

Exhibit No.: _____
Issue: Property Taxes, Capital
Structure
Witness: David W. Gibson
Type of Exhibit: True-Up Rebuttal Testimony
Sponsoring Party: The Empire District Electric
Company
Case No.: ER-2001-299
Date Prepared: August 13, 2001

Before the Public Service Commission
Of the State of Missouri

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Service Commission

True-up Rebuttal Testimony

of

David W. Gibson

August 13, 2001

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
TRUE-UP REBUTTAL TESTIMONY OF DAVID W. GIBSON
ON BEHALF OF THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

1 Q. STATE YOUR NAME AND ADDRESS PLEASE.

2 A. David W. Gibson. My business address is 602 Joplin Street, Joplin, Missouri.

3 Q. ARE YOU THE SAME DAVID W. GIBSON WHO HAS PREVIOUSLY
4 SUBMITTED DIRECT REBUTTAL AND SURREBUTTAL TESTIMONY IN THIS
5 CASE?

6 A. Yes, I am.

7 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?

8 A. Witnesses for the Staff and the Public Counsel filed true-up direct testimony on
9 August 7. I will be providing Empire's rebuttal to certain portions of that true-up
10 direct testimony. I will be rebutting the amount of property taxes included in the true-
11 up. I will also address the testimony of Staff witness Roberta A. McKiddy concerning
12 her recommendation on the capital structure to be used in this case.

13

14

PROPERTY TAXES

15

16 Q. DO YOU AGREE WITH THE PROPERTY TAX EXPENSE THAT WAS
17 INCLUDED IN THE TEST YEAR TRUE-UP?

18 A. No, I do not. The amount of property taxes included in the test year was not updated
19 to reflect the substantial amount of new property taxes Empire will be required to pay
20 due to the addition of the new State Line Combined Cycle ("SLCC") plant. As the
21 Commission is aware, Empire pays property taxes based on the value of its property.
22 With the addition of over \$98,000,000 for the SLCC plant, which is now on-line and

1 providing service to Empire's customers, Empire's property tax payments to the
2 various political subdivisions in the state in Empire's service area will increase
3 substantially. The failure of the Staff to provide an updated amount of property tax in
4 the cost of service to reflect this substantial property addition is, in my view, a clear
5 violation of the matching principle whereby revenues are based or "matched" with
6 their associated rate base and expenses. In this case, revenue levels have been
7 recommended by the Staff and OPC based on the completion of the new SLCC plant.
8 Also included are fuel costs, reduced purchased power capacity costs, and other
9 revenue and expense effects of this new power plant. The Staff, however, has ignored
10 the property taxes that will be paid as a direct result of this plant being built.

11 Q. PLEASE EXPLAIN?

12 A. The property taxes that are included in the Staff's case for the test year ending
13 December 31, 2000 reflect plant balances as of December 31, 2000. The property
14 taxes associated with the new SLCC plant have not been included in the true-up.

15 Q. HOW DOES THAT HAPPEN?

16 A. Property taxes are based on not only plant in service, but also on any amounts of
17 Construction Work in Progress (CWIP) that the Company has at the beginning of the
18 calendar year. This means that Empire will pay property taxes during the year 2001
19 for the new State Line plant even though it was not included in plant in service until
20 later in the year.

21 Q. PLEASE EXPLAIN.

22 A. First of all, a distinction needs to be made between property taxes paid and property
23 taxes that are expensed. The Company capitalized, during 2001, an amount of taxes
24 which was attributable to the new State Line plant. This will be paid during 2001.
25 During 2001, the Company will pay approximately \$2,230,000 in property taxes
26 attributable to SLCC which were capitalized during 2001. The following table depicts

the total amount of property taxes that the Company has incurred since 1996 and the amounts accrued during the test year ending June 30, 2001.

	<u>1996 *</u>	<u>1997 *</u>	<u>1998 *</u>	<u>1999 *</u>	<u>2000 *</u>	<u>2001 **</u>
Electric	5,725,1390	5,600,347	6,175,726	7,107,179	6,632,627	6,708,703
Water	57,503	50,741	53,581	62,420	67,072	74,110
E-Watch			2,366	2,366	2,366	2,366
Non-utility	319	320	321	307	346	340
Unit Trains	45,838	38,100	40,269	45,791	53,024	53,030
Clearing	3,123	1,823	4,707	3,805	0	-1,506
Construction	<u>256,523</u>	<u>576,769</u>	<u>125,896</u>	<u>235,853</u>	<u>977,529</u>	<u>2,229,378</u>
Total	6,088,446	6,268,099	6,402,866	7,457,721	7,732,964	9,066,421

* - Year ending 12-31.

** - Year ending 6-30

Q. PLEASE EXPLAIN THE PREVIOUS TABLE.

A. The table shows total property taxes by category (i.e. electric, water etc.) for the calendar years 1996 through 2000. The amounts shown for 2001 represent the amounts for the period ending June 30, 2001. As can be seen, the amount charged to construction during the test year is substantially higher than that experienced during the previous years. The amounts shown as electric represent the amounts that would have been expensed during the indicated period. If we were to accept the Staff recommendation, then the Company's rates would be set at a level which would only cover those costs during the test year and not those which will be experienced in 2001 as a result of the new plant in service.

Q. ARE CAPITALIZED TAXES RECOVERED THROUGH THE ADDITION OF PLANT TO RATE BASE?

A. Yes, the amount of capitalized property taxes is added to the applicable plant asset and recovered in rates through the life of the asset. The distinction here is that the question is over the amount of taxes which will be recovered as an ongoing expense. Revenues and other expenses have been adjusted to reflect the addition of the State Line plant, but this has not been the case with property taxes.

1 Q. PLEASE EXPLAIN.

2 A. As I mentioned before, the property taxes for the test year ending December 31, 2000
3 are based on plant balances as of December 31, 2000. Thus, the rate base in the test
4 year has been updated for the period through June 30, 2001 but no increase has been
5 reflected for the property taxes that will be paid as a result of these plant additions.

6 Q. WHAT IS YOUR RECOMMENDATION AS TO THE PROPER LEVEL OF TAX
7 TO BE INCLUDED IN THIS CASE?

8 A. Total Company property taxes should be increased by the amount of additional tax
9 capitalized attributable to SLCC or approximately \$1,027,000.

10 Q. WHAT ASSURANCE DOES THE COMMISSION HAVE THAT THIS IS A
11 KNOWN AND MEASURABLE ITEM OF EXPENSE?

12 A. I have always heard that the only two known and "certain" things in life are death and
13 taxes. We are talking about taxes here. The amount of increase in taxes due to the
14 additional plant was calculated by taking the amount of plant in service times the
15 property tax rate at the end of 1999. This was then subtracted from the amount of
16 property taxes that the Staff included for the end of December 2000. The only
17 difference in this calculation and the original Staff calculation was the amount of plant
18 in service. In this instance, the same plant balance that was used by the Staff for the
19 true-up was used to calculate the additional property taxes.

20 Q. ISN'T IT POSSIBLE THAT THESE TAXES MAY DECREASE?

21 A. As can be seen from the preceding table, property taxes have increased since 1996.
22 That time period includes the last addition to generation facilities in 1997. Our
23 assessed valuation for property in service at the end of 2000 has increased by over
24 15% over the prior year. The bulk of that increase is attributable to SLCC.

25

26

27

CAPITAL STRUCTURE

Q. ARE THERE ANY ITEMS IN THE CAPITAL STRUCTURE DISCUSSED BY MS. MCKIDDY IN HER TRUE-UP TESTIMONY WITH WHICH YOU DISAGREE?

A. Yes, Ms. McKiddy in her true-up testimony calculated the capital structure to be that which is in effect at June 30, 2001. The basic problem with this is that it does not represent a "normal" capital structure for Empire. As has been pointed out previously in this case, a normal capital structure should be used by the Commission in this case. The effect of using an abnormal capital structure for Empire coupled with an abnormally low return on equity does not result in a fair and reasonable rate of return.

Q. WHY DO YOU SAY THAT IT DOES NOT RESULT IN A FAIR AND REASONABLE RATE OF RETURN?

A. Ms. McKiddy recommends a fair return based on a common equity percent of 37.76%. She mentioned in her surrebuttal testimony that the average common equity percentage in the capital structure for all electric utilities was 38%. The data that she used to justify this was prepared by C. A. Turner Utility Reports. What she neglected to mention in her use of that 37.76% figure was that the return on equity for those utilities that made up the data in the C. A. Turner Utility Reports was 13.2%. I have attached a copy of the pertinent part of the C. A. Turner Utility Reports which shows this as Schedule DWG -1. Obviously, the 13.2% return on equity percentage that goes with the 37.76% figure she used is substantially more than she is recommending in this case. She also failed to mention that the authorized return for those companies according to C. A. Turner Utility Reports was 11.91%. Therefore, I think that it is inconsistent and inappropriate for Ms. McKiddy to conclude that the capital structure she recommends is normal, when the equity percentage she selectively relies upon is derived from data which also shows that the average return on common equity earned

1 by those same companies is fully 3.7% higher than her high end recommendation and
2 the authorized return for those same companies is fully 2.4% higher.

3 Q. WHY DO YOU BELIEVE HER USE OF THE DATA IN THAT FASHION IS
4 INCONSISTENT AND INAPPROPRIATE?

5 A. Just as a company is not allowed to obtain rate relief based on a single issue while at
6 the same time ignoring other related matters, the same should hold true for any
7 analysis that is performed on its capital structure. In this instance, it appears that
8 pertinent and directly related data associated with a lower common equity ratio was
9 ignored by Ms. McKiddy. The result of this misuse of data to justify a particular
10 capital structure is not something that this Commission should sanction.

11 Q. WHAT HAS HAPPENED TO THE COMMON EQUITY BALANCE SINCE THE
12 END OF DECEMBER 2000?

13 A. The balance for common equity at the end of December 2000 was \$240,152,911. The
14 amount was correctly identified by OPC witness Mr. Mark Burdette. Ms. McKiddy
15 erroneously stated that the amount of common equity was \$220,578,999. Since the
16 end of the year, common equity has continued to decrease to \$231,960,394. The
17 reason for this decline was not addressed by either witness and no attempt to adjust for
18 the abnormality was made. The reason for the decrease is that earnings have not been
19 sufficient to cover dividends.

20 Q. WHAT IS THE CAPITAL STRUCTURE THAT YOU ARE RECOMMENDING?

21 A. The capital structure that I am recommending for the true-up is 45% common equity,
22 7.9% trust preferred and 47.1% long-term debt. This was supported in my rebuttal
23 and surrebuttal testimony which was previously filed.

24 Q. DOES THIS CONCLUDE YOUR TRUE-UP REBUTTAL TESTIMONY?

25 A. Yes, it does.

ELECTRIC

COMPANY	OPER REV \$ MILL. (1)	% ELEC REV (2)	NET PLANT \$ MILL. (3)	NET PLANT PER \$ REV (4)
ALLETE (NYSE-ALE)	1,331.9	44	1,479.7	1.11
American Electric Power Co. (NYSE-AEP)	13,723.0	75	22,070.0	1.61
Bangor Hydro-Electric Co. (NYSE-BOR)	206.3	100	231.8	1.12
Black Hills Corporation (NYSE-BKH)	1,235.9	12	777.0	0.58
Central Vermont Public Serv. Corp. (NYSE-CV)	362.6	100	310.6	0.86
Cleco Corporation (NYSE-CNL)	741.4	81	1,254.3	1.69
DPL Inc. (NYSE-DPL)	1,437.0	86	2,382.1	1.66
DQE, Inc. (NYSE-DQE)	1,333.9	80	1,688.0	1.27
DTE Energy Company (NYSE-DTE)	5,597.0	77	7,327.0	1.31
Edison International (NYSE-EIX)	11,635.0	66	17,618.2	1.51
El Paso Electric Company (NYSE-EE)	508.4	99	1,381.2	2.72
Empire District Electric Co. (NYSE-EDE)	250.3	99	588.4	2.75
FirstEnergy Corporation (NYSE-FE)	7,001.7	79	7,499.6	1.07
FPL Group, Inc. (NYSE-FPL)	7,082.0	80	9,642.0	1.36
GPU, Inc. (NYSE-GPU)	5,571.6	66	6,964.6	1.25
Green Mountain Power Corp. (NYSE-GMP)	271.8	100	193.9	0.71
Hawaiian Electric Industries, Inc. (NYSE-HE)	1,719.0	73	1,661.7	0.97
IDACORP, Inc. (NYSE-IDA)	768.1	96	1,781.2	2.32
IPALCO Enterprises, Inc. (NYSE-IPL)	842.8	96	1,732.3	2.06
Kansas City Power & Light Co. (NYSE-KLT)	931.8	100	2,480.8	2.66
Maine Public Service Company (NYSE-MAP)	71.5	84	43.5	0.61
OGE Energy Corp. (NYSE-OGE)	3,298.7	47	3,228.6	0.98
Otter Tail Power Company (NYSE-OTTR)	359.4	45	513.9	0.92
Pinnacle West Capital Corp. (NYSE-PNW)	3,690.2	95	4,947.2	1.34
Potomac Electric Power Co. (NYSE-POM)	2,623.9	87	4,564.0	1.74
Southern Company (NYSE-SO)	23,472.7	72	25,119.4	1.07
UIL Holdings Corporation (NYSE-UIL)	811.8	97	530.7	0.65
Unisource Energy Corporation (NYSE-UNS)	945.0	100	1,712.6	1.81
Western Resources, Inc. (NYSE-WR)	2,246.4	75	3,965.6	1.77
AVERAGE				

COMPANIES

S&P BOND RATING	MOODY'S BOND RATING	COMMON EQUITY RATIO (3)	% RETURN ON BOOK VALUE COMMON EQUITY (4)	TOTAL CAPITAL	REGULATION ALLOWED ROE	ORDER DATE
BBB+	Baa1	49	16.6	11.2	11.60	11/94
A-	A3	33	9.4	8.4	12.25	
BBB	NA	42	10.8	8.2	11.00	11/99
A+	A1	38	18.3	12.3		06/95
BBB+	NA	47	7.7	8.9	11.00	12/98
A+	A2	38	14.6	9.8	12.25	10/96
BBB+	Aa3	23	14.9	11.9	13.00	02/92
BBB	A3	33	16.4	11.2	12.87	03/88
A-	A3	45	10.9	8.6		06/00
A+	A1	21	13.9	9.6	11.60	06/99
BBB	Baa3	36	13.5	10.7		
A-	A3	39	10.0	8.4	11.25	
BB+	Baa3	38	12.9	9.7	13.79	
AA-	Aa3	54	13.8	10.5	11.00	3/99
A+	A2	31	2.8	5.7	11.73	
BBB	Ba1	46	NM	4.4	11.25	03/98
BBB+	A3	21	11.5	4.8	11.30	
AA-	A2	45	17.3	11.3		
AA-	Aa2	46	27.7	15.3		08/95
A	A1	40	16.5	9.6	12.90	01/98
NA	NA	51	13.3	10.4	10.70	12/99
A+	Aa3	37	14.4	9.8	14.14	
AA-	Aa3	51	18.9	13.4	12.00	
A-	Baa1	50	13.3	9.9	11.25	08/98
A	A1	33	9.3	7.8	11.01	
AA-	A1	31	14.0	9.2	12.71	
BBB+	A3	44	12.2	9.5	11.50	12/96
BBB	Ba2	15	10.8	8.4		03/96
BBB	Ba2	34	3.9	6.2		
		38	13.2	9.5	11.91	

Schedule DWG-1

AFFIDAVIT

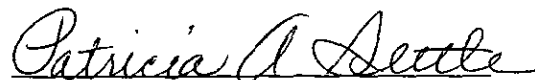
STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 13th day of August, 2001, before me appeared David W. Gibson, to me personally known, who, being by me first duly sworn, states that he is the Vice President - Finance of The Empire District Electric Company and acknowledged that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.



David W. Gibson

Subscribed and sworn to before me this 13th day of August, 2001.



Patricia A. Settle, Notary Public

My Commission expires: August 16, 2002.

