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August 3, 2001

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

**FILED**

AUG 3 2001

Missouri Public  
Service Commission

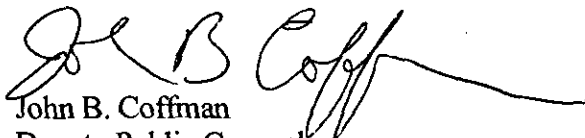
**RE: The Empire District Electric Company**  
**Case No. ER-2001-299**

Dear Mr. Roberts:

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

Thank you for your attention to this matter.

Sincerely,

  
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 3 2001

Missouri Public  
Service Commission

**REPLY BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL**

John B. Coffman (#36591)  
Deputy Public Counsel

August 3, 2001

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## **I. INTRODUCTION**

This Reply Brief will respond to arguments made in the initial briefs filed by Empire District Electric Company (Company) and by the Staff of the Commission (Staff). The Office of the Public Counsel (Public Counsel) believes that very little needs to be said that has not already been presented to the Commission in its Initial Brief filed on July 20, 2001. Failure to address to any arguments contained in briefs of any other parties should not be as construed as acquiescence to those arguments.

While this brief advocates that the Commission utilize the actual capital structure for Company when determining the overall rate of return, the actual capital structure on June 30, 2001 will be determined through the true-up procedure which includes testimonial filings and an evidentiary hearing scheduled for later this month. Public Counsel will file on August 7, 2001 prepared direct testimony regarding what Company's actual capital structure reflected on June 30, 2001, the Commission-ordered true-up date.

## II. ARGUMENT

### **A. What capital structure is appropriate for Empire?**

Company argues for use of a hypothetical capital structure, claiming that its actual capital structure is not representative of the capital structure which Empire will have in place in the future. Company's Initial Brief, p. 32. Empire witness Dave Gibson testified that the capital structure existing during the Commission-approved test year period in this case was "abnormal" and testified further that Company is planning to issue additional common equity later in 2001. Id. However, as Staff and Public Counsel have both pointed out, the Commission must calculate rates based upon the interrelationship of a utility's investments, expenses and all other relevant factors within a prescribed test year in order to appropriately set just and reasonable rates.

In this particular case, the Commission has determined that certain components of ratemaking should be updated ("trued-up") with the most recent data that can be appropriately audited. This will be accomplished through a true-up procedure that allows testimony and an evidentiary hearing to occur later this month regarding actual Company data as of June 30, 2001. Staff and Public Counsel are in agreement that the appropriate capital structure approved in this case should be updated to this true-up date. This generous additional audit period will allow the capital structure used to be based upon the most up-to-date data. Presumably, this additional time period will have allowed Company to issue additional equity. Regardless, the Commission should approve no capital structure for purposes of calculating rates that is not based upon an *actual* capital structure.

**B. What return on common equity is appropriate for Empire?**

Company found little to criticize in the Discounted Cash Flow (DCF) analysis of Public Counsel Financial Analyst Mark Burdette. Company states that the dividend yield and stock price Mr. Burdette chose in connection with his DCF analysis were "fundamentally sound." Company Initial Brief, p. 44. The only criticism Company makes with regard to Mr. Burdette's DCF analysis is a suggestion that he should have used a higher growth rate component (one that has no relation to Company-specific data).

Company witness Murray used an inappropriate amount of selective judgment in the particular calculated growth rates he used to arrive at his unreasonably high return on common equity recommendation of 11.5%. Ex. 87, p. 5. Company's recommended growth rate is wholly unsupported by the evidence or any reasonable analysis. As Public Counsel has previously illustrated, if Mr. Murray had considered the entire range of his very own calculated growth rate, his recommended return on equity would be dramatically lower than 11.5%. Ex. 87, p. 5.

The following is Company's only criticism of Mr. Burdette's DCF analysis:

A more reasonable growth rate i.e. the 4.57% overall average of all growth rates for the Public Counsel's six comparison companies (Ex. 86, p. 15) would take the Public Counsel's return to the 11% range.

Company Brief, p. 45.

The 4.75% rate is not related to historic or projected growth rates for Empire District Electric Company. To "revise" Public Counsel's recommendation as Company suggests would completely ignore the evidence regarding Empire's own growth rate data. This would be a misapplication of DCF theory. An appropriately sustainable growth rate should be *company-specific*. Mr. Burdette analyzed the growth rates of comparable companies as a check -- to provide some insight into the reasonableness of his recommendation. Ex. 86, p. 12. Mr. Burdette

first calculated growth rates specifically for Empire on a historical and projected basis regarding earnings per share, dividends per share and book value per share:

The following table shows the results of the analysis of growth rates for EDE. The high growth rate is 4.77% and the low growth rate is 0.0%. The overall average of all growth rates is 2.19% (Schedule MB-6, page 1). Negative growth rates were **not** used in calculations of overall averages. The average rate of Empire's *projected* growth, not including the 0.0% DPS projection, is 3.43%.

**Growth rate summary (EDE): Overall average = 2.19%.**

	<u>EPD</u>	<u>DPS</u>	<u>BVPS</u>
Historic Compound Growth	4.77%	0.0%	1.62%
Historic Value Line Growth	1.00%	2.25%	2.00%
Projected Growth	3.15%	0.00%	2.50%

	<u>Historic</u>	<u>Projected</u>
Retention Growth	2.25%	4.61%

Ex. 86, p. 15.

Empire's growth rates have been and are expected to be lower than the growth rates of comparable companies. Ex. 86, pps. 15-16.

As Staff accurately pointed out in its Initial Brief, all three of the principle witnesses regarding return on equity in this case testified that the dividends paid out by Empire are not expected to increase, and thus if growth in dividends were the sole factor considered, the growth factor would actually be 0.0%. Staff Initial Brief, p. 44. Mr. Burdette's calculated growth rate of 3.5% is really quite generous given that it is much greater than the overall average of Empire growth rates. Ex. 86, p. 16.

### III. CONCLUSION

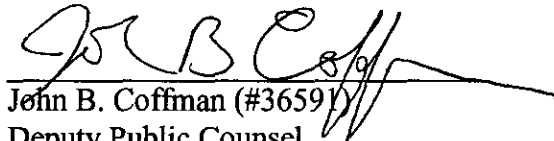
Public Counsel respectfully requests the Commission to calculate the overall rate of return for Company based upon its actual capital structure as of June 30, 2001, as will be determined through the upcoming true-up procedure.

The appropriate return on common equity that should be used in this calculation is 10.06%; however, it would be just and reasonable to utilize a return on common equity anywhere within the range of 10.00% and 10.25%.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

BY:

  
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**CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 3<sup>rd</sup> day of August 2001:

**General Counsel**

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

**Henry T. Herschel**

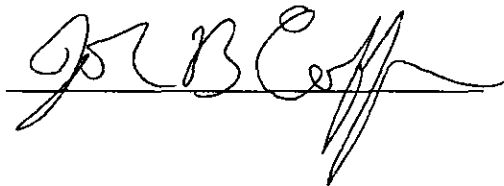
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A handwritten signature in dark ink, appearing to read "Stuart W. Conrad", is written over a horizontal line. The signature is stylized with a large "S" and "C" and a prominent "W".