Mr. Hevert had applied some simple, well-established, logical and straightforward tests of reasonableness to his COE estimates, he would have realized there is something wrong with his modeling assumptions. For example, it is well-established in the investment community that utility stocks are viewed as bond-proxies, such that the primary cause for utility stock price changes is a change in bond yields.[43] A majority of a utility equity investor's return is realized through the dividend yield, with the growth in the dividend making up less than half of an investor's total return over longer holding periods.[44] An awareness of this basic characteristic of utility stock investments implies a maximum COE of 6% for utility stocks, given that electric utility companies currently have a dividend yield of 3%, which means equity investors do not expect more than 3% of total returns to be achieved by capital gains.

Another basic accepted rough estimate for a U.S. company's COE is to simply add a 3% to 4% risk premium to the company's bond yield.[45] Adding a 3% risk premium to recent utility bond yields of 3.4% to 3.75% results in a COE estimate of 6.4% to 6.75%. These simple tests of reasonableness show how inflated Mr. Hevert's COE estimates are. Of course, since Mr. Hevert

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[42] Ex. 36, Empire witness Robert Hevert, direct testimony, p. 61, Table 8.
[43] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 21, l. 9 – 22, l. 3.
[44] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 39, l. 19 – 40, l. 2
[45] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 39, ll. 13 – 18.

claims he is trying to replicate investors' expectations in his models, the most direct means to determine the accuracy of his assumptions is to analyze the information that influences stock prices. Mr. Hevert claims he does so by using analysts' projected 5-year compound annual growth rates ("CAGR") in EPS in his various model estimates. Mr. Hevert claims this is how investors use equity analyst estimates to project returns. However, if Mr. Hevert reviewed equity analyst reports, he would recognize that this is not the purpose for which they provide 5-year CAGR in EPS. They provide it so that investors can perform relative analyses of P/E ratios, not for use in absolute valuation models, such as the DCF.[46] Because Mr. Hevert incorrectly assumes a 5-year EPS growth rate used for purposes of relative P/E stock analyses is also used as a perpetual growth rate in a fundamental constant-growth DCF method, his COE estimates are inflated, even at 9%.

Mr. Hevert's most incredible results come from his CAPM analyses. These results depend on Mr. Hevert's market risk premium estimates (12.15% to 12.25%) that are twice that used by investors for purposes of estimating a reasonable COE to apply to projected utility cash flows. In fact, Mr. Murray discovered market risk premiums used by investor analysts covering APUC's stock that were in the range of 5.5% to 7%.[47] For Mr. Hevert to claim he is accurately and reliably estimating the market risk premium at a level twice those used by professional investment analysts is unfounded. Likewise, Mr. Hevert's claim that investors expect that the market will deliver compound annual returns of around 15% over the long-term is irrational and not grounded in reality. As Mr. Murray determined, Mr. Hevert's assumptions would result in a stock market capitalization to GDP ratio of 67.5x. To put this in perspective, when markets were trading at lofty valuation levels right before the market downturn in response to the COVID-19 pandemic national

[46] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 13, l. 13 – 16, l. 4.
[47] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 19, l. 14 – 20, l. 3

emergency, this ratio was 1.4x. Mr. Hevert's assumed market returns would result in a total stock market capitalization level of $13.3 quadrillion in 50 years compared to an estimated total GDP of $196.3 trillion in 50 years.[48] Because of the absurd valuation levels embedded in such assumptions, there is no need to get into other details of Mr. Hevert's CAPM analysis.

Mr. Hevert's bond-yield-plus-risk premium COE analysis assumes that allowed ROEs are a good proxy for COE. As Mr. Murray demonstrates throughout his testimony, this is a faulty conclusion and only perpetuates the widening spread between allowed ROEs and COE as COE continues to decline.[49]

b. Capital structure – what capital structure should be used for determining rate of return?

The Commission should set Empire's rate-of-return ("ROR") based on a capital structure of 46% common equity and 54% long-term debt, as Public Counsel witness David Murray recommends. Mr. Murray's capital structure recommendation specifically considered merger condition 5 the Commission imposed on Empire and its affiliates when the Commission approved APUC's acquisition of Empire in Case No. EM-2016-0213. It was apparent when APUC proposed to acquire Empire that APUC intended to consolidate Empire's debt financing needs with its affiliates at some affiliate level above Empire. Understanding this to be the case, condition 5 recognized the likelihood that APUC would manage the corporate level capital structure to the most cost efficient level, but potentially not share this cost efficiency with Empire's ratepayers. The regulated utility ratepayers of LUCo's subsidiaries provide the cash flows that allow LUCo to utilize a more leveraged capital structure and still maintain a 'BBB' credit rating. Empire's assets

[48] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 18, l. 28 – 19, l. 13
[49] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 31, l. 12 – 32, l. 2.

comprise approximately half of LUCo's assets.[50] Empire's ratepayers provide most of the stable cash flows that allow LUCo's capital structure to contain a debt ratio of 54%. Despite Empire's ratepayers allowing LUCo to have a more leveraged capital structure, Empire is asking its ratepayers to pay for a more costly capital structure that only contains 47% debt. Empire is asking its ratepayers to pay $8.6 million more per year for its equity rich capital structure, [51] even though Empire's ratepayers are now being charged for debt based on LUCo's more leveraged capital structure. This adds insult to injury for Empire's ratepayers. Not only are Empire's ratepayers paying for a more costly capital structure than LUCo's capital structure, they are paying for a more costly capital structure than Empire requested in its last rate case when it was still a publicly-traded, standalone company. Empire's requested a 49.01% common equity ratio in Case No. ER-2016-0016. [52] Not only did Empire request a lower common equity ratio in that case, it even requested a lower ROE to apply to that equity ratio (9.9% in 2016 vs. 9.95% in this case). Empire, or more appropriately APUC, simply has no regard for the Commission's conditions, at least as they relate to charging Empire's ratepayers for a costlier capital structure than that maintained by the entity raising its debt capital or even the market-tested, objective capital structure maintained by Empire when it was still a standalone entity.

Without Mr. Murray's testimony, the Commission would have no evidence on a comparison of the most economical capital structure for purposes of setting Empire's ROR. Incredibly, through all the rounds of testimony in this case Empire provided no evidence comparing and contrasting Empire's capital structure to that of the entity or entities it relies on for financing. Despite the fact that Condition 5 obligated it to do so in its direct case. Interestingly

[50] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 16, ll. 14-17.
[51] Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, p. 21, ll. 8-12.
[52] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 11, ll. 18-23.

enough, Empire witness (Richard) who provided the figures used to determine Empire's capital structure ratios and, therefore, would presumably be the witness who could describe why they represent Empire's accurate and reliable capital structure, has punted this responsibility to Empire's ROR consultant, Mr. Hevert.[53] Staff also accepted the capital structures Ms. Richard supplied as being representative of Empire's consolidated capital structure. Public Counsel witness Murray determined that the figures Empire and Staff were relying on are based on Empire's deconsolidated financial statements where Empire separated Empire's electric and water utility operations from its gas distribution operations.[54] Removing Empire's gas distribution operations from the Empire's consolidated financial statements causes a higher equity ratio to be assigned to the Empire electric operations.[55] As Mr. Murray discusses in his testimony, deconsolidating Empire's Gas Company from the rest of Empire would result in Empire Gas having a common equity ratio of 37.28%.[56] Mr. Murray indicates the cause for the disparity between the Empire Gas capital structure as compared to Empire's consolidated capital structure is the fact that Empire Gas was not financially managed as a separate stand-alone entity. Therefore, the investment community did not assess Empire Gas as a stand-alone credit entity.[57] The same situation now holds true for Empire's relationship with LUCo. LUCo's capital structure is now the most consequential for managing the amount of debt LUCo's regulated utility subsidiaries can support, because this is the capital structure supporting the LUCo debt platform. Although APUC intends to manage its regulated utility subsidiary capital structures toward allowed equity ratios,[58]

[53] Ex. 6, Empire witness Sheri Richard, surrebuttal testimony, p. 8, ll. 5-9.
[54] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, pp. 6 – 7.
[55] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 8, ll. 5-7.
[56] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 8, ll. 3-5.
[57] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 7, l. 21 – p. 8, l. 7.
[58] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 13, ll. 7-19.

these capital structures are not being managed for purposes of targeting the amount of leverage the regulated subsidiaries can sustain for purposes of maintaining a 'BBB' credit rating.

Mr. Hevert claims to have addressed merger Condition 5 by comparing the capital structure Ms. Richard supplied to him to capital structures of his proxy group.[59] This was not the analysis the Commission ordered Empire to provide in subsequent rate cases after APUC acquired Empire. Even after Empire had the opportunity to review Mr. Murray's detailed comparison of Empire's capital structure to that of LUCo and APUC in his direct testimony, no Empire witness rebutted Mr. Murray's detailed capital structure testimony. Although Condition 5 obligates Empire to provide such evidence, Empire had other reasons to be aware of the relevancy of this debate, since the Commission used LUCo's capital structure when deciding the RORs for two of Empire's affiliates, Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty Midstates") and Liberty Utilities (Missouri Water) LLC ("Liberty Water"). In Case Nos. GR-2014-0152 and WR-2018-0170, respectively, the Commission recognized that these subsidiaries relied on LUCo for their debt financing, and consequently, the capital structure that supports their assets is LUCo's. Empire is now in the same boat due to APUC's decision to consolidate Empire's financing needs with those of Liberty Midstates, Liberty Water and all of LUCo's other subsidiaries under the LUCo umbrella. All of these regulated utility subsidiaries support LUCo's low-risk regulated utility business risk profile, which affords it the ability to carry a debt ratio that has at times been as high as in the 55% to 60% range[60] despite APUC's communication to debt investors that it targets a debt ratio in the **__________ ** range.[61] The higher debt ratios APUC targets for its regulated utility capital structures is also apparent in LUCo's FFO/debt ratios, which is a prominent and

[59] Ex. 38C, Empire witness Robert Hevert, surrebuttal testimony, pp. 3, l. 19 – 4, l. 2.
[60] See Case Nos. GR-2014-0152, GR-2018-0013, and WR-2018-0170.
[61] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 12, ll. 18-22.

heavily weighted credit metric considered by rating agencies and fixed-income investors. LUCo's FFO/debt ratios are consistently in the 15% to 16% range,[62] which is consistent with the target APUC's CEO, Ian Robertson, communicates to investors as being appropriate for the lower business risk associated with LUCo's regulated utilities.[63] However, Empire's FFO/debt ratios have been in the 21% to 23% range, which implies much less financial risk (lower debt in capital structure) than APUC considers economical for LUCo's regulated utilities.[64] Empire's FFO/debt ratios imply it could have an 'A' rating,[65] but since it no longer accesses debt capital markets independently, this provides no benefit to Empire's ratepayers. In fact, although Empire witnesses Hevert, Timpe, and Cochrane vigorously defend the virtues of Empire maintaining an equity-rich capital structure with more longer-term debt as opposed to shorter-term debt, these arguments are hollow considering Empire now relies on LUCo, which doesn't hold the aforementioned virtues. In fact, LUCo's consolidated credit facility has more restrictive terms than Empire's old credit facility.[66] Consequently, Empire's ratepayers are being asked to pony up for a more costly capital structure even though they no longer have their own credit facility and the credit facility they rely on is based on LUCo's consolidated risks, which includes its more leveraged capital structure. The most direct means to ensure no harm to Empire's ratepayers due to these APUC corporate decisions is to ensure that it pays for a capital structure that is consistent with the terms of the capital it is being charged, which is the capital structure of LUCo.

Although Staff attempted to discern whether LUCo had a more economical capital structure than Empire, it incorrectly attributed the $395 million of LUCo off-balance-sheet debt to

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[62] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 16, ll. 12-13.
[63] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 36, ll. 15-20.
[64] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 16, ll. 18-21.
[65] Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, p. 19, ll. 4-7.
[66] Ex. 210C, Public Counsel witness David Murray, rebuttal testimony, p. 38, ll. 19-29.

APUC's non-regulated operations,[67] which are owned by Algonquin Power Company (referred to as Liberty Power Group). Consequently, Staff accepted LUCo's per books capital structure as an accurate representation of the leverage supporting LUCo's investments, which led to its conclusion that Empire had a more economical capital structure.[68] Although Public Counsel's audit of the timing of the off-balance-sheet debt issuances proves that this debt was in fact used for LUCo's regulated utility subsidiaries,[69] due to the complexity of APUC's organizational structure, which includes multiple levels of holding companies and various debt platforms, it is understandable that Staff had this misunderstanding. APUC's financing strategies are constantly changing and it is difficult to ascertain the purpose of the six companies (four between LUCo and APUC) that exist between Empire and its ultimate parent company, APUC.[70] It also doesn't help that Empire has not been forthcoming, at least to Public Counsel, with corporate-level transactional information or strategic materials.[71] Public Counsel notes that, to the extent the Commission has any doubt about the accuracy and reliability of Mr. Murray's testimony as it relates to the use of the $395 million of off-balance-sheet debt, the Commission can simply compel Empire to provide affiliate financing agreements that would provide indisputable evidence of the flow of funds into LUCo for its use. That being said, during a March 18, 2020, technical conference, Public Counsel witness Murray discussed why he was certain the $395 million of debt was in fact used for LUCo's investments. Empire's representative, Mark Timpe, during that technical conference, never refuted Mr.

[67] Ex. 108, Staff witness Peter Chari, rebuttal testimony, p. 15, ll. 16-21.
[68] Ex. 101, Staff Cost of Service Report, p. 12, ll. 19-25.
[69]Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, pp. 15, l. 5 – 16, l.. 5.
[70] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 7, ll. 12-23.
[71] This seems to be a change from the level of cooperation of Empire's affiliates. Public Counsel witness David Murray received more forthcoming responses in the Liberty Midstates rate case, Case No. GR-2018-0013. Liberty Midstates was forthcoming with a direct explanation of the purpose of three of the holding companies between LUCo and APUC, which was only to provide financing for the next immediate lower holding company. These are the entities that used the $395 million in debt proceeds to buy LUCo's equity to make it appear to have more equity in its capital structure, despite the fact that LUCo guarantees this debt.

Murray's explanation of these transactions nor has he done so in testimony. Public Counsel was confident enough that these technical matters were resolved and understood that Mr. Murray summarized this discussion in his surrebuttal testimony. Unfortunately, even after it was established that the $395 million was used for LUCo's investments, Staff inexplicably stuck with its original position.

Consistent with the competent and substantial evidence in Mr. Murray's testimony, as highlighted above, a capital structure of 46% common equity and 54% long-term debt, is just and reasonable.

c. Cost of debt – what cost of debt should be used for determining rate of return?

The appropriate, fair and reasonable cost of debt that the Commission should authorize Empire is LUCo's embedded cost of debt of 4.65%. Public Counsel's recommended use of this cost of debt is contingent on the Commission adopting Public Counsel's recommended capital structure because this is the cost of debt that is embedded in this capital structure. Additionally, Public Counsel notes that this cost of debt is based entirely on third-party debt either directly guaranteed by LUCo or third-party debt issued at its regulated subsidiaries.[72] Additionally, this debt cost is reasonable, considering Ameren Missouri's cost of debt was 4.6% in its recently completed rate case, Case No. ER-2019-0335.[73]

If the Commission adopts the Company's recommended capital structure, the cost of debt needs to be adjusted downward because it includes affiliate debt provided to Empire from LUCo. The terms LUCo assigned to its affiliate loan were based on an internal procedure that assigned

[72] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 14, ll. 17-25.
[73] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 14.

terms to this affiliate loan based on debt LUCo issued in 2017. This is despite the fact that these proceeds were raised through short-term debt at LUCo. After Mr. Murray adjusted for this violation of the affiliate transaction rule, he determined the appropriate cost of debt to be 4.75%.[74]

Empire's cost of debt recommendation is wrong because it deconsolidates Empire's capital structure, which would imply that Empire Gas is capitalized with 37.28% common equity and 62.72% long-term debt. If this deconsolidation is accepted for purposes of this case, then logically Empire Gas would be assigned a cost of debt of 6.82% based on its one debt issuance in 2006.[75] This is an example of the problem of adopting capital structures of entities that no longer have actively managed capital structures for purposes of raising debt.

2. Rate Design, Other Tariff and Data Issues[76]

a. ~~*Should the GP and TEB rate schedules be fully consolidated?*~~
b. ~~*Should the CB and SH rate schedules be partially consolidated?*~~
c. ~~*Should "grandfathered" multifamily customers taking service through a single meter be given the option of being served on the CB/SH rate schedule?*~~
d. ~~*How should Empire's revenue requirement be allocated amongst Empire's customer rate classes (Class revenues responsibilities)?*~~
e. ~~*How should the rates for each customer class be designed?*~~
f. ~~*What should be the amount of the residential customer charge?*~~
g. ~~*Should Empire continue its Low-Income Pilot Program as is, or modify it?*~~
h. ~~*Should Empire be ordered to consolidate the PFM rate schedules into the GP/TEB rate schedule in a future proceeding?*~~
i. ~~*Should Empire be ordered to incorporate shoulder months into the Special Contract / Praxair rate structures in the next rate proceeding?*~~
j. ~~*Should Empire be ordered to work to incorporate shoulder months into the rate structures of all non-lighting rate schedules?*~~
k. ~~*Should Empire be ordered to retain each of the following: Primary costs by voltage; Secondary costs by voltage; Primary service drops; Line extension by rate schedule and voltage; Meter costs by voltage and rate schedule*~~

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[74] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 9, ll. 10-26.
[75] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 8, ll. 3-5.
[76] Public Counsel's witness on the remaining issue is Geoff Marke.

l. ~~*Should Empire be ordered to use of AMIs for near 100% sample load research as soon as is practical, but no more than 12 months after 90% of AMI are installed*~~
m. ~~*Should Empire be ordered to retain individual hourly data for future bill comparisons*~~
n. ~~*Should Empire be ordered to retain coincident peak determinants for use in future rate proceedings*~~
o. ~~*How should the amount collected from customers related to the SBEDR charge be billed, and should there be a separate line item on customers' bills?*~~
p. ~~*By when should Empire move customers served on CB/SH that exceed the demand limits of those schedules to the appropriate rate schedule.*~~
q. ~~*What, if any, revenue neutral interclass shifts are supported by the class cost of service study?*~~
r. *How should any revenue requirement increase or decrease be allocated to each rate class?*

Because of the flawed billing data caused by the high number of customer bills that Empire estimated as described under Issue 22 and in the testimony of Public Counsel witness Geoff Marke, and Staff witnesses Robin Kliethermes and Gary Bangert, Public Counsel cannot recommend any revenue neutral shifts between classes in this case. However, both Staff's and Public Counsel's filed cases show that Empire's current rate revenues exceed its revenue requirement and, therefore, overall its rates should be reduced. Given the unprecedented turmoil in the economy caused by the COVID-19 national emergency, Public Counsel primarily recommends that if the Commission finds that Empire's rates should be reduced, it is only the residential customer class' rates that should be reduced, and that the rates of all of the other customer classes remain unchanged. As a secondary alternative to 100% of the reduction going to residential customer class rates, Public Counsel recommends for 75% of the reduction go to residential customer class rates and the remaining 25% go to commercial service/small heating service customer class rates.

Public Counsel witness Geoff Marke's recommendation primarily has two bases. First, the data used to inform the parties' Class Cost of Service ("CCOS") studies are flawed and inaccurate due to the excessive amount of estimated bill data upon which they are based. Second, this nation is in the midst of a national emergency due to the COVID-19 pandemic that has

triggered an economic downturn nationally and around the world, likely of historic proportions, and which is most directly impacting Empire's residential customers in terms of their utility bills, because physical distancing requirements force residential customers to self-isolate at their homes. Residential customers cannot "shut down." The nature of this pandemic requires physical distancing and quarantining, which necessitates continued utility service to maintain social order and to flatten the curve of patients who require intensive medical care. Empire is one of many utilities who have responded by suspending utility service disconnections for non-payment. Quite simply, relative to Empire's other customer classes, Empire's residential customers are in the worst position to recover from the economic impacts of the COVID-19 pandemic and the recovery of the commercial and industrial customers depend first on the health and well-being of their employees and customers.

Likewise, Empire's commercial service/small heating class is being severely impacted by the COVID-19 pandemic. These non-residential customers, which employ many of Empire's residential customers, are struggling in the current economic climate. A reduction in their electric bills could mean that these businesses stay open thus enabling the employees to pay their electric bills.

Public Counsel's recommendation is based primarily upon an attempt to allocate costs in a way Public Counsel believes is best designed to help the public during this time of crisis. Public Counsel would not have put forth this proposal if it believed such allocation would negatively impact Empire's larger customers. In fact, Public Counsel recommends an outcome where large customers would see no rate increase, whereas the non-unanimous stipulation agreed to by Empire's large commercial customers contemplates a revenue increase.

~~*s. How should any residential revenue requirement increase or decrease be apportioned to the energy (kWh) rates?*~~
~~*t. What, if any, changes to the CB, SH, GP and TEB customer charge are supported by the class cost of service study?*~~
~~*u. What, if any, changes to the CB, SH, GP and TEB customer charge should be made in designing rates resulting from this rate case?*~~
~~*v. How should any CB and SH revenue requirement increase or decrease be apportioned to the energy (kWh) rates?*~~
~~*w. How should any GP and TEB revenue requirement increase or decrease be apportioned to the demand (kW) and energy (kWh) rates?*~~
~~*x. How should any LP revenue requirement increase or decrease be apportioned to the demand (kW) and energy (kWh) rates?*~~
~~*y. What, if any, changes to the current SC-P energy (kWh) rates should be made to align with Market Prices?*~~
~~*z. How should production-related costs be allocated to each rate class?*~~
~~*aa. How should plant accounts 364, 366 and 368 be classified?*~~
~~*bb. How should primary and secondary distribution plant facility costs be allocated to each rate class?*~~
~~*cc. How should General plant facility costs be allocated to each rate class?*~~

3. Jurisdictional Allocation Factors[77]

a. What is the appropriate jurisdictional allocation factors to be used in the cost of service?

Any allocation factors for affiliate transactions should be based on the costs and values of the goods or services provided and received.[78]

4. WNR and SRLE Adjustment Mechanisms[79]

a. Should the Commission approve, reject, or approve with modifications Empire's proposed Weather Normalization Rider?

The Commission should reject it. Empire's proposed weather normalization rider should be dismissed out-of-hand and not even be considered before Empire demonstrates with historical empirical data that it can provide consistently accurate bills to its customers. The number of

[77] To the extent this is an issue related to affiliate transactions, Public Counsel's witness is Robert Schallenberg.
[78] Ex. 220C, Public Counsel witness Robert Schallenberg, direct testimony, pp. 6-7, 17-19.
[79] Public Counsel's witnesses on these issues are Lena Mantle and Geoff Marke.

customer bills that Empire estimated increased 654% in 2018 from 2017 levels, and 293% in 2019. The Commission should have no faith in Empire's proposed weather normalization rider when Empire does not have even basic billing and metering data for its billing system as a daily course of business. Empire would be adding a layer of complexity to bills, here weather fluctuations, when Empire, as a normal course of its business is estimating so many of its customers' bills. Further, Empire has not considered many details and their ramifications when creating its proposal. Among those is how it will explain such a complex rider to its customers and how it would present it on their bills.

In addition to the foregoing, the General Assembly has not mandated that the Commission must permit utilities such as Empire to use a weather normalization rider. It is not a utility entitlement, but an option the Commission may authorize, circumstances warranting. Empire's quarterly FAC surveillance reports show that Empire has been able to earn a fair return without a weather normalization rider.

Instead of entertaining Empire's request for a weather normalization rider in this case, the Commission should begin a working file for obtaining input for a rule for applications for and designs of such a mechanism for electric and gas utilities, a rulemaking provided for in section 386.266.3 RSMo. Such a rule would provide consistency in weather normalization mechanisms and reporting requirements that would help Staff and other parties review the implementation and financial true-ups of such mechanisms.

b. Is it lawful for the Commission authorize Empire to implement a Sales Reconciliation to Levelized Expectations ("SRLE") mechanism, such as those Staff and Empire are proposing in this case?

No, it is not lawful for the Commission to authorize a SRLE, either as proposed by Staff or Empire. Staff's SRLE does not solely compensate the utility for revenue fluctuations due to weather and conservation. Section 386.266.3, RSMo, limits the scope of such a rate adjustment mechanism to addressing revenue impacts from weather, conservation, or both. Staff's proposal goes beyond that to reconcile any discrepancy in utility revenues on an annual basis.[80] The SRLE thereby attributes any revenue fluctuation to weather or conservation, regardless of the cause. Customers simply using less energy because there are fewer people living in a home, or customers moving in and out of Empire's service territory, are thus treated as conservation and weather, and Empire is rewarded. Therefore, the SRLE does not follow statutory authority, and should be rejected as unlawful.

In addition, Subsection 13 of Section 386.266 plainly states that the Commission "shall have previously promulgated rules to implement the application process for any rate adjustment mechanism under subsections 1 to 3 of this section prior to the commission issuing an order for any such rate adjustment."[81] Following statutory language, a mechanism under Subsection 3 of Section 386.266, including the SRLE, cannot be approved before the Commission promulgates rules for the application thereof. This Commission has not promulgated any such rules, and so any SRLE proposal should be rejected. This Commission should begin its rulemaking process though for the implementation of any such mechanism to provide clear guidance to all parties.[82]

[80] Ex. 205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 24.
[81] § 393.266.13, RSMo.
[82] Ex. 204NP, Public Counsel witness Lena Mantle, rebuttal testimony, p. 7.

c. Should the Commission adopt Staff's Sales Reconciliation to Levelized Expectations Proposal ("SRLE") or approve the SRLE with modifications as suggested by the Company?

No. Staff's proposed methodology is not an appropriate substitute for Empire's proposed weather normalization rider, nor should the Commission feel that it has to provide a substitute for Empire's proposal since a weather normalization rider is a privilege, not a right. Staff witness Robin Kliethermes testified that the billing data it is relying on in this case is of poor quality and the Commission should be cautious in using it. When the unprecedented economic conditions brought forward by the national emergency of the COVID-19 pandemic are taken into account, the economy will prove to be a greater confounding variable than weather at least until Empire's next rate case. The SLRE is designed so that Empire is held harmless from reductions in usage, even if those reductions are due to customer efforts to be able to afford a minimal amount of service. Public Counsel urges the Commission not to experiment with a shareholder risk-reduction mechanism when it lacks credible empirical data for designing that mechanism, and when economic forecasts predict pronounced economic hardships for Empire's customers due to the COVID-19 pandemic.

5. FAC[83]

a. What is the appropriate incentive mechanism in Empire's FAC for sharing between Empire and its retail customers the difference between its actual and base net fuel costs?

The appropriate mechanism for sharing between Empire and its customers for costs for which Empire recovers through its FAC is a sharing of 85% to Empire's customers and 15% to Empire. The FAC is a surcharge on customer bills that covers the increase and decrease in fuel and purchased power costs and revenues in between rate cases. The FAC's enabling statute reads

[83] Public Counsel's witness on this issue is Lena M. Mantle.

that the Commission may include "features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased-power procurement activities" when approving a FAC.[84] This efficiency incentive has historically taken the form of a sharing of the difference between the actually incurred fuel and purchased power costs and the cost included in customer rates. Currently, when fuel and purchased-power costs are higher than expected, customers pay for 95% of the increased costs while the utility bears the remaining 5%. Conversely, when fuel and purchased-power activity costs are lower than what was calculated in the previous rate case, customers receive a return of 95% of their excess-payments, and the company retains 5% of the savings.[85] For context, it is worth noting that the 5% of the increased or decreased fuel costs amounts to Empire absorbing only 0.1% of total fuel and purchased power costs since Empire started using an FAC eleven years ago.[86]

This sharing should be changed within Empire's FAC to 85/15 split whereby customers pay for 85% of all incremental increases in fuel and purchases power costs, while the Company pays for 15%. When fuel and purchased power costs drop below values set in this rate case, Empire would receive 15% of those gains while customers would be credited 85%. This 85/15 sharing mechanism protects customers against increasing fuel costs better than the 95/5 sharing, while still enabling the utility to recover nearly 99% of its total fuel costs.[87] The 85/15 sharing also better incentivizes and rewards economic decision making by enabling the utility to receive 15% of the efficiencies achieved from decreasing fuel and purchase power costs as opposed to the currently allowed 5% through the 95/5 sharing. With an 85/15 sharing mechanism, Empire would recover 101.7% of its actual fuel costs if its actual costs are 10% below the fuel and purchased power costs

[84] § 386.266.1, RSMo (2019).
[85] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 8.
[86] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 12.
[87] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 11-12.

set in this rate case. Empire's history of using its FAC demonstrates the need for a stronger incentive to properly manage fuel and purchased power costs in the interest of customers. The 85/15 sharing is also rooted in guidance from Missouri's Legislature.

A. A sharing ratio of 85/15 better incentivizes efficient fuel operations than the current practice of 95/5.

The 85/15 sharing better incentivizes efficient fuel operations than the 95/5 sharing because the increased potential to capitalize on fuel efficiencies and decreased costs. Under the 85/15 sharing, an electric utility enjoys 15% of the positive differential when fuel and purchase power costs drop below the levels set in a previous rate case.

Currently, the 95/5 sharing grants a utility 5%, or less than 1% of all total fuel costs, for efficient behavior. In the opposite scenario when costs end up being higher than the net base energy costs that were set in the last rate case, the 85/15 sharing would still enable Empire to recover nearly all, almost 99%, of its fuel costs including the vast majority of increased costs within and outside of Empire's control.[88] This nature of Public Counsel's proposal is key because "an after-the-fact prudence review is not a substitute for an appropriate financial incentive, nor is an incentive provision intended to be a penalty against the company. Rather, a financial incentive recognizes that fuel and purchased power activities are very complex and there are actions [Empire] can take that will affect the cost-effectiveness of those activities."[89]

An 85/15 sharing also better maximizes on a public utility's inherit profit-seeking because it more resembles regulatory lag.[90] In a pure regulatory lag scenario with no FAC, "the utility [has]

[88] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 11-12.
[89] *Report and Order*, ER-2008-0318 p. 72.
[90] *See Report and Order*, ER-2007-0002 p. 18 (discussing the merits of regulatory lag as it aligns a utility's profit incentive with the public policy goal of reducing fuel costs).

a strong incentive to maximize its income and minimize its costs."[91] This is because in such a scenario the utility recoups all of the benefits of reducing fuel and purchased power costs. The 95/5 sharing negates nearly all of the regulatory lag benefits by providing companies with little incentive to put forth any effort to decrease costs. Since Empire has recovered 99.9% of its fuel and purchased power costs in the 11 years it has had a FAC,[92] the 95/5 sharing mechanism has removed nearly all of the regulatory lag incentive for Empire. The 85/15 sharing is of course not a return to a pure regulatory lag state, but compared to 95/5, it is a marked departure from providing Empire little when it reduces costs.

B. A sharing ratio of 85/15 should be utilized to better ensure that customers are only paying for prudent fuel costs given Empire's past hedging practices.

Public Counsel's proposed 85/15 sharing within Empire's FAC is additionally supported by real concerns regarding Empire's past hedging practices. In the sixth prudence review of Empire's FAC, Case No. EO-2017-0065, Public Counsel presented evidence that Empire lost nearly $100 million through its gas hedging practices.[93] "Gas hedging" refers to a risk management strategy whereby a buyer negotiates a set price for natural gas to "hedge" against the risk of price fluctuations in the market. Empire had engaged in these gas hedging practices since 2002, and continued to use the same hedging strategy even as the price of gas dropped following improvements in hydraulic fracturing technology.[94] Empire consequentially continued to lose money through its hedging since 2009 as the price of natural gas precipitously dropped, while Empire continued to pay its hedge prices. After the Commission first authorized Empire to use a

[91] *Report and Order*, ER-2007-0002 p. 18.
[92] Ex. 205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, pg. 8.
[93] Ex 205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 3.
[94] *Report and Order*, Case No. EO-2017-0065, pp. 8-9.

FAC in July 2008,[95] Empire sat on its hands for years, and did nothing to change its hedging practices even as the "shale revolution" raged onward with low and stable gas prices.

Empire maintained that its hedging practices were not imprudent, and this Commission agreed with Empire's argument.[96] Despite maintaining that its hedging was a prudent course of action, Empire stopped its hedging practices following the Commission's EO-2017-0065 Order and Public Counsel's protests. Since changing risk management strategies, Empire has realized far lower losses.[97] This is to say that Empire defended its hedging as prudent, only to abandon it once its losses were publically aired and challenged.

One could turn to Empire's hedging episode as a testament to the effectiveness of the prudence review process, and argue that no change to Empire's FAC sharing mechanism is necessary. Empire's practices were identified, and subsequently changed to the benefit of customers without any negative finding from the Commission. However, this change occurred after nearly a $100 million loss with no security that a future loss may not occur again. The lesson from this anecdote is not that the prudence review process was good enough, but that the 95/5 sharing was unable to dissuade Empire from altering its hedging protocols. As a result, customers incurred losses, and there is then no reason why future losses could not continue to occur so long as Empire is unwilling to alter its risk management processes until a full prudence review hearing. Empire's intransigence in the face of ever dropping gas prices effectively places all of the weight of customer security onto the prudence review process. This strains administrative burdens for all parties, and erodes consumer confidence in institutions. The peril of addressing utility behavior solely through the prudence review process is precisely what this Commission identified, that "an

[95] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, Sch. LMM-D-2, p. 6.
[96] *Id.* at 19-20.
[97] Ex. 205HC, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 5.

after-the-fact prudence review is not a substitute for an appropriate financial incentive."[98] A more appropriate financial incentive is needed for Empire, and an 85/15 sharing fulfills that role.

C. A sharing ratio of 85/15 is based on guidance from the Missouri Legislature on how much sharing is appropriate within ratemaking mechanisms between customers and their utility, whereas the past 95/5 sharing ratios are based on regulatory happenstance, and deference to the status quo.

Unlike the 95/5 sharing mechanism, Public Counsel's proposal is supported by the record and legislative guidance. The ultimate genesis of the 95/5 sharing ratio is not the FAC statute or other concrete prescription. Instead, this Commission's predecessors crafted the ratio out of whole cloth in 2007.[99] There was at least foundation for some type of sharing mechanism, as the previous Commission noted "after-the-fact prudence reviews alone are insufficient to assure [that electric utilities] will continue to take reasonable steps to keep its fuel and purchased power costs down."[100] The Commission decided then that the risk of paying for 5% of increased FAC costs would encourage those reasonable steps. However, the 95/5 ratio was not sponsored by any party to that earlier proceeding. An 85/15 sharing can instead look to what the Legislature deemed to be a sufficient incentive for prudent spending within its most recently created rate mechanism: PISA. Both PISA and the FAC address cost recovery delayed by regulatory lag. They are then both statutory exceptions to general ratemaking principles. The FAC targets fuel and purchased power costs,[101] while PISA allows deferrals for qualifying capital spending.[102] When Missouri's Legislature enacted the FAC, it gave the Commission discretion to create "incentives to improve the efficiency and cost-effectiveness" of electric utility fuel activities.[103] The Legislature was

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[98] *Report and Order*, Case No. ER-2008-0318, p. 72.
[99] *Report and Order*, ER-2007-0002, p. 18
[100] *Report and Order*, EO-2007-0004, p. 54 (May 17, 2007).
[101] § 386.266, RSMo.
[102] § 393.1400, RSMo.
[103] § 386.266.1, RSMo.

otherwise silent on how much sharing is appropriate in a mechanism designed to recoup regulatory lag. But the General Assembly has not remained silent on what incentivizes prudence.

The Legislature most recently deliberated on the amount of sharing necessary to include in a ratemaking mechanism in 2018 with PISA's passage.[104] The Legislature agreed that 85/15 is the ratio that would balance the goal of incentivizing increased capital expenditures, while still protecting ratepayers' interests.[105] There is no other express guidance on what sharing is appropriate to balance incentives with customer protections in any ratemaking mechanism. The FAC statute still retains its grant of discretion to this Commission on designing an incentive mechanism for the FAC, but Public Counsel's point is not that PISA and an FAC's sharing ratio can never differ or that the Commission has lost discretion. Rather, absent justification to the contrary, the legislative compromise that produced the 85/15 PISA split is a baseline for what is a necessary incentive for ratemaking mechanisms.

b. What is the appropriate base factor?

The base factor is a price per energy value derived from the NBEC. Public Counsel cannot independently determine the NBEC or base factor, but Public Counsel is positive that what the signatories to the stipulation offer the Commission does not accurately reflect Empire's fuel and purchased power costs. This is something that even Empire recognizes. In its suggestions in opposition to Public Counsel's motion to modify the test year Empire filed on January 3, 2020, Empire points out to the Commission that the position Empire is taking with respect to including

[104] § 393.1400, RSMo.
[105] Ex 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 13-14.

Asbury costs and revenues in its FAC base would result in an immediate under-recovery of FAC costs.[106]

The base factor in the stipulation includes fuel and operations and maintenance expense and revenues from SPP as if the Asbury station is still in operation, as does Staff's true-up base factor. These base factors are both inaccurate and do not reflect actual fuel or purchased power costs.[107] Asbury is no longer operational, and is no longer incurring the same costs or providing revenues as it did before when it was generating electricity.

The retirement of Asbury also results in increased purchased power to supply the needs of Empire's customers. Of the total generation that Empire's fuel run estimated for its direct case, 18.5% of the generation was provided by Asbury.[108] The absence of that amount of generation will result in greater purchased power for Empire. The amount of purchased power is used to determine the appropriate transmission percentage to include in the FAC. An increase in purchased power results in an increase in the percentage of transmission costs and revenues included in the FAC base factor calculation

The result of relying on an inaccurate base factor is that incurred fuel costs now that Asbury has retired are higher than the estimated NBEC.[109] Using Empire witness Aaron Doll's workpapers, Public Counsel witness Lena Mantle estimates that Empire's total annual fuel costs will increase approximately $1.3 million due to Asbury's closure.[110] The Commission should recognize that any increasing fuel costs will not be absorbed by Empire, but paid through customer

[106] *Empire's Suggestions in Opposition to Public Counsel's Motion to Modify Test Year,* p. 5.
[107] Ex. 205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 9.
[108] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 22.
[109] Ex. 205HC, Public Counsel witness Lena Mantle, surrebuttal testimony, p.7 ln 12.
[110] Ex. 203HC, Public Counsel witness Lena Mantle, direct testimony, p. 23.

bills when Empire's FAC is adjusted at the next Empire FAC rate change case. Therefore, customer bills will increase following this rate case so long as the inaccurate base factor is used for ratemaking purposes.[111]

However, the Commission's Staff is able to correct this inaccuracy. Public Counsel generally supports the reliability of Staff's fuel runs, provided that reasonable assumptions and inputs are used. Asbury last generated electricity on December 12, 2019.[112] All the Commission needs to do in order to have an accurate base factor is to order its Staff to recalculate the NBEC and base factor while accounting for Asbury's retirement. Such a recalculation will require increasing the amount of transmission revenues and fuel costs incurred.

c. *What costs and revenues should flow through Empire's FAC, including, but not necessarily limited to, the following?*

The nature of the costs and revenues that flow through Empire's FAC should remain the same as those which currently flow through it, with the exception of the addition of transmission revenues and the removal of short-term capacity costs as described in Public Counsel's positions to the more specific issues below.

i. *What is the appropriate percentage of transmission costs for the FAC?*

The appropriate percentages of transmission costs and revenues to flow through Empire's FAC should be modified to match the supply-side mix circumstances that will impact those transmission costs and revenues when rates from this case become effective; *i.e.*, 50% percent of MISO transmission costs and a percentage of SPP costs based on a Staff fuel run that does not

[111] Ex. 203HC, Public Counsel witness Lena Mantle, direct testimony, p. 24.
[112] Ex. 219C, Public Counsel witness John Robinett, surrebuttal/true-up direct testimony, Sch. JAR-S-2C.

include Empire's Asbury plant as a supply-side resource.[113] These percentages are consistent with the Commission's transmission percentage determination in Empire's last general electric rate case, Case No. ER-2016-0023, and reflect the policy that Empire's customers pay only for the transmission costs Empire necessarily incurs to meet its Missouri retail customers' needs. The stipulation and agreement limits any revisions to Empire's FAC tariff sheets to those changes necessary for Empire to continue utilizing its FAC.[114] The percentage of transmission costs are not changed by the stipulation. This approach means that the signatories continued to treat Asbury as if it will still provide nearly 20% of Empire's total generation to SPP.[115] However, following Asbury's final shut down, Empire's transmission costs will increase as it becomes more reliant on the SPP market to meet its customers' needs. The percentage of transmission costs should then accordingly change. The appropriate change to those percentage can be found, as with the base factor, by having the Commission Staff complete a more accurate fuel run that accounts for Asbury's retirement.[116] This will result in a higher percentage of transmission being including the FAC, but is ultimately consistent with Commission practice and recognizes the reality of what Empire's customers are supporting.[117]

Transmission revenues that are consistent with (complement) the transmission costs that flow through Empire's FAC should flow through in the same percentages as the costs.[118] Empire receives revenues under the same SPP schedules for which it is assessed charges, and some of those charges flow through its FAC. Empire also receives revenues from MISO for reactive power.

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[113] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 14-16.
[114] Stipulation paragraph 6.
[115] Exhibit 203HC, Public Counsel witness Lena Mantle, direct testimony, p. 22.
[116] Exhibit 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 16.
[117] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 16, fn 14.
[118] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 15-16

For consistency, the costs for that reactive power service should be offset by the revenues Empire receives for that reactive power service.[119]

> ii. *What, if any, portion of the MJMEUC contract should be included or excluded from the FAC?* ~~*Should the Company provide any additional reporting requirements within its FAC monthly reporting in regards to MJMEUC?*~~

When the purchased power contract Empire entered into with the Missouri Joint Municipal Electric Utilities Commission ("MJMEUC") goes into effect on June 1, 2020, it should be treated under Empire's FAC as any other contract for the sale of power would.[120] Accordingly, energy sales revenues should flow through Empire's FAC, and Empire's fuel and O&M reimbursements from MJMEUC should apply as offsets to the fuel costs that flow through Empire's FAC. Empire's FAC Tariff sheet 17z positively states that the revenue from off-system sales is to be included in its FAC. Off-system sales is defined by Empire's FAC tariff as revenues and costs "from off-system sales and SPP energy and operating markets [sic]." This includes the MJMEUC contract, which will include energy sales and revenues. The parties to the stipulation and agreement believe instead that those revenues should "be retained by the Company until the allocations are examined in the next general rate case," with the justification that full and partial requirement sales to municipalities are excluded from the FAC[121] even though the MJMEUC contract is not a full or partial requirement sale to municipalities. The Commission will recall that arbitrarily excluding off-system sales revenues from flowing through Ameren Missouri's FAC is precisely what the Commission found to be imprudent, improper, and unlawful in the case of Union Electric d/b/a

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[119] Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, p. 14.
[120] *See* Ex. 203NP, Public Counsel witness Lena Mantle, direct testimony, pp. 16-18.
[121] Ex. 20, Empire witness Aaron Doll, rebuttal testimony, pp. 7-8.

Ameren Missouri.[122] The Commission can forestall this imprudent act by ordering Empire to follow its tariff and flow all off-system revenues through its FAC.

The MJMEUC contract is very different than a full or partial requirements contract for individual municipalities. Empire's FAC Tariff sheet 17z exempts full or partial requirement sales to municipalities from the definition of off-system sales that must be included in the revenues that flow through Empire's FAC. Examples of such partial and full requirement sales contracts include those that Empire has with the cities of Mt. Vernon and Monett.[123] These contracts are noticeably very basic. These contracts, that are FERC Electric tariff contracts,[124] simply require *Empire* to provide the capacity and energy each municipality needs.[125] The MJMEUC contract is not a FERC electric tariff contract, and it is very complicated. It includes ***____________________

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______________________________________ ***[126] MJMEUC will not ***______

______________________________________ ***[127] Thus, Empire's contract with MJMEUC is not a full or partial requirements contract with a municipality. It is instead a far more extensive off-system sales contract that should be treated as such by the terms of Empire's FAC.

However, there is a portion of the MJMEUC contract revenues that should not flow through Empire's FAC, per the terms of Empire's FAC tariff sheets. Tariff sheet 17z only includes

[122] *Report and Order*, Case No. EO-2012-0074, p. 2.
[123] Ex. 277, Empire Response to OPC DR 8053 in ER-2019-0374—Current full req. contracts for Mt. Vernon and Monett.
[124] Ex. 277, Empire Response to OPC DR 8053 in ER-2019-0374—Current full req. contracts for Mt. Vernon and Monett, p. 2 of Monett Contract, p. 1 of Mt. Vernon Contract.
[125] Ex. 277, Empire Response to OPC DR 8053 in ER-2019-0374—Current full req. contracts for Mt. Vernon and Monett, p. 3 of Monett Contract, p. 2 of Mt. Vernon Contract.
[126] Ex. 203, Public Counsel witness Lena Mantle, direct testimony, Sch. LMM-D-3.
[127] *Id*.

capacity revenue from contracts that last less than one year as part of the definition of "off-system sales." Empire's contract with MJMEUC is for more than one year, including the portion addressing capacity revenues. Accordingly, in keeping with the FAC tariff sheets, Empire's revenues from MJMEUC for contracted capacity should not flow through its FAC because Empire's contract with MJMEUC is for a period greater than one year, and, per Empire's FAC tariff sheets, those revenues should not flow through Empire's FAC.

~~*iii. Should any wind project costs or revenues flow through the FAC before the wind projects revenue requirements are included in base rates?*~~

iv. Should any short-term capacity costs flow through the FAC from the effective date of this rate case?

No. Empire's short-term capacity costs should be excluded from flowing through Empire's FAC.[128] Empire's short-term capacity needs were foreseeable, and self-created when Empire elected to prematurely retire Asbury, and Empire's retail customers should not be forced to bear those costs that Empire imposed on itself. Staff witness J Luebbert identifies several reasons for concern regarding Empire's ability to meet its short-term capacity needs.[129] Empire shut down a 200 megawatt high-capacity factor baseload generating unit, Asbury, while not investing in any other resource for baseload generation. Instead, Empire is making, for it, massive investments in intermittent energy sources like wind energy generation, even as SPP is changing its methodology for judging capacity from wind energy resources.[130] Wind energy resources are currently accredited for capacity at 28% of their generation potential, but that will be reduced from anywhere

[128] Ex.205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 20.
[129] Ex. 111, Staff witness J. Luebbert, rebuttal testimony, p. 3.
[130] Ex. 278, SPP Solar and Wind ELCC Accreditation Study, August 2019, pp. 5-6.

to 19.9% to 14.6%. Simultaneously, Empire is entering into a new capacity arrangement with MJMEUC, which will reduce the capacity available for Empire's Missouri retail customers.

Furthermore, Empire's IRP update last month showed that its capacity balance for the summer of 2020 is **———— **[131] A likely result of all of these decisions and factors is that Empire will be deficient in short-term capacity, with the ultimate repercussion being either deficiency penalties and increased liabilities for its customers or costs for short-term capacity.[132] It was Empire's decision to hobble its energy reserves by shutting down the functional and recently upgraded 200 MW Asbury generating resource. It was Empire's decision to invest in more intermittent generation. It was Empire's decision to take on a new contract with MJMEUC. These decisions were out of the control of Empire's customers, and, accordingly, the customers should not be charged for any resulting capacity shortfall costs that Empire incurs.[133]

~~*d. When should Empire be required to provide its quarterly FAC surveillance reports?*~~

6. Credit Card Fees[134]

a. Should Empire's credit card fees be included in Empire's revenue requirement?

No. Many credit card users are eligible for cashback, rewards and other financial benefits from or through their credit card issuer. These benefits reduce and may more than completely offset the convenience fees these customers are incurring to pay Empire for using their credit cards.[135] Empire's customers have available to them the option of making direct payments from their financial institutions without incurring any fee—by using automated clearing house ("ACH")

[131] Update, Case No. EO-2020-0284 (Mar. 23, 2020).
[132] Exhibit 111, Staff witness J. Luebbert, rebuttal testimony, p. 3.
[133] Ex. 205NP, Public Counsel witness Lena Mantle, surrebuttal testimony, p. 20.
[134] Public Counsel's witness on this issue is Amanda Conner.
[135] Ex. 200, Public Counsel witness Amanda Conner, direct testimony, p. 10

payments. It is unduly discriminatory to require customers who cannot get credit cards, and those who do not wish or have no way to pay their bills online, to pay in their rates for customer credit card convenience fees of a subset of customers, convenience fees that the credit card companies otherwise would require merchants such as Empire to pay for accepting payment by credit card.

Public Counsel is recommending that Empire should not be allowed to add the credit card convenience fee to their cost of service. The socialization of these fees are not only unjust for those unable to pay in this method, but it is charging customers twice for their internet payment option, and this is not fair to those who cannot or will not be using this method to pay their Empire electric bills.

b. If so, what level of fees should be included?

N/A.

7. Rate case Expense [136]

a. How much of Empire's rate case expenses should be included in Empire's revenue requirement?

Empire's expense for using a chartered plane for four individuals to travel between the cities of Joplin and Jefferson in Missouri should not be included when the cost of renting a car, hotel rooms, and three meals a day for them is less.[137] After the Commission determines the amount of allowable rate case expenses, then it should reduce that amount by the shared mechanism chosen by the Commission for determining the amount of Empire's rate case expense to include in Empire's revenue requirement.

b. Should Empire's prudent rate case expenses be normalized or amortized, and over what period of time?

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[136] Public Counsel's witness on these issues is Amanda Conner.

[137] Ex. 101, Staff's Cost of Service Report, Staff Witness Angela Niemeier, p. 73, ll. 11-15.

Since Empire files rate cases every three years, and no more than four to continue its Fuel Adjustment Clause, its rate case expenses should be normalized over three years since this is the normalized time period over which Empire comes in for rate cases.[138]

c. Should Empire's prudent rate case expenses be shared between Empire's shareholder and Empire's retail customers? If so, how?

Recognizing that both the utilities and their customers benefit by matching prospective rates with what it takes for the utility to provide prospective service—investment, costs, etc.—the purpose of general rate cases, the Commission ordered in Case No. ER-2014-0370 that Kansas City Power & Light Company's rate case expenses be shared between it and its customers based on a ratio of the amount of increase requested and the amount granted by the Commission.[139] The Commission's same rationale applies in this case. As Public Counsel and the Commission's Staff both recommend, the appropriate sharing in this case should be calculated in this same manner using Staff's rate case expense amount.

8. Management expense[140]

a. Should any of Empire's management expenses not be included in Empire's revenue requirement?

Yes. Empire's management expense includes meal costs for what Empire claims without support are business meetings in the amount of $686,087. The disallowance of all other charges Public Counsel has deemed unreasonable or unjustifiable due to lack of justification of how these charges benefit Empire's retail customers is $3,021,797. The total test year disallowance of $3,707,884 recorded in account 923 for the test year.[141] Public Counsel also has a disallowance of $3,006,363 in account 923 for the true-up. Since

[138] Ex. 200, Public Counsel witness Amanda Conner, direct testimony, p. 6, ll. 1-2.
[139] Ex. 200, Public Counsel witness Amanda Conner, direct testimony, p. 4, ll. 1-10.
[140] Public Counsel's witness on this issue is Amanda Conner.
[141] Ex. 202, Public Counsel witness Amanda Conner, surrebuttal & true-up direct testimony, Sch. ACC-S-1.

Staff's account 923 number is based only on the test year, the amount that should be removed from account 923 is $3,707,884.

9. Allowance for Funds Used During Construction[142]

a. What metric should be used for Empire's carrying cost rate for funds it uses during construction that are capitalized?

The Commission should order Empire to apply a cost of short-term debt to 100% of the construction work in progress ("CWIP") balances to determine the amount of allowance for funds used during construction ("AFUDC") to allow in rate base.

The AFUDC is the capitalization rate applied to CWIP balances to determine an amount to be included in rate base for financing charges. Under the formula for the Uniform System of Accounts (USOA), this rate is determined by giving 100% weight to the short-term debt rate for CWIP balances that are equal to or less than the amount of short-term debt carried on the books. For CWIP balances that exceed the level of short-term debt, the AFUDC rate is based on long-term capital costs with the equity rate based on the most recent allowed ROE. Therefore, if a company is not utilizing short-term debt to initially fund its CWIP, this causes a higher rate base to be charged to ratepayers.

The USOA formula is logical and reasonable for companies financially managed as stand-alone companies because their capital structures are actively managed for purposes of maintaining reasonable capital balances, which includes the use of short-term debt as bridge financing to fund CWIP. [143] It does not makes sense for Empire because it no longer manages its dividend payments, capital structure, liquidity and long-term debt as if it were a stand-alone entity. If Empire were still a stand-alone publically-traded entity with general public shareholders, it would pay a quarterly dividend to its shareholders, which would require Empire to issued short-term debt to fund its CWIP. However, Empire did not pay a dividend to

[142] Public Counsel's witness on this issue is David Murray.
[143] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 15, ll. 15-16.

LUCo at all in two quarters of 2019, thereby reducing the amount of short-term debt Empire would have needed to issue as a stand-alone entity to fund its capital expenditures. [144] This causes a higher AFUDC rate due to the fact that only higher-cost long-term debt and equity capital is used to determine the AFUDC carrying charge. To ensure Empire's ratepayers are not charged excessive AFUDC because it is no longer financially managed as a standalone entity – a result of APUC's acquisition of Empire, the Commission should order Empire's AFUDC be determined based only on Empire's short-term debt costs, including those from its refinancing of its $90 million of first mortgage bonds in June of 2018.

b. *Should Empire's rate base be reduced to reflect the source and cost of the financial transaction behind Empire's $90 million promissory note with LUCo?*[145]

Yes. Empire's June 1, 2018, refinancing of its mortgage bonds was not a normal business decision; instead, by refinancing secured first mortgage bonds with proceeds of an unsecured 15-year promissory note with LUCo where LUCo obtained the funds from its line-of-credit facility provided LUCo a preference—a financial advantage—and was contrary to the affiliated services agreement cost allocation manual for transactions between Empire and LUCo.[146] The agreement with LUCo states under section 2.1 that "All services rendered under this Agreement will be provided at actual costs thereof". Empire has contractual rights that LUCo's actual costs be the basis for any charges to Empire for LUCo goods and services. LUCo did not incur the $450,000 note origination fee it charged Empire, and LUCo's actual interest costs were, and are, much less than what LUCo is charging Empire for interest. Because the true cost of the first mortgage bond refinancing is the short-term interest rate LUCo incurred, that short-term debt impacts Empire's AFUDC charges included in Empire's rate base. In short, Empire's AFUDC charges included in Empire's rate base would be overstated if this short-term debt is not considered properly. It is

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[144] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 15, ll. 17-19.
[145] Public Counsel included this issue in the issues that Public Counsel provided to Staff, and the other parties, on Friday, April 3, 2020, to include in the list of issues, but Staff omitted it in the joint issues list that it filed on April 8, 2020.
[146] Ex. 220NP, Public Counsel witness Robert Schallenberg, direct testimony*,* Sch. 16 (LUCo ASA); Ex. 221 (APUC CAM).

Public Counsel's position that these excess AFUDC charges that both Empire and Staff have included in their determinations of Empire's rate base must be removed.

10. Cash Working Capital[147]

a. *What is the appropriate expense lag days for measuring Empire's income tax lag for purposes of cash working capital?*

The Commission should assign an expense lag of 365 days as the appropriate metric for measuring Empire's income tax lag for purposes of cash working capital ("CWC") due to the Company's lack of income tax liability. This will reduce Empire's CWC by $14,002,453. CWC represents the net amount of funds required to finance the day-to-day operations of a regulated utility. In this case, the adjustment deals specifically with the amount of funds necessary to cover the difference in time between when Empire pays income taxes to a government agency and when it collects the money for those payments. However, Empire has not actually paid income tax to a government agency in at least four years. Acknowledging that Empire receives the income tax expense from its customers through its rates, but never uses those funds to pay government agencies demonstrates an indefinite expense lag. If an expense lag of 365 days is applied to Staff's current income tax calculation of $15,829,209, the reduction in CWC is $14,002,453. This is Public Counsel's position.

~~b. *What is the appropriate expense lag days for cash vouchers?*~~
~~c. *Should bad debt expense be a component of cash working capital? If so, what is the appropriate lag days?*~~
~~d. *What is the appropriate expense lag days for employee vacation?*~~

11. Accumulated Deferred Income Tax[148]

a. *Should Empire's booked accumulated federal income tax include a reduction for net operating loss?*

[147] Public Counsel's witness on this issue is John Riley.
[148] Public Counsel's witness on this issue is John Riley.

No. Empire's proposed accumulated deferred income tax ("ADIT") reduction of $2,621,928 by an accounting entry labeled, Net Operating Loss ("NOL"), should be disregarded. When Empire was included as part of the consolidated group in Liberty's consolidated tax returns, it no longer had the use of specific NOL tax deductions. NOLs are tax return items, and Empire cannot randomly apply them to its rate base.

b. ~~*Should FAS 123 deferred tax asset for stock-based compensation be included in ADIT balances for rate base?*~~

12. Tax Cut and Jobs Act of 2017 federal income tax rate reduction from 35% to 21% impact for the period January 1 to August 30, 2018[149]

a. How should the Commission treat the 2017 TCJA regulatory liability the Commission established in Case No. ER-2018-0366 when setting rates for Empire in this case?

The Commission should recognize that Empire has had the use of interest free money as a result of the Tax Cuts and Jobs Act stub period and, therefore, reduce Empire's rate base, just as the Commission reduces rate base for accumulated deferred taxes. Section 393.137.3, RSMo, requires the stub period amount to be included in this general rate case, and amortized over a period the Commission establishes. The stub period tax overearning of $11,728,453 should be returned to Empire's Missouri retail customers as quickly as possible and, so long as Empire continues to have the free use of the funds, then the funds balance should be applied as an offset to Empire's rate base.

13. Asbury[150]

a. Is it lawful to require Empire's customers to pay for Asbury costs through new rates?

No. In 1898, the U.S. Supreme Court said in *Smyth v. Ames*, 169 U.S. 466, 546-47 (1898),[151] "We hold, however, that the basis of all calculations as to the reasonableness of rates to

[149] Public Counsel's witness on this issue is John Riley.
[150] Public Counsel's witnesses on these issues are John Robinett and Geoff Marke.
[151] https://advance.lexis.com/document/searchwithindocument/?pdmfid=1000516&crid=ed6c19db-704f-4be4-bb46-988b45207d8f&pdsearchwithinterm=used&ecomp=73h9k&prid=134f54cf-6bf6-4ce4-b38e-a1a253684be4.

be charged by a corporation maintaining a highway under legislative sanction must be the fair value of the property being used by it for the convenience of the public," and "What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience. On the other hand, what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it are reasonably worth." This is the core of public utility ratemaking commonly expressed by the phrase "used and useful." Phrased differently the concept is that a utility's customers should not pay for the utility's investment in plant or profit on that investment unless the investment is useful for and actually being used to provide utility service to them—here electrical service used by the utility's customers.[152]

In *State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882*, 887-888 (Mo. App. 1981), the Court said that to address the problem of inflation causing rates based on historical period facts to be lower than what the Commission would have ordered by the time those rates took effect, the Commission adopted different approaches:

> A number of devices are available and have been used in rate cases to counter inflation. One method of coping with this problem is "trended cost" of capital investment, which was suggested by the Missouri Supreme Court in *State ex rel. Missouri Water Co. v. Public Service Commission, 308 S.W.2d 704 (Mo. 1958)* and which has been utilized by the Commission since that time. *See also* *State v. N.J. Bell Tel. Co., supra.* Another device is the "discounted cash flow" calculation which has been and continues to be used by the Commission. Another device is the use of a year-end rate base rather than taking a full year average. 1 Priest, Principles of Public Utility Regulation 205 (1969); 54 Boston U.L. Rev. 873 (1974); *Potomac Elec. Power Co. v. Public Service Commission, supra.* This device also has been adopted by the Commission and was used by it in this case.
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> Even more and newer devices to meet the inflation problem have been suggested and used. One such new device now being urged is the use of a future or "projected test year" instead of an historical test year. Note, The Use of the Future Test Year

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[152] *State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882*, 889-90 (Mo. App. 1981) (Error to disallow cost recovery for investment that is being used to provide service, and is also "fully operational and used for service."); *State ex rel. Missouri Power & Light Co. v. Public Service Com., 669 S.W.2d 941*, 90 (Mo. App. 1984).

> in Utility Rate-Making, 52 Boston U.L.Rev. 791 (1972). *See,* *New England Tel. & Tel. Co. v. Public Utilities, 390 A.2d 8 (Me. 1978)*. This particular approach would not be available in Missouri because of the adoption by popular vote of Initiative Proposition 1, now *Section 393.135*. However, the Commission in this case did use a modified version of the projected year model by utilizing a test year which was adjusted to take into account known and measurable future changes. That concept was implemented by the holding of what the Commission denominates as "a true-up hearing."

While the Commission began using updates and true-ups to address inflationary impacts on a utility's cost of service, known and measurable changes that occur after the test year can also have the impact of reducing a utility's cost of service. The circumstances here are similar to those the Commission faced when the Western District Court of Appeals reversed it in 1984 for disallowing Missouri Power & Light Company any recovery for contract tree trimming expense because Missouri Power & Light Company ceased to use contract tree trimmers during the update period following the test year, except that there, unlike here, the evidence was that Missouri Power & Light Company did not intend to permanently cease using contract tree trimmers. In its opinion reversing the Commission the Court said,

> The test year in the present case consisted of the twelve month period ending March 31, 1982. The purpose of the test year is to establish a reasonably expected level of earnings and expenses. Data for the test year was enlarged by known and measurable changes through June 30, 1982. As to tree trimming expense, a portion of the 1981 calendar year expense noted above was incurred in the test year and such costs continued in the first three months of 1982.
>
> By reason of the updating of information to June 1, 1982, it was determined that the utility had cancelled some contract distribution tree trimming. This was explained as being attributable to the depressed economy, fewer housing starts and very little new commercial or industrial activity. While tree trimming continued to be necessary work to maintain service, the utility decided to use its own line employees who were otherwise under-utilized in performing normal service connection work. Utility witnesses expressed the opinion that when the economy improved, they would return to their contract suppliers for tree trimming service. There was no predictable date when this would occur.
>
> The commission in its order determined that all contracts by the utility for tree

trimming by outside firms had ceased as of August 31, 1982 and the utility had no tree trimming contracts for the remainder of 1982 or for 1983. On this account, the commission ruled that no allowance would be made in the test year for tree trimming. The utility argued then and now for inclusion of $180,788.00 in tree trimming expense computed on the five year average adopted in principle in the 1980 rate case.

* * * *

The facts applicable to the category of tree trimming expense, amplified by the record in the prior rate case for this utility, are not the subject of any contest. In the earlier case, when the data base showed increasing expense for distribution contract tree trimming, the commission adopted the concept of a normalized average of five years expense, the net effect of which was to disallow the utility a portion of tree trimming cost actually incurred and expended in the test year. The basis and justification for normalization is that rise and fall of fluctuating expenses will project a reasonable allowance in determining a rate producing a fair return in future years.

There was no dispute in the present case that for the test year ending March 31, 1982, the utility had incurred substantial distribution contract trimming expense approximating the five year average allowance granted in the prior rate case. There is thus no factual basis to sustain disallowance of all tree trimming expense if the test year data and the five year average concept are the appropriate factors to consider in reaching the decision.

The report and order announces a commonly accepted principle of utility rate making. The test year is a period past, but is employed as a vehicle upon which to project experience in a future period when the rates determined in the case will be in effect. (Emphasis added). Normalization of a test year cost by multi-year averaging of the cost based on experience assumes that the cost rises and falls, with the consequence that the actual cost incurred in the test year is not representative. A decrease in the cost for a particular year does not warrant abandonment of the concept, but instead validates the assumption that the cost does not follow a level course. The decrease is factored into the projection in the mathematics of averaging. If the assumptions are correct, the test year then becomes representative by using the multi-year average in place of the actual test year expenditure. In theory, there is no reason why zero costs in some of the spread years may not be included in calculating the normalized cost.

The order in this case abandons the cost average approach to the expense for tree trimming at a time when the decline in these expenses makes the average approach more favorable to the utility in computation of the rate base. Were this expense item merely to have decreased, there would be no tenable ground to support the order excluding this category of expense from the test year in which tree trimming expenses were in fact incurred. The cancellation of the tree trimming contracts and the absence of current contracts for future service are therefore the only facts in the

> case which arguably support the commission decision.
>
> The evidence in the case was that Missouri Power and Light had incurred tree trimming expense for the services of outside contractors each year from 1975 to 1982 and that the practice of using contract labor had been approved and advocated by the commission. Such expense incurred in the test year was substantial and at least supported the normalized five year average of $180,788.00. It is true that at the date of the commission hearing, there were no tree trimming contracts in effect or in prospect. The suspension of use of contract tree trimmers and the use of utility line crews to perform the task were, however, temporary cost conservation measures intended to retain in the company's employ the skilled force needed for more sophisticated work when business improved. The commission decision to disallow all contract tree trimming expense assumes, contrary to the evidence that no such expense will be incurred in future years. The record shows the intention of the company to resume use of contract tree trimming and no purpose to assign this work permanently to regular company employees.
>
> In the face of this evidence, we conclude that the decision by the commission to disallow contract distribution tree trimming expense was without any reasonable basis in the evidence and was arbitrary. By the factoring process, inherent in the normalization concept, an appropriate adjustment is made for those years in which this expense item declines or is not incurred. Recognizing that the rate base is itself no more than an estimate, the fact that in a particular year there is no contract tree trimming expense is not alone a sufficient basis to disallow all costs for contract tree trimming from the projection of future expenses. Tree trimming work is regularly needed to maintain service and the suspension of contracts for the work was a temporary condition. By continued use of the five year cost average, including as a divisor those years in which no contract expense was incurred, the expense projection will continue to be normalized by actual experience.
>
> The tree trimming expense item advocated by Missouri Power and Light should have been included by the commission as an expense allowable to compute rates for service.[153]

In contrast to the circumstances before the Commission in the Missouri Power and Light case, here, even before APUC indirectly acquired Empire, APUC's plan as early as February 2016 was for Empire to shut Asbury down as soon as the early- to mid-2020's,[154] and after acquiring Empire it accelerated that date to before April 2019,[155] then revised it

[153] *State ex rel. Missouri Power & Light Co. v. Public Service Com.*, 669 S.W.2d 941, 943-45 (Mo. App. 1984).
[154] Ex 206HC, Public Counsel witness Geoff Marke, direct testimony, Sch. GM-6 HC.
[155] Ex. 272, EO-2018-0092- report and order- final.

to 2019.[156] In this case Empire's witness Tim Wilson testified on August 14, 2019, in his direct testimony (Exhibit No. 41, p. 6) that Empire would retire Asbury "by no later than June 2020." Subsequently, by choking off access to economic coal at Asbury by reducing its onsite coal inventory to less than a thirty (30)-day full capacity burn supply by October 22, 2019, and last receiving a coal delivery on November 14, 2019,[157] Empire burned the last of its usable coal at the Asbury site on December 12, 2019, and shut Asbury down for the last time that same day.[158] Note the December 11, 2019, Asbury shift supervisor log entries from Exhibit No. 275C that follow:

> -estimated shut down at 0800 Thurs.
> -sent messages or spoke to everybody on the list for last shutdown
> ***-NOTICE: Don't say last shutdown, we are on outage until retirement date***
> (Emphasis added).

Empire's assertion that, after Empire shut Asbury down until Empire retired Asbury on March 1, 2020,[159] it notified the SPP IM market daily that Asbury was in an outage[160] does not change the fact that Asbury has been neither used nor useful for Empire's customers since December 12, 2019, well within the true-up cutoff date of January 31, 2020, and well before the anticipated July 11, 2020, effective date of new rates in this case. As a unit that Empire shutdown on December 12, 2019, with no intention of ever running it again, the impacts of Asbury must be removed from Empire's test year cost of service, as updated and trued-up, to meaningfully project experience into the future. Just

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[156] Ex. 273C, vol 1 empire exec summary_irp_ c 2019, and Ex. 276, EO-2019-0106 Empire notice change in preferred plan.
[157] Ex. 267, Empire response to mo er-2019-0374 mpsc dr 0337.
[158] Ex. 275C, Empire response to OPC DR 2099 (Asbury Shift supervisor log for Dec. 2019 through February 2020); Ex. 219C, John Robinett, surrebuttal/true-up direct testimony, p. 2.
[159] Ex. 20, Empire witness Aaron Doll, rebuttal testimony, p. 2.
[160] Ex. 263, Empire response to MPSC DR 333.

as there was "no tenable ground to support the order excluding this [contract tree trimming] category of expense from the test year" in the Missouri Power and Light case, there is no tenable ground to support an order that includes the financial impacts on Empire of Asbury operating during the test year used for setting prospective rates. To do otherwise flies in the face of using the test year "***as a vehicle upon which to project experience in a future period when the rates determined in the case will be in effect.***"

b. Is it reasonable to require Empire's customers to pay for Asbury costs through new rates?

No. For the same reasons it is not lawful for customers to pay for non-existing plant costs, it is not reasonable to require Empire's customers to pay for operating them. See the arguments under subpart *a*. immediately above. There is no logical or equitable reason why Empire should continue to charge its customers as if Asbury is continuing to operate, when Empire shut Asbury down for the final time on December 12, 2019.[161] Reasonable rates compensate a public utility for its investment in, and its operation and maintenance expense associated with, investments that actually provide service to its customers, nothing more.[162]

c. If it is unlawful and/or unreasonable to include the costs of the retired Asbury plant in rates, what amount should be removed from Empire's cost of service?

The Commission should remove, at a minimum, the depreciation expense and operations and maintenance (O&M) expense from Empire's cost of service and rate base. Both categories amount to $11,179,375 for depreciation expense based on Staff's true up accounting schedules,[163]

[161] Ex. 219C, Public Counsel witness John Robinett, surrebuttal/true-up direct testimony, p. 2.
[162] *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improv. Co. v. PSC of W. Va.*, 262 U.S. 679, 692-93 (1923).
[163] Ex. 124, Staff True Up Accounting Schedules, ER-2019-0374 Schedule 05 p. 1 ln 8-15 (Mar. 27, 2020).

and between **________________________ _** for O&M expense.[164] The Asbury station should be removed from plant-in-service and accumulated depreciation reserves, and set to zero.

14. Fuel Inventories[165]

a. What is the appropriate number of burn days to use for Asbury fuel inventory?

Zero. By December 12, 2019, Empire had no usable coal inventory remaining at Asbury,[166] and Empire had no intention of generating electricity from its 200 MW coal-fired generator at Asbury after that date, submitting Asbury into the SPP market as being in outage for lack of fuel[167] until it officially retired Asbury on March 1, 2020.[168]

~~**15. Energy Efficiency.**~~

16. Operation and Maintenance Normalization[169]

a. What is the appropriate level of operation and maintenance expense to be included in the cost of service?
~~*b. Should inflation factors be used to calculate operation and maintenance expense?*~~
~~*c. What is the appropriate normalized average of years to be used for the Riverton, State Line Combined Cycle Unit, the Common Unit and State Line 1 Unit?*~~

No amount should be included for Asbury operation and maintenance expense because Asbury is not operating or being maintained, and it has not operated since December 12, 2019.

~~**17. Pension and OPEB (FAS 87 and FAS 106)**~~

[164] Ex. 219C, Public Counsel witness John Robinett, surrebuttal/true-up direct testimony, p. 4.
[165] Public Counsel's witness on this issue is Robert Schallenberg.
[166] Ex. 219C, Public Counsel witness John Robinett, surrebuttal/true-up direct testimony, Schs. JAR-S-1C and JAR-S-2C; and Exs. 261C, February 2020 Fuel Report submitted by Empire on 03-31-2020 BEGR-2020-1067, and 262C, Electric Net Fuel and Purchased Power Report submitted by Empire on 03-31-2020 BFMR-2020-1070.
[167] Ex. 263, Empire response to MPSC DR 333.
[168] Ex. 20, Empire witness Aaron Doll, rebuttal testimony, p. 2.
[169] Public Counsel's witness on this issue is John Robinett to the extent it involves Asbury expenses.

18. Affiliate Transactions[170]

While Public Counsel includes argument under each of the three points listed under this issue (*a.-c.*), it first presents a fairly lengthy reproduction of the facts and analysis the Missouri Supreme Court laid out in its 2013 opinion that Public Counsel cited in its position statements—*Office of the Public Counsel v Mo.PSC*, 409 S.W.3d 371 (Mo. banc 2013).

As Public Counsel asserted in its position statement on Empire's affiliate transactions, the lack of evidence that Empire's transactions with its affiliates are prudent is fatal to its filed case with tariff sheets designed to increase its rates. The second sentence of § 393.150.2, RSMo, is "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . electrical corporation . . ., and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible." In *Office of the Public Counsel v Mo.PSC*, 409 S.W.3d 371 (Mo. banc 2013), the Missouri Supreme Court reversed the Commission for presuming that transactions between a Commission-rate-regulated natural gas utility (Atmos Energy) and its affiliate (Atmos Energy Marketing LLC) were prudent. In that opinion the Court stated,

> When a regulated gas corporation such as Atmos Energy engages in a business transaction with an affiliated entity, it is required to abide by the affiliate transaction rules set forth in the Missouri Code of State Regulations. *4 CSR 240-40.015-40.016*. Due to the inherent risk of self-dealing, the presumption of prudence utilized by the PSC when reviewing regulated utility transactions should not be employed if a transaction is between a utility and the utility's affiliate.
>
> Because the PSC reviewed the transaction between Atmos and its affiliate through the lens of the presumption of prudence, its order is unlawful and unreasonable. Accordingly, the order is reversed and the case remanded to the PSC for further

[170] Public Counsel's witness on this issue is Robert Schallenberg.

review consistent with this opinion.[171]

Here, the applicable affiliate transactions rule is *20 CSR 4240-20.015*, but the language of this rule does not differ materially from the rule applicable to gas utilities, formerly *4 CSR 240-40.015-40.016*, and now *20 CSR 4240-40.015*. While the Missouri Supreme Court's holding in *Office of the Public Counsel v Mo.PSC*, 409 S.W.3d 371, is for a Commission-created rate adjustment mechanism designed to flow a natural gas utility's actual natural gas costs through to its retail customers, the rationale of the holding is equally applicable to the circumstances here.

Regarding that rationale the Court said the following at 409 S.W.3d at 376-379:

> ***A. Presumption of Prudence***
>
> The burden is on the gas corporation to prove that the gas costs it proposes to pass along to customers are just and reasonable. *§ 393.150.2; see also Matter of Kansas Power and Light Co., 30 Mo. P.S.C. (N.S.) 76 (1989)* (The gas corporation "has the burden of showing its proposed rates are just and reasonable ... [and] of showing the reasonableness of costs associated with its rates for gas.)
>
> While the burden of proof rests on the gas corporation, the PSC's practice has been to apply a "presumption of prudence" in determining whether a utility properly incurred its expenditures. The presumption of prudence is not a creature of statute or regulation. It first was recognized by the PSC in *Matter of Union Electric, 27 Mo. P.S.C. (N.S.) 183 (1985)* and has been applied by it since that point.
>
> Under the presumption of prudence, a utility's costs "are presumed to be prudently incurred. ... However, the presumption does not survive a showing of inefficiency or improvidence" that creates "serious doubt as to the prudence of an expenditure." *Id. at 193*, quoting *Anaheim, Riverside, Etc. v. Fed. Energy Reg. Com'n, 669 F.2d 799, 809, 216 U.S. App. D.C. 1 (D.C. Cir. 1981)*. If such a showing is made, the presumption drops out and the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent. *Id*.
>
> The Missouri court of appeals has applied the presumption of prudence in numerous cases involving non-affiliated companies. *See, e.g., State ex rel. Assoc. Natural Gas Co. v. Public Serv. Comm'n, 954 S.W.2d 520 (Mo. App. 1997)*. It also has applied it in one case involving affiliated companies, simply stating without any analysis

[171] *Office of the Public Counsel*, 409 S.W.3d at 372.

that, "Although UE purchased the CTGs from its affiliates, the commission properly presumed that UE was prudent in its purchase of the CTGs." *State ex rel. Pub. Counsel v. Pub. Serv. Comm'n, 274 S.W.3d 569, 582 (Mo. App. 2009)*.

This Court has not addressed directly whether the presumption of prudence is valid in either affiliate or non-affiliate cases, although it did note its existence, without addressing its legitimacy, in *dicta* in a non-affiliate case, *State ex rel. Riverside Pipeline Co., L.P. v. Pub. Serv. Comm'n of State, 215 S.W.3d 76, 85 (Mo. banc 2007)*. Riverside upheld a stipulation between the PSC and certain energy companies that precluded prudence review by the PSC.

The OPC agrees that a presumption of prudence is appropriately applied in arms-length transactions, and this Court concurs. When dealing at arms-length, there is a diminished probability of collusion and the pressures of a competitive market create an assumption of legitimacy.

OPC argues, however, that a presumption that a transaction was agreed to prudently should not apply to *affiliate* transactions because of the greater risk of self-dealing when contracting with an affiliate. This Court again agrees. As noted in the report of a Congressional staff investigation of the particularly egregious affiliate dealings between Enron and its pipeline subsidies in the wake of Enron's collapse:

> [W]henever a company conducts transactions among its own affiliates there are inherent issues about the fairness and motivations of such transactions. ... One concern is that where one affiliate in a transaction has captive customers, a one-sided deal between affiliates can saddle those customers with additional financial burdens. Another concern is that one affiliate will treat another with favoritism at the expense of other companies or in ways detrimental to the market as a whole.

Staff of Senate Comm. on Gov't Affairs, 107th Cong., *Committee Staff Investigation of the Federal Energy Regulatory Commission's Oversight of Enron 26*, n.75 (Nov. 12, 2002); *see also* Judy Sheldrew, *Shutting the Barn Door Before the Horse Is Stolen: How and Why State Public Utility Commissions Should Regulate Transactions Between A Public Utility and Its Affiliates*, *4 NEV. L.J. 164, 195 (2003)*.

This greater risk inherent in affiliate transactions arises because agreements between a public utility and its affiliates are not "made at arm's length or on an open market. They are between corporations, one of which is controlled by the other. As such they are subject to suspicion and therefore present dangerous potentialities." *Pac. Tel. & Tel. Co. v. Pub. Utils. Comm'n, 34 Cal. 2d 822, 215 P.2d 441, 449 (Cal. 1950) (Carter, J., dissenting)*.

Indeed, as the PSC acknowledged in *State ex rel. Atmos Energy Corp. v. Pub. Serv. Comm'n of State, 103 S.W.3d 753, 763-64 (Mo. banc 2003)*, the affiliate transaction

rules were adopted in response to the very kinds of concerns now raised by OPC. In that case, the concern was with a profit-producing scheme among certain public utilities termed "cross-subsidization," through which some utilities would abandon their traditional monopoly structure and expand into non-regulated areas. "This expansion [gave] utilities the opportunity and incentive to shift their non-regulated costs to their regulated operations with the effect of unnecessarily increasing the rates charged to the utilities' customers." *Id. at 764. See also United States v. Western Elec. Co., 592 F. Supp. 846, 853 (D.D.C.1984)* ("As long as a [utility] is engaged in both monopoly and competitive activities, it will have the incentive as well as the ability to 'milk' the rate-of-return regulated monopoly affiliate to subsidize its competitive ventures").

Here, the concern is with an ability to offer a lower bid than one's competitors because of access to inside information about costs and terms and because of an ability to shift fixed costs to the regulated utility, thereby allowing the affiliate to bid lower due to lower overhead costs. While this Court does not suggest that there was such conduct here, the risk of this conduct and the incentive to undertake it inherently exists in affiliate transactions.

For these reasons, the rationale for permitting a presumption of prudence in arms-length transactions simply has no application to affiliate transactions. The PSC enacted the affiliate transaction rules in 2000 with the precise purpose of thwarting unnecessary rate hikes due to cross-subsidization. *State ex rel. Atmos, 103 S.W.3d at 764*. Those rules require that a utility must show that it paid the lesser of the fair market rate or the fully distributed cost to the regulated gas corporation and require that records be kept supporting these calculations. *4 CSR 240-40.016(4)(B)* ("[T]he regulated gas corporation shall document both the fair market price of such ... goods and services and the fully distributed cost to the regulated gas corporation to produce the ... goods or services for itself.")

The affiliate rules' stated purpose is to "prevent regulated utilities from subsidizing their non-regulated operations ... and provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities." *240-40.015*. A presumption that costs of transactions between affiliates were prudent is inconsistent with these rules.

For these reasons, the majority of other courts to address the issue have concluded that a presumption of prudence should not be applied to affiliate transactions. In *US W. Commc'ns, Inc. v. Pub. Serv. Comm'n of Utah, 901 P.2d 270 (Utah 1995)*, the Supreme Court of Utah held that the Utah Public Service Commission correctly placed the burden on a telephone provider of proving that the services rendered by its affiliate were not duplicative. In support of its decision, the court remarked; "While the pressures of a competitive market might allow us to assume, in the absence of a showing to the contrary, that nonaffiliate expenses are reasonable, the same cannot be said of affiliate expenses not incurred in an arm's length transaction." *Id. at 274*.

The Supreme Court of Idaho reached a similar conclusion in *Boise Water Corp. v. Idaho Pub. Utilities Comm'n, 97 Idaho 832, 555 P.2d 163 (1976)*. The court refused to make an exception to the rule placing upon the utility the burden of proving reasonableness of its operating expenses paid to an affiliate, stating; "The reason for this distinction between affiliate and non-affiliate expenditures appears to be that the probability of unwarranted expenditures corresponds to the probability of collusion." *Id. at 169*. *See also, Turpen v. Oklahoma Corp. Comm'n, 1988 OK 126, 769 P.2d 1309, 1320-21 (Okla. 1988)* ("It is generally held that, while the regulatory agency bears the burden of proving that expenses incurred in transactions with nonaffiliates are unreasonable, the utility bears the burden of proving that expenses incurred in transactions with affiliates are reasonable); *Michigan Gas Utilities v. Michigan Pub. Serv. Comm'n, 206234, 1999 Mich. App. LEXIS 1954, 1999 WL 33454925 (Mich. App. Feb. 9, 1999)* ("the utility has the burden of demonstrating that its transactions with its affiliate are reasonable"). This Court concurs. A presumption of prudence is inconsistent with the rationale for the affiliate transaction rules and with the PSC's obligation to prevent regulated utilities from subsidizing their non-regulated operations.

The PSC counters that it always has recognized a presumption of prudence and that this Court cannot read the affiliate transaction rules to negate that presumption in the case of affiliated transactions because the affiliate transaction rules themselves state that they did not "modify existing legal standards regarding which party has the burden of proof in commission proceedings." *4 CSR 240-40.015(6)(C) & 240-40.016(7)(C)*. This argument is based on a misunderstanding of the concept of burden of proof.

Missouri law sets out the burden of proof in PSC proceedings. As noted earlier, those statutes provide that a gas corporation has the burden to prove that the gas costs it proposes to pass along to customers are just and reasonable. *§ 393.150.2*. The PSC has no authority to adopt rules changing the burden of proof set out in the relevant statutes, and it was proper for the affiliate transaction rules to note that they did not attempt to do so. *See Kanakuk-Kanakomo Kamps, Inc. v. Dir. of Revenue, 8 S.W.3d 94, 98 (Mo. banc 1999)* (A regulation that is beyond the scope of the statute is a nullity).

A change in the presumption of prudence does not change the burden of proof set out in the PSC governing statutes. The presumption of prudence does not address the burden of proof at all. It sets out *an evidentiary presumption* created by the PSC. That standard provides that the utility's expenditures are presumed to be prudent until adequate contrary evidence is produced, at which point the presumption disappears from the case. *See Deck v. Teasley, 322 S.W.3d 536, 539 (Mo. banc 2010)* (discussing general law of presumptions). This presumption affects who has

> the burden of proceeding, but it does not change the burden of proof, which by statute must remain on the utility.[6] *§ 393.150.2*.
>
> Further, the presumption of prudence is not even a creature of statute or of PSC regulations or rules. It was created by PSC case law. It cannot be applied inconsistently with the PSC's governing statutes and rules. As discussed above, the application of a presumption of prudence to a transaction with an affiliated company is inconsistent with the PSC's statutory and regulatory obligations to review affiliate transactions. Accordingly, the presumption of prudence is inapplicable to affiliate transactions.

In the Atmos case, Atmos was buying natural gas as a commodity from its affiliate Atmos Energy Marketing LLC and passing the costs of those affiliate transactions on to its customers. Here Empire is attempting to collect in prospective rates future costs it incurs with its affiliates for good and services they provide to Empire, including financial services from LUCo and personnel services from LUSC—Liberty Utilities Service Corp.

Although the burden is on Empire to show that historically it has incurred those costs prudently, and there is no reason to believe it will not do so in the future, the record is barren of that evidence. However, the evidence in the record does show that Empire's June 1, 2018, refinancing of its $90 million of first mortgage bonds with its affiliate LUCo was imprudent and did not comply with *20 CSR 4240-20.015*.

a. Are Empire's transactions with its affiliates imprudent?

Empire's June 1, 2018, refinancing of its $90 million first mortgage bonds by executing a 15-year $90 million unsecured promissory note with it affiliate LUCo is imprudent. Moreover, there is insufficient evidence to opine that any of Empire's separate annual $100 million of

[6] Although the above analysis is dispositive, it bears noting that the PSC has not identified any rule, regulation or decision in which it affirmatively determined prior to the adoption of the affiliate transaction rules that the presumption of prudence was applicable to affiliate transactions. For this reason also, AEM's argument is not well taken.

transactions with its affiliates[172] are prudent. Finding that they are prudent is a prerequisite to the Commission including them in Empire's cost of service it uses for setting Empire's rates. *Office of the Pub. Counsel v. Mo. PSC*, 409 S.W.3d 371 (Mo. 2013), and § 393.150.2, RSMo.

Empire's failure to comply with the Commission's electric utility affiliate transactions rule 20 CSR 4240-20.015 as explained in part in subpart B below is also imprudent. By complying with that rule Empire not only should have established that the costs of having affiliates provide the goods and services was prudent, it would also have created the documentation from which the prudency of Empire entering into transactions with its affiliates could be evaluated, i.e., had Empire complied with that rule it would have established that the costs of having affiliates provide the goods and services was prudent, and there would be sufficient information to reach a conclusion as to the prudency of the costs Empire incurred in its annual $100 million of transactions with its affiliates. The Commission promulgated its documentation rules for the same reason Public Counsel seeks to enforce them now – they provide the basis for determining prudency, and when complied with, the rules work to prevent this contentious issue from coming before the Commission for decision.

Empire's $90 million first mortgage bonds refinancing is imprudent because Empire had better refinancing terms available to it—either by issuing new first mortgage bonds or by issuing commercial paper. First mortgage bonds and commercial paper have lower interest rates than unsecured promissory notes and lines-of-credit, respectively, because they are secured financings. The Algonquin enterprise's Treasury Department—comprised of eight individuals (one employed

[173] Ex. 242, Empire response to AO-2018-0179 OPC DR 1028, and Ex. 243, Empire response to AO-2018-0179 OPC DR 1091.

by Liberty Utilities Corp. and the other seven employed by Liberty Utilities (Canada) Corp.)[173]—developed the refinancing, which the boards of directors of Empire and LUCo authorized be executed.[174]

Mr. Timpe is principally responsible for the Treasury functions for Empire and its Midwest affiliates.[175] This common control over the terms of transactions between utilities and their affiliates goes to the heart of why the utility must show those transactions are prudent before the costs of those transactions can be included in the utility's cost of service used for setting rates.

Public Counsel does not concede that it would have been prudent for Empire to do the following, but in response to Empire's argument that LUCo used its line-of-credit to finance its 15-year note with Empire because it gets better terms for its long-term bond issuances when it aggregates short-term debt into a larger issuance, Public Counsel points out the following: Empire would have been better off retaining the $90 million debt by paying off its first mortgage bonds with proceeds from commercial paper it issued, and then, when LUCo had available sufficient short-term debt to aggregate to obtain better long-term bond terms, Empire could have refinanced its short-term commercial paper debt by executing long-term debt with LUCo on the same terms that LUCo got for its long-term bonds. Instead, LUCo drew $90 million on its line-of-credit, the rates of which have ranged from 3.25% to 3.8125%, for the $90 million it loaned to Empire, charged Empire an origination fee of $450,000, and executed a 15-yr unsecured promissory note

[173] Ex. 242, Empire response to AO-2018-0179 OPC DR 1028, and Ex. 243, Empire response to AO-2018-0179 OPC DR 1091.
[174] Ex. 244; Empire response to AO-2018-0179 OPC DR 1119, and Ex. 245, Empire response to AO-2018-0179 OPC DR 1121.
[175] Ex. 246; Empire response to OPC DR 1085.

with Empire at a 4.53% interest rate and a "make whole" provision, i.e., all interest is due, regardless of when Empire pays off the note.

b. Do Empire's transactions with its affiliates comply with Commission Rule 20 CSR 4240-20.015 (Affiliate Transactions)?

No. The Commission's affiliate transactions rule requires that, for rate purposes, the cost of an electric utility's transactions to acquire goods or services is the lesser of the utility's fully distributed cost to provide the good or service itself and the fair market value of the good or service.[176] It also requires that "[w]hen a regulated electrical corporation purchases information, assets, goods or services from an affiliated entity, the regulated electrical corporation shall either obtain competitive bids for such information, assets, goods or services or demonstrate why competitive bids were neither necessary nor appropriate."[177] Empire did not obtain competitive bids when it entered into its $90 million 15-year promissory note with LUCo. Nor has Empire obtained competitive bids for any of its other affiliate transactions, including those for the services Liberty Utilities Service Corp. provides.

Empire attempts to support the terms of its $90 million first mortgage bond refinancing by relying on comparisons to financings its affiliates engaged as proxies for the terms of the $90 million 15-year promissory note it executed with LUCo.[178] Empire has not demonstrated why it obtaining competitive bids for this refinancing was neither necessary nor appropriate, and Empire was capable of refinancing these bonds itself, i.e., there was no reason it could not have competitively bid the refinancing. The Commission's Staff concurs that Empire violated the

[176] 20 CSR 4240 -20.015(2)(A)1.
[177] 20 CSR 4240 -20.015(3)(A).
[178] Ex. 43, Empire witness Mark Timpe, rebuttal testimony, pp. 7-8.

Commission's affiliate transactions rule in this refinancing.[179] In her rebuttal testimony Staff witness Kimberly K. Bolin testifies, "This is a violation because LUCo is charging its affiliate, Empire, a higher interest rate for money it obtained at a lower rate."[180] In her surrebuttal testimony she recommends that the Commission treat Empire's interest cost of its $90 million 15-year promissory note with LUCo to be 2.15% for purposes of matching Empire's interest cost for the $90 million to match LUCo's. While treating the interest on Empire's note with LUCo at LUCo's cost of funds to lend the $90 million would eliminate LUCo's interest profiting at the cost of Empire's retail customers, it probably does not bring Empire's cost of the $90 million refinancing down to fair market value and the cost at which Empire could have obtained the funds itself—Empire, in an arms'-length transaction, could have issued commercial paper at a lower interest cost and, likely, a lower origination fee.

While the Commission's affiliate transactions rule allows the use of Commission-approved cost allocation manuals that may include benchmarking to satisfy the rule's market value requirements,[181] the Commission has not approved the cost allocation manual Empire is using,[182] nor should it. That manual would replace the requirement of using the lesser of the utility's fully distributed cost or fair market value with using the lesser of "a fully distributed cost ("FDC") basis to reflect all costs incurred in providing goods, assets, information, and services, or the current fair market price ("FMP")."[183] It would also allow Empire to assign costs to the Missouri public from its affiliates, primarily Liberty Utility Services Company, based on the Massachusetts' Formula,[184]

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[179] Ex. 106, Staff witness Kimberly Bolin, rebuttal testimony, pp. 11-13.
[180] *Id*. at p. 12.
[181] 20 CSR 4240 -20.015(3)(D).
[182] Ex. 220NP, Public Counsel witness Robert Schallenberg, direct testimony, p. 7; Ex. 25, Empire witness Jill Schwartz rebuttal testimony, pp. 3-4.
[183] Ex. 221, AO-2017-0360 app. (APUC CAM), Appendix 9 to APUC CAM, p. 4, 16-17 of 24.
[184] Ex. 221, AO-2017-0360 app. (APUC CAM), Appendix 9 to APUC CAM, pp. 7 of 24.

which it describes as follows: "The Massachusetts Formula approved for this allocation is an arithmetic average of total company revenues (electric, water, and gas), total company payroll (Electric and Gas) excluding Empire Electric payroll related to the provision of activities that benefit common entities, and net plant in service (electric, water, and gas) excluding Empire Electric plant in service that benefit common entities."[185] As Public Counsel witness Robert Schallenberg observes, these factors are wholly unrelated to either the nature or quantities of the goods and services Empire's affiliates are providing it.[186]

How Empire was charged for its $90 million first mortgage bond refinancing is persuasive evidence that Empire is not complying with the cost allocation manual it says it is following. Had it complied with that manual, Empire's cost for the $90 million 15-year note would have been based on LUCo's fully distributed cost. That primarily was LUCo's cost to draw $90 million on its line of credit. LUCo did not incur $450,000 to originate the 15-year promissory note with Empire, but charged Empire that amount as an origination fee. Because Empire did not comply with the 20 CSR 4240 -20.015(3)(A) requirement to obtain competitive bids for that refinancing, what Empire's fully distributed costs to refinance those bonds—including any origination fee—is unknown, and unknowable.

Through its witness Jill Schwartz, Empire points to 20 CSR 4240 -20.015(2)(B) for Empire's authority for how Empire costs the corporate support that its affiliates, primarily Liberty Utility Services Company, provide it. As Ms. Schwartz testifies, that subsection states:

> Except as necessary to provide corporate support functions, the regulated electrical corporation shall conduct its business in such a way as not to provide any

[185] Ex. 221, AO-2017-0360 app. (APUC CAM), Appendix 9 to APUC CAM, p. 10 of 24.
[186] Ex. 220NP, Public Counsel witness Robert Schallenberg, direct testimony, p. 6.

preferential service, information or treatment to an affiliated entity over another party at any time.

A plain reading of that rule provision shows the exception is directed at activities the utility performs, not those of an affiliate. In other words, only when the utility is providing corporate support functions is this exception available. Empire has no employees and its affiliate Liberty Utility Services Company is the primary provider of Empire's corporation support functions. The exception does not apply here. It makes no sense to interpret this provision in a way that would permit affiliates to be treated preferentially for their charges to a utility for corporate support functions when the whole purpose of the rule is to protect the utility's customers from costs that are higher than they would have been if an affiliate was not involved in the transaction. In short, it makes sense to allow subsidies to flow from the affiliate to the utility, but not from the utility to the affiliate.

While Public Counsel could raise additional arguments, Public Counsel believes these are sufficient to show the merit of its position on this issue.

c. *What amount should be included in Empire's revenue requirement for its transactions with its affiliates?*

None, except as noted following. Empire admits that it included affiliate transactions in its cost of service,[187] but neither Empire nor Staff can quantify the dollar value of Empire's affiliate transactions they included in their cases.[188] Based on Empire's 2018 and 2019 affiliate transactions reports,[189] Empire has about $100 million of transactions with its affiliates annually. Since Empire did not provide information to show these transactions were prudent, it must be assumed that they

[187] Ex. 226, Empire response to OPC DR 1001; Ex. 227, Empire response to OPC DR 1005; Ex. 228, Empire response to OPC DR 1006.
[188] Ex. 225, Empire response to OPC DR 1000; Ex 253, Staff response to OPC DR 0326.
[189] Ex. 220C, Public Counsel witness Robert Schallenberg, direct testimony, Sch. RES-D-6 C (Empire's 2018 affiliate transactions report); Ex. 229 (Empire's 2019 affiliate transactions report).

were imprudent. Therefore, at a minimum, Empire's and Staff's costs-of-service for Empire should be reduced by $100 million. Both should also be reduced by the effect of the $450,000 origination fee LUCo charged Empire for their $90 million 15-year promissory note, and Empire's also should be reduced for the interest rate difference between that note and the interest LUCo pays for its $90 million draw on its line-of-credit it used to finance that note. (Staff has addressed that in its case, but not the interest rate impact on Empire's allowance for funds used during construction). Further, in both Empire's and Staff's costs-of-service for Empire their rate base should be reduced by $4,719,774 for the impact on Empire's allowance for funds used during construction rate caused by not including the impact of Empire being treated as having $90 million of short-term debt after it refinanced its first mortgage bonds.

~~19. Riverton 12 O&M Tracker~~
~~20. Software Maintenance Expense~~
~~21. Advertising Expense~~
22. Customer Service[190]

a. Is Empire providing satisfactory customer service?
i. If not, what should the Commission order to ensure better customer service?

Empire serves approximately 175,000 retail electric customers, of which approximately 156,000 (nearly 90%) are in Missouri.[191] During the six months before Algonquin acquired Empire in July of 2017 Empire estimated fewer than 1,000 of its customers' bills each month. However, afterward Empire's estimated customer bills skyrocketed to a high of 25,578 in December of 2019 (30 months later) before Empire finally reduced that level to 5,658 in January 2020 and 1,179 in February 2020.[192] At the Commission's local public hearings in Bolivar, Joplin

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[190] Public Counsel's witness on this issue is Geoff Marke.
[191] Ex. 101, Staff direct cost-of-service report p. 3, ll. 5-7.
[192] Ex. 207NP, Public Counsel witness Geoff Marke, revenue requirement rebuttal testimony, Sch. GM-R-3 (Empire response to Staff data request no. 255).

and Branson many members of the public testified about the extent to which Empire estimates their bills, and one, Ms. Kathleen McCarthy testified to getting an estimated bill that was about 50% higher (over $120) than her corrected bill.[193] Further, this issue was so pervasive that KY3 news in Springfield covered it in July of 2018.[194] Public Counsel first became aware of this issue and the extent of it through comments filed in EFIS (255 comments), evidence at the Bolivar, Joplin and Branson local public hearings, including a Change.org Investigation Petition (4,452 signatures),[195] and Staff and Public Counsel discovery.

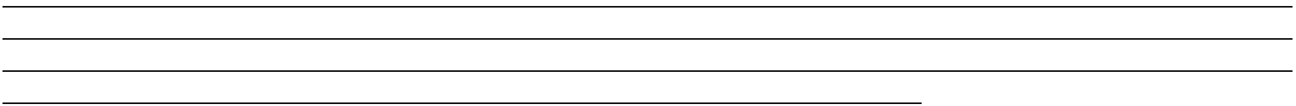
Following, by month, are the number of customer bills Empire estimated from January 2019 through February 2020[196]:

	2017	**2018**	**2019**	**2020**
January	742	5594	1730	5668
February	362	10639	663	1179
March	232	19393	1114	
April	521	14469	682	
May	545	20874	1011	
June	354	17894	997	
July	1866	17982	2864	
August	637	14388	5557	
September	1001	6309	9681	
October	509	15534	19306	
November	2769	9810	15593	
December	11517	9644	25578	

[193] Tr. 5:48-51; Branson, MO LPH - February 4, 2020.
[194] https://www.ky3.com/content/news/Liberty-Utilities---Empire-District-has-been-estimating-on-some-customers-bills-488678541.html.
[195] Bard, J. (2020) Investigate Liberty Utilities (Empire). *Change.Org*. https://www.change.org/p/missouri-public-service-commission-investigate-liberty-utilities-empire.
[196] Ex. 207NP, Public Counsel witness Geoff Marke, revenue requirement rebuttal testimony, Sch. GM-R-3, Empire response to Staff data request no. 255.

Further on the issue of customer service, Public Counsel witness Geoff Marke testifies, "Empire's customers pay in the upper quartile to receive bottom quartile service when benchmarked against other utilities."[197] This is illustrated in the following figure and tables from this testimony (Figure 1, and Tables 1, 2, 3, 4, and 5):

**Figure 1: Empire 116 out of 138 Utilities per J.D. Power Customer Satisfaction Scores[198]



[197] Ex. 209, Public Counsel witness Geoff Marke surrebuttal testimony, p. 5, ll. 16-17.
[198] Ex. 206C, Public Counsel witness Geoff Marke, direct testimony, p.7, ll. 1-3.

Table 1: Empire's JD Power Category Scores Compared to National Average[199]

Table 2: JD Power High, Low, Average and Missouri-Specific Utility Score Comparisons [200]

Table 3: Rankings of 2018 average monthly price for residential customers in Missouri per S&P Global Market Intelligence[201]

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[199] *Id.*, p. 8, 1.
[200] *Id.*, p. 8, l. 1.
[201] *Id.*, p. 8, l. 3.

Table 4: 2018 EIA utility bundled retail sales of "comparable" Missouri utilities [202]

Utility	Ownership	Customers	Sales (MW)	Revenues	Average Price
Barton County	Coop	6,564	159,345	17,763,000	11.15
Sac Osage	Coop	11,121	151,722	19,353,200	12.6
Ozark	Coop	33,324	535,3186	1,925,200	11.57
Barry	Coop	9,667	182,820	20,639,500	11.29
New-Mac	Coop	17,740	413,943	44,041,000	10.64
Southwest	Coop	41,317	611,562	65,113,000	10.65
Webster	Coop	18,520	384,763	31,904,000	8.29
White River Valley	Coop	44,231	787,048	97,635,000	12.41
Laclede	Coop	37,064	685,606	69,410,800	10.12
Se-MA-NO	Coop	6,106	112,216	9,955,800	8.87
Springfield	Muni	115,823	3,142,918	272,379,900	8.67
Empire	IOU	154,042	4,321,595	522,849,900	12.10
Evergy West	IOU	326,627	8,385,396	805,203,200	9.60
Evergy Metro	IOU	289,299	8,675,389	966,953,500	11.15
Ameren Missouri	IOU	1,223,595	33,699,583	3,161,693,900	9.38

Table 5: S&P Global Market Intelligence 2018 four largest average annual electric residential bills for Investor Owned Utilities in the United States [203]

US Rank	Utility	Largest Average Residential Annual Bill
1	Maui Electric	$2,141
2	Hawaii Electric Light	$2,096
3	Nantucket Electric Co.	$2,077
4	**Empire District Electric**	**$1,936**

These cost figures are compounded by the fact that Empire is the only Missouri investor-owned utility whose shareholders do not contribute a cent to low-income bill assistance (all of these costs are borne by ratepayers) despite Empire's service territory operating in 13 out of 16 counties with larger poverty rates (below $24,600 for a family of four) than the Missouri average

[202] *Id.*, p. 18, ll. 9-11.
[203] Ex. 206C, Public Counsel witness Geoff Marke, direct testimony, pp. 19, 3.

(14.2%).[204] In fact, Empire has collected over $500 million in revenues each of the past three years and donated less than $500 thousand in charitable giving to support its community.[205]

Public Counsel urges the Commission to find this quality of service is unacceptable, and recommends that the Commission explicitly reduce the return on equity the Commission would otherwise allow Empire by 60 basis points in response. Public Counsel witness Geoff Marke provides two empirical studies which show the relationship between utility customer satisfaction and return on equity, and which support the Commission imposing a 60 basis point reduction from the return on equity it would be appropriate for the Commission to award Empire if Empire provided satisfactory customer service. He also summarizes Public Counsel's position:

> By every metric I have seen, Empire has scored poorly relative to the industry norms when it comes to customer satisfaction. The sheer number of estimated bills over such an extended time has only served to reinforce my position that Empire should be held accountable for its failure in quality of service. I strongly recommend that the Commission hold the Company accountable and make the explicit reduction in ROE tied to their overall failure in providing appropriate quality of service. Empire's customers pay in the upper quartile to receive bottom quartile service when benchmarked against other utilities. The Commission issuing a reduced ROE as a result of poor quality of service should produce better results.[206]

~~*b. Is Empire providing reliable service?*~~
~~*i. If not, what should the Commission do?*~~

~~**23. Estimated Bills**~~
~~**24. Material and Supplies**~~
~~**25. Asset Retirement Obligations**~~
~~**26. LED Replacement Tracker**~~
~~**27. May 2011 Tornado Unamortized AAO Balance**~~

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[204] *Id*., p. 20.
[205] Ex. 209, Public Counsel witness Geoff Marke, surrebuttal testimony, p. 6, ll. 4-8.
[206] Ex. 209, Public Counsel witness Geoff Marke, surrebuttal testimony, p. 7, ll. 4-12.

28. Depreciation and Amortization[207]

a. What is the appropriate level of depreciation and amortization expense of plant to include in the cost of service?

See Public Counsel's positions on Issue 13 (Asbury).

~~*b. Should depreciation expense for transportation equipment that was charged through a clearing account be removed from depreciation expense?*~~
~~*i. What are the authorized depreciation rates for accounts 371 & 373 to be used in the cost of service?*~~

~~**29. Iatan/Plum Point Carrying Costs**~~
~~**30. Incentive Compensation**~~
~~**31. Customer Demand Program (DSM)**~~
~~**32. Bad Debt Expense**~~

33. Retail Revenue[208]

a. What is the appropriate amount to remove from retail revenue for unbilled revenue, franchise tax revenue, and FAC revenue?
b. What is the level of billing determinants per rate schedule that should be used to calculate retail rate revenue in this case?
c. Should the billing adjustment and the retail revenues be trued up to January 31, 2020 in the cost of service?

See Public Counsel's positions on Issue 13 (Asbury) for all subparts.

~~**34. Other Revenue**~~
35. Tax Cut and Job Acts Revenue[209]
a. What is the appropriate amount of tax cut and job act revenue to remove from test year revenues?
b. Should revenues associated with the tax cut and job act stub period be removed from revenue?

~~**36. Property Insurance**~~
~~**37. Injuries and Damages**~~

[207] Public Counsel's witness on this issue is John Robinett, but only as to Asbury.
[208] Public Counsel's witnesses on this issue are Geoff Marke and John Robinett, but only as to Asbury impacts.
[209] Public Counsel's witness on this issue is John Riley.

38. Payroll and Overtime[210]

a. What is the appropriate test year amount of payroll expense?
b. What is the appropriate test year amount for overtime expense?

Both should be adjusted to disallow affiliate transactions.

~~**39. Retention Bonuses**~~
40. Employee Benefits[211]

a. What is the appropriate level of employee benefits to include in the cost of service?

It should be adjusted to disallow affiliate transactions.

41. Property Taxes[212]
a. What is the appropriate amount of property taxes to include in the cost of service?

See Public Counsel's positions on Issue 13 (Asbury)—property taxes for Asbury should not be included.

~~*b. What is the proper method to be used for calculating the property tax amount to be included in the cost of service?*~~

~~**42. Dues and Donations**~~

43. Outside Services[213]

a. What is the appropriate amount of outside services to include in the cost of service?

It should not include affiliate transactions.

44. Common Property Removed from Plant and Accumulated Depreciation[214]

a. What is the appropriate method and amount for removal of common property from plant in service and accumulated depreciation?

The impacts of Asbury should be excluded.

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[210] Public Counsel's witness on this issue is Robert Schallenberg.
[211] Public Counsel's witness on this issue is Robert Schallenberg.
[212] Public Counsel's witnesses on this issue are John Robinett and Robert Schallenberg.
[213] Public Counsel's witness on this issue is Robert Schallenberg.
[214] To the extent it involves Asbury, Public Counsel's witness on this issue is John Robinett.

~~**45. Retirement**~~

46. Case No. EM-2016-0213 Commission-ordered conditions[215]

a. *Has Empire complied with Condition A.4 the Commission imposed in Case No. EM-2016-0213?*

No. This condition states:

> A.4. Empire shall not seek an increase to the cost of capital as a result of this Transaction or Empire's ongoing affiliation with Algonquin Power & Utilities Corp. and its affiliates other than Empire after the Transaction. Any net increase in the cost of capital Empire seeks shall be supported by documentation that: (a) the increases are a result of factors not associated with the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates; (b) the increases are not a result of changes in business, market, economic or other conditions caused by the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates; and (c) the increases are not a result of changes in the risk profile of Empire caused by the Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates. The provisions of this section are intended to recognize the Commission's authority to consider, in appropriate proceedings, whether this Transaction or the post Transaction operations of Algonquin Power & Utilities Corp. or its non-Empire affiliates has resulted in capital cost increases for Empire. Nothing in this agreement shall restrict the Commission from disallowing such capital cost increases from recovery in Empire's rates.

Empire has not provided any testimony comparing Empire's cost of capital before APUC acquired it with its cost of capital after APUC acquired it. In fact, Public Counsel witness Murray testifies that Empire requested a rate of return in its last rate case, Case ER-2016-0023, based on a requested return on equity of 9.9% applied to a common equity ratio of 49.01%.[216] Now, under APUC's ownership, Empire is requesting a rate of return based on a return on equity of 9.95% applied to a common equity ratio of 53.07% (see p. 21 of Ex. 7 , Empire witness Sheri Richard's True-up Direct Testimony). Empire's higher requested return on equity applied to a higher equity

[215] Public Counsel's witness on this issue is David Murray.

[216] Ex. 210C, Public Counsel witness David Murray, direct testimony, p. 11, ll. 16-23.

ratio violates this condition A4. Empire has not provided any evidence to demonstrate why Empire needs to maintain a higher equity ratio than it maintained when it was a standalone entity. The primary consequence of a higher equity ratio under Empire's new circumstance of it being owned by APUC is that it generates a higher revenue requirement for its shareholders at the expense of its retail customers—ratepayers. Additionally, although Empire requests a more equity-rich capital structure upon which to set its rates, it assigns the cost to an affiliate promissory note to Empire from LUCo, based on LUCo's more leveraged capital structure. Although this mismatch is inappropriate, perhaps more inappropriate is the fact that this affiliate note was funded by lower-cost short-term debt LUCo incurred to fund it. [217]

i. If not, what relief should the Commission grant?

The Commission should adopt Public Counsel's recommended use of LUCo's adjusted capital structure and resulting rate of return positions and consider this item for choosing the low end of Public Counsel's reasonable ROE range, which is 8.5%.

b. Has Empire complied with Condition A.5 the Commission imposed in Case No. EM-2016-0213?

No. Condition A.5 states:

> A5. If Empire's per books capital structure is different from that of the entity or 5 entities in which Empire relies for its financing needs, Empire shall be required to provide evidence in subsequent rate cases as to why Empire's per book capital structure is the most economical for purposes of determining a fair and reasonable allowed rate of return for purposes of determining Empire's revenue requirement. If Empire's per books capital structure is different from that of the entity or 5 entities in which Empire relies for its financing needs, Empire shall be required to provide evidence in subsequent rate cases as to why Empire's per book capital

[217] Ex. 210C, Public Counsel witness Murray, direct testimony, p. 15, ll. 4-11.

structure is the most economical for purposes of determining a fair and reasonable allowed rate of return for purposes of determining Empire's revenue requirement.

In its direct case Empire did not show a comparison of Empire's capital structure to those of the entities on which it relies for its financing needs to first, determine whether they differed, and second, justify why Empire's capital structure is the most economical among them. Empire's rate-of-return witness Hevert claims he complied with this condition by comparing Empire's per books capital structure to those of his proxy group. [218] This does not comply with the condition. The condition requires a comparison of Empire's capital structure to that of the entity or entities on which it relies for its financing needs. The financing transactions between Empire and its immediate parent company, LUCo, establish and confirm that LUCo is the primary platform used to issue debt to third-party debt investors for Empire and LUCo's other subsidiaries. These third-party debt investors determine their required compensation, *i.e.*, coupon rate on debt, for buying LUCo's debt issuances by determining LUCo's entire debt responsibility, which includes the debt it unconditionally guarantees. [219] The only party in this case that thoroughly addressed this condition is Public Counsel, although it was not Public Counsel's obligation to do so. Even when Empire was given the chance to respond to Public Counsel's direct evidence in its rebuttal, Empire still did not do so. Empire clearly has failed to comply with this condition. Not only has Empire failed to comply with this condition, through Empire's discovery responses, Public Counsel found documents which confirm that APUC targets a ** __________ ** equity ratio for its regulated utilities, as compared to the **__________ ** equity ratio it targets for its non-regulated utility investments. [220] Empire's equity ratio does not match its lower business risk.

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[218] Ex. 36, Empire witness Robert Hevert, direct testimony, p. 12, ll. 2-11.
[219] Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, pp. 16-17.
[220] Ex. 210C, Public Counsel witness David Murray, direct testimony, pp. 12, l. 16 – 13, l. 6.

i. If not, what relief should the Commission grant?

The Commission should adopt Public Counsel's recommended use of LUCo's adjusted capital structure and resulting rate of return positions and consider this item for choosing the low end of Public Counsel's reasonable ROE range, which is 8.5%.

c. Has Empire complied with Condition A.6 the Commission imposed in Case No. EM-2016-0213?

No. Condition A. 6 states:

> A. 6. The Joint Applicants will not obtain Empire financing services from an affiliate, unless such services comply with Missouri's Affiliate Transaction Rules.

Empire has not demonstrated how its decision to provide funds to Empire through an affiliate promissory note issued by LUCo was more economical to Empire than if Empire had issued debt directly to third-party debt investors. In fact, the cost of the long-term debt LUCo provided to Empire was not based on the blended cost of debt LUCo issued in March 2017, which consisted of 6 differing maturities-3-year, 5-year, 7-year, 10-year, 20-year and 30-year (Ex. , Empire witness Cochrane Surrebuttal testimony, p. 13). Apparently Empire decided that using an implied spread from 10-year and 20-year promissory notes was sufficient for an affiliate transaction, even though this was not how these arms-length transactions were executed. Empire also transferred its short-term financing functions and facilities to LUCo, even though Empire does not have direct access to this liquidity and has more stringent terms than the terms of Empire's prior standalone credit facility.[221]

i. If not, what relief should the Commission grant?

The Commission should adopt Public Counsel's recommended use of LUCo's adjusted capital structure and resulting rate of return positions and consider this item for choosing the low end of Public Counsel's reasonable ROE range, which is 8.5%.

d. Has Empire complied with Condition G.3 the Commission imposed in Case No. EM-2016-0213?

[221] Ex. 211C, Public Counsel witness David Murray, rebuttal testimony, p. 38.

No. Condition G.3 states:

> G.3 Empire shall provide Staff and OPC access to and copies of, if requested by Staff or OPC, the complete Liberty Utilities Co, LU Central and Empire Board of Directors' meeting minutes, including all agendas and related information distributed in advance of the meeting, presentations and handouts, provided that privileged information shall continue to be subject to protection from disclosure and Empire shall continue to have the right to object to the provision of such information on relevancy grounds.

After requesting Algonquin Power & Utilities Corporation's and The Empire District Electric Company's Board of Director minutes and materials as they relate to The Empire District Electric Company's assets/operations (OPC DR 3003), Empire made minutes/materials related to Empire and Liberty Utilities (Central) available. However, available information did not include information related to Liberty Utilities Company, Liberty Utilities Finance Company GP1 and/or Algonquin Power & Utilities Corporation's financing decisions related to managing LUCo's capital structure and/or APUC's capital structure. Access to information as it relates to managing corporate level capital structures were specifically contemplated by Condition A.5. Additionally, when Public Counsel followed-up with data requests asking for copies of specific materials/documents cited in the documents Public Counsel reviewed in response to DR 3003, Empire did not provide them.[222] Empire asserts that it is not required to provide this information to Public Counsel because the condition contemplated its right to object "for lack of relevance."[223] It was APUC's decision to consolidate Empire's financing needs with the rest of its affiliates at the LUCo corporate level. If Empire still had its own financing functions, financings and external capital structure, then objections to providing such information on relevance grounds might be understandable, but this is not the case. APUC makes material and consequential financing

[222] Ex. 212C, Public Counsel witness David Murray, surrebuttal/true-up direct testimony, Sch. DM-S-1.
[223] Ex. 6, Empire witness Sheri Richard, surebuttal testimony, p. 9, ll. 1-6.

decisions for the management of its regulated investments held in subsidiaries of LUCo. The conditions the Commission imposed on Empire when it conditionally approved APUC's acquisition of Empire anticipated this potential obstruction to information, and were intentionally designed for the purpose of providing transparency into corporate level decisions that may impact Empire's access to financing and the management of its capital structure.

i. If not, what relief should the Commission grant?

The Commission should adopt the low end of Public Counsel's return-on-equity range for non-compliance—8.5%, and compel Empire to comply with this condition prospectively.

CONCLUSION

Because there is no evidence in this case that any of Empire's transactions with its affiliates were prudent—a showing that Empire had the burden to make—the Commission should not include $100 million of affiliate transactions costs in Empire's cost-of-service that it uses for setting rates in this case. Because Empire shut Asbury down for the final time on December 12, 2019, the Commission cannot include Empire's costs of running Asbury and investment in Asbury as if Asbury is still running for determining Empire's cost-of-service for setting rates in this case, an impact of $32.9 to $43.5 million. Public Counsel's evidence of rate of return more closely aligns with how analysts actually evaluate investing in equity and debt supported by Empire's utility operations and, therefore, the Commission should adopt Public Counsel's recommended rate of return of 6.77% based on a return-on-equity of 9.25%, a cost of long-term debt of 4.65%, and a capital structure of 46% common equity and 54% long-term debt.

For all the foregoing reasons, the Commission should determine all of the Public Counsel's issues in favor of Public Counsel, and design new rates for Empire to collect about $160 million less annually than Empire's current rates are designed to collect.

Respectfully,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 6th day of May 2020.

/s/ Nathan Williams