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 THE EMPIRE DISTRICT ELECTRIC COMPANY

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The Empire District Electric Company ("Empire" or "Company") submits this reply brief in response to the initial briefs of the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("OPC"), ICI Explosive USA, Inc. ("ICI") and Praxair, Inc. ("Praxair").

Reply to Staff

The Staff supports a continuation of the "emergency" standard because the historical application of that standard has, for the most part, tilted the scale against the utility. Because the utility is required to demonstrate conclusively that it meets the emergency criteria, the Staff is free to argue that it is unable to test the company's evidence through a full, comprehensive audit and because of the "complexity" of the filing the request must be denied (Ex. 4, p. 13) or as in the present case when the Staff audit shows a revenue deficiency, argue that the audit results are invalid because all possible adjustments were not made. It is a real catch-22 situation and as a consequence, in practice, the continued application of the emergency standard has essentially removed the Commission from exercising its discretion with respect to interim rate relief. Empire urges the Commission to take another look at the interim case process and reassert its right to exercise its discretion without adherence to the rigid emergency standard. This is precisely what the implementation of the "good cause" standard will accomplish.

Realizing this, the Staff criticizes the good cause standard urged by Empire on the grounds that it is indefinite and vague. (Staff's Initial Brief, pp. 2, 11) The Staff obviously wants to require the continued satisfaction of long-established precise criteria in all cases to prevent the Commission from exercising its discretion to act on a case by case basis depending on the particular facts and circumstances. In this regard, the Staff would have the Commission ignore the law established by the *Laclede* case which affirmed the Commission's considerable discretionary power when it comes to interim cases by stating:

> The "file and suspend" provisions of the statutory sections quoted above lead inexorably to the conclusion that the Commission does have discretionary power to allow new rates to go into effect immediately or on a date sooner than that required for a full hearing as to what will constitute a fair and reasonable permanent rate. This indeed is the intended purpose of the file and suspend procedure. Simply by non-action, the Commission can permit a requested rate to go into effect. Since no standard is specified to control the Commission in whether or not to order a suspension, the determination as to whether or not to do so necessarily rests in its sound discretion. *State ex rel Laclede Gas Co. v. P.S.C.*, 535 S.W.2d 561, 566 (Mo. App. 1976).

What this clearly contemplates is that the Commission may allow a rate increase to take effect without a full comprehensive audit and without a hearing, if, in its discretion the Commission determines that this is the proper thing to do. No standards are specified! In exercising this discretion, the Commission need only satisfy itself that the increase is justified and this satisfaction can clearly come from something less than a full-blown audit and contested hearing. In fact, the *Laclede* case stands for the proposition that the Commission has the authority to allow interim rates to take effect based on the type of evidence that has been presented in this docket, namely:

- Direct Testimony and Schedules of Robert B. Fancher which shows Empire's return on equity at 7.97%.
- The Staff's abbreviated analysis which shows a revenue deficiency for Empire in the range of $3.186 to $5.540 million.
- Surveillance reports which show Empire's return on equity at 7.56% and a return on Missouri jurisdictional rate base of 7.88% (Ex. 4, p. 10).

Although not apparent in its brief, the Staff grudgingly conceded on cross-examination that the Commission has the discretion to deviate from the emergency standard if it wishes (Tr. 340, 341) and this is precisely what the Commission should do.

The Staff also argues that Empire's request violates the prohibition against single-issue ratemaking; violates test year and matching doctrines; violates the stipulation in Empire's last case; and is based upon faulty information. The Staff is wrong on all four points.

As previously explained, Empire's request cannot be construed to constitute single-issue ratemaking. In reaching its decision to seek interim rate relief, Empire took into account and considered all relevant expense and revenue factors (Ex. 2, p. 4; Ex. 4, pp. 9, 13; Tr. 89, 145) and there is ample evidence before the Commission to permit it to do the same. Moreover, the fact that Empire only requested a portion of its revenue deficiency based on fuel and purchased power costs does not somehow magically transform the request into unlawful single-issue ratemaking. Any other possible offsetting items in other components of the revenue requirement calculation are taken into account in the common equity calculation. As has been explained previously, Empire's return on equity, which takes into account all elements of cost, (Ex. 4, pp. 9, 11) was 7.97% as of June 30, 1996. To increase that return to 11.25%, the mid-point of the Staff's recommended range in the last case, would require an annual revenue increase of $6 million. The $6 million amount is derived from the simple mathematical computation which is undertaken to go from one return on equity, 7.97%, to a second return on equity, 11.25% as illustrated by the following:

> Return on Equity = Net to Common ÷ Common Equity
> = $15,581,348 ÷ $195,468,573
> = 7.97%
>
> Thus, if Empire were to earn 11.25%, the equation would become:
>
> Net to Common = Common Equity x Return on Equity
> = $195,468,573 x 11.25%
> = $21,990,214
>
> In order to calculate the deficiency, one merely subtracts the net to common at 7.97% from that at 11.25% ($21,990,214 - $15,581,348) or a deficiency of $6,408,866.

Stated another way, if Empire was earning 11.25% return on equity, the mid-point in the 1995 case, it would be receiving an additional $6.4 million in revenues. This is why Empire witness Fancher testified that the Company considered all relevant factors in its request, (Tr. 145; Ex. 3, Sched(s). 1, 2, 3) but elected to seek recovery of only $4 million. (Ex. 4, p. 2) The Staff would get to the same result through a similar simple calculation. (Tr. 272-273)

Thus it is readily apparent that in asking for only $4 million, Empire has left on the table the additional revenue necessary to produce the 11.25% return. Surely the Staff is not suggesting that there is a requirement that a utility must seek to recover its entire revenue deficiency. The 11.25% return and the additional $2 million necessary to get to that point represents and includes all other relevant factors in addition to fuel and purchase power costs. (Ex. 4, p. 9; Tr. 89)

The Staff grossly misstates Empire's case when it suggests that the Company believes an interim increase can be granted without consideration of all relevant factors. As explained by Empire witness McKinney in his direct testimony, it is clear that considering all relevant factors, Empire's actual return is inadequate and rate relief is necessary and appropriate. Because the Commission has considerable discretion to grant interim rate relief, the fact that only a portion of the revenue deficiency is sought does not mean that the single-issue ratemaking concept is an impediment to the Company's request. (Ex. 2, p. 4)

Empire's request does not violate test year or matching doctrines. Empire is well aware that its interim case is based on a test year ending June 30, 1996 while its permanent case is based on a test year ending September 30, 1996, with isolated adjustments through May 31, 1997. Because of this situation, Empire has proposed basing its requirement for a refund on a comparison of any interim increase authorized to the revenue requirement as of September 30, 1996, absent any isolated adjustments through May 31, 1997, as decided by the Commission in Case No. ER-97-81. Empire believes this will have the effect of removing from consideration any revenue requirement which might be associated with State Line Unit II, or with any other items which are beyond the September 30, 1996 test year ordered in Case No. ER-97-81. This approach will provide ample protection for customers and should eliminate any argument that matching doctrines are violated.

Empire's interim request does not violate the stipulation and agreement from Case No. ER-95-279. In making its request, Empire utilized as a base the cost of purchased power and gas reflected in "runs" made by Empire and the Staff <u>before</u> the settlement was reached in Case No. ER-95-279. (Ex. 5, p. 3) In fact, Staff witness Featherstone admitted that the fuel run used by Empire was <u>not</u> the fuel run used by the Staff for settlement purposes. (Ex. 11, p. 8) Empire was not aware of the actual purchased power or gas costs allegedly underlying the settlement and built into or used to develop the stipulated rates in the Staff's settlement case until the Staff filed its rebuttal testimony in this interim rate case. Furthermore, Empire does not contend that any party agreed to any cost determination underlying the settlement of Case No. ER-95-279.

Empire's quantification of its interim request is not based upon faulty information. As indicated, Empire has no knowledge of any "final" Staff fuel and purchased power run used by the Staff as a basis for the settlement of the last case other than what the Staff has said in this case. Once again, to calculate the amount of its interim request, Empire considered as a "base" the cost of purchased power and gas in runs which were made available <u>prior</u> <u>to</u> the settlement of ER-95-279, and Staff witness Featherstone agrees. (Ex. 11, p. 8)

The Staff also expresses concern over the fact that Empire has not filed for interim relief in the other jurisdictions in which it has operations, i.e. Kansas, Oklahoma and Arkansas. The reasons are obvious and are set out in the record. Empire's Missouri operations constitute 85% of its total business. (Ex.2, p.5) Its Arkansas business makes up only approximately 3% of Empire's total operations Oklahoma operations constitute approximately 3% and Kansas operations constitute 7 - 8%. (Tr.86) Kansas and Oklahoma rates are higher than Missouri rates. (Tr. 146) In addition, because changes in fuel and purchased power costs are adjusted automatically in Oklahoma and Arkansas, Empire is already recovering significant portions of its revenue deficiency in those jurisdictions. (Ex.2, p.5; Tr. 146) Finally, most of Empire's growth is in Missouri. (Tr. 147)

The $19 per share stock price, raised as an issue at page 20 of the Staff's brief, is explained by the rumors in the broker community that Empire was going to be acquired. (Tr. 149)

Reply to OPC

The OPC criticizes Empire for not offering a new standard which the Commission should use for purposes of granting interim rate relief. The OPC has not been paying attention. Throughout this proceeding, Empire has urged the Commission to utilize a "good cause" standard which it first enunciated in a 1978 Missouri Power & Light Company case at 22 Mo P.S.C. (N.S.) 257 (1978).

At page 5 of its initial brief, the OPC flippantly characterizes Empire's criterion for interim rate relief as whether or not the company is "nice" and whether or not "its rates are low compared to other utilities in the state." The OPC, however, has conveniently ignored the real substance of the testimony of Empire's witnesses McKinney and Fancher which is set out at pages 3 through 5 of the OPC's brief. That testimony demonstrates that Empire has suggested specific criteria which the Commission might use in applying a good cause standard. The first is whether or not the company is achieving the results intended by the Commission in its most recent rate case. Surely in the case of Empire it would have to be conceded that the Commission did not intend for the Company to have a $6 million plus revenue deficiency only 7 ½ months after it received a $1.4 million rate increase.

Another factor suggested by Empire for the Commission to consider is the company's record with respect to management decisions and the level of its rates. If management decisions are prudent resulting in reduced costs, but rates are so low that returns are inadequate, this should be taken into account. Surely all would agree that if the Commission recognizes a higher degree of risk and sets higher rates for companies which embark in building high-cost nuclear plants, it should likewise not penalize a company which decides to purchase power rather than to build plants, a decision which ultimately benefits the customers.

A third factor suggested by Empire is whether or not the utility has made efforts to reorganize or downsize. Again all would surely agree that a company should be rewarded in some fashion for efforts to hold down costs in this area.

Finally, it should be noted that Empire has not increased its common dividend since the fourth quarter of 1992, or the fact that the price has declined since the end of 1992 from 21-1/4 to 18-3/4 at the end of 1996, or a reduction of almost 14%. Clearly, Empire's shareholders have not received a windfall during these times.

In claiming at page 7 of its initial brief that Empire has two theories to its interim case, the OPC again demonstrates that it has not been paying attention. Empire has always maintained that its interim rate increase request is justified based on all relevant factors. Contrary to the OPC, this is not a "belated claim" that arose for the first time at the hearing. Rather, Empire determined in the spring of 1996 that its return on equity of 7.97%, derived from a consideration of all relevant factors, (Ex. 4, p. 9) clearly demonstrated that it had a revenue deficiency. Empire decided to intentionally understate its interim request when compared to its actual revenue deficiency in order to simplify the processing of this case and therefore calculated the amount of its rate increase based only on the increased cost of purchased power and fuel. (Tr. 145)

At page 6, the OPC summarizes its reasons for opposing Empire's request and continues to adhere to standards which, in Empire's view, are inappropriate in evaluating a company's need for interim rate relief and which imply that a utility should reduce cash expenditures to serve new or existing customers. Empire believes that it has a duty to provide safe and adequate service to both current and new customers. It would be imprudent for the Company to reduce these expenditures just to prove a need for interim rate relief as apparently suggested by the OPC. Furthermore, the ability of a company to obtain sources of funds are based partially on the perception of capital markets as to the competence of company management to make prudent decisions. If this were not the case, then the source of funds would diminish and capital costs would rise, thus ultimately increasing rates.

The OPC also continues to present Empire's request for interim rate relief as a repackaged fuel adjustment clause even though no automatic rate adjustments are requested and in spite of the fact that fuel and purchased power costs make up only part of the increase which the Company believes is warranted. Again, Empire requested the lesser sum because it believed that this was an approach which could lead to it receiving at least $4 million in rate relief earlier than if it had requested its full $6 million revenue deficiency. As it now appears, this may have been a mistake. Even if the Commission were to grant the full $4 million interim increase only a portion of this amount would be realized prior to the law date of the permanent case.

Finally, the OPC wants any refund provision to be based on an interest rate of nine percent so as not to increase shareholder wealth. In response, Empire believes that since the time frame that any interim over-charge (if any) would be in effect only five to seven months, a rate closer to current short-term rates or approximately 5% would be more appropriate.

Reply to ICI and Praxair

The position of ICI and Praxair in this proceeding is particularly disappointing given the fact that in most instances industrial customers have been on the cutting edge of changes in utility regulation including the encouragement of utility companies and Commissions to exercise their discretion and to think "outside the box". ICI and Praxair, through their brief, reflect traditional, stale thinking in an effort to obtain a perceived short-term advantage without apparent consideration of the long-term consequences. In any event, Empire has anticipated and has previously addressed the relevant substantive issues raised by ICI and Praxair. A couple of comments, however, are in order.

First, it is clear ICI and Praxair have not been paying attention either. For example, it took ICI and Praxair 25 pages of its initial brief to come to the startling realization that Empire has based the amount of its request for interim rate relief on a calculation of increased fuel costs. ICI and Praxair then make the mistake of concluding that consideration of all relevant factors through a return calculation was an afterthought on the part of Empire. ICI and Praxair need to reread the testimony in this case and review the transcript.

ICI and Praxair do apparently concede that the Commission may allow rates to take effect upon a filing by a utility company without suspension, but that under those circumstances a consideration by the Commission of all relevant factors is required. (ICI & Praxair Brief, p. 4) Empire would agree. The point, of course, is that for the *Laclede* case to make any sense, the Commission consideration of all relevant factors must occur through some abbreviated fashion, short of an audit or hearing. Because the Commission has absolute discretion in this regard and because an audit or hearing is not required, Empire submits that this "consideration of all relevant factors" could consist of nothing more than the review of a surveillance report or the supporting documentation or testimony submitted by the utility. Presumably the surveillance report which provides rate of return information and other data as prescribed by the Commission is intended to serve some purpose and could be the basis of a Commission decision. In any event, obviously in the present case much more has occurred. All parties have filed testimony. The Staff has conducted an audit and found a revenue deficiency, contested hearings have been held and now briefs have been filed.

ICI and Praxair argue that the emergency standard should be retained because it is consistent with the historical regulatory structure. (In the opening statement, they went so far as to suggest that the Commission couldn't abandon the standard because it is a rule. Tr. 33-34) This is the same type of reasoning -- do it because it has always been done this way -- for which many utilities were criticized when building large baseload plants during the 1970's and 1980's and for which utilities are now criticized by industrial customers when special contracts are sought. If one does not review policies or structures from time to time, then it is easy to become entrenched in reasoning that may no longer be correct. ICI and Praxair have fallen into this trap.

ICI and Praxair attempt to show that Empire's June 30, 1996 7.97% return on equity is somehow irrelevant. Examples of adjustments are provided in order to presumably arrive at a more correct figure. This argument, however, does not refute the 7.97% return, but instead only sets out possible adjustments that may or may not be made in a permanent rate case. The false argument is also made that the work performed by Staff witness Winter in testing the interim request included only three adjustments. The fact is that the Staff used an average plant in service and depreciation reserve using beginning and ending test year balances to provide a reasonable matching of rate base revenues and expenses.

> "Since Staff did not adjust per book operating revenues or expenses unless otherwise indicated, the averaging of the plant in service and depreciation reserve produces a reasonable matching of the rate base investment with the revenues generated by the investment and the costs incurred in the process," (Ex. 15, p. 6)

Even with this adjustment, Staff witness Winter arrived at a revenue deficiency in the range of $3.2 million to $5.5 million which shows the reasonableness of the Company's request for an interim increase of approximately $4 million.

Although ICI and Praxair are correct in the assertion that Empire is opposed to accepting the same arrangement for incentive regulation that was accepted by Union Electric Company ("UE"), the reason is simply because of the 100 MW direct access experiment. Empire has approximately 700 MW of net generating capacity as opposed to UE's 8,300 plus MW. Surely it does not make any sense to argue that Empire should be expected to undertake a 100 MW experiment. If proportions mean anything, then 100 MW to UE would mean only about 8 MW to Empire. (Ex. 4, p. 7)

ICI and Praxair assert that "Union Electric and Empire are dissimilar utilities" (Initial Brief, p. 20). They then go on to argue that UE has a significantly different risk profile than Empire because of the Calloway nuclear unit. Does this mean that the Commission should set UE's rate of return higher than Empire's because of the riskier nuclear plant as opposed to more economical purchased power that was the option chosen by Empire? Prudent low-cost options should be recognized and rewarded by the Commission. This establishes a "win/win" situation for both customers and the utility while encouraging prudent low-cost alternatives.

While ICI and Praxair argue at page 20 of their initial brief that Empire does not face the risk of sharing earnings with ratepayers as does UE it should be recognized that UE does not begin sharing until it reaches a 12.61% return on equity, a point 460 basis points above Empire's return on equity at the time the request was filed. Given its current rate level, it is unlikely that Empire would come close to achieving a level of earnings which would require a sharing with ratepayers.

It is also of interest to note that UE is allowed to file for a rate increase when its return on equity falls to 10% which is considerably above Empire's actual return on equity.

In Section VII of their initial brief, ICI and Praxair argue that the proposed refund provision by Empire violates the ratemaking principle of proper matching. Again, it should be kept in mind Empire's interim rate request is for a $4 million interim increase as opposed to the full $6 million deficiency based on an 11.25% rate of return. What is being asked for by Empire is in the revenue deficiency range calculated by Staff witness Winter using the same twelve month period. The time frames match as do the results. The protection for the ratepayers via the permanent case is against any overcharge after a full and comprehensive audit has been conducted. If this were not the case, then the Staff would have to conduct a full audit of both the interim rate request and the permanent request, a result which surely is not intended by the interim process.

CONCLUSION

In the evolving competitive electric utility business in which the Commission has demonstrated an innovative approach with respect to the top end of the earnings spectrum through the implementation of incentive ratemaking mechanisms and rate caps, the Commission should not be hamstrung on the other end of the earnings spectrum through adherence to a rigid emergency standard adopted over two decades ago, the application of which has virtually eliminated Commission discretion. Unlike the emergency standard for interim rate relief, the good cause standard gives the Commission considerable latitude to take into account a variety of factors including circumstances unique to the particular utility. The discussion of the other parties urging adherence to the old test is stale. This case affords the Commission an opportunity to revisit the subject of interim rate relief and entertain a new dialogue on this topic, a dialogue which Empire hopes will lead the Commission to adopt a good cause standard. Such a standard would provide the Commission wide latitude to consider each request for interim relief based on its own particular facts and circumstances thereby including, but not limited to, those factors mentioned by Empire's witnesses. In the final consideration, the requested increase should be authorized.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered on this 10th day of January, 1997, to all parties of record.

James C. Swearengen

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