BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric Company's Tariff Revision Designed to Increase Rates, on an Interim Basis and Subject to Refund, for Electric Service Provided to Customers in the Missouri Service Area of the Company.	))))))	Case No. ER-97-82

INITIAL BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

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I. INTRODUCTION

On August 1, 1996, The Empire District Electric Company (Empire) filed proposed tariff sheets designed to increase annual revenues, on an interim basis, by $4,018,071. Based upon Empire's failure to file the necessary permanent case, the Commission rejected Empire's tariff sheets. As the Commission noted, by "its very nature, an interim rate request is merely ancillary to a permanent rate request." Order Regarding Request For Interim Rate Relief, Case No. ER-97-43 (issued August 23, 1996) (citing to State ex rel. Laclede Gas Company v. Public Service Commission, 535 S.W.2d 561 (Mo.App. 1976)).

In light of the Commission's decision in Case No. ER-97-43, Empire, on August 30, 1996, simultaneous with the filing of its permanent rate proceeding, filed tariff sheets designed to implement the interim increase which is the subject of this proceeding. Following the filing of testimony, the Commission held, on November 25 and 26, 1996, an evidentiary hearing in this matter.

As was explained in Staff's opening statement, historically "this has been an easy case." (Tr. 21 and 36). For 47 years, the Commission has grappled with the issue of interim rate relief and its underlying policy concerns. Based upon dozens of situations in numerous cases, the Commission has steadfastly held to its established requirement that interim rate relief be granted only in "emergency" situations. As will be demonstrated later in this brief, the "emergency" standard is time-tested; is flexible in that it allows for near-emergency situations; protects the customer and demands evidence of tangible harm to the utility before rates are increased on an interim basis without benefit of a full Staff audit.

In contrast to the logic inherent within the "emergency" standard, Empire requests the

Commission to adopt a "good cause shown" standard. Based upon Empire's complete failure to provide any definition to its standard, the "good cause shown" standard necessarily fails to exhibit any of the qualities, with the exception of being infinitely flexible, reflected in the "emergency" standard. As the record indicates, Empire's request is actually based upon its desire to shield shareholders from the "volatile and unpredictable" nature of natural gas prices (Brill Direct, Ex. 5, p. 3), a characteristic that has, in the past, worked to the benefit of Empire's shareholders.

On December 1, 1993, Empire filed tariff sheets designed to increase electric revenues by approximately $8 million, Case No. ER-94-174. Utilizing a test year of December 31, 1993, updated through March 31, 1994, Empire ultimately settled the case. Applying Empire's logic from the current case to the 1994 proceeding, the Stipulation was likely built upon a natural gas price of approximately $2.30 / MMBtu (12 months ended natural gas price for March 1994). (Featherstone Rebuttal, Ex. 11, Sch. 5). By the time tariff sheets for that case had been approved, August 12, 1994, the 12 month weighted natural gas price had fallen to $1.97 / MMBtu. (Id.). Prices continued to plummet (Tr. 168-169) and ultimately reached a low of $1.53 / MMBtu. (Featherstone Rebuttal, Ex. 11, Sch. 5). Rather than offer to return the benefits of falling gas prices to its ratepayers, Empire's shareholders received the sole benefit from the "volatile and unpredictable" nature of natural gas prices. (Brill Direct, Ex. 5, p. 3; Tr. 97).

Unlike ER-94-174, in which Empire's shareholders benefitted from the volatility and unpredictability inherent in natural gas prices, today, Empire asks that ratepayers shield its shareholders from such risk.[1],[2] Specifically, Empire claims that natural gas and purchased power

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[1] Empire has, for some time, been well aware of its dependence upon natural gas, both for use in its own gas-fired generation facilities as well as in the price it pays for power purchased from

prices have increased significantly from those contained within the settlement of its last proceeding, ER-95-279. It is this desire to shield its shareholders from such volatility and unpredictability that forms the underpinnings of Empire's request to abandon the "emergency" standard and replace it with a "good cause shown" standard.[3]

As this brief will detail, the logic of decades of Commission precedent, the persuasiveness of dozens of other jurisdictions, the stable nature of Empire's current financial condition and the fatal flaws underlying Empire's interim request all mandate the same conclusion - that Empire's "good cause shown" standard be rejected and its request for interim rate relief denied.

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power marketers and other utilities. (McKinney Direct, Ex. 2, p. 2). Certainly such a situation existed at the time of Empire's last proceeding. (Id.). Despite recognizing the volatile and unpredictable nature of natural gas prices, especially in light of its dependence upon natural gas, Empire refused to "lock in gas costs" through the futures market. (Tr. 81, 180). Evidence indicates that Empire knew how to "lock in" such prices. (Tr. 181). Nevertheless, Empire explains that its refusal to "lock in" natural gas prices was based upon a belief "that spot gas prices would fall after the winter season." (Ex. 7; Tr. 93, 185).

[2] The volatile and unpredictable nature of natural gas prices are reflected in Empire's risk profile, a risk profile that is captured in Empire's stock price and ultimately its authorized return on equity through the DCF calculation. (Tr. 169-170). It would be unequitable to expect ratepayers to compensate Empire shareholders for such risk through the DCF calculation, but then remove such risk from the shareholders and place it upon the ratepayers.

[3] The record appears to indicate that Empire would prefer the implementation of an automatic fuel adjustment recovery mechanism. (McKinney Direct, Ex. 2, p. 2; Tr. 72). As the Commission is well aware, such a mechanism was declared illegal in that it constituted single-issue ratemaking. State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41 (Mo. banc 1979). Interestingly, the fuel adjustment clause, in its last form, did not address increases in natural gas prices and would therefore not be effective in shielding Empire's shareholders from volatility and unpredictability in the price of natural gas. "The Commission concludes that the cost of gas should not be passed on to the customer through the fuel adjustment clause". Re: Fuel Adjustment, 20 Mo.P.S.C. 563, 573-574 (1976).

II. THE COMMISSION SHOULD MAINTAIN ITS RELIANCE UPON THE EMERGENCY STANDARD IN ASSESSING THE PROPRIETY OF INTERIM RATES. RECOGNIZING SUCH A STANDARD, THE COMMISSION SHOULD DISMISS EMPIRE'S INTERIM RATE REQUEST

A. MISSOURI COMMISSION PRECEDENT

In the first case regarding interim relief, Southwestern Bell Telephone Company filed, on May 24, 1949, an application for a temporary rate increase. As its basis for interim relief, Southwestern Bell noted that it was granted increased rates of $3.4 million under authority of the Commission in Case No. 11,191. On appeal, the Circuit Court reversed, for lack of jurisdiction, the Commission's decision in Case No. 11,191. The practical effect of the Court's decision was to relegate Southwestern Bell to the rates in effect prior to Case No. 11,191, rates previously found by the Commission to produce an unreasonably low rate of return. This unreasonably low rate of return was further exacerbated by the incurrence of a $2.3 million wage increase incurred since the Commission's Order in Case No. 11,191. As a result, Southwestern Bell asked the Commission, in an effort to achieve the objectives previously expressed by the Commission in Case No. 11,191, to authorize interim rate relief in the amount of $5.7 million. Re: Southwestern Bell Telephone Company, 2 Mo.P.S.C. (N.S.) 131 (1949).

In its Report and Order, the Commission, noticing the lack of suspension period, found that "parties who desire to oppose or at least look closely into the situation probably will be denied sufficient time to prepare thoroughly their side of the case" effectively resulting in a situation in which "[t]he Commission, in its haste to render immediately needed relief, is more likely to err than where the case is tried in the normal way." (Id. at 134). As such, the Commission, while maintaining that "it has the power to prescribe the conditions under which temporary and emergency operations are to be carried on," effectively limited emergency / interim relief to those situations in which the utility could make a showing of confiscation. (Id.).

The interim standard as set forth in the Southwestern Bell case, remained in place until the Commission in 1975 clarified the standard. Re: Missouri Public Service Company, 20 Mo.P.S.C. (N.S.) 244 (1975). In that case, the Commission discussed the rationale underlying interim relief.

> Under the present circumstances, the mechanism of interim rate relief exists to fill a void in the regulatory process. It is recognized that the machinery of permanent rate relief does at times grind exceedingly slow and that the companies under the jurisdiction of the Commission may, from time to time, find themselves facing emergencies which require timely action by the Commission. However, the fact that time is of the essence in an interim case creates certain constraints which would otherwise not be present in a normal proceeding. The Commission must accept at face value the evidence presented to it by the Company, because time does not permit extensive verification of this evidence by the Commission and its Staff.

(Id. at 249-250). As such, the Commission deemed it appropriate to provide clarification to the previously expressed Southwestern Bell standard. "Therefore, it is incumbent upon the Company to demonstrate conclusively that an emergency does exist. The Company must show that (1) it needs additional funds immediately, (2) that the need cannot be postponed, and (3) that no other alternatives exist to meet the need but rate relief." (Id.). Finding that Missouri Public Service Company had failed to meet the requirements necessary for interim relief, the Commission denied the request for emergency rates.

Since the Missouri Public Service Company case, the Commission has frequently reiterated the emergency or near emergency standard.[4] Re: Missouri Public Service Company, 22 Mo.P.S.C.

[4] The standard set forth in the Missouri Public Service Company case has also been referred to as a "test of immediate need". See, Re: Missouri Public Service Company, 22 Mo.P.S.C. (N.S.) 427, 429 (1978).

(N.S.) 427 (1978); Re: Kansas City Power & Light Company, 23 Mo.P.S.C. (N.S.) 413 (1980); Re: Missouri Public Service Company, 24 Mo.P.S.C. (N.S.) 245 (1981); Re: Martigney Creek Sewer Company, 25 Mo.P.S.C. (N.S.) 641 (1983); Re: Arkansas Power & Light Company, 28 Mo.P.S.C. (N.S.) 143 (1986); and Re: Raytown Water Company, 1 Mo.P.S.C. 3d 184 (1991).

The only exceptions to the consistent application of the emergency or near emergency standard are found in two cases. In Re: Missouri Power & Light Company, Case No. 17,815 (September 14, 1973), no precise standards were discussed; however, it may very well have been a silent application of the immediate need standard since the Company was earning 2.89% on common equity in 1973 in contrast to the 11.9% return authorized by the Commission in 1970. In the other case, Re: Missouri Power & Light Company, 22 Mo.P.S.C. (N.S.) 257 (1978), a "good cause shown" standard was purportedly applied. However, the peculiar facts of the case explain the anomaly. The parties had reached a stipulation in a permanent case as to revenue requirement but the stipulation was rejected by the Commission due solely to rate design considerations. The Company subsequently filed for and received interim relief in the amount previously stipulated to in the permanent rate case.

B. APPROACH OF OTHER STATES TOWARDS INTERIM RELIEF

The authority to grant interim rate relief has been almost universally recognized to exist in the regulatory commissions of this nation. As was recognized in the case of State ex rel. Laclede Gas Company v. Public Service Commission:

> The very real necessity of recognizing such a power in the regulatory agency has long been recognized by courts throughout the country. Not a single case has been cited by Jackson County nor found by independent research which has ever denied such a power to a regulatory agency such as the Missouri Public Service Commission. On the other hand, numerous cases from diverse jurisdictions have

recognized and given effect to such an implied power even in the absence of specific statutory authority.

535 S.W.2d 561, 566 (Mo.App. 1976) (Citations omitted). Generally, the decision to grant interim relief is deemed to be within the sound discretion of the commission. (Id. at 568).

Similar to the approach taken by the Missouri Public Service Commission, the vast majority of jurisdictions have limited interim relief to those situations in which a utility can meet some form of an "emergency" standard. (See Attachment 1).[5]

In the case of Re: Jersey Central Power & Light Company, the New Jersey Board of Public Utility Commissioners addressed the type of situation which would justify interim relief.

> Indeed, since Hope and pursuant to the legal standards we have enunciated, this board is duty bound to provide necessary funds to a utility on an emergency basis, subject to refund in the event of a financial and service crisis. We have defined emergency in rather stringent terms to protect the consumer. There has to be a showing that but for an immediate infusion of ratepayer funds petitioner would not be able to continue to provide safe, adequate, and proper service or reasonably access the market for needed construction or expense. This may take the form of a coverage crisis, an inability to access the financial markets for needed construction, and/or a cash-flow crisis. Mere attrition in earnings is not sufficient unless it impacts financing, construction, or service. It is our inescapable conclusion, after review of this record, that JCP&L is in an emergency financial crisis impacting its ability to

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[5] Attachment 1 only presents those cases which are easily accessible to the Commission through Public Utility Reports (PUR). Therefore, the absence of a particular jurisdiction from Attachment 1 should not be construed as an indication that the jurisdiction does not utilize the emergency standard. A review of the headnotes contained in the index to PUR indicates that many of these jurisdictions utilize some form of the emergency standard, however, those cases are not reported and therefore not easily accessible. For instance, **Colorado:** Re: Public Service Company of Colorado, Docket No. 1420, Decision No. C80-1039 (May 27, 1980); **Georgia:** Re: Georgia Power Company, Docket No. 2532-U (August 7, 1973); **Maryland:** Re: Maryland Marine Utilities, Inc., 76 Md.P.S.C. 332, Case No. 7892, Order No. 67055 (June 17, 1985); **Oklahoma:** Re: Oklahoma Gas & Electric Company, Cause No. 28123, Order No. 238068 (May 9, 1983); Re: Oklahoma Natural Gas Company, Cause No. 28069, Order No. 236244 (April 5, 1983); **Utah:** Re: US West Communications, Docket No. 85-049-02 (1985); **Wisconsin:** Re: Monroe County Telephone Company, 2-U-6221 (July 27, 1965).

> serve customers this day and in the months to come and that a rate increase of $60 million in base rates is absolutely necessary for continued service. Without such relief petitioner and its customers will surely suffer irreparable harm unprecedented in electric utility regulatory experience.

Re: Jersey Central Power & Light Company, 38 PUR4th 115, 117 (N.J. 1980) (Emphasis added).

Similarly, in the case of Re: Commonwealth Edison Company, 40 PUR4th 62 (Illinois 1982), the Illinois Commerce Commission discussed its standards relevant to interim rate relief.

> In deciding this question, the commission believes that there must exist an obvious revenue deficiency coupled with one or more of the following: a sudden decline in revenues caused by factors outside the control of the utility; an inability to arrange debt financing or attract capital at reasonable costs without increased operating revenues; an evidentiary showing that deferral of partial rate relief until a final order can be issued would result in an unreasonable and harmful loss of revenue to the petitioning utility; and that reasonable grounds exist for the commission to believe that the utility would be entitled to rate relief at the time a final order is issued. . . . The commission must act in such a manner as to maintain the financial integrity of the utility and maintain its responsibility to the utility's ratepayers.

(Id. at 64) (Emphasis added). Specifically, the Commission found in that case that:

> The evidence presented in these proceedings and stated in the prefatory portion of this order established that irreparable harm to respondent and to its ratepayers could result in the near and distant future from the denial of the request for interim relief. Various company and staff exhibits, as discussed herein, conclusively show that Edison has an obvious revenue deficiency, is unable to arrange debt financing or attract capital at reasonable costs without increased operating revenues, is experiencing an erosion of earnings during an inflationary period which could seriously impair the company's ability to meet its immediate and far-reaching financial requirements, and that the company's present and projected interest coverages and capital structure would hamper the marketability of securities.

(Id. at 80). As will be seen from the following analysis, Empire fails to meet any of the criteria utilized in granting interim rate relief to Common Wealth Edison.

In still another case, the Indiana Public Service Commission applied an emergency standard in its assessment of the need for interim relief. "Although petitioner is facing an impending cash shortage, there was little or no evidence presented concerning possible curtailments of service, efforts to reduce operating costs or efforts to obtain alternative financing. Based upon the limited evidence presented, the commission could not grant petitioner emergency rate relief." Re: Hoosier Energy Rural Electric Cooperative, Inc., 62 PUR4th 419, 422 (Indiana 1984).

In 1983, the Massachusetts Department of Public Utilities, after previously adopting a lesser standard for the consideration of interim rate relief, returned to the logic of the emergency standard. While the passage does appear long, it is extremely informative in that it presents the consequences, as experienced in Massachusetts, of adopting a lesser standard for interim relief and ultimately the rationale for that State's return to the "emergency" standard.

> We find it appropriate in this case to take the opportunity to reassess and clarify the department's requirement and guidelines for petitions for interim relief. In Re Western Massachusetts Electric Co. (1975) D.P.U. 18252, we stated:
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> "While there is no specific statutory authority to act on an interim basis, the department has recognized that there may be circumstances of great urgency requiring that relief be given to a utility more quickly than would be the case if a full and careful investigation were undertaken. Thus, the department has from time to time entertained petitions for interim rate increases. However, the granting of an interim rate increase necessarily means that the department must act without a full hearing and without subjecting the proposed rate filing to close scrutiny. It is for this reason that we approach requests for interim increases cautiously and have adopted the position that a genuine emergency must exist before such increases will be granted."
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> Further in Re Boston Edison Co. (1978) D.P.U. 19300-A, we stated:
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> "The standard applicable to requests for emergency interim relief is well settled. . . Specifically, we believe that interim rate relief is and should remain extraordinary relief, and that it should be granted only where the company can demonstrate clearly and convincingly that it is the only practical way to avoid probable, immediate, and irreparable harm either to its business or to the interests of its customers."

The department, in certain cases, has found that companies have met this burden and has granted emergency interim relief. See Re Haverhill Gas Co. (1975) D.P.U. 18261-A.

Thus, historically, the interim relief procedure existed as a device to provide relief to companies which demonstrated by "clear and convincing" evidence that such relief was necessary "to avoid probable, immediate, and irreparable harm either to its business or to the interest of its customers." Re Western Massachusetts Electric Co., *supra*. This standard for interim relief, the so-called "emergency" standard, was modified by the department in Re New England Teleph. & Teleg. Co. (1980) 41 PUR4th 121, to a less restrictive standard because of the department's expressed concern about the effects of regulatory lag in an inflationary period. The department's modified standard was explained in detail in Re Western Massachusetts Electric Co. (1981) D.P.U. 557. In that decision we explained that the "D.P.U. 380 standard is intended to directly address the negative impact of regulatory lag upon a company in an inflationary economy." Therefore, in order to meet the modified standard, a company had to show that regulatory lag existed and that such regulatory lag had a negative effect on the company as a result of the impact of an inflationary economy.

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Since the adoption of the modified standard in D.P.U. 380 companies have, with increasing frequency, sought interim relief and have sought to expand upon the reasons for interim relief. This experience indicates that the broadening of our previous standard has served mainly to impose administrative burdens upon an already tightly constrained six-month suspension period. The filing and reviewing of such interim proposals have presented serious problems in the expeditious and proper treatment of general rate filings.

In light of these factors, the department hereby returns to the strict emergency standard as described in the Western Massachusetts Electric and Boston Edison cases. We will henceforth grant interim relief only in extraordinary cases where a genuine emergency is clearly shown to exist.

Re Fitchburg Gas & Electric Light Company, 52 PUR4th 197, 201-202 (Mass. 1983) (Emphasis added).

As one can easily see, the emergency standard has been accepted by virtually all the jurisdictions of this nation. And in those instances when other standards have been implemented, common sense has mandated a return to the logic of the emergency standard.

C. EMPIRE'S PROPOSED STANDARD

Recognizing the emergency standard historically employed by the Commission in its assessment of interim rate relief and its current financial situation, Empire has made no claim of an "emergency" situation. (Fancher Rebuttal, Ex. 4, pp. 1-2). Instead, while suggesting that the strict nature of the emergency standard was developed solely in response to an era, the 1970's, in which the Commission's "audit resources were stretched thin" and without any understanding of the demands on Staff's current audit resources (Tr. 118-119), Empire believes that the standard is no longer applicable.[6] (Fancher Rebuttal, Ex. 4, pp. 1-2). Rather it is Empire's position, that "the question of granting interim rate relief is really a matter of Commission discretion given all of the facts and circumstances." (Id.). In place of the well-reasoned "emergency" standard, Empire contends that the Commission should employ a "good cause shown" standard. (Id. at 4-5).

In contrast to the definitiveness, as previously discussed, contained within the "emergency" standard, Empire's proposed "good cause shown" standard is replete with vague, ambiguous factors. While characterizing its position as a standard, Empire noticeably fails to present any definiteness as to what would constitute "good cause shown". Rather, Empire suggests, in its testimony, that "good cause shown" can be met based solely upon broad claims regarding (1) the need to eliminate regulatory lag (Id. at 2 and 5); (2) increasing fuel prices since its last proceeding (Brill Direct, Ex. 5,

[6] As was previously set forth in this brief, the "emergency" standard was not developed in the 1970's as Empire claims. Rather, the "emergency" standard had its genesis in the late 1940's.

pp. 2-5)[7] and (3) a return on common equity of 7.97% (total company basis) for the twelve months ended June 30, 1996. When pressed during cross-examination for more definitive criteria, Empire's answers were continually vague. Instead of solid, concrete criteria, similar to that contained within the "emergency" standard, Empire instead suggested several additional ambiguous factors for the Commission's consideration such as (1) where the utility's rates rank in relation to other utilities within the State; (2) the company's decision regarding recovery of stranded costs; and (3) the company's historical operations. (Tr. 94-95). Based upon its analysis of these ambiguous factors, Empire requested that its interim rates be allowed to go into effect without any suspension or Staff review. (McKinney Direct, Ex. 2, p. 6).

Nowhere does Empire make claims regarding its inability to access capital markets,[8] its failure to continue its construction programs, an inability to provide safe and adequate service or its inability to pay day-to-day operating expenses. Despite the complete absence of such typical "emergency" factors, Empire claims that the "situation which exists today cries out for enlightened, innovative regulatory solutions to individual situations which this Commission is fully capable of providing." (Id.) (Emphasis added).

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[7] In an effort to impress upon the Commission the need for an interim increase, Empire claims that it forecasts natural gas prices to be in excess of $2.29 / MMBtu for the remainder of 1996. (McKinney Direct, Ex. 2, p. 3). Interestingly, Empire has not been successful in forecasting such prices in the recent past (Ex. 7, Tr. 77) and readily admits that "you cannot" forecast these volatile natural gas prices. (Tr. 185).

[8] Not only has Empire not made such a claim, rather, Empire has demonstrated its ability to access such markets by recently issuing $25 million of First Mortgage Bonds in November of 1996. (Broadwater Direct, Ex. 14, pp. 4 & 8; Supplemental Order Approving Financing, Case No. EF-94-259 (issued November 27, 1996)). Additionally, Empire's stock price on the date of the hearing was trading at its high for 1996. (Ex. 19; Broadwater Direct, Ex. 14, p. 7).

While couched in terms of various ambiguous factors, Empire's "good cause shown" standard is, in essence, nothing more than a complaint regarding a utility's failure to attain what it perceives to be a reasonable rate of return. (Tr. 94 and 172). While such a failure may be a legitimate concern, and would therefore properly be addressed in a permanent rate proceeding, it alone should not be the basis for interim rate relief. In the previously cited Laclede case, the Western District Court of Appeals addressed the situation of a utility earning below its previously authorized rate of return. In that case, Laclede argued that the Commission should be compelled to authorize interim rates in non-emergency situations, based solely upon failure to attain an authorized rate of return.

> This same basic argument has been presented to a number of courts through the country and the judicial reaction has been divergent. However, the majority and better view rejects the argument that any return less than the rate previously set must be deemed prima facie unreasonable. Thus in Mountain States T. & T. Co. v. Public Utility Commission of Colorado, *supra* at p. 85, a majority of a three-judge federal court rejected an argument similar to that of Laclede in the present case, holding as follows:
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> Mountain Bell assumes that the figure 8.9 percent is an absolute and that the slightest departure from this level of return - even an infinitesimal fraction of a percentage point - is *per se* confiscatory and unconstitutional. But the cases do not support the company in this assertion. Rather the decisions recognize that the regulatory agency has some flexibility in fixing the rate of return - its decision being subject to existing economic conditions.

Laclede at 570 (citing to Mountain States Teleph. & Teleg. Co. v. Colorado Pub. Utilities Commission, 345 F.Supp. 80 (DC Colo. 1972)).

Based upon the Court's affirmance of its use of the "emergency" standard, the Missouri Commission has repeatedly refused to allow interim rate increases based solely upon a utility's failure to earn at its authorized rate of return. "A mere showing that a company's return is below its previously authorized rate of return has never prompted the Commission to grant interim relief."

Re: Empire District Electric Company, 24 Mo.P.S.C. (N.S.) 376, 379 (1981); "It appears that the amount requested by the Company is based on making the Company whole by allowing it to earn its previously authorized return. Under its emergency standard, the Commission does not grant interim relief in amounts designed to insure that a Company achieves its authorized return." Re: Gas Service Company, 25 Mo.P.S.C. (N.S.) 633, 638 (1983).

Similar to the decisions of the Missouri Commission and courts, public utility regulatory commissions have universally rejected failure to earn an authorized rate of return as a rationale for interim rates. "The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient, standing alone, to justify the granting of interim relief." Washington Utilities and Transportation Commission v. Pacific Northwest Bell Telephone Company, 11 PUR4th 166, 168 (Wash. 1975); "[T]he mere failure of a company to realize a previously authorized rate of return . . . is not sufficient in and of itself to warrant interim relief." Re Potomac Electric Power Company, 9 PUR4th 363, 366 (D.C. 1975); "The mere fact that the utility is not earning its previously authorized rate of return is not sufficient to compel interim relief." Re Washington Water Power Company, 22 PUR4th 485, 488 (Idaho 1977) (citing to Mountain States Teleph. & Teleg. Co. v. Colorado Pub. Utilities Commission, 345 F.Supp. 80 (DC Colo. 1972); "However, for a temporary rate increase to be allowed, there must be more than a showing of revenue deficiency, revenue loss, or inability to earn the authorized rate of return. The relief of a temporary rate increase is available on an emergency basis to meet a sudden and urgent financial need." Re East Honolulu Community Services, Inc., 118 PUR4th 259, 262 (Hawaii 1990).

In the event the Commission adopts a failure to earn an authorized rate of return standard, such as the one implicitly requested by Empire, it should be with full knowledge of the ultimate effect of such a decision. As the Massachusetts Commission has noted, "[t]his experience indicates that the broadening of our previous standard has served mainly to impose administrative burdens upon an already tightly constrained six-month suspension period. The filing and reviewing of such interim proposals have presented serious problems in the expeditious and proper treatment of general rate filings." Fitchburg Gas & Electric Light Company at 202.

Certainly a withdrawal from the "emergency" standard in Missouri will be accompanied by similar "administrative burdens". As has previously been recognized by the Commission and forewarned by all non-Company parties to this proceeding, every permanent rate increase will contain the obligatory interim rate request. Re: Empire District Electric Company, 24 Mo.P.S.C. (N.S.) 376, 379 (1981) (Oligschlaeger Direct, Ex. 16, p. 6; Tr. 28). Every rate filing before the Commission will require the filing of two sets of testimony, one for the permanent case and one for the interim proceeding. Similarly, every rate filing will involve two hearing memorandums, two separate hearings, two sets of briefs, two separate deliberations, two separate scenarios and two report and orders. Certainly, Missouri stands to learn something from Massachusetts' previous expedition down and retreat off the slippery slope.

It is readily apparent that a utility's failure to earn at an authorized rate of return is not "good cause shown" for interim rate relief. Similarly, the vague factors suggested by Empire do not constitute a coherent basis for the Commission to rely upon in its consideration of interim rate relief. The Commission should dismiss Empire's interim "good cause shown" standard, confirm the logic of the "emergency" standard and reject Empire's interim rate request.

D. EMPIRE'S CURRENT FINANCIAL SITUATION

In its testimony, Empire has attempted, in an effort to meet its "good cause shown" standard, to paint a picture of a utility suffering from the effects of "considerable fluctuations and uncertainty in [its] operating cost." (McKinney Direct, Ex. 2, p. 2). Such "fluctuation and uncertainty" has resulted, Empire claims, in a return on equity for the 12 months ending June 30, 1996 of 7.97%. (Fancher Direct, Ex. 3, p. 2). In addition, Empire has employed two other financial measures, budgeted data and earnings per share, in an attempt to meet its "good cause shown" standard. (Id.). Not surprisingly, Empire paints a misleading picture. In fact, under cross-examination, Empire admits to the distorted nature of its picture.

Empire claims that its return on equity is unreasonable based upon a comparison to that ordered as the beginning point for sharing under the current Union Electric (UE) experimental alternative regulatory plan. (Fancher Direct, Ex. 3, pp. 2-3). However, even Empire admits that such a comparison is improper. Such a comparison fails to take into account UE's differing capital structure or cost of debt. (Tr. 111). Such a comparison fails to account for the vast difference in risk profiles between the two companies due in part to UE's ownership of a nuclear facility. (Tr. 112). Such a comparison fails to account for the different goals underlying rate base / rate of return regulation and incentive regulation. (Tr. 113). Such a comparison fails to account for the fact that UE, as part of its Stipulation, was required to make refunds to its ratepayers as well as one-time credits under its sharing plan. (Tr. 114). Finally, such a comparison fails to account for the fact that UE is limited in its ability, under the plan, to request a rate increase. (Tr. 132). Clearly, Empire's comparison to the UE experimental alternative regulatory plan is inappropriate. The Commission should not be swayed by such a superficial comparison.

Empire's distorted claims in regards to its return on equity were further disclosed during cross-examination. While on the stand, Mr. Fancher admits that, in support of its filing, Empire used unadjusted, per-book figures (Tr. 129); figures which fail to eliminate even the Company's water utility operations. (Tr. 262). Additionally, Empire, for purposes of its presentation, has utilized a total company, rather than Missouri jurisdictional, return on equity figure.[9] Noticeably, Mr. Fancher was unable to quantify what the return on equity amount was for Empire's Missouri operations. (Tr. 110). Utilization of such a total company figure, essentially assesses sole responsibility for Empire's return on equity figure to its Missouri operations. Although it assesses such responsibility to Missouri, Empire admits that total company return figures may be affected as a result of Empire's operations in three other jurisdictions. (Tr. 116). Despite such dependence on operations in other jurisdictions, Empire has neglected to file rate proceedings in Arkansas, Kansas or Oklahoma for several years. (McKinney Direct, Ex. 2, p. 5; Tr. 69-71, 116-117). Recognizing the fact that Empire has had additional rate base items brought on line in that time period, in the form of combustion turbines, rates in those non-Missouri jurisdictions are likely to be inadequate. (Id.) As such, it is inappropriate to assess blame for Empire's return on equity figure to Missouri operations and regulation.

Empire's return on equity calculation is also severely distorted by Empire's failure to annualize in a manner consistent with Commission policy. For instance, Empire's deflated return on equity figure fails to annualize the effect of Empire's recent reorganization. As Mr. McKinney detailed in cross-examination, Empire's reorganization effort was completed at the end of October,

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[9] Such an error has historically been fatal in a utility's effort to receive interim rate relief. In the case of Re: Arkansas Power & Light Company, the Commission noted that "[w]hen there is a failure to quantify the amount of interim relief necessary to eliminate any perceived financial emergency on a "Missouri only" basis the justification for interim rate relief has not been established." 28 Mo.P.S.C. (N.S.) 143, 148 (1986).

1995. (Tr. 49). Therefore, use of the June 1996 test year for the interim proceeding would result in recognition of only seven (sic) months of such reorganization benefits / savings. (Tr. 50). Additionally, use of the June 1996 test year fails to provide recognition for a full year of the increased rates, ordered in Empire's last proceeding, Case No. ER-95-279, which went into effect on November 15, 1995. (Id.). Furthermore, Empire's calculation fails to account for Empire's most recently experienced customer levels or revenues. (Winter Direct, Ex. 15, p. 3). Finally, Empire's calculation fails to recognize $767,000 in reduced O&M expense that Empire admits has occurred. (Tr. 88, 96).

Similarly, Empire's return on equity calculation fails to normalize in a manner consistent with Commission policy. As was detailed during cross-examination, Empire's calculation fails to account for the extreme nature of weather experienced by Empire during the early months of 1996. (Tr. 171). Additionally, Empire's calculation fails to account for the effects of a major storm experienced during the spring of 1996. (Tr. 89, 98, 128 - 129). Similarly, Empire fails to normalize for the increased purchased power costs as a result of an abnormally long outage at its Asbury generation plant (Tr. 128) or the reduced output of its hydroelectric facility (Tr. 163-164).

In addition to a distorted return on equity calculation, Empire has relied upon a comparison to budgeted figures in its attempt to paint its financial picture. Specifically, Empire compares its actual net operating income for the twelve months ended June 30, 1996 to its budgeted figures for the same time period. (Fancher Direct, Ex. 3, p. 3 and Sch. RBF-1). Such comparisons suffer two fatal flaws. First, the actual figures suffer from the same fatal errors as those reflected in its return on equity calculation. That is, Empire's net income is based upon total company operations (including water) and, therefore, as stated previously, are likely depressed due to Empire's infrequent rate proceedings in other jurisdictions in conjunction with Empire's increased rate base (i.e. - combustion turbines). In fact, Empire was unable to point the Commission to its Missouri jurisdictional budgeted or actual figures. (Tr. 115-116). Additionally, the Company's net operating income, similar to its return on equity calculation, fails to annualize or normalize consistent with Commission policies. Second, in light of Missouri's rate base / rate of return regulation, budgeted figures are irrelevant. (Tr. 115). Specifically, these figures are unaudited and merely reflect the hopes of Empire's management.

Finally, Empire has utilized an earnings per share calculation in its attempt to paint its distorted financial picture. (Fancher Direct, Ex. 3, p. 3 and Sch. RBF-2). As with Empire's other calculations, its earnings per share calculation is faulty. Similar to its return on equity and operating income figures, Empire's earnings per share calculation is derived from total company operations (including water operations) and fails to normalize or annualize consistent with Commission policy. Also, Empire's earnings per share comparison is artificially deflated by Empire's issuance of common stock in April of 1996. (Tr. 117-118). This issuance of additional common stock would have the effect, in Empire's own words, of "dilut[ing] earnings." (Tr. 118).

In contrast to the distorted financial picture painted by Empire, Staff Witness Broadwater presents a more accurate financial portrait. As detailed in his testimony, Empire's preferred stock, secured debt and commercial paper all continue to be considered investment grade by both Standard & Poor's as well as Moody's. As indicated in its May 1996 Utilities Rating Service, Standard & Poor's expects such a rating to remain stable. (Broadwater Direct, Ex. 14, p. 3). Additionally, Empire's dividends are expected to remain at current levels. (Id. at 4 and Sch. 2).

Furthermore, Empire in anticipation of issuing $25 million in First Mortgage Bonds, calculated an interest coverage ratio that was well in excess of the 2.00 times required by its bond indenture. (Id. at 4). Empire's interest coverage ratio remained well in excess of its required ratio even after accounting for the interest payments attendant to its November bond issuance[10]. (Id.). An analysis of Empire's income statement further reveals the distorted nature of Empire's claimed financial situation. As detailed in Mr. Broadwater's testimony, Empire's net income available for common stock for the twelve months ended September 30, 1996 was down only 2.27% from the same period in 1995. However, this decrease is inflated by Empire's inclusion of a one-time charge of $4.5 million associated with the Company's early retirement program. Elimination of this one-time charge from Empire's income statement indicates that Empire's net income for the twelve months ended September 30, 1996 was down a mere 0.06% from the previous year. (Id. at 5).

Empire's true financial condition is also apparent in its current stock price. Unlike the situation in which a company's stock plummets in the face of unmanageable costs or declining revenues, Empire's stock, on the date of hearing, was trading at its high for 1996. (Ex. 19; Broadwater Direct, Ex. 14, p. 7). Certainly, one would not expect to encounter such a situation in a company whose situation "cries out for enlightened, innovative regulatory solutions." (McKinney Direct, Ex. 2, p. 6).

Certainly, Empire will attempt to buttress its case by relying upon Staff's own return on equity calculation. Recognizing that the Commission had routinely cited low return on equity

[10] Although the record indicates that Empire's bond issuance was to occur in November of 1996 (Broadwater Direct, Ex. 14, p. 4), it is Staff's understanding that such an issuance did not actually occur until December 3, 1996.

figures (1-3%)[11] in support of a finding of an "emergency" situation, Staff conducted a quick review of the Company's books, a review that only contained three adjustments. (Tr. 263 and 274; Winter Direct, Ex. 15, p. 5).[12] Specifically, Staff's minimal review indicated that Empire had a return on equity for the twelve months ended June 30, 1996 of 9.62%. (Id. at 7). Staff's calculation is notable in that it reflects an increase of 1.65% over that suggested by Empire. This increase is based solely upon (1) elimination of the one-time reorganization charges (Id. at 5); (2) elimination of water operations and recognition of jurisdictional allocations (Tr. 263); and (3) adjustment to depreciation expense (Winter Direct, Ex. 15, pp. 5 & 6).

Despite such corrections, Staff's return on equity calculation is still understated. Significantly, Staff's calculation does not: (1) recognize the effect of a full year of operations under the rates ordered in Empire's last rate proceeding (Id.); (2) normalize for the effects of abnormally cold weather (Id. at 3; Tr. 122); (3) normalize for the effects of the spring 1996 major storm (Id.); (4) annualize for experienced customer growth (Id.) or (5) normalize increased purchased power associated with the extended Asbury outage or the reduced output of the hydroelectric facility (Tr. 165-166). As can be seen, each of these adjustments would impact Empire's revenue or expense levels and ultimately have the effect of driving Empire's true return on equity calculation even higher. The incomplete nature of Staff's return on equity calculation is best demonstrated by the fact

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[11] See, Re: Missouri Power & Light Company, 22 Mo.P.S.C. (N.S.) 257 (1978) in which the Commission references a return on equity of 1.2%. Re: Missouri Power & Light Company, Case No. 17,815 (September 14, 1973) in which the Commission references a return on equity of 2.89%.

[12] Empire itself admits that Staff's calculation is not the result of an "audit". (Tr. 124). Rather, Staff's calculation is based solely upon a "review". A review that is designed to "look at the books as they are, take out those things that you see as obvious adjustment." (Id.).

that, due to time constraints inherent in the interim request procedure, Staff was unable to provide for the 50 to 60 adjustments routinely found in the context of a Staff audit. (Tr. 283 - 284).

Clearly, Empire, in an attempt to sell its "good cause shown" standard, has presented the Commission a distorted financial picture. Rather than rely upon the distortions of the Company, the Commission should focus on the objective presentation of Staff. Based upon Staff's objective presentation, it is clear that Empire's financial situation does not warrant a departure from the Commission's "emergency" standard. Therefore, Empire's interim rates tariffs should be rejected.

III. EMPIRE'S INTERIM RATE REQUEST SHOULD BE REJECTED IN THAT IT (1) CONSTITUTES ILLEGAL SINGLE ISSUE RATEMAKING; (2) VIOLATES THE TEST YEAR AND MATCHING DOCTRINES AS ORDERED IN EMPIRE'S LAST RATE PROCEEDING, CASE NO. ER-95-279; (3) VIOLATES THE EXPRESS PROVISIONS OF THE STIPULATION AND AGREEMENT IN CASE NO. ER-95-279; AND (4) IS BASED UPON FAULTY FUEL / PURCHASED POWER ASSUMPTIONS

A. EMPIRE'S INTERIM REQUEST VIOLATES THE LEGAL PROHIBITION AGAINST SINGLE-ISSUE RATEMAKING

As was previously mentioned, Empire seeks a Commission order authorizing it to increase electric rates, on an interim basis, by $4,018,071. In quantifying its interim rate request, Empire notes that this amount is determined "by simply taking the production cost computer models <u>used in Case No. ER-95-279</u> and applying <u>current</u> fuel and purchase power costs." (McKinney Direct, Ex. 2, p. 4) (Emphasis added). Specifically, Empire takes the annualized fuel and purchased power volumes from one of Staff's fuel runs in Case No. ER-95-279 and replaces them with the natural gas and purchase power price experienced by Empire as of June 30, 1996. (Brill Direct, Ex. 5, pp. 2-5). Notably, all other cost of service items (payroll, revenues, rate base, etc.), including all remaining fuel model inputs (outage rates, coal prices, heat rates, etc.), have remained at levels utilized for setting rates in Empire's last proceeding. (Featherstone Rebuttal, Ex. 11, pp. 18-19). Surprisingly, Empire itself admits the interdependence of all these cost of service items. "Yes, changing the input costs will have an effect on the dispatch." (Brill Direct, Ex. 5, p. 5; Tr. 164).

Section 393.270.4 of the Revised Missouri Statutes 1994 states that the Commission, in determining the price to be charged for electricity,

> [M]ay consider all relevant factors which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service . . .

(Emphasis added). In 1957, the Missouri Supreme Court had the opportunity to interpret this provision.

> "Due regard" to one factor, "among other things", simply requires consideration of that factor. It is not preclusive of other relevant factors. Indeed, the phrase "among other things" clearly denotes that "proper determination" of such charges is to be based upon *all* relevant factors.

State ex rel. Missouri Water Company v. Public Service Commission, 308 S.W.2d 704, 718-719 (Mo. 1957) (citing to New York Telephone Co. v. Public Service Commission, 309 N.Y. 569; 132 N.E.2d 847, 850 (1956)). "Although the quoted section of the statute refers to 'complaints', the requirement that all relevant factors be considered is of course applicable under the file and suspend method also." State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 56 (Mo. banc 1979). The statutory requirement to consider reasonable average return, "among other things" has generally been referred to as the doctrine against single-issue ratemaking. See, State ex rel. Office of Public Counsel v. Public Service Commission, 858 S.W.2d 806, 812 (Mo.App. 1993).

In the foremost case regarding single-issue ratemaking, Utility Consumers Council of Missouri (UCCM), *supra*, the Missouri Supreme Court addressed, in light of Section 393.270.4, the legality of the fuel adjustment clause. As noted by the Court, "A fuel adjustment clause (FAC), once authorized by the commission as part of the utility's rate structure, enables the utility to pass on to the consumer any increase (or decrease) in the cost of fuel automatically and without any need for further consideration of compensatory decreases (or increases) in other operating expenses." UCCM at 49. As noted, two of the principal objections surrounding the use of fuel adjustment clauses concerned (1) the utility's ability to effectuate an increase in rates without consideration of all factors (Id.) and (2) the fact that "utilities would lose any incentive to keep down fuel costs where they know such costs can be fully and automatically passed on to the consumer." (Id.) (citing to Re: Union Electric Co., 92 PUR3d 254, 262; 16 Mo.P.S.C. (N.S.) 245, 254 (1971) "Furthermore, under such a proposal, management would not be encouraged to bargain for the lowest coal rates possible when it would know any increase granted would be immediately 'flowed through' to customers. Also many other factors, other than cost of fuel, affect this Company's rates of return.").

While noting such objections, the Court decided that its sole "determination is limited to whether or not a fuel adjustment clause has been authorized by the legislature." (Id. at 51). Ultimately, the Court concluded that by "permitting an electric utility to utilize a fuel adjustment clause, the commission permits one factor to be considered to the exclusion of all others in determining whether or not a rate is to be increased" in contravention of the requirements of Section 393.270.4. (Id. at 56).

The doctrine against single-issue ratemaking has been analyzed by the Commission in numerous recent cases. Re: Southwestern Bell Telephone Company, Case No. TR-96-28 (issued

June 21, 1996) (Tariff sheets designed to increase rates for local and toll operator services "constitute single issue ratemaking by increasing rates for a single service without taking into account the entirety of SWBT's costs and revenues."); Re: Missouri Gas Energy, 165 PUR4th 181 (1995) (Weather Normalization Clause violated doctrine against single-issue ratemaking); Staff of Missouri Public Service Commission v. Southwestern Bell Telephone Co., 2 Mo.P.S.C.3d 479, 584 (1993) (Alternative regulation plan that establishes sharing grid with yearly credits returned to customers based solely upon Southwestern Bell's return on equity does not constitute single-issue ratemaking); Re: Missouri Public Service, 1 Mo.P.S.C.3d 200, 213 (1991) (Deferral of extraordinary costs do not constitute "single issue ratemaking since only deferral is being allowed and if recovery is approved, rates are not based just on the deferred costs."). In fact, the strict nature of the single-issue ratemaking doctrine has even been recognized by the General Assembly in its enactment of Section 393.292 RSMo which provides for an exception to the single-issue ratemaking doctrine by allowing for an increase in a utility's electric rates solely as a "result of a change in the level or annual accrual of funding necessary for its nuclear power plant decommissioning trust fund."

As was mentioned, Empire's entire interim rate request is based upon an increase in fuel and purchased power costs over those Empire believes to be contained within the rates agreed to by Stipulation in Case No. ER-95-279. Notably, Empire makes this single-issue request while recognizing the rationale underlying the single-issue ratemaking doctrine, "As you're aware, there are lots of other things that are ongoing that cause rate of return to go up or down." (Tr. 73). Despite this admission, Empire continues to request interim relief based solely on increased natural gas and purchased power prices. Given this reliance on a single issue (fuel and purchase power), Empire's interim request fails to consider "all relevant factors" which "have a bearing upon a proper determination" of Empire's electric rates. (Tr. 100). As Staff Witness Featherstone notes, and Empire admits, Empire's interim request fails to account for other revenue requirement items such as increased revenues, increased customer numbers and decreased employee numbers. (Featherstone Rebuttal, Ex. 11, p. 20; Tr. 100, 138). Additionally, Empire's interim request fails to account for changes in Empire's capital structure, return on equity or cost of debt. Such a request, recognition of Empire's increased fuel / purchased power costs to the exclusion of <u>all</u> other cost of service items, constitutes classic single-issue ratemaking in contravention of Section 393.270.4.

Besides violating the doctrine single-issue ratemaking, Empire's request also violates the underlying policy concerns. As was detailed earlier, one of the objections underlying the fuel adjustment clause concerned the cost containment efficiency of a utility in those situations where it is assured it can merely pass costs through to the consumer. As was previously mentioned, approval of Empire's "good cause shown" standard would result in the filing of the obligatory interim rate request with every permanent rate filing. Just as Empire has targeted its increased fuel / purchased power costs as support for its interim rate filing, other utilities would bemoan their increased labor, capital or debt costs as support for their interim rate request. If successful, "utilities would lose any incentive to keep down . . . costs where they know such costs can be fully and automatically passed on to the consumer." (<u>UCCM at 49</u>) (citing to <u>Re: Union Electric Co.</u>, 92 PUR3d 254, 262; 16 Mo.P.S.C. (N.S.) 245, 254 (1971).

In response to single-issue ratemaking concerns of Staff, Empire presented the testimony of its Vice President of Commercial Operations. Specifically, Empire suggests that single-issue ratemaking concerns are avoided (1) by the Commission's discretion to order interim rate relief; (2) by Empire's claimed inadequate return on equity; and (3) by its Vice President's confidence that

Empire will receive a rate increase in excess of $4 million in the permanent proceeding.[13] When asked during cross examination how these facts address the statutory provision against single-issue ratemaking, Empire's witness was unable to provide answers with substance. Such failure is not surprising when one notes that this legal testimony was offered by a non-attorney (Tr. 63), was offered by an individual who professes that he "is not an expert in Commission policies" (Tr. 54-55); was not based upon any statutes, case law or Commission orders (Tr. 62) and was not prepared by the witness in question (Id.).

As is clearly seen from the above, in contrast to Staff's single-issue ratemaking argument, which depends upon statutory citations and case law, Empire has presented assurances that lack substance. The Commission should not be swayed by Empire's "trust us, everything is alright" attitude. Instead, the Commission should recognize its legal limitations and reject Empire's interim rate request.

B. EMPIRE'S INTERIM REQUEST VIOLATES THE TEST YEAR AND MATCHING DOCTRINES AS FOLLOWED BY THIS COMMISSION FOR DECADES

In addition to violating the prohibition against single-issue ratemaking, Empire's interim rate

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[13] It is worth noting that a comparison to the final outcome of Empire's permanent rate proceeding is totally irrelevant in that the interim case is based upon an entirely different test year. (Tr. 49). As such, the outcome of the permanent proceeding will be based upon differing levels of rate base, expenses and revenues. Even the shift of a couple of months in a test year can have a significant effect on an ultimate revenue requirement. This fact is best demonstrated by the $7 - $8 million revenue requirement effect of the '97 combustion turbine which Empire anticipates will be placed on-line during the test year of the permanent rate case and therefore captured within the rates of the permanent rate proceeding. Such a comparison between the results of the interim proceeding and the results of the permanent proceeding, with its increased rate base due to the combustion turbine, is like comparing "apples and oranges". (Id.). An appropriate comparison is only possible if the Commission orders a test year for the permanent proceeding of the twelve months ended June 30, 1996.

request is in violation of the Commission's Order Establishing Test Year in Case No. ER-95-279 as well as the matching principle contained within the Commission's Suspension Order And Notice in that proceeding.

As the Commission has previously indicated,

> The purpose of using a test year is to create or construct a reasonable expected level of earnings, expenses and investments during the future period in which the rates, to be determined herein, will be in effect. All of the aspects of the test year operations may be adjusted upward or downward to exclude unusual or unreasonable items, or include unusual items, by amortization or otherwise, in order to arrive at a proper allowable level of all of the elements of the Company's operations. . . . The true-up procedure has received broad acceptance as a proper ratemaking tool. A true-up permits adjustments outside of the test year without improperly disturbing the revenue-expense relationship. . . . By specifying a grouping of accounts that should be trued-up, the Commission is not inferring that the parties should be limited to those items. Thus far, the Company appears to have proposed as many adjustments as possible to increase revenues. The Staff's adjustments appear to generally result in revenue decreases. The Commission has no desire to entertain isolated adjustments, but seeks a "package" of adjustments designed to maintain the proper revenue-expense, rate base match at a proper point in time. Evidence of "picking and choosing" by a party with the intent of simply raising or lowering revenue requirement will not be condoned.

Re: Kansas City Power & Light Company, 26 Mo.P.S.C. (N.S.) 104, 109-110 (1983). (Emphasis added).

Empire's instant request, although done over the course of two cases, is nothing more than "picking and choosing by a party with the intent of raising revenue requirement." In Empire's last rate proceeding, Case No. ER-95-279, the Commission ordered a test year consisting of the twelve months ending March 31, 1995, updated through June 30, 1995. (Order Establishing Test Year, Issued June 16, 1995). As reflected in the Commission's Suspension Order And Notice in the same proceeding, any updating should "maintain the proper revenue-expense-rate base match at a proper point in time." (Suspension Order And Notice, Issued March 28, 1995) (citing to Re: Kansas City

Power & Light Company, 26 Mo.P.S.C. (N.S.) 104, 110 (1983). Although the case ultimately settled and the docket closed with the issuance of the Commission's Report and Order, Empire's interim request constitutes an improper update to the test year ordered in that case.

As stated earlier, Empire's interim rate request was calculated "by simply taking the production cost computer models used in Case No. ER-95-279 and applying current fuel and purchase power costs." (McKinney Direct, Ex. 2, p. 4). While Empire updated its fuel and purchase power costs, all other cost of service items (payroll, revenues, rate base, etc.), including all remaining fuel model inputs (outage rates, coal prices, heat rates, etc.), have remained at levels utilized for setting rates in Empire's last proceeding. (Featherstone Rebuttal, Ex. 11, pp. 18-19). In addition to violating the doctrine against single-issue ratemaking, *supra*, such exclusive updating of costs: (1) fails to "maintain the proper revenue-expense-rate base match at a proper point in time", in contravention of the matching concept as stated in the Commission's Suspension Order and (2) constitutes "picking and choosing" by Empire with the intent of simply increasing its revenue requirement.

As Staff Witness Featherstone correctly points out,

> The effect of the Company's interim rate proposal would be to implement rates based on unmatched revenue requirement components. Empire's proposal can be thought of as the equivalent of re-opening the stipulation revenue requirement from Case No. ER-95-279 to incorporate several expense increases, without examining any concurrent changes to rate base, revenues or other expense items. The July 1996 contracted gas prices which Empire is seeking rate treatment through this interim case took effect eight months after the effective date of new rates from Case No. ER-95-279 (November 15, 1995). Many other revenue requirement changes have occurred since November 1995; some of which have been noted earlier, such as increased revenues, increased customer numbers and decreased employee numbers. Yet, Empire has not proposed to offset the alleged increases in gas and purchased power expense by any revenue requirement decreases as would be appropriate in maintaining the proper matching of revenue requirement components. The

> Company's attempt to isolate the two cost elements of gas and purchased power costs in this interim filing clearly violates the test year revenue / expense / rate base relationship.

(Featherstone Rebuttal, Ex. 11, pp. 19-20) (Emphasis added).

The Commission should recognize that Empire's interim rate request, in addition to violating the legal doctrine against single-issue ratemaking, violates sound ratemaking principles such as the matching and test year doctrines. Such doctrines have been relied upon for decades by this Commission in its efforts to formulate proper rates. Empire has failed to present "good cause" for the Commission's abandonment of such doctrines. As such, the Commission should reject Empire's interim rate filing.

C. EMPIRE'S INTERIM REQUEST VIOLATES THE STIPULATION AND AGREEMENT FROM ITS LAST PROCEEDING

As noted previously, Empire's last proceeding, Case No. ER-95-279, was resolved among the parties and memorialized in a Stipulation and Agreement. That Stipulation was adopted by the Commission in resolution of all issues in that case. (Report and Order, Case No. ER-95-279, page 7, Issued November 3, 1995). Provision 12 of the approved Stipulation specifically provides, "[a]ll parties agree that, except to the extent specified in paragraphs 4 through 10, none of the signatories hereof shall be 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." (Ex. 20) (Emphasis added). Such a provision is contained within all Stipulations filed with the Commission in recognition of the fact that any information underlying a Settlement would be, by its very nature, unreliable. As Staff Witness Featherstone points out:

> The settlement did not identify the individual components making up the revenue requirement. Each party to the case would have a different interpretation and belief in how the dollar settlement was determined. Empire in its direct testimony seeking interim rate relief is going "behind the settlement agreement" in an attempt to justify its request. Other parties to the rate proceeding could have used different amounts for determining the values of specific components of the settlement agreement which likely will be different from the quantification Empire is advancing in this current proceeding.

(Featherstone Rebuttal, Ex. 11, p. 5).

As its basis for its interim rate request and contrary to the express provisions of the Stipulation and Agreement regarding cost determinations, Empire claims that natural gas prices have increased "approximately 53% above the prices <u>used in production costing computer models which were utilized by the Staff in settling ER-95-279</u>." (McKinney Direct, Ex. 2, p. 2) (Emphasis added). Empire's violation of the Stipulation is further exacerbated by its use of information released in the context of a prehearing conference. In support of such claims, Empire has utilized Staff's fuel model output schedule. (Brill Direct, Ex. 5, Sch. VEB-2).[14]

Rule 408 of the Federal Rule of Evidence codifies the common law doctrine barring the admissibility of offers to compromise. As McCormick notes in his treatise, "The policy aspect (of such inadmissibility) is to promote the settling of disputes, which would be discouraged if offers of compromise were admitted in evidence." McCormick, <u>Law of Evidence</u>, §274 (2d ed. 1972). McCormick notes that such a doctrine becomes difficult to apply in regards to admissions of fact

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[14] The header on Schedule VEB-2 indicates that the schedule, which reflects the results of Staff fuel run 146, was prepared on September 27, 1995 at 11:50:53. Reference to the Commission's Order Granting Protective Order And Establishing Procedural Schedule clearly indicates that this document was prepared and disseminated during the Commission ordered prehearing conference. Additionally, Staff testimony clearly indicates that this schedule was "updated during the prehearing conference." (Featherstone Rebuttal, Ex. 11, p. 8).

disclosed in the course of negotiations. "The generally accepted doctrine of denying the protection of the exclusionary rule to statements of fact has serious drawbacks, however. It tends to discourage freedom of communication in attempting compromise, and, taken with its exceptions, it involves difficulties of application. As a result the trend is to extend the protection to all statements made in compromise negotiations." (Id.) (Emphasis added).

The doctrine of inadmissibility of settlement discussions has been adopted by the Commission and promulgated in its rules. 4 CSR 240-2.090(7) provides that "[f]acts disclosed in the course of a prehearing conference are privileged and, except by agreement, shall not be used against participating parties before the commission unless fully substantiated." The Commission's Rule encompasses the same policy concerns as that contained within the Federal Rule; encouragement of the free exchange of information in the context of settlement discussions.

Empire's violation of the expressed provisions of the Stipulation provides the Staff with a great deal of concern. As was mentioned, such information is, by its very nature, unreliable, and should therefore be entitled to little, if any, weight. The Commission should send a clear message to the utilities of this state and reject Empire's interim rate filing.

D. EMPIRE'S QUANTIFICATION OF ITS INTERIM RATE REQUEST IS BASED UPON FAULTY INFORMATION

The unreliability of the information purportedly underlying a Stipulation and Agreement is clearly demonstrated in Empire's case. "Because of Empire's violation of the Stipulation and Agreement in alleging how certain elements of cost of service were treated, it is necessary for Staff to address the specific claims made by the Empire witnesses." (Featherstone Rebuttal, Ex. 11, p. 5). Specifically, Staff, in the context of its rebuttal filing, has highlighted glaring errors in Empire's claims regarding the prices "utilized by the Staff in settling ER-95-279". While Staff is able to shed some light on the correct prices utilized in its assessment of the settlement of ER-95-279, it is unable to provide any information as to quantification of prices made by Empire, Public Counsel or intervenors. As Mr. Featherstone points out, "[e]ach party to the case would have a different interpretation and belief in how the dollar settlement was determined." (Id.).

In its testimony, Empire claims, based upon fuel run 146, that Staff utilized a natural gas price of $1.54 / MMBtu and a purchased power price of $16.57 / Mwh in settling ER-95-279. (Brill Direct, Ex. 5, pp. 2-5). Based upon its assessment of current gas and purchased power prices, Empire quantifies its fuel underrecovery, and therefore interim relief request, as $4,018,071. As indicated in Staff's rebuttal testimony, "Empire has not correctly identified the natural gas (or purchased power) price used in Staff's 'final' fuel run." (Featherstone Rebuttal, Ex. 11, p. 7).

As Mr. Featherstone indicates, "Staff's 'final' fuel and purchase power run was run number 171. This fuel run formed the basis for the fuel expense that was included in the $1.4 million settlement amount." (Id.). As reflected in fuel run 171, attached as Schedule 2 to Mr. Featherstone's Rebuttal Testimony, the actual natural gas price utilized by Staff was $1.635 / MMBtu. Additionally, the actual purchased power price utilized by Staff was $16.57 / Mwh. (Id.). Reflection of these two price changes results in a reduction of Empire's interim relief request of over $865,000, or approximately 22%. (Id. at 12).

In addition to utilizing the wrong prices underlying Staff's assessment of the settlement in the last rate proceeding, Empire's case is flawed by its selective utilization of current natural gas prices. As reflected in Mr. Featherstone's testimony, Staff's fuel runs, in order to account for gas price fluctuations, reflect a composite gas price based upon "a weighted average, on a volume of gas usage basis, for each of the individual twelve months ended for these periods." (Id. at 9-10). In comparison, Empire, failed to utilize a weighted average monthly price (Tr. 171) and instead has utilized the average of two contract amounts for the month of July 1996. (Featherstone Rebuttal, Ex. 11, pp. 9-10). It is well known that natural gas prices are susceptible to a great deal of fluctuation. As Empire itself admits, "gas prices have proven to be very volatile and unpredictable in nature." (Brill Direct, Ex. 5, p. 3). Recognizing such a fact, Empire's interim request is clearly flawed.

As reflected, in addition to violating multiple legal and ratemaking doctrines, Empire's quantification of its interim relief request is premised upon flawed price assumptions. Such evidence, on the part of Empire, underscores Staff's claim that it is unreliable to attempt to go "behind the settlement agreement". Recognizing such unreliability, the Commission should reject Empire's interim rate filing.

IV. IN THE EVENT THE COMMISSION AUTHORIZES AN INTERIM RATE INCREASE, STAFF'S REFUND PROVISIONS, INTEREST RATE PROVISION AND RATE DESIGN SHOULD BE ADOPTED

A. BASIS FOR REFUNDS

As has previously been mentioned, Empire's interim rate request is based upon its claim that "natural gas costs and purchased power costs have increased significantly" since its last case. (Brill Direct, Ex. 5, p. 2). In quantifying its request for interim relief, Empire has replaced the natural gas and purchased power prices it believes are contained within the Stipulation from the last case with prices experienced in July of 1996. (McKinney Direct, Ex. 2, p. 4). However, in its attempt to pay "lip-service" to ratepayer safeguards, Empire proposes to base any refunds, not on the price of natural gas or purchased power, but on a comparison to the results of its pending permanent proceeding. (Tr. 66, 88). "The interim rider provides for a refund mechanism if the revenues produced by the next permanent rate increase do not exceed the revenues produced by the interim rates. . . . [A]ny revenues which might be collected under the interim schedule will be subject to refund should the Commission determine in the permanent case that the $4 million interim award was not appropriate." (McKinney Direct, Ex. 2, pp. 4 & 5).

As Staff details in its testimony, Empire's refund proposal suffers from two significant flaws. First, Empire's interim request is premised solely upon alleged increases in the cost of gas and purchase power. As such, Empire's interim request fails to look at all relevant factors. (See section regarding single-issue ratemaking, *supra*). Comparisons with a permanent rate proceeding, which looks at all relevant factors, would be comparable to comparing "apples and oranges." (Oligschlaeger Rebuttal, Ex. 17, pp. 13-14).

Second, Empire's interim rate request is based upon a different test year than its pending permanent proceeding. (Tr. 64, 123). Empire's interim request is based upon a June 30, 1996 test year for fuel and purchased power and a June 30, 1995 test year for all other cost of service items. As the Commission has recently ordered, the permanent proceeding is based upon the twelve months ended September 30, 1996, with isolated adjustments through May 31, 1997. Specifically, the permanent rate proceeding "is driven in part by the need to include in rate base a new generating unit which is being installed at the State Line location." (McKinney Direct, Ex. 2, p. 5). This rate base addition alone will result in a revenue requirement increase of approximately $7 - $8 million. (Tr. 48). Therefore, a comparison between the interim proceeding, and its checkered test year, and the permanent proceeding, and its differing test year, would be comparable to comparing "apples and oranges". (Oligschlaeger Rebuttal, Ex. 17, p. 14; Tr. 49). This "apples and oranges" comparison and

Empire's "lip-service" attention to ratepayer safeguards is made readily apparent in the following exchange between Commissioner Kincheloe and Myron McKinney:

> 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 that, in the event the permanent case didn't come up with $4 million, that we would -- we would rebate that difference or refund that difference.
>
> Q. I think what you need to do is justify the $4 million, I think, without regard to rate base that will not be in service for this case. And if the Company wants to make the offer, I think that's the offer that needs to be made in terms of refund for this case --
>
> A. Okay.
>
> Q. -- to be considered in my view.

(Tr. 90-91) (Emphasis added). Despite such suggestions from the bench, Empire never made the offer to justify its interim case with a full blown audit based upon the same test year and the same rate base as that underlying the interim case.

In the event the Commission orders an interim rate increase, logic dictates that, since refunds can not be made via comparison to the permanent proceeding, refunds be made based upon the same factors on which the increase is ordered, i.e., natural gas and purchased power prices. "In other words, any interim rate refund should be based on the difference between the natural gas and purchased power prices ordered or agreed to as a result of Empire's pending permanent rate increase Case No. ER-97-81, and the costs of gas and purchased power on which the interim increase is based." (Id.).

B. INTEREST RATE ON REFUNDS

Empire has proposed to pay interest on any refunds due customers at a rate of 5% per annum. (Fancher Direct, Ex. 3, p. 3). While suggesting such a proposal, Empire does not appear adamant regarding its position. "[I]f the Commission feels 9 percent is more appropriate, that's fine." (Tr. 139). In contrast to Empire's position, Staff believes that the appropriate interest rate which should be paid to customers is 9%. The 9% interest rate is the rate that is currently in effect for customer deposits. (Tr. 156). This rate presumably will be in effect until a decision is made in the permanent rate proceeding. Any interim rate increases, if allowed, will also only be in effect until the final ruling in the permanent rate case. (Sochinski Rebuttal, Ex. 13, p. 5). The reasoning and logic here is inescapable. Customers entitled to refunds under interim rate relief, should it be granted, are entitled to the same interest which would be paid for customer deposits during the same period.

C. RATE DESIGN

If the Commission determines that an interim rate increase is justified in this case, the interim rate increase should be implemented through the cost based proposal made by Staff. In its testimony, Empire proposes that any interim increase be implemented through an additional $0.001349 per kilowatt-hour surcharge. (Fancher Direct, Ex. 3, p. 3). This flat-rate proposal should be rejected in favor of the "time-of-use" method as proposed by Staff Witness James Watkins. This "time-of-use" methodology would permit any interim surcharge to be applied on a similar basis as the rates established in Empire's most recent rate design case, Case No. EO-91-74.

The flat-rate proposal set forth by Empire will lead to inequities among ratepayers on several counts. First, the proposal does not account for differences in energy losses incurred in providing services to various classes. (Johnstone Direct, Ex. 9, p. 3). A proper treatment of losses is necessary because a metered kilowatt-hour for a secondary customer places a higher demand on a generator than a metered kilowatt-hour for a primary customer. This situation occurs because the secondary customer's usage is measured after losses have occurred through the distribution transformer, secondary lines, and service line. (Watkins Rebuttal, Ex. 12, p. 4). Unless some adjustments are made, a Large Power Customer would pay a 3% higher surcharge than a Large General Service Customer, and based on the loss percentages calculated in Case No. EO-91-74, any customers being served at transmission voltage will pay a 8.4% higher surcharge than residential customers for the same energy usage. (Id. at 5).

Secondly, accepting the premise put forward by Empire, that the interim rate increase is justified by an increase in gas rates, the flat rate does not properly account for gas prices by season and time of day. The effect of higher gas prices on generation costs is not uniform throughout the hours of the year. Higher gas prices will have the greatest effect during on-peak hours in the summer and the least effect during off-peak hours in the winter. The flat rate surcharge proposed by Empire would cause customers with high winter usage, e.g. space heating, to help pay the summer air-conditioning bills of other customers. It also causes customers with high annual load factors to pay for a disproportionately larger share of the surcharge than customers with low annual load factors. (Id.).

The methodology proposed by Staff would resolve the rate inequities inherent in Empire's flat rate proposal. The Staff proposal would account for this as follows:

(1) Differences in losses among customers <u>within</u> a class are accounted for by applying current tariff provisions for adjusting losses.

(2) Differences in losses among customers <u>between</u> class is accounted for by adjusting the hourly class loads to reflect the actual load on a generator prior to calculating the hourly cost allocations.

(3) Differences in costs by season and time of day are accounted for by Empire's determination of the cost increases due to higher gas prices by season and time of day.

(Id. at 6-7).

By following this methodology, if interim rates are granted, the rate design currently in effect for Empire will be preserved and the impact on customers will be more uniform across customers classes. (Tr. 238).

V. CONCLUSION

As has been repeatedly demonstrated throughout this brief, Empire's interim rate request is highlighted by several flaws which mandate its rejection. In contrast to the logic and common-sense contained within the Commission's well developed "emergency" standard, Empire's "good cause shown" standard features vague, ambiguous factors which provides the utilities of this State little guidance regarding interim rate relief. As the Massachusetts Commission has previously learned "such a broadening of [the] previous standard [will] serve mainly to impose administrative burdens upon an already tightly constrained suspension period." Additionally, Empire's interim request violates the legal ban against single-issue ratemaking as well as the test year and matching doctrines. Finally, Empire, in addition to violating the Stipulation and Agreement in the previous proceeding, has quantified its request on inherently unreliable figures. For all these reasons, Empire's interim rate increase should be rejected.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 31st day of December, 1996.

JURISDICTIONS WHICH UTILIZE THE EMERGENCY STANDARD

ALASKA	Re: Municipality of Anchorage d/b/a Anchorage Sewer Utility	37 PUR4th 97 (1980)
ARKANSAS	Re: Arkansas Power and Light Company	10 PUR4th 474 (1975)
	Re: Arkansas Louisiana Gas Company	93 PUR3d 201 (1972)
	Re: Fordyca Water Company	88 PUR (N.S.) 98 (1951)
CALIFORNIA	Re: Citizen's Utility Company of California	89 PUR3d 334 (1971)
	Re: Citizen's Utility Company of California	19 PUR3d 177 (1957)
	Re: Southern Counties Gas Company	18 PUR3d 338 (1957)
DISTRICT OF COLUMBIA	Re: Chesapeake & Potomac Telephone Company	56 PUR4th 53 (1983)
	Re: Chesapeake & Potomac Telephone Company	95 PUR3d 339 (1972)
	Re: Potomac Electric Power Company	95 PUR3d 99 (1972)
FLORIDA	Re: People's Gas Systems, Inc.	98 PUR3d 205 (1972)
HAWAII	Re: Lanai Water Company, Inc.	163 PUR4th 623 (1995)
	Re: East Honolulu Community Services, Inc.	118 PUR4th 259 (1990)
IDAHO	Re: Washington Water Power Company	37 PUR4th 576 (1980)
	Re: Washington Water Power Company	22 PUR4th 485 (1977)
ILLINOIS	Re: Temporary Rate Increases	77 PUR4th 747 (1986)
	Re: Commonwealth Edison Company	49 PUR4th 62 (1982)
INDIANA	Re: Indiana-America Water Company	88 PUR4th 43 (1987)
	Re: Public Service Company of Indiana	72 PUR4th 660 (1986)
	Re: Hoosier Energy Rural Electric Cooperative Inc.	62 PUR4th 419 (1984)
	Re: Wayne County Rural Electric Membership Corp.	98 PUR3d 525 (1973)
	Re: Indianapolis Power & Light Company	88 PUR3d 401 (1971)

	Boone County Rural Electric Membership Corp. v. Indiana Public Service Commission	159 N.E.2d 121 (Ind. 1959) 29 PUR3d 409 (1959)
LOUISIANA	Ex parte Louisiana Power and Light Company	70 PUR4th 460 (1985)
	Ex parte Gulf States Utilities Company	80 PUR4th 370 (1986)
MAINE	Re: Central Maine Power Company	45 PUR4th 191 (1982)
MASSACHUSETTS	Re: Western Massachusetts Electric Company	52 PUR4th 32 (1983)
	Re: Fitchburg Gas & Electric Co.	52 PUR4th 197 (1983)
MICHIGAN	Re: Consumers Power Company	66 PUR4th 1 (1985)
MONTANA	Re: Montana-Dakota Utilities Company	14 PUR4th 115 (1976)
NEW HAMPSHIRE	Public Service Company of New Hampshire v. State of New Hampshire	2 PUR4th 59 (1973)
	Re: Public Service Company of New Hampshire	95 PUR3d 401 (1972)
NEW JERSEY	Re: Jersey Central Power and Light Company	38 PUR4th 115 (1980)
	Re: Public Service Electric and Gas Company	6 PUR4th 302 (1974)
NEW MEXICO	Re: El Paso Electric Company	38 PUR4th 289 (1980)
	Re: Gas Company of New Mexico	28 PUR4th 20 (1978)
NEW YORK	Re: Long Island Lighting Company	100 PUR4th 237 (1989)
NORTH CAROLINA	Re: Carolina Power and Light Company	4 PUR4th 387 (1974)
OHIO	Re: Dayton Power & Light Co.	41 PUR4th 136 (1980)
OREGON	Re: Portland General Electric Company	86 PUR4th 463 (1987)
PENNSYLVANIA	Pennsylvania Public Utility Commission v. Pennsylvania Electric Co.	26 PUR4th 337 (1978)
TEXAS	Re: Lo-Vaca Gathering Company	4 PUR4th 349 (1973)
VERMONT	Re: Franklin Electric Light Company	118 PUR4th 267 (1990)
	Re: Green Mountain Power Corporation	98 PUR3d 291 (1973)
WASHINGTON	Washington Utilities and Transportation Commission v. Pacific Northwest Bell Telephone Co.	11 PUR4th 166 (1975)

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