REPORT AND ORDER UPON RECONSIDERATION

I. BACKGROUND

A. Procedural History

On February 1, 2006, The Empire District Electric Company ("Empire") filed proposed tariff sheets, Tariff File No. Ye-2006-0597, designed to implement a general rate increase for retail electric service. The matter was opened and denominated ER-2006-0315. The new rates contained therein were designed to produce an additional $29,513,713 in gross annual electric revenues, excluding gross receipts, sales, franchise, and occupational taxes, a 9.63% increase over existing revenues. The tariff sheets proposed an effective date of March 3, 2006.

The Commission issued its Suspension Order and Notice on February 7, 2006, suspending the proposed tariff sheets for 180 days plus six months from the original proposed effective date, that is, until January 1, 2007. In that order, the Commission also set an evidentiary hearing and a deadline for intervention applications. Intervention was granted to Praxair, Inc.~~,~~ and Explorer Pipeline Company ("the Industrials"), Aquila, Inc., Kansas City Power & Light, and the Missouri Department of Natural Resources ("DNR").

On April 11, the Commission adopted a procedural schedule that included dates for the filing of prepared testimony and a briefing schedule. On June 26 and June 27, pursuant to notice provided by the Company through billing inserts, the Commission convened local public hearings within Empire's service territory, at Joplin and Reeds Spring, respectively.

Pursuant to the procedural schedule, the Commission convened an evidentiary hearing on September 7 at its offices in Jefferson City, Missouri. Proceedings continued during that week and during the week of September 15. The true-up portion of the hearing was held on November 20. The Commission heard the testimony of 44 witnesses; 153 exhibits were offered during the hearing, including the pre-filed testimony of the witnesses. Most of those exhibits were admitted, some over objection preserved for appeal, some of which were admitted after a portion was stricken. Some of the exhibits were not admitted, although of some, administrative notice was taken.

Many issues were resolved by the agreement of the parties. On August 18, a Stipulation and Agreement as to Certain Issues was filed and served on the p arties. No party objected and the stipulation was approved by the Commission on August 31. On September 13, a Nonunanimous Stipulation and Agreement Regarding Rate Design Issues was filed. No party objected and the stipulation became unanimous by operation of Commission rule on September 20. Two further stipulations were filed, one concerning corporate allocations and one on regulatory plan amortizations. As timely objections were raised to those two stipulations, by Commission rule the stipulations are reduced to nonbinding position statements and all issues contained therein remain for determination on the merits.

On November 20, at the conclusion of the hearing, with no further briefing or pleadings due, the parties were informed that although no further filings were required, they were welcome to file any supplemental pleading they believed was appropriate. The Industrials availed itself of the opportunity and filed a True-Up Brief on November 27.

On December 21, 2006, the Commission issued a Report and Order in this matter, to be effective December 31, 2006. Empire, the Office of the Public Counsel ("OPC"), and the Industrials each filed an Application for Rehearing with regard to the Report and Order.

On December 28, 2006, Empire filed revised tariffs sheets with a proposed effective date of January 27, 2007, and a motion for expedited treatment requesting approval of the revised tariff sheets to be effective January 1, 2007. Empire stated that the tariff sheets were filed in compliance with the Commission's December 21, 2006 Report and Order. On December 28, 2006, OPC and the Industrials objected to the tariff filing. On December 29, 2006, the Staff of the Commission filed its Staff Recommendation regarding the tariff filing, in which Staff explained that it had reviewed the filed tariff sheets. Staff stated that the tariff sheets were in compliance with the Report and Order, and Staff recommended expedited approval of the tariff sheets, as described in the cover pleading of the Staff Recommendation.

The Commission found those tariff sheets to be an accurate reflection of the revenue increase authorized by the Report and Order, and on December 29, 2006, the Commission issued its Order Granting Expedited Treatment and Approving Tariffs, to be effective December 31, 2006. On January 1, 2007, the Industrials filed an Application for Rehearing with regard to that order.

On January 4, 2007, OPC filed a Petition for Writ of Mandamus with the Missouri Court of Appeals, Western District, seeking to have the Order Granting Expedited Treatment and Approving Tariffs issued by the Commission on December 29, 2006, set aside. On March 12, 2007, the Court of Appeals issued an order denying OPC's petition.

On January 9, 2007, the Commission issued its Order Supplementing and Clarifying Report and Order, to be effective January 19, 2007. Empire, OPC, and the Industrials each filed an Application for Rehearing with regard to the Order Supplementing and Clarifying Report and Order. Thereafter, on January 27, 2007, the Commission issued its Order Setting Conference.

Before this conference could take place, the Industrials filed a Petition for Writ of Review with the Cole County Circuit Court on January 31, 2007. The Circuit Court issued a Writ, but the Commission moved to have the Writ set aside and the case dismissed. Consistent with filings made by the Commission and the Industrials, the case was dismissed by the Court on November 21, 2007.

On March 19, 2007, OPC filed a Petition for Writ of Mandamus with the Missouri Supreme Court seeking an order requiring the Commission to vacate and rescind its December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs and directing the Commission to provide an effective date for any subsequent tariff approval order that allows at least ten days to prepare and file an application for rehearing. On May 1, 2007, the Missouri Supreme Court issued a preliminary writ directing the Commission to respond to OPC's petition. Following briefs and oral argument, on October 30, 2007, the Supreme Court made its preliminary writ peremptory and issued an opinion directing the Commission to vacate its December 29 order and allow the Public Counsel a reasonable time to prepare and file an application for rehearing. The Supreme Court did not examine the lawfulness or reasonableness of the substance of the Commission's December 29, 2006 order, and considered only the timing of the issuance of said order.

On December 4, 2007, the Commission issued an Order Vacating December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, and Order Approving Tariffs, to be effective December 14, 2007. Also on December 4, 2007, the Commission issued a Notice of Correction with regard to the Tariff File Number referenced in the December 4th Order Approving Tariffs. On December 13, 2007, OPC and the Industrials filed Applications for Rehearing regarding the Order Vacating December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, and Order Approving Tariffs. On January 15, 2008, the Commission issued an Order of Clarification regarding the tariff sheets approved by the December 4th Order Approving Tariffs.

The Commission, having reconsidered its Report and Order issued December 21, 2006 and Order Supplementing and Clarifying Report and Order issued January 9, 2007, and, upon due consideration of all issues, review of the record and pleadings herein, and without the admission of additional evidence, issues this Report and Order Upon Reconsideration.

With its December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, the Commission found and concluded that the revised tariffs sheets filed by Empire on December 28, 2006, with a proposed effective date of January 27, 2007, were just and reasonable and were in compliance with the Commission's December 21, 2006 Report and Order. With its December 4, 2007 Order Vacating December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, and Order Approving Tariffs, the Commission found and concluded that said tariff sheets are consistent with the Commission's Report and Order and the January 9, 2007 Order Supplementing and Clarifying Report and Order. This remains the Commission's finding and conclusion. The Commission, having reached the same substantive conclusions herein as in its December 21, 2006 Report and Order, finds and concludes that Empire need not file additional or different tariff sheets to comply with this Report and Order Upon Reconsideration.

B. Previous Agreement Concerning Fuel and Purchased Power Expense

On April 30, 2004, ~~The Empire District Electric Company ("~~Empire~~")~~ filed proposed tariff sheets, Tariff File No. YE-2004-1324, designed to implement a general rate increase for retain electric service. The matter was opened and denominated ER-2004-0570. The proposed rates were designed to produce an additional $38,282,294 in gross annual electric revenues. In partial settlement of that matter, on February 22, 2005, a Nonunanimous Stipulation and Agreement Regarding Fuel and Purchased Power Expense ("2005 Stipulation") was filed and served on the parties. No party objected and the stouplat8ion became unanimous by operation of Commission rule on March 1.[19] As such, it was subsequently approved by the Commission in its Report and Order issued on March 10, 2005.

The 2005 Stipulation purported to resolve the fuel and purchased power expense at issued in ER-2004-04-0570 by agreement to a certain level of recovery of those expenses in Empire's permanent rates, not subject to refund, and recovery of an additional amount of an interim basis, subject to true-up and refund, referred to as the Interim Energy Charge ("IEC"). The IEC was to be in effect for a maximum period of three years, unless earlier terminated by the Commission. The 2005 Stipulation provided:

> The IEC tariff or rate schedule will expire no later than 12:01 a.m. on the date that is three years after the original effective date of the revised tariff sheets authorized by the Commission in this case, Case No. ER-2004-0570, unless earlier terminated by the Commission. (page 4)

and

> In consideration of the implementation of the IEC in this case and the agreement of the Parties to waive their respective rights to judicial review or to otherwise challenge a Commission order in this case authorizing and approving the subject IEC, for the duration of the IEC approved in this case Empire agrees to forego any right it may have to request the use of, or to use, any other procedure or remedy, available under current Missouri statute or subsequently enacted Missouri statute, in the form of a fuel adjustment clause, a natural gas cost recovery mechanism, or other energy related adjustment mechanism to which the Company would otherwise be entitled. (page 12)

[19] The Commission's Staff did file comments in response to the Nonunanimous Stipulation, but expressly stated that these were not objections.

One of the many issues in the present matter is whether the language in the 2005 Stipulation precludes Empire from seeking a different fuel adjustment clause, precludes Empire from seeking to terminate the IEC and recover all of its fuel and purchased power expenses through its permanent rates, or precludes the Commission from terminating the IEC *sua sponte* and including all of the fuel and purchased power expenses in Empire's permanent rates.

On March 24, 2006 in the present matter, Empire requested clarification of the 2005 Stipulation. In its initial filing creating the present case, Empire sought to terminate the ~~use~~ IEC and implement an energy cost recovery rider ("ECR"). Certain other ~~P~~parties asserted that such a request contravened the 2005 Stipulation. Empire asserted that the 2005 Stipulation anticipated the use of the IEC for up to three years, but that it could be terminated at any time during that period by the Commission, contemplating the possibility that the IEC could be terminated early, allowing Empire to avail itself of the newly-created ECR.

After review of the matter, the Commission issued an Order on May 2, 2006 that determined that Empire's position was not supported by the language in the 2005 Stipulation and that Empire is precluded from requesting the use of another fuel adjustment mechanism during the period in which the IEC is in effect, but may have the option of requesting that the IEC be terminated. The Commission required that Empire remove from its pleadings and other filings in this matter any request, or testimony in support of a request, for an ECR. Empire did not seek rehearing of that Order, but did not remove the precluded language. On May 26, 2006, ~~Praxair, Inc., and Explorer Pipeline, Inc. ("T~~the Industrials~~"),~~

filed a Motion to Reject Specified Tariff Sheets and Strike Testimony seeking to strike not only the precluded language, but also language pertaining to termination of the IEC and inclusion of the associated expenses in permanent rates. On June 1, 2~~6~~006, Empire conceded that it ~~should~~ would strike the precluded language but not the additional language the Industrials sought to have stricken. The commission, by Order issued June 15, 2006 rejected tariffs and struck testimony pertaining to the ECR, but not that pertaining to termination of the IEC and inclusion of the associated expenses in permanent rates.

II. DISCUSSION

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.[20]

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[20] In making its Findings of Fact and Conclusions of Law, the Commission is mindful that it is required, after a hearing, to "make a report in writing in respect thereto, which shall state the conclusion of the commission, together with its decision, order or requirement in the premises." Section 386.420.2, RSMo 2000. Because Section 386.420 does not explain what constitutes adequate findings of fact, Missouri courts have turned to Section 536.090, which applies to "every decision and order in a contested case," to fill in the gaps of Section 386.420. *St ex rel. Laclede Gas Co. v. Pub. Serv. Comm'n. of Missouri.,* 103 S.W.3d 813, 816 (Mo.App., W.D. 2003); *St. ex rel. Noranda Aluminum, Inc. v. Pub. Serv. Comm'n.,* 24 S.W.3d 243, 245 (Mo. App., W.D. 2000). Section 536.090 provides, in pertinent part: Every decision and order in a contested case shall be in writing and…the decision…shall include or be accompanied by findings of fact and conclusions of law. The findings of fact shall be stated separately from the conclusions of law and shall include a concise statement of the findings on which the agency bases its order.

A. Jurisdiction

The record shows that Empire operates generation plants for the purpose of generating electricity for sale at retail. The Commission concludes that Empire is thus an electrical corporation within the intendments of Section 386.020(15) and a public utility pursuant to Section 386.020(42), RSMo Supp. 2005.[21] The Commission thus has jurisdiction over Empire's services, activities, and rates pursuant to Sections 386.020(42), 386.250 and Chapter 393.

B. Burden of Proof

Section 393.150.02 provides in part, "At any hearing involving rate sought to be increased, the burden of proof to who that the increased rate or proposed increased rate is just and reasonable shall be upon the…electrical corporation…and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

C. Ratemaking Standards and Practices

Missouri courts have not ad opted a bright-line standard for determining the adequacy of findings of fact. *Glasnapp v. State Banking Bd.,* 545 S.W.2d 382, 387 (Mo.App 1976). Nonetheless, the following formulation is often cited: The most reasonable and practical standard is to require that the findings of fact be sufficiently definite and certain or specific under the circumstances of the particular case to enable the court to review the decision intelligently and ascertain if the facts afford a reasonable basis for the order without resorting to the evidence. *Id. (quoting* 2 Am.Jur.2d Administrative Law § 455, at 268).

Findings of fact are inadequate when they "leave the reviewing court to speculate as to what part of the evidence the [Commission] believed and found to be true and what part it rejected." *St. ex rel. Int'l. Telecharge, Inc. v. Mo. Pub. Serv. Comm'n.,* 680, 684 (Mo.App., W.D. 1991)(quoting *St. ex rel Am. Tel. & Tel. Co. v. Pub. Serv. Comm'n.* 701 S.W.2d 745, 754 (Mo.App., W.D. 1985). Findings of fact are also inadequate that "provide no insight into how controlling issues were resolved" or that are "completely concubinary." *St. ex rel. Monsanto Co. v. Pub. Serv. Comm'n,* 716 S.W.2d 791, 795 (Mo. banc 1986) (relying on *St. ex rel. Rice v. Pub. Serv. Comm'n*, 359 Mo. 109, 220 S.W.2d 61 (1949).

[21] Unless otherwise specified, all statutory references are to the Revised Statutes of Missouri) RSMo), revision of 2000.

The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,[22] subject to judicial review of the question of reasonableness.[23] A "just and reasonable" rate is one that is fair to both the utility and is customers;[24] it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and]…to insure to the investors a reasonable return upon funds invested."[25] In 1925, the Missouri Supreme Court stated.[26]

> The enactment of the Public Service Act marked a new era in the history of pubic utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested.*** These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.[27] "[T]he dominant thought and purpose of the policy is the protection of the public … [and] the protection given the utility is

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[22] Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or y other of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

[23] St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri, 291 Mo. 432, 236 S.W. 852 (1922); City of Fulton v. Pub. Serv. Comm'n, 275 Mo. 67, 204 S.W. 386 (1918); *error dis'd*, 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; City of St. Louis v. Pub. Serv. Comm'n of Missouri, 276 Mo. 509, 207 S.W. 799 (1919); Kansas City v. Pub. Serv. Comm'n of Missouri, 276 Mo. 539, 210 S.W.381 (1919), *err dis'd*, 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; Lightfoot v. City of Springfield, 361 Mo. 659, 236 S.W.2d 348 (1951).

[24] St. ex rel. Valley Sewage co. v. Pub. Serv. Comm'n, 515 S.W.2d 845 (Mo.App., K.C.D. 1974).

[25] St. ex rel. Washington University et al. v. Pub. Serv. Comm'n. 308 Mo. 328, 344-45, 272 S.W. 291, 973 (banc 1925)

[26] *Id.*

[27] May Dep't Stores Co. v. Union Elec. Light & Power Co., 341 Mo. 299, 107 S.W.2d 41,48 (1937).

merely incidental."[28] However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.[29] "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."[30]

The Commission has exclusive jurisdiction to establish public utility rates,[31] and the rates it sets have the force and effect of law.[32] A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;[33] neither can a public utility change its rates without first seeking authority from the Commission.[34] A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.[35] Thus, "[r]atemaking is a balancing process."[36]

Ratemaking involves two successive processes:[37] first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a

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28 St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n, 179 S.W.2d 123, 126 (1944).

29 St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n, 585 S.W.2d 41, 49 (Mo. banc 1979).

30 St. ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 886 (Mo. App., W.D. 1981).

31 May Dep't Stores, supra, 107 S.W.2d at 57.

32 Utility Consumers Council, supra, 585 S.W.2d at 49.

33 *Id.*

34 Deaconess Manor Ass'n v. Pub. Serv. Comm'n, 994 S.W.2d 602, 610 (Mo. App., W.D. 1999).

35 May Dep't Stores, supra 107 S.W.2d at 50.

36 St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, 765 S.W.2d 618, 622 (Mo. App., W.D. 1988).

37 It is worth noting here that Missouri recognizes two distinct ratemaking methods: the "file-and-suspend" method and the complaint method. The former is initiated when a utility files a tariff implementing a general rate increase and the second by the filing of a complaint alleging that the subject utility's rates are not just and reasonable. See Utility Consumers Council, supra, 585 S.W.2d at 48-49; St. ex rel. Jackson County v. Pub. Serv. Comm'n, 532 S.W.2d 20, 28-29 (Mo. banc 1975), *cert. denied,* 429 U.S. 822, 50 L.Ed.2d 84, 97 S.Ct. 73 (1976).

reasonable rate of return to the investors.[38] The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers. Revenue requirement is usually established based upon a historical test year that focuses on four factors:[39] (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses.[40] The calculation of revenue requirement from these four factors is expressed in the following formula:

$$\mathbf{RR = C + (V - D)\,R}$$

where:
RR = Revenue Requirement;
C = Prudent Operating Costs, including Depreciation Expense and Taxes;
V = Gross Value of Utility Plant in Service;
D = Accumulated Depreciation; and
R = Overall Rate of Return or Weighted Cost of Capital.

The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.[41] The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. Section 393.140(4) authorizes the Commission to prescribe uniform

[38] St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n, 850 S.W.2d 903, 916 n. 1 (Mo. App., W.D. 1993).
[39] In the present case, the test year was established as the twelve months ending December 31, 2003, updated for known and measurable changes through June 30, 2004. In the Matter of the Tariff Filing of the Empire District Electric Company to Implement a General Rate Increase for Retail Electric Service to Customers in its Missouri Service Area, Case No. ER-2004-0570 (Order Concerning Test Year and True-up, and Adopting Procedural Schedule, issued June 17, 2004) at 7.
[40] *Id., citing* Colton, "Excess Capacity: Who Gets the Charge From the Power Plant?," 34 Hastings L.J. 1133, 1134 & 1149-50 (1983).
[41] See St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n, supra.

methods of accounting for utilities and Section 393.140(8) authorizes the Commission to examine a utility's books and records and, after hearing, to determine the accounting treatment of any particular transaction. In this way, the Commission can determine the utility's prudent operating costs. Section 393.230 authorizes the Commission to value the property of electric utilities operating in Missouri, that is, to determine the rate base.[42] Section 393.240 authorizes the Commission to set depreciation rates and to adjust a utility's depreciation reserve from time-to-time as may be necessary.

The Revenue Requirement is the sum to two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a Rate of Return. For any utility, its fair Rate of Return is simply its composite cost of capital. The composite cost of capital is the sum of the weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical costs; however, in the case of Common Equity, the cost used is its estimated cost.

Based on the detailed findings set forth below in this Report and Order Upon Reconsideration, the Commission concludes that Empire has a revenue deficiency. Further, as illustrated by the Commission's findings and conclusions on individual issues, all as set out below, the Commission finds and concludes that Empire should be authorized an additional $27,709,820 in traditional

[42] Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."

revenue requirement (including the IEC), in addition to $10,469,228 for regulatory plan amortizations, for a total of $38,179,048 additional revenue requirement. With regard to the net rate increase to Empire's customers, however, the traditional revenue requirement needs to be reduced by the true-up value of the IEC ($8,809,651).[43] Accordingly, and based on the Commission's findings in this case, the Commission concludes that tariffs designed to increase Empire's total electric revenues by $29,369,397 are just and reasonable. As Empire's tariffs filed with the Commission on December 28, 2006 are designed to produce an increase in Empire's gross annual electric revenues of $29,369,397 ($27,709,820 - $8,809,651 + $10,469,228), Empire is not directed to file additional or different tariff sheets in response to this Report and Order Upon Reconsideration.

D. Overview

1. The Parties

The Empire District Electric Company is a publicly-traded Kansas corporation, headquartered in Joplin, Missouri. Empire provides retail electric service in Missouri, Kansas, Arkansas, and Oklahoma; retail water service in Missouri; and is also certificated to provide telecommunication services in Missouri. In addition, Empire recently acquired Aquila, Inc.'s natural gas distribution operations in Missouri. On April 18, 2006, the Commission issued an order approving that transaction; on June 15 it recognized the adoption of Aquila's relevant tariffs.

[43] See Oligschlaeger True Up Testimony, p. 10; Staff Recommendation and accompanying Memorandum filed on December 29, 2006.

Intervenor Praxair, Inc., produces compressed gases at a plant near Neosho, Missouri, within Empire's service territory. Praxair is served under interruptible rates, which means that service to Praxair can be reduced on short notice, making more power available to Empire to serve other customers.

Intervenor Explorer Pipeline, Inc., operates a refined petroleum products pipeline stretching from the coast of the Gulf of Mexico to the Chicago area, with various truck terminals along that route. Explorer uses electric compressors to move its products through the pipeline and has three compressor stations within Empire's service territory.

Intervenor Kansas City Power & Light is a regulated electric and gas utility that operates in Missouri and elsewhere.

Intervenor Aquila, Inc. is a regulated electric and gas utility that operates in Missouri and elsewhere.

The Missouri Department of Natural Resources ("DNR") is an executive branch department authorized and established by Chapter 640, RSMo. Sections 640.150 through 640.185 charge the Department with certain responsibilities with respect to energy.

The Public Counsel ("OPC") is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"[44]

The Staff of the Commission traditionally appears as a party in Commission proceedings and is represented by the Commission's General

[44] Sections 386.700 and 386.710.

Counsel, an employee of the Commission authorized by statute to "represent and appear for the Commission in all actions and proceedings involving this or any other law [involving the Commission.]"[45]

2. Empire's Proposed General Rate Increase

As filed, Empire's proposed tariffs sought additional gross annual Missouri jurisdictional revenue of approximately $29.5 million annually, a 9.63% increase.

3. Empire's Operations

Empire provides electric service in an area of about 10,000 square miles in Southwest Missouri and the adjacent areas of Arkansas, Kansas and Oklahoma. As of September 30, 2005, Empire had 135,222 residential electric customers, 23,773 commercial customers, 366 industrial customers, 1,861 public authority customers, and 4 wholesale customers in 121 communities in 20 counties. Most of these communities are small; the largest is Joplin, with about 45,500 inhabitants at the end of 2004.

About 88.8% of Empire's 2005 retail electric revenues are derived from Missouri. In Missouri, as of September 30, 2005, Empire had 118,631 residential customers, 20,968 commercial customers, 294 industrial customers, 1,503 public authority customers, and 3 wholesale customers.

E. The Issues

As required by the procedural schedule, the parties jointly filed a list of issues to be determined by the Commission. Each party also filed a statement of its position with respect to each issue. In setting out the issues developed by the parties and the parties' stated positions on those issues, the Commission seeks

[45] Section 386.071.

only to inform the reader of these under the applicable statutes and rules. Those issues as formulated by the parties are fully recited at the beginning of the discussion of each issue, set forth below. [46]

1. Return on Common Equity: What return on common equity should be used for determining Empire's rate of return?

The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.[47] The United States Supreme Court, in two frequently-cited decisions, has established the constitutional parameters that must guide the Commission in its task.[48] In the earlier of these cases, Bluefield Water Works, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[49]

In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be

[46] Only the issues and sub-issues not resolved by the two unanimous stipulations are shown. The numbering of the issues is unchanged from the original list, except that an issue which arose during the true-up period has been added to the list and is addressed herein. ~~The parties' positions on the issues are discussed, to the extent necessary, elsewhere in this order.~~

[47] Phillips, The Regulation of Public Utilities, *supra*, 394; Goodman, 1 The Process of Ratemaking, *supra* 606.

[48] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield Water Works & Improv. Co. v. Pub. Serv., Comm'n of West Virginia, 262 U.S. 679, 43 S. Ct. 675, 67 L.Ed. 1176 (1923).

[49] Bluefield, supra, 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

> reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[50]

The Court restated these principles in Hope Natural Gas Company, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[51]

Two principal methods have emerged for determining the cost of Common Equity: these are the "market-determined" approach and the "comparable earnings" approach.[52] The market-determined approach relies upon stock market transactions and estimates of investor expectations.[53] Examples of market-determined methods are the discounted cash flow ("DCF") and the capital asset pricing model ("CAPM").[54] The comparative earnings approach relies upon the concept of "opportunity cost," that is, the return the investment would have earned in the next best alternative use.[55] The comparative earnings approach requires a comparative study of earnings on common equity in enterprises of

[50] Id., 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.
[51] Hope Nat. Gas Co., *supra*, 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).
[52] Phillips, *supra*, 394.
[53] Id.
[54] Id.
[55] Id., at 397.

similar risk, regardless of whether the enterprises are regulated or unregulated.[56] A method that was used by Empire witness Vander Weide, and which does not fall within the boundaries of either of the principal approaches referred to above, is the Risk Premium method. This method is "relatively straightforward" and requires that the analyst "(1) determine the historic spread between the return on debt and the return on common equity, and (2) add this risk premium to the current debt yield to derive an approximation of current equity return requirements."[57] In the final analysis, it is not the method employed, but the result reached, that is important.[58] The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[59]

The annual form of the DCF method of calculating a fair return on common equity can be expressed algebraically by this equation:

$$k = D_1/P_S + g$$

where: k is the cost of equity;
g is the constant annual growth rate of earnings, dividends and book value per share;
D_1 is the expected next period annual dividend; and
P_S is the current price of the stock.

Assuming that dividends grow at a constant annual rate, g, this equation can be solved for k, the cost of equity. The term D1/PS is called the dividend

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[56] Id., at 397-98.
[57] Id., at 399.
[58] Within a wide range of discretion the Commission may select the methodology. Missouri Gas Energy v. Public Service Comm'n, 978 S.W.2d 434 (Mo. App., W.D. 1998), rehearing and/or transfer denied; State ex rel. Associated Natural Gas Co. v. Public Service Commission, 706 S.W.2d 870, 880, 882 (Mo. App., W.D. 1985); State ex rel. Missouri Public Service Co. v. Fraas, 627 S.W.2d 882, 888 (Mo. App., W.D. 1981). It may select a combination of methodologies. State ex rel. City of Lake Lotawana v. Public Service Comm'n of State, 732 S.W.2d 191, 194 (Mo. App., W.D. 1987).
[59] Fed. Power Comm'n v. Nat. Gas Pipeline Co., 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

yield component of the annual DCF model, and the term g is called the growth component of the annual DCF model. The annual DCF model is only a correct expression for the present discounted value of future dividends if the dividends are paid annually. The quarterly DCF model differs from the annual DCF model in that it expresses a company's price as the present discounted value of a quarterly stream of dividend payments. The quarterly DCF equation shows that the cost of equity is: the sum of the future expected dividend yield and the growth rate, where the dividend in the dividend yield is the equivalent future value of the four quarterly dividends at the end of the year, and the growth rate is the expected growth in dividends or earnings per share.[60]

The CAPM describes the relationship between a security's investment risk and its market rate of return. This relationship identifies the rate of return that investors expect a security to earn so that its market return is comparable with the market returns earned by other securities that have similar risk. The general form of the CAPM is as follows:

$$\mathbf{k = Rf + \beta\ (Rm - Rf)}$$

where:
k = the expected return on equity for a specific security;
Rf = the risk-free rate;
β = beta; and
Rm - Rf = the market risk premium.[61]

The "Risk Premium Method" is based on the principle that investors expect to earn a return on an equity investment in Empire that reflects a "premium" over and above the return they expect to earn on an investment in a

[60] Vander Weide Direct at 20-23.
[61] King Direct at 20.

portfolio of bonds. This equity risk premium compensates equity investors for the additional risk they bear in making equity investments instead of bond investments. The formula for the ex ante risk premium calculation is as follows:

$$RP_{PROXY} = DCF_{PROXY} - I_A$$

Where: RP_{PROXY} = the required risk premium on an equity investment in the proxy group of companies, DCFPROXY = a average DCF cost of equity on a portfolio of proxy companies, and

I_A = the yield to maturity on an investment in A-rated utility bonds.

Empire is a publicly-traded utility. Empire's consolidated common equity ratio has ranged from a high of 48.02% to a low of 37.26% from 2001 through 2005. During the past five years, Empire's average return on common equity ("ROE") has been fairly low. Although Empire's ROE was above 8% in 2001 and 2002, since then it has been 6% or lower. Empire's corporate credit rating by Standard & Poor's was downgraded, on May 16, 2006, from BBB to BBB-, the lowest investment grade rating, although it does give Empire a "stable" outlook. Further, it removed Empire from a negative credit watch on February 13, 2006.[62]

The industry national average ROE for electric utilities in 1st Quarter 2006 was 10.57%, and 10.55% for the year 2005.[63] Empire's ROE was 6.04% for 2005.[64] Empire's ROE is expected by analysts to be 6.5% for 2006. Since 2001, Empire has paid out virtually all of its earnings as dividends, dipping below 100%

[62] Murray Direct at 13-14.
[63] Murray Direct at 32.
[64] Murray Direct at 14-15.

only once in the past five years.[65] Empire's 2005 Annual Report, filed with the Commission as required by statute, states that Empire's total operating revenues were $386,160,000 for the 12 months ended December 31, 2005, versus $325,540,000 for the 12 months ended December 31, 2004. These 2005 revenues resulted in an overall net income applicable to common stock of $23,768,000 for an earnings per share of $0.92 as compared to the 2004 net income applicable to common stock of $21,848,000 for an earnings per share of $0.86. These revenues and net incomes were generated from total property, plant and equipment of $896,033,000 at December 31, 2005 and $857,035,000 at December 31, 2004. [66]

James Vander Weide is a Research Professor at Duke University who testifies in this matter on behalf of Empire. Charles King is an economic consultant who testifies in this matter on behalf of OPC. David Murray is a Utility Regulatory Auditor III who testifies in this matter on as a member of the Staff. All three are experienced in testifying and are experts in the area of regulatory economics.

Vander Weide estimated Empire's cost of equity in two steps. First, he applied the quarterly DCF method yielding a result of10.9%; the risk premium method (both the ex ante and ex post methods) which yielded results of 11 % and 11.4% respectively;[67] and the CAPM yielding a result of12.2% to a proxy group of comparable companies, including 34 electric utilities and 13 gas utilities, for a total of 47 companies, and determined that the average cost of equity for his

[65] Murray Direct at 15.
[66] Murray Direct at 13.
[67] Vander Weide Rebuttal at 43.

proxy companies was 11.3%.[68] Second, he adjusted the average cost of equity for the proxy group for the difference in the financial risk implied by the capital structure of Empire[69] by adding 40 basis points to the result to reach his recommendation of 11.7%.[70]

King used the DCF method, applying it to two groups of comparison companies. The first group consisted of 16 electric companies that derive over 75% of their revenue from regulated utility service, noting that Empire generated 93.2% of its 2005 revenue from such services.[71] The second group consisted of those plus 10 additional companies that derive a significant portion of their revenue from unregulated activities. As a check, King calculated Empire's cost of common equity using the CAPM analysis, producing a 9.85% ROE.[72] Using the classic DCF method, King's analyses produced results of 9.65% for the first group, 10.09% for the second group and 10.57% for Empire itself.[73] Based on his conviction that the DCF for the first g group, whose derivation of revenue is most closely aligned with Empire's, was the more appropriate conclusion, King gives 9.65% as his final recommendation.[74]

Murray primarily relied on a comparable-companies method to determine the cost of common equity for Empire. He first relied on the Standard & Poor's list of vertically-integrated electric utilities, of which there are eleven, including Empire. He then applied additional criteria to narrow the group to six, including

[68] Vander Weide Direct at 49.
[69] Vander Weide Direct at 50.
[70] Vander Weide Direct at 51.
[71] King Direct at 6.
[72] King Direct at 23.
[73] King Direct at 15.
[74] King Direct at 27-28.

Empire. He then treated the five remaining comparables as a group. Using the DCF method, and after compensation for growth volatility, Murray arrived at a range of 9.0% - 9.3% for the proxy group of comparable companies. Murray also used the CAPM analysis to check the reasonableness of his DCF results. Using three different variables in the risk premium value in the CAPM formula, the resulting ROEs for the proxy group were 6.24%, 8.98% and 10.26%. Using forward-looking risk premium inputs yielded 7.39% - 8.79% ROEs for the proxy group. Finally, Murray selected a group of four comparable companies and applied the DCF method and the CAPM to them to further test the reasonableness of his company-specific DCF result. Using the comparable company analysis, giving “considerable deference” to the projected earnings per share growth rates and adding ten basis points for every notch of credit rating differential from the comparable company average of BBB+, Murray recommended an ROE for Empire of 9.2% - 9.5%. In his rebuttal testimony, Murray revised the growth rate and dividend yield, resulting in a revised recommendation of 9.5% - 9.6%.[75]

Determining ROE “is an area of ratemaking in which agencies welcome expert testimony and yet must often make difficult choices between conflicting testimony.[76] The experts did not agree in their recommendations or in the methods used to reach those recommendations, although they used the same formulae and performed similar analyses. Vander Weide and King both began with DCF approaches, and both then used a CAPM analysis. King used it as a

[75] Murray Rebuttal at 3.
[76] Goodman, 1The Process of Ratemaking, *supra*, 606.

check on his DVF analysis, Vander Weide as a second computational method from which to derive an average; he then went on to apply two risk premium analyses. Murray started with a comparable companies approach, then applied the DCF and CAPM analyses to his group of companies. Their methods were similar; the difference in results is derived mainly from the comparable companies that formed the "proxy group." Vander Weide's consisted of 47 regulated energy utilities; King's consisted of 16 regulated electric utilities that derive over 75% of their revenue from retail electric service; Murray's consisted of 5 comparable, vertically-integrated, regulated energy utilities.

Each of the expert witnesses used a comparative analytical strategy in which Empire's cost of common equity was determined by examining a proxy group of regulated utilities selected on the basis of comparable investment risk. They each selected a sample that they believed had "comparable risk" They all went on to use other analytical tools to check the reasonableness of their results. In addition, Vander Weide performed an additional risk assessment and added 40 basis points to his calculated return.

All of the three analysts performed the sort of risk-based, comparative analysis required by Hope and Bluefield. All three analysis yielded results that, at least initially, fall within the "zone of reasonableness" defined by this Commission in a previous case (within 100 basis points above or below the industry average).[77] The national average ROE was 10.57% in the first quarter

[77] In the Matter of Missouri Gas Energy, Case No. GR-2004-0209 (Report and Order, issued Sept. 21, 2004) 20.

of 2006 and 10.55% for calendar year 2006; Vander Weide was at 11.3% (prior to adding the 40 basis points); King was at 9.65% and Murray was at 9.5-9.6%.

Finding: The Commission finds that none of the experts' final results appear to be reasonable. Although Empire's financial position seems more than average, it is not more so than in the last rate case. On the other hand, the risk associated with investment in Empire does not appear to have abated significantly since then.[78] In that case, Empire was granted an ROE of 11%. An ROE of 11.7% is well beyond an appropriate compensation for any perceived additional risk; an ROE of 9.5% assumes that investment in Empire involves very little risk.

Empire's DCF and ex ante risk premium calculations yielded the results of 10.9% and 11.0%, respectively, using the largest group of comparable companies. Although the Commission is unwilling to set a minimum number of companies in a proxy group, it understands that the smaller the sample size, the greater the chance, statistically, for error. A sample group of five companies is simply too small to perform a credible analysis in this scenario. The OPC used two samples, the larger of which yielded a higher ROE. We view as less credible the reduction of the sample size to yield the low ROE the OPC recommended. When a sufficiently large group is used as the proxy, the results fall between 10% and 11%~~, which makes sense since the national average is approximately 10.5%~~.

[78] The evidence is unrefuted that Empire's credit rating is the lowest investment-grade rating. It has not been able to realize the return on equity of 11.0% authorized in its last rate case.

Conclusion: The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's Hope and Bluefield decisions. Pursuant to those decisions, returns for Empire's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of Hope and Bluefield unmistakable requires a *comparative method*, based on a quantification of risk.

Investor expectations of Empire are not the sole determiners of ROE under Hope and Bluefield, we must then compare it to the performance of other companies that are similar to Empire in terms of risk. Hope and Bluefield also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

In its decision in Missouri Gas Energy, the Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the national average.[79] However, the national average is an indicator of the capital market in which Empire will have to compete for necessary capital. One requirement imposed by Hope and Bluefield is that Empire's rates be sufficient to permit it to obtain necessary capital.

In light of the comparable companies' average ROE at or near 10.9%, the national average ROE~~ of 10.5%~~, and the perceived risks associated with

[79] ***Id.***

investment in Empire (including the downgrade of empire's credit rating to the lowest investment grade after this case was filed), the Commission concluded that 10.9% is the reasonable and appropriate ROE for Empire.[80]

2. Capital Structure: What capital structure should be used for determining Empire's rate of return? Should the unamortized expenses and discounts be reduced from the total principal amount of long-term debt and trust preferred stock outstanding for determining Empire's capital structure for ratemaking purposes?

Empire's actual consolidated capital structure as of March 31, 2006, was composed of 43.99% long-term debt, at an embedded cost of7.02%; 6.27~~32~~% trust preferred securities, at an embedded cost of 8.90% and 49.74% common equity. All three of the parties who provided witnesses on this topic agreed that this is the capital structure to be used in the calculation of the rate of return, including agreement on the embedded cost of long-term debt.[81] Based on the ROE determination discussed above, the Staff recommends a rate of return of 8.37% - 8.42%.[82] Empire seeks an overall rate of return of 9.55%.[83]

The composition of the capital structure and the embedded cost of the components other than common equity is not difficult to ascertain. It is simply a "snap shot" as of a given moment in time. The parties that filed testimony and

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[80] As set forth in Empire's Application for Rehearing filed herein with regard to the December 21, 2006 Report and Order, Empire submits that competent and substantial evidence consisting of the testimony of its witness Dr. James H. Vander Weide demonstrates that the appropriate cost of common equity for the Company is 11.7 percent and not the 10.9 percent found by the Commission. Of the three rate of return recommendations presented in this case, only the Company's recommendation accurately captures and reflects the market-based rate of return expectations of investors in companies whose business and financial risks are comparable to Empire's. In the event the Commission desires to change its holding on this issue, Empire would be pleased to prepare an additional proposed report and order for the Commission's consideration.

[81] Murray Rebuttal at 3-4.

[82] Murray Rebuttal at 3.

[83] Keith Direct at 11.

took a position on this issue agreed to use of Empire's actual consolidated capital structure.

Having determined Empire's Cost of Common Equity, the Commission may calculate Empire's composite weighted cost of capital, that is, its fair rate of return:

Component	Proportion	Cost	Weighted Cost
Long-term Debt	43.99%	7.02%	3.09%
Preferred securities	6.27~~5.32~~%	8.90%	0.56~~.45~~%
Common equity	49.74%	10.9%	5.42~~3~~%
	100.00%		9.07%

Finding: Empire's actual consolidated capital structure as of March 31, 2006 was composed of 43.99% long-term debt, at an embedded cost of 7.02%; 6.27~~32~~% trust preferred securities, at an embedded cost of 8.90%; and 49.74% common equity.[84]

Conclusion: The Commission will use Empire's actual consolidated capital structure as of March 31, 2006, the end of the update period ordered in

[84] As set forth in Empire's Application for Rehearing filed herein with regard to the December 21, 2006 Report and Order, the Commission correctly noted that the parties agreed to use Empire's actual consolidated capital structure, but the Commission's Order Concerning Test Year and True-Up and Adopting Procedural Schedule (April 11, 2006) identified capital structure as an item to be trued-up as of June 30, 2006. The capital structure used in the Report and Order is as of March 31, 2006, while the capital structure as of June 30, 2006, is found in the testimony of Staff witness Mark Oligschlaeger (Exh. 148, p. 3). The result of using the June 30, 2006 capital structure would not change Empire's overall revenue requirement, after consideration of the regulatory amortization, and would not cause higher rates. However, using the June 30, 2006, capital structure would serve to reduce the amount of regulatory amortization included in the revenue requirement by approximately $300,000. In the event the Commission desires to change its holding on this issue, Empire would be pleased to prepare an additional proposed report and order for the Commission's consideration

this case. The use of updated figures is generally preferable, as they more nearly reflect the Company as it will exist on the day that the new rates will take effect.

3. **Off-system Sales:** What amount should be included in Empire's revenue requirement for off-system sales:

The Staff recommends that the amount to be included in the off-system sales is that which actually occurred in the 12-month period ending March 31, 2006, as most representative of the level of off-system sales on an ongoing basis.[85] Although in the previous case, which was less than five years ago, the Staff opined that a five-year average was more reasonable, that previous position was an aberration; in all the preceding Empire cases over the last ten years (encompassing four rate cases) the Staff recommended that the amount not be averaged.[86] Though the Staff notes that it more often uses the trued-up test year to determine the level of off-system sales, it does sometimes use an average, usually over five years, which it feels such an average is appropriate to reach more "normalized" results.[87]

Staff Witness Fischer explains that, in this instance, the result of averaging the off-system sales over five years resulted in an amount that appeared to be skewed too high when the "AEP transactions" were included, and too low when they were excluded.[88] Empire Witness Keith asserts that a five-year average is more appropriate in a rate case than using the true-up test year alone, because any aberrational peaks and valleys are smoothed out in the averaging process.

[85] Fischer Surrebuttal at 3.
[86] Fischer Surrebuttal at 4.
[87] Fischer Surrebuttal at 4.
[88] Fischer Surrebuttal at 7.

However, even with averaging, Empire believes it would be appropriate to remove the AEP transactions from the group of off-system sales to be averaged. Moreover, Mr. Keith asserts that the AEP transactions are not an off-system sale at all, and should be excluded on that basis as well.[89] OPC, the only other party to submit testimony on this issue, uses a five-year average without any insertions or removals of any off-system sales transactions. Although OPC Witness Smith conceded that the AEP transactions are not technically off-system sales as the term is generally used, they are a type of transaction appropriately included. He notes that,

> while the individual transaction might have been unusual, the average annual level of off-system sales margin when this transaction in 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.[90]

Although the Commission is not bound by its previous decisions,[91] in light of the fact that in the last case, decided just under two years ago, the Commission authorized use of a five-year average, it is unnecessarily complicated to change back and forth, especially when there is little actual difference between the five-year average and the 12-month amount.

Finding: The Commission agrees with OPC that using an average smoothes out the peaks and valleys, and that to exclude a transaction because it was unusual defeats the purpose of calculating the average

Conclusion: The Commission concludes that the AEP transaction was properly included in the calculation of off-system sales. Although not an off-

[89] Keith Rebuttal at 10-13.
[90] Smith Surrebuttal at 3.
[91] See the discussion under "f." below.

system sale *per se*, we agree with OPC that it is the type of transaction properly included in the category of off-system sales. The Commission concludes that the continued use of an unadjusted five-year average for the calculation of off-system sales is the most reasonable alternative.

4. Regulatory Plan Amortizations. Should Empire's revenue requirement include regulatory plan amortizations? If so, (i) how should Empire's off-balance sheet obligations be valued for purposes of the amortizations and (ii) should the amortized amount be subject to an income tax gross-up?

The Staff, in true-up testimony, updated its calculations for the Regulatory Plan amortizations authorized in the Stipulation and Agreement for Case No. EO-2005-0263 to reflect the Staff's updated true-up revenue requirement. The Staff proposed changes to the methodology used to calculate the Regulatory Plan amortizations in the area of capital structure allocation and in the amount of additional book depreciation required to meet the rating agency metrics.

In the amortization calculations it sponsored in supplemental direct testimony, the Staff derived the long-term debt component used in the ration analysis by taking Empire's total company capital structure, determining the portion of that capital structure supported by long-term debt, and then applying a Missouri jurisdictional plant allocation factor to that long-term debt amount. At that time, that approach was believed to provide an accurate quantification of Empire's long-term debt associated with its electric operations. Since then, Empire has acquired significant natural gas operations. To ensure that the debt associated with new gas and existing non-regulated operations was not included in the amortization intended only for Missouri jurisdictional electric operations, the Staff revised its approach so the amount of debt attributable to Empire's electric business is more appropriate. Under the new approach, the Staff analyzed Empire's Electric Balance Sheet as of June 30, 2006, and determined the amount of Empire's net investment in its electric operations not reflected in its rate base (such as construction work in progress and net regulatory assets). The Staff then combined this amount with its recommended electric rate base and applied the current percentage of long-term debt in Empire's capital structure to the combined rate base/balance sheet net investment amount to determine the amount of long-term debt attributable to Empire's electric operations used in the Regulatory Plan calculation.

With regard to the issue of the March 31, 2006 discounted present values of the two involved purchased power contracts, OPC asserts that the off-balance sheet obligations should be discounted back to their individual present values by applying a 10% risk factor (see Robertson Rebuttal at 23-24). This would, according to the OPC, serve to determine the debt-equivalent value of each off-balance-sheet obligation.

The Staff notes that off-balance sheet obligations are considered fixed obligations (i.e., debt) by credit rating agencies for calculating leverage and coverage ratios and are included in credit rating agencies' analyses of debt levels. Standard and Poor's, in its Research Report dated May 18, 2006, established the current value of Empire's off-balance sheet obligations. The Staff notes that S&P makes numerous adjustments in its determination of that amount, including those necessary to bring the value current. To be conservative, Staff used that amount in its calculations, without further adjustment (see Oligschlaeger Supplemental Direct at 9-10).

In prior testimony, the Staff recommended that the Commission order that any Regulatory Plan amortizations included in rates be treated as book depreciation by Empire, and that a tax straight-line depreciation deduction equal to the amount of the amortizations be reflected in the ratemaking process. The Staff has made updated calculations to determine the amount of additional book depreciation required by Empire to address the full cash flow requirements of the credit rating agency metrics, as measured in the Regulatory Plan amortization calculation. Consistent with any increase in book depreciation, Empire will recognize a corresponding increase in the tax straight-line depreciation deduction used in calculating deferred income taxes. The impact on deferred tax expense has also been considered in the Regulatory Plan amortization calculations, consistent with the increased book depreciation and increased tax straight-line depreciation deduction resulting from the amortization amounts granted in rates. This impact on deferred tax expense was not considered in the Staff's prior Regulatory Plan amortization calculations. The net result of the Staff's proposed increase in book depreciation recovery through the Regulatory Plan amortization mechanism addresses the agreement to provide Empire the opportunity to obtain the necessary after-tax cash flow required to meet the two Regulatory Plan credit metrics.

The Staff's current Regulatory Plan amortization calculations show, for the IEC Termination scenario, an amount of $20,745,271; and the IEC Continuation scenario, an amount of $43,009.776. This resulted in a change of the Staff's total revenue requirement recommendation under the IEC Termination scenario to $27,865,449, and for the IEC Continuation scenario to $27,750,809. This significant increase mostly related to Empire's greater average debt level for the twelve months ended June 30, 2006, compared to the twelve months ended March 31, 2006. All other things being equal, higher debt levels will drive the Company's Regulatory Plan financial ratios lower, and thereby increase the amount of the necessary amortizations to maintain Empire at investment grade credit ratings.[92]

The OPC supported Staff's changes, which it understood Staff would file as part of its true-up testimony.[93] OPC expected a change to reflect additional investment in excess of rate base. The primary investment related to Missouri electric operations that is not contained in rate base is construction work in progress. OPC believed it appropriate to add CWIP to rate base prior to synchronizing the Missouri electric operations investment with the capital structure. The CWIP balance should be reduced by the amount of short term debt used in the additional amortization calculation. OPC is unaware of other such items not included in rate base. If a prudent investment in Missouri electric

[92] Oligschlager True-Up at 12-15.

[93] OPC did not have an opportunity to review the revisions as true-up testimony was concurrently filed. OPC expected the changed calculation to increase the amortization to recognize decreased cash flow due to reduced deferred income tax resulting from treating the amortization as additional book depreciation expense. The reduction in cash flow creates a need for additional amortization to meet the financial metrics in the Regulatory Plan. OPC also expected and supported Staff's changes to revise the calculation format so the investment in Missouri jurisdictional retail electric operations in properly synchronized with the capital structure, which is required to preclude cash flow to operations other than Missouri retail electric operations.

operations is recorded in the future, it should be reviewed for inclusion in the additional amortization calculation.[94]

Empire specifically refrained from addressing the issue of amortizations in its true-up testimony and no other party has taken a position on the issue. In addition, it appears the parties involved in this issue are all now treating the Elk River Wind Farm agreement as a purchased power agreement. With the changes the Staff made to its position, which are reasonable, there appears to be no further dispute on this issue.

Finding: We find the Staff's methodology for calculation of the regulatory plan amortizations to be correct, including the use of the S&P valuation of off-balance sheet obligations without further adjustment. We find that the adjustment recommended by the OPC in this regard would result in an unreasonably low valuation of the off-balance sheet obligations and thereby would tend to defeat the purpose of the amortization.~~Finding no dispute among the parties who filed testimony on this issue that the Staff's present calculation of the regulatory plan amortizations is correct, we find that Staff's calculation is correct.~~

Conclusion: The Commission concludes that the Staff's position on off-balance sheet obligations is reasonable and appropriate. As to the other sub-issues of regulatory plan amortizations, the Staff has revised its position and recalculated the amounts to be included in the regulatory plan amortizations. Having reviewed those revisions, the Commission finds the Staff's methodology, as applied to the Commission's findings herein, to be reasonable. ~~The Staff has revised its position on this issue and recalculated the amounts to be included in~~

[94] Trippensee True-up at 2-5.

~~the regulatory plan amortizations. Having reviewed the Staff's revisions, the Commission finds the Staff's position to be reasonable. As no party disputes them, the Commission concludes that the amortization amounts submitted by the Staff are appropriate.~~

5. Fuel and Purchased Power Expense: What is the appropriate level of on-system fuel and purchased power expense Empire should be allowed to recover in rates:

Empire uses a variety of fuel sources to generate electricity, and the fuel costs at issue in this matter include not only the market price of the fuel used in power plants, but the costs associated with obtaining that fuel.[95] In instances in which Empire's costs of generating electricity are greater than the cost of buying electricity generated by another company or if Empire's power needs exceed its generation capacity, Empire may purchase power from another provider. If Empire generates more power than its customers need, then it can sell that power through off-system sales. Those off-system sales are included in the revenue requirement elsewhere as discussed above, and are not included as an offset to fuel and purchased power costs.[96]

The costs of many of the fuels Empire uses to generate power have risen due to causes both foreseen and unforeseen. Fuel prices are generally increasing,[97] but certain circumstances have created more erratic price increases, resulting in a highly volatile market for most fuel sources, but especially for natural gas. A train derailment in May 2005 constrained the movement of coal out of the Powder River Basin in Wyoming, and Hurricanes

[95] As an example, see Fischer Direct at 22.
[96] Fischer Direct at 29.
[97] See Choe Rebuttal Schedule 2

Rita and Katrina significantly disrupted natural gas supply from the Gulf Coast.[77] Empire has significant dependence on natural gas and exposure to natural gas price volatility. Although Empire has diversified its fuel mix for the generation of electricity, it still expects to burn approximately 10 million MMBtu in a "normalized" year.[78] At such consumption levels, a ten cent change in the price of natural gas per MMBtu results in a $1 million change in fuel costs.[79]

For ratemaking purposes, Empire's total fuel costs are computed using a modeling program that ascertains, based on which generating units are used for a given duration throughout the year, what the total fuel costs will be. As Empire is so heavily dependent on natural gas, the anticipated price of gas figures prominently in the calculation. The difference in the forecasted price of natural gas is the reason that the position taken by the Industrials is so far a field from the positions taken by other parties on this issue, and the reason the OPC position differs slightly from Empire's and the Staff's positions.

There is another small reason for the different results of Empire and the Staff. Although they use the same model, they differed slightly on other inputs to the model than just the price of natural gas, such as transportation costs. However, the price of natural gas is the main factor in the differences in the projected fuel cost. No party involved in this case can predict, with any accuracy, the price for natural gas in the coming year. As the Commission is convinced that the spike in natural gas prices in 2005 was an aberration, looking to the test

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[77] Tarter Direct at 12.
[78] Tarter Surrebuttal at 3.
[79] Tarter Surrebuttal at 3.

year for guidance on the appropriate level of fuel and purchase power cost would be unreasonable.

Under the previous rate case, in which the fuel and purchased power issue was resolved by the 2005 Stipulation as discussed above, $103 million (Mo jurisdictional) was included in base rates and $8 million (Mo jurisdictional) was recoverable through an interim energy charge ("IEC") that could fluctuate within limits. If the fuel price was below the minimum, refunds would be made to customers; if the fuel price was above the upper limit, Empire would simply bear the cost without recourse to recovery of those costs in rates.[80]

Empire asserts that the fuel costs it incurred have been prudently incurred. Although the actual numbers for its hedging program are classified in this case as highly confidential, it can be said that Empire has implemented a sound hedging program that is effective in ameliorating the volatility of natural gas prices.[81] This is not to say that Empire will never have to buy gas on the spot market, as Empire does not hedge 100% of the most it could ever need. Empire's present plan to hedge approximately 80% of anticipated need for a weather-normalized year is both proper and prudent.

In addition to the new hedging program, Empire has engaged in other activities to mitigate the volatility of natural gas prices. During periods of high volatility, Empire's energy traders are staffed to cover extended hours in an effort to find the most economical power available on an hourly basis. During summer of 2005, when fuel oil was less expensive than natural gas, Empire burned fuel

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[80] Commission Case No. Er-2004-0570.
[81] Tarter Direct at 14-15.

oil in some of its dual fuel units. Since October 2005, Empire has been receiving power from the Elk River Wind Farm. Finally, Empire has signed a letter of intent to be a partner in the Iatan 2 coal-fired generation facility.[82]

~~Based on its fuel model run,~~ Empire proposes an annual total company fuel and purchased power expense including demand charges of $166,956,600~~$166,012,277~~ ($137,839,369 Missouri jurisdictional) or $30.95~~$30.87~~/MWh.[98] This amount is comprised of total variable fuel and energy costs from the production cost model run of $140,908,100 with the remaining $25,104,177 assigned to purchase demand charges, natural gas firm transportation charges and other on-system fuel-related charges.[83] The Staff proposes a fuel and purchased power expense of $161,981,643[84] ($135 million Missouri jurisdictional), only $3 million less than Empire.[85] OPC proposes a fuel and purchased power expense of $164,804,530,[86] close to mid-way between Staff and Empire. The Industrials did not run a fuel model, but based on its fuel price input, would propose a fuel and purchased power expense of $133,249,000 ($109 million Missouri jurisdictional),

Empire asserts that, since the rates from the last rate case were put into effect, it has expended fuel costs in excess of the amount it may recover in rates by over $18 million.[87] Throughout the record, this amount is loosely referred to as a "loss." It is not a loss in the traditional sense, as Empire operated at a profit

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82 Tarter Direct at 14.
98 Transcript at 1219.
83 Tarter Rebuttal at 2; Keith True-Up at 9.
84 Oligschlager True-Up at 3.
85 Keith True-up at 9.
86 Transcript at 699.
87 Transcript at 934.

during all times at issue in this matter. The total company fuel cost is one of the most significant elements making up Empire's revenue requirement. Empire has and is expected to continue to under-recover fuel costs if the 2005 Stipulation is left in place.

Finding: We do not find the Industrials' position on fuel and purchased power expense to be credible. Although there is no way to accurately predict what fuel prices will do,[88] the fuel prices used by the Industrials do not appear to be consistently derived from actual, spot or futures prices, nor do they appear to be appropriately normalized for weather.[89]

Having eliminated the position of the Industrials as not credible, the highest model run for the Missouri jurisdiction is only $3 million from the lowest. The remaining positions are Empire, which ran its own model; the OPC, which ran Empire's fuel model but substituted a different natural gas price, and the Staff, which ran its own fuel model. Having reviewing the differences in model inputs between the Staff and Empire, we find Empire's inputs to be more credible than the Staff's. Empire has a greater familiarity with the intricacies of its system and facilities and is better able to know which facilities require certain fuel ratios, which facilities are used for peaking or based load and all the other myriad inputs into the fuel model.

Conclusion: Having considered the prices and methodologies of the Industrials, OPC, Staff and Empire in developing their positions, the Commission

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[88] See Choe Rebuttal at 3-6, Busch Supp. Direct at 3.
[89] Tarter Rebuttal at 9,10: Brubaker Surrebuttal at 9.

concludes that Empire's is reasonable and most likely to accurately predict its annual fuel costs.

6. Fuel and Purchased Power Expense Recovery Method: What method should be used for recovery by Empire of its fuel and purchase power expense? Alternatively, should the Commission continue to enforce the 3-year term of the Interim Energy Clause that was approved by the Commission in Case No. ER-2004-0570? Is the Commission barred from terminating the Interim Energy Clause by Section 386.266.8? Relying upon the four corners of the Stipulation and Agreement, are the terms of the IEC ambiguous? In the event that the Stipulation and Agreement is found to be ambiguous, do Empire's actions demonstrate its belief that it was bound to a 3-year term? What is the practical construction that Empire has given to the agreement? What is the burden of proof of ambiguity and on whom does it rest? What is the significance of a burden of proof? Has Empire properly applied to terminate the Interim Energy Clause, approved by the Commission in Case No. ER-2004-0570? What standard should the Commission apply in deciding whether to prematurely terminate the IEC? What would be the extent of Empire's financial harm if it were bound to the remaining term of the IEC? What is the comparative financial harm that would be experienced by the ratepayers if the Stipulation and Agreement were prematurely terminated? In the event that Empire is permitted to prematurely terminate the Interim Energy Clause, what amount of revenues collected by Empire under the IEC should be refunded to customers?

As discussed above, many of the parties entered into a Stipulation and Agreement to settle the fuel and purchased power issues in the previous rate case. Consideration having been given and received, that agreement, referred to as the 2005 Stipulation, appears to be a binding contract among the signatory parties. It is unambiguous in its requirement that Empire may not, during the term of the IEC portion of the agreement, seek any other kind of fuel adjustment recovery mechanism. For that reason, Empire's tariff filings and supporting testimony concerning an "Energy Cost Recovery" mechanism were stricken and will not be addressed in this order.

The 2005 Stipulation established a set amount of fuel and purchased power recovery in base rates, with an additional amount recoverable through an additional charge, within fixed limits. If the fuel and purchased power costs fell within this "collar," Empire could recover them. If fuel and purchased power costs were below the collar, then Empire would refund a certain portion to ratepayers. If fuel and purchased power costs were above the collar, then Empire would absorb those costs. The 2005 Stipulation anticipated that the "IEC Period" would last for a maximum of three years from the date on which it was approved, unless earlier terminated by the Commission.

The 2005 Stipulation does not "lock" Empire into a limited amount of Missouri jurisdictional fuel recovery ($102,994,356 in base rates and $8,249,000 through the IEC) for three years because the 2005 Stipulation contains no "moratorium" language. In other words, the 2005 Stipulation does not prohibit Empire from filing a rate case at any time to seek recovery of all of its costs, including fuel and purchased power costs, through base rates. Likewise, the 2005 Stipulation does not prohibit a proper party from filing a complaint with the Commission against Empire at any time concerning the Company's rates and charges, including those rates and charges concerning the recovery of fuel costs. Further, t~~However, t~~he 2005 Stipulation ~~does~~ contemplates that the Commission might terminate the IEC~~agreement~~ at some time other than the end of the agreed-to expiration date. The Commission's obligations to ensure just and reasonable rates cannot be constrained by an agreement among the parties. There is no evidence in the record that would permit the Commission to modify the 2005 Stipulation to allow for recovery of all prudently incurred fuel and purchased power costs. On the contrary, the consensus appears to be that the

Commission does not have authority to modify it.[90] Likewise, no evidence was given for ways to adjust other parts of the revenue requirement equation to offset the under-recovery of fuel and purchased power costs. The Commission may retain the 2005 Stipulation as it is or terminate it prior to its scheduled expiration. The 2005 Stipulation does not allow sufficient recovery of Empire's prudently incurred fuel and purchase power costs by $26.8 million annually.

There are several questions set forth in the description of this issue that pertain to Empire's actions concerning the 2005 Stipulation: whether by its action or inaction it ratified the 2005 Stipulation, whether it may properly seek termination, or whether the 2005 Stipulation is unambiguous. The 2005 Stipulation appears to be a contract that binds the signatories unambiguously to its terms. As stated above, however, the terms do not prohibit Empire from seeking rate relief during the three year period, and the terms do specifically authorize the Commission to terminate the IEC within the three year period. ~~However, the Commission is not a party to the 2005 Stipulation and the Commission's approval of it does not and cannot bind the Commission to its terms.~~

In discussing whether the Commission is bound by or to its prior decisions, the Missouri Supreme Court quoted an Illinois case and concluded as follows,

> "The construction contended for seems to be in conflict with the act. One of its primary purposes was to set up machinery for continuous regulation as changes in condition require. It appears to be inherent in the act itself." The statute of Illinois is different form that of Missouri, but we think the "spirit of the act" analysis is logical and

[90] See the Notice Requiring Filing issued on September 20, 2006 and the responses thereto.

> should be the standard in this state. In fact, this court said in *State ex rel. Chicago, R.I. & P.R.R. Co. v. Public Service Commission*, 312 S.W.2d 791, 796 (1958): "Its [Commission's] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem in the public interest." To rule otherwise would make §393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to ratepayers. ***Since the very purpose of having the Commission is to have an agency with such expertise as to be sensitive to changing conditions, we rule the trial court was in error in rejecting the Commission's action in that regard.[91]

In its September 20, 2006 response to a Commission notice, the Industrials asserted:

> Nevertheless, to the extent that Empire is permitted to prematurely terminate the IEC, the Commission would be undertaking the judicial role of rescission of a contract. Consistent with contract law, courts undertaking such rescission would seek to return the parties to their positions prior to the contract. This would involve a return of all previously exchanged consideration. As such, other changes to the Stipulation and Agreement that would be necessary would be to return the entire amount of IEC revenues collected up to the point of recission.[92]

We are not persuaded by this~~find this~~ argument~~ to be nonsense~~. It is clear under Missouri law that the ~~Commission may ignore a contract between Empire and other entities and proceed with its statutory obligation to ~~setting of just and reasonable rates must be of utmost importance to the Commission. We look to a Missouri Supreme Court case from 1930, in which the Court handed down the following bits of wisdom:

[91] *State ex rel. Jackson County, et al. v. Public Service Commission,* 532 SW2d 20, 29 (Mo Banc, 1975)
[92] Response of Praxair/Explorer to Commission Notice Requiring Filing, filed September 20, 2006 at 3.

The fixing of public utility rates being an exercise of the police power of the state, it must follow that the Legislature could not by contract, statutory enactment, or otherwise limit or abridge the right of the state to fix reasonable rates for public service, because to do so would be to abridge the exercise of the police power of the state, a thing which the Constitution prohibits. This proposition is so well settled by numerous decisions of this court that nothing more need be written on this subject.

* * *

In determining whether or not the franchise contract precludes the Public Service Commission from taking cognizance of the company's application for increase in rates, and conducting an investigation to determine whether the rates fixed by the franchise ordinance are reasonable, three well settled propositions of law must be kept in mind: (1) That the fixing of reasonable rates to be charged by the utility for public service is the exercise of the police power of the state; (2) that the Legislature can delegate the exercise of that power to a body created by it; and (3) that, by the passage of the Public Service Commission Act, the Legislature did delegate that power to the Public Service Commission, and under the power so delegated the commission may at any time, on its own motion or on complaint, conduct a hearing for the purpose of determining whether or not the rates charged by a utility for the service it renders to the public are just and reasonable to both the utility and the public.

* * *

This brings us to the vital question in the case, and that is, whether or not the rates fixed by the franchise contract are subject to future regulation by the Commission.

* * *

The contention is that, after the commission approved the contract, the rates fixed thereby were not subject to regulation or change […}.

* * *

If the statute be given that construction, it would abridge the exercise of the police power of the state in the fixing of reasonable rates and for that reason would be unconstitutional.

* * *

Every utility is entitled to charge a rate that will produce a reasonable net income on the fair value of its property after deduction for depreciation and necessary expenses incident to operation.

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If, as we have held, a municipal corporation may not by contract fix and regulate utility rates, it must follow that it cannot by contract, fix and regulate the factors which determine such rates, and thus

> accomplish by indirection what the law prohibits it from doing directly.
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> * * *
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> The commission has exclusive power to determine and fix reasonable rates irrespective of the rates fixed by the franchise ordinance, but it has no jurisdiction to construe or enforce the contract as to extension of car lines, street paving, etc., or to try to determine an alleged breach thereof. When the application for increase in rates was filed with the commission, it was the official duty of the commission to determine and fix just and reasonable rates of fare, and leave the construction and enforcement of the contract to a court having jurisdiction to determine such matter.[cites and notes omitted][93]

The case quoted above is uncannily on point. In the present matter, the utility and other entities limited by contract the amount of recovery of the utility's major expense. The contract was submitted to and approved by the Commission.[94] Upon discovery that it was significantly under-recovering its cost, the utility asked the Commission to establish rates that would permit it to fully recover its reasonably incurred costs. The other parties to the contract asserted that the contract precludes the utility from recovering the costs that were limited by the contract.

It is important to note that the terms of the 2005 Stipulation specifically provided that it could be terminated by the Commission before it expired:

> The IEC tariff or rate schedule will expire **no later than** 12:01 a.m. on the date that is three years after the original effective date of the revised tariff sheets authorized by the Commission in this case, Case No. ER-2004-0570, **unless earlier terminated by the Commission.** [emphasis added, page 4]

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[93] *State ex rel. Kansas City Public Service Company v. Latshaw,* 30 SW2d 105, 107-110 (Mo Banc 1930).

[94] For an exhaustive discussion on whether such approval raises equitable estoppel issues, see *State ex rel. Capital City Water Co. v. Missouri Public Service Commission,* 850 SW2d 903 (Mo. App. 1993).

Therefore, the Commission need not address the issues surrounding the contractual relations between Empire and the other signatories to the 2005 Stipulation. The Commission must determine just and reasonable rates based on what it deems to be Empire's prudently incurred costs. To the extent that the 2005 Stipulation limits recovery of Empire's prudently incurred fuel and purchased power expenses, then it attempts to limit one of the "factors which determine rates" and is overcome by the Commission's exercise of the police power granted to it. The Commission's prior approval of the 2005 Stipulation in no way estops or hampers it in its determination of just and reasonable rates. Empire may recover the prudently incurred fuel and purchased power costs at the level determined above in base rates.

This Commission has the duty to ensure that rates are just and reasonable in a manner that will allow a utility to adequately recover its costs. The Commission cannot set rates at a level that could place a utility in serious financial jeopardy. Further, without adequate revenues, a utility cannot ensure safe and adequate service for its customers. Whatever limitation, if any, the terms of the 2005 Stipulation may have placed on Empire's ability to seek termination of the IEC within the three year period, the terms of the 2005 Stipulation do not limit the Commission's ability to terminate the IEC if such action is in the public interest. The existing IEC agreement has and will continue to create a significant under-recovery of costs for Empire because of the volatility of natural gas prices that was unforeseen at the time the IEC agreement was reached. This Commission cannot abrogate its duty to both the utility and its customers simply because some of the parties have previously reached a Stipulation and Agreement that addresses the issue of fuel costs to the serious detriment of the utility. Given our statutory mandate, the Commission must ~~ignore the Stipulation and Agreement as it pertains to fuel cost recovery, and~~ set rates that are just and reasonable and that may better ensure Empire's solvency and its ability to provide safe and adequate service to its customers.

As to the question of refunds to customers set forth in the issues list, we have found that during the test year, Empire under-recovered its prudently incurred fuel and purchased power costs. Therefore, any refund to customers of amounts collected pursuant to the 2005 Stipulation would be unreasonable and unjust in that it would exacerbate the under-recovery.

Finding: The Commission finds that the terms of the 2005 Stipulation specifically authorize termination of the IEC by the Commission prior to the expiration of the agreed-upon maximum term. The Commission also finds that the IEC established by the 2005 Stipulation ~~does not allow~~has prevented ~~sufficient recovery of~~ Empire~~'s~~ from recovering prudently incurred fuel and purchased power costs of approximately~~by~~ $~~26.8~~24 million~~ annually~~, and, therefore, has deprived Empire the opportunity to earn a fair and reasonable return on the value of the assets it has devoted to the public service. The Commission further finds that these results will likely recur if the IEC remains in place.

Conclusion: The Commission concludes that it need not address the issues surrounding the contractual relations between Empire and the other signatories to the 2005 Stipulation and that the terms of the 2005 Stipulation specifically authorize termination of the IEC by the Commission. The Commission concludes that it must determine just and reasonable rates based on what it deems to be Empire's prudently incurred costs. To the extent that the 2005 Stipulation limits recovery of Empire's prudently incurred fuel and purchased power expenses, then it attempts to limit one of the "factors which determine rates" and is overcome by the Commission's exercise of the police power granted to it. Moreover, the Commission concludes that its prior approval of the 2005 Stipulation in no way estops or hampers it in its determination of just and reasonable rates, and that continuation of the IEC under these circumstances would not be consistent with the public interest. The Commission concludes that Empire may recover the prudently incurred fuel and purchased power costs at the level determined above in base rates.[99]

7. Gain from unwinding forward natural gas contract: Should Empire's gain from unwinding a forward natural gas contract during the test year offset test year fuel and purchased power expense? If so, should the entire gain be an offset in the test year, or should it be amortized and only a portion of the gain be applied as an offset in the test year?

This issue concerns the transaction to undo (referred to as "unwinding") a portion of a long-term natural gas contract between Empire and British Petroleum that had locked in the price of natural gas deliveries scheduled to take place in

[99] As set forth in Empire's Application for Rehearing filed herein with regard to the December 21, 2006 Report and Order, Empire submits that based on competent and substantial evidence and as a matter of law, the Company should have been able to seek an ECR or FAC in this proceeding and Empire should have been granted the authority to implement such a mechanism. In the event the Commission desires to change its holdings on this issue, Empire would be pleased to prepare an additional proposed report and order for the Commission's consideration. The resolution of this issue to the satisfaction of Empire would, however, require significant changes to the remainder of the Report and Order and would require the filing of new tariffs.

the summers of 2009, 2010 and 2011. The positions were closed to market and Empire recorded a gain of slightly over $5 million.

Some of the parties differ on how this should be recorded on Empire's books. Empire believes that, as the transaction was in the past and is of a non-recurring nature, it should be used to off-set the under-recovery of fuel and purchased power expenses that occurred in the same year as the unwinding.[100] The Industrials assert that, since these were forward positions, the benefit of the transaction should flow through to retail customers. They assert that the "net impact of reflecting this gain along with current forward prices for unhedged natural gas volumes is to decrease Empire's claims by approximately $12 million per year."[101] The Staff recommended that gain be amortized over a five year period and netted against fuel expense, noting that Empire's hedging program directly related to provision of regulated electric service. As the gain from unwinding this contract was exceptionally large, the Staff recommended "smoothing [it] out" over five years.[102] Empire seeks to use the gain from the unwinding to directly offset the under-recovery of fuel and purchased power costs, as the unwinding and under-recovery occurred in the same year.[103]

Finding: The Commission agrees that the transaction was of a non-recurring nature, that it was clearly within the category of fuel costs, and that it occurred in the same time period as an under-recovery of fuel costs. It seems reasonable that a gain in the fuel category should offset a loss in the fuel

[100] Keith Rebuttal at 4-8.
[101] Brubaker Direct at 11-12.
[102] Fischer Direct at 20.
[103] Keith Rebuttal at 4-5.

category of roughly the same time. We do not find the Industrial's position to be reasonable, in that it multiplies the effect of the transaction in a way unfair to Empire. Although the Staff's suggestion for an amortization does smooth out the transaction, we do not believe it is appropriate in this instance to do so.

Conclusion: The Commission concludes that the most reasonable approach to this issue is to allow Empire to use the gain to directly offset the under-recovery of fuel and purchased power costs.

8. Incentive Compensation: Are all the costs of Empire's incentive compensation plan an expense Empire should recover from Empire's ratepayers? If not, what costs should be recovered?

Empire has three incentive compensation plans. For officers, there is the management incentive compensation plan; for salaried non-officer employees, there is a discretionary compensation incentive award; and for certain other employees, there is a program that offers certain lump-sum payments in the nature of bonuses called "Lightning Bolts."

In its disallowance of a portion of the incentive compensation Empire pays its employees, the Staff applied what it views as straightforward criteria: At a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the plan.[104] In addition, the Staff excluded incentive payments for goals related to financial performance because these goals primarily benefit the shareholder.[105]

[104] Report and Order in Case Nos. EC-87-114 and EC-87-115, Union Electric Company, 29 Mo.P.S.C. (N.S.) 313, 325 (1987).
[105] Report and Order in Case No. GR-96-285, Missouri Gas Energy (MGE), 5 Mo.P.S.C.3d 437, 458 (1997)

In its review of Empire's costs of providing electric service, the Staff included the entire amount of the base salary in payroll. For incentive pay, the Staff used criteria espoused in a previous Commission order[106] to analyze the goals on which the incentive pay was contingent. To be included in cost of service, Staff asserts that incentive compensation should be the result of employees performing beyond basic job requirements and provide a benefit to ratepayers. The Staff eliminated awards pertaining to earnings goals, as those primarily benefit shareholders, not, customers. The Staff also eliminated payment for goals related to non-regulated activities. The Staff eliminated the cash incentives paid out relating to goals in which the results were over-budget or past the scheduled completion date.

The Staff eliminated all expenses for stock options during the test year, as they are granted with no increase in duties or goals and no measurement as to whether any specific goals were met. These stock options accumulate dividend equivalents, which Staff asserts are intended to focus executives' efforts on dividend maximization, with no direct connection to improvement in operating performance or quality of service to the ratepayer. Therefore, the Staff asserted that the stockholders should bear those costs; the Staff excluded costs for performance shares for the same reason.

As to discretionary compensation incentive awards for salaried non-officer employees, the Staff allowed recovery of a portion of this program's costs. In some instances, employees received awards for objectives that were already

[106] Report and Order in Case No. GR-96-285, Missouri Gas Energy (MGE), 5 Mo.P.S.C.3d, 458 (1997)

part of the employees' job duties and some employees received awards for objectives unrelated to their jobs, such running the United Way campaign. Based on the sample provided by Empire, the Staff calculated a percentage of awards that compensated for performance of normal job duties as opposed to the percentage related to charitable activities and activities related to the provision of services other than retail electric service, then applied that percentage to the total discretionary pool awarded to employees. The Staff disallowed the resulting amount from the cost of service recoverable in rates.

Finally, as to the Lighting Bolts incentive compensation program, the Staff disallowed these awards, as they did not relate to the provision of electric service, but related to such activities as working on the United Way Campaign and the Aquila United, Inc. gas property acquisition, or were for performing normal duties. Moreover, the Staff notes that there were no performing normal duties. Moreover, the Staff notes that there were no performance criteria for receipt of the awards; they were given solely at the Company management's discretions.[107]

Empire counters that it is reasonable and prudent to have three components of executive pay: annual base salary, annual bonus, and a long-term incentive. With non-executive pay: annual base salary, annual bonus, and a long-term incentive. With non-executive employees, Empire has found it increasingly important to have a portion of compensation tied to key company objectives. Empire notes that, with respect to the total compensation package for executives, Empire places total cash compensation at the 25th percentile and

[107] McMellen Direct at 9-17

total direct compensation near the 38th percentile of the average compensation at a peer group of companies.[108] Empire notes that variable pay is a primary component of a performance-based work culture.[109] Empire agrees that some of the objectives for which it gives performance-based compensation may be within the normal scope of an employee's duties. It asserts that if it were to roll the incentive-based compensation for those duties into the base salary, the Staff would not object to the higher base salary. It would remove "an effective driver of performance and achievement," which may "prevent an employer from operating as effectively and efficiently as possible."[110] On the other hand, Empire could just as easily re-write its job descriptions in such a way that clarifies what level of performance is compensated by base pay and what additional performance merits incentive compensation. If that additional performance relates to the provision of retail electric service in Missouri, the Staff would not disallow it.

There are sound reasons to use incentive pay. The Commission does not agree with the Staff that the spread of incentive-based compensation is a slippery slope, but does understand the Staff's discussion of the use of objective criteria that it can apply even-handedly. No other party took a position on this issue.

Finding: The Commission finds that the Staff reasonable applied objective criteria for exclusion of certain incentive compensation. The Staff disallowed compensation related to charitable activities and activities related to the provision of services other than retail electric service. The Staff disallowed

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108 Bauer Rebuttal at 7-9
109 Bauer Rebuttal at 11
110 Bauer Rebuttal at 9

the Lighting Bolts incentive compensation, as they did not relate to the provision of electric service and there were no performance criteria for receipt of the awards; they were given solely at the Company management's discretion.

Conclusion: We conclude that incentive compensation for meeting earnings goals, charitable activities, activities unrelated to the provision of retail electric service, discretionary awards, and stock options should not be recoverable in rates.

9. Low Income Assistance Program: Should Empire's Experimental Low-Income Program (ELIP) be continued with changes? If so, what should those changes be, should the Customer Program Collaborative (CPC) determine those changes and have oversight responsibility respecting the program, and how should the cost of the program be included in Empire's cost-of-service for collection from ratepayers? What should be done with unspent ELIP funds?

On April 24, 2003, after a successful collaborative process to develop and implement an experimental rate discount program targeted to low-income customers in Empire's Joplin service area, the Commission approved tariff sheets that established the experimental low-income program ("ELIP"). Qualifying low-income program recipients with a household income of up to 50% of the Federal Poverty level receive bill discounts of $40. Program recipients with a household income of 51% to 100% of the Federal Poverty level receive bill discounts of $20. The discounts are available for up to 24 months under the current tariff.

The ELIP is funded by a shareholder contribution of $150,000 and a ratepayer contribution of $150,000 annually, for a total annual budget of$300,000 annually.

The OPC notes that the program costs in each year have fallen far short of the total $300,000 annual allotment, never exceeding $150,000. The total discounts applied appear to have fallen dramatically in the first quarter of 2006 to less than $15,000. The OPC asserts that the funding level should be reduced and the following steps should be taken to increase customer participation: modify the eligibility criteria to extend participation beyond 24 months, with the expectation that extending the length of participation maintain the previous level of annual expenditures rather than increasing it and earmark $2,000 annually for outreach, with the expectation that the collaborative group that created the program could develop recommendations on potential outreach methods.

The OPC also supports increasing the level of support for the poorest families to $50 monthly, increasing the maximum qualifying household income to 125% of the federal poverty level, and allocating up to $30,000 of existing program funds to add an experimental arrearage repayment incentive to the program. A flexible, simple to understand arrearage repayment incentive is likely to benefit Empire's entire customer base by encouraging a greater level of repayment, and is consistent with the program's goals.

Finally, the OPC recommends that the ratepayer contribution be reduced by $100,000 annually, or if the program is not modified, the ratepayer contribution should cease. If the program is terminated, OPC asserts that the balance should be refunded to ratepayers instead of to ProjectHelp for helping elderly and disabled Empire customers with emergency energy-related expenses, and that interest should be paid to ratepayers of any unspent fund balance.[111]

Empire suggests ending the program and asking the collaborative group for guidance on use of the unused fund balance.[112] The Staff believes that the ELIP should be eliminated and the funds redirected to the low-income weatherization program, which the Staff believes is a more effective and lasting way to reduce energy bills for low-income families than the ELIP.[113] The Staff notes that the weatherization program is currently funded at $155,000 annually, and the entire amount is being used. However, the Staff believes that the collaborative group is best suited to determining where the fund dollars can be most effectively spent, and would refer the matter to that group for final allocation.[114]

While the Staff makes a sound argument that weatherization and other energy-saving methods provide a more long-term benefit to low-income customers, it would be unreasonable to require all low-income customers to weatherize their homes instead of, or as a prerequisite to, receipt of ELIP assistance. Many low-income customers rent their homes. The suggestion that landlords be required to weatherize or at least apply for weatherization assistance is beyond the control of tenants and unreasonable.

If the ELIP is terminated, the presently effective tariff provides that the unspent balance will be delivered to ProjectHelp. The transfer of such a large

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[111] Meisenheimer Direct at 13-19.
[112] McCormack Rebuttal at 4.
[113] Empire does not oppose this. See McCormack Surrebuttal at 2.
[114] Mantle Rebuttal at 3-4.

balance would be unreasonable. The funds should be redirected to another demand-side management program for low-income customers. The Commission will require that change when Empire files its tariffs in compliance with this order.

The OPC's suggestions have merit, except that the funding level shall not be reduced at this time. The Commission expects the collaborative group to make a recommendation as to the funding levels of both the ELIP and the demand-side management programs discussed below. If the collaborative group recommends a change, then Empire may propose a tariff change.

Finding: The Commission finds that the ELIP is a reasonably effective program. If the program were terminated in this case, the presently effective tariff provides that the unspent balance will be delivered to ProjectHelp, an unreasonable result. As all the witnesses on this topic noted, the collaborative group is the appropriate body to design changes to the program for Commission approval. The OPC makes several suggestions for improvement to the program, all but one of which the Commission finds have merit.

Conclusion: The Commission concludes the OPC's suggested changes shall be made, except that the level of funding will not be altered at this time. The Commission will not terminate the ELIP at this time. The collaborative group shall make a recommendation as to the funding levels of both the ELIP and the demand-side management programs discussed below. If the collaborative group recommends a change, then Empire may propose a tariff change. In any event, Empire shall revise its tariff to clarify that, if any of its energy assistance or demand-side management programs is terminated, any unspent funds will be redirected to the remaining program(s). The Commission will require that change be made when Empire files its tariffs in compliance with this order.

10. Unspent Funding of Current Energy Efficiency and Affordability Programs: What should be done with unspent funds from the current energy efficiency and low income weatherization programs? What should be the amortization amount respecting the demand side management (DSM) regulatory asset account?

Demand-side management programs are those that help utility customers reduce their demand. Weatherization programs, conversions to energy-efficient appliances and changing lights from incandescent to compact fluorescent are all examples of demand-side management.

Staff notes that the funds in question were collected entirely from ratepayers. Staff recommends that any unspent funds be placed as a negative amount in the demand-side program account for future demand-side programming.[115]

Empire proposes the following accounting treatment:

> Costs of $53,000 associated with the CPC and new DSM and affordability programs to be funded in 2006 have been included as a regulatory asset in rate base. This amount included $10,000 for the Missouri Residential Market Assessment, approximately $41,500 for AEG's consulting work and approximately $1,500 for travel and related expenses. Furthermore, an adjustment to increase expenses of $5,300 has been included in the income statement. This adjustment reflects the amortization of the regulatory asset over ten years in accordance with the Stipulation and Agreement reached in Case No. EO-2005-0263.[116]

The Staff agrees with Empire's approach, but would alter the amounts to reflect actual costs incurred.[117]

[115] Mantle Rebuttal at 5.
[116] McCormack Direct at 4-5.
[117] McMellen Rebuttal at 2.

Finding: The Commission finds that the Staff and Empire's accounting methodology is reasonable, but shall reflect actual costs incurred, provided that the same level of funding is dedicated to the programs and that any unspent balance remains dedicated to the programs.

Conclusion: The Commission concludes that these programs, lawfully in place, are valuable and likely to make a lasting difference in the energy bill burdens shouldered by low-income customers. Therefore, the Commission concludes that the Staff's recommendation concerning the continuity of these programs and their accounting treatment is reasonable and will be adopted.

11. Corporate Allocations (True-Up Issue)

Empire experienced significant changes to its corporate structure during the true-up period of this proceeding. Mark Oligschlaeger provided testimony on this issue for Staff, W. Scott Keith provided testimony for Empire, and Russell W. Trippensee provided testimony for OPC on this issue. On June 1, 2006, Empire completed its acquisition of Aquila, Inc.'s Missouri natural gas properties and formed a new subsidiary to operate Empire's new gas business. This change affects Empire's corporate allocations on a going-forward basis.[118] While Staff testified that there should be few direct impacts on Empire's electric operations as a result of this change, Staff also testified that the change causes a reduction in the percentage of administrative and general (A&G) costs otherwise allocable to Empire's electric operations.[119]

[118] Oligschlaeger True Up Testimony, pp. 6-7.
[119] Oligschlaeger True Up Testimony, p. 7.

Testimony was provided regarding the "Massachusetts Formula" analysis of the amounts in revenue, plant in service, and payroll costs experienced by Aquila, Inc.'s former Missouri gas properties in calendar year 2005, compared to these same items for Empire's pre-existing electric, water and non-regulated operations for the same period of time. This analysis revealed that Empire's gas properties, all other things being equal, were estimated to make up approximately 9.37% of Empire's total utility operations.[120] Empire proposed use of this number, while Staff suggested certain adjustments.

After the filing of true-up testimony, the parties engaged in settlement negotiations, and Empire, Staff, and OPC entered into and filed herein a Stipulation and Agreement Regarding Corporate Allocations. The Industrials objected to this Stipulation, and, by operation of Commission rule 4 CSR 240-2.115(2)(D), this Stipulation was considered to be a non-binding statement of position by the signatory parties. Empire provided testimony that it expected to realize synergies in excess of increased costs related to the common costs associated with the combined operations of the electric and gas companies,[121] and the signatory parties agreed that Empire's revenue requirement in this proceeding should be reduced by $500,000 to reflect the impact on certain test year A&G allocation factors and that Empire's revenue requirement should be reduced by $150,000 to reflect the impact on certain test year general plant allocation factors. At the true-up hearing in this matter, Staff reiterated this position.

[120] Oligschlaeger True Up Testimony, p. 7.
[121] Keith True-Up, p. 3.

Finding: Empire's acquisition of Aquila, Inc.'s Missouri natural gas properties affects corporate allocations in that there should be a reduction in the percentage of administrative and general costs otherwise allocable to Empire's electric operations. Further, the Commission finds that the parties' recommendations, as set forth in the non-unanimous Stipulation and Agreement Regarding Corporate Allocations and supported by the testimony, are reasonable and will result in just and reasonable rates.

Conclusion: As a result of Empire's acquisition of Aquila, Inc.'s Missouri gas properties, Empire's revenue requirement in this proceeding should be reduced by $500,000 to reflect the impact on test year A&G allocation factors pertaining to FERC USOA expense accounts 920 through 935, and that Empire's revenue requirement should be reduced by $150,000 to reflect the impact on test year general plant allocation factors pertaining to FERC USOA plant in service accounts 389 through 398.

F. The Settled Issues

Four separate Stipulations and Agreements were filed. None were joined by all parties. The Commission has the legal authority to accept a stipulation and agreement as offered by the parties as a resolution of issues raised in this case.[122] In reviewing that Stipulation and Agreement, the Commission notes that:[123]

> (a) Every decision and order in a contested case shall be in writing, and, except in default cases disposed of by stipulation, consent

[122] Section 536.060, RSMo Supp. 2004.

[123] Section 536.090, RSMo Supp. 2004. This provision applies to the Public Service Commission. St. ex rel. Midwest Gas Users' Assoc. v. Pub. Serv. Comm'n, 976 S.W.2d 485, 496 (Mo. App., W.D. 1998).

> order or agreed settlement, the decision, including orders refusing licenses, shall include or be accompanied by findings of fact and conclusions of law. * * *

Consequently, the Commission need not make either findings of fact or conclusions of law with respect to the issues resolved by the Stipulation and Agreement. The Commission convened an evidentiary hearing in this case and the parties presented such evidence as they chose; the requirement of a hearing has been met.

On August 18, 2006, the Staff and Empire jointly filed a Nonunanimous Stipulation and Agreement as to Certain Issues. The issues to which the parties stipulated were: banking fees, outside services, Edison Electric Institute expense, health care expense, life insurance expense, rate case expense, deferred income taxes, Energy Center income statement, Energy Center rate base, state tax flow-through, prepaid pension asset, allocation of taxes other than income taxes, FAS 87 pension costs, other post-employment benefit costs, test period revenue, retirement work in progress, other maintenance costs, cash working capital, growth on sales to municipals, storm damage tracker expense and tariff issues relating to the Experimental Green Power Schedule, Rider EGP, street lighting service charge, tariff section 5, sheets 12-17 and 17a, and tariff sheet header presentation. The Stipulation and Agreement also provided that the testimony of witnesses concerning these issues would be admitted without the witnesses taking the stand to present the testimony or being subject to cross-examination. No party filed a timely objection or request for hearing with respect to this Nonunanimous Stipulation and Agreement. The Commission issued an

Order Approving the Stipulation and Agreement as to Certain Issues on August 28, 2006.

On September 13, 2006, the Staff, the OPC and the Industrials jointly filed a Nonunanimous Stipulation and Agreement Regarding Rate Design Issues. No party filed a timely objection or request for hearing with respect to this Nonunanimous Stipulation and Agreement. The Stipulation and Agreement settled all issues under the Class Cost-of-Service/ Rate Design heading in the issues listed by the Parties on August 28, 2006, including the sub-issues. The Signatories agreed that (1) customer charges will not change; (2) that if the IEC is not terminated, any increase in permanent rates the Commission orders in this case, whether or not generated as a result of a regulatory amortization, shall be changed in proportion to each class' percentage of current permanent revenues, as trued-up; (3) that if the IEC is terminated, rates shall be changed, whether or not generated as a result of a regulatory amortization, in proportion to each class's current share of total rate revenues as trued-up, where total rate revenues are equal to current permanent revenues plus the IEC revenues; and (4) that the methodology the Staff employed to determine the rate revenues shown in Schedules DCR-l and DCR-3 attached to the Direct testimony of Staff witness David C. Roos shall be the methodology used to determine rate revenues for purposes of changing permanent rates. No party filed an objection to the Stipulation and Agreement. Therefore, the Commission may, pursuant to Commission Rule 4 CSR 240-2.115(2), treat it as unanimous. The Commission has reviewed the Stipulation and Agreement Regarding Rate Design Issues filed in this case and is of the opinion that it is just and reasonable and shall be approved.

Two other Stipulations and Agreements were filed, but timely objections were raised to them. They have become, by operation of Commission rule 4 CSR 240-2.115(2)(D), non-binding statements of position by the signatory parties. The issues included in those Stipulations and Agreements have been fully addressed in the Findings of Fact and Conclusions of Law above.

IT IS THEREFORE ORDERED:

1. That, as stated in the Report and Order issued December 21, 2006, the proposed electric service tariff sheets submitted under Tariff File No. YE-2006-0597 on February 1, 2006, by The Empire District Electric Company for the purpose of increasing rates for retail electric service to customers are ~~hereby~~ rejected. The specific sheets rejected are:

P.S.C. Mo. No. 5, Section A

21st Revised Sheet No. 1, Canceling 20th Revised Sheet No. 1

P.S.C. Mo. No. 5, Section 1

13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1
10th Revised Sheet No. 2, Canceling 9th Revised Sheet No. 2

P.S.C. Mo. No. 5, Section 2

12th Revised Sheet No. 1, Canceling 11th Revised Sheet No. 1
1st Revised Sheet No. 1a, Canceling Original Sheet No. 1a
12th Revised Sheet No. 2, Canceling 11th Revised Sheet No. 2
12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3
7th Revised Sheet No. 3a, Canceling 6th Revised Sheet No. 3a
13th Revised Sheet No. 4, Canceling 12th Revised Sheet No. 4
8th Revised Sheet No. 4a, Canceling 7th Revised Sheet No. 4a
12th Revised Sheet No. 6, Canceling 11th Revised Sheet No. 6
12th Revised Sheet No. 7, Canceling 11th Revised Sheet No. 7
5th Revised Sheet No. 7a, Canceling 4th Revised Sheet No. 7a
8th Revised Sheet No. 9, Canceling 7th Revised Sheet No. 9
5th Revised Sheet No. 9a, Canceling 4th Revised Sheet No. 9a

7th Revised Sheet No. 13, Canceling 6th Revised Sheet No. 13

P.S.C. Mo. No. 5, Section 3

13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1
17th Revised Sheet No. 2, Canceling 16th Revised Sheet No. 2
12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3
12th Revised Sheet No. 4, Canceling 11th Revised Sheet No. 4

P.S.C. Mo. No. 5, Section 4

5th Revised Sheet No. 17, Canceling 4th Revised Sheet No. 17
(Sheets No. 21, 22, and 23 were previously rejected)

P.S.C. Mo. No. 5, Section 5

7th Revised Sheet No. 12, Canceling 6th Revised Sheet No. 18
5th Revised Sheet No. 13, Canceling 4th Revised Sheet No. 18
4th Revised Sheet No. 14, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 15, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 16, Canceling 3rd Revised Sheet No. 18
4th Revised Sheet No. 17, Canceling 3rd Revised Sheet No. 18
1st Revised Sheet No. 17a, Canceling Original Sheet No. 18

2. That the tariff sheets previously filed by The Empire District Electric Company and approved by the Commission both in its December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs and its December 4, 2007 Order Vacating December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, and Order Approving Tariffs, to be effective December 14, 2007, shall remain in effect; provided, however, that, as clarified in the Order of Clarification issued herein on January 15, 2008, tariff sheets which took effect on or after January 2, 2007 shall not be impacted or otherwise displaced by this order. ~~file proposed electric service tariff sheets in compliance with this Report and Order.~~

~~P.S.C. Mo. No. 5, Section A~~

~~21st Revised Sheet No. 1, Canceling 20th Revised Sheet No. 1~~

~~P.S.C. Mo. No. 5, Section B~~

~~2nd Revised Sheet No. 1, Canceling 1st Revised Sheet No. 1~~
~~1st Revised Sheet No. 2, Canceling Original Sheet No. 2~~
~~1st Revised Sheet No. 3, Canceling Original Sheet No. 3~~
~~1st Revised Sheet No. 4, Canceling Original Sheet No. 4~~
~~1st Revised Sheet No. 5, Canceling Original Sheet No. 5~~
~~1st Revised Sheet No. 6, Canceling Original Sheet No. 6~~
~~1st Revised Sheet No. 7, Canceling Original Sheet No. 7~~
~~1st Revised Sheet No. 7a, Canceling Original Sheet No. 7a~~
~~1st Revised Sheet No. 8, Canceling Original Sheet No. 8~~

~~P.S.C. Mo. No. 5, Section 1~~

~~13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1~~
~~10th Revised Sheet No. 2, Canceling 9th Revised Sheet No. 2~~
~~6th Revised Sheet No. 3, Canceling 5th Revised Sheet No. 3~~

~~P.S.C. Mo. No. 5, Section 2~~

~~12th Revised Sheet No. 1, Canceling 11th Revised Sheet No. 1~~
~~1st Revised Sheet No. 1a, Canceling Original Sheet No. 1a~~
~~12th Revised Sheet No. 2, Canceling 11th Revised Sheet No. 2~~
~~1st Revised Sheet No. 2a, Canceling Original Sheet No. 2a~~
~~12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3~~
~~7th Revised Sheet No. 3a, Canceling 6th Revised Sheet No. 3a~~
~~13th Revised Sheet No. 4, Canceling 12th Revised Sheet No. 4~~
~~8th Revised Sheet No. 4a, Canceling 7th Revised Sheet No. 4a~~
~~12th Revised Sheet No. 5, Canceling 11th Revised Sheet No. 5~~
~~12th Revised Sheet No. 6, Canceling 11th Revised Sheet No. 6~~
~~12th Revised Sheet No. 7, Canceling 11th Revised Sheet No. 7~~
~~5th Revised Sheet No. 7a, Canceling 4th Revised Sheet No. 7a~~
~~6th Revised Sheet No. 8, Canceling 5th Revised Sheet No. 8~~
~~8th Revised Sheet No. 9, Canceling 7th Revised Sheet No. 9~~
~~5th Revised Sheet No. 9a, Canceling 4th Revised Sheet No. 9a~~
~~6th Revised Sheet No. 9b, Canceling 5th Revised Sheet No. 9b~~
~~5th Revised Sheet No. 10, Canceling 4th Revised Sheet No. 10~~
~~5th Revised Sheet No. 10a, Canceling 4th Revised Sheet No. 10a~~
~~3rd Revised Sheet No. 11, Canceling 2nd Revised Sheet No. 11~~
~~3rd Revised Sheet No. 11a, Canceling 2nd Revised Sheet No. 11a~~
~~3rd Revised Sheet No. 12, Canceling 2nd Revised Sheet No. 12~~
~~3rd Revised Sheet No. 12a, Canceling 2nd Revised Sheet No. 12a~~
~~7th Revised Sheet No. 13, Canceling 6th Revised Sheet No. 13~~
~~4th Revised Sheet No. 14, Canceling 3rd Revised Sheet No. 14~~
~~4th Revised Sheet No. 14a, Canceling 3rd Revised Sheet No. 14a~~
~~4th Revised Sheet No. 14b, Canceling 3rd Revised Sheet No. 14b~~
~~4th Revised Sheet No. 14c, Canceling 3rd Revised Sheet No. 14c~~

~~4th Revised Sheet No. 14d, Canceling 3rd Revised Sheet No. 14d~~
~~4th Revised Sheet No. 14e, Canceling 3rd Revised Sheet No. 14e~~

~~P.S.C. Mo. No. 5, Section 3~~

~~13th Revised Sheet No. 1, Canceling 12th Revised Sheet No. 1~~
~~6th Revised Sheet No. 1a, Canceling 5th Revised Sheet No. 1a~~
~~17th Revised Sheet No. 2, Canceling 16th Revised Sheet No. 2~~
~~8th Revised Sheet No. 2a, Canceling 7th Revised Sheet No. 2a~~
~~12th Revised Sheet No. 3, Canceling 11th Revised Sheet No. 3~~
~~1st Revised Sheet No. 3a, Canceling Original Sheet No. 3a~~
~~12th Revised Sheet No. 4, Canceling 11th Revised Sheet No. 4~~
~~4th Revised Sheet No. 5, Canceling 3rd Revised Sheet No. 5~~
~~2nd Revised Sheet No. 6, Canceling 1st Revised Sheet No. 6~~
~~1st Revised Sheet No. 7, Canceling Original Sheet No. 7~~
~~1st Revised Sheet No. 8, Canceling Original Sheet No. 8~~
~~1st Revised Sheet No. 9, Canceling Original Sheet No. 9~~

~~P.S.C. Mo. No. 5, Section 4~~

~~4th Revised Sheet No. 1, Canceling 3rd Revised Sheet No. 1~~
~~11th Revised Sheet No. 2, Canceling 10th Revised Sheet No. 2~~
~~9th Revised Sheet No. 3, Canceling 8th Revised Sheet No. 3~~
~~9th Revised Sheet No. 4, Canceling 8th Revised Sheet No. 4~~
~~5th Revised Sheet No. 4a, Canceling 4th Revised Sheet No. 4a~~
~~3rd Revised Sheet No. 4b, Canceling 2nd Revised Sheet No. 4b~~
~~3rd Revised Sheet No. 4c, Canceling 2nd Revised Sheet No. 4c~~
~~3rd Revised Sheet No. 5, Canceling 2nd Revised Sheet No. 5~~
~~14th Revised Sheet No. 6, Canceling 13th Revised Sheet No. 6~~
~~6th Revised Sheet No. 7, Canceling 5th Revised Sheet No. 7~~
~~3rd Revised Sheet No. 8, Canceling 2nd Revised Sheet No. 8~~
~~1st Revised Sheet No. 8a, Canceling Original Sheet No. 8a~~
~~2nd Revised Sheet No. 8b, Canceling 1st Revised Sheet No. 8b~~
~~2nd Revised Sheet No. 8c, Canceling 1st Revised Sheet No. 8c~~
~~4th Revised Sheet No. 9, Canceling 3rd Revised Sheet No. 9~~
~~3rd Revised Sheet No. 10, Canceling 2nd Revised Sheet No. 10~~
~~3rd Revised Sheet No. 11, Canceling 2nd Revised Sheet No. 11~~
~~3rd Revised Sheet No. 12, Canceling 2nd Revised Sheet No. 12~~
~~3rd Revised Sheet No. 13, Canceling 2nd Revised Sheet No. 13~~
~~3rd Revised Sheet No. 14, Canceling 2nd Revised Sheet No. 14~~
~~4th Revised Sheet No. 15, Canceling 3rd Revised Sheet No. 15~~
~~5th Revised Sheet No. 16, Canceling 4th Revised Sheet No. 16~~
~~5th Revised Sheet No. 17, Canceling 4th Revised Sheet No. 17~~
~~1st Revised Sheet No. 18, Canceling Original Sheet No. 18~~
~~1st Revised Sheet No. 19, Canceling Original Sheet No. 19~~
~~1st Revised Sheet No. 20, Canceling Original Sheet No. 20~~

~~2nd Revised Sheet No. 21, Canceling 1st Revised Sheet No. 21~~

~~P.S.C. Mo. No. 5, Section 5~~

~~5th Revised Sheet No. A, Canceling 4th Revised Sheet No. A~~
~~4th Revised Sheet No. 1, Canceling 3rd Revised Sheet No. 1~~
~~5th Revised Sheet No. 2, Canceling 4th Revised Sheet No. 2~~
~~2nd Revised Sheet No. 2a, Canceling 1st Revised Sheet No. 2a~~
~~5th Revised Sheet No. 3, Canceling 4th Revised Sheet No. 3~~
~~4th Revised Sheet No. 4, Canceling 3rd Revised Sheet No. 4~~
~~3rd Revised Sheet No. 5, Canceling 2nd Revised Sheet No. 5~~
~~3rd Revised Sheet No. 6, Canceling 2nd Revised Sheet No. 6~~
~~4th Revised Sheet No. 7, Canceling 3rd Revised Sheet No. 7~~
~~4th Revised Sheet No. 8, Canceling 3rd Revised Sheet No. 8~~
~~5th Revised Sheet No. 9, Canceling 4th Revised Sheet No. 9~~
~~6th Revised Sheet No. 10, Canceling 5th Revised Sheet No. 10~~
~~5th Revised Sheet No. 11, Canceling 4th Revised Sheet No. 11~~
~~2nd Revised Sheet No. 11a, Canceling 1st Revised Sheet No. 11a~~
~~7th Revised Sheet No. 12, Canceling 6th Revised Sheet No. 12~~
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~~4th Revised Sheet No. 16, Canceling 3rd Revised Sheet No. 16~~
~~4th Revised Sheet No. 17, Canceling 3rd Revised Sheet No. 17~~
~~1st Revised Sheet No. 17a, Canceling Original Sheet No. 17a~~
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~~1st Revised Sheet No. 17d, Canceling Original Sheet No. 17d~~
~~1st Revised Sheet No. 17e, Canceling Original Sheet No. 17e~~
~~1st Revised Sheet No. 17f, Canceling Original Sheet No. 17f~~
~~5th Revised Sheet No. 18, Canceling 4th Revised Sheet No. 18~~
~~3rd Revised Sheet No. 19, Canceling 2nd Revised Sheet No. 19~~
~~3rd Revised Sheet No. 20, Canceling 2nd Revised Sheet No. 20~~
~~3rd Revised Sheet No. 21, Canceling 2nd Revised Sheet No. 21~~
~~5th Revised Sheet No. 22, Canceling 4th Revised Sheet No. 22~~
~~5th Revised Sheet No. 23, Canceling 4th Revised Sheet No. 23~~
~~2nd Revised Sheet No. 23a, Canceling 1st Revised Sheet No. 23a~~
~~5th Revised Sheet No. 24, Canceling 4th Revised Sheet No. 24~~
~~4th Revised Sheet No. 25, Canceling 3rd Revised Sheet No. 25~~
~~6th Revised Sheet No. 26, Canceling 5th Revised Sheet No. 26~~
~~5th Revised Sheet No. 27, Canceling 4th Revised Sheet No. 27~~
~~5th Revised Sheet No. 28, Canceling 4th Revised Sheet No. 28~~
~~5th Revised Sheet No. 29, Canceling 4th Revised Sheet No. 29~~

~~3rd Revised Sheet No. 30, Canceling 2nd Revised Sheet No. 30~~
~~3rd Revised Sheet No. 31, Canceling 2nd Revised Sheet No. 31~~
~~1st Revised Sheet No. 32, Canceling Original Sheet No. 32~~
~~1st Revised Sheet No. 33, Canceling Original Sheet No. 33~~
~~1st Revised Sheet No. 34, Canceling Original Sheet No. 34~~
~~1st Revised Sheet No. 35, Canceling Original Sheet No. 35~~
~~2nd Revised Sheet No. 36, Canceling 1st Revised Sheet No. 36~~
~~2nd Revised Sheet No. 37, Canceling 1st Revised Sheet No. 37~~
~~2nd Revised Sheet No. 38, Canceling 1st Revised Sheet No. 38~~
~~2nd Revised Sheet No. 39, Canceling 1st Revised Sheet No. 39~~
~~2nd Revised Sheet No. 40, Canceling 1st Revised Sheet No. 40~~
~~1st Revised Sheet No. 41, Canceling Original Sheet No. 41~~

3. That, as stated in the Report and Order issued December 21, 2006, the Nonunanimous Stipulation and Agreement Regarding Rate Design, filed on September 13, 2006, and deemed to be unanimous by operation of Commission Rule, is hereby approved. The parties shall comply with the terms of the Stipulation and Agreement.

4. That all ~~pending~~ motions filed herein on or prior to December 28, 2006, currently pending and not otherwise specifically addressed~~disposed of~~ herein, are hereby denied.

5. That the Application for Rehearing filed by Explorer Pipeline and Praxair, Inc. with regard to the December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs and the Applications for Rehearing filed herein by The Empire District Electric Company, the Office of the Public Counsel, and Explorer Pipeline and Praxair, Inc., with regard to the Commission's December 21, 2006 Report and Order are determined to be moot.

6. That the Applications for Rehearing filed herein by The Empire District Electric Company, the Office of the Public Counsel, and Explorer Pipeline

and Praxair, Inc., with regard to the Commission's January 9, 2007 Order Supplementing and Clarifying Report and Order are determined to be moot.

7. That any applications for rehearing and/or clarification field herein with regard to the Order Vacating December 29, 2006 Order Granting Expedited Treatment and Approving Tariffs, and Order Approving Tariffs, issued on December 4, 2007, to be effective December 14, 2007, shall remain pending before this Commission. All other pending rehearing applications not specifically addressed herein shall also remain pending before this Commission.

8~~5~~. That this Report and Order Upon Reconsideration shall become effective on ____________________, 2008~~December 31, 2006~~.

~~6. That this case may be closed on January 31, 2007.~~