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 Rate Increase for Retail Electric Service Provided to Customers in its Missouri Service Area.	))))	Case No. ER-2006-0315

STAFF RESPONSE TO NOTICE REQUIRING FILING

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") pursuant to the Missouri Public Service Commission's ("Commission") September 14, 2006 Notice Requiring Filing ("Notice"). In response to each of the four items of inquiry set out in the Notice, the Staff respectfully states as follows:

I. Provide the Commission a legal analysis of the Commission's ability to make changes to the IEC, as well as an explanation as to how the IEC resulting from the "2001 Rate Case" was altered prior to its suspension and termination.

A. LEGAL ANALYSIS

1. SUMMARY OF LEGAL ANALYSIS: In Item 1 of the Notice, among other things, the Commission required that the parties provide the Commission legal analysis of the Commission's ability to make changes to the interim energy charge ("IEC"). The Staff interprets this request as requiring the Staff to briefly cover some of the ground already covered to date by The Empire District Electric Company ("Empire" or "Company"), the Office of the Public Counsel ("Public Counsel") and Praxair, Inc. ("Praxair") and Explorer Pipeline, Inc. ("Explorer Pipeline") regarding whether Empire may terminate the current IEC. First, as indicated below, the Commission has taken the position in the past, regarding the adoption of forms of alternative regulation other than the IEC, that the Commission needed the agreement of the affected electrical corporation, but not that of the other parties. Next, respecting the issue of whether the Commission

has the authority to adopt changes to the alternative regulation, *State ex rel. Jackson County v. Public Serv. Comm'n*, 532 S.W.2d 20 (Mo. banc 1975), *cert. denied*, 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976) indicates that the Commission does have that authority. Thus, it is the Staff's position that the Commission may, on the basis of competent and substantial evidence, make changes to the current IEC to which Empire concurs.

2. In performing the requested legal analysis, one must go to the Nonunanimous Stipulation And Agreement Regarding Fuel And Purchase Power Expense ("Nonunanimous Stipulation And Agreement") of Empire, Praxair / Explorer Pipeline and Public Counsel in Case No. ER-2004-0570, which is the source of the instant IEC, and the law. First, the terms of the Nonunanimous Stipulation And Agreement, for example, paragraphs 6, 7 and 8, stating that the Nonunanimous Stipulation And Agreement is void if not approved unconditionally and without modification by the Commission, did not permit the Commission to make changes to the IEC, at least at the outset. The Staff filed Staff's Response To Nonunanimous Stipulation And Agreement in Case No. ER-2004-0570 in which the Staff recommended that the Commission condition its approval on modifications proposed by the Staff. Empire, Praxair / Explorer Pipeline and Public Counsel filed a Reply in Case No. ER-2004-0570 urging that the Commission reject the Staff's modifications. On March 10, 2005, the Commission issued a Report And Order in Case No. ER-2004-0570 in which the Commission stated, in part:

> IT IS THEREFORE ORDERED: . .
>
> 2. That Empire District Electric Company may file proposed electric service tariff sheets in compliance with this Report And Order.

. . . .

5. That the Nonunanimous Stipulation and Agreement Regarding Fuel And Purchase Power Expense, filed on February 22, 2005, and deemed to be unanimous by operation of Commission rules, is hereby approved. The parties shall comply with the terms of the Stipulation And Agreement.

. . . .

7. That this Report And Order shall become effective on March 27, 2005.

3. Next, the Staff's legal analysis in response to the Commission's September 14, 2006 Notice is not different from that performed by the Staff on numerous occasions after *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Serv. Comm'n*, 585 S.W.2d 41 (Mo. banc 1979) and before the Legislature passed and the Governor signed Senate Bill 179, establishing Section 386.266 as law. As with other forms of alternative regulation which have been experimented with on a limited basis, Empire must concur in the ultimate form of the alternative regulation in order for the Commission to authorize it and the utility to effectuate it, that is until Section 386.266 is available to Empire. In the early to mid-1980's, the Commission used a mechanism, referred to at the time as "forecasted fuel," to address increasing fuel costs during a time of high inflation for electric companies that sought to use the procedure. *See, e.g., Re Kansas City Power & Light Co.*, Case No. ER-83-49, et al., Report And Order, 26 Mo.P.S.C.(N.S.) 104, 127 (1983); *Re Kansas City Power & Light Co.*, Case No. ER-84-4, Report And Order, 26 Mo.P.S.C.(N.S.) 531 (1984); *Re Kansas City Power & Light Co.*, Case No. EO-85-185 and EO-85-224, Report And Order, 28 Mo.P.S.C.(N.S.) 228, 403 (1986). The Commission itself terminated the use of this mechanism. 28 Mo.P.S.C.(N.S.) at 403-04. Regarding another form of alternative regulation, the

Commission stated as follows in *Re Southwestern Bell Telephone Company*, Case No. TC-93-224, et al., Report And Order, 2 Mo.P.S.C.3d 479, 572, 585 (1993):

> . . . The Commission addresses its authority to approve an alternative regulation plan in the Conclusions of Law. The Commission has concluded that it has the necessary authority to approve a reasonably structured alternative regulation plan, as described in this Report And Order, and that a company may voluntarily agree to operate under such a plan.

See also State ex rel. Laclede Gas Co. v. Public Serv. Comm'n, 535 S.W.2d 561, 567 n.1 (Mo.App. K.C. 1976) (power of Commission as a matter of necessary implication from practical necessity). The Commission has not held that the approval, acquiescence or non-objection of the other parties was also necessary.

4. The Staff notes the March 27, 2005 effective date of the Commission's Report And Order in Case No. ER-2005-0570 and Section 386.266.10, which appears to be applicable and states: "Nothing contained in this section shall be construed as affecting any existing adjustment mechanism, rate schedule, tariff, incentive plan or other ratemaking mechanism currently approved and in effect." Thus, Section 386.266.8 does not appear to be applicable because the Case No. ER-2004-0570 IEC predates Section 386.266.8. Section 386.266.8 states: "In the event the commission lawfully approves an incentive or performance based plan, such plan shall be binding on the commission for the entire term of the plan. . . ." If Section 386.266.8 were applicable, it is not clear from the language of Section 383.266.8, whether the Commission on its own, during the term of the plan, could change the plan in any manner. The Staff also notes the following language of the last sentence in Section 386.266.1: ". . . The commission may, *in accordance with existing law*, include in such rate schedules features designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness

of its fuel and purchased power procurement activities." (Emphasis added). As previously addressed, the Commission has held that "existing law" requires the utility's concurrence with the alternative regulation proposed to be adopted by the Commission for the Commission to be able to adopt an alternative form of regulation and the alternative form of regulation to be effectuated.

5. Regarding what is the authority of the Commission, after it approves a form of alternative regulation agreed to by the utility, and agreed or acquiesced to by other parties, the Staff would note that the fairly recent decision of the Western District Court of Appeals respecting the Union Electric Company ("UE") first experimental alternative regulation plan ("EARP") in *Union Electric Co. v. Public Serv. Comm'n*, 136 S.W.2d 146, 152 (Mo.App. W.D. 2004) provides limited guidance:

> UE urges that the EARP is a contract that binds the Commission relative to its authority to supervise rates. The EARP does set forth negotiated guidelines to be followed by the parties and the Commission. And the Commission did approve and adopt the EARP. However, it must be clarified that the Commission is not a signatory to the EARP and never relinquished its role as arbiter. In its July 21, 1995, Order adopting the stipulation of the parties, the Commission made a finding that "any unresolved issue concerning sharing will be brought to the Commission." This finding was not challenged by UE at the time. The stipulation itself clarified that nothing in the stipulation was "intended to impinge or restrict in any manner the exercise by the Commission of any statutory right, including the right of access to information, and any statutory obligation."

6. The Staff still would direct the Commissioners to a case that they are frequently cited to: *State ex rel. Jackson County v. Public Serv. Comm'n*, 532 S.W.2d 20 (Mo. banc 1975), *cert. denied*, 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976). In this case regarding a general rate increase filed by Missouri Public Service Company ("MPS"), Case No. 18,180, Jackson County tried to invoke an announcement made by the Commission, on the Commission's own, in the Commission's Report And Order in

the immediately preceding MPS rate increase case, Case No. 17,763, that there would be a moratorium on rate increases for MPS for a period of at least two years from the effective date of the Case No. 17,763 Report And Order. The Missouri Supreme Court in its review of the Commission's Report And Order in Case No. 18,180 noted that the parties to Case No. 17,763 did not address the moratorium issue during the proceedings in Case No. 17,763. The moratorium issue was apparently added by the Commission on its own. The Commission, in ordering in its December 14, 1973 Report And Order in Case No. 17,763 a two-year period of repose on rate increases, stated that the two-year moratorium was based upon a thorough analysis of the updated and projected test year presented in the case. There was no judicial review of the Commission's Report And Order imposing the moratorium in Case No. 17763. *Id.* at 21-23.

On August 4, 1974, MPS filed revised tariffs, eventually denominated Case No. 18,180, requesting increased rates for electric service. Various motions to dismiss the tariffs were filed premised on the two-year moratorium adopted by the Commission, on its own, in MPS's prior rate case. A hearing was held at which evidence was submitted indicating that circumstances had changed in MPS's operations since the Commission's Report And Order of December 14, 1973. The Commission issued Orders overruling/denying motions to dismiss MPS's revised tariffs. The Commission found that MPS had adduced sufficient evidence to establish a prima facie showing of substantial and altered circumstances. On June 13, 1975, the Commission authorized an increase in rates. 532 S.W.2d at 21-23.

The City Of Kansas City and the County of Jackson sought judicial review of the Commission's decision. The Missouri Supreme Court stated that a moratorium

was in conflict with the spirit of the Public Service Commission Law, that spirit being continuous regulation to meet changes in conditions as required by these changes in conditions. The Court quoted from a Missouri Supreme Court decision in *State ex rel. Chicago, Rock Island, & Pacific Railroad Co. v. Public Serv. Comm'n*, 312 S.W.2d 791, 796 (Mo. banc 1958) as follows:

> "Its [Commission's] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem to be in the public interest." To rule otherwise would make §393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to the consumers. [Citation omitted.]

532 S.W.2d at 29; *See also*, *State ex rel. General Tel. Co. v. Public Serv. Comm'n*, 537 S.W.2d 655, 661-62 (MoApp.1976)[1]; *State ex rel. Arkansas Power & Light Co. v. Public Serv. Comm'n*, 736 S.W.2d 457, 462 (Mo.App. 1987); *State ex rel. Associated Natural Gas Co. v. Public Serv. Comm'n*, 706 S.W.2d 870, 880 (Mo.App. 1985); *State*

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[1] In the *General Telephone* case, the Court of Appeals held that the Commission's decision in a prior General Telephone Company case had no binding effect in a subsequent General Telephone Company case:

> Insofar as the conclusion in the 1962 case is concerned, it has no binding effect in a future rate case. A concise statement of the applicable rule is found in 2 Davis, Administrative Treatise Section 18.09, 605, 610, (1958), as follows:
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> > "* * * For an equity court to hold a case so as to take such further action as evolving facts may require is familiar judicial practice, and administrative agencies necessarily are empowered to do likewise. When the purpose is one of regulatory action, as distinguished from merely applying law or applying law or policy to past facts, an agency must at all times be free to take such steps as may be proper in the circumstances, irrespective of its past decisions. * * * Even when conditions remain the same, the administrative understanding of those conditions may change, and the agency must be free to act * * *." (Footnotes omitted.)
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> Clearly the commission in this case was not bound by the action in the 1962 case.

537 S.W.2d at 661-62.

ex rel. St. Louis v. Public Serv. Comm'n, 47 S.W.2d 102, 105 (Mo.banc 1931); *Marty v. Kansas City Light & Power Co.*, 259 S.W. 793, 796 (Mo. 1923).

7. There is one other Commission case that the Staff would cite the Commissioners to: *Missouri Gas Energy v. Public Serv. Comm'n*, 978 S.W.2d 434 (Mo.App. 1998). This case involves appellate review of a decision of the Commission in a 1996 Missouri Gas Energy ("MGE") (a division of Southern Union Company)) rate increase case, Case No. GR-96-285, wherein the Commission determined, according to the Western District Court of Appeals, that the carrying cost rates for an accounting authority order ("AAO") granted in 1994 in *Re Missouri Gas Energy*, Accounting Authority Order, Case No. GO-94-234, 3 Mo.P.S.C.3d 201 (1994) should be for ratemaking purposes the weighted average short-term debt interest rate for allowance for funds used during construction ("AFUDC") of 4% for 1994 and 6% for 1995 and 1996, instead of the 10.54% rate which was requested by MGE in its Application for an AAO in Case No. GO-94-234 and authorized by the Commission in the AAO it issued in 1994. This 1994 AAO was preceded by several other AAOs, all for the same purpose of capitalizing and deferring recognition of certain costs respecting the utility's investment in new service lines and mains. This construction was occurring for the utility to comply with the Commission's gas line safety rules promulgated in 1989 in response to federal legislation. These two earlier AAOs had been granted in 1989 and 1992, in Case No. GO-90-51 and Case No. GO-92-185, respectively. 978 S.W.2d at 436-37.

The 1989 AAO was granted to MGE's predecessor, Kansas Power & Light Company, which later changed its name to Western Resources, Inc. ("KP

Western"). The carrying cost authorized in 1989 was 10.96%, but in a 1991 rate case the carrying cost was reduced by the Commission to 10.54%, which is the overall weighted cost of capital that the Commission determined in *Re Kansas Power & Light Co.*, Report And Order, Case No. GR-91-291, 1 Mo.P.S.C.3d 235, 252 (1992). This same carrying cost of 10.54% was utilized by the Commission as the carrying cost for the 1992 AAO, Case No. GO-92-185. A 1993 KPL Western rate increase case, *Re Western Resources Inc.*, Report And Order, Case No. GR-93-240, 2 Mo.P.S.C.3d 378, 381-82 (1993), ended in a settlement. While the 1993 rate increase case was pending, Southern Union Company agreed to purchase from KP Western, and KP Western agreed to sell to Southern Union Company, KP Western's Missouri utility operations and facilities. *Re Western Resources, Inc, d/b/a Gas Service and Southern Union Co., d/b/a Missouri Gas Energy*, Report And Order, Case No. GM-94-40, 2 Mo.P.S.C.3d 598 (1993). Missouri statutes require Commission approval of such a transfer. As part of the settlement, the Staff agreed to continue to support the deferral through AAOs of the costs of the changeout of gas service lines and mains for safety reasons. 978 S.W.2d at 436-38.

In the Commission's 1997 MGE rate increase case, *Re Missouri Gas Energy*, Report And Order, Case No. GR-96-285, 5 Mo.P.S.C.3d 437, 465 (1997), the Commission determined that the carrying cost rates for an accounting authority order (AAO) granted in 1994 in Case No. GO-94-234 should be 4% for 1994 and 6% for 1995 and 1996 rather than the 10.54% which was utilized by the Commission when the AAO was granted in 1994 in *Re Missouri Gas Energy*, Accounting Authority Order, Case No. GO-94-234, 3 Mo.P.S.C.3d 201 (1994). MGE citing *United States v. Winstar*, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996) argued in essence that the Commission was

contractually bound from reducing the carrying cost from the 10.54% utilized in the Commission's 1994 Order approving the settlement. MGE asserted that there was "'no doubt that an agreement like the Settlement Agreement in this case would be considered a binding and enforceable contract if the only parties to it had been private parties.'" 978 S.W.2d at 438. The Court held that the agreement referred to by MGE, which also dealt with the issue of the transfer of assets and ownership of the utility from KP Western to MGE, merely permitted MGE to continue to use the 10.54% figure allowed in KP Western's AAO. The Court commented that even if the facts elevated the actions of the Commission to invoking contract obligations, "[MGE] can point to no language in the Agreement to Transfer Assets that would support the result it wishes to obtain." *Id.*

Citing *State ex rel. Office of Public Counsel v. Public Serv. Comm'n*, 858 S.W.2d 806 (Mo.App. 1993), which is an earlier Western District Court of Appeals decision on AAOs, the Court stated that AAOs are not final, are dependent upon further action in a ratemaking case and create no expectation that the deferral terms within them will be followed in a ratemaking proceeding. The Court noted that "[t]he whole idea of AAOs is to defer a final decision on current extraordinary costs until a rate case is in order," where the utility is allowed to make a case that the deferred costs should be included. 978 S.W.2d at 438. The Court even commented that there was language in the 1994 AAO concerning MGE which provided the appropriate caveat that the Commission reserved the right to consider the ratemaking treatment to be accorded the expenditures covered by the AAO in a later proceeding. Thus, there was no authority for the proposition put forth by MGE that the Commission was bound by the terms of an AAO. *Id.*

MGE also made an equitable estoppel argument for continuation of the 10.54% carrying cost, asserting that the 1993 settlement and the 1994 AAO caused the equitable estoppel doctrine to be dispositive. The Western District Court of Appeals, noting that equitable estoppel is not ordinarily applicable to the government, identified the elements of equitable estoppel as follows, as it applies to a government entity:

> (1) a statement or act by the government entity inconsistent with the subsequent government act;
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> (2) the citizen relied on the act;
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> (3) injury to the citizen;
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> (4) the governmental conduct complained of must amount to affirmative misconduct;
>
> (5) there must be exceptional circumstances and a manifest injustice will result;
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> (6) equitable estoppel will not be invoked if it will interfere with the proper discharge of governmental duties, curtail the exercise of the State's police power or thwart public policy; and
>
> (7) equitable estoppel is limited to situations where public rights must yield because private parties have greater equitable rights.

978 S.W.2d at 439; *See State ex rel Capital City Water Co. v. Public Serv. Comm'n,* 850 S.W.2d 903, 910 (Mo.App. W.D. 1993).[2] "The party claiming equitable estoppel has the

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[2] Capital City Water Company ("Capital City") asserted, among other things, before the Western District Court of Appeals that the Commission was estopped from finding a contract between Capital City and Public Water Supply District No. 2 of Cole County, Missouri imprudent because of the Commission's prior approval of the contract and the Commission's actions in other rate proceedings based upon the contract. The Western District stated, in part, as follows:

> . . . The Commission's principal interest is to serve and protect ratepayers, *State ex rel. Crown Coach Co. v. Pub. Serv. Comm'n*, 238 Mo.App. 287, 179 S.W.2d 123, 126 (1944), and as a result, the Commission cannot commit itself to a position that, because of varying conditions and occurrences over time, may require adjustment to protect the ratepayers, *State ex rel. Chicago, Rock Island & Pacific Railroad Co.*, 312 S.W.2d at 796. The Commission requires flexibility in exercising its ratemaking function to deal with changing and unforeseen circumstances. *Id.* As a result, contracts between public utilities and their customers cannot limit the ratemaking authority of the Commission.

burden of proof and every fact creating the estoppel must be established by clear and satisfactory evidence. *Van Kampen*, 685 S.W.2d at 625." 850 S.W.2d at 910.

B. ALTERATION OF PREVIOUS IEC

8. Item I of the Commission's request for information also seeks "an explanation of how the IEC resulting from the '2001 Rate Case' was altered prior to its suspension and termination." In a nutshell, the modification, or alteration, of that previous, original IEC was the result of a Commission-approved unanimous stipulation and agreement. The remainder of this section provides some context.

9. The previous IEC was proposed in a unanimous partial stipulation and agreement[3] filed on June 4, 2001 in Case No. ER-2001-299, and was approved by the Commission in its Report And Order issued September 20, 2001. The amount to be collected under the IEC was approximately $19.65 million (Missouri retail).

10. Less than six months later, on March 8, 2002, Empire filed a general rate increase case (Case No. ER-2002-424)[4]. Among the Company's proposals in Case No. ER-2002-424 was a rebasing (or modification) of the IEC to reduce the amount of fuel and purchased power charges to its customers. Specifically, Empire proposed to reduce the base rate of $23.37/MWh to $21.69/MWh and the IEC charge from $5.00/MWh to $2.47/MWh.

May Dept. Stores Co., 107 S.W.2d at 49; *State ex rel. Imperial Utility v. Borgmann*, 664 S.W.2d 215, 219 (Mo.App.1983). Public utilities have no authority to enter into a contract which cannot be modified or revoked by the state. 64 Am.Jur.2d *Public Utilities* § 81 (1972). 850 S.W.2d at 911.

[3] Unanimous Stipulation And Agreement Regarding Fuel And Purchased Power Expense And Class Cost Of Service And Rate Design

[4] Also on March 8, 2002, Empire filed for interim rate relief, a request that the Commission denied by Order issued May 9, 2002.

11. On May 14, 2002, during the pendency of Case No. ER-2004-424, Empire, Public Counsel, Praxair and the Staff, who were the only parties to both Case No. ER-2002-424 and the earlier Case No. ER-2001-299, filed their Unanimous Stipulation And Agreement Regarding Error In Case No. ER-2001-299 And An Immediate Reduction Of The Interim Energy Charge ("Stipulation"). The Stipulation was docketed as Case No. ER-2002-1074. As the title of the Stipulation indicates, the document was not merely concerned with a modification of the existing IEC. Additionally, the parties recognized a need to "clean up" certain other matters pertaining to the IEC. In light of Empire's above-noted willingness to reduce the amount of its IEC charge, an idea that the other three parties supported, the parties were able to propose an IEC reduction and to address the other IEC-related concerns in one agreement. On June 4, 2002, the Commission approved the Stipulation, with an effective date of June 14, 2002, which was less than nine months after the October 2, 2001 effective date of the original IEC.

12. Among other things, the Stipulation provided for a reduction in the amount collected under the IEC of approximately $7 million per year on an annual basis. As pointed out in its direct case in Case No. ER-2002-424, Empire supported a reduction the IEC because fuel and purchased power prices had been declining at the time and because the Company had initiated a hedging program for its natural gas purchases and had been successful in locking in relatively favorable prices for a significant portion of its natural gas requirements on a going forward basis.

13. Ultimately, the original IEC was terminated as part of a Unanimous Stipulation And Agreement, filed October 28, 2002 and approved by the Commission in

its Report And Order dated November 14, 2002. New permanent rates went into effect on or about December 1, 2002, and Empire's customers received a refund of the full amount of the IEC, with interest. Thus the original IEC, including the subsequent modification, was in effect for only about 14 months of its two-year term.

14. Unlike the instant proceeding, in which Empire's proposed termination of the current IEC is opposed by three of the four signatories to the Nonunanimous Stipulation And Agreement that spawned it (Case No. ER-2004-0570), all the parties to Case No. ER-2002-424 were in agreement that the previous IEC should not continue in its then-existing form. 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]. It should be noted, however, that direct testimony filings by the parties other than Empire were not made until some three months after the parties had already filed, and the Commission had approved, the reduction in the amount collected under the IEC pursuant to the aforementioned Stipulation in Case No. ER-2002-1074.

II. Specifically, may the Commission change the fuel cost "collar" based on the fuel cost already in evidence?

15. Based on its legal analysis as set forth above, the Staff takes the position that, since the IEC is a form of alternative regulation, the Commission may not order a change in the fuel cost "collar" unless Empire either proposes it or otherwise agrees to it.

III. As the IEC was established as part of a Stipulation and Agreement, if the fuel cost "collar" is changed, are other changes to the Stipulation and Agreement

[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.

necessary to make the resulting IEC and Stipulation and Agreement not inequitable to signatory parties? What about non-signatory parties? if yes, please explain those other changes in detail, including specific suggestions for language changes.

16. If the Commission were to establish an IEC, the Staff does not believe that other changes to the Stipulation and Agreement would make the resulting IEC and Stipulation and Agreement "not inequitable" either to the non-Empire signatory parties or to the non-signatory parties. The Staff does, however, believe that the degree of inequity resulting from a Commission decision to establish an IEC could be reduced by specifying the following:

a) that the "floor" of the IEC would remain the same as it is in the current IEC[6]; and

b) that any under-recovery of the Company's fuel and purchased power costs experienced up until the effective date of the new IEC would be ineligible for future recovery by Empire.

IV. Regardless of the answers and legal analysis in response to questions 1-3 above, at what level should the fuel cost "collar" be set?

17. The most appropriate new fuel cost "collar" within Empire's present IEC mechanism, if the Commission were to order one, would be to substitute as an upper limit, or "cap," the Staff's recommended level of overall fuel and purchased power costs in this proceeding. The Staff's current recommended level of expense in this proceeding is $159,420,692 (total Company), or $29.68/MWh. It should be noted, however, that the Staff's recommended level of fuel/purchased power expense will change as a result of the true-up audit. The true-up audit will include review of changes to fuel transportation costs, natural gas prices and the impact of these changes to fuel/purchased power expense. Once the Staff's true-up testimony and accounting schedules are filed on

[6] See the Staff's response to Item IV herein.

September 27, 2006, it will be appropriate to use the updated Staff recommendation to set the fuel/purchased power expense "cap" value using known and measurable information through June 30, 2006, which is the end of the true-up period ordered for this proceeding.

18. The Staff would recommend that no change be made to the lower limit of the IEC "collar" ("floor") currently in effect; *i.e.*, $125 million (total Company), or $21.97/MWh.

WHEREFORE, the Staff submits its Response to the Commission's September 14, 2006 Order Directing Filing.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed by first-class mail, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 20th day of September 2006.

/s/ Dennis L. Frey