EXHIBIT

Exhibit No.:	
Issue(s):	Rate of Return
Witness/Type of Exhibit:	Burdette/Rebuttal
Sponsoring Party:	Public Counsel
Case No.:	ER-2001-299

REBUTTAL TESTIMONY

OF

MARK BURDETTE

Submitted on Behalf of
the Office of the Public Counsel

THE EMPIRE DISTRICT ELECTRIC COMPANY

Case No. ER-2001-299

Exhibit No. 87
Date 5/29/01 Case No. ER-2001-299
Reporter KRM

May 3, 2001

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In The Matter Of The The Empire District Electric Company's Tariff Sheets Designed to Implement a General Rate Increase for retail Electric Service Provided to Customers in the Missouri Service Area of the Company.	)))))	Case No. ER-2001-299 Tariff No. 200100518

AFFIDAVIT OF MARK BURDETTE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Mark Burdette, of lawful age and being first duly sworn, deposes and states:

1. My name is Mark Burdette. I am a Financial Analyst for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 6.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Mark Burdette

Subscribed and sworn to me this 3rd day of May 2001.

Bonnie S. Howard
Notary Public

My commission expires May 3, 2001.

REBUTTAL TESTIMONY

OF

MARK BURDETTE

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2001-299

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Mark Burdette, P.O. Box 7800, Jefferson City, Missouri 65102-7800.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri (OPC or Public Counsel) as a Public Utility Financial Analyst. Also, I am an adjunct faculty member with Columbia College. I teach undergraduate Business Finance and graduate-level Managerial Finance.

A. ARE YOU THE SAME MARK BURDETTE WHO FILED DIRECT TESTIMONY IN THIS CASE?

Q. Yes, I am.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. I will respond to the Direct testimony of Empire witness Donald Murry and Staff witness Roberta McKiddy.

CAPITAL STRUCTURE

Q. WHAT ARE YOUR COMMENTS REGARDING MR. MURRY'S SELECTION OF CAPITAL STRUCTURE FOR EMPIRE?

A. Mr. Murry's recommendation for Empire's overall rate of return is too high because it is based on a hypothetical capital structure containing more common equity than Empire's actual capital structure.

Q. IS EMPIRE'S ACTUAL CAPITAL STRUCTURE OUT OF LINE WITH THE ELECTRIC UTILITY INDUSTRY?

A. No. As I stated in my direct testimony, "Empire's current common equity ratio is very similar to the average level of common equity of my comparable group. Based on Value Line's methodology, Empire's common equity ratio was 40% for year 2000, compared to an average level of 40.8% for my comparable group." (Burdette-Direct, page 10, beginning on line 10).

Empire's actual capital structure is within the zone of reasonableness for an electric utility. Therefore, it is appropriate to use to calculate Empire's overall rate of return.

Q. DOES EMPIRE'S MANAGEMENT HAVE THE RESPONSIBILITY OF SETTING THE COMPANY'S CAPITAL STRUCTURE?

A. Yes. Empire's management makes the decisions concerning how the Company's assets are financed, including the determination of the relative levels of common equity, preferred stock and debt.

Q. HOW IS THIS RELEVANT IN THIS PROCEEDING?

A. Mr. Murry recommends a hypothetical capital structure that contains more common equity than Empire's actual level. This leads directly – and inappropriately - to an increased rate of return and higher revenue requirement. Empire's contention is that the hypothetical capital structure reflects what the actual capital structure will be at some point in the future.

Q. IS THERE ANY GUARANTEE THAT EMPIRE WILL ALTER ITS CAPITAL STRUCTURE TO MATCH THE HYPOTHETICAL STRUCTURE?

A. No. Empire's management is under no obligation to alter the Company's capital structure. Empire's revenue requirement, and the rates paid by Missouri's ratepayers, should not be artificially increased based on a capital structure that is not representative of the Company's actual financing. Empire retired its preferred stock, issued additional long term debt, and chose to not issue additional common stock, *due to the Company's involvement in the eventually unsuccessful merger with UtiliCorp.* Empire's management set the capital structure and rates should be based on that capital structure.

Q. DID EMPIRE HAVE TO FILE A RATE CASE AT THIS TIME?

A. No. Empire's management chose to file a rate case at this time, with the current capital structure in place. The Company's actual capital structure is the capital structure that should be used in this proceeding. If the Company wants rates based on an alternative capital structure, it is within management's control to form that capital structure and then file a rate case. Until such time, however, the rates paid by Empire's customers should be based on the Company's current financing mix.

Q. DO YOU HAVE COMMENTS REGARDING STAFF WITNESS MCKIDDY'S RECOMMENDED CAPITAL STRUCTURE?

A. Ms. McKiddy appropriately utilizes Empire's actual capital structure as of 31 December 2000, which is the end of the test year in this case. However, Ms. McKiddy and I calculate slightly different levels of common equity (Burdette-Direct, Schedule MB-2; McKiddy-Direct, Schedule 10). I use a common equity level of $240,152,911, which is $19,573,912 more than Ms. McKiddy's level of $220,578,999. I have been unable to determine the reason for this discrepancy.

EMBEDDED COST OF LONG TERM DEBT

Q. DO YOU HAVE COMMENTS REGARDING MR. MURRY'S OR MS. MCKIDDY'S RECOMMENDATIONS FOR EMPIRE'S EMBEDDED COST OF LONG TERM DEBT?

A. Yes. All parties filing testimony on the appropriate cost of long term debt to use for Empire are within three basis points (3.0 b.p.); Staff calculated a cost of 7.88%, I calculated a cost of 7.895%, and Company calculated a cost of 7.91%. The embedded cost and actual level of long term debt will be included in the true-up process in this proceeding.

Public Counsel essentially agrees with Staff's methodology for calculating the embedded cost of Empire's debt. Although I will review the recommendation, I anticipate Public Counsel agreeing with Staff's trued-up calculations for the embedded cost and level of long term debt.

COST OF COMMON EQUITY

Q. WHAT IS YOUR RECOMMENDED COST OF COMMON EQUITY FOR EMPIRE?

A. Empire should be allowed a return on common equity of 10.0% to 10.25%.

Q. WHAT ARE THE RECOMMENDATIONS OF THE OTHER COST OF CAPITAL WITNESSES?

A. Mr. Murry recommends a cost of common equity of 11.5% to 12.0%. Ms. McKiddy recommends a range 8.50% to 9.50%.

Q. WHAT ARE YOUR COMMENTS REGARDING MR. MURRY'S RECOMMENDED RETURN ON COMMON EQUITY (ROE)?

A. Mr. Murry utilizes the Discounted Cash Flow model (DCF) and the Capital Asset Pricing Model (CAPM).

The DCF requires two components to calculate ROE: the expected dividend yield (based on expected dividends and current stock price) and the long-term sustainable growth rate. Mr. Murry tends to focus only on the larger of his calculated growth rates and ignores the rates on the lower end of the range. This fact inflates his DCF recommendation because the growth rate flows directly to ROE in the DCF model – if the growth rate is increased one percentage point, the calculated ROE increases one percentage point.

Mr. Murry's recommendation of 11.5% is composed of his calculated dividend yield, either 4.84% or 4.94% (Schedule DAM-12), plus a growth rate. If dividend yield equals 4.84%, Mr. Murry is using a growth rate of 6.66% (11.5% - 4.84% = 6.66%). This rate is obviously too high for Empire and is wholly unsupported by evidence or analysis.

Under some circumstances, it is appropriate to exclude particular calculated growth rates. For example, I exclude negative growth rates from my calculations. I also exclude particularly high compound growth rates if the company being analyzed had a payout ratio greater than 1.0 during the period (meaning the company paid out more in dividends than it earned). However, excluding growth rates merely because they don't create the desired ROE is not appropriate. Had Mr. Murry considered his full range of calculated growth rates, his recommended ROE for Empire would be lower than 11.5%.

Q. WHAT ARE YOUR COMMENTS CONCERNING MR. MURRY'S CAPM ANALYSIS?

A. Mr. Murry calculated an ROE for Empire utilizing two different interpretations of the CAPM (Schedules DAM-15 and DAM-16). However, Mr. Murry fails to explain his applications of the CAPM. His two schedules include various calculations and adjustments with *no supporting quantitative or qualitative evidence* for his methodologies. The MPSC should disregard Mr. Murry's CAPM analysis.

Q. PLEASE SUMMARIZE YOUR COMMENTS CONCERNING MR. MURRY'S RECOMMENDED ROE.

A. Mr. Murry utilizes two models to calculate an ROE for Empire. First, he uses the DCF, in which he uses a growth rate much too high for Empire. Second, he applies the CAPM twice, using different methodologies containing various adjustments, yet he doesn't explain the calculations or the adjustments.

The MPSC should disregard Mr. Murry's analysis of Empire's ROE and overall rate of return. The appropriate ROE for Empire is in the range of 10.0% to 10.25%.

Q. WHAT ARE YOUR COMMENTS REGARDING MS. MCKIDDY'S RECOMMENDED ROE?

A. Ms. McKiddy's recommended range of ROE for Empire – and certainly the lower portion of her range – is simply too low to appropriately reflect the risk of Empire's common stock.

I agree with Ms. McKiddy's growth rate range for Empire of 3.0% - 4.0%. However, I believe Ms. McKiddy used stock prices in her DCF analysis that are too old, resulting in a dividend yield that is too low. Her calculation of average stock prices used information going back to October 2000 (McKiddy-Direct, Schedule 14).

The DCF method calls for a current, expected dividend yield. The stock price used should be as current as possible to be representative of the opportunity that actually exists for investors. Had Ms. McKiddy used more current stock prices, her calculated DCF cost of equity for Empire would have increased.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.