

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

In the Matter of the Sixth Prudence Review of)
Costs Subject to the Commission-Approved)
Fuel Adjustment Clause of The Empire District)
Electric Company.)

Case No. EO-2017-0065

STAFF'S REPLY BRIEF

Staff's prudence review of Empire's Fuel Adjustment Clause (FAC) included, among other things, a review of Empire's natural gas fuel hedging activities.¹ In all, Staff determined that Empire performed its gas fuel hedging in accordance with its Energy Risk Management Policy, its Commission-approved FAC tariff and Commission rules and found no imprudence on the part of Empire.

Staff has no new arguments in defense of its prudence review report. Staff's Initial Brief explains in detail the scope and conduct of Staff's review and how Staff determined no imprudence by Empire management. Staff will not burden the record by restating the same points.

However, Staff does take issue with OPC's incorrect application of the prudence standard.

Public Counsel's flawed argument that Staff's Prudence Review is "insufficient and unreliable"² misleads the Commission because OPC has relied on an incorrect application of the prudence standard. OPC employs a slight-of-hand word-play which twists the meaning of the words "prudent" and "imprudent" in a way that conflates the application of both words.

¹ The FAC Review Period was March 1, 2015 through August 31, 2016.

² *Initial Brief of the Office of Public Counsel*, p. 36.

OPC's attack of Staff's prudence review relies on semantics. Public Counsel correctly states "...that Staff did not review Empire's FAC costs to determine whether the company's costs were prudent."³ But, by OPC's turn of phrase it hopes the Commission draws the inference that Staff did not, in OPC's view, do a "sufficient or reliable prudence review" because Staff admitted it did not make determinations of prudence. Simply put, OPC's claim that Staff's prudence review is insufficient is based on an incorrect application of the prudence standard.

What OPC fails to grasp is that a prudence review does not require the Staff to make individual prudence determinations on the decisions evaluated by Staff during its prudence review.

Staff has stated many times that its prudence review sought to identify "imprudent" decisions based on information known at the time the decisions were made – not to make determinations that Empire's decisions were categorically "prudent". This is an important distinction.

A decision not declared "prudent" does not mean that the decision was "imprudent". Rather it means there was no clear evidence at the time the decision was made that the decision of the utility's decision-makers was unreasonable or inappropriate. Even if it is determined upon later review that the outcome of a decision was not "good", it cannot be concluded that the decision was "imprudent" without proving up inefficiency or improvidence by the decision-makers with knowledge available at the time the decision was made.

³ *Initial Brief of the Office of Public Counsel*, p. 37.

Hindsight will always inform whether the outcome of a decision was “good” or not, and is not permitted under the prudence standard. Staff’s approach to Empire’s prudence review followed the prudence standard affirmed by the courts:⁴

[A]utility’s costs are presumed to be prudently incurred.... However, the presumption does not survive “a showing of inefficiency or improvidence.”...[W]here some other participant in the proceeding creates a serious doubt as to the prudence of an expenditure, then the applicant has the burden of dispelling these doubts and proving the questioned expenditure to have been prudent.... (*emphasis added*)

And, for Public Counsel to calculate its alleged “unnecessary” costs of Empire’s gas hedging activities – costs which occurred during an unforeseen period of historic low gas prices, it had to rely on hindsight.⁵ No one could have known at the time Empire placed its gas hedges what the future market price of gas would be for gas delivered in the Review Period. Unlike OPC, Staff evaluated Empire’s hedging decisions for imprudence *without the benefit of hindsight* as required under the court’s prudence standard.⁶

...[T]he company’s conduct should be judged by asking whether the conduct was reasonable at the time, under all the circumstances, *considering that the company had to solve its problem prospectively rather than in reliance on hindsight*. In effect, our responsibility is to determine how reasonable people would have performed the tasks that confronted the company. [internal citations omitted](*emphasis added*).

Lastly, Staff’s Initial Brief explains how Empire’s customers were protected from natural gas price volatility as a result of the Company’s gas hedging activities. Mindful

⁴ Ex. 200, Staff’s *Sixth Prudence Review of Costs Related to the Fuel Adjustment Clause for The Electric Operations of The Empire District Electric Company* (Staff’s *Prudence Review Report*), p. 3, *citing to State ex rel. Associated Natural Gas Co. v. Public Service Commission of State of Missouri*, 954 S.W.2nd 520, 528-529 (Mo. App. W.D. 1997).

⁵ See Staff’s *Initial Brief* pp. 5-8. At the time Empire placed its gas hedges (between 2010 and 2015), it could not be foreseen that the Review Period would experience historically low gas prices.

⁶ Ex. 200, Staff’s *Sixth Prudence Review of Costs Related to the Fuel Adjustment Clause for The Electric Operations of The Empire District Electric Company* (Staff’s *Prudence Review Report*), p. 3, *citing to State ex rel. Associated Natural Gas Co. v. Public Service Commission of State of Missouri*, 954 S.W.2nd 520, 528-529 (Mo. App. W.D. 1997).

that 40% of Empire's generation fleet depends on a stable supply of natural gas, Empire managed its natural gas supply portfolio in a way that protected its customers from the risk of gas price volatility given all the information known at the time its hedging decisions were made.⁷ Staff identified no incidents of imprudence by Empire's management during the Review Period.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 26th day of October 2017.

/s/ Robert S. Berlin

⁷ See *Initial Brief of Staff*, pp. 5-8