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Issue: Commissioner Questions - Fuel Adjustment Base Factor
Witness: Todd W. Tarter
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Before the Public Service Commission
of the State of Missouri

Supplemental Testimony to Address Commissioner Questions

of

Todd W. Tarter

on behalf of

The Empire District Electric Company
a Liberty Utilities Company

May 6, 2020

Liberty Utilities
EMPIRE DISTRICT

SUPPLEMENTAL TESTIMONY TO ADDRESS COMMISSIONER QUESTIONS
OF
TODD W. TARTER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2019-0374

I. INTRODUCTION

Q. Please state your name and business address.

A. Todd W. Tarter. My business address is 602 S. Joplin Avenue, Joplin, Missouri.

Q. By whom are you employed and in what capacity?

A. I am employed by Liberty Utilities Service Corp. as the Senior Manager, Strategic Planning for Liberty Utilities' Central Region which includes The Empire District Electric Company ("Empire" or "Company").

Q. Are you the same Todd W. Tarter who filed direct, rebuttal and surrebuttal testimony in this matter on behalf of Empire?

A. Yes.

Q. What is the purpose of your supplemental testimony?

A. My supplemental testimony addresses certain questions directed to Empire by the Missouri Public Service Commission ("Commission"). In particular, I address questions 1, 3 and 4(b) regarding the Fuel Adjustment Clause ("FAC") that were contained within the "Commissioner Questions" issued April 28, 2020.

II. RESPONSES TO COMMISSION FAC QUESTIONS 1, 3 AND 4(B)

Q. Will the base fuel rate for the FAC be reset in the next rate case?

A. Yes, it is appropriate to reset the FAC base factor in the next rate case. When rates from the next rate case become effective, Empire's generation mix will have changed with the retirement of the Asbury coal-fired resource and the addition of new wind resources. Aside from updating the Company's resources, all pertinent costs, prices and revenues should be updated to then current levels. Any other proposed changes to the FAC base factor should also be made at that time if needed.

Q. What is the appropriate base factor for the FAC and what evidence supports it?

A. Pursuant to the Global Stipulation and Agreement ("Stipulation"), the FAC base factor should remain at the current $24.15/MWh with no change to the FAC eligible components as described within the Stipulation. The current FAC base factor of $24.15 was established in the Company's last general rate case, upon consideration of all factors. The Stipulation provides for no changes to base rates and no change to the FAC base factor. There is no substantial evidence which would require the base factor to be changed at this time, so long as other components are remaining constant and base rates are not changing. The FAC base factor and the amount of FAC eligible costs in base rates work in concert with each other. Since a portion of fuel recovery occurs in the base rates and any over or under recovery is contingent on the FAC base factor, which is calculated in the FAC rider, it is very important that the base factor correctly matches the base energy costs and revenues in the revenue requirement so the correct amount of prudently incurred FAC eligible costs are collected in total.

Q. What is the appropriate base factor for the FAC and what evidence supports it if the stipulation is not approved?

A. Based on the Company's written testimony in this case (Tarter Direct, Rebuttal and Surrebuttal and Doll Direct, Supplemental Direct, Rebuttal and Surrebuttal), the appropriate FAC base factor as proposed by the Company is $24.16/MWh. This is very close to the existing FAC base factor, but it is based on a different set of FAC eligible components. To arrive at this FAC base factor proposal, Empire considered all eligible FAC cost components and updated all annualized and normalized model assumptions on a total company basis. Empire utilized its production cost model to simulate the Southwest Power Pool Integrated Marketplace ("SPP IM") to calculate a net fuel and purchased power ("F&PP") cost level. That is, within the model, Empire resources were dispatched against price curves with their dispatched generation sold into the SPP market with these resources receiving revenue based on the market approach. Within the model, the cost of Empire's native load was supplied from the SPP market and not from the cost of Empire's generating resources. Multiple sets of hourly market prices were utilized, and the market prices were correlated to the natural gas price within the model. This level of F&PP expense was developed by running the hourly production cost computer model using normalized sales levels, normalized outage data, and projected fuel and purchased power prices. Other F&PP cost/revenue components that are eligible for the FAC were normalized and added outside the model. The cost and revenue components of the FAC base factor calculation are summarized in Schedule TWT-3 of Todd W. Tarter's direct testimony. In summary, the Company's proposed FAC consist of net F&PP energy costs (without purchased demand or natural gas firm transportation charges). This includes F&PP costs and revenues associated with selling energy from the Company's resources into the SPP IM, including ancillary and other charges, the cost of purchasing Empire's native load energy from the market, RTO transmission expense and the net ARR/TCR offset. Additionally, costs and revenues that should flow through Empire's FAC include fuel related costs such as unit train costs, undistributed and other costs, variable natural gas transportation expenses, Plum Point PPA O&M costs, the cost of the AQCS consumables, net emissions cost and the net sales of RECs. The FAC base is then calculated on a per unit basis utilizing net system input expressed in kilowatt hours or megawatt hours. The appropriate amount of transmission costs that should be included in the FAC is 100% of all retail-based charges which also includes SPP Schedule 1A Tariff Administration and Schedule 12 FERC Assessment. Furthermore, this should also include any and all charges from the Midcontinent Independent System Operator ("MISO") for the pseudo-tie of Plum Point into the SPP market. If these other proposed changes are not implemented, the FAC base factor should remain at the current $24.15/MWh with no change to the FAC eligible components as described within the Stipulation. The Stipulation is the proper resolution of all issues in this rate case.

Q. What is FAC question 4(b) of the commissioner questions?

A. Ms. Mantle also states in her surrebuttal testimony that, "Since the FAC was established, Empire has recovered over 99.9% of its FAC costs placing almost all of the risk associated with its FAC costs on the customers and very little on Empire (0.1%). OPC's modest proposal would shift 0.2% more risk to Empire still leaving 99.7% of the risk on the customers." Under the current sharing percentage Empire has absorbed an average of $150,000 a year in FAC costs for the past 11 years, so what is the real harm of requiring Empire to be exposed to an additional 0.2% of FAC risk?

Q. How does the Company respond to this FAC question from the Commission?

A. There are multiple items to address in this question; therefore, I will start by attempting to answer the primary question before I address the other aspects. Yes, there is potential harm by changing the FAC sharing mechanism to OPC's recommendation.

Q. Please continue.

A. First, this issue should not be framed around shifting from 99.9% recovery to 99.7% recovery (those percentages would not be fixed recovery amounts as a result of this case). It is really a question about the 95%/5% sharing mechanism in the current FAC and moving to an 85%/15% sharing mechanism that OPC is recommending. The 0.2% differential mentioned within the question is based on historical recovery percentages over a long period of time, and this could be different moving forward based on how actual FAC eligible costs compare to a given FAC base factor. The average of $150,000 per year, mentioned in the question is also a long-term historical average over the past eleven years. There have been times over the past eleven years when FAC eligible costs have been higher than the FAC base factor and the Company has absorbed costs, and times when FAC eligible costs have been lower than the FAC base factor and the Company has retained costs. For example, over the recent three-year period 2017-2019, Empire collected about 99.62% of the actual FAC costs with the 95%/5% sharing mechanism, and had to absorb about $1.3 million in that period. If the sharing mechanism would have been 85%/15% during that period, Empire would have collected about 98.85% of the actual FAC costs and would have had to absorb nearly $4 million in prudently incurred fuel costs in that three year period. The differential during this period is about 0.77% and not 0.2%. On average, Empire absorbed nearly $444,000 per year during this period, and not $150,000. Had the sharing mechanism been 85%/15%, which is the OPC recommendation, Empire would have been required to absorb about $1.3 million per year on average during this period, not $150,000. That would most certainly constitute real harm.

Q. Can customers be similarly harmed by changing the FAC sharing mechanisman from 95%/5% to 85%/15%?

A. Most definitely. If the circumstances were reversed from my previous example, and FAC eligible costs were below the FAC base factor for an extended period of time, customers would over pay for energy costs during that period. Today, customers would over pay 5% of the difference between actual energy costs and the FAC base under this scenario. With the OPC recommendation, this percentage would increase to 15%.

Q. Can an unfavorable change to a Company's FAC be viewed negatively by the financial community?

A. Yes. In general terms, when an electric utility has an energy cost recovery mechanism this is usually considered favorably by the financial community. Rating agencies have generally pointed to what they view as any positive industry regulation as a key driver to a Company's favorable ratings outlook. This includes an improved business risk profile due to strengthening cost recovery through the regulatory process including timely recovery of costs through various rate mechanisms including base rates and rate surcharges such as an FAC. Fundamental to a positive outlook from the financial community is the expectation that a Company can continue to effectively manage risk. Changing the current 95%/5% sharing mechanism to an 85%/15% sharing mechanism places more of the over/under FAC balance at risk. This is likely to be perceived negatively by the investment community, potentially harming the Company's financial profile and its ability to attract the financing necessary to meet its customers' needs at the best rates possible.

Q. Does the Company's current FAC have any safeguards to protect customers?

A. Yes. The Empire FAC and the Commission's rule governing FACs include two safeguards that limit FAC recovery to actual, prudently-incurred energy costs. The first safeguard is a true-up process that ensures that the FAC collections during the Recovery Period do not exceed actual energy costs incurred during the Accumulation Period. The second safeguard involves a requirement that Empire's energy costs be subjected to periodic Prudence Reviews, which will ensure that only prudently-incurred energy costs are passed through to customers using the FAC. It should also be noted that there is no incentive for the Company to have higher than necessary fuel and purchased power costs. The Company does not earn a profit on this expense category.

Q. Is there an another reason why the FAC sharing mechanism should not be changed to 85%/15% (the OPC recommendation) which places more risk on the FAC over/under balance and can lead to harm for either the Company or its customers?

A. Yes. Sometimes the sharing mechanism has been referred to as an incentive mechanism, as if the FAC base factor is some kind of perfect target that the Company can manage future F&PP costs around. However, this is not necessarily the case. Currently, a significant portion of Empire's Missouri electric retail customers' FAC eligible costs are recovered in base rates. If prudently incurred FAC eligible costs are either higher or lower than the level in base rates on a per unit basis, then a percentage of that difference is either recovered from or returned to customers respectively via the FAC rider. This means that unless the actual prudently incurred FAC eligible costs are exactly equal to the FAC base factor on a per unit basis, then customers will either under pay or over pay for those costs in that period. At this time that percentage is 5% of the difference, but OPC is proposing this should be 15% of the difference. Therefore, the sharing mechanism determines how much the

Company and its customers will retain or absorb. Ultimately, this all hinges on the FAC base factor that is set in a general rate case. This FAC base factor is just an estimate which will be in place without adjustments until the next general rate case. This is why a proposal to put more of the over/under FAC balance at risk is viewed by the Company as less of an incentive, and more of an added risk associated with not being able to accurately forecast future energy costs during a general rate case. Even if fuel analysts use production cost models to help calculate an FAC base factor, there are still many assumptions that have to be made, and it is difficult to model the marketplace due to the complex interactions of many factors including resource costs, unit outages and market prices. Moreover, the fact that future FAC eligible costs cannot be forecast with certainty is one of the primary reasons for having an FAC in the first place.

Q Does this conclude your supplemental testimony?

A. Yes.

VERIFICATION OF TODD W. TARTER

Todd W. Tarter, under penalty of perjury, declares that the foregoing supplemental testimony is true and correct to the best of his knowledge, information, and belief.

/s/*Todd W. Tarter*
Todd W. Tarter
Senior Manager, Strategic Planning