

**BEFORE THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS**

In the Matter of the Application of The Empire)
District Electric Company for Approval of its)
Asbury Environmental and Riverton Cost) Docket No. 17-EPDE-280-TAR
Recovery (AERR) Rider to Replace the Existing)
Asbury Environmental Cost Recovery (AECR))
Rider)

**NOTICE OF FILING OF STAFF'S
REPORT AND RECOMMENDATION**

COMES NOW, the Staff of the State Corporation Commission of the State of Kansas ("Staff" and "Commission," respectively), and files its Report and Recommendation (R&R) dated June 12, 2017, attached hereto and made a part hereof by reference. Staff recommends the Commission approve the Application by The Empire District Electric Company to amend and replace its Asbury Environmental Cost Recovery ("AECR") Rider with the proposed Asbury Environmental and Riverton Cost Recovery ("AERR") Rider with Staff's updated revenue requirement of \$1,740,667.00, or \$0.00798 per kWh. The average Kansas residential customer's bill will increase by \$4.89 per month or a total AERR surcharge of \$8.41 per month.

WHEREFORE, Staff submits it's Report and Recommendation for Commission review and consideration, and for such other relief as the Commission deems just and proper.

Respectfully submitted,

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**REPORT AND RECOMMENDATION
UTILITIES DIVISION**

TO: Chairman Pat Apple
Commissioner Shari Feist Albrecht
Commissioner Jay Scott Emler

FROM: Chad Unrein, Senior Auditor
Adam Gatewood, Managing Financial Analyst
Justin Grady, Chief of Accounting and Financial Analysis
Jeff McClanahan, Director of Utilities

DATE: June 12, 2017

SUBJECT: Docket No. 17-EPDE-280-TAR: In the Matter of the Application of The Empire District Electric Company for Approval of its Asbury Environmental and Riverton Cost Recovery (AERR) Rider to Replace the Existing Asbury Environmental Cost Recovery (AECR) Rider

EXECUTIVE SUMMARY:

Empire District Electric Company (Empire) filed an Application requesting approval of its Asbury Environmental and Riverton Cost Recovery (AERR) rider. The AERR rider will replace the current Asbury Environmental Cost Recovery (AECR) rider and includes in the rider the incremental revenue requirement associated with the new Riverton 12 combined cycle natural gas unit (Riverton 12). Staff conducted an audit of Empire's Application, as discussed below, and recommends approval of Empire's requested AERR rider with Staff's updated revenue requirement and capital structure calculations. If approved, the revised AERR rider will result in an incremental revenue increase of \$958,186, recovered as an increase of \$0.00464 per kWh. This increase would be added to the current AECR rider revenue requirement of \$782,481 or \$0.00334 per kWh, equaling a total AERR revenue requirement of \$1,740,667 or \$0.00798 per kWh. The average Kansas residential customer using 1054 kWh per month will see an increase of \$4.89 per month or a total AERR surcharge of \$8.41 per month.

BACKGROUND:

On January 6, 2017, Empire District Electric Company filed its Application requesting the Kansas Corporation Commission's (KCC) approval of its AERR rider, which would replace the

existing AECR rider. On April 14, 2015, the Commission issued an Order in Docket No. 15-EPDE-233-TAR approving the AECR rider on an interim basis to recover costs associated with Empire's environmental retrofit of the Asbury coal-fired generation station to meet the Environmental Protection Agency's enacted air quality standards and avoid the cost of processing two Empire rate cases over an 18-month period.

On March 16, 2016, Empire (EDE), Liberty Sub Corp (LSC), and Liberty Utilities (Central) Co. (LUCo) filed a Joint-Application in Docket No. 16-EPDE-410-ACQ (16-410 Docket) seeking Commission approval of an Agreement and Plan of Merger that called for LUCo to acquire all of the capital stock of Empire by way of merging LSC with Empire. On October 6, 2016, the Joint Applicants, along with KCC Staff and the Citizens Ratepayer Board (CURB), filed a Joint Motion requesting that the Commission issue an Order approving the terms and conditions as set forth in the Unanimous Settlement Agreement (Settlement Agreement). On December 22, 2016, the Commission issued its Order approving the Joint Application and Settlement Agreement.

As part of the Settlement Agreement, Empire agreed to withdraw its Application for a rate increase filed on September 16, 2016, in Docket No. 17-EPDE-101-RTS (17-101 Docket) and not re-file a request to change its base rates prior to May 1, 2018, with new rates effective no sooner than January 1, 2019. Additionally, Empire agreed to seek an Order from the Commission to amend its current AECR rider to include the revenue requirement associated with the new Riverton 12 following the close of the Empire acquisition transaction.

Staff and CURB agreed to not categorically oppose Empire's request to amend the AECR rider provided the revised rider met the following conditions¹:

- (1) The revised rider should be referred to as the AERR rider;
- (2) The revised rider should update Gross Plant and Accumulated Depreciation associated with all components of the AERR revenue requirement to the most recent data possible;
- (3) The AERR rider will use the least cost capital structure determined by comparing the actual capital structure of any other entity which Empire receives financing from (including but not limited to the consolidated Algonquin Power & Utilities Corporation (APUC) capital structure);
- (4) The AERR rider will use a return on equity of 9.3%;
- (5) The AERR rider will be implemented on an interim basis, subject to true-up and eventual refund or recovery in Empire's next base rate case, with the agreement that Staff and CURB reserved their rights to challenge the reasonableness of any of the costs collected under the AERR rider in Empire's next general rate case.

Like the AECR rider, the AERR rider is to be implemented on an interim basis, subject to refund. The rationale for this concept is that the rider could be implemented without a comprehensive review (and attendant costs) that typically accompanies a utility rate filing, with a full review of all components of the revenue requirement calculation at the time Empire files its next rate case. Once the full review is complete, the revenue requirement will be recalculated, and any revenue recovery in excess of the Commission determined rate will be refunded.

¹ 17-EPDE-410-ACQ; Order on 12/22/16, Exhibit A, p7, para 26.

Empire's total conversion cost of Riverton 12 from a simple cycle natural gas turbine to a combined cycle natural gas turbine was \$168,553,709, which was approximately \$7 million under-budget. Riverton 12 was placed into service on May 16, 2016, and is currently being used to service Empire's customers.

ANALYSIS:

As Stated above, Staff suggested to Empire that it would not object outright to Empire's request to amend the AECR rider to include investments in Riverton 12, if Empire followed the conditions in the Settlement Agreement. Staff verified that Empire's AERR Application met the terms and conditions as set forth in the Settlement Agreement from the 16-410 Docket. As part of Staff's review of Empire's AERR rider Application, Staff issued discovery, reviewed and analyzed Empire's workpapers, verified the components of the revenue requirement calculation, and determined that the revenue requirement was correctly calculated. Through discovery, Staff acquired Empire's purchase orders for the Riverton 12 project and verified the total Riverton 12 project cost. Staff did not perform a full review of the prudence of Empire's investment in Riverton 12 or the actual capital cost expenditures. Staff will perform a comprehensive audit of all components of the revenue requirement calculation (weighted average cost of capital, depreciation rates, the Kansas jurisdictional allocator, etc.) at the time Empire files its next rate case.

Pursuant to condition No. 2 of the Settlement Agreement; Staff updated the revenue requirement to include an update to gross plant, accumulated depreciation, and depreciation expense through February 28, 2017. The income tax calculation within the revenue requirement was automatically recalculated following Staff's plant and capital structure updates. The calculation of Staff's AERR revenue requirement is detailed in Attachment 1 to this report.

In the Application, Empire's filed Weighted Average Cost of Capital (WACC) was 7.57%. Empire's WACC calculation contains three components: the APUC pro forma capital structure, which consisted of a 55% debt ratio and 45% equity ratio;² the EDE cost of debt of 6.15%; and the cost of equity of 9.30% stated in the Settlement Agreement. Pursuant to condition No. 3 as specified in the Settlement Agreement, Staff updated the three components of the WACC calculation using the same methodology used by Empire. Staff evaluated the actual capital structures of EDE, LUCo, and APUC at first quarter ending March, 31, 2017, to determine the least cost capital structure of the affiliates. In Staff's analysis, the APUC capital structure was determined to be the least-cost alternative of the three affiliates with a 57% debt ratio and 43% equity ratio, which Staff utilized in its WACC calculation.³ Staff verified the capital structure data of each affiliate using several publicly available sources of financial data.

² APUC is Algonquin Power & Utilities Corporation. APUC's operations are organized across two primary North American business units consisting of the Liberty Power Group which owns and operates a diversified portfolio of non-regulated renewable and thermal electric generation utility assets; and the Liberty Utilities Group, which owns and operates a portfolio of regulated electric, natural gas, water distribution and wastewater collection utility systems, and transmission operations. (Algonquin 2017 Q1 Report, Management's Discussion and Analysis; p.1) Empire resides in the Liberty Utilities Group of APUC.

³ KCC DR 12.

The Settlement Agreement does not specify the cost of debt to use in the AERR rider. Staff considered that the weighted cost of debt tied to the long-term debt of the Empire subsidiary of APUC was appropriate in this circumstance as this cost is specific to Empire's financing activity and, therefore, would capture bond investors' view of risks and their required return for Empire. Empire's embedded cost of debt at March 31, 2017, was 5.07%⁴. Staff verified that the weighted cost of debt was calculated as it would be in a traditional rate case. The inputs to the weighted cost of debt were verified using several publicly available sources of financial data.

The third component of the return incorporated in the AERR rider was the return on equity. The Settlement Agreement stated that cost of equity in the AERR rider will be 9.30%, which is consistent with the most recent return on equity allowed by the Commission for an electric investor owned utility.⁵ Utilizing these three components, the resulting WACC was 6.90%. The support for Staff's WACC calculation is detailed in Attachment 2 to this report.

Staff's updates to the revenue requirement calculation and WACC detailed above resulted in a total AERR rider revenue requirement of \$1,740,667 or a decrease of \$127,035 from Empire's filed Application. When compared to the current AECR rider, the revised AERR rider will result in an incremental revenue increase of \$958,186, recovered as an increase of \$0.00464 per kWh. An average Kansas customer using 1054 kWh will see an increase of \$4.89 per month or 4.83%.

In the 16-410 Docket, Staff witness Justin Grady's Testimony in support of the Settlement Agreement provides a detailed analysis of the savings resulting from the delay of Empire's rate increase filed in the 17-101 Docket and the rate moratorium provision of the Settlement Agreement. The analysis uses a Net Present Value (NPV) calculation to quantify the ratepayer's value that could be attributed to the delay of the probable rate increase. As part of the calculation, Staff removed the impact to the expected revenue requirement associated with the Riverton 12 combined-cycle conversion, which is consistent with the Settlement Agreement not to contest Empire's Application to amend the AECR rider to include the Riverton 12 investment. After Staff made several adjustments to Empire's revenue requirement calculation consistent with the Commission's current ratemaking practice, Staff arrived at a potential revenue requirement increase of around \$4.1 million per year. Using a discount rate of 8% and taking into account the negative effects for increased corporate overheads, the NPV for delaying the rate increase over the 20-month rate moratorium equated to \$5.77 million or about \$597 per Kansas customer.

While Empire agreed to withdraw its pending rate increase as part of the Settlement Agreement, the rate increase was not eliminated, but simply deferred until Empire re-files its request sometime after May 1, 2018, with rates going into effect sometime after January 1, 2019. Empire's withdrawn rate increase would have resulted in a significant increase in customers' bills of approximately 25%. In order to lessen the impact of any future rate increase and avoid rate shock on Empire's customers, Staff and CURB agreed that Empire should seek an Order from the Commission to amend its existing AECR rider to include the Riverton 12 revenue requirement increase as soon as practical, provided the filing complies with conditions as set forth in the Settlement Agreement.

⁴ KCC DR 12.

⁵ See September 10, 2015, Order on KCP&L's Application for Rate Change, Docket No. 15-KCPE-116-RTS. <http://estar.kcc.ks.gov/estar/ViewFile.aspx/20150910114007.pdf?Id=fce20218-fbcb-4a93-b060-5a0be2f9328f>

Staff and CURB have engaged in discussion surrounding each of the parties' respective views of the Application. Staff and CURB proposed a notification be sent to Empire's Kansas customers to provide background information regarding the AECR rider's replacement with the AERR rider. The notice provides customers information about the Settlement Agreement from the 16-410 Docket and Empire's withdraw of its request for a rate increase in the 17-101 Docket. Also, the notification discusses Empire's investment in the conversion of Riverton 12, the inclusion of the costs in the AERR rider's revenue requirement, and the AERR rider's average cost for customers on a monthly basis. The notification will be sent to all Kansas customers as a billing insert. Empire provided Staff and CURB an advanced copy of the notification, which is included as Attachment 3 to this report.

RECOMMENDATION:

Staff recommends the Commission approve Empire's request to amend and replace its AECR rider with the proposed AERR rider with Staff's updated revenue requirement of \$1,740,667 or \$0.00798 per kWh with the following conditions:

1. Empire's AERR rider is to be implemented on an interim basis, subject to refund.
2. The AERR rider will terminate with the rates effective date of the Commission's Order in Empire's next general rate case.
3. Prior to the AERR rider becoming effective, Empire shall file a revised AERR rider tariff containing Staff's recommended changes, as attached to this Report and Recommendation.
4. The Customer notice as attached to this Report and Recommendation and agreed to by Empire and CURB shall be sent to each of Empire's Kansas customers.

The Empire District Electric Company
the Asbury Environmental and Riverton Rider (AERR) Revenue Requirement

Line No.	Description	Amount (\$)
1	I. AERR Costs	
2	Rate Base	
3	Plant and Equipment In Service at February 28, 2017	\$ 303,924,684
4	Accumulated Depreciation	7,836,365
5	Total Rate Base (Line 3 - Line 4)	\$ 296,088,319
6		
7	Kansas Jurisdiction Allocation Percentage	5.06%
8		
9	Kansas Jurisdictional Rate Base (Line 5 x Line 7)	\$ 14,982,069
10	Rate of Return on Rate Base	6.90%
11	Return on Rate Base (Line 9 x Line 10)	\$ 1,033,047
12		
13	Expenses	
14	Depreciation Expense	\$ 310,675
15	Income Taxes	396,945
16	Total Expenses (Sum Lines 14 - 15)	\$ 707,620
17		
18	Total AERR Revenue Requirement (Line 11 + Line 16)	\$ 1,740,667
19		
20	II. True-Up Adjustment	
21	Prior Year Actual AERR Revenue Requirement	\$ -
22	Prior Year Actual AERR Revenue	-
23	Current Year True-Up Adjustment (Line 21 - Line 22)	\$ -
24		
25	III. Total AERR Revenue Requirement (Line 18 + Line 23)	\$ 1,740,667
26		
27	IV. Kansas Retail Revenue Sales - kWh (for the Twelve Months Ending June 30, 2016)	218,064,176
28		
29	V. Kansas AERR Rate per kWh	\$ 0.00798

The Empire District Electric Company
Proforma Capital Structure and Weighted Cost of Capital

	<u>March 31, 2017</u>		
	<u>% of</u>	<u>Cost</u>	<u>Weighted</u>
	<u>Total</u>	<u>Rate</u>	<u>Cost</u>
First Mortgage Bonds/Unsecured Debt	56.87%	5.07%	2.88%
Common Equity	43.13%	9.30%	4.01%
Total	<u>100.00%</u>		<u>6.90%</u>

Note:

The components of Staff's WACC calculation consists of the the Algonquin Power & Utilities Corporation capital structure of 57/43, Empire District Electric cost of debt of 5.07%, and a 9.30% cost of equity as stated in the Stipulation and Agreement in Docket No. 16-EPDE-410-ACQ.

Source: Empire's response to Staff Data Request No. 12

NOTICE OF REPLACEMENT OF EXISTING ENVIRONMENTAL RIDER

The Empire District Electric Company ("Empire"), A Liberty Utilities Company, has filed an application with the Kansas Corporation Commission ("Commission") requesting approval to replace its existing environmental rider. The proposed rider is designed to continue to recover costs associated with the investment in new environmental control equipment at its Asbury generating station and it will now include the investment in Empire's New Riverton 12 combined cycle natural gas fired generating unit ("Riverton 12"). The new charge will be called the Asbury Environmental and Riverton Cost Rider or "AERR." The proposed AERR charge is designed to recover annual costs of \$1,867,702 from Empire's Kansas customers.

Empire's Application has been filed as part of the Settlement Agreement approved by the Commission in the recent merger between Empire and Liberty Utilities. In that Settlement Agreement, Empire agreed to withdraw its pending rate case and agreed to not change its base rates any sooner than January 1, 2019. While Empire agreed to withdraw its pending rate increase late last year, this rate increase request was deferred, not eliminated. In order to lessen the impact of any future rate increase on customers, Empire, the Commission Staff, and the Citizens' Utility Ratepayer Board ("CURB") agreed that Empire would seek an order from the Commission to amend its existing environmental rider to include the Riverton 12 revenue requirement increase as soon as practical, provided the filing complies with certain conditions as set forth in the Settlement Agreement.

Under the proposed AERR, a residential customer using about 1,000 kilowatt-hours per month will see an incremental increase of \$5.50 on monthly bills. The proposed AERR will increase the cost of electricity to all of Empire's approximately 9,669 Kansas retail customers, of which 8,214 are residential, 1,245 are commercial and small industrial, 49 are large industrial and 161 are public authority and street and highway customers.

Regulatory Responsibility

The Commission regulates public utilities including home telephone, natural gas, electric and water companies, as well as motor carriers, oil and gas pipeline, and oil and gas producers. The Commission's regulatory oversight of public utilities primarily pertains to rates and terms of service. In order to ensure that customers of regulated utilities are provided sufficient and efficient service at just and reasonable rates, utilities may not change their rates without Commission approval.

Additional Information

A complete copy of Empire's Application and supporting testimony is available on the Commission's website at: <http://www.kcc.ks.gov> searching Docket Filings for docket number 17-EPDE-280-TAR. If you need additional assistance or more information about the proposed change to the existing rider, you can contact Empire at 1-800-206-2300, or contact the Commission's Office of Public Affairs and Consumer Protection at 1-800-662-0027, or at public.affairs@kcc.ks.gov.

CERTIFICATE OF SERVICE

17-EPDE-280-TAR

I, the undersigned, certify that a true and correct copy of the above and foregoing Notice of Filing of Staff's Report and Recommendation was electronically served this 14th day of June, 2017, to the following:

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