

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

In the Matter of the tariff filing of The)	
Empire District Electric Company)	
to implement a general rate increase for)	Case No. ER-2006-0315
retail electric service provided to customers)	
in its Missouri service area)	

EMPIRE'S RESPONSE TO NOTICE REQUIRING FILING

Comes now The Empire District Electric Company ("Empire" or the "Company"), by counsel, and for its Response to the Notice Requiring Filing issued by the Missouri Public Service Commission (the "Commission") on September 14, 2006, respectfully states as follows:

1. Provide the Commission a legal analysis of the Commission's ability to make changes to the IEC, as well as an explanation of how the IEC resulting from the "2001 Rate Case" was altered prior to its suspension and termination.

Consistent with its position that the Commission may lawfully consider Empire's request in this case to terminate the Interim Energy Charge ("IEC") tariffs implemented following approval by the Commission of the Nonunanimous Stipulation and Agreement Regarding Fuel and Purchased Power Expense in Case No. ER-2004-0570 (the "Agreement"), the Company also believes that, consistent with the terms of the Agreement and in the exercise of its statutory authority, the Commission may make changes to the IEC tariff. In summary, in exercising its duty to establish just and reasonable rates, the Commission has broad latitude.

First, the Agreement itself does not contain any provision restricting Empire's ability to request termination or modification of the IEC tariff or the Commission's authority to entertain such a request. If the parties had intended to limit Empire's ability

or the Commission's powers to terminate or modify the IEC, such limitations would have been contained in the Stipulation. The Agreement, however, contains no "moratorium" language. Moreover, at page two, the Agreement provides as follows (emphasis added):

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 . . . unless earlier terminated by order of the Commission.*

While the clear and unambiguous language and intent of the Agreement limits the life of the IEC tariff, it does not require that the IEC tariff remain in effect for three years. Furthermore, nothing in the Agreement suggests that Empire's base rates or the fuel component of those base rates remain in effect for three years. The Agreement contains no "moratorium" language that prohibits Empire from filing a rate case to seek recovery of all of its costs, including fuel and purchased power costs, through base rates.¹ Nor does the Agreement contain moratorium language that prohibits Empire from seeking recovery of its fuel costs through a combination of base rate treatment coupled with an IEC.

More importantly, and in direct response to the Commission's question, the Agreement does not contain any provision, and none exists in the law, which even arguably may be interpreted as limiting the *Commission's* ability to modify or terminate the IEC tariff. The Agreement does not restrict the Commission's ability to modify, at any time, the amount which may be collected by Empire through its base rates or the amount which may be collected through an IEC or other surcharge, nor does the

¹ Although the Agreement provides that the IEC shall be in effect for three years as described in the Agreement and that Empire shall not request the use of another type of adjustment mechanism or AAO to recover variable fuel and purchased power costs while the IEC is in effect, there is no similar language regarding base rates and the corresponding base rate tariffs. It should be clear to the Commission that Empire's base rates may be adjusted in this proceeding to account for fuel and purchased power costs, whether or not the IEC tariff remains in place.

Agreement limit the Commission's ability to modify the term of an IEC or other surcharge tariff. Furthermore, as a matter of law, the parties could not so limit the Commission.

The fixing of reasonable rates is an exercise of the sovereign police power of the state, and this sovereign power cannot be contracted away.² As the Supreme Court of Missouri has held:

Under it the sovereign police power of the State is preserved intact, irrespective of contracts with reference to rates for public service. Under it no contract as to rates will stand against the order of the Public Service Commission for reasonable rates, whether such reasonable rates be lower or higher than the contract rate.³

Further, the Commission "cannot commit itself to a position that, because of varying conditions and occurrences over time, may require adjustment to protect the ratepayers."⁴ The Commission must be able to exercise flexibility in its ratemaking function to deal with changing and unforeseen circumstances.⁵ "As a result, contracts between public utilities and their customers cannot limit the ratemaking authority of the Commission. **Public utilities have no authority to enter into a contract which cannot be modified or revoked by the state.**"⁶

² *Ex rel. City of Sedalia v. Public Service Commission*, 204 S.W. 497, 499 (1918); see also *City Water Company of Sedalia v. City of Sedalia*, 231 S.W. 942, 944-945 (1921); *Ex rel. Missouri Gas & Electric Service Company v. Trimble*, 271 S.W. 43 (Mo. banc 1925); *Ex rel. Kansas City Public Service Company v. Latshaw*, 30 S.W.2d 105, 108 (Mo. banc 1930); *Gaines v. Van Gibbs*, 709 S.W.2d 541, 544 (Mo. App. S.D. 1986).

³ *Ex rel. Kansas City Public Service Company v. Latshaw*, 30 S.W.2d 105, 108 (Mo. banc 1930); see also *Bertha A. Mining Company v. The Empire District Electric Company*, 235 S.W. 508 (Mo.App. 1921).

⁴ *Ex rel. Capital City Water Company v. Mo PSC*, 850 S.W.2d 903, 911 (Mo.App. W.D. 1993) (internal citations omitted).

⁵ *Id.*

⁶ *Id.* (internal citations omitted) (emphasis added)

Missouri statutes provide that the Commission has the duty to ensure that charges for utility service are “just and reasonable.”⁷ The fixing of just and reasonable rates involves a balancing of investor and consumer interests.⁸ In determining the price to be charged for service, the Commission is to consider all facts which in the Commission’s judgment have any bearing upon of the question of what is “just and reasonable.”⁹

Additionally, the enactment of RSMo. Section 386.266 did not limit or abrogate the Commission’s power to modify (or terminate) Empire’s existing IEC tariff, a position advanced by Praxair/Explorer in this case. Subsection 5 of the statute reads (emphasis added) that “(o)nce such an *adjustment mechanism* is approved by the commission under this section, it shall remain in effect until such time as the commission authorizes the *modification, extension, or discontinuance* of the mechanism in a general rate case or complaint proceeding.”¹⁰ On the other hand, Subsection 8 of the statute reads that “(i)n the event the commission lawfully approves an *incentive or performance based plan*, such plan shall be binding on the commission for the entire term of the plan.”¹¹ Subsection 8 of the statute does not pertain to Empire’s existing IEC.

Whether or not Empire’s existing IEC is an “incentive or performance based plan” as contemplated by the statute, it is clear that Senate Bill 179 did not take effect and become law until after the Agreement was executed and approved by the Commission. In fact, the bill was not even signed by the Governor until July of 2005, while the Agreement was executed in February of 2005. Statutes are generally presumed to

⁷ *Ex rel. Midwest Gas Users’ Association v. Public Service Commission of the State of Missouri*, 976 S.W.2d 470, 475 (Mo.App. W.D. 1998).

⁸ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 602-603 (Mo banc. 1944).

⁹ *Midwest Gas Users’ Association*, 976 S.W.2d at 478.

¹⁰ Emphasis added.

¹¹ Emphasis added.

operate prospectively. Absent an express intention to the contrary by the legislature, a substantive provision of a statute cannot be applied retroactively.¹²

There most certainly is not a clear expression by the legislature of any intent that the statute be given retroactive application. In fact, the express language of the statute demonstrates that the statute is only to be applied prospectively. Subsection 10 of the statute reads as follows:

Nothing contained in this section shall be construed as affecting any existing adjustment mechanism, rate schedule, tariff, incentive plan, or other ratemaking mechanism currently approved and in effect.

The Commission's ability to make changes to the current IEC tariff is consistent with what was done regarding the IEC tariff which was implemented as a result of Empire's "2001 Rate Case," Commission Case No. ER-2001-299. Paragraph nine of the Unanimous Stipulation and Agreement entered into in that case reads, in part, as follows:

The rate schedules to be filed by Empire pursuant to this Agreement will indicate that the IEC itself . . . will expire at 12:01 a.m. on October 1, 2003.

The Report and Order (effective October 2, 2001) issued in Empire's 2001 Rate Case, reads, in part, as follows:

The revenue from the IEC is to be collected by Empire on an interim and subject to true-up and refund basis under the terms of the Stipulation and Agreement.

The tariff, or IEC rider, implemented in conformity with the Report and Order reads, in part, as follows:

This interim rider shall be in effect from October 2, 2001 through September 30, 2003.

¹² *Dalba v. YMCA of Greater St. Louis*, 69 S.W.3d 137, 140 (Mo.App. E.D. 2002); see also *Department of Social Services v. Villa Capri Homes, Inc.*, 684 S.W.2d 327, 332 (Mo. banc 1985).

The IEC tariff implemented as a result of Empire's 2001 Rate Case, however, did not remain in effect through September 30, 2003. Instead, the amount collected pursuant to the IEC rider was modified by the Commission approximately eight months after it took effect when in Case No. ER-2002-1074, Empire filed a tariff sheet designed to reduce the Company's electric rates by approximately \$7 million annually through a credit to the then-existing Commission-authorized IEC. With an agreement of the parties before it, the Commission approved the tariff effective June 14, 2002.

Additionally, in the context of a rate case initiated by Empire in March of 2002 (Commission Case No. ER-2002-424), the IEC authorized by the Commission in ER-2001-299, and modified in ER-2002-1074, terminated at 12:01 a.m. on the Commission-ordered effective date of the new rates resulting from that rate case -- December 1, 2002. All monies collected under the IEC were refunded to Empire's customers, with interest.

In summary, in the case of the IEC which resulted from Empire's 2001 rate case, the parties agreed and the Commission ordered that the amount collected under the IEC be reduced, and ultimately terminated.

The irony here is that when Empire's fuel costs were less than expected, all parties -- including Empire -- agreed to the modification and eventual termination of the 2001 IEC tariff. Now, however, when Empire's fuel costs have greatly exceeded expectations, Praxair/Explorer and OPC are unwilling to agree to any modification or termination. In any event, as a matter of law in exercising its duty to set just and reasonable rates, the Commission is authorized to terminate the IEC tariff, modify its terms and/or adjust the amount collected by Empire through base rates.

2. Specifically, may the Commission change the fuel cost "collar" based

on the projected fuel costs already in evidence?

As discussed above, pursuant to the Agreement and as a matter of law, the Commission may modify Empire's current IEC tariffs, including the fuel cost "collar," based on the projected fuel costs in evidence in this proceeding. Specifically, the record reflects a new base level of total Company fuel and purchased power expense of \$166,012,277, as set out in the rebuttal testimony of Company witness Todd Tarter (Exhibit 17). Using the Staff's Missouri jurisdictional allocation factor of 82.56 percent, this is equal to \$137,059,736 of fuel and purchased power expense on a Missouri jurisdictional basis.¹³

Also set out in the supplemental direct testimony of Company witness Tarter, (Exhibit 15), is evidence indicating a 2009 total Company cost for fuel and purchased power in the amount of \$184,171,272 (\$32.75/MWH) or \$152,051,802 Missouri jurisdictional. This amount was computed using the financial natural gas contract information as of July 10, 2006.

3. As the IEC was established as part of a Stipulation and Agreement, if the fuel cost "collar" is changed, are other changes to the Stipulation and Agreement necessary to make the resulting IEC and Stipulation and Agreement not inequitable to signatory parties? What about non-signatory parties? If yes, please explain those other changes in detail, including specific suggestions for language changes.

Paragraph 5(a) of the Agreement states that except as expressly specified therein, the terms of the Agreement are not binding in any other proceeding. The current rate case is such a proceeding. Paragraph 1(c) of the Agreement, however, gives the Commission the right to terminate the IEC tariff in less than three years.

¹³ This amount is expected to change during the true-up hearing to account for customer growth and an updated gas price. At this time, the Company is working with Staff to derive a Net System Input amount which will be needed to update the fuel and purchased power cost.

Further, under its general rate making authority as described herein, the Commission may order a new or modified IEC tariff under conditions it deems appropriate. Assuming the Commission has the authority to modify other provisions of the Agreement, no such modifications are necessary or appropriate. All parties received adequate consideration for the Agreement, and, as stated above, the Agreement contemplated modification or termination of the IEC tariffs by the Commission.¹⁴ The Commission should, however, clarify that in its next rate case, Empire may request a fuel adjustment mechanism.

4. Regardless of the answers and legal analysis in response to questions 1-3 above, at what level should the fuel cost "collar" be set?

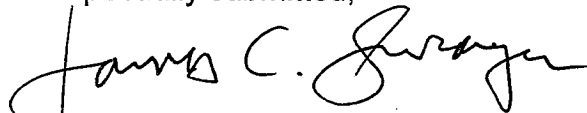
Empire's position is that the Commission should authorize base rate recovery of Missouri jurisdictional fuel and purchased power costs in the amount of \$137,059,736 or \$0.03330 per kilowatt-hour. In addition the Commission could authorize an IEC using the current IEC rate of \$0.002131 per kilowatt-hour (as contained in the Agreement). This would result in a fuel and purchased power expense ceiling or collar of \$145,837,367 on a Missouri jurisdictional basis.¹⁵ Under this scenario, Empire would recover approximately \$137 million of fuel and purchased power costs through base rates and approximately \$9 million through the IEC.

¹⁴ It should be noted, however, that Empire should have the ability to seek termination of the IEC (if it is not terminated in this case) and the use of Senate Bill 179, RSMo. Section 386.266, in any future rate case proceeding.

¹⁵ All amounts are subject to change during the "true-up" audit.

The Commission has the duty to establish just and reasonable rates in this proceeding so that Empire may continue to provide safe and adequate service while having the opportunity to earn a reasonable rate of return. In so doing, Empire should be allowed to recover its prudently incurred fuel and purchased power costs. One way to accomplish this would be to modify the terms of the existing IEC tariff by adjusting the base or floor, adjusting the ceiling or collar, or otherwise modifying its terms. The Commission may also permit recovery of Empire's prudently incurred fuel and purchased power costs by way of new base rates with or without an IEC or fuel adjustment mechanism.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "James C. Swearengen", written over a horizontal line.

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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was electronically transmitted, sent by U.S. Mail, postage prepaid, or hand-delivered, on this 20th day of September, 2006, to:

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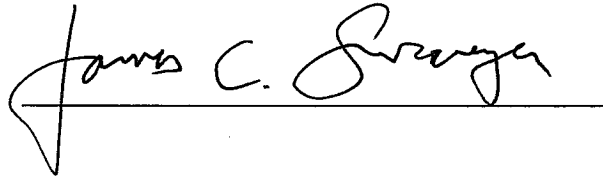
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