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

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

RESPONSE OF PRAXAIR, INC. AND EXPLORER PIPELINE COMPANY TO
MOTION FOR CLARIFICATION OR, IN THE ALTERNATIVE,
REQUEST FOR EXTENSION TO CONDUCT FURTHER DISCOVERY
AND MOTION FOR HEARING

COMES NOW, Praxair, Inc. and Explorer Pipeline Company and in response to the Motion for Clarification filed by The Empire District Electric Company ("Empire") on March 17, 2006, respectfully states as follows:

**EXECUTIVE SUMMARY**

Praxair / Explorer assert that the Interim Energy Charge, as described in the Stipulation and Agreement, approved by the Commission and reflected in Empire's tariffs is not ambiguous. That IEC has a definite term of three-years with no provision for early termination. The IEC represents the product of negotiations between Empire and its customers and should not be overturned by the Commission.

In the event that the Commission finds that an ambiguity exists, Praxair / Explorer question whether the Commission has the authority to interpret the contract between Empire and its customers which implements the Stipulation. Arguably, the interpreter of any ambiguity in a contract would be a court of law. Setting this argument aside for the moment, Praxair / Explorer maintain that Empire's actions leading up to the execution of the Stipulation and since that time have been inconsistent with its current assertion that the IEC could be prematurely terminated. Clearly, the intent of the parties was to implement a 3-year IEC.

## I. **<u>THE FOUR CORNERS OF THE STIPULATION REVEALS THE INTENT OF THE PARTIES TO IMPLEMENT AN INTERIM ENERGY CHARGE WITH A THREE (3) TERM WITH NO PROVISION FOR EARLY TERMINATION</u>**.

### A. Background

1. On March 10, 2005, the Commission issued its Report and Order in Docket No. ER-2004-0570. As part of its ultimate finding granting Empire a $25.7 million permanent rate increase, the Commission also approved a Nonunanimous Stipulation and Agreement ("Stipulation")[1] providing for the collection of an <u>additional</u> $8.2 million in the form of an Interim Energy Charge (IEC).[2] In effect, the Commission granted Empire the ability to increase its electric revenues by **<u>13.1%</u>**.

2. Less than a year later, Empire is again back before the Commission seeking an additional increase of **<u>9.63%</u>**. If granted, this represents, in total, an increase for Empire electric customers of approximately 22.7% in the span of approximately 21 months. More relevant to the current pleading, Empire also seeks to terminate the IEC from its previous proceeding and replace it with a fuel adjustment clause called an Energy Cost Recovery Rider ("ECR").

3. Recognizing the <u>explicit</u> three (3) year term of the IEC established in Case No. ER-2004-0570, Empire filed its current Motion for Clarification requesting a Commission finding that "Empire may seek to terminate its existing IEC and implement an ECR in this case."

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[1] The Stipulation and Agreement reflected only the agreement of Empire, Praxair/Explorer and OPC. However, it was treated as being unanimous because under Commission rules, no other party, including Staff, submitted a timely objection.

[2] Report and Order, Case No. ER-2004-0570, issued March 10, 2005.

4. Despite Empire's claims that the language of the Stipulation is clear and unambiguous, it is interesting that Empire has entitled its request as a Motion for **<u>Clarification</u>**. American Heritage Dictionary defines clarify as "to clear of confusion or uncertainty." An impartial reading of: (1) the entirety of the Stipulation; (2) the Commission's Report and Order approving that Stipulation; and (3) Empire's tariffs implementing that Stipulation and Report and Order demonstrates that there is no "confusion or uncertainty" for the Commission to clarify. These documents demonstrate, without ambiguity, that the agreed-upon and Commission-approved IEC has a fixed term of three years.

5. Consider how this IEC (and all prior IECs) were designed: ***First***, they represent numerous compromises of positions that are reflected in the "cap" or "collar" numbers and the operation of the IEC. Rates are set reflecting the collar or cap number and the utility collects revenues at that level **even though actual fuel and purchased costs may be below that level.**[3] The customers take the risk that they may pay more than actual incurred costs at a given point in time. ***Second***, the utility takes the risk that its costs may rise above the cap or collar. This is the protection for the customers from escalating fuel and purchased power costs. ***Third***, the customers take the risk that the utility may be able to drive its costs below the "threshold" level, for in such case the utility would be entitled to retain all the savings it could gain by reducing its costs below the threshold. This is intended and designed to be an **incentive** for the utility to aggressively pursue reductions in its fuel and purchased power costs. ***Fourth***, between the two numbers, at the end of the IEC term, there is a provision for a prudence review

[3] In Empire's case, as will be discussed *infra*, until comparatively recently, expenses were stated to be $25 million ***below*** the cap level at which rates were set.

and true-up proceeding to validate the expenses, and calculate any refund that may be due above the actual prudent costs, down to the threshold level of costs ***Fifth***, the mechanism is balanced in that the customers are protected against fuel and purchased power costs rising above the cap or collar level for the duration of the IEC while the utility has the designed incentive noted in ***third*** above and recovery of its costs below the collar that are reviewed through the true-up process. Moreover, the point of calculation is 3 years. Much can happen in 3 years. Prices fluctuate and, as they do, they may for a short period appear to be favoring one side of the bargain or the other. But the relevant point in time is 3 years. ***Sixth***, in this case, the parties negotiated a provision that, if at the end of the second year, this is more than a $10 million over-recovery, Empire will refund the amount that exceeds $10 million back to the customers. Note that the entire $10 million is not refunded; only the excess above that amount. This leaves $10 million in Empire's refund account which could be offset by under-recoveries in the third and final year of the IEC. This provision also is not accidental but was negotiated.

6. The entire mechanism is a compromise of various strongly-held positions. And, it is a contract that has been approved by the Commission as unanimous in what is now a final order. It represents a balance of the interests of the respective utility and customers represented by the parties' selection of the collar and threshold fuel and purchased power values. Those levels were not set accidentally but were set after consideration and reflection by the parties with the full understanding on all sides of the operation of the mechanism and the significance the selection of specific collar and threshold numbers had on its operation. To suggest that one party may unilaterally terminate the mechanism before its negotiated term certainly violates this carefully

balanced contract and, at base, is simply unfair. It is nothing more than "buyers' remorse" about a contract that, as will be seen, was touted by Empire as highly beneficial, but now, in a "snapshot view" appears as beneficial to the customers.

7. What would be the result if Empire were successful in reducing its fuel and purchased power costs below the threshold level thereby entitling it to retain the savings it obtained below that level? Would the contracting customers be heard to come forward to the Commission and ask that the mechanism be terminated so that Empire's rates could be reduced? They should not be permitted to make such an assertion as that would deny Empire the benefit of that part of its bargain. But Empire now seeks to deny the customers the benefit of ***their*** side of the bargain simply because it currently suits Empire's whims.

8. As will be seen *infra*, Empire loved the deal it got in the beginning, touting it to its investors and Wall Street. Of course, that was when the skies were sunny and Empire was significantly over-recovering its fuel and purchased power expenses. When fortunes swing the other way, Empire whines that it wants out of its once-beloved deal. It is a sad fact that the divorce rate in this country is at record levels, but it would doubtless be higher were Empire's flexible ethics applied to the marriage contract. "For better or for worse" would survive only through the honeymoon. Once the hair curlers and cold cream came out of the drawer or a "night out with the boys" became too frequent, there would be a rush to the divorce lawyer.

9. The motives underlying Empire's pending Motion should be very apparent. In light of the subsequent passage of SB179 and the options available to electric utilities under that subsequent legislation, Empire, now apparently overcome by

"buyers' remorse," is really asking for the Commission to undo the terms of a three year contract that it bargained for (and that the Commission through now-Chairman Davis both solicited[4] and approved) regarding the method by which Empire should be permitted to collect fuel and purchased power expenses from its customers.

**B. The Four Corners of the Stipulation and Agreement provides clear intent of the Parties as to the length of the Interim Energy Charge.**

10. A fundamental rule of contract interpretation is to give effect to the intent of the parties. As long ago as 1894, the Missouri Supreme Court noted the following:

> The prime rule for the construction of contracts is that the intent of the parties (as contained in the language used by them) shall be given effect. That intent it is the chief purpose of interpretation to discover. There are many recognized rules to aid in that discovery in legal proceedings, among them those which require the interpreter to consider everything within the four corners of the document, and permit the circumstances in which it originated to be taken into account in ascertaining what was probably intended by it.[5]

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[4] During the hearing, Commissioner Davis challenged the parties to "think out of the box."
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COMMISSIONER DAVIS: Stu, let me ask you one more question.
MR. CONRAD: Sure.
COMMISSIONER DAVIS: Do you think there -- I'm just trying to think outside the box here.
MR. CONRAD: Sure.
COMMISSIONER DAVIS: Do you think it is conceivable that there is any way that we could develop some sort of -- I mean, this would probably require the unanimous consent of all parties concerned, but that some sort of sharing grid could be developed or something like that?
I know we -- I mean, it's never been used in this context before, but would something like that be feasible?
MR. CONRAD: That's an interesting --
COMMISSIONER DAVIS: Obviously I want to encourage Empire to be prudent and would like to find some
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way to reward them for purchasing cheaper gas, you know. I don't know. I'm just --

[5] Hanna v. South St. Joseph Land Co., 28 S.W. 652 (Mo. 1894) (emphasis added).

11. In the case at hand, the intent of the parties to the Stipulation can only be understood by reading the entirety ("four corners") of the document and reconciling all of the provisions of that Stipulation. When this is undertaken, it is clear that all of the parties, including Empire, intended for the IEC to exist for a period of three years.

12. The comprehensive Stipulation consists of the following: (1) provisions regarding the amount of fuel and purchased power to be included in base rates; (2) provisions regarding the additional amount of fuel and purchased power to be recovered through interim rates; (3) provisions for the refund of any amount over-collected after two years; (4) provisions for the calculation of interest on this year 2 refund; (5) provisions for a true-up after the three year term; (6) provisions for the determination of an interest rate to be included in the refund of any trued up amount and (7) provisions for the length of the interim energy charge and an explicit termination date. <u>These are the four corners of the document</u> that provide the clear intent of a three-year interim energy charge.

13. To Empire's disappointment there are: (1) **no** provisions for an early termination; (2) **no** provisions for the calculation of refunds in the event of an early termination; (3) **no** provisions for the calculation of interest on the refund in the event of an early termination; and (4) **no** provisions for a true-up in the event of an early termination.

14. In substance, the Stipulation provides for the resolution of all fuel and purchased power expense issues through the inclusion of $102,994,356 of expense in permanent rates and "to provide for the recovery by the Company of an additional

amount of its Missouri jurisdictional variable fuel and purchased power costs on an interim basis, subject to true-up and refund, said additional amount to be collected through an Interim Energy Charge ("IEC")." The Stipulation then continues to clearly provide that, "[t]he IEC **shall** be in effect for three (3) years as described herein."[6] As found by the Missouri Supreme Court, the use of the word "shall" connotes a mandate. "We need not review, again, the fact the word "shall" in its legal connotation is accepted as a mandate calling for compliance."[7] In this case, the word "shall" connotes a mandate as to the ***length of the term*** of the IEC – ***three years***.

15. To further establish the mandatory term of the IEC, the Stipulation provides a specific ending date. "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".[8]

16. Further demonstrating that the IEC could not be terminated early, the Stipulation provides for a safeguard to eliminate the possibility that the amount collected under interim rates could become too large. "After the IEC has been in effect for two (2) years, if the amount held subject to refund at that time exceeds $10 million, Empire shall refund to its customers the amount in excess of $10 million with interest."[9] The interest rate used in determining this refund amount shall be the "prime rate of interest on the day the IEC has been in effect for two (2) years."[10] The Stipulation does not provide for the termination of the IEC at that time – indeed, it explicitly continues it –

[6] Stipulation at Section 1 (page 2) (emphasis added).
[7] State ex rel. Scott v. Kirkpatrick, 484 S.W.2d 161, 164 (Mo. 1972).
[8] Id. at Section 1(c) (page 4).
[9] Id. at Section 1(d) at pages 4-5 (emphasis added).
[10] Id. at Section 1(f) at page 6 (emphasis added).

and leaves Empire with a $10 million cushion against under-recovery as it heads into the final year of the IEC.

17. Furthermore, the Stipulation provides for a true-up audit to be conducted ***subsequent*** to the expiration of the IEC. This true-up audit is used to determine whether all or a portion of revenue collected by Empire pursuant to the IEC exceeds Empire's actual costs for fuel and purchased power.[11] Again, demonstrating the mandatory three (3) year term of the IEC, the Stipulation provides that any refund will be made with interest at a rate equal to "the prime rate of interest <u>on the day the IEC has been in effect for three (3) years</u> (<u>the end of the IEC Period</u>), as found in the Money Rates section of the Wall Street Journal."[12]

18. In the Report and Order adopting the Stipulation, the Commission made only brief reference to the Stipulation and the creation of an IEC. The Commission mentioned only one particular provision – the length of the IEC. At ¶59 of the Report and Order, the Commission notes that "[t]he IEC **<u>shall</u>** be in effect for three years." Noticeably, the Commission, like the parties to the Stipulation, deemed it appropriate to use the word "shall" – a word of mandatory connotation.

19. Most telling regarding the definite three-year term of the IEC created by the Stipulation in Case No. ER-2004-0570, are the compliance tariffs prepared and filed by Empire and approved by the Commission implementing the Interim Energy Charge. Unlike Empire's specious current arguments, it wrote its tariffs reflecting its understanding of the Stipulation that the Commission had approved using the following language:

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[11] Id. at Section 1(e) at page 5 (emphasis added).
[12] Id. at Section 1(f) at page 6 (emphasis added).

> This interim rider shall be in effect from March 27, 2005 through March 26, 2008. After the IEC has been in effect for two (2) years, if the amount held subject to refund at that time exceeds $10 million, Empire shall refund to its customers the amount in excess of $10 million with interest. The interest rate shall be the prime rate of interest on the day the IEC has been in effect for two (2) years as shown in the Wall Street Journal.
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> Upon expiration of the IEC, an audit will be performed and the Commission will determine if all of a portion of the revenue collected by Empire pursuant to the IEC shall be refunded. Methods of determination of refunds due and refunds paid are shown in Case No. ER-2004-0570.
>
> Such refunds, if any shall be based upon the billing units of the customer to which these amount were applied. Any refund will appear as a one-time credit on the customer's bill unless paid by check.[13]

20. Commission Staff, though not a party to the Stipulation itself, concurred in Empire's compliance tariffs, and advised the Commission through its Recommendation that the compliance tariffs should be approved as being in compliance with the Stipulation and thus the Report and Order.

21. Finally, and perhaps most importantly, Section 4 of the Stipulation provides a total and complete bar against the actions undertaken by Empire in the current rate proceeding – the termination of the IEC in favor of other fuel expense treatment mechanisms.

> 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 or a fuel adjustment clause, a natural gas cost recovery mechanism, or other

[13] Tariff of The Empire District Electric Company, P.S.C. Mo. No. 5, Sec. 4, 4th Revised Sheet No. 17. (emphasis added) (Attached hereto as Exhibit 1).

> energy related adjustment mechanism to which the Company would otherwise be entitled.[14]

**C. Unlike the Interpretation provided by the Four Corners Analysis utilized by Praxair / Explorer, Empire blatantly ignores three corners and focuses entirely on a single provision.**

22. In its Motion for Reconsideration filed April 4, 2006, Empire is heard to pay lip service to the fundamental doctrine of contractual interpretation as noted above. As Empire notes,

> When a document, such as the Agreement, is clear and unambiguous on its face, the parties thereto are bound by that clear and unambiguous language and may not look outside the four corners of the document. In this regard, an agreement is ambiguous only if its terms are susceptible of more than one meaning so that reasonable persons may fairly and honestly differ in their construction of the terms. If there is no ambiguity, the court need not resort to construction of the agreement, but rather the intent of the parties must be determined from the four corners of the agreement.[15]

23. Contrary to the "four corner" analysis of the Stipulation previously provided by Praxair / Explorer in this pleading, Empire is now heard to base its blatant breach of contract on a single corner of the Stipulation while conveniently ignoring the other three corners of the document. As highlighted in Empire's Motion for Clarification, Empire focuses solely on the following provision of the Stipulation: "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 order of the Commission."[16]

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[14] Id. at Stipulation, Section 4, page 12.
[15] Empire Motion for Reconsideration and Response to Public Counsel's Request for Extension of Time and the Motion for Expedited Discovery of Praxair and Explorer, filed April 4, 2006, at pages 3-4.
[16] Id. at Section 1(c) at page 4.

24. Unlike Empire's self-serving suggestion that this provision was intended to allow Empire to opt out of the IEC and to adopt another energy cost recovery mechanism, this provision was merely intended to recognize the Commission's superintending statutory obligation over Missouri's public utilities to ensure safe and adequate service at just and reasonable rates. It is a well known doctrine of law that the Commission's authority over its utilities is ongoing and that the Commission may not abrogate its duties to regulate these utilities.[17] In this regard, recognizing that this responsibility is ongoing, it has been found to be an abrogation of Commission authority for the Commission to bind itself to a rate moratorium.[18] As such, parties have typically been heard to say that its agreements and stipulations can not be used to bind the Commission.

25. Recognizing the true meaning underlying the provision "unless earlier terminated by order of the Commission", Empire's argument is recognized for the red herring that it is. The four corners of the Stipulation demonstrate that this IEC was intended to last for three years. The Commission's Report and Order demonstrates that this IEC was intended to last for three years. And, most importantly, Empire's tariffs implementing the IEC demonstrates that this IEC was intended to last for three years.

26. Given Empire's argument that this IEC was structured to allow it to prematurely terminate the IEC in favor of an alternative recovery mechanism, it is important for the Commission to ask itself certain questions. Recognizing: (1) that Empire previously had an IEC; (2) that Empire previously had negotiated with the parties to terminate that IEC; (3) that Empire is represented by the same management that

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[17] State ex rel. Jackson County v. Public Service Commission, 532 S.W.2d 20 (Mo. 1975).
[18] Id.

suffered through the work and effort of terminating that IEC; and (4) that Empire is represented by experienced counsel, it is fair to presume that such an experienced entity with sophisticated legal counsel well understood the operation of the IEC and would have negotiated with respect to an early termination clause if one was desired. In fact, as reflected in the tariffs initiating Case No. ER-2004-0570, Empire initially sought a longer period – 5 years. Explicit provisions would need to be added in order to manifest the ability for early termination. Such provisions would certainly: (1) provide for notice to the other parties; (2) address the handling of prudence and true-up issues; (3) deal with how any monies collected up to that period of time would be handled; (4) provide for a determination of interest on any refunds; and (5) mandate how refunds would be credited to customers. None of these provisions are contained in the Stipulation. The phrase "unless earlier terminated by order of the Commission" contains none of these provisions. Empire's specious argument should be summarily rejected and the IEC be left in place as bargained for by the parties and approved by the Commission.

## III. IN THE EVENT THAT THE COMMISSION FINDS THAT THE STIPULATION IS AMBIGUOUS, THEN IT IS APPROPRIATE TO TAKE EVIDENCE TO DEDUCE THE TRUE INTENT OF THE PARTIES.

27. The "four corners" of the Stipulation demonstrate that the Parties intended Empire's IEC to have a definite three year term. This fact is confirmed not only by examination of the Stipulation itself, but also by the Commission's Report and Order and Empire's tariffs implementing the IEC. The Commission should enter its Order denying the relief requested in Empire's Motion for Clarification.

28. Should, however, the Commission finds that an ambiguity exists in the Stipulation, then this matter should be addressed in the context of the evidentiary

hearings already scheduled in this proceeding. Addressing this matter in the context of those hearings will allow for all the due process contemplated by the Public Service Commission statutes and regulations. Specifically, this additional time will allow the non-Empire Parties to engage in additional discovery regarding the perceived ambiguity, conduct depositions into the intent of the Parties, present witnesses and testimony and conduct cross-examination.

29. Even the limited discovery conducted to date confirms Empire's understanding that it settled for a three year term on its IEC.

**A. Empire's actions <u>leading up</u> to the execution of the Stipulation and Agreement clearly indicate that it needed a long-term Interim Energy Charge without the risk of early termination. This need for a long-term IEC was driven by the expectations of Wall Street analysts. The risk of early termination of the IEC would undermine any benefits associated with that IEC.**

30. In the tariffs Empire filed to initiate Case No. ER-2004-0570, Empire requested a 5 year IEC:

> <u>This interim rider shall be in effect from April 27, 2004 through April 27, 2009</u>. This rider will be subject to an annual true-up audit to determine if any portion of the revenues collected exceed Empire's actual and prudently incurred cost for fuel and purchased power during the interim period, and refunds, if warranted will be issued. Empire shall refund the excess, if any above the greater of the actual or the base, plus interest. Interest will be equal to the prime rate in effect on the day the IEC expires annually and will be applied to any amount to be refunded. No refund will be made if Empire's actual and prudently incurred costs for fuel and purchased power during the IEC period equal or exceed the forecast amount
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> Such refunds, if any shall be based upon the billing units of the customer to which these amounts were applied. Any refund will appear as a one-time credit on the customer's bill.[19]

[19] Proposed PSC Mo. No. 5, Section 4, 4th Revised Sheet No. 17, filed April 30, 2004 (emphasis added) (Attached hereto as Exhibit 2).

Recognizing that the tariffs filed to implement a rate proceeding essentially constitutes the Company's "wish list", it is telling that Empire's "wish list" centered upon a five (5) year interim energy clause and did not contain any provision for early termination.[20]

31. In support of its proposed ER-2004-0570 "wish list," Empire filed several pieces of Direct Testimony asserting its need for a fuel recovery mechanism to protect against the long-term volatility in the natural gas market. CEO William Gipson noted that the implementation of an interim energy charge would be beneficial in that it would result in fewer future rate proceedings.

> Empire has put forth three separate methodologies. These include a Fuel and Purchased Power Adjustment Clause ("FAC"), an Interim Energy Charge ("IEC"), and the twelve-month ending forecast that uses production cost modeling. Implementation of one of the alternatives is needed to provide a timely recovery of fuel and purchased-power expenses. This will also allow for fewer rate cases, improved credit risk and financial flexibility and continued customer protection against fuel price volatility through Empire's hedging activities.[21]

Despite its CEO's proclamation that the implementation of an IEC would lead to fewer rate proceedings, Empire has filed the pending proceeding a mere eleven months after being granted its long-sought IEC mechanism.

32. Empire's version of the IEC contained in those proposed tariffs, as well as the version contained in the Stipulation and approved by the Commission contained no early termination clause because an early termination clause would have introduced an element of regulatory risk and would not have provided the assurances that credit rating agencies needed that Empire would recover its prudently incurred fuel costs. As discussed in an on-the-record presentation, Empire perceived that its credit rating had

[20] In an on-the-record presentation designed to address whether the Commission would lift its suspension of the proposed IEC tariff, Empire notes that the duration of the proposed IEC was "relatively long". (Tr. 94).
[21] Gipson Direct, Case No. ER-2004-0570, at page 6 (Attached hereto as Exhibit 3).

been negatively impacted by a lack of a fuel adjustment mechanism. Indeed, Empire's Vice President – Energy Supply pointed out that a Commission decision to implement a long-term IEC would be well accepted by credit rating agencies. "I know they look at us having higher risk, not being able to recover our natural gas costs and they would look at a decision to put this [an IEC] in place positively."[22] This sentiment was echoed by Empire's CEO:

> I'm a firm believer that the equity analysts and data analysts have given us significant signals in terms of what their expectations are from companies like Empire, and their expectation is that we find a means by which we can cover our prudently incurred fuel and purchased power costs.[23]

33. Logic dictates, therefore, that any credit rating agency that looked upon the implementation of an IEC as positive would similarly look at an early termination provision, and the regulatory risk associated with such a termination provision, as detrimental. In fact, Empire's CEO noted that credit rating agencies have failed to give enough credit to the IEC mechanism ***because it was not more permanent in nature***.

> I know that in our particular case, the Standard and Poor's evaluation that was issued right after the conclusion of our '01 case commended the Commission for making that decision [implementation of an IEC] in that case. But also, you know, throw in a little jab because it was not permanent in nature, and of course, they're looking for something that's more permanent in nature.[24]

Certainly, therefore, any provision, such as an early termination clause, which made the IEC less permanent, would be looked upon negatively by credit agencies.

34. Against this increasing pressure of attempting to meet analysts' expectations and recognizing the criticism it had already taken for its failure to

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[22] Tr. 109, Case No. ER-2004-0570.
[23] Tr. 141-142, Case No. ER-2004-0570.
[24] Id. At 160.

implement a "more permanent" solution for fuel and purchased power recovery, it is ludicrous to believe, as Empire has suggested in the current proceeding, that Empire management agreed to an early termination provision for its IEC. In fact, in response to a question from Commissioner Clayton, Empire's CEO addressed the critical nature that a long term IEC would play in the minds of credit analysts:

> Q. I'm trying to understand the significance between an interim energy charge that has a life of only six months versus a life, perhaps, over two or three years, over a longer period of time. And I guess what I'm trying to get at is for this short-term decision that we have to make, how big of a message is it being sent to the analysts and to the equity markets and the like?
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> A. <u>I think it's - - I think it is a big one</u>, and it's for the reasons that I just spoke.[25]

In essence, Empire management would now have this Commission believe that, despite the critical nature of the term of the IEC and Empire's claims of expressed concerns by Wall Street analysts that this IEC be "more permanent", Empire agreed to introduce an element of regulatory risk by agreeing to an IEC that could be terminated by any party, at any time. Interestingly, given Empire's current statements, it appears that Empire's management believes that it agreed to an IEC with an early termination clause, <u>but then kept this material provision secret from the SEC, investors, credit agencies, bankers and its own Board of Directors</u>.

**B. Empire's public actions <u>following</u> the execution and approval of the Stipulation and Agreement clearly indicate that it believed that the IEC would last for a definite term of three years.**

35. Following Empire's execution of the Stipulation and the issuance of the Commission's Report and Order which approved the Stipulation, Empire took

[25] Id. At 161 (emphasis added).

several actions which are inconsistent with its current stated position that the IEC could be terminated prior to the 3 year expiration date.

36. SEC Rules promulgated at 17 C.F.R. §229.303 provide specific directions to publicly traded companies on the type of information to be included as Management's Discussion and Analysis of Financial Condition and Results of Operations in its 10K Annual Report. Specifically Subsection (a)(3)(ii) requires that the Company:

> Describe any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship **shall** be disclosed.[26]

According to the Securities and Exchange Commission's 1989 release interpreting item 303(a) a "disclosure duty exists where a trend, demand, commitment, event or uncertainty is both [1] presently known to management and [2] reasonably likely to have material effects on the registrant's financial condition or results of operation."[27] Any omission of facts, required to be stated under Section 303(a), will produce liability under Section 11 of the Securities Act of 1933.[28]

37. On March 15, 2005, a scant five days after the issuance of the Commission's Report and Order in ER-2004-0570, Empire filed its 10K annual report with the SEC. Given the requirements of 17 C.F.R. §229.303, Empire provided a section entitled Management Discussion And Analysis of Financial Condition And Results of Operations. Consistent with the obligation to disclose any items that may have "a

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[26] 17 C.F.R. §229.303(a)(3)(ii) (emphasis added).
[27] Management' Discussion and Analysis of Financial Condition, Securities Act Release No. 6835 (May 18, 1989), Fed. Sec. L. Rep. (CCH) Par. 72,436 at 62,143, reprinted at Par. 73,193, at 62,842.
[28] Steckman v. Hart Brewing, 143 F.3d 1293 (9th Cir. Ct. App. 1998).

material favorable or unfavorable impact", Empire disclosed such items as: (1) the weather sensitivity of sales by customer class; (2) the movement of a single customer from an on-system wholesale customer to an off-system market-based rate customer; and (3) a general increase in economic activity in its service territory.

38. Similarly, consistent with its duty to disclose material items, as contained in 17 C.F.R. §229.303(a)(3)(ii), Empire provides a lengthy description of the IEC. Paying close attention to the language used in its 10K, the Commission will note that Empire's description at that time, is based upon the "entirety of the four corners of the document":

> In addition, the order approved an annual Interim Energy Charge (IEC) of approximately $8.2 million effective March 27, 2005 and <u>expiring three years later</u>. The IEC is $0.0021 per kilowatt hour of customer usage. The recent extraordinarily high natural gas prices and extreme volatility of natural gas led the MPSC to allow forecasted fuel costs to be used rather than the traditional historical costs in determining the fuel portion of the rate increase. <u>At the end of two years</u>, the excess money collected from customers, if any, above $10 million of the greater of the actual and prudently incurred costs or the base cost of fuel and purchased power set in rates, will be refunded to the customers with interest equal to the current prime rate at that time. <u>At the end of the three year term of the IEC</u> all excess money collected from customers, if any, of the greater of the actual and prudently incurred costs or the base cost of fuel and purchased power set in rates, will be refunded to the customers with interest equal to the current prime rate at that time.[29]

If its current assertions are correct, Empire neglected to inform the SEC and its current and prospective investors of the possibility, if not probability, that the IEC could be unilaterally terminated before its specified 3 year term. Given the importance of fuel and purchased power recovery to Empire, any provision for unilateral early termination would be considered an item which could is "reasonably likely to have material effects on

[29] The Empire District Electric Company 2004 10K Annual Report, filed March 15, 2005, at page 22 (emphasis added) (Attached hereto as Exhibit 4).

the registrant's financial condition or results of operations." As such, one is left to question whether Empire did not actually believe that the IEC could be terminated prematurely or whether Empire violated federal regulations, and has incurred liability under the Securities Act of 1933, by failing to disclose such a material provision to the SEC as well as current and potential investors?

39. In its quarterly report filed with the SEC on May 9, 2005, Empire again extols the virtue of the IEC it has just recently been allowed to implement. "The Missouri Public Service Commission (MPSC) issued a final order on March 10, 2005 approving an annual increase in base rates of approximately \$25.7 million, or 9.96%, effective March 27, 2005 as well as an annual Interim Energy Charge (IEC) of approximately \$8.2 million effective March 27, 2005 <u>and expiring three years later</u>."[30] Empire's report continues to discuss the provisions Empire feels are material for shareholders and investors to consider:

> We will be required to refund to our customers any money collected under the IEC in excess of the greater of the actual and prudently incurred costs of fuel and purchased power or the base cost of fuel and purchased power set in rates (the "Excess IEC Amount"). Any portion of the Excess IEC Amount over \$10 million will be refunded at the end of two years and the entire Excess IEC Amount not previously refunded will be refunded ***at the end of three years***. Each refund will include interest at the current prime rate at the time of refund.[31]

As with its 10K Annual Report, Empire neglected to inform the SEC as well as its current and prospective investors that the IEC could be unilaterally and prematurely terminated prior to the three year term it was asserted by Empire to cover. It seems ludicrous that Empire would disclose material provisions related to every other aspect of the IEC: the

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[30] The Empire District Electric Company 2004 10Q Quarterly Report, filed May 9, 2005, at page 15 (emphasis added) (Attached hereto as Exhibit 5).
[31] Id. at pages 18-19 (emphasis added).

base amount of fuel collected, the amount collected under the IEC, the existences of possible refunds, the timing of refunds, and the interest to be returned with refunds, but negligently forget a material provision which could allow for the unilateral and early termination of such an important expense collection mechanism. A far more reasonable explanation is that Empire knew the IEC contract was for three years and fully understood the implications of the agreement it had made – indeed, had bargained for – but now suffers "buyer's remorse."

40. Still three months later, with the filing of yet another 10Q Quarterly Report, Empire again did not disclose any belief that the IEC could be unilaterally terminated before the full three year term. At this point in time, however, Empire was beginning to recognize the possibility that different ratemaking mechanisms might be available under newly passed legislation.

> The Missouri Public Service Commission (MPSC) final order issued on March 10, 2005 approved an annual increase in base rates for our Missouri electric customers of approximately $25.7 million, or 9.96%, and also approved an annual IEC of approximately $8.2 million effective March 27, 2005 <u>and expiring three years later</u>.
>
> * * * * *
>
> On April 27, 2005, the Missouri House passed SB 179 which authorizes the MPSC to grant fuel adjustment clauses for utilities in the state of Missouri. The bill had previously passed the Missouri Senate. The bill was signed by Governor Blunt on July 14, 2005 and will go into effective on January 1, 2006. Prior to that time, rulemaking on how the law will be implemented will need to be completed.[32]

Despite its recognition of the passage of SB179, Empire again failed, in contravention of 17 C.F.R. §229.303(a)(3)(ii), to notify the SEC, as well as its current and prospective

[32] The Empire District Electric Company 2004 10Q Quarterly Report, filed August 8, 2005, at pages 19 and 20 (emphasis added) (Attached hereto as Exhibit 6).

investors, that its Interim Energy Charge was subject to unilateral termination before the full three year term.

**C. Empire's private actions following the execution and approval of the Stipulation and Agreement, in the form of statements to its Board of Directors, clearly indicate that it believed that the IEC would last for a definite term of three years.**

41. Since the execution of the Stipulation and Agreement, Empire management has met with its Board of Directors at least nine times. Praxair / Explorer's review of Empire's Board of Director minutes indicates that, <u>at no time</u>, did Empire management discuss the possibility of early termination with its Board of Directors. In fact, at a July 27 & 28, 2005 Board Meeting, Empire's CEO brags **____________________________________________________________

____________________________.** This confidence in the current level of the IEC is repeated by the CEO in an earnings call with analysts on July 29, 2005. Certainly management's failure to discuss a premature termination provision with its Board of Directors is not consistent with the actions of a Company that believes that such a provision exists.

42. At the same Board meeting, Empire's CEO sets forth long term plans designed to "manage to" the IEC. **____________________________________________________________

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____________________________________________________.** Such comprehensive plans designed "to manage to the IEC" in July, 2006, are not reflective of a management that believes it could prematurely terminate the IEC a mere 6 months later.

43. At a Board Meeting in October, 2005, Empire again discusses the IEC, specifically how the IEC positively affects the Company's risk management profile. Among the statements made about the IEC are the following:

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It is inconsistent to believe that a Company would so thoroughly reflect upon the benefits of the IEC and take steps to effectively manage to the IEC, but then believe that the same Company could prematurely terminate the IEC a mere three months later.

**D. Empire has publicly acknowledged that the IEC is a proven and effective regulatory tool for the recovery of fuel and purchased power costs. The early termination of the IEC and the implementation of the proposed ECR eliminates any incentive Empire has to manage these costs with an eye towards least cost to ratepayers.**

44. Empire undoubtedly will attempt to characterize this dispute as being permitted to avail itself of the provisions and benefits of SB179. The Commission should not be swayed by such mischaracterization. An IEC, such as that currently in

place for Empire, is exactly the type of fuel recovery mechanism anticipated by SB179. In fact, Section 386.266.1 specifically authorizes the Commission to approve rate schedules implementing "an interim energy charge." Moreover, the Empire IEC also complies with Section 386.266.1 in that it is "designed to provide the electrical corporation with incentives to improve the efficiency and cost-effectiveness of its fuel and purchased power procurement activities."

45. Thus, while Empire will inevitably attempt to paint this dispute as availing it of the opportunities of SB179, what should be realized is that this Stipulation, agreed to on February 22, 2005 and implemented by the Commission on March 27, 2005, effectively <u>gave Empire the benefits of SB179 nine months before that legislation became law</u>. As such, the Commission should not be swayed as to debates regarding the merits or desirability of other fuel recovery mechanisms under SB179. In all actuality, this is merely a thinly veiled attempt by a utility to have the Commission protect it from its previous management decisions.

46. Interestingly, while Case No. ER-2004-0570 was being considered, Empire was repeatedly heard to sing the praises of the IEC mechanism, the same mechanism it now attempts to abandon. At hearing, Empire's Vice President – Energy Supply proclaimed, "I know and understand the IEC very well and it's <u>a proven regulatory tool</u>."[33] As if reverberating off the wall, CEO Gipson followed with this statement, "With respect to the interim energy charge, it's <u>a proven, regulatory tool</u>."[34] One day later in the hearing, Empire's counsel made the following statement, "I would submit to you that while the IEC may not represent a traditional approach, <u>it represents a</u>

[33] Case No. ER-2004-0570, Tr. 98 (emphasis added).
[34] Id. at 128 (emphasis added).

workable approach, one that has worked and is currently working."[35] Thus, while arguably not permitted by then current law, the Parties worked, in good faith, to get Empire the exact "proven regulatory tool" it now chastises.

47. Despite under-recovery of its fuel & purchased power expense in the first quarter under the new IEC, Empire's view of the IEC had not changed. In fact, Empire was continuing to advocate it as a workable approach to the recovery of fuel and purchased power. In an earnings call held on July 29, 2005, Empire's CEO never questioned the structure of the IEC, but instead remarked that Empire's under-recovery of fuel and purchased power in the quarter then just ended was largely caused by plant outages and Empire management's decision to hedge only 30% of its natural gas needs for the quarter.

> Q. Yes, it is, it's just a little bit, um, concerned as to what happened in the quarter with, you know, the 17 cent hit in fuel and purchased power price and, how, you know, how that's going to play out through the rest of the year. The hedged percentages are helpful, but can you give us a little bit more color as to why there was such a negative impact in the quarter?
>
> A. Well, the negative impact in the quarter was because of our hedged position in the quarter and the volatility, you know the high prices, you know. If you look at . . . you gotta take a look also at some of the things that, I think it'll be helpful to tell you some of the things that we're doing to mitigate our exposure on, uhh, on fuel and purchased power prices. We're reexamining our outage schedules and moving a few of those around. We're putting some further emphasis on heat rate and utilizing the machines that we have in a more effective way. Um, you know, this is an issue that is, you know, at the top of our, the top of our priorities today. ***I think it's also important to note that on a 12 month ending basis, on fuel and purchased power, we're still below the bottom of the collar on fuel and purchased power.*** Um, I don't wanna, I don't want to leave you with the impression that the second quarter was an aberration, but there were a lot of factors that led to, um, led to our being over the collar in that quarter. Among those, plant outages, higher than normal weather, higher purchased power market, um, and as Greg reminds me, ***we were only hedged about 30% in the quarter***. Um, I think it's also important to note that the top of that collar, on a total company basis is about $25 million more than what was in base fuel and

[35] Id. at 274 (emphasis added).

purchased power prices for the test year. ***Um, we're gonna, we're gonna manage this thing, Tim, just like we always have managed our fuel and purchased power, to do the very best we can to mitigate our risk of, uh, uh, those costs that would exceed the collar.***

* * * * *

Q. And then, could you give just a little more color on the outages you experienced in the quarter. Sounds like it was above what you were looking for.

A. No, no. It's just the timing was a little different. We, we had planned outages in the quarter for Iatan Unit 1 and for Asbury. Um, Iatan, of course we have a minority share, and Kansas City changed the outage schedule in the quarter, such that it moved it from one month, and delayed it and caused us to delay the outage on Asbury. You know, the timing, with changing weather between April and May is what had some impact there.[36]

48. Clearly, Empire believed and continues to believe that an IEC is a "proven, regulatory tool" for the recovery of fuel and purchased power expense. Undoubtedly, Empire would prefer a fuel recovery mechanism which shields it from <u>all</u> risk and volatility in the fuel and purchased power markets. Such a recovery mechanism fails to provide for the "incentives to improve the efficiency and cost-effectiveness of [Empire's] fuel and purchased power procurement activities" as contemplated in Section 386.266.1. The IEC agreed to in the last Empire rate case was a bargained for provision between Empire and its customers and, given the clear intent of the parties to leave that IEC in place for three years, should not be disturbed by this Commission.

## IV. EMPIRE WOULD NOT BE FINANCIALLY HARMED BY BEING HELD TO ITS BARGAIN FOR THE TERM OF ITS IEC.

49. While Empire will undoubtedly attempt to paint a dire financial picture of its ongoing financial results if forced to continue to operate under the IEC for

[36] Empire District Electric Earnings Conference Call, held July 29, 2005, available at www.empiredistrict.com link to Presentations.

another 23 months, such predictions of doom and gloom obviously fail to account for the accommodations made by the parties to Empire's Experimental Regulatory Plan.

50. In the Stipulation and Agreement in Case No. EO-2005-0263, the Parties, including Praxair / Explorer, agreed to ratemaking protections in order to assure that Empire can maintain an investment grade rating for its debt during the term of the agreement. Included in these safeguards is the possibility of additional amortizations to maintain Empire's investment grade financial ratios. Specifically, the Stipulation provides for an analysis to determine if Empire meets Standard & Poor's guidelines for: (1) Adjusted Total Debt to Total Capitalization; (2) Adjusted Funds from Operations Interest Coverage; and (3) Adjusted Funds from Operations as a Percentage of Average Total Debt. In this regard, if Empire under-recovers fuel and purchased power expense under the IEC, and to the extent that this under-recovery is not offset by revenue growth or reductions in other expense items, it may have an effect on Empire's "funds from operations". To the extent that this under-recovery may cause Empire's ratio of: (1) Adjusted Funds from Operations Interest Coverage and (2) Adjusted Funds from Operations as a Percentage of Average Total Debt to slip below the ratio range set forth by Standard and Poor's and adopted by the Parties, then Empire will be eligible for additional amortizations to the extent necessary to bring these ratios back into line with those guidelines.

51. Given the possibility of additional amortizations, there is no threat to Empire's financial health as a result of its continued operation under the bargained-for IEC. Under the IEC, Empire is assured of maintaining an investment grade debt rating

and will be able to raise necessary capital to fund its construction commitments in Iatan 1 and 2.

WHEREFORE, Praxair / Explorer respectfully requests that the Commission: (1) find the IEC Stipulation in Case No. ER-2004-0570 to be clear and unambiguous; (2) require Empire to continue to operate under the bargained-for IEC; and (3) deny the relief set forth in Empire's Motion for Clarification. In the alternative, in the event that the Commission finds that an ambiguity exists, the Commission should to allow it more time to conduct further discovery such that it can further deduce the intent of the Parties to that Stipulation. Such discovery should be followed by a hearing at which evidence is presented, cross-examination conducted and all due process rights recognized.

Respectfully submitted,

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EXPLORER PIPELINE INC.

<u>CERTIFICATE OF SERVICE</u>

I HEREBY CERTIFY that I have this day served the forgoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.

David L. Woodsmall

Dated: April 24, 2006