Exhibit No.:
Issue: *Rate-of-Return*
Witness: *Matthew J. Barnes*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No.: *ER-2008-0093*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MATTHEW J. BARNES

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2008-0093

Jefferson City, Missouri
April 2008

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OF THE REBUTTAL TESTIMONY OF

MATTHEW J. BARNES

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REBUTTAL TESTIMONY

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CASE NO. ER-2008-0093

Q. Please state your name.

A. My name is Matthew J. Barnes.

Q. Are you the same Matthew J. Barnes who has previously contributed to the rate-of-return portion of the Staff Cost of Service Report (Staff Report) filed in this proceeding by the Staff of the Missouri Public Service Commission (Staff)?

A. Yes, I am. The Staff Report was filed on February 22, 2008.

Q. In the Staff Report, did you recommend a fair and reasonable rate-of-return on the Missouri jurisdictional electric utility rate base for The Empire District Electric Company (Empire or Company)?

A. Yes, I did.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Dr. James H. Vander Weide. Dr. Vander Weide sponsored rate-of-return testimony on behalf of Empire.

EXECUTIVE SUMMARY

Q. Please summarize your rebuttal testimony.

A. I will address the inconsistencies in Dr. Vander Weide's methodology in this proceeding compared to previous methodologies in Empire's last proceedings in

Case No. ER-2006-0315, Case No. ER-2004-0570 and AmerenUE Case No. ER-2007-0002. I will also present Staff's corrected rate-of-return recommendation for Empire and the results of a company-specific discounted cash flow model (DCF).

CORRECTIONS

Q. Do you have any corrections to make to Staff's recommended rate-of-return for Empire?

A. Yes. Due to a calculation error in Column 3 of Schedule 17 of the Staff Report, Staff's calculation of Empire's dividend yield increased to 4.04 percent from 3.73 percent. This in turn increased Staff's return on equity and rate-of-return recommendation for Empire. Staff now recommends a return on equity in the range of 9.70 percent to 10.85 percent, with a mid-point of 10.28 percent. Staff's rate-of-return for Empire is now in the range of 8.37 percent to 8.95 percent, with a mid-point of 8.66 percent.

Q. Staff did not previously provide a company-specific return on equity for Empire in the Staff Report due to a misprint in Standard & Poor's (S&P) Earnings Guide and the Institutional Brokers Estimate System (I/B/E/S) publications for January 2008. Has Staff received the correct information?

A. Yes. Staff updated Schedule 15, Schedule 16, and Schedule 17 of the Staff Report and attached them to this testimony. Staff notes that S&P no longer publishes the Earnings Guide, which contained information on analysts' projected 5-year earnings per share growth rate Staff used in estimating the cost of common equity for Empire. Therefore, Staff eliminated S&P from the estimated growth rates.

Q. What are the company-specific results using historical and projected growth rates?

A. Using the historical and projected growth rates produces a company-specific cost of common equity of 9.47 percent for Empire.

Q. What are the company-specific results using projected growth rates?

A. Using the projected growth rates produces a company-specific cost of common equity of 12.85 percent for Empire. The projected growth rates are based on estimates from two analysts.

Q. Did Staff give any weight to the company-specific DCF results in determining its return on equity recommendation for Empire?

A. No, Staff merely provided the company-specific results for informational purposes to the Commission as it has done in recent rate cases.

DR. VANDER WEIDE'S RECOMMENDED COST OF COMMON EQUITY FOR EMPIRE

Q. Please summarize Dr. Vander Weide's recommended cost of common equity for Empire.

A. Dr. Vander Weide's recommended cost of common equity of 11.6 percent is based on five cost of common equity estimation methods: (1) DCF; (2) ex ante risk premium; (3) the ex post risk premium; (4) historical capital asset pricing model (CAPM); and (5) DCF CAPM.

Q. Did Dr. Vander Weide make any upward adjustments to his cost of common equity in this case to reflect the alleged higher level of financial risk of Empire compared to his comparable companies?

A. No, he did not.

Q. Has Dr. Vander Weide made any upward adjustments to his cost of common equity for alleged higher levels of financial risk in previous cases before the Missouri Public Service Commission (Commission)?

A. Yes. Dr. Vander Weide made upward adjustments to his cost of common equity recommendations in the previous Empire proceedings in Case No. ER-2006-0315 and Case No. ER-2004-0570, as well as the previous AmerenUE proceeding in Case No. ER-2007-0002.

Q. Why did Dr. Vander Weide not make an upward adjustment to his cost of common equity in this case as he consistently did in previous cases?

A. Beginning on page 42, line 1 through line 19 of his direct testimony, Dr. Vander Weide testifies to the following question and answer:

> Q. You noted earlier that the cost of equity depends on a company's capital structure. Is there any way to adjust the 11.6 percent cost of equity for your proxy companies to reflect the higher financial risk embodied in Empire's rate making capital structure in this proceeding?
>
> A. Yes. Since my proxy companies are a conservative proxy for the risk of investing in Empire, Empire should have a weighted average cost of capital that is equal to or greater than the weighted average cost of capital for my proxy companies. It is a simple matter to determine what cost of equity Empire should have in order to satisfy this condition. Since Empire's ratemaking capital structure contains significantly more leverage than the average capital structure of my proxy companies, and the cost of equity increases with leverage, it is evident that such an adjustment would produce a significantly higher cost of equity for Empire.
>
> Q. Have you made such an adjustment?
>
> A. No. Since the Commission did not accept a financial risk adjustment in its recent AmerenUE decision, **Empire has requested that I not make a financial risk adjustment in this proceeding** [Emphasis Added].

This is inconsistent compared to the last three proceedings in Missouri that Dr. Vander Weide has been a cost of capital witness. In fact, in Empire's last two rate cases and the AmerenUE rate case, Dr. Vander Weide was very persistent about making upward adjustments to his cost of capital due to his belief that the market value of his proxy group's common equity ratio results in a less leveraged capital structure than Empire's book value capital structure.

Q. Do you have any evidence that Dr. Vander Weide insists that an upward adjustment needs to be made in order for a utility company to attract capital?

A. Yes. Staff and The Office of Public Counsel (OPC) conducted a deposition of Dr. Vander Weide in Empire's previous rate proceeding in Case No. ER-2004-0570. The following is an excerpt from Dr. Vander Weide's deposition:

> Q. And could you explain to me why you recently changed your methodology for determining ROE and you just recently started performing this leverage adjustment that you just described?
>
> A. Yes. Because I didn't believe that just looking at the results of DCF and CAB[P]-M and risk premium model would allow that companies to attract capital in the marketplace, because the marketplace looks at current interest rates and market value capital structures. Applying cost of DCF models and risk premium models and CAP-M models to the company's book value capital structures will be insufficient to allow the companies to attract capital in the marketplace.
>
> Q. So for the previous 30 years when you weren't utilizing this leverage adjustment, you were doing it incorrectly?
>
> A I was doing it partially. I was correctly applying the DCF. I was correctly applying the risk premium and CAP-M. I did not take the final test, which I believe is necessary to allow the company to attract capital in the marketplace. I don't believe it's incorrect. It just wasn't complete.

Q. So for 30 years you thought it was appropriate to recommend an incomplete DCF recommendation to public utility commissions?

A. I viewed my assignment in those – during that time as providing the results of cost-of-equity models, such as the DCF and the CAP-M and risk premium. I did not view my assignment as taking the further step of recommending the rate-of-return that would allow a company to truly attract capital in the marketplace. I knew that it was incomplete, but I didn't view my assignment at taking that additional step.

Q. And when did your assignment change?

A. In the testimonies that I cited.

Q. And why did your assignment change?

A. Because I informed the companies that I was working with that if we did things in the way we always have, they would not be able to attract capital in the workplace, and they agreed that I ought to take the additional step to make sure they could attract capital in the marketplace.

Q. So if the Commission – if the Missouri Public Service Commission accepts your method, are you guarantying to the company that they'll be able to attract capital in the marketplace?

A. One can never guarantee the future, because the future is unknown, but I can guarantee that they'll have – and one also doesn't know what the other elements are in a rate process, like the operating expenses and fuel adjustment clauses and so on.

But I am saying, with regard to the cost-of-capital itself, it would have the opportunity to attract capital in the marketplace. Whereas, if one doesn't take this final step, then with regard to the cost-of-capital components themselves, we would know in advance they wouldn't even have an opportunity to attract capital in the marketplace.

Apparently Dr. Vander Weide believes that an upward adjustment to the cost of capital has to be made in order for a utility company to attract capital, but in this case he does not make that adjustment, which leaves one to believe that his current recommended cost of common equity of 11.60 percent is not high enough for Empire to attract capital.

Q. Does Dr. Vander Weide explain why he suddenly decided not to make an upward adjustment in this case which according to his testimony in the deposition cited above is critical to be able to attract capital?

A. Yes, he says the Company requested him not to make an upward adjustment because the Commission did not accept an upward adjustment in the Report and Order in AmerenUE rate case, Case No. ER-2007-0002.

Q. Did the Commission discuss the credibility of Dr. Vander Weide in the Report and Order in AmerenUE Case No. ER-2007-0002?

A. Yes. The Commission discussed Dr. Vander Weide's credibility on Page 41 of the Report and Order for AmerenUE issued May 22, 2007 in Case No. ER-2007-0002. The Commission said:

> In sum, the financial risk upward adjustment proposed by AmerenUE's witnesses appears to be a transparent effort to inflate the company's proposed return on equity to obtain a better bargaining position in the hope the Commission would simply split the difference between the extreme positions. **Such efforts call into question the credibility of these witnesses** [Emphasis Added]. Indeed, Vander Weide came close to acknowledging that his proposed return on equity was extreme when at the hearing he indicated an eleven percent return on equity, in line with the amounts that the Commission has allowed Kansas City Power & Light and The Empire District Electric Company in recent rate cases, "would be a benchmark that the financial community would look at."

Q. Are there any other inconsistencies with Dr. Vander Weide's testimony?

A. Yes. Dr. Vander Weide did not use natural gas companies in his proxy group as he did in the last Empire rate case, and he does not explain why he changed his methodology.

Q. Dr. Vander Weide uses the quarterly compounding version of the DCF model to estimate the return on equity for Empire. Does Value Line, a widely recognized and used investor information source, provide quarterly projected compounded dividends for the next year?

A. No, Value Line publishes the projected dividend on an annual basis. This information is used by investors for determining the prices they are willing to pay for stocks. Because Staff's estimated cost of equity for Missouri regulated utilities is based on Staff's analysis of investor expectations, Staff believes it is important to replicate how it believes investors would estimate an expected dividend yield. Value Line does not publish projected quarterly dividends; therefore, Staff can not imagine that investors employ such precision to estimate the cost of common equity for Empire. If the projected quarterly compounding version of the DCF model is important to an investor, Staff believes that Value Line would publish this information. In Staff's opinion, it appears that Dr. Vander Weide uses this methodology to arrive at a higher dividend yield that results in a higher return on equity recommendation for Empire's revenue requirement determination.

Q. The Commission has cited in recent Report and Orders a "Zone Of Reasonableness", or ZOR, that is based on the Regulatory Research Association's national average authorized ROE's and adding 100 basis points above and below the average to develop the ZOR. Do you have information available for the Commission that would allow the Commission to develop its ZOR?

A. Yes.

Q. What was the average authorized ROE for 2007?

A. The average authorized ROE for 2007 was 10.36 percent based on 39 electric rate cases. The lowest authorized ROE was 9.10 percent and the highest authorized ROE was 11.35 percent.

Q. What was the average authorized ROE for the first quarter of 2008?

A. The average authorized ROE for the first quarter of 2008 was 10.32 percent based on nine decisions. Dr. Vander Weide's recommended ROE of 11.60 percent for Empire is approximately 1.28 percent or 128 basis points higher than the national average of 10.31 percent. If the Commission accepts Dr. Vander Weide's recommendation, Missouri will have the highest authorized ROE in the nation according to the 2007 data.

Q. Did Staff research all of the authorized ROEs to determine if there are any unique circumstances that would justify elimination of any of the authorized ROEs from the averages?

A. No.

SUMMARY AND CONCLUSIONS

Q. Please summarize the conclusions of your rebuttal testimony.

A. My conclusions regarding the cost of common equity are listed below.

1. The Commission should recognize Dr. Vander Weide's inconsistencies in this proceeding compared to the last two Empire proceedings in Case No. ER-2006-0315, ER-2004-0570 and the AmerenUE rate case,

Case No. ER-2007-0002. It appears that Dr. Vander Weide is recommending a return on equity that is convenient for Empire.

2. My cost of common equity of 9.70 percent to 10.85 percent with a mid-point of 10.28 percent would produce a fair and reasonable rate-of -return of 8.37 percent to 8.95 percent with a mid-point of 8.66 percent for Empire.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

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

AFFIDAVIT OF MATTHEW J. BARNES

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Matthew J. Barnes, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Matthew J. Barnes

Subscribed and sworn to before me this 3rd day of April, 2008.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

Notary Public

The Empire District Electric Company
Case No. ER-2008-0093

Historical and Projected Growth Rates
for the Comparable Electric Utility Companies
and The Empire District Electric Company

Company Name	(1) Historical Growth Rate (DPS, EPS and BVPS)	(2) Projected 5-Year EPS Growth IBES (Mean)	(3) Projected 5-Year EPS Growth S&P	(4) Projected 3-5 Year EPS Growth Value Line	(5) Average Projected Growth	(6) Average of Historical & Projected Growth
Alliant Energy	-3.83%	6.00%	6.00%	5.50%	5.83%	1.00%
Ameren Corp.	1.17%	7.30%	6.00%	3.00%	5.43%	3.30%
American Electric Power	-2.50%	6.02%	6.00%	6.50%	6.17%	1.84%
Cleco Corp.	2.83%	14.00%	14.00%	6.50%	11.50%	7.17%
DPL Inc.	0.17%	8.88%	9.00%	10.50%	9.46%	4.81%
Entergy Corp.	6.42%	10.60%	11.00%	9.50%	10.37%	8.39%
FirstEnergy Corp.	4.00%	11.00%	9.00%	9.00%	9.67%	6.83%
FPL Group	5.50%	9.90%	10.00%	11.00%	10.30%	7.90%
Hawaiian Electric	0.58%	8.53%	9.00%	1.50%	6.34%	3.46%
IDACORP, Inc.	-2.67%	6.00%	6.00%	2.00%	4.67%	1.00%
NSTAR	3.25%	6.50%	7.00%	8.50%	7.33%	5.29%
Pinnacle West Capital	3.17%	5.73%	6.00%	1.50%	4.41%	3.79%
PNM Resources	3.25%	9.13%	9.00%	2.50%	6.88%	5.06%
Progress Energy	2.92%	5.04%	5.00%	3.50%	4.51%	3.72%
Southern Company	1.92%	5.03%	5.00%	3.00%	4.34%	3.13%
Westar Energy	-2.67%	5.58%	6.00%	4.50%	5.36%	1.35%
Average	**1.47%**	**7.83%**	**7.75%**	**5.53%**	**7.04%**	**4.25%**
The Empire District Electric Company	**0.50%**	**6.00%**	*	**8.50%**	**7.25%**	**3.88%**

Proposed Range of Growth for Comparables: **5.55%-6.70%**

Column 5 = [(Column 2 + Column 3 + Column 4) / 3]

Column 6 = [(Column 1 + Column 5) / 2]

Sources: Column 1 = Average of 10-Year and 5-Year Annual Compound Growth Rates from Schedule 13-3.

Column 2 = I/B/E/S Inc.'s Institutional Brokers Estimate System, March 20, 2008.

Column 3 = Standard & Poor's Earnings Guide, January 2008.

Column 4 = The Value Line Investment Survey: Ratings and Reports, November 30, December 28, 2007 and February 8, 2008.

*As of January 1, 2008 S&P no longer publishes the Earning Guide that listed the projected 5-year EPS growth rate for companies.

REVISED - SCHEDULE 15

The Empire District Electric Company
Case No. ER-2008-0093

Average High / Low Stock Price for September 2007 through December 2007
for the Comparable Electric Utility Companies and
The Empire District Electric Company

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	-- September 2007 --		-- October 2007 --		-- November 2007 --		-- December 2007 --		**Average High/Low Stock Price (09/07 - 12/07)**
Company Name	High Stock Price	Low Stock Price	High Stock Price	Low Stock Price	High Stock Price	Low Stock Price	High Stock Price	Low Stock Price	
Alliant Energy	$39.030	$36.610	$40.570	$37.320	$42.000	$38.880	$43.410	$40.690	**$39.814**
Ameren Corp.	$53.890	$50.250	$54.400	$51.810	$54.200	$51.960	$54.740	$52.840	**$53.011**
American Electric Power	$46.970	$44.060	$48.700	$45.050	$48.230	$45.360	$49.490	$46.320	**$46.773**
Cleco Corp.	$26.030	$22.410	$26.760	$24.500	$29.840	$25.090	$28.760	$24.600	**$25.999**
DPL Inc.	$26.820	$25.980	$29.040	$25.710	$30.480	$28.700	$31.000	$29.200	**$28.366**
Entergy Corp.	$111.950	$102.120	$120.890	$108.210	$125.000	$114.040	$123.390	$114.740	**$115.043**
FirstEnergy Corp.	$66.180	$61.080	$69.920	$63.390	$69.760	$66.310	$74.980	$68.100	**$67.465**
FPL Group	$63.490	$58.230	$68.480	$60.260	$70.140	$65.530	$72.770	$67.520	**$65.803**
Hawaiian Electric	$21.870	$20.620	$23.200	$21.680	$23.490	$20.920	$23.950	$22.600	**$22.291**
IDACORP, Inc.	$33.900	$31.200	$36.450	$32.360	$35.740	$33.000	$36.720	$33.680	**$34.131**
NSTAR	$35.050	$32.450	$35.440	$33.450	$35.620	$33.590	$37.000	$34.860	**$34.683**
Pinnacle West Capital	$40.700	$39.480	$42.620	$39.500	$43.640	$39.040	$44.500	$42.000	**$41.435**
PNM Resources	$23.620	$21.190	$25.210	$23.050	$25.060	$21.710	$23.950	$21.410	**$23.150**
Progress Energy	$48.160	$44.960	$48.000	$44.750	$49.060	$46.310	$50.250	$48.250	**$47.468**
Southern Company	$37.480	$35.040	$37.230	$35.160	$38.750	$35.150	$39.350	$37.360	**$36.940**
Westar Energy	$25.430	$23.500	$26.750	$24.290	$26.760	$24.770	$26.830	$25.280	**$25.451**
	-- November 2007 --		-- December 2007 --		-- January 2008 --		-- February 2008 --		
The Empire District Electric Company	**$24.340**	**$22.690**	**$23.500**	**$22.260**	**$23.290**	**$21.180**	**$23.020**	**$20.370**	**$22.877**

Notes:

Column 9 = [(Column 1 + Column 2 + Column 3 + Column 4 + Column 5 + Column 6 + Column 7 + Column 8) / 8].

Sources: S & P Stock Guides: October 2007, November 2007, December 2007, January 2008, February 2008, and March 2008.

REVISED - SCHEDULE 16

The Empire District Electric Company
Case No. ER-2008-0093

Discounted Cash Flow (DCF) Estimated Costs of Common Equity
for the Comparable Electric Utility Companies and
The Empire District Electric Company

	(1)	(2)	(3)	(4)		(5)
Company Name	Expected Annual Dividend	Average High/Low Stock Price	Projected Dividend Yield	Average of Historical & Projected Growth		Estimated Cost of Common Equity
Alliant Energy	$1.40	$39.814	3.52%	1.00%		4.52%
Ameren Corp.	$2.54	$53.011	4.79%	3.30%		8.09%
American Electric Power	$1.67	$46.773	3.57%	1.84%		5.41%
Cleco Corp.	$0.90	$25.999	3.46%	7.17%		10.63%
DPL Inc.	$1.10	$28.366	3.88%	4.81%		8.69%
Entergy Corp.	$3.10	$115.043	2.69%	8.39%		11.09%
FirstEnergy Corp.	$2.15	$67.465	3.19%	6.83%		10.02%
FPL Group	$1.78	$65.803	2.71%	7.90%		10.61%
Hawaiian Electric	$1.24	$22.291	5.56%	3.46%		9.03%
IDACORP, Inc.	$1.20	$34.131	3.52%	1.00%		4.52%
NSTAR	$1.43	$34.683	4.12%	5.29%		9.41%
Pinnacle West Capital	$2.12	$41.435	5.12%	3.79%		8.90%
PNM Resources	$0.97	$23.150	4.19%	5.06%		9.25%
Progress Energy	$2.47	$47.468	5.20%	3.72%		8.92%
Southern Company	$1.66	$36.940	4.49%	3.13%		7.62%
Westar Energy	$1.16	$25.451	4.56%	1.35%		5.90%
Average			**4.04%**	**4.25%**		**8.29%**
The Empire District Electric Company	**$1.28**	**$22.877**	**5.60%**	**3.88%**	*	**9.47%**

Proposed Dividend Yield:	**4.04%**
Proposed Range of Growth:	**5.55% - 6.70%**
Estimated Proxy Cost of Common Equity:	**9.59%-10.74%**
Empire Company-Specific Using Average Projected Growth	**12.85%**

Notes: Column 1 = Estimated Dividends Declared per share represents the projected dividend for 2008.

Column 3 = (Column 1 / Column 2).

Column 5 = (Column 3 + Column 4).

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, November 30, December 28, 2007 and February 08, 2008

Column 2 = Schedule 15.

Column 4 = Schedule 14.