BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Empire District Electric Company for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Company's Missouri Service Area.	)))))	Case No. ER-2014-0351

INITIAL POSTHEARING BRIEF

OF

MIDWEST ENERGY CONSUMERS GROUP

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COMES NOW the Midwest Energy Consumers' Group ("MECG") pursuant to the Commission's October 28, 2014 *Order Setting Procedural Schedule*, and provides its Initial Brief in this matter. On April 8, 2015, several parties to this proceeding filed a *Revised Stipulation and Agreement* ("Revised Stipulation"). That Revised Stipulation provided a resolution of the revenue requirement and certain other issues in this case. Recognizing that the Revised Stipulation was unopposed, the Commission may simply approve that stipulation. That Revised Stipulation also set forth the following issues for decision by the Commission: (1) Class Cost of Service / Revenue Allocation; (2) Large Power Rate Design; (3) Need for a Time-Differentiated Facilities Demand Charge for the Large Power rate class; and (4) Inclusion of Transmission Costs in the Empire Fuel Adjustment Clause.

On the same day, several parties to this proceeding filed a Non-Unanimous Stipulation which seeks to resolve these remaining issues. Unlike the Revised Stipulation and Agreement, the Non-Unanimous Stipulation drew objection from MECG. As the Missouri Court of Appeals has found, given this objection, the Commission may not simply approve that Non-Unanimous Stipulation.[1] Instead, the Commission is required to make specific findings of fact and conclusions of law on the issues purportedly resolved by the Non-Unanimous Stipulation. Therefore, given the Commission's responsibility to make specific findings of fact and conclusions of law on these issues, MECG provides this Initial Brief on the issues remaining for decision in this proceeding.

[1] *State ex rel. Fischer v. Public Service Commission*, 645 S.W.2d 39 (Mo.App. 1982).

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I. INTRODUCTION

It is well accepted that energy rates play a fundamental role in an industrial company's ability to compete in a global market.

> Competitive industrial rates are an important factor in helping to retain and expand industry within the utility's service area. Business retention and expansion result in positive impacts on local economy and employment. Further, if businesses relocate or expand in Empire's service area, it has the potential of lowering costs for customers as the fixed costs are spread over larger amount of billing determinants. The converse is also true – if businesses shift operations from Empire's area, the remaining customers bear the burden of the same fixed costs but over a smaller amount of billing determinants thereby increasing rates for all customers. Thus, the Commission should be cognizant of how its decisions affect industrial rates.[2]

The need for competitive electric rates was recently recognized by the Commission in its recent Ameren decision. There, given concerns about its ability to compete in the global market, the Commission took the unprecedented step of setting rates for Noranda based upon incremental cost rather than fully embedded cost.

> The first step to determining whether either of the reduced rates proposed by Noranda is reasonable is to determine Ameren Missouri's incremental cost to serve Noranda. The experts also refer to incremental cost as Ameren Missouri's avoided cost, meaning the cost that Ameren Missouri would avoid if the Noranda smelter shuts down. Either term means the point at which other ratepayers would benefit from Noranda's presence on the system. At any price above that point, Noranda is making a contribution to Ameren Missouri's fixed costs. At a price below that point, Noranda would not be making a contribution to Ameren Missouri's fixed costs and Ameren Missouri's other ratepayers would be better off without Noranda on the system.[3]

Given the recognized importance of industrial electric rates to a company's ability to compete globally, MECG analyzed the competitiveness of Empire's industrial rates. Early on, it became apparent that there is something suspicious with Empire's industrial

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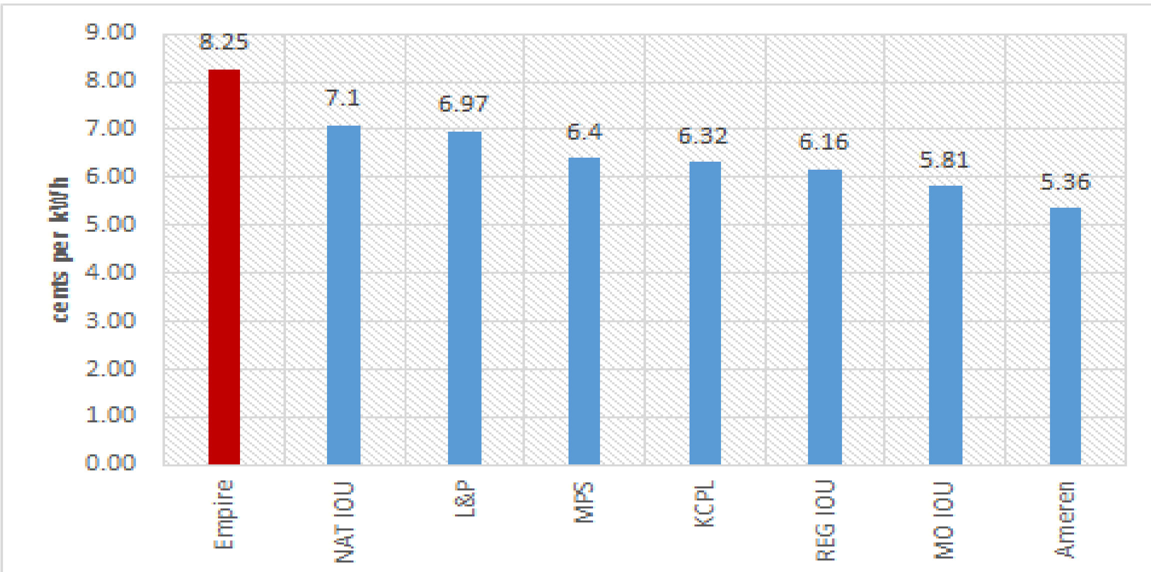
[2] Exhibit 700, Maini Direct, at pages 14-15.
[3] *Report and Order*, Case No. ER-2014-0258, issued April 29, 2015, at pages 120-121.

rates; Empire's industrial rates are <u>above</u> the national average industrial rate. Specifically, data published by the Edison Electric Institute shows that Empire's industrial rate is 16% <u>above</u> the national average.[4] Concerns with Empire's industrial rate are made even more apparent when viewed on a regional level where Empire's industrial rate is 34% <u>above</u> the regional average.[5]

Figure 1: 2014 Average Industrial Rate Comparisons



Source: Exhibit 700, Maini Direct, page 14.

While such statistics may cast suspicion on Empire's industrial rate, further analysis revealed that these problems are actually disconcerting. Specifically, while Empire's industrial rate is significantly <u>above</u> the national average, Empire's residential rate remains <u>below</u> the national average.[6] This fact, residential rates being <u>below</u> average while industrial rates are <u>above</u> average is symptomatic of a cost allocation problem. "A

[4] Exhibit 700, Maini Direct, page 15.
[5] *Id.*
[6] *Id.* at page 15.

critical factor could be not assigning costs to those classes that cause them; leading to a misalignment of rates with the embedded costs to serve."[7]

Given such disconcerting statistics and industrial customers' handicap competing in the global market, MECG set out to identify and provide recommendations to reduce existing subsidies and prevent future subsidies. Specifically, MECG's positions in this case take steps towards remedying <u>current</u> interclass (class cost of service / revenue allocation issue) and intraclass (Large Power rate design issue) subsidies. In addition, MECG made recommendations to prevent <u>additional</u> intraclass subsidies (fuel adjustment clause rate design) from being created.

In the final analysis, it is important to recognize that MECG has not asked the Commission to take the drastic step of setting industrial rates based upon incremental costs, as was done in the Ameren case.[8] Rather, MECG simply asks that the Commission utilize the embedded cost standard and take the simple step of moving industrial rates towards cost in a timely fashion.[9] Such a step would help minimize the disadvantage Empire industrial customers face in the global market.

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[7] *Id.* at page 16.

[8] It is important to recognize that the Commission's decision to reduce Noranda's rates well below embedded cost and, instead, utilize an incremental cost standard was done with the blessing of the residential advocate – Office of the Public Counsel. Here, however, while it admits that industrial rates are well above embedded costs, Public Counsel has resisted all steps to reduce industrial rates towards embedded cost in any kind of timely fashion.

[9] Such movement is not novel. For instance, in the recent Nevada Power case, the Nevada Public Service Commission, concerned with the residential subsidy, ordered Nevada Power to eliminate the residential subsidy. See, *Order*, Docket No. 14-05004, issued October 9, 2014, at pages 15-16.

II. OVERVIEW OF POSITIONS

CLASS COST OF SERVICE / REVENUE ALLOCATION: MECG recommends that the Commission eliminate 25% of the residential subsidy currently existing in Empire's rates. Such a position will help address the fact that industrial rates are above the national average while residential rates are below the national average. Given a 25% elimination, the residential subsidy will continue for three more rate cases, approximately 5 years. In contrast, the Non-Unanimous Stipulation would ensure that the residential subsidy continues for 10 more rate cases or approximately 17 years.

LARGE POWER RATE DESIGN: MECG recommends that the Commission address the current intraclass subsidy in the LP rate schedule. Specifically, that schedule creates a subsidy for the benefit of low load factor Large Power customers that utilize the Empire system in an inefficient manner. The Commission should address this subsidy by reducing the second LP energy block by 0.5¢ / kWh. This reduction would be made up by increasing the LP billing demand. In this way, the Commission would take steps towards proper price signals by collecting fixed costs through a demand (per kW) charge and variable costs through a variable (per kWh) charge.

Furthermore, MECG recommends that the Commission order Empire to present an LP rate schedule, in its next rate case, which contains a time-differentiated billing demand. Such a change would recognize the varying cost of capacity between on-peak and off-peak hours. In this way, the Commission can send proper price signals to industrial customers that will postpone or even eliminate future capacity additions.

TRANSMISSION COSTS IN FUEL ADJUSTMENT CLAUSE: Consistent with the Commission's recent decision in ER-2014-0258, MECG recommends that the Commission only allow the inclusion of transmission costs in Empire's fuel adjustment clause to the extent that such transmission costs are for the purpose of: (1) transmitting energy from third-party generators to Empire's load ("purchased power") or (2) off-system sales.[10] The Commission should not include transmission costs incurred for the purpose of transmitting energy from Empire's own generators to its load.

Furthermore, to the extent that it allows for the inclusion of fixed costs in the fuel adjustment clause, the Commission should seek to avoid creating additional intraclass subsidies by collecting such fixed costs through a demand (per kW) charge. In this way, the fuel adjustment clause energy charge (per kWh) would only collect variable costs.

[10] Originally, MECG had recommended that the Commission disallow all transmission costs in the fuel adjustment charge. Given the Commission's recent decision, however, it has reduced its recommendation in order to be consistent with the Commission's previous guidance.

III. CLASS COST OF SERVICE / REVENUE ALLOCATION

As indicated, statistics regarding Empire's industrial rates raise questions regarding the existence of cost allocation problems. Specifically, Empire's industrial rate is well above the national average while Empire's residential rate is below the national average. While such statistics may raise suspicions, the existence of cost allocation problems can only be confirmed through class cost of service studies.

In this case, four class cost of service studies were presented to the Commission.[11] Without fail, those studies evidence the existence of a residential subsidy. Specifically, the Empire,[12] MECG,[13] Staff,[14] and Public Counsel[15] studies all conclude that residential rates are producing a return that is below average and, as a result, residential rates require a revenue neutral increase. In addition, as Public Counsel readily admits, ***the residential subsidy has grown*** significantly since Empire's last rate case.

> Schedule DED-7 provides a comparison of the RRORs from the 2011 rate case and those filed in this proceeding. The residential class RRORs decrease from 0.75 (prior case) to 0.62 in the current rate case. However, the General Power ("GP"), Special Contract ("SC-P") and Total Electric Building ("TEB") classes all appear to be earning RRORs greater than the prior rate case.[16]

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[11] The Office of the Public Counsel presented two class cost of service studies. The first used the A&E method for allocating fixed production costs. The second used the Average & Peak methodology. (Exhibit 300, Dismukes Direct, page 16). The Commission has repeatedly rejected the use of the Average & Peak methodology. "The Commission will once again reject Public Counsel's P&A study because it has the effect of double counting average demand." *Report and Order*, Case No. ER-2014-0258, issued April 29, 2015, at page 71. Nevertheless, MECG still references both the Public Counsel A&E and Average & Peak results because both methodologies demonstrate the existence of a residential subsidy.

[12] Empire's class cost of service study demonstrates that residential rates are producing the lowest return on equity of all non-lighting rates. (Exhibit 115, Overcast Direct, page 21.

[13] MECG's updated class cost of service study shows that residential rates require a 10.10% revenue neutral shift in order to reach true cost of service. (Exhibit 702, Maini Surrebuttal, page 13).

[14] Staff's updated class cost of service study shows that residential rates require a 8.06% revenue neutral shift in order to reach true cost of service (Exhibit 210, Kliethermes Rebuttal, page 5), modified at Tr. 122.

[15] Public Counsel's Average & Excess methodology shows that residential rates are producing a below average return of 4.63%, while Empire earned an overall return of 6.70%. (Exhibit 300, Dismukes Direct, Schedule DED-2). Similarly, the Peak & Average methodology shows that residential rates are producing a below average return of 5.81%, while Empire earned an overall return of 6.70%. (*Id.* at Schedule DED-3).

[16] Exhibit 300, Dismukes Direct, Schedule DED-7. A relative rate of return of 1 indicates that rates are producing revenues equal to cost. A relative rate of return below 1 indicates that rates are producing

Given the agreement between the studies, several parties filed a Non-Unanimous Stipulation which accepted the results of Staff's class cost of service study.[17] As can be seen, the results of the MECG and Staff studies are remarkably consistent in their conclusions and magnitude. While the Staff study indicates that residential rates are 8.06% below cost of service, the MECG study quantifies the residential subsidy at 10.10%. Similarly, the Staff study indicates that the industrial Large Power rates are 8.35% above cost, while MECG finds that the Large Power rates are 9.90% above cost.

	MECG	**Staff**
Residential	+10.10%	+8.06%
Commercial Bldg.	-5.30%	-2.37%
Commercial Space Htg.	-0.40%	-2.52%
Total Electric Bldg.	-5.40%	-6.71%
General Power	-10.60%	-7.90%
Large Power	-9.90%	-8.35%
Schedule SC-P	-3.30%	+2.68%
Feed Mill	-22.60%	-38.07%
Lighting	-15.40%	-19.16%

Source: Exhibit 702, Maini Surrebuttal, page 13.

Given the consistency of the results, MECG maintains that the Commission does not need to decide which class cost of service methodology is most appropriate.[18] At this point, the existence of a residential subsidy is an accepted fact. It has been demonstrated by all studies and agreed upon by all parties. Similarly, it is undisputed and accepted that

revenues below cost of service. A relative rate of return above 1 indicates that rates are producing revenues above cost of service. Therefore, a reduction in the residential relative rate of return from 0.75 to 0.62 indicates that the residential subsidy has existed for a period of time and is growing. ("Thus, classes with a relative rate of return greater than 1.0 entails that those classes are likely earning an amount greater than the Company's overall rate of return. Those classes with a relative return below 1.0 can be said to be earning an amount less than the Company's overall rate of return.") *Id.* at pages 27-28.

[17] "The Signatories agree that Staff's proposed rate design and revenue allocation methodology should be used in this case" See, *Non-Unanimous Stipulation and Agreement on Certain Issues*, filed April 8, 2015, at page 3.

[18] As the Commission held in the recent Ameren decision, "Also, because the results of the A&E [MECG] and BIP [Staff] studies are similar, the Commission does not need to decide which particular study is most appropriate." *Report and Order*, Case No. ER-2014-0258, issued April 29, 2015, at page 71.

industrial rates are well above cost of service. Rather, the only disputed issue is the appropriate steps to be taken by the Commission in reducing the residential subsidy and alleviating the uncompetitive industrial rates.

In the Non-Unanimous Stipulation, the Signatory Parties, after agreeing upon a class cost of service study, agree with Staff's proposal to address the residential subsidy. Specifically, the Stipulation expressly recommends that the Commission adopt "a revenue neutral shift to the residential class of .75%, with a .85% decrease for LP, TEB, and GP rate classes."[19] Given that the Staff's quantification of the residential subsidy is 8.06%, it would take 10 more rate cases, after this case, for the residential subsidy to be eliminated.[20] Recognizing that Empire's files a rate case approximately every 20 months,[21] **it would take almost 17 years to eliminate the residential subsidy**.

The evidence indicates that Staff's recommendation, as agreed to by the other Signatory Parties, is completely arbitrary. In the recent Ameren rate case, Staff quantified the residential subsidy at 2.94%.[22] In that case, Staff recommended that the Commission eliminate 0.5% of the residential subsidy. Therefore, the Staff recommended that the Commission eliminate 17.0% of the residential subsidy.[23] In contrast, in this case, Staff only recommends that the Commission eliminate 9.3% of the residential subsidy.[24] Inexplicably, despite the much larger subsidy in this case, Staff recommends that the Commission take a much slower approach.

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[19] See, *Non-Unanimous Stipulation and Agreement on Certain Issues*, filed April 8, 2015, at page 3. See also, Exhibit 204, Staff Rate Design and Class Cost-Of-Service Report, at pages 3 and 28.
[20] 8.06% ÷ 0.75% = 10.75 (11) rate cases or 10 more rate cases after this case.
[21] Empire has had five rate cases in the 100 months since January 1, 2007. (See, Exhibit 201, Staff Report – Cost of Service Revenue Requirement, page 10, as corrected at Tr. 121). Therefore, Empire averages a rate case approximately every 20 months.
[22] Tr. 130.
[23] 0.5 ÷ 2.94 = 17.0%
[24] 0.75 ÷ 8.06 = 9.3%.

In contrast to Staff's glacial approach to addressing the residential subsidy, MECG recommends that the Commission eliminate one fourth of the residential subsidy in this case.[25] There are several advantages of such movement. ***<u>First</u>***, given Staff's accepted cost of service results, this would result in an increase to the residential class of only 2.0%. Recognizing that the revenue requirement settlement in this case provides for an overall increase of 3.88%,[26] MECG's recommended rate shift would only result in a total residential increase of 5.88%. Understanding that this virtually mirrors Empire's requested increase of 5.5%,[27] and that there were no stated concerns about Empire's initial request producing rate shock,[28] there should not be concerns about a 5.88% residential increase causing rate shock. ***<u>Second</u>***, unlike the joint proposal of the Signatory Parties which would take 17 years to alleviate the residential subsidy, the MECG recommendation, if continued in future cases, would alleviate the residential subsidy in approximately 5 years. ***<u>Third</u>***, by addressing the residential subsidy at a quicker pace than Staff's glacial approach, the Commission can signal that its concern for Missouri industrial rates extends beyond Noranda. Specifically, the Commission can indicate that it is concerned that Empire's industrial customers are paying rates that are 16% <u>above</u> the national average. ***<u>Fourth</u>***, moving class revenue requirements closer to cost will help restore equity and fairness amongst classes and will help eliminate the need to contemplate providing subsidies to retain businesses as it had to do with Noranda.

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[25] Exhibit 702, Maini Surrebuttal, page 15.
[26] Tr. 132.
[27] Exhibit 132, Walters Direct, page 2.
[28] Section 393.155 allows the Commission to phase-in rates to avoid rate shock. No parties have made a request to phase-in Empire's rate increase.

III. LARGE POWER RATE DESIGN

A. THE COMMISSION SHOULD TAKE STEPS TO ELIMINATE THE INTRACLASS SUBSIDIES IN LARGE POWER RATES BY MOVING FIXED COSTS OUT OF THE LARGE POWER ENERGY CHARGES.

In the previous section, MECG sought to address the interclass subsidy that currently exists in Empire's rates. Specifically, consistent with all of the class cost of service studies in this case, MECG seeks to eliminate the residential subsidy by shifting costs from Large Power rates to the residential class. The obvious effect of such a proposal would be a greater increase for residential customers than for industrial customers.

In this section, MECG seeks to address the intraclass subsidy that exists within Empire's Large Power ("LP") rate class. Specifically, as a result of Empire's collection of fixed costs through LP energy charges, a subsidy for the benefit of low load factor LP customers is created. Through its recommendation in this case, MECG seeks to take steps towards eliminating this intraclass subsidy by reducing the energy charge and increasing the billing demand charge.

In its Direct Testimony, Empire indicated its concern with the current design of rates.

> There are a number of significantly important issues with respect to Empire's currently authorized rate design. First, Empire's current rates place far too much reliance on volumetric recovery of fixed costs. Second, the 1 current rate designs do not provide Empire a reasonable opportunity to earn its allowed return in the face of events beyond the Company's control, such as weather and conservation. Third, the rates that consist of a customer charge and volumetric charges do not properly assign costs to the cost causer. Fourth, current rates are not economically efficient, with the result being inefficient use of resources resulting from incorrect price signals.[29]

[29] Exhibit 115, Overcast Direct, pages 21-22.

Of utmost importance, Empire expressed a concern with the Commission's continued reliance on volumetric energy charges for the collection of fixed costs.

> Volumetric recovery of fixed costs directly contributes to other problems with rate design. Essentially, when fixed costs are recovered volumetrically, the utility is at much greater risk for revenue recovery. . . Volumetric rates provide no revenue stability for the utility, since the bulk of costs do not change with volume, and any change in kWh from the weather normalized volume of sales will inevitably produce either too much or too little revenue. . . Changing rate design to recover fixed costs in fixed charges improves the opportunity to earn the allowed return.[30]

Empire also provided abundant reasons for the Commission to rely more heavily on demand charges instead of energy charges. The Commission's reliance on volumetric energy charges for the collection of fixed costs has the effect of subsidizing low load factor customers that utilize the Empire system inefficiently.

> Customers using services with the same cost characteristics should bear similar costs. Also, customers in the same class should not be subject to a rate or practice that imposes an unreasonable burden on a portion of the class for other customers served in that class. Empire's currently authorized rates do not address these requirements, since rates based on kWh charges collect more revenue from the larger customers in the class for essentially the same costs or in some cases even lower total fixed costs.[31]

Finally, the use of energy charges for the collection of fixed costs results in misleading price signals and inefficient customer utilization of the Empire system.

> Current volumetric rates are inefficient because the price signal at the margin is much greater than the marginal cost of additional kWh consumption. This means that customers use electricity inefficiently. It also means that other resource allocation decisions are inefficient. By improving the price signal and matching marginal cost to marginal revenue, electricity is used more efficiently and the utility has a more reasonable opportunity to earn its allowed return.[32]

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[30] *Id.* at pages 22-24.
[31] *Id.* at page 26.
[32] *Id.*

Given all the problems with the use of energy charges for the collection of fixed costs, Empire recommended that the Commission take certain steps. Of primary importance, Empire recommends that the Commission "remove all fuel and variable costs from base rates."[33]

In its testimony, MECG agreed with the direction of Empire's recommendation. Specifically, with regard to the Large Power rate class, MECG agreed that the Commission should reduce its reliance on energy charges and collect more fixed costs through the billing demand charge. Specifically, MECG recommends that the second energy block rate be reduced by 0.5 ¢ / kWh. Given that the second energy block is currently 3.5 ¢ / kWh in the winter and 3.63 ¢ / kWh in the summer, this would reduce the energy charge to 3.0 ¢ / kWh and 3.13 ¢ / kWh respectively.[34] Recognizing that the current base cost of fuel is 2.747 ¢ / kWh, these energy blocks will still be above the variable cost of fuel.[35] Further, the corresponding increase in demand charges is reflective of the cost driver in this case – an increase in fixed costs (the Asbury environmental retrofit).[36]

As indicated, such movement would have definite positive benefits. ***First***, such movement would reduce Empire's reliance on variable energy sales in order to collect its fixed costs. This should provide greater certainty to Empire in collecting its revenue requirement and reduce its business risk. ***Second***, such movement will also reduce the subsidy that currents flows to the benefit of low load factor customers that inefficiently use the Empire system. ***Third***, this movement will send better price signals regarding the

[33] *Id.* at 28.
[34] Exhibit 702, Maini Surrebuttal, page 17.
[35] Tr. 134.
[36] Exhibit 700, Maini Direct, page 28.

price of energy relative to the price of capacity. Given that the billing demand charge will be increased under this proposal, industrial customers will be appropriately sent the pricing signal that capacity is more expensive. In response, industrial customers will attempt to reduce its peak or move portions of its peak to off-peak. Under all scenarios, the Empire electric system will be used more efficiently.

In contrast, the Signatory Parties to the Non-Unanimous Stipulation make the recommendation that the Large Power rate increase be applied equally to all charges within that rate schedule.[37] The illogical nature of such a recommendation is obvious. As demonstrated, the current energy charge is well above the current Empire base cost of fuel is 2.831 ¢ / kWh.[38] Given this, it is apparent that these energy charges collect a significant amount of fixed costs. In this case, the base cost of fuel will decrease.[39] As such, the energy charges should also decrease. Despite this fact, the Signatory Parties seek to increase the energy charge[40] and, thus, exacerbate Empire's problem regarding the collection of fixed costs in the energy charge. Clearly, the Non-Unanimous Stipulation fails to recognize that the increase in this case is entirely the result of a change in fixed costs[41] and that energy costs have actually decreased. The Commission should not make the same mistake when making its decision.

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[37] Exhibit 204, Staff Rate Design and Class Cost-Of-Service Report, at pages 3 (step 3).
[38] Tr. 134.
[39] The actual base cost of fuel resulting from this case will change depending on whether the Commission decides to include transmission costs in the fuel adjustment clause. Either way, the base cost of fuel in the fuel adjustment clause will decrease. If the Commission excludes transmission costs from the fuel adjustment clause, the base cost of fuel will decrease from 2.747 ¢ / kWh to 2.588 ¢ / kWh. (Exhibit 704).
[40] Tr. 133.
[41] See, Exhibit 132, Walters Direct, page 3, quantifying the impact of the Asbury environmental upgrade at $19.8 million.

B. THE COMMISSION SHOULD SEND PROPER PRICE SIGNALS BY REQUIRING EMPIRE TO SUBMIT, IN ITS NEXT RATE CASE, LARGE POWER RATES THAT HAVE A TIME-DIFFERENTIATED BILLING DEMAND CHARGE.

While the setting of rates should seek to avoid cost subsidies, it also should seek to send proper price signals. Specifically, as discussed in the previous section, the Commission should attempt to set the LP billing demand charge so that it collects all fixed costs, while the energy charges collect the variable costs of service. While this is a worthwhile goal, such ratemaking does not properly recognize that cost of capacity (a fixed cost) will vary over time. Specifically, capacity costs are much higher during the peak hours of a day than during the non-peak hours. In this way, a properly established demand charge will reflect the time-differentiated cost of capacity.

> It was previously pointed out that the size of a utility plant and, hence, the total investment in the business is determined by the quantity of service it must render during periods of peak demand. Just as in the case of appointing total demand costs among classes, customers within each class who use the service during peak demand periods should contribute a larger percentage toward the class's share of the capital costs than should off-peak users. ***<u>As there is no attempt to separate these two groups of customers, the rate schedule discriminates against those who use the service in off-peak hours</u>***.[42]

In its current LP rate schedule, Empire collects a billing demand charge. Unfortunately, however, that billing demand charge does not reflect the differences in the cost of capacity during on-peak hours versus the cost of capacity during off-peak hours. Given this, MECG recommends that the Commission order Empire to present a time-differentiated billing demand charge in its next case. The value of such a time-differentiated billing demand charge is obvious.

[42] *The Economics of Regulation*, Charles F. Phillips, Jr., (1969, revised edition) at pages 355-356 (emphasis added).

> Time differentiation of the billing demand sends pricing signals that encourage industrial customers to shift operations to move any peaks to an off-peak period. In this way, future utility capacity additions can either be postponed or cancelled.[43]

The evidence demonstrates that Empire is fully capable of providing such a time-differentiated demand charge. In fact, Empire's current SC-P and SC-t rate schedules current charge for demand costs based upon a time-differentiated billing charge.[44]

[43] Exhibit 700, Maini Direct, page 29.
[44] *Id.*

IV. TRANSMISSION COSTS IN THE FUEL ADJUSTMENT CLAUSE

A. THE COMMISSION SHOULD ONLY INCLUDE TRANSMISSION COSTS IN THE FUEL ADJUSTMENT CLAUSE TO THE EXTENT THAT THE ARE INCURRED TO TRANSPORT PURCHASED POWER

In its filing, Empire seeks to include an extensive list of SPP and MISO transmission costs in its fuel adjustment clause.[45] Specifically, relying on the Ameren fuel adjustment clause approved in 2012,[46] Empire seeks:

•Inclusion of net transmission costs and revenue recorded in FERC accounts 565 and 457, respectively;

•Inclusion of insurance premium for replacement power recorded in FERC account 924; and

•Inclusion of transmission expense allocation charges recorded in FERC account 575.[47]

As the Commission has recently held, however, Missouri law authorizing fuel adjustment clauses only allows for the inclusion of transmission costs to the extent that those costs are related to the transmission of purchased power to Empire's load or the sales of excess energy. As such, the inclusion of transmission costs associated with the transmission of power from Empire's own generation to its load is beyond the scope of the authorizing statute and, therefore, not eligible for inclusion in the fuel adjustment clause.

In 1979, while addressing the legality of the fuel adjustment clause, the Missouri Supreme Court set forth a general prohibition against retroactive ratemaking.

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[45] Exhibit 124, Tarter Direct, page 6 and Schedule TWT-3.
[46] *Id.* at pages 5-6 ("In general, Empire's proposed FAC tariff changes, for transmission charges/revenue and next-day market charges, are based on the existing Ameren Missouri FAC.").
[47] *Id.* at page 6.

> The Companies take the risk that rates filed by them will be inadequate, or excessive, each time they seek rate approval. To permit them to collect additional amounts simply because they had additional past expenses not covered by either clause is ***retroactive rate making, i.e., the setting of rates which permit a utility to recover past losses or which require it to refund past excess profits collected under a rate that did not perfectly match expenses plus rate-of-return with the rate actually established***. Past expenses are used as a basis for determining what rate is reasonable to be charged in the future in order to avoid further excess profits or future losses, but under the prospective language of the statutes, *§§ 393.270(3)* and 393.140(5) they cannot be used to set future rates to recover for past losses due to imperfect matching of rates with expenses.[48]

Finding that the Commission had no statutory authority, the Supreme Court held that the Commission's use of a fuel adjustment clause was unlawful.[49]

Given this prohibition, Missouri law is clear, absent express statutory authorization, utilities may not surcharge increased costs between rate cases.

> It is for the legislature, not the PSC, to set the extent of the latter's jurisdiction. The mere fact that the commission has approved similar clauses in the past, or that other states permit them, is irrelevant if they are not permitted under our statute[.][50]

After *UCCM*, the Missouri General Assembly enacted statutory authorization for fuel adjustment clauses.

> Subject to the requirements of this section, any electrical corporation may make an application to the commission to approve rate schedules authorizing an interim energy charge, or periodic rate adjustments outside of general rate proceedings to reflect increases and decreases in its prudently incurred fuel and purchased-power costs, including transportation[.][51]

Therefore, the costs to be included in a fuel adjustment clause are allowed only to the extent that section 386.266.1 authorizes it.

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[48] *State ex rel. Utility Consumers Council of Missouri v. Public Service Commission*, 585 S.W.2d 41, 59 (Mo. banc 1979) (emphasis added). ("UCCM").
[49] *Id.* at 47 ("We have concluded that application of an FAC to residential and small commercial customers, as was done in this case, was beyond the statutory authority of the commission and that the FAC, roll-in, and surcharge were therefore unathorized and cannot continue in effect.")
[50] *Id.* at 54.
[51] Section 386.266.

Very recently, the Commission had its first opportunity to interpret the scope of Section 386.266 as it pertains to the inclusion of transmission costs. In its Report and Order in the recent Ameren case (ER-2014-0258), the Commission noted that utilities incur transmission costs for three reasons: (1) to transmit power from its own generation to its own load; (2) to transmit power from other parties' generation to its own load; and (3) to sell excess power to third parties (off-system sales). Recognizing that Section 386.266 is limited to transmission costs for "purchased power", the Commission held that Ameren could not include transmission costs associated with transmitting power from its own generation to its own load.

> The evidence demonstrated that for purposes of operation of the MISO tariff, Ameren Missouri sells all the power it generates into the MISO market and buys back whatever power its needs to serve its native load. From that fact, Ameren Missouri leaps to its conclusion that since it sells all its power to MISO and buys all that power back, all such transactions are off-system sales and purchased power within the meaning of the FAC statute. The Commission does not accept this point of view.
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> Therefore, of the three reasons Ameren Missouri incurs transmission costs cited earlier, the costs that should be included in the FAC are 1) costs to transmit electric power it did not generate to its own load (true purchased power) and 2) costs to transmit excess electric power it is selling to third parties to locations outside of MISO (off-system sales). Any other interpretation would expand the reach of the FAC beyond its intent.[52]

Given the limited scope of Section 386.266, Empire's proposed changes to its fuel adjustment need to be rejected. Specifically, Empire seeks to include <u>all</u> transmission costs recorded in Account 565.[53] As the Commission has held, however, the Account 565 transmission costs also include the transmission costs associated with transmitting

[52] *Report and Order*, Case No. ER-2014-0258, issued April 29, 2014, at pages 115-116.
[53] Exhibit 124, Tarter Direct, page 6 and Schedule TWT-3.

electricity from a utility's own load.[54] Clearly, such costs are beyond the scope of Section 386.266 and should be excluded from the fuel adjustment clause. Given this, the Commission should reject Empire's proposed requested to include transmission costs in its fuel adjustment clause or order Empire to submit an FAC tariff which is consistent with Section 386.266.

B. <u>TO THE EXTENT THAT THE COMMISSION ALLOWS FOR THE INCLUSION OF TRANSMISSION COSTS IN THE FUEL ADJUSTMENT CLAUSE, THESE COSTS SHOULD BE COLLECTED THROUGH A DEMAND CHARGE.</u>

As previously indicated, Empire filed an extensive amount of testimony expressing its concern that a large percentage of its fixed costs are collected on a per kWh (variable) basis instead of through a fixed (per kW) basis. As Empire notes, the utility's reliance on energy sales in order to collect its fixed costs exposes Empire to an undercollection of its fixed costs resulting from diminished sales and abnormal weather. Given this, Empire proposes to shift the collection of fixed costs out of energy charges and into either a customer or demand charge. Ultimately, such movement will enhance the certainty that Empire will collect its revenue requirement and reduce its overall business risk.

Contrary to Empire's overarching goal to reduce its reliance on energy sales for the collection of fixed costs, Empire inexplicably seeks to collect transmission fixed costs through the per kWh energy charges in the fuel adjustment clause. As MECG's witness notes, the use of energy charges to collect fixed costs represents poor ratemaking.

> Despite this stated concern, the Company's proposal to include fixed costs such as fixed natural gas transportation costs and transmission costs in the FAC and recover them through a volumetric charge: a) will further

[54] *Report and Order*, Case No. ER-2014-0258, issued April 29, 2014, at page 113.

> exacerbate the issue of assigning costs to cost causers, b) will send flawed pricing signals and c) will result in economic inefficiency.[55]

Given the disconnect between the manner in which FAC costs are incurred and the manner in which they are collected from ratepayers, MECG proposed that the fuel adjustment clause be collected through both a demand (per kW) and an energy (per kWh) charge. "Should the Commission allow the Company to include recovery of transmission costs through the FAC, I recommend that Empire establish a $ / kW demand charge for recovery of fixed costs for demand metered customer classes."[56]

Such a recommendation is not unique. Jurisdictions that are concerned with cost-based rates and preventing intra-class subsidies have previously sought to recover these fixed costs through demand (per kW) charges. For instance, in Minnesota, Xcel Energy collects such costs through a demand charge.[57] Furthermore, Florida electric utilities utilize a fuel adjustment clause that contains both demand and energy charges.[58]

Ultimately, proper ratemaking dictates that types of costs should be carefully aligned with types of charges. In this way, fixed costs are collected through customer and demand charges (for those classes with a demand charge) and energy charges used solely for the collection of variable costs. To the extent, therefore, that the fuel adjustment clause is to include fixed costs, they should be collected through a demand (per kW) charge.

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[55] Exhibit 700, Maini Direct, page 12.
[56] Exhibit 702, Maini Surrebuttal, page 6.
[57] *Id.* at page 6 (footnote 1).
[58] See, *In re: Fuel and purchased power cost recovery clause with generating performance incentive factor*, Florida Public Service Commission 140001-EI, issued December 19, 2014, at pages 22-24.

V. CONCLUSION

For all the foregoing reasons and based upon the evidence in this case, MECG respectfully requests that the Commission reject the Non-Unanimous Stipulation and Agreement and issue its Report and Order reflecting the following positions:

1. The Commission should reject the glacial elimination of the residential subsidy contained in the Non-Unanimous Stipulation and Agreement. Instead, the Commission should eliminate 25% of the residential subsidy in this case.

2. The Commission should seek to address the current intraclass subsidy in Empire's Large Power rates by reducing the second energy block by 0.5 ¢ / kWh and increasing the billing demand charge.

3. The Commission should require Empire, as part of its next case, to include a time-differentiated billing demand charge for the Large Power rate class.

4. The Commission should only allow transmission costs in the fuel adjustment clause to the extent that those costs are associated with "purchased power" and off-system sales.

5. To the extent that the Commission allows for the inclusion of fixed costs (transmission costs) in the fuel adjustment clause, it should require Empire to collect those fixed costs through a demand (per kW) and not energy (per kWh) charge.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing 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.

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David L. Woodsmall

Dated: May 15, 2015