Exhibit No.:
Issue: Energy Cost Recovery, Fuel and Purchased Power Expense, Off-System Sales
Witness: Ralph C. Smith
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Office of Public Counsel
Case No. ER-2006-0315
Date Testimony Prepared: August 2006

BEFORE THE

PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

SURREBUTTAL TESTIMONY OF

RALPH C. SMITH

ON BEHALF OF

THE OFFICE OF PUBLIC COUNSEL

August 18, 2006

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-2006-0315**

AFFIDAVIT OF RALPH C. SMITH

STATE OF MICHIGAN)
) ss
COUNTY OF WAYNE)

Ralph Smith, of lawful age and being first duly sworn, deposes and states:

1. My name is Ralph C. Smith. I am a Senior Regulatory Consultant at Larkin & Associates. PLLC.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony consisting of pages 1 through 9.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Ralph C. Smith

Ralph C. Smith
Senior Regulatory Consultant

Subscribed and sworn to me this 18th day of August 2006.

Hugh Larkin Jr

Notary Public

HUGH LARKIN JR.
NOTARY PUBLIC WAYNE CO., MI
MY COMMISSION EXPIRES Sep 13, 2007

My commission expires September 13, 2007

TABLE OF CONTENTS

I. INTRODUCTION

Q. Would you please state your name?

A. Ralph C. Smith.

Q. Are you the same Ralph C. Smith that testified previously on behalf on the Office of the Public Counsel (Public Counsel or OPC) in this proceeding?

A. Yes, I am.

Q. Mr. Smith, what areas will you be addressing in your surrebuttal testimony?

A. My surrebuttal testimony will respond to the rebuttal testimony of Empire District Electric Company ("Empire" or "EDE") witness W. Scott Keith concerning off-system sales and EDE witness Todd W. Tarter concerning fuel and purchased power.

II. FUEL AND PURCHASED POWER EXPENSE

Natural Gas Price Assumptions

Q. What test year is being used in this proceeding?

A. The Commission's April 11, 2006 order accepted Empire's recommendation that the test-year be the twelve-month period ending December 31, 2005, adjusted and updated for any known and measurable changes through March 31, 2006. The Order stated the proposed test year is suitable and no party had objected to it. The Commission thus adopted the test year recommendation by Empire, updated and adjusted for known and measurable changes through March 31, 2006.

Q. What update period did EDE use in its rebuttal filing for natural gas costs?

A. Empire appears to have used calendar 2007. Empire witness Todd Tarter's rebuttal testimony at pages 10-11 lists six changes that the Company has made in its new fuel and purchased power model run. Changes 5 and 6 appear to reflect a shifting of the period modeled to calendar 2007. Change 5 indicates that: "the hedged portion of natural gas has been updated to reflect Empire's current July 2006 hedged position <u>for calendar 2007</u>." (Emphasis added.) Change 6 indicates that: "the spot natural gas prices have been updated to reflect the amount needed to physically hedge the remaining expected gas needs <u>for 2007 based on prices from July 10, 2006</u>." (Emphasis added.) Calendar 2007 is significantly outside of the test year update period, which is the 12 months ended March 31, 2006.

Q. What natural gas futures prices were used in EDE's rebuttal filing?

A. EDE appears to have used natural prices as of July 10, 2006. EDE witness Tarter's rebuttal testimony at page 8, lines 18-19 states that: "Empire has updated the natural gas pricing in this run based on information as of July 10, 2006."

Q. Does that address the natural gas price concerns raised in your direct and rebuttal testimony?

A. No. Empire has shifted from using natural gas prices from November 2005 that did not reflect the lower level of gas prices from test year and update period ordered by the Commission to using natural gas prices for periods extending into 2007 that are well beyond the cut-off date ordered by the Commission for updates. This also raises a concern that EDE has gone too far outside of the test year in its 7/28/06 production cost run, and as a result of using a different period, has produced higher overall fuel and purchased power costs than the costs that would result from using model inputs that do not go beyond the end of the update period ordered by the Commission.

Q. Should Empire's fuel cost be further updated to reflect July 10, 2006 NYMEX natural gas price information, as was apparently done in Empire's rebuttal testimony?

A. No. The updates to test year information should be coordinated, and should be consistent through the same date. The date that has been approved by the Commission is for known and measurable changes through March 31, 2006. Because the July 10, 2006 information is beyond that point, I am recommending that the Commission should not allow Empire to update its fuel cost to reflect the July 10, 2006 NYMEX natural gas price information. Empire's update using natural gas prices as of July 10, 2006 should also be rejected because it utilizes gas prices for each of the 12 months in calendar year 2007 which are clearly outside of the test year and update period ordered by the Commission.

Off System Sales Margin

Q. At page 12 of his rebuttal, Mr. Keith claims that "an unusual transaction that took place with AEP" needs to be removed from the five-year average for off-system sales. Please respond.

A. While this individual transaction might have been unusual, the average annual level of off-system sales margin when this transaction is included in computing the average is very close to the actual test year amount and to Empire's test year budget amount for off-system sales margin. Thus, even though an exactly identical transaction has not reoccurred,

(1) the historical level of off system sales margins have remained fairly constant since the AEP contract expired and (2) Empire's budget projections show that the Company expects this trend to continue so both historical and projected data support the use of a normalized level that is in line with what the Commission Staff and I have recommended as being reasonable for purposes of this rate case.

Q. At page 12, Mr. Keith claims that you mischaracterized a transaction as an off-system sale to AEP, when this transaction was a sale by Empire of short-term energy purchased from AEP by Empire, not a sale of capacity or energy to AEP from Empire.

A. I agree with Mr. Keith that the description of the transaction in my direct testimony was incorrect; however, this does not affect my recommendation concerning the normalized amount of off-system sales margin that should be used for purposes of this case. Empire was able to profit from the energy it resold in the wholesale market during the term of that transaction. In Empire's own records, the Company included those margins with its other off-system sales activity.

Q. At page 13 of his rebuttal, Mr. Keith contends that the sale of excess AEP energy off-system "represents the resale of a supply resource to which Empire no longer has access." He also suggests that additional costs need to be applied against the off-system sales margin. Please respond.

A. The purpose of using a five-year average is to obtain a reasonable, representative amount. A utility's supply sources will vary from year to year. The fact that Empire's current supply sources are not exactly identical to the supply sources it had in each of the historical five years used to compute the average does not mean that transactions should be excluded from the average, or that additional costs should be allocated to prior year transactions. Moreover, in Empire's current case, the reasonableness of the results of the straight-forward five-year average, without Empire's tinkering, are corroborated by other Empire data, including the test year amount and Empire's test year budget amount of off-system sales margin. After Empire's proposed alterations to the historical data in the five-year average, the average is no longer representative of current or projected conditions.

Q. At pages 14-15 of his rebuttal, Mr. Keith suggests that fixed charges associated with that AEP contract were never included in Missouri retail cost of service in any manner, but should now be explicitly allocated to and included in the determination of Empire's Missouri retail cost of service by reducing the off-system sales margins reported by Empire in those prior years. Please respond.

A. This analysis and recommendation by Mr. Keith are flawed and should be rejected for two reasons. First, off-system sales margin is measured by the difference between the price realized for the sale of energy and the cost of that energy. For computing off-system sales margin, utility fixed costs, whether related to plant or power purchases are not considered. Consequently, retroactively reallocating annual fluctuations in prior year fixed costs related to utility owned plant assets would not be appropriate, and attempting to retroactively reallocate fixed costs for a purchased power contract is not appropriate either. Any retroactive reallocation of fixed costs to reduce recorded off-system sales margins is inappropriate and should be rejected.

Second, a utility's fixed costs of providing electricity can vary between rate cases, as can its revenues. Mr. Keith's analysis apparently presumes that the rates paid by Empire's Missouri ratepayers do not cover individual elements of the utility's cost of service, such as a power supply contract, unless each change in each element is specifically and explicitly counted in a formal rate case. Thus, under Mr. Keith's apparent analysis and logic, if Empire's fixed charges increased by $1 million in a year for an increase in net utility-owned plant, he would assume that the cost <u>was</u> included in Missouri retail rates since it related to a tangible utility plant asset, but if its fixed charges increased by $1 million in that same year for a new purchased power contract, he would assume that the $1 million for the power contract was <u>never</u> included in the Missouri retail cost of service. I disagree with Mr. Keith's attempt to retroactively reallocate prior year costs in a manner inconsistent with how Empire recorded such costs on its books. Moreover, I find his selective logic to be questionable and believe that a more reasonable assumption would be that the rates paid by Empire's Missouri ratepayers did cover all elements of the utility's cost of service unless it is specifically demonstrated in a formal rate case that the utility's rates for a period selected as a test year do not cover the costs in that period.

Q. What is the objective of the analysis of off-system sales for purposes of this Empire rate case?

A. The objective of the analysis is to identify a reasonable, representative amount that can be used in the derivation of Empire's Missouri jurisdictional revenue requirement. As demonstrated in the following table, which is similar to one presented on page 15 of my direct testimony, my recommended level of off-system sales margin achieves this objective, whereas Empire's revised proposal fails to, and is significantly too low in comparison with (1) Empire's test year actual, (2) Empire's test year budgeted, (3) Empire's 2006 budgeted, and (4) a five-year average of Empire's recorded off-system sales margins:

Off System Sales Margin Comparison

Line	Period	Amount	Reference
1	Test Year Actual	$ 2,800,379	Empire Revenue Adj 15 W/P C1
2	Test Year Budgeted	$ 2,834,106	Empire Revenue Adj 15 W/P C1
3	2006 Budgeted	$ 4,077,839	Response to OPC 5039
4	Five-Year Average ending 9/30/05	$ 2,751,905	Empire Revenue Adj 15 W/P B1
4A	Five-Year Average ending 12/31/05	$ 2,827,911	Rebuttal Schedule RCS-R1
4B	Five-Year Average ending 3/31/06	$ 2,862,416	Rebuttal Schedule RCS-R2
5	Empire proposed (original)	$ 1,478,214	Empire Revenue Adj 15 W/P B1
5A	Empire proposed (revised)	$ 1,552,197	W. Scott Keith rebuttal, p.17
	Empire revised proposed amount in comparison with:		
6	Test Year Actual	$ (1,248,182)	Line 5A - Line 1
7	Test Year Budgeted	$ (1,281,909)	Line 5A - Line 2
8	2006 Budgeted	$ (2,525,642)	Line 5A - Line 3
9	Five-Year Average	$ (1,310,219)	Line 5A - Line 4B

Five Year Average for Period Ended 3/31/06 Compared with:

10	Test Year Actual	$ 62,037	Line 4B - Line 1
11	Test Year Budgeted	$ 28,310	Line 4B - Line 2

Summary of Recommendations

Q. Please summarize the recommendations you have made in your surrebuttal testimony.

A. My surrebuttal testimony recommends the following adjustments to the Missouri jurisdictional revenue requirement requested by Empire in its application and testimony:

- An appropriate normalized amount for off-system sales margin should be used. Public Counsel recommends using a five-year average through March 31, 2006 which results in $2,862,416 of off-system sales margin as shown on line 1 in Schedule RCS-R2, that was attached to my rebuttal testimony. This is $1,310,219 more than EDE's revised amount of $1,552,197. After applying an estimated Missouri retail allocation of 82.21%, the estimated Missouri jurisdictional impact of this adjustment is $1,077,131.

Additionally, I have the following concerns and recommendations concerning the production cost run that was presented in summary results form in Schedule TWT-1 to Empire witness Tarter's July 28, 2006 rebuttal testimony:

- Empire's proposal to revise its fuel cost to reflect July 10, 2006 NYMEX natural gas price information applied to the Company's expected gas needs in calendar 2007 should be rejected because the updates to test year information should be coordinated, and should be consistent through the same date. The date that has been approved by the Commission is for known and measurable changes through March 31, 2006. Because the July 10, 2006 information is beyond that point, at this time, I am recommending that the Commission should not use Empire's proposed fuel cost update to reflect the July 10, 2006 NYMEX natural gas price information when it determines Empire's Missouri jurisdictional revenue requirement in this case.
- The Commission should order the parties presenting fuel model results in testimony to use (1) EDE's actual spot market purchase prices for the first quarter of 2006 and (2)

March 31, 2006 NYMEX natural gas futures prices (less an appropriate basis difference) as the input in their fuel models and to re-run the models using such prices for spot purchases in the respective months.

Q. Does this complete your surrebuttal testimony at this time?

A. Yes, it does.