BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the tariff filing of The Empire District Electric Company to implement a general rate increase for retail electric service provided to customers in its Missouri service area.	)))))	**Case No. ER-2004-0570**

CONCURRING OPINION OF COMMISSIONER LIN APPLING

I write in response to the Dissenting Opinion of my fellow Commissioners, Steve Gaw and Robert Clayton, III. Like them, I took an oath before taking up my duties at this Commission, to faithfully and honestly discharge the duties of my office.[1] Chief among these duties is to be fair, "fair to the public, and fair to the investors."[2] Having served my country as a military officer for most of my adult life, I do not take oaths lightly.

Thus, I am disappointed to learn that my dissenting colleagues believe the majority made a decision in this case that was not fair, that was based on "blind acceptance" of company testimony and that predisposes the majority to hurt utility ratepayers in the future. Having made my decision strictly on the basis of what I heard in the hearing room and read in the briefs and other pleadings filed by the parties, I do not take this challenge lightly.

[1] Section 386.110, RSMo 2000.

[2] St. ex rel. Washington University et al. v. Pub. Serv. Comm'n, 308 Mo. 328, 345, 272 S.W. 971, 973 (banc 1925).

The dissenting Commissioners criticize several aspects of the majority's findings, including: 1) the chosen return on equity capital (ROE); 2) lack of adherence to regulatory principles in the Hope and Bluefield decisions; 3) inconsistency with earlier Commission decisions; and 4) failure to rely upon the Discounted Cash Flow (DCF) method of analysis. I respectfully disagree with their opinions.

Return on Equity

The cost of common equity was, as it always is, a contest of experts. Company witness Murry recommended 12%, Company witness Vander Weide recommended 11.3% and the Company's position was 11.65%, the midpoint between its two witnesses. Office of the Public Counsel (OPC) witness Allen suggested a range of 8.96% - 9.41%, and PSC Staff witness Murray suggested a range of 8.29% - 9.29%. These positions were on either side of the industry average of 11.00%.

It was clear to me from the hearing and the prefiled testimony that Empire's rates have been too low and that the company has suffered from inadequate capitalization. Its credit rating had been downgraded, making the cost of borrowed money higher.[3] It had paid out more in dividends every year than it earned. In my opinion, it was inadequate capitalization and declining borrowing ability that led Empire to an over-reliance on gas-fired generation – it's cheaper to build! In hindsight, it's easy to say that the Company should not have made itself so vulnerable to gas price fluctuations.

[3] The Dissenters allege that "the majority failed to consider the 'standard of capital attraction' or 'financial integrity' requirements." In fact, those are exactly the things I considered.

Further, the decisions made over the last 17 years to invest in gas-fired generation began at a time when natural gas prices were very low. Only recently has the natural gas market become the volatile creature that the Dissent frequently cites to. It is inappropriate, in my opinion, for the Dissent to assert such sharp criticism of Empire's management decisions with 20/20 hindsight. I don't think it was mismanagement for the Company to build the type of generation it could afford, looking at the total economic environment of the last 17 years. Living within your means is good management.

In thinking through this case and the contrary opinions of the common equity experts, it was reasonable to find that the Company's return needed to be higher than it has been. In this process, the industry average served as a guide. The common equity figures offered by Staff and Public Counsel were below the national average, and that makes no sense to me. If anything, Empire seems like a less attractive investment than the average electric utility.

The recommendations of the Company experts were both above the average, but Vander Weide was not very far above it. Vander Weide's recommendation seemed about right in view of Empire's credit rating downgrade, high dividend-to-earnings ratio and increased risk factors that the market attributes to Missouri's regulatory environment. For this reason, I found Vander Weide's recommendation to be more persuasive than those offered by the other witnesses and to be a good place to start. The majority agreed to reduce Vander Weide's recommendation of 11.3% to adjust for two decisions that reduced Empire's regulatory risk: 1) using the accrual method for net salvage to allow partial recovery of the Company's net salvage totals; and 2) and implementing an Interim Energy Charge to recover a portion of the volatile costs of natural gas. In my opinion, this is not "blind acceptance" of the Company's testimony.

Hope and Bluefield Principles

The Dissenters state: "when discussing the 'standard of comparable earnings', these decisions (i.e., Hope and Bluefield)[4] obligate the Commission to review certain factors when determining an appropriate return on equity: (1) the proximity in time of the comparable return on equity; (2) the geographic proximity of the comparable return on equity; and (3) the corresponding risks and uncertainties. Finally, the Dissenters claim, when considering the "financial integrity standard", the Commission is obligated under the Bluefield standard to consider an efficient and economical management." They say we did not do this.

Unlike my colleagues in their dissent, I relied on what I heard during the hearing and read in the case papers submitted and accepted into evidence. That is what my oath requires. The dissenting Commissioners did not restrict themselves to the evidence of record. In scolding the majority for relying on the 11.00% ROE cited above -- which is in the record -- they point to contrary indicators which were not in evidence. That is not an appropriate criticism. The Dissenters are lawyers, and they know that the Commission's decision must be based on the evidence in the record.[5]

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[4] Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[5] The Dissenters state: "any reliance, in March of 2005 on a national average ROE from the 1st Quarter of 2004 is obviously flawed and clearly dated. Despite their public availability, the majority made no effort to review return on equity decisions issued after the 1st Quarter of 2004."

If the record did not include information of appropriate geographic or temporal proximity, that is the fault of the parties. Perhaps they will do better next time.

Earlier Commission Decisions and DCF Analysis

The Dissenters are disturbed by the majority's "drastic departure from over 30 years of established Commission precedent to rely upon the DCF formula in analyzing the 'standard of capital attraction.'" The DCF model, as the majority's Order explains, is the chief example of the market-determined standard.[6] It is a method that has been relied on by this and other Commissions for many years in determining the cost of common equity. But it is not the *only* method. As the majority pointed out in the Commission's Order, The Constitution "does not bind ratemaking bodies to the service of any single formula or combination of formulas."[7]

As noted earlier, the Commission's Staff advocated the lowest cost of common equity figures of any of the parties. It is difficult to understand why Staff's return on equity recommendation is lower than that offered by the Public Counsel, yet that has been the trend recently.

Staff expert Murray's company-specific, DCF-derived, cost-of-common-equity estimate for Empire was a range of 8.29% - 9.29%. His DCF analysis of a proxy group resulted in an estimated average cost of common equity ranging from 7.17% - 8.62%. Using two versions of the Capital Asset Pricing Model (CAPM), Murray produced two estimated costs of common equity for Empire,

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[6] C.F. Phillips, Jr., The Regulation of Public Utilities, 394-396 (1993).

[7] Fed. Power Comm'n v. Nat. Gas Pipeline Co., 315 U.S. 575, 586, 62 S.Ct. 736, 743, 86 L.Ed. 1037, 1049-50 (1942).

7.04% and 9.35%. His CAPM analyses of the proxy group produced results of 7.35% and 10.01%. Finally, Murray performed a Risk Premium analysis on Empire and produced an estimated cost of common equity of 9.23%. From this constellation of nine results, Murray offered the range 8.29% to 9.29% -- the results of his company-specific DCF analysis of Empire -- as his final recommendation to the Commission.

I am not persuaded by this method. It is not comparative, does not properly account for risk and does not allow the Company to pay its operating costs while also providing its shareholders with an opportunity to earn an adequate return on their investment.

As to the issue of an "efficient and economical management", I note that there was no prudence issue in this case. In fact, the most striking evidence that I recall as to management's efficiency and economy had to do with Empire's excellent natural gas hedging program. It seems to me that the record shows that Empire's management has done a good job, especially considering recent market trends in natural gas pricing.

If appealed, the courts will examine the Commission's order in this case to determine whether it is reasonable.[8] By "reasonable," the courts mean that the order must be "supported by substantial and competent evidence on the whole record."[9] "Reasonable" also encompasses an inquiry into whether the decision was "arbitrary, capricious, or unreasonable, or whether the

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[8] AG Processing, Inc. v. Pub. Serv. Comm'n, 120 S.W.3d 732, 734 (Mo. banc 2003).

[9] St. ex rel. Laclede Gas Co. v. PSC of Mo., 2005 Mo. App. LEXIS 343, 17-18 (Mo. Ct. App., W.D. 2005); St. ex rel. Associated Natural Gas Co. v. Pub. Serv. Comm'n, 954 S.W.2d 520, 528 (Mo. App., W.D. 1997).

[Commission] abused its discretion."[10] Whether an order "is supported by competent and substantial evidence is judged by examining the evidence in the context of the whole record. An [order] that is contrary to the overwhelming weight of the evidence is, in context, not supported by competent and substantial evidence."[11]

The Dissenting Opinion, unlike the majority's Order, will not be reviewed at all. The dissenting Commissioners need not restrict themselves to the evidence of record but are free to scold the majority for doing so. This is like playing trump cards that the rest of us have not seen.

The Dissenters say that the Commission's decision in this case "sends a reward package to the Company, paid for without consent by the citizens and businesses of southwest Missouri." I disagree. I say that the Commission's decision in this case sets just and reasonable rates that are fair to the Company as well as to the ratepayers, firmly founded on the evidence of record and not contrary to the overwhelming weight of the evidence in this case. To the extent that the Dissenters urge this Commission to ignore the record and base its decision on information outside the record, they are in error.

For these reasons, I respectfully concur.

Linward "Lin" Appling, Commissioner

Dated at Jefferson City, Missouri,
on this 17th day of March, 2005.

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[10] *Id.*

[11] Hampton v. Big Boy Steel Erection, 121 S.W.3d 220, 223 (Mo. banc 2003).