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August 3, 2001

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FILED

AUG 3 2001

Missouri Public  
Service Commission

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

**RE: Case No. ER-2001-299 – 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**

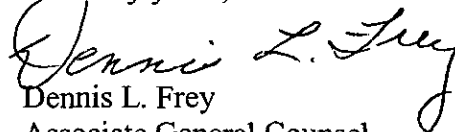
Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the **STAFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

  
Dennis L. Frey

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Enclosure  
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

FILED

AUG 3 2001

Missouri Public  
Service Commission

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

**STAFF'S PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW**

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission"), and respectfully states:

The following proposed findings of fact and conclusions of law are being submitted pursuant to the ordered procedural schedule in this case. The proposed findings of fact are organized in the same manner as Staff's Initial Brief (filed July 20, 2001); *i.e.*, they track Issues No. 1 through 7, as set forth in the Revised List Of Issues, List Of Witnesses And Order Of Cross-Examination (filed June 4, 2001). The proposed conclusions of law are grouped at the end of the document.

**Findings of Fact**

The Missouri Public Service Commission, having considered all of the competent evidence upon the whole record, makes the following findings of fact:

**1. Cost of Service - Depreciation**

While the parties agree that the depreciation should be based on calendar year 2000, for plant other than its State Line Combined Cycle unit Empire asserts that it should recover from Missouri customers \$28,445,716 per year for depreciation while the Staff states that the recovery

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should be \$18,249,834 per year. The difference in the depreciation recovery the Staff and Empire propose is attributable to differences in their approaches to determining average service lives, net salvage and amortization of net salvage; \$5,664,500 is attributable to differences in plant average service lives, \$2,832,250 is attributable to net salvage, and \$1,699,350 is attributable to differences in amortizing net salvage.

Empire takes present plant and predicts future events in determining depreciation. In contrast, the Staff relies on data from past events to determine depreciation. Empire projects both the date generation plant will be retired and all the major maintenance cost events that it anticipates will transpire before that retirement date. It then uses the estimates of the costs associated with those projected events and investment already made as the basis for determining the depreciation rates it proposes for its generation plant. In contrast, the Staff uses existing mortality data to determine average service lives for Empire's generation plant and the actual expenditures Empire has made to determine the depreciation rates that it proposes. Further, Empire includes net salvage cost as a depreciation rate component while the Staff separately states net salvage cost as an expense. Like its determination of depreciation, Empire projects the date generation plant will be retired, the cost of removal at that date and the gross salvage value of the plant at that date in determining net salvage cost. In contrast, the Staff uses the plant removal costs that Empire has incurred in the past five years and the gross salvage value it has realized during those same five years to project Empire's net salvage cost.

The parties agree that depreciation and net salvage cost should be reviewed frequently. A potential advantage of Empire's approach is that the rate impact of depreciation and net salvage cost should remain at a constant level for each particular generating unit during the life of that unit. The disadvantages are that it relies on both projections of when future events will occur

and on the costs associated with those future events. In contrast, because the Staff's approach is based on data from the recent history of the company, the depreciation and net salvage cost that the Staff propose more closely track the recent experience of the company and do not require the estimation of costs that will not be incurred until far in the future.

Empire presented the testimony of its consultant to support the average service lives for generation plant that it proposes in this case. Notably absent in this case is testimony from employees of Empire that Empire will retire units on or about the dates sponsored by that consultant. It is not disputed that using dates certain for retiring generating units has the impact of shortening plant service lives. Further, the testimony of Empire witness Beecher that Empire needed to construct its State Line combined cycle unit to meet load demand it projected in the past dovetails with the testimony of Staff witness Adam that Empire projects load demand in the near future that it does not now have capacity to meet and, therefore, is planning the construction of additional generating units to meet that load, but has no plans for replacing existing generating capacity. The generation unit retirement dates sponsored by Empire's consultant are not credible.

The Staff and Empire agree that for the State Line Combined Cycle unit the design life of 35 years should be used for the average service life, since there is no empirical data upon which to determine average service lives of the plant at that unit. With the exception of the State Line Combined Cycle unit, the Staff based its average service lives on mortality data received from Empire. It used that mortality data to create survivor curves and, ultimately, determine average service lives. The approach to determining service lives taken by the Staff is essentially the same as that used by Empire, except that Empire truncated the survivor curves by using dates certain for retiring all plant at each separate generating unit. This results in shortening the

average service life of the plant. Having found that the fixed retirement dates in the testimony of Empire's consultant are based on his experience with generating units owned by other utilities, but not based on prior experience with Empire or even Empire's planned retirement dates, with the exception of plant at the State Line Combined Cycle unit, the Commission rejects the average service lives proposed by Empire and finds that the average service lives that the Staff determined are the appropriate service lives to be used in this case for establishing depreciation. Those average service lives are set forth in Appendix A, attached hereto.

The Staff and Empire disagree as to whether future major maintenance costs should be considered when determining depreciation; Empire would include them, the Staff would not. Because Empire's approach requires that both the date each future major maintenance cost will be incurred and the magnitude of those costs be projected, the Commission finds it to be too speculative. The Commission finds that depreciation rates should not include these estimated future costs and that the appropriate time to consider such costs is when they are known.

The Staff and Empire also disagree on whether depreciation rates should include net salvage value. Inclusion of net salvage value creates the need to project the date that plant will be removed, the cost of removal at the time it is removed and the gross salvage value, for plant that may never be removed or at least not be removed for some considerable time after it is retired. Unit 6 at Empire's Riverton site was retired, but presently remains on site. This uncertainty provides sufficient grounds to reject Empire's determination of net salvage cost. The Staff's approach of treating net salvage cost as an expense based on Empire's recent historical data reduces this uncertainty. Additionally, separately stating net salvage cost, rather than incorporating it in depreciation rates, appropriately identifies the significance of net salvage cost on rates. The Commission finds that net salvage cost considered in setting rates should be based

on historical net salvage cost that Empire has actually incurred in the recent past and that it should be treated as an expense.

Although not listed as a separate issue in the list of issues made by the parties, the Staff has recommended that Empire be required to submit mortality data in Gannett-Fleming format and the parties have briefed this recommendation. The Commission finds that Empire should be required to provide mortality data to the Commission's Staff in a format that is usable by it—in this case the Gannett-Fleming format--and that, to the extent that 4 CSR 240-20.030(3)(H) may require Empire to keep mortality data in two formats, the rule is waived.

## **2. Cost of Service - Bad Debt**

There is no direct and predictable correlation between revenue and bad debt expense. (Boltz Surrebuttal, Ex. 40, p. 2, line 5; also Tr. 335, lines 7-10.) There is no correlation between increased revenues and increased bad debts at Empire at this time. (Boltz Surrebuttal, Ex. 40, p. 1, lines 19-20.)

Whether a direct correlation between revenue levels and bad debts for a utility is dependent upon case-by-case circumstances. (GR-96-285, 5 Mo. P.S.C. 3d, p. 447.)

The relationship between revenues and bad debt write-offs at Empire in the last five years has varied greatly. (Boltz Surrebuttal, Ex. 40, Schedules 1 and 2; also Tr., p. 309, line 21 through p. 310, line 22.)

A certain level of bad debts, or uncollectibles, is typically built into utility revenue requirements as an expense.

Automatic factor-ups of bad debts are inappropriate.

There is no way to predict whether bad debts will increase by a certain set factor.

Revenues and customers may increase but bad debt expense and actual write-offs may decrease in any given year. (Boltz Surrebuttal, Ex. 40, p. 1, lines 22-23.)

When a utility orders a rate increase for a company, the fact that the utility will have to pay increased income taxes on a proportional basis as a result of the increased revenues is a known and certain fact.

Whether uncollectibles will increase as a result of a rate increase and the amount they will increase by is a matter of speculation.

Unlike the situation with bad debt expense, there is a direct relationship between income tax expense and revenue requirement levels. (Boltz Surrebuttal, Ex. 40, p. 3, lines 5-6.)

### **3. Payroll - Incentive Pay**

Incentive awards were accrued and expensed by Empire for the year 2000 in the amount of \$323,000. This particular incentive award plan was commenced by Empire in 1997 for its non-union, non-officer employees and includes hourly and salaried employees through mid-managers. The first payment under this plan occurred in 1998.

Empire's witness on the issue of recovery of non-union, non-officer employee incentive award compensation was Mr. Myron W. McKinney and the Staff's witness was Ms. Janis E. Fischer.

Mr. McKinney explained that as each year starts, the officers decide how much money will be accrued on a monthly basis over the year, usually 2.0 – 2.5% of the payroll that is paid, for the lump sum incentive awards that are made in late February of the following year, and the managers have wide discretion in the application of those monies.

The approach followed by the Staff is that incentive compensation recovered from ratepayers should reward employees for performance that is both exceptional and beneficial to

ratepayers. As a consequence, incentive compensation for the performance of normal job duties, or incentive compensation for exceptional performance that is not beneficial to ratepayers, i.e., does not increase or enhance the provision of safe and reliable service, should not be recovered from ratepayers and will be sought to be disallowed by the Staff from recovery from ratepayers.

The Staff applied the criteria established by the Commission in a 1987 Staff excessive earnings complaint case against Union Electric Company, *Staff of the Missouri Public Service Commission v. Union Electric Company*, Report And Order, Case Nos. EC-87-114, et al., 29 Mo.P.S.C.(N.S.) 313, 325 (1987), and subsequently followed by the Commission, where the Commission held that “[a]t a minimum, an acceptable management performance plan should contain goals that improve existing performance, and the benefits of the plan should be ascertainable and reasonably related to the incentive plan.”

Empire contended that to measure the Empire incentive awards plan against the management incentive plan addressed in Case Nos. EC-87-114, et al. would not be appropriate because the UE plan dealt with corporate goals and objectives and applied to management employees, while Empire’s plan concerns individual goals and objectives and is not available to employees at the officer level. The Staff showed that it would be consistent to apply the criteria adopted by the Commission in Case Nos. EC-87-114, et al. to Empire’s current incentive award plan for non-bargaining unit, non-officer employees.

Empire’s witness admitted in testimony, as did Empire in response to a Staff data request, that due to the pending merger with UtiliCorp, Empire did not comply with the criteria of its own program in making incentive awards for the year 2000, i.e., managers and supervisors were not required to formulate base and incentive objectives. In fact, for the year 2000, not only did virtually all Empire employees eligible under the plan receive an incentive award, but certain

ineligible employees received incentive awards, i.e., some employees, who had been with Empire less than a year at the time the incentive awards were made for the year 2000, received incentive awards.

The Commission finds that recovery of incentive compensation costs is not appropriate if employees are not even aware of the criteria on which compensation will be ultimately based. Improved job performance that benefits ratepayers is a proper objective of an incentive award plan, but maintaining the status quo is not an example of improved job performance. Furthermore, the performance which was the basis for the incentive awards made by Empire were merger related and arose from a failed merger the costs of which Empire pledged that it would not seek recovery from ratepayers. Empire's own witness testified that it was Empire's intention that no expenses related to the merger were to be included for rate recovery.

Empire's alternative proposal offered in the supplemental surrebuttal testimony of Mr. McKinney and Empire's initial brief that the Commission adopt a five-year or four-year average of Empire's incentive awards is not appropriate. Ms. Fischer testified that in the case of each individual for which documentation was provided to the Staff for review for incentive awards, for the years 1996 through 2000, the incentive objectives did not meet the rate recovery criteria utilized by the Commission for incentive compensation.

#### **4. Class Cost of Service/Rate Design**

This issue was settled among all of the parties. A unanimous stipulation and agreement, covering this issue, along with fuel and purchased power expense, was filed on June 4, 2001.

### 5-a) Capital Structure

In May 1999, Empire and UtiliCorp announced that they had executed an agreement for the merger of the two companies. The merger agreement provided that Empire could not issue any additional common equity prior to the closing of the merger.

In the years immediately prior to the announcement of the Company's proposed merger with UtiliCorp, the Company's year-end capital structure was as follows:

	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>1998</u>
Common Equity	45.90%	45.77%	45.86%	45.19%
Preferred Stock	7.82%	7.07%	7.34%	6.42%
Long-Term Debt	46.28%	47.16%	43.80%	48.39%
Short-Term Debt	0.00%	0.00%	0.00%	0.00%

Following the merger announcement, the Company incurred a large amount of new long-term debt in order to finance construction of its new State Line Combined Cycle power plant and to redeem the outstanding preferred stock. These events combined to drive the Company's common equity percentage down and its long-term debt percentage up. As of December 31, 2000, the Company's capital structure was as follows:

Common Stock Equity	39.80%
Preferred Stock	0.00%
Long-Term Stock	60.20%
Short-Term Debt	0.00%

On January 2, 2001, UtiliCorp announced that it was terminating the merger. Following this announcement, the Company was free to issue new common equity. However, the Company chose not to issue new common equity, because it believed that the issuance of common stock then would not have been prudent, since it would have diluted earnings for 2001.

In March 2001, the Company issued \$50,000,000 of trust preferred securities ("TOPrS"). TOPrS are a form of preferred stock, which pays dividends at a specified rate -- 8.5% of the face amount of the securities, in this case -- however the payments are deductible as interest. TOPrS are not classified as common equity.

Company witness David W. Gibson testified that the Company planned to reinstitute its dividend reinvestment plan ("DRIP Plan"). As of the date of the evidentiary hearing in this case, the DRIP Plan had not been implemented, however. Neither Mr. Gibson nor any other witness offered any evidence on how many shareholders might participate in this program, how much common equity it might produce or when it would produce it, or what impact the DRIP Plan would have on the Company's capital structure.

Company witness Gibson also testified that the Company plans to issue additional common equity later this year. Neither he nor any other witness said how many shares the Company would offer, at what price the shares would be offered, how much capital this would generate, or what effect the new offering would have on the company's capital structure. The Company presented no evidence that it was firmly committed to issuing new common equity.

As of June 30, 2001, the Company's capital structure is as follows:

Common Stock Equity	(To be determined through the true-up process)
Preferred Stock	(To be determined through the true-up process)
Long-Term Stock	(To be determined through the true-up process)
Short-Term Debt	(To be determined through the true-up process)

The percentage of common equity that is included in the Company's capital structure as of June 30, 2001 is unusually low, when compared to this Company's past capital structure. However, Empire's common equity percentage as of June 30, 2001 is similar to that of other companies in the electric utility industry.

The Company states that it aspires to have a capital structure that includes about 45% common equity, and states that that would be similar to the common equity percentage that it has usually maintained in the past. However, the Company has taken no steps to bring its common equity percentage up to 45%, and it does not have any firm plans to do so.

The Staff and the OPC both contend that the Commission should adopt the Company's actual capital structure as it exists as of the true-up date, June 30, 2001. The Company contends that the Commission should adopt a capital structure as follows:

Common Equity	45.0%
Trust Preferred Securities	7.9%
<u>Long-term debt</u>	<u>47.1%</u>

It is unreasonable for the Commission to believe that the Company will increase its common equity percentage to 45% in the immediate or foreseeable future as the Company claims that it intends to do.

#### **5-b) Return on Equity**

Historically, the Commission has primarily relied upon the Discounted Cash Flow ("DCF") Method of determining the appropriate return on equity ("ROE") for a regulated utility company. The Company, the Staff and the OPC all recommend that the Company rely primarily upon the DCF Method to establish the appropriate return on equity in this case.

The objective of the DCF Method is to determine the discount rate that equates anticipated future cash flows from a company's common stock to the current market price of the common stock.

The DCF Method equation is:  $k = D_1 / P_0 + g$ , where  $k$  is the cost of common stock equity ("ROE"),  $D_1$  is the annual dividend that the company is expected to pay,  $P_0$  is the present

price of the company's common stock, and  $g$  is the expected growth in dividends continuously summed into the future.

There are three variables in the DCF Method equation, namely  $D_1$ ,  $P_0$  and  $g$ . The data that are used to determine what value to select for all of these three variables in the DCF equation should be determined as of the same date.

The Company has paid annual dividends of \$1.28 per share every year from 1993 to 2000. All parties agree that this is the proper figure to use for  $D_1$  in the DCF equation.

The DCF Method requires the use of a current spot market price for the company's common stock. However, that requirement may be relaxed, to use an average price over a longer period of time, in order to minimize the effects on the dividend yield that result from the daily volatility of the stock market, provided that the resulting price is representative of the current price of the stock.

The Company's common stock traded within a broad range during 2000, with a low price of \$18.90 per share and a high price of \$30.75 per share during the year. On January 2, 2001, the day before UtiliCorp announced the termination of its proposed merger with the Company, the price of the Company's common stock closed at \$25.4711 per share. The next morning, following UtiliCorp's announcement that it was terminating the merger, the price of the stock opened at \$20.18 per share. From January 3, 2001 until the date of the hearing on this case, the common stock generally traded in a narrow range between \$19.00 and \$20.00. On May 31, 2001, the stock price closed at \$19.75.

Company witness Dr. Donald A. Murry used stock price data for a historical period that included the first nine months of 2000. From this he concluded that the price to use in the DCF equation ranged from a low of \$18.90 to a high of \$27.10.

Staff witness Roberta A. McKiddy used stock price data for a historical period from October 1, 2000 through March 4, 2001. The average price during that time period was \$24.25, but Ms. McKiddy recommended a yield of 5.50%, thus implicitly choosing a stock price of \$23.27.

OPC witness Mark Burdette used stock price data for the six-week historical period immediately preceding the preparation of his testimony, namely February 16, 2001 to March 23, 2001. He determined that Empire's average stock price was \$19.515.

The stock price data used by Dr. Murry was the oldest of these three, with some of the prices dating back to January 1, 2000, more than 20 months ago, and therefore cannot be considered current. The stock price data used by Mr. Burdette is the most current; it all comes from 2001, and it all occurred after the termination of the UtiliCorp merger was announced.

The stock price data used by Ms. McKiddy covers a longer period of time than Mr. Burdette's data covers – about six months, both before and after the termination of the merger. The Commission finds that this period is the most representative for determining the Company's current stock price, because it minimizes the effect of the anomalies in the stock price caused by the termination of the proposed merger, while also relying on more current data.

The appropriate price ( $P_0$ ) to use in the DCF formula is \$23.27, as proposed by the Staff.

The third factor in the DCF equation,  $g$ , is an estimate of future growth. This factor should represent the estimated sustainable growth of dividends within the DCF context. Future growth may be estimated by analyzing growth over recent historical periods and by reviewing projections, by outside sources, of future Company growth.

All parties agree that it is not likely that the Company's dividends will grow within the next few years. All parties also agree, however, that a company such as Empire may expect and

experience growth, even when dividends do not increase. In such circumstances, the estimates of growth may take into consideration the expected growth of other factors, such as earnings per share or book value per share.

Staff witness McKiddy made five separate calculations of the historical growth rates of the Company's dividends per share, earnings per share and book value per share. She averaged the five results to determine that the Company's historical growth rate was 2.10% per year. Ms. McKiddy then averaged the projections of future growth rates from two outside sources to estimate that the Company's future growth rate will be 4.00% per year. Utilizing both her determination of the historical growth rate and her estimate of the future growth rate, she estimated the value of  $g$  at 3.00% to 4.00% per year.

OPC witness Burdette estimated the growth factor,  $g$ , to be 3.50%, squarely in the middle of Ms. McKiddy's range.

Company witness Murry did not separately calculate historical growth and future growth, as did Ms. McKiddy and Mr. Burdette, but rather attempted to calculate a single growth rate for a single period that includes both historical results from 1994-1996 to the present and projected future results from the present until 2003-2005. He made no attempt in his analysis to consider growth rates for book value per share. Although he looked at the growth rate for dividends per share, he did not consider dividend growth in his analysis, apparently because the growth in dividends per share over his chosen study period was 0%. Dr. Murry thus considered only the growth in earnings per share. He determined that the appropriate growth rate for Empire is 5.42% to 6.00% per year.

Dr. Murry's analysis of the growth factor,  $g$ , is deficient, because it depends entirely upon the growth of earnings per share, ignoring the growth of dividends per share and book value per

share, and because it is heavily dependent upon projections of future growth, instead of utilizing historical data. The result is a growth rate that is much higher than Empire has ever achieved in recent years, and it is unreasonable to expect Empire to achieve it.

Ms. McKiddy's recommended range is based upon multiple measures of growth (dividends per share, earnings per share and book value per share), instead of depending only on earnings per share and balances historical performance with projections of future performance. Since the Commission must determine a single value for "g", the Commission adopts the OPC's recommended growth rate "g" of 3.50% per year, which is at the mid-point of the Staff's recommended range.

Recent declines in the price of the Company's common stock would drive the yield portion of the DCF equation ( $D_1 / P_0$ ) up by about 1% (if the current price of the stock is assumed to be \$20 per share). However recent declines in the estimates by outside sources of the Company's growth rate would be approximately equal to this increase and would offset it. That is, using the DCF Method to calculate the ROE with more current stock price data would not have any significant effect on the result that is obtained.

Tests of reasonableness utilizing the risk premium method and the capital asset pricing method confirm that the ROE determined through the DCF Method is a reasonable result.

The Company's argument that this ROE is inadequate and that it "fails the basic measures of financial integrity" is unpersuasive. Although the Company's credit ratings have recently been downgraded by both Fitch and Moody's, all of the Company's securities are still classified as "investment grade," so the Company should still be able to attract capital. In fact, the Company obviously is able to attract capital, because it has done so within the last six months, through its issuance of \$50 million worth of trust preferred securities in March 2001.

There is no merit in the Company's argument that the ROE must be set at a level that will allow the Company to increase its dividend.

#### **6. State Line Power Plant and Energy Center**

**(a) What are the appropriate capital costs for inclusion in rate base for the State Line Combined Cycle Unit?**

This issue was settled among all the parties. A unanimous stipulation and agreement was filed on May 25, 2001.

**(b) What are the appropriate expenses for Operation and Maintenance at the State Line Power Plant and the Empire Energy Center?**

(Note: This matter will be addressed in the August true-up process.)

**(c) What are the appropriate in-service criteria for determining whether the new State Line Combined Cycle Unit should be included in rate base?**

This issue was settled among the parties. A stipulation and agreement was filed May 14, 2001, and the only non-signatory party did not oppose it.

#### **7. Fuel and Purchased Power Expense**

This issue was settled among all of the parties. A unanimous stipulation and agreement, covering this issue, along with class cost of service and rate design, was filed on June 4, 2001.

### **Conclusions of Law**

#### **Jurisdiction:**

The Missouri Public Service Commission has jurisdiction over The Empire District Electric Company's services, activities, and rates pursuant to Section 386.250 and Chapter 393 RSMo.

**Burden of Proof:**

Section 393.150.2 RSMo 2000 provides in part, "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the...electrical corporation...and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."

**Commission's Authority:**

Pursuant to Section 393.130.1 RSMo 2000, the Commission has authority to prohibit the implementation of electric service rates that are unjust or unreasonable.

**Stipulations And Agreements:**

The following stipulation and agreements were executed by the parties:

a) In-Service Criteria: Stipulation And Agreement Regarding In-Service Criteria, filed May 14, 2001 (not opposed). The in-service criteria identified in the stipulation and agreement are reasonable and appropriate for determining whether or not the State Line Combined Cycle plant is in service for purposes of this rate case. (Note: This question will be addressed in the August true-up process.)

b) State Line Combined Cycle Unit Capital Costs: Unanimous Stipulation And Agreement As To State Line Combined Cycle Unit Capital Costs, filed May 25, 2001. The agreement constitutes a just and reasonable settlement of this issue. (Note: Pursuant to the agreement, a minimum of \$191.9 million will be added to rate base for the State Line Combined Cycle plant, with the precise amount to be determined in connection with the August 2001 true-up process.)

c) Fuel and Purchased Power Expense and Class Cost of Service and Rate Design: Unanimous Stipulation And Agreement Regarding Fuel And Purchased Power Expense And Rate Design, filed June 4, 2001. Given the combination of the volatile natural gas and wholesale electricity markets and the relatively high vulnerability of Empire to natural gas price increases, a refundable "interim energy charge" mechanism, based on a "base" and a "forecast" value is the appropriate mechanism for recovering fuel and purchased power expense in this case. The unanimous stipulation and agreement constitutes a just and reasonable settlement of all of the indicated issues. (Note: The precise effect of the unanimous stipulation and agreement will be determined as a result of adjustments made during the true-up phase of this case.)

**Contested Issues:**

Empire is entitled to the opportunity to recover in rates the depreciation that it incurs and the Commission has broad discretion in determining depreciation. See *State ex rel. Capital City Water Co. v. Public Service Commission of Missouri*, 298 Mo. 524, 252 S.W. 446, 451-452 (Mo. banc 1922). The Missouri Supreme Court, in two separate rate cases involving regulated utilities, has approved the explanation of depreciation stated by the U.S. Supreme Court in *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151, 54 S.Ct. 658 (1934) that follows:

Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is, in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered.

(*State ex. Rel Martigney Creek Sewer Co. v. Public Service Commission*, 537 S.W.2d 388, 397 (Mo. banc 1976); *State ex rel City of St. Louis v. Public Service Commission*, 341 Mo. 920, 110 S.W.2d 749, 767-768 (banc 1937)). In this case the Commission's Staff and Empire District

Electric Company hotly contest the depreciation that Empire should be allowed to recover through Missouri customer rates.

There is competent and substantial evidence based upon the whole record for adopting the Staff's disallowance of incentive award compensation for Empire's non-union, non-officer employees for the year 2000. The Staff's adjustment is lawful, as the Missouri Supreme Court stated in *State ex rel. Hotel Continental v. Burton*, 334 S.W.2d 75, 80 (Mo.banc 1960):

. . . the commission's express statutory power to determine and prescribe just and reasonable rates and to determine what rates will permit a fair return, includes the power to determine what items should be included in a utility's operating expense and what items should be excluded, and how excluded items, if any, should be handled and treated, in order that the commission may arrive at a reasoned determination of the issue of "just and reasonable" rates.

Except when there are very unusual circumstances present, such as a change in the capital structure that is clearly an aberration and that is clearly temporary, the Commission should adopt a capital structure that corresponds with the Company's actual structure as of the true-up date. No such unusual circumstances are present in this case. Accordingly, the appropriate capital structure in this case is the actual capital structure that existed as of June 30, 2001, which is:

Common Stock Equity	(To be determined through true-up process)
Preferred Stock	(To be determined through true-up process)
Long-Term Stock	(To be determined through true-up process)
Short-Term Debt	(To be determined through true-up process)

The DCF Method is the appropriate method to use to determine what ROE the Company is authorized to earn. However, the results obtained from application of the DCF Method should be checked for reasonableness by comparison with the results obtained through other methods.

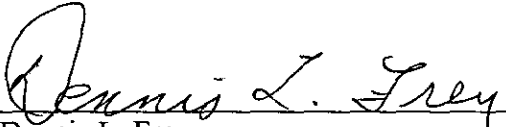
The results should also be compared with the results obtained through analysis of comparable companies and expected growth rates.

The Company's annual dividend,  $D_1$ , is \$1.28 per share. The appropriate stock price,  $P_0$ , is \$24.25. The Company's sustainable growth rate,  $g$ , is 3.50%. The appropriate ROE for Empire, determined from the DCF Method equation, is therefore:  $k = \$1.28/\text{yr.} / \$24.25 + 3.50\% = 8.78\%$ .

**WHEREFORE**, the Staff prays that the commission accept its Proposed Findings OF Fact And Conclusions OF Law as set out above.

Respectfully submitted,

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**Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 3<sup>rd</sup> day of August 2001.

Dennis L. Lry

**Service List for  
Case No. ER-2001-299  
Verified: August 3, 2001 (ccl)**

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EMPIRE DISTRICT ELECTRIC COMPANY (ER-2001-299) AVERAGE SERVICE LIVES		
ACCOUNT NUMBER	ACCOUNT	AVERAGE SERVICE LIFE (YRS)
<b>RIVERTON - STEAM PRODUCTION</b>		
311.00	STRUCTURES & IMPROVEMENTS	95.0
312.00	BOILER PLANT EQUIPMENT	54.0
314.00	TURBOGENERATOR UNITS	63.0
315.00	ACCESSORY ELECTRIC EQUIPMENT	56.0
316.00	MISCELLANEOUS POWER PLANT EQUIPMENT	51.0
Total Riverton		
<b>ASBURY- STEAM PRODUCTION</b>		
311.00	STRUCTURES & IMPROVEMENTS	95.0
312.00	BOILER PLANT EQUIPMENT	54.0
312.00	UNIT TRAIN	15.0
314.00	TURBOGENERATOR UNITS	63.0
315.00	ACCESSORY ELECTRIC EQUIPMENT	56.0
316.00	MISCELLANEOUS POWER PLANT EQUIPMENT	51.0
Total Asbury		
<b>IATAN - STEAM PRODUCTION</b>		
311.00	STRUCTURES & IMPROVEMENTS	95.0
312.00	UNIT TRAIN	0.0
312.00	BOILER PLANT EQUIPMENT	54.0
314.00	TURBOGENERATOR UNITS	63.0
315.00	ACCESSORY ELECTRIC EQUIPMENT	56.0
316.00	MISCELLANEOUS POWER PLANT EQUIPMENT	51.0
Total Iatan		
<b>OZARK BEACH - HYDRO</b>		
331.00	STRUCTURES & IMPROVEMENTS	61.0
332.00	RESERVOIRS, DAMS, & GATEWAYS	60.0
333.00	WATER WHEEL, TURBINE & GENERATOR	68.0
334.00	ACCESSORY ELECTRIC EQUIPMENT	70.0
335.00	MISCELLANEOUS POWER PLANT EQUIPMENT	41.0
Total Ozark Beach		

EMPIRE DISTRICT ELECTRIC COMPANY (ER-2001-299) AVERAGE SERVICE LIVES		
ACCOUNT NUMBER	ACCOUNT	AVERAGE SERVICE LIFE (YRS)
<b>RIVERTON - COMBUSTION TURBINE</b>		
341.00	STRUCTURES & IMPROVEMENTS	55.0
342.00	FUEL HOLDERS, PRODUCERS & ACCESSORIES	26.0
343.00	PRIME MOVERS	52.0
344.00	GENERATORS	55.0
345.00	ACCESSORY ELECTRIC EQUIPMENT	28.0
346.00	MISCELLANEOUS POWER PLANT EQUIPMENT	25.0
<b>Total Riverton C.T.</b>		
<b>ENERGY CENTER - COMBUSTION TURBINE</b>		
341.00	STRUCTURES & IMPROVEMENTS	55.0
342.00	FUEL HOLDERS, PRODUCERS & ACCESSORIES	26.0
343.00	PRIME MOVERS	52.0
344.00	GENERATORS	55.0
345.00	ACCESSORY ELECTRIC EQUIPMENT	28.0
346.00	MISCELLANEOUS POWER PLANT EQUIPMENT	25.0
<b>Total Energy Center C.T.</b>		
<b>STATE LINE - COMBUSTION TURBINE</b>		
341.00	STRUCTURES & IMPROVEMENTS	55.0
342.00	FUEL HOLDERS, PRODUCERS & ACCESSORIES	26.0
343.00	PRIME MOVERS	52.0
344.00	GENERATORS	55.0
345.00	ACCESSORY ELECTRIC EQUIPMENT	28.0
346.00	MISCELLANEOUS POWER PLANT EQUIPMENT	25.0
<b>Total State Line C.T.</b>		

EMPIRE DISTRICT ELECTRIC COMPANY (ER-2001-299) AVERAGE SERVICE LIVES		
ACCOUNT NUMBER	ACCOUNT	AVERAGE SERVICE LIFE (YRS)
<b>TRANSMISSION</b>		
352.00	STRUCTURES & IMPROVEMENTS	73.0
353.00	STATION EQUIPMENT	45.7
354.00	TOWERS & FIXTURES	77.0
355.00	POLES & FIXTURES	54.0
356.00	OVERHEAD CONDUCTOR & DEVICES	70.0
Total Transmission		
<b>DISTRIBUTION</b>		
361.00	STRUCTURES & IMPROVEMENTS	50.5
362.00	STATION EQUIPMENT	40.9
364.00	POLES, TOWERS & FIXTURES	41.1
365.00	OVERHEAD CONDUCTORS & DEVICES	47.7
366.00	UNDERGROUND CONDUIT	33.7
367.00	UNDERGROUND CONDUIT & DEVICES	27.7
368.00	LINE TRANSFORMERS	39.9
369.00	SERVICES	33.0
370.00	METERS	38.7
371.00	INSTALLATION ON CUSTOMER PREMISES	19.4
373.00	STREET LIGHTING & SIGNAL SYSTEMS	42.4
Total Distribution		
<b>GENERAL</b>		
390.00	STRUCTURES & IMPROVEMENTS	23.4
391.10	OFFICE FURNITURE & EQUIPMENT	20.8
391.20	COMPUTER EQUIPMENT	7.0
392.00	TRANSPORTATION EQUIPMENT	10.5
393.00	STORES EQUIPMENT	25.3
394.00	TOOLS, SHOP & GARAGE EQUIPMENT	40.0
395.00	LABORATORY EQUIPMENT	37.6
396.00	POWER OPERATED EQUIPMENT	15.0
397.00	COMMUNICATION EQUIPMENT	20.2
398.00	MISCELLANEOUS EQUIPMENT	26.7
Total General		
Total Plant		

EMPIRE DISTRICT ELECTRIC COMPANY (ER-2001-299) AVERAGE SERVICE LIVES		
ACCOUNT NUMBER	ACCOUNT	AVERAGE SERVICE LIFE (YRS)
<b>STATE LINE - COMBINED CYCLE</b>		
311.00	STRUCTURES & IMPROVEMENTS	35.0
312.00	BOILER PLANT EQUIPMENT	35.0
314.00	TURBOGENERATOR UNITS	35.0
315.00	ACCESSORY ELECTRIC EQUIPMENT	35.0
316.00	MISCELLANEOUS POWER PLANT EQUIPMENT	35.0
341.00	STRUCTURES & IMPROVEMENTS	35.0
342.00	FUEL HOLDERS, PRODUCERS & ACCESSORIES	35.0
343.00	PRIME MOVERS	35.0
344.00	GENERATORS	35.0
345.00	ACCESSORY ELECTRIC EQUIPMENT	35.0
346.00	MISCELLANEOUS POWER PLANT EQUIPMENT	35.0
<b>Total State Line C. C.</b>		
<b>Total Plant and State Line C.C.</b>		