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Issue: Fuel Adjustment
Witness: W. Scott Keith
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Electric
Case No.
Date Testimony Prepared: April 2010

Before the Public Service Commission
of the State of Missouri

Direct Testimony

of

W. Scott Keith

April 2010

****Denotes Highly Confidential****

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DIRECT TESTIMONY
OF
W. SCOTT KEITH
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI
CASE NO.

INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is W. Scott Keith and my business address is 602 S. Joplin Avenue, Joplin, Missouri.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR JOB TITLE AND WHAT ARE YOUR JOB RESPONSIBILITIES?

A. I am presently employed by The Empire District Electric Co. ("Empire" or "the Company") as the Director of Planning and Regulatory. I have held this position since August 1, 2005. Prior to joining Empire I was Director of Electric Regulatory Matters in Kansas and Colorado for Aquila, Inc. from 1995 to July 2005.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND FOR THE COMMISSION.

A. In August 1973, I received a Bachelor of Business Administration degree with a major in Accounting at Washburn University, Topeka, Kansas.

Q. WHAT EXPERIENCE HAVE YOU HAD IN THE FIELD OF PUBLIC UTILITIES?

A. In 1973, I accepted a position in the firm of Troupe Kehoe Whiteaker & Kent as a staff accountant. I assisted in or was responsible for fieldwork and preparation of exhibits for rate filings presented to various regulatory commissions and audits leading to opinions on financial statements of various types of companies including utility companies.

In September 1976, I accepted a position with the staff of the Kansas Corporation Commission ("KCC"). My responsibilities at the KCC included the investigation of utility rate applications and the preparation of exhibits and presentation of testimony in connection with applications that were under the jurisdiction of the KCC. The scope of the investigations I performed on behalf of the KCC included the areas of accounting, cost of service and rate design.

In March of 1978, I joined the firm of Drees Dunn & Company and continued to perform services for various utility clients with that firm until it dissolved in March of 1991.

From March of 1991 until June of 1994, I was self-employed as a utility consultant and continued to provide clients with analyses of revenue requirements, cost of service studies and rate design. In connection with those engagements I also provided expert testimony and exhibits to be presented before regulatory commissions.

As I mentioned earlier, I was employed by Aquila, Inc. as the Director of Regulatory for its electric operations in Kansas and Colorado from 1995 to July 2005.

Q. HAVE YOU PREVIOUSLY PARTICIPATED IN ANY REGULATORY PROCEEDINGS?

A. Yes, I have. I have testified before regulatory commissions in the states of Kansas, Colorado, Indiana, Missouri, Oklahoma and West Virginia. I have also testified before the Federal Energy Regulatory Commission ("FERC").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will support the Fuel Adjustment Clause ("FAC") rate schedules that have been filed by Empire to reflect the actual energy costs that Empire has incurred during the six-month period September 2009 through February 2010. This six-month period is an Accumulation Period specified in Empire's FAC tariff that was approved by the Missouri Public Service Commission ("Commission") in its Report and Order issued in Case No. ER-2008-0093.

EXECUTIVE SUMMARY

Q. PLEASE PROVIDE AN OVERVIEW OF YOUR TESTIMONY IN SUPPORT OF THE FAC RATE SCHEDULES FILED BY EMPIRE.

A. The Commission's rule governing fuel and purchased power cost recovery mechanisms for electric utilities – specifically 4 CSR 240-20.090(4) – requires Empire to make periodic FAC filings that are designed to enable Commission review of the actual fuel costs, purchased power costs and off-system sales margins the Company has incurred during an Accumulation Period. In addition, these periodic filings are designed to adjust the FAC rates up or down, to reflect the actual energy costs incurred during the Accumulation Period. Empire's FAC tariff calls for two annual filings: a filing covering the six-month Accumulation Period running from September through February and a second filing covering the Accumulation Period running from March through August. Any increases or decreases in rates that are approved by the Commission, or that take effect by operation of law, are then collected from or refunded to customers over two six-month Recovery Periods: June through November and December through May.

Since the implementation of the FAC in Empire's last rate case, the variable cost of fuel and purchased power used by the Company's Missouri customers has varied from the base cost established in the last rate case. For the Accumulation Period September 2009 through February 2010, Empire's actual variable fuel and purchased power costs less off-system sales margins, have exceeded the base energy costs included in the Company's Missouri rates in Case No. ER-2008-0093 by approximately $3.2 million. In accordance with the FAC tariff, Empire has absorbed 5% of the overall increase in Missouri variable fuel and purchased power costs during the six-month period September 2009 through February 2010. Therefore, in accordance with the Commission's FAC rule and Empire's approved FAC tariff, the Company has filed FAC rate schedules that are designed to recover energy cost increases of approximately $3.1 million from its Missouri jurisdictional customers, and approximately an additional $339,000 of un-recovered energy costs from the prior recovery period ending November 30, 2009 for a total of $3.48 million. As reflected in the rate schedules filed by the Company, Empire has developed two Cost Adjustment Factors ("CAF") of $0.00160 per kilowatt-hour (kWh) for primary service and a CAF of $0.00163 per kWh for secondary service. These CAFs will enable Empire to recover the difference between base costs of fuel and purchased power built into its rates in the last general rate, the fuel and purchased power costs that were actually incurred during the Accumulation Period

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and the true-up of fuel and energy costs during the Recovery Period ended November 30, 2009 over a Recovery Period running from June 2010 through November 2010.

Q. DOES THE EMPIRE FAC TARIFF INCLUDE PROVISIONS THAT ARE DESIGNED TO LIMIT EMPIRE'S FAC RECOVERYS TO THE ACTUAL COST OF ENERGY?

A. Yes. The Empire FAC and the Commission's rule governing FACs include two safeguards that limit FAC recovery to the actual, prudently-incurred fuel and purchased power costs. The first safeguard is a true-up process that ensures that the FAC collections during the Recovery Period do not exceed actual fuel and purchased power 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 are passed through to customers using the FAC. The staff of the Commission has recently completed a formal Prudence Review of Empire's past energy costs during its operation of the FAC. This case has been designated EO-2010-0084 and the Commission's staff has recommended no disallowances or adjustments to Empire's energy costs during the first year of the operation of Empire's FAC. The first year of operation of Empire's FAC covered the 12-months ending August 31, 2009.

<u>THE PROPOSED FAC RATE ADJUSTMENT</u>

Q. WHY HAS EMPIRE FILED FAC-RELATED RATE SCHEDULES AT THIS TIME?

A. The Commission's rules – specifically 4 CSR 240-20.090(4) – and Empire's FAC tariff require the Company to make periodic FAC filings that enable the Commission to review Empire's actual fuel and purchased power costs and off-system sales margins so that Empire's FAC rates can be adjusted to reflect the actual energy costs the Company incurs to provide electric service to its Missouri customers. Empire's Missouri FAC tariff calls for two FAC adjustment filings per year: a filing covering the six-month Accumulation Period running from September through February and a second filing covering the Accumulation Period running from March through August. The Missouri FAC rate schedules related to my testimony are Empire's third filing under the FAC that was approved by the Commission in ER-2008-0093. Empire is seeking an increase in its FAC rates to reflect 95% of the difference between the base energy costs built into its base Missouri rates and Empire's actual Missouri energy costs for the Accumulation Period, plus a true-up of the costs recovered during the first Recovery Period ending November 30, 2009. This increase in FAC rates will be reflected on the Missouri customers' bills over the six-month Recovery Period running from June 2010 through November 2010.

Q. HOW HAVE EMPIRE'S AVERAGE ENERGY COSTS CHANGED OVER THE COST INCLUDED IN BASE RATES DURING THE THIRD ACCUMULATION PERIOD?

A. Empire's average energy costs per kWh have increased over the level built into its base electric rates, which is why the FAC rate schedules filed by the Company seek an increase in the rates charged to the Missouri customers. More specifically, Empire's Missouri base rates included an average cost of energy per kWh of net system production of $0.02780 during the Accumulation Period of September 2009 through February 2010. Empire actually incurred average energy costs of $0.02923 per kWh during the Accumulation Period. This represents an overall increase in average energy costs of $0.00143 per kWh during the Accumulation Period, or about 5.1 percent above than the average cost built into base rates. Pursuant to Empire's FAC tariff, Empire is requesting to pass on to its Missouri customers 95 percent of this cost increase plus approximately $339,000 of under recovered energy cost from the Recovery Period ending November 30, 2009 or an average of $0.00163 per kWh sold during the upcoming Recovery Period.

Q. PLEASE BRIEFLY DESCRIBE THE REASONS FOR THE INCREASE IN THE AVERAGE COST OF ENERGY DURING THE ACCUMULATION PERIOD?

A. A number of factors caused the average fuel and energy cost to increase during the Accumulation Period. For example, the weather during December 2009 through February 2010 was abnormally cold, which increased the level peaking generation needed to meet the demands of our customers. This peaking generation is fired using natural gas, which is a higher priced fuel than coal for example. In fact, the Empire system established an all-time peak demand of 1,198 megawatts on January 8, 2010.

Q. WHAT IS THE MONTHLY FAC INCREASE FOR A TYPICAL RESIDENTIAL CUSTOMER?

A. For Missouri residential customers using 1,000 kWh per month, the electric bill will increase by approximately $2.03 per month over the six-month period June

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2010 through November 2010, when the current FAC charge is applied to their bill and the previous negative FAC factor of $0.00040 is eliminated from their bill.

Q. WAS THE AVERAGE ENERGY COST IN LINE WITH EXPECTATIONS?

A. No. Primarily driven by the colder than normal weather and the corresponding increase in customer usage, the average energy costs came in above budget, which is based upon normal weather. Our budget anticipated an average fuel and purchased power energy costs during the current Accumulation Period of $27.81 per megawatt-hour of net system production. The actual results were above budget by around 5 percent at $29.23 per megawatt-hour.

Q. DO YOU EXPECT THE AVERAGE COST OF FUEL AND PURCHASED POWER TO INCREASE DURING THE NEXT ACCUMULATION PERIOD FROM MARCH 2010 THROUGH AUGUST 2010?

A. Yes. Our current budget anticipates average energy costs of **________** per megawatt-hour during the next Accumulation Period. Empire's Missouri fuel adjustment clause includes a seasonal base cost factor that takes the higher summer energy costs into account. In addition, the energy costs for next six-month Accumulation Period will also reflect the transition from a long-term purchased power contract that is scheduled to expire on May 31, to two new base load energy resources, Plum Point and Iatan 2. During this transition period, Empire expects to rely more on its gas fired generation resources until these new units are fully available, which in turn increases overall average fuel expense during the Accumulation Period.

Q. DO YOU BELIEVE EMPIRE'S FUEL ADJUSTMENT CLAUSE IS

REASONABLE AND APPROPRIATE?

A. Yes. The design of the Commission's rule governing the FAC was the subject of much discussion and debate prior to being approved by the Commission. In addition, there was much discussion and debate concerning Empire's FAC tariff in Case No. ER-2008-0093. This was the case in which the Commission ultimately approved Empire's FAC tariff. Empire's FAC filing is being made in accordance with the Commission's rules governing the FAC and in accordance with the FAC tariff approved for Empire.

Q. PLEASE DESCRIBE HOW EMPIRE IS PROPOSING TO RECOVER THE ENERGY COST INCREASES EXPERIENCED DURING THE SEPTEMBER 2009-FEBRUARY 2010 ACCUMULATION PERIOD?

A. The FAC rate schedule filed by Empire will recover the energy cost increase actually incurred during the Accumulation Period by applying two Cost Adjustment Factors or CAFs of $0.00160 for primary service and $0.00163 for secondary service to the actual Missouri kWh sales that take place during the June 1, 2010 to November 30, 2010 Recovery Period. The proposed CAFs were calculated in accordance with Empire's authorized FAC tariff. I have attached to my testimony as Schedule WSK-1 a copy of one of Empire's approved FAC tariff sheets. In addition to the tariff sheet, I have included as page 2 of Schedule WSK-1 a monthly analysis of the energy costs and energy cost recovery that has taken place during the Accumulation Period. Schedule WSK-1 contains the basic information and FAC formula that Empire used to calculate the CAFs that have been included in the proposed revised FAC rate schedule sheet 17c. The Empire

FAC tariff and the formula included therein were approved by the Commission in Case No. ER-2008-0093.

Q. HOW WERE THE VARIOUS VALUES USED TO DETERMINE THE PROPOSED CAFS THAT ARE SHOWN ON SCHEDULE WSK-1 DEVELOPED?

A. The data upon which Empire based the values for each of the variables in the approved CAF formula are included on the schedule, and came from Empire's books and records. Schedule WSK-1 contains all of the basic information that is required to calculate the proposed change in the CAF. In addition, I have filed the detailed information required by 4 CSR 240-3.161(7)(A) with this testimony as a separate set of supporting workpapers. In addition, as required by 4 CSR 240-3.161(7)(B), I have separately provided to all parties of record in Case No. ER-2008-0093 with a set of these workpapers.

Q. IS EMPIRE IN COMPLIANCE WITH THE PROVISIONS OF THE COMMISSION'S FAC RULE CONCERNING PERIODIC REPORTING AND SURVEILANCE?

A. Yes. Empire has complied with all of the Commission's rules, 4 CSR 240-3.161(5) and (6), governing periodic reports and surveillance using the Commission's electronic filing system and provided all of the parties to ER-2008-0093 with copies of the periodic compliance reports and copies of surveillance reports at the same time they were filed with the Commission.

Q. IF REVISED FAC SHEET 17C IS APPROVED BY THE COMMISSION, WHAT SAFEGUARDS EXIST TO ENSURE THAT THE FAC REVENUE

COLLECTED BY EMPIRE DOES NOT EXCEED THE ACTUAL ENERGY COST INCURRED BY EMPIRE DURING THE ACCUMULATION PERIOD?

A. As I mentioned earlier, Empire's FAC and the Commission's rules provide two mechanisms designed to limit the FAC amounts collected from customers to Empire's actual, prudently-incurred energy costs. First, at the end of each Recovery Period the Company is required to true-up the amounts collected from customers through the CAF with the energy costs that were actually incurred during the Accumulation Period to which the CAF applies. In addition, Empire's energy costs will be subjected to periodic Prudence Reviews to ensure that only prudently-incurred energy costs are collected from customers through the FAC. These two mechanisms serve as checks that ensure that Empire's Missouri customers pay only the prudently-incurred, actual cost of energy used to provide electric service in Missouri (less the 5% Empire is absorbing) – no more and no less.

Q. WHAT ACTION IS EMPIRE REQUESTING FROM THE COMMISSION WITH RESPECT TO THE FAC RATE SCHEDULE THAT THE COMPANY HAS FILED?

A. As provided by 4 CSR 240-20.090(4), Staff has thirty (30) days from the date the FAC rate schedule is filed to conduct a review and to make a recommendation to the Commission as to whether the rate schedule complies with the Commission's FAC rules, the requirements of Section 386.266, RSMo, and Empire's approved FAC. The Commission has sixty (60) days from the date of Empire's filing to either approve the rate schedule or to allow it to take effect by operation of law. Empire believes its FAC filing satisfies all of the requirements of applicable statutes, the Commission's rules, and Empire's approved FAC. Empire requests that, following Staff's review, the Commission approve 3rd revised FAC sheet 17c to be effective as of June 1, 2010, which is the first day of the Recovery Period prescribed in Empire's FAC tariff.

Q. IS EMPIRE REQUESTING ANY OTHER CHANGES TO THE FAC TARIFF AT THIS TIME?

A. No other changes to the FAC tariff sheets are being requested at this time.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes, it does.