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Witness: Frank C. Graves
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Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

Frank C. Graves

on behalf of

The Empire District Electric Company

December 2021

TABLE OF CONTENTS
FOR THE REBUTTAL TESTIMONY OF FRANK C. GRAVES
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2021-0312

SUBJECT **PAGE**

I. INTRODUCTION AND SUMMARY ... 1

II. MISAPPLICATION OF "USED AND USEFUL" STANDARD TO ASBURY COSTS ... 6

III. UTILITY'S OBLIGATION TO REDUCE CUSTOMER COSTS THROUGH RETIREMENT OF ASSETS THAT ARE NO LONGER ECONOMIC ... 16

IV. FAIRNESS OF EMPIRE SHAREHOLDERS NOT SHARING THE ASBURY COSTS WITH CUSTOMERS ... 20

V. APPROPRIATENESS OF SECURITIZATION FOR RECOVERY OF ASBURY COSTS ... 23

REBUTTAL TESTIMONY OF FRANK C. GRAVES
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2021-0312

I. INTRODUCTION AND SUMMARY

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

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

Q. Are you the same Frank C. Graves who provided Direct Testimony in this matter on behalf of The Empire District Electric Company ("Empire" or the "Company")?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony in this proceeding before the Missouri Public Service Commission ("Commission")?

A. In this testimony, I respond to the Office of Public Counsel (OPC) witnesses Dr. Geoff Marke and John A. Robinett, Midwest Energy Consumers Group (MECG) witness Greg R. Meyer, and Commission Staff (Staff) witnesses Amanda C. McMellen and Mark L. Oligschlaeger regarding my recommendation that Empire should be allowed to recover the same return the Commission has authorized it to earn on the Asbury power plant through a regulatory asset mechanism. More specifically, I respond to the following opinions:

- Empire should not be allowed to fully recover and earn return on the remaining undepreciated past investment costs at Asbury after the plant's retirement because i) it

is no longer "used and useful" (see witnesses Meyer[1], Marke[2] and Oligschlaeger[3]); ii) retirement of Asbury earlier than the end of its expected depreciation life was allegedly not due to factors outside the control of Empire (see witnesses Marke[4]); iii) Empire's customers should not be expected to pay for both the costs of the retired Asbury plant and the cost of replacement generation plants when only the latter are providing electricity (see witness Meyer[5]); and iv) Empire's shareholders should share a portion of the risks associated with the Asbury plant becoming uneconomic since the purpose of utility regulation is not to shield monopoly utilities from all economic risk (see witness Oligschlaeger[6]).

- Empire should use the securitization approach instead of its proposal to use regulatory asset treatment for recovering the remaining undepreciated past investment costs at Asbury (see witness Meyer[7]).

Q. Please summarize your responses.

A. None of the arguments I summarize above justifies disallowing full recovery of return on and of the undepreciated past investments at Asbury that were made based on prudent decisions in the past, after the changes in outlook for market conditions outside the control of Empire made it economically attractive for its customers to replace Asbury with cheaper resources. Empire's proposed approach to full recovery of and return on past investment costs at Asbury through the regulatory asset treatment has been a common approach

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1 Meyer at PP. 11-12.
2 Marke at p. 26.
3 Staff CoS Report at p. 136.
4 Marke at pp. 34-35.
5 Meyer at p. 11.
6 Staff CoS Report at pp. 136-137.
7 Meyer at pp. 18-20.

1 adopted by other state utility commissions and should be adopted here. The misguided and
2 punitive approaches suggested by those who would disallow return on or incomplete
3 recognition of past prudent costs violate the regulatory compact and would create adverse
4 incentives for utilities and additional costs for customers in the future, as I explain later in
5 my testimony.

6 The Commission's determination in this matter on the appropriate regulatory
7 treatment for the recovery of past investment costs at the Asbury plant should be designed
8 to encourage and promote the right incentives to the utility to make decisions on system
9 adjustments that are expected to result in lower costs for customers. That requires not
10 penalizing beneficial and prudent past decisions. I explained in my direct testimony that
11 the past environmental upgrade investments at Asbury were done prudently to achieve
12 expected cost savings for customers compared to other options available at the time, and
13 none of the interveners and Staff witnesses here have disagreed with that conclusion in
14 their direct testimonies. Since it is established that those past investment decisions were
15 prudent, those investment costs are no longer relevant to subsequent evaluations of the
16 decision to retain vs. retire the plant as a result of changing market fundamentals and
17 regulatory outlook. Those past investments are sunk costs, so the remaining issue that
18 appears to be disputed by the interveners and the Staff is whether Empire's decision to
19 retire Asbury was prudent.

20 Based on my review of Empire's resource planning analysis and its key
21 assumptions at the time, as reported in my direct testimony, I concluded that Empire's
22 decision to retire the plant, instead of continuing to operate and incur additional capital
23 costs was also prudent. That decision to retire should not in any way be dependent on how

much of the sunk costs are still to be recovered from customers, since those sunk costs would be the same regardless of whether the plant retires or continues to operate in the future. Empire identified the retirement option as the best option to achieve cost savings for customers in the future compared to the option with continued operations of the plant at a higher cost for customers.

None of the direct testimony of the parties provide evidence that challenges Empire's studies demonstrating that customers would remain better off (lower rates) when retiring Asbury with continued full cost recovery. If the customers' responsibilities for paying some or all of the pre-tax return on the retired investment were waived or not allowed by the Commission in this case, the customers would receive an unwarranted windfall that would have inequitable and inefficient consequences that I have outlined in my direct testimony. That is because in addition to already receiving the savings benefits in the future from Empire's decision to retire Asbury, customers would be receiving an unjustified "bonus" of being relieved of having to pay the cost incurred by Empire in creating the savings benefit for the customers, i.e., the cost to Empire of foregoing ongoing use and recovery of its remaining unrecovered investment in Asbury. Therefore, the Commission's pending determination of the recovery of past investment costs at Asbury should not penalize Empire for choosing the option that saves costs for customers going forward.

Securitization is a mechanism that has been proposed for cashing out these sunk costs to Asbury's shareholders and replacing them with a very high quality, nonbypassable bond for the same amount. This mode of cost recovery is sometimes necessary and appropriate, especially where the utility has experienced some unexpected and non-

1 standard extra costs (such as severe storm response), and where the costs are not associated
2 with any savings to customers and their conventional recovery would result in a spike in
3 rates. Here that is not the case, nor is securitization necessary to mitigate rate impacts.
4 Securitization also disrupts normal financial planning for the utility, and it can influence
5 costs of debt or debt capacity, notwithstanding its super priority and low interest rates.
6 There is simply no compelling need or reason to adopt it here.

7 **Q. How is the rest of your testimony organized?**

8 A. I explain in Section II why the "used and useful" standard is misapplied here by the
9 interveners. It is a blunt tool that should only be used in a very specific context, and
10 certainly not in the context of the retirement of an uneconomic asset that was previously
11 found prudent and where the decision to retire the plant results in substantial savings to
12 customers, even after taking into account the fact that customers are asked to pay the
13 remaining pre-tax return on the retired plant. In Section III, I rebut the argument that the
14 Company should bear the losses since the decision to retire the Asbury plant was within
15 Empire's control. I further argue in Section IV that it would not be fair to split the losses
16 between Empire and its customers, because, contrary to its rhetorical claims, such loss-
17 splitting is not a sharing at all but purely a one-sided taking from the utility's investors.
18 Such down-side outcome splitting is not appropriate because any upside from prudent
19 planning is never split in this manner. Customers retain any and all the benefits above the
20 costs of any asset while it is used and useful. I elaborate in Section V why securitization
21 is not the appropriate recovery mechanism for the undepreciated investments in the Asbury
22 plant.

II. MISAPPLICATION OF "USED AND USEFUL" STANDARD TO ASBURY COSTS

Q. What is the "used and useful" standard in utility regulation?

A. In traditional ratemaking principles, "used and useful" as a concept refers to whether a plant is actually used in service, and whether it is useful in providing service.

Q. Is Asbury used and useful?

A. No. It was retired by Empire after being used and useful for many years.

Q. Does that mean that Empire should not be allowed recovery of its investment at Asbury?

A. No. It is a widely accepted principle that utilities should be allowed recovery of the investments that they made prudently. All of the underlying costs of the Asbury unit have been found and shown to be prudent, as I discuss at length in my Direct testimony.

Q. Please explain prudence and its application to a utility's decision to either build or retire new infrastructure.

A. Prudence refers to the quality of decision making that went into choosing and managing the assets a utility is obligated to build and maintain for reliable service. Because prudence only applies to the quality of a utility's decision making, it can only be evaluated on the basis of information that was available at the time a decision was made, not based on subsequent outcomes that could not have been reasonably anticipated or that were not then-perceived as likely enough to occur to reverse the decisions to choose and sustain an asset.

Q. Does this apply to the Company's decision to build Asbury?

A. Yes, it does. At that time, the Company conducted analyses that indicated that it needed new capacity and that Asbury would be the most economical choice, based on the

1 information available about the market at that time. Following a review by the
2 Commission, customer representatives, and other stakeholders, that decision was deemed
3 prudent and Empire was directed to construct Asbury. The same process applied to the
4 incremental investments Empire made at Asbury after its construction.

5 **Q. Does the prudence standard apply to the decision to retire Asbury?**

6 A. It does. In much the same manner that Asbury's construction was determined to be in the
7 best interests of customers based on the information that was available at that time, the
8 analyses described in the testimony of various Company witnesses in this proceeding
9 likewise explain why customers will benefit if Asbury is retired.

10 **Q. Is that to say that decisions regarding an investment can be prudent when they are**
11 **made even though, later, the asset in which the investment was made becomes not**
12 **used and useful?**

13 A. Correct. It is problematic to apply used and useful standard to determinations of investment
14 recovery in the context of existing assets that were used for many years, that were long
15 deemed used and useful and that were generating customers benefits, but which have been
16 retired once they became uneconomic due to changing economic circumstances. Applying
17 the used and useful standard here would create perverse and extremely undesirable
18 incentives and side-effects, discouraging utilities from making decisions that save money
19 for customers. Thus the "used and useful" standard must be applied in a very limited way
20 often in conjunction with other considerations, including overall customer welfare, balance
21 of interests, and public interest objectives. I explain these considerations in more detail
22 below.

Q. Please summarize how the interveners and Staff propose to apply the "used and useful" standard to the Asbury sunk cost recovery?

A. Witnesses Meyer, Robinette and Oligschlaeger opine that once a generation plant retires, it no longer qualifies for the utility owner of that plant to recover the undepreciated balance of past investment costs and/or earn a return on the undepreciated balance.[8]

Q. Do you agree with their proposed application of the "used and useful" standard here?

A. No. Utility regulators and courts have long concluded that a utility may include prudent investments no longer being used to provide service in its rate base as long as the regulator reasonably balances consumers' interest in fair rates against investors' interest in maintaining financial integrity and maintaining a reasonable opportunity to recover a fair return on prudent utility investments. With the retirement and full-cost recovery of Asbury, the proper balancing of interests would be achieved, for several reasons.

First, customers receive substantial cost savings in rates even after paying the remaining pre-tax return on the retired Asbury, whereby Empire recoups its remaining (prudent) investment in Asbury under standard ratemaking.

Second, as I pointed out in my direct testimony, the balancing of interest test clearly fails if customers were to receive all of the cost savings relating to the retirement of Asbury but Empire were not allowed to fully recoup its remaining investment in Asbury. That approach would penalize the act that resulted in finding and obtaining the savings that will be received by customers, in effect chilling utilities from seeking and taking such cost-saving decisions in the future.

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[8] Meyer at p. 11, and Staff CoS Report at p. 136.

Third, there is no balancing of interest that would be achieved by “loss-sharing” when Asbury retires, since there was no gain-sharing while it operated and for many years reduced customers’ costs relative to not having the plant. The regulatory bargain is that the utility receives only break-even cost recovery even when the asset is well “in-the-money” (as it was for many years with this plant), so the utility should not receive a penalty if/when the plant becomes “out-of-the-money” for reasons that do not involve a finding of imprudence. This would be particularly inequitable and egregious when the utility has itself identified the opportunity for win-win savings. It also creates perverse incentives to all utilities in the state to avoid finding such improvements for customers.

As I pointed out in my direct testimony, with respect to Asbury, the unwarranted windfall to customers (and the unjustified penalty to shareholders) from avoiding having to pay the entire return on and instead only allowing the recovery of the current undepreciated value as suggested by some of the parties in this proceeding, based upon the undepreciated value of the past investments at Asbury would be $116 million. This is the present value of the annual returns that Empire would have earned on that investment cost balance until year 2038 under the Preferred Plan of the 2019 IRP.

Denying a utility the ability to fully recover its remaining investment in a retired plant, where that retirement has demonstrated to have significant future net benefits to customers, results in poor regulatory policy with very adverse incentives and signaling to investors and lenders. Customers and their regulators should encourage and reward utilities for finding new opportunities to reduce future costs, even if that involves retiring a previously serviceable and prudently incurred investment. (Most of those obligatory utility investments last many decades, a period of time for which utility planners cannot possibly

be credibly held to account for foreseeing all future circumstances.) In contrast, denying full recovery would likely give utilities an incentive to operate plants until they have recouped all of their investment, even when closing the plant would save customers money.

The retirement of a generation asset tells us nothing about the prudence or benefits of the decisions to have built the plant, to have invested capital in its continuing operations, or to have elected to retire it at some particular time. Likewise, a shift in circumstances that justifies retirement is no indicator of whether the plant has been useful in the past or what has caused it to become less valuable now. A prudently-chosen long-lived asset, *from its inception,* is intrinsically exposed to the possibility of conditions changing that could make it less economical than was originally expected or expected at various maintenance and upgrade events. Nonetheless, such an asset may have been expected and realized to be more than useful enough (*i.e.*, beneficial) in the past to justify having invested in it with customers retaining responsibility for paying off all its costs.

The "used and useful" standard also does not consider why the asset is no longer attractive, or what it saves to take it out of service. In short, it is benefit-blind, and insisting on its application is a bit like refusing to pay your stockbroker for any stocks that made lower returns than average return for the portfolio, even if your portfolio was doing very well. For example, if the utility had not demonstrated at the time of the investment decision that the investment would lead to robust benefits for its customers relative to other alternatives, and indeed it proved to be a poor performer or non-functional, then it would

be appropriate to deny the full recovery of that investment.[9] But of course, that is not the case here.

Note that the "used and useful" approach also provides no information about what went wrong (if anything) that could and should have been avoided, or how costly an oversight that may have been (if found). It simply classifies the whole asset and all its costs as now disqualified for cost recovery.

Q. Please elaborate as to why prudently made investments should be recovered in full, even if no longer useful; in particular, please address the fact that this is not the practice in unregulated industries, where some products or businesses fail, creating losses for their owners.

A. Under cost-based regulation, utilities have the obligation to serve all customers in its service territory. Whereas unregulated companies can choose when and which suitable market to enter, as well as the scale of business according to their circumstances, utilities as regulated monopolies in contrast have the obligation to serve every customer within their service territory at reasonable cost. If an unregulated business is not profitable in a certain market, they are free to exit that market. (They also did not have to enter it in the first place.) Utilities do not have that option to pick and choose where and how to play. Further, unregulated companies have control over their own price levels. They can price their products and services at levels that they think the market will bear and can adjust the price levels depending on the desirability of their products and services at any given time. If their investments turn out to be profitable and highly desirable to customers, unregulated

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[9] Note that the disallowance amount in that case should be estimated based on the cost difference relative to cost of the next best alternative, and not based on the entire investment cost of the selected option.

companies can raise prices and keep the benefits for themselves. On the other hand, if they fail to commercialize their products or services, or if their investments are not in the money, they bear the losses. Thus, the risk of loss is balanced by the opportunity for large unregulated profits in a well-chosen market.

In sharp contrast, regulators review, approve, monitor and restrict the prices that regulated utilities can charge for their services. Whether their investments lead to an unexpected gain (saving lots of costs compared to the next best alternative that might have been chosen) does not affect the regulated utilities' expected earnings. If the investment is "in the money" (as is expected when prudent investments are initially made), those benefits (savings) are passed on to customers; utilities do not get to keep the upside as a thank-you or reward for the well-chosen assets. As such, it follows that utilities should not bear downside losses when assets turn out to be out-of-the-money in the future, unless this outcome was the result of subsequent imprudent management.

Staff Witness Oligschlaeger in his testimony appears to share a similar view: "Staff views that the purpose of utility regulation is not to shield monopoly utilities from all economic risk, but rather to serve as best as it can as a surrogate for the competitive forces facing unregulated industries. In a more competitive environment, if an unregulated company's assets become uneconomic over time through the normal operation of market forces, the company in question is not able to pass that impact on to customers. This does not necessarily mean that regulated utilities must likewise in all circumstances bear the entire financial burden of uneconomic but prudent investments. Unlike competitive businesses, a regulated utility does have an obligation to provide safe and adequate service

to all customer in its service territory."[10] Correctly noted in his comments is the observation that the used and useful idea (of losing recovery of an out-of-the-money asset) appears to be what unregulated markets do – but we should not imitate that for utilities because they do not get the other parts of the competitive market bargain. Further, the assets utilities are obligated to build have very long lives, making them intrinsically vulnerable to technological change and other economic forces outside of the utility's control.

Q. What have regulators in other jurisdictions determined is appropriate in situations where operationally viable assets turn out to be less useful than new alternatives?

A. As I explained in my direct testimony, I have found that other state regulatory commissions have generally allowed full recovery of prudently incurred past investment costs, including costs such as construction work in progress and those associated unusable inventory, when economics and regulatory mandates have driven early plant retirements and where such recovery meets the balancing test of consumer and utility interests, and where both parties benefit from the decision. As I further explained in my direct testimony, this reflects fairness with respect to the regulatory mandates and constraints the utility is operating under as well as the important recognition that punitive treatment would have perverse incentives, discouraging utilities from looking for opportunities to obtain lower cost resources than they currently have. While commissions may have approved different approaches in addressing this issue, I have found that they have respected the continuity of full cost recovery treatment for prudently incurred investments.

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[10] Staff CoS Report at p. 136.

Q. What is the standard for regulatory policy making in this regard?

A. Incentivizing and rewarding prudent decision making, particularly in regard to investments that utilities make on behalf of their customers, should be the standard for regulatory policy. This means recognizing that prudent planning for resource development by utilities involves the expectation that the investments approved by regulators will be those that are expected to create benefits for ratepayers but also that the utility is not obligated to guarantee those benefits, nor should it be penalized if those benefits are reduced because of changes to factors that are beyond its control. Staff witness Oligschlaeger acknowledges this point in his testimony: "There is always an inherent risk in the utility industry, as well as for unregulated businesses, that economic decisions that were prudent and reasonable at the time they were made will prove to be less than optimal at a later time due to constantly changing factors."[11] Put differently, in some (but not the majority) of the planning scenarios evaluated at the time of the decisions, the selected assets from the day they are planned will be exposed to some possible future adverse conditions that can lead to higher-than-expected costs relative to the alternative options. I emphasize that this is a "feature" of the planning process, not a "bug": the total benefits of long-lived assets cannot be precisely forecasted or controlled, so the assets should be selected when they are expected to produce robust expected net benefits (but not guaranteed to do so). In that sense, having some inherent (albeit low) risk of premature obsolescence associated with the selected assets means is actually preferred. [12] Otherwise, the expected savings would be lost: if the utility makes an extremely risk-averse decision and waits until the chosen asset is

[11] Staff CoS Report at p. 136.
[12] Staff CoS Report at p. 136.

1 essentially risk-free, the expected savings would be foregone. Accordingly, such assets
2 chosen based on expected benefits should not face a punitive response if/when adverse
3 conditions turn out to prevail.

4 This combination of an obligation to serve with very long-lived assets plus only
5 cost recovery under the best of circumstances (no excess returns for very good assets)
6 dictates that Empire should not be penalized for adopting the strategy to retire and replace
7 the Asbury plant, which provided valuable and reliable electric service to customers for
8 many years. If Empire convincingly demonstrates (and it has) that doing so would lead to
9 substantial savings for its customers, inclusive of fully recovering all the undepreciated
10 costs of the retired plant, (something that is not contested by any of the parties in their
11 direct testimony and reports), then it should be allowed full recovery of past investments.

12 **Q. What kind of distortions would applying the "used and useful" standard on an ex**
13 **post basis create?**

14 A. Applying the standard on an *ex post* basis, after the regulators already approved the
15 decision to construct the plant in the first place, would be a flawed approach not only
16 because it conflicts with prudent planning practices (as I explained above), but also because
17 it would distort incentives for any utility to pursue the least cost option going forward, if
18 doing so at all put sunk assets at risk. It would create the signal for resource planners and
19 investors (beyond Empire) that the Commission's past findings of prudence cannot be
20 relied upon. Such an application of the "used and useful" standard creates a *per se*
21 expectation of under-recovery of the allowed cost of capital: the utility would break even
22 if the investment is in the money, and would lose the value of part of its investment in some
23 cases. Punishing a utility for an outcome that arose out of technology and market conditions

that were out of the control of the utility, and not out of imprudent planning, would create a bias against utility investors having a fair chance to fully recover their invested costs with a reasonable return.

Importantly, technical obsolescence and possible cost disallowance via used and useful standards is <u>not</u> a risk that the cost of equity covers, which might otherwise appear to be an excuse for disallowances. That is, it is not correct to imagine that because a risk premium on equity has been allowed in the past that all forms of possible burdening and loss of value from regulatory decisions have been compensated and are fair game. The ROE per se cannot cover this kind of risk if it means investors have to face a "heads I breakeven, tails I lose" exposure. Such an asymmetric risk exposure would deter investors from supporting the utility and, in turn, discourage the utility from continually optimizing its investments in order to reduce costs for customers, whenever doing so may carry the risk of disallowance. Indeed, staying the course in that case would be preferable, even if it means that another option can lead to a net benefit for the customers in the long run. Finally, disallowing the utility from fully recovering its prudent investment might heighten business risk, potentially increasing borrowing costs for the utility.

For these reasons, a regulated utility's prudently incurred investments should be fully recoverable from customers, even if circumstances beyond the utility's control in the future make those investments less economic than what the utility initially projected.

III. <u>UTILITY'S OBLIGATION TO REDUCE CUSTOMER COSTS THROUGH RETIREMENT OF ASSETS THAT ARE NO LONGER ECONOMIC</u>

Q. Please summarize the arguments by the witnesses for the interveners and the Staff regarding Empire's control in deciding to retire Asbury.

A. Some interveners contend that whether to retire the Asbury plant was entirely within Empire's control and that this somehow justifies not paying for the plant. Implicitly, this argues that it would have been fine to keep paying for the plant if Empire had not noticed or pursued the opportunity to replace it – even though that would have left available savings through the reduction of costs to customers on the table. For example, Witness Marke alleges that in this instance there are no events beyond Empire's management's control that would cause its investments in the Asbury plant to be stranded.[13] Further, he believes that because it was Empire who made the decision to retire the plant, the Company should also bear any losses associated with that decision. In other words, Empire should live with the consequences of its decision, even though that decision was made in customer's best interest.

Q. How do you respond?

A. The fact that the retirement decision was "in Empire's control" is essentially tautological, as all asset management dispositional decisions are within its control, save a catastrophic natural disaster destroying the plant. What is relevant is why and how it chose to exercise its control, which I have shown was done prudently. Further, I disagree with the notion that this retirement was not due to factors outside of Empire's control. Only the timing of the decision itself was Empire's discretion; external events dictated the prudency of doing so.

This can be seen by noting that the list of factors that may cause a generation asset to lose value that Witness Marke provides is correct but considerably incomplete. He cites[14]

[13] Marke at p. 34.
[14] Marke at pp. 33-34.

1 deregulation, nuclear power plant cost overruns, carbon pricing schemes as examples of
2 reasons why investment in a generation assets may be stranded, but as I explain in my
3 direct testimony, there are other equally valid and substantial reasons as well that are
4 applicable here. For example, unexpected and sustained low natural gas prices negatively
5 impacted the actual and projected operating margins of the Asbury plant relative to SPP
6 energy prices. Lower-than-expected gas prices mean that SPP energy prices have cleared
7 at lower levels, and the Asbury plant's realized operating margins have been lower than
8 anticipated. Empire cannot influence regional natural gas markets whose drivers include
9 international conditions and the behaviors of hundreds of unregulated suppliers. Likewise,
10 Empire does not have control over the decreasing cost of wind and solar technologies or
11 the extent to which such plants will be built by others. Likewise, it is not responsible for
12 the low load growth in its service territory. Even if these possibilities were considered,
13 there is no reason to believe that the Company could or should have anticipated these as
14 the base or most likely scenario at the time.

15 **Q. Weren't Empire's customers "promised" during the last decade that Asbury would**
16 **continue to operate for many years until 2030s?**

17 A. No. When Empire makes investments to serve its customers, the Company has only an
18 obligation to make the best decisions possible, given the information available at the time
19 those decisions are made. It is neither required, nor possible, to have perfect foresight into
20 the disposition of energy markets decades into the future. Thus, there is no justification
21 for applying financial penalties if/when the market prices ultimately vary from the forecasts
22 that were the basis for the decision to build and sustain generation -- especially because
23 those forecasts have been reviewed and deemed prudent by the Commission. The true

"promise" from Empire is to provide reliable service at costs that are as low as reasonably possible at the time the required resources are chosen, and to keep evaluating and updating those decisions to see if they should be sustained or can be improved upon. It is more like being promised a ride that is safe and clean, but not guaranteed which car will be used. The cars all need to be paid for, or else there is no car service, but some will last longer than expected and some less. Importantly, there is a complementary promise from the other sides of the bargain, the customers, which is to fully pay for anything prudently chosen to provide their service.

In the case of the Asbury plant, Empire's promise was to retrofit the plant within a certain timeframe and budget so that the plant could operate in compliance with the environmental standards at the time. The expectation was that the plant would continue to operate long enough to justify these expenditures, unless and until something unforeseen might come along that would make it no longer economic, because a better option emerged. Indeed this happened, and Empire appropriately made that adjustment.

Q. What incentives would be created for utilities if the Commission were to not allow full cost recovery after a utility retires an uneconomic generation plant and replaces it with a lower cost option for customers?

A. As I explain above, a decision to disallow full cost recovery would signal to the utilities in the state and their shareholders that they cannot rely on findings of prudency for resource planning purposes, and that should a selected asset turn out to be uneconomic because of reasons beyond their control, the utilities will be expected to carry all losses. The intelligent response to that exposure would then be for a utility to always "stay the course" with their older assets, never replacing them before they are fully depreciated. They would

be driven to this because doing so guarantees full cost recovery – even in the presence of a more economically superior option that would overall yield cost savings to customers. A disallowance decision here would set a "no good deed goes unpunished" precedent, where utilities make proper decisions by retiring uneconomic assets and saving customers money in the long run, but are penalized for doing so. This is a point that Staff witness Oligschlaeger also makes in his direct testimony, "… Complete assignment of the remaining Asbury capital costs to shareholders might provide incentives for Empire and other electric utilities to avoid taking timely action to retire plant assets that become uneconomic due to the dynamic nature of the industry."[15] The Commission must take this into account in determining Asbury's treatment in this case.

IV. FAIRNESS OF EMPIRE SHAREHOLDERS NOT SHARING THE ASBURY COSTS WITH CUSTOMERS

Q. Staff witness Oligschlaeger supports a "sharing of the remaining unrecovered capital costs for Asbury" as an appropriate remedy.[16] What arguments does he provide?

A. According to Mr. Oligschlaeger, a full cost recovery of the Asbury plant for Empire means that customers would pay the entire costs for capital improvement projects that "were only in service for a short period of time." At the same time, as I note above, he observes that a full disallowance would not incentivize Empire and other electric utilities to act upon opportunities to retire uneconomic plants and create savings for customers. Nonetheless, on balance, he argues, the appropriate decision is to ask both Empire shareholders and customers to share the unrecovered costs, somehow splitting the difference.

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[15] Staff CoS at p. 137.
[16] Staff CoS at p. 137.

Q. How do you respond?

A. This recommendation by the Staff witness for cost-sharing of undepreciated costs of the Asbury plant is not grounded in either true fairness or economic efficiency. First, Staff's recommendation misapplies the balancing test to the facts in the present case. As I previously pointed out, none of the parties in their direct testimony have provided any evidence that challenges Empire's studies that demonstrate that retiring Asbury will save so much costs in the future that customers would remain better off (lower rates) even with continued full cost recovery of the past investment. If the customers' responsibilities for paying some or all of the pre-tax return on the retired investment were waived or not allowed by the Commission because the Staff wanted to have utility shareholders "share" some of the costs, the customers would receive an unwarranted windfall. That is because in addition to already receiving the savings benefits from Empire's decision to retire Asbury, customers would be receiving an unjustified "bonus" of being relieved of having to pay the cost incurred by Empire in creating the savings benefit for the customers, i.e. the cost to Empire of foregoing its remaining unrecovered investment in Asbury.

With the retirement and full-cost recovery of Asbury, the proper balancing of interests is achieved because customers receive substantial cost savings in rates even after them paying the remaining pre-tax return on the retired Asbury, and Empire recoups its remaining (prudent) investment in Asbury. The balancing test clearly fails under Staff's recommendation if customers receive all of the costs savings relating to the retirement of Asbury and Empire is allowed to recoup only a portion of its remaining investment in Asbury—penalizing Empire for the act that resulted in finding and obtaining the savings that will be received by the customers.

Q. **What about his concern that some of the unrecovered costs arise from components of the plant that have only been in service for a short time?**

A. The number of years in which the capital improvement projects have been in place is not relevant. Take the AQCS project for example. Empire was obligated to implement the project and integrate the control equipment into the plant's operations, which is what the Company did. The depreciation schedule was based on the *estimated* lifetime of the project and does not reflect a *guaranteed* lifetime. In principle, Empire could have just as plausibly requested the full recovery of the project over a shorter time period. The present value of the costs underlying the control equipment would be the same, but Empire would have much more fully recovered those costs by now.

Furthermore, Empire's customers already receive any and all benefits associated with any and every utility resource that turns out to be more valuable than was expected when it was selected and built.[17] This is the practice under cost-of-service regulation. In particular, the Asbury coal plant being cheaper to operate for many years than other types of plants or the market price of power has been a longstanding customer benefit, and that surplus benefit is not shared with Empire's investors under cost-based regulation. Therefore, it is not now a balancing of interests to have customers and shareholders split the losses if/when prudently developed assets lose their economic advantage due to circumstances beyond the utility's control. Splitting the losses might be a fair proposition only if there was also a sharing of benefits. However, such value-based pricing does not exist under utility regulation. Balancing of interests already occurs under regulation by

[17] Because the utility is regulated under a cost of service model, customers accrue all of these savings compared to the next best alternative.

only (and always) allowing full cost-based recovery of prudently chosen investments that the utility was obligated to make.

V. APPROPRIATENESS OF SECURITIZATION FOR RECOVERY OF ASBURY COSTS

Q. Please summarize the arguments that MECG witness Meyer used to support using securitization as a cost recovery instrument.

A. MECG witness Meyer proposed that in order to recover the remaining undepreciated past investment costs at Asbury, Empire should use the securitization mechanism instead of the Company's proposed regulatory asset treatment. As authorized by the recent legislation (Senate Bill 202), securitization represents a "middle ground" and a "reasonable compromise" for all parties, according to witness Meyer.[18] Furthermore, he avers that allowing Empire to pursue regulatory asset treatment is tantamount to "foreclosing the use of securitization by any of the Missouri utilities," and as a result would "lead to unnecessary increases in customer rates."[19]

Q. How do you respond?

A. Securitization as a cost-recovery mechanism may be necessary and appropriate under certain circumstances, but that is not the case here. In situations where the utility has experienced some unexpected and non-standard extra costs, securitization can be helpful. For example, winter storm Uri costs are appropriate to be securitized because the utility did not plan for these one-time costs, and conventional recovery could lead to a sudden rate hike. The winter storm costs are not associated with actions that the Company is pursuing

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[18] Meyer at p. 19.
[19] *Ibid*

to produce savings to customers. In contrast, in the case of Asbury, the need to recover the plant's undepreciated investment costs arises because Empire identified a resource plan that will save customers millions of dollars. Further, securitization also disrupts normal financial planning for the utility, and it can influence costs of debt or debt capacity (because not all rating agencies regard securitization as off-balance sheet), notwithstanding its super priority and low interest rates.

The notion that a compromise in the form of securitization is warranted because different parties propose different solutions is a false one. As explained above, those disparities of viewpoint about what is "fair" are not taking past prudence findings, the regulatory bargain under cost-of-service ratemaking, nor future incentives into account in their recommendations. There is not a need for securitization here.

Finally, while I cannot speak to the Missouri legislature's intent when it passed Senate Bill 202 into law to authorize securitization, I am not aware of any requirement to make the mechanism the default avenue for recovery of undepreciated past investment costs. It is always useful to have another tool in the toolkit, but the tool's applicability depends on the specific context of the case. Here, I do not see a compelling reason or need for Empire to use securitization over regulatory asset treatment.

Q. Does this conclude your Rebuttal Testimony?

A. Yes.

VERIFICATION

I, Frank C. Graves, under penalty of perjury, on this 20th day of December, 2021, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Frank C. Graves