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 tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.	)))))	Case No. ER-2008-0093

INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

OFFICE OF THE PUBLIC COUNSEL
Lewis R. Mills, Jr. (#35275)
Public Counsel
Missouri Office of the Public Counsel
P.O. Box 2230
Jefferson City, MO 65102-2230
(573) 751-1304
(573) 751-5562 FAX

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I. INTRODUCTION

In its opening statement, The Empire District Electric Company opined that the Commission cannot take into account "general economic conditions" when setting rates for Empire in this case. (TR. 28-29). This is simply not the case. Of course the Commission can take into account general economic circumstances when determining a just and reasonable rate. Indeed it would run afoul of the "all relevant factors" standard if it did not. "Just" rates mean fair to the user. This is the same concept under which a just punishment for stealing a loaf of bread is different from a just punishment for premeditated murder. The Commission not only can, but must, take the entire record into account in making its decisions in this case. That includes Volumes 2, 3, and 4 of the transcripts of the local public hearings.

This brief will address the five main contested issues in this case: Off-system Sales Margins, Return on Equity, Depreciation, the Rules Tracker, and the Fuel Adjustment Clause.

II. OFF-SYSTEM SALES MARGINS

A. Introduction

When Empire has more capacity and/or energy than it needs to serve its native load, it can sell this capacity or energy. Such sales are referred to as off-system sales, and the profit from such sales is referred to as off-system sales margins. For the past few years, Empire has been able to make such sales, and the margins from the sales have been increasing. Because off-system sales are a significant source of revenue that can supplement sales to native load, for every dollar of off-system sales margins that the Commission includes in the ratemaking calculus in this case, the revenue increase from native-load customers decreases by a dollar.

Empire, despite the fact that the opening of the Southwest Power Pool (SPP) Energy Imbalance Service (EIS) market just over a year ago was a game-changing event, proposed the use of a five-year average of the last five years of off-system sales margins. (Exhibit 2, Keith Direct) This would be approximately $3.4 million. However, in Mr. Keith's surrebuttal testimony (Exhibit 4), Empire agreed to use Staff's proposed $4.4 million number. Mr. Keith confirmed this change of position during cross-examination. (TR. 154).

Staff's proposed $4.4 million off-system sales margin number is derived by taking the off-system sales margins for the first six months of 2007 and doubling it. (Exhibit 204, Staff Cost of Service Report; Exhibit 209, Eaves Surrebuttal). This is an unusual – if not unique – way of calculating a revenue or expense item for ratemaking. Staff witness Eaves testified that his choice of annualization method was "definitely" outcome-based. (TR. 181)

Public Counsel proposed using the off-system sales margins for the twelve months ending December 31, 2007 (the end of the update period).[1] This is

[1] In his True-up Rebuttal Testimony, filed June 16, 2008, Public Counsel witness Kind recommends using the twelve months ended February 29, 2008 (the end of the true-up period). This is approximately $6.1 million. This true-up level adds further support to Public Counsel's position that older data is not representative of the levels of off-system

approximately $5.9 million. Because of a number of factors, including the SPP EIS market beginning in February 2007, this is the most representative – and of the three proposals in this case, the only representative – figure for Empire's going-forward level of off-system sales margins.

The parties agree that, if the Commission authorizes the use of a fuel adjustment clause, the significance of the difference in positions is somewhat diminished. In fact, Empire would not object to using Public Counsel's proposed $5.9 million level of off-system sales margins if it was authorized to use a fuel adjustment clause. (TR. 155) But the Commission should set the level of off-system sales margins to match as closely as possible the expected level of margins even if it does authorize a fuel adjustment clause. Empire agrees that even with a fuel adjustment clause, the base level of off-system sales margins should accurately reflect the expected level of off-system sales margins. (TR. 155-156; 160-161)

B. The SPP market

Perhaps the most significant recent change that affects the level of off-system sales margins that Empire is able to achieve is the opening of the SPP EIS market in February 2007. Empire concedes that the SPP EIS market just began in 2007 and Empire has been able to take advantage of it. (TR. 157) Empire has no reason, and the record gives no indication, that the market will go away. (TR. 157)

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sales margins that Empire can expect during the period that rates set in this case are in effect.

Staff witness Eaves concurred that Empire will operate in that market "for the foreseeable future." (TR. 185)

Staff witness Eaves agreed that the development of the SPP market is a very important change in circumstances that makes prior history less relevant. (TR. 171-172) He agreed that this change will allow empire to realize higher OSS margins. (TR. 172) Mr. Eaves testified that the OSS margins were higher in the second half of 2007 than the first because of the EIS market. (TR. 175) Mr. Eaves testified that his choice of annualization method was "definitely" outcome-based. (TR. 181)

In addition to the EIS market, which deals with energy, SPP is investigating the opening of a capacity market. SPP may have a capacity market in the future – "they may be talking and moving towards that" – and Empire could participate in that market. (TR. 163) Even without an organized, RTO-sponsored capacity market, uncontroverted evidence in the record is that: "at present there is a good capacity market for selling capacity in the SPP region, and the prices at which that capacity is sold in future years have been rising." (TR. 198). Mr. Kind, in a discussion with Commissioner Clayton, elaborated on the fact that there is a strong capacity market in the SPP region and prices for capacity are rising:

> Q. I understand. I just -- you have a different analysis than what Mr. Eaves had. So what other factors did you look at aside from Riverton and the SPP market?
>
> A. Well, the other main factors would have just been my general background, knowledge of energy and capacity markets in the SPP region, and that general knowledge leads me to believe that

there is an upward trend in capacity prices in the SPP region just as there is in the MISO region.

Q. Do you know why there is an upward trend in prices?

A. Yes. It's really pretty clear. SPP is one of the NERC reliability regions that currently has the greatest amount of excess capacity, and that amount of excess capacity is slowly going away as in general additional units aren't added in the region that would keep up with the load growth in the region. And so just the -- essentially the tightening of supply will lead to an increase in the market price of capacity.

Q. And then is it -- is it your understanding that that market will continue to tighten in terms of capacity in the years to come?

A. Well, at least in the near term over, say, the next three or four years. At some point it will tighten enough where people will start building additional capacity.

…

Q. Mr. Kind, in response to questions from Commissioner Davis, and I think Commissioner Clayton touched on this as well, you talked about a capacity market in SPP. Is there an organized market for capacity in SPP the same way there is for energy?

A. No, there's not.

Q. Is Empire nonetheless able to sell capacity to other counterparties within the SPP?

A. Yes, they are.

Q. Can you elaborate on that?

A. Well, it's somewhat similar really to the situation at MISO right now, which doesn't have a formal capacity market, meaning there's no capacity market that's run by the RTO. However, the existence of an RTO can facilitate a capacity market's development, and that's because it just allows other members of the RTO to really say, you know, I'm providing their capacity that they need to meet their reserve requirements, and once that's accomplished then someone can buy and sell energy in the energy market that is run by the RTO. But the -- there is a little bit of a difference right now even between the informal capacity4 markets in MISO and SPP. However, SPP appears to be quickly catching up with MISO in terms of the amount of6 capacity transactions that I hear about taking place.

Q. Is the BPU contract that we've talked about here today an example of a bilateral contract between members of the SPP?

A. Yes, it is.

Q. And is there anything that would limit or hinder Empire's ability to enter into similar contracts in the future?

A. No, there is not anything.

(TR.200-201; 204-205)

C. The BPU contract

Empire argues that, despite the clear change wrought by the opening of the SPP EIS market, the fact that one particular capacity contract (the Board of Public Utilities or BPU contract) expires after the summer of 2008 will reduce its ability to continue to achieve the level of off-system margins it has achieved since the beginning of the SPP EIS market. This particular contract is neither so significant nor so unique that its expiration should influence the Commission's decision.

Even though Empire has no plans to renew the BPU contract, it has not affirmatively decided not to renew. (TR. 157-158) Empire admits that BPU is in the market again for purchases as soon as the summers of 2009 and 2010. (TR. 158) Empire witness Keith does not know that Empire will not seek to again sell capacity to BPU. (TR. 162) With the addition of the new Riverton unit, Empire will have more capacity than it did just a year or so ago, and could use that to supply BPU's capacity needs. (Exhibit 303, Kind Rebuttal). Mr. Kind testified that "The new Riverton unit is 150 MW, well more than the amount of capacity that they would grow into through load growth in just a couple of years." (TR. 200) Even Staff concedes that it is possible that Empire could bid for and obtain that contract again in the future. (TR. 198) Furthermore, even if Empire does not bid on or is not awarded a new contract with BPU, it has plenty of opportunity to sell the capacity that now goes to BPU. Public Counsel witness Kind agreed that:

"either through BPU or through potential capacity market in SPP … Empire Electric will have the opportunity to have future capacity sales in the future and … there should be some accounting in rates for that…." (TR. 199)

Mr. Kind further explained why there is no need to adjust Public Counsel's proposed level of off-system sales margins to reflect the expiration of the current BPU contract:

> Q. How did you address the BPU contract in evaluating Public Counsel's position?
> A. Well, I saw no need to … make an adjustment to eliminate it.
> …
> [I]t's part of my determination that they're going to be able to make a level of capacity and energy sales in the future that would be at a level at least comparable to the sales level during calendar 2007.
> Q. You think they'll have a contract that will replace that or you just think in the market they'll be able to find -- they'll be able to enhance their sales just because of the availability?
> A. I don't think it would be solely through the market. I think it's likely that they will have some additional capacity sales contract in 2009. (TR. 202-203)

Although Empire witness Keith said that the BPU contract was the single biggest factor in increased OSS margins (TR. 162), Empire's own annual report says that the primary factor in the increase is the SPP EIS market (TR. 164-165).

D. Additional considerations

Although the record indicates that using calendar year 2007 would be the highest level of OSS margins ever, using the 2007 level of customers would also be the highest level ever. (TR. 186) Simply because it is higher than historical levels does not make it inappropriate, especially since the record shows that the opening of the SPP EIS market was truly a paradigm shift for the utilities that operate in that region. (TR. 164-165; 171-172). Staff agreed that using the most recent twelve months to establish a level of off-system sales margins should not be ruled out simply because those twelve months would establish a historically high number:

> Q. Is there anything inherently wrong with using the highest number in the analysis period if you believe it's representative of the going-forward number?
>
> A. I think if it's -- if it's trending and I think that's what you have to look at when you're looking at that period, not just that it's the highest level for that year, but there's a trending and you can reasonably predict that the number is going to be at a higher level in the future.
>
> Q. So there's nothing inherently wrong with using the highest number?
>
> A. No, I think if you -- if you -- just because it's a higher number doesn't mean it's – it shouldn't be used. There could be -- there's factors leading up to why that number is higher, and if those2 factors are going to remain the same or constant, then the higher number is not necessarily a bad number.
>
> (TR. 186-187)

Although Public Counsel proposed, and the Commission agreed, to use a five-year average in the last case, the opening of the SPP EIS market has severely damaged the usefulness of most of the last five years' historical data. Furthermore, Empire's off-system sales margins have been higher than the five-year average amount included in rates set by the Commission in Empire's last rate case. (TR. 159)

Staff witness Eaves testified that his choice of annualization method was "definitely" outcome-based. (TR. 181) Staff witness Eaves had a vague recollection of using a similar "double a half-year" calculation, but was not able to point to any other Staff member using it. (TR. 168-169). Nor was he able to cite a single instance in which the Commission found it to be an appropriate way to calculate expense or revenue. (TR. 169) Mr. Eaves testified that Staff's revenue requirement calculation in this case is primarily based on the update period – calendar year 2007. (TR. 188) The only items for which Staff used the "double a half-year" approach are this one, and the (uncontested) transmission revenue issue that Mr. Eaves provided testimony about. (TR. 189).

The fact that Asbury had an extended outage during the latter half of 2007 actually would have lowered the off-system sales margins; but for that outage the off-system sales margin level would have been higher. (TR. 202).

Mr. Gipson testified that the first quarter of 2008 had off-system sales margins of $1.9 million compared to 1.4 million for the same quarter in 2007. (TR. 227-228) That is an increase of $.5 million for just one quarter. If that increase is annualized, Empire will achieve off-system sales margins in 2008 that are $2 million higher than 2007.

III. RETURN ON EQUITY

Public Counsel supports the testimony and conclusion of Michael Gorman[2] that Empire should be allowed a return on equity of 10 percent. Empire witness Vander Weide testified to a return on equity of a whopping 11.6 percent. Staff witness Barnes supported a return on equity of 10.26 percent, the midpoint of a range of 9.72 percent to 10.80 percent. (Exhibit 219, Barnes Surrebuttal Testimony, page 2).

The Commission should carefully evaluate the credibility of each witness who testified on this issue. "Evaluation of expert testimony is left to the Commission which 'may adopt or reject any or all of any witnesses' testimony.' " State ex rel. GS Technologies Operating Co., Inc. v. Public Service Commission of the State of Missouri, 116 S.W.3d 680, 690 (Mo. App. W.D. 2003). "Further, [a reviewing] Court defers to the judgment of the Commission as to the credibility of witnesses." Greenlee v. Dukes Plastering Serv., 75 S.W.3d 273, 275 (Mo. 2002).

The Commission has found Dr. Vander Weide not to be credible in the recent past, and should do so again in this case. In Case No. ER-2007-0002, the last AmerenUE rate case, Dr. Vander Weide proposed a return on equity of 12.2 percent. The Commission made the following Findings of Fact about Dr. Vander Weide and his position in that case:

> Yet, Vander Weide acknowledged that, so far as he knew, if this Commission allowed AmerenUE a return on equity of 12.2 percent, or even 12.0 percent, it would be the highest return on equity allowed to any integrated electric utility in the country.

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[2] Mr. Gorman testified on behalf of intervenors Enbridge Energy, LP, Explorer Pipeline Company, General Mills, Praxair, Inc., and Wal-Mart Stores, Inc., herein referred to as the Industrial Intervenors.

> In large part, the overly high return on equity recommendations put forward by AmerenUE's witnesses result from their inclusion of a large financial risk add-on premium, based on the allegedly greater financial risk resulting from the market value of common equity in AmerenUE's capital structure.
>
> …
>
> In sum, the financial risk upward adjustment proposed by AmerenUE's witnesses appears to be **a transparent effort to inflate the company's proposed return on equity** to obtain a better bargaining position in the hope the Commission would simply split the difference between the extreme positions. **Such efforts call into question the credibility of these witnesses.** Indeed, Vander Weide came close to acknowledging that his proposed return on equity was extreme when at the hearing he indicated an eleven percent return on equity, in line with the amounts that the Commission has allowed Kansas City Power & Light and The Empire District Electric Company in recent rate cases, "would be a benchmark that the financial community would look at."
>
> Case No. ER-2007-0002, Report and Order, pages 40-41; emphasis added).

Furthermore, in a recent Kansas City Power and Light Company rate case, the Commission used the zone of reasonableness analysis to summarily reject the testimony of a qualified expert without any analysis of his testimony. In that case the Commission stated: "Because the return on equity recommended by DOE [witness Woolridge] falls outside of the 'zone of reasonableness', the Commission will discard it and find that it merits no further discussion." (Report & Order, Case No. ER-2006-0314, pages 21-22). Although the Commission was not quite so explicit in the AmerenUE case, it is clear that it found Dr. Vander Weide to not be a credible witness, primarily because his return on equity recommendation was unreasonably high compared to national averages and the other witnesses in the case. Dr. Vander Weide finds himself in exactly the same situation here, and the Commission should treat his testimony in exactly the same way.

If the Commission allows Empire to use a fuel adjustment clause, it should make an explicit adjustment to lower the return on equity that it would otherwise have allowed. Such an adjustment is explicitly contemplated by Section 386.266.7 RSMo Cumm. Supp. 2007, which provides:

> The commission may take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation's allowed return in any rate proceeding, in addition to any other changes in business risk experienced by the corporation.

> Industrial Intervenor witness Gorman testified that:

> Q WOULD YOUR RECOMMENDED RETURN ON EQUITY CHANGE IF THE 7 COMMISSION APPROVES A FUEL ADJUSTMENT MECHANISM FOR EMPIRE IN THIS PROCEEDING?
> A Yes, because a fuel adjustment mechanism will produce a meaningful reduction to Empire's operating risk. As such, Empire's investment risk will decrease because of the implementation of the fuel adjustment clause. As set forth below, I am estimating a return on equity that is based on Empire's existing operating and financial risk. If the Commission implements regulatory mechanisms that reduce Empire's operating risk, then my return on equity would compensate Empire for risk included in that rate of return that it no longer is assuming. As such, it may be necessary to reduce the authorized return on equity if the Commission implements a fuel adjustment mechanism that meaningfully shifts a portion of fuel cost recovery risk from Empire to Empire's ratepayers. However, I would note that a reduced return on equity may impact the amount of regulatory amortization expense needed to be included in Empire's cost of service in order to maintain the credit metric guidelines consistent with its Regulatory Plan. Nevertheless, customers would be better off paying regulatory amortization expense, compared to an excessive return on equity, because the regulatory amortization will mitigate future increases to rates. Hence, customers receive the

> benefit of lower rates later by paying regulatory amortization expense now.
> Q IF THE COMMISSION APPROVES A FUEL ADJUSTMENT MECHANISM THAT 6 REQUIRES EMPIRE TO CONTINUE TO ASSUME FUEL COST RECOVERY RISK, 7 WOULD THAT CHANGE ANY OF YOUR FINDINGS?
> A No. If Empire under-recovers some fuel cost and its return on equity is lowered by, for example, 0.5%, then its equity return would be reduced from 10% down to 9.5%. At this return, I would note that Empire's earned return on equity would still be within the range (9.5% to 10.3%) I have estimated as fair compensation for Empire's total investment risk. Also, a return on equity of 9.5% based on the credit metric calculations in this proceeding could still produce credit metrics that support Empire's Regulatory Plan credit metrics targets. As such, a fuel adjustment mechanism that continues to place some cost recovery risk on Empire can be designed without eroding Empire's financial integrity, or ability to earn a fair rate of return. Further, I would note that if Empire was required to take some fuel cost recovery risk, it may be able to put that risk off onto a third party supplier, or financial counterparty through traditional fuel procurement activities. As such, Empire has the ability to manage fuel cost recovery risk through creditworthy counterparties in a manner that exceeds customers' abilities to manage this volatile cost.
> (Exhibit 501, Gorman Direct, pages 3-4).

Although he would find it unnecessary based on his proxy group to make an explicit adjustment, Staff witness Barnes did not disagree that an adjustment could be made depending upon which witness's analysis the Commission primarily relied:

> Q. We've also been discussing the fuel adjustment clause and how it relates or does it relate to ROE, I guess. First of all, do you believe that a fuel adjustment clause lowers risk?
>
> A. Yes, I do.
>
> Q. And is that something that should factor into the ROE calculation?
>
> A. I guess it depends on which witness you -- you go with. In my analysis, 15 of the 17 companies already have some sort of mechanism in place to recover fuel costs, and therefore, since I used a comparable company approach to determine the return on equity

> for Empire, that's -- that -- that risk has already been either adjusted or accounted for in the stock price of -- of those companies. And part of the DCF model is the current stock price, so I don't think an adjustment should be made to my recommendation.
> (TR. 528)

The Commission should also recognize that the Regulatory Amortizations that are a part of Empire's Regulatory Plan created by the Stipulation and Agreement in Case No. EO-2005-0263 lower Empire's risk and thus should lead to a lower return on equity:

> Q. Gotcha. There was also -- we've been discussing the regulatory amortization that's currently in place for Empire. And again, I believe it was Dr. Vander Weide's testimony that that really wasn't an Empire factor for ROE purposes because that was related to cost of debt and not cost of equity. Is that how you understood his testimony?
> A. That's what I understood, yes.
> Q. And do you agree with that, and why, if -- you know, whether you agree, disagree, why?
> A. I don't agree with that. I do -- I believe it does have an impact on the equity
> investor. I'll pretty much say the same answer as I did to your previous question. Investors are going to see -- investors are going to see that that amortization is in place and they're going to account for that. Now, it's my understanding that my comparable -- I think KCP&L and Empire are the only companies I'm aware of that actually have that plan, but the -- the cash flows are more certain with that in place. And it -- it ensures that the company has the opportunity to maintain their credit rating.
> (TR. 528).

IV. DEPRECIATION

A. Introduction

Empire witness Donald S. Roff prepared a Depreciation Study which would increase the annual depreciation expense by $1,929,108 (Schedule DSR-3, Roff Direct Testimony). However both the Staff and Public Counsel found numerous significant distortions in that Roff Depreciation Study, and the Staff recommended that the current depreciation rates continue (Rosella L. Schad, Rebuttal Testimony page 2, line 14-16, and to page 3, lines 17-19). Public Counsel supports the recommendations that the current depreciation rates continue, and Public Counsel also recommends the Commission Order include certain findings so that similar distortions will not be included in future depreciation studies.

In cross examination Mr. Roff admitted that parts of his study do not comply with Commission rules:

> "Q. Do you know whether or not your depreciation study complies with the Commission's rules?
>
> A. I believe there are certain parts of it that probably do not, and they've been addressed in my surrebuttal testimony.
> Q. Have you changed your depreciation study, then?
> A. No."
> (TR. 311)

B. Inconsistent Treatment of the Reserve Deficiencies and Surpluses

One major distortion in the Roff Depreciation Study was Mr. Roff's inconsistent treatment of the reserve deficiencies and surpluses. Because of past events, some accounts may have more money in the actual book depreciation reserve[3] than the theoretical reserve amount needed (a reserve "surplus") and other accounts may have less money in the actual book reserve than the theoretical reserve amount needed (a reserve "deficiency"). Mr. Roff used a double standard

[3] "Depreciation Reserve" or "reserve" refers to the "Accumulated Provision for Depreciation."

for these book reserve deficiencies and surpluses. Mr. Roff <u>did</u> adjust for the book reserve amount in the group of accounts in which that adjustment <u>increases</u> the charges to the customers, but <u>did not</u> adjust for the book reserve amount in the group of accounts in which that adjustment would <u>reduce</u> the charges to the customers. (page 8, Dunkel Direct Testimony).

In cross examination, Mr. Roff admitted he had used this inconsistent treatment of the book reserves:

> Q. Is it correct that you admit that Mr. Dunkel is partially correct when he says that you have been inconsistent and actually used the book reserve in calculating an adjustment for certain plant accounts?
> A. Yes, partially correct.
> (TR. 313)

Exhibit 311 shows that Mr. Roff's inconsistent treatment of the reserve produced proposed depreciation expense in his Depreciation Study that were $1,194,759 more per year that the depreciation expense that would be produced if the book reserve was treated uniformly in all accounts.[4] Mr. Roff agreed that Exhibit 311 accurately reflects the numbers discussed n cross-examination. (TR. 320; see also Exhibit 302, Dunkel Surrebuttal). Obviously the Roff Depreciation Study must be rejected, because it proposed $1.2 million of annual depreciation expense that is based on Mr. Roff's inconsistent treatment of reserve surpluses and deficiencies.

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[4] The $1,194,759 amount does not include any reserve redistributing, as shown on the note on the bottom of Exhibit 311. In this proceeding, Mr. Roff had objected to redistributing the reserve (Page 3, lines 15-21 of the Roff Rebuttal testimony). The Public Counsel is not pursuing the reserve redistributing issues because it has a small dollar impact (Surrebuttal Testimony of Dunkel, page 10, lines 4-7).

In addition, the Commission should also make a finding that for all accounts the reserve deficiency or reserve surplus in each account should be recovered over the remaining life of that account. Absent such a Commission finding, a company witness can locate groups of accounts that have reserve deficiencies, and propose higher depreciation expense to recover those deficiencies, without also proposing to likewise reduce depreciation rates in those groups of accounts that have a reserve surplus. Such inconsistent treatment of reserve surpluses and deficiencies is improper, and can be prevented by the Commission stating that for all accounts the reserve deficiency or reserve surplus in each account should be recovered over the remaining life of that account.

Nationwide the depreciation rates proposed in whole life depreciation studies are generally calculated to recover the reserve surplus or deficiencies over the remaining life. For example, in the recent AmerenUE proceeding in Missouri, Case No. ER-2007-0002, the whole life depreciation study filed by AmerenUE included the adjustments for the actual book reserve amounts in each account. In that AmerenUE proceeding, AmerenUE witness Wiedmayer stated "The reserve variance amortization developed in this study is based on the variance between the book accumulated depreciation and the calculated accrued depreciation using an amortization period equal to the composite remaining life for each property group." (Exhibit 302, Dunkel Surrebuttal, page 2). The adjustment for the reserve surplus or deficiency is a simple calculation. (Exhibit 302, Dunkel Surrebuttal, page 3-4).

In a current case in Kansas, Mr. Roff's testified that the depreciation rates should be adjusted for the book reserve amounts both when there is a reserve surplus and when there is a reserve deficiency. Mr. Roff's Direct Testimony[5] in that Kansas case stated:

> "Q. WHEN YOU USE THE TERM "RESERVE POSITION", WHAT
> DO YOU MEAN?
> A. The term "reserve position" refers to the difference between a theoretical reserve and the existing book reserve. If the theoretical reserve is greater **than the book reserve**, past depreciation has been inadequate compared to the depreciation parameters developed in the Kansas and SSU study, and **an upward adjustment to the depreciation rate is required.** If the opposite is true, **a downward adjustment to the depreciation rate is required**."

(Schedule WWD-2, and Exhibit 300, Dunkel Direct, page 5; emphasis added).

The FERC Uniform System of Accounts (USOA) requires that the service value of the property be depreciated "over the service life of the property." (General Instruction number 22 of FERC USOA 18 C.F.R. 101). However, the investment is not depreciated "over the service life" if there is no recognition of the actual book depreciation reserve amount. For example, assume an investment of $1,000 with an average service life of 10 years with only 4 years remaining life. Under "unadjusted" whole life depreciation, the annual depreciation expense would be $100 ($1,000/10 years = $100 per year). Since there are only 4 years remaining before the investment retires, $400 will be collected under the new rates

[5] Direct Testimony of Donald S. Roff for Atmos Energy Corporation before the State Corporation Commission of Kansas, in Docket No. 08-ATMG-280-RTS, page 14.

and added to the depreciation reserve amount. However, $1,000 is needed when the investment retires, so the "unadjusted" whole life calculation effectively assumes that there is already $600 in the depreciation reserve account. This assumed $600 is called the "theoretical" reserve amount. However, if there is only $500 in the actual book depreciation reserve account, collecting an additional $400 in future depreciation accruals would mean that only $900 ($500 in depreciation reserve plus $400 in future accruals) will be collected over the service life of the property. This is an under collection of $100. On the other hand, if there is $700 in the actual book depreciation reserve account, collecting an additional $400 in future depreciation accruals would cause a total collection of $1,100 ($700 in depreciation reserve plus $400 future accruals) and result in an over collection of $100. (Dunkel Surrebuttal, pages 3-4)

A Commission ruling that for <u>all</u> accounts the reserve deficiency or reserve surplus in each account should be spread over the remaining life of that account would prevent both the over-collections and under-collection. However, if left without Commission guidance, some company witnesses will raise the depreciation rates in those account categories that have a reserve deficiency, but <u>not</u> lower the depreciation rates in those account categories that have a reserve surplus. The Commission should make it clear that this double standard is not acceptable in Missouri. The Commission should rule that that for <u>all</u> accounts the reserve deficiency or reserve surplus in each account should be spread over the remaining life of that account.

C. Reimbursements

The Staff criticized Mr. Roff's treatment of reimbursement (Exhibit 217, Schad Rebuttal, pages 5-7). The Staff is correct that Mr. Roff's treatment of reimbursement is incorrect and overstates the depreciation rates.

Mr. Roff's Depreciation Study inflates the proposed depreciation rates by including in the depreciation rates the costs caused by reimbursed accidents or reimbursed relocations, but failing to include, or fully include, the offsetting insurance payments or reimbursements the Company receives.

Staff points out that insurance proceeds were eliminated in Mr. Roff's analysis (Exhibit 217, Schad Rebuttal, page 6). Assume a careless driver hits and destroys an Empire pole or other facility, and the driver's insurance company pays Empire for the property destroyed and other costs caused by that accident. Since the insurance company has paid for those costs, those same costs should not also be recovered from the customers through the depreciations rates, but that is what Mr. Roff effectively proposes. The early retirements and other cost caused by such an accident are properly included in the depreciation rate calculations, <u>if</u> the offsetting insurance payments the Company received are <u>also</u> included in the depreciation calculation as "Salvage", which insurance payment offsets the costs. Mr. Roff <u>did</u> include the early retirements and other <u>cos</u>ts caused by such an accident in the depreciation rate calculation, but he <u>did not</u> include the offsetting <u>insurance payments</u> the Company receives (Transcript pages 330-332). This makes the customers pay for these early retirements and other costs caused by such an accident through the depreciation rates, in spite of the fact the insurance company also pays for these same costs. This is a double recovery, and is not appropriate.

The record makes it very clear that Mr. Roff's depreciation calculations included the costs caused by such a reimbursed accident, but did not include the offsetting insurance payment. Mr. Roff stated "that insurance proceeds were eliminated from the depreciation study". (TR. 330). However, he makes clear that the various costs and losses the company incurred as the result of the reimbursed accident <u>were</u> included in his depreciation rate calculations. (TR. 331-332)

Mr. Roff conceded that "the removal costs associated with that insurance reimbursed retirement" were included as cost in his depreciation rate calculations. (TR. 331) He also conceded that "For the insurance reimbursed retirement, the amount equal to the original cost of retirement line would be a reduction to the accumulated depreciation account." (TR. 331) And Mr. Roff finally conceded that "In the life analysis … this insurance reimbursed retirement [would] tend to decrease the realized life of the plant…." (TR. 332).

The record makes it very clear that Mr. Roff's depreciation calculations included the costs caused by such a reimbursed accident, but did not include the offsetting insurance payment. This makes the customers pay for the costs that are actually recovered from the insurance company. This overstates the depreciation expense, is a double recovery, and is not appropriate.

An example of another type of reimbursement is when the Department of Transportation pays Empire to remove existing Empire facilities to make room for highway construction. (Transcript page 323). The Staff correctly states that Mr. Roff's calculations greatly understate the reimbursements received by Empire. Staff witness Schad stated:

> "For example, for Account 364, Distribution Poles, Towers, and Fixtures, years 2002-2006, the total retirements, salvage, and cost of removal amounts from the historical cost of removal/salvage data supplied to Staff were $1,185,264, $1,457154, and $1,797,365, respectively. Net salvage is salvage minus cost of removal and equals $1,457,154 minus $1,797,365 or -$340,211. Staff's annual net salvage percentage for the period 2002-2006 is -$340,211 divided by $1,185,264 or -29%. Mr. Roff's calculation for annual net salvage percentage for this account for the same time period, 2002-2006, is in the range -130% to -134%..... Using the existing average service life of 46 years, and the net salvage percentages of -125 % for Mr. Roff and -29 % for Staff, generates depreciation rates of 4.9% and 2.8%, respectively."
> (Exhibit 217, Schad Rebuttal, page 7)

In the above Staff example the -29% net salvage calculated by Staff is the correct net salvage, not the -130% to -134 % calculated by Mr. Roff.

For the above calculations, Mr. Roff was using the same reimbursement amounts and same other input figures that the Staff used: the sum of years 2002-2006. (Exhibit 27, Roff Surrebuttal, schedule DSR-3, page 5 of 10). But in the process of converting the dollar amounts to percents, Mr. Roff introduced a distortion. He divided the Reimbursement amount by a much larger figure than he divided into the Salvage, or Cost of Removal. The Salvage and Cost of Removal were the percent of Retirements, but the Reimbursement was the percent of

Additions, in Mr. Roff's calculation. (TR. 324-329) These percents are not comparable, they are "apples to oranges". The Staff calculations is correct. Simple addition and subtraction of the data for the years 2002-2006 on Mr. Roff's own Surrebuttal Schedule DSR-3, page 5 of 10 shows that the Staff calculated amount of -$340,211 is the portion of the Cost of Removal that has not been covered by the Salvage and Reimbursements amounts shown. -$340,211 is -29% of the retirements in that period (-$340,211/$1,185,263=-29%). Mr. Roff's use of -130% to -134% for these years means he is including at least $1,540,840 (-130% *$1,185,263 retired=-$1,540,842) of allegedly unrecovered Cost of Removal for these years. $1,540,840 of allegedly unrecovered Cost of Removal is over 4 times the $340,211 Cost of Removal that has actually not been covered by the Salvage and Reimbursements. Mr. Roff's "apples to oranges" calculation is incorrect and overstates the depreciation rate. Staff is correct.

D. Conclusion

1. Public Counsel agrees with Staff that Mr. Roff's proposed depreciation rates should not be adopted, and that the current depreciation rates should continue.

2. The Commission should find that that for all accounts the reserve deficiency or reserve surplus in each account should be spread over the remaining life of that account.

3. The Commission should find that when the early retirements and other costs caused by an accident are included in the depreciation rate calculation, any

offsetting insurance payments the company receives must also be included in the depreciation rate calculation. Failing to include the offsetting insurance payments makes the customers improperly pay for these early retirements and other cost caused by such an accident, in spite of the fact the insurance company also pays for these same costs.

4. The Commission should find that the treatment of reimbursement as presented by the Staff is correct, and Mr. Roff's treatment of reimbursements is not acceptable. For example for the years 2002-2006 in account 364, the Staff calculated amount of -$340,211 is the portion of the Cost of Removal that has not been covered by the Salvage and Reimbursements. This unrecovered net salvage amount should properly be recovered in depreciation rates. Mr. Roff's treatment of reimbursement, which attempts to recover in depreciation rates a net salvage amount that is much larger than the unrecovered amount, is inappropriate and would result in excessive depreciation rates.

V. RULES TRACKER

A. Introduction

Counsel for Empire described the current Staff/Empire[6] proposal as follows: "Under Empire's proposal, if Missouri expenditures do not reach $8.9 million, that in the following year Empire would be **required** to spend $8.9 million **plus** the shortfall from the prior year…." (TR. 358; emphasis added).

It is well-settled law that post-test year changes in expenses should be included in rates only if they are known and measurable. In a case involving GTE North, the Commission adopted Staff's position on separation factors because the Commission found that "the Staff's method of determining separations is more reasonable than the Company's which includes projected data."[7] The Western District Court of Appeals upheld the Commission decision, and listed the "known and measurable" requirement first in explaining when post-test year changes in expenses should be included in rates:

> "The accepted way in which to establish future rates is to select a test year upon the basis of which past costs and revenues can be ascertained as a starting point for future projection." State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 645 S.W.2d 44, 53 (Mo. App. 1982). A test year is a tool used to find the relationship between investment, revenues, and expenses. Certain adjustments are made to the test year figures; "normalization" adjustments used to eliminate non-recurring items of expenses or revenues and "annualization" adjustments used to reflect the end-of-period level of investment, expenses and revenues. Adjustments are also made for events occurring outside the test year. The criteria used to determine whether a post-year event should be included in the analysis of the

6 The Staff proposal and the Empire proposal differ only in that Staff proposes to increase rates in this case by the average of the estimated costs in the first two years following the Report and Order in this case, while Empire proposes to use the average of three years' worth of estimates.

7 State ex rel. GTE North, Inc. v. Missouri Public Service Com., 835 S.W.2d 356, 371 (Mo. Ct. App. 1992).

> test year is whether the proposed adjustment is (1) "known and measurable," (2) promotes the proper relationship of investment, revenues and expenses, and (3) is representative of the conditions anticipated during the time the rates will be in effect. (*Ibid.*, at 368).

B. Broad estimates of future costs should not be included in current rates

Public Counsel opposes the Staff/Empire tracker mechanism for the estimated cost of compliance with the recently-promulgated vegetation management and infrastructure inspection rules. As Public Counsel witness Robertson succinctly stated in his Rebuttal Testimony:

> The primary concern of the Public Counsel is that the actual costs of the rules implementation are not known and measurable at this time; therefore, the deferral of the costs, as proposed by Mr. Palmer, does not make sense from a regulatory perspective. It does not make sense because Mr. Palmer is requesting that the Commission authorize a "tracker" for deferral of costs based totally on estimates of future costs. I know of no instance where the Commission has authorized such a request for future unknown costs.
>
> …
>
> Whatever the costs incurred may be they will begin outside of the test year and update period of the instant case and, at this time, they are not even close to known and measurable. Therefore, it is not appropriate to decide the ratemaking treatment of the costs in this case.
>
> (Exhibit 308, pages 3-6).

The changes from the new rules are not known and measurable by any standard. Empire witness Palmer acknowledged that the contract with one of its tree-trimming contractors will expire shortly and will be rebid. (TR. 375). Empire does not even know what contractors will be doing tree-trimming work, much less what it really will cost.

As to the infrastructure inspections, the best that Empire could say about its guesses as to future costs is that they “had kind of a feel for that….”

> There's another company, OSMOS, that has done infrastructure inspections for years. We've used them on our transmission system, and we have consulted with those folks to **get an idea on the distribution pole inspection expense**. We have very good information on what it cost to inspect transmission poles, and **there's some type of correlation** certainly between those and distribution poles. So **we had kind of a feel for that** ahead of time as well.
> (TR. 379; emphasis added)

The Commission cannot fulfill its statutory duty of protecting the public if it sets rates based on “an idea” or a “kind of a feel” about what costs might be in the future.

Empire admitted that its estimates of the cost of compliance cover a very broad range: “Empire believes that it will ultimately incur additional costs in the amount of **4 to $6 million per year** to comply with the new vegetation management and infrastructure rules.” (TR. 357; emphasis added)

The sole source of the data (ECI) that goes into Empire’s estimates is a company that is likely to benefit if Empire spends more money on tree-trimming. (TR. 405-406) The Commission should be very hesitant to rely on such data and the resulting estimates. Even if the Commission disregards this blatant conflict of interest, the Commission should not abandon the long-established practice of only allowing known and measurable changes outside the test year to be recovered from ratepayers.

Staff witness Oligschlaeger candidly admitted that the costs he proposes to include in current rates are just estimates:

> Q. So the dollar amount that you have recommended doesn't necessarily -- doesn't necessarily mean that Empire will be in compliance with the new rules?
> A. Admittedly what we are dealing with are at this point estimated costs of compliance with the rules. That amount, in terms of minimum compliance, it may be more, it may be less.
> (TR. 414)

There is little evidentiary support for the estimates. Empire witness Keith, the main sponsor of the tracker, did not know where the data on which the estimates are based came from. (TR. 392). And there is no real-world experience at Empire or any other utility that would provide a basis for confidence in Empire's estimates:

> Q. Now, what in-the-field actual experience does Empire have complying with the Commission's new proposed rules?
> A. Well, they haven't taken effect yet, so we haven't specifically complied with them yet at this point. However --
> Q. Have there been any other Missouri utilities had any in the field experience complying with the proposed rules?
> A. I don't know.
> Q. You don't know any that do, do you?
> A. I don't -- I don't know of any.
> (TR. 392-393)

Mr. Oligschlaeger has no experience in tree-trimming and did not personally verify Empire's estimates. Another Staff employee (Dan Beck), not a witness in this case, for some reason not revealed in the record, concluded that Empire's estimates appear reasonable. (TR. 407). The Staff witness who did testify did not know how Mr. Beck verified the estimates. (TR. 407). Mr.

Oligschlaeger conceded that Mr. Beck has not worked for a utility in a capacity related to vegetation management, and neither has Mr. Oligschlaeger. (TR. 408)

The recent storms took out a lot of branches and a lot of trees in Empire's service territory. (TR. 384). There is no indication in the record that Empire took this into account in arriving at its estimates of compliance costs.

C. The proposed tracker mechanism is inconsistent with the new rules and would be very bad ratemaking practice

Staff witness Oligschlaeger described how the proposed tracker would operate:

> Q. Mr. Oligschlaeger, just in a general sense, under your proposal, if EDE realizes in any given year that it's going to take less than the amount that Staff has proposed to adequately trim trees, in your view, does the company have an incentive to go on and spend the balance in any event?
>
> A. I think the idea is they would be required to spend the additional amount, and we don't think that's inappropriate to the extent that they can have the resources to go beyond minimum compliance with the rules as they exist, we would certainly expect that they would do so and use any extra dollars to go beyond the minimal levels of compliance.
>
> Q. But assuming they were able to do a reasonable and prudent job for less than the amount, under your proposal they would be required to spend more; is that correct?
>
> A. Our proposal to give them up front resources to meet the rule compliance is premised upon the expectation and the requirement that they spend those dollars, yes.
>
> (TR. 404)

A simple example illustrates the problem with this concept. Assume Empire is able to fully comply with the vegetation management rules and prudently conduct its vegetation management for only $5.1 million (annual Missouri jurisdictional), $1 million less than the $6.1 million that Empire now guesses will be spent. Under the Empire/Staff proposal, in the second year Empire will be **required** to spend $2 million more than is necessary and prudent for vegetation management. It almost goes without saying that it is poor ratemaking practice to simply require a certain amount of money be spent on a task – particularly since we have only broad guesses about what it will really cost to prudently perform that task.

Also, the rules themselves provide for deferrals and Empire has not followed the provisions in the rules for deferrals. Staff's proposal is not consistent with the new rule:

> Use of a deferral mechanism such as what is I think contemplated in the vegetation management and infrastructure systems rules would probably give rise to regulatory assets or liabilities in which the company's actual expenditures for compliance with the rules will be1 compared to whatever level of compliance costs are included in rates, and the opportunity would be afforded the company to come back in its next rate case and either recover any excess expenditures it has made from customers or to refund back or to give back to customers any under-expenditures it made for those areas compared to the level set in rates.
>
> Now, the tracker mechanism that the Staff is proposing is not a regulatory asset or regulatory liability. It's not based on those kinds of mechanisms for truing up the company's actual cost to its rate levels. It's basically based upon a premise, you give them money -- the companies certain funds up front to accomplish certain things. You monitor whether they are being accomplished, and if they do not spend the amount of money allowed to them in rates for the intended purposes, then certain consequences would happen.
>
> But the excesses or the shortfalls, any difference between the amounts they, the company, actually spends compared to the amount given -- provided to them in rates in this case would not be recoverable in the next rate case.
>
> (TR. 412-413)

Furthermore, what the Staff and the Company propose is not normalization. Staff witness Oligschlaeger conceded that normalization necessarily uses historical data. (TR. 406).

If Empire spends money imprudently on tree-trimming, the only way to get at it would be to do a prudence disallowance in a subsequent rate case. (TR. 410-411). But Staff does not have employees with the kinds of experience that would be helpful in making a case for such a disallowance. (TR. 412)

D. Other considerations

There are many other issues with the proposal. For example, it is not fully fleshed out; it is more of a concept than a concrete and detailed ratemaking mechanism. (*Ibid*., page 6). Empire did not know whether costs that it incurred in the test year and asserts are related to rule compliance have been segregated. (TR. 391). Staff did not exclude any costs that were associated with the new rules that may have been incurred in the test year. (TR. 408-409) nor did Staff segregate them so they could be tracked. To the extent that some rule-compliance costs are included in base rates, the tracker would allow for double-counting of those expenses.

Empire witness Keith did not know whether the tree-trimming costs are billed by contractors on a total-company basis, or on the basis of work actually performed in Missouri. (TR. 395)

Empire's vegetation management practices change over time even without rules changes. (TR. 369). When Empire's tree-trimming costs increase, as they did between 2005 and 2006, those increases are captured in rate cases. (TR. 369-370)

Staff's proposal would compensate Empire for amounts that Empire is not even estimating will be spent for a year after the rates in this case go into effect. (TR. 415-416). And Empire's is worse: by averaging three years' worth of estimates, it proposes charging customers today based on estimates of what it might spend three years from now.

VI. FUEL ADJUSTMENT CLAUSE

A. Empire is barred by the Stipulation and Agreement approved in Case N. ER-2004-0570 from seeking approval of a fuel adjustment clause in this case

In Empire's last rate case, Case No. ER-2006-0315, in an order entitled "Order Clarifying Continued Applicability of the Interim Energy Charge," issued May 2, 2006, the Commission stated that: "The Commission clarifies that The Empire District Electric Company, pursuant to the Stipulation and Agreement [in Case No. ER-2004-0570], may not make any request for an energy cost recovery rider while the existing interim energy charge is effect."

Public Counsel has argued in this case, in Case No. ER-2006-0315, and in the second Supreme Court mandamus action (SC89176) that (at least as of October 1, 2007 when Empire filed this case) the only lawfully-approved tariffs for Empire were those filed in compliance with the Report and Order in Case No.

ER-2004-0570 and approved by the Commission. As a result, the existing interim energy charge embodied in those tariffs was in effect when this case was filed, and Empire was prohibited from requesting a fuel adjustment clause in this case. The Commission clearly disagrees, as evidenced by the pleadings and briefs it filed in SC89176. Although confident that a decision in SC89176 will prove Public Counsel right, Public Counsel is equally confident that the Commission will not change its position in this case without a court order. Accordingly, this brief will not further elaborate on the arguments that the Commission has already rejected on this issue.

B. Even if the Commission determines that Empire is not barred from requesting a fuel adjustment clause, the Commission should reject Empire's request

Public Counsel does not believe that allowing Empire to use a fuel adjustment clause would be in the public interest. Public Counsel witness Kind outlines the main reasons why not in his Rebuttal Testimony:

> 1) According to Empire's own testimony, the Company expects that the new rates resulting from this case will only be in effect for a very limited period of time (21 months). At line 1 on page 15 of his direct testimony, Mr. Keith states that "the rates coming out of this rate case will go into effect around September 1, 2008 and are expected to remain in place until June of 2010."
>
> 2) Empire has used the expected level of fuel costs for the year 2008 in order to run its production cost model and estimate the base line level of production costs to include in its base rates. The operation of law date in this case is September 1 so the level of costs included in Empires new base rates will reflect the level of costs built into rates for at least the first four months after new rates go

into effect (assuming rates are set based on 2008 fuel cost inputs in the production cost model).

3) Empire has protected itself against extreme price volatility in the price of its coal and natural gas fuel supplies by entering into long-term contracts or hedging arrangements for much of the fuel that it expects to burn over the twenty-one month period when new rates would be in effect.

4) Starting in January 2009, Empire will begin receiving wind energy from a new wind purchased power agreement with Horizon Wind Energy. Empire witness Scott Keith states on page 31 of his direct testimony that "Empire anticipates purchasing approximately 350,000 megawatt-hours of energy under this contract annually." Mr. Keith identifies this new wind purchase as one of the "sources of energy that can be used to offset natural gas price volatility. At line 3 on page 31 of his direct testimony, Mr. Keith notes that "the wind energy is purchased at a fixed annual cost and is typically used to offset the energy from higher cost resources, such as those using natural gas."

(Exhibit 303, Kind Rebuttal, pages 6-7)

C. If the Commission decides to authorize Empire to use a fuel adjustment clause, it should allow no more than 60 percent of the changes in fuel and purchased power costs to flow through the fuel adjustment clause

Pursuant to 386.266.4 RSMo Cumm. Supp. 2007, the Commission may "approve, modify, or reject adjustment mechanisms…." The Commission has the authority to reject a fuel adjustment clause, and thus allow zero percent of changes in fuel costs to flow through a fuel adjustment clause and one hundred percent to flow through base rates. The Commission also has the authority to approve a fuel adjustment clause that passes one hundred percent of the change in fuel costs through the clause (although it is hard to imagine a scenario where that would be appropriate). Thus it cannot be seriously argued that the Commission does not have the authority to modify a fuel adjustment clause so that it passes through some percentage between zero and one hundred of the changes in fuel costs above or below those included in base rates. Empire, despite proposing to pass 95 percent of such changes through its fuel adjustment clause, tries to make such an argument. The Commission should summarily reject this argument.

Public Counsel witness Kind explained why only 60 percent of the change in fuel and purchased poser expense should be passed through a fuel adjustment clause:

> Public Counsel believes that Empire should not be permitted to use periodic adjustments under the FAC to recover any more than 60% of any increase in fuel cost. If fuel costs decline, Empire should not be forced to pass through more than 60% of the decreased fuel costs to customers through FAC periodic adjustments. OPC arrived at this 60% level recommendation by taking into account the unique circumstances cited earlier that we believe make it inappropriate for the Commission to grant Empire's request for an FAC at this time. These same unique circumstances mean that Empire would get more than adequate protection against fuel price and earnings volatility with a mechanism that allows the Company to recover 60% of any variation in fuel cost over the twenty-one month period that Empire expects the FAC to be in effect.
> (Exhibit 303, Kind Rebuttal, page 11).

A big part of Empire's argument against flowing less than one hundred percent of the changes in fuel and purchased power costs through the fuel adjustment clause is based on Empire witness Overcast's rather hysterical outcries about "disallowances." Dr. Overcast in his rebuttal testimony repeatedly asserted that a fuel adjustment clause that did not capture one hundred percent of the changes in fuel and purchased power costs would impose a disallowance of prudently incurred costs on Empire. (See, *e.g.*, Exhibit 10, Overcast Rebuttal, pages 2, 4, 10, 11). Yet on cross-examination, Dr. Overcast admitted that failing to catch all changes in expense between rate cases is **not** considered to be a disallowance. (TR. 569-570).

Another big part of Empire's argument against flowing less than one hundred percent of the changes in fuel and purchased power costs through the fuel adjustment clause is based on Empire witness Overcast's misleading schedule (Exhibit 11, Overcast Surrebuttal, Surrebuttal Schedule HEO-1) that shows increases in costs of types of coal that are not even used by Empire. That schedule, which illustrates a rather alarming trend in the spot price of a number of types of coal, has very little bearing on Empire. First, Empire has a significant portion of its coal needs locked in, and buys only a very small portion on the spot market . (Exhibit 303, Kind Rebuttal, page 8). Second, Empire does not use **any** of the types of coal shown on Dr. Overcast's Surrebuttal Schedule HEO-1, except for Powder River Basin coal. (TR. 560-566; see also Exhibits 312, 313, 315, and 316).

D. The cost and revenues related to SO2 emission allowances should be flowed through a fuel adjustment clause

Public Counsel witness Kind testified that the cost and revenues related to SO2 emission allowances should be not flowed through a fuel adjustment clause. Both Empire and Staff disagree. Mr. Kind testified that such a flow through is not permitted by the Empire regulatory plan approved by the Commission in Case No.

EO-2005-0263. The paragraph pertaining to SO2 Emission Allowances in the Regulatory Plan Stipulation and Agreement states in part that:

> Empire will record the proceeds, in the event that revenues exceed original cost or the allowance is loaned to a third party, from emission allowance transactions in Account 254, the balance in this account will be Regulatory Liabilities, to be used as an offset to rate base in any future rate case until a final decision is made on the amortization treatment in future rate cases.
> Case No. EO-2005-0263, Stipulation and Agreement, page 20)

Mr. Kind also had an in-depth discussion of the SO2 emissions allowance issue with Commissioner Clayton. (TR. 762-766).

WHEREFORE, Public Counsel respectfully offers this Initial Brief and prays that the Commission conform its decision in this case to the arguments contained herein.

Respectfully submitted,

OFFICE OF THE Public Counsel

/s/ Lewis R. Mills, Jr.

By:______________________________

Lewis R. Mills, Jr. (#35275)
Public Counsel
P O Box 2230
Jefferson City, MO 65102
(573) 751-1304
(573) 751-5562 FAX
lewis.mills@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the following this 18th day of June 2008: