BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of The Empire District Electric Company of Joplin, Missouri for authority to file interim tariffs increasing rates for electric service provided to customers in the Missouri service area of the Company.	)	Case No. ER-97-82

INITIAL BRIEF OF
ICI EXPLOSIVES USA, INC. AND PRAXAIR, INC.

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TABLE OF CONTENTS

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I. INTRODUCTION.

A. Procedural Background.

On August 30, 1996, Empire District Electric Company (Empire) filed tariffs designed to increase its Missouri Service Area revenues on an interim basis. On the same date, Empire filed a request for permanent rate relief, docketed as ER-97-81. ICI Explosives USA Inc. and Praxair, Inc. (ICI and Praxair) timely filed an intervention on September 10, 1996. On September 23, 1996, the Commission suspended the filing through February 28, 1997 and granted the interventions.

B. Introductory Comments.

Recent years have often seen Empire before this Commission seeking rate relief. In ER-95-279, Empire sought roughly $8.5 million in permanent relief, but agreed to a stipulation increasing its rates only $1.4 million. That stipulation was approved on November 3, 1995 and increased rates were implemented on November 15, 1995. Comes again Empire, arguing that its fuel and purchased power costs have increased over the amounts that were (allegedly) included in the ER-95-279 settlement.

Interim filings are not new to Empire,[1] but this case is unique: Empire disclaims that it is in or approaching an "emergency" situation. The Commission confronts, not an imperiled utility, but a utility that only ten months before settled an $8.5 million rate case for $1.4 million and whose jurisdictional equity return is, based only on Staff's limited analysis, nearly 10 percent. Empire provided no jurisdictional data but only provided total company data that no one claims is a proper basis for a jurisdictional revenue requirement.

Empire filed suggestions urging the Commission to depart from its interim relief standard. Following Empire's interim filing and interventions, both Staff and Public Counsel moved that the interim filing be dismissed or, in the alternative, suspended so that even a cursory investigation could be had.[2]

C. Empire's Justification for Relief is the Classic Circular or "Bootstrap" Argument.

This case represents a direct assault on the Commission's policy regarding interim rate relief -- a policy that has been in place since the mid-1940s. As demonstrated in this brief, Empire's argument is circular and its justification is a bootstrap. Moreover, granting relief not only would do violence to the Missouri standard for interim relief, it emasculates a number

[1]In ER-81-229, Empire's plea for interim relief was rebuffed by the Commission, the latter finding that neither its financial integrity nor its ability to render safe and adequate service had been shown to be imperiled. In that case, included among other things cited by Empire as the source of its troubles, were of "fuel cost increases, the lack of a fuel adjustment clause, and the Commission's prior inattention to its 'low' return."

[2]ICI and Praxair joined in Staff's Motion and were supportive of the position of Public Counsel.

of equally well-recognized regulatory policies including the principle of matching and normalization, and, in the circumstances of this case, single issue ratemaking.

II. LEGAL BACKGROUND.

Because this case represents such a clear attack on a number of regulatory principles, a limited discussion of the rationale behind those principles appears to be in order.

A. Missouri Is a "File and Suspend" Jurisdiction.

Missouri recognizes two methods by which a rate case may be initiated. The first is by the "file and suspend" procedure; the second is through the "complaint" procedure. State ex rel. Jackson County v. Public Service Commission, 532 S.W.2d 20 (Mo. en banc 1975), cert. denied, 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976). Once a utility files for changed rates, the Commission has discretion to suspend effectiveness of the filing and direct an investigation or hearing or allow it to go into effect without such a hearing or investigation. Id., at 28; May Department Stores Co. v. Union Electric Co., 107 S.W.2d 41 (Mo. 1937).

B. The Commission May to Suspend A Filing or Allow It to Become Effective, But All Relevant Factors Must Be Considered.

Even under the file and suspend method, the Commission "must of course consider all relevant factors including all operating expenses and the utility's rate of return, in determining that no hearing is required and that the filed rate should not be suspended." State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 49 (Mo. en banc 1079) ("UCCM"). The Court held that Section 393.270(4) required consideration of all facts having any bearing upon the establishing of a proper maximum price. Id., at 56.

> neither impulse nor expediency can be substituted for the requirement that such rates be 'authorized by law' and 'supported by competent and substantial evidence upon the whole record.'

State ex rel. Missouri Water Co. v. Public Service Commission, 308 S.W.2d 704, 720 (Mo. 1957). UCCM cited Missouri Water for the above statement and for Missouri Water's holding that consideration of all relevant factors is required, even if a rate is not suspended. The question becomes, under what, if any, circumstances, are there exceptions to this rule.

III. EMERGENCY STANDARDS.

In its earlier Motion to Dismiss, Commission Staff summarized Commission emergency relief precedents stretching back to 1949; Public Counsel's Motion to Dismiss responded to Empire's claim that some different standard was in force. Those discussions by Staff and Public Counsel are on point, and we incorporate them by reference in this brief.

A. The Emergency Standard in the Courts.

Interim cases have rarely made it to reviewing courts. Generally review is denied on the basis that any interim issues were mooted by a subsequent permanent rate increase. See, e.g., State ex rel. American District Telegraph Co. v. Public Service Commission, 641 S.W.2d 779 (Mo. App., W. D. 1982); State ex rel.

Capital City Water Co. v. Public Service Commission, 252 S.W.2d 252 (Mo. en banc 1923).

State ex rel. Laclede Gas Company v. Public Service Commission, 535 S.W.2d 561 (Mo. App., D.K.C. 1976) is an exception. The court granted review of an interim case ruling because the question was of recurring nature and great public concern. The Commission had **denied** interim relief to Laclede,[3] but argued to the Court that its power to **grant** interim relief was inferred from Sections 393.140(1) and 393.150, R.S.Mo., the sections establishing the "file and suspend" method. Importantly, the Commission argued to the court that "in reliance upon the quoted statutory provisions, **it had adopted a rule** in Re: Southwestern Bell Tel. Co., 2 Mo.P.S.C. (N.S.) 131, under which it can and has granted special interim relief in **emergency** situations." Id., at 566 (emphasis added).

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[3]Laclede argued that it had: suffered a decline in rate of return on total capital and equity; incurred higher cost of debt; experienced decreases in operating income; experienced loss of load; that earnings per share had dropped from $2.46 to $2.14 in less than one year (1973) and was projected to fall to $1.67 in the next fiscal year; that Laclede stock had fallen in value and was selling below book; that interest coverage on indentures had fallen. The Court, however, noted that: Laclede could still arrange debt financing; that denial would not result in insolvency, inability to serve present customers, or inability to pay dividends; that salaries hadn't been reduced or personnel terminated; and bond ratings wouldn't be affected.

The Laclede Court noted two Commission rulings where interim emergency relief had been granted,[4] reviewed a few decisions from other jurisdictions and then held:

> We hold that the Commission has power **in a proper case** to grant interim rate increases within the broad discretion implied from the Missouri file and suspend statutes and from the practical requirements of utility regulation.

Id., at 567 (emphasis added).

The more recent UCCM case, supra, confirmed the holding in Laclede, and stated that "[a]n interim rate increase may be requested **where an emergency need exists.**" UCCM, supra, at 48 (emphasis added). UCCM also held that the failure of the Commission to consider all relevant factors, including those that would establish a framework "in which to determine if overall rates are reasonable," UCCM, supra, at 57, and therefore invalidated the electric fuel adjustment clause.

B. The Emergency Standard Should Be Retained.

1. The Emergency Interim Relief Standard Is Required By Missouri Law.

Our conclusion from the above cases is rather straightforward. Inter alia, UCCM holds that the Commission must consider all relevant factors before fixing a rate, or even before allowing a filed rate to go into effect without suspension. UCCM also explicitly confirms the earlier Laclede case dealing directly

[4]The cases were: Re: Sho-Me Power Corp., Case No. 17,381 (1972) (applicant operating at a loss of over $70,000 per month and had paid no dividends for five years); and Re: Missouri Power & Light Co., Case No. 17,815 (1973) (relief necessary to avoid a "threat to the company's ability to render adequate service").

with interim relief, that the Commission, **in a proper case**, has the authority to grant interim relief. Indeed, UCCM further supports this conclusion by its reference to Laclede later in the opinion where, after ruling that the fuel adjustment clause was unlawful, the Court said:

> If the electric companies are faced with an "emergency" situation because of rising fuel costs, **they can take advantage of the method set up by the legislature to deal with such situations** and file for an interim rate increase on the basis of an abbreviated hearing [citing Laclede].

UCCM, supra, at 57 (emphasis added).

Since the UCCM court cites Laclede when referring to an "emergency situation," the question then becomes: What constitutes a "proper case" under Laclede and UCCM? Since in the Laclede case the Commission itself asserted that it had established a "rule" in the Southwestern Bell case, and since the Laclede court **affirmed** the Commission's denial of interim relief to Laclede, finding no imminent financial or service threat (thus affirming, at least in that circumstance, the Commission's own application of its rule), we conclude that the "emergency" test is inextricably tied to the preservation of the utility as an operating financial entity, and the preservation of its ability to provide save and adequate service to its customers.[5]

[5]Consistent with this interpretation, in Re: Raytown Water Company, 3 Mo.P.S.C. (N.S.) 18 (1994), the Commission **approved** interim relief because otherwise the utility would have been unable to arrange the short term borrowing necessary to "ensure that its customers receive safe and adequate service." In the earlier case of Re: Empire District Electric Company, 24 Mo.P.S.C. (N.S.) 376 (1981) the Commission **denied** interim relief because there had been no showing that the utility's financial integrity or its ability to render safe and adequate service would be threatened by the denial.

Laclede also shows that declines in rates of return do not, by themselves, demonstrate impending financial doom. Something other than "rising fuel costs" is also required to justify interim relief. The UCCM court noted that the electric companies could seek interim relief if they were "faced with an 'emergency' situation **because of** rising fuel costs." While rising fuel costs might **cause** an emergency, they do not **establish** an emergency. UCCM, supra, at 57 (emphasis added).

2. The Emergency Standard Is Sound Public Policy.

The UCCM court expressed preference for the rate case method because it involved other parties in the process. UCCM, supra, at 49. This regulatory structure, which some might label cumbersome, was designed to protect consumers against exploitation were competition in inherently unavailable or inadequate, and to insure that utilities serve the public interest. UCCM, supra, at 48.

The Laclede court recognized that the Commission needed a means to deal with emergency conditions. It confirmed the Commission's principle that the purpose of an expedited interim hearing is to ascertain whether emergency conditions exist that would impair a utility's ability to render adequate service or imperil its financial integrity. Laclede, 535 S.W.2d at 568.

Here, then, is the public policy conundrum: On one hand, an abbreviated investigatory/hearing procedure sacrifices the confidence derived from a fully developed investigation and hearing. On the other hand, to require a full investigation and hearing might result in the collapse of a utility. The compromise that the Commission has drawn for the past 50 years is: Is the exigency faced by the utility so imminent, so threatening, and so potentially damaging to the public it serves that the **public interest** in the preservation of safe and adequate utility service outweighs the **competing public interest** in a full-blown evidentiary proceeding.

It follows then that, **absent** compelling emergency conditions, there is no justification to cut short the preferred full rate case procedure with all its analytical and procedural protections. The present emergency standard is not rigid; cases show that there is still ample room for Commission consideration of utility-specific factors and conditions. But demonstration of an emergency situation representing imminent impairment of financial viability or imminent jeopardy to safe and adequate service is the sine qua non of interim relief in Missouri. As such it is fully consistent with rational public policy and should be retained.[6]

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[6]Empire witnesses offered two alternatives. Mr. McKinney urged retrospective evaluation of whether prior relief achieved its "purpose" -- a position not helpful to Empire here because the prior case was settled -- and which assumes that the Commission has some private agenda other than fixing just and reasonable rates based on a representative test period. McKinney, Tr. 94. Mr. Fancher complained that the emergency standard required that a utility be financially ruined before relief could be granted (which is a misperception of the standard), but appeared to propose a "relation to other utilities" (a "doing worse than the others") standard which, of course, is no different than current practice utilizing the discounted cash flow model. Note, of course, that Mr. Fancher would appear to want to compare to Union Electric. Since all utilities are not managed uniformly, nor do they face similar risk profiles, such a gross level comparison would be meaningless.

C. Application of the Interim Emergency Standard to Empire.

Taking its evidence at face value, Empire has only shown that its fuel costs have risen, but perhaps not beyond a level which Empire could have prevented or significantly mitigated. It argues that increase results in a reduced equity return to a level just below 8 percent for the total company (without jurisdictional data), but which Staff, on a very limited review, concluded **was not less than 9.62 percent on a Missouri jurisdictional basis**. Empire is not imperiled, financially or otherwise. Empire freely admits that it meets neither an "emergency" nor "near emergency" test.

These facts put Empire close to the situation of Laclede discussed in State ex rel. Laclede Gas Company v. Public Service Commission, 535 S.W.2d 561 (Mo. App., D.K.C. 1976). Like Empire, Laclede conceded that it had not met the emergency standard, but contended its income during the test year would not produce the return allowed by the Commission's last rate order in 1969. Like Empire, Laclede's claim was based on a stipulation with language remarkably similar to that approved in ER-95-279. The Court held that the Commission had made no determination in the prior case of a "minimum" return or that any particular return figure might not also be reasonable.

> Particularly in view of the nature of the 1969 rate order and the reservations specifically contained therein and which have been quoted above, **Laclede simply cannot hold too closely to a contention that any variation from the 1969 rate of return must necessarily be unjust and unreasonable.**

Id., at 573 (emphasis added). Since by the time the interim case was before the Court, the permanent case had been decided, Laclede argued that the Commission's finding of a higher rate of return supported its interim case. The Court, however, pointed to this as a strong reason the whole question of just and reasonable rates should be left to a full rate proceeding in which all facts can be developed with a full opportunity for audit and a mature consideration by the Commission "unless **imperative facts** require to the contrary." Id., at 574 (emphasis added). The Court ruled that Laclede had not met its burden. Neither has Empire.

ICI and Praxair joined in the Commission Staff's Motion to Dismiss and supported the similar renewed motion by the Public Counsel. This hearing was necessary to establish that Empire was **not** in an emergency situation. By Empire's concession that it faces no exigent circumstances, and its reliance, like Laclede, on a "computed" settlement number, Empire fails in its burden to show entitlement to relief and the motions to dismiss should now be granted. It is without prejudice to that essential position that we go forward to address the particulars of Empire's presentation to this Commission.

IV. EMPIRE'S ARGUMENT SUMMARIZED.

Empire's entire case appears to us as based on three pivotal points:

- We [Empire] calculated that we settled the last case for 11.25 percent return on equity. We calculated our interim test period return on equity at 7.97 percent. That's lower than the 11.25 percent that we settled for in the last case. By doing this calculation we consider all relevant factors.

- A convenient way to measure our need for additional revenue is to focus on fuel and purchase power costs which have increased above the level that we were allowed in the last case. We have calculated our claim for relief based on the amount these costs increased over what was included in our last case. These increased costs are really driving the request for interim relief.

- The Commission should not be concerned that the amount of interim relief is excessive. In the permanent case we will be subject to a full audit and we justify a much larger increase and will refund any overcharge, with interest in the unlikely event that the permanent is less.

In each of these points, Empire is wrong.

V. EMPIRE'S CALCULATED EQUITY RETURN IS BASED ON A FLAWED PREMISE AND IS AN ERRONEOUS INDICATOR OF ANY ENTITLEMENT TO RELIEF.

A. A Regulated Utility is Not Entitled to a Guaranteed Rate of Return.

No one questions the principle of utlity law that a regulated public utility is entitled to the **opportunity** to earn an appropriate rate of return on the value of the shareholder property that is used and useful in meeting its service obligation. Exploration of these terms can consume literally days of hearings. At base, however, only an **opportunity** to earn a return is provided. Utility management retains control of the operations of the utility. McKinney, Tr. 76. Utility management may make good decisions and increase shareholder return, or make poor decisions that reduce that return. Management may see its good decisions nullified by unanticipated events such as storms, equipment failure, generating outages, or other simple but costly force majeure occurrences. Neither a return, nor a return at a particular level of return at any particular time is guaranteed. Laclede, supra, at 569-73.

Empire's argument proceeds from an erroneous assumption that a particular rate of return was established in the prior case. But lurking behind that error is the more basic misunderstanding that it is guaranteed some particular rate of return coming out of that case. This assumption is incorrect and should be rejected.[7]

B. ER-95-279 Did Not Establish An Approved Rate of Return of 11.25 Percent.

ER-95-279, Empire's prior rate case, concluded in a November 3, 1996 Report and Order (Exhibit 20) that accepted the terms of a unanimous settlement worked out by the parties to that case. Exhibit 20, p. 6. Empire had sought an increase of $8,543,910; the settlement allowed an increase of $1,400,000, 16.5 percent of the original request. McKinney, Tr. 75; Exhibit 20, Appendix A. The Commission approved and adopted the settlement as in the public interest and on the basis that it "meets the needs of [Empire] in permitting increased rates to go into effect quickly, in time for the winter heating season." Exhibit 20, p. 6.

The ER-95-279 Stipulation includes the following limiting paragraph:

> 12. All parties agree that, except to the extent specified in paragraphs 4 through 10, none of the signatories hereof shall be

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[7]The Commission has repeatedly recognized this principle in evaluating emergency interim relief in prior cases, noting that it would not grant "make whole" relief, but would only grant enough relief to address the "emergency." This position is entirely consistent with Laclede, supra, but would be difficult to do for Empire, since it faces no emergency to rectify.

> deemed to have approved or acquiesced in any ratemaking principle or any method of cost determination or cost allocation underlying or allegedly underlying the Stipulation and Agreement and the revised rate schedules provided for herein.

Exhibit 20, Attachment A, p.6. Paragraphs 4 through 10 of the Stipulation and Agreement did not establish a rate of return, either on equity or overall, either for the jurisdictional business or for Empire as a total company. The Stipulation also includes the following language:

> 15. All parties agree that this Stipulation and Agreement represents a negotiated dollar settlement for the sole purpose of disposing of this case, and none of the signatories to this Stipulation and Agreement shall be prejudiced or bound in any manner by the terms of the Stipulation and Agreement in any other proceeding, except as otherwise specified herein.

Id., p. 7.

Empire Witnesses McKinney and Fancher admitted that the settlement had no rate of return figures associated with it. McKinney, Tr. 85; Fancher, Tr. 130. Empire's claim that the prior case established an 11.25 percent rate of return, or, for that matter, any rate of return, is incorrect. Indeed, Empire's testimony indicates that it was Empire that made this calculation. Mr. Fancher testified that "we" (i.e., Empire) calculated the return on equity at 11.25 percent (Fancher, Exhibit 3, p. 2, l. 22). Fancher, Tr. 130.[8] On the same basis, other parties could contend for a settled equity return of 8 percent, thus

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[8]Since Empire had calculated that its prior case (though settled) had resulted in an 11.25 percent equity return, it would be interesting to see what a similar calculation would have produce if it were assumed that Empire received all the $8.5 million it had originally sought in the ER-95-279 case.

putting even Empire's unadjusted calculation of 7.97 percent equity return right on target.[9]

C. Empire's Claim of a 7.97 Return On Equity is Misleading.

Empire's witness Mr. Fancher testified that he had calculated Empire's return on equity for the test period at 7.97 percent. Fancher, Exhibit 3, p. 2; Fancher, Exhibit 4, p. 9; Fancher, Tr. 110.

Empire's calculation of its return on equity figure was made on the total Empire company and on its unadjusted, per-book numbers. Fancher, Tr. 110, 129. Mr. Fancher could not state what the equity return was for the Missouri jurisdiction. Fancher, Tr. 110. Empire had not performed any of the "routine" normalization or matching adjustments that are performed in rate cases. No wonder Mr. Fancher's return calculation was 7.97 percent. He had made no adjustments for

- **Normal weather**. Weather is an important driver for both natural gas prices and consumption of natural gas for peaking generation. Brill, Tr. 170, 177. No investigation had been made whether the weather in the interim test period was normal, and thus no implications could be drawn as to whether the unadjusted period was a representative period. Fancher, Tr. 122. There are also revenue effects associated with weather. Broadwater, Tr. 320. Since Empire used unadjusted numbers to make its calculation, appropriate adjustments for such weather conditions were not made or evaluated. Brill, Tr. 171.

- **Other Jurisdictional Impacts**. Empire operates in Oklahoma, Arkansas and Kansas as well as Missouri. It has not filed for relief in any of these jurisdictions for several years (McKinney, Tr. 69), and since addition of a major plant addition in State Line I.

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[9]Empire's assertions regarding what was included in this ER-95-279 Stipulation and Agreement will be addressed again in the context of its claims regarding fuel and purchased power expense.

McKinney, Tr. 69-71. These factors would serve to reduce Empire's total company return on equity. Fancher, Tr. 116; Broadwater, Tr. 311. Empire's total company numbers also included its water system. Winter, Tr. 263; Broadwater, Tr. 311. A low return on that system could further reduce Empire's total company return on equity. Broadwater, Tr. 311; see, Fancher, Tr. 116.

- **Spring Storm Expense.** Empire's service area was hit by a significant storm during the test period, necessitating significant repairs to Empire's electrical distribution system. McKinney, Tr. 98. All the expenses of repair incurred during the test period were included. Regulatory principles, however, require amortization of such extraordinary expenses. Empire made no such adjustment. McKinney, Tr. 98; Fancher, Tr. 128. Including the unamortized expenses associated with these repairs concentrates them in the test period, distorts it, and necessarily reduces Empire's return on equity. Fancher, Tr. 128; Broadwater, Tr. 319, 321.

- **Asbury Generating Station Outage.** Empire's Asbury unit experienced an unplanned outage during the test period. Fancher, Tr. 128. Since Asbury is a base-load coal generating station, its loss increased Empire's expenses for natural gas burned in its other units and increased the expense for replacement purchased power. Fancher, Tr. 128; Brill, Tr. 163. Both factors increased Empire's expenses during the test period without a corresponding increase in revenues and reduced Empire's return on equity. Brill, Tr. 165; Broadwater, Tr. 319. Corrective adjustments would obviously be necessary, but Empire made none. Brill, Tr. 163.

- **Reduced Production From Hydro Generation.** Empire experienced a reduction in output from hydro during the test period. Brill, Tr. 163. Generation from hydro is usually inexpensive. Reduction of generation from hydro necessitated increased expense for generating fuels at Empire-owned units, and increased in purchase power expense to make up shortfalls. Brill, Tr. 163 ("[I]t would be replaced at a higher cost"). This further reduces the return on equity that Empire calculated, but would be corrected by adjustments. Brill, Tr. 165.

- **Customer Additions and Growth.** Establishing a representative test year period would require adjustments to reflect customer growth or loss during the period. Winter, Exhibit 15, p. 3. The adjustments would match increasing revenues with increasing investments and expenses. In the case of customer costs, it would adjust out both revenues and associated expenses.

Although experiencing load growth in Missouri, Empire offered no such adjustments to its per books numbers.

- **Empire Calculation Reflects only 7.5 Months of Earlier Rate Relief**. The interim test period (selected by Empire) ran from July 1, 1995 through June 30, 1996. Empire received rate relief that became effective November 15, 1995. Even if all other things remained constant during the test period, only 62.5 percent (7.5 / 12 = 62.5) of this rate relief would be reflected. Since the rate relief affected only Empire's Missouri operations, it would be concentrated in Missouri -- not spread across the total company. Empire made no adjustment for this partial reflection of its rate relief. Revenue calculations were not updated. McKinney, Tr. 50, 59.

- **Expenses of Restructuring Operations**. Beginning before the hearing in its prior rate case, and continuing through October of 1995 (McKinney, Tr. 49), Empire was engaged in a restructuring program to "form an organization that would be effective" and better position the company to "move into the competitive situation that we would find going forward." McKinney, Tr. 50. Associated expenses were considerable and were concentrated within the interim test period. Such expenditures are not representative of normal operations. They might be amortized over a longer period of expected ratepayer benefit, or might be eliminated as nonrecurring expenses. Empire directed no analysis to this issue and made no adjustment for it in its return on equity calculation. McKinney, Tr. 49.

- **Stock Issuance/Capital Structure**. Equity return is nothing more than a percentage quotient obtained through dividing properly calculated earnings by the properly calculated equity investment. Holding the dividend constant while increasing the divisor will result in a lower quotient. Corrective adjustment is needed for the effects of dilution through additional equity investment during the period. Broadwater, Tr. 302, 309. Although additional equity was issued during the interim test period, Empire made no adjustment to its calculated return on equity, nor did it update its capital structure to reflect issuance of additional capital stock issued during the test period. McKinney, Tr. 59; Fancher, Tr. 117-118; Broadwater, Tr. 309.

- **O&M Expense Reductions**. In response to questions from Commissioner Kincheloe, Mr. McKinney revealed that Empire had reduced ongoing O&M expense by $767,000. McKinney, Tr. 88. He later admitted that this amount had not been removed from the interim rate request. McKinney, Tr. 96, l. 20. Mr. Brill stated that it had not been adjusted out because it was "out of period of that test year" (Brill, Tr. 175).[10]

D. Even Staff's Abbreviated Review Does Not Confirm Empire's 7.97 Percent Return Calculation.

Staff Witness Winter testified that he had a very limited opportunity to evaluate Empire's filing. Winter, Tr. 162-63. He testified that he had performed only a very rough calculation essentially intended to seek a rough rate of return calculation (Winter, Tr. 285) to validate that Empire was **not** in an emergency or near-emergency position (Winter, Exhibit 15, p. 2), and had validated not less than a 9.62 percent return on his limited review. Winter, Exhibit 15, p. 7; Winter, Tr. 263. Mr. Winter based his calculations on the per books numbers which ordinarily are the starting point for Staff adjustments to annualize revenues and expenses.

Mr. Winter's work product was presented in this case using Staff's "EMS" computer program produced an output document similar in appearance to a revenue requirement/deficiency calculation in a full rate case. The labels for the various lines are part of the software. Winter, Tr. 265. Mr. Winter confirmed through cross-examination that his calculations did **not** establish a revenue surplus/deficiency and that he had made only three adjustments to Empire's per-book numbers:

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[10]Mr. Broadwater confirmed that any earnings per share figures would reflect imprudence in management decisions regarding fuel purchases. Broadwater, Tr. 319.

Mr. Brill's statement is all the more interesting because of Mr. Brill's reference to July, 1996 natural gas costs are also "out of period" and Empire proposed to tie the refund, if any, to the permanent case.

- **Restructuring Process Costs**. Mr. Winter **reduced** Empire's interim test year expenses by over $5 million ($5,056,787) to eliminate the costs of Empire's voluntary early retirement program ($4,583,188) and associated severance costs ($473,599). These costs represented the one-time increased expenses associated with Empire's restructuring process and its incentives to senior employees to leave Empire's employ.[11]

- **Depreciation Expense**. Mr. Winter (1) increased depreciation expense by $399,070 to annualize it and then (2) removed depreciation charged to clearing accounts ($794,735) to eliminate double-counting of these expenses through the clearing account process. The result was a net reduction to Missouri jurisdictional expense of $395,685.

Winter, Tr. 263, 264. He was direct about not having calculated a revenue requirement for Empire. "Absolutely not," he testified. Winter, Tr. 264, l. 16.[12]

Mr. Winter's abbreviated adjustments demonstrated a 9.62 percent equity return, even using the weighted cost of capital figures from the prior case without further adjustment -- a return on equity 23 percent greater than that Mr. Fancher calculated. Mr. Winter did not adjust for weather (Fancher, Tr. 122), customer growth in revenue, forced outages, reduced hydro production, and non-recurring storm expense, among other things. If

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[11]It deserves note that Empire included these one-time costs, without adjustment. Clearly they **increase** test period costs (for the basis of justifying a rate increase) but should significantly **reduce** future period costs (when Empire would collect the rates it justified with the increased expenses). The total cost of this single issue **exceeds** the increase sought based on fuel. By choosing fuel, Empire deflects attention from contributing factors that are well within the control of management.

[12]Mr. Winter confirmed that Exhibit 18, a true-up exhibit from ER-95-279, represented perhaps 50-60 adjustments in that prior case, a number much more representative and "fairly typical" of what Staff would do in a full case. Winter, Tr. 282-84; Oligschlaeger, Tr. 333.

made, these adjustments would raise Empire's equity return still higher, and perhaps above 10 percent.

E. Empire's Claimed Analogy to Union Electric Is False.

Empire's witness Mr. Fancher sought to claim an analogy between Empire and Union Electric, asserting that an approved equity return for Union Electric had been established at 12.61 percent. This comparison is false.

Mr. Fancher's reference was to the stipulation that resulted in a limited incentive regulation mechanism for Union Electric. Exhibit 8. As was brought out on cross-examination, Empire would be unwilling to accept the same arrangement as Union Electric and on that basis alone the comparison is meaningless.

Union Electric and Empire are dissimilar utilities. Union Electric has a significantly different risk profile than Empire. Fancher, Tr. 111. Empire does not own even a portion of a nuclear generating station; Union Electric owns all of its Callaway nuclear unit. Id. Union Electric's service territory is considerably different from that of Empire with the result that weather conditions will differ. Union Electric (in its most current related stipulation) accepted a 100 mW direct access experiment.

The Union Electric stipulation Mr. Fancher referenced established a "band" within which Union Electric could operate, and within which it was precluded from seeking any rate increases. Earning above the 12.61 percent limit would result in sharing of earnings with ratepayers (Fancher, Tr. 132), a risk Empire does not presently face; a reconciled return below the 10 percent lower limit would allow Union Electric to seek a rate increase (Fancher, Tr. 132), and then such would be subject to full rate case audit. Fancher, Tr. 137; Oligschlaeger, Tr. 335-37. The Union Electric stipulation does not permit Union Electric to seek either an interim relief case or a case under an abbreviated audit. Fancher, Tr. 132, 137; Oligschlaeger, Tr. 335-37.

The calculation of either limit or any return for Union Electric within the band was only made after a number of reconciliation adjustments are first made to Union Electric's per book results. Exhibit 8; Fancher, Tr. 134-35; Oligschlaeger, Tr. 334. Many of what Staff Witness Winter characterized as "routine annualizations and normalizations" (Winter, Exhibit 15, p. 3, l. 2) -- annualizations which Mr. Winter had not completed for Empire because of procedural limitations (Id., l. 1) and which Empire had not done at all (Fancher, Tr. 129) -- would be included. Empire's comparison is apples to oranges and is meaningless.

F. Empire's Per Books Calculation Does Not Represent Consideration of All Relevant Factors As Required By Law.

Empire contends that, because Mr. Fancher made a total company equity return calculation, this necessarily considered "all relevant factors." McKinney, Tr. 89 ("The return on equity represents all those other things"). This type of analysis is not the consideration of all relevant factors required by Missouri law. Mr. Fancher responds differently depending on who asks the question. Compare: Fancher, Tr. 140 (". . . have we considered all factors, and no, we have not."), with Fancher, Tr. 145

("We did consider all relevant factors. All expenses are included. All revenues are included.") Inclusion of a series of numbers in a calculation is not a substitute for considered evaluation of relevant factors. It does not address questions as to whether the series of numbers are properly includable, are themselves proper and accurate representations of what they purport to be, and **or that there are not other relevant factors that have been omitted from the calculation.** Empire has excluded even factors that it agreed were relevant from its calculation. See, e.g., Fancher, Tr. 155, dealing with Empire's failure to make adjustments to eliminate the expenses associated with employees who are no longer on Empire's payroll. Mr. McKinney admitted that not all the numbers, revenue and expenses for the test period were looked at. McKinney, Tr. 101.

Empire's reference in its testimony and during cross examination to "all relevant factors" recognizes that the UCCM case, supra, applies to this docket. Review of the Court's decision in the UCCM case, however, reveals a substantially different set of circumstances than those apparently assumed by Empire.

Adjustments that Empire **did not** make to its per book numbers demonstrate that all "relevant factors" were not considered in Mr. Fancher's calculation. Just to identify a few items:

(1) Mr. Fancher conceded during cross-examination that levels of employment were "relevant factors," but failed to adjust employment expense levels of the company to reflect its early retirement program or to adjust out or correct the one-time $5 million of expenses that Empire had incurred in its early retirement program;

(2) Mr. Fancher failed to adjust for the 7 1/2 months of Empire's $1.4 million revenue increase effective November 15, 1995;

(3) Mr. Fancher failed to adjust for the storm damage expenses; and

(4) Mr. Fancher failed to adjust for the forced outages that occurred during the interim test period.

The UCCM court was not impressed with claims that the utilities had properly calculated the amount of fuel and purchased power expenses and the kWh sales during a particular period, nor even that the Commission Staff had a full opportunity to audit those selected expenses. The court saw that through the fuel adjustment mechanism, the Commission had changed the legislature's basic structure of utility regulation. The Commission' fuel adjustment mechanism frustrated a **comprehensive review** of **all** the utility's operations over a representative time period. Focus was shifted to selected expenses and revenue items and away from other relevant factors. The Court recognized that, while one expense item or group of expense items may have increased, others may have decreased. Only a **comprehensive review** of all these factors can amount to "consideration of all relevant factors."

UCCM's test is not satisfied by a utility-generated calculation based on its per books numbers; obviously only through the process of an audit and investigation by all interested parties will "relevant factors" be identified and examined. Just as here, Empire did not adjust for numerous identified items, Empire may have overlooked other items in its per books numbers that a more thorough analysis would reveal.

Empire's contention is an exercise in question-begging. UCCM requires the **Commission** to consider all relevant factors -- not the utility. The UCCM Court stated a clear preference for the full rate case method and "consideration" means more than just one party's view of what is a relevant factor.

VI. EMPIRE'S FUEL CALCULATIONS ARE FLAWED AND PROVIDE NO BASIS FOR RELIEF.

Seeking to avoid UCCM, Empire contends that it has only used fuel and purchased power expense as an expedient way of identifying an amount of relief to award. See, McKinney, Tr. 88. However, Empire incorrectly assumes that the ER-95-279 settlement established a base level of fuel cost. Evidence demonstrated that much of the claimed increased natural gas cost could have been avoided had Empire hedged its position in a market that its own witnesses characterized as "volatile" and "unpredictable." Instead it attempts to shift the consequences of its decisions to its ratepayers.

A. Empire's Claim for Interim Relief Is Based on a Fuel and Purchased Power Cost Increase.

Empire's witness Brill was the source of the $4.018 million calculation on which Empire based its interim relief request. Mr. Brill testified:

> The purpose of my testimony is to describe the calculations used for determining the fuel and purchased power adjustment **on which Empire has based its request for interim rate relief.**

Brill, Exhibit 5, p. 2 (emphasis added). Empire tries to argue both sides of the issue. Empire Witness Fancher states that he has reviewed "all relevant factors," (even though the record established otherwise). Empire Witness Brill testifies that Empire has based its interim rate relief request on **his** $1.54/MMBtu fuel and purchased power adjustment. On one hand, Mr. Brill's view appears to be confirmed by Mr. McKinney who testified that if there were a fuel adjustment clause, Empire would not be before the Commission for interim relief. McKinney, Tr. 72. However, Mr. McKinney asserted that Empire's method to calculate

> "the deficiency is simply to use the fuel and purchase power as a calculation tool, something to simplify what was intended to be a simple interim request."

McKinney, Tr. 58. See also, McKinney, Exhibit 2, p.2; McKinney, Tr. 73.

It seems to us irrefutable that Empire has based its request for interim relief on Mr. Brill's calculation of increased fuel costs. McKinney, Tr. 87. No other evidence supports the calculation of Empire's $4.018 million figure. Mr. Fancher's testimony and his attempt to suggest consideration of all relevant factors through a return calculation seems more an afterthought in recognition that seeking to base an rate increase request on an increase in fuel and purchased power costs runs afoul of the UCCM decision and single issue ratemaking.

B. Empire's Claim that the ER-95-279 Settlement Established a Level of Fuel and Purchased Power is Without Merit.

Mr. Brill based his calculation on a contention that a $1.54/MMBtu cost of natural gas had been "built in" to the ER-95-279 settlement. Brill, Exhibit 5, pp.2-3. Mr. Brill then calculated the difference between that number and what he contended was a more "current and reasonably expected" gas cost of $2.335 and $2.38/MMBtu and multiplied that difference by the MMBtus in what he claimed was the final Staff fuel run.[13] Mr. Brill apparently just changed only those numbers in the run; Empire did not update kWh sales for the different period. McKinney, Tr. 59; Brill, Tr. 163-64.[14]

Empire simply has no basis to point to any figure whatsoever as a "final" fuel run. The ER-95-279 settlement states that it is a "negotiated dollar settlement only." Exhibit 20, Attachment A, p. 7. It thus belies Empire's attempt to reach behind that settlement to extract some other party's contentions as to a level of included fuel or any other component of that settlement. As pointed out by Staff Witness Featherstone, other parties to the ER-95-279 proceeding could have used different amounts for various rate components in their respective evaluations of the settlement and those amounts would quite likely be different from those Empire would have used. Indeed, Empire Witness McKinney, despite earlier claims of agreement to specific natural gas prices (Tr. 74) conceded on cross-examination that there had been

[13]Mr. Brill's "current" price for natural gas was taken from two contracts that he had obtained for July, 1996 supplies -- a period out of the test period for the interim case. No analysis of these contracts was offered, nor were they demonstrated to be representative. Had Mr. Brill chosen to use an average of natural gas prices during the test period, his calculation would have been more subdued.

[14]The justification offered by Mr. McKinney for this procedure was that "everyone had already agreed to" those runs. McKinney, Tr. 60. Once again, Empire misunderstands the language of the ER-95-279 settlement stipulation which denies agreement to particular alleged components of that settlement. But, even if there **had** been explicit agreement to certain "runs" in the earlier docket, those runs were with respect to a **different test period.** Quite obviously, the matching principle would, at a minimum, require revision of kWh sales to update the model.

no specific agreement regarding the price of natural gas in that earlier proceeding. McKinney, Tr. 75.

Staff Witness Featherstone confirmed that the ER-95-279 Stipulation and Agreement did not identify or place values on any cost elements associated with the settlement. Featherstone, Exhibit 11, p. 6. Mr. Featherstone further testified that Staff had utilized a figure of $1.63/MMBtu per its original direct testimony filing. Featherstone, Exhibit 11, pp. 6-7. Mr. Featherstone testified that Mr. Brill's assumption regarding the level of purchased power cost was also in error. Id.

Only Staff would be in a position to know on what basis Staff chose to evaluate the settlement. During cross-examination, Mr. Brill admitted that he had assumed that the level of natural gas cost available to Empire (Brill, Tr. 166), admitted that he did not know what natural gas cost the case was settled on (Brill, Tr. 166), admitted that he had no knowledge of the gas cost underlying the stipulation (Brill, Tr. 167), and admitted that he was not personally involved in the ER-95-279 settlement discussions and did not know what price was ever communicated to Empire. Brill, Tr. 167. Mr. Brill obviously relied on what he was told by someone else at Empire. He was misinformed, made an assumption, and his assumption was wrong.

A collateral issue here should not be missed. The settlement stipulation in ER-95-279 was agreed to by Empire and all other parties as a dollar settlement only. Its language disavowed approval or acquiescence in any underlying cost allocation component. The settlement was accepted, and rates were implemented. Case closed. All disputes and speculation regarding values placed on particular components of that settlement are merged in that settlement and become legally irrelevant in a subsequent proceeding. It matters not what Staff's final run was, nor what **Empire's belief** as to the level of fuel included in those rates was. It is error to look behind the closed settlement. Empire's attempt to collaterally attack the settlement in ER-95-279 should be soundly rejected.

C. Empire Accepted the Risk of a Volatile Gas Marketplace by Declining to Hedge Its Purchasing Decisions.

Both Mr. Brill and Mr. McKinney attributed Empire's interim request to increases in the cost of natural gas and purchased power. McKinney, Tr. 59, 72; Brill, Tr. 160. Mr. Brill acknowledged the volatility and unpredictability of natural gas as a fuel. Brill, Tr. 169. Given volatile and unpredictable commodity prices, a prudent purchaser seeks a hedge.

Mr. Brill testified that Empire had familiarity with hedges and had purchased both call and collared options before. Brill, Tr. 181, 184. Mr. McKinney conceded that Empire had predicted natural gas costs between \$1.82 and \$1.91/MMBtu. McKinney, Tr. 77. Mr. McKinney was then confronted with Exhibit 6 and acknowledged that Empire had employed hedges to stabilize its natural gas costs as recently at 1995. McKinney, Tr. 79. Mr. McKinney further admitted that Empire could have "locked in" a cost of natural gas for the summer of 1996 at a price between \$1.80 and \$1.85/MMBtu and that Empire would not seek to recover the difference between \$1.82/MMBtu and the cost claimed. McKinney, Tr. 78.

After some waffling about who had made the decision (Brill, Tr. 185-87), Mr. Brill admitted that he had made the decision not to lock in a lower purchase price of $1.80 to $1.85/MMBtu because he felt there was a reasonable assumption that the cost of this volatile and unpredictable commodity would come back down. Brill, Tr. 185. He acknowledged that "our judgment at that time wasn't correct." Brill, Tr. 185, ll. 14-15. He sought to justify his decision by arguing that "had we obligated ourselves for this past summer, we could not have used the gas in August." Brill, Tr. 187, ll. 21-23.[15] Even if true, Mr. Brill fails to recognize that with a locked in $1.80/MMBtu price for natural gas this summer, even with a minimum purchase obligation greater than its current needs, others would have paid Empire to take the quantities of low-priced gas that Empire had **under option** but could not use. Empire is not the only natural gas customer on Williams. At a minimum, it could certainly have recovered the cost of its option **and at the same time exonerated its ratepayers from the risk of a drastic upswing in "volatile" "unpredictable" gas prices.**

[15]Mr. Brill testified that a collared option required the purchaser to take a minimum quantity of gas at the low end of the collar. Mr. Brill fails to distinguish between a "collared option," which remains as its name implies, an **option**, and a "collar" or "collared purchase" which does require a minimum take obligation. Mr. Brill did testify that "I'm not an expert in this area. I think there are other things that can be done." Brill, Tr. 184, ll. 18-19. We respectfully submit that Mr. Brill is more expert and better able to assess the risk of such hedges than the ratepayers to whom he now seeks to shift the consequences of his decision not to lock in a lower gas cost. Lack of management knowledge or expertise ought not to fall on the shoulders of ratepayers.

The Commission should analyze the risks in this circumstance. Empire had the opportunity to lock in a position in natural gas (apparently quantity was not a problem, since Mr. Brill contends that it could have locked up more than it actually ended up needing) at between $1.80 and $1.85/MMBtu. Empire (actually, Mr. Brill) decided not to do so. Empire would have faced little risk from this choice. If it had locked in a price at $1.80/MMBtu and the price had dropped to the $1.54/MMBtu price Empire now contends was "built in" to the last rate case settlement, Empire could have purchased at the lower level. If a minimum purchase had been agreed as a worst case Empire would have had increased costs of only $0.26/MMBtu and might even have been able to mitigate that by an arbitrage, storage injection, or swap.[16] As it is, Empire comes to the Commission claiming the difference between $2.38/MMBtu and $1.54/MMBtu, and asks that its ratepayers shoulder that responsibility.

Empire's position is puzzling. Mr. McKinney testified that Empire had predicted gas costs in the $1.82 to $1.91/MMBtu range, yet declined an opportunity to lock in below that cost. The opportunity to lock in a price below that band (or at the lowest edge of it) should not have been missed. Empire declined the minimal risk of a hedge itself, and attempts now through this interim filing to thrust the responsibility for its improvident decision on its ratepayers. This attempt should be rejected.

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[16]If Empire felt that the cost might come down, but still projected costs in the $1.82-$1.92 range, locking in at below that level with an **option** seems prudent. If the cost dropped, the cost of the option would easily be recovered.

VII. EMPIRE'S ASSERTION THAT A REFUND OBLIGATION PROTECTS THE RATEPAYERS FROM OVERCHARGE IS AN EVASION OF THE RATEMAKING PRINCIPLE OF PROPER MATCHING.

As its most basic position, Empire contends that the Commission should not be concerned that the request for interim relief is excessive, since a full audit will be performed in the permanent case and any excess will be refunded. This position overlooks the difference in test year and the driving forces in the two cases. It would charge ratepayers for the cost of plant before that plant has been placed in service or shown to be prudently acquired.

A. The Test Periods of the Two Cases Do Not Match.

The interim test period is the twelve months ended June 30, 1996; the permanent test year ends September 30, 1996 with limited modifications through May 31, 1997 to include the expected in-service date of its new State Line II unit. McKinney, Tr. 51, 65. Empire witnesses recognized the discrepancy between the two test years. McKinney, Tr. 49, 51; Fancher, Tr. 123. There may be other unexplored differences between the two periods, such as weather. The two cases are driven by different forces and have different considerations.

Here is where Empire's case collapses. Even the unlawful fuel adjustment clause attempted to charge utility customers the costs related to the kilowatthours they consumed. There was an ongoing true-up of incremental cost differences, positive or negative. Empire proposes no such ratepayer protection. As Mr. Johnstone testified:

> Empire misses the mark when it suggests that the final determination of rates in the permanent case would determine whether or not there ought to be a refund. It proposes that rates go into effect immediately while costs that would justify the permanent increase include the Stateline facility that will not be in operation for many months to come. Thus, the comparison of today's rates to costs that may be a basis for rates that may be determined to be appropriate for some future period is not an appropriate procedure and does not offer ratepayers the protection that they ought to have.

Johnstone, Exhibit 9, pp. 2-3.

B. Empire's Proposal Violates the Regulatory Principle of Matching.

Empire's proposal presents a significant timing and causation difference. Rates supposedly based on an increase in the cost of natural gas and purchased power are not justified by increased rates imposed at a much later time, and which later rates are claimed to be justified by an increase in generating plant that was not used and useful during the period the earlier rates were in effect. The situation is almost a classic circular bootstrap. Empire urges the Commission to provide additional money today with the promise that it will be justified in a later filing by factors other than those claimed to support the currently-sought increase.

The regulatory principle of matching (which the Commission recognizes in its suspension orders and did so in Empire's permanent case) is based on a desire to be fair, accurate and representative.[17] The expenses incurred during a particular

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[17]Indeed, the Commission's suspension order in the permanent case (ER-97-81) references and requires the matching principle be observed. Report and Order, p. 2.

test period are matched to revenues received during that same test period, with adjustments to make them representative. Costs associated with additional utility plant are matched (1) with the period that the plant is used and useful to ratepayers and (2) the investment in the plant is recovered over the life of the plant as the value of the investment is depreciated.[18] A major part of most rate cases involves such calculations and disputes about them.

Commissioner Kincheloe put his finger on the problem in his questions to Mr. McKinney and later to Staff Witness Watkins:

> [BY COMMISSIONER KINCHELOE]:
>
> Q. How can you justify the rate you're asking for here based on a rate base that is a different rate base in a different case?
>
> A. **I'm not sure I can answer that question.** Again, what we were trying to do was just provide some protection to the customer . . . .

Tr. 90, ll. 17-25 (emphasis added); see, also, Tr. 242-43. As Mr. Watkins had no direct answer either, and responded: "[O]nce you've done it, I mean, you kind of have to live with it . . . .") Watkins, Tr. 243.

Judge Kincheloe's question is on point, but unanswered. We would suggest that the answer to the question asked Mr. McKinney is: You cannot. The conclusion, of course, is to reject Empire's request as wrongly founded. Protection to the customer is provided through the principle of matching and that principle

[18]Empire Witness McKinney agreed. He testified that the matching principle was designed to match expenses, rate base, and revenues over a similar period of time. McKinney, Tr. 55.

requires rejection of Empire's request. There is no practical protection in the proposed refund procedure.

C. Empire's Proposal Arguably Violates the Statutory Prohibition Against Construction Work in Progress in Regulatory Rate Base.

The effect of Empire's proposal, to potentially overcharge customers today because of increases in fuel and purchased power charges, then justify that overcharge with increases in rate base in a later period, operates to charge customers today for the costs of utility plant before that plant becomes used and useful.

Several years ago, the Commission dealt with the question of whether construction work in progress (CWIP) properly belonged in utility rate base. Controversy erupted between utilities and customers. In 1976 the citizens of the State of Missouri resolved the question by withdrawing authority for the Commission to include CWIP in utility rate base in Missouri. Section 393.135 R.S.Mo. Although acknowledging the statutory prohibition (Fancher, Tr. 142), Empire's proposal invites the Commission to violate that statutory prohibition by allowing future increases in plant (that have not yet been determined to be necessary or prudent, and which are certainly not in service at this time) to be used to justify charges coming out of this interim case.

D. Empire's Proposal Places Empire (and the Commission) in a Dilemma.

Empire cannot argue both sides of the causation/matching/interim relief issue. If the increase it seeks is measured by consideration of all relevant factors, but on an interim increase, it seeks no more than an advance on its permanent rate case, a procedure which violates Section 393.135, R.S.Mo., and numerous other regulatory principles. On the other hand, if Empire seeks an increase because of an upswing in fuel and purchased power costs, when even Empire concedes that all relevant factors have **not** been considered, and it transgresses UCCM decision by seeking to engage the Commission in prohibited single-issue ratemaking. The only exception to this whole conundrum, and the solution to it, is the application of the emergency standard which the Commission has recognized as the standard for **interim relief** for nearly fifty years -- a test which Empire admits it does not meet -- and the resultant rejection of Empire's request.

VIII. EMPIRE'S PROPOSED REVENUE SPREAD IS UNREASONABLE AND DOES NOT PROPERLY RECOGNIZE PRINCIPLES OF COST CAUSATION.

Empire's original proposal proposed a surcharge to all customers of an equal amount per kilowatthour used. While not completely inconsistent with increased fuel and purchased power costs as the cause of the increase, this approach fails to recognize class loss differences, and differences in fuel and purchased power costs between peak, off-peak and seasonal usage. In addition to opposing interim relief for the numerous reasons stated in this brief, ICI and Praxair further oppose the proposed recovery methodology suggested by Empire. Staff joins us in this opposition.

A. If the Basis of the Increase Is Increased Fuel and Purchased Power Costs, Recognition of Class Loss Characteristics Should Be Given.

Empire does not write on a clean slate. In ER-95-279, the approved rates that were implemented differentiated as to energy costs across seasons and time of day. Preceding these changes, the Commission had determined in EO-91-74, Empire's most recent class cost of service and rate design case, to accept a settlement providing a different cost allocation methodology. Mr. Watkins, Staff's technical rate witness here, also testified in EO-91-74. He agreed with ICI and Praxair that Empire's failure to properly recognize differences in losses and differences between peak and off-peak usage and seasonal variations made its equal cents/kWh proposal unacceptable. Watkins, Exhibit 12, p. 4; Johnstone, Exhibit 9, pp. 3, 10. Mr. Watkins stated that, even if the causative factor was high gas costs, such effects were not uniform throughout the hours of the year. Id., at 5. Mr. Watkins stated:

> Unless the rate increases (surcharges) track the cost increases, rates will be moved away from cost of service, there will be revenue requirements shifts within and among classes, and customers will receive the wrong price signals.

Id. Mr. Watkins also stated:

> The effect of a uniform surcharge summer and winter will be for customers with high winter usage, e.g., space heating, to help pay the summer air-conditioning bills of other customers, and for customers with high annual load factors to pay for a disproportionately larger share of the costs than customers with low annual load factors.

Id.

Mr. Watkins explicitly agreed with ICI and Praxair witness Johnstone, who testified:

> [T]he spread of the increase on a kWh basis is inappropriate. If Empire were to spread the increase on an energy basis, it would be appropriate to account for differences in fuel and purchased power cost by time of day and it would also be appropriate to account for the differences in energy losses incurred in providing service to the various classes. Empire has done neither. The result is a method that allocates too much cost to high load factor customers an to customers with above-average off-peak usage.

Johnstone, Exhibit 11, p. 3.

ICI and Praxair have high load factors, among the highest on the Empire system. Praxair, an interruptible customer, Praxair's may technically exceed a 100 percent load factor. A surcharge as proposed by Empire unreasonably shifts costs to them.

B. Staff's Proposal, While Assuming Relationship to Costs of Fuel and Purchased Power, Corrects for Some of Empire's Deficiencies.

Mr. Watkins proposed an alternative method to "remed[y] the flaws in Empire's proposal." Watkins, Exhibit 12, p. 2. He proposed splitting the increase between seasons and peak and off-peak periods, and developing a separate kWh charge for each period and class. Watkins, Exhibit 12, p. 6. Mr. Watkins acknowledged that insufficient data forced him to make hypothetical assumptions about the timing of costs sales to the respective customer classes, but his proposal did account for differences in losses. Id., at 6-7.

Mr. Watkins could offer no proposal regarding how any other expenses should be handled, since he saw no evidence in the record about any other expense. Watkins, Tr. 230, 231. His recommendation would change if a revenue deficiency were not related to any specific item. Watkins, Tr. 232.

Impact questions remained unresolved. Responding to Vice-Chair Drainer, Mr. Watkins acknowledged that he was unable to prepare impact studies to show the effect of the increase as proposed by Empire. Watkins, Tr. 236. Indeed, his numbers were only illustrative. He acknowledged a much greater impact than average on high load factor customers. Watkins, Tr. 239.

C. Commission Concern Regarding Customer Impact May Suggest an Equal Percentage Increase.

Empire's proposal is, at least, consistent with its on-again, off-again justification of increased fuel and purchase power costs. If that be the justification, recognition of the factors that Mr. Johnstone and Mr. Watkins identified is needed. However, as noted earlier, that approach runs the Commission afoul of the UCCM decision. Johnstone, Exhibit 11, pp. 3, 10. If on the other hand, the increase request is not related to fuel and purchased power, there is no basis for a kWh allocation is removed. The changes in other costs must be considered, but were blatantly ignored by Empire. In such a case, Mr. Watkins stated that

> [Y]ou may as well do something equivalent to factoring up the rates and put it on a percent of the bill.

Watkins, Tr. 233.

Given legitimate concern with customer impact, an equal percentage increase among and within all customer classes is at least a means of evaluating impact, even in the absence of data sufficient to perform an accurate impact analysis. To be clear, ICI and Praxair do not believe **any** relief has been shown to be needed. But, if the Commission determines to grant relief, an equal percentage increase is the acceptable method, would not disturb existing rate relationships between and among customer classes, and would provide known impacts based on the same set of facts.

WHEREFORE, ICI and Praxair pray for a decision of the Commission in accordance with the foregoing and, specifically, that Empire's application for interim relief be denied.

Respectfully submitted,

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ATTORNEYS FOR ICI and PRAXAIR

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by telecopy and U.S. mail postage prepaid addressed to all known parties in interest as shown on the Commission's service list.

Dated: December 31, 1996.

Stuart W. Conrad

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