

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Tariff Filing of The Empire)	
District Electric Company to Implement a General)	Case No. ER-2006-0315
Rate Increase for Retail Electric Service Provided)	
to Customers in its Missouri Service Area.)	

STAFF’S RESPONSE TO EMPIRE’S MOTION FOR CLARIFICATION

COMES NOW the Staff (“Staff”) of the Missouri Public Service Commission (“Commission”), and for its Response to the Motion For Clarification (“Motion”) filed by The Empire District Electric Company (“Empire”) on March 24, 2006, respectfully states as follows:

1. On February 1, 2006, Empire filed with the Commission proposed tariff sheets bearing an effective date of March 3, 2006, which are designed to produce a gross annual revenue increase of \$29,513,713 for electric service provided to retail customers in Empire’s Missouri service area. Included in Empire’s filing is a proposal to terminate the Interim Energy Charge (“IEC”) approved in Case No. ER-2004-0570, Empire’s last general rate increase case, and to replace it with an Energy Cost Recovery rider (“ECR”). According to the supporting Direct testimony of Messrs. W. L. Gipson, W. Scott Keith and Todd W. Tarter, also filed on February 1, Empire is proposing the ECR in order to take advantage of the fuel and purchased power cost recovery provisions of Senate Bill 179, which the Governor signed into law in July 2005 and which was codified as Section 386.266 RSMo.

2. The IEC currently in effect pursuant to the Commission’s March 10, 2005 Report And Order in Case No. ER-2004-0570 was proposed in a Nonunanimous Stipulation And Agreement (“Stipulation And Agreement”) filed in that case by Empire, the Office of the Public Counsel (“Public Counsel”), Praxair, Inc. (“Praxair”) and Explorer Pipeline Company (“Explorer”). The Staff, the Missouri Department of Natural Resources, Aquila, Inc. and Union

Electric Company d/b/a AmerenUE, the other parties to that case, did not object to the Stipulation And Agreement¹; accordingly, the Commission's rule on nonunanimous stipulation and agreements permits the Commission to treat a nonunanimous stipulation and agreement as a unanimous stipulation and agreement, and the Commission did so in Case No. ER-2004-0570.

3. Empire's March 24, 2006 Motion addresses its proposal in its direct testimony to terminate the IEC, and instead to recover Empire's fuel and purchased power costs in base rates in conjunction with the implementation of the ECR. In effect, the ECR would allow the periodic adjustment (up or down) of the amount of fuel and purchased power costs included in base rates in order to reflect Empire's actual cost experience. Empire seeks a Commission order "clarifying that Empire may seek to terminate its existing IEC and implement an ECR in this case."

4. Although the Staff was not a signatory to the Stipulation And Agreement and was not privy to the negotiations that produced the specific terms thereof, the Staff reviewed the Stipulation And Agreement in reaching its decision not to oppose it, and as indicated above, filed a pleading in response. The Staff's reading of Empire's direct testimony on fuel and purchased power in the pending case caused the Staff to raise the issue with Empire, Praxair, Explorer and Public Counsel, the signatories to the Stipulation And Agreement, whether Empire's direct testimony is consistent with what was agreed to by the signatory parties and approved by the Commission in Case No. ER-2004-0570; that is, whether Empire, under the terms of the Stipulation And Agreement, can, on its own, propose that the Commission terminate the IEC earlier than at the conclusion of the IEC's three (3) year term (12:01 a.m. on March, 27, 2008). The Staff related to these parties that such a question should be brought to the Commission earlier in the case than the filing of direct testimony by the parties other than Empire, and that the

¹ The Staff filed a pleading in response to the Stipulation And Agreement in which it cited three specific concerns about the language, but also indicated its non-opposition.

Staff was willing to do so itself. Empire, in response to this inquiry by the Staff, filed its Motion on March 24, 2006.

5. The question whether Empire may seek implementation of an ECR in this proceeding depends on the Commission's decision regarding the threshold question of whether or not the IEC may be terminated early. The following language from paragraph 4 (pages 12-13) of the Stipulation And Agreement is applicable:

In consideration of the implementation of the IEC in this case and the agreement of the Parties to waive their respective rights to judicial review or to otherwise challenge a Commission order in this case authorizing and approving the subject IEC, for the duration of the IEC approved in this case Empire agrees to forego any right it may have to request the use of, or to use, any other procedure or remedy, available under current Missouri statute or subsequently enacted Missouri statute, in the form of a fuel adjustment clause, a natural gas cost recovery mechanism, or other energy related adjustment mechanism to which Empire would otherwise be entitled.

If the Commission decides that the IEC must or shall continue, the Staff submits, based on Empire's March 24, 2006 Motion,² that even Empire would agree that it may not seek implementation of an ECR in this case. If, however, the Commission decides that Empire may seek early termination of the IEC, or the Commission otherwise decides to early terminate the IEC, then the question arises whether the above-quoted language precludes Empire from seeking to replace the IEC with an ECR.

6. After giving the threshold question careful consideration on almost a daily basis beginning prior to the filing of Empire's Motion, the Staff, as a non-signatory and a non-participant in the negotiations, after reviewing the record in Case Nos. ER-2004-0570, ER-2002-1074, ER-2002-424, ER-2001-299 and EO-2005-0263, and considering Empire's Motion, cannot say that the Stipulation And Agreement or other documents are conclusive as to the threshold question of whether or not Empire may seek early termination of the IEC.

² Empire states in paragraph 4 of its Motion: "Empire believes that the intent of its agreement is to insure that the IEC, unlike most tariffs, will be in effect for no longer than three years, and to prohibit the Company from having an energy related adjustment mechanism in place in addition to the IEC (a fixed rate surcharge)." (Empire's emphasis.)

7. The Stipulation And Agreement itself contains language that is not necessarily consistent with Empire's position as outlined in its Motion. Paragraph 1 (page 2) of the Stipulation And Agreement provides that "[t]he IEC shall be in effect for three (3) years as described herein." The term "IEC Period," which is defined on page 2 of the Stipulation And Agreement as "[the] three-year period during which the IEC is in effect," is used throughout the document. In addition, paragraph 1.f. (at page 6) of the Stipulation And Agreement specifies that, [t]he interest rate to be used for purposes of any refund required . . . shall be the same as the prime rate of interest on the day the IEC has been in effect for three (3) years (the end of the IEC period) as found in the Money rates section of the Wall Street Journal." No mention is made of how, in the event that Empire or another party seeks early termination of the IEC, the interest rate applicable to any refund amount would be early determined to permit an early refund. If the present IEC is terminated in the pending case, there will be no refund unless there is a precipitous decline in fuel and purchased power prices between the current date and the early termination date of the IEC. The Staff believes it is highly unlikely that Empire would incur any refund obligation from the current IEC in this timeframe.

8. The Motion makes note of the phrase, "unless earlier terminated by order of the Commission" (paragraph 1.c., p. 4 of the Stipulation And Agreement), the presumed implication being that Empire's proposal is permissible because (i) early termination can be accomplished by a Commission order, (ii) the Commission would not order early termination on its own motion, and thus (iii) the Commission would only order early termination if it was proposed by one or more parties, as Empire is doing in the pending case. However, regardless of whether Empire may propose early termination under the Stipulation And Agreement, and irrespective of whether said language appears as part of the Stipulation And Agreement, the Commission *always* retains the power to terminate the IEC, in the context of a general rate proceeding, before the expiration of its three-year term. (See, e.g., *State ex rel. Jackson County v. Public Serv. Comm'n*, 532

S.W.2d 20, 29-30 (Mo. banc 1976), *cert. denied*, 429 U.S. 822, 97 S.Ct. 73, 50 L. Ed.2d 84 (1975).) (The Commission could also on its own motion initiate a proceeding to address the continued efficacy of the IEC.) The parties to the Stipulation And Agreement could join in an agreement to terminate the IEC and present it to the Commission for its approval. Thus, the presence of the “unless earlier terminated by order of the Commission,” language in the Stipulation And Agreement may only serve to recognize the law.

9. Empire also asserts that the parties to the Stipulation And Agreement understood that Empire, at the conclusion of the IEC agreed to in the Stipulation And Agreement, intended, and evidently still intends, to use SB 179 (now Section 386.266 RSMo) in connection with the recovery of its fuel and purchased power costs. Paragraph 6 (page 16) in the Commission-approved Stipulation And Agreement (“Agreement”) in Case No. EO-2005-0263, which authorized Empire’s regulatory plan regarding Iatan 2, effective August 12, 2005, states: “Empire has expressly stated that it intends exclusively to rely upon the [fuel and purchased power cost recovery] mechanism of SB 179 for its recovery of fuel and purchased power costs. Accordingly, the Signatory Parties intentionally make no provision for any other fuel and purchased power cost recovery mechanism in this Agreement.” Given that the effective period of the Agreement constituting Empire’s regulatory plan extends into 2010,³ the Staff would point out that the quoted language can be squared with a reading of the Stipulation And Agreement in Case No. ER-2004-0570 as binding the parties to a three-year effective term for the current IEC, in addition to a reading of the Stipulation And Agreement as permitting an early termination of the IEC.

10. Neither the Report And Order nor the Stipulation And Agreement in Case No. ER-2004-0570 contains language specifically stating that Empire or any other party to the

³ The plan expires upon the effective date of new rates reflecting Empire's Iatan 2 investment in rate base. This date is currently expected to occur sometime in 2010.

Stipulation And Agreement may request early termination of the IEC. Moreover, the Commission may have been under the belief that the IEC would be in effect for three (3) years because on page 32 of its Report And Order authorizing the IEC, the Commission states: “The IEC shall be in effect for three years.” At that time, Empire did not file a motion for clarification or raise with the Staff any concerns regarding this language.

11. The Staff would note that Empire’s filed tariff sheet implementing the IEC authorized in Case No. ER-2004-0570 contains no language indicating that the IEC may be terminated by Commission Order prior to the expiration of its three-year term. The tariff sheet simply states: “This interim rider shall be in effect from March 27, 2005 through March 26, 2008.” As stated in its Recommendation, filed March 18, 2005, the Staff concluded that the tariff sheet was consistent with the Commission’s authorizing Report And Order. However, it should also be noted that the tariff sheet implementing Empire’s previous IEC is likewise devoid of any mention of the possibility of an early termination, and that IEC was terminated early as explained below. The currently effective IEC tariff sheet does contain language concerning the potential refund with interest after 2 years, and also mentions the possibility, “[u]pon the expiration of the IEC,” of a refund in amounts determined in an audit using methods “shown in Case No. ER-2004-0570.”

12. In a meeting among Empire, the signatory parties to the Stipulation And Agreement and the Staff, prior to Empire filing its Motion, Empire suggested that, by advocating that the IEC cannot be terminated early in Empire's pending rate case, a party would be advocating removal of the subject matter of fuel and purchased power from the case, and that this would be a violation of the requirement that the Commission must consider all relevant factors in a rate proceeding. The Staff does not find this argument persuasive on any level. The Staff has never sought to use the existence of an IEC to prevent a utility from filing a general rate case. Furthermore, if Empire’s rationale is correct, then the agreement by the signatory parties to

Empire's regulatory plan, respecting, for example, (i) additional amortizations to maintain financial ratios, and (ii) the prudence of Iatan 2 and other infrastructure investments, would violate the requirement that the Commission must consider all relevant factors in a rate proceeding. The Stipulation And Agreement approved by the Commission regarding the Empire regulatory plan states as follows on page 5 regarding Iatan 2 and other infrastructure investments:

III.C.7. Cost Recovery Of Capital Investments In Iatan 1, Iatan 2, Asbury SCR And V84 CT

Conditioned on Empire's continued compliance with the terms of this Agreement, and so long as Empire continues to implement its infrastructure investment commitments described herein (or modifications to its infrastructure investment commitments where such modification(s) have been approved by the Commission), the Signatory parties agree that they will not take the position that the investments identified in paragraph III.C.1 should be excluded from Empire's rate base on the ground that the projects were not necessary at the time of this agreement, or that Empire should have used alternative technologies. . . .

13. Notwithstanding the foregoing, it should be noted that early termination of an IEC is not without precedent. Indeed, Empire's previous IEC was only in effect for approximately fourteen months of its two-year term when it was terminated as part of a Commission-approved unanimous global settlement in Case No. ER-2002-424. In fact, the agreement to end that IEC followed an earlier unanimous agreement (entered into during the pendency of Case No. ER-2002-424) to modify the IEC by reducing the annual amount collected by \$7 million.⁴ Natural gas and purchased power prices were falling at that time, and Empire's customers ultimately received a full refund of the amount collected under the IEC.

14. The most important factor distinguishing the situation in Case No. ER-2002-424 from the current one is that, although the parties to that case differed initially in their view as to precisely what action should be taken, all agreed that the IEC should not continue in its then-

⁴ Unanimous Stipulation And Agreement Regarding Error In Case No. ER-2001-299 And An Immediate Reduction Of The Interim Energy Charge, approved by the Commission on June 4, 2002 in Case No. ER-2002-1074.

existing form. It was a period of falling natural gas and purchased power prices, and the Staff does not recall a question arising as to whether terminating the IEC early was permissible. In fact, prior to entering into the agreement to terminate the IEC, all four parties to Case No. ER-2002-424 had filed direct testimony advocating either modification or termination of the IEC.⁵ However, the filings by the non-utility parties did not occur until after the parties had already submitted, and the Commission had approved, the aforementioned Unanimous Stipulation And Agreement in Case No. ER-2002-1074 (footnote 4 herein), which, among other things, reduced the annual amount to be collected under the IEC by \$7 million.

15. It should be noted that the current IEC had been in effect for only about ten months when Empire filed its rate increase case on February 1, 2006, seeking to terminate it. That left more than two years remaining in the IEC Period for fuel and purchased power prices to decline. The volatility of natural gas and purchased power prices is such that the trend over the initial months of the existing IEC could reverse during the considerable remaining life of the IEC.

16. The Staff would further note that the Agreement in Case No. EO-2005-0263, which constitutes Empire's regulatory plan respecting the construction of Iatan 2, provides for certain dollar amortizations to be included in Empire's cost of service in order to help Empire maintain investment grade credit metrics from the August 12, 2005 effective date until and including the time of Empire's required rate case filing which incorporates Empire's investment in Iatan 2 (estimated to be December 1, 2009). Consequently, if Empire finds, as a result of much higher prudently incurred fuel and purchased power expense, that its cash flows even with

⁵ Case No. ER-2004-424: See, respectively, Empire witness Beecher Direct (p. 5), filed March 8, 2002 (or Beecher Supplemental Direct, (pp. 5-6), filed March 28, 2002); Public Counsel witness Busch Direct (p. 7), filed August 16, 2002; Praxair witness Brubaker Direct (pp. 4-5), filed August 16, 2002; Staff witness Featherstone Direct (pp. 11, 15), filed August 22, 2002.

the IEC are falling below certain benchmarks, Empire may seek ratemaking recognition of this condition via the amortization mechanism provided for in that Agreement.

17. As noted above, the Staff reviewed the Stipulation And Agreement and did not oppose it in Case No. ER-2004-0570. The Staff did not foresee the dispute that has occurred and thus made no inquiry that might have illuminated this matter while it was still before the Commission for the Commission's approval.⁶ Again, the Staff did not participate in the negotiations which led to the execution of the Stipulation And Agreement, to which the Staff was not a party. Presumably, the signatories know their intentions and understandings with respect to the language of the Stipulation And Agreement.

WHEREFORE, the Staff respectfully submits its response to Empire's Motion For Clarification.

⁶ The Stipulation And Agreement contains no provision for the Commission's involvement in dispute resolution, a feature that was recognized by the Western District Court of Appeals regarding AmerenUE's experimental alternative regulation plan. *State ex rel. Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.3d 146, 152 (Mo.App. 2004).

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronic mail to all counsel of record this 24th day of April 2006.

/s/ Dennis L. Frey