BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the tariff filing of The Empire District Electric Company to implement a general rate increase for retail electric service provided to customers in its Missouri service area.	)))))	Case No. ER-2004-0570

APPLICATION FOR REHEARING

COMES NOW The Empire District Electric Company ("Empire" or "Company"), by and through the undersigned counsel, pursuant to RSMo. §386.500, 4 CSR 240-2.080, and 4 CSR 240-2.160, and respectfully applies to the Public Service Commission of the State of Missouri (the "Commission"), to grant rehearing with respect to its *Report and Order* (the "*Order*") issued in the above-captioned case on March 10, 2005, to be effective March 27, 2005.

The Order represents a positive step forward with respect to utility regulation and moves Missouri closer to the mainstream with respect to return on equity, depreciation rates and timely recovery of volatile fuel costs. Empire anticipates, however, that other parties to this case are likely to request rehearing and ultimately seek judicial review of the Order. For this reason, Empire is compelled to submit this application for rehearing.

In this regard, Empire submits that competent and substantial evidence consisting of the average of the recommendations of Empire's two cost of capital witnesses, Dr. Vander Weide (11.3 percent) and Dr. Murry (12.0 percent), demonstrates that the appropriate cost of common equity for Empire is 11.65 percent. The competent and substantial evidence also demonstrates that Empire should be allowed the opportunity to earn an overall rate of return of 9.54 percent, as illustrated below.

	Ratio	Cost	Weighted Cost
Long-Term Debt	43.89%	7.25%	3.18%
Preferred Securities	6.30%	8.93%	0.56%
Common Equity	49.81%	11.65%	5.80%
Total	100.00%		9.54%

To the extent that the Commission gave no weight to the testimony of Empire witness Dr. Murry due to its belief that he relied exclusively on a company specific DCF model, the Commission erred. Although Dr. Murry relied primarily on the results of his DCF analyses using forecasted earnings per share information and current market prices, Dr. Murry also estimated the cost of common equity for Empire using alternative methodologies and then compared those results to results from similar calculations for a group of comparable companies. Dr. Murry's comparable companies were selected on the basis of being financially healthy electric utilities with financial and business risk similar to those of Empire. Dr. Murry put all of his calculations in the perspective of current market conditions and the financial circumstances of Empire. Unlike Staff witness Murray and Public Counsel witness Allen, Dr. Murry did not rely solely on his company-specific DCF analysis. Therefore, his cost of equity recommendation of 12 percent should have been given considerable weight.

The Commission did properly recognize the validity of the risk-based comparative analysis performed by Empire witness Dr. Vander Weide, and the Commission's decision correctly gave weight to his expert testimony. However, Dr. Vander Weide's recommended upward adjustment of 60 basis points to 11.3 percent (from the 10.7 percent average cost of equity for his proxy companies) should not have been disregarded by the Commission. Dr. Vander Weide's 60 basis point adjustment and his 11.3 percent ROE recommendation are based on the fact that Empire's capital structure contains significantly more leverage than the average capital structures of his proxy companies. He therefore concluded an upward ROE adjustment

(to 11.3 percent) is necessary in order to allow Empire's investors an opportunity to earn a commensurate return on their investment. The average of Dr. Vander Weide's 11.3 percent recommendation and Dr. Murry's 12 percent recommendation is 11.65 percent.

While the majority properly relies upon the expert testimony of Dr. Vander Weide, correctly recognizes the significance of the *Hope* and *Bluefield* decisions, and gives appropriate weight to the evidence regarding the national average for ROEs, the dissent fails in this regard. In fact, the dissent improperly relies on statistics and other information not in the record. The dissent also cites two rate case decisions - a Kansas case involving Aquila, Inc. ("Aquila") and a Missouri case involving Missouri Gas Energy ("MGE") - as a basis for its conclusion concerning an appropriate ROE. In the Aquila case, the Kansas Corporation Commission authorized an ROE of 10.5 percent on a capital structure consisting of 33.6% equity. In the MGE case, this Commission authorized an ROE of 10.5 percent with a capital structure consisting of 29% equity. The MGE decision has been reversed by the Circuit Court of Cole County.

The dissent apparently fails to recognize that the 10.5 ROE awards in the Aquila and MGE decisions do not satisfy the standards of *Hope* and *Bluefield.* In fact, in the MGE case on review the Circuit Court of Cole County, citing *Hope* and *Bluefield,* held:

> Authorizing a ROE of 10.50 percent for MGE is arbitrary, capricious, and unlawful, and is not based on competent or substantial evidence. Imposing a ROE on MGE below the 11.1 percent national average, coupled with the imposition of a 'more risky' 29.99 percent equity-based capital structure, is unlawful, unreasonable, arbitrary, capricious and not based on competent or substantial evidence.

Given that the Circuit Court of Cole County has ruled that the 10.5 percent ROE award for MGE is inadequate and unlawful given MGE's more risky capital structure (29% equity), it follows that the same rationale would apply to the Aquila decision.

The dissent is also critical of Empire's management decisions concerning natural gas generation. Setting aside for a moment the fact that Empire has a long history of efficient management,[1] and that customer complaints are practically non-existent[2] the criticism is still unwarranted. The Company's generation plans were presented to the Staff and others as a part of Empire's resource planning process prior to construction of these facilities. Furthermore, Empire's investment in gas fired generation took place at time of very low natural gas prices and no prudence challenges have been made regarding the Company's decisions with respect to particular plant additions. In addition, the record in this case fails to support a finding of improper management on this or any other issue. In fact, Staff testimony in this proceeding reflects that Empire has been "efficient" with respect to its natural gas hedging program (Tr. 631-632, 645) and the Public Counsel agreed that Empire has not been imprudently managed (Tr. 1572).

The dissent's suggestion that the Commission must use the recommendations of its "objective Staff" and may not rely on testimony from a witness who has been hired by a party with "a monetary interest in the outcome"[3] is alarming. Taken to its logical conclusion, this would mean that in any proceeding the Commission will not rely on company testimony, nor on testimony offered by the Public Counsel or any other party with "a monetary interest in the outcome." This approach to adjudication, which runs contrary to the long history of regulation in this state, would constitute a denial of the procedural due process rights of parties appearing before the Commission. Pursuant to the Fifth and Fourteenth Amendments to the Constitution, a

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[1] *See In the matter of The Empire District Electric Company of Joplin*, Case No. ER-83-42, 1983 Mo.PSC Lexis 49; 26 Mo. PSC (N.S.) 58, where the Commission authorized an upward adjustment to the Company's return on equity for management efficiency.

[2] Empire's average number of complaints with the Commission has been below one per 1,000 customers in five of the last six full years, and is continuing that trend during the first eight months of 2004. Kiebel Direct Testimony, Ex. 53, p. 19.

[3] *See Dissenting Opinion of Commissioners Gaw and Clayton*, page 12.

party with a property interest at stake must receive the procedural safeguards that the Due Process Clause requires. The Due Process Clause requires a fair and impartial tribunal. Moreover, pursuant to RSMo. 393.150.2, an electrical corporation bears the burden of proving that a proposed increased rate is just and reasonable. It would be difficult to satisfy this burden if the corporation is, in essence, told ahead of time that its own witnesses and experts "are suspect in their agenda" and that the corporation must therefore rely on the witnesses offered by the Staff.

The dissent incorrectly suggests that the majority has decided not to use the DCF model in future rate cases because of flaws and shortcomings in Staff's and Public Counsel's company-specific DCF analyses. The *Order* properly renounces the exclusive use of a company-specific DCF analysis as the basis for an ROE determination and correctly recognizes the significance of the *Hope* and *Bluefield* decisions as related to expert testimony and ROE. The Commission correctly recognizes that a comparative analysis is required under *Hope* and *Bluefield* and that a utility must be allowed the opportunity to earn a return which is sufficient to ensure confidence in its financial integrity.

The dissent concludes that the *Order* sends a signal to Missouri utilities that the "welcome matt (sic) is out and the days of generally lower than average utility rates in Missouri are over." If, however, Missouri regulated utilities have consistently provided service at lower than average rates, part of the cause may be the fact that in the past the Commission authorized lower than average returns on equity. It is unclear how the dissent can conclude that the standards of *Hope* and *Bluefield* may be satisfied by a commission that consistently authorizes lower than average ROEs.

The majority correctly recognizes that the Commission cannot authorize returns "commensurate with returns on investments in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprises, so as to maintain its credit and to attract capital,"[4] while at the same time guaranteeing Missouri ratepayers lower than average rates. The majority correctly recognizes that the Commission has a duty to balance the interest of the ratepayers with that of the shareholders[5] and that the interests of customers are not the only factors in considering the public interest. The majority correctly recognizes that the Commission must insure just and reasonable rates, while considering whether the rate will allow the company to maintain its financial integrity, attract necessary capital, fairly compensate investors for the risk they assume, and protect the relevant public interest.[6]

WHEREFORE, The Empire District Electric Company respectfully requests that the Missouri Public Service Commission grant rehearing with respect to its *Report and Order* issued in the above-captioned case on March 10, 2005, for the purpose of rehearing the cost of capital issues raised herein and upon rehearing a new order be issued consistent with this pleading.

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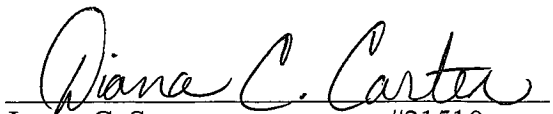
[4] *See, Federal Power Commission v. Hope Natural Gas Company*, 320 US 591 (1944); *see also, Bluefield Waterworks v. Public Service Commission,* 262 US 679 (1923).
[5] *State ex rel. Union Electric Company v. Missouri Public Service Commission*, 765 S.W.2d 618, 625 (Mo.App. W.D. 1988)
[6] *Id.*

Respectfully submitted,



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ATTORNEYS FOR THE EMPIRE DISTRICT ELECTRIC COMPANY

Certificate of Service

I hereby certify that the foregoing has been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record on the 25th day of March, 2005.