

*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**

**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*

*Exhibit No.* 27  
*Date* 5/22/01 *Case No.* ER-2001-299  
*Reporter* KRW

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

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's<sup>1</sup>) 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.

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<sup>1</sup> 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 prefiled surrebuttal testimony?

14          A.   Yes.

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

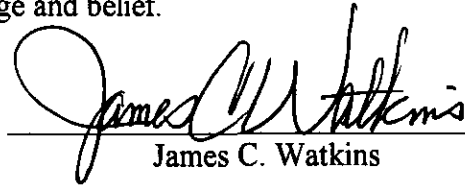
IN THE MATTER OF THE )  
APPLICATION OF THE EMPIRE )  
DISTRICT ELECTRIC COMPANY FOR )  
A GENERAL RATE INCREASE. )

Case No. ER-2001-299

**AFFIDAVIT OF JAMES C. WATKINS**

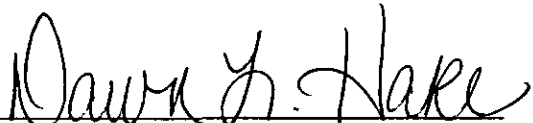
STATE OF MISSOURI     )  
                                  ) ss  
COUNTY OF COLE     )

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 22<sup>nd</sup> day of May, 2001.

DAWN L. HAKE  
Notary Public - State of Missouri  
County of Cole

  
Notary Public

My commission expires My Commission Expires Jan 9, 2005