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

REPLY/TRUE-UP BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

I. INTRODUCTION

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. It will respond to the arguments raised in the initial briefs of The Empire District Electric Company on all of these issues, and the initial brief of the Staff on the issues of Off-system Sales Margins and the Rules Tracker. It will also briefly address Public Counsel's true-up position on Off-system Sales Margins.

II. OFF-SYSTEM SALES MARGINS

Reply to Staff and Empire

The only criticism the Staff makes in its initial brief of Public Counsel's approach (which is to use the most current 12 months of off-system sales margins) is that Public Counsel "overlooks" the fact that off-system sales margins have increased since the Southwest Power Pool began its Energy Imbalance Service

(EIS) market, and so the margins in the most recent 12 months are higher than levels achieved before the EIS market began operating. (Staff brief, pages 15-16). Public Counsel's proposal does not "overlook" the fact that current levels of off-system sales margins are high; it is driven by this fact. All the evidence in the case demonstrates that the opening of the EIS market caused a profound and permanent change – for the better – in Empire's ability to make a profit in the off-system sales market. Of the three levels of off-system sales margins proposed in this case, only Public Counsel's fully incorporates this change.

The main thrust of Empire's argument is that historical (*i.e.*, pre-EIS market) levels fluctuated quite a bit. Such fluctuations are to be expected when there is not a functioning, liquid market, but they are a thing of the past. With a smoothly-functioning market like the EIS market, dramatic fluctuations will not occur. There will certainly be changes from year-to-year, but they will be more gradual, driven by Empire's available capacity and energy, and the changing needs of other market participants. Gone are the days when one year was significantly higher than the previous year because a particular capacity contract began, or one year was significantly lower than the previous year because a contract expired.

Empire argues (at page 18) that it is not possible to predict a future year's off-system sales margins based on the current year, and before the EIS market began, that would have been a true statement.[1] But it is no longer true; the EIS

[1] Indeed, that is why Public Counsel proposed using a five-year average in Empire's last case.

market will eliminate the fluctuations that historically characterized Empire's off-system sales margins. Empire has given no reason other than an examination of pre-EIS data to show why it believes its off-system sales margins will decline from the current levels. Public Counsel has submitted evidence of several reasons why it will not decline: the EIS (energy) market is in place and will continue; there is a robust capacity market in SPP and may eventually be a capacity market run by SPP; the new Riverton unit will provide Empire with even more capacity and energy to sell; the Board of Public Utilities (BPU) contract could be renewed, or in any event be replaced by another contract.

Empire gives two reasons why Public Counsel's position that off-system sales margins in the future will be similar to current levels is flawed: "historical data show[s] that significant increases in off-system sales in one year were never sustained in the immediately following years;" and the BPU contract expires this summer. Both of these supposed flaws are only flaws only if one ignores the SPP markets. The markets for energy and capacity in the SPP region did not exist before February 2007, and there is no evidence in the case that the historical fluctuations will recur. Similarly, while historically the expiration of a particular contract might have led to a drop-off in off-system sales margins, a liquid market will allow Empire to readily sell the capacity and energy now being sold to BPU.

True-up Position

In his True-up Rebuttal Testimony (Exhibit 317), Public Counsel witness Ryan Kind recommended that the Commission use the level of off-system sales margins for the 12 months ending February 29, 2008 (the end of the true-up period). Mr. Kind testified that:

> I recommend including $6,116,915 in Empire's revenue requirement. This is the level of OSS margin revenues that Empire actually achieved during the 12 months ending February 29, 2008. As other major revenue, expense and rate base items are trued up to reflect their current levels, this component of Empire's revenue requirement should not be excluded. Including the level of OSS margin revenues for the 12 months ending February 29, 2008 will better reflect Empire's current operating environment because it will include a full year of operational results from participating in the Southwest Power Pool (SPP) Energy Imbalance Service (EIS) market which only began operating in February 2007.
> (Exhibit 317, page 2).

Mr. Kind noted that Empire recognizes in its SEC filings that its participation in the SPP EIS market is facilitating a higher level of OSS margins. Mr. Kind also noted that the extended outage at the Asbury plant means that updated off-system sales margin levels are probably understated:

> Because the extended outage at the Asbury plant continued well into the true-up period, the portion of the 12 months ending February 29, 2008 that was impacted by the Asbury outage was substantially greater than the portion of the 12 months ending December 31, 2007 that was impacted by the Asbury outage. Therefore, the OSS operating results for the more recent time period should be considered to be a conservative estimate of the ongoing level of OSS margin revenues that should be achievable when Empire's generating fleet returns to more normal operations with the Asbury plant no longer out of service due to an unplanned outage rather than accepting the Staff and Company recommendations which fail to fully reflect the impact that the SPP EIS market is having on Empire's ability to generate increasing levels of OSS margin revenues.
> (Exhibit 317, page 4).

Staff and Empire recommend using the same level of off-system sales margins calculated by Staff witness Dana Eaves in the main phase of the case. Public Counsel addressed the flaws in Staff's approach in Public Counsel's initial brief, and will not rehash them here. But the fairly significant increase in just the two months of the true-up period – despite the extended Asbury outage – shows that Staff's approach continues to underestimate Empire's real ability to achieve off-system sales margins. At the very least, this increase demonstrates that Public Counsel's position in the main phase of the case ($5,955,336 of off-system sales margins) is much more representative than the lower number proposed by Staff and agreed to by Empire.

III. RETURN ON EQUITY

Public Counsel's initial brief addressed this issue in depth, and there was nothing in Empire's initial brief that requires a detailed response. Almost all of Empire's initial brief is focused on getting the Commission to accept Dr. Vander Weide's position. As discussed in Public Counsel's initial brief, the Commission should give little credence to Dr. Vander Weide, and great credence to Mr. Gorman.

IV. DEPRECIATION

Empire, for reasons not disclosed in its brief, chose to completely ignore the testimony of Public Counsel witness Dunkel. Public Counsel hopes that this is not indicative of a strategy to address Public Counsel's position only in the Reply Brief when Public Counsel has no opportunity to respond.

Nonetheless, there are a few points in Empire's brief that bear response. On page 30 of its initial brief, Empire claims that: "The results of Mr. Roff's depreciation study provide a fair and reasonable level of depreciation expense."

But 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)

On pages 26 through 28 of its initial brief, Empire discusses the issue of not changing depreciation rates during the term of a regulatory plan. However the Staff made it very clear that because of the errors and discrepancies in Roff's depreciation study, Staff opposed Mr. Roff's proposed depreciation rates even if there was no issue related to the regulatory plan. As Staff stated:

> Empire's depreciation study utilizes inappropriate methodologies and is not based upon reliable data. Therefore, it is Staff's position that the Commission should not accept the results of Mr. Roff's study even absent Empire's current operation under its regulatory plan." (Staff witness Schad, Rebuttal Testimony page 2, line 16-19)

Public Counsel also opposes Mr. Roff's proposed depreciation rates because of the inconsistent treatments and discrepancies in the Roff Depreciation Study, which are reasons in addition to issues related to the regulatory plan. The problems with Mr. Roff's Study were presented at length in Public Counsel's Initial Brief, and will not be repeated here.

V. RULES TRACKER

Both Staff and Empire recognize that the vegetation management and infrastructure rules provide a utility the opportunity to request deferral and subsequent recovery of incremental cost of compliance with the rules. But they both nonetheless advocate for an entirely different mechanism than the one explicitly provided for in the rules. These rules are brand new, and yet both the Staff and Empire urge the Commission to pass over the cost-recovery mechanism the Commission just created in the rules in favor of a fatally-flawed tracker mechanism. In fact, Empire appears to be revising its proposal even in its brief. (Empire initial brief, page 25). The Commission should not abandon the mechanism it just adopted in its rules for a poorly-developed mechanism.

The main problems with the tracker mechanism are that it is based on estimates (for which there is little support in the record) and that it requires a certain level of expenditure with no evidence that that level is appropriate. Nothing in the briefs of the Staff or Empire counters these problems. Staff, at page 19, refers to a Stipulation and Agreement in AmerenUE's last rate case, despite the explicit prohibition in stipulations and agreements against using them to bind signatories in future cases. Suffice it say that there is no evidence that Public Counsel (or any entity other than AmerenUE) considers the AmerenUE mechanism to be a tracker, nor is there any evidence about what parties in the AmerenUE rate case got in exchange for agreeing to the mechanism in that case.

Empire admits that its estimate of compliance covers a broad range: "Empire believes that it will ultimately incur on average an additional $4 to $6 million per year to comply with the new vegetation management and infrastructure rules." (Empire initial brief, page 21). But then Empire immediately goes on to say that its "proposal is that the annual expenditure be initially set at … $8.9 million on a Missouri jurisdictional basis … for the purpose of developing rates in this case." (Empire initial brief, page 22).

Nothing in its brief or in the record in the case explains where the estimates came from nor why the Commission should find them reliable. Empire states that "Staff has reviewed Empire's estimates and believes that those estimates are reasonable projections of Empire's added costs." (Empire initial brief, page 23-24). But as Public Counsel pointed out in its initial brief, 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) In short, Staff's "review" has no support in the record.

In its brief, Empire attributes a word to Public Counsel witness Robertson that Mr. Robertson did not use in order to mischaracterize his testimony. Empire states, at page 23, Empire argues that "Even Public Counsel witness Robertson believes that Empire will incur some amount of **additional** costs in order to comply with the new Commission rules." (emphasis added). But Mr. Robertson did not say that. What he said was:

> From my reading, my analysis, my audit of the company, what I read about the current vegetation practices and what they will do in the future, **I believe they will incur a certain amount of costs to meet those standard rules**.
>
> Having said that, there's a certain amount of vegetation costs included in rates. Whether they will exceed that amount, that's possible. It's possible they won't. Since it's based on estimates, I can't really tell you what they're going to incur, and I don't think they can either.
>
> (TR. 248; emphasis added).

Mr. Robertson never conceded that Empire would incur **additional** costs. In fact, he made it clear that he did not know whether the costs to comply with the rule will exceed the costs included in rates, and he made it clear that Empire does not know that either. This is a far cry from conceding, as Empire inaccurately alleges, that there will be additional costs.

Empire also discusses normalization. But what it and the Staff propose is not normalization; indeed it is the antithesis of normalization. The following testimony from Staff witness Oligschlaeger explains how normalization is done and not done:

> Q. Is normalization by definition based on historical data?

> A. The way the Staff approaches it, I would agree with that, yes.
>
> Q. Is there another accepted definition of normalization that relies on projected data?
>
> A. I suppose there could be. It's not -- if that's ever been tried in Missouri, it's not tried very often.
>
> Q. So in Missouri at least, the accepted definition of normalization is to use historical data to come up with a -- a normalized number?
>
> A. I would agree with that.
>
> (TR. 406).

Empire asserts that Public Counsel argues that the proposed tracker would eliminate a prudence review. (Empire initial brief, page 25). But what Public Counsel actually said, and Empire does not refute this, is:

> 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)
>
> (Public Counsel initial brief, page 33).

In summary, there is no valid support for Empire's estimates, and even if there were, including estimates of future costs has always been, and should remain, a very rare exception to the ratemaking model and should not be made here. This is particularly true when the Commission has just created a mechanism in its new rules to deal with these exact costs.

VI. FUEL ADJUSTMENT CLAUSE

Empire argues that the Commission ended the Interim Energy Charge (IEC) in its Report and Order in Case Number ER-2006-0315. Public Counsel asserts that the Commission in its Report and Order intended that the IEC would end when the tariffs that implemented and continued the IEC were replaced by the compliance tariffs approved sometime after the Report and Order. So long as those prior tariffs were still in effect, the IEC was still in effect. Empire argues that the Commission terminated the IEC in its Report and Order in ER-2006-0315, and terminated it again in its Report and Order Upon Reconsideration in that case. But Empire doesn't explain why, if it was terminated in the original Report and Order, it was necessary for the Commission to terminate it in the Report and Order Upon Reconsideration. And if the IEC was not terminated until the Report and Order Upon Reconsideration (effective April 5, 2008), then it was still in effect when this case was filed.

Empire argues that Missouri should allow fuel adjustment clauses because other states allow them. (Empire initial brief, pages 31-32) Empire does not explain why this discussion is relevant in light of Senate Bill 179 which authorized the Commission to allow fuel adjustment clauses. No party is arguing that the Commission does not have the authority in this case to allow one.

Empire quotes selectively from the Final Order of Rulemaking in Case Number EX-2006-0472 for the proposition that "prohibiting recovery of a significant portion of Empire's prudently-incurred cost of service will deny the Company its legal right to a reasonable opportunity to earn a fair rate of return." (Empire initial brief, page 39). The entire Comment and Response from the Final Order of Rulemaking states:

> COMMENT: Several lay commenters verbally suggested that it would only be fair for utilities to pass through only 50% of fuel costs and that the utility and its shareholders be required to pay the other 50%.
>
> RESPONSE: These commenters may be confusing the proposal by other commenters that no more than 50% of fuel and purchased power costs be recovered in a RAM and that 50% remain in base rates, a proposal to be discussed more fully below. If not, then the Commission must disagree with this comment in that it would not allow for the setting of just and reasonable rates that allow the utility a reasonable return.

Empire argues that "There is no reason to believe prudence reviews for electric companies will be any less effective [than those for gas companies in Actual Cost Adjustment reviews]." First, there is no evidence that prudence reviews in Actual Cost Adjustment (ACA) cases are in fact effective. Staff witness Mantle testified that she was only aware of one ACA imprudence disallowance, and could not even remember how long ago it occurred. (TR. 708). The only evidence is that Staff proposes adjustments in a certain percentage of cases. There is no evidence that Staff discovers the majority of imprudent actions, nor that the Commission makes adjustments based on Staff's imprudence proposals. But more importantly, there is a great deal of evidence that prudence reviews of electric companies will be orders of magnitude more difficult and time-consuming than those of gas companies, and it is unclear that Staff (much less any other entity) will have the resources to do these prudence reviews. Aquila, Inc. began operating with a fuel adjustment clause after its ER-2007-0004 rate case; those fuel adjustment clause tariffs were approved by an order effective July 5, 2007. Almost a year later, Staff still did not have personnel "looking at the prudence of the purchasing." (TR. 709) The Commission has seven or eight people working full time on reviewing gas purchasing. (TR. 710) Staff witness Mantle testified that the Commission will have only six to review the much-more complicated electric utility prudence issues, and those same six will also review integrated resource planning and nuclear power plant issues as well. (TR. 716). Ms. Mantle testified that there are enormous numbers of decisions made by electric utility operations in every hour of every day, and she was unaware that each of those decisions were adequately documented. (TR. 710-714) All of this testimony goes to the difficulty of adequately reviewing electric utility prudence and the importance of designing a fuel adjustment clause that creates a strong incentive for the utility to make prudent decisions in the first instance. No evidence in the case indicates that a mere 5% stake will provide such an incentive.

WHEREFORE, Public Counsel respectfully offers this Reply/True-up Brief and prays that the Commission conform its decision in this case to the arguments contained herein.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, emailed or hand-delivered to the parties of record this 3rd day of July 2008.

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