



Martha S. Hogerty
Public Counsel

State of Missouri

Bob Holden
Governor

Office of the Public Counsel
Governor Office Building
200 Madison, Suite 650
P.O. Box 7800
Jefferson City, Missouri 65102

Telephone: 573-751-4857
Facsimile: 573-751-5562
Web: <http://www.mo-opc.org>
Relay Missouri
1-800-735-2966 TDD
1-800-735-2466 Voice

August 30, 2001

Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

FILED
AUG 30 2001
Missouri Public
Service Commission

RE: The Empire District Electric Company
Case No. ER-2001-299

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case please find the original and eight copies of **PUBLIC COUNSEL'S TRUE-UP REPLY BRIEF**. Please "file" stamp the extra-enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "JB Coffman".
John B. Coffman
Deputy Public Counsel

JBC:jb

cc: Counsel of Record

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In The Matter Of The Empire District Electric)
Company's Tariff Sheets Designed to Implement)
a General Rate Increase for retail Electric)
Service Provided to Customers in the Missouri)
Service Area of the Company.)

Case No. ER-2001-299
Tariff No. 200100518

FILED

AUG 30 2001

**Missouri Public
Service Commission**

PUBLIC COUNSEL'S TRUE-UP REPLY BRIEF

John B. Coffman (#36591)
Deputy Public Counsel

August 30, 2001

Public Counsel is involved with only one contested issue in the true-up phase of this case, which is briefed below.

There is no dispute regarding what the actual capital structure for Empire District Electric Company (Company) was at the end of the true-up period on June 30, 2001; however, the capital structure issue litigated previously remains contested (use of this actual capital structure v. use of a pro-forma or hypothetical capital structure).

Public Counsel is in agreement with the Staff of the Commission (Staff) regarding the appropriate payroll level and payroll calculations contained in the testimony of Staff witness Fischer. (Exhibits 134 and 135).

EMBEDDED COST OF TRUST PREFERRED STOCK

This issue involves whether Trust-Originated Preferred Securities (TOPrS) should be considered debt or equity for regulatory purposes. Staff acknowledges that TOPrS are a hybrid between debt and equity. (Transcript 1219). Company witness David W. Gibson states that TOPrS have characteristic that are normally associated with debt instruments but receive equity treatment by Standard & Poor's. (Exhibit 121, p.1). Public Counsel simply recommends that the Commission consistently treat TOPrS as either debt or equity for all regulatory purposes.

The Commission first addressed the issue of whether TOPrS was debt or equity in a Missouri Gas Energy (MGE) rate case, Case No. GR-96-285. At that time, MGE was under a stipulated restriction that prevented it from filing a rate case unless its capital ratio reached a certain financial benchmark. As the Commission acknowledged in that

case, whether TOPrS was to be considered debt or equity for regulatory purposes was entirely dispositive of the entire rate case. In other words, if the Commission had found that TOPrS were debt, MGE would never have been able to file a rate case and its customers would not have suffered a rate increase of \$7,527,513. Ibid., Report and Order, issued on January 22, 1997, p. 12. The Commission ruled that TOPrS were to be considered **equity** instead of debt as was recommended by MGE and Staff:

The Commission finds that the TOPrS issued by Southern Union Financing Company I constitutes the creation of **equity, not debt**, with respect to Southern Union. Therefore, Southern Union has demonstrated compliance with the Stipulation And Agreement in GM-94-40, and it is entitled to implement a general rate increase in this case.

Id., p. 13. (emphasis added).

The Commission went on to note that treating TOPrS as equity was consistent with a Federal Reserve Board memorandum which set forth technical reasons explaining why TOPrS could be treated as equity. Id.

In this case, Staff has treated the TOPrS issued by Company as debt for the purposes of calculating its embedded costs. (Exhibit 125, p. 5.) Company supports Staff's calculation of embedded costs, citing several reasons why it believes TOPrS are more appropriately treated as debt. (Exhibit 121, pp. 1-3).

It should be noted that Public Counsel would have no objection to the Commission treating TOPrS as debt if the Commission did so consistently for all regulatory purposes. What Public Counsel contends is profoundly unfair is treating TOPrS as equity in a situation when it works to the detriment of consumers and then in another situation treating TOPrS as debt when that particular classification works to the

detriment of ratepayers. Based upon Staff analysis of TOPrS, consumers always get the short end of the stick. Regulated utilities should not be encouraged to treat a hybrid like TOPrS in a manner that gives shareholders every benefit and ratepayers every detriment. A more just and reasonable approach to this hybrid would be to determine **consistently** whether TOPrS is debt or equity for **all** regulatory purposes.

The Commission distinguishes between the manner in which embedded costs are calculated between in debt and equity components. (Exhibit 127, p. 4). The reason for this distinction is important because the cost of issuing equity is an ownership cost appropriately attributed to shareholders. Staff's method of calculating the embedded cost of Empire's TOPrS involved deducting all unamortized issuance expenses from the amount outstanding **and** including a yearly amortization expense. (McKiddy True-Up Direct, Exhibit 124, Schedule 4). Both of these procedures increase the embedded cost. (Exhibit 127, p. 1). Although this "double counting" is the usual procedure used to calculate the embedded cost of long-term **debt**, it is not appropriately applied to ownership cost of **equity** components in the capital structure as it produces an embedded cost that is too high and unrepresentative of the actual cash cost to the utility. (Exhibit 127, pp. 102).

Public Counsel witness Mark Burdette testified that the appropriate methodology for calculating the embedded cost of TOPrS is a deduction of the unamortized issuance expense from the amount outstanding, but not including a yearly amortization. Id. Mr. Burdette's method appropriately considers the actual cash flow from the company received and the actual cash flow the company must pay out to service this trust preferred

stock. Id. Moreover, this method produces the accurate level of revenue needed to service the TOPrS. Id.

Mr. Burdette included \$48,442,500 of TOPrS in Empire's capital structure at an embedded cost of 8.77% (Exhibit 126, Schedules MB-1T and MB-3T). This produces exactly the amount of revenue Empire will need to service its TOPrS. Ms. McKiddy utilized an identical level of TOPrS, but applied an embedded cost 8.88%. Her recommendation produces excess revenue of \$51,694. (Exhibit 127, p. 4).

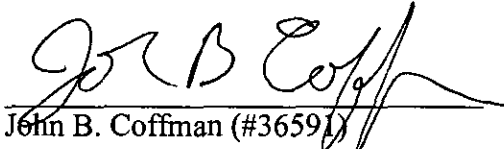
CONCLUSION

Public Counsel simply urges the Commission to be consistent in its treatment of TOPrS and thus treat consumers and shareholders in an even-handed manner. If the Commission continues to consider TOPrS as equity for regulatory purposes, it should adopt the embedded cost calculations of Public Counsel witness Mark Burdette and approve its embedded cost at 8.77%.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

BY:


John B. Coffman (#36591)
Deputy Public Counsel

Governor Office Building
200 Madison Street, Suite 650
P O Box 7800
Jefferson City, MO 65102-7800

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 30th day of August 2001:

General Counsel

Missouri Public Service Commission
P O Box 360
Jefferson City, MO 65102

Henry T. Herschel

308 E. High Street
Suite 301
Jefferson City, MO 65101

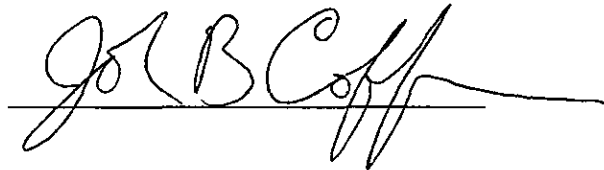
James C. Swearengen/Gary W. Duffy/

Dean L. Cooper

Brydon, Swearengen & England, PC
P O Box 456
Jefferson City, MO 65102-0456

Stuart W. Conrad, Esq.

Finnegan, Conrad & Peterson, LC
3100 Broadway, 1209 Penntower Office
Kansas City, MO 64111

A handwritten signature in cursive script, appearing to read "J. B. Conrad", is written over a horizontal line. The signature is fluid and stylized, with a long horizontal stroke extending to the right.