

Exhibit No.:
Issue: Rate of Return
Payroll Adjustments
Witness: Myron W. McKinney
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District
Case No.: ER-2001-299
Date Prepared: May 2, 2001

**Before the Public Service Commission
of the State of Missouri**

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Missouri Public
Service Commission

Rebuttal Testimony

of

MYRON W. MCKINNEY

May 2001

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF MYRON W. MCKINNEY
ON BEHALF OF THE EMPIRE DISTRICT ELECTRIC COMPANY**

CASE NO. ER-2001-299

1 Q. PLEASE STATE YOUR NAME.

2 A. Myron W. McKinney.

3 Q. ARE YOU THE SAME MYRON W. MCKINNEY WHO SUBMITTED DIRECT
4 TESTIMONY IN MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION")
5 CASE NO. ER-2001-29 ON BEHALF OF THE EMPIRE DISTRICT ELECTRIC
6 COMPANY ("EMPIRE")?

7 A. Yes, I am.

8 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS CASE?

9 A. To respond to the direct testimony of Commission Staff witness Janis E. Fischer
10 regarding certain adjustments to Empire's cost of service in the area of payroll and to
11 memorialize some areas of agreement. I also will rebut the reasonableness of Staff's
12 proposed rate of return in this case as proposed by Staff witness Roberta McKiddy.

13 **RATE OF RETURN**

14 Q. DO YOU AGREE WITH THE RATE OF RETURN RECOMMENDED BY MS.
15 MCKIDDY FOR EMPIRE IN THIS CASE?

16 A. No, I do not, but rather than focus my criticism on the methodology involved, I would
17 simply ask the Commission to look at the overall reasonableness of the impact of
18 applying Ms. McKiddy's proposed rate of return, coupled with other proposed Staff
19 adjustments, on Empire's 2000 financial results.

1 Q. PLEASE EXPLAIN.

2 A. For the calendar year 2000, which also happens to be the test year in this proceeding,
3 Empire earned \$23.6 million net to common, which represents earnings of \$1.35 per
4 share or a return on equity ("ROE") of 9.8%. Applying even the high end of Staff's
5 recommended ROE range (9.5%) in this case, coupled with other Staff adjustments to the
6 test year, would have resulted in earnings of \$13.4 million or about \$0.76 per share for
7 year 2000. Seventy-six cents per share compares to a dividend payout (which has not
8 been increased since October of 1992) of \$1.28 per share. Clearly, when seen in this
9 light, the result of the Staff's proposed rate of return is not fair and reasonable. Mr.
10 David Gibson and Dr. Donald Murray discuss the flaws in the Staff's methodology in
11 detail in their rebuttal testimonies but, obviously, the result of this extremely low ROE
12 recommendation fails any sort of a first screen for reasonableness.

13 In summary, the Staff's proposed ROE will bring about unacceptable financial results,
14 will prevent Empire from having an opportunity to earn a reasonable return and will
15 provide no cushion for investors from economic events that may impact Empire's
16 revenues.

17 Q. ARE THERE ANY SPECIFIC FLAWS IN MS. MCKIDDY'S ANALYSIS WHICH
18 YOU WISH TO ADDRESS?

19 A. Yes. For purposes of her calculations, Ms. McKiddy used Empire's stock price data for
20 the period October 2000 through March 4, 2001. This time period includes share price
21 data prior to the termination of Empire's proposed merger with UtiliCorp United Inc.
22 ("UtiliCorp"). As a consequence, she has used stock price information which does not
23 represent the value of Empire's common stock at the present time or in the reasonably

1 foreseeable future. This mistake, when plugged into her analysis, is partly to blame for
2 her unreasonable ROE recommendation.

3 Q. ARE YOU FAMILIAR WITH SCHEDULE DAM-25 TO THE REBUTTAL
4 TESTIMONY OF DONALD MURRAY?

5 A. Yes. It is a graph that shows Empire's daily closing stock price for the period October
6 2000 through March 2001. I have attached that document to my testimony as Schedule
7 MWM-1.

8 Q. CAN YOU EXPLAIN SOME OF THE RATHER EXTREME FLUCTUATIONS IN
9 THE PRICE OF EMPIRE STOCK CONTAINED IN THE SCHEDULE?

10 A. Yes. It can be readily seen that from October 2000 forward the Empire stock price was
11 gradually working up toward the \$29.50 level which was the price announced at the time
12 the merger agreement with UtiliCorp was signed. However, in late November 2000 the
13 market became concerned with rumors that UtiliCorp might not be inclined to proceed
14 with the merger. These rumors were driven to some degree by perceived disagreement
15 between UtiliCorp and St. Joseph Light & Power Company ("SJLP") regarding the
16 repairs and resulting condition of the SJLP Lake Road plant. However, after UtiliCorp
17 announced in mid-December that it did intend to close the SJLP merger, Empire shares
18 increased to a level of \$26.31 at the end of the year. On January 2, 2001, after trading
19 closed on the New York Stock Exchange, UtiliCorp announced it was terminating the
20 Empire merger. Empire stock had closed at \$25.875 on that day. The following day,
21 January 3, 2001, Empire shares fell to \$20.00 and closed at that level, after heavy trading
22 of over one million shares. Since January 3, 2001, Empire shares have traded in a fairly

1 narrow range between \$17.50 and \$20.00, but certainly nowhere near the \$26.00 level
2 which is included in Staff ROE testimony and analysis.

3 **PAYROLL ADJUSTMENTS**

4 Q. DO YOU AGREE THAT STAFF WITNESS JANIS FISCHER HAS CAPTURED ALL
5 THE ELEMENTS OF EMPIRE'S PAYROLL IN HER ANNUALIZATION OF
6 PAYROLL?

7 A. No, I believe an additional incentive compensation adjustment of approximately
8 \$323,000 which was provided to Empire's non-bargaining unit employees in February of
9 2001 was not included in the Staff's annualization. This payment is typically made in
10 February for employees who have achieved certain predetermined goals during the
11 preceding year. This payment is an integral part of Empire's Pay for Performance Plan
12 which rewards high performing employees with incentive payments. Ms. Fischer has
13 indicated that she will review the payment and it may be included in the Staff's June 30
14 true-up calculation. If it is not, this item will continue to be an issue in this case.

15 Q. ARE THERE OTHER AREAS OF CONCERN REGARDING THE ANNUALIZATION
16 OR THE TRUE-UP?

17 A. Yes. On page 14 of her direct testimony, Ms. Fischer discusses the process for filling
18 vacancies in the salary base. Although Empire is making an effort to fill vacancies as
19 quickly as possible, some vacancies will remain on the June 30, 2001 cut-off date. I
20 would simply request that the Staff, and ultimately the Commission, allow inclusion of
21 salaries in situations where Empire can clearly demonstrate that an active search is
22 ongoing, or that a vacancy occurred due to the transfer of an internal applicant to fill an
23 existing vacancy.

REBUTTAL TESTIMONY
MYRON W. MCKINNEY

1 Q. IS THERE ANOTHER AREA OF CONCERN WITH PAYROLL?

2 A. Yes. The exclusion of payments under the Management Incentive Plan ("MIP") was a
3 matter of disagreement. However, after discussion with Staff at the Prehearing
4 Conference, Company and Staff have agreed on an adjustment of \$22,479 which would
5 be included in future Staff calculations of payroll.

6 Q. ARE THERE OTHER AREAS IN MS. FISCHER'S TESTIMONY YOU WISH TO
7 ADDRESS?

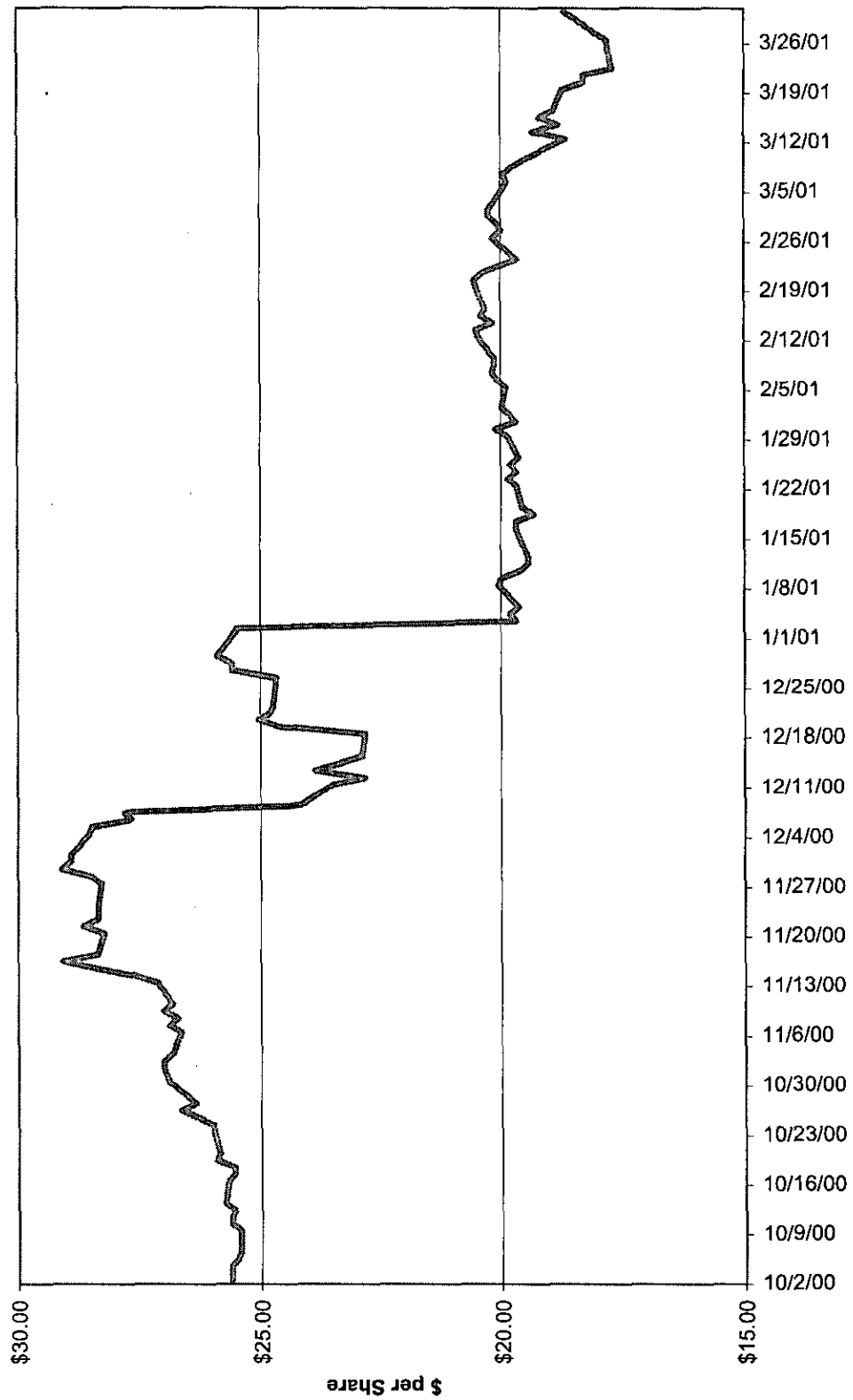
8 A. Only one. In the Adjustments for Outside Services, Ms. Fischer excluded the cost for the
9 PricewaterhouseCoopers audit of the Centurion Customer Information System and the
10 PeopleSoft installation. It is my understanding that after additional discussions between
11 Empire and Staff, that Staff is allowing a five-year amortization of this expenditure and
12 that allowance will be included in further Staff runs. This treatment will resolve this
13 issue from Empire's standpoint.

14 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY AT THIS TIME?

15 A. Yes.

Schedule DAM 25

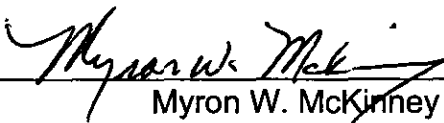
Empire Daily Closing Price
October 2000 through March 2001



AFFIDAVIT

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 2nd day of May, 2001, before me appeared Myron W. McKinney, to me personally known, who, being by me first duly sworn, states that he is the President and Chief Executive Officer 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.


Myron W. McKinney

Subscribed and sworn to before me this 2nd day of May, 2001.


Patricia A. Settle, Notary Public

My commission expires: August 16, 2002.

