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Issue: Reason for Rate Case

Witness: W. L. Gipson

Type of Exhibit: Direct Testimony

Sponsoring Party: Empire District

Case No.

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

**Direct Testimony**

**of**

**W. L. Gipson**

**February 2006**

*Empire* Exhibit No. 5  
Case No(s). EP-2006-0315  
Date 9-05-06 Rptr PF

DIRECT TESTIMONY  
OF  
W. L. GIPSON  
THE EMPIRE DISTRICT ELECTRIC COMPANY  
BEFORE THE  
MISSOURI PUBLIC SERVICE COMMISSION  
CASE NO.

1   **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2   A. William L. Gipson, 602 Joplin Street, Joplin, Missouri 64801.

3   **Q. WHO IS YOUR EMPLOYER AND WHAT POSITION DO YOU HOLD?**

4   A. The Empire District Electric Company ("Empire" or "Company") is my employer. I hold the  
5   position of President and Chief Executive Officer.

6   **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

7   A. I hold a Bachelor of Science Degree in Business Management Technology and an Associate  
8   Degree in Computer Science from Missouri Southern State College (now University) in  
9   Joplin, Missouri.

10   **Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.**

11   A. Prior to joining Empire I worked for an international furniture manufacturing company and a  
12   regional bank. I joined Empire as a Computer Programmer in 1981. I have held positions in  
13   Information Services, Economic Development and Operations. My employment with  
14   Empire has been continuous since 1981.

15   **Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THIS OR ANY**  
16   **OTHER REGULATORY BODY?**

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1 A. Yes, I have presented testimony before the Missouri Public Service Commission  
2 ("Commission"), the Kansas Corporation Commission, the Oklahoma Corporation  
3 Commission, and the Arkansas Public Service Commission.

4 **Q. MR. GIPSON, WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

5 A. The purpose of my testimony is to provide the background for Empire's decision to request  
6 rate relief.

7 **Q. PLEASE DESCRIBE EMPIRE.**

8 A. Empire is a Kansas corporation with its principal office and place of business at 602 Joplin  
9 Street, Joplin, Missouri 64802. Empire is engaged in the business of providing electrical  
10 utility services in Missouri, Kansas, Arkansas and Oklahoma; water utility services in  
11 Missouri; and has a certificate of service authority issued by the Commission to provide  
12 certain telecommunications services. In addition, Empire has entered into an agreement  
13 with Aquila, Inc. ("Aquila") to acquire Aquila's natural gas distribution operations in  
14 Missouri. A Commission ruling on the acquisition, case no. GO-2006-0205, is expected in  
15 mid 2006.

16 **Q. WILL YOU PLEASE DESCRIBE THE AREA SERVED BY EMPIRE AND GIVE A**  
17 **BRIEF DESCRIPTION OF THE CUSTOMERS SERVED.**

18 A. Empire provides electric service in an area of approximately 10,000 square miles in  
19 southwest Missouri and the adjacent corners of the states of Kansas, Oklahoma, and  
20 Arkansas. Empire's operations are regulated by the utility regulatory commissions of these  
21 four states as well as the Federal Energy Regulatory Commission ("FERC"). The area  
22 embraces 121 incorporated communities in 20 counties in the four-state area. Most of the

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1 communities in the service area are small, with only 29 containing a population in excess of  
2 1,500. Only 10 communities have a population in excess of 5,000, and the largest city is  
3 Joplin, Missouri, with a population of approximately 45,500 at year end 2004.

4 The area economy is diversified. The service territory features small to medium  
5 manufacturing operations, medical, agricultural, entertainment, tourism, and retail interests  
6 all contributing to average or above-average customer growth over the last several years.

7 At September 30, 2005, Empire served 135,222 residential customers, 23,773  
8 commercial customers, 366 industrial customers, 1,861 public authority customers, and four  
9 v/holesale customers throughout our system. In Missouri, Empire served 118,631 residential  
10 customers, 20,968 commercial customers, 294 industrial customers, 1,503 public authority  
11 customers, and three wholesale customers. In addition to electric service, Empire also  
12 provides regulated water service to approximately 4,500 customers in the Missouri  
13 communities of Aurora, Marionville, and Verona.

14 **Q. ARE ANY OF YOUR CUSTOMERS ALSO SHAREHOLDERS OF EMPIRE?**

15 A. Yes. Of the 4.9 million shares held by registered shareholders, over 2.1 million are held by  
16 Missouri investors, with approximately 897,000 held by registered shareholders in our  
17 service territory. The majority of the registered shareholders within our Missouri service  
18 territory are individual investors who, on average, own less than 500 shares each. Of those

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same investors, nearly one third own 100 shares or less. Please see the table below.

Number of Shares	Registered Shareholders	
	Missouri	MO Service Territory
100 or less	711	540
101 - 500	804	582
501 - 1000	347	271
1001 - 5000	415	344
Greater than 5000	81	69
Total	2,358	1,806

**Q. HOW MUCH OF A RATE INCREASE IS EMPIRE REQUESTING?**

A. Empire is requesting an overall increase in its Missouri retail rates of \$29,513,713 million, approximately a 9.63 percent increase.

**Q. WHY DOES EMPIRE NEED A MISSOURI RETAIL RATE INCREASE AT THIS TIME?**

A. The major factors driving the need for a Missouri rate increase at this time are increases in both fuel and purchased energy costs. In our last electric rate case, in the spring of 2005, the Commission authorized an Interim Energy Charge ("IEC"), which was designed to recover the level of fuel and energy costs that were foreseen at that time. As natural gas prices and purchased power costs, which are driven in part by natural gas prices, have continued to surge upward, beyond what was foreseen last spring, Empire's fuel and energy costs have exceeded the ceiling price established in the IEC. Given the absence of a fuel adjustment mechanism in Missouri, a general rate proceeding is Empire's only means of recovering the additional fuel and energy costs that exceed the ceiling established in the IEC.

**Q. DOES EMPIRE HAVE A NATURAL GAS HEDGING PROGRAM IN PLACE?**

A. Yes. We have had an active natural gas hedging program in place since 2001. Mr. Brad Beecher of Empire described this program in detail during the last general electric rate case.

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1 Mr. Todd Tarter will present testimony about our Energy Risk Management policy in this  
2 proceeding.

3 **Q. How has the program worked?**

4 A. Ey and large the company has been successful in delaying the impact of the increase in  
5 natural gas prices we are currently seeing. However, as natural gas prices have continued to  
6 climb, the associated cost increases must be reflected in the rates we charge for electricity if we  
7 are to have reasonable opportunity to recover our costs and earn a fair return for our shareholders.

8 **Q. HOW HAS EMPIRE ADDRESSED SENATE BILL 179 IN THIS RATE FILING?**

9 A. On July 14, 2005, Governor Matt Blunt signed into law Senate Bill 179, enabling the  
10 Commission to promulgate rules that would allow electric utilities in Missouri the  
11 opportunity to recover fuel and purchased power costs through an energy cost recovery  
12 mechanism outside of a general rate case. The Commission Staff, starting in August of this  
13 year, began a series of meetings in Jefferson City with all of the various parties interested in  
14 the new energy cost recovery rule in an effort to see if any consensus could be reached  
15 between the various parties prior to the official start of the formal rulemaking process.  
16 Empire has participated in all of those meetings. It is our understanding that the formal start  
17 of the rulemaking process concerning energy cost recovery is imminent and should be  
18 completed by mid 2006. Empire, as part of this rate case, is requesting that our current IEC  
19 be replaced by an Energy Cost Recovery rider or tariff ("ECR") that will be constructed to  
20 comply with the Commission rules on energy cost recovery. Mr. Scott Keith will address  
21 the ECR Empire is requesting in detail in his testimony.

1 **Q. WHAT OTHER FACTORS ARE DRIVING EMPIRE'S REQUEST FOR A RATE**  
2 **INCREASE?**

3 A. Cost of capital, payroll, and various other expenses have risen somewhat. However,  
4 excluding fuel, our operation and maintenance expenses have risen less than 1% since our  
5 last rate case, Case No. ER-2004-0570, which had a test year ending December 2003. We  
6 have worked diligently to control these expenses. Fuel is the area in which we are  
7 experiencing excessively higher costs.

8 **Q. PLEASE ELABORATE ON EMPIRE'S HIGHER FUEL COSTS.**

9 A. As stated by Company witness Todd Tarter, "The costs of nearly all forms of fuel, including  
10 fuel oil and coal, have been rising recently, but the key drivers are certainly the rapid  
11 increases in natural gas and purchased power prices." The average price of on-system fuel  
12 and purchased power, including demand charges, at YTD November 2005 was  
13 \$28.30/MWh; an increase of 34% over the TME December 2003 average price of  
14 \$21.15/MWh.

15 **Q. WHAT IS EMPIRE DOING TO MITIGATE THE INCREASES IN NATURAL GAS**  
16 **PRICES?**

17 A. As indicated, Empire is attempting to control the volatility associated with fuel costs  
18 through the use of a natural gas hedging program which has been in place since 2001. In  
19 addition, Empire began receiving wind energy from the Elk River Wind Farm in October  
20 2005. These tools aid in mitigating price volatility and provide price stability for Empire  
21 and our customers. Empire witness Todd Tarter explains the hedging program, wind  
22 energy, and additional measures utilized to manage fuel costs in his direct testimony.

1 **Q. WHAT IS EMPIRE RECOMMENDING RELATED TO THE RECOVERY OF**  
2 **FUTURE INCREASES AND DECREASES IN FUEL AND ENERGY PRICES?**

3 A. Again, Empire is requesting implementation of an ECR as contemplated by Senate Bill  
4 179. Not only will the ECR provide a timely recovery of fuel and purchased-power  
5 expense, but it will also protect customers from high prices being locked into base rates  
6 during a period of declining energy prices. As stated earlier, Mr. Scott Keith will address  
7 details of the ECR in his testimony.

8 **Q. WHAT IS YOUR UNDERSTANDING AS TO HOW RATING AGENCIES VIEW**  
9 **ENERGY COST RECOVERY MECHANISMS?**

10 A. Rating agencies have a positive view of energy cost recovery mechanisms because they  
11 allow for timely recovery of fuel and purchased power costs. As such, they view passage of  
12 Senate Bill 179 as a very positive step for regulation in the state of Missouri. According to  
13 Standard & Poor's , "A regulatory weakness has been Missouri's lack of a permanent fuel  
14 adjustment clause (FAC), but recently enacted legislation provides for the authorization of  
15 FACs that should improve cost recovery and bolster cash flow" (RATINGSDIRECT, June  
16 27, 2005).

17 **Q. WHAT WILL HAPPEN TO THE RATES CHARGED TO EMPIRE'S MISSOURI**  
18 **ELECTRIC CUSTOMERS IF EMPIRE'S NATURAL GAS COSTS DECREASE**  
19 **FROM THE HIGH LEVELS THAT ARE DRIVING THIS RATE CASE?**

20 A. The rates charged to the Missouri retail customers to recover energy costs will go down.  
21 Again, Empire as part of this filing is requesting that it be allowed to implement an ECR as  
22 contemplated by Senate Bill 179. As envisioned in the legislation, as fuel and energy costs



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1 move up and down so do the electric rates used to recover these costs. Not only will the  
2 ECR provide for a more timely and accurate recovery of fuel and purchased-power  
3 expense, but it will also protects the customers from the potential for unnecessarily high  
4 base electric rates due to high energy costs at the time of a general rate filing.

5 **Q. WHAT IS THE COMPANY'S PROPOSED RETURN ON EQUITY ("ROE") IN**  
6 **THIS CASE?**

7 A. Empire is proposing an ROE of 11.7 percent. In his direct testimony, Company witness Dr.  
8 James H. Vander Weide explains why 11.7 percent is appropriate for Empire. The  
9 Company's ability to provide its customers with reliable electric power service is directly  
10 dependant upon the allowed ROE and cost recovery. If Empire is to continue to provide our  
11 customers with the outstanding level of service they have come to expect the Company must  
12 be able to finance significant capital projects.

13 **Q. DOES EMPIRE NEED ADDITIONAL CAPACITY?**

14 A. Yes, the Company will need additional capacity in 2010.

15 **Q. PLEASE EXPLAIN EMPIRE'S NEED FOR CAPACITY IN 2010.**

16 Currently, Empire has a contract with Westar Energy for 162 MW of energy supplied from  
17 the Jeffrey Energy Center. This contract will expire May 31, 2010. Based on Empire's  
18 current energy needs and expected growth the capacity and energy associated with this  
19 contract will need to be replaced.

20 **Q. HOW DOES EMPIRE PROPOSE TO ADDRESS FUTURE CAPACITY NEEDS?**

21 A. We intend to meet future capacity needs of our customers through a combination of direct  
22 investment in generating facilities and longer-term capacity and energy contracts. In addition to

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1 moving forward on the construction of a new generating unit at Riverton, Kansas, Empire has  
2 signed a letter of intent with Kansas City Power & Light Company that provides the Company  
3 with an ownership interest in 100 MW from the proposed Iatan2 coal unit. Also, the Company  
4 issued a Request for Proposals ("RFP") for base load energy and capacity beginning 2010. We  
5 have shared the responses to our RFP with the Commission Staff, the Office of Public Counsel  
6 and other parties involved in Case No. ER-2005-0263. Company witness, Todd Tarter, discusses  
7 in detail the future capacity needs and possible solutions in his testimony.

8 **Q. ARE YOU REQUESTING ANY AMORTIZATION TO MEET FINANCIAL RATIO**  
9 **TARGETS AS PROVIDED FOR IN CASE NO. EO-2005-0263?**

10 A. Not in the initial rate filing. Empire is currently working with the parties involved in the  
11 regulatory plan on how to best meet the future capacity requirements. At this point, these plans  
12 may include a new purchased power contract. According to Standard & Poor's *Utilities &*  
13 *Perspectives*, May 12, 2003, "Standard & Poor's Ratings Services views electric utility  
14 purchased-power agreements ("PPA") as debt-like in nature...". From the point a commitment  
15 on the new contract is made, the rating agencies may adjust their financial ratio calculations to  
16 accommodate the new power contract. If Empire finalizes the details of the new contract within  
17 the true-up period, we recommend that this be taken into account as a true-up adjustment.

18 **Q. ARE THERE ANY OTHER COMMENTS YOU WOULD LIKE TO MAKE?**

19 A. Yes, I would like to reiterate the importance of implementing the ECR. Allowing Empire to  
20 recover fuel and purchased power expense through an ECR will result in fewer general rate  
21 cases, improve our credit profile and increase our financial flexibility. Implementation of

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1 the ECR will allow us to continue to provide exceptional service to our customers and  
2 provide financial stability with an equitable rate of return to our shareholders.

3 At twelve month ending ("TME") December 31, 2005, the actual average rate for our  
4 Missouri retail customers was 6.91¢/kWh. With an ECR the rate would have been  
5 7.24¢/kWh, an increase of 4.8 percent. During times of decreasing fuel and purchased  
6 power cost customer rates will decrease. For example, at TME December 2002, 6.38¢/kWh  
7 was the actual average retail rate. We refunded the amount collected from IEC to customers,  
8 reducing the average retail rate to \$5.98. However, under an ECR the average retail rate  
9 would have decreased further to 5.69¢/kWh. As you can see by employing this mechanism,  
10 both shareholders and customers are winners. Shareholders do not absorb the cost of higher  
11 fuel when prices rise and customers benefit when prices decline.

12 **Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY AT THIS**  
13 **TIME?**

14 **A.** Yes, it does.