Exhibit No.:
Issue: Capital Structure/Cost of Capital
Witness: Larry J. Stoll
Sponsoring Party: St. Joseph Light & Power Company and UtiliCorp United Inc.
Case No.: EM-2000-292
Date Prepared: June 26, 2000

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EM-2000-292

Surrebuttal Testimony

of

Larry J. Stoll

Jefferson City, Missouri

Exhibit No. 21
Date 7-13-00 Case No. EM-2000-292
Reporter na

**BEFORE THE PUBLIC SERVICE COMMISSION**
**OF THE STATE OF MISSOURI**
**SURREBUTTAL TESTIMONY OF LARRY J. STOLL**
**ON BEHALF OF ST. JOSEPH LIGHT & POWER COMPANY**
**CASE NO. EM-2000-292**

Q. Please state your name and business address.

A. Larry J. Stoll, 520 Francis Street, St. Joseph, Missouri.

Q. By whom are you employed and in what capacity?

A. I am employed by St. Joseph Light & Power Company ("SJLP") as Vice President-Finance, Treasurer and Assistant Secretary.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to respond to certain matters addressed in the prepared rebuttal testimony of David P. Broadwater filed in this case on behalf of the Missouri Public Service Commission Staff ("Staff"). In this regard, I have also reviewed related work papers provided to me by the Staff. I am also sponsoring Surrebuttal Schedules LJS-1 through LJS-7, which were prepared by me or under my direction and supervision.

<u>General Discussion</u>

Q. Please describe generally the issues presented by Mr. Broadwater's rebuttal testimony as you understand them.

A. Mr. Broadwater is the Staff rate of return witness. In proposing his recommendation as to an appropriate rate of return for SJLP, he has utilized SJLP's actual capital structure at December 31, 1999. I agree with his use of the actual capital structure; however, errors in amounts or calculations must be corrected. Mr. Broadwater also recommends a return on equity ("ROE") of 9.27 percent to 10.51 percent for SJLP. I do not agree that this is an appropriate return for SJLP. In addition, Mr. Broadwater's recommended cost of short-term debt does not reflect current economic conditions.

Q. Do you have any general observations regarding his testimony?

A. Mr. Broadwater has developed and presented with his testimony a number of schedules which contain inappropriate assumptions, errors in data and errors in calculations which, when corrected, do not support his recommendations.

<u>Historical Economic Conditions</u>

Q. Do you have any comments concerning the historical economic conditions presented by Mr. Broadwater?

A. Yes. Mr. Broadwater spent a great deal of time recapping historical interest rates and inflation rates; however, his analysis fails to recognize the importance of the current economic conditions as opposed to what went on in the early 1980s and even the early 1990s. As he correctly noted, the discount rate set by the Federal Reserve Board is one of the most commonly accepted indicators of economic conditions. During the latter half of 1999 and continuing on into 2000, the Federal Reserve has ratcheted up the discount rate a number of times. The most recent was a 50 basis point move on May 16, 2000 to 6.00 percent. This rate is 100 basis points higher today than what it was at the end of 1999, and 150 basis points greater than the rate used as a basis for the calculations in SJLP's last electric rate case.

Q. How do increases in the Federal Reserve discount rate affect a company's cost of capital?

A. Each increase in the Federal Reserve discount rate is generally followed by increases in the prime lending rate offered by banks throughout the nation. This, in turn, forces upward pressure on other interest-bearing instruments and ultimately increases the cost of equity capital.

Q. Has Mr. Broadwater recognized this increase in cost of monies in his recommendation regarding SJLP's cost of capital?

A. No. Mr. Broadwater has chosen not to calculate the current cost of equity and has utilized a cost of short-term debt which is driven by a discount factor 100 basis points lower than what exists today.

## Return on Equity

Q. If Mr. Broadwater did not calculate a current cost of equity, how did he arrive at the equity returns recommended in this case?

A. Mr. Broadwater indicated that because SJLP's stock price is currently trading based on an anticipation of receiving $23 in UtiliCorp stock for each share of SJLP stock, the dividend yield portion of the DCF calculation could not be used. As a result, he chose to utilize Staff's calculation in SJLP's last electric rate case, Case No. ER-99-247, as a starting point and compared the result to the DCF calculation for five companies he has deemed comparable to SJLP.

Q. How do you characterize this approach?

A. As inappropiate.

Q. Why?

A. Mr. Broadwater failed to recognize that Staff had included March 1999 in its average stock price calculation in the last case. As a result, he has inadvertently included an impact of the merger announcement made in early March of that year. The resulting dividend yield portion of the calculation is thus understated.

Q. Have you corrected Staff's calculation in the last case to exclude March 1999?

A. Yes.

Q. What were the results?

A. Schedule LJS-1 is a copy of Staff's schedule in the last case which calculates SJLP's average stock price to be used in the dividend yield portion of the DCF calculation. I have made corrections to that schedule to exclude March 1999. The resulting dividend yield goes up by 12 basis points. Therefore, the corrected Staff recommendation in that case, adjusted to exclude the impact of the merger on SJLP's stock price, as recommended by Mr. Broadwater in this case, is 9.39 percent to 10.63 percent, as illustrated on Schedule LJS-4.

Q. What did Mr. Broadwater's DCF calculations for his comparable companies reveal?

A. Mr. Broadwater indicated that his calculations for comparable companies resulted in a return on equity in a range that would indicate a deviation from SJLP's last case was not necessary.

Q. Do you agree?

A. No. The peer group DCF calculations indicate a range of 9.52 to 11.68, significantly greater than the 9.27 to 10.51 recommended by Mr. Broadwater in this case.

Q. Is the peer group DCF results in this case comparable to Staff''s calculation in the last rate case?

A. The average peer group DCF results increased from 9.41 in the last case to 10.41 in this case (See attached Schedules LJS-2 and LJS-3, which are copies of schedules filed by the Staff in SJLP's last rate case and in this case).

Q. What caused this change?

A. The dividend yield portion of the DCF calculation drove the resulting change. Because dividend yields are tied to current interest rates, and because, as Mr. Broadwater noted, current interest rates have been escalating over the past several months, the resulting cost of equity for the peer group has increased.

Q. What does this mean?

A. It means that SJLP's cost of equity should also increase.

Q. Why?

A. If the 1999 rate case DCF calculation is to be used as the basis in this case, then the range set in that case should be increased by 100 basis points to correspond with increases to those return requirements of comparable companies. Schedule LJS-4 shows the impact of correcting the dividend yield to exclude the March 1999 stock price and of increasing the ROE by the same 100 basis points as that of the peer group.

Q. What should be the equity return used in this case?

A. The return on equity should be in the range of 10.39 percent to 11.63 percent, with a mid-point of 11.01 percent.

Q. Is this range consistent with the range calculated by Mr. Broadwater in this case for his selected peer group?

A. Yes. The peer group range is from 9.52 percent to 11.68 percent. The corrected range for SJLP in this case of 10.39 percent to 11.63 percent falls inside the range Mr. Broadwater calculated for the peer group in this case.

Capital Structure

Q. What capital structure did Mr. Broadwater recommend in this case?

A. He recommended the use of SJLP's actual capital structure at December 31, 1999.

Q. Were the amounts shown by Mr. Broadwater correct?

A. No. The amounts he shows for common equity and short-term debt on his Schedule 11 are incorrect. In addition, the long-term debt shown on that schedule, which is calculated on his Schedule 12-1, is also incorrect.

Q. Have you corrected Mr. Broadwater's schedules to reflect actual amounts?

A. Yes. Schedules LJS-5 and LJS-6 show the corrections to the data and calculations.

Q. What is the resulting actual capital structure at December 31, 1999.

A. The common equity percent is 54.92, the long-term debt is 38.17 percent and the short-term debt is 6.91 percent.

Embedded Cost of Long-Term Debt

Q. What embedded cost of debt did Mr. Broadwater recommend in this case?

A. Mr. Broadwater recommended 8.14 percent.

Q. Was Mr. Broadwater's calculation of 8.14 percent done correctly?

A. No. Mr. Broadwater erroneously added the Unamortized Debt Issuance Expense and the Unamortized Losses on Required Debt to the principal amounts outstanding, even though his schedule indicates such amounts should be deducted.

Q. Have you corrected Mr. Broadwater's calculation?

A. Yes. Schedule LJS-6 is a copy of Mr. Broadwater's Schedule 12-1, corrected for his error.

Q. What should the corrected embedded cost of long-term debt be?

A. As shown on Schedule LJS-6, the corrected embedded cost of long-term debt should be 8.44 percent.

## Cost of Short-Term Debt

Q. What cost of short-term debt did Mr. Broadwater use in this case?

A. Mr. Broadwater used 6.32 percent.

Q. Do you agree with the use of this cost in this case?

A. No. SJLP's short-term interest rates float with the current costs of monies. As a result, the three increases in the Federal Funds rates since December 31, 1999 have increased the Company's cost of short-term borrowing.

Q. What is the average cost of short-term borrowing following the last Federal Funds increase?

A. On May 16, 2000 (date of latest increase), SJLP's average short-term borrowing rate was 7.03 percent.

Q. Should the current short-term borrowing rate of 7.03 percent be used to examine revenue requirements in this case?

A. Yes. As noted by Mr. Broadwater, current economic conditions should drive the basis for the cost of money in this case.

## Cost of Capital

Q. Mr. Broadwater, on page 25 of his testimony, indicated that his return range is based on the current and projected economic conditions. How do you respond?

A. I disagree. As previously illustrated, Mr. Broadwater took an equity return that was calculated in early 1999 and has adopted it in its entirety without modification to reflect current economic conditions. Likewise, he utilized a cost of short-term debt which is based on a historical interest rate level which does not exist today.

Q. Have you corrected Mr. Broadwater's cost of capital calculation to correct for the errors noted and to adjust SJLP's equity return and cost of short-term debt for current economic conditions?

A. Yes. Schedule LJS-7 is a copy of Mr. Broadwater's Schedule 21 and shows that the Staff's cost of capital range, when corrected for the errors noted, should be in the range of 9.42 percent to 10.10 percent, with a mid-point of 9.76 percent.

Q. What is the impact of correcting Staff's cost of capital on SJLP's electric revenue requirement as calculated by the Staff?

A. Staff's Accounting Schedule 1-1, sponsored by Steve Traxler, shows that SJLP has excess revenues of $60,000 to $1,635,000 with a mid-point of $836,000. Correcting Mr. Broadwater's errors would result in the need for a rate increase of $250,000 to $1,850,000 with a mid-point of $1,050,000.

Q. Would the results be similar for the Natural Gas and Steam operations of SJLP?

A. Yes. The Natural Gas operations, when corrected for Mr. Broadwater's errors, would result in the need for a rate decrease of $23,000 to a rate increase of $27,000 with a mid-point of $2,000. The Steam operations would need a rate increase of $57,000 to $105,000 with a mid-point of $81,000.

Q. If the proposed acquisition of SJLP is not consummated, is it likely that SJLP will seek an immediate rate increase?

A. Yes.

Q. Does this conclude your Surrebuttal Testimony?

A. Yes.

# Monthly High / Low Average Dividend Yields for St. Joseph Light and Power Company

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Month / Year | High Stock Price | Low Stock Price | Average High / Low Price | Expected Dividend 1999 | Projected Dividend Yield |
| December 1998 | 18.000 | 17.563 | $17.782 | $1.00 | 5.62% |
| January 1999 | 17.938 | 17.500 | $17.719 | $1.00 | 5.64% |
| February 1999 | 17.438 | 15.500 | $16.469 | $1.00 | 6.07% |
| ~~March 1999~~ | ~~21.000~~ | ~~16.875~~ | ~~$18.938~~ | ~~$1.00~~ | ~~5.28%~~ |
| Average | | | | | 5.78 ~~5.66%~~ |

**Projected Dividend Yield for St. Joseph Light and Power Company:** 5.78 ~~5.66%~~

Notes: Column 3 = [ ( Column 1 + Column 2 ) / 2 ].

Column 4 = Estimated Dividends Declared per share represents the projected dividends for the 12 months ended December, 1999.

Column 5 = ( Column 4 / Column 3 ).

Sources: Standard & Poor's Corporation's Security Owner's Stock Guide, and Telescan Inc.'s Wall Street City Database System.

ST. JOSEPH LIGHT A OWER COMPANY
CASE NO. ER-99-247

# DCF Estimated Costs of Common Equity for the Six Comparable Electric Utility Companies

| Company Name | (1) Expected Annual Dividend | (2) Average High/Low Stock Price | (3) Projected Dividend Yield | (4) Average of Historical & Projected Growth | (5) Estimated Cost of Common Equity |
|---|---|---|---|---|---|
| Black Hills Corporation | $1.02 | $24.266 | 4.20% | 4.74% | 8.95% |
| Cleco Corporation | $1.63 | $31.781 | 5.13% | 4.22% | 9.35% |
| Hawaiian Electric | $2.50 | $37.469 | 6.67% | 2.61% | 9.28% |
| Idaho Power | $1.86 | $33.172 | 5.61% | 3.03% | 8.64% |
| Minnesota Power | $2.06 | $36.399 | 5.66% | 4.69% | 10.35% |
| Western Resources | $2.14 | $31.203 | 6.86% | 3.06% | 9.92% |
| Average | | | 5.69% | 3.73% | 9.41% |

Notes: Column 1 = Estimated Dividends Declared per share represents the average projected dividends for 1998 and 1999.

Column 3 = ( Column 1 / Column 2 ).

Column 5 = ( Column 3 + Column 4 ).

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, November 20, 1998 December 11, 1998 and January 8, 1999.

Column 2 = Schedule 23.

Column 4 = Schedule 22.

UtiliCorp United Inc. & St. Joseph Light & Power Company
EM-2000-292

## DCF Estimated Costs of Common Equity for the Five Comparable Companies

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Company Name | Expected Annual Dividend | Average High/Low Stock Price | Projected Dividend Yield | Average of Historical & Projected Growth | Estimated Cost of Common Equity |
| Black Hills Corporation | $1.09 | $22.648 | 4.81% | 4.74% | 9.55% |
| Cleco Corporation | $1.70 | $32.359 | 5.25% | 4.26% | 9.52% |
| Hawaiian Electric Industries | $2.48 | $28.203 | 8.79% | 2.89% | 11.68% |
| Minnesota Power | $1.07 | $16.859 | 6.35% | 4.79% | 11.14% |
| OGE Energy | $1.33 | $18.937 | 7.02% | 3.14% | 10.16% |
| Average | | | 6.45% | 3.96% | 10.41% |

Notes: Column 1 = Estimated Dividends Declared per share represents the average projected dividends for the last three quarters of 1999 and the first quarter of 2000.

Column 3 = ( Column 1 / Column 2 ).

Column 5 = ( Column 3 + Column 4 ).

Sources: Column 1 = The Value Line Investment Survey: Ratings & Reports, February 18, 2000 and April 7, 2000.

Column 2 = Schedule 23.

Column 4 = Schedule 22.

ST. JOSEPH LIGHT & POWER COMPANY
CASE NO. EM-2000-292

Corrected Staff Recommended Return on Equity

| | Return on Equity Range | | |
|---|---|---|---|
| Staff Recommended Return on Equity Case No. ER-99-247 | 9.27% | 9.89% | 10.51% |
| Adj. to Eliminate March 1999 From the Dividend Yield Calculation | 0.12% | 0.12% | 0.12% |
| Corrected 1999 Recommendation | 9.39% | 10.01% | 10.63% |
| Adj. To Reflect Peer Group Movement From Case No. ER-99-247 to Current Calculation Per Staff | 1.00% | 1.00% | 1.00% |
| Corrected Return on Equity to Reflect Current Economic Conditions | 10.39% | 11.01% | 11.63% |

**Capital Structure as of December 31, 1999**
**for St. Joseph Light and Power Company (Consolidated Basis)**

| Capital Component | Amount in Dollars | Percentage of Capital |
|---|---|---|
| Common Stock Equity | 96,187,818 ~~$95,805,325~~ | 54.92 ~~53.99~~% |
| Preferred Stock | 0 | 0.00% |
| Long-Term Debt | 66,861,585 ~~69,338,415~~ | 38.17 ~~39.07~~% |
| Short-Term Debt | 12,101,424 ~~12,309,411~~ | 6.91 6.94% |
| **Total Capitalization** | 175,150,827 ~~$177,453,151~~ | **100.00%** |

**Financial Ratio Benchmarks**
***Total Debt / Total Capital - Including Preferred Stock***

| Standard & Poor's Corporation's Utility Rating Service 9/30/98 Electric Utility Companies (Average Business Position) | AA | A | BBB |
|---|---|---|---|
| | 42% | 56% | 63% |

## Embedded Cost of Long-Term Debt as of December 31, 1999 for St. Joseph Light and Power Company

| Long-Term Debt | (1) Interest Rate | (2) Principal Amount Outstanding (12/31/~~98~~ 9) | (3) Annualized Cost to Company (1 * 2) |
|---|---|---|---|
| First Mortgage Bonds: | | | |
| 9.44% Series due February 1, 2021 | 9.440% | $22,500,000 | $2,124,000 |
| 5.85% Series due February 1, 2013 | 5.850% | 5,600,000 | 327,600 |
| Medium-Term Notes | | | |
| 7.13% Series due November 29, 2013 | 7.130% | 1,000,000 | 71,300 |
| 7.16% Series due November 29, 2013 | 7.160% | 3,000,000 | 214,800 |
| 7.16% Series due November 29, 2013 | 7.160% | 3,000,000 | 214,800 |
| 7.16% Series due November 29, 2013 | 7.160% | 3,000,000 | 214,800 |
| 7.17% Series due December 1, 2023 | 7.170% | 2,000,000 | 143,400 |
| 7.17% Series due December 1, 2023 | 7.170% | 5,000,000 | 358,500 |
| 7.33% Series due November 30, 2023 | 7.330% | 3,000,000 | 219,900 |
| 8.36% Series due March 15, 2005 | 8.360% | 20,000,000 | 1,672,000 |
| Less: Unamortized Debt Issuance Expense | | 438,009 | |
| Less: Unamortized Losses on Reacquired Debt | | 800,406 | |
| Add: Annual Amortized Debt Issuance Expense | | | 35,774 |
| Add: Annual Amortized Losses on Reacquired Debt Expense | | | 48,100 |
| Total | | ~~$69,338,415~~ 66,861,585 | $5,644,974 |

Embedded Cost of Long-Term Debt = $5,644,974 / ~~$69,338,415~~ 66,861,585

= ~~8.14%~~ 8.44

Notes:

See Schedule 12-2 for the amounts of the Unamortized Premium & Debt Discount and the Annual Amortized Debt Discount Expense.

Sources: St. Joseph Light and Power Company's response to Staff's Data Information Requests No. 3802.

## Weighted Cost of Capital as of December 31, 1999
## for St. Joseph Light and Power Company (Consolidated Basis)

| Capital Component | Percentage of Capital | Embedded Cost | Weighted Cost of Capital Using Common Equity Return of: 10.39 ~~9.27%~~ | 11.01 ~~9.89%~~ | 11.63 ~~10.51%~~ |
|---|---|---|---|---|---|
| Common Stock Equity | 54.92 ~~53.99%~~ | — | 5.71 ~~5.00%~~ | 6.05 ~~5.34%~~ | 6.39 ~~5.67%~~ |
| Preferred Stock | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% |
| Long-Term Debt | 38.17 ~~39.07%~~ | 8.44 ~~8.14%~~ | 3.22 ~~3.18%~~ | 3.22 ~~3.18%~~ | 3.22 ~~3.18%~~ |
| Short-Term Debt | 6.91 ~~6.94%~~ | 7.03 ~~6.32%~~ | .49 ~~0.44%~~ | .49 ~~0.44%~~ | .49 ~~0.44%~~ |
| Total | 100.00% | | 9.42 ~~8.62%~~ | 9.76 ~~8.96%~~ | 10.10 ~~9.29%~~ |

Notes:

See Schedule 11 for the Capital Structure Ratios.

See Schedule 12-1 for the Embedded Cost of Long-Term Debt.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merger St. Joseph Light & Power Company with and into UtiliCorp United Inc., and, in Connection Therewith, Certain Other Related Transactions. | ) | Case No. EM-2000-292 |

County of Buchanan )
)
State of Missouri )

**AFFIDAVIT OF LARRY J. STOLL**

**Larry J. Stoll, being first duly sworn,** deposes and says that he/she is the witness who sponsors the accompanying testimony entitled "Capital Structure/Cost of Capital"; that said testimony was prepared by him/her and/or under his/her direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he/she would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his/her knowledge, information, and belief.

L. J. Stoll

Subscribed and sworn before me this 19th day of June, 2000.

Jacqueline F. Finchum
Notary Public

JACQUELINE F. FINCHUM
MY COMMISSION EXPIRES June 16, 2002
NOTARY SEAL
Andrew County
NOTARY PUBLIC, STATE OF MISSOURI

My Commission expires:

June 16, 2002