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September 17, 2001

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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

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of **STAFF'S SUPPLEMENTAL 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

Dennis L. Frey
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DLF:sw
Enclosure
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

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

COMES NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission"), and for its Supplemental Proposed Findings Of Fact And Conclusions Of Law, respectfully states as follows:

On August 3, 2001, pursuant to the procedural schedule adopted in this case, the Staff filed its Proposed Findings Of Fact And Conclusions Of Law. On August 23, 2001, the true-up hearing was held, and briefs dealing with true-up issues were filed on September 4, 2001.

On September 11, 2001, the Commission issued its Order Directing Filing, in which it requested, but did not order, that the parties file supplemental proposed findings of fact and conclusions of law that incorporate the issues addressed in the true-up hearing. Accordingly, the proposals below update the aforementioned August 3rd filing based on the issues raised during the true-up phase of this proceeding; namely, "capital structure/cost of capital" and "property taxes." Except as specified below, the Staff continues to support its Proposed Findings Of Fact And Conclusions Of Law, filed on August 3rd.

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Findings of Fact

Under Section 5-a ("Capital Structure") of Staff's Proposed Findings Of Fact And Conclusions Of Law, the fourth paragraph on Page 10 is revised to read in full as follows:

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

Common Stock Equity	$231,960,394	37.76%
Preferred Stock (TOPrS)	48,442,500	7.88%
Long-term debt	334,006,533	54.36%
Short-term debt	0	0
Total capitalization	$614,490,427	100.00%"

The following Section 5-c should be inserted after Section 5-b in Staff's Proposed Findings Of Fact And Conclusions Of Law:

5-c) Embedded Cost of Trust Preferred Stock

In March 2001, the Company issued $50,000,000 of Trust-Originated Preferred Securities ("TOPrS), which pay a dividend of 8.5% per year. Although the TOPrS pay a dividend, they have many of the characteristics of debt, and they are a hybrid, neither debt nor equity. Staff witness McKiddy, Company witness Gibson, and OPC witness Burdette all testified that the TOPrS are more like debt than they are like equity. (Tr. 1218, line 24 – Tr. 1219, line 3; Tr. 1209, line 10 – Tr. 1210, line 2; Tr. 1225, lines 21-23).

The Commission finds that, for the purpose of determining their embedded cost, TOPrS should be regarded as long-term debt rather than as equity. The proper method of calculating the embedded cost of long-term debt is to deduct the unamortized debt issuance expense from the amount outstanding and then include a yearly amortization expense. (Tr. 1227, line 23 – Tr. 1228, line 8). The embedded cost of the TOPrS is 8.88%. (McKiddy True-Up Direct, Ex. 124, Sch. 5).

The following Section 8 should be inserted after Section 7 (p. 16) in Staff's Proposed Findings Of Fact And Conclusions Of Law:

8. Property Taxes

The amount of property taxes to be paid at year-end 2001 is based on the assessment of eligible property as of January 1, 2001. (Boltz True-Up Surrebuttal, Ex. 123, p. 2). The amount of property taxes to be paid at year-end 2002 will be based on the assessment of eligible property as of January 1, 2002. (Boltz True-Up Surrebuttal, Ex. 123, p. 2; Tr. 1148). There are no assessments for property tax purposes between January 1, 2001 and January 1, 2002. (Boltz True-Up Surrebuttal, Ex. 123, p. 2). The operation of law date in this case is October 2, 2001.

In computing property taxes for inclusion in cost of service, the Staff divided the amount of property taxes actually paid in the year 2000 by the total actual balance of Empire's electric property as of January 1, 2001. The Staff's computation is based on known and measurable factors.

By capitalizing the property taxes paid on construction in progress, the Staff's approach accounts for the full value of the new State Line Combined Cycle unit, as of the last assessment made of Empire's property at the true-up cut-off. (Boltz True-Up Surrebuttal, Ex. 123, pp. 7-8).

The Company seeks to include in the amount of property taxes to be recognized as an expense item, an estimate of the tax to be paid on the State Line Combined Cycle unit based on an estimate of the assessed value of the unit as of January 1, 2002, as well as an estimate of the then-applicable tax rate. The amount of property taxes of which the Company seeks inclusion in cost of service is not known and measurable.

No party, including the Company, seeks inclusion in cost of service of any other cost or revenue item that does not occur on or before July 31, 2001, the end of the agreed-upon and ordered true-up period.

The payment of the estimated amount of property tax at issue would not occur until approximately seventeen months after the close of the update period and fifteen months after the operation of law date. During this period, there could well be other cost or revenue effects that would offset any increased revenue requirement resulting from SLCC property taxes, but no attempt has been made to take account of such costs.

Inclusion of the property taxes at issue as an expense item would violate the matching principle, in that reflecting an expense for property taxes out through 2002 would not be consistent with the timing of the measurement of other expense, revenue and rate base items, which were reflected at a point no later than July 31, 2001.

In past rate cases the Commission has never ordered the inclusion in cost of service of costs to be incurred after the operation of law date, let alone costs *estimated* to be incurred fifteen months thereafter. (Tr. 1179).

The Staff's treatment of property taxes is consistent with its past practice as well as with past Commission decisions. (Boltz True-Up Surrebuttal, Ex. 123, pp. 9-10).

<u>Conclusions of Law</u>

The second full paragraph on page 19 is revised to read in full as follows:

"Except where 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	37.76%
Preferred Stock (TOPrS)	7.88%
Long-term debt	54.36%
Short-term debt	0
Total capitalization	100.00%"

The full paragraph on page 20 of the Staff's Proposed Findings of Fact and Conclusions of Law should be changed to correct a typographical error, and as revised, it should read in full as follows:

"The Company's annual dividend, D1, is \$1.28 per share. The appropriate stock price, P0, is \$23.27. The Company's sustainable growth rate, g, is 3.505. The appropriate ROE for Empire, determined from the DCF Method equation, is therefore: k= \$1.28/yr. / \$23.27 + 3.50% = 8.78%."

The following paragraph should be added at the end of the section on "Conclusions of Law" (p.20):

The record contains competent and substantial evidence to support the fact that Staff's treatment of property taxes is reasonable and appropriate. (Mo. Const., Art. V, Sec. 18 (1945), as amended; Section 393.130.1 RSM0 2000).

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 17th day of September 2001.

Dennis L. Frey

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Case No. ER-2001-299
Verified: September 17, 2001 (ccl)

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