BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

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

Stuart W. Conrad MoBar No. 23966
FINNEGAN, CONRAD & PETERSON, L.C.
1209 Penntower Office Center
3100 Broadway
Kansas City, Missouri 64111
(816) 753-1122
FAX: (816) 756-0373

ATTORNEYS FOR ICI and PRAXAIR

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I. INTRODUCTION.

Based on its Initial Brief, Empire District Electric Company (Empire) attended a different hearing. Empire's brief is creative, but has little to do with the record or the facts in this proceeding.

Empire's argument has two major flaws:

(1) Empire has failed to establish a revenue deficiency "in excess of $6 million"[1] as it contends, or, for that matter, in any other amount; and

(2) Empire urges a shortcut procedure, demonstrates absolutely no justification for such a shortcut, and then amply demonstrates why a full proceeding is needed to set rates absent a true emergency.

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[1]Empire Initial Brief, p. 2.

II. EMPIRE HAS FAILED TO ESTABLISH OR QUANTIFY ANY REVENUE DEFICIENCY.

A. Empire's Assertion of a Higher Revenue Deficiency is Flawed.

Empire's argument proceeds from the unproven assumption that it "was experiencing a revenue deficiency in excess of $6 million." Empire Initial Brief, p. 2. No credible evidence supports this claim. Empire's statement references its own unverified position statement in the Hearing Memo (Exhibit 3), and its counsel's opening argument. No Empire witness offered such testimony.

There are only two places in the transcript where the $6 million figure appears. One is in connection with ICI's, Praxair's and Commission Staff's joint objection to the inclusion of this very unsubstantiated claim in the Hearing Memo (Tr. p. 105, l. 24)[2], and in the opening statement by counsel for Empire (Tr. p. 17, l. 18).

Neither of these constitutes competent evidence. Assertions in various locations in Empire's brief to a determination of a $6

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[2]When objecting to the admission of the Hearing Memo as an exhibit, Staff counsel predicted the very attempt that Empire has made to cite the Hearing Memo as though it was evidence. The very language of the hearing memo disclaims evidentiary effect for statement therein and, if the hearing memo is now to be converted to evidence rather than simply a list of issues with the respective parties' positions on those issues **provided for the convenience of the Commission**, it is doubtful if agreement can be obtained in the future to the text of a hearing memorandum.

million "revenue deficiency" are circular, build upon fallacies and should be disregarded.

Lacking evidentiary support, Empire derives this figure by a erroneous two-step process. First, Empire miscalculates a 7.97% return on equity by selectively including millions in unrepresentative and non-recurring expenses and excluding millions of new revenue dollars. Armed with this flawed result, Empire then reasons backward to a hypothetical $6.4 million it contends would be required to get to a still further hypothetical 11.25% return.

This is a clear bootstrap. Understandably, Empire left this argument to the unverified hearing memo and its counsel's opening statement; no Empire witness subjected themselves to cross-examination on this procedure. The prior case was settled and had no statements regarding rate of return on equity or overall rate of return. There was no settled rate of return and there is no basis to even assume that the rate of return coming out of that settlement (accepted by Empire) was 11.25% or any other rate of return number.

Even if a rate of return had been established in the prior case, this is nothing more than giving Empire an **opportunity** to earn that return. There is no constitutional right even to profitable operations, <u>a fortiori</u> to a particular return figure. <u>FPC v. Natural Gas Pipeline Company</u>, 315 U.S. 575, 590 (1942).

B.Empire's Assertion of High Gas Prices is Faulty.

Empire also argues that it faces "higher" gas prices (Empire Initial Brief, p. 2), which Empire then characterizes as a "53% increase in natural gas prices and a [sic] 8% increase in the price of purchased energy." Empire Initial Brief, pp. 2-3. "Higher" than what? A 53% increase from what figure? Empire's answer is to claim that these prices were higher than those "reflected in Empire's rates which became effective November 15, 1995." Id., at 3.

This argument is deficient. Neither natural gas prices nor purchased power prices were "reflected" in Empire's rates. The prior rate case was settled -- a settlement accepted by Empire management. The express language of that settlement rules out any inference regarding any level of included fuel, natural gas or any other component of Empire's rates. Exhibit 20, Attachment A, p. 7. There is no "reflected" natural gas price from which a calculation of 53% or any other increase or decrease calculation legitimately could be based.

C.Empire's Proposal Remains Unlawful Single Issue Rate-making.

The only revenue calculation claimed by Empire was its $4.018 million based on claimed "increases" in natural gas and purchased power costs. Even the basis of this calculation is wrong. Featherstone, Exhibit 11, p. 6. Mr. Featherstone testified that Mr. Brill's assumption regarding the level of purchased power cost was in error. Id. As was demonstrated by cross-examination of both Messrs. McKinney and Brill, Empire had the

opportunity to minimize these costs and failed, as shown by the testimony of Messrs. McKinney and Brill. McKinney, Tr. 77-79; Brill, Tr. 181-87. The entire basis of Empire's argument and its brief is so detached from the evidence in this proceeding as to border on fantasy.

Empire then argues that seeking "only a portion" of its averred revenue deficiency does not constitute unlawful single issue ratemaking. Empire Initial Brief, p. 3. Empire's statement concedes that single issue ratemaking is unlawful. Empire's argument also assumes some higher level of revenue deficiency (as refuted above), but the only claim that Empire made was to increased natural gas and purchased power costs amounting to $4.018 million -- clearly single issue ratemaking.

Empire seeks to occupy both sides. Its witnesses (and its brief) argue that the basis for any relief is an increase in natural gas costs, yet try to avoid single issue ratemaking by the duplicitous argument that looking at the **total company** return on equity considers all relevant factors. The flaw in single issue ratemaking is that it focuses attention on a change in one factor while ignoring others that potentially offset the claimed change -- precisely the case here. Only through a **comprehensive** review of all relevant factors can this be avoided. State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41 (Mo. en banc 1979) ("UCCM").

D.Empire Disregards Relevant Factors in Calculating a Rate of Return.

It is also specious to argue that Empire "took into account all relevant factors" when its own witnesses admitted that Empire had not done so. McKinney, Tr. 100; Fancher, Tr. 137-38.[3] Again, the assertions in Empire's brief lack record support. Empire argues that Staff considered all relevant factors (Empire Initial Brief, p. 3, but Staff witness Winter expressly disclaimed such a position. Empire claims that Staff developed a "revenue deficiency," but Mr. Winter strongly disclaimed any finding of "revenue deficiency." Winter, Tr. 264, l. 16.

Empire argues that its calculation of its "revenue deficiency" includes "no other significant factors to offset these costs." Empire Initial Brief, p. 8. Let's test this assertion against the record of the case. Over $5 million of non-recurring expenses associated with Empire's reorganization efforts were included and are at least as material as the $4.018 million Empire claims as fuel cost increases. Winter, Tr. 263, 264. An uncertain but unamortized expense was included for storm damage

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[3]In redirect, Empire's counsel attempted to patch up Mr. Fancher's admission. Fancher, Tr. 145. All this attempt did was confirm that Empire had simply added up columns of numbers. Empire performed no analysis whether such expenses were representative (such as the **inclusion** of over $5 million of one-time expenses associated with reorganization), nor with whether all revenue and income items had been included (such as the **exclusion** of 4 1/2 months (38%) of the additional revenue from the last case). Mr. Fancher had not even attempted to present a **Missouri jurisdictional** number (but didn't hesitate to compare to Union Electric's **Missouri jurisdictional** numbers, nor even to what Empire claims the Staff **Missouri jurisdictional** ROE midpoint was in the last rate case.

repair. McKinney, Tr. 98; Fancher, Tr. 128. An unquantified but certain cost fuel cost increase resulting from unplanned Asbury generating station outage was included. Fancher, Tr. 128; Brill, Tr. 163, 165; Broadwater, Tr. 319. Hydro output during the test period was reduced. Brill, Tr. 163-65. Four and one-half months of prior rate relief was disregarded. McKinney, Tr. 50, 59.[4]

To be sure, Empire swept all these **expense** items (and perhaps other improper expenses yet undisclosed) into its flawed return on equity calculation. But that begs the question. Such calculations are not representative and grossly distort any financial results.

Empire's actions in this case provide an excellent example justifying the rule requiring that all relevant factors must be considered. Empire's apparent view is that its unadjusted period-end account balances are the relevant factors to be considered. Were the definition of "relevant factors," so narrow, rate cases would be easy; the Commission would never have to consider whether the balances were representative or whether the actions and decisions which resulted in those balances were prudent. Account balances could be plugged into a computer spreadsheet and a button pushed. But the definition of "relevant factors" is not so narrow as Empire would contend. Questions of

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[4]Staff Witness Winter limited review adjusted out the reorganization costs and two other depreciation-related adjustments. He did not even attempt to normalize growth figures, nor properly adjust for the effect of the last rate case. Even with those minimal adjustments, his calculation of Empire's return was well in excess of that calculated by Empire and approached 10%.

prudence, matching, non-recurrence are also relevant factors for Commission consideration.

III. EMPIRE'S ARGUMENT REGARDING RELIEF IS INCONSISTENT.

Empire seems unable to come to a coherent, much less cohesive, strategy in its case. On one hand, it argues that something other the well-recognized and judicially confirmed emergency standard should be employed. Offering rationales from non-Missouri jurisdictions (in none of which Empire does business), Empire argues that the interim emergency standard ought to be something other than it is, but never states what would constitute its "just cause" standard nor does it attempt to explain how the Commission would employ such a standard. Empire Initial Brief, p. 4-5.[5]

At the same time, Empire argues that an interim case "by its very nature" calls for shortcuts to the full rate case investigatory process (Empire Initial Brief, p. 4) and asserts that the proposed interim increase has some "urgency" associated with it. Empire Initial Brief, p. 8. Of course, Empire admits that it faces no exigent circumstance which could or would justify departure from the full evidentiary standard.

The source of this claimed "urgency" is unclear. Empire's stock is at near-record highs. Empire just finished and is engaged in a significant new borrowing to finance further construction activities. Oligschlaeger, Exhibit 17, p. 6. The

[5]ICI and Praxair have addressed the existing emergency standard in Section III of their Initial Brief. Empire's discussion adds nothing further to the debate.

rationale for a shortcut proceeding in a true emergency situation is to identify and provide that amount of relief -- and only that amount of relief -- needed to preserve the operational and financial integrity of the utility. Only the public interest in preserving the utility from imminent collapse is sufficient to override the public interest in setting just and reasonable rates after the **Commission's** consideration of all relevant factors. UCCM, supra. It is patently illogical to claim on one hand that the investigation should be cut short, and on the other admit that there is no basis for doing so.

A.Empire's Factual Assertions Are Flawed.

Empire claims that nothing in Commission practice or law requires a utility to seek to recover all its costs. The risk that a utility might miss an expense has not proven to be a serious threat to public welfare. The usual problem (as demonstrated clearly in this case) is that of a utility selectively trying to recover all its costs (whether or not prudent or representative) and ignoring revenues received.

The law gives the Commission the responsibility to set "just and reasonable" rates after consideration of all relevant factors. UCCM, supra. In a given rate case, this abstract standard is infused with meaning through comprehensive investigation of the utility's claims, through aggressive examination of its financial operations and structure, and through deliberate and thoughtful evaluation of the prudence of management's decisions. These are all considerations which Empire seeks to avoid, not

because of a true emergency, but because of some unstated "urgency." From this objective of just and reasonable rates comes the various principles to which Staff and others have referred such as matching, normalization, maintenance of the integrity of a definite test period, customer grown and weatherization adjustments, and elimination of non-representative non-recurring items of revenue and expense. Even Staff's abbreviated review and its three adjustments raised Empire's **Missouri jurisdictional** return on equity to nearly 10%.

Empire urges the Commission to take a "global" view. Said another way, Empire urges the Commission to ignore Empire's lack of emergency and ignore ratemaking principles and seek some basis to give Empire some more ratepayer money. Empire approaches the question as though the Commission were somehow predisposed to discard its own precedents and Missouri law in order to give Empire anticipatory relief from its permanent case.

Take a quick look the list of "facts" which Empire urges the Commission to review "globally":

Claimed "Fact"	Comment
Empire claims the "lowest average rates of any regulated electric utility in the state."	Whether true or not, irrelevant to the question before the Commission of whether Empire meets the standards for emergency relief. Simply having lower costs does not justify a rate increase.

Claimed "Fact"	Comment
Empire has taken steps to reduce costs	We certainly hope so, since Empire should seek to operate efficiently. Rather than seek to pass these claimed economies to ratepayers, however Empire would charge ratepayers the non-recurring costs associated with its cost reductions, while attempting to capture the future benefit of reduced expenses for its shareholders.
85% of Empire business is in Missouri and that is where the growth is being experienced	Growth means additional kWh sales, yet Empire proposed no growth adjustment to normalize its revenues to a representative level as would be experienced during the period rates would be likely to be in effect. Failure to do so cannot be the basis of just and reasonable rates.
Empire average rates are higher in other jurisdictions	Perhaps Empire's cost of service in the other jurisdictions is higher than in Missouri. Perhaps other jurisdictions are less circumspect in their regulatory activities. In large measure this is irrelevant and immaterial. Empire's calculation of its 7.97% return on equity was a **total company** figure and did not take into account that Empire has brought on at least one major generating unit since it has had rate relief in other jurisdictions which pulls the **total company** ROE figure down.

Claimed "Fact"	Comment
Empire is recovering "increased" fuel and purchased power costs in Oklahoma and Arkansas	The comparison doesn't help Empire. That is exactly what Empire is seeking to do here -- create a "de facto" fuel adjustment clause. Such a result is unlawful in Missouri. Once again Empire tries to walk on both sides of the fence.
Gas costs used in Empire's last case aren't reflective of current market.	Nor are any other costs put forward by Empire reflective of its current operations because of Empire's failure to consider the effect of its competitive positioning process or its growth (see claimed "fact" No. 3 above). Further, the last case was settled and there were no gas costs, reflective or otherwise, included in the result. Moreover, gas costs declined in the period following the next preceding rate increase, but Empire didn't complain about the windfall when gas prices dropped.
Empire's return on equity is 7.97% even though a rate increase was granted only 7 1/2 months earlier	Empire didn't even offer a calculation of a rate of return on a Missouri jurisdictional basis, nor do a proper test year calculation. What, for example, happened to a normalization to reflect the 4 1/2 months of increased revenue over the remainder of the test period.? Why were non-recurring expenses (e.g., reorganization, windstorm) not eliminated? Why was there no growth adjustment when growth is claimed as the basis for the permanent increase (see Empire's claimed "fact" No. 3 above).

These aren't relevant facts and some are not even facts at all. They represent a distorted, one sided view of Empire's short term financial results which pick and choose to include high levels of non-recurring expense and ignore admitted growth and even the effect of past rate increases.

IV.EMPIRE'S CHANGE IN REFUND PARAMETERS DOES NOT JUSTIFY RELIEF.

In apparent realization of its original error and that its attempt to recover expenses associated with construction work in progress may be unlawful, Empire attempts to exclude the revenue effect of the expected new plant addition from the refund calculation. Too little, too late. Empire's proposed mechanism, though moving in the correct direction, still does not address the concerns of growth, normalization, and mixing of periods. Once again, an appropriate basis for refund would be to actually review the fuel expenses associated with the twelve months ended June 30, 1996. However, since there is no basis of comparison (the prior case being settled) there is no basis to demonstrate that any particular level of such costs was built into the existing settled rates. Of course, to do so would demonstrate that Empire's request violates the rule against single issue ratemaking. There is no basis to calculate a refund, and importantly, there is no basis to grant relief in the first place.

V.CONCLUSION.

At base, Empire's argument reduces to whining that, although it settled the past case at a level which its management accepted, it is not as profitable as it would like. While that may be sufficient basis to file another permanent case (in which all relevant factors could be considered **by the Commission**), Empire has shown no basis that interim relief should depart from the proven emergency requirements. Even Empire's claims as to an underrecovery are specious because its calculations selectively include non-recurring expenses and exclude relevant revenues. Empire's "good cause" standard disappears in ambiguity with Empire's assertions that the Commission should consider how Empire has "historically conducted its operations," "rate comparisons to other utilities" and, with some irony, the "impact of past rate increases." Empire Initial Brief, p. 7.

The irony comes from the fact that Empire's last rate case was settled by Empire management at a level which was, presumably, acceptable to them. Of course, Empire completely disregards this rate relief in making its calculation of its claimed 7.97% return on equity. The Commission should not be decoyed from a review of Empire's costs and revenues.

Empire wholly failed to meet its burden of proof in this proceeding. It has not shown an emergency, or near-emergency, nor has it shown any justification to depart from the existing emergency standard. All Empire wants is an "advance" on its

permanent case out of the pockets of its ratepayers. This attempt should be soundly rejected by the Commission.

Respectfully submitted,

Stuart W Conrad sw

Stuart W. Conrad 23966
FINNEGAN, CONRAD & PETERSON, L.C.
1209 Penntower Office Center
3100 Broadway
Kansas City, Missouri 64111
(816) 753-1122
FAX: (816) 756-0373

ATTORNEYS FOR ICI and PRAXAIR

CERTIFICATE OF SERVICE

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

Dated: January 10, 1997.

Stuart W Conrad sw

Stuart W. Conrad

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