

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

In the Matter of the tariff filing of The)	
Empire District Electric Company)	
to implement a general rate increase for)	Case No. ER-2004-0570
retail electric service provided to customers)	
in its Missouri service area)	

**MOTION TO LIFT
SUSPENSION OF IEC TARIFF
AND SUGGESTIONS IN SUPPORT THEREOF**

Comes now The Empire District Electric Company ("Empire" or "Company"), by counsel, and for its Motion to Lift Suspension of IEC Tariff and Suggestions in Support Thereof, respectfully states as follows to the Missouri Public Service Commission ("Commission"):

SUMMARY

On April 30, 2004, Empire filed with the Commission revised tariff sheets designed to implement a general rate increase for retail electric service provided by the Company. The Commission initially suspended all of Empire's tariff sheets for a period of 120 days, plus six months. By this motion Empire requests the Commission to lift the suspension which would otherwise apply to the tariff sheet containing Empire's proposed Interim Energy Charge ("IEC") (Interim Energy Charge Rider, Rider IEC, P.S.C. Mo. No. 5, Section 4, 4th Revised Sheet No. 17, cancelling 3rd Revised Sheet No. 17). Empire asks that the Commission lift the suspension as to the IEC as soon as possible and in any event no later than June 15, 2004.

I. PROCEDURAL BACKGROUND

On April 30, 2004, Empire filed with the Commission proposed tariff sheets designed to implement a general rate increase for retail electric service provided by the Company. The new retail electric service rates are designed to produce an additional \$38,282,294 in gross annual electric revenues excluding gross receipts, sales, franchise, and occupational taxes, a 14.82% increase over existing revenues. Contained within Empire's filing are three separate methods to address increases in fuel and purchased power costs. Those included first, a Fuel and Purchased Power Adjustment Clause ("FAC"); second, an IEC; and third, the twelve-month ending forecast that uses the traditional production cost modeling approach. (Gibson direct testimony, p. 6).¹

The Commission issued its Suspension Order and Notice on May 5, 2004, whereby, among other things, it suspended all the proposed tariff sheets, to include the alternate sheets P.S.C. Mo. No. 5, Section 4, 4th Revised Sheet No. 17, cancelling 3rd Revised Sheet No. 17 (Interim Energy Charge Rider, Rider IEC/or Rider FA), for 120 days until September 27, 2004 (Section 393.150.1, RSMo). The Commission's Order further suspended the tariff sheets an additional six months until March 27, 2005 (Section 393.150.2, RSMo).

Sheet No. 17 was originally filed in the alternative because legislation was under consideration in the Missouri General Assembly that would have authorized a fuel

¹All testimony references are to Empire direct testimony filed in Case No. ER-2004-0570.

adjustment clause. Now that the General Assembly has adjourned without authorizing a fuel adjustment clause, Empire will withdraw the sheet entitled "Fuel Adjustment, Rider FA, P.S.C. Mo. No. 5, Section 4, 4th Revised Sheet No. 17, cancelling 3rd Revised Sheet No. 17." The sheet entitled "Interim Energy Charge Rider, Rider IEC, P.S.C. Mo. No. 5, Section 4, 4th Revised Sheet No. 17, cancelling 3rd Revised Sheet No. 17" will remain at issue, and is the subject of this motion.

II. IMPORTANCE OF NATURAL GAS TO EMPIRE AND ITS CUSTOMERS

Empire has been adding gas-fired electric generation since the mid-1990's. Said capacity additions were consistent with state, regional and national trends given that gas-fired capacity additions were viewed as more friendly to the environment than coal and as requiring less capital at a time of great uncertainty as to the regulatory arena. (Beecher direct testimony, p. 6).

Natural gas is currently the primary fuel source for 704 MW of Empire's 1264 MW of generating capacity. (Id.). Empire burned 6.5 million MMBtu of natural gas in 2003. (Id. at p. 5). Under normalized weather conditions, Empire could easily burn nearly 10 million MMBtu in a year. (Id.). Thus, for purposes of illustration, understating natural gas prices in a rate proceeding by only \$1/MMBtu could cause Empire's shareholders to absorb an approximately \$6.4 million reduction to retained earnings in a year. (Id.). Likewise, overstating natural gas prices by a similar amount would take an extra \$6.4 million out of the pockets of Empire's customers unnecessarily.

III. DEVELOPMENTS IN THE NATURAL GAS MARKET

The concept of a \$1/MMBtu swing in gas prices, one way or the other, is not

novel. Natural gas prices have increased from between \$2-\$3/MMBtu in the mid-1990s to over \$4.50/MMBtu for the majority of 2003. (Beecher direct testimony, p. 7). In 2003 alone, the New York Mercantile Exchange (“NYMEX”) closing prices for January 2003 through December 2003 ranged from a low of \$4.44/MMBtu in October 2003, to a high of \$9.00/MMBtu in March 2003. (Beecher direct testimony, p. 10).

Empire has used hedging strategies (strategies employed to offset price risk) in an attempt to remove volatility for both the Company and its customers. Empire’s Risk Management Policy allows for the utilization of traditional physical purchases, as well as financial tools such as call options, collars, swaps, and futures contracts to protect against adverse price movements. (Beecher direct testimony, p. 8).

In spite of these efforts, Empire’s natural gas expenses continue to rise with the market. Futures prices for the remainder of the year 2004 range from a low of \$5.59 in May 2004 to a high of \$6.12 in December 2004. (Beecher direct testimony, p. 11). These futures prices remain high for 2005, ranging from \$5.28 (May and June 2005) to \$6.26 (January 2005).

IV. LEGAL BASIS FOR THE IEC

Case law establishes that the Commission has the authority to authorize the IEC proposed by Empire. In *State ex rel. Midwest Gas Users’ Association v. Public Service Commission*, 976 S.W.2d 470 (Mo. App. W.D. 1998), the Court of Appeals found the purchased gas adjustment (“PGA”) clause and associated actual cost adjustment (“ACA”) process to be lawful. In doing so, the Court found that the “PSC is not required to treat all items of cost and expense in exactly the same way.” *Id.* at 479.

The Court of Appeals was well aware of an earlier Missouri Supreme Court decision in *State ex rel. Utility Consumers Council, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo. banc 1979) where the court struck down as unlawful a fuel adjustment clause ("FAC") previously utilized by electric utilities. The Court distinguished the PGA/ACA process from the fuel adjustment clause by stating that the FAC clause "was just a formula stuck into the utilities' rate schedules. The companies could substitute new numbers in the formula and begin charging them without PSC oversight or approval. For this reason, as well as because the costs at issue in the FAC in *Utility Consumers Council* were subject to the control of the utilities, and included labor costs and other costs of producing electricity, and because the Court believed that the amount of money spent for fuel might affect the bottom line and could be offset by savings in other areas, the FAC was not approved."

The Court of Appeals found that the PGA/ACA process addressed these concerns. The Court stated as follows:

When the PSC undertakes a general ratemaking proceeding, it considers whether to allow a PGA. The fact that a PGA is part of the rate is taken into consideration by the PSC in setting the rate approved during the rate case. By allowing a PGA, the PSC is necessarily determining that due to the unique nature of gas fuel costs, including the fact that natural gas is a natural resource, not a product which must be produced with labor and materials, the fuel cost component of the rate must be treated differently than other components because it is different. It has therefore provided a mechanism which allows fuel cost increases to be passed on, and fuel cost savings to be passed on, in the amount incurred. As in the case of the FAC, the companies can affect their fuel costs by their choices of where to purchase their fuel. But, unlike the FAC, the PGA is *not* a formula stuck into the posted rates. Rather, the companies must set a specific PGA amount and post it as part of their rates. It is a rate, not a formula; the consumer reviewing it knows exactly what he or she is being charged. The PSC conducts a prudence review of each PGA clause and has

authority to disapprove them initially. The rate and any adjustments to it are again reviewed by the PSC when it conducts a later prudence review of the PGA and of any ACA adjustment. That it would do so was a part of the PSC's rationale in permitting the use of a PGA in the first instance. In these circumstances, we do not believe that the use of a PGA mechanism violates the principle of single-issue ratemaking.

Midwest Gas Users' at p. 480.

The IEC proposed by Empire operates similar to the PGA/ACA process and not like the FAC. The IEC will be taken into account in the setting of Empire's base rates. It addresses the unique nature of gas fuel costs and provides a "a mechanism which allows fuel cost increases to be passed on, and fuel cost savings to be passed on, in the amount incurred." It is not simply a formula stuck into the posted rates. Customers will know exactly what they are being charged. The amounts collected will be subject to annual prudence review. Therefore, the IEC is lawful and the Commission has the authority to approve the use of the IEC should it choose to do so. In fact it has done so on at least two prior occasions, one of which involved Empire.

V. MOTION

By this motion, Empire requests that the Commission lift its suspension of its IEC tariff filed April 30, 2004, and permit said tariff to go into effect on or before June 15, 2004, thereby allowing the Company to recover its actual and prudently incurred costs for fuel and purchased power.

During the first week after Empire filed the tariff sheets which initiated this rate case (between April 30, 2004, and May 7, 2004) gas futures for the next ten months increased \$0.50/MMBtu. As of May 20, 2004, gas futures for the period June through October, 2004, settled at \$6.54/MMBtu. This compares to \$3.30/MMBtu which Empire

believes is embedded in its existing base rates. As indicated above, this volatility in the gas market continues to put Empire at great risk. If the Commission waits the traditional eleven months after Empire's filing to make a decision in this case, significant financial harm can come to Empire during the intervening period.

The Commission is not required to wait eleven months to make a decision as to the tariffs that have been proposed in this case. In fact, the Commission may lift the suspension of the requested tariff at any time with or without a hearing. In *State ex rel. Laclede Gas Co. v. Public Service Commission*, et al., 535 S.W.2d 561 (Mo.App.W.D. 1976), the Missouri Court of Appeals provided support for the Commission's decision to lift a suspension of rate tariffs. The Court stated that the determination as to whether or not to order a suspension rests in the Commission's sound discretion. *Id.* at p. 566. The Court, in reaching this decision, cited for support, among other cases, *State ex rel. Utilities Commission v. Morgan*, 192 S.E.2d 842 (1972), which was said to have been "decided under a file and suspend statute substantially similar to that of Missouri." The Court of Appeals further cited to the Commission's underlying brief which utilized *State ex rel. Utilities Commission v. Morgan*, as well as *City of Pittsburgh v. Pennsylvania Public Utility Commission*, 115 A.2d 858 (1955) for the premise that a commission does not exhaust its powers by suspending a filed rate and, therefore is not precluded from thereafter withdrawing or modifying the suspension. *Id.* at 568, n.2.

To facilitate the implementation of the IEC as requested by this motion, the Commission should order the immediate convening of a technical conference for the purpose of determining the amount of fuel and purchased power costs in Empire's

current base rates,² the true-up and refund procedure³ and any other relevant matters.

Should the Commission deem a hearing to be appropriate, one can be held and concluded prior to June 15, 2004. The matter of an IEC is one with which the Commission is familiar and the “facts” surrounding such a proposal should not be in dispute. The IEC is a proven regulatory tool. It has been implemented successfully in this jurisdiction and protected both customers and shareholders. The only real issue as to Empire’s motion is a policy question: that is, should the Commission, under the circumstances, approve the implementation of an IEC as requested? The Commission should be able to resolve this policy issue in less than a day without the need for any prefiled testimony.

Moving forward in this fashion will ultimately provide protection for both Empire and its customers. The risks to which Empire is exposed by fuel and purchased power price volatility flow equally to its customers. If Empire’s proposed IEC is adopted sooner, rather than later, both constituencies would be provided with a mechanism that would allow the price ultimately paid by Empire’s customers to track the actual cost paid by Empire, whether that cost is increasing or decreasing. In this regard, it has been reported that the Commission’s own Staff has recognized that if the Commission fails to utilize a technique such as the IEC to deal with these costs, it will ultimately be forced to pick one number and one side will be harmed.

²Empire believes that the fuel and purchased power costs embedded in its existing base rates are approximately \$18.09 per megawatt hour (energy only without demand charges).

³If the IEC is allowed to take effect as requested herein. Empire would propose to true-up

WHEREFORE, Empire respectfully moves the Commission to issue its order:

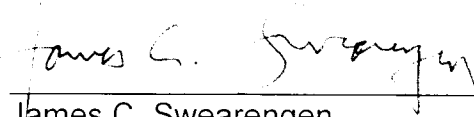
- a) lifting the suspension that would otherwise be applicable to the following tariff sheet and allow it to go into effect on June 15, 2004:

Interim Energy Charge Rider, Rider IEC, P.S.C. Mo. No. 5,
Section 4, 4th Revised Sheet No. 17, cancelling 3rd
Revised Sheet No. 17;

- b) convening an immediate technical conference for the purposes stated herein; and
- c) for such other and further relief as deemed appropriate under the circumstances.

the IEC initially when new rates take effect as a result of this case.

Respectfully submitted,



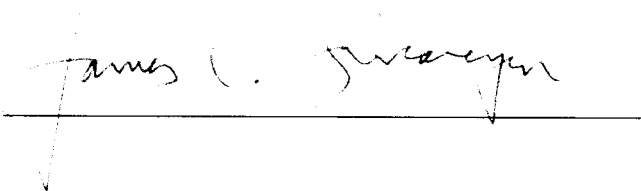
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ATTORNEYS FOR THE EMPIRE DISTRICT ELECTRIC COMPANY

CERTIFICATE OF SERVICE


The undersigned certifies that a copy of the foregoing was, on this 20TH day of May, 2004, sent via electronic mail, U.S. Postage, or hand delivered, to all parties of record.



AFFIDAVIT

State of Missouri)
) ss
County of Jasper)

I, David W. Gibson, having been duly sworn upon my oath, state that I am the Vice President, Regulatory and General Services of The Empire District Electric Company, that I am duly authorized to make this affidavit on behalf of The Empire District Electric Company and that the matters and things stated in the foregoing Motion hereto are true and correct to the best of my information, knowledge and belief.


David W. Gibson

Subscribed and sworn before me this 20th day of May, 2004.


Notary Public

My Commission expires:

02-09-2008

