

Exhibit No.:

*Issues: Stipulation And Agreement
Regarding Fuel and Purchase
Power Expense*

Witness: James C. Watkins

Sponsoring Party: MoPSC Staff

Type of Exhibit: Direct Testimony

Case No.: ER-2001-299

Date Testimony Prepared: May 22, 2001

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

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MAY 22 2001

Missouri Public
Service Commission

**DIRECT TESTIMONY IN SUPPORT OF THE
STIPULATION AND AGREEMENT REGARDING
FUEL AND PURCHASE POWER EXPENSE**

JAMES C. WATKINS

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

*Jefferson City, Missouri
May 2001*

1 **DIRECT TESTIMONY IN SUPPORT OF**
2 **STIPULATION AND AGREEMENT REGARDING**
3 **FUEL AND PURCHASED POWER EXPENSE**
4 **JAMES C. WATKINS**
5 **THE EMPIRE DISTRICT ELECTRIC COMPANY**
6 **CASE NO. ER-2001-299**

7
8 Q. Please state your name and business address.

9 A. My name is James C. Watkins and my business address is Missouri Public
10 Service Commission, 200 Madison Street, P. O. Box 360, Jefferson City, Missouri 65102.

11 Q. Are you the same James C. Watkins who previously filed direct, rebuttal and
12 surrebuttal testimony on the issue of customer class cost of service in this case?

13 A. Yes, I am.

14 Q. Do you have another role in this case?

15 A. Yes. I am one of the Staff's rate case coordinators. Mr. Cary G. Featherstone
16 is the other rate case coordinator assigned to this rate case.

17 Q. What is the purpose of this direct testimony?

18 A. The purpose of my direct testimony in support of the Stipulation And
19 Agreement Regarding Fuel And Purchased Power Expense (Agreement) is to provide the
20 Commission with the Staff's rationale for entering into this agreement and demonstrate
21 that the Commission's approval of the Agreement will result in just and reasonable rates.

22 Q. Do you have any prior experience with the mechanisms involved in the
23 Agreement?

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1 A. Yes. During the mid-80's one of my responsibilities was to forecast fuel
2 prices and determine an appropriate "allowance for forecasted fuel expense" to be
3 included in the revenue requirement of electric utilities, subject to true-up and refund. I
4 was also involved in setting up the mechanics of this process, participating in the true-up
5 audits and monitoring any required refunds.

6 Q. Does the Agreement in this case provide for a similar process?

7 A. Yes. The Agreement is based on a similar process; however, the situation
8 is somewhat different and the process has been refined. During the mid-80's, the concern
9 of the fuel price forecast was to forecast how fast fuel prices would increase. There was
10 little, if any, concern that fuel prices might fall. Today's forecasting concerns are whether
11 natural gas prices will rise or fall and similarly, whether electricity prices in the wholesale
12 market (purchased power prices) will rise or fall. An additional concern regarding the
13 wholesale market is whether price spikes in the wholesale market could occur at a time
14 when, due to forced outages of its generating units, Empire would be required to purchase
15 power at extremely high prices.

16 The Agreement also provides for a true-up and refund process whereby records
17 of each individual customer's payments for the Interim Energy Charge (IEC) are retained
18 and, in the event of a refund, the overcharges to each individual customer are refunded to
19 that customer, plus interest.

20 Q. Why does the Staff believe that it is necessary for the Commission to
21 approve an Interim Energy Charge in this case?

22 A. The Staff believes that the magnitude of the effect on Empire and its
23 customers of guessing wrong as to the future direction of fuel and purchased power costs

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1 makes it necessary to have a mechanism in place to limit this risk. The IEC basically
2 represents the difference between a forecast that fuel and purchased power costs will
3 return to historical levels and a fairly conservative forecast of costs based on recent prices
4 and a continuing upward price trend suggested by futures prices. This difference amounts
5 to approximately \$20 million per year on a Missouri jurisdictional basis. This is roughly
6 equivalent in magnitude to Empire's Missouri unadjusted test-year Net Operating Income
7 before taxes.

8 If rates are set based on historical costs and it turns out that actual costs are at
9 the forecasted level, Empire's entire Net Operating Income for the year could be wiped
10 out and Empire could suffer serious financial results. If, on the other hand, rates are set
11 based on forecasted costs and it turns out that actual costs are actually at historical levels,
12 Empire's Net Operating Income would be doubled and its customers would have been
13 "overcharged" by \$20 million.

14 Q. Why does the Staff believe that approval of the Interim Energy Charge will
15 result in just and reasonable rates?

16 A. Approval of the Interim Energy Charge will result in rates that recover at
17 least the level of costs based on historical prices and at most the level of costs based on a
18 fairly conservative upward forecast of prices. Within this range, the IEC will recover
19 exactly Empire's prudently incurred actual fuel and purchased power costs. Furthermore,
20 this approach shares the burden of the price risk between Empire and its customers in such
21 a way as to greatly reduce the risk to both Empire and its customers.

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1 Q. If the Commission approves the Stipulation And Agreement Regarding
2 Fuel And Purchased Power Expense, will that affect the Commission's resolution of other
3 issues in this case?

4 A. Yes. It will affect the resolution of the Rate Design (distribution of class
5 revenue increases) issue. At the time of filing direct testimony on Class Cost of Service
6 and Rate Design issues, none of the parties anticipated the possibility of the inclusion of an
7 Incremental Energy Charge in the determination of Empire's rates. The parties' positions
8 regarding the rate design treatment of the IEC has now been provided in the parties'
9 surrebuttal testimony and/or position statements.

10 If the Agreement is approved, the portion of the overall revenue requirement
11 associated with the IEC will be collected from each customer class on an equal-cents-per-
12 kWh basis. It will, therefore, be necessary for the Commission to determine how the
13 remaining portion of Empire's revenue requirement, i.e., the non-refundable "base"
14 portion not associated with the IEC, should be collected from ratepayers. The
15 Commission will also need to determine whether the distribution of non-IEC class
16 revenues determined by the Commission should remain in effect on and after October 1,
17 2003, the proposed expiration date of the IEC.

18 Q. What is the Staff's position on the rate design treatment of the IEC?

19 A. The Staff's position is that the Commission should decide the appropriate
20 distribution to customer classes of any increase in Empire's "base rates" (the non-
21 refundable portion of the overall increase in revenues), then approve the IEC to be an
22 additional charge to appear of each rate schedule. Upon the expiration of the IEC, the
23 "base" rates determined by the Commission would remain in effect without need of

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1 adjustment. This position is entirely consistent with the Staff's customer class cost-of-
2 service study methodology and results. It is also entirely consistent with the Staff's
3 recommendations on rate design.

4 Q. If the Commission rejects the Staff's position on Rate Design, will future
5 (October 1, 2003) adjustments to "base" rate levels be required?

6 A. Not necessarily; however, the Commission should be aware that it is only
7 the Staff's (and the Office of the Public Counsel's¹) recommendation that results in the
8 same distribution of "base" revenues to customer classes, both during the period in which
9 the IEC is in effect and after it expires, as it recommended in its prefiled testimony in this
10 case. During the period in which the IEC is in effect, the overall distribution of revenues
11 (including the IEC revenues) will be affected by the equal-cents-per-kWh allocation of the
12 IEC costs.

13 If the Commission adopts Praxair's position that the Commission should only
14 determine the distribution of overall revenues (including the IEC revenues), the resulting
15 distribution of "base" revenues to customer classes will not be as Praxair recommended in
16 its prefiled testimony in this case, either during the period in which the IEC is in effect or
17 after it expires, unless new tariffs reflecting its proposed rate design are put into effect
18 October 1, 2003. Failing to readjust the rate design, effective October 1, 2003, could
19 result in Praxair being the only customer on Empire's system to receive a rate reduction in
20 this case while every other Empire customer receives a rate increase.

¹ Empire's stated position on this issue is that "Empire believes it is appropriate in this case to increase rates to all classes equally." It is not clear to the Staff from this statement whether Empire supports an equal percentage increase to "base" rates.

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1 The nature of the Commission's decisions regarding the appropriate rate design
2 have been made more complicated in this case because, while the parties all initially
3 proposed the distribution of any revenue increase to customer classes based on some
4 percentage of current revenues, the IEC charge is an equal cents-per-kWh charge. An
5 equal cents-per-kWh charge represents a different percentage of current revenues for each
6 class.

7 Q. What is your recommendation to the Commission regarding the Stipulation
8 And Agreement Regarding Fuel And Purchased Power Expense?

9 A. I recommend that the Commission approve the Stipulation And Agreement
10 Regarding Fuel And Purchased Power Expense as the most reasonable resolution of the
11 related issues and as the resolution of the issues most likely to result in just and reasonable
12 rates.

13 Q. Does this conclude your prefled surrebuttal testimony?

14 A. Yes.

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

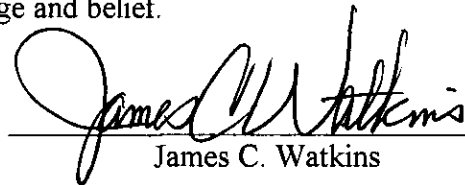
IN THE MATTER OF THE)
APPLICATION OF THE EMPIRE)
DISTRICT ELECTRIC COMPANY FOR)
A GENERAL RATE INCREASE.)

Case No. ER-2001-299

AFFIDAVIT OF JAMES C. WATKINS

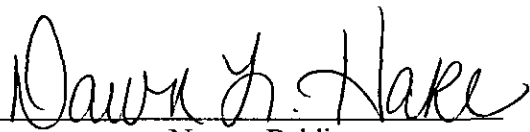
STATE OF MISSOURI)
) ss
COUNTY OF COLE)

James C. Watkins, of lawful age, on his oath states: that he has participated in the preparation of the foregoing written testimony in question and answer form, consisting of 6 pages of testimony to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.


James C. Watkins

Subscribed and sworn to before me this 22nd day of May, 2001.

DAWN L. HAKE
Notary Public - State of Missouri
County of Cole
My Commission Expires Jan 9, 2005


Notary Public

My commission expires _____