Exhibit No.:
Issues: *Rate of Return*
Witness: *Shana Atkinson*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Rebuttal Testimony*
Case No.: *ER-2010-0130*
Date Testimony Prepared: *April 2, 2010*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

SHANA ATKINSON

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2010-0130

Jefferson City, Missouri
April 2010

TABLE OF CONTENTS

OF THE REBUTTAL TESTIMONY OF

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Q. Please state your name.

A. My name is Shana Atkinson.

Q. Are you the same Shana Atkinson who prepared Section V of the Staff's Cost of Service Report, Rate of Return, filed in this proceeding on February 26, 2010?

A. Yes, I am.

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 ("ROR") testimony in this proceeding on behalf of The Empire District Electric Company ("Empire").

EXECUTIVE SUMMARY OF REBUTTAL TESTIMONY

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 most recent Missouri proceeding in Case No. ER-2008-0093 and cases in other jurisdictions in which Dr. Vander Weide filed testimony. Specifically, Staff has noticed that Dr. Vander Weide's risk premium analysis uses forecasted yields in some cases and average current yields in other cases. Also, Dr. Vander Weide had been generally giving his discounted cash flow ("DCF") analysis twenty percent weighting in relation to other cost of capital estimation

methods, but now in this proceeding, for reasons he does not explain, he gives his DCF estimate a 33 percent weight. I will also critique Dr. Vander Weide's comparable groups and his exclusive use of projected earnings growth rates for purposes of calculating his constant-growth DCF.

CORRECTIONS

Q. Do you have any corrections?

A. Yes. Staff made an input error and needed to correctly input the perpetual growth rate as 3.35% in the calculation for the row that included The Empire District Electric's company-specific cost of equity in column (9) on Schedule 19 of the COS Report. Therefore at the bottom of column (9), the cost of equity should be 11.61% and not 11.48%. However, as Staff discussed in the Cost of Service Report, Staff does not consider this result to be representative of Empire's current cost of equity due to simplifying assumptions Staff made which Staff considers reasonable when applied to a proxy group, but not necessarily to an individual company (corrected Schedule 19 is attached).

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

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

A. Dr. Vander Weide's recommended cost of common equity of 11.0 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. Dr. Vander Weide determined the cost of common equity to be

11.7 percent using the DCF method, 11.3 percent using the ex ante risk premium method, 11.3 percent using the ex post risk premium method, 9.5 percent using the historical CAPM method and 10.3 percent using the DCF CAPM method. Dr. Vander Weide averaged his two risk premium estimates for a final risk premium estimate of 11.3 percent. Dr. Vander Weide did the same for his CAPM estimates for a final CAPM estimate of 9.9 percent. Dr. Vander Weide's final recommended cost of common equity of 11.0 percent was calculated by taking a simple average of his DCF method (11.7%), the average of his risk premium methods (11.3%) and the average of his CAPM methods (9.9%).

Q. Has Dr. Vander Weide always arrived at his recommended return on equity ("ROE") by taking a simple average of the average of the two risk premium methods, the average of the two CAPM methods and the DCF method instead of taking a simple average of the five different cost of common equity estimation methods?

A. No. In past cases, Dr. Vander Weide has usually used a simple average of his five individual cost of common equity estimates. This methodology resulted in his DCF estimate receiving 20 percent weight in past cases. Using Dr. Vander Weide's current methodology results in his DCF estimate receiving 33 percent weight.

Q. What averaging technique has Dr. Vander Weide used in past rate cases in which he sponsored testimony in Missouri?

A. Dr. Vander Weide used a simple average of the five estimates for the The Empire District Gas Company, Case No. GR-2009-0434; The Empire District Electric Company, Case No. ER-2006-0315; and for Union Electric Company d/b/a/ AmerenUE ("AmerenUE"), Case No. ER-2007-0002.

Q. What has Dr. Vander Weide's approach been in cases in other jurisdictions in which he has recently sponsored ROR testimony?

A. Dr. Vander Weide has used a simple average of the five cost of common equity estimation estimates in the following cases: the Atmos Energy case in Georgia in October 2009, Docket No. 30442; the Duke Energy Carolinas case in North Carolina in June 2009, Docket No. E-7 Sub 909; and the Progress Energy case in Florida in March 2009, Docket No. 090079-EI.

Q. Are you aware of any other cases in which Dr. Vander Weide has filed testimony in which he applied his current averaging technique?

A. Staff is only aware of the last Missouri Empire case, Case No. ER-2008-0093, in which Dr. Vander Weide also applied the averaging technique of weighting his DCF results by 33 percent.

Q. Did Staff review all cases in which did Dr. Vander Weide has filed ROR testimony in other jurisdictions to determine when he started using the 20 percent averaging technique compared to the 33 percent averaging technique he used in this and the last Empire case?

A. No. The Company objected to Staff Data Request No. 330, in which Staff had requested Dr. Vander Weide's past testimonies over the most recent three years. Staff was surprised by this objection given the fact that Dr. Vander Weide provided very specific past testimonies from 1994 to 2003 in a data request response in a past AmerenUE rate case, Case No. ER-2007-0002. Although Staff was not able to review all of Dr. Vander Weide's testimonies since the last Empire rate case, Staff did review the testimonies it could access through various public utility commission websites. In each testimony that Staff reviewed

since the last Missouri Empire electric rate case, including the Empire District Gas case, Case No. GR-2009-0434, Dr. Vander Weide has used the 20 percent averaging technique.

Q. Does Dr. Vander Weide explain in his Direct testimony why he changes his averaging technique from case to case?

A. No.

Q. Does Dr. Vander Weide's change in DCF weightings affect his final recommended ROE in this proceeding?

A. Yes.

Q. What would Dr. Vander Weide's recommendation have been in this case if he used a simple average of his five cost of common equity estimates?

A. The simple average of the five methods is equal to 10.82 percent. This is lower than the results of 11 percent using his current averaging technique that gives each of the three methodologies 33 percent weight.

Q. Does Staff believe it is acceptable for a witness to use judgment concerning the appropriate models and assumptions to use in the models when estimating the cost of equity?

A. Yes. Staff understands that consistency can come at the expense of reliability if certain events in the capital markets cause illogical results. However, if a witness diverges from past practice or appears to be just plain random in their practices, then Staff would expect the witness to explain his rationale for the change in these practices. Dr. Vander Weide has not done so.

Q. In the most recent Missouri Empire electric rate case, Case No. ER-2008-0093, Dr. Vander Weide used the average current yield to maturity on

A-rated utility bonds in his risk premium methods to estimate the cost of equity. Does he use the average current yield to maturity on A-rated utility bonds in this case?

A. No. He uses the forecasted yield to maturity on A-rated utility bonds for estimating the risk premium for his risk premium methods.

Q. Did Dr. Vander Weide make a similar change to his CAPM methodology?

A. Yes. In Empire's last case, Dr. Vander Weide used the average current yield to maturity on 20-year Treasury bonds to estimate the risk-free rate for his CAPM methods. In this case, Dr. Vander Weide used the forecasted yield to maturity on 20-year Treasury bonds to estimate the risk-free rate for his CAPM methods.

Q. Has Dr. Vander Weide used the average current yield to maturity on A-rated utility bonds and 20-year Treasury bonds instead of the forecasted yield to maturity on A-rated utility bonds and 20-year Treasury bonds in any other recent cases besides the most recent Missouri Empire rate case, Case No. ER-2008-0093?

A. Yes. Some recent cases in which Dr. Vander Weide has used the average current yield instead of the forecasted yield are the Atmos Energy case in Georgia in October 2009, Docket No. 30442; and the Atmos Energy case in Tennessee in October 2008, Docket No. 0800197; and the Xcel Energy case in North Dakota in December 2007, Docket No. PU-07-776.

Q. Did Dr. Vander Weide use the forecasted yield for the CAPM and the risk premium in any cases between the December 2007 Xcel Energy case (used average yield) and the October 2009 Atmos Energy case (used average yield)?

A. Yes. Two cases that he used the forecasted yield in this time period are the Progress Energy case in Florida in March 2009, Docket No. 090079-EI and the Duke Energy Carolinas case in North Carolina in June 2009, Docket No. E-7 Sub 909.

Q. What was Dr. Vander Weide's reason for using the average current yield instead of the forecasted yield in the cases mentioned previously in which he used the average current yield?

A. Although Dr. Vander Weide states in his Direct testimony in the Atmos Energy case in Georgia in October 2009, the Atmos Energy case in Tennessee in October 2008, and the Xcel Energy case in North Dakota in December 2007, that he believes it is appropriate in "theory" to add the risk premium to the forecasted yield to maturity on bonds, apparently the average current yield on A-rated utility bonds and forecasted yields on A-rated utility bonds were approximately equal at the time of his studies and the average current yield values were readily available to him. Although Dr. Vander Weide appears to believe it is appropriate in "theory" to base a risk premium cost of equity estimate based on projected yields, he seems to supplant his own judgment when he believes that this theoretically correct estimate is too high or too low. He does not state, in his Direct testimonies where he used the forecasted yield, the reason for using the forecasted yield instead of the average current yield. Also, he does not state why he believed it was appropriate to use the average current yield to maturity on 20-year Treasury bonds instead of the forecasted yield to estimate the cost of equity using his CAPM methods. Additionally, he does not identify the magnitude of the difference between forecasted yields and average current yields that would cause him to choose one method compared to the other.

Q. Does Staff believe it is appropriate to base a risk premium and CAPM cost of equity estimate on projected yields?

A. No. In this case, using projected yields overstates the current cost of equity capital. Basing risk premium cost of equity estimates on projected bond yields is similar to basing a DCF estimated cost of equity on projected stock prices. Dr. Vander Weide did not use projected stock prices in his DCF analysis because current stock prices reflect investors' expectations regarding changes in interest rates as well as company-specific risks. Current bond prices, and therefore current bond yields, reflect investors' expectations concerning future interest rates. Therefore, the current yield does not need to be adjusted.

Q. Does Dr. Vander Weide give a reason in the instant case for using the forecasted yield instead of the average current yield?

A. No. Dr. Vander Weide states, on pages 32-33 and 39-40 of his Direct testimony, that he uses the forecasted yield to maturity on A-rated corporate bonds from *Blue Chip Financial Forecasts* in estimating the forecasted yield on A-rated utility bonds and he uses data from *Blue Chip Financial Forecasts* in estimating the 20-year Treasury bonds for the risk free rate for his CAPM methods, but he does not give a reason for using the forecasted yields.

Dr. Vander Weide's method of estimating the forecasted yield on A-rated utility bonds differs in this case compared to the June 2009 Duke Energy Carolinas case. In this case, he forecasted the A-rated utility bond yield by using the *Blue Chip Financial Forecasts* forecast for Baa-rated corporate bonds plus the current spread between A-rated utility bonds and Baa-rated corporate bonds. In the June 2009 Duke Energy Carolinas case, Dr. Vander Weide forecasted the A-rated utility bond yield by adding the spread between

A-rated and AA-rated utility bonds to the Global Insight forecast of the yield to maturity on AA-rated bonds. Staff is not sure why Dr. Vander Weide used different techniques for these two cases or the effect it had on his cost of equity estimates.

In regard to Dr. Vander Weide's estimation of the forecasted yield of the 20-year Treasury bonds in this case, Dr. Vander Weide calculated the forecasted yield differently than in the June 2009 Duke Energy Carolinas case. In this case, he estimated the forecasted yield by using the *Blue Chip Financial Forecasts* forecast for 30-year Treasury bonds plus the current difference between 30-year and 20-year Treasury bonds. In the June 2009 Duke Energy Carolinas case, to obtain a forecasted yield for the 20-year Treasury bond, Dr. Vander Weide compared the current average yield for the 20-year Treasury bond to the average yield for the 10-year Treasury bond. He then added the difference between the current yields on the 30-year and 20-year Treasury bonds, to Bloomberg's average forecasted yield for 10-year Treasury bonds in 2010. Staff is uncertain how these changes have impacted Dr. Vander Weide's results.

Q. What would Dr. Vander Weide's risk premium cost of equity estimates have been if he had used the average yield to maturity on A-rated utility bonds in July 2009, the month that Dr. Vander Weide used for his forecasted yields, rather than projections in this case?

A. The average yield to maturity on A-rated utility bonds in July 2009, according to the Mergent Bond Record, was 5.97 percent. If Dr. Vander Weide had used this yield, his estimated risk premium would be 4.92 percent for his ex ante risk premium method. If you add the 5.97 percent to the risk premium of 4.92 percent, the estimate for this method would be 10.89 percent compared to the 11.3 percent estimate using projected yields for the

ex ante method. If you add the 5.97 percent to his estimated risk premium of 4.2 to 4.5 percent for his ex post risk premium method, the estimate for this method would be a range of 10.17 to 10.47, with a midpoint of 10.32 compared to the 11.3 percent using projected yields for the ex post method.

Q. What would Dr. Vander Weide's CAPM estimates have been if he had used the average yield to maturity on 20-year Treasury bonds for July 2009 to estimate the risk free rate for his CAPM methods?

A. The average yield to maturity on 20-year Treasury bonds for July 2009, according to the Federal Reserve, was 4.38 percent. Using the 4.38 percent as the risk-free rate for Dr. Vander Weide's Historical CAPM method, the estimate for that method would be 8.93 percent. If Dr. Vander Weide had used 4.38 percent for the risk-free rate in his DCF-Based CAPM method, his estimate would have been 10.13 percent.

Q. If Dr. Vander Weide had applied the same methodologies he applied in past cases, what final cost of common equity estimate would be achieved?

A. Applying equal weight to his five ROE estimation approaches and using average current yield information instead of projected yields**,** Dr. Vander Weide's estimated cost of common equity would have been approximately 10.40 percent ((11.7% + 10.89% + 10.32% + 8.93% + 10.13%)/5).

Q. Do you believe this result would be a reliable cost of equity estimate?

A. No. Staff is not just concerned about Dr. Vander Weide's unexplained inconsistencies, Staff also does not believe Dr. Vander Weide uses appropriate proxy groups or applies his methodologies appropriately to estimate Empire's cost of equity.

Q. Do you have any concerns about the companies Dr. Vander Weide selected for his electric utility proxy group for his DCF estimation?

A. Yes. According to the March 2010 AUS Monthly Report, nine of Dr. Vander Weide's comparable companies do not receive at least 70 percent of their revenues from electric utility operations. Five of these nine companies receive 50 percent or less of their revenues from electric utility operations. It is important to use this criterion because the objective of selecting a comparable group is to find companies that are as "pure play" as possible. "Pure play" means that the comparable company is confined, as much as possible, to the operation that is the subject of the cost-of-capital study. Also, according to the Edison Electric Institute 2008 Financial Review, ten of Dr. Vander Weide's comparable companies are not classified as "Regulated." Based on this criteria, Staff would eliminate fourteen of Dr. Vander Weide's twenty eight comparable companies

Q. What growth rate does Dr. Vander Weide use in his DCF analyses?

A. Dr. Vander Weide relies exclusively on equity analysts' five-year earnings per share ("EPS") growth forecasts.

Q. Please explain why exclusive reliance on analysts' projected five-year EPS growth rates currently produce upwardly biased results.

A. The DCF model requires constant and sustainable growth rates and analysts' EPS forecasts are based on nearer-term expectations (five years or less). Such growth rates are not likely to be sustainable if not consistent with long-term trends. Dr. Vander Weide's average growth of projected EPS growth rates used in his DCF model is 6 percent. Staff does not believe investors would consider an average projected growth of 6 percent to be sustainable in the long term. This 6 percent is not sustainable due to the fact that it

is higher than long-term projected economic growth rates provided by the Congressional Budget Office (4.2 percent for 2015 through 2020).

Q. Do you have any concerns about Dr. Vander Weide's ex ante risk premium approach?

A. Yes. Dr. Vander Weide's estimated risk premium is based on his application of the DCF to an index of "electric" utility companies. Therefore, his risk premium is only as reliable as his DCF cost of common equity estimates are and the comparability of this index to Empire. Another concern is that Staff is not sure why Dr. Vander Weide would start with the Moody's group of electric utilities in his risk premium analysis, when he started with the Value Line group of electric utilities for his DCF cost of equity analysis in his Direct testimony. Nevertheless, both of his "comparable" groups include companies that are not comparable to Empire. According to the March 2010 AUS Monthly Report, half of Dr. Vander Weide's twenty companies in his comparable group for his ex ante risk premium approach have less than 70 percent of revenues from electric utility operations. Five of these ten companies have less than 50 percent of revenues from electric utility operations.

Q. Is Dr. Vander Weide's average of his CAPM methods within Staff's overall range?

A. Yes, Dr. Vander Weide's average of his CAPM methods is at the top of Staff's range. Although Staff has methodological concerns about Dr. Vander Weide's CAPM estimates due to the fact that his estimate is within Staff's ROE range, Staff will not delve into the details of his CAPM estimate.

Q. Dr. Vander Weide's DCF-Based CAPM estimates the risk premium on the market portfolio from the difference between the DCF cost of equity for the S&P 500 and the

yield to maturity on 20-year Treasury bonds. Does Staff believe that Dr. Vander Weide's estimate of the S&P 500's cost of equity is reasonable?

A. No. Dr. Vander Weide estimated the cost of equity to be 12.6 percent for the Standard & Poors' ("S&P") 500. Staff reviewed expected returns for various asset classes provided by the Missouri State Employee's Retirement System (MOSERS) on its website. According to this information, the expected returns for large capitalization domestic equities is only 8.50 percent. This provides a reality check regarding Dr. Vander Weide's DCF estimated returns for the S&P 500. Being that MOSERS must make investment decisions involving billions of dollars, it would seem that they have a vested interest in providing a reasonable estimate of expected capital market returns.

SUMMARY AND CONCLUSIONS

Q. Please summarize the conclusions of your Rebuttal testimony.

A. The Commission should recognize Dr. Vander Weide's unexplained inconsistencies in his recommended ROE estimation approaches in this proceeding, compared to not only past cases in other jurisdictions in which he has filed testimony, but even to past cases in which he has filed testimony in Missouri. To the extent Dr. Vander Weide does not provide a logical explanation for these changes; these changes should be viewed with a skeptical eye due to Dr. Vander Weide's past practice in Missouri of changing his methodologies without explaining the reason for these changes. The estimation of the cost of common equity using the DCF methodology with reasonable inputs and an appropriate proxy group clearly supports an estimated cost of common equity in the 9 percent range.

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 for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri Service Area of the Company	))))	Case No. ER-2010-0130

AFFIDAVIT OF SHANA ATKINSON

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Shana Atkinson

Subscribed and sworn to before me this 1st day of April, 2010.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires: December 08, 2012
Commission Number: 08412071

Notary Public

The Empire District Electric Company
Case No. ER-2010-0130

Multiple-Stage 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)	(6)	(7)	(8)	(9)
Company Name	Annualized Quarterly Dividend	Growth Years 1-5	6	7	Growth Years 8	9	10	Growth in Perpetuity	Cost of Equity
Alliant Energy	$1.50	4.47%	4.28%	4.09%	3.91%	3.72%	3.54%	3.35%	8.98%
American Electric Power	$1.64	3.84%	3.75%	3.67%	3.59%	3.51%	3.43%	3.35%	8.52%
Cleco Corp.	$0.90	9.25%	8.27%	7.28%	6.30%	5.32%	4.33%	3.35%	8.45%
DPL Inc.	$1.14	10.35%	9.18%	8.02%	6.85%	5.68%	4.52%	3.35%	9.85%
IDACORP, Inc.	$1.20	4.75%	4.52%	4.28%	4.05%	3.82%	3.58%	3.35%	7.74%
Northeast Utilities	$0.95	8.01%	7.23%	6.46%	5.68%	4.90%	4.13%	3.35%	8.60%
PG&E Corp.	$1.68	6.72%	6.15%	5.59%	5.03%	4.47%	3.91%	3.35%	8.29%
Pinnacle West Capital	$2.10	3.70%	3.64%	3.58%	3.53%	3.47%	3.41%	3.35%	9.59%
Progress Energy	$2.48	4.94%	4.68%	4.41%	4.15%	3.88%	3.62%	3.35%	10.47%
Southern Company	$1.75	4.71%	4.48%	4.25%	4.03%	3.80%	3.58%	3.35%	9.37%
Westar Energy	$1.20	4.00%	3.89%	3.78%	3.68%	3.57%	3.46%	3.35%	9.46%
Xcel Energy	$0.98	6.32%	5.83%	5.33%	4.84%	4.34%	3.85%	3.35%	9.23%
								Average:	**9.05%**
								Proposed Range:	**8.55% - 9.55%**
Empire District Electric	$1.28	6.00%	5.56%	5.12%	4.68%	4.23%	3.79%	3.35%	11.61%

Sources: Column 1 = The Value Line Investment Survey: Ratings and Reports, November 27 and December 25, 2009 and February 5, 2010.
Column 2 = Average Projected Growth from Brokers' Estimates and Value Line Estimates. For Empire District Electric the only projected growth rate available was the Value Line Estimate.

SCHEDULE 19