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**Missouri Public
Service Commission**

Exhibit No.

Issue:

Witness: William L. Gipson

Type of Exhibit: Rebuttal Testimony

Sponsoring Party: Empire District

Case No. ER-02-424

Date Testimony Prepared: 9/24/02

**Before the Public Service Commission
of the State of Missouri**

Rebuttal Testimony

Of

William L. Gipson

September 24, 2002

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THE EMPIRE DISTRICT ELECTRIC COMPANY
CASE NO. ER-2002-424

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REBUTTAL TESTIMONY
OF
WILLIAM L. GIPSON
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE
THE MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2002-424

INTRODUCTION

1 Q. Please state your name.

2 A. William L. Gipson

3 Q. Are you the same William L. Gipson who filed direct testimony in this case
4 before the Missouri Public Service Commission ("Commission") on behalf of The
5 Empire District Electric Company ("Empire" or "Company")?

6 A. Yes.

7 Q. What issues do you address in your rebuttal testimony?

8 A. I will address issues concerning Fuel and Purchased Power as well as issues
9 concerning Return on Equity ("ROE") and Capital Structure. Specifically, on the
10 Fuel and Purchased Power issues I will respond to the direct testimony of
11 Commission Staff ("Staff") witness David Elliott. On the ROE and Capital
12 Structure issues, I will respond to the direct testimony of Staff witness David
13 Murray and Office of the Public Counsel ("Public Counsel") witness Mark
14 Burdette.

15 **RETURN ON EQUITY**

16 Q. What is your understanding of the ROE issue?

17 A. Empire recommends a 12% ROE. The Staff supports a range of 9.16% to 10.16%
18 and the Public Counsel a range of 10.1% to 10.4%.

1 Q. How do you respond generally to the recommendations of the Staff and Public
2 Counsel on the ROE issue?

3 A. The Staff's suggested range is completely unreasonable and will be harmful to
4 Empire and its customers if adopted by the Commission. The high side of the
5 Public Counsel's range, the 10.4% ROE, begins to approach the range of
6 reasonableness.

7 Q. Please explain.

8 A. Credit and finance matters are of critical importance to Empire. We must
9 compete with all other publicly-traded companies when accessing capital markets
10 for the issuance of both debt and equity to provide us with the capital necessary to
11 build utility infrastructure. The authorization by this Commission of a non-
12 competitive ROE for Empire will jeopardize the Company's ability to attract
13 investors in these capital markets which in turn will result in higher capital costs
14 and higher rates for our customers.

15 Q. How do these facts relate to the Staff's ROE recommendation?

16 A. For the Staff to suggest an ROE range which, for the most part, is below the 10%
17 ROE authorized by the Commission for Empire just last October in Case No. ER-
18 2001-299, is incredible. Moreover, in that case the Commission actually found
19 that the Public Counsel's calculations, which produced an ROE range of 10.0%,
20 to 10.25% to be well-reasoned, so the Commission could just as easily have
21 authorized a 10.25% return on equity in that case. In any event, this clearly
22 demonstrates that returns in the range suggested by the Staff are unreasonable,

1 especially given what has happened to the financial market conditions since the
2 last case and the particular circumstances surrounding Empire.

3 Q. Why do you say the Staff suggested ROE is not competitive?

4 A. C. A. Turner Utility Reports, pages 7 and 8, attached as Rebuttal Schedule WL-
5 1, lists a number of statistics for Empire along with 23 other electric utilities. The
6 average regulatory allowed ROE for this sample is 11.71%. The very lowest
7 allowed ROE (10%) in this table is the ROE ordered by this Commission in
8 Empire's last rate case. While the Public Counsel's high end, the 10.4% ROE
9 may approach the realm of "competitiveness" the Staff's recommendation does
10 not.

11 Q. What is your understanding of how the rating agencies view the ROEs authorized
12 by this Commission?

13 A. On July 2, 2002 Empire's corporate rating was downgraded to BBB by Standard
14 and Poor's ("S&P"). In its report, S&P said in part:
15 "The rating action on energy provider EDE reflects a downward trend in the
16 company's financial profile that was not adequately stemmed in recent regulatory
17 actions. Roughly 80% of EDE's revenues are derived in Missouri, where the
18 regulatory environment is marked by relatively low allowed ROEs, (emphasis
19 added) low plant depreciation allowances, and the lack of a permanent fuel
20 adjustment clause to help shield the company from its markedly increased
21 dependence on natural gas."

22 Q. What does this tell you?

1 A. This tells me that the rating agencies have left Empire with little room to
2 accommodate for adverse change in external factors like poor weather, rising
3 natural gas and purchased power prices, wind or ice storms, etc. and underscores
4 the need for fair regulatory treatment. Furthermore, it tells me that an ROE in the
5 10% range, as the Staff has recommended in this case, will damage Empire's
6 future ability to attract investors to provide the cash necessary to continue to build
7 utility infrastructure and will ultimately result in the erosion of the quality of
8 electric power service to Empire's customers.

9 Q. How should the Commission respond?

10 A. The Commission should set an allowed ROE for Empire that is fair, meaning an
11 opportunity for the Company to earn a return on its investment comparable to
12 other businesses with similar risks. Also, the use of an Empire-specific discounted
13 cash flow ("DCF") model as utilized by the Staff and the Public Counsel is simply
14 wrong as this is a circular mechanical methodology that bases Empire's ROE on
15 how well or how poorly Empire fared in its previous Missouri rate case.
16 Moreover, this mechanical company-specific DCF approach fails to consider
17 current market conditions and the financial circumstances and well being of
18 Empire. Empire witness Donald A. Murry addresses these matters in greater detail
19 in his testimony.

20 **CAPITAL STRUCTURE**

21 Q. What is your understanding of the capital structure issue?

22 A. The issue is whether or not short term debt should be included in Empire's capital
23 structure for ratemaking purposes in this case. Empire believes short term debt

1 should be excluded and other Empire witnesses will address this issue in greater
2 detail. From my perspective, this is a credibility issue.

3 Q. Why do you say this?

4 A. The capital structure which the Commission uses for ratemaking purposes in this
5 case should be the capital structure which will be in place during the time the
6 rates set in this case will be in effect. It is Empire's position that the present level
7 of short term debt in the Company's capital structure is not consistent with its
8 historical capital structure nor is it representative of the capital structure we will
9 have in place in the future. In fact, the short term debt will be replaced to a
10 considerable extent by permanent financing.

11 Q. Does Empire have a recent track record with respect to its financing plans?

12 A. Yes. We recently replaced debt financing with equity financing as we told the
13 Commission we would do in the last rate case. The Commission chose not to
14 believe us in the last case ("The Commission finds that the company's contention
15 that it will increase its common equity percentage to 45% in the immediate or
16 foreseeable future is not realistic." Report and Order Case No. ER-2001-299 page
17 15). The Commission was wrong, however, as we carried through on our promise
18 and our common stock equity ratio (excluding current liabilities at June 30, 2002)
19 is now 47%. This time I would hope it would be presumed that we are making a
20 truthful representation about our financing plans and that the Commission will
21 adopt our proposed capital structure.

1 **FUEL AND PURCHASED POWER**

2 Q. Generally speaking, what is Empire's position with respect to the Fuel and
3 Purchased Power issues?

4 A. Empire simply seeks to recover in rates its actual and prudently incurred Fuel and
5 Purchased Power costs.

6 Q. What is your understanding of the Staff's position on these issues?

7 A. The Staff's position in this case, as I understand it, is a Fuel and Purchased Power
8 recommendation that will prevent Empire from recovering costs that are
9 reasonable and absolutely essential to Empire's ability to continue to provide safe
10 and reliable electric utility service. I say this because the Staff's position, if
11 adopted by the Commission, would deny Empire complete recovery of the costs
12 for Fuel and Purchased Power that are part of the backbone of the Company's
13 electric utility operations. This is a result which cannot be justified. Furthermore,
14 this sort of regulatory treatment will result in Empire not being able to earn its
15 Commission-authorized return, and, again, it will decrease the cash necessary to
16 build utility infrastructure.

17 Q. Please compare the Staff's position in this case to Empire's.

18 A. Apples to apples (see Rebuttal Schedule WLG-2 – attached to my testimony).
19 Staff's position based on Run 128 and partial resolution of some gas
20 transportation charges is \$17.45/MWH NSI without demand charges. Empire's
21 initial filed position is \$18.37/MWH and Empire's updated position is
22 \$18.09/MWH. The differences here, when applied to Missouri jurisdictional
23 sales, amount to approximately \$2.5 million. Or, put another way, given

1 Empire's current (June 30, 2002) weighted outstanding number of common
2 shares, the difference is about \$0.08 per share.

3 Q. What do you understand to be the drivers of this difference?

4 A. Both the Company and the Staff utilize production cost models that rely on a
5 variety of inputs to develop the most economical dispatch of generating units and
6 purchased power. While the Company and the Staff agree on most of these
7 inputs, Empire believes that the Staff has used unrealistic costs in certain
8 instances and has also made unrealistic assumptions about the availability of
9 purchased power.

10 Q. Please explain.

11 A. The output of Staff's model would require the Company to achieve a level of
12 dollar-per-MWH NSI without demand charges not seen since twelve months
13 ended November 2000, and is \$1.49/MWH below the twelve-months ended June
14 2002 actual of \$18.94/MWH. Simply put, the Staff fails to perform any kind of
15 assessment or to exercise an informed judgment as to the Company's ability to
16 perform to the levels the Staff proposes. The Staff's approach on this issue, if
17 approved by the Commission, will sanction the underrecovery of costs which we
18 are required to incur to maintain reliable service.

19 Q. Do you want to make any final points?

20 A. Yes. The economic success of Missouri depends on a viable infrastructure which
21 includes competitive and financially viable utilities such as Empire. The
22 overriding public policy issue for this Commission in this case is whether it will
23 provide to Empire the kind of financial resources necessary to maintain a

1 financially viable utility which in turn can maintain the type of reliable utility
2 service and utility infrastructure that is necessary for economic development in
3 this state. Missouri should not be seen as an extreme outlier in this regard.

4 Q. Does this conclude your rebuttal testimony?

5 A. Yes.

ELECTRIC

COMPANY	OPER REV \$ MILL (1)	% ELEC REV	NET PLANT \$ MILL	NET PLANT PER \$ REV (1)
ALLETE, Inc. (NYSE-ALE)	1,516.3	40	1,368.6	0.90
American Electric Power Co. (NYSE-AEP)	61,199.0	6	24,447.0	0.40
Black Hills Corporation (NYSE-BKH)	1,274.0	14	1,338.8	1.05
Central Vermont Public Serv. Corp. (NYSE-CV)	298.9	100	307.0	1.03
Cleco Corporation (NYSE-CNL)	1,092.7	57	1,549.9	1.42
DPL Inc. (NYSE-DPL)	1,168.5	99	2,501.3	2.14
DQE, Inc. (NYSE-DQE)	1,253.5	81	1,696.0	1.35
Edison International (NYSE-EDX)	12,468.3	73	7,982.0	0.64
El Paso Electric Company (ASE-EE)	687.5	99	1,356.6	1.97
Empire District Electric Co. (NYSE-EDE)	278.5	99	758.8	2.72
FirstEnergy Corporation (NYSE-FE)	10,002.5	74	12,483.9	1.25
FPL Group, Inc. (NYSE-FPL)	8,460.0	88	12,271.0	1.45
Great Plains Energy (NYSE-GXP)	1,681.2	85	2,624.4	1.56
Green Mountain Power Corp. (NYSE-GMP)	275.2	100	197.4	0.72
Hawaiian Electric Industries, Inc. (NYSE-HE)	1,653.0	75	1,633.1	0.99
IDACORP, Inc. (NYSE-IDA)	6,285.3	16	1,889.0	0.30
Maine Public Service Company (ASE-MAP)	39.3	80	47.5	1.21
OGE Energy Corp. (NYSE-OGE)	2,718.5	51	3,303.3	1.22
Otter Tail Corporation (NDQ-OTTR)	671.4	58	572.0	0.85
Pinnacle West Capital Corp. (NYSE-PNW)	3,654.6	96	6,055.1	1.66
Southern Company (NYSE-SO)	10,170.3	83	23,484.5	2.31
UIL Holdings Corporation (NYSE-UIL)	1,123.8	64	551.4	0.49
UniSource Energy Corporation (NYSE-UNS)	1,171.1	98	1,671.8	1.43
Westar Energy, Inc. (NYSE-WR)	2,110.0	82	4,017.2	1.90
AVERAGE				

COMPANIES

S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE		REGULATION	
			COMMON EQUITY (4)	TOTAL CAPITAL	ALLOWED ROE	ORDER DATE
BBB+	Baa1	50	11.1	8.4	11.60	11/94
BBB+	A3	29	12.0	7.3	11.58	-
A+	A1	36	17.0	9.3	-	06/95
BBB+	NR	48	2.5	5.0	11.00	06/01
BBB+	A2	32	20.8	8.3	12.25	10/96
BBB+	A2	25	23.7	11.0	-	09/00
BBB-	Baa1	25	NM	NM	12.87	03/88
B+	Ba3	20	NM	13.3	11.60	06/99
BBB-	Baa3	40	12.6	9.8	-	-
A-	Baa1	37	3.0	5.6	10.00	-
BBB	Baa1	34	11.8	8.8	12.12	-
A	Aa3	45	10.7	7.8	-	3/02
A-	A1	32	NM	2.4	-	-
BBB	Baa2	53	11.6	9.4	11.25	01/01
BBB+	A3	25	11.9	5.1	11.22	-
A-	A2	40	13.5	8.9	-	-
NR	NR	54	12.7	8.2	10.70	12/99
A-	A1	37	10.8	8.2	14.14	-
A+	Aa3	51	14.6	10.7	12.00	-
A-	A3	43	12.8	7.9	11.25	08/98
A+	A1	37	12.5	8.2	12.98	-
NR	A3	44	12.1	9.3	11.50	12/96
BBB-	Ba2	17	9.1	8.1	-	03/96
BBB-	Ba1	22	NM	2.7	11.02	09/01
		36	12.3	8.0	11.71	-

Empire District Electric Company
Case No. ER-2002-424
Summary of Annualized Fuel & Purchased Power Expense

Revised 9/19/02

Description	Source of Annualized Value	Staff Filed Run 127	Staff Run 128	Empire Filed	Empire Adjusted
<u>ON SYSTEM MODEL OUTPUTS</u>					
Annualized fuel	Fuel Run	\$53,808,652	\$54,571,006	\$63,697,784	\$63,472,000
Purchased power	Fuel Run	\$26,119,012	\$24,545,074	\$20,782,000	\$19,054,000
Western Adjustment	Discrepancy in TME Price		\$276,662		
Total On System Model Outputs		\$79,927,664	\$79,392,742	\$84,479,784	\$82,526,000
<u>FUEL TRANSPORTATION COSTS</u>					
Gas Transportation-fixed	Current Contract Price	\$3,285,044	\$3,285,044	\$3,285,044	\$3,285,044
Gas Transportation-commodity related (variable)	Current Contract Price	\$133,209			\$327,023
Losses @ 2.37 percent	Gas Tariff		\$864,326	\$821,416	\$909,427
Gas Supply Realignment (GSR)	12-mo Ended 6/30/02		\$135,202		\$267,333
Total fuel transportation		\$3,418,253	\$4,284,572	\$4,106,460	\$4,788,827
<u>NON-DISTRIBUTED AND OTHER FUEL RELATED COSTS</u>					
Fuel Handling - Nonlabor	Test Year - DR No. 255	\$193,558	\$193,559		\$193,559
Asbury Unit Train Maint. Costs	Test Year - DR No. 55	\$88,475	\$88,475		\$88,475
Rail Spur Costs	Test Year - DR No. 255	\$77,549	\$77,549		\$77,549
Iatan Unit Train Maint. Costs	Test Year - DR No. 55	\$10,617	\$10,617		\$10,617
Lease Iatan Unit Train	Test Year - DR No. 255	\$115,216	\$115,216		\$115,216
Property Taxes - Unit Trains	Test Year - DR No. 255	\$67,628	\$67,628		\$67,628
Lease Steel Train to Union Pacific	Test Year - DR No. 255	(\$675,000)	(\$675,000)		(\$675,000)
Lease Alum Unit Train	Test Year - DR No. 255	\$598,125	\$598,125		\$598,125
Lease Train for Genwal Coal	Test Year - DR No. 255	\$55,780	\$55,780		\$55,780
ARCO advance pymnt amortization	Test Year - DR No. 255	\$567,151	\$567,151		\$567,151
Maintenance of Railroad	Test Year - DR No. 255	\$79,263	\$79,263		\$79,263
Other-Nonlabor	Test Year - DR No. 255		\$96,684		\$96,684
Total non-distributed and other fuel related costs		\$1,099,099	\$1,275,047	\$1,484,000	\$1,275,047
<u>PURCHASE POWER DEMAND CHARGES</u>					
Western Resources	Current contract	\$16,193,520	\$16,193,520	\$16,193,520	\$16,193,520
WR Off-line auxiliary	12-mo Ended 6/30/02	\$57,549	\$57,549		
Total demand charges		\$16,251,069	\$16,251,069	\$16,193,520	\$16,193,520
OFFSET in MWH (4,902,060 vs 4,867,833)					\$520,472
<u>TOTAL ON SYSTEM FUEL AND PURCHASE POWER (NSI)</u>		\$100,696,085	\$101,203,430	\$106,263,764	\$104,262,922
<u>OFF SYSTEM SALES</u>					
Cost of off system sales (Fuel)	12-mo Ended 6/30/02	\$1,700,820	\$1,700,820	\$317,999	\$1,700,820
Cost of off system sales (Purchased Power Energy)	12-mo Ended 6/30/02	\$3,630,018	\$3,630,018	\$847,170	\$3,630,018
Off-system sales (Demand Charges)	12-mo Ended 6/30/02	\$1,711,911	\$1,711,911	\$1,712,128	\$1,711,911
Energy exchanged - SWPA	Test Year	\$1,598	\$1,598		
<u>TOTAL OFF SYSTEM FUEL AND PURCHASE POWER</u>		\$7,044,347	\$7,044,347	\$2,877,297	\$7,042,749
<u>TOTAL FUEL AND PURCHASE POWER (NSO)</u>		\$107,740,432	\$108,247,777	\$109,141,061	\$111,305,671
NSI \$ w/out purchase power demand		\$84,445,016	\$84,952,361	\$90,070,244	\$88,069,402
NSI \$/MWH w/out purchase power demand		17.35	17.45	18.37	18.09

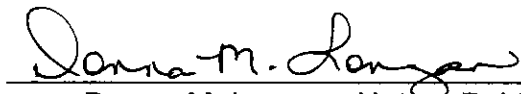
AFFIDAVIT

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 20th day of September, 2002, before me appeared W.L. Gipson, to me personally known, who, being by me first duly sworn, states that he is the President and Chief Executive Officer of The Empire District Electric Company and acknowledged that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.


W.L. Gipson

Subscribed and sworn to before me this 20th day of September, 2002


Donna M. Longan, Notary Public

My commission expires: January 24, 2004

