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

REPLY BRIEF OF THE STAFF OF THE MISSOURI PUBLIC SERVICE COMMISSION

David Woodsmall
Acting Deputy General Counsel
Missouri Bar No. 40747

R. Blair Hosford
Carol M. Keith
Assistants General Counsel

Attorneys for the Staff of the
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
(573) 751-8700
(573) 751-9285 fax

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I. INTRODUCTION

Pursuant to the briefing schedule in this case, the Staff of the Public Service Commission of the State of Missouri ("Staff") submits this Reply Brief. In the instant Reply Brief, the Staff will address some of the assertions and arguments raised in other parties' Initial Briefs. Staff is not conceding a point merely because it fails to address an allegation or argument of another party in this brief, or even because Staff did not address such allegation or argument in its Initial Brief. Any lack of a response in this brief to any allegation, argument or issue in another party's Initial Brief should not be construed as acquiescence on the part of Staff. For a more detailed discussion and analysis of the issues in this case, Staff would refer the Commission to Staff's Initial Brief filed herein on December 31, 1996.

II. ARGUMENT

In its Brief, The Empire District Electric Company ("Empire") attempts to divert the single-issue ratemaking criticisms of the other parties by resorting to information outside the record of this proceeding. As was explained in Staff's Motion To Strike filed January 7, 1997, Empire attempts to justify its $4 million interim request through comparisons to a $6 million revenue deficiency that Empire claims was based upon an all relevant factors analysis. (Initial Brief at 2 and 3). In addition to resorting to information outside the record of this proceeding, Empire's claim raises further questions. For instance, Empire was obviously aware that single-issue ratemaking would be a concern in this proceeding. Recognizing the existence of such a concern, Empire devoted a portion of the Direct Testimony of Myron McKinney to responding to this eventual criticism. (McKinney Direct, Ex. 2, p. 4). Specifically, Mr. McKinney relies solely upon a litany of theoretical justifications to support Empire's claims that single-issue ratemaking is not an obstacle to the Commission granting interim rates. Noticeably the all relevant factors analysis that Empire now claims was conducted is not referenced by Mr.

McKinney. Certainly, if such an analysis had been conducted, wouldn't Empire have merely provided such a study rather than subject itself to the single-issue ratemaking concerns it knew would ultimately arise? Additionally, if such a study had been conducted wouldn't the Executive Vice President - Commercial Operations, the Vice President - Finance / Chief Financial Officer, or the Vice President - Energy Supply, all of whom filed testimony in this proceeding, been aware of the existence of such a study and included such a study in their prepared testimony? The Commission should not be diverted by Empire's last minute claims regarding the existence of an all relevant factors study. Instead the Commission should recognize the fatal flaw contained with Empire's interim request and dismiss its interim tariffs.

Empire attempts to justify its failure to conduct an all relevant factors analysis by stating that this failure was the result of a need "to simplify the process". (Initial Brief at 2). Staff, as well as the courts of this state, would concede that ratemaking can become complicated. The Western District Court of Appeals notes that "[a]lthough ratemaking guidelines appear simple, the actual implementation of ratemaking employs complicated and sophisticated theories accompanied by few givens and many variables." State ex rel. Associated Natural Gas Company v. Public Service Commission, 706 S.W.2d 870, 874 (Mo.App. 1985). In fact, that particular Court compared ratemaking to "translating and deciphering the Rosetta Stone." Id. However, mere claims regarding the need for simplicity does not excuse a company's failure to comply with legal doctrines such as single-issue ratemaking. Such doctrines were clearly deemed necessary to the development of just and reasonable rates. Empire's need "to simplify the process" does not excuse its failure to abide by the single-issue ratemaking doctrine and ultimately will not save its interim relief request.

On page 3 of its Initial Brief, Empire presents several statements that are also without support on the record. Specifically, Empire claims that even if the Commission were to grant Empire the $4 million interim rate request, "it will not produce the 11.25% return". Staff is somewhat confused by Empire's ability to make such claims in light of the fact that Empire has never presented a study supporting its calculation. Additionally, such a statement likely suffers from the same shortcomings underlying Empire's calculation of its current return on equity. Specifically, it is likely that this figure: (1) is based upon total company operations, rather than Missouri jurisdictional operations (Tr. 129); (2) fails to remove water utility operations (Tr. 262); (3) fails to annualize for Empire's last rate increase (Tr. 50); (4) fails to annualize for Empire's recent reorganization (Tr. 50); (5) fails to annualize for recently experienced customer levels (Winter Direct, Ex. 15, p. 3); (5) fails to normalize for weather (Tr. 171); (6) fails to normalize for the effects of the wind storm experienced in the spring of 1996 (Tr. 89, 98, 128-129); (7) fails to normalize increased purchased power as a result of the abnormally long outage at Asbury (Tr. 128); (8) fails to normalize for reduced output at the hydroelectric facility (Tr. 163-164); and (9) fails to recognize the $767,000 reduction in O&M costs (Tr. 88, 96). All of these shortcomings are more completely addressed at pages 16 through 19 of Staff's Initial Brief. In light of the fact that none of the routine rate case normalization and annualization adjustments have been applied to the per book data underlying Empire's interim request, it is impossible for Empire or any other party to accurately state what its return on equity truly is or the effect of a $4 million interim rate increase on that return on equity. In fact, it is entirely possible Empire will earn well in excess of 11.25% if it received the $4 million interim increase. Without the necessary support quantifying the impact a $4 million rate increase will have on Empire's earnings, the Commission should reject Empire's interim rate request.

As the Staff predicted, Empire has attempted "to buttress its case by relying upon Staff's own return on equity calculation." (Staff Initial Brief at 20). In fact, despite repeated reminders that Staff's analysis **was not** a revenue requirement calculation (Tr. 264), Empire in its brief mischaracterizes Staff's testimony by stating that its interim request "falls within the Staff's revenue deficiency range." (Initial Brief at 3). Repeatedly throughout the testimony, hearings and briefs in this case, Empire was informed that Staff's calculation was merely designed to demonstrate that Empire does not suffer from an emergency situation. In fact, despite recognizing the very limited nature of Staff's review, Empire continues to linger in its belief that Staff's calculations support its interim request.

As was pointed out in its Initial Brief, Staff's return on equity calculation does not support Empire's interim relief request. Staff's calculation is notable in that it reflects an increase of 165 basis points over the return on equity suggested by Empire. (Staff Initial Brief at 21). The reason this 165 basis point increase is notable is that it reflects only 3 adjustments: (1) elimination of the one-time reorganization charges (Winter Direct, Ex. 15, p. 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). This significant increase in calculated return on equity based upon 3 adjustments begs the question: What would Empire's return on equity be if Staff had sufficient time to provide for the 50 to 60 adjustments routinely found in the context of a Staff audit? (Tr. 283 - 284).

As indicated, Staff's calculation met its designed goal of testing whether Empire was in an emergency situation. Empire's return on equity clearly demonstrates that Empire is not in an emergency situation. Staff's very preliminary calculation indicates that Empire's return on equity for Missouri operations is 9.62%. (Winter Direct, Ex. 15, pp. 5 & 6). When analyzed in

conjunction with the fact that: (1) Empire's preferred stock, secured debt and commercial paper all continue to be considered investment grade (Broadwater Direct, Ex. 14, p. 3); (2) Empire's dividends are expected to remain at current levels (Id. at 4); (3) Empire continues to be able to access the debt markets as demonstrated by its December 1996 bond issuance (Id.); (4) Empire's interest coverage is well over the 2.00 times required by its bond indenture (Id.); (5) Empire's adjusted net income for the twelve months ended September 30, 1996 was down only 0.06% from the previous year (Id. at 5); and (6) Empire's stock on the date of hearing was trading at its high for 1996 (Ex. 19, Broadwater Direct, Ex. 2, p. 6), clearly Staff's return on equity calculation demonstrates that Empire is in solid financial condition and is not in an emergency situation deserving of interim rate relief.

As warned by all parties to this proceeding, as previously experienced by the Massachusetts Department of Public Utilities, and as previously recognized by the Commission, deviation from the emergency standard, as Empire suggests, will result in a situation in which every permanent rate increase request will carry 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; Fitchburg Gas & Electric Light Company, 52 PUR4th 197 (Mass. 1983). Certainly Empire's 9.62% return on equity, stable financial condition and ability to access the capital markets do not warrant the development of a different interim standard by the Commission or acceptance of its inevitable downside results.

On page 4 of Company's Initial Brief, Empire, in an attempt to assure the Commission that Staff's lack of a "full audit" of its interim rate request should not be a concern, notes that "an interim request by its very nature calls for an immediate, abbreviated and expedited process, [therefore] something less than a 'full' audit should be expected." Staff would agree with Empire

that historically interim rate requests have been granted on less than a full audit, in essence an expedited process. However, as was pointed out previously, the Commission has historically required proof of an emergency situation prior to granting interim relief. In the case at hand, where Empire is clearly not in an emergency situation, logic dictates that additional procedural safeguards be provided. Specifically, the Commission should require that a full Staff audit in the permanent proceeding, based upon the same test year, be conducted to justify Empire's interim rate request with any difference between the interim increase granted and any permanent increase ultimately ordered being made refundable. Recognizing Empire's opposition to such a test year in the permanent proceeding, the Commission should reject Empire's interim request.

In the case at hand, Empire has guaranteed that such a safeguard will not exist in this proceeding. Not only has Empire based its interim request on a different test year, but in an attempt to avoid the safeguard of any Staff review, Empire even requested that the interim rates go into effect without Commission suspension. (McKinney Direct, Ex. 2, p. 6). Staff audits have been recognized as an essential component to the development of just and reasonable rates. Recognizing the inability of Staff to conduct such an audit, ratepayer interests remain completely unprotected if Empire's interim rate request is granted. As such, the Commission should reject Empire's interim rate request.

Empire further attempts to comfort the Commission regarding the lack of a "full Staff audit" by claiming that Staff has historically recommended rate adjustments based upon less than a "full, thorough and comprehensive audit". (Initial Brief at 4). As support for this statement, Empire references Mr. Oligschlaeger's testimony regarding the rate reductions which occurred as a result of the Tax Reform Act of 1986. However, as pointed out by Mr. Oligschlaeger, "[i]n comparing the number of adjustments that I recall being made in the context of those proceedings

to what I would call a normal full-blown rate case audit, I'd say probably a majority of the adjustments were made in the Tax Reform Act audits". (Tr. 343). Mr. Oligschlaeger continues to note that "[c]ertainly the number of adjustments that we would have proposed in the Tax Reform Act proceeding would have been far in excess of the, I think the three adjustments that Mr. Winter talks about in his testimony." (Tr. 355). As is readily apparent, Empire's comparison of Staff's minimal review in the pending rate proceeding, in which 3 adjustments were made, to the Tax Reform Act audits, in which a majority of the adjustments were made, is baseless and should not excuse the lack of procedural safeguards inherent in Empire's interim rate request.

On pages 4 and 5 of its Initial Brief, Empire attempts to use several Commission orders from the last 20 years in an attempt to legitimize its proposed "good cause shown" standard. As indicated in Staff's Initial Brief, much of Empire's purported support is misplaced. In 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 case. Clearly the unique nature of the facts in that case distinguish it from the current proceeding. Unlike Empire's current proceeding, Staff had completed its full audit of the earnings of Missouri Power & Light Company (MPL). All testimony had been filed and an agreement reached as to MPL's revenue deficiency. The safeguards inherent within the "emergency" standard were not necessary to protect ratepayers in that such protection had been guaranteed through Staff's full audit.

Despite Empire's claims that the Commission had effectively abandoned the emergency standard in the MPL case, the Report and Order clearly demonstrates that the Commission, since it considered many of the factors utilized for emergency relief, implicitly applied the emergency standard to MPL.

> The return on common equity for the Company's gas operations for this period was 1.2 percent. . . Second quarter earnings fell approximately $337,000 short of covering the second quarter common dividends. In addition, using the SEC method of calculation, the Company's interest coverage is 2.00. Further deterioration would preclude the Company from selling Mortgage Bonds. . . This interim rate relief could prevent the interest coverage ratio from falling below the two times level and allow the Company to finance its construction budget, most of which cannot be deferred. Re: Missouri Power & Light Company, 22 Mo.P.S.C. (N.S.) 257, 258 (1978).

As is apparent from the record in the current proceeding, even the standard utilized in the MPL case would not entitle Empire to interim relief. Specifically, Empire currently is earning approximately 9.62% return on equity. (Winter Direct, Ex. 15, pp. 5 & 6). Empire's interest coverage ratios are well in excess of that required by its indenture agreements. (Broadwater Direct, Ex. 14, p. 4). Empire has had no problems financing its current construction budget. Clearly, the case that Empire cites as its foremost support for a good cause standard would dictate that the Commission reject Empire's interim rate filing.

More amazing is Empire's attempt to cite Re: Raytown Water Company, 1 Mo.P.S.C. 3d 184 (1991) as support for its claim that the Commission has applied a "less than emergency standard in granting interim relief." (Initial Brief at 5). In that case, the Commission specifically stated that "[f]rom evidence adduced at the hearing on the stipulation the Commission finds that an emergency exists under the historical standard." Id. at 186. Specifically, the Commission

referenced Raytown Water's inability to access additional debt. Id. at 187. Clearly this case does not support Empire's proposed "good cause shown" standard.

Finally, Empire refers the Commission to Re: Arkansas Power & Light Company, 28 Mo.P.S.C. (N.S.) 143 (1986) as support for the proposition that the Commission can deviate from the emergency standard based upon compelling circumstances. Certainly, Staff would agree with such a proposition. However, the true proposition expressed in the Arkansas Power & Light case is that compelling circumstances should be present prior to departure from the standard. "When it cannot be determined from the record whether an emergency or near-emergency condition exists, and when no compelling reason is shown for departure from the standard, the request for interim rate relief should be denied." Id. at 148. As in the Arkansas Power & Light case, Empire has failed to show compelling circumstances for departure from the logic of the "emergency" standard. Therefore, Empire's request for interim rate relief should be denied.

On page 10 of its Initial Brief, Empire, caught between the proverbial Scylla and Charybdis, proposes to base any requirement for a refund on a comparison of the result of the interim proceeding to the revenue requirement calculated in the permanent proceeding as of September 30, 1996. Empire obviously makes such a proposal based upon Commissioner Kincheloe's questions regarding Empire's inability to justify its interim request with a permanent proceeding based upon the same test year. (Tr. 94). However, this new proposal still is not sufficient. First, Empire is still proposing to base a refund on a comparison of an interim increase calculated on single-issue factors to a revenue requirement considering all relevant factors. Second, the refund would still be based on a different test year from that which the interim increase was based.

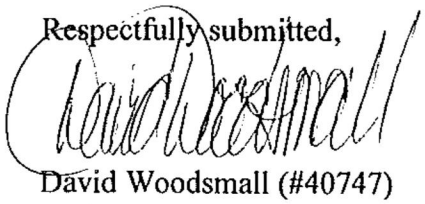
Implicitly, Empire is admitting what Commission Kincheloe and Staff have already recognized, that the interim proceeding lacks the fundamental safeguards inherent within a permanent proceeding based upon an identical test year to that underlying the interim rate request. Absent such a safeguard there will never be justification, through a Staff audit, for Empire's interim request. Without such safeguards, ratepayer interests mandate the rejection of Empire's interim rate request.

In contrast to its concession in regards to interim rate refundability, Empire refuses to recognize that its quantification of interim rate relief is faulty. As was stated throughout its brief, Empire designed its interim increase to reflect the increase in natural gas & purchased power prices since Empire's last proceeding. (Initial Brief at 2). In support of its request, Empire claims to have used Staff's final fuel run as the basis for its quantification of interim rate relief. Based upon its perception of what was Staff's final fuel run, Empire requested $4 million in interim relief. However, it is uncontroverted at this point that Empire's request is grossly in error. As indicated in Mr. Featherstone's testimony, and never challenged by Empire, Staff's final fuel run was actually run number 171. (Featherstone Rebuttal, Ex. 11, p. 8). Applying Empire's logic to Staff fuel run number 171 results in an actual interim request of $3,149,890. (Id. at 12). Empire's continued advocacy of a $4 million interim increase, in light of Staff's uncontroverted evidence, defies logic and calls into question Empire's true motivation.

III. CONCLUSION

For the foregoing reasons, and for the plethora of reasons discussed in Staff's Initial Brief, the Staff respectfully requests the Commission reject Empire's interim rate increase.

Respectfully submitted,

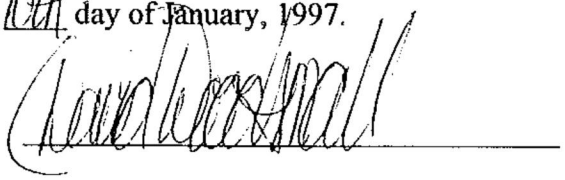


David Woodsmall (#40747)
Acting Deputy General Counsel

Attorney for the Staff of the
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102
(573) 751-8700
(573) 751-9285 (fax)

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 10th day of January, 1997.



Service List for Case No. ER-97-82
Updated: January 10, 1997

James C. Swearengen
Brydon, Swearengen & England
312 East Capitol Avenue
Jefferson City, MO 65102

Stuart W. Conrad
Finnegan, Conrad & Peterson
1209 Penntower Office Center
3100 Broadway
Kansas City, MO 64111

Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102