

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

Staff of the Missouri Public Service Commission,)	
)	
)	
Complainant,)	
)	
v.)	Case No. EC-2009-
)	
The Empire District Electric Company,)	
)	
Respondent.)	

COMPLAINT

COMES NOW the Staff of the Missouri Public Service Commission (Staff), by counsel, and for its Complaint against The Empire District Electric Company (Empire) states as follows:

General Allegations

1. Empire is an electrical corporation as defined in Section 386.020(15) and a public utility as defined in Section 386.020(42).¹
2. Empire is subject to the jurisdiction, control and regulation of the Missouri Public Service Commission pursuant to Chapters 386 and 393.
3. Section 386.390.1 provides that:

Complaint may be made... ..by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any... ..public utility, including any rule, regulation or charge heretofore established or fixed by or for any... ..public utility, in violation, or claimed to be in violation, of any provision of law, or of any rule or order or decision of the commission....
4. Section 386.570.1 provides that:

¹ All statutory citations are to RSMo 2000, unless otherwise noted.

Any... ..public utility which violates or fails to comply with any provision of...
...this or any other law... ..is subject to a penalty of not less than one hundred
dollars nor more than two thousand dollars for each offense.

5 Section 386.570.2 provides that:

Every violation of the provisions of this or any other law or of any order, decision, decree, rule, direction, demand or requirement of the commission, or any part or portion thereof, by any corporation or person or public utility is a separate and distinct offense, and in case of a continuing violation each day's continuance thereof shall be and be deemed to be a separate and distinct offense.

6. Section 393.190.1 provides that:

No...electrical corporation...shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public...without having first secured from the commission an order authorizing it to do so. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void. . . . Nothing in this subsection contained shall be construed to prevent the sale, assignment, lease or other disposition by any corporation, person or public utility of a class designated in this subsection of property which is not necessary or useful in the performance of its duties to the public, and any sale of its property by such corporation, person or public utility shall be conclusively presumed to have been of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value.

7. Thus, every day's passage since the unauthorized sale of a part of an electrical corporation's system or works constitutes a separate and distinct offense; each subject to a penalty of not less than one hundred dollars nor more than two thousand dollars.

8. Commission Rule 4 CSR 240-2.070 (1) provides that "...the commission staff through the general counsel... ..may file a complaint...."

9. Commission Rule 4 CSR 240-2.070 (3) provides that "...[f]ormal complaint may be made by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any person, corporation or public utility, including any rule

or charge established or fixed by or for any person, corporation or public utility, in violation or claimed to be in violation of any provision of law or of any rule or order or decision of the commission....”

10. Commission Rule 4 CSR 240-2.070 (4) provides that “[t]he commission shall not be required to dismiss any complaint because of the absence of direct damage to the complainant.”

11. Commission Rule 4 CSR 240-2.070 goes on to state as follows:

(7) Upon the filing of a complaint in compliance with these rules, the secretary of the commission shall serve by certified mail, postage prepaid, a copy of the complaint upon the person, corporation or public utility against whom the complaint has been filed, which shall be accompanied by a notice that the matter complained of be satisfied or that the complaint be answered by the respondent, unless otherwise ordered, within thirty (30) days of the date of the notice.

(8) The respondent shall file an answer to the complaint within the time provided. All grounds of defense, both of law and of fact, shall be raised in the answer. If the respondent has no information or belief upon the subject sufficient to enable the respondent to answer an allegation of the complaint, the respondent may so state in the answer and assert a denial upon that ground.

(9) If the respondent in a complaint case fails to file a timely answer, the complainant’s averments may be deemed admitted and an order granting default entered. The respondent has seven (7) days from the issue date of the order granting default to file a motion to set aside the order of default and extend the filing date of the answer. The commission may grant the motion to set aside the order of default and grant the respondent additional time to answer if it finds good cause.

(11) When the commission determines that a hearing should be held, the commission shall fix the time and place of the hearing. The commission shall serve notice upon the affected person, corporation or public utility not fewer than ten (10) days before the time set for the hearing, unless the commission finds the public necessity requires that the hearing be held at an earlier date.

(12) All matters upon which a complaint may be founded may be joined in one (1) hearing and no motion for dismissal shall be entertained against a complainant for misjoinder of causes of action or grievances or misjoinder or nonjoinder of parties.

12. Pursuant to 4 CSR 240-2.070 (5)(E), Staff states that it has contacted Empire regarding the subject of this complaint.

13. Empire entered into certain fixed-price forward physical gas contracts with British Petroleum on November 18, 2004, under which Empire purchased natural gas at the fixed price of \$4.525 per dekatherm (Dth), payable on delivery, for delivery to its generating plants in July and August of 2010 and 2011.

14. Empire entered into these fixed-price forward physical gas contracts as part of its ongoing natural gas hedging activities.

15. On or about February 15, 2008, Empire “unwound” a portion of these fixed-price forward physical gas contracts, selling, without Commission authority or approval, its rights under those contracts to 992,000 Dths of gas scheduled for delivery in July and August of 2010 and 2011. Specifically, 248,000 Dth of contracted gas delivery were unwound for each of the months of July 2010, August 2010, July 2011 and August 2011.

16. Empire claims it sold its rights to the gas on the above-described terms in order to book a gain to income to offset a portion of its loss resulting from an extended outage at the Asbury generating plant in late 2007 and early 2008.

17. As a result of the sale of its rights under the fixed-price forward physical gas contracts, Empire recorded a gain of \$1.3 million, after taxes, in its Statement of Operations for the first quarter 2008.

18. The amount of this gain was based upon the difference between the contracted value of the gas and its higher market value at the time of the unwinding. The market value of the gas at the time of unwinding, as measured by NYMEX natural gas

futures contracts adjusted for “basis difference,” was \$7.420 per Dth for gas deliverable in 2010, and \$7.325 per Dth for gas deliverable in 2011.

19. The Staff asserts that Empire’s rights under these fixed-price forward physical gas contracts are part of Empire’s works or system necessary or useful in the performance of supplying electricity to the public.

20. Although it may not be necessary to determine at this time the prudence of the transaction in question, the Staff is bringing this complaint case to establish that the fixed-price forward physical gas contracts are property, i.e., assets, that are part of Empire’s system or works, necessary or useful for the provision of service to the public, and, therefore, are covered by Section 393.190.1. The Staff believes a determination respecting the lawfulness of such transactions is appropriate now before Empire or any of the remaining electrical corporations within the Commission’s jurisdiction engage in similar activity without obtaining Commission authorization. A workable process was developed for SO₂ emission allowances and the Staff believes a similar process should be considered for fixed-price forward physical gas contracts.

Intangible Property / Intangible Assets Are Part of a Utility’s System or Works

21. The Commission has previously established jurisdiction with regard to certain intangible property, i.e., assets, finding that it is part of a utility’s system or works necessary and useful in the performance of the utility’s duties to the public.² In its Order Establishing Jurisdiction and Clean Air Act Workshops, effective September 8, 1992, in Case No. EO-92-250, *Re Kansas City Power & Light Co.*, 1 Mo.P.S.C.3d 359, the Commission determined that “[SO₂] emission allowances are necessary and useful in the

² Staff recognizes that the Commission is not bound by *stare decisis*, and provides this information only for illustrative purposes.

performance of KCPL's duties to the public and are part of KCPL's 'system', and any sale or transfer of these allowances is void without prior Commission approval." (Case. No. EO-92-250, Mimeo pg. 5, 1 Mo.P.S.C.3d at 362).³

22. The Commission, in Case No. EO-92-250, established that SO₂ emission allowances are part of a utility's "system," as distinguished from its "works." "The Commission, though, believes that a utility's system is greater than the physical parts which would be its 'works'. A utility's system is the whole of its operations which are used to meet its obligation to provide service to its customers." (Case. No. EO-92-250, Mimeo pg. 5, 1 Mo.P.S.C.3d at 362). Both a utility's "system" and its "works" are included in the listing of assets covered by Section 393.190.1. This section establishes that a utility cannot sell assets that are necessary or useful in the performance of its duties to the public without prior commission approval, and that all such sales are void, *ab initio*. (see Section 393.190.1). If assets are sold to a good faith purchaser for value, without prior Commission approval, then those assets are conclusively presumed to not be necessary or useful in the performance of the utility's duties to the public, as to that purchaser only. (see Section 393.190.1).

23. In recognizing that SO₂ allowances are part of a utility's system, and necessary and useful in the performance of the utility's duty to the public, the Commission also recognized that trading of SO₂ allowances was an integral part of the

³ The Clean Air Act Amendments of 1990 (CAAA) included provisions to reduce the amount of sulfur dioxide (SO₂) emitted annually by establishing a base line of emissions for each steam-electric generating unit and requiring each unit to meet emission limitations by specified deadlines. (Case No. EO-92-250, pg. 2, *citing* 42 U.S.C.S. §§7651 *et. seq*). Under the CAAA, each steam-electric generating unit is allocated an allowance of SO₂ emissions, which can be used by the utility against the SO₂ it emits. Surplus allowances can be sold or banked for future use or sale if that utility uses pollution controls to reduce the SO₂ in its emissions or burns low sulfur coal so that the amount of SO₂ emitted is minimized. (see Case. No. EO-92-250, pg. 3, *citing* 42 U.S.C.S. §7651b).

CAAA, and consistent with its intent. (*see* Case. No. EO-92-250, pg. 3). The Commission also recognized that the process of securing Commission approval incidental to each discrete sale of SO₂ allowances would hamper the trading of these allowances, and possibly impede Missouri's utilities in the maximization of the benefits of the national allowance market. (*see* Case. No. EO-92-250, pg. 5).

24. The Commission, through Case Nos. EO-98-401 (AmerenUE), EO-95-184 (KCPL), and EO-2005-0020 (Empire), established utility-specific proceedings as the means of approving the sales of SO₂ allowances by a particular utility, with no interruption to the trading of the allowances. The processes and terms of each utility's sales approvals are then subject to adjustment as necessary through the Commission's regulation of each subject utility.

The Fixed-Price Forward Physical Gas Contracts Are Part of Empire's System or Works, Necessary or Useful in the Performance of its Duties to the Public

25. Empire's decision to use its combined cycle generating unit and peaking combustion turbine generating units (CTs) is influenced by (1) Empire's cost of gas, (2) its knowledge of the efficiency of its generation units, and (3) the price of purchased power, which is correlated to the current market price of gas.

26. The specified fixed-price forward physical gas contracts gave Empire the rights to purchase gas for delivery in July and August of 2010 and 2011, at the price of \$4.525 per Dth, payable on delivery.

27. The Commission has determined that SO₂ allowances "attach" to SO₂-producing generating units, and are thus integrated into a utility's system. (*see* Case. No. EO-92-250, pg. 5, 1 Mo.P.S.C.3d at 362).

28. In that Empire's combined cycle and CT generating units require natural gas to generate electricity necessary in meeting its obligations to ratepayers, Empire's rights to that fuel attach to these units, thus integrating Empire's contractual rights to the future delivery of gas into Empire's system or works, for purposes of Section 393.190.1.

29. Since Empire's rights to future delivery of gas are necessary and useful to Empire in the performance of its duties to the public, it cannot be sold absent prior Commission approval. (*see* Section 393.190.1).

30. The practice of hedging against volatility in natural gas prices has been recognized as a tool to be utilized by Missouri's utility companies as early as Union Electric's 1995 request to "implement a pilot project entitled 'Use of Financial Markets To Manage Gas Costs,'" in Case No. GT-95-315. Hedging by entering into fixed-price forward physical gas contracts allows a utility to predetermine the price of a commodity portion of the gas it will need in the future to provide service to its customers. The use of fixed-price forward physical gas contracts is just one method of hedging.

31. Costs associated with Empire's ongoing natural gas hedging activities have been included in Empire's cost of service in its most recent rate case, No. ER-2008-0093, and in its prior rate cases.

This Sale of Empire's Contractual Rights Is of Potential Monetary Harm to Ratepayers

32. In order to meet its customers' demand for electricity in July and August, 2010 and 2011, Empire will have to (1) contract for the purchase of replacement gas by entering into additional fixed-price forward physical contracts, (2) purchase replacement gas on the spot market, or (3) purchase electricity from another utility or exempt wholesale generator, in order to meet its estimated energy requirements for the summer

of 2010 and 2011 to replace the gas generation that would have been available, but for the unwinding of the fixed-price forward physical contracts.

33. Empire was authorized the use of a Fuel Adjustment Clause (FAC) on a going forward basis in Case No. ER-2008-0093. If Empire subsequently utilizes the FAC to flow through any costs incurred over and above the fixed-price forward physical gas contractual price of \$4.525 per Dth unwound by Empire, its ratepayers will be harmed.⁴

34. Even having been granted the FAC requested in Case No. ER-2008-0093, should Empire file a rate case including July or August of 2010 or 2011 or periods prior to those dates in its test year, Empire could request recovery of any fuel costs incurred in excess of what Empire's cost of gas would have been had it not sold its rights under the fixed-price forward physical gas contracts.

35. Empire might argue that the Staff's complaint case is unnecessary or premature because there will be subsequent opportunities for the Commission to address any questions of whether the sale of the fixed-price forward physical gas contracts in question was imprudent as the Staff is alleging. The Staff is bringing this complaint case to establish that the fixed-price forward physical gas contracts are property, i.e., assets, that is part of the Empire system or works necessary or useful for the provision of service to the public, and, therefore, are covered by Section 393.190.1. The Staff believes that the Commission should make that determination now before Empire or any of the remaining electrical corporations within the Commission's jurisdiction engage in similar or additional activity without first obtaining Commission authorization.

⁴ Staff recommended Empire be granted the use of an FAC, as described more fully in the Staff Reports and Testimony submitted in Case No. ER-2008-0093. However, Staff specifically recommended disallowance, as imprudent, of any flow-through of increased fuel costs related to replacement gas or power incurred due to Empire's unwinding of these contracts. (*see* True-Up Direct Testimony of Mark Oligschlaeger, pg. 8, L. 16 - pg. 9, L. 14).

Conclusion

36. Rights under fixed-price forward physical gas contracts for future delivery of gas are part of Empire's works or system are necessary or useful in the performance of supplying electricity to the public.

37. Empire's failure to secure Commission approval prior to disposing of this element of its works or system necessary or useful in the performance of its duties to the public constitutes a violation of Section 393.190.1.

38. This sale of an element of Empire's works or system necessary or useful in the performance of its duties to the public is void.⁵ (*see* Section 393.190.1).

WHEREFORE, the Staff respectfully requests that the Commission find that Empire's rights under the fixed-price forward physical gas contracts for future delivery of gas are property/assets that are part of Empire's works or system that are necessary or useful in Empire's performance of supplying electricity to the public; find that Empire disposed of its rights under the fixed-price forward physical gas contracts; find that Empire failed to secure Commission approval for the disposition of its rights under the fixed-price forward physical gas contracts prior to their disposal; find that Empire's doing of all of the above is in violation of Section 393.190.1, rendering the sale void⁶; authorize the General Counsel's Office to seek penalties against Empire for violating Section 393.190.1; direct Empire to not engage in the sale or other disposition of fixed-price forward physical gas contracts without obtaining Commission authorization; and order such other relief as is just and reasonable.

⁵ Unless such sale is demonstrated to have been to a purchaser in good faith for value – see Section 393.190.1.

⁶ Unless such sale is demonstrated to have been to a purchaser in good faith for value – see Section 393.190.1.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to, this 6th day of February, 2009:

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