

**UTILICORP UNITED INC.**  
**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

**FILED<sup>3</sup>**

JUN 26 2000

Missouri Public  
Service Commission

In the matter of the Joint Application of     )  
UtiliCorp United Inc. and St. Joseph Light     )  
& Power Company for authority to merge     )  
St. Joseph Light & Power Company with     )  
and into UtiliCorp United Inc. and, in     )  
connection therewith, certain other related     )  
transactions     )

Case No. EM-2000-292

**UtiliCorp United Inc. and St. Joseph Light & Power Company Merger**

**Surrebuttal Testimony**

June 26, 2000

**ORIGINAL**

Exhibit No.:  
Issue: Capital Structure/Cost of Capital  
Witness: Larry J. Stoll  
Sponsoring Party: St. Joseph Light & Power Company  
and UtiliCorp United Inc.  
Case No.: EM-2000-292  
Date Prepared: June 26, 2000

MISSOURI PUBLIC SERVICE COMMISSION  
Case No. EM-2000-292

Surrebuttal Testimony

of

Larry J. Stoll

Jefferson City, Missouri

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI  
SURREBUTTAL TESTIMONY OF LARRY J. STOLL  
ON BEHALF OF ST. JOSEPH LIGHT & POWER COMPANY  
CASE NO. EM-2000-292**

1 Q. Please state your name and business address.

2 A. Larry J. Stoll, 520 Francis Street, St. Joseph, Missouri.

3 Q. By whom are you employed and in what capacity?

4 A. I am employed by St. Joseph Light & Power Company ("SJLP") as Vice President-  
5 Finance, Treasurer and Assistant Secretary.

6 Q. What is the purpose of your surrebuttal testimony?

7 A. The purpose of my surrebuttal testimony is to respond to certain matters addressed in the  
8 prepared rebuttal testimony of David P. Broadwater filed in this case on behalf of the  
9 Missouri Public Service Commission Staff ("Staff"). In this regard, I have also reviewed  
10 related work papers provided to me by the Staff. I am also sponsoring Surrebuttal  
11 Schedules LJS-1 through LJS-7, which were prepared by me or under my direction and  
12 supervision.

13 General Discussion

14 Q. Please describe generally the issues presented by Mr. Broadwater's rebuttal testimony as  
15 you understand them.

16 A. Mr. Broadwater is the Staff rate of return witness. In proposing his recommendation as  
17 to an appropriate rate of return for SJLP, he has utilized SJLP's actual capital structure at  
18 December 31, 1999. I agree with his use of the actual capital structure; however, errors  
19 in amounts or calculations must be corrected. Mr. Broadwater also recommends a return  
20 on equity ("ROE") of 9.27 percent to 10.51 percent for SJLP. I do not agree that this is

1 an appropriate return for SJLP. In addition, Mr. Broadwater's recommended cost of  
2 short-term debt does not reflect current economic conditions.

3 Q. Do you have any general observations regarding his testimony?

4 A. Mr. Broadwater has developed and presented with his testimony a number of schedules  
5 which contain inappropriate assumptions, errors in data and errors in calculations which,  
6 when corrected, do not support his recommendations.

7 Historical Economic Conditions

8 Q. Do you have any comments concerning the historical economic conditions presented by  
9 Mr. Broadwater?

10 A. Yes. Mr. Broadwater spent a great deal of time recapping historical interest rates and  
11 inflation rates; however, his analysis fails to recognize the importance of the current  
12 economic conditions as opposed to what went on in the early 1980s and even the early  
13 1990s. As he correctly noted, the discount rate set by the Federal Reserve Board is one  
14 of the most commonly accepted indicators of economic conditions. During the latter half  
15 of 1999 and continuing on into 2000, the Federal Reserve has ratcheted up the discount  
16 rate a number of times. The most recent was a 50 basis point move on May 16, 2000 to  
17 6.00 percent. This rate is 100 basis points higher today than what it was at the end of  
18 1999, and 150 basis points greater than the rate used as a basis for the calculations in  
19 SJLP's last electric rate case.

20 Q. How do increases in the Federal Reserve discount rate affect a company's cost of capital?

21 A. Each increase in the Federal Reserve discount rate is generally followed by increases in  
22 the prime lending rate offered by banks throughout the nation. This, in turn, forces

1 upward pressure on other interest-bearing instruments and ultimately increases the cost of  
2 equity capital.

3 Q. Has Mr. Broadwater recognized this increase in cost of monies in his recommendation  
4 regarding SJLP's cost of capital?

5 A. No. Mr. Broadwater has chosen not to calculate the current cost of equity and has  
6 utilized a cost of short-term debt which is driven by a discount factor 100 basis points  
7 lower than what exists today.

8 Return on Equity

9 Q. If Mr. Broadwater did not calculate a current cost of equity, how did he arrive at the  
10 equity returns recommended in this case?

11 A. Mr. Broadwater indicated that because SJLP's stock price is currently trading based on an  
12 anticipation of receiving \$23 in UtiliCorp stock for each share of SJLP stock, the  
13 dividend yield portion of the DCF calculation could not be used. As a result, he chose to  
14 utilize Staff's calculation in SJLP's last electric rate case, Case No. ER-99-247, as a  
15 starting point and compared the result to the DCF calculation for five companies he has  
16 deemed comparable to SJLP.

17 Q. How do you characterize this approach?

18 A. As inappropriate.

19 Q. Why?

20 A. Mr. Broadwater failed to recognize that Staff had included March 1999 in its average  
21 stock price calculation in the last case. As a result, he has inadvertently included an  
22 impact of the merger announcement made in early March of that year. The resulting  
23 dividend yield portion of the calculation is thus understated.

1 Q. Have you corrected Staff's calculation in the last case to exclude March 1999?

2 A. Yes.

3 Q. What were the results?

4 A. Schedule LJS-1 is a copy of Staff's schedule in the last case which calculates SJLP's  
5 average stock price to be used in the dividend yield portion of the DCF calculation. I  
6 have made corrections to that schedule to exclude March 1999. The resulting dividend  
7 yield goes up by 12 basis points. Therefore, the corrected Staff recommendation in that  
8 case, adjusted to exclude the impact of the merger on SJLP's stock price, as  
9 recommended by Mr. Broadwater in this case, is 9.39 percent to 10.63 percent, as  
10 illustrated on Schedule LJS-4.

11 Q. What did Mr. Broadwater's DCF calculations for his comparable companies reveal?

12 A. Mr. Broadwater indicated that his calculations for comparable companies resulted in a  
13 return on equity in a range that would indicate a deviation from SJLP's last case was not  
14 necessary.

15 Q. Do you agree?

16 A. No. The peer group DCF calculations indicate a range of 9.52 to 11.68, significantly  
17 greater than the 9.27 to 10.51 recommended by Mr. Broadwater in this case.

18 Q. Is the peer group DCF results in this case comparable to Staff's calculation in the last  
19 rate case?

20 A. The average peer group DCF results increased from 9.41 in the last case to 10.41 in this  
21 case (See attached Schedules LJS-2 and LJS-3, which are copies of schedules filed by the  
22 Staff in SJLP's last rate case and in this case).

23 Q. What caused this change?

1 A. The dividend yield portion of the DCF calculation drove the resulting change. Because  
2 dividend yields are tied to current interest rates, and because, as Mr. Broadwater noted,  
3 current interest rates have been escalating over the past several months, the resulting cost  
4 of equity for the peer group has increased.

5 Q. What does this mean?

6 A. It means that SJLP's cost of equity should also increase.

7 Q. Why?

8 A. If the 1999 rate case DCF calculation is to be used as the basis in this case, then the range  
9 set in that case should be increased by 100 basis points to correspond with increases to  
10 those return requirements of comparable companies. Schedule LJS-4 shows the impact  
11 of correcting the dividend yield to exclude the March 1999 stock price and of increasing  
12 the ROE by the same 100 basis points as that of the peer group.

13 Q. What should be the equity return used in this case?

14 A. The return on equity should be in the range of 10.39 percent to 11.63 percent, with a mid-  
15 point of 11.01 percent.

16 Q. Is this range consistent with the range calculated by Mr. Broadwater in this case for his  
17 selected peer group?

18 A. Yes. The peer group range is from 9.52 percent to 11.68 percent. The corrected range  
19 for SJLP in this case of 10.39 percent to 11.63 percent falls inside the range Mr.  
20 Broadwater calculated for the peer group in this case.

21 Capital Structure

22 Q. What capital structure did Mr. Broadwater recommend in this case?

23 A. He recommended the use of SJLP's actual capital structure at December 31, 1999.

1 Q. Were the amounts shown by Mr. Broadwater correct?

2 A. No. The amounts he shows for common equity and short-term debt on his Schedule 11  
3 are incorrect. In addition, the long-term debt shown on that schedule, which is calculated  
4 on his Schedule 12-1, is also incorrect.

5 Q. Have you corrected Mr. Broadwater's schedules to reflect actual amounts?

6 A. Yes. Schedules LJS-5 and LJS-6 show the corrections to the data and calculations.

7 Q. What is the resulting actual capital structure at December 31, 1999.

8 A. The common equity percent is 54.92, the long-term debt is 38.17 percent and the short-  
9 term debt is 6.91 percent.

10 Embedded Cost of Long-Term Debt

11 Q. What embedded cost of debt did Mr. Broadwater recommend in this case?

12 A. Mr. Broadwater recommended 8.14 percent.

13 Q. Was Mr. Broadwater's calculation of 8.14 percent done correctly?

14 A. No. Mr. Broadwater erroneously added the Unamortized Debt Issuance Expense and the  
15 Unamortized Losses on Required Debt to the principal amounts outstanding, even though  
16 his schedule indicates such amounts should be deducted.

17 Q. Have you corrected Mr. Broadwater's calculation?

18 A. Yes. Schedule LJS-6 is a copy of Mr. Broadwater's Schedule 12-1, corrected for his  
19 error.

20 Q. What should the corrected embedded cost of long-term debt be?

21 A. As shown on Schedule LJS-6, the corrected embedded cost of long-term debt should be  
22 8.44 percent.



Cost of Short-Term Debt

1

2 Q. What cost of short-term debt did Mr. Broadwater use in this case?

3 A. Mr. Broadwater used 6.32 percent.

4 Q. Do you agree with the use of this cost in this case?

5 A. No. SJLP's short-term interest rates float with the current costs of monies. As a result,  
6 the three increases in the Federal Funds rates since December 31, 1999 have increased  
7 the Company's cost of short-term borrowing.

8 Q. What is the average cost of short-term borrowing following the last Federal Funds  
9 increase?

10 A. On May 16, 2000 (date of latest increase), SJLP's average short-term borrowing rate was  
11 7.03 percent.

12 Q. Should the current short-term borrowing rate of 7.03 percent be used to examine revenue  
13 requirements in this case?

14 A. Yes. As noted by Mr. Broadwater, current economic conditions should drive the basis  
15 for the cost of money in this case.

16 Cost of Capital

17 Q. Mr. Broadwater, on page 25 of his testimony, indicated that his return range is based on  
18 the current and projected economic conditions. How do you respond?

19 A. I disagree. As previously illustrated, Mr. Broadwater took an equity return that was  
20 calculated in early 1999 and has adopted it in its entirety without modification to reflect  
21 current economic conditions. Likewise, he utilized a cost of short-term debt which is  
22 based on a historical interest rate level which does not exist today.

1 Q. Have you corrected Mr. Broadwater's cost of capital calculation to correct for the errors  
2 noted and to adjust SJLP's equity return and cost of short-term debt for current economic  
3 conditions?

4 A. Yes. Schedule LJS-7 is a copy of Mr. Broadwater's Schedule 21 and shows that the  
5 Staff's cost of capital range, when corrected for the errors noted, should be in the range of  
6 9.42 percent to 10.10 percent, with a mid-point of 9.76 percent.

7 Q. What is the impact of correcting Staff's cost of capital on SJLP's electric revenue  
8 requirement as calculated by the Staff?

9 A. Staff's Accounting Schedule 1-1, sponsored by Steve Traxler, shows that SJLP has  
10 excess revenues of \$60,000 to \$1,635,000 with a mid-point of \$836,000. Correcting Mr.  
11 Broadwater's errors would result in the need for a rate increase of \$250,000 to  
12 \$1,850,000 with a mid-point of \$1,050,000.

13 Q. Would the results be similar for the Natural Gas and Steam operations of SJLP?

14 A. Yes. The Natural Gas operations, when corrected for Mr. Broadwater's errors, would  
15 result in the need for a rate decrease of \$23,000 to a rate increase of \$27,000 with a mid-  
16 point of \$2,000. The Steam operations would need a rate increase of \$57,000 to  
17 \$105,000 with a mid-point of \$81,000.

18 Q. If the proposed acquisition of SJLP is not consummated, is it likely that SJLP will seek  
19 an immediate rate increase?

20 A. Yes.

21 Q. Does this conclude your Surrebuttal Testimony?

22 A. Yes.

**Monthly High / Low Average Dividend Yields  
for St. Joseph Light and Power Company**

	(1)	(2)	(3)	(4)	(5)
<u>Month / Year</u>	<u>High Stock Price</u>	<u>Low Stock Price</u>	<u>Average High / Low Price</u>	<u>Expected Dividend 1999</u>	<u>Projected Dividend Yield</u>
December 1998	18.000	17.563	\$17.782	\$1.00	5.62%
January 1999	17.938	17.500	\$17.719	\$1.00	5.64%
February 1999	17.438	15.500	\$16.469	\$1.00	6.07%
<del>March 1999</del>	<del>21.600</del>	<del>16.875</del>	<del>\$18.938</del>	<del>\$1.00</del>	<del>5.28%</del>
Average					<u>5.72</u> <u>5.66%</u>

Projected Dividend Yield  
for St. Joseph Light and Power Company: 5.72  
5.66%

Notes: Column 3 = [ ( Column 1 + Column 2 ) / 2 ].

Column 4 = Estimated Dividends Declared per share represents the projected dividends for the 12 months ended December, 1999.

Column 5 = ( Column 4 / Column 3 ).

Sources: Standard & Poor's Corporation's Security Owner's Stock Guide,  
and Telescan Inc.'s Wall Street City Database System.

ST. JOSEPH LIGHT & POWER COMPANY  
CASE NO. ER-99-247

**DCF Estimated Costs of Common Equity  
for the Six Comparable Electric Utility Companies**

	(1)	(2)	(3)	(4)	(5)
Company Name	Expected Annual Dividend	Average High/Low Stock Price	Projected Dividend Yield	Average of Historical & Projected Growth	Estimated Cost of Common Equity
Black Hills Corporation	\$1.02	\$24.266	4.20%	4.74%	8.95%
Cleco Corporation	\$1.63	\$31.781	5.13%	4.22%	9.35%
Hawaiian Electric	\$2.50	\$37.469	6.67%	2.61%	9.28%
Idaho Power	\$1.86	\$33.172	5.61%	3.03%	8.64%
Minnesota Power	\$2.06	\$36.399	5.66%	4.69%	10.35%
Western Resources	\$2.14	\$31.203	6.86%	3.06%	9.92%
Average			<u>5.69%</u>	<u>3.73%</u>	<u>9.41%</u>

Notes: Column 1 = Estimated Dividends Declared per share represents the average projected dividends for 1998 and 1999.

Column 3 = ( Column 1 / Column 2 ).

Column 5 = ( Column 3 + Column 4 ).

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, November 20, 1998 December 11, 1998 and January 8, 1999.

Column 2 = Schedule 23.

Column 4 = Schedule 22.

UtiliCorp United Inc. & St. Joseph Light & Power Company  
EM-2000-292

**DCF Estimated Costs of Common Equity  
for the Five Comparable Companies**

	(1)	(2)	(3)	(4)	(5)
Company Name	Expected Annual Dividend	Average High/Low Stock Price	Projected Dividend Yield	Average of Historical & Projected Growth	Estimated Cost of Common Equity
Black Hills Corporation	\$1.09	\$22.648	4.81%	4.74%	9.55%
Cleco Corporation	\$1.70	\$32.359	5.25%	4.26%	9.52%
Hawaiian Electric Industries	\$2.48	\$28.203	8.79%	2.89%	11.68%
Minnesota Power	\$1.07	\$16.859	6.35%	4.79%	11.14%
OGE Energy	\$1.33	\$18.937	7.02%	3.14%	10.16%
			<u>6.45%</u>	<u>3.96%</u>	<u>10.41%</u>
Average					

Notes: Column 1 = Estimated Dividends Declared per share represents the average projected dividends for the last three quarters of 1999 and the first quarter of 2000.

Column 3 = ( Column 1 / Column 2 ).

Column 5 = ( Column 3 + Column 4 ).

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, February 18, 2000 and April 7, 2000.

Column 2 = Schedule 23.

Column 4 = Schedule 22.

ST. JOSEPH LIGHT & POWER COMPANY  
CASE NO. EM-2000-292

Corrected Staff Recommended Return on Equity

	<u>Return on Equity Range</u>		
Staff Recommended Return on Equity Case No. ER-99-247	9.27%	9.89%	10.51%
Adj. to Eliminate March 1999 From the Dividend Yield Calculation	<u>0.12%</u>	<u>0.12%</u>	<u>0.12%</u>
Corrected 1999 Recommendation	9.39%	10.01%	10.63%
Adj. To Reflect Peer Group Movement From Case No. ER-99-247 to Current Calculation Per Staff	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>
Corrected Return on Equity to Reflect Current Economic Conditions	10.39%	11.01%	11.63%

**Capital Structure as of December 31, 1999  
for St. Joseph Light and Power Company (Consolidated Basis)**

<u>Capital Component</u>	<u>Amount in Dollars</u>	<u>Percentage of Capital</u>
Common Stock Equity	96,187,818 <del>\$95,805,325</del>	54.92 <del>53.99%</del>
Preferred Stock	0	0.00%
Long-Term Debt	66,861,585 <del>69,338,415</del>	38.17 <del>39.07%</del>
Short-Term Debt	12,101,424 <del>12,309,411</del>	6.91 <del>6.94%</del>
<b>Total Capitalization</b>	<b>175,150,827 <u><u>\$177,453,151</u></u></b>	<b><u><u>100.00%</u></u></b>

**Financial Ratio Benchmarks  
Total Debt / Total Capital - Including Preferred Stock**

Standard & Poor's Corporation's  
Utility Rating Service 9/30/98  
Electric Utility Companies  
(Average Business Position)

<u>AA</u>	<u>A</u>	<u>BBB</u>
42%	56%	63%

Embedded Cost of Long-Term Debt as of December 31, 1999  
for St. Joseph Light and Power Company

	(1)	(2)	(3)
	Interest	Principal	Annualized
Long-Term Debt	Rate	Amount Outstanding (12/31/99)	Cost to Company (1 * 2)
First Mortgage Bonds:			
9.44% Series due February 1, 2021	9.440%	\$22,500,000	\$2,124,000
5.85% Series due February 1, 2013	5.850%	5,600,000	327,600
Medium-Term Notes			
7.13% Series due November 29, 2013	7.130%	1,000,000	71,300
7.16% Series due November 29, 2013	7.160%	3,000,000	214,800
7.16% Series due November 29, 2013	7.160%	3,000,000	214,800
7.16% Series due November 29, 2013	7.160%	3,000,000	214,800
7.17% Series due December 1, 2023	7.170%	2,000,000	143,400
7.17% Series due December 1, 2023	7.170%	5,000,000	358,500
7.33% Series due November 30, 2023	7.330%	3,000,000	219,900
8.36% Series due March 15, 2005	8.360%	20,000,000	1,672,000
Less: Unamortized Debt Issuance Expense		438,009	
Less: Unamortized Losses on Reacquired Debt		800,406	
Add: Annual Amortized Debt Issuance Expense			35,774
Add: Annual Amortized Losses on Reacquired Debt Expense			48,100
Total		<u>\$69,338,415</u>	<u>\$5,644,974</u>
		66,861,585	
			\$5,644,974
	Embedded Cost of Long-Term Debt	=	<u>\$69,338,415</u>
			66,861,585
		=	8.44%
			8.44

Notes:

See Schedule 12-2 for the amounts of the Unamortized Premium & Debt Discount and the Annual Amortized Debt Discount Expense.

Sources: St. Joseph Light and Power Company's response to Staff's Data Information Requests No. 3802.



**Weighted Cost of Capital as of December 31, 1999  
for St. Joseph Light and Power Company (Consolidated Basis)**

Capital Component	Percentage of Capital	Embedded Cost	Weighted Cost of Capital Using Common Equity Return of:		
			10.39 9.27%	11.01 9.89%	11.63 10.51%
Common Stock Equity	54.92 53.99%	—	5.71 5.00%	6.05 5.34%	6.39 5.67%
Preferred Stock	0.00%	0.00%	0.00%	0.00%	0.00%
Long-Term Debt	38.17 39.87%	8.44 8.14%	3.22 3.18%	3.22 3.18%	3.22 3.18%
Short-Term Debt	6.91 6.94%	7.03 6.32%	-49 0.44%	-49 0.44%	-49 0.44%
Total	<u>100.00%</u>		<u>9.42 8.62%</u>	<u>9.76 8.96%</u>	<u>10.10 9.29%</u>

**Notes:**

See Schedule 11 for the Capital Structure Ratios.

See Schedule 12-1 for the Embedded Cost of Long-Term Debt.

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


In the Matter of the Joint Application of     )  
UtiliCorp United Inc. and St. Joseph     )  
Light & Power Company for Authority to     )  
Merger St. Joseph Light & Power Company     )  
with and into UtiliCorp United Inc., and,     )  
in Connection Therewith, Certain Other     )  
Related Transactions.     )

Case No. EM-2000-292

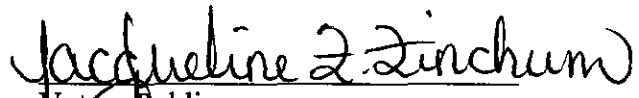
County of Buchanan     )  
   )  
State of Missouri     )

**AFFIDAVIT OF LARRY J. STOLL**

**Larry J. Stoll, being first duly sworn,** deposes and says that he/she is the witness who sponsors the accompanying testimony entitled "Capital Structure/Cost of Capital"; that said testimony was prepared by him/her and/or under his/her direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he/she would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his/her knowledge, information, and belief.

  
\_\_\_\_\_

Subscribed and sworn before me this 19<sup>th</sup> day of June, 2000.

  
\_\_\_\_\_  
Notary Public

My Commission expires:

June 16, 2002

