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February 22, 2001

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FILED³

FEB 22 2001

Missouri Public
Service Commission

RE: Case No. ER-2001-452

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the highly confidential version of **STAFF'S RESPONSE TO COMMISSION ORDER, AND RECOMMENDATION** and one non-proprietary version of the Staff's Response.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Dennis L. Frey
Associate General Counsel
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DLF:ccl
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

NP
FILED³

FEB 22 2001

In the Matter of the Tariff Revisions of)
The Empire District Electric Company)
Designed to Increase Rates on an Interim)
Basis for Electric Service to Customers in)
its Missouri Service Area)

Missouri Public
Service Commission

Case No. ER-2001-452

STAFF'S RESPONSE TO COMMISSION ORDER, AND RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff"), and for its Response to Commission Order and Recommendation, respectfully states as follows:

1. On February 16, 2001, The Empire District Electric Company ("Empire" or "Company") filed with the Missouri Public Service Commission ("Commission") revised tariff sheets along with a Motion for Expedited Treatment and to Implement Tariff Sheets in less than Thirty Days ("Motion") and supporting testimony. The tariff sheets bear an issuance date of February 16, 2001 and an effective date of March 18, 2001.

2. According to the Company's Motion, the impact in Missouri of the requested interim rate increase will be \$16,770,495 for the March-September 2001 period. The tariff sheet filing proposes implementation of the interim increase as a two-step surcharge to customers, one to commence on March 1 and the other on July 1, 2001. The surcharge would be subject to refund pending the Commission's decision in the permanent rate case (ER-2001-299), filed on November 3, 2000, wherein the Company requested a permanent increase of \$41,467,926 on an annual basis. Thus, Empire is seeking to receive approximately 40% of the amount previously

requested, earlier than required by law and with considerably less scrutiny than afforded a traditional rate increase.

3. On February 20, the Commission issued an Order Directing Filing, wherein the Staff was directed to file by February 22, 2001, "a pleading advising the Commission whether it will be able to file its recommendation concerning the tariff filing in time for the Commission to act in accordance with the motion for expedited treatment, and if not, when it will be able to file its recommendation."

4. It is to be noted that Empire is requesting expedited treatment and did not afford the Staff the courtesy of a meeting to advise the Staff of the impending filing, as other utilities have done. Such a meeting would have permitted the Staff to gain a better understanding of the Company's request than has presently been possible. On multiple occasions prior to the filing, Staff accountants, present on site at Empire to perform their audit in connection with the Company's permanent rate increase case, asked whether Empire had any plans to file an interim rate case and were given no indication of the February 16 filing. The Staff first learned that the Company was considering an interim rate increase filing at a meeting with the Company's President/CEO on January 24, 2001. At that time, the indication was that the question would be presented to the Company's Board of Directors and that a decision would be forthcoming within ten days (i.e., on or about February 4th). The Board of Directors met on or about February 1, 2001. Following that meeting, Staff was told that the Board had, in effect, left the question whether to file for an interim rate increase up to Company management. The Staff reiterated its earlier statement that it needed to know as quickly as possible. The first time that the Staff learned of the Company's intention to file its interim rate request was on the day of the filing,

February 16. Empire elected not to give the Staff any advance notice of the specifics of the February 16 filing or that there would be a February 16 filing.

5. Even in the wake of its February 16 filing, Empire has not exhibited the degree of cooperation that would be expected from a party requesting expedited treatment of its request. On February 19, the first business day following the Company's filing, an on-site Staff accountant requested copies of the filing and the supporting work papers. Although the Staff accountant was assured that the information would be produced without the need for a data request, as of noon on February 22, the Staff had not received the work papers, which are essential to its analysis.

6. This matter raises a concern that the Company has created a time frame for Commission and Staff action, and the appearance of a crisis in which the Commission and Staff will not be permitted to conduct the necessary level of review of the Company's filing. is attempting to create a crisis situation in which the Commission/Staff/OPC will overlook and approve requests with significant deficiencies. Although it is recognized that an interim rate filing entails a compressed time frame for analysis, Empire's failure to disclose its impending filing has prevented the Staff from conducting as thorough an analysis of Empire's request as would otherwise have been possible. In his Direct testimony (page 13), filed in support of the Company's request, David W. Gibson, General Manager of Finance and Assistant Secretary at Empire, suggests that "the Commission may want to explore the possibility of using outside auditors in order to assist the Staff in this interim case." Although the statement indicates a recognition that, with the Staff filing date of April 3, 2001, the Company has placed the Commission and the Staff in a time bind, his suggestion is completely unrealistic in light of Empire's requested time frame for implementation. It might also be noted that, under

Commission rules, Empire is not required to respond to data requests in less than 20 days. Even if Staff could have issued its data requests on the day of the subject filing, the Company's track record in this case suggests that the Staff may very well not have received answers until March 8, which is only ten days before the 30-day effective date of the proposed tariff sheets.

7. Empire does not lack for experience in dealing with the Commission and its Staff. The timing of the filing of Empire's interim rate case is very curious. The Staff's Direct testimony is scheduled to be filed in Case No. ER-2001-299 on April 3, 2001. UtiliCorp, Empire's merger partner at the time, filed its request for a natural gas surcharge back on November 2, 2000, and the projected in service date of the State Line Combined Cycle unit was known well before that.

8. For reasons noted above, Staff's response is based on its much accelerated, but very brief review of Empire's filing necessitated by the Company's request for expedited treatment and the recent Commission order of February 20 in this case. The Company has chosen to couch its request as a surcharge designed to address its projected financial condition. Consequently, the Commission should apply the traditional interim rate increase standard for evaluation of Empire's request. In brief, Empire has not presented a set of facts and circumstances that would support a grant of interim rate relief.

9. The Company's Motion states that the relief it seeks does not require the existence of an emergency situation, thereby tacitly admitting that such an emergency does not exist. In State ex rel. Fischer v. Public Serv. Comm'n, 670 S.W.2d 24 (Mo. App. 1984), The Western District Court of Appeals in discussing interim rate increases noted the emergency criteria:

... the Commission's authority to grant an interim rate increase is necessarily implied from the statutory authority granted to enable it to deal with a company in which immediate rate relief is required to maintain the economic life of the company so that it might continue to serve the public.

Id. at 26; emphasis added.

In 1983, the Commission noted that "[t]hat the Commission has traditionally granted interim relief **only** in response to emergency or near emergency conditions." *Re Gas Service Company*, Case No. GR-83-207, 25 Mo.P.S.C.(N.S.) 633, 637 (emphasis added). Thus, the historical standard applied by the Commission since 1949 has consistently required a showing of some emergency or immediate need for rate relief. This standard was first enunciated in a nascent form in *Re Southwestern Bell Telephone Company*, Case No. 11,634, 2 Mo. P.S.C. (N.S.) 131 (June, 1994), but evolved into a more detailed articulation. In addition to *Re Southwestern Bell Telephone Company*, the emergency or immediate need standard has been applied by the Commission in a long line of cases: *Re Sho-Me Power Corporation*, Case No. 17,381 (1972); *Re Union Electric Company*, Case No. 17,965 (1974); *Re Laclede Gas Company*, Case No. 18,021 (1974); *Re Missouri Public Service Company*, Case No. 18,502 (1975); *Re St. Joseph Light & Power Company*, Case No. ER-77-93 (1977); *Re Missouri Public Service Company*, Case No. ER-79-59 (1978); *Re Kansas City Power & Light Company*, Case No. ER-80-204 (1980); *Re: Kansas City Power & Light Company*, ER-81-42 (1981); *Re Missouri Public Service Company*, Case No. ER-81-154 (1981); *Re The Empire District Electric Company*, Case No. ER-81-229 (1981); *Re Missouri Power & Light Company*, Case Nos. GR-81-355 and ER-81-356 (1981); and *Re Sho-Me Power Corporation*, Case No. ER-83-20 (1982).

The standard for interim rate relief was set forth in, among other cases, *Re Missouri Public Service Company*, Case No. 18,502, 20 Mo. P.S.C. (N.S.) 244 (1975). To be eligible, a utility company must show that: (1) it needs the additional funds immediately, (2) that the need

cannot be postponed, and (3) that no other alternatives exist to meet the need but rate relief. "Although the Commission has, on occasion, granted interim rate relief in a nonemergency situation, those instances are few and in response to particular pressing circumstances." *Re Missouri Power & Light Company*, Case Nos. GR-81-355 and ER-81-356 (1981). The instant filing of Empire is not such an occasion. Furthermore, Staff is not aware that the Commission has ever authorized interim rate relief in an electric case, without suspension of the proposed interim tariffs. Indeed, in *Re Gas Service*, Case No. GR-83-207, 25 Mo. P.S.C.(N.S.) 633, 637 (1983), the Commission stated: "[o]rdinarily an interim request results in an expedited hearing and a limited Staff audit." Even an expedited hearing and a limited Staff audit would require suspension of the tariffs.

10. The Staff asserts, based on its partial review of the Company's filing, that the Company has failed to show that it meets any of the three conditions justifying relief set forth above. The Staff has identified a sufficient number of concerns regarding Empire's request that the Staff can affirmatively state that it cannot recommend approval of the requested surcharge tariff to be applied to March 1, 2001 usage. Staff recommends, therefore, that the interim surcharge be suspended and that the Commission issue an order establishing a prehearing conference for the parties to discuss a procedural schedule. Staff's recommendation is based on the following concerns or deficiencies with the Company's request:

- 1) Empire does not meet the Commission's existing interim relief criteria. In particular, Empire's emergency is not based on actual conditions or supported by known data. Actual data indicates that Empire's returns are adequate if not excessive. Empire's "emergency" is largely based on a forecast of future gas prices. Missouri's experience has proven that no one can accurately forecast gas prices, let alone predict gas prices with a reliability to justify an immediate increase in rates. ** _____

_____ ** The projection of Empire's 2001 earnings is highly dependent on the in-service date for the State Line Combined Cycle unit. ** _____

2) Empire has not shown "good cause" for the Commission to approve a rate increase effective March 1, 2001. **

been denied an interim increase in the past with no known significant adverse results. Out of a total of six such past requests, dating back to 1976, only two were granted in part, and none since 1980. Late last year, the Commission denied St. Joseph Light & Power Company's expedited request for an Accounting Authority Order, another decision that has not resulted in the adverse consequences predicted by that utility. In Empire's most recent request for interim rate relief (Case No. ER-97-82), also via the surcharge mechanism and subject to refund pending the outcome in the companion permanent rate increase case (Case No. ER-97-81), the Commission suspended the Company's proposed tariff sheets for 120 days plus an additional month beyond the effective date, and set a procedural schedule.

- 3) Empire's has no emergency financing crisis, and any current problems that do exist are a result of its management decisions. Empire admits that it can finance. Empire has no pending financing cases before the Commission except this request to use its customers as a financing alternative. Empire does have a shelf registration for \$80 million of which only \$50 million has been issued. The Company's capital structure issues related to its debt to equity ratio were created by Empire's actions to reap an expected premium of \$275 million for its shareholders through the proposed merger with UtiliCorp. Empire bought back its preferred stock and agreed not to issue common stock to facilitate the merger with UtiliCorp. These decisions reduced its equity capital, thereby increasing its debt to equity ratio. Empire made these decisions to reduce its capital at a time when it now claims it needs capital to finance additional customer needs. Any additional interest costs caused by Empire's decisions to buy back its preferred stock or issue no additional common stock to accommodate a UtiliCorp merger should not automatically be assumed to be the ratepayers' responsibility. These additional interest costs are possible merger costs to be charged below-the-line, related to Empire's failed attempt to capture the \$275 million premium for its shareholders.
- 4) Empire's surcharge tariff refund provision does not protect its customers from paying for gas costs it does not incur or for a power plant that is not fully operational and used for service. Empire will only refund monies to customers if the Commission ultimately finds an overall permanent rate increase to be less than the monies collected under this rider. This refund provision allows Empire to keep monies for gas costs it did not pay and for

plant that is not fully operational and used for service if it can offset those reductions in costs with increases in its cost of service respecting other items in the permanent rate case. The "fully operational and used for service" criterion of Section 393.135 RSMo raises some legal issues with Empire's surcharge tariff that will need to be evaluated by the Commission. Empire's proposed surcharge allows it to charge for the State Line Combined Cycled unit beginning July 1, 2001 even if the unit is not fully operational and used for service on this date, and to retain the monies so long as the unit is fully operational and used for service before the operation-of-law date in the permanent rate case.

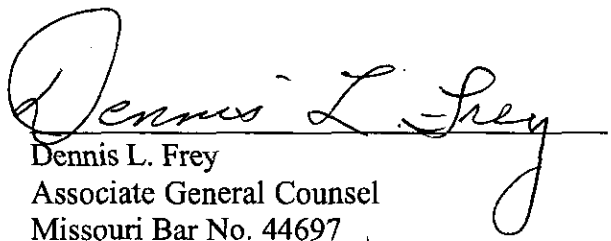
- 5) Empire's interim request reduces its incentive to: 1) purchase gas at the lowest possible price, 2) purchase cheaper purchase power rather than operate its units on gas, and 3) reduce its overall cost of service. Any of these actions will decrease its permanent rate increase request, thereby increasing the risk that Empire will have to make refunds to customers. Empire is motivated to delay any of these actions until after the higher cost levels are permanently built into its rates. After the permanent rate increase occurs, actions by Empire to reduce its costs will result in higher profits for its shareholders at the expense of the higher rates paid by its customers.
- 6) Empire has not reduced its interim request by the cost reductions that it admits it has experienced in salaries and related employee expenses. Empire has not reduced its interim increase to reflect the customer growth that it admits it is experiencing. The Company's request violates the matching principle used to ensure that rates are just and reasonable.
- 7) Empire supports its request by focusing only on the increasing cost of gas and the in-service date of a new power plant, both of which issues may well be disputed in the permanent rate increase case. The Company does not recognize the fact that present rates include salaries for approximately 62 employees that Empire admits are no longer on the Company's payroll. Thus, Empire requests that the Commission hurriedly approve a rate increase for gas costs that it expects to pay without offsetting these unknown costs with actual known cost savings of reduced payroll for employees no longer on its payroll.
- 8) Empire has apparently overstated the cost of its July 1, 2001 surcharge by adding income taxes for the interest component of the rate of return shown on Table 3 of Mr. Gibson's testimony. Income tax expense is only appropriate for the equity component of the rate of return.
- 9) Empire has placed the full responsibility on its Missouri customers to remedy the purported jeopardy to its financial integrity. Empire is presently treating its customers in other states as exempt from its request that its customers pay early for the State Line Combined Cycle unit. Empire's customers in other states are thus being afforded a permanent benefit of not paying for the new unit until Empire chooses to take action in those other states to charge its non-Missouri customers for this new plant.

11. The foregoing is the result of the Staff's accelerated, but very brief review. The Staff anticipates that upon further review, additional issues will be identified and need to be addressed, such as: If the Commission were to grant Empire's interim rate relief request, what is the appropriate interest rate to be applied to any refunds the Company may be required to make once the permanent rate increase case is decided?

WHEREFORE, for the reasons set forth above, the Staff recommends that the Commission deny the Company's Motion that its proposed tariff sheets be authorized to go into effect commencing March 1, 2001, suspend the tariff sheets, and set a prehearing conference for the purpose of recommending a procedural schedule to the Commission.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 22nd day of February 2001.

Dennis L. Frey

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Case No. ER-2001-452
Verified: February 22, 2001 (ccl)

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