STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

TRANSCRIPT OF PROCEEDINGS
Evidentiary Hearing

May 16, 2008
Jefferson City, Missouri
Volume 8

In the Matter of The Empire District Electric Company of Joplin, Missouri for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of The Company) No. ER-2008-0093

CHERLYN D. VOSS, Presiding,
REGULATORY LAW JUDGE.

JEFF DAVIS, Chairman,
TERRY JARRETT,
KEVIN GUNN,

COMMISSIONERS.

REPORTED BY:
PAMELA FICK, RMR, RPR, CCR #447, CSR
MIDWEST LITIGATION SERVICES

APPEARANCES:

PAUL A. BOUDREAU, Attorney at Law
JAMES C. SWEARENGEN, Attorney at Law
DIANA CARTER, Attorney at Law
DEAN L. COOPER, Attorney at Law
L. RUSSELL MITTEN, Attorney at Law
Brydon, Swearengen & England, P.C.
312 East Capitol
P.O. Box 456
Jefferson City, MO 65102-0456
(573)635-7166
rmitten@brydonlaw.com

FOR: The Empire District Electric Company.

SHELLEY WOODS, Assistant Attorney General
P.O. Box 899
Supreme Court Building
Jefferson City, MO 65102
(573)751-3321

FOR: Missouri Department of Natural Resources.

STUART CONRAD, Attorney at Law
Finnegan, Conrad & Peterson
3100 Broadway
1209 Penntower Officer Center
Kansas City, MO 64111
(816)753-1122
stucon@fcplaw.com

DAVID WOODSMALL, Attorney at Law
Finnegan, Conrad & Peterson
428 East Capitol, Suite 300
Jefferson City, MO 65101
(573)635-2700
dwoodsmall@fcplaw.com

FOR: Industrial Intervenors.

LEWIS R. MILLS, JR., Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, MO 65102-2230
(573)751-4857

FOR: Office of the Public Counsel and the Public.

KEVIN THOMPSON, General Counsel
STEVEN DOTTHEIM, Chief Deputy General Counsel
STEVE REED, Chief Litigation Attorney
JENNIFER HEINTZ, Assistant General Counsel
P.O. Box 360
200 Madison Street
Jefferson City, MO 65102
(573)751-3234

FOR: Staff of the Missouri Public Service Commission.

P R O C E E D I N G S

JUDGE VOSS: We're here for the fourth day of the hearing in Commission Case No. ER-2008-0093 In the Matter of Empire District Electric Company of Joplin, Missouri for authority to file tariffs increasing rates for electric service provided to customers in the Missouri service area of the company.

We are beginning the issue of ROE today. I'm assuming there will be opening statements on ROE beginning with Empire.

MR. SWEARENGEN: Thank you, Judge. May it please the Commission. I'm Jim Swearengen appearing on behalf of Empire District Electric Company. As Judge Voss indicated, the issue before you today is return on equity.

I think the Commission has heard the return on common equity issue involving Empire at least two times over the last several years and on several other occasions with regard to other utility companies that you regulate. What you are asked to do with this issue in this case, as in any case, is to determine a fair return.

And the courts have told us, and I'm sure you understand, that to be fair, a return must be comparable to returns investors expect to earn on other investments of similar risk. To be fair, a return must be sufficient to assure confidence in the company's final integrity, and to be fair, a return must be adequate to maintain and support the company's credit and to attract capital. So those are the standards that we are looking at.

Just like all other regulated utilities serving Missouri, the Empire District Electric Company must be allowed a reasonable opportunity to recover both its prudently incurred operating costs and to earn a reasonable return on its investment.

Generally in utility rate cases on this issue, you hear from company experts who traditionally will urge a Commission to award on the high end of the spectrum. And usually you'll hear from the Public Counsel, intervenor, customer witnesses and the Staff who may urge a return on the low end of the spectrum.

Sometimes you get somebody that makes a recommendation in the middle. Sometimes the differences are great, other times they're not so great.

As a part of this process, you're usually asked to read several hundred pages of prepared testimonies and schedules. And it's not uncommon, as you are aware, for these witnesses in the hearing process to undergo several hours of cross-examination at the conclusion of which you are faced with a record which arguably would support a wide range of possibilities with regard to an appropriate return.

I've been doing this for several years, and it's always been somewhat unclear to me how helpful to you all of this often highly technical and conflicting expert testimony is with regard to your ability to reach a decision. And that may be why several years ago this Commission began to look at the average allowed returns for the gas and electric utility industry as a tool to help you evaluate the various recommendations that you are presented with in these cases.

And in doing this, it's my understanding that in recent cases, you have concluded that the national average return might be a good indicator of the capital market in which the utilities you regulate must compete for capital. And as a result, you use this average to determine a range of returns I think that you've characterized as a zone of reasonableness. Usually this zone is 100 basis points on either side of the average. So, for example, if you determine that the national average for the gas utility industry is 10 and a half percent, then the zone of reasonableness would be a range running from 9 and a half percent to 11 percent. Excuse me, 9 and a half to 11 and a half percent.

After having gone through several cases in which you all have utilized this -- this tool and having read some of your decisions discussing it, I'm not really certain how helpful this tool has been, but really how appropriate it is as a method to determine the cost of capital in a rate proceeding.

What I do know is that since the Commission has started utilizing this approach, it has spawned considerable controversy in these cases as to the companies and the numbers you ought to look at in determining the so-called national average. So instead of arguing about which cost of capital model is appropriate, we're spending more time arguing about the national average, and we have some of that in this case.

For example, Empire's witness, Dr. Vander Weide says if you're going to utilize the zone of reasonableness as a tool in this case, you should focus on returns allowed for integrated electric utilities such as Empire which are currently making large investments in the electric generating plant. And on this point, the -- his evidence will show that the average return on equity award for integrated electric utilities during the period October 2007 through March of this year is 10.7 percent, and that would indicate a zone of reasonableness from 9.7 to 11.7 percent.

Others will offer evidence and argue that the zone is something else. And as I indicated, I'm not sure how -- how productive all of this will be in the final consideration when you have to make a decision.

In any event, I submit to you that there is perhaps another way for the Commission to view and consider the ROE issue at least in this case involving Empire. As I indicated earlier, this is not the first time in recent history that you've had to deal with a return on equity issue in a case involving Empire.

Back in 2004 it was Case ER-2004-0570, Dr. Vander Weide suggested an 11.3 percent return for Empire. The Staff in that case proposed a range of 8.29 to 9.29 and the Public Counsel supported a range of 8.96 to 9.41. In your deliberations in that case, you started with Dr. Vander Weide's proposed return of 11.3 percent, reduced it by 30 basis points and concluded that an 11 percent return on equity was appropriate.

In Empire's next case, the 2006 case, Dr. Vander Weide proposed an 11.7 percent ROE for the company. The Public Counsel said the ROE ought to be 9.65 percent and the Staff proposed a range of 9.5 to 9.6. And you will recall in that case that the Commission authorized a 10.9 percent return which was about 130 basis points above the Staff and Public Counsel's high and about 80 basis points below what Dr. Vander Weide had recommended, which brings us to the current case.

And we submit to you that the evidence in this case will demonstrate that Empire's financial circumstances, generally speaking, have not really changed over the last several years. They certainly haven't improved any. For example, the construction expenditures that this company is experiencing have increased and will continue to increase. Fuel costs have continued to rise. And the evidence will be that interest rates have actually gone up since your last rate decisions involving this company.

As a result of this, I submit that there really is no reason for you to believe that you should award anything below the 10.9 or the 11 percent that you previously found to be appropriate. If anything, the evidence suggests that you should be moving in the other direction, you should be moving upward.

The other thing to keep in mind is that during the period of time when you had authorized the 10.9 and the 11 percent returns for this company, its actual earned returns did not even come close to these numbers. I think you've heard evidence in this case that Empire's ROE in recent years has ranged from about 5.8 percent to a high of 8 and a half or perhaps 9 percent at the best. So they haven't really come close to earning that return that you have authorized.

Again, if you would look at the recommendations of the parties in this case, Dr. Vander Weide has an 11.6 recommendation which is consistent with his past proposals in the prior cases except that he's not proposing a financial risk adjustment in this case as he did in the other two.

We have the Staff supporting a range of 10.3 to 10.8 with a midpoint recommendation of 10.26.

And finally, the Industrials' witness who I think is endorsed by the Public Counsel has an ROE range of 9.5 to 10.3 with a midpoint recommendation of 10 percent. So what you have is Dr. Vander Weide's recommendation which is about where it was in the last case, and you have recommendations from the other parties that have actually increased somewhat from the last proceeding.

Now, if you want to do calculations, you can do that. I took Dr. Vander Weide's 11.6 recommendation, took the high side of the Staff's range which is 10.8 and the high end of the Industrial/Public Counsel range which is 10.3 and averaged those, and I got 10.95 which is right between the last two awards that you've made for this company.

Now, does that have any significance? I don't know, but I think it's interesting and it's something you should -- should consider. My point again is that if you thought a 10.9 percent return or an 11 percent return was the right award for Empire back in 2005 and 2006 given that nothing has really changed to improve Empire's economic circumstances, and given further that the recommendations of the other parties to this case are actually higher than they were in those cases, there really isn't any reason for you to consider anything lower than those other returns.

Just a couple of final points when you look at Dr. Vander Weide's testimony. His cost of equity methods, he applied them to a large group of comparable companies. I think his group consisted of 37 companies. He uses this large number of companies because the uncertainty in cost of equity estimated for an individual company can be greatly reduced if you use a large sample. The other witnesses had not used that large of a sample size.

As he has done in the past, Dr. Vander Weide used three approaches. He did the traditional DCF calculation which indicates a return on equity of 11.3 percent. He performed a risk premium calculation which produced an 11 percent ROE. And finally, he did the CAPM approach, and that indicated a 12 and a half percent return on equity. And as he has done in past proceedings, he averaged those, and the average is 11.6 percent which is his recommendation.

He has characterized this proposed return as conservative because in his judgment -- and the evidence will show that Empire faces a greater business risk than the comparable companies, and the financial risk of the comparable companies is less than Empire's financial risk because of Empire's capital structure -- it's also a conservative recommendation because interest rates are increasing.

We have a second witness on the ROE issue which is Mr. Ed Overcast who discusses Empire's ongoing construction program and the risks associated with that. The thrust of his testimony on this point is that given Empire's construction risk, its ROE should be set at the higher end of the range of reasonableness to compensate.

We -- in conclusion, I would submit that given all these circumstances, specifically Empire's current financial and economic circumstances of the construction risk which it faces, the 11.6 proposed return is fair and reasonable. Thank you.

JUDGE VOSS: Thank you. Staff?

MS. KLIETHERMES: If it pleases the Commission. I am Sarah Kliethermes representing Staff of the Missouri Public Service Commission. As Mr. Swearengen noted, ratemaking involves setting a fair return and allowing the utility a reasonable opportunity to earn that return. In setting that fair return, it is worth noting that at this time the average ROE for the most recent four quarters is 10.21 percent.

Mr. Barnes, a witness for Staff, comes in at a recommendation of 10.26 percent which is just above that industry average. Mr. Gorman, on behalf of the Industrials, comes in just below average at an even 10 percent. However, Dr. Vander Weide comes in at 11.6 percent which is 139 basis points above the industry average. What is significant about that is that each of those basis points is worth $67,043.

As regards the reasonableness of Empire's opportunity to earn their approved return, it should be noted that Empire suggests that the allowed ROE should be inflated to compensate them for the risk they perceive as attendant to a bad regulatory environment here in Missouri.

However, that reasoning ignores Empire's ability to collect additional amortizations to preserve credit metrics and the rates. That ability is owing to Empire's regulatory plan, and that plan as well as -- pardon -- this Commission's demonstrated willingness to establish regulatory assets and liabilities to account for extraordinary costs, such this [sic] past ice storm, does not strike me as evidence of the presence of an unfriendly regulatory environment here at the Missouri Commission.

Thus, it is inappropriate to inflate Empire's allowed ROE to compensate for risk which does not exist. That's all.

JUDGE VOSS: Thank you. Public Counsel?

MR. MILLS: Good morning. May it please the Commission. In his opening statement, Mr. Swearengen talked to you about how difficult it is to find the proper ROE to award a utility company, and I certainly don't disagree with that. It is frequently one of the most contested, and often the most contested, and frequently one of the most important in terms of dollars in the case before you.

Mr. Swearengen didn't really suggest, unfortunately, a good way to deal with that difficulty, so I will. You should look to the credibility of the witnesses. In this case you are fortunate to have three witnesses on this issue with which you have considerable experience over the last several years. You've seen the testimony of these three witnesses, and you have generally picked Michael Gorman as the most credible.

In fact, in a recent case in which

Dr. Vander Weide testified, you found his testimony to be so high as to not really be worth much consideration. That was the AmerenUE rate case ER-2007-002, and in that case, you found the testimony of Michael Gorman to be credible and based your ROE recommendation upon his testimony. Not exactly what he recommended, but certainly based upon his testimony, and I suggest that you do the same here.

Mr. Swearengen also talked to you somewhat about some recent awards in ROE for -- for Empire and for some other utilities. If you will recall, at the exact same time that you awarded Empire a 10.9 percent return on equity in Case No. ER-2006-0315, you awarded KCPL a return equity of 11.25 percent in Case No. ER-2006-0314.

Since that time, you've had -- had an opportunity to reconsider the appropriate -- appropriate return on equity to award KCPL, and in Case ER-2007-0291, you dropped considerably from the 11.25 percent ROE that you had previously awarded, and in that case awarded KCPL an 11 -- I'm sorry -- a 10.75 ROE. And that 10.75 ROE was coupled with an extremely equity-rich capital structure so that the combination of a 10.75 ROE and KCPL's high equity ratio gave KCPL an effective ROE of considerably higher because of the amount of equity in the capital structure.

So I would suggest that rather than look at the 10.9 percent you most recently awarded Empire, that you look at some of the awards that you've given the other electric utilities since that time, particularly the KCPL case, the Aquila case, the AmerenUE case in which the awards were in the -- in the low tens to the mid tens. Thank you.

JUDGE VOSS: Thank you. Industrials?

MR. WOODSMALL: Thank you, your Honor. Good morning. When I was coming over today, I was actually not going to make an opening statement and I was just going to rest on the opening statement that I made on Monday. But a number of issues came up in the context of Mr. Swearengen's opening statement that I felt needed some rebuttal, so I'm going to take the chance to rebut some of those things, and you'll also hear me echo some of the things that Mr. Mills just noted.

In justifying their 11.6 ROE, Empire likes to take the woe-is-me approach. They talk about the actual ROE that they've earned. It's important to understand that the ROE that the company has earned is not reflective just of the Missouri electric operations. There's a number of things that go into the total company ROE.

Empire's had in the past deregulated operations. Now they've wrapped those up, but those deregulated operations in the past could have drug down their total company ROE. Empire operates in a number of other states: Arkansas, Oklahoma and Kansas. So the operations in those other states to the extent that they're not earning the ROE authorized in Missouri will drag down their total company ROE. Empire has water operations. What is the return being earned by those water operations?

So there's a number of different factors that can go into whether a company makes their authorized ROE. And I dare say in this case, the fact that they're not earning it, their authorized ROE, it may be because of what's going on with Missouri electric operations, but it's entirely possible it's going on because of things going on in other states and other operations that have nothing to do with this case.

Mr. Swearengen talked a bit about the sample size used by Mr. Vander Weide. Basically taking the approach that a larger sample size is better, he suggests that Mr. Vander Weide's approach ought to be adopted. That is completely contrary to the evidence in this case. While Dr. Vander Weide has a higher sample size, the evidence presented indicates that the sample size difference between his proxy group and Mr. Gorman's is of no significance. In fact, when Mr. Gorman ran his analysis using Dr. Vander Weide's proxy group, there was no change. So sample size is a red herring. It's a nonissue in this case.

There was talk -- Mr. Swearengen talked about the national average ROE. As Staff noted, the national average ROE is dropping significantly. There is debate about which of the authorizations are relevant to this case. I've heard both sides of that debate, and I don't know if you can make any definite conclusions, but in the first quarter of '07, the national average ROE, Staff said 10.2. A different study says 10.15 percent. So I submit that with a 10.15 or a 10.2 national average ROE, 11.6 is way out of the ball park.

There -- there was discussion in the testimony about the need for a reduction in authorized ROE to account for the decrease in risk if the Commission grants an FAC. And you heard the CEO, the CEO of Empire state that if the Commission grants an FAC, that there is reduction in risk for Empire. Look at the testimony in the UE case. In the UE case, UE recognizes that if they're given an FAC, there's a 25 point reduction in risk in ROE. So keep that in mind.

Echoing something Staff said, construction risk, while part of the overall company risk for Empire in this case, is not out of normal -- is not abnormal, and, in fact, whatever construction risk there is there is largely mitigated by the use of the regulatory plan amortization.

In fact, in this case you heard testimony that the regulatory plan amortization may come out at zero. So if construction risk is as large as they say, how come that amortization is zero? I submit to you construction risk is being accounted for and should not be accounted for separately.

Finally, echoing some of the statements of Public Counsel, look at the conclusions that you've made in the last UE case, look at the finding that you made regarding Dr. Vander Weide's testimony and Mr. Gorman's. In that case, as Public Counsel noted, you said that Dr. Vander Weide's recommendation was so high as to be lacking credibility. You also noted that it would be the highest ROE in the nation for that year. And as I mentioned on Monday, such findings have not dissuaded him here. Again, his recommendation would be the highest in the nation. Thank you, and have a great weekend.

JUDGE VOSS: Thank you. Would Empire like to call its first witness?

MR. SWEARENGEN: I would, and I will call Dr. Vander Weide.

JUDGE VOSS: Before we begin, how do you pronounce your name? I've heard two or three different pronunciations already.

DR. VANDER WEIDE: Vander Weide.

JUDGE VOSS: Vander Weide. All right.

DR. VANDER WEIDE: Yes.

JUDGE VOSS: That's how Mr. Swearengen said it, but I wanted to make sure. Vander Weide. Thank you.

(The witness was sworn.)

JUDGE VOSS: Thank you. Please proceed.

MR. SWEARENGEN: Thank you, Judge.

DIRECT EXAMINATION BY MR. SWEARENGEN:

Q. Would you state your name for the

record, please.

A. Yes. My name is James H. Vander Weide.

Q. And what is your occupation?

A. I am a research professor of finance at the Fuqua School of Business of Duke University.

Q. Have you caused to be prepared for purposes of this proceeding certain direct, rebuttal and surrebuttal testimony in question-and-answer form?

A. Yes, I have.

Q. And do you have copies of that testimony with you this morning?

A. Yes, I do.

MR. SWEARENGEN: And for the record, I believe Dr. Vander Weide's direct testimony has been marked as Exhibit 28; is that correct, your Honor?

JUDGE VOSS: Let me just double-check that.

MR. SWEARENGEN: And there are two versions of that. There is a nonproprietary version as well as a highly confidential version.

JUDGE VOSS: I'm checking and they're both 28, so 28 and 28 HC.

MR. SWEARENGEN: Thank you.

BY MR. SWEARENGEN:

Q. And Dr. Vander Weide, I believe, then, that your rebuttal testimony would be Exhibit 29 and your surrebuttal Exhibit 30. Are there any changes that you wish to make this morning, any changes or corrections with respect to any of that testimony?

A. Yes, there are several typos in my testimony. The first is in my rebuttal testimony on page 7, lines 10 and 11. There's a sentence that begins "These data indicate." That sentence should be deleted.

Q. Say that again. What -- what page and what line?

A. Page 7 of my rebuttal testimony, lines 10 and 11. There's a sentence that begins "These data indicate." That sentence should be stricken.

JUDGE VOSS: Okay. I don't see that sentence on page 7, lines 10 and 11.

THE WITNESS: Okay. Maybe -- I'm sorry. Maybe I have a -- a version that was before that was -- that was corrected, then. I'm sorry.

BY MR. SWEARENGEN:

Q. Are there any other changes that you think need to be made?

A. On page 12 of the rebuttal testimony, line 16, it says, "And investors use analysts' forecast -- analysts' growth forecast." There should be an S on the "forecast."

Q. I believe that's in there.

A. Is that -- is it?

Q. I believe that's been corrected.

A. Okay. I'm sorry, then. Then I -- then I have no other corrections.

Q. All right. Thank you. With that, Dr. Vander Weide, if I asked you the questions that are contained in your direct, rebuttal and surrebuttal testimonies, would your answers this morning then be the same?

A. Yes, they would.

Q. And would they be true and correct to the best of your knowledge, information and belief?

A. Yes, they would.

MR. SWEARENGEN: With that, your Honor, I would offer into evidence Dr. Vander Weide's direct, rebuttal and surrebuttal testimonies and tender the witness.

JUDGE VOSS: Are there any objections to the admissions of Exhibits 28 NP and HC, 29 and 30?

(NO RESPONSE.)

JUDGE VOSS: Hearing none, they're admitted.

(EXHIBIT NOS. 28 NP AND HC, 29 AND 30 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE VOSS: Department of Natural Resources, I believe, is not here at present, so that brings us to Public Counsel.

MR. MILLS: Just very briefly, your Honor.

CROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Vander Weide, do you think it's possible for experts in the field to agree upon a number to use for a representative national average for a company such as Empire District Electric Company?

A. Are you asking just whether it's possible for them?

Q. Yes.

A. Yes.

Q. Assume with me that for purposes of this case the experts all agreed on what the appropriate national average would be. Can you -- can you make that assumption?

A. Yes.

Q. In your opinion, how far off of that national average would a witness have to be to -- to lack credibility?

A. I myself would not give a lot of credence to just the national average allowed rate of return. There's a great deal of circularity in using average allowed rates of return in other states as an indicator of the cost of equity at present in this state.

Q. So it's your testimony that -- that the national average gives no indicia of credibility of a witness?

A. That's correct.

MR. MILLS: Okay. I have no further questions.

JUDGE VOSS: Staff?

CROSS-EXAMINATION BY MS. KLIETHERMES:

Q. Good morning, Dr. Vander Weide. My apologies for mispronouncing your name earlier.

A. No problem.

Q. Were you compensated for any analysis you prepared in this case?

A. Yes.

Q. What was your compensation for the preparation of that analysis?

A. The total amount? I don't have that with me today.

Q. Could you ball park a figure?
A. No, I just don't have that information.
Q. Did you exclude distribution-only electric companies from your calculation of the industry average?
A. Yes, I did, because I believe they're not comparable in risk to the integrated electric utilities.
Q. Did you include in your proxy group utilities whose electric operation revenues comprise less than 70 percent of their total revenues?
A. In my calculation of the average allowed rates of return?
Q. Pardon, no. In your proxy group calculations.
A. Okay. Now, let me go back to the prior question. Was your prior question with regard to my proxy companies?
Q. Oh, with regard to your calculation of the industry average.
A. Allowed rate of return?
Q. Yes.
A. For those I did not include distribution-only companies. And so now you asked me about the proxy companies?

Q. Yes. And the question regarding the proxy companies is whether you included utilities whose electric operation revenues comprise less than 70 percent of their total revenues.
A. I did include -- I did not use 70 percent as a screen, and there were some companies that have less than 70 percent. But more importantly, my companies have less -- have a lower average risk than Empire.
Q. Is an element of selecting a proxy group ascertaining that the companies in that group are comparable to the utility for which rates are to be determined?
A. That is an element, yes.
Q. Is there a magic number to determine the size of a proxy group?
A. There's not a magic number, but as long as the group is comparable in risk, the more companies, the better.
Q. So you would agree that it is not appropriate to include dissimilar companies to inflate the size of a proxy group? And pardon me. There are probably too many negatives in that question.
Would you agree that it is inappropriate

to include dissimilar companies in a proxy group to inflate the size of the proxy group?

A. There are no companies that are exactly similar to the company. What's important is that the group on average is similar in risk. And my evidence indicates, for instance, that my group have an average bond rating of BBB plus, and Empire has a bond rating of BBB minus. So my group is a conservative proxy for the risk of Empire.

Q. All right. You've previously testified before this Commission, correct?

A. Yes.

Q. In the analysis underlying those prior testimonies, have you included natural gas utilities in your proxy groups?

A. Yes, I have.

JUDGE VOSS: Could we go back one second? I just got a message. Could you move the microphone a little closer to you? I think you're not picking up very well on delivery. Thank you very much. I'm sorry. Please proceed.

BY MS. KLIETHERMES:

Q. If you're aware, are most natural gas utilities distribution only?

A. Yes, they are.

MS. KLIETHERMES: Thank you. You've been very helpful.

JUDGE VOSS: Industrials?

MR. WOODSMALL: Just one question.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Sir, have you ever testified on behalf of any commission staffs, consumer groups, public counsels?

A. No, I have not.

MR. WOODSMALL: Thank you.

JUDGE VOSS: Questions from the bench, Commissioner Jarrett?

QUESTIONS BY COMMISSIONER JARRETT:

Q. Good morning, Doctor.

A. Good morning.

Q. I had a question. One of the issues raised in the opening statement was about the fuel adjustment clause, and I know at least one of the other experts on the ROE issue had indicated a less -- that if an FAC is in place, that there -- there's less risk and therefore the ROE should reflect that. And I believe in your testimony, you indicated that that is not the case, and I was wondering if you could explain why.

A. Yes. There -- there are several things to keep in mind. One is that Empire starts before we discuss a fuel adjustment clause at a -- at a higher risk level than the proxy companies. They have a BBB minus bond rating from S&P. The proxy companies for almost everyone in this -- in this proceeding have BBB plus. So Empire begins being more risky than the -- than the proxy companies.

The proxy -- all of us have used proxy companies, and the standard is -- or the issue is whether Empire is -- would become less risky than the proxy companies if they had a fuel adjustment clause.

There are several reasons why they would not become less risky than the proxy companies. One is, they start out more risky than the proxy companies, and two, the proxy companies virtually all have fuel adjustment clauses already.

So the -- the cost of equity for the proxy companies is a conservative estimate of the cost of equity. It's possible that Empire would become -- would move closer to the proxy companies. They would have slightly less risk and they would move in the -- in the -- as closer to the proxy companies but they would not become less risky than the proxy companies. And hence, there would be no reason to reduce the cost of equity from the proxy group.

Q. Right. But you would agree, then, that for Empire's sake, having a fuel adjustment clause would reduce their risk?

A. It would be better for them to have a fuel adjustment clause like all the other proxy companies do, and they would move in the direction of the proxy companies, but they would not become less risky than the proxy companies.

Q. And in similar questions about the regulatory amortizations that Empire has, how does that figure into your calculation for the ROE?

A. Well, there -- there are two issues involved. One is whether the company earns a fair rate of return or not; that is, a return that's commensurate or comparable to returns earned by comparable companies. That's what my testimony is about and that's -- and that has -- and that is not affected by the amortizations. That only affects the cash flow of the company and their ability to finance their construction programs. It doesn't affect the required rate of return.

But a second issue, of course, is whether they're -- whether they will continue to have the credit quality and the bond rating required to finance the construction program. Empire already has a BBB minus bond rating which is one grade below -- above a junk bond rating. Without the amortizations, Empire could well move below the -- the investment-grade credit rating which would greatly increase their cost of debt in particular.

Public Service of New Mexico, for instance, just recently asked for a fuel adjustment clause, and it was denied in New Mexico. Their bonds were downgraded and they recently had to issue a bond with a 9.25 percent interest rate on it. That could happen to Empire without the amortizations. But the amortization is a different issue than the rate of return. The amortizations don't affect the rate of return itself.

Q. Mr. Mills, I believe in his opening statement, talked a little bit about the history of what this Commission has done and specifically talked about the KCP&L recent case where we awarded a 10.75 ROE to KCP&L. And I note that -- would you say that KCP&L is similar to Empire as far as risk, if you know --

A. I believe that -- I believe that it's -- at least it's my recall that KCPL has a BBB bond rating. Empire is one grade below that at BBB minus.

I think it's also important to keep in mind with regard to the 10.75 for KCPL that interest rates have increased quite dramatically in recent months. The interest rate on Baa-rated utility bonds, for example, since the end of the year has moved up from about 6 and a half to 6.81 percent.

To keep that -- to put that in perspective, at the time of the last two Empire proceedings, the interest rate on Baa-rated utility bonds, which is Empire's rating, was approximately 6 percent.

So we now have interest rates for Empire that are roughly 80 basis points higher than they were at the time of the last two cases and are also higher than it were -- than they were at the time of the KCPL case.

COMMISSIONER JARRETT: Thank you, Doctor. I appreciate your answers, and I have no further questions.

JUDGE VOSS: Commissioner Gunn?

COMMISSION GUNN: Yeah, I just have a couple -- couple questions.

QUESTIONS BY COMMISSIONER GUNN:

Q. To go back to Commissioner Jarrett's question, you said that -- that Empire is essentially starting so far behind the proxy companies that the -- a fuel adjustment clause would never get them to catch up or -- and I apologize if this is -- if some of these questions are basic, because I'm new and your testimony is dense and a lot of numbers in there.

So -- but what -- what then makes them appropriate proxy companies if the risk level is so unrelated to Empire's situation?

A. Well, first of all, there -- there aren't very many proxy companies that have greater risk than -- than Empire, and there aren't even very many that have a BBB minus credit rating. And we need a large group of proxy companies to get an accurate estimate of the cost of equity.

So the best thing we can do is take -- is to take companies that on average are slightly less -- are somewhat less risky than Empire. They have a BBB plus credit rating compared to Empire's BBB minus, and then to recognize although we need to include companies that are less risky to have a reasonable size proxy group, that Empire's cost of equity should be higher than that of the proxy group or at least to recognize that the proxy group is a conservative estimate of the cost of equity for

Empire.

Q. My second question is, were you able or did you review either the testimony or the transcripts of Mr. Gipson, either in this hearing or...

A. No, I did not.

Q. Because he stated that several -- they've done several things, including two large wind programs, as well as a -- as a significant hedging program. Did you take those kind of risk-reduction factors into account when -- when you were making your analysis?

A. Yes, I did. First of all, they're implicitly included in -- in my proxy company analysis because the proxy companies have bond ratings that are less risky than -- than Empire, and the bond rating agencies would consider all of those factors. Likewise, they're included in the stock prices.

However, the -- the factor that makes Empire -- one of the factors that make Empire risky is that they are more concentrated in natural gas generation than most other electric utilities, and natural gas prices have been moving up very rapidly just as gasoline and oil prices have been moving up.

Without a fuel adjustment clause, Empire's always a step behind in recovering those costs. And that's one of the primary reasons why they have not been able to earn their allowed rate of return in recent years. Missouri represents far and away the vast percentage of their -- of their operations. Their operations in other states have a minimal impact on their -- on their overall rate of return.

But the fact that they can't recover on a timely basis their fuel costs is the major factor that -- that causes them to earn less than their allowed rate of return.

Q. I appreciate that, but that didn't really answer my question. I'll ask you again just to -- just to -- just to be clear or just so I understand your testimony.

What you're saying is, is that you assume that the bond rating analysis -- analysts take into -- into account proxy companies' reliance on alternative forms of energy generation such as wind. That's your -- that's your assumption?

A. Yes.

Q. And then -- and they -- and that is one of the factors that they put into their bond rating, and therefore, they have a higher bond rating, they must be doing a better job in reducing their risk through wind and -- and that. Do you have independent verification that those bond houses took the wind -- specifically the wind generation and hedging programs for natural gas on your proxy companies?

A. I didn't do a study just on that particular issue, but I'm aware that bond rating agencies consider all the factors that affect the risk, including the investment in wind energy, wind energy projects.

Q. And then -- and then to get to my question, which -- which you went into fuel adjustment clauses and some other things, but just -- it's a very simple kind of issue. You did not specifically or did you specifically take into account these wind programs, both the ones that it's currently completed and the one that is contemplated, in your risk analysis of -- for Empire?

A. I did not explicitly consider it. I did implicitly through the comparable companies.

COMMISSIONER GUNN: Great. Thank you. I don't have anything else.

JUDGE VOSS: Chairman Davis?

QUESTIONS BY CHAIRMAN DAVIS:

Q. Good morning.

A. Good morning.

Q. Good morning, Dr. Vander Weide. Going back to some of your previous testimony in -- to the -- to the S&P BBB minus rating, what is the -- can you quantify numerically the difference between being BBB minus, BBB, BBB plus?

A. It would -- it would certainly vary over the business cycle. With regard to interest rates, normally in a -- in -- in a normal market, it might be 25 basis points or so. Right now we're in an economic environment where investors are particularly sensitive to risk because of the things that are happening in the economy.

Q. Uh-huh.

A. And so BBB minus bond yields have increased more than have -- have other bond yields, so the spread is -- is higher than 25 basis points at this time with regard to interest rates.

Q. So what -- what is the spread now?

A. The -- the current interest rate on -- let me see. I believe I have that data in my possession here. The current interest rate on -- on -- they don't go by BBB minus and BBB plus, but a -- a BBB equivalent would be 681.

And the -- the A-rated which is the only other one that they look at, they look at double AA [sic] and a Baa, which is equivalent to BBB. That difference is now 52 basis points between those two categories, the 681 for the Baa's and 629 for the A's. That would be on the cost of debt.

On the cost of equity, I -- I would suggest that the difference between a BBB and a BBB minus would be maybe 25 to 50 basis points.

Q. Okay. Dr. Vander Weide, do you recall what percentage of Empire's operations are in Missouri versus the other three or four states, three?

A. I don't recall it with -- with -- exactly, but my recall is that it's something like 82 percent, 82 to 85, something like that.

Q. Okay. And do you recall what percentage of -- of Empire's generation supply is -- is fueled by natural gas?

A. I don't recall the exact percentage, but I recall that -- that it's the highest percentage of -- of their -- of their generation sources.

It's -- and -- and that it's at a higher percentage than the average electric utility throughout the country. In fact, the average electric utility is much more heavily reliant on coal.

Q. Right.

A. Whereas Empire has -- has been more reliant on natural gas. Now, that -- that could be -- that's environmentally a much better fuel source than coal, but it -- but it has had a rapid increase in price in recent years.

Q. Uh-huh. Now, does that include purchased power?

A. Purchased power is predominantly natural gas from natural-gas-fired sources.

Q. Uh-huh.

A. And so purchased power will tend to go up with the price of natural gas just like your own self-generation with natural gas.

Q. Okay. Do you recall being asked some questions about -- about national averages?

A. Yes.

Q. Okay. So in essence here, you've got the -- the PSC Staff stating, you know, there's one national average for -- for all electric utilities in terms of ROE, and then you have said we need to take the -- the national average for the, quote,

vertically integrated utilities?
A. Yes.
Q. The ones that aren't just wires-only distribution companies. Is that -- is that a fair statement?
A. That's correct.
Q. Why do you think the -- the average for the vertically integrated electric utilities is more significant?
A. One, Empire is a vertically integrated electric utility.
Q. Uh-huh.
A. And two, vertically integrated electric utilities at this time face significantly more risk than the wires-only or the distribution-only electric utilities. They face significantly more risk because we're in a -- we're in a period where there's a shortage of supply of generation capacity compared to the demand.
But the choices that one has to fulfill to increase that supply are very difficult and they require a whole lot of dollars. And construction expenditures are usually one of the primary risks. A rapid increase in construction expenditures and especially in a rising-cost

environment is a source of great risk for utilities.

And the -- and the integrated utilities which have generation, obviously, are in a construction mode which makes them more risky than the wires-only company -- companies. And that's evidenced by the fact that the allowed rates of return for wires-only companies are quite a bit lower than that for integrated electric utilities. The average for integrated companies has been 10.7 over the last six months.

Q. And that's compared to 10 --

A. About a 10 -- 10.25 or 10.3 overall, including the wires-only companies.

Q. Okay. And I think you may have answered this question for -- for Commissioner Jarrett earlier, but I want to ask it one more time just to be sure. Why don't the amortizations for Empire Electric affect its rate of return?

A. The -- the amortizations are an issue of having access to debt, meet -- meeting the -- the standard for a BBB minus credit rating. That was what they were designed to do. And it was recognized that if Empire were to fall below investment grade, which they would if their BBB minus were to be lowered one -- one grade, that like Public Service of

New Hampshire, their debt costs would go way up.

The cost of equity is different than the cost of debt. And so the amortizations were primarily put in place to make sure that Empire would have access to the debt markets. Their allowed rate of return on equity, however, is -- is a different issue, and it has to be allowed -- it has to be a return that's commensurate with what investors can expect to get on other electric utilities or other investments of comparable risk.

And since the other electric utilities and -- and proxy groups have similar type of -- of -- of risk characteristics, and, indeed, as I've suggested, are less risky than Empire, this would not reduce Empire's cost of equity.

Q. Okay. And one last question based -- based on your -- on your previous responses to my questions. So if we go out and we look at the decisions made by other public utility commissions in the country concerning ROE, is it fair to assume that those commissions made -- made their respective decisions, that they considered whether they were wires-only companies or whether they were, in fact, vertically integrated?

A. They -- they did consider that, and

that's -- and that's why the average allowed returns for the wires-only companies are quite a bit less and are pulling down the national -- nationwide average from the vertically integrated companies.

Q. And would it also be fair to assume that they considered, you know, what portion of the companies' earnings were derived from electric utility revenues as opposed to, say, a utility like Hawaii Electric that has a significant banking operation?

A. Yes.

CHAIRMAN DAVIS: Thank you.

JUDGE VOSS: Additional questions from the bench?

COMMISSIONER GUNN: Nothing.

JUDGE VOSS: Recross based on questions from the bench? Let's see. Public Counsel?

MR. MILLS: Just a few, thank you.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Vander Weide, have you done a study that supports your estimate that the spread on cost equity between BBB and A is 25 to 50 basis points?

A. No. That's a matter of professional judgment.

Q. Now, you said that over the last six

months, the -- the awarded ROE for wires-only companies -- I'm sorry -- for vertically integrated companies was 10.7 percent; is that correct?

A. Yes, and I supplied that data in my -- either my rebuttal or surrebuttal testimony.

Q. And what is that figure if you take it over the last year rather than just the last six months?

A. As -- as shown in my surrebuttal testimony, Exhibit -- or schedule 1, over the last year it was 10.6.

Q. Now, is there an issue about cost of debt in this case?

A. I don't believe so.

Q. Okay. So if Empire's cost of debt has gone up since its last rate case, that increase is captured by and agreed upon by all the witnesses; is that correct?

A. Their embedded cost of debt would be -- would be -- would be reflected. The -- however, the current interest rate on the cost of debt is an indicator that the cost of equity has also gone up. It's an indicator that capital markets are demanding higher returns.

Q. Well, Dr. Vander Weide, I didn't ask you about the cost of equity. My question was about cost of debt, and I believe you agreed with me; is that correct?

A. No, I didn't agree with you.

Q. Okay. Let me ask it again. You do not agree that if Empire's cost of debt has gone up since its last rate case, that increase is captured by and agreed upon by all the witnesses?

A. No, because there's a difference between the embedded cost of debt and the current interest rate. The --

Q. Which -- which do you consider to be Empire's cost of debt at this time?

A. The evidence -- when I was talking about the interest rate at 6.81, that was not evidence on Empire's embedded cost of debt, that was evidence on the current interest rates.

Q. And what -- what does Empire actually pay out when it's writing checks? Does it pay out based on its embedded cost of debt?

A. It pays out on its embedded cost of debt, but I was using that as --

Q. Thank you. That's -- that's all.

A. -- an indicator of the cost of equity.

Q. Is it your testimony that equity

investors view a utility's access to or lack thereof -- well, their access to capital markets has no impact on -- on their risk profile?

A. Their access to capital markets does have an impact on its risk profile.

MR. MILLS: Okay. Thank you. That's all the questions I have.

CHAIRMAN DAVIS: Judge, I'm sorry. Can I go back? I've got a couple of unrelated questions that I forgot to ask Mr. Vander Weide that I'd like to go back and ask.

JUDGE VOSS: Please proceed, Chairman.

CHAIRMAN DAVIS: I'm sorry. Sorry, Mr. Mills.

QUESTIONS BY CHAIRMAN DAVIS:

Q. Dr. Vander Weide, do you recall what Empire's market capitalization is?

A. It's -- it's the lowest of all -- of all the proxy electric utilities. I believe it's a little over a billion dollars, but -- but it is the lowest of all of the -- of the companies in my -- in my proxy group.

Q. Okay. So does that make it a small cap or a micro cap?

A. That would make it a small cap company.

Q. Okay. And do people that invest in small cap utilities have different expectations than people that invest in large cap utilities?

A. Yes. Small -- small cap utilities are considered to be riskier in other things equal. And -- and, indeed, small cap companies in general are considered riskier, and investors demand that there's a lot of evidence, and investors demand a higher return to compensate for that risk.

Q. So they -- they expect a risk premium?

A. Yes.

Q. Is it fair to say that -- that over time that a majority of small cap stocks have tended to outperform their -- their large cap counterparts?

A. Yes, it is.

CHAIRMAN DAVIS: Thank you. No further questions.

JUDGE VOSS: Any additional questions from the bench?

(NO RESPONSE.)

JUDGE VOSS: Mr. Mills, did you have anything else based on the additional questions from the bench?

MR. MILLS: No. And I was finished with

my cross-examination in any event.

JUDGE VOSS: Okay. All right. Industrials?

MR. WOODSMALL: Yes, thank you.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. You were talking in questions to Commissioner Jarrett about risk being implicit in the BBB minus/BBB plus, depending on who you were talking about. Do you recall talking about implicit risk?

A. Yes.

Q. Can you tell me if a company's operating risk, for instance, exposure to nuclear operations, would that be implicit in the rating given by a bond company?

A. Yes, it would.

Q. Okay. Can you tell me if risk associated with operations in deregulated states, would that be implicit in the bond rating?

A. I'm not sure what you mean by "deregulated states."

Q. Okay. For instance, operations in New York where the generation has spun off, would that be implicit in the bond rating?

A. Generally not because if the -- if the operation is spun off, it would no longer be owned by the electric utility and hence, would not be implicit in the utility's bond rating.

Q. A utility, a regulated utility, would their bond rating reflect any risk implicit in their operations in deregulated states as a T&D company?

A. If they owned operations in -- in deregulated states, it would, but --

Q. Thank you, sir.

A. -- with regard to consolidated --

Q. Can you tell me -- would you tell me, would -- if a utility had -- had an affiliate that had foreign operations, would that risk be implicit in a bond rating?

A. Yes.

Q. If a utility operated in a state that had exposure to hurricanes, would that risk be implicit in a bond rating?

A. Yes.

Q. Would a utility that has a small market capitalization, would that be implicit in a bond rating?

A. It would.

Q. Were you a witness in a recent UE case, ER-2007-0004?

A. Yes.

Q. And would you agree in that case the Commission rejected an adjustment for higher financial risk?

A. Yes.

Q. Can you tell me -- we've talked about -- can you tell me what the other electric utilities are that operate in Missouri?

A. Well, there's AmerenUE which is the largest, and there's KCPL and Aquila.

Q. Okay. And I believe we heard testimony earlier that KCP&L was authorized an ROE recently of 10.75. Do you recall that?

A. Yes.

Q. Can you tell me what the Commission authorized AmerenUE in the case in which you testified?

A. 10.2.

Q. Okay. And are you aware that the Commission authorized Aquila in their recent case an ROE of 10.25 percent?

A. No, I'm not.

Q. Okay. Can you tell me if Aquila, AmerenUE and KCP&L are all vertically integrated?

A. Yes, they are.

Q. Okay. And assuming the Commission authorized an ROE for Aquila of 10.25 -- let's make that assumption -- can you give me a state average for these three vertically integrated companies? The three numbers are 10.25, 10.75 and 10.2.

A. I don't have a calculator with me, but I'm sure you have that, if you'd...

Q. Would you accept, subject to check, a 10.40 is a state average for these three vertically integrated companies?

A. That sounds about right.

Q. Okay. Can you tell me why equity is more expensive than debt?

A. Yes, because an equity investor faces greater risk as a result of their being in a residual position.

Q. And if something were to happen to increase the likelihood that debt would be paid off and there would be a greater residual in the event of a bankruptcy, that would reduce the risk for equity holders?

A. That factor by itself could impact the risk.

Q. Okay. And would you agree that the regulatory amortization increases the likelihood that debt holders would be paid off in the event of a bankruptcy?

A. I haven't examined that question.

Q. Okay. Real quickly running back, the Aquila that you mentioned was a vertically integrated company in Missouri. Can you tell me what their bond rating is currently?

A. No, I don't have that information available.

Q. Do you know if Aquila is junk-bond-rated?

A. I believe it is a low rating, but I don't have that information.

Q. So you don't know if utility -- if Aquila is investment grade or junk bond?

MR. SWEARENGEN: Your Honor, I'm going to object. He's answered it -- he's asked it twice, he's answered it twice. He doesn't know.

BY MR. WOODSMALL:

Q. Okay. Can you tell me how Aquila --

JUDGE VOSS: Sustained.

MR. WOODSMALL: I'll move on.

BY MR. WOODSMALL:

Q. Can you tell me how Aquila compares to Empire in the amount of gas generation they have?

A. No.

MR. WOODSMALL: Okay. I have no further questions. Thank you.

JUDGE VOSS: Two things. First, actually, I slipped to the wrong cross-examination list, so I'll have to come back to Staff. Apology. I covered up the other one, so I can't read it now.

And I wanted to clarify something. Mr. Woodsmall asked you if you had testified in the Ameren case and identified that case as ER-08-0004. That was actually 0002. And the Aquila case --

MR. WOODSMALL: Okay. And it was 2007. I'm sorry.

JUDGE VOSS: Yeah. The Aquila case -- you might have said 2007. It was the 4 and the 2. The 2 case was actually the Ameren case, and the 0004 was the Aquila case.

MR. WOODSMALL: You're correct. I stand corrected.

JUDGE VOSS: I was the judge, so I know. Staff, please proceed with your cross-examination -- or recross based on questions from the bench.

MS. KLIETHERMES: Certainly.

RECROSS-EXAMINATION BY MS. KLIETHERMES:

Q. Some of the Commissioners were asking you about whether Empire's regulatory plan should reduce the allowed ROE. Does the existence of the regulatory plan additional amortizations provide Empire with additional cash flow?

A. Yes, it does.

Q. Does Empire pay its dividends in cash or in stock?

A. In cash.

Q. Was it your testimony that equity investors do not look at debt ratings?

A. I don't recall saying that.

Q. You've made several references to whether or not you've performed various analyses. Could you tell me whether you were compensated by the hour in this case?

A. Yes, I was.

Q. And what was that hourly rate?

A. $425 an hour.

MS. KLIETHERMES: That's all. Thank you.

JUDGE VOSS: Redirect?

MR. SWEARENGEN: Yes, your Honor, thank you. Just a couple of questions.

REDIRECT EXAMINATION BY MR. SWEARENGEN:

Q. I want to take you back. I think it was

Mr. Jarrett that was asking you about the increase in -- in interest rates. And you mentioned the -- a 6.81 figure, and I think you said it was for a Baa-rated utility?

A. Yes.

Q. And it was unclear to me if you said -- and I don't recall -- what point in time were you referring to?

A. That was -- that's in April of '08, of 2008, the most recent data available.

Q. And that is the utility bond yield for what type of utility?

A. For a Baa-rated electric utility.

Q. And what -- what is the rating for Empire?

A. B -- Baa.

Q. Now, I think in response to one of the questions from the bench, you indicated that those interest rates had increased recently. Do you recall that?

A. Yes, I do.

Q. With regard to Empire, for example, the decision in Empire's last case, can you quantify that?

A. Yes. At the time of the decision -- the time of the decision in Empire's last case was December 2006. And the Baa-rated -- the yield on Baa-rated bonds at that time was 6.05 percent compared to 6.81 percent today.

Q. And that's an increase of how much?

A. Of 76 basis points.

Q. And then I think it -- Mr. Mills was asking you about the -- the relationship between the cost of debt and the cost of equity. What is the impact on the cost of equity by an increase in the cost of debt, if there is any?

A. Well, certainly one would have to measure the cost of equity specifically, but generally it's an indicator that the cost of equity has likely increased as well.

Q. You had several questions about how the regulatory amortization that's authorized for Empire might impact your recommendation for the Commission's decision on an appropriate return on equity for Empire. Is it your testimony that the regulatory amortization can be used to make up for any perceived shortfall in Empire's authorized return on equity?

A. It's my testimony that -- that it cannot be used to make up for a shortfall in their authorized return on equity.

Q. And why is that?
A. Because the -- the amortization reflects a -- an increase in cash flow, but it doesn't reflect their return on equity.
Q. And Commissioner Jarrett was asking you about the fuel adjustment clause, and there was mention the company's president, Mr. Gipson, has indicated that a properly designed fuel adjustment clause will lower Empire's risk. Do you recall his question?
A. Yes, I do.
Q. And I think Mr. Jarrett was trying to determine what your position was vis-à-vis that position that the president of the company had stated. What -- do you recall that?
A. Yes.
Q. And what was your answer?
A. My answer is that it -- it very likely would reduce their risk, but it wouldn't reduce their risk below that of the proxy companies. And hence, the -- there -- there would be no reason why one should lower the required return for Empire compared to the proxy companies, because the proxy companies are already a conservative estimate. They're less risky than Empire.

It would not make Empire to be less risky than the proxy companies, and so the result of applying different methodologies to the proxy companies will still be conservative, although, perhaps, not quite as conservative as it was previously.

Q. And why are the proxy companies less risky than Empire?

A. Partly because virtually all of them have fuel adjustment clauses already, and they also have construction work in progress for their construction programs which is very similar to the amortization program.

Q. I think it was the Staff counsel that asked you about why you did not use as a screen for your proxy group a 70 percent figure. Do you recall that?

A. Yes, I do.

Q. And what was your understanding of that question?

A. My -- my understanding is that there's -- there's no reason to -- to impose a requirement that they have 70 percent revenues from electric because the purpose of the cost of -- of equity isn't to identify the business that they're in entirely, it's to estimate the risk.

And I don't -- if -- if we already have risk included in the bond ratings or we have evidence that 70 percent electric doesn't affect the risk, then the only impact of that restriction is that it reduces our sample size without changing the nature of the risk.

And my studies have indicated that the 70 percent electric does not impact the risk of the proxy group because my proxy group, for example, has the same risk as -- as the Staff's proxy group, even though I didn't include a 70 percent criterion. We -- both my group and theirs have a BBB plus credit rating.

Q. Along those same lines, I think Staff counsel asked you about the fact that you have used natural gas companies previously in formulating your proxy group, but you did not do so in this case?

A. Yes.

Q. And why is that?

A. Because although there are certain similarities between natural gas and electric, and natural gas at the time of my previous testimonies were comparable in risk, although conservatively comparable in risk, they had higher bond ratings, they are not involved in the construction programs that electric utilities are involved in at this time.

The demand for natural gas is not expanding and -- and the supply is adequate, and so their capital expenditures are -- are -- are lower than our other capital expenditures as a percent of their business for the electric companies. And that -- that has changed since my last testimony, and that makes the natural gas no longer appropriate as proxies.

MR. SWEARENGEN: I believe that's all I have. Thank you.

JUDGE VOSS: Mr. Vander Weide, you are excused. You may step down.

At this time let's take a real quick break and come back at 10:30.

(A RECESS WAS TAKEN.)

JUDGE VOSS: All right. We're going to go back on the record. I believe Mr. Mills will return shortly. And I believe Empire is ready to call your second witness?

MR. SWEARENGEN: Yes, your Honor. We call Mr. Overcast at this time.

(The witness was sworn.)

JUDGE VOSS: Please proceed.

DIRECT EXAMINATION BY MR. SWEARENGEN:

Q. Would you state your name for the record, please.

A. H. Edwin Overcast.

Q. And by whom are you employed and in what capacity?

A. I'm a director of Energy -- EMS at Black & Veatch.

Q. And just briefly, what is the business of Black & Veatch?

A. Black & Veatch is an engineering and consulting company.

Q. Have you caused to be prepared for purposes of this proceeding certain direct, rebuttal and surrebuttal testimony in question-and-answer form?

A. Yes, I have.

Q. And do you have copies of that testimony with you today?

A. Yes, I do.

Q. For the record, I believe your direct testimony has been marked as Exhibit 8, your rebuttal as Exhibit 9 and I believe your surrebuttal as Exhibit 10.

MR. SWEARENGEN: Does that comport with

the law judge's records?

JUDGE VOSS: I have, at least on your chart, direct testimony NP as 8, a direct testimony schedule HC as 9 --

MR. SWEARENGEN: Okay.

JUDGE VOSS: -- and NP schedule as 9 NP. And then rebuttal is 10 and surrebuttal is 11.

MR. SWEARENGEN: Okay. Thank you.

BY MR. SWEARENGEN:

Q. Do you have all those testimonies with you, sir?

A. Yes, I do.

Q. And are there any changes or corrections that you need to make at this time with regard to any of that?

A. Yes. There's one typo in surrebuttal, page 5, line 3. The word "earning" should be "earnings."

Q. That's the surrebuttal testimony, page 5, line 3?

A. Yes. It's the first word in.

Q. Are there any other changes that need to be made?

A. Not that I'm aware of.

MR. SWEARENGEN: Now, your Honor, I

understand this witness's testimony also covers topics other than -- than return on equity, but I am going to go ahead and offer all of his testimony at this time with the understanding that that ruling will be deferred until all of his issues have been covered. So I would go ahead and offer his testimony into evidence at this time and tender the witness for cross-examination on the return on equity issue.

JUDGE VOSS: All right.

MR. SWEARENGEN: Thank you.

JUDGE VOSS: We'll begin with the Office of Public Counsel.

MR. MILLS: Judge, I have no questions for this witness on ROE. I will have some questions when we get around to the FAC.

JUDGE VOSS: Staff?

CROSS-EXAMINATION BY MS. KLIETHERMES:

Q. Good morning, Mr. Overcast.

A. Good morning.

Q. Were you compensated for your participation in this case?

A. Yes.

Q. And what was that compensation?

A. I don't know exactly.

Q. You're billed out by your employer, I assume?

A. Yes.

Q. And do you know what rate you were billed out at?

A. I think it's $300 an hour.

Q. Is it your testimony that a bad regulatory environment creates the need for a utility to have a higher improved ROE?

A. I don't -- I don't think that's my testimony, no.

Q. Is it your testimony that a unfavorable regulatory environment creates the need for an ROE to increase?

A. No. I think my whole testimony focuses on the kinds of events that create a probability that the utility will not earn its allowed return during the rate-effective period and that there are issues in the regulatory environment that contribute to that, and it's important that the utility overall and it's just a fundamental principle that the utility have a reasonable opportunity to earn the allowed return.

Q. Was the industry national average ROE for electric utilities in the first quarter of 2006 10.57 percent?

A. I don't know.

Q. Do you know if the industry national average ROE for electric utilities in the year 2005 was 10.55 percent?

A. Let's see. I have a table that has -- that compares the returns. Let me just refer to that.

Q. If I could perhaps withdraw that previous question and instead ask whether you're aware on page 45 of the Commission's Report and Order entered in Case ER-2004-0570 whether the Commission made the statement that the industry average is 11 point cent percent -- sorry -- 11.0 percent?

A. No, I'm not.

Q. Would you be surprised by that fact?

A. In 2000 --

Q. This would be the case ER-2004-0570. And I'm sorry, I jumped around there. I -- I had initially asked you about the years 2005 and 2006, and I pulled out the wrong order for which I apologize. However --

MR. SWEARENGEN: Did you understand the question?

JUDGE VOSS: You might need to restate the question.

BY MS. KLIETHERMES:

Q. Would it surprise you if in the Report and Order in Case ER-2004-0570, the Commission stated that the industry average was 11 percent as regards the time period of that case?

A. I don't know what the time period of that case was, and I'm not familiar with that case.

Q. All right. Does Empire have a regulatory plan in place in Missouri?

A. You mean the regulatory amortization plan? Yes.

Q. Is an element of that plan that Empire receives additional amortizations to preserve credit?

A. That's my understanding, yes.

Q. How many of the utilities in Empire's proxy group have available additional amortizations to preserve credit? And by "Empire's proxy group," I mean the -- the proxy group used by Empire's witnesses in this case.

A. I am not sure that there are any that have that specific kind of plan.

Q. Are you aware that Empire has regulatory tracker mechanisms in place in Missouri for its pension and post retirement benefit costs?

A. Most utilities do, yes.

Q. Do tracker mechanisms provide increased opportunity for the utility to earn its allowed returns in your opinion?

A. Yes, they improve the -- they improve the opportunity during the allowed return.

Q. On pages 38 to 39 of your direct testimony, you recommend that the Commission consider an approach allowing Empire to defer and probably recover any unusual expenses for changes in costs outside of the company's control. And if you need a moment to review that, just take your time.

A. Yes, I do.

Q. Do you include in your list of such costs storm damage and vegetation management expenses?

A. Yes.

Q. What is your knowledge of the parties' recommendations for treatment of ice storm damages in this case?

A. I believe that you have agreed to defer to county treatment.

Q. What is your knowledge of the various parties' positions on treatment of vegetation management costs in this case?

A. I'm not aware.

Q. Would it surprise you if Staff's proposal in this case is to allow upfront recovery of some vegetation management costs?

A. Some but not all?

Q. Yes.

A. No.

Q. On your schedule HEO-12, page 1 to your direct testimony, you characterize Missouri's current policy as "Missouri may permit post test year known and measurable changes," do you not?

A. Yes.

Q. What is the ordered test year for this proceeding?

A. The ordered test year, I believe, is calendar year 2007. Company filed 12 months ended June, and I believe you've given them an update until the end of 2007.

Q. For the current rate proceeding, is it your understanding that the parties' revenue requirement recommendations are all based upon known and measurable events -- events through December '07, six months past the test year?

A. I'm not sure about every one of them, so I couldn't answer that question.

Q. Are you aware that the Commission has ordered a true-up proceeding in this case through February 2008?

A. No, I'm not.

Q. Are you aware of whether this Commission has ever had a policy of not considering information beyond the test year in determining the need for rate changes?

A. No. And as I indicated in this -- in this point, that they do consider those.

Q. On schedule HEO-13 to your direct testimony -- have you found your place?

A. Yes.

Q. On that schedule 13, does the line bolded as ROE reflect Empire's actual earned ROEs?

A. Yes.

Q. Does the line bolded as average electric ROE reflect average authorized ROEs for the industry?

A. Yes.

Q. Are adequate cash flows important to the equity investor in your opinion?

A. Yes.

MS. KLIETHERMES: That's all, thank you.

JUDGE VOSS: Industrials?

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Very briefly, just to clarify a question she just asked you. You indicated, I believe, in response to her question, that tracker mechanisms, quote, increase the opportunity to earn an authorized ROE; is that correct?

A. Yes.

Q. Okay. And you would agree that the pension tracker used in this case is such a tracker mechanism; is that correct?

A. I'm not familiar with how it works, so I don't really know.

Q. Okay. Are you aware that the company in this case is seeking at least as an alternative a tracker mechanism for tree trimming costs?

A. It's my understanding that there is an issue related to tree trimming costs, yes.

Q. Okay. Would you agree that the FAC is a tracker mechanism?

A. Yes.

MR. WOODSMALL: No further questions. Thank you.

JUDGE VOSS: Questions from the bench? Commissioner Jarrett?

COMMISSIONER JARRETT: No questions.

JUDGE VOSS: Chairman Davis?

CHAIRMAN DAVIS: He'll be back, won't

he?

JUDGE VOSS: He'll be back later this afternoon -- I'm assuming it will be this afternoon -- on fuel adjustment costs. All right. Since there are no questions from the bench, I will move to redirect.

MR. SWEARENGEN: Nothing further, thank you.

JUDGE VOSS: Mr. Overcast, you may step down. I believe we will see you probably this afternoon. These cross-examination witnesses go much more rapidly than I would anticipate. Staff, would you like to call your witness?

MS. KLIETHERMES: Matt Barnes.

(The witness was sworn.)

DIRECT EXAMINATION BY MS. KLIETHERMES:

Q. Have you prepared prefiled testimony in this case?

A. Yes, I have.

Q. Is that your prefiled rebuttal numbered 218?

A. I believe so.

Q. And is your surrebuttal No. 219?

A. Yes.

Q. Did you also participate in the preparation of Staff's cost of service report which has been marked No. 204?

A. Yes, I did.

Q. And if I were to ask you the same questions contained in your prefiled testimony, would you have the same answers today?

A. Yes, I would.

Q. And if you were to contribute in the same manner to the report, would your contribution be the same?

A. Yes.

MS. KLIETHERMES: I move for the admission of Nos. 218 and 219 and tender the witness for cross.

JUDGE VOSS: Are there any objections to the admission of Exhibits 218 and 219?

(NO RESPONSE.)

JUDGE VOSS: Hearing none, they're admitted.

(EXHIBIT NOS. 218 AND 219 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE VOSS: And cross-examination beginning with Public Counsel.

MR. MILLS: No questions.

JUDGE VOSS: Department of Natural Resources is not present. The Industrials?

MR. WOODSMALL: No, no questions, thank you.

JUDGE VOSS: That brings us to Empire.

MR. SWEARENGEN: Yes, your Honor, thank you.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Good morning, Mr. Barnes.

A. Good morning.

Q. How are you doing?

A. Pretty good.

Q. Just as a matter of housekeeping, the Staff report that was filed in this proceeding, you're responsible for portions of that; is that right?

A. Yes, I am.

Q. And I have a copy of that in front of me and it's -- I'm looking at page 5, Rate of Return and Summary, and then it goes on for several pages to discuss rate of return; is that correct?

A. That's correct.

Q. And your -- and -- and I can cross-examine you on that; is that correct?

A. Yes.

Q. Okay. Thanks. I assume that you're familiar with the order issued by this Commission in

Empire's last electric rate case, at least with regard to the return on equity decision; is that a fair statement?

A. I'm somewhat familiar with it, yes.

Q. Okay. Is it your understanding and would you agree that in that case which was ER-2006-0315, the Commission concluded that the reasonable and appropriate return on equity for Empire was 10.9 percent?

A. I believe that's correct, yes.

Q. And would you agree that the Commission reached that decision in December of 2006? That's when the Report and Order was issued?

A. I believe so, yes.

Q. Now, in the case prior to that, there's been some testimony today about that, the prior Empire rate case was ER-2004-0570. Are you familiar with the Commission's rate of return decision in that case?

A. Somewhat, yes.

Q. So would you agree that in that proceeding, Empire was awarded an 11 percent return on equity?

A. Yes.

Q. And that order -- Report and Order was

issued in March of 2005; would that be correct?
A. Yes, I believe so.
Q. And I think -- and what I call your direct testimony or perhaps a portion of the Staff report that you were responsible for, you say that Empire has not earned either the 10.9 or the 11 percent return on equity; is that right?
A. That's correct.
Q. And if you have that report in front of you, can you turn to page 11? Do you have that?
A. Yes.
Q. During that first full paragraph, you state that Empire's earned ROE has ranged from a low of 5.8 percent in 2004 to a high of 8.5 percent in 2006, correct?
A. Correct.
Q. And you also indicated there that Value Line investment survey estimates that Empire's ROE from 2008 will be 8.5 percent; is that right?
A. That's right.
Q. Were -- were you in the hearing room or listening to the testimony of Mr. Bill Gipson when he testified earlier this week?
A. I heard just very little over the intranet, but I was not down here. I didn't hear his

full testimony.

Q. Did you hear him testify that for 2007 Empire's earned return on equity was about 7 percent?

A. I didn't hear that.

Q. Would it be fair to say that you're familiar generally with the Staff testimony on this issue in the last Empire rate case?

A. I was not a witness, but I am somewhat familiar with it.

Q. And would you agree with me that in that case the Staff had an ROE range that they recommended of 9.5 to 9.6?

A. Subject to check, I think so.

Q. Okay. And I think you said earlier you were aware that the Commission in that case awarded Empire a 10.9 percent return; is that right?

A. That's correct.

Q. Okay. And that would be about 130 basis points above the Staff high?

A. Yes.

Q. And am I correct in understanding that in the current case, that your recommendation and Staff's recommendation is a range from 9.72 percent to 10.8 percent; is that -- is that correct? I know there were some different numbers in your direct testimony, but I think you updated that.

A. Yes, 9.72 to 10.8.

Q. Okay. And the midpoint of that is 10.26?

A. That's correct.

Q. And since -- since you had that recommended range, can I assume that if the Commission awarded Empire either a 9.72 percent return or a 10.8 percent return or anything in between, you would be in agreement with that?

A. Yes, I would.

Q. If -- is the revenue requirement difference between your -- your midpoint, your 10.26 midpoint and your 10.8 high side which is about 50 basis points, is the revenue requirement associated with that about $3 million?

A. I'm not for sure. I haven't done that calculation.

Q. If I compare the high side of the Staff's recommendation in the last case which was 9.6 percent with the high side of your recommendation in this case which is 10.8 percent, am I correct that that represents a 120-basis-point increase?

A. That's a 120-basis-point difference, yes.

Q. And it's 120 basis points higher in this case than it was in the last --

A. Compared to what Staff recommended in the last case, yes.

Q. Now, in formulating your return on equity recommendation in this case, am I correct that you used a group of so-called comparable companies?

A. Yes, I did.

Q. Would I be correct if I said that all of your comparable companies operate under some sort of a fuel adjust mechanism?

A. I believe all of them but two, but the majority of them do, yes.

Q. And how many companies do you have in your proxy group?

A. I have 17.

Q. And you would agree with me that Empire currently does not have a fuel adjustment clause; is that right?

A. No, it does not.

Q. But it is asking for one in this case; is that right?

A. That's correct.

Q. If you could turn to the -- page 14, I guess, of the Staff report. Do you have that in front of you?

A. Yes.

Q. Now, the lines are not numbered, but at the bottom of that page, you talk about growth rates in the context of the discounted cash flow or DCF model; is that correct?

A. Yes.

Q. And there at the bottom of the page, you say the Staff decided to rely on projected growth rates because historical growth rates are volatile; is that correct?

A. That's correct.

Q. Okay. And that's still your testimony?

A. Yes, it is.

Q. And would I be correct in understanding that you used projected growth rates for purposes of your DCF calculation in this case?

A. Yes, that's one component of the DCF model.

Q. And you're familiar with the DCF model, I take it?

A. Yes.

Q. Do you have your rebuttal testimony handy, Mr. Barnes?

A. Yes, I do.

Q. I'm looking at page 2 of your rebuttal testimony.
A. Okay.
Q. Beginning on that page, you discuss something you call a company-specific DCF calculation; is that correct?
A. That's correct.
Q. And is a company-specific DCF calculation one in which the DCF model is applied to the stock price dividend and growth rate for a single company?
A. Yes.
Q. And in this case ROE?
A. That's correct.
Q. And you don't apply it to any other companies, you just apply it to a single company, correct?
A. The DCF model?
Q. No. The company-specific DCF calculation. It's specific to one company?
A. That's correct.
Q. Okay. Would I be correct if I said that in past cases before this Commission, the Staff utilized a company-specific DCF model for purposes of its return on equity recommendation?

A. They did at one time, yes.

Q. Would it be fair to say that for many years, the Staff relied primarily on that type of a calculation for purposes of its recommendation?

A. I can't speak for before I started. I've been here about five years, but since I've been here, I believe the Staff used -- I may be wrong about this, but the first Empire -- the 2004 Empire case, I think Staff used a company-specific, but I may be wrong in that. And I believe the Commission ordered that it wasn't in compliance with Hope and Bluefield.

Q. So let me ask you this, then. If I represented to you that historically that's what the Staff has -- has done, you don't know one way or the other?

A. No, I don't.

Q. Okay. Thank you. However, for purposes of this case, you did, in fact, I think, as you indicated on page 3 of your rebuttal testimony, make a company-specific DCF calculation using projected growth rates; is that right?

A. Yes.

Q. And that figure that you calculated the specific cost of equity for Empire using projected growth rates is 12.85 percent; is that true?

A. That -- that's what the model presented, yes.
Q. Okay. And that's still your testimony?
A. Yes.
Q. On page -- back to the Staff report, page 7, do you have that in front of you?
A. Yes, I do.
Q. In the third paragraph, you talk about certain schedules that you have that show public utility bond yields. Do you see that?
A. Yes.
Q. And am I correct, then, if I turn to schedule 5-1, is that the schedule that you're talking about there?
A. Yes, it is. That's the average yields on mergers of public utility bonds.
Q. Okay. And let me ask you this. What's being averaged there? Can you tell the Commission?
A. It's averaged from 1980 to the present.
Q. Well, let me ask this question. It says "Average yield on public utility bonds." What types of bonds are we looking at? How is that -- what -- the numbers represent an average of what?
A. Investment-grade utility bonds.
Q. Okay. And are there various categories

or classes of investment-grade utility bonds?

A. No. They just list them as -- as Dr. Vander Weide pointed out, a Baa which is equivalent to BBB.

Q. So is your testimony that this exhibit represents Baa, the yields on Baa bonds?

A. Let me -- let me step back here. What this number represents here is the average of Baa and AA bonds as well.

Q. Okay.

A. I apologize.

Q. Could there be a third category of bond in that calculation as far as you know?

A. I'd have to go back and look at Moody's, but there could be A-rated bonds as well.

Q. Okay. I take it you didn't check that, you didn't -- you didn't make the calculations that are shown on there? You just took --

A. No. That's from the Moody's report.

Q. Okay. Thank you. If I look at your schedule 5-1, am I correct in December of 2006 the average yield for public utility bonds was 5.83 percent?

A. That's correct.

Q. And then the most recent number you have is December of 2007, and that shows the yield at 6.23 percent; is that correct?

A. Yes.

Q. Okay. Do you have your surrebuttal testimony?

A. Yes, I do.

Q. And you have something attached to it called, I think, your third revised schedule 15; is that right? Is there a schedule 15 that's been revised several times?

Actually, the document I have says, "Revised schedule 15," but I think maybe it was the third time this schedule was revised.

A. The one that shows historical and projected growth rates?

Q. That's correct.

A. Yes.

Q. Now, that second column, the projected five-year EPS growth, IBES, the average shown there is 7.72 percent; is that right?

A. That's right.

Q. And the average S&P forecast is 7.65?

A. That's correct.

Q. And Value Line growth forecast is 5.53; is that correct?

A. That's correct.

Q. And those are shown in columns 2, 3 and 4?

A. Yes.

Q. And am I correct that in your DCF analysis that you performed in this case, you propose a growth rate of 5.55 percent to 6.63 percent?

A. That's correct, initially, yes.

Q. And you've got the low end of your growth rate from Value Line; is that right?

A. Yes, that's correct.

Q. And with regard to your high end growth rate, I think on page 6 of your surrebuttal testimony, you say you get that by averaging the 5.55 percent with the 7.72?

A. That's correct.

Q. Okay. Well, since you took the low growth rate forecast as the low number of your range, would it not have been reasonable to have taken the 7.72 percent high growth forecast for the high end of your range?

A. No, it wouldn't have been reasonable to do that.

Q. And why not?

A. I believe that it's just too high. It's higher than gross domestic product, and I didn't think it was reasonable.

Q. So can I conclude from that that the growth rate component of your DCF model is really just a matter of your judgment?

A. Yes.

Q. Okay. Have you done any studies to validate your procedure for estimating the growth rate component of your DCF model?

A. Could you repeat that question, please?

Q. Have you done any studies to validate your procedure for estimating the growth rate component of your DCF model?

A. I have not done a separate analysis or study, no.

Q. If you look at page 5 of your surrebuttal testimony.

A. That's correct.

Q. I think on line 5 you say, "Staff believes that investors make their investment decisions primarily based upon the annual dividend assumption, and for that reason it is appropriate to recommend ROE estimations based on that assumption." Is that -- that's your testimony?

A. Based on the annual dividend, yes.

Q. Has the Staff done any quantitative studies to validate its belief as to how investors make investment decisions?

A. As far as the annual -- the annual dividends expected, is that what you're referring to?

Q. Have you done any quantitative study, you or anybody on the Staff, to validate your belief as to how investors make investment decisions?

A. My -- my analysis would show that, but we haven't done any separate studies or...

Q. On page 4 of your surrebuttal, I think at line 15, do you have that in front of you?

A. Yes.

Q. You state that, "Value Line does not publish quarterly projected dividends"; is that correct?

A. That's correct.

Q. Would you agree that Value Line does report a company's most recent -- four most recent quarterly dividend payments?

A. Historical they do, yes.

Q. Yes. Would you agree that it would not be that difficult for an investor to multiply the recent historical quarterly dividends by the factor one plus growth rate to estimate next year's

dividends using a constant growth DCF model?
A. It's possible investors could do that.
MR. SWEARENGEN: Okay. Thank you. That's all I have. Thank you.
JUDGE VOSS: Questions from the bench? Commissioner Jarrett?
QUESTIONS BY COMMISSIONER JARRETT:
Q. Good morning, Mr. Barnes.
A. Good morning.
Q. You were here for -- for Dr. Vander Weide's testimony, were you not?
A. Yes, I was.
Q. There was a lot of debate about the zone of reasonableness issue and what companies should be included as you tried to figure the average. One school of thought is that you use all electric companies, and if you do that, then the average is about 10.2, something like that?
A. Uh-huh, yes.
Q. And then another school of thought is that you should only use the integrated companies with significant capital projects, and if you use that, then the average is about 10.7, I believe was the testimony. And I believe Dr. Vander Weide's position was that you should use just the integrated

companies with significant capital projects. Is that the way you recalled it?

A. From what he said? Yes.

Q. Yes. Which school of thought do you subscribe to and why?

A. I would include all of the companies. The wires-only companies, those -- generally speaking, they were less risky than integrated companies, but that's just based on business risk, not the entire risk of the company. Therefore, I would -- I would -- that's why I would keep those in that proxy group, if that's what you want to call it.

Q. Okay. And then there was, I guess, some talk about choice of proxy groups. Can you tell me why your proxy group is more similarly situated to Empire than Dr. Vander Weide's proxy group?

A. My -- my proxy group, I try to narrow it down. Instead of just trying to come up with the most companies that you can, I try to narrow it down to companies that are more comparable to Empire. And my criteria that I used to select those companies I believe is more precise than what Dr. Vander Weide's is. And the main component would be the 70 percent of electric revenues.

Q. And why is that the most important?

A. It -- it ensures that you select a company that is more comparable to Empire. Empire actually has more revenues than 70 percent. It's -- it's -- it's a number I used in the last couple cases that I've -- I've been on. I think it's reasonable to do that, to select companies that are similar in risk as Empire.
Q. We've also been discussing the fuel adjustment clause and how it relates or does it relate to ROE, I guess. First of all, do you believe that a fuel adjustment clause lowers risk?
A. Yes, I do.
Q. And is that something that should factor into the ROE calculation?
A. I guess it depends on which witness you -- you go with. In my analysis, 15 of the 17 companies already have some sort of mechanism in place to recover fuel costs, and therefore, since I used a comparable company approach to determine the return on equity for Empire, that's -- that -- that risk has already been either adjusted or accounted for in the stock price of -- of those companies. And part of the DCF model is the current stock price, so I don't think an adjustment should be made to my recommendation.

Q. Gotcha. There was also -- we've been discussing the regulatory amortization that's currently in place for Empire. And again, I believe it was Dr. Vander Weide's testimony that that really wasn't an Empire factor for ROE purposes because that was related to cost of debt and not cost of equity. Is that how you understood his testimony?
A. That's what I understood, yes.
Q. And do you agree with that, and why, if -- you know, whether you agree, disagree, why?
A. I don't agree with that. I do -- I believe it does have an impact on the equity investor. I'll pretty much say the same answer as I did to your previous question. Investors are going to see -- investors are going to see that that amortization is in place and they're going to account for that. Now, it's my understanding that my comparable -- I think KCP&L and Empire are the only companies I'm aware of that actually have that plan, but the -- the cash flows are more certain with that in place. And it -- it ensures that the company has the opportunity to maintain their credit rating.
COMMISSIONER JARRETT: Thank you, Mr. Barnes. I don't have any further questions.
THE WITNESS: Thank you.

JUDGE VOSS: Commissioner Gunn?

QUESTIONS BY COMMISSIONER GUNN:

Q. I just want to get some clarity on stuff with the fuel adjustment clause. Staff's recommending the fuel adjustment clause, and it's -- it was included in your calculation for ROE. Just -- just to be clear, if -- if there was -- if -- if a fuel adjustment clause was for whatever reason excluded from this, can you explain again if that significantly impacts your ROE, and if so, how?

A. If it is not approved?

Q. If it's not -- if for some reason it's not, we can't -- we can, whatever, for some reason it's out of the calculation.

A. I'm not for sure how that would impact my analysis because that's just one component that goes into it.

Q. The risk would -- would -- the risk would be higher?

A. For Empire?

Q. Right.

A. Yes. Without a fuel adjustment clause?

Q. Without a fuel adjustment clause.

A. Possibly, yes. I don't -- I can't quantify it. I don't know how much --

Q. Right.
A. -- it would -- you know.
Q. But as a general -- as a general proposition, risk would be higher?
A. Right.
Q. And as a general proposition, if the risk is higher, then the ROE -- the ROE would have to be recalculated to take into effect -- into account that higher risk?
A. That's correct.
Q. And -- and you may -- you can't quantify that right now?
A. Right.
Q. That would involve a lot of other calculations?
A. Yes, it would.
COMMISSIONER GUNN: Okay. All right. Thank you.
JUDGE VOSS: Did you have any additional questions, Commissioner?
COMMISSIONER JARRETT: No.
QUESTIONS BY JUDGE VOSS:
Q. I had a couple. You testified in ER-2007-0004, Aquila's last rate case?
A. No, I did not. We had a consultant.

JUDGE VOSS: Okay. I couldn't remember because it went back and forth between those two cases. Thank you.

All right. Redirect [sic] based on questions from the bench? Public Counsel?

MR. MILLS: Just a couple, your Honor.

RECROSS-EXAMINATION BY MR. MILLS:

Q. In response to questions by Commissioner Gunn, you were talking about the FAC and that contribution to risk. Do you recall that?

A. Yes.

Q. Is fuel price risk one risk factor that impacts a utility?

A. Yes, it is.

Q. Are there a lot of other risk factors as well?

A. Yes. That's not the only one.

Q. Does your analysis of proxy groups take into account specifically for each company all of the different risk factors?

A. I believe it does, but I don't have them listed what they are. But there's very many of them, so...

Q. Does your -- does your analysis take in -- take those into account explicitly and can quantify each -- each risk factor?

A. No, it does not.

Q. Okay. Now, does Empire's current stock price represent investors' understanding that Empire does not currently have a fuel adjustment clause?

A. I believe that it would.

MR. MILLS: Those are all the questions I have. Thank you.

JUDGE VOSS: Industrials?

MR. WOODSMALL: Thank you, your Honor.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. Taking off of that last question and more specifically to Commissioner Gunn's question, you said that risk for Empire would be higher without the FAC. Is that what you said?

A. It -- it -- maybe I need to step back and -- and look at the question. It would be about the same as it is now. I don't know if it would actually go up.

Q. Okay.

A. But...

Q. And so, the risk that is implicit in Empire now is the risk without an FAC; is that right?

A. That's right. In my analysis, yes.

Q. Okay. And when you select your

comparable companies, those are companies that have a total risk profile that's comparable to Empire without the FAC; is that correct?

A. The majority of my companies already have an FAC, but again, there's many other factors that go into analyzing risk, so...

Q. And to repeat that, the comparable companies have a total risk profile that is comparable to Empire's without an FAC; is that correct?

A. Yes, yes.

Q. Okay. And if Empire gets an FAC, it will reduce their risk vis-à-vis the total risk profile of the comparable companies; is that correct?

A. Yes.

Q. Okay. And, in fact, do you have your -- the Staff report cost of service report?

A. Yes, I do.

Q. At page 17, the top paragraph, you recommended at that time that the Commission approves an FAC, that they should adopt an ROE that it's -- that's at the lower end of your ROE range; is that correct?

A. That's correct.

Q. And is that still your recommendation?

A. Well, after -- after discovering that a majority of my companies already have a fuel adjustment clause in place, although not all of them do, if the Commission believes that Empire is less risky, then they can move to the lower end of my range, but --

Q. And at least you believe that Empire would be less risky?

A. Yes.

Q. Okay. Finally, in response to some questions from Commissioner Jarrett, you talk about the different -- the two different schools of thought of integrated companies being more or less risky than overall companies. Do you recall those questions?

A. Yes.

Q. Have you heard one school of thought -- it was presented at EEI at agenda here, that the nonintegrated companies are more risky because they have smaller balance sheets to absorb risk?

A. I wasn't there for that presentation, so I don't know.

Q. Have you ever heard that train of thought, that school of thought before?

A. No, I haven't.

Q. Would you agree with that, that because of their lower -- their smaller balance sheets, they have less ability to absorb risk?

A. I don't know without looking at more information on that.

MR. WOODSMALL: Okay. No further questions. Thank you.

JUDGE VOSS: Commissioner Davis, did you have any questions for Staff witness on ROE?

CHAIRMAN DAVIS: No, I'll -- I'll forego. Thank you. Thank you. Good to see you, Mr. Barnes.

THE WITNESS: You too, Mr. Chairman.

MR. SWEARENGEN: Do I get a chance here sometime?

JUDGE VOSS: Yes. I was just looking at my chart which is ever changing to see who was next. Proceed, Mr. Swearengen.

MR. SWEARENGEN: Thank you.

RECROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Mr. Barnes, following up on Commissioner Jarrett's line of questioning and Mr. Woodsmall's line of questioning about what companies that you should look at in trying to determine the national average, I'm kind of intrigued. Are you saying that the wires-only company should be included in that calculation?

A. Yes.

Q. Okay. I'm looking at page 41 of the transcript of this case, and the General Counsel of the Commission made his opening statement and I'm going to read from it. He said, "Now" -- this is -- this Mr. Thompson -- he said, "Now, how you form the midpoint, how you figure the average of recent awards has to do, obviously, with which award you look at and over what time period. Dr. Vander Weide suggests, for example, that you don't look at the pipes and wires awards, the companies that are not traditionally vertically integrated electric utilities like Empire. I agree with that. It's only fair to exclude awards made to companies that are different that operate differently."

Were you aware that the General Counsel of the Commission made that statement?

A. No, I was not.

MR. SWEARENGEN: Okay. That's all I have.

JUDGE VOSS: Redirect?

MS. KLIETHERMES: Briefly, thank you.

REDIRECT EXAMINATION BY MS. KLIETHERMES:

Q. Mr. Barnes, earlier Mr. Swearengen was asking you about prior Staff utilization of a company-specific DCF analysis. Do you recall that?

A. Yes.

Q. Do you know if the Commission has made any rulings that have caused the Staff to cease using a company-specific DCF analysis?

A. I believe they did recently -- not recently, but I believe the first Empire case, but I'm not for sure.

Q. You had stated earlier in response to a question by Mr. Swearengen that you initially used a growth rate component of your DCF model of a certain value. Did you later revise that value in your subsequent testimony?

A. I think the value I was referring to was -- had already been corrected by surrebuttal. Is that what your question is? I think so.

Q. Earlier, Mr. Swearengen was asking you about whether an investor might calculate quarterly dividend yields with a formula involving projected growth rate. Do you recall that?

A. Yes.

Q. Would that calculation necessarily imply that dividend values are not constant?

A. It could.

Q. To your knowledge has -- are Empire's dividend values constant in recent history?

A. They've been constant in recent history, yes.

Q. Earlier you were discussing some -- some matters with Commissioner Jarrett -- Jarrett, pardon me. Does your use of the 70 percent electric revenues criteria necessarily screen out companies that have revenues primarily derived from natural gas?

A. That screens out companies that have less than 70 percent of revenues, electric revenues.

Q. So if a company has 70 percent electric revenues, they necessarily couldn't have more than 30 percent natural gas revenues, correct?

A. That's correct.

MS. KLIETHERMES: That's all. Thank you.

JUDGE VOSS: You may step down. Thank you.

Staff, would you like to call your next witness?

MS. KLIETHERMES: Staff calls Mr. Mark Oligschlaeger. I believe Mr. Oligschlaeger has testified and he will testify again; is that correct?

JUDGE VOSS: That's correct. Mr. Oligschlaeger, just remember that you're still under oath.

MS. KLIETHERMES: And I would tender him for cross.

JUDGE VOSS: Public Counsel?

MR. MILLS: No questions.

JUDGE VOSS: Industrials?

MR. WOODSMALL: No questions.

JUDGE VOSS: Empire?

MR. SWEARENGEN: Yes, thank you.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Mr. Oligschlaeger, does depreciation increase a company's net income?

A. No, it does not.

Q. Would a regulatory amortization like the type that we're talking about in this case increase a company's net income?

A. Not if that amortization was booked to expense.

MR. SWEARENGEN: Okay. That's all I have.

JUDGE VOSS: Questions from the bench? Commissioner Jarrett?

COMMISSIONER JARRETT: I have no

questions.

JUDGE VOSS: Commissioner Gunn?

COMMISSIONER GUNN: None for me.

JUDGE VOSS: Chairman?

CHAIRMAN DAVIS: Have a good day, Mr. Oligschlaeger.

THE WITNESS: You too, Mr. Chairman.

JUDGE VOSS: Does -- any redirect?

MS. KLIETHERMES: No, Judge.

JUDGE VOSS: I didn't think so. You may step down.

Mr. Gorman is the last witness on ROE who will be testifying on Tuesday. I think we'll bring Mr. Overcast up on all fuel adjustment clause issues. Would the parties like to call him now or take a brief break first?

MR. SWEARENGEN: Take a break.

JUDGE VOSS: Okay. Why don't we go ahead and take a lunch break and come back at 12:30. Does that sound good to everyone? 12:45? All right. We'll be back at 12:45. Thank you.

(THE LUNCH RECESS WAS TAKEN.)

JUDGE VOSS: Okay. Just to confirm, we are going to move Mr. Gorman to Monday after the end of the fuel adjustment clause witnesses. And then we will have a presentation on the two pending stipulations Tuesday morning assuming commencing at 9:00 unless a notice changing that time goes out.

Are we going to have opening statements on the fuel adjustment clause now?

MR. DOTTHEIM: I would suggest that since the -- all witnesses on the fuel adjustment clause are on Monday except for Dr. Overcast, that we have the -- the opening statements on Monday morning.

JUDGE VOSS: Does Empire have a problem with that?

MR. MITTEN: We have no problem with that.

JUDGE VOSS: Since your witness is -- primary witness I believe is going today. All right. That is fine. I'll make a note of that. And let's -- what would you like to do -- oh, yes?

MS. CARTER: Judge, I'm sorry. For clarification, the stip presentations, are you wanting witnesses to be here and available? We have quite a few people from out of town. Are you just wanting the attorneys?

JUDGE VOSS: I'll send out a notice. How's that?

MS. CARTER: Sounds good.

JUDGE VOSS: That will clarify it. Okay.

CHAIRMAN DAVIS: Judge, for the record, I would be fine with the attorneys, and maybe if those people that are from, quote, out of town would be available by phone just in case anyone had questions. That way you don't have to incur the expense of having someone travel to Jefferson City.

JUDGE VOSS: In fact, if you would, I could establish a phone port for an hour or so in the morning to let those witnesses be available. I'll just send out a notice if a phone port's available with a phone number.

MS. CARTER: Thank you, Judge.

JUDGE VOSS: Empire, would you like to call your first witness?

MR. MITTEN: Empire recalls Dr. Overcast. Your Honor, while Dr. Overcast is taking the stand, I believe Mr. Swearengen, when Dr. Overcast appeared on cost of equity issues, had offered his prefiled testimony into evidence. This is the last issue on which Dr. Overcast will be testifying, so I would renew that offer at this time.

JUDGE VOSS: Let's see. Are there any objections to the admission of Exhibit 8 and 9 NP and

9 HC and Exhibit 10 and 11 into the record?

(NO RESPONSE.)

JUDGE VOSS: Hearing none, those exhibits are admitted.

(EXHIBIT NOS. 8 AND 9 NP, 9 HC, 10 AND 11 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. MITTEN: And Dr. Overcast is available for cross-examination.

JUDGE VOSS: Staff?

CROSS-EXAMINATION BY MR. DOTTHEIM:

Q. Good afternoon, Dr. Overcast.

A. Good afternoon.

Q. Dr. Overcast, I'd like to refer you to your direct testimony, and in particular, I'd like to first direct you to page 5 of your direct testimony, lines 12 and 13, where you make a reference to the rate-effective period and you make reference to the rate-effective period as being the first 12 months the rates are effective. Am I reading that correctly?

A. Yes, that's correct.

Q. Okay. Dr. Overcast, I can take that two ways, and I was wondering if you could help me. I can take the first 12 months the rates are effective as -- if, for example, we're looking at rates that go into effect, for example, September 1, for example, 2008, would the first 12 months the rates are effective be September 1, 2008 to August 31, 2009, or would the first 12 months the rates are effective be September 1, 2009 to August 31, 2010?

A. If the rates take effect on September 1st, 2008, the rate-effective period would be September 1st, 2008 until August 31st, 2009.

Q. Okay. And the second period I was referring to would -- would be 12 months showing an actual 12-month period where the new rates were in effect for each month of that 12-month period for a full 12 months, were they not, for that second period?

A. Assuming there was no intervening case or anything like that.

Q. Okay.

A. This is just a device to help us talk about when things really matter coming out of a rate case.

Q. Okay. And subsequently throughout your -- your testimony, when you make reference to a rate-effective period, you're referring consistently to that first 12 months that the rates are in effect?

A. Yes.

Q. So if -- if I could refer you to page 28 of your testimony, and I'd like to refer you to lines 17 to 19.

A. Yes.

Q. And on line 18, you use the term "rate-effective period," and you're using in that sentence rate-effective period consistent with how you just previously indicated?

A. Yes.

Q. That -- that sentence I've just referred you to on -- on page 28, is there a source for that statement you make on page 28, lines 17 to 19?

A. Well, there's -- there's several pieces to it, and based on my discussions with analysts in the past when I've been an employee of utility companies and represented those utility companies with analysts, they tell me that they're concerned about what the utility actually earns, not what the allowed return is. And I mean, there's a simple example that will illustrate that. Suppose you --

Q. Okay. Dr. Overcast, fine. You've answered my question. Thank you. Dr. Overcast, I'd like to refer you to page 7 of your direct testimony. And I'd like to refer you to your -- your answer that begins at line 8. And you enumerate a number of items on lines 10 through 27. Are those items out of control -- out of the control of a utility company?

A. Some are, some aren't.

Q. Item 17, changes in unit capacity ratings, is that item out of the control of a utility company?

A. Sometimes it may be, yes.

Q. But it can be --

A. It can be under control, too. It can be either one.

Q. Item 12, is that item, changes in maintenance schedules, is that out of the control of a utility company?

A. No. And those are -- those are filed as part of this case. They have a -- they've given you a five-year plan of what their scheduled maintenance is, and it's a fact that those schedules differ over time. And plants such as coal plants have different activities that occur over different periods, and some maintenance outages are longer than others.

Q. Dr. Overcast, I'd like to refer you again to page 28 of your -- your direct testimony. And I'd like to direct you to lines 13 and 14 on page 28 where you make reference to the Stipulation and Agreement entered into by the company and other parties in Case No. EO-2005-0263. Have you reviewed that Stipulation and Agreement?

A. Yes, I have.

Q. Do you happen to have a copy of the --

A. No, I don't.

Q. -- Stipulation and Agreement?

MR. DOTTHEIM: May I approach the witness?

JUDGE VOSS: Yes, you may.

BY MR. DOTTHEIM:

Q. Dr. Overcast, I'm handing to you what I'll represent is a copy of the Commission's Order Approving the Stipulation and Agreement which you referred to on line -- lines 13 and 14. And I'd like to -- and attached to that Order Approving the Stipulation and Agreement is a copy of that Stipulation and Agreement. I'd like to ask you to -- to take a look at those documents.

Dr. Overcast, have you had an opportunity to review the document which I've handed to you?

A. I've looked at it in the past, yes.

Q. Okay. So you recognize that document?

A. Yes.

Q. Okay. I'd like to direct you to page 5.

MR. MITTEN: Are you talking page 5 of the order on the regulatory plan?

MR. DOTTHEIM: Yes. Yes, I'm sorry. Thank you, Mr. Mitten.

BY MR. DOTTHEIM:

Q. I'm -- I'm referring to -- to page 5 of the Stipulation and Agreement which is attachment 1 to the Order Approving Stipulation and Agreement. And I'd like to refer you to section -- or section 7 which contains the heading Cost Recovery of Capital Investments in Iatan 1, Iatan 2, Asbury SCR and V84 S -- excuse me, V84 CT, and I'd like to direct you to the last paragraph at the bottom of the page that continues onto the next page.

That paragraph states, does it not, "If any party proposes the disallowance of Iatan 1 or Iatan 2 costs, Empire agrees not to seek to avoid such disallowance on the ground that such expenditures were the responsibility of KCPL and were not within Empire's control. Empire maintains the ability to litigate prudence issues related to these expenditures on any other basis." Did I read that accurately?

A. Yes.

Q. Okay. Dr. Overcast, do you know whether there's a owners committee respecting Iatan 1 and Iatan 2?

A. I'm not familiar with the arrangements.

Q. Okay. I'd like to next direct you to page 6 of the Stipulation and Agreement, the section that has the heading 9. Infrastructure Investment Monitoring. And in particular, that section continues on to page 9, and I'd like to direct you to the second-to-last paragraph on page 9.

That paragraph states, does it not, "Signatory parties retain the right to assert in any proceeding that Empire did not properly monitor significant factors or circumstances and as a result did not properly execute its infrastructure investment plan." Did I read that accurately?

A. Yes, that's correct.

Q. I'd next like to direct you to page 11 of the Stipulation and Agreement, the section that has the heading, 2. Amortizations to Maintain Financial Ratios. That first paragraph.

That paragraph states in part, does it not, "This agreement contains provisions that provide Empire the opportunity to maintain its debt at investment-grade rating during the period of the construction expenditures contained in this agreement. Empire understands that it is responsible to take prudent and reasonable actions to maintain its -- to maintain Empire's debt at investment-grade levels and avoid actions that result in the downgrade." Did I read those sentences accurately?

A. That's what it says.

Q. Thank you. Dr. Overcast, I'd like to direct you to page 38 of your direct testimony, lines 10 through 12 where you make reference to Kansas City Power & Light, Case No. ER-2006-0314.

A. Yes.

Q. There's been a subsequent Kansas City Power & Light rate case, has there not?

A. I believe I heard that this morning, yes.

Q. Okay. In your direct testimony, I'd like to direct you back to page 16, the sentence at the bottom of the page that continues to the top of the page where you state, "In adopting the interim energy charge for Empire in previous years, the Commission created an asymmetric risk for the company," do you not?

A. Yes.

Q. Empire entered into those interim energy charge agreements in previous years by means of Stipulations and Agreements, did it not?

A. Yes.

Q. Dr. Overcast, in your rebuttal and surrebuttal testimony, you make references to the Staff's proposal for a fuel adjustment clause as a penalty or as penalizing. Could you provide a definition of penalty or penalizing as you use it in your testimony?

A. I think the -- the basic -- the basic intent of that is that if -- if you don't recover 30 percent of your changes in fuel costs, that comes dollar for dollar out of the earnings that this Commission is authorized and you give no reasonable opportunity for Empire to -- to earn its allowed return. And I think that's a penalty so long as those costs are prudently incurred.

Q. And when you say "penalty," what do you mean by penalty? Can you expand on that?

A. Yeah, the penalty in this case is -- is you have a lower return than the Commission authorized simply because of a -- of a provision in the fuel adjustment clause recovery, and that has multiple implications. It has implications -- I mean, you read to me off of page 11 about the agreement that Empire's responsible for trying to maintain its investment grade.

Well, if you're going to take 30 percent of the increase in fuel cost and not let them recover it, then earnings aren't going to equal the allowed return. You have no chance. That's a penalty. That's penalizing them. That's penalizing somebody when they incur prudent costs, and, you, through some mechanism, disallow recovery of those costs, and those costs reduce earnings dollar for dollar.

Q. Dr. Overcast, I still don't think you've identified or defined for me the word "penalty." You've chosen that word as opposed to some other word. What meaning does that word penalty offer?

A. It's a penalty when you impose a mechanism on the utility that reduces their return even when they are behaving prudently and wisely and efficiently and everything else. It's just a penalty.

Q. Dr. Overcast, are you familiar with the legislation under which Empire is proposing a fuel adjustment clause in this case?

A. Yes, I am.

Q. Prior to the adoption of that legislation, was a fuel adjustment clause lawful in

Missouri?

A. It's my understanding that they were not.

Q. Dr. Overcast, you're not an attorney, are you?

A. No, I'm not.

Q. Okay. I'd like to refer you to your surrebuttal testimony, page 3, lines 19 to 23.

A. You said page 2?

Q. No, sir, I'm sorry. Page 3, lines 19 to 23.

A. Yes.

Q. Okay. You remarked there upon the level of hedging, "55 percent of the volumes that Empire has employed related to its natural gas supply in 2009," do you not?

A. Yes.

Q. Would you agree that the percentage that you cite in your testimony is the result of Empire's own actions?

A. It's a result of a plan that they have filed before this Commission that talks about how they manage their risks.

Q. Would Empire have been prudent to hedge a greater percentage of its 2009 gas supply?

A. Well, that's a difficult question to answer. When -- when are you talking about would it have been prudent? I mean, prudence -- prudence says that I operate on the basis of what I know at the moment that I make the decision, not what I know six months or a year or two years later.

Q. What do you know about Empire's decision to hedge 55 percent of the volume of its --

A. They were acting under a specific program that they've described in their -- in their risk management process, and it's a reasonable program based on my experience buying gas for a gas utility and testifying on PGAs.

Q. And I'm asking you in regards to the timing that Empire utilized.

A. Well, I think the answer stays the same. I think -- I think -- you know, with 20/20 hindsight and you know that gas prices are up significantly in 2009, yeah, you would have liked to have hedged, but suppose the opposite happened; then you would have been overhedged. I mean --

Q. I --

A. -- they're just -- this sort of business of Monday morning quarterbacking on a -- on a -- on a regulatory plan or a hedging plan that's designed to manage risk just doesn't get us really to anything. I mean, it's -- the plan is the plan. It's a plan that's been used in the past, it's been used effectively. You have -- you have effectively approved this plan in the past because you've approved their -- their fuel cost in the -- in rate cases, and so it is the plan.

If you knew -- you know, if you had perfect information and knew everything that was going to happen, yeah, you might want to do a -- hedge more gas earlier, but that's not their plan. And based on the information they had available at the time, they were doing exactly what they should have done.

Q. And that's what I'm asking you. On the basis of what they previously did without hindsight.

A. Well, and my answer is that they -- they have behaved prudently.

Q. Okay. And on the basis of your understanding, what plan are you referring to that was approved?

A. You -- you approved their fuel costs and there's a -- there's a hedging component of that fuel cost plan --

Q. And --

A. -- in several rate cases. I understand that this hedging is not new.

Q. And so you are referring to a prior rate case or rate cases?

A. I'm referring in general to the -- to the fact that there's one filed in this case. There's a -- there's a risk management plan. They have a hedging plan as part of their risk management and they've -- they've adhered to it in the past. And it specifically, as I recall, spells out how much they hedge in each -- in each period based on a reasonable method for hedging.

Q. And in setting rates in a previous rate case, the Commission would have approved prospectively that hedging plan?

A. No, because they would have approved the actual expenses in the test year, but the actual expenses reflected the hedging plan.

Q. Well, excuse me. I misunderstood you. I thought you were indicating that there was some approval in a prior rate case or rate cases of the hedging plan to which I was directing you on page 3 of your testimony, lines 19 to 23.

A. Well, implicitly, when you -- when you approved the fuel costs that went into base rates and that -- those fuel costs included this hedging plan, a hedging plan that they've been using, then you implicitly approved the hedging plan and the way they've implemented the hedges.

Q. Dr. Overcast, do I understand your testimony correctly that Empire has very little control over the level of fuel and purchased power expense it incurs?

A. Well, to the extent that the markets that they purchase those in are competitive markets, they are a price-taker, okay? To the extent they purchase fuels in those markets, they basically have purchased them at prices that are set by the market, not by Empire.

And Empire -- Empire does everything they can do to control those costs, and those are all facts that are in the case. But the result -- the ultimate result is that no matter how well you plan, something is going to be different and those costs are going to be different. And Empire does not have control over things like the price in the purchased power in the -- in the market because it's a competitive market.

Q. It has some control, does it not?

A. Oh, absolutely, and you've assumed they have some control when you set the base rates. You've assumed that everything they've done in that historic period that those base rates are set for is prudent.

Q. And it has some control over its other fuel costs other than purchased power, does it not?

A. It does have some control, yes. But again, it's not complete control because all those markets are competitive. And, you know, their -- their risk management --

MR. WOODSMALL: Your Honor, I believe he answered the question. Can we start limiting the amount of just gratuitous verbatim going on here?

JUDGE VOSS: You're objecting to it --

MR. WOODSMALL: Yes, I am.

JUDGE VOSS: -- on the basis of gratuitous verbatim or asking him --

MR. WOODSMALL: Or just gratuitous...

JUDGE VOSS: If the question has already been asked and answered, then it's appropriately stricken. If not, then --

MR. WOODSMALL: These are yes-or-no questions, and I believe he's answered it.

MR. MITTEN: They're Mr. Dottheim's questions, though.

MR. WOODSMALL: But it's my record just as much as Mr. Dottheim's record.

JUDGE VOSS: Overruled unless it's already been asked and answered. Additional questions that are subsequently asked can be objected to and ruled on independently.

Please proceed, Mr. Dottheim.

BY MR. DOTTHEIM:

Q. Dr. Overcast, the Stipulation and Agreement in Case No. EO-2005-0263 that you referred to on page 28 of your direct testimony --

A. Yes.

Q. -- Empire has benefited from that Stipulation and Agreement, has it not?

A. In terms of cash flow, yes.

Q. Dr. Overcast, you're director of R.J. Redden?

A. R.J. Redden was dissolved at the first of the year. It's EMS, a division of Black & Veatch.

Q. Does EMS stand for anything in particular?

A. Energy Management Services.

Q. Do you know a Mr. William J. Kemp?

A. Yes.

Q. Could you identify who Mr. William J.

Kemp is?
A. He's an employee of the firm.
Q. Do you know if Mr. Kemp filed testimony in the Great Plains Energy/Kansas City Power & Light/Aquila case now pending before the Commission?
A. It's my understanding that he did, yes.
Q. Do you know whether Black & Veatch is a contractor for Iatan 2 and/or Iatan 1?
A. No, I do not.
MR. DOTTHEIM: If I could have a moment, please. Thank you for your patience, Dr. Overcast.
JUDGE VOSS: Are you finished, Mr. Dottheim?
MR. DOTTHEIM: Yes, thank you.
JUDGE VOSS: Public Counsel?
MR. MILLS: I'd like to start by having an exhibit marked.
(EXHIBIT NO. 312 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)
CROSS-EXAMINATION BY MR. MILLS:
Q. Dr. Overcast, does Empire currently use any Northern Appalachian coal?
A. They indicate here they do not.
MR. MILLS: Judge, Dr. Overcast's testimony had a -- had a -- surrebuttal testimony had

a graph attached to it as HEO-1. I don't know if the bench has color copies. It's a little easier to follow if they're in color. I've got some extras if you-all want some.

JUDGE VOSS: That would be great. And actually, I printed mine off in color, so if there aren't enough...

BY MR. MILLS:

Q. Do you have a copy of your surrebuttal testimony there?

A. Yes, I do.

Q. Could you look at HEO-1?

A. Yes.

Q. What is reflected by that really, really scary looking red line that goes way up at the end?

A. I believe that is Appalachian coal.

Q. Is it Northern or Central?

A. I think that says it's Northern. I don't have it in color, so --

Q. Oh, let me -- let me give you a copy in color then.

JUDGE VOSS: Do you have enough, Mr. Mills, because mine is in color and I have already seen it.

THE WITNESS: Yeah. It's Northern.

It's okay.

MR. MILLS: I do have plenty. Thank you.

I'd like to have another exhibit marked.

(EXHIBIT NO. 313 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. MILLS:

Q. Dr. Overcast, does Empire currently use any coal from the Central Appalachian region?

A. No.

Q. And is that reflected on the blue line that goes steeply up to the right side of your Exhibit HEO-1?

A. Yes, it is.

MR. MILLS: I'd like to have another exhibit marked.

(EXHIBIT NO. 314 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. MILLS:

Q. Dr. Overcast, does Empire currently use any Illinois Basin coal?

A. As this response indicates, they do not, but the price of Midwestern coal is tied to the Illinois Basin.

Q. And let's explore that for a minute.

What -- what studies have you done to show the correlation of the price of Midwestern coal that Empire used with the Illinois Basin prices?

A. I've not done any studies. That was Empire -- Empire prepared that response on my behalf.

Q. Do you have any studies or any analysis that you rely upon to let you know that the Midwestern coal that Empire does rely on is tied to the price of the Illinois Basin?

A. No, I have not done any independent study.

MR. MILLS: I'd like to have another exhibit marked.

(EXHIBIT NO. 315 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. MILLS:

Q. Dr. Overcast, does Empire currently rely on any Uintah Basin coal?

A. No, they do not.

Q. Now, with the last deal we talked about on -- on your last schedule HEO-1 to your surrebuttal testimony, the Illinois Basin is that -- that green line that goes up in the latter months of the -- of the schedule; is that correct?

A. Yes.

Q. And the Uintah Basin, at least on my printout and as it appears to show up on the screen, is a -- is a perhaps a pink or maybe a purplish color that also goes up to the right on the --
A. Yes.
Q. Okay. Dr. Overcast, do you know what percentage 2007 coal burn came from the Powder River Basin?
A. No, I'm not aware of that number.
MR. MILLS: I'd like to have another exhibit marked.
(EXHIBIT NO. 316 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)
BY MR. MILLS:
Q. Dr. Overcast, I've handed you a response -- a question and a response to Public Counsel data request 2018 that seems to indicate that in 2007 approximately 86 percent of Empire's coal burned came from the Powder River Basin.
A. Yes, that's what it says.
Q. Does that appear consistent with your understanding?
A. Yes.
Q. Okay. Now, if you look at the chart on the screen, which one of those lines is the Powder

River Basin?
A. Well, this one here in 2007, they were a little below $10, now they're at 15. That's about a 50 percent increase in the price of coal.
Q. Of all those lines, the Powder River Basin is -- is the lowest, is it not?
A. That's correct.
Q. With the -- with the least -- the lowest -- also the lowest rate of increase; is that correct?
A. I haven't really done the analysis, but a 50 percent increase is pretty significant over just a few months.
Q. Well, how much analysis do you need to do to be able to tell that that's the lowest increase on that graph?
A. Well, you'd have to just look at -- and see what it was. For example, the UIB was almost $35 in 2007 and it's now 40. That's less than a 50 percent increase. Illinois Basin was -- looks about --
Q. What -- what period of time are you looking at the UIB?
A. 2007 was about --
Q. It started a little less than 25. It's

gone up to 40.
A. Well, in 2007 -- if you look in 2007 and early 2007, it was up almost $35.
Q. I see. You're taking the higher point in 2007.
A. Well, I mean, you can take whatever point you want to take. I mean, Powder River Basin's been as high as $20. I mean, it's -- and historically. But I was just -- I was comparing 2007 to 2008.
Q. Okay. The Powder River Basin doesn't show as steep of an increase as any of the other coals that you show on this, does it?
A. It's not as sharp, that's true. It's still a significant increase.
Q. Now, do you have a copy of your surrebuttal testimony with you?
A. Yes, I do.
Q. Can I get you to turn to page 9, please?
A. Yes.
Q. Now, the sentence that begins at the end of line 17 and then the answer continues for a couple of more sentences to the end of line 22, is it your point there that only 195,734 megawatt hours of wind energy would remain in a normal year to reduce

exposure to natural gas for spot price -- spot market purchases if 100 percent of the 154,266 megawatts of load growth was served from the Meridian Way Wind Farm?

A. Well, that's just the mathematics of it. You serve 154 -- I mean, you don't literally serve that 154, but the amount that's left to offset gas at most is 195,734 if you take growth into account.

Q. But that 195,734 is only valid if you assume that you do use all of the Meridian Way to serve the load growth. Is that not correct mathematically?

A. Well, it's just -- it's an arithmetic presentation that says you're going to grow -- you're going to get 350,000 megawatt hours of growth offset to 154,000. I mean, gas is going to be at the margin most of the time for growth, and so if you let the wind serve that, then the rest of it is available to reduce the exposure to natural gas and spot prices.

Q. Arithmetically, is your example only valid if the 100 percent of the load growth is served from the Meridian Way Wind Farm?

A. Kilowatt hours aren't painted. You can't tell which kilowatt hour serves which customer. All I've assumed here is that if you're talking about having available supply to offset a cost, you've got to take into account load growth because load growth is also going to come out of gas-fired units and purchased power for the most part, just like --

Q. Sir, I'm not asking you about that. I'm asking you about your example.

A. But I didn't assume --

Q. Is your example --

A. Okay.

Q. Is your example only mathematically accurate if you do assume that?

A. Yes.

Q. Now, if a utility is billed, for example, for -- for an increase in computer software prices outside of a test year, how does the utility recover that increase?

A. If it's outside of a test year, it's -- they don't -- they don't recover it.

Q. Okay. Would they perhaps be able to include it in a -- in a subsequent test year and then include it in rates following another rate case?

A. It's a capital investment?

Q. It's a software -- say it's an expense.

A. Expenses that are lost.

Q. Well, if the price is at one level, it

goes up and it stays up, will they not in a
subsequent rate case and -- and -- and be able to
recover the increase from that point forward?
A. All right. You're buying a piece of
computer software that you're expensing, not
capitalizing --
Q. Right.
A. Well, I'm -- I just have problems with
your assumption, I guess, more than anything else.
Q. Okay. Well, let's -- let's take any
expense that stays at one level, it goes up, it stays
at the second level, but the increase is outside of a
test period. How does a utility -- in traditional
ratemaking, how does a utility recover that expense?
A. They don't recover it until they have a
rate case where those costs are incorporated into
their O&M expenses.
Q. And assuming it's found prudent, it's --
it's included in their O&M expenses, then from the
point of the end of the rate case going forward, they
would recover it; is that correct?
A. Yes.
Q. Is the period of time from which they
begin incurring it to when they're able to recover it
following a rate case, is that considered a

disallowance?

A. No.

Q. Now, at page 2 of your surrebuttal testimony at approximately lines 11 through 15, you're discussing your response to Public Counsel; is that correct, at least in part?

A. In part, yes.

Q. In there you refer to Public Counsel witness Kind's suggestion that the disallowance of prudently incurred costs represents a reasonable opportunity for Empire to earn its allowed return?

A. When you disallow the recovery --

Q. Well, sir, first of all, answer my question. Is that what you're saying in your testimony? Because I've sort of paraphrased it. I don't want you to --

A. Well, I don't -- later on I make that point, but that's not the point that's being made here.

Q. Okay. Well, let's look at page 1, line 13. Are you saying there that -- that OPC suggests that disallowance of prudently incurred costs represents a reasonable opportunity for Empire to -- to earn a reasonable -- to earn its allowed return at roughly lines 13 through 15?

A. What I'm saying there is that if you propose to disallow 40 percent of Empire's fuel cost, they have no opportunity to earn their allowed return.
Q. Okay. Is it your testimony that Mr. Kind has proposed to disallow 40 percent of Empire's fuel cost?
A. He has proposed to allow recovery of 60 percent, therefore proposed to disallow 40 percent.
Q. So your answer is yes?
A. Yes.
Q. Okay. Can you point to me in his testimony where he uses the word "disallowance"?
A. He does not use that word.
Q. Okay. Now, let's look at page 8 of your surrebuttal testimony. At line 7 you have a short sentence and the answer that begins, "The statement is factually incorrect." Do you see that?
A. Yes.
Q. In the -- what is the -- what is the word -- the phrase "the statement" refer to in that sentence?
A. The statement that they've protected themselves from fuel cost changes through contracts

and hedges.

Q. Okay. Is that Mr. Kind's testimony or is that your testimony?

A. That is Mr. Kind's testimony. He said that they were protected from -- through contracts and hedges and gave that as a reason to reject the fuel adjustment clause.

Q. And do you have a copy of Mr. Kind's testimony with you?

A. No, I do not.

Q. Okay. Let me hand you a copy and suggest that you look at perhaps page 7 of his testimony, lines 3 through 6.

A. Right.

Q. Is that the answer -- the -- the testimony that you were referring to in your testimony?

A. Yes.

Q. Does not Mr. Kind say that they have entered into long-term contracts or hedging arrangements for much of the fuel that it expects to burn?

A. Yes.

Q. Is it your testimony that that statement is factually incorrect?

A. No. It's the implication that somehow --
Q. Dr. Overcast, you've answered my question. Thank you. And when -- when you talk about in -- in your testimony about the rate-effective period, you're referring to the first 12 months after a rate order -- order in this case; is that correct?
A. First 12 months with effective rates from this case, yes.
Q. And is it your understanding that the rates established in this case will only be in effect for 12 months, or is it your testimony -- well, let me just ask that.
A. No, they will go until there's another rate case.
Q. Okay. Do you have any knowledge about when the next expected rate case is?
A. I believe that there is one expected in a -- within another year after the end of the rate-effective period.
Q. Mr. Kind testifies that if the next case is filed when it's expected, that rates set in this case will be in effect for approximately -- approximately 21 months. Is that consistent with

your understanding?

A. That's consistent my understanding.

Q. Okay. Now, we've gone through some of this already, but if you look at page 8 of your surrebuttal testimony at line 23 and continuing onto the next page, you state that, "Schedule HEO-SR-1 provides evidence of the sharp increase in coal prices since the time this case was filed"; is that correct?

A. Yes.

Q. And is HEO-SR-1 the graph that we've talked about at the beginning of my cross-examination?

A. Yes, and it's the one that shows the 50 percent increase in Powder River Basin costs.

Q. And turning back to HEO, the surrebuttal testimony, of what relevance are the other lines to the issues in this case, other than the Powder River Basin line?

A. Well, the Illinois Basin has some relevance in that it's correlated to the price they pay for Midwestern coal. The other ones --

Q. Let's go back to that because I thought you testified that you had no basis to make that correlation.

A. I have none, but the company has.
Q. Well, but you're the -- you're the witness testifying.
A. Well, I'm -- I'm just telling you that's what -- that's what I've been told by the company.
Q. And when did they tell you that?
A. They wrote it in their response to the data request.
Q. But you have no -- you have no --
A. I've not done it independently, no.
Q. Okay.
MR. MILLS: That's all the questions I have. Thank you.
JUDGE VOSS: Thank you.
MR. MILLS: Oh, and I would like to offer Exhibits --
JUDGE VOSS: 312 to 316? That's what I have.
MR. MILLS: Well, except for and which was -- which was...
JUDGE VOSS: I have DR 2016 is 12 --
MR. MILLS: Okay.
JUDGE VOSS: -- 2015 is 13, 2017 is 14, 2019 is 15 and 2018 is 16.
MR. MILLS: And I would like to offer

all of those except for 314 because this witness was not able to verify some of the information in that answer.

JUDGE VOSS: Okay. Are there any objections to the admissions of Exhibits 312, 313, 315 and 316?

(NO RESPONSE.)

JUDGE VOSS: Hearing none, those exhibits are admitted.

(EXHIBIT NOS. 312, 313, 315 AND 316 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE VOSS: Industrials? Are there questions from the bench? Commissioner Jarrett?

COMMISSIONER JARRETT: No questions.

JUDGE VOSS: Commissioner Gunn?

COMMISSIONER GUNN: No questions.

JUDGE VOSS: Chairman?

QUESTIONS BY CHAIRMAN DAVIS:

Q. Good afternoon, Dr. Overcast.

A. Good afternoon.

Q. Going back to the questions from Mr. Dottheim on cross-examination, did those questions give you the impression that -- that he was suggesting that Empire should have hedged more of

their natural gas purchases for -- for '08 and '09?
A. That was the impression I was given, yes.
Q. If we did exactly what Mr. Dottheim had suggested, if we -- if Empire had hedged 100 percent of its natural gas costs or whatever its expected burn would be, would Mr. Brubaker's proposed method of fuel and purchased power cost recovery in this case even be possible?
A. That's a good question. I think it would still be possible, but the fundamental problem is even if you hedged 100 percent of what you expect to -- to be your fuel costs, one of the things we know about forecast is they're always wrong. And so there's two possible outcomes. One is, gas prices are lower and they bought this gas for more than -- more than the market price so they would be in the position of losing money.
Secondly, if -- if you assume that the weather is warmer than normal in the summer and colder than normal in the winter, they're going to have to buy a bunch more gas anyway, and then you're going to buy that at the market price. So you're still subject to price volatility even with 100 percent hedged at the -- at the normal expected burn.

Q. Uh-huh. Now, was the -- do you recall in Staff's estimates a -- was their -- their hedge price was roughly 678,683, somewhere in that range per million BTU; is that correct?

A. Yes, it's in the high $6 range.

Q. Okay. And it was page 8 of your surrebuttal testimony, lines 15 through 17, I think you noted that Empire has -- has only 4,700,000 MM BTU of natural gas hedged out of 8,500 million BTU based on the budget forecast. Do you recall that?

A. Yes, that's correct.

Q. So they've got roughly 3.7 million -- million BTU of natural gas that's not hedged?

A. Correct.

Q. And what's the price of natural gas today?

A. Well, the price for 2009 runs from just a little below $10 to as high as $12 depending on the month.

Q. Okay.

A. So if you assume, for example, a $4 uptick in the hedge price they ultimately pay, you'd be looking at $15 million of unrecovered costs just associated with the normal volume of gas. That's 15 million of additional cost.

And then if you factor in the impact on the -- on purchased power which is heavily tied to gas, you'd probably be looking at something over $20 million that would be the increase in cost during the rate-effective period just from those couple of things.

Q. Now, can you -- can you go back and just tell me how you calculated that additional 15 million?

A. I took the difference between 47 -- 4.7 million and 8.5 million of 3.8 million MM BTUs --

Q. Uh-huh.

A. -- and said let's suppose the hedge price is $4 higher.

Q. Okay.

A. Then I based that on a price that runs between 10 and $12, so I don't know exactly what it's going to be, but $4 times 3.8 million is 15.2 million if I did the math right in my head.

Q. Okay.

A. And then I said there's -- since --

Q. Purchased power costs are going to go up?

A. They're tied to gas, so they're going to go up as well, and another 5 million for that, and that gave me $20 million. And under the Staff's proposal, Empire would not recover 6 million of that, and that 6 million would come against their earnings, that comes right out of earnings. It's ignoring for a moment the tax effect of that which I can't do in my head, but --

Q. Right.

A. And that's almost 20 percent of their proposed earnings. And -- and if -- and if we're wrong about that and it's a hot summer and a cold winter and they have to buy more than this amount, the numbers -- the numbers just get bigger, and that all comes out of earnings.

Q. So what would -- what would the result be if gas goes to $15 a million BTU?

A. Okay. Let's see. That's about 8 -- $8 higher than the number that's in there. So $8 higher times 3.8 million would be 30 million -- a little over $30 million. And the effect on purchased power at that price would probably be another ten. You're talking $40 million.

And under -- under the various proposals, they would recover -- from the Staff's proposal, they would recover 28 million of that. Under the OPC proposal, they'd recover 24 million.

And the rest of it just reduces earnings. It gives them no opportunity to earn their allowed return.

And that also has an impact on their amortization agreement because the dollars from the amortization agreement assume that you earn your allowed return. So there wouldn't be enough total dollars necessarily for them to even maintain their credit rating if -- even with the amortization agreement, and that could be -- mean a downgrade.

And you heard this morning from Dr. Vander Weide that interest rates for a BB company are this week 9 and a quarter, and Empire just sold that at, I believe it was 6 and three-eighths this week. So you can see the difference in cost that's going to have on the cost of capital, and that's a cost that customers bear for the whole life of those loans.

CHAIRMAN DAVIS: Uh-huh. Thank you, Dr. Overcast.

JUDGE VOSS: Are there any additional questions from the bench?

(NO RESPONSE.)

JUDGE VOSS: Recross based on questions from the bench, Staff?

MR. DOTTHEIM: No questions.

JUDGE VOSS: Public Counsel?

MR. MILLS: One second, please.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Dr. Overcast, I think -- and correct me if I haven't really paraphrased this correctly, but I think the discussion you just had with Chairman Davis sort of was designed to illustrate your point, that if you don't have a full tracking fuel adjustment clause, that the company may not have an opportunity to -- to get as much revenue as it otherwise would. Is that close to what you said in a very short summary?

A. Well, I'm not focused on revenue there. I was focused on how much money would they have to show as earnings.

Q. Okay.

A. And it's -- what happens is, if you disallow or if you -- and you don't like my word disallow, but if they are not permitted to recover prudently incurred costs in the magnitude recommended by -- well, even by Empire -- I -- you know, I don't even support their -- their -- their 5 percent disallowance, I believe you ought to have a full tracking fuel clause. And I also believe the best incentive to manage your fuel -- fuel cost -- cost is a prudence review.

Q. Okay. Well, let me ask you about --

A. But the point is -- the point is, they have no reasonable opportunity to earn their allowed return there because fuel costs have gone up, we know that.

Q. Okay. Well, you've made that point. Let me ask you about a corresponding point that you -- that you make in your testimony on page 11, line -- I'm sorry -- surrebuttal testimony at page 11, lines 4 through 6. Is it your testimony that under the kinds of numbers that you discussed with Chairman Davis, that that will ultimately cost ratepayers more?

A. My -- my -- the point I'm making there is --

Q. Well, first answer me yes or no, and then you can elaborate if you need to.

A. Well, in...

Q. The kinds of numbers that you were talking about with Chairman Davis, is it your testimony that those kinds of numbers would ultimately raise costs for consumers?

MR. MITTEN: Could I ask counsel to identify the specific numbers he was talking about?

BY MR. MILLS:

Q. Well, either the 20 million increase that you first postulated or the 40 million increase that you second postulated, either one.

A. I'm very careful there to talk about the balance including the impacts if they don't earn their allowed return and their bond rating is downgraded. I mean, if you issue 20-year bonds and you're paying 3 percent more interest on those bonds than you would have paid otherwise --

MR. MILLS: Judge, can I get you to instruct the witness to answer my yes-or-no question with a yes or no?

JUDGE VOSS: If it can't be answered with a yes or no, just say I don't know.

THE WITNESS: I don't think I can answer it with a yes-or-no answer. I think it requires an explanation.

MR. MILLS: Thank you. That's all I have.

JUDGE VOSS: Industrials?

MR. WOODSMALL: No.

JUDGE VOSS: Redirect?

MR. MITTEN: Thank you, your Honor.

REDIRECT EXAMINATION BY MR. MITTEN:

Q. Dr. Overcast, could you please turn to page 28 of your direct testimony? Do you have that?

A. Yes.

Q. Mr. Dottheim asked you some questions regarding the testimony that appears at lines 17 through 19 on page 28, and you indicated in your response that there was an illustration that you wanted to provide, but he cut you off. Could you identify what illustration you were talking about?

A. Sure. What I was going to talk about, it's much the same that I -- that I talked with Commissioner Davis about. The idea is that if you don't earn your allowed return, then you're not going to meet those cash flow metrics because the -- the amortization agreement assumes that you are earning your allowed return, and if you don't meet those metrics, then you're potentially subject to a downgrade.

In fact, I can't remember which rating agency said their assumptions about Empire included that Empire would get a reasonable fuel adjustment clause. And I guess the standard of reasonable that I'm used to is a full tracking fuel clause because that's what most utilities have.

Q. Mr. Dottheim also asked you some

questions about a list that appears on page 7 of your direct testimony. Could you please turn to that? And specifically, I'm focusing on lines 10 through 27.

A. Yes.

Q. He asked you about whether or not the utility controlled the items that you have in your list. Are there items in that list that are outside Empire's control?

A. Any -- in my view, anything that you purchase in a competitive market, you have no control over the price because you're a price-taker. That's the definition of a competitive market, so that's input prices.

Things like fuel delivery constraints, there have been problems with -- with the availability of railcars to deliver -- to deliver coal. Empire has no control over that. Another kind of fuel delivery issue that Empire has no real control over is the delivery of gas. That's subject to the FERC's review of pipeline transportation rates. Now, they can intervene and they can be a party, but it's a rate case and you're not really in control in any sense on that.

They -- they have no control over the

weather obviously, they have no control over the amount of rain and how that affects the hydro variability. They have no control over changes in transmission rates subject to formulas. And then there's a lot of nonrecurring events there that they really don't have control over: Flooding, strikes, things that they don't have any control over.

So I mean, there's plenty of things they don't have control over, and the important point is, the ones they do have control over, they address, they -- they make filings. And ultimately under the -- under the statute and the rules, this Commission is going to do a prudence review. And if they weren't prudent, then those costs would be disallowed. And you know, I think prudence review is a pretty big hammer and --

MR. WOODSMALL: Your Honor, again, I believe the question's been asked and answered. The question was, are there any items here that are within their control, and we have gone way beyond that question.

JUDGE VOSS: So are you suggesting --

MR. WOODSMALL: I'm suggesting that the witness be told to answer the question, just the question, and then allow the attorney to ask another question.

MR. MITTEN: Your Honor --

JUDGE VOSS: This is his witness, but one thing I want to say is, are you suggesting that he's getting outside the scope?

MR. WOODSMALL: He's getting well beyond the scope of the questions. In a previous order, a written order from the Commission, we were told to control the witnesses, and that's what I'm asking you to do is control the witness.

MR. MITTEN: Your Honor, if I'm concerned that the answer is beyond the scope of my question, that's my objection to make, not Mr. Woodsmall's.

JUDGE VOSS: Yes, that's what I was trying to clarify, whether Mr. Woodsmall's objection was whether he was getting outside the scope of questions asked on cross-examination.

MR. WOODSMALL: No, he -- he's getting outside -- he's no longer answering the question.

MR. MITTEN: I'm satisfied that he's answering the question.

MR. WOODSMALL: You'd be satisfied if we gave him an hour just to talk ad nauseam.

JUDGE VOSS: We're not here to put new

direct testimony into the record. If he is truly responding to issues that were raised by opposing counsel or the Commissioners, then I think it's reasonable to let him speak.

MR. WOODSMALL: That's not -- what I'm saying is, the question here was are there items in this list that are within their control, and now all of a sudden we're talking about prudence reviews. If he wants to ask other questions, he can, but this is no longer responsive to the question.

MR. MILLS: And Judge, in response to your concerns, I don't believe there were any questions either in cross-examination or from the bench about prudence reviews, so I think you're right, I think this is outside the scope of cross and questions from the bench.

JUDGE VOSS: Is that a formal objection, Mr. Mills?

MR. MILLS: No, because -- because he's already answered, but I think to the extent we're going on and on about this, I think it's a valid concern that it's outside the scope.

JUDGE VOSS: Yeah, please keep your redirect to the topics that were addressed, and please try to keep your answers that also. Thank you.

THE WITNESS: Yes, your Honor.

BY MR. MITTEN:

Q. Mr. Dottheim did ask you some questions about the prudency of the company's hedging. Do you recall those questions?

A. Yes.

Q. Have you read the Commission's rules governing fuel adjustment clauses?

A. Yes.

Q. Are you familiar with the prudency reviews that are required by those rules?

A. Yes.

Q. Based on your understanding of the rules, would the company's hedging program be reviewable during the prudency review?

A. Yes.

Q. Do you think those prudency reviews are adequate to assure that the costs that are flowed through the fuel adjustment clause are prudent --

MR. DOTTHEIM: I object, a leading question.

JUDGE VOSS: Could you rephrase the question?

BY MR. MITTEN:

Q. Let me rephrase. Do you have an opinion as to whether or not the prudency reviews are adequate to assure that the costs flowed through the prudency --

MR. DOTTHEIM: I object, a leading question.

BY MR. MITTEN:

Q. Let me rephrase. What is your opinion as to whether or not the prudency reviews are satisfactory to assure that costs flowed through the fuel adjustment clause are prudently incurred?

A. I think that that is a -- the best way to ensure that the fuel clause operates properly is through prudence reviews, and I base that on the fact that most jurisdictions have fairly thorough prudence reviews, and when they find imprudent expenses, they disallow them.

Q. Mr. Dottheim also asked you a number of questions regarding what I think is commonly referred to around here as the regulatory plan stipulation. Do you recall those?

A. Yes.

Q. Do you still have a copy of that stipulation in front of you?

A. Yes.

Q. Specifically, Mr. Dottheim asked you questions about pages 5 and 6 of the stipulation, pages 6 through 9 of the stipulation and page 11. Do you recall that?

A. Yes.

Q. Now, each of the pages that I just referred to and that Mr. Dottheim asked you questions about are in the section of the stipulation that is entitled Infrastructure Investments and Monitoring; is that correct? The title I'm referring to is on page 3 of the stipulation.

A. Yes, item C.

Q. Do you still have Mr. Kind's testimony in front of you?

A. No.

Q. Mr. Mills asked you some questions about some testimony that appears at page 7 of Mr. Kind's rebuttal testimony. Do you recall those questions?

A. Yes.

Q. And you were going to state what you believe the implications of the testimony that appears at lines 3 through 6 was. Do you recall that?

A. Yes.

Q. Could you please tell me what you think the implication of that testimony is?
A. Well, the implication of that testimony is that over the short period, there can't be a lot of dollars at risk, and as we've demonstrated as I've discussed with Commissioner Davis, those numbers could be very large based on market prices today in the order of -- if it was 20 million of extra costs, that's 8 million that would be disallowed. And that's more than -- more than 20 percent of the Staff's recommended return.
Q. Dr. Overcast, do you still have a copy of what Mr. Mills had marked as Exhibit 314? That would be Public Counsel data request number 2017.
A. Yes.
Q. You indicated that the company had provided you information that Midwestern coal used by Empire, the price of that coal was closely tied to Illinois Basin coal; is that correct?
A. Yes.
Q. And did you rely on that information in your analysis in this case?
A. Yes.
MR. MITTEN: Your Honor --
MR. MILLS: Judge, I object because when

I asked him, he testified that the information was this DR that he was just handed. There's no way that he could have relied on this DR that I just handed him, that it was responded to on April 29th, 2008 in preparation of his testimony. So if counsel wants to clarify that there's something else, but I don't think that's accurate.

MR. MITTEN: Your Honor, I didn't ask him if he relied on the DR, I asked him if he relied on the information and he said he did.

MR. MILLS: And in -- and his testimony previously was the information was the DR.

JUDGE VOSS: Mr. Overcast might want to clarify what he said earlier. Did he -- did you misspeak? Do we need to open up some more cross-exam?

THE WITNESS: You know, I've spent so much time talking to these folks about where these costs came from and what -- what their fuels were and going through, I mean, if you just look at these exhibits that -- that -- where I've got all the fuel, different types of fuel, different cost of coal, you know, I -- honest -- in all honesty, I can't remember everything that -- that they told me.

JUDGE VOSS: Well, let's step back and

let Mr. Mills reask that question. Is that acceptable to you, Mr. Mills, just to make sure there's clarification for the record in case there's a different answer?

MR. MILLS: Sure. Do you have a specific recollection of information given to you other than this DR that would lead you to believe that the price of Midwestern coal is tied to the price of Illinois Basin coal?

THE WITNESS: Not that I can remember, no.

MR. MILLS: And when did you first see this DR?

THE WITNESS: I reviewed all these DRs before they were filed, so I don't know -- I don't remember what date.

MR. MILLS: Sometime after the DR was asked and the response was prepared, correct?

THE WITNESS: Yes.

MR. MILLS: No further questions.

JUDGE VOSS: Does that bring up any additional questions from the bench?

(NO RESPONSE.)

JUDGE VOSS: We'll go back to redirect.

MR. MITTEN: I don't think I have any

further questions on redirect. Thank you, your Honor.

JUDGE VOSS: Okay. Mr. Overcast, you are excused.

THE WITNESS: Thank you.

JUDGE VOSS: Now some procedural matters. It's my understanding that no other witnesses are prepared today to testify on this issue, so we want to go to the second company witness; is that correct?

MR. MILLS: It was my understanding that we were going to stop when we got done with Mr. -- Dr. Overcast.

JUDGE VOSS: All right. I did want the parties to know I have a phone line for out-of-town witnesses. I'll send an order out to this effect for Tuesday morning from 10:00 to noon to be available without having to travel here from distant locations to answer Commission questions should they arise on Tuesday morning.

And I had a question, Mr. Mills, about Exhibit 14. Are you going to try to get that authenticated by a different witness or is it a dead exhibit? Before I threw away our copies, I wanted to make sure. And --

MR. MILLS: If we -- as of now, it's dead. If we try to resurrect it, I'll provide additional copies.

JUDGE VOSS: Okay. And then Mr. Woodsmall, are your clients who did not sign the third stipulation going to give any kind of a position statement?

MR. WOODSMALL: Yes, you'll have it this afternoon.

JUDGE VOSS: Okay. Thank you.

MR. WOODSMALL: Your Honor, to tie up another loose end from real early in this case, there was the discussion about Mr. Oligschlaeger's responsive testimony and then the discussion about whether surrebuttal was improperly filed. I had reserved the right to file additional testimony. That's been subsumed in the second stipulation, so we don't -- we won't be filing any additional testimony in case you had that still hanging out there.

JUDGE VOSS: I noticed that it was listed in the automatically --

MR. WOODSMALL: Right.

JUDGE VOSS: -- admitted testimony, so -- okay. Are there any other issues that we need to address before going off the record?

MR. WOODSMALL: I guess --

MS. CARTER: Judge, did you by any chance hear back from Commissioners regarding whether or not they'd have cross-examination for Blake Mertens regarding the fuel adjustment clause?

JUDGE VOSS: The Commissioners that were here had not indicated they had any questions. I have not heard from Commissioner Murray or Commissioner Clayton because they are out of town.

MS. CARTER: Because of funeral plans, he won't be available on Monday, but he'll be one of the Empire witnesses available by phone on Tuesday for the stip presentation if questions were to arise.

JUDGE VOSS: There's also the possibility with it being a single person phoning, that he could potentially be allowed to phone in.

MR. WOODSMALL: Can I clarify it on the record that we are bringing Gorman in on Monday afternoon now?

JUDGE VOSS: On Monday, yes. In the order that I'll put out, I will -- I will simply state that the hearing will be recessed during the stip presentation in the event Mr. Gorman isn't concluded on Monday for any reason. That way it will still hold the hearing open; won't assume the hearing's over. All right. Anything else?

MR. MILLS: Just briefly, Judge. What is the -- what is the Commission looking for in the stip presentation hearing on Tuesday? Do you want parties to present the stipulation, sort of walk through it or do you want to have people just available to answer questions or what do you have in mind?

CHAIRMAN DAVIS: How about a very brief overview and then just be prepared to answer questions?

MR. MILLS: Great. Thank you.

MR. WOODSMALL: What time is that on Tuesday?

JUDGE VOSS: That's at 10:00. Well, I would assume start at 9:00 on Monday since everyone seems to now be adverse to the 8:30 start time you originally requested.

CHAIRMAN DAVIS: And for the record, right now agenda is scheduled for noon on Tuesday, and there is no Thursday agenda scheduled for next week.

JUDGE VOSS: If there are no additional issues, this concludes today's portion of the hearing. We'll reconvene Monday morning at 9:00 a.m. Thank you.

(WHEREUPON, the hearing of this case was recessed until May 19, 2008, at 9:00 a.m.)

I N D E X

ISSUE: ROE

Opening Statement by Mr. Swearengen	439
Opening Statement by Ms. Kliethermes	448
Opening Statement by Mr. Mills	450
Opening Statement by Mr. Woodsmall	452
JAMES H. VANDER WEIDE	
Direct Examination by Mr. Swearengen	456
Cross-Examination by Mr. Mills	460
Cross-Examination by Ms. Kliethermes	461
Cross-Examination by Mr. Woodsmall	465
Questions by Commissioner Jarrett	465
Questions by Commissioner Gunn	469
Questions by Chairman Davis	474
Recross-Examination by Mr. Mills	480
Questions by Chairman Davis	483
Recross-Examination by Mr. Woodsmall	485
Redirect Examination by Mr. Swearengen	491
H. EDWIN OVERCAST	
Direct Examination by Mr. Swearengen	498
Cross-Examination by Ms. Kliethermes	500
Cross-Examination by Mr. Woodsmall	506
MATTHEW J. BARNES	
Direct Examination by Ms. Kliethermes	508
Cross-Examination by Mr. Swearengen	510
Questions by Commissioner Jarrett	525
Questions by Commissioner Gunn	529
Questions by Judge Voss	530
Recross-Examination by Mr. Mills	531
Recross--Examination by Mr. Woodsmall	532
Recross-Examination by Mr. Swearengen	535
Redirect Examination by Ms. Kliethermes	536
MARK OLIGSCHLAEGER	
Cross-Examination by Mr. Swearengen	539

ISSUE: FUEL ADJUSTMENT CLAUSE

H. EDWIN OVERCAST

Cross-Examination by Mr. Dottheim	543
Cross-Examination by Mr. Mills	560
Questions by Chairman Davis	576
Recross-Examination by Mr. Mills	582
Redirect Examination by Mr. Mitten	584

EXHIBITS INDEX

	MARKED	REC'D
Exhibit No. 8 Direct Testimony of H. Edwin Overcast	*	543
Exhibit No. 9NP/HC Schedules	*	543
Exhibit No. 10 Rebuttal Testimony of H. Edwin Overcast	*	543
Exhibit No. 11 Surrebuttal Testimony of H. Edwin Overcast	*	543
Exhibit No. 28NP/HC Direct Testimony of James H. Vander Weide	*	460
Exhibit No. 29 Rebuttal Testimony of James H. Vander Weide	*	460
Exhibit No. 30 Surrebuttal Testimony of James H. Vander Weide	*	460
Exhibit No. 218 Rebuttal Testimony of Matthew J. Barnes	*	509

EXHIBITS INDEX (CONTINUED)

	MARKED	REC'D
Exhibit No. 219 Surrebuttal Testimony of Matthew J. Barnes	*	509
Exhibit No. 312 Document regarding usage of Northern Appalachian coal (DR 2016)	560	576
Exhibit No. 313 Document regarding usage from the Central Appalachian region (DR 2015)	562	576
Exhibit No. 314 Document regarding usage of Illinois Basin coal (DR 2017)	562	**
Exhibit No. 315 Document regarding usage of Uintah Basin coal (DR 2019)	563	576
Exhibit No. 316 Document regarding usage of Powder River Basin coal (DR 2018)	564	576

* Marked in a previous volume.
** Not yet received into evidence.

CERTIFICATE OF REPORTER

STATE OF MISSOURI)
)ss.
COUNTY OF COLE)

I, PAMELA FICK, RMR, RPR, CSR, CCR #447, within and for the State of Missouri, do hereby certify that the witness whose testimony appears in the foregoing deposition was duly sworn by me; that the testimony of said witness was taken by me to the best of my ability and thereafter reduced to typewriting under my direction; that I am neither counsel for, related to, nor employed by any of the parties to the action to which this deposition was taken, and further that I am not a relative or employee of any attorney or counsel employed by the parties thereto, nor financially or otherwise interested in the outcome of the action.

____

PAMELA FICK, RMR, RPR, CSR, CCR #447