

*Exhibit No.:*  
*Issue:* Fuel and Purchased Power  
*Witness:* V. William Harris  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Surrebuttal Testimony  
*Case No.:* ER-2001-299  
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**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**V. WILLIAM HARRIS**

*Exhibit No.* 57  
*Date* 5/29/01 *Case No.* ER-2001-299  
*Reporter* KRM

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

**CASE NO. ER-2001-299**

*Jefferson City, Missouri*  
*May 2001*



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1 include nonrecurring events that are not reasonably expected to occur in a normal year.  
2 An example in this case is that Empire's State Line Unit 2 was shut down much of the  
3 year 2000 while it was being reconfigured to operate as a part of the new State Line  
4 Combined Cycle (SLCC) unit that is expected to be placed in-service in June 2001.  
5 Because rates are set based on what should be expected in a normal year, the Staff adjusts  
6 or normalizes actual test year results so that these nonrecurring events are not reflected in  
7 the new rates. It is not reasonable to expect that normalized test year results will  
8 approximate actual test year results.

9 Q. How does the level of expense for normalized fuel and purchased power  
10 that Empire is recommending compare to the Staff's recommendation in this case?

11 A. As stated by Mr. Sweet on page 2, lines 19 through 21 of his rebuttal  
12 testimony, Empire's position is "approximately \$30 million" over the Staff's  
13 recommendation **as filed in its direct testimony**. As the result of discussions during the  
14 prehearing conference, the Staff's has modified its original recommendation as filed in its  
15 direct testimony. I will discuss this later in my surrebuttal testimony.

16 Q. Did Mr. Beecher make any other statements in his rebuttal testimony that  
17 the Staff disagrees with?

18 A. Yes. In discussing the difference between the Staff's and the Company's  
19 fuel and purchased power expense, Mr. Beecher states on page 18, lines 3-5, "However, a  
20 difference of this magnitude, without any explanation provided by Staff, causes me great  
21 concern." This statement is simply not true. The Staff explained the differences to  
22 Mr. Beecher and other Company representatives in discussions during the prehearing  
23 conference. Many factors, including the SLCC unit and outage assumptions for the Iatan  
24 plant, explain the difference. The most significant differences include:

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1           •       Empire's filing included the SLCC unit that is projected to be  
2                   placed in-service this June. Although it will be a major issue in the Staff's  
3                   true-up case, the Staff did not include the SLCC unit in its direct filing test  
4                   year ended December 31, 2000.

5           •       Empire modeled 64 days of outages at the Iatan plant compared to  
6                   18 days in the Staff's model. The Company agreed that its modeled  
7                   outages for Iatan were too high and that it would adjust them. The Staff  
8                   has seen no evidence to date that any adjustment was made to the  
9                   Company's fuel model. (This continues to be one of the biggest  
10                  differences between Empire's and the Staff's fuel and purchased power  
11                  expense).

12          •       Empire's case did not reflect a contract reduction in the freight rate  
13                  for coal at the Iatan plant that became effective on January 1, 2001  
14                  (reduction of \$1.10 per ton).

15          •       Empire's case did not include two purchased power demand  
16                  contracts that expired on May 31, 2001 and were included in the Staff's  
17                  December 31, 2000 test year.

18          Q.     Do Empire and the Staff continue to have significant differences in the  
19                  fuel and purchased power costs?

20          A.     Yes. However, as a result of the prehearing conference (and discussions  
21                  of the differences) the Company, the Staff and the Office of the Public Counsel (OPC)  
22                  reached an agreement in principle to a process of forecasting fuel and purchased power  
23                  expense. This mechanism will be subject to a true-up to actual costs. Please refer to the  
24                  surrebuttal testimony of Staff witness Cary G. Featherstone.

1 A Stipulation and Agreement filed on May 11, 2001 identifies the agreements  
2 reached through extensive negotiations.

3 Natural Gas Prices

4 Q. On page 18, lines 4-5, Mr. Beecher states that the Staff's "understatement  
5 of predicted costs is particularly disconcerting given the volatility of the natural gas  
6 market." He also states on page 20, lines 10-11, "Given the amount of natural gas  
7 Empire will use, and the volatility of natural gas prices, Empire could very well find itself  
8 in serious financial difficulty." Does the existence of volatility indicate that natural gas  
9 prices are necessarily high?

10 A. No. Volatility shouldn't suggest that natural gas prices are either high or  
11 low. Webster's New World Dictionary defines "*volatile*" as "likely to shift quickly and  
12 unpredictably; unstable; not lasting long; fleeting." Rogets II Thesaurus lists  
13 "*capricious*" as the synonym for "*volatile*" and defines them both as "following no  
14 predictable pattern." It adds the example of "capricious stock-market fluctuations."  
15 Natural gas prices can and do decrease as well as increase. For example, the following  
16 data is from Mr. Kaplan's Schedule SMK-6, *Henry HUB Cash Price and EDE Supply*  
17 *Price*, in his direct filing:

| <u>Date</u> | <u>Henry Hub \$ per MMBtu</u> | <u>EDE \$ per MMBtu</u> |
|-------------|-------------------------------|-------------------------|
| 12/1/96     | \$3.78                        | \$4.60                  |
| 1/1/97      | \$3.47                        | \$4.75                  |
| 2/1/97      | \$2.55                        | \$3.44                  |
| 12/1/97     | \$2.37                        | \$3.15                  |
| 1/1/98      | \$2.10                        | \$3.07                  |

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|   |         |        |        |
|---|---------|--------|--------|
| 1 | 2/1/98  | \$2.17 | \$2.17 |
| 2 |         |        |        |
| 3 | 12/1/98 | \$1.69 | \$2.18 |
| 4 | 1/1/99  | \$1.87 | \$2.46 |
| 5 | 2/1/99  | \$1.78 | \$2.20 |

6 (The above natural gas prices are commodity only and do not include  
7 transportation charges.)

8 Notice that January, February and March prices went down all three years at  
9 Henry Hub and the only price increase for EDE was from \$2.17 on 2/1/98 to \$2.20 on  
10 2/1/99. The fact that natural gas prices were up in the year 2000 (but falling again in  
11 2001) merely supports the up and down fluctuations inherent in a volatile market.

12 Q. On page 4, lines 18-20 of his rebuttal testimony, Mr. Sweet states  
13 "The Staff utilized three-year historical average natural gas prices which, unless natural  
14 gas prices somehow drop dramatically, virtually guarantees that Empire will not recover  
15 its fuel expense." Similarly, on page 16 - lines 22 and 23, Mr. Beecher states "The Staff  
16 thereby assumes the natural gas prices will decrease in the future." Is there any evidence  
17 that natural gas prices have dropped since the Staff's direct filing?

18 A. Yes. In fact, natural gas prices have been decreasing since the beginning  
19 of the year. Mr. Kaplan's Schedule SMK-4 (filed in his rebuttal testimony) shows actual  
20 natural gas prices of \$9.13 in January dropping to \$5.73 in February and dropping again  
21 to \$5.12 in March 2001. OPC witness James A. Busch's rebuttal testimony (page 3,  
22 lines 3 and 4) shows this downward trend continuing with prices of \$5.15 on April 2 and  
23 \$4.85 on May 1. The cash price quoted in the *Wall Street Journal* for Wednesday, May 9  
24 was \$4.15.

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1 Q. On page 16, lines 21 and 22 of his rebuttal testimony, Mr. Beecher states  
2 that the "Staff's fuel run is not representative of the current or future market and is not as  
3 high as recent historical prices." (emphasis added) Do you agree?

4 A. Yes. The Staff does not want to predict unknown future prices (that may  
5 or may not come to pass) and either HIGH or LOW historical prices in a constantly  
6 fluctuating market - that is why Staff uses an average to smooth out fluctuation between  
7 high and low historical prices. It is not the goal in ratemaking to set costs at levels either  
8 too low or too high.

9 On page 8, lines 5 through 8 of his rebuttal testimony, Mr. Kaplan  
10 discusses the Staff's use of three-year average prices to smooth out fluctuations caused by  
11 volatile gas prices and concludes that it is the Staff's objective to reduce volatility.  
12 However, volatility is inherent in the natural gas market and the Staff is not attempting to  
13 reduce or change that fact. What the three-year average does is smooth out high and low  
14 prices resulting from volatility by averaging them.

15 Q. On page 5, line 18 of his rebuttal testimony, Mr. Sweet refers to "real  
16 world experience" and Mr. Beecher discusses historical experience "in the real world" on  
17 page 18, line 23, of his rebuttal testimony. Are these statements consistent with  
18 Mr. Kaplan's approach to natural gas prices?

19 A. No. Mr. Kaplan's approach is to (attempt to) eliminate volatility by only  
20 including high futures prices. If rates are set using high futures prices and actual prices in  
21 the "real world" are much less, then Empire stands to reap the benefit of windfall profits  
22 at the ratepayers' expense. However, the Staff's approach of averaging high and low  
23 historical prices smoothes out these large fluctuations and reduces the risk to both sides.

24 Q. Have natural gas futures prices been falling?

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A. Yes. The following table illustrates how futures strip prices have fallen this year, for the period from the Company's interim filing on February 15 to its rebuttal filing on May 3 to the Staff's review of the rebuttal on May 10:

| Date         | Schedule SMK-3        | Schedule SMK-4         | Wall Street Journal |
|--------------|-----------------------|------------------------|---------------------|
| <u>Mo/Yr</u> | <u>Interim Filing</u> | <u>Rebuttal Filing</u> | <u>May 10</u>       |
| 03/01        | \$5.51                | ----                   | ----                |
| 04/01        | \$5.48                | ----                   | ----                |
| 05/01        | \$5.45                | \$4.55 (cash price)    | \$4.15 (cash price) |
| 06/01        | \$5.46                | \$4.48                 | \$4.20              |
| 07/01        | \$5.48                | \$4.55                 | \$4.27              |
| 08/01        | \$5.50                | \$4.62                 | \$4.34              |
| 09/01        | \$5.47                | \$4.66                 | \$4.37              |
| 10/01        | \$5.48                | \$4.70                 | \$4.40              |
| 11/01        | \$5.56                | \$4.88                 | \$4.57              |
| 12/01        | \$5.66                | \$5.05                 | \$4.75              |

Mr. Beecher (on page 17, lines 1 and 2, of his rebuttal testimony) states that unless prices decrease more than slightly, Empire incurs all the risk under the Staff's approach. Under Mr. Kaplan's approach, using future prices that have since been steadily declining, the ratepayer bears all the risk.

Q. On page 20, lines 7 through 11, of his rebuttal testimony Mr. Beecher states that the Staff "is far from being realistic or fair" in its approach to natural gas costs and is placing Empire at serious financial risk by virtually guaranteeing that Empire will not recover costs. Do you agree?

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1           A.     No, it was never Staff's intention for anyone to incur all the risk. As early  
2 as January of this year, the Staff began developing a plan for use of "forecasted fuel" for  
3 rate purposes and discussed this option with Company personnel in Joplin. The Staff did  
4 not include this in its direct filing because it wanted to discuss this with all parties and  
5 obtain their input (which it did during the prehearing conference). All parties fully  
6 participated in prehearing discussions regarding the concept of truing-up fuel.  
7 Subsequently, the Company, the OPC and the Staff agreed in principle to a stipulation  
8 regarding fuel and purchased power expense, including natural gas prices.

9           Q.     Is there anything else you would like to address relating to Empire's  
10 rebuttal testimony?

11          A.     Yes. Beginning on page 23, line 38, of his rebuttal testimony and  
12 continuing through page 24, line 16, Mr. Beecher launches an attack on the Staff's use of a  
13 three-year average for operation and maintenance (O&M) expenses at Iatan, despite the  
14 fact that Staff changed its position during the prehearing conference to a two-year average  
15 and reflected it in its accounting schedules. Mr. Beecher indicated, at that time, that the  
16 use of a two-year average for Iatan O&M expense was acceptable to Empire.  
17 Accordingly, the Staff was surprised when it read in Mr. Beecher's rebuttal testimony that  
18 Empire still has a disagreement on this issue.

19          Q.     Please summarize.

20          A.     The Company went to great lengths in its rebuttal to discredit the Staff's  
21 direct case knowing full well that the Staff had modified its original position on fuel and  
22 purchased power expense as a result of discussions held during the prehearing  
23 conference. Accordingly, since the Staff's position as filed in its direct testimony no

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1 longer exists for practical purposes, the statements Empire made in rebutting it are  
2 irrelevant.

3 Q. Does this conclude your surrebuttal testimony?

4 A. Yes, it does.

