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Supporting Recovery of the Remaining
Investment in Asbury
Witness: Frank C. Graves
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Date Testimony Prepared: March 2022

**Before the Public Service Commission
of the State of Missouri**

Direct Testimony

of

Frank C. Graves

on behalf of

The Empire District Electric Company d/b/a Liberty

March 2022



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THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
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DIRECT TESTIMONY OF FRANK C. GRAVES
THE EMPIRE DISTRICT ELECTRIC COMPANY
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1 **I. INTRODUCTION AND SUMMARY**

2 **Q. Please state your name, position, and address.**

3 A. My name is Frank C. Graves. I am a Principal at the Brattle Group. My business address
4 is One Beacon Street, Suite 2600, Boston MA, 02108.

5 **Q. On whose behalf are you testifying in this proceeding?**

6 A. I am testifying on behalf of The Empire District Electric Company d/b/a Liberty
7 (“Liberty” or “Company”).

8 **Q. Please summarize your educational background and professional experience.**

9 A. For most of my professional career spanning over 30 years as a consultant, I have
10 worked in regulatory and financial economics, especially regarding long-range planning
11 for electric and gas utilities, and in litigation matters related to securities litigation and
12 risk management. My education includes an M.S. with a concentration in finance from
13 the M.I.T. Sloan School of Management in 1980, and a B.A. in Mathematics from
14 Indiana University in 1975.

15 In regard to utility resource planning and cost recovery risks, which are central
16 matters in this case, I have extensive experience in system planning with capacity
17 optimization and production costing models, load forecasting, fuel procurement and risk
18 management, and pollution control compliance. On a number of occasions, I have
19 examined the benefits and prudence of the decision to retire coal-fired power plants and
20 replace them with a portfolio of renewable, storage, and gas-fired peaking resources.
21 Recently, I have focused on evaluating pathways to deep decarbonization of our energy
22 sector as well as the benefits and impacts of distributed energy resources. In regard to

1 customer and financial impacts, I have developed or used many utility financial
2 projections for revenue requirements and rate projections, and I have evaluated financial
3 risk and cost of capital in a wide variety of settings for energy infrastructure and utility
4 investments. My background and qualifications are described in greater detail in the
5 attached Direct Schedule FCG-1.

6 **Q. Have you previously testified before the Missouri Public Service Commission**
7 **(“Commission”) or any other regulatory agency?**

8 A. I have given expert testimony on financial and regulatory issues before the Federal
9 Energy Regulatory Commission (“FERC”), many state regulatory commissions, and
10 state and federal courts. I also previously submitted testimony for Liberty in
11 Commission Case No. ER-2021-0312.

12 **Q. What is the purpose of your Direct Testimony in this proceeding?**

13 A. I have been asked by Liberty to opine on the appropriateness of recovering through
14 securitization the undepreciated investments and other energy transition costs related to
15 the Asbury 1 coal-fired unit (“Asbury”) from Liberty’s customers after the retirement
16 of the unit in March 2020. More specifically, I will:

- 17 • Evaluate the prudence of past major capital investment decisions at Asbury in
18 years 2008-2014 that contribute substantially to its undepreciated costs. These occurred
19 largely to comply with federal air quality protection requirements, based on then-
20 projected cost savings relative to retirement and replacement with new resources;
- 21 • Assess the prudence of the recent decision to retire the unit by reviewing the
22 reasonableness of the modeling approach and results in the Company’s 2019 Integrated
23 Resource Plan (“IRP”); and

1 • Summarize the regulatory and economic principles underlying the treatment for
2 recovery of sunk costs on retiring plants and describe why securitization as Liberty's
3 proposed undepreciated cost recovery mechanism for Asbury is reasonable and
4 appropriate in light of customer benefits, incentives and regulatory policy consistency.

5 **Q. What are your main conclusions?**

6 A. Based on my expertise, experience, and my review of Liberty's filings and past analyses,
7 I reached the following conclusions:

8 • The Company's past major capital investments at Asbury were prudently chosen
9 to save expected costs for customers and to comply with environmental regulations.

10 • The retirement of Asbury was reasonable in light of changes in the recent
11 industry outlook of key market fundamentals and resulting benefits for Liberty's
12 customers. In fact, the decision to retire Asbury will reduce customers' costs in nearly
13 every individual year of the next two decades, so there is no intertemporal distributional
14 or risk issue of deferred benefits at play.

15 • The fact that Asbury became economically obsolete and Liberty's management
16 determined the need to retire the plants does not indicate that Liberty's investments in
17 the facility were imprudent. That is a normal possible outcome for long-lived assets
18 chosen under considerable, largely uncontrollable uncertainty, which can and should
19 occur from time to time, if resources are being selected efficiently in the first instance.

20 • Longstanding and well-justified ratemaking principles and standards in the
21 utility industry strongly dictate that prudent investments should be recoverable from
22 customers, even if their costs should at some point prove less economic than was
23 originally expected. The question of "balancing of interests" between customers and

1 investors does not apply here and to suggest any kind of disallowance would not be
2 equitable.

3 • Consideration of whether Asbury is currently “used and useful” does nothing to
4 inform a fair or productive treatment of the appropriate carrying costs incurred by the
5 Company related to Asbury because it is far too coarse an indicator of why and to what
6 extent possible problems in asset value have arisen, or what the advantages of the
7 replacement (if any is needed) may be. That is, the used and useful concept overlooks
8 many important and relevant considerations. Here there are many customer benefits to
9 the retirement of Asbury, and any non-recovery would result in an unwarranted windfall
10 to customers that would penalize and discourage prudent decision-making by the
11 Company and other similarly situation utilities.

12 • Liberty should be fully compensated for the investment it made in a valuable
13 asset that the Company expected to run for many more years – until recently when a
14 previously unforeseen and unavailable alternative to deliver better long-term value came
15 along. To do otherwise would penalize the Company, discouraging future capital
16 investments, and generally disincentivizing all jurisdictional utilities from being
17 proactive and doing the right thing on customers’ behalf in regard to asset replacements.
18 This is particularly important at this juncture in the energy sector’s transition,
19 characterized by a variety of newer technologies gaining acceptance and the improved
20 economics of renewable resources.

21 • The recoverable amounts should include the financial carrying costs at the
22 utility’s weighted average cost of capital on the Asbury plant, accruing from the date of
23 its retirement up to the date of securitization.

1 • Many state regulatory commissions have allowed recovery of prudently incurred
2 investment costs, including costs such as abandoned construction work in progress and
3 those associated with unusable inventory, when shifting market economics,
4 uncontrollable external changes, and/or new regulatory mandates have caused
5 premature obsolescence or retirement. Among the approved cost recovery mechanisms,
6 securitization has emerged in different jurisdictions as an attractive and sometimes
7 preferred low-cost tool that offers benefits to all stakeholders involved. The same holds
8 true here.

9 **Q. How is your testimony organized?**

10 A. I first describe the past capital expenditures at Asbury and the conditions that required
11 the selection and installation of the equipment that makes up the large majority of the
12 undepreciated investments remaining at the plant in Section II. I review the
13 reasonableness of the modeling approach used in the Company's 2019 IRP in Section
14 III and the basis for the expected cost savings from the retirement and replacement of
15 Asbury in Section IV. In Section V, I assess the decisions for the Company's capital
16 investments at Asbury prior to the retirement of the plant, which I find to be reasonable
17 and prudent. I then summarize the regulatory and economic principles underlying
18 appropriate regulatory treatment of plants like Asbury, and I describe some examples of
19 such approvals and cost recovery for retiring plants owned by utilities in other
20 jurisdictions in Section VI. All of this leads me to conclude that the proposed cost
21 recovery sought by Liberty for Asbury through securitization is reasonable and
22 appropriate, as explained in Section VII.

1 **II. PAST CAPITAL INVESTMENTS AT ASBURY**

2 **Q. Please summarize your understanding of the undepreciated investments whose**
3 **cost Liberty is proposing to recover.**

4 A. The Company made several significant capital expenditures to operate and maintain
5 Asbury over the past 20 years. Facilitating Asbury's continuing operations under
6 federally-mandated environmental regulations was a key driver of those investments,
7 which have not yet been fully amortized and recovered in rates. These include:

- 8 • \$33 million in 2008 for the installation of Selective Catalytic Reduction ("SCR")
9 for the removal of nitrous oxides; and
- 10 • \$141 million in 2014 (with an additional \$1.4 million during 2015-2017) for the
11 installation of the Air Quality Control System ("AQCS") that included a dry circulating
12 fluidized bed scrubber for sulfur dioxide removal, powder activated carbon injection
13 system for mercury removal, a pulse jet fabric filter baghouse for removal of particulate
14 matter from the flue gas, and the conversion from a forced draft boiler to a balanced
15 draft. This \$141 million expenditure includes \$21 million investment for a turbine
16 upgrade.¹

17 Each of these major investments were reviewed and approved by the
18 Commission.²

19 Additionally, the Company incurred a number of other expenditures related to
20 sustaining the plant and its capabilities, representing about one fourth of the current net
21 book value. Table 1 depicts the composition of the current net book value of Asbury of
22 capital expenditures. Together, the SCR and AQCS investments listed above account

¹ The AQCS project also included the retirement of Asbury 2.

² See Missouri Public Service Commission, Case No. EO-2005-0263 and Case No. ER-2014-0351.

1 for 73 percent, *i.e.*, the vast majority, of the current total undepreciated investment (*i.e.*,
2 net book value) of \$199 million at Asbury.

3 **TABLE 1: NET BOOK VALUE OF ASBURY**

	Book Cost	Estimated Accumulated Depreciation	Estimated Net Book Value
Asbury AQCS	\$142,304,321	\$19,843,667	\$122,460,654
Asbury SCR	\$32,762,867	\$9,430,342	\$23,332,525
Remainder	\$108,057,969	\$55,180,986	\$52,876,983
Total	\$283,125,157	\$84,454,995	\$198,670,162
AQCS & SCR Share	62%	35%	73%

4
5 *Sources and Notes:* The Empire District Electric Company. Asbury Asset Listing as of February 29,
6 2020. The \$142 million AQCS book cost includes the \$21 million investment for the turbine upgrade
7 completed as part of the project. Of the \$199 million in estimated net book value, \$15 million will
8 be generation plant retained for use as part of the various wind projects the Company has under
9 development

10 **Q. Please describe the environmental regulations that necessitated the installation of**
11 **SCR at Asbury.**

12 A. The U.S. Environmental Protection Agency (“EPA”) issued the final Clean Air
13 Interstate Rule (“CAIR”) in March 2005 to address interstate transport of fine particulate
14 matter and ozone (smog), which contributed to downwind states not being able to meet
15 National Ambient Air Quality Standards.³ CAIR required 28 states, including Missouri,
16 to reduce their emissions of sulfur dioxide (“SO₂”) and/or nitrogen oxides (“NO_x”).⁴
17 Missouri elected to participate in the EPA-administered cap-and-trade programs for SO₂
18 and NO_x emissions. The installation of SCR at Asbury helped the Company to comply
19 with this regulation, allowing the company to avoid the high cost of purchasing SO₂ and

³ Rule To Reduce Interstate Transport of Fine Particulate Matter and Ozone (Clean Air Interstate Rule); Revisions to Acid Rain Program; Revisions to the NO_x SIP Call; Final Rule, 70 Fed. Reg. 25161 (May 12, 2005), <https://www.federalregister.gov/documents/2005/05/12/05-5723/rule-to-reduce-interstate-transport-of-fine-particulate-matter-and-ozone-clean-air-interstate-rule>.

⁴ Missouri was one of the 23 states, along with the District of Columbia, required to reduce *both* SO₂ and NO_x emissions.

1 NO_x allowances through the EPA-administered cap and trade system. It is my
2 understanding that the Commission reviewed and approved this plan a few years prior
3 to its actual expenditures and installation.⁵

4 **Q. Why was the investment in AQCS necessary?**

5 A. The Company considered the installation of AQCS retrofits at Asbury in its 2010 IRP
6 to comply with emerging environmental regulations related to emissions of SO₂,
7 particulates, and mercury.⁶ In particular, it was known by 2010 that the EPA would
8 propose air toxics standards for coal-fired generation units in 2011 with an expected
9 compliance deadline around 2015.⁷ Coal plants not meeting the emission standards by
10 2015 would have to retire. The EPA in February 2012 issued the final Mercury and Air
11 Toxics Standards (“MATS”) limiting the amount of mercury, heavy metals, acid gas,
12 and organic hazardous air pollutants from power plants.⁸

13 The Company had studied its exposure to this regulation in its 2010 IRP. Black
14 & Veatch, an engineering firm, conducted the study, which resulted in the development
15 of technical specifications for the AQCS system. The completion of the AQCS project
16 in 2014 allowed the Asbury plant to comply with the MATS rule in time for compliance
17 by April 2015. Around the same time of the MATS release, the EPA also finalized the
18 Cross-State Air Pollution Rule (“CSAPR”), which replaced the CAIR.⁹ CSAPR

⁵ Missouri Public Service Commission, Case No. EO-2005-0263.

⁶ 2010 IRP, Volume III, page 11.

⁷ “History of the MATS Regulation,” U.S. Environmental Protection Agency, <https://www.epa.gov/mats/history-mats-regulation>; 2010 IRP, Volume III, page 12.

⁸ National Emission Standards for Hazardous Air Pollutants From Coal- and Oil-Fired Electric Utility Steam Generating Units and Standards of Performance for Fossil-Fuel-Fired Electric Utility, Industrial-Commercial-Institutional, and Small Industrial-Commercial-Institutional Steam Generating Units; Final Rule, 77 Fed. Reg. 9303 (February 16, 2012), <https://www.federalregister.gov/documents/2012/02/16/2012-806/national-emission-standards-for-hazardous-air-pollutants-from-coal-and-oil-fired-electric-utility>.

⁹ Revisions to Federal Implementation Plans To Reduce Interstate Transport of Fine Particulate Matter and Ozone; Final Rule and Proposed Rule, 77 Fed. Reg. 10341 (February 21, 2012), <https://www.federalregister.gov/documents/2012/02/21/2012-3704/revisions-to-federal-implementation-plans-to-reduce-interstate-transport-of-fine-particulate-matter>.

1 imposed rules to reduce ozone and fine particulate emissions by reducing SO₂ and NO_x
2 emissions. While legal disputes over CSAPR were still unfolding, the Company
3 expected to meet the CSAPR requirements with the installation of AQCS.

4 **III. REASONABLENESS OF THE 2019 IRP MODELING APPROACH AND**
5 **RESULTS**

6 **Q. Please summarize Liberty’s resource planning studies over the last five years**
7 **regarding the economics of the retirement of Asbury and the addition of renewable**
8 **generation.**

9 A. Liberty has conducted four studies since 2016 involving updated least-cost resource
10 plans for how best to serve its customers. In the first of these, its 2016 IRP, the outlook
11 for key market fundamentals (fuel and market price outlook, cost of new wind, *etc.*)
12 favored retaining of Asbury until 2035. But starting in the 2017 Generation Fleet
13 Savings Analysis (“GFSA”), various market changes including the evolution of the
14 Southwest Power Pool (“SPP”) market, reductions in forecasted natural gas prices, fairly
15 flat (almost no) load growth, substantial drops in the cost of new wind as well as more
16 creative investment vehicles, and improving (much higher) wind generation capacity
17 factors resulted in reduced economic support for retaining Asbury beyond 2019.
18 Specifically, Liberty’s 2017 GFSA results showed that retiring Asbury by the Spring of
19 2019 and adding 800 MW of new wind generation shortly after would result in \$325
20 million in 20-year present value revenue requirement (“PVRR”) savings under the base
21 case outlook for its customers compared to no new wind and retaining Asbury until its
22 notional book life through 2035.¹⁰ However, no immediate system plans were changed
23 at the time.

¹⁰ 2017 GFSA, p. 1.

1 Similarly, Liberty’s 2018 IRP Update again preferred Asbury retirement, with
2 an estimated \$169 million 20-year PVRR savings from retirement of Asbury in 2019 in
3 conjunction with the addition of 600 MW new wind in 2020, compared to no wind and
4 retaining Asbury until 2035.¹¹ In its July 2018 report and order¹² the issue of the
5 retirement of Asbury was deferred for future consideration, but the Commission found
6 that Liberty had “made reasonable decisions to acquire up to 600 MW of wind” and
7 authorized the Company to record the capital investment as utility plant in service.

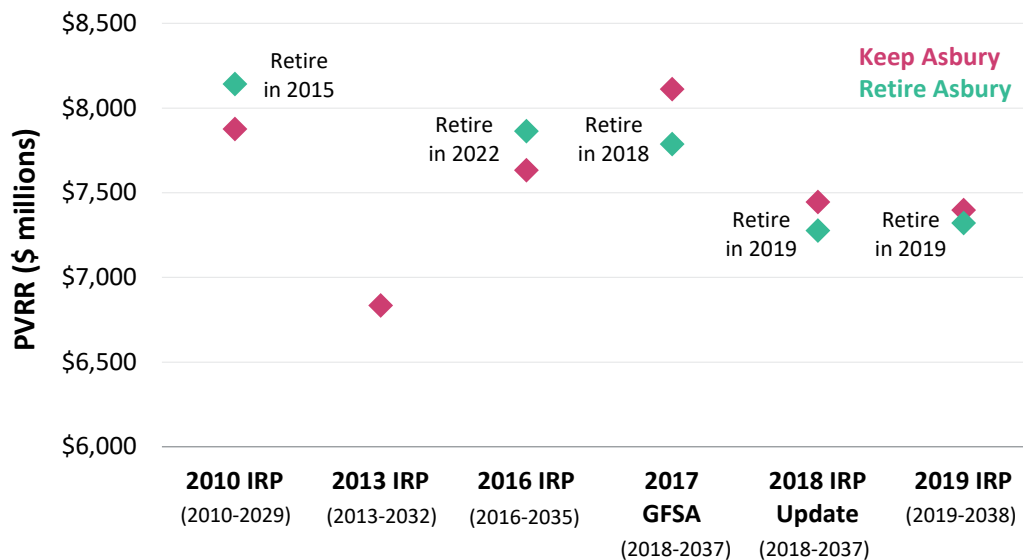
8 Finally, as I explain in further detail below, Liberty’s 2019 IRP confirmed the
9 recommended retirement findings from both the 2017 GFSA and 2018 IRP Update.
10 Figure 1 below presents a comparison of the ranges for projected 20-year PVRRs from
11 retaining Asbury through 2035 (or beyond) in each of those IRPs as well as additional
12 IRPs going back to 2010. The evolution of the comparative value of the plant to the
13 system over time, indicates retaining Asbury was preferred to retirement until 2016, but
14 starting in 2017 and thereafter¹³ the retirement of Asbury became and remained less
15 expensive. This transition is understandable in light of changes in market fundamentals
16 and new opportunities to invest in wind became more economic.

¹¹ 2018 Notice of Change in Preferred Plan, page 8.

¹² *In the Matter of the Application of The Empire District Electric Company for Approval of its Customer Savings Plan*, Report and Order, Docket No. File No. EO-2018-0092, July 11, 2018, pages 15 and 24.

¹³ Note that the PVRR values shown on the chart reflect the projected costs under the deterministic reference case outlook in each study. The projected PVRRs on an expected value basis (*i.e.*, probability-weighted average of PVRRs across sensitivity cases) were similar to the deterministic PVRR projections and showed a similar pattern over time to the deterministic values shown on the chart.

FIGURE 1: EVOLUTION OF THE PROJECTED 20-YEAR DETERMINISTIC PVRR FOR THE RETIREMENT OF ASBURY RELATIVE TO KEEPING THE PLANT ONLINE



Sources and Notes: 2010 IRP, Volume V, Table F-6; 2013 IRP, Volume 6, Appendix 6J; 2016 IRP, Volume 6, Appendix 6J; 2017 GFSA, Table 15; 2018 IRP Update, Figure 3; 2019 IRP, Volume 6, Appendix 6J.

Q. Please explain the evolving economic and market circumstances on the path to Liberty’s ultimate decision to retire Asbury.

A. The economic benefit of the Asbury plant to the system began to deteriorate around 2015, due to both plant-specific factors such as operating cost per megawatt hour (“MWh”), and market conditions altering its utilization and profitability (benefits to customers) at prevailing market prices in the SPP. As noted above, this declining attractiveness had been noted in the 2016 and 2018 resource evaluations. Thus, in its 2019 IRP, Liberty developed 16 alternative resource plans to be evaluated to determine if it should be retained vs. retired and possibly replaced. The features of these cases are summarized in Table 2 below.

Plan 4, in which Asbury was to be retired at the end of 2019 and replaced with a mix of solar and solar-plus-storage, was selected as the Company’s Preferred Plan, leading to the situation faced in this proceeding as to how to address the recovery of its

1 undepreciated past investment costs. Here, I will review some of the key market
2 conditions and associated modeling assumptions that went into that analysis and
3 describe how they are consistent with good industry practices for resource evaluation.
4 That is, I will explain why retirement of Asbury was a prudent decision that results in
5 an expected net benefit to customers even after accounting for the customers continuing
6 to be responsible for appropriate carrying charges on the retired plant.

TABLE 2: SUMMARY OF ALTERNATIVE RESOURCE PLANS

Plan	Plan Description	Renewable vs. Gas	Utility Scale vs. Distributed	Retirements	DSM Portfolio
0	Customer Savings Plan	Gas	Utility Scale	No Early Retirements	RAP
1	Asbury End of Life - Least Cost	Renewable	Utility Scale	No Early Retirements	RAP
2	Early Asbury Retire - Utility Scale Renewables	Renewable	Utility Scale	Asbury 2019	RAP
2B	Early Asbury Retire - Utility Scale Renewables - All 2023 Solar	Renewable	Utility Scale	Asbury 2019	RAP
2 - MAP	Early Asbury Retire - Utility Scale Renewables + MAP DSM	Renewable	Utility Scale	Asbury 2019	MAP
3	Early Asbury Retire - Utility Scale Thermal	Gas	Utility Scale	Asbury 2019	RAP
4	Early Asbury Retire - Distributed Renewable	Renewable	Distributed	Asbury 2019	RAP
5	Early Asbury Retire - Distributed Thermal	Gas	Distributed	Asbury 2019	RAP
6	Early Asbury Retire - Utility Scale Mix	Mix	Utility Scale	Asbury 2019	RAP
7	Early Asbury Retire - Distributed Mix	Mix	Distributed	Asbury 2019	RAP
8	Early Asbury, Peaker Retire - Utility Scale Renewables	Renewable	Utility Scale	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP
9	Early Asbury, Peaker Retire - Utility Scale Thermal	Gas	Utility Scale	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP
10	Early Asbury, Peaker Retire - Distributed Renewable	Renewable	Distributed	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP
11	Early Asbury, Peaker Retire - Distributed Thermal	Gas	Distributed	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP
12	Early Asbury, Peaker Retire - Utility Scale Mix	Mix	Utility Scale	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP
13	Early Asbury, Peaker Retire - Distributed Mix	Mix	Distributed	Asbury 2019; Energy Center Units 1&2 2021; Riverton Units 10&11 2025	RAP

8
9 *Sources and Notes:* 2019 IRP, Volume 1, Table 1-2. DSM – Demand-side Management; RAP – Realistic
10 Achievable Potential; MAP – Maximum Achievable Potential.

1 **Q. Please describe the modeling inputs and assumptions behind Liberty’s final**
2 **retirement analysis and how they compare to industry expectations at the time of**
3 **the 2019 IRP.**

4 **A.** As is appropriate for resource planning, Liberty used recognized sources for its input
5 assumptions and also considered the uncertainty surrounding several of the key factors
6 such as load growth rates, fuel prices, carbon prices, and capital costs in order to assess
7 the expected benefits and associated risks of each of the alternative resource plans. I
8 discuss each of these briefly below.

9 ***Load Forecast and Resulting Timing of Need for New Capacity***

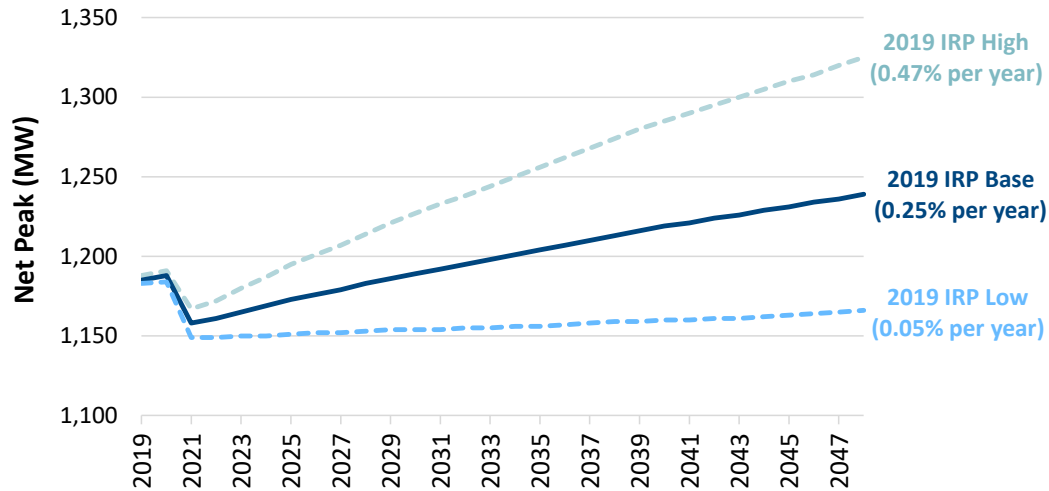
10 During the period 2015 – 2019, load growth for the Company had been declining at an
11 average rate of 0.8% per year.¹⁴ In this context, the 2019 IRP projected modest future
12 peak growth of 0.25% per year in its base case scenario after the loss of a few
13 municipalities in 2019,¹⁵ as shown in solid dark blue in Figure 2 below.
14 Contemporaneously, the North American Electric Reliability Corporation (“NERC”)
15 was projecting slightly higher rates of peak demand growth for the broader market area,
16 SPP, in which Liberty operates the plant for the 2020–2029 period (0.6% per year),
17 while in this period the IRP’s projected demand is essentially flat.¹⁶ A higher load
18 forecast would likely have been more favorable to the need for keeping Asbury online,
19 and this condition was also evaluated for the high load growth scenario shown in aqua
20 below (top line).

¹⁴ 2019 IRP, Volume 3, Table 3-45; 2020 IRP Annual Update, page 11. Empire also had 111 MW of capacity purchases, implying a total system capacity of 1,613 MW. *See* 2019 IRP Volume 3, Table 6-15.

¹⁵ Compounded annual growth rate from 2021 to 2048. *See* 2019 IRP, Volume 3, Table 3-67.

¹⁶ North American Electric Reliability Corporation, “2019 Long-Term Reliability Assessment,” December 2019, page 40, https://www.nerc.com/pa/RAPA/ra/Reliability%20Assessments%20DL/NERC_LTRA_2019.pdf.

**FIGURE 2: COMPARISON OF WINTER PEAK ASSUMPTIONS
IN THE 2019 IRP**



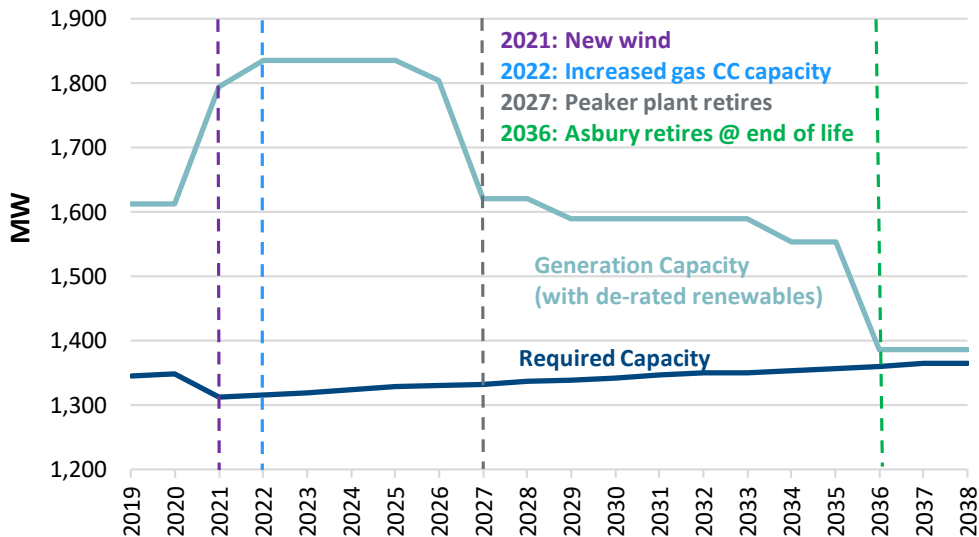
Sources and Notes: 2019 IRP, Volume 3, Table 3-67.

In 2019, Liberty had a total net winter capacity of 1,502 MW including Asbury, relative to a peak load of 1,111 MW,¹⁷ a reserve margin of 391MW or about 35% -- more than is typically needed (but which can occur if load growth drops dramatically). This capacity situation combined with the modest growth forecast described above resulted in Liberty being “long” in capacity during the projected 20-year planning window, with or without Asbury or any replacements for it. That is, it was expecting to have reserve margins until 2038 that would remain above the 13.6% reliability requirement, as shown in Figure 3 (with Asbury) and Figure 4 (without) below.¹⁸ This indicates that at least in regard to resource adequacy, there was no further need for the coal plant, even if load growth proved higher than in the reference case.

¹⁷ 2019 IRP, Volume 6, Table 6-15; 2020 IRP Annual Update, page 11.

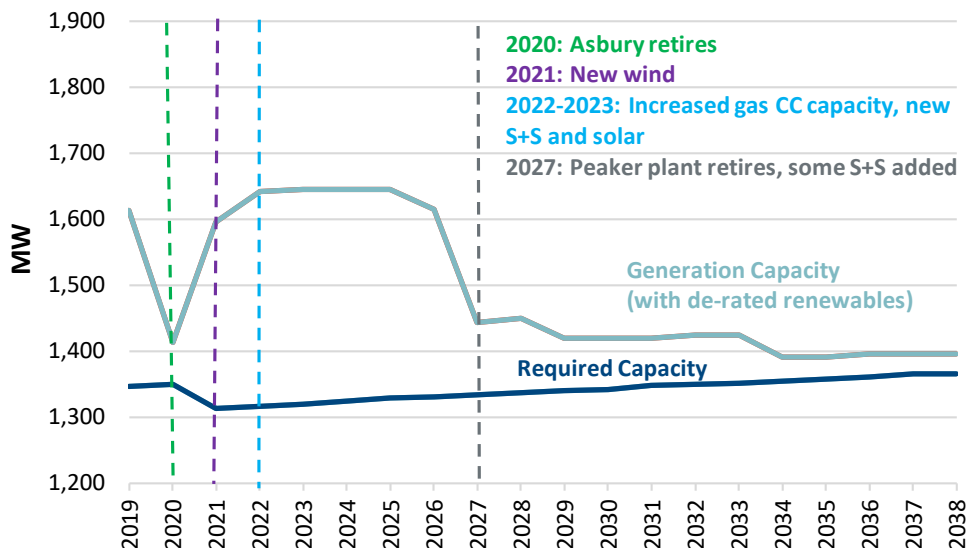
¹⁸ Capacity shortfalls are not the only reason for adding or retaining vs. retiring capacity. New capacity may also be important for energy cost savings or environmental benefits (or both) as here for the new wind units Empire is adding. (Also, wind units are not comparable in capacity performance to a fossil unit.)

FIGURE 3: 2019 IRP PLAN 1 WINTER CAPACITY BALANCE
(With Asbury Until 2036)



Sources and Notes: 2019 IRP, Volume 6, Table 6-15. Required capacity = (peak load with demand-side management) × (1 + 13.6% reserve margin). Capacity credits for wind, solar, and solar-plus-storage are 30%, 5%, and 24%, respectively.

1 **FIGURE 4: 2019 IRP PREFERRED PLAN WINTER CAPACITY BALANCE**
2 **(With Asbury Retiring in 2020)**

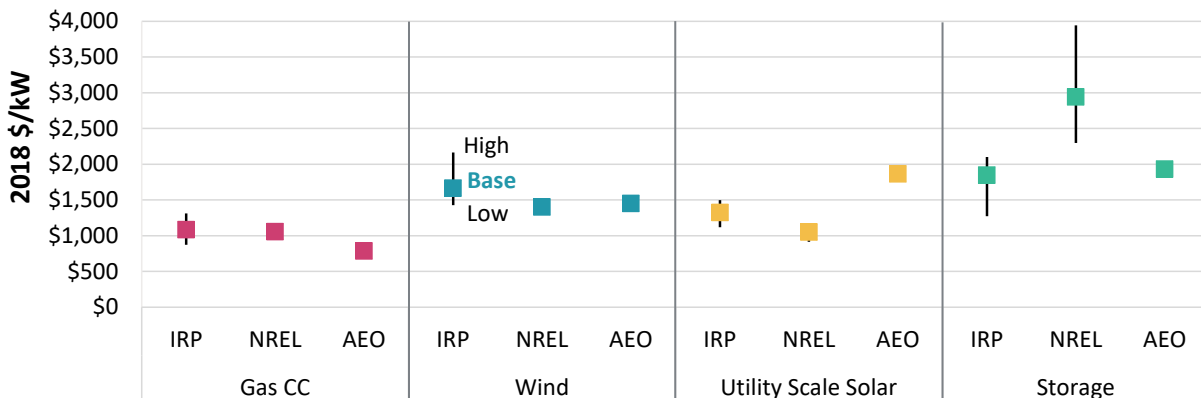


3 *Sources and Notes:* 2019 IRP, Volume 6, Table 6-25. Required capacity = (peak
4 load with demand-side management) × (1 + 13.6% reserve margin). Capacity credits
5 for wind, solar, and solar-plus-storage are 30%, 5%, and 24%, respectively.
6

7 **Capital Costs**

8 Several types of possible new generation capacity to replace Asbury (if attractive for
9 energy benefits) were considered in the 2019 IRP. The capital cost assumptions Liberty
10 used to evaluate these were largely consistent with industry estimates (or a bit higher
11 for gas combined cycle (“CC”) and wind) based on comparisons to then available
12 projections from the National Renewable Energy Laboratory (“NREL”) and the U.S.
13 Department of Energy (“DoE”) Energy Information Administration’s (“EIA”) Annual
14 Energy Outlook (“AEO”). Liberty’s IRP finds that the lowest cost resources to replace
15 Asbury’s power are new solar and storage, whose cost estimates were reasonable. Figure
16 5 below shows these costs for the different types of generation capacity. These costs
17 alone do not establish whether Asbury was attractive or not, but given that wind and
18 solar have no fuel costs, their low capital costs directionally supported retirement.

**FIGURE 5: COMPARISON OF CAPITAL COST ASSUMPTIONS
IN THE 2019 IRP**



Sources and Notes: 2019 IRP installed capital costs, AEO 2019 regional overnight capital costs, and NREL 2018 overnight capital costs (adjusted based on AEO regional multipliers). NREL storage costs reflect installed capital costs.

Natural Gas Prices

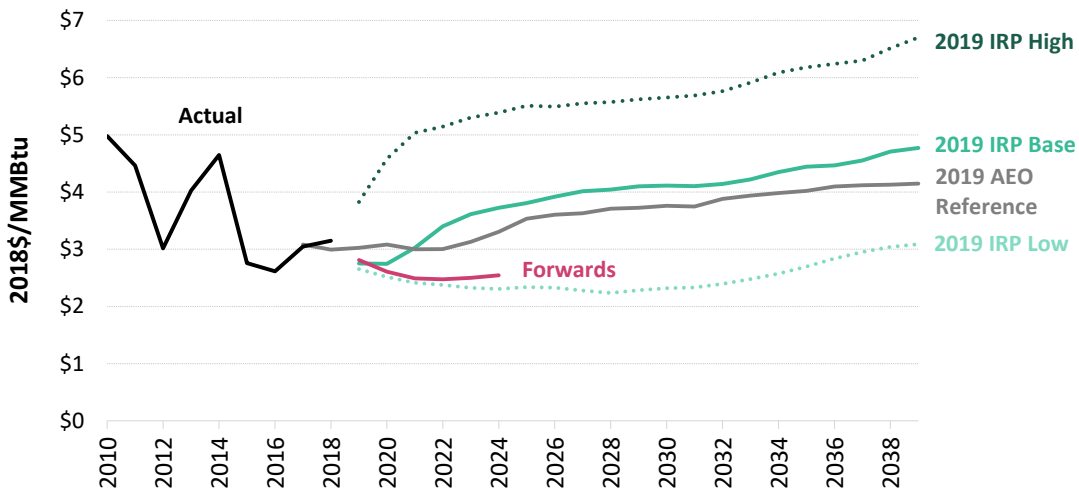
One of the most important assumptions of a resource plan is the expected trajectory and range of alternatives considered for the future price of natural gas. This is important because gas-fired generation is often “on the margin” (last dispatched to serve load) in power markets including SPP, hence often setting the market price of energy.¹⁹ There are several sources for these gas price outlooks, including commercial forecasting services, the publications of the U.S. DoE’s EIA, and forward prices for gas trading at large hubs adjusted for basis differential costs to the generation sites.

Here, Liberty used gas price forecasts based on the ABB Power Market Advisory database. This is a respected source, but given the differences in opinion among

¹⁹ Power plants are scheduled and “dispatched” to collectively always provide the right amount of power needed across a large area (power system) at any instant in time. This is done using sophisticated system simulation tools to identify which plants would be the least costly to use in any minute to satisfy total load taking into account which ones can be so utilized without overloading any of the transmission wires that deliver the power to customers. The result of this process is generally to use the cheapest plants first (often hydro or renewables like wind and solar, which have no fuel cost at all), then nuclear, and then whichever of coal or efficient gas plants are next cheapest (which can change over time as fuel prices move), and finally inefficient older plants or plants burning much more expensive fuels like oil. In a market region like SPP, the marginal costs of the last plant utilized in any hour sets the market price for power paid to all the units then operating, subject to some additional adjustments for satisfying transmission constraints (if any).

1 forecasters, it is useful to compare it to other viewpoints. Figure 6 shows that the base
 2 Henry Hub gas price forecast in the 2019 IRP (in solid green) is largely consistent with
 3 (just a bit above) the 2019 AEO reference case projections (in grey) but squarely in the
 4 range that EIA considered in that AEO report. Average annual forward prices for power
 5 hedging as of January to March 2019 provide another reference point. Also on Figure 6
 6 (shown in pink); these were lower than the 2019 IRP base forecast (and in fact more
 7 consistent with the low gas price forecast in the 2019 IRP), suggesting conservatism in
 8 this analysis, because lower gas prices would tend to reduce how frequently Asbury
 9 would be attractive and profitable relative to market prices. That is, if Asbury was
 10 already unattractive at the IRP’s price forecast, it would have been more so against the
 11 prevailing gas forward prices.

12 **FIGURE 6: COMPARISON OF HENRY HUB GAS PRICE OUTLOOKS**
 13 **IN THE 2019 IRP**



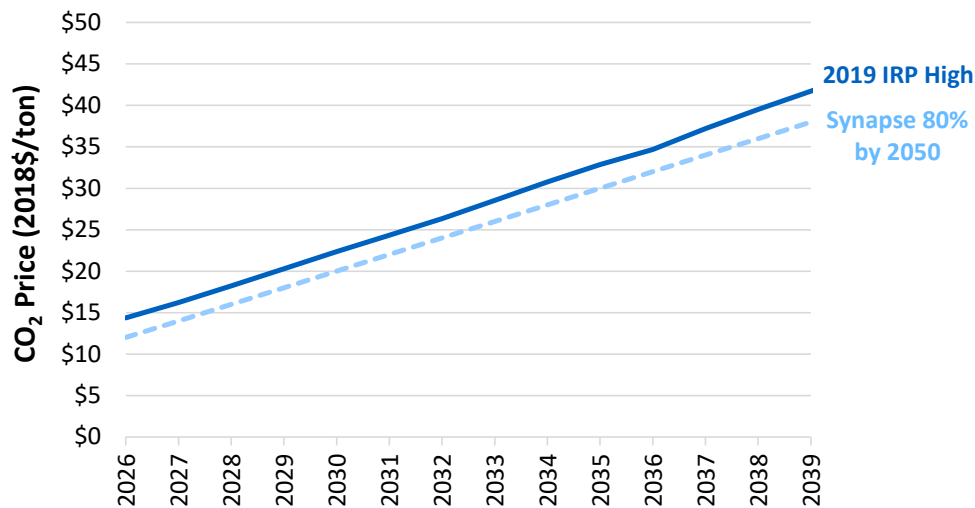
14
 15 Sources: 2019 IRP, Volume 4, Table 4-18; AEO 2019; S&P Global Market Intelligence. Average
 16 annual forwards as of January to March 2019.

17 ***Carbon Prices***

18 Carbon dioxide (“CO₂”) emissions are not formally priced or penalized in SPP or in
 19 Missouri, but nearly every utility in the U.S. has, for the past 10-20 years, included a

1 penalty surcharge in their resource planning studies to reflect an estimate of the social
 2 costs of global warming and/or the price at which the utilities expect such emissions
 3 which may eventually be penalized in state or federal policies. Liberty included two
 4 carbon scenarios, each weighted with a 50% probability: a base scenario with no carbon
 5 price and a scenario that assumes CO₂ prices would be in place in the mid-2020s, at
 6 levels consistent with common industry benchmarks for U.S. utility resource planning.
 7 Specifically, the 2019 IRP’s carbon price forecast (shown in solid blue in Figure 7
 8 below) is based on a Synapse analysis of the carbon price needed to reach the 80% by
 9 2050 CO₂ reduction target consistent with the Paris Accord (shown in dashed light
 10 blue).²⁰ Synapse provides a widely used and comprehensive survey of utility practices
 11 in carbon price modeling.

12 **FIGURE 7: COMPARISON OF CARBON PRICES IN THE 2019 IRP**



13
 14 Sources: 2019 IRP, Volume 4, Figure 4-17; 2019 IRP, Volume 6, pages 6-42 to 6-43;
 15 Nina Peluso, “The Price of Emissions Reduction: Carbon Price Pathways through
 16 2050,” Synapse Energy Economics, November 15, 2018, Figure 2, \$60 by 2050 case,
 17 [https://www.synapse-energy.com/about-us/blog/price-emissions-reduction-carbon-](https://www.synapse-energy.com/about-us/blog/price-emissions-reduction-carbon-price-pathways-through-2050)
 18 [price-pathways-through-2050](https://www.synapse-energy.com/about-us/blog/price-emissions-reduction-carbon-price-pathways-through-2050).

²⁰ 2019 IRP, Volume 4, page 4-82; Nina Peluso, “The Price of Emissions Reduction: Carbon Price Pathways through 2050,” Synapse Energy Economics, November 15, 2018, Figure 2, \$60 by 2050 case, <https://www.synapse-energy.com/about-us/blog/price-emissions-reduction-carbon-price-pathways-through-2050>.

1 **Q. Please describe the modeling techniques and tools used by Liberty in its 2019 IRP.**

2 A. Liberty used three levels of modeling tools in its 2019 IRP. First, for its market-area
3 simulation, the company relied on ABB's integrated energy market models to develop
4 natural gas, coal, and power prices for its regional power market, SPP. Second, these
5 results became inputs, along with additional assumptions for load, emissions prices, and
6 new resource capital costs and the details of each alternative resource plan, to the Aurora
7 planning model, which was used to perform portfolio optimization. Aurora finds the
8 least-cost supply expansion plan by minimizing the utility's system PVRR across a
9 selection of available resource options. Each portfolio is evaluated in an hourly,
10 chronological dispatch analysis of the existing and future available resources for use in
11 the SPP market by Aurora, to find the least-cost mix under the assumed scenario
12 conditions. Third, the output of this step was then used in a proprietary financial module
13 developed by Liberty's consultant, Charles River Associates, to perform utility
14 accounting and to express the plant and system costs on the basis of annual revenue
15 requirement calculations.²¹

16 This process was repeated for the base case and stochastic (probabilistic
17 scenario) combinations of the various high/low future conditions for each major input
18 assumption described above. The ultimate preference for a resource plan is based on
19 what plan has the lowest base case PVRR and the greatest robustness for that ranking
20 across risk conditions.

21 **Q. Do you consider Liberty's modeling approach and assumptions used in the 2019**
22 **IRP to be reasonable?**

²¹ 2019 IRP, Volume 6, pp. 6-129 to 6-133.

1 A. Yes. Liberty’s multi-stage modeling and optimization approach to assess the economics
2 of the retirement of Asbury was comprehensive. Aurora is a reputable simulation
3 software widely used by others in the industry for resource planning and market
4 forecasts, and all major assumptions and sensitivities were reasonable and largely
5 consistent with industry expectations at the time of the 2019 IRP.

6 **IV. EXPECTED COST SAVINGS FROM RETIREMENT AND REPLACEMENT**
7 **OF ASBURY**

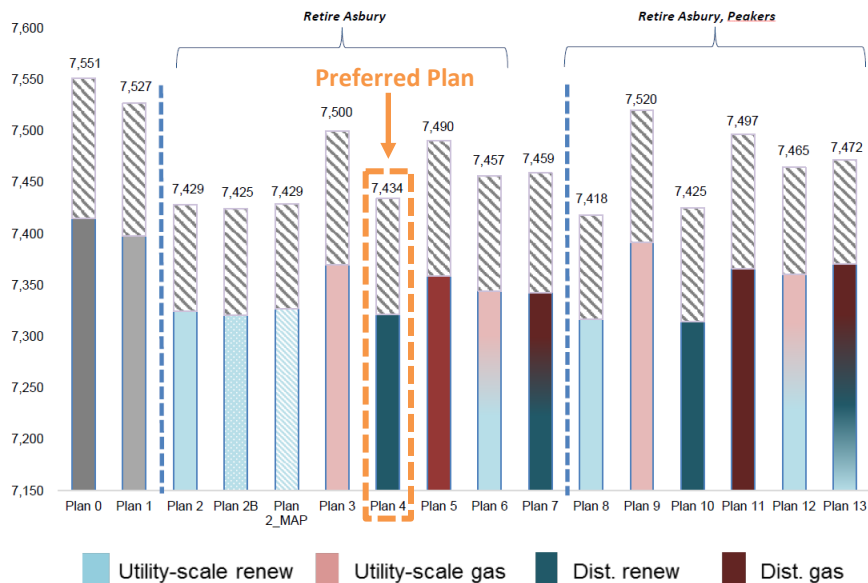
8 **Q. Please explain the cost savings and robustness analysis results that Liberty found**
9 **in that 2019 IRP.**

10 A. Liberty measured the cost savings by comparing the net present value (“NPV”) of long-
11 run costs required to serve retail customer loads over a 20-year planning period across
12 each of the 16 alternative plans summarized in Table 2 above. The Company considered
13 risks associated with the uncertainty around load growth, fuel prices, carbon prices, and
14 capital costs to evaluate their impact on each of the alternative resource plans.²² This
15 analysis determined that retiring Asbury in 2019 and replacing it with a mix of solar and
16 storage would result in PVRR savings relative to operating the plant until 2035, finding
17 \$93 million of benefit from retirement on a 20-year *expected value basis* (i.e.,
18 probability-weighted average across the sensitivity cases) as shown in Figure 8.²³

²² 2019 IRP, Volume 1, p. 1-33.

²³ 2019 IRP, Volume 7, pp. 7-10 to 7-12. Asbury is replaced with solar/solar-plus-storage upon retirement at end of life in 2035 in Plan 1.

**FIGURE 8: PVRR WITH RISK VALUE FOR ALL PLANS IN 2019 IRP
(2019–2038)**



Source: 2019 IRP, Volume 7, Figure 7-3.

Q. What are the key components of the PVRR savings when comparing the Preferred Plan to keeping the plant through 2035 in Plan 1?

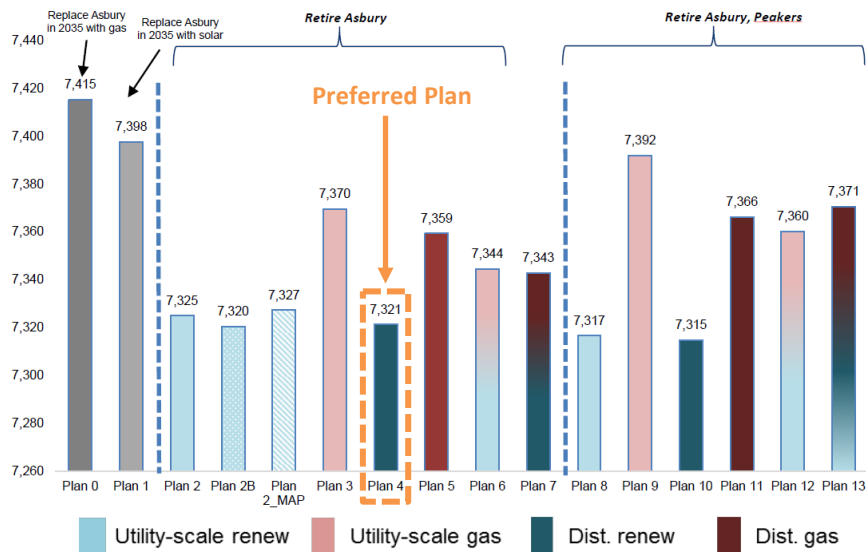
A. In order to understand the drivers of the PVRR savings, it is necessary to look at a specific scenario that Liberty modeled with its component assumptions for load growth, fuel prices, carbon prices, and capital costs. This analysis determined that retiring Asbury in 2019 and replacing it with a mix of solar/solar-plus-storage would reduce the PVRR by \$76 million (from \$7,398 million in Plan 1 to \$7,321 million in Plan 4, the Preferred Plan) on a 20-year *deterministic basis*²⁴ compared to operating the plant until 2035 under its original life, as occurs in Plan 1,²⁵ shown in Figure 9 below.

²⁴ The projected savings on a *deterministic basis* reflect PVRR reductions under a single, fixed set of base case assumptions for future market fundamentals (such as load growth and fuel prices). In contrast, the projected savings on an *expected value basis* reflect the probability-weighted average of PVRR savings over multiple scenarios/sensitivities spanning a wide range of possible realized values for those future market fundamentals.

²⁵ 2019 IRP, Volume 7, pages 7-10 to 7-12. In Plan 1, Asbury is replaced with solar-plus-storage upon retirement at the end of its life in 2035.

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FIGURE 9: DETERMINISTIC PVRR FOR ALL PLANS IN 2019 IRP (2019–2038)



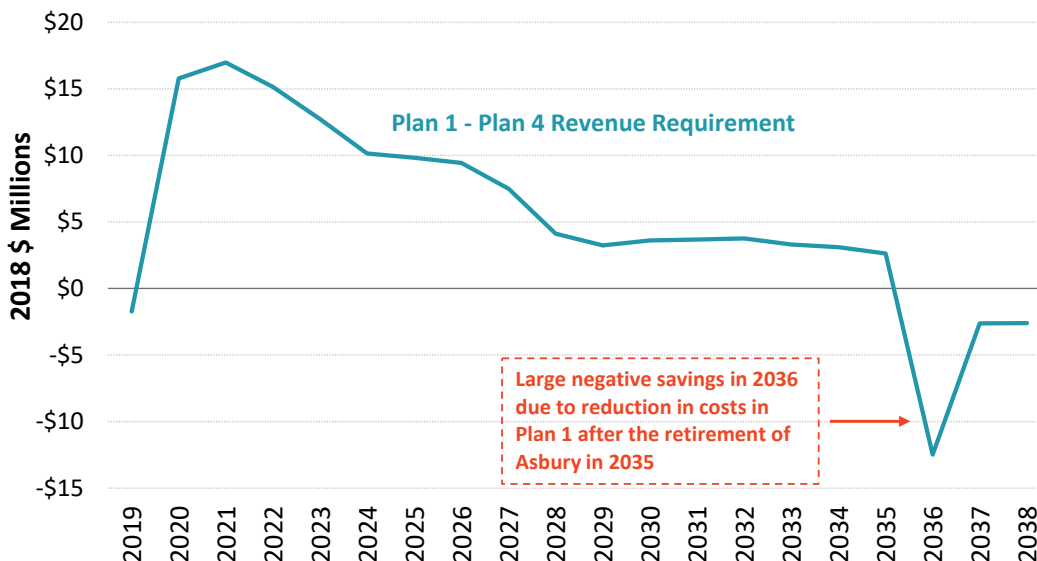
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Source: 2019 IRP, Volume 7, Figure 7-1.

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Notably, the PVRR cumulative savings from the Preferred Plan arise almost immediately in all years, and they occur with only a slow annual decline over all of the next 15 years after the retirement of Asbury. Thus this is not a highly deferred future benefit that might be considered speculative if dependent on many complex future conditions. The annual revenue requirement savings in the Preferred Plan relative to Plan 1 (which retains Asbury until 2035) are shown below in Figure 10.

1 **FIGURE 10: ANNUAL REVENUE REQUIREMENT SAVINGS FROM THE**
2 **RETIREMENT OF ASBURY**

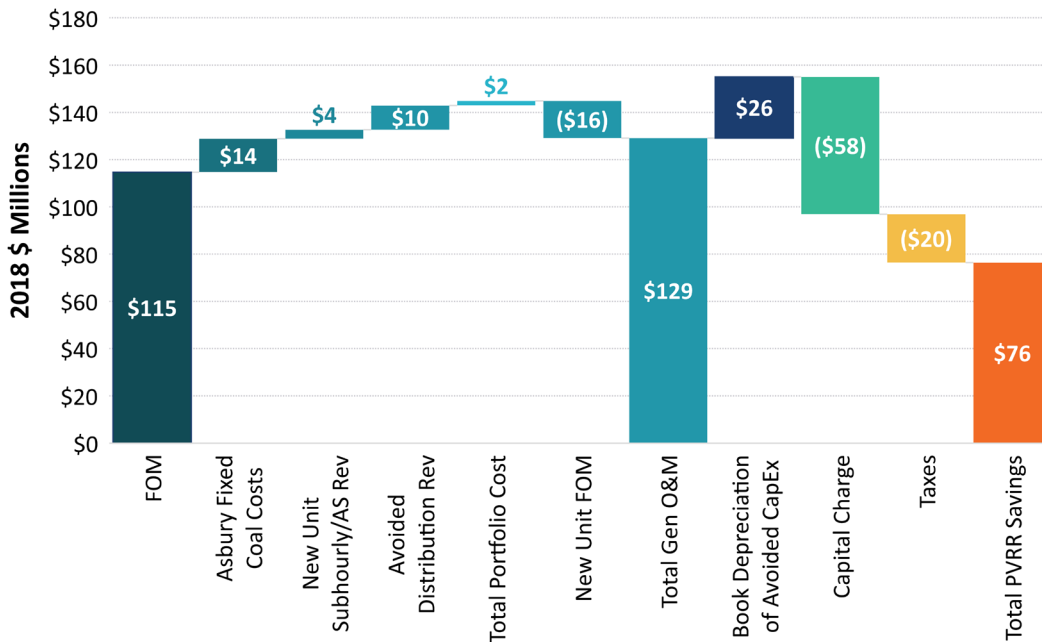


3
4 *Source: 2019 IRP, Data Response 0017.*

5 The drivers of the \$76 million deterministic PVRR savings in the base case are
6 decomposed in Figure 11 below. It shows that the largest sources are a \$129 million
7 reduction in total (system-wide) generation operations and maintenance (“O&M”) costs
8 and \$26 million reduction in book depreciation costs. The reduction in total generation
9 O&M costs are lower largely due to avoiding \$115 million of Asbury fixed operations
10 and maintenance (“FOM”) costs and Asbury fixed coal costs. The reduction in book
11 depreciation costs arises from \$46 million in savings from longer depreciation life of
12 undepreciated past investment costs at Asbury in the Preferred Plan, partly offset by \$20
13 million of increased depreciation costs associated with new resources in the Preferred
14 Plan. These savings are further reduced (though still substantial) by a \$58 million
15 increase in capital charge costs, which stem from return on and of new solar and storage
16 coming online after the retirement of Asbury. Figure 11 below illustrates these savings
17 and cost components.

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FIGURE 11: TOTAL SYSTEM PVRR SAVINGS FROM THE RETIREMENT OF ASBURY



3
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Source: 2019 IRP, Data Response 0017.

5 **Q. Did Liberty evaluate the projected performance of Asbury against future market**
6 **conditions if the plant had continued to operate?**

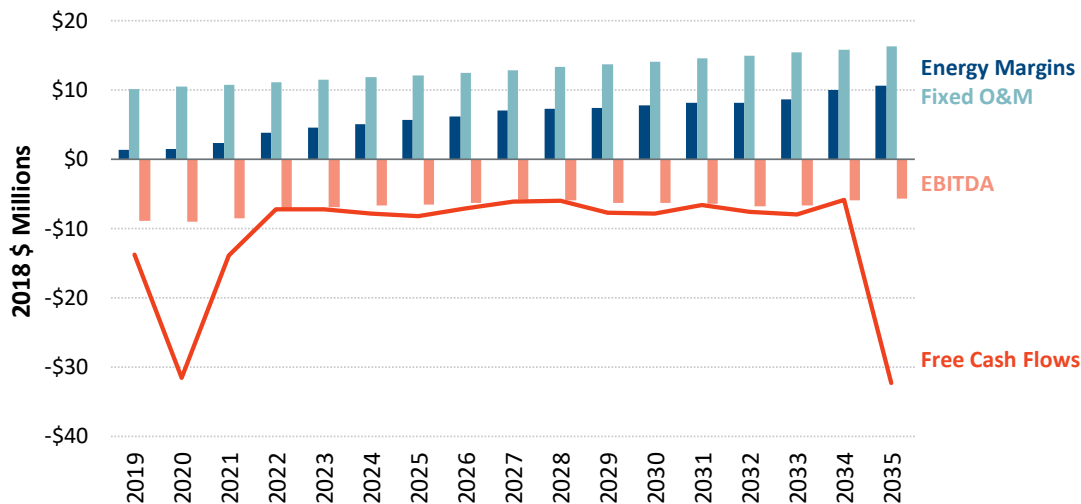
7 A. Yes. The 2019 IRP forecasted Asbury operations would result in continuing losses if it
8 were not retired, with negative \$113 million in net PV of cash flows through 2035
9 (assuming 6.71% discount rate).²⁶ The projected energy margins and free cash flows
10 (net market operating margins) for the unit over time are shown in Figure 12 below.²⁷
11 Projected energy margins for the plant are small in the near term (about \$2 million or
12 \$4/MWh) and increasing to about \$11 million (\$13/MWh) in 2035. But the fixed O&M
13 costs (about \$13 million per year on average) exceed these projected energy margins,
14 hence resulting in negative EBITDA values. The annual free cash flows include the

²⁶ Discount rate based on Empire’s after-tax weighted average cost of capital (“ATWACC”). See 2019 IRP, Volume 6, p. 6-18.

²⁷ The margins shown in this analysis does not attribute any capacity value to Asbury for this period, since Empire was projected to be long in capacity in Plan 1 until Asbury retires in 2036.

1 additional capital investments Asbury would have needed in the near-term to operate
2 past October 2020 – in the order of approximately \$20 million – for the construction of
3 a new landfill and to convert the existing bottom ash handling from a wet to dry system
4 in order to comply with the EPA’s rule on the disposal of coal combustion residuals.²⁸

5 **FIGURE 12: PROJECTED OPERATING MARGINS FOR ASBURY**



6
7 *Sources and Notes:* 2019 IRP, Data Responses 0017 and 0020. Earnings before Interest, Taxes,
8 Depreciation, and Amortization (“EBITDA”) = Energy Margins – Fixed Operations and
9 Maintenance (“O&M”). Free Cash Flows = Energy Margins – Fixed O&M – Ongoing Capital
10 Expenditures (“CapEx”). Ongoing CapEx does not include Black & Veatch additions in 2020 Fair
11 Market Valuation study.

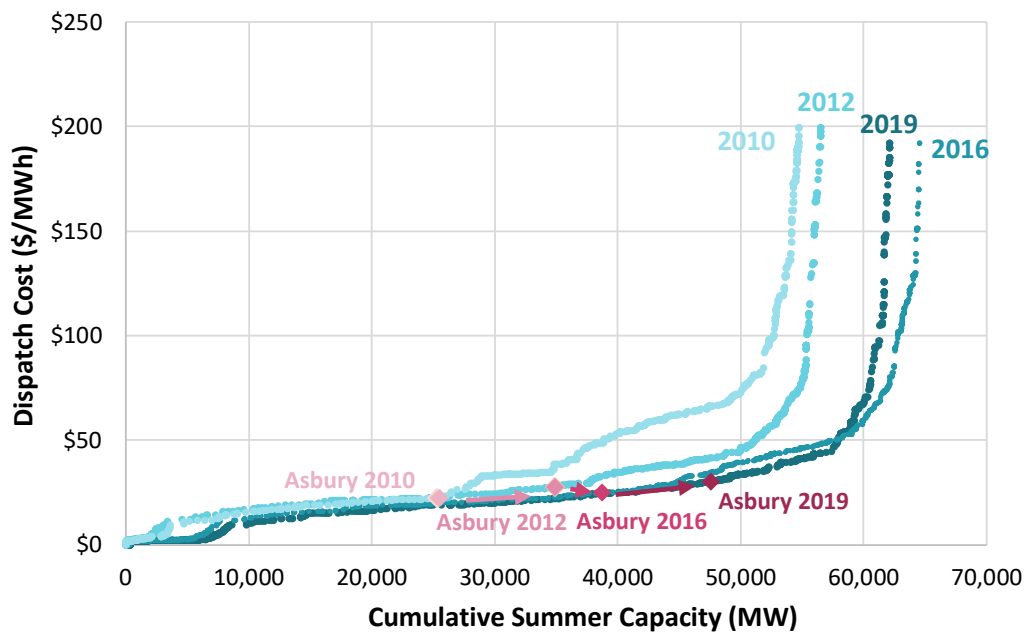
12 **Q. How did changing market conditions between 2010 and 2019 lead to Asbury’s**
13 **declining economic performance against the market and a reversal of the**
14 **previously expected need for the plant?**

15 **A.** There were many significant changes in market fundamentals that occurred in the last
16 decade affecting SPP and most of the electric industry. An overview of these
17 consequences is seen in Figure 13 below, which shows how Asbury’s position on the
18 SPP supply curve has gotten progressively worse in the past decade (moving farther out
19 the curve towards more expensive plants with relatively less usage), primarily due to

²⁸ 2019 IRP, Volume 1, p. 1-9; 2019 IRP Volume 6, p. 6-26.

1 decreasing gas prices and the declining cost and increasing penetration of renewable
2 generation.

3 **FIGURE 13: SPP SUMMER SUPPLY CURVES IN 2010, 2012, 2016, AND 2019**

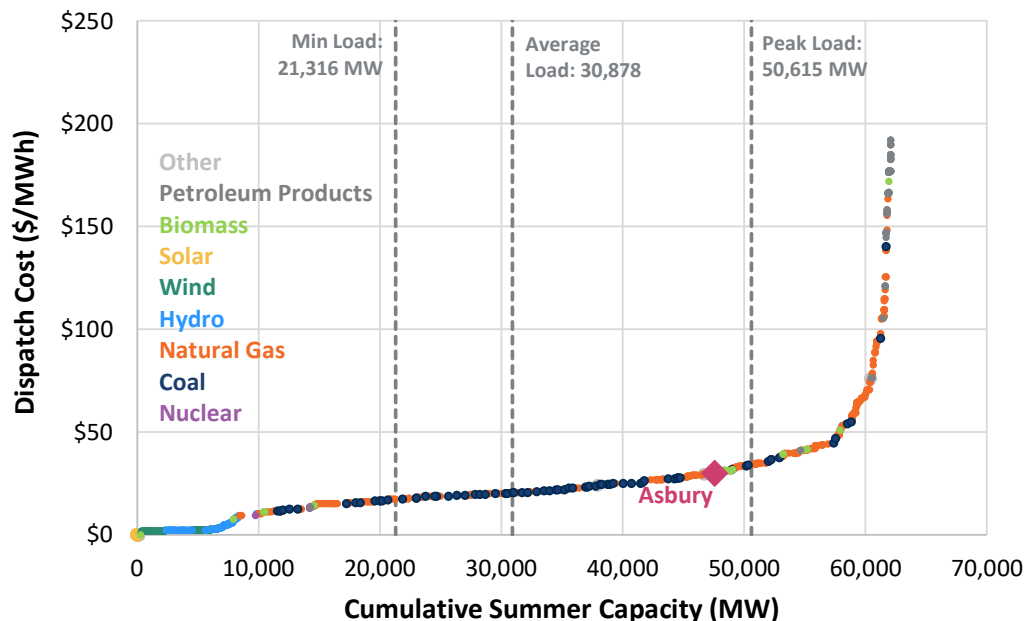


4
5 *Sources and Notes:* S&P Global Market Intelligence, data as of November 18, 2020. Units are
6 assigned the following capacity credits: 95% for nuclear; 90% for hydro, coal, gas, and oil, 80%
7 for solar, and 20% for wind.

8 A closer inspection of the 2019 supply curve by fuel type, in Figure 14 below,
9 shows that Asbury's marginal cost had become higher than the majority of coal units in
10 SPP (dark blue points in the supply curve) and is on the expensive end more generally
11 – *i.e.*, fairly close to the end of the dispatch ladder needed to serve peak load – making
12 the unit uneconomic to run in a large number of hours. (The curve is color coded by
13 type of fuel to reveal the merit order of dispatch.) This is not because of something going
14 wrong with the unit but because (as explained more fully below) of the mostly
15 unexpected sustained low gas prices (until very recently, following Storm Uri and
16 increasing unrest in central Europe) and higher penetration of renewable generation

1 driven by their continued substantial cost reductions. The latter is precisely what Liberty
2 is now taking advantage of on behalf of its customers.

3 **FIGURE 14: 2019 SPP SUMMER SUPPLY CURVE**



4
5 *Sources and Notes:* S&P Global Market Intelligence, data as of November 18, 2020. Units are
6 assigned the following capacity credits: 95% for nuclear; 90% for hydro, coal, gas, and oil,
7 80% for solar, and 20% for wind.

8 **Q. What were the major industry and SPP changes that caused this declining**
9 **usefulness of the Asbury plant?**

10 **A.** The economic viability of existing coal plants all around the U.S. began deteriorating in
11 the early part of the last decade largely as a result of decreasing wholesale power prices
12 and increasing costs for coal plants to comply with major federal environmental
13 regulations that imposed tightening emission standards and required coal plants to install
14 and operate emissions control equipment. While the environmental retrofits needed to
15 satisfy regulations such as the EPA's Mercury and Air Toxics Standards were expected
16 in the industry as early as 2010, the realized levels and ongoing future expectations of

1 low wholesale power prices were not foreseen at the beginning of the last decade and
2 indeed their persistence has been somewhat of a surprise for the past several years.

3 Lower wholesale power prices were driven by three major, roughly concurrent
4 developments that appeared in the beginning of the last decade: (i) the continued and
5 sustained decline in natural gas prices; (ii) a broad market and political/regulatory shift
6 towards more renewable generation;²⁹ and (iii) slowing growth in electric consumption.
7 The combination of these factors lowered the cost of generation from gas-fired and
8 renewable generation plants relative to coal plants, reduced the need for capacity and
9 energy generation from coal plants, and lowered the wholesale power prices or system
10 marginal costs for both energy and capacity in many regions.

11 As a result of these broad trends, approximately a third of the U.S. coal fleet that
12 was operating in 2012 has now retired, and another 55 GW (about a quarter of the
13 remaining coal generation) are slated to do so over the next 10 years.³⁰

14 **Q. Do you consider Liberty's analyses of cost savings and its resulting decision to**
15 **retire Asbury to be reasonable?**

16 **A.** Yes. Liberty's modeling techniques were comprehensive, and the Company's scenario-
17 based and stochastic evaluations of the potential cost savings under key uncertainties in
18 the future provided a robust analytical basis to stress-test the economic performance of
19 the retirement of Asbury for Liberty's customers. The conditions that led to Asbury
20 becoming uneconomical were not foreseen as likely to occur so rapidly or deeply by

²⁹ It is certainly the case that the capital and operating costs of renewable resources had been visibly falling for the decade before 2010, but in nearly all cases it was not competitive with conventional fossil fuels so had not yet had a big impact on power markets.

³⁰ Velocity Suite, ABB Inc., data as of February 18, 2021.

1 experts throughout the industry, and Liberty's analyses of the associated risks and
2 changes were timely and credible.

3 The new resources (mostly much smaller and deferred) that will eventually
4 replace Asbury are more economical than Asbury would have been, and market trends
5 are likely to make that finding even stronger in the future, as renewable costs continue
6 to decline and recent market conditions are probably softer than they were foreseen to
7 be in 2019. In addition, the public pressure to shift away from fossil fuels is certainly
8 going to persist and may well strengthen over the next several years, further depressing
9 the economic value (or regulatory acceptability) of coal plants.

10 **Q. You have described Liberty's modeling in its 2019 IRP indicating that the resource**
11 **plan with the retirement of Asbury would lower the future costs for its customers.**
12 **Did Liberty also take into account the continued recovery of undepreciated past**
13 **investment costs at Asbury under that resource plan?**

14 **A.** Yes. Liberty concluded that retiring Asbury would save so much costs in the future that
15 customers would remain better off (lower rates) even with continued full cost recovery
16 of the past investments.

17 **V. PRUDENCE OF INVESTMENT DECISIONS PRECEDING RETIREMENT**

18 **Q. Please review the past investments that comprise the majority of the current**
19 **undepreciated investment balance at the Asbury plant.**

20 **A.** As of February 2020, the plant had net book value ("NBV") of unrecovered investment
21 of \$199 million. As I described in Section II above, the majority (73%) of this NBV is
22 from the 2014 AQCS retrofits (\$122 million) and the 2008 SCR retrofit (\$23 million).
23 In this section, I provide my assessment of the prudence of the decisions underlying
24 these two retrofits, which account for about three quarters of the total undepreciated past

1 investment balance for Asbury. As I explain below, these decisions were made under
2 economic conditions that were considerably different than today, and the type of
3 conditions that now prevail were at best considered an unlikely scenario a decade or so
4 ago when these retrofits were under consideration. I discuss them in order of size of
5 remaining NBV, beginning with the more expensive AQCS.

6 **A. AQCS Retrofits**

7 **Q. How did Liberty evaluate benefits to its customers from the AQCS retrofits at the**
8 **time of that investment decision?**

9 A. In its 2010 IRP analysis, the Company evaluated the potential cost savings from
10 installing the AQCS retrofits to continue operating Asbury compared to a retirement in
11 2015. At that time, the Asbury plant was expected to operate through 2035. The capital
12 cost of the AQCS project was estimated to be \$158 million, though that amount was not
13 certain at the time since the full engineering analysis of the project was not yet
14 completed.³¹

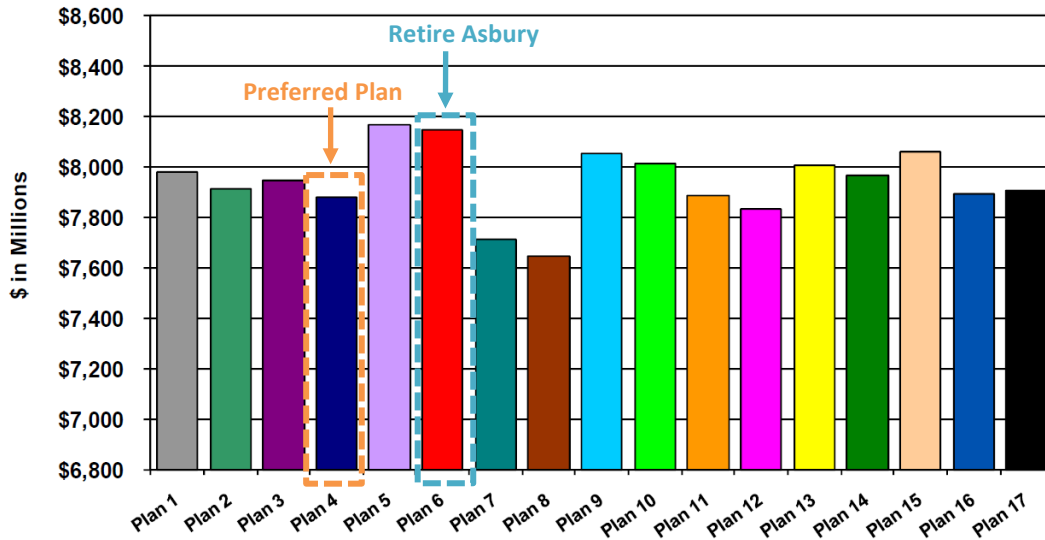
15 The 2010 analysis concluded that the AQCS option (Plan 4, or “the Preferred
16 Plan”) would save approximately \$267 million for customers in 20-year PVRR
17 compared to retiring Asbury in 2015 and replacing it with a new gas combined-cycle
18 generation plant (Plan 6).³² The comparison of the deterministic PVRRs across all plans
19 modeled is shown in Figure 15 below.

³¹ 2012 IRP Annual Update, pp. 10 – 11.

³² 2010 IRP, Volume V, Table F-6. Plans 1–6 represent resource plans under base assumptions. Plan 7 and Plan 8 are the same as Plan 1 and Plan 2, respectively, except for assuming lower future load due to removing Monett load. Plans 9-17 assume retaining Asbury under various sensitivities for CO₂ prices, fuel prices, and load growth. Thus, these plans are not lower in PVRR because they include a more economical resource mix but because they assume different future market conditions. *See also* 2010 IRP, Volume V, p. S-3.

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FIGURE 15: DETERMINISTIC PVRR FOR ALL PLANS IN 2010 IRP (2010–2029)



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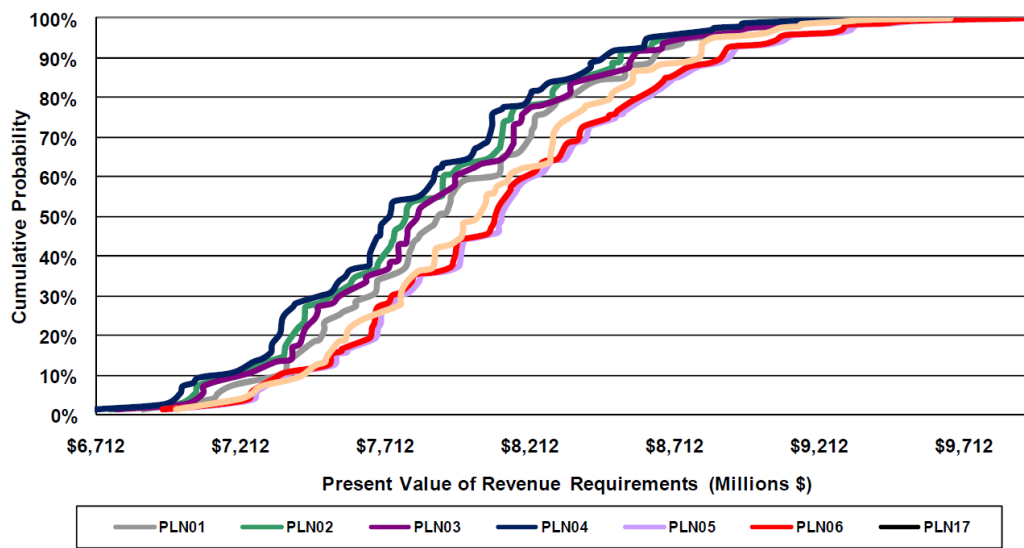
Source: 2010 IRP, Volume V, Figure 3-4.

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The Company also tested the robustness of this preference for Plan 4 across a broad range of alternative risk scenarios reflecting uncertainty in environmental costs, market and fuel prices, load, capital and transmission costs, and interest rates.³³ The resulting risk profiles for the PVRR costs of Plans 1 – 6 (*i.e.*, the resource plans modeled under base assumptions) are shown in Figure 16 below, with that of the Plan 4 (in dark blue) seen consistently to the left of all the other curves, including that of Plan 6 which retired and replaced Asbury (in red). In fact, Plan 6 consistently ranks as nearly the most expensive alternative under most conditions. This demonstrates that Plan 4 was reliably the lowest risk and the cheapest strategy, about \$200 – \$300 million less costly than Plan 6.

³³ 2010 IRP, Volume I, pp. ES-19 to ES-22; 2010 IRP, Volume V, pp. 27 – 32.

1 **FIGURE 16: RISK PROFILES OF ALL BASE SCENARIOS (2010–2029)**



2
3 *Source:* 2010 IRP, Volume V, Figure 3-5.

4 The Company also conducted a 40-year break-even analysis in which it tested
5 the sensitivity of its finding to the possible range of capital costs of the AQCS
6 equipment. This study concluded that the AQCS retrofits would be more economical
7 than the retirement option as long as the actual capital costs did not increase by more
8 than \$21 million beyond the initial estimate.³⁴

9 In addition, the Company evaluated the break-even capital cost of the AQCS
10 retrofits in 2011 as a result of newly decreasing expectations for future natural gas prices
11 and changes in the outlook for allowance prices of GHG and SO₂/NO_x emissions that
12 had occurred since its 2010 IRP analysis. The sensitivity results presented to the
13 Company’s Board of Directors in October 2011 concluded that the AQCS retrofits
14 would continue to result in cost savings relative to the retirement option as long as the
15 AQCS capital cost remain below \$137 million.³⁵ The AQCS project was completed in

³⁴ Ventyx, “Empire District Integrated Resource Plan,” 2010, p. 41.

³⁵ Strategic Projects Presentation to Empire Board of Directors, October 24, 2011, slide 12.

1 late 2014 at an actual cost of \$121 million, below the estimate in 2010 and below the
2 break-even thresholds estimated in late 2011.³⁶

3 **Q. What were the key drivers of the cost savings expected from sustaining the plant**
4 **with the AQCS rather than retiring Asbury?**

5 A. Savings from continuing to operate Asbury in future years (*i.e.*, the AQCS option)
6 relative to the retirement option depend largely on the relative magnitude of the
7 following: i) future operating margins of the plant relative to SPP energy prices; ii) cost
8 of replacing the capacity of Asbury with new resources at a future year when Liberty
9 would need new capacity to meet its resource adequacy requirements; and iii) future
10 capital expenditures on the plant that would be avoided by the retirement of Asbury.
11 The higher the future operating margins (greater profitability) for Asbury and the higher
12 the cost of replacing its capacity, the higher would be the savings from the AQCS option.
13 Conversely, the higher the future capital expenditures at the plant that could be avoided
14 by retirement, the lower the savings would be from the AQCS option.

15 As of the 2010 IRP (when the Company evaluated the potential customer cost
16 savings from the AQCS retrofits), the Company was projecting the Asbury operating
17 margins and the replacement capacity costs to be sufficiently enough to more than offset
18 the capital expenditures that were required, making the retrofits superior to early
19 retirement of Asbury.

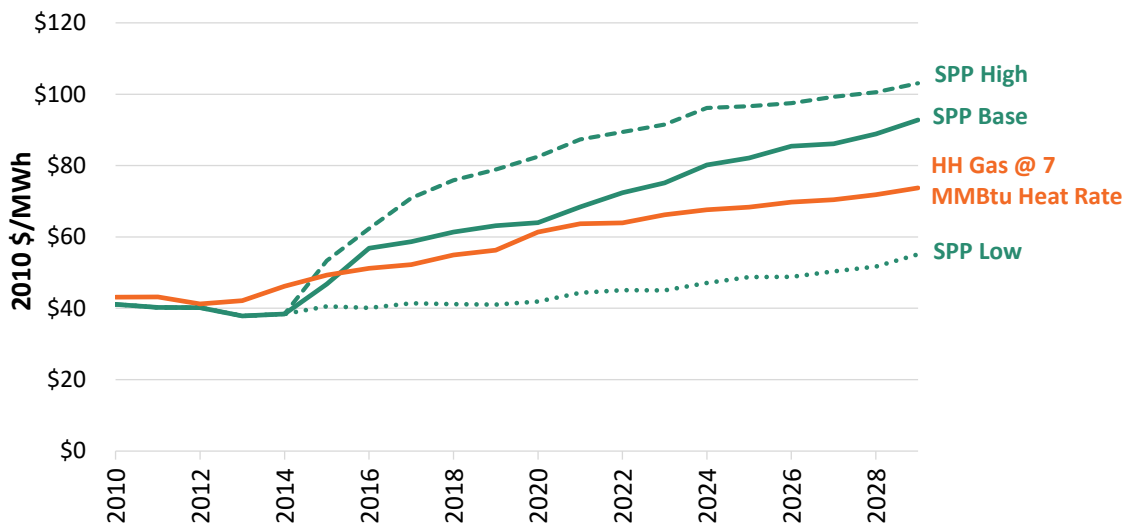
20 ***Future Operating Margins of Asbury***

21 One of the key drivers for the Asbury retirement economics is gas prices. Figure 17
22 shows the Company's outlook in the 2010 IRP for SPP wholesale energy prices (shown

³⁶ Empire District Electric Company. Asbury Asset Listing as of February 29, 2020. The AQCS project also included \$21 million investment for a turbine upgrade.

1 in green) and Henry Hub gas prices, expressed in terms of what they would cost for
 2 electricity at a new gas plant (shown in orange). The projected increase in gas prices,
 3 and the resulting increase in wholesale energy prices, were then expected to result in
 4 growing operating margins and high system benefits from Asbury in the future.

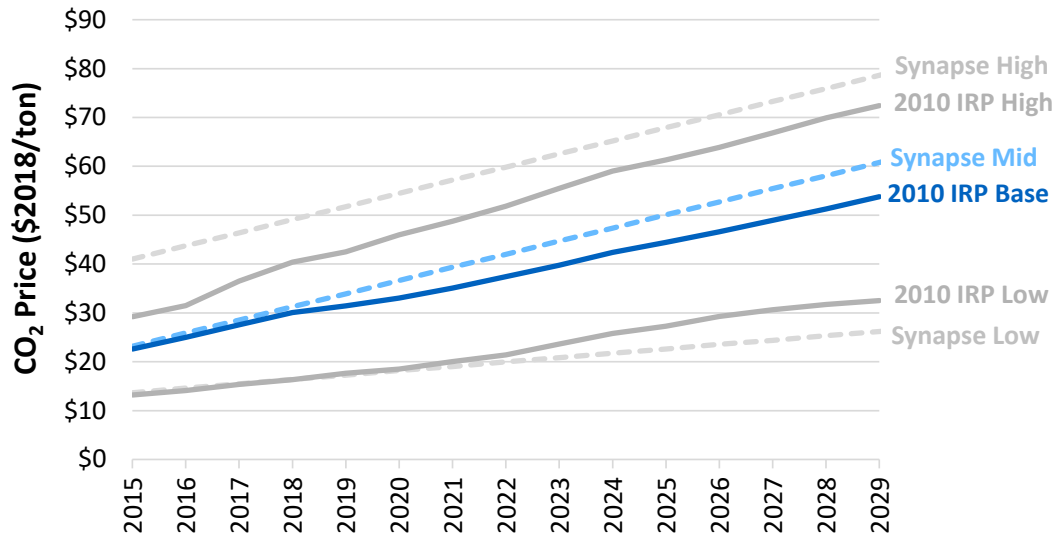
5 **FIGURE 17: SPP ENERGY PRICE AND HENRY HUB GAS PRICE**
 6 **FORECASTS IN THE 2010 IRP**



7
 8 *Source: 2010 IRP, Volume III, Figure 3-2 and Table 3-6.*

9 In addition, the possibility of carbon emissions pricing in the future would impact the
 10 operating margins of coal plants through an increase in both coal fuel costs and
 11 wholesale energy prices. Gas plants would also face an increased cost, but because gas
 12 is often on the margin and is less carbon-intensive than coal, the net effect would be
 13 more adverse to the economics of the coal plant. The carbon prices applied are shown
 14 in solid blue in Figure 18 below in comparison to the range of similar assumptions used
 15 by other utilities around the country at that time.

**FIGURE 18: COMPARISON OF CARBON PRICE FORECASTS
IN THE 2010 IRP**



Source: 2010 IRP, Volume III, Table 3-9; David Schlissel *et al.*, “Synapse 2008 CO2 Price Forecasts,” July 2008, Table 2, https://schlissel-technical.com/docs/reports_34.pdf.

The carbon prices applied by the Company are essentially centered in the industry range. These are non-trivial carbon prices, more than enough to have meaningful environmental impact on industry practices with regard to dispatch and development of new fossil fuel plants. Hence, they were a very legitimate test of the consequences of such pricing (which has not occurred, though most utilities continue to evaluate their fleet as if this will occur or as if they should choose the resources that would be best if it were to occur.)

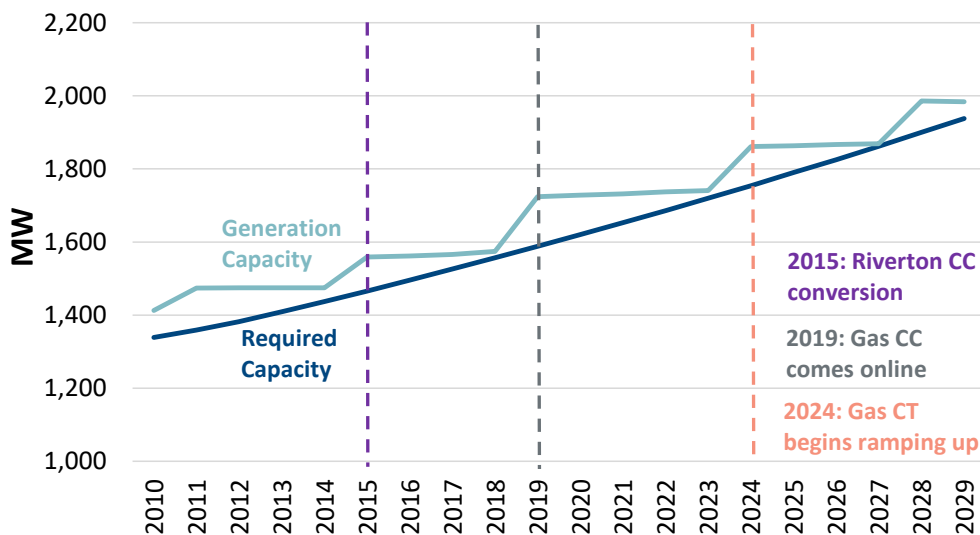
Replacement Capacity Costs

Regarding the replacement capacity costs associated with the retirement of Asbury, the key factors are the timing of the need for Liberty to replace Asbury’s capacity with new resources and the projected cost of such new resources when they need to be installed. As of 2010, the Company was projecting significant future load growth such that the retirement of Asbury before its end of life would have required immediate replacement of that capacity with new resources. Figure 19 below shows that even with the continued

1 operation of Asbury under the preferred resource Plan 4, the Company was projecting
2 only a small, iteratively fleeting capacity surplus between its total generation capacity
3 and the load requirements for its customers. That is, they were essentially in balance
4 with the Preferred Plan, recognizing lead times and scale economies in power plant
5 expansion.

6 **FIGURE 19: CAPACITY BALANCE IN THE 2010 IRP PREFERRED PLAN**

7 **(PLAN 4)**



8
9 *Sources and Notes:* 2010 IRP, Volume V, Table B-1. Required capacity = (peak load with
10 demand-side management) × (1 + 13.7% reserve margin).

11 With regard to costs, the next best alternative of new generation to replace Asbury’s
12 capacity (a gas CC) was projected to cost about \$720/kW, or over \$140 million to build
13 (in addition to having higher operating costs than the coal plant under then-prevailing
14 gas price forecasts).³⁷

15 **Q. Have you evaluated the reasonableness of the Company’s projections in those**
16 **studies compared to the prevailing industry outlook at the time?**

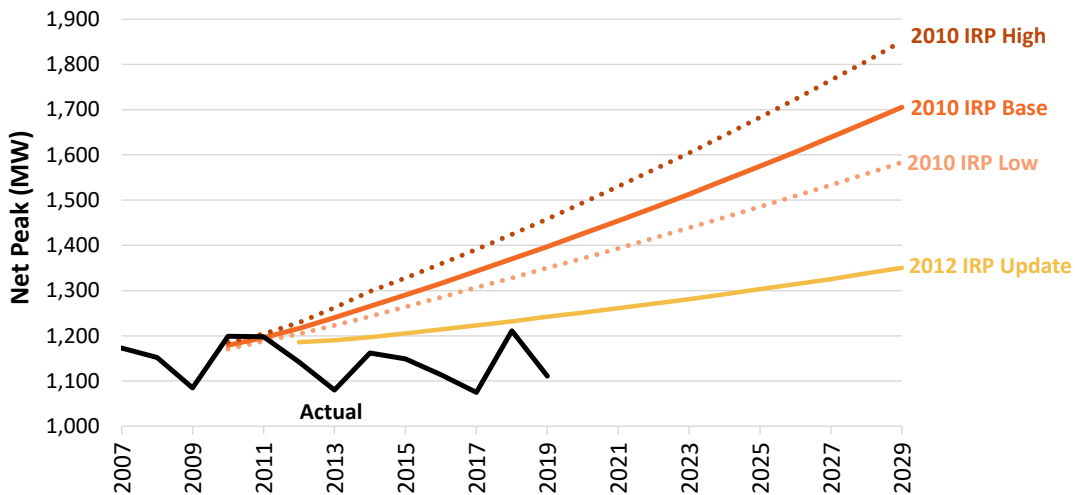
³⁷ 2010 IRP, Volume III, Table 4-3. Assumes replacement of Asbury with a 200 MW gas CC.

1 A. Yes, I have. The Company’s long-term projections for future load growth, gas prices,
2 and carbon prices were consistent with the prevailing industry outlook as of 2010.

3 ***Load Growth***

4 The 2010 IRP projected peak load growth of 1.9% per year.³⁸ This was higher than the
5 1.3% compounded annual growth rate for peak load in SPP over the next 10 years
6 forecasted by NERC’s reliability assessment at the time.³⁹ However, the 2010 IRP also
7 included a low peak demand forecast with an annual growth rate of 1.6% per year from
8 2010 – 2020 as a sensitivity to account for the uncertainty in load projections, shown in
9 Figure 20 below.⁴⁰ The Company later revised its forecast downward in the 2012 IRP
10 Update (shown in yellow), which projected a growth in peak load of 0.8% per year
11 (about two and a half times lower than the 2010 base forecast).⁴¹

12 **FIGURE 20: WINTER PEAK FORECASTS IN THE 2010 IRP AND 2012 IRP**
13 **UPDATE**



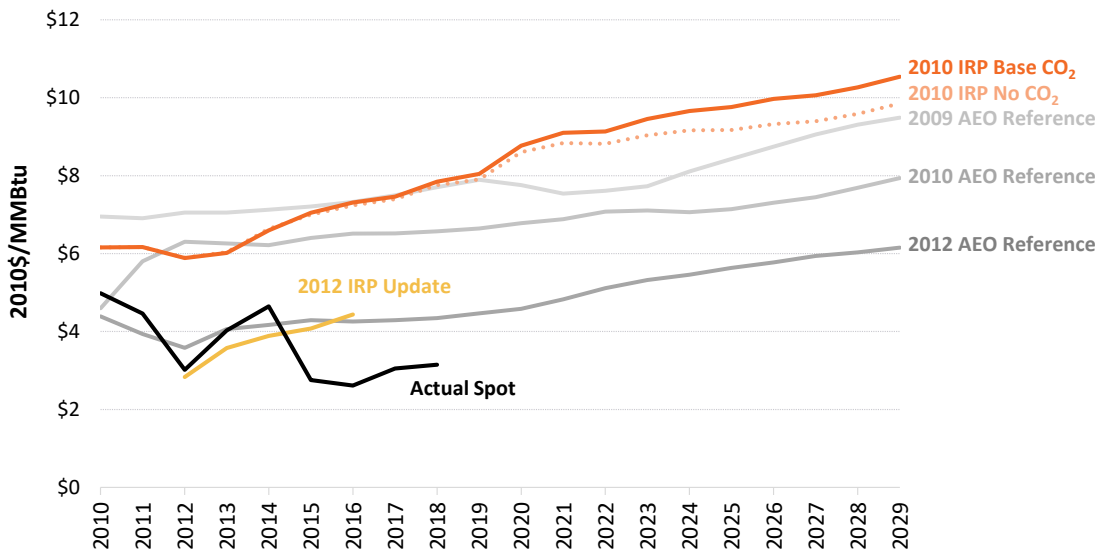
14 *Source:* 2010 IRP, Volume II, Table 2-11; 2012 IRP Annual Update, Table 4.

³⁸ Compounded annual growth rate from 2010 to 2020. *See* 2010 IRP, Volume II, Table 2-11.
³⁹ North American Electric Reliability Corporation, “2010 Long-Term Reliability Assessment,” October 2010, p. 158, https://www.nerc.com/files/2010_LTRA_v2-.pdf.
⁴⁰ 2010 IRP, Volume II, Table 2-11.
⁴¹ Compounded annual growth rates from 2012 to 2029. *See* 2012 IRP Annual Update, Table 4.

Natural Gas Prices

The Company used natural gas price forecasts based on the ABB/Ventyx Fall 2009 Power Market Advisory Service Electricity & Fuel Price Outlook, with any carbon price expected to start in 2015. Figure 21 shows that these forecasts (in orange) were in the range of the 2009 AEO reference case Henry Hub price projections (in light grey). A revised forecast in the 2012 IRP update (shown in yellow) was somewhat lower than the 2012 AEO reference case (shown in dark grey) and actual realized Henry Hub spot prices (shown in black) were much lower than any of the projections. This decline in natural gas prices, shown through the progressively lower prices in the AEO projections, could not have been anticipated as the base or most likely condition at the time and, as explained earlier, is one of the reasons the operational economics at Asbury declined.

FIGURE 21: HENRY HUB GAS PRICE OUTLOOKS IN THE 2010 IRP AND 2012 IRP UPDATE



Sources and Notes: 2010 IRP, Volume III, Table 3-6; 2012 IRP Annual Update, Table 1; AEO 2009; AEO 2010; AEO 2012. The data in Table 1 of the 2012 IRP Update are NYMEX Henry Hub spot market prices plus a basis adjustment for the Southern Star Central Pipeline (where Empire takes delivery). The Southern Star prices are adjusted to Henry Hub prices using forwards as of January to March 2012 from S&P Global Market Intelligence. See 2012 IRP Annual Update, p. 6.

1 ***Carbon Prices***

2 As discussed above and shown in Figure 18, the CO₂ prices used in the 2010 IRP were
3 within the range of industry expectations, with the base case forecast in the middle of
4 the Synapse 2008 forecast (the most recently available at the time).⁴²

5 **Q. Did other coal plants in the U.S. also install pollution control equipment around**
6 **2015 to comply with the environmental regulations?**

7 A. Yes. For example, Montrose units 2 and 3, and Sibley unit 3 in Missouri and Eckert
8 Station units 4-6 in Michigan installed retrofits in 2015 and 2016 for reducing mercury
9 emissions, but Montrose and Sibley retired later in 2018, while Eckert retired in 2020.
10 Similarly, the North Valmy unit 1 in Nevada installed dry sorbent injection (“DSI”)
11 equipment at the end of 2014 for reducing SO₂ and acid gas emissions, but was
12 scheduled for retirement in 2021. During the period 2014 – 2016, about 63 GW of coal
13 capacity (209 units) in the U.S. installed environmental control equipment (12 GW from
14 38 units in the SPP region). Of these units, 9 GW (including Asbury) have already
15 retired largely due to deteriorating outlook for market fundamentals, and 14 GW is
16 announced to retire by 2030.⁴³

17 **Q. What are your conclusions with respect to the prudence of the Company’s 2010-**
18 **11 decision to invest in the AQCS?**

19 A. The Company’s projections as of 2010 for the key drivers of the potential cost savings
20 from installing AQCS retrofits instead of retiring Asbury were reasonable and consistent
21 with the contemporaneous industry outlook. In addition, the Company’s evaluation in

⁴² David Schlissel *et al.*, “Synapse 2008 CO₂ Price Forecasts,” July 2008, Table 2, https://schlissel-technical.com/docs/reports_34.pdf.

⁴³ Velocity Suite, ABB Inc., data as of February 18, 2021.

1 2010 considered reasonable scenarios and sensitivities to evaluate the robustness of the
2 projected cost savings with the AQCS option.

3 **B. SCR Retrofit**

4 **Q. Please describe the industry outlook prior to 2008 for the key drivers affecting the**
5 **economics of continued investments at existing coal plants?**

6 A. Prior to 2008, the long-term gas price outlook in the energy sector generally favored
7 continued investments at existing coal plants. In the 2007 Annual Energy Outlook, the
8 EIA forecasted the natural gas price to reach \$6.76/MMBtu in 2010 (2008 dollars) and
9 \$6.15/MMBtu by 2020. Similarly, in the 2007 IRP, the Company forecasted a gas price
10 at \$6.47/MMBtu (2008 dollars) in 2010, and escalating at 3% to reach \$7.80/MMBtu
11 by 2020, assuming that a carbon tax would begin in 2012.⁴⁴ These projected gas prices
12 reflect a consistent assumption across most utilities in the U.S. that also drove
13 widespread continued investments in coal fired plants. Indeed, after Hurricane Katrina
14 in August 2005, there was general anxiety in the energy industry that our gas and oil
15 infrastructure was fragile and insufficient, causing prices to rise rapidly and generally
16 stay high until the financial crisis in collateralized lending caused the Great Recession
17 starting around mid-2008. Even then, they did not drop to historic lows.

18 In addition, prior to 2008, customer load in the SPP region was expected to have
19 substantial growth. In 2007, NERC's reliability assessment forecasted a 1.7% annual
20 average load growth rate over the next 10 years in the SPP region, and the Company
21 forecasted a 2.6% annual load growth rate within its footprint, indicating the expectation

⁴⁴ Gas forecast data taken from U.S. Energy Information Administration, "Lower 48 Wellhead and Henry Hub Spot Market Prices for Natural Gas, 1990-2030 (2005 dollars per thousand cubic feet)," February 2007. <https://www.eia.gov/outlooks/archive/aeo07/gas.html>, and 2007 IRP, Volume I, p. 13.

1 of a need to invest in economic and reliable power to its customers and satisfy Empire's
2 planning reserve margin of 13.7%.⁴⁵

3 Emissions allowance prices at the time also favored continued investments in
4 control equipment at the time. Economic studies conducted by the EPA found the NO_x
5 emissions allowance costs to be \$1,603/ton in 2010 (or about \$6/MWh for a coal plant
6 without SCR controls), increasing to \$1,973/ton in 2015. The Company similarly
7 projected \$1,622/ton in NO_x emissions costs, increasing to \$1,711/ton in 2015.⁴⁶
8 Generally, the industry anticipated high gas and NO_x emissions allowance prices, which
9 would favor investing in emissions control equipment in coal plants instead of either
10 retiring the coal to be replaced by new gas units or not installing the emissions controls.

11 **Q. Did other coal plant owners in the SPP region invest in SCR and other capital-**
12 **intensive control equipment around 2008?**

13 A. Yes. For example, Sibley unit 3 owned then by Kansas City Power and Light (now
14 Evergy Missouri West) installed a selective catalytic reduction system in 2009, while
15 Sibley units 1-2 installed selective non-catalytic reduction systems in 2008, yet all three
16 units retired in 2018. Additionally, the Tecumseh Energy Center unit 7 of Westar Energy
17 (now Evergy Kansas Central) installed a low NO_x Burner with close-coupled over-fire
18 air in 2008, but retired in 2018.⁴⁷

⁴⁵ North American Electric Reliability Corporation, "2007 Long-Term Reliability Assessment, 2007-2016," October 2007, page 194, <https://www.nerc.com/pa/RAPA/ra/Reliability%20Assessments%20DL/LTRA2007.pdf>; 2007 IRP, Volume II, Table 2. 2007 IRP, Volume III, p. 17.

⁴⁶ Emission cost data taken from U.S. Environmental Protection Agency, "Regulatory Impact Analysis for the Final Clean Air Interstate Rule," March 2005, Table D-3, <https://archive.epa.gov/airmarkets/programs/cair/web/pdf/finaltech08.pdf>; and 2007 IRP, Volume III, Table ES-2. Numbers are reported in 2008 real dollars, assuming a 0.8 lbs/MMBtu uncontrolled NO_x emissions rate and 10 MMBtu/MWh heat rate based on approximating historical Asbury operating data.

⁴⁷ Velocity Suite, ABB Inc., data as of February 18, 2021.

1 **VI. REGULATORY STANDARDS AND CRITERIA FOR RECOVERY OF**
2 **PRUDENTLY INCURRED PAST INVESTMENTS**

3 **Q. What are the economic reasons for cost recovery of undepreciated assets that are**
4 **not used to the end of their initially expected lifespans?**

5 A. Longstanding and economically well-justified ratemaking principles and standards in
6 the utility industry strongly indicate that all prudently undertaken investments should be
7 fully recoverable from customers, even if the underlying assets at some point prove less
8 economic than was originally intended. This is particularly important in those instances
9 where retiring those prudent investments is likely to produce net savings to customers
10 (even after accounting for those customers paying for the retired investments) and where
11 disallowing full recovery of those prudent investments would result in an unwarranted
12 windfall to customers and penalize the utility and its investors.

13 Resources are chosen because they are expected to have the lowest costs, but
14 seeking absolute confidence that such will occur under any and all future circumstances
15 would be uneconomical for customers, if not impossible. In fact, prudent planning for
16 resource development by utilities should entail the expectation that the chosen assets
17 will mostly, *but not under all* circumstances, result in lowest cost for customers relative
18 to other alternatives. That is, a prudent resource plan should, from the day it is planned
19 and chosen, be understood to be partially exposed to other alternatives turning out to
20 have lower costs in some (but less than the majority of) reasonably foreseeable planning
21 scenarios. This is unavoidable because utility investments involve long-lived assets that
22 will operate over a horizon that cannot possibly be precisely forecasted or controlled. It
23 is also economically better that resources be chosen (as they were here) when they are
24 expected to produce robust but not absolute cost savings or benefits. (Indeed, this is why

1 risk analysis is done via scenarios in IRPs. Nothing is ever found or chosen because it
2 is always going to be better than everything else no matter what could happen.)

3 As a consequence, from inception, prudently chosen investments will have a
4 built-in modest risk of possible future disappointment – of becoming “out-of-the-
5 money” sometime during their engineering lives. If not, uneconomic, overly risk-averse
6 decisions would be made instead, causing expected savings to be lost – for example, by
7 waiting too long or for too much certainty to build, or by the utility choosing resource
8 options that have lower investment risk (such as only relying on purchased power) but
9 higher expected costs to customers. For the same reason that a prudently chosen plant
10 will face some downside risk at inception, it is also not good planning practice to
11 abandon it abruptly if/when it first falls out-of-market because there will still be
12 significant future uncertainty and a possibility that its attractiveness will improve, or
13 that its replacement would be more economical if delayed a few years (while other
14 technologies improve and become cheaper). Fixed costs of shutting down may also be
15 substantial or accelerated in time, making it more economical to wait a while on
16 abandoning a weak asset for the option value of possible better future circumstances.

17 Importantly, when a resource is chosen with strong expected benefits, it will
18 usually have produced many years of net benefits even if it eventually falls short of the
19 original hopes, should it become bested by some new technology or by a shift of market
20 conditions towards circumstances that were originally seen as unlikely. When such
21 occurs, the prudent decision for the utility is to acknowledge its previously attractive
22 investment is no longer providing a benefit to its customers and to retire the investment.
23 Reasonable ratemaking principles and standards that recognize and support such
24 decision-making and allow the utility full recovery on and of the retired investment

1 provide the proper balance between the rights of both the customers and the utility's
2 investors. Denying full recovery, on the other hand, would result in giving utilities an
3 unhelpful incentive to operate plants until they have recouped all of their investment,
4 even though closing the plant would be more cost effective and save customers money.

5 **Q. Unregulated firms face obsolescence risk for their assets, yet they have no recourse**
6 **to sunk cost recovery. Please explain why their situation is different than that of a**
7 **utility, and why cost recovery of stranded assets is consistent with the regulatory**
8 **obligation to serve and the cost-based pricing constraints under which a utility**
9 **operates.**

10 A. The obligation to serve under cost-based regulation means that regulated utilities are not
11 like unregulated firms in a couple of meaningful ways. First, unregulated companies can
12 choose when and which market to enter and exit, whereas utilities have the obligation
13 to serve every customer within their service territory. That obligation also extends to
14 making investments in a least-cost manner as agreed by regulatory review. In return,
15 customers bear the full costs of those choices and enjoy their full benefits.

16 Second, for their products and services, unregulated companies can charge what
17 the market will bear, and they can keep the benefits (extra profits) for themselves when
18 they have in-the-money assets. Of course, if they fail to successfully commercialize a
19 product, they have to bear the sunk costs, but that risk of loss is balanced by their
20 opportunities for large unregulated profits in well-chosen market niches. In contrast,
21 utilities do not have free rein when it comes to determining when and where to enter a
22 market nor on what to charge for their services. Instead, the level of earnings is subject
23 to review and approval by the regulators. If investments made by utilities result in
24 unexpected gains, i.e. substantial avoided costs or reduced risks, utilities do not get to

1 keep the upside. Thus, utilities should not be assigned the downside losses when assets
2 happen to lose their economic advantages, e.g. under a simple “used and useful”
3 criterion. Further, the used and useful standard does not help inform a fair or productive
4 treatment, because it is far too coarse an indicator of the size or causes of possible
5 problems which overlooks many relevant considerations. Here, there are many
6 customer benefits to the retirement of Asbury, and any non-recovery of appropriate
7 carrying costs since its retirement would result in an unwarranted win to customers that
8 would penalize and discourage prudent decision-making by the Company and other
9 similar situated electric utilities. This misapplication of used and useful standard in this
10 context would create a “heads I break even, tails I lose” set of outcomes, which *per se*
11 deprives the utility of a balanced opportunity for expecting to earn its allowed cost of
12 capital. In expectation, it could only earn somewhat less. Such built-in deprivation
13 would harm its access to capital and undermine its ability to provide the requisite quality
14 of service.

15 **Q. Please describe the unintended adverse incentives that would arise from a**
16 **regulatory policy disallowing recovery of retired out-of-the-money assets that were**
17 **prudently chosen.**

18 A. Disallowing full recovery and appropriate carrying charges of retired out-of-the-money
19 assets that were prudently chosen and approved sends the wrong signals to and creates
20 perverse incentives for resource planners and investors. Such a disallowance means that
21 prior regulatory approvals cannot be relied upon. Going forward, it creates the
22 expectation that utility investments cannot be expected to recover a full return on their
23 costs: they will break even if the assets remain attractive, but will lose part of their value
24 under unfavorable market conditions. As a result, investors would hesitate to support

1 the utility. Every prudent asset intrinsically includes some chance it will not fulfill its
2 expected value benefits under every circumstance. In addition, disallowance of any
3 portion of the Company's prudent investments and appropriate carrying charges in this
4 case sets a "no good deed goes unpunished" precedent, where the utility saves customers
5 money by retiring uneconomic assets but is penalized for doing so. Staying the course
6 would then be preferable for the utility, even if it means that another option leads to a
7 net savings for customers in the long run.

8 **Q. Aren't utility equity investors compensated for the risk of possibly not having all**
9 **their investment costs recovered? Isn't that what the cost of equity allowance is**
10 **for?**

11 A. No, while that argument is superficially appealing, it stems from a misunderstanding on
12 several levels. According to that argument, anything that foreseeably could go wrong is
13 already priced into the risk premium for equity. Therefore, equity prices already reflect
14 such risks, and disallowance should be allowed to go forward without further
15 compensating investors. But that is not entirely correct. Not every type of risk, even
16 though it may be foreseen by investors as possible, is priced into the cost of equity. In
17 particular, one-sided, asymmetric risks that involve sudden, large, uncontrollable, non-
18 standard possibilities of loss (only, with no upside) are neither measured nor
19 compensated in cost of equity allowances. In fact, Liberty's allowed cost of equity does
20 not compensate investors (at Liberty, or Liberty's shareholders) for the risk of not being
21 allowed the recovery and the appropriate carrying charges of prudently incurred but no
22 longer used and useful costs.

23 **Q. Please explain how asymmetric risks arise and why they differ from risks that are**
24 **compensated in the cost of equity.**

1 A. While it is generally understood and agreed upon in financial economics that investors
2 in an efficient financial market (such as we have in the U.S.) are aware of essentially all
3 material future risks, it is not the case that all those risks are recognized in the same way.
4 Risks that involve sharing in the variability of the economy as a whole tend to be priced
5 into the cost of capital, because they tend to be undiversifiable. Risks that are unique or
6 “idiosyncratic” to just the firm or product in question (such as whether an invention will
7 work, or a large contract will be executed) tend to be priced into the valuation of those
8 companies via assumptions about what it will do to their expected cash flows, but not
9 via an adjustment to their cost of capital. So, it is not correct to say that any risk that
10 utility investors can imagine, such as plant disallowances if prematurely shutdown, has
11 already been reflected in the cost of capital.

12 In fact, the capital asset pricing model (“CAPM”) method of assessing the cost
13 of equity starts with the presumption that only systematic risk is priced, and its statistical
14 methods only measure the extent of co-variability of the proxy stocks with the market
15 as a whole. Hence, those measurements cannot reflect idiosyncratic, asymmetric risks,
16 and major disallowances for a utility are of that nature: that is, they involve only one-
17 sided possibilities (all downside), they are unique to the circumstances of a particular
18 utility, and they will have little or no correlation with the state of the market as a whole.

19 Second, because risks like disallowance affect forecasted cash flows, they also
20 affect equity valuation. This means that if we calculate the cost of equity with the
21 discounted cash flow (“DCF”) method for a firm facing this problem, both its growth in
22 expected dividends and its company valuation will reflect the problem, and will do so
23 in a mostly offsetting way (as long as the growth forecast and price are

1 contemporaneous). As a result, the DCF-measured return on equity also will not be
2 greater for firms facing potential disallowances than for firms that are not.

3 **Q. Please explain why an expected possible loss is not offset by an investor demand**
4 **for more profits in the future.**

5 A. The reason is that there is no mechanism to force that recovery. An example may help.
6 Consider two very similar homes with similar valuations, but one suddenly becomes
7 aware that it is in a region that is going to be close to a new airport. The value of the
8 airport-exposed home will fall, but it will not thereafter be expected to appreciate at a
9 higher rate than the other home, simply because it became aware of new risk. Both will
10 grow at the rate of the overall housing stock. The airport house can only recover that
11 lost value if the risk goes away. Similarly, the value of a stock will fall if it faces a
12 downside risk like a catastrophic loss, but once that is reflected in its price, the stock
13 will now appreciate just like a normal stock in its industry. More formally, the expected
14 cash flows of the firm will fall, but the discount rate (or market-expected returns) on its
15 future will not increase. The stock simply drops in value to the point where the normal
16 return is adequate for new buyers to want it and for old shareholders to retain it,
17 notwithstanding their disappointment.

18 **Q. Does the regulatory process of setting allowed returns somehow offset this**
19 **problem?**

20 A. No, the allowed cost of equity is normally assessed with the CAPM and DCF methods,
21 which, as I described above, will not measure this kind of risk.⁴⁸ These methods estimate

⁴⁸ Further, when cost of equity measurements rely on a proxy group, it is necessary that that group face the same risks as the utility of interest as a precondition for it even being relevant to ask whether a particular type of risk is priced or not. Since large write-offs are relatively rare, they are very unlikely to even be part of the comparison group's data.

1 the expected rate of return on assets or businesses of equivalent risk. Utility ratemaking
2 applies that to the book value of the rate base assets – hence there is no extra allowance
3 of any kind for conditions where that rate base, initially recognized as prudent, might
4 get reduced because of future conditions. If that kind of ratemaking were the plan, then
5 the allowances based on the market cost of capital would not be enough.

6 Moreover, there would be a paradox that giving some extra allowance for
7 potential disallowances would seem to give permission for any sized disallowance in
8 the future – because notionally that right would have been paid for already. Clearly there
9 is no combination of payments and future disallowances that would be fair
10 compensation for operating under those policies, as the extra allowance would only be
11 enough if there were years of collecting it as a premium and if the possible future
12 disallowances were capped at amounts consistent with how the risk was initially
13 predicted and priced. This also demonstrates why asymmetric risks are more like an
14 insurance problem. That industry only covers a certain dollar amount of future risk for
15 a certain, limited amount of time, where the risk arises under knowable circumstances
16 familiar to the underwriter. When the risk is open-ended and non-standard, insurance is
17 often not available or is incredibly expensive.

18 **Q. Does Liberty’s analysis of cost savings relating to the retirement of Asbury take**
19 **into account Liberty’s request in this proceeding for customers to continue to pay**
20 **the pre-tax return on the retired investment?**

21 A. Yes. In all resource plans evaluated in Liberty’s 2019 IRP analyses, the undepreciated
22 past investment costs at Asbury are assumed to be fully recovered from its customers in
23 the future years. The depreciation period for that recovery is assumed to be slower in
24 the Preferred Plan compared to Plan 1: depreciation period goes until 2048 in the

1 Preferred Plan, versus until 2036 in Plan 1.⁴⁹ A tax markup of the equity component is
2 needed for the amounts to be compensatory.

3 **Q. What would be the result if customers did not continue to pay the pre-tax return**
4 **on the retired investment?**

5 A. If the customers' responsibilities for paying some or all of the pre-tax return on the
6 retired investment were waived here, numerous inequitable and inefficient
7 consequences could arise. Most notably, barring Liberty from recovering the costs of
8 prudent investments it made on behalf of its customers would constitute an unjustified
9 penalty imposed on the Company that would conflict with precedent and industry
10 standards.

11 Utility regulators and courts have long concluded that a utility may include
12 prudent investments no longer being used to provide service in its rate base as long as
13 the regulator reasonably balances consumers' interest in fair rates against investors'
14 interest in maintaining financial integrity. With the retirement and full-cost recovery of
15 Asbury, the proper balancing of interests is achieved because customers receive
16 substantial cost savings in rates even after customer pay the remaining pre-tax return on
17 the retired investment, whereby Liberty recoups its remaining (prudent) investment in
18 Asbury. On the other hand, the balancing of interest test clearly fails if customers receive
19 all of the cost savings relating to the retirement of Asbury and Liberty is not allowed to
20 recoup its remaining investment in Asbury – penalizing the act that resulted in finding
21 and obtaining the savings that will be received by the customers.

22 There is no balancing of interest that would be achieved by “loss-sharing” when
23 Asbury retires, since there was no gain-sharing while it operated and for many years

⁴⁹ 2019 IRP, Data Response 0017.

1 reduced customers' costs relative to not having the plant. The regulatory bargain is that
2 the utility receives an opportunity to achieve breakeven cost recovery via risk-adjusted
3 authorized returns on and of the capital the Commission directs it to place in service
4 under its obligation to serve its customers. It earns only that same level of return in
5 instances when those its investments are well "in the money" and creating significant
6 benefits in excess of the asset's costs -- as Asbury did for many years. There is no
7 "upside" to utility investors for this success. Accordingly, it is not reasonable or a "fair
8 balancing of interests" that a utility should receive a penalty if/when a plant becomes
9 "out-of-the-money" for reasons that are beyond the control of its management. This
10 would be particularly inequitable and egregious when the utility has itself identified the
11 opportunity for win-win savings to customers from retiring the asset.

12 With respect to Asbury, the unwarranted windfall to customers (and the
13 unjustified penalty to shareholders) from avoiding to pay the entire return on (but
14 continuing to pay only the return of) the current undepreciated value of the past
15 investments at Asbury would be \$116 million.⁵⁰ This is the present value of the annual
16 returns that Liberty would have earned on that past investment cost balance until year
17 2038 under the Preferred Plan of the 2019 IRP.

18 Denying a utility the ability to recover its remaining investment in a retired plant,
19 where that retirement has been demonstrated to have significant future net benefits to
20 its customers, results in poor regulatory policy with very adverse incentives and
21 signaling to utilities, investors and lenders. Customers and their regulators should
22 encourage and reward utilities for finding new opportunities to reduce future costs, even

⁵⁰ 2019 IRP, Data Response 0016. Corresponds to the net present value of the return on rate base at the 6.71% discount rate used in the 2019 IRP. *See* 2019 IRP, Volume 6, p. 6-18.

1 if that involves abandoning a previously serviceable and prudently incurred investment.
2 In contrast, denying full recovery would likely give utilities an incentive to operate
3 plants until they have recouped all of their investment even though closing the plant
4 would save customers money.

5 **Q. Liberty is requesting to recover the undepreciated plant balance and other energy**
6 **transition costs of Asbury through securitization. Do the regulatory principles that**
7 **you described above still apply and support this approach?**

8 A. Yes, they do. Securitization is a useful mechanism to allow for full recovery of prudent
9 costs made by the Company via proceeds from a lump sum bond issuance while creating
10 carrying cost reduction benefits for customers. As proposed, the undepreciated plant
11 balance and other energy transition costs, are to be recovered via the proceeds of a
12 dedicated securitized utility tariff bond issuance. The bonds issued at a lower interest
13 rate will be repaid over time through a non-bypassable customer charge, this will allow
14 for additional customer savings when compared to the traditional recovery method,
15 which would be to include these costs in Liberty's rate base as a regulatory asset that
16 would earn a return at the Company's full WACC. This is a win-win scenario: the
17 Company receives immediate cash payment creating full recovery, including
18 appropriate carrying charges since its retirement through the issuance of the securitized
19 utility tariff bonds, and customers benefit from the low interest rate (and possibly more
20 deferred, i.e. slower, payback of the principal costs) on the energy transition costs. In
21 fact, this approach has been used in other jurisdictions for undepreciated coal assets (see
22 Appendix A) as well as in other context (see Company witness Niehaus' direct
23 testimony). Note that I am not opining that Liberty's full cost recovery in rate base
24 would have been inappropriate. The asset's history and the quality of the associated

1 planning decisions about it all support that mechanism for full cost recovery. However,
2 securitization is a fair treatment that offers other benefits that can be attractive, as
3 indicated here.

4 **VII. CONCLUSIONS**

5 **Q. Please summarize your conclusions.**

6 A. It is appropriate for Liberty to fully recover its remaining undepreciated investment at
7 Asbury because:

8 i) Liberty's past major capital investments at Asbury were prudently chosen to
9 save costs for Liberty's customers and comply with environmental regulations.

10 Those conclusions about environmental equipment were often made in
11 conjunction with consideration of possibly retiring the plant, which was found
12 to be unattractive at that time. The plant has been useful and provided important
13 service to customers for many years;

14 ii) The retirement of Asbury was reasonable and responsive to the recent industry
15 outlook that involved rapidly shifting key market fundamentals relative to what
16 was foreseen just a few years earlier. Retirement is expected to be beneficial for
17 Liberty's customers on a present value basis and annually for many years into
18 the future; and

19 iii) It is reasonable for Liberty to receive recovery of past investment costs, along
20 with respective carrying charges associated with Asbury via a securitized utility
21 tariff bond. This allows full recovery under lower carrying costs for customers,
22 a win-win mechanism that balances benefits to both the Company and
23 customers.

1 In order to maintain the financial health and credibility of the Company, it is important
2 that Liberty's be allowed to recovery all the costs included in its petition. This is in part
3 to protect the cash flow and balance sheet and also to signal and assure investors and
4 lenders that the Commission is fairly recognizing that (1) the past investment costs
5 incurred at the plant were already thoroughly subjected to established processes for
6 identifying prudent investment choices to meet mandated needs, which have integrity
7 for future rate treatment; and (2) it is encouraging (rather than penalizing) utility
8 decisions of this kind, finding system improvements where retirements and the proposed
9 replacement with other lower cost resources will create lower going-forward costs for
10 customers than would have otherwise been incurred with the continued operation of
11 Asbury. This kind of utility behavior should be supported, not discouraged. In today's
12 marketplace with the move towards renewable generation and decarbonization, it is even
13 more imperative to incent utilities and investors to act as Liberty has done here.

14 Because of these economic findings, and because of the traditional and well-
15 justified regulatory compact between a utility, its Commission, and its customers, the
16 proper treatment of Liberty's undepreciated investments and other energy transition
17 costs at the Asbury coal plant is to allow Liberty to recover those past investment costs
18 via a securitized utility tariff bond.

19 **Q. Does this conclude your Direct Testimony at this time?**

20 **A.** Yes, it does.

VERIFICATION

I, Frank C. Graves, under penalty of perjury, on this 21st day of March, 2022, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Frank C. Graves

APPENDIX A: EXAMPLES OF HISTORICAL COST RECOVERY THROUGH SECURITIZATION FOR COAL PLANT RETIREMENTS IN OTHER STATES

Decision Year	Utility	Plant	State	Docket	Recovery Allowed	Undepreciated Costs Allowed for Recovery
2018	Consumers Energy	D.E. Karn	Michigan	U-20165	<u>Securitization</u> : including remaining book value (pursuant to settlement agreement)	\$779 million
2018	Wisconsin Electric Company	Pleasant Prairie	Wisconsin	6630-ET-101 & 05-UR-109	<u>Full Return</u> : Pursuant to settlement agreement, partial securitization, including remaining net book value; remaining investment fully recovered	\$100 million securitized \$300 million fully recovered
2020	Public Service Company of New Mexico	San Juan	New Mexico	19-00018-UT	<u>Securitization</u> : as requested by utility, including remaining net book value	\$360 million