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In the Matter of The Empire District Electric Company of Joplin, Missouri, for Authority to File Tariffs Increasing Rates for Electric Service Provided to Customers in the Missouri ServiceArea of the Company) Case No. ER-2006-0315

COLLEEN M. DALE, Presiding,
CHIEF REGULATORY LAW JUDGE

REPORTED BY:
PAMELA FICK, RMR, RPR, CCR #447, CSR
MIDWEST LITIGATION SERVICES

APPEARANCES:

JAMES C. SWEARENGEN, Attorney at Law
JANET E. WHEELER, Attorney at Law
RUSS MITTEN, Attorney at Law
DEAN COOPER, Attorney at Law
Brydon, Swearengen & England, P.C.
312 East Capitol
P.O. Box 456
Jefferson City, Missouri 65102-0456
(573) 635-7166
FOR: The Empire District Electric Company

STUART CONRAD, Attorney at Law
DAVID WOODSMALL, Attorney at Law
Finnegan, Conrad & Peterson
3100 Broadway
1209 Penntower Office Center
Kansas City, Missouri 64111
(816) 753-1122

FOR: Praxair, Inc.
Explorer Pipeline, Inc.

JAMES M. FISCHER, Attorney at Law
Fischer & Dority
101 Madison, Suite 400
Jefferson City, Missouri 65101
(573) 636-6758

FOR: Kansas City Power & Light Company

DIANA CARTER, Attorney at Law
Brydon, Swearengen & England, P.C.
312 East Capitol
P.O. Box 456
Jefferson City, Missouri 65102-0456
(573) 635-7166

FOR: Aquila

SHELLEY A. WOODS, Assistant Attorney General
P.O. Box 899
Supreme Court Building
Jefferson City, Missouri 65102
(573) 751-3321
FOR: Missouri Department of Natural Resources

LEWIS R. MILLS, JR., Public Counsel
P.O. Box 2230
200 Madison Street, Suite 650
Jefferson City, Missouri 65102-2230
(573) 751-4857
FOR: Office of the Public Counsel and the Public

KEVIN THOMPSON, General Counsel
DENNIS L. FREY, Senior Counsel
STEVEN DOTTHEIM, Chief Deputy General Counsel
NATHAN WILLIAMS, Deputy General Counsel
P.O. Box 360
200 Madison Street
Jefferson City, Missouri 65102
(573) 751-3234

FOR: Staff of the Missouri Public Service Commission

P R O C E E D I N G S

JUDGE DALE: Good morning. We are back for the second day of the Empire rate case ER-2006-0315, September 6th, 2006, and we are beginning with opening statements concerning return on equity and capital structure.

MR. SWEARENGEN: Would you like me to go ahead, your Honor?

JUDGE DALE: Yes. I see a question in the back.

MR. WILLIAMS: I don't see any video.

MR. THOMPSON: I don't see any Commissioners.

JUDGE DALE: You're not seeing the podium?

MR. WOODSMALL: We're not seeing anything.

JUDGE DALE: Let's go off the record.

(DISCUSSION HELD OFF THE RECORD.)

JUDGE DALE: Okay. We really are back on the record and ready for those opening statements. However, it appears that Mr. Swearengen has left the room.

MR. THOMPSON: Does that mean they concede, your Honor?

JUDGE DALE: Off the record again.

(DISCUSSION HELD OFF THE RECORD.)

MR. SWEARENGEN: Would you like me to proceed?

JUDGE DALE: Yes, please proceed, Mr. Swearengen.

MR. SWEARENGEN: Thank you, your Honor. May it please the Commission. Jim Swearengen for the Empire District Electric Company.

The issue this morning is rate of return, to kind of refresh the Commission's memory. We have two witnesses on that topic. Dr. James Vander Weide who testified on behalf of Empire in its last rate case is here today, and Bill Gipson, the CEO of Empire also has a -- some brief testimony on rate of return in his, I believe it was rebuttal testimony, so he will be here as well.

As I indicated yesterday, we believe that the evidence in this case will demonstrate that the company should be authorized to earn a rate of return on its common equity of at least 11.7 percent.

Of the three rate of return recommendations which the Commission will have before it in this case, we believe that only the company's accurately reflects the market base rate of return expectations of investors in companies whose business and financial risks are comparable to Empire.

Once again, as I indicated to the Commission yesterday, the company's approach to estimating a cost of common equity in this case is virtually identical to the method it used in the last rate case, the last electric rate case which was Case Number ER-2004-0570, and that case was decided by this Commission in March of 2005.

In that -- in that case the Commission endorsed the method used by the company's expert witness. Dr. Vander Weide, who was the company's expert in that case and will testify today, based his cost of equity recommendation on a discounted cash flow analysis which he applied to a broad group of proxy companies whose risk profiles are comparable to Empire's. That's the method he used in the last case, and it's also the method that he's used in the present case.

In both proceedings he has evaluated his DCF result using other analytical methods and his own reason and judgment. In the last case the Commission concluded that such a method produces a return on equity that is fair to the company and its customers alike.

The Commission also concluded that this method allows Empire to attract the capital that is necessary for it to meet its future obligations, and we believe the Commission should reach the same conclusions in this proceeding.

Briefly, Dr. Vander Weide uses a two-step process to determine Empire's cost of equity. The first step involves developing a proxy group of companies whose risk profiles are similar to Empire's, and then applying market-based data for this proxy group to three standard methods used to estimate the cost of capital.

The first is the DCF model, the second is the capital asset pricing model, and third, he used two variations of the risk premium model. Having done this, he has developed a range of rates of return for investments and companies that are attended by corresponding risks and uncertainties to those of Empire which is a critical step in complying with the legal standards of the Hope and Bluefield cases.

Based on the results of the cost of equity estimates he derived from his methods, Dr. Vander Weide calculated the average rate of return for his proxy group of companies to be 11.3

percent.

In his opinion, however, the cost of equity for the proxy group does not accurately reflect investors' expected or required returns on an equity investment in Empire. He believes this is true because Empire's capital structure is more highly leveraged than the average of the companies in his proxy group.

Accordingly, to adjust for this difference and the increased financial risk that is implied by Empire's more highly leveraged capital structure, Dr. Vander Weide estimates that Empire's true cost of equity is 11.7 percent.

Briefly commenting on the approach used by the Staff and Public Counsel witnesses, we believe that because the groups of proxy companies that they used to derive the data they input into their financial models is much smaller than the group that Dr. Vander Weide used, that their data suffer from the kinds of statistical distortions that are inherent in small survey samples.

We believe that distorted data, distorted data inputs, lead to distorted and unreliable results which accounts for the unreasonably low equity return recommendations of both the Staff and the Public Counsel.

I mentioned briefly yesterday that we have an agreement I think with the Staff on the appropriate capital structure for Empire as of March 31, 2006, which is 43.99 percent long-term debt, 6.27 trust preferred stock and 49.74 percent common equity.

However, it's my understanding that that capital structure would be trued up, and depending on the results of that, Empire may have an issue with it at that time. But presently we're in agreement with the Staff's proposal.

I think the issue here is one between the company and the Staff on the one hand and the Public Counsel on the other. As we understand it, both Empire and the Staff, in making their capital structure calculation, reduced the long-term debt and trust preferred stock outstanding by the unadvertised expenses that were associated with the issuance of those securities. I don't believe the Public Counsel took that approach, and I think that accounts for the difference between the positions on that issue. Thank you.

MR. THOMPSON: May it please the Commission. I addressed the matter of rate of return yesterday in the general opening so I'll be brief today.

Mr. Murray has sponsored testimony which shows or suggests a return on equity of 9.5 to 9.6 percent. Public Counsel's witness, Mr. King, has sponsored testimony that proposes 9.65. And Dr. Vander Weide has proposed 11.7, quite a bit higher. And yet Dr. Vander Weide's own discounted cash flow analysis came up with the result of 9.9 which is not all that much above what the other two experts have suggested.

So the recommendation of Staff is that the Commission select a figure from within the range defined by the recommendations of David Murray and Charles King, so somewhere between 9.5 and 9.65. We believe that their use of well-recognized financial and analytical methods supports those figures.

Now, Dr. Vander Weide, he starts out with standard financial analytical methods. He employs four different methods and then averages the results as the first step. But then he has a second step, and we have a lot of trouble with that second step.

The second step is an adder, a 40-basis-point adder, and he says that this adder is justified because Empire, because it has a more highly leveraged capital structure, it's carrying more debt, is a riskier investment. Well, of course, the holders of equity securities are gonna get paid last. They get paid what's left over after the debts are paid, and so it is riskier.

But as I said yesterday, who made the decision to carry all that debt? How did that money help the ratepayers? I think we have to focus on the fact that this is a company that has been paying the same dividend for quite a few years, that's paying a dividend that is not supported by its earnings per share.

In fact, this is a company whose stock, whose equity stock is more like a bond. It's like a coupon. There's a particular dividend that is going to be paid by that share regardless of how the company is doing, regardless of its earnings. I think you have to take that into account.

There have been management decisions made that have placed this company in a precarious financial position. Yesterday you heard a lot of talk about the bet that management made. I think -- I think Mr. Woodsmall raised that in his opening statement. Management made a bet. They bet that natural gas prices would not rise such that the interim energy charge, the IEC that they agreed to, would become a bad bargain. And as Mr. Woodsmall pointed out, that was a bad bet.

Well, management has made a number of bets, bad bets, and when it pays a dividend that is not supported by its earnings per share, it's making a bad bet there too. I urge you to take that into account when you select the return on equity in this case. Thank you.

JUDGE DALE: Mr. Mills?

MR. MILLS: Thank you and may it please the Commission. Mr. Thompson hit the nail on the head. I think that the biggest problem with Dr. Vander Weide's testimony is first, he starts with a group of companies that are not truly comparable.

Public Counsel witness King started with the same group of companies that Dr. Vander Weide began with, but then removed the ones that were not truly comparable to come up with a really much better comparable group.

Dr. Vander Weide, having started with a group that was inherently more risky than Empire, in addition to that, chose to make a completely arbitrary 40 percent -- 40-basis-point adjustment on top of that, and that takes his recommendation from way too high into the range of ludicrous.

I mean, even without the 40 percent -- 40-basis-point adjustment, his -- his cost of equity would have been way too high. With that, it simply is not credible.

I think the cross-examination of Dr. Vander Weide will establish some of these points, and as you -- I'm not sure the Commissioners are aware of this, but Public Counsel witness King had an accident in the airport on his way in yesterday, is scheduled for surgery tomorrow and will not be able to make it for the hearing today.

We are going to arrange to have him taken out of order one day next week when we know more about his recovery prognosis and his ability to travel. So we will be doing cross-examination of the other witnesses today and we will be saving Mr. King until next week. Thank you.

COMMISSIONER CLAYTON: It happened in the airport?

MR. MILLS: On his way here, yeah.

COMMISSIONER CLAYTON: And from where did he travel?

MR. MILLS: He was traveling from Maine

through D.C. to here, and it was in the D.C. -- well, I don't think it was in the D.C. airport. I think it was in one of the airports around D.C., Baltimore maybe.

COMMISSIONER CLAYTON: Oh, so it didn't happen in St. Louis?

MR. MILLS: No, it didn't happen in St. Louis. It happened in the D.C. area, and that's as far as he made it here, and that's where he was --

COMMISSIONER CLAYTON: So he's not staying at your house, or something like that, convalescing?

MR. MILLS: No.

COMMISSIONER CLAYTON: Okay. Thanks. Send him our best.

MR. MILLS: Okay. Thank you.

JUDGE DALE: Mr. Woodsmall?

MR. WOODSMALL: Your Honor, I would merely note that Praxair/Explorer put a brief portion on return on equity in its prehearing brief, and we'd waive any opening statement.

JUDGE DALE: Thank you. The remaining parties, DNR, KCP&L and Aquila are all excused today from participation. So we are ready for the first witness.

MR. SWEARENGEN: We'd call Dr. Vander Weide at this time.

JUDGE DALE: Yes.

MR. SWEARENGEN: Thank you.

JUDGE DALE: Sir, if you'll allow me to swear you, and then I would like for you to say your last name for us, please.

THE WITNESS: Okay. Vander Weide.

JUDGE DALE: Vander Weide. Everybody got that? It would be nice if we could all pronounce it one way.

THE WITNESS: It's a very difficult name.

(The witness was sworn.)

JUDGE DALE: Thank you. Please be seated. Please proceed.

DIRECT EXAMINATION BY MR. SWEARENGEN:

Q. Thank you. Would you state your name for the record, please.

A. Yes. My name is James H. Vander Weide.

Q. And what is your occupation?

A. I am Research Professor of Finance and Economics at the Fuqua School of Business at Duke University.

Q. And have you testified before this

Commission previously?

A. Yes, I have.

Q. And did you -- do I understand correctly you testified in the last Empire electric rate case?

A. Yes.

Q. Did you cause to be prepared for purposes of this proceeding certain direct, rebuttal and surrebuttal testimony in question and answer form?

A. Yes, I did.

Q. And is it your understanding that with respect to your direct and I believe your rebuttal testimony, there was also an executive summary that is included with that testimony?

A. That's correct.

Q. And for the record, let me note that your direct testimony has been marked as Exhibit 1, your rebuttal testimony, Exhibit 2 -- excuse me, your direct is Exhibit 2, your rebuttal is Exhibit 3 and your surrebuttal is Exhibit 4.

If I asked you the questions that are contained in those testimonies, your direct, your rebuttal and your surrebuttal, would your answers today under oath be the same?

A. Yes, they would.

Q. And would those answers be true and correct to the best of your knowledge, information and belief?

A. Yes.

MR. SWEARENGEN: Thank you. Your Honor, he is testifying only on this issue and only today, according to my understanding of the proceedings, and he will not be back on any other issue, as would be the case with Mr. Gipson who will be testifying later.

So at this time I would offer into evidence Exhibits 2, 3 and 4, his direct, rebuttal and surrebuttal testimonies, and tender the witness.

JUDGE DALE: Are there any objections?

(NO RESPONSE.)

MR. THOMPSON: No objection.

JUDGE DALE: Then Exhibits 2, 3 and 4 are admitted into evidence.

(EMPIRE EXHIBIT NOS. 2, 3 AND 4 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. SWEARENGEN: Now, your Honor, let me -- I think I need to state and clarify that included in that testimony on pages 53 and 54 of his direct testimony, Exhibit No. 2 is testimony that the Commission has earlier indicated that it intended to strike from this proceeding and, of course, this is the first time that that testimony has been offered. And I want to make it clear that I am offering it again to the -- or for the first time to the Commission notwithstanding the Commission's ruling in that -- in that previous order.

I think that -- and my reason -- my reasons are as follows: First of all, I think as you indicated yesterday, the Commission may very well change its mind in this proceeding on whether or not its going to authorize a fuel adjustment clause for this company. This is something that -- and I think you should hear.

Second, I don't think under any stretch of the imagination the answers to these questions can be construed to violate any order or agreement involving this company. They're purely related to the question of rate of return.

The witness has assumed that Empire will have a fuel adjustment clause for purposes of his calculation. And then he says if Empire doesn't get a fuel adjustment clause, that rate of return ought to be higher than the 11.7 that -- that he has recommended. So I don't know how that could be construed to be contrary to any prior order or stipulation.

So with those comments, I want to make it clear that I am including that in my offer this morning.

JUDGE DALE: Was this testimony included in the order --

MR. SWEARENGEN: Yes.

JUDGE DALE: -- as what should be removed?

MR. SWEARENGEN: Yes. The testimony that I just referred to on page -- pages 53 starting with lines 6 through line 16, and page 54 starting with line 1 through line 7, the Commission earlier indicated should be stricken.

And as I said, it hasn't been offered until this morning, so at best that offer -- that order would have been premature on this topic and I'm offering it at this time.

JUDGE DALE: Then I will reinstate or restate that that testimony on page 52, lines 5 through 16, and 54, lines 1 through 7 are not admitted into evidence.

MR. SWEARENGEN: Okay. And then under those circumstances under the Commission rule, I would ask that it nonetheless be preserved in the record. Thank you.

JUDGE DALE: Mr. Mills, did you have a question?

MR. MILLS: No, I don't -- and I don't really have a question. I do question the notion that the Commission may somehow decide to change its mind. The Commission issued an order. Empire decided not to apply for rehearing or reconsideration of the order. I think it's final.

I think if Empire has some notion of collaterally attacking that order at some point in this proceeding and reopening that issue, I would strenuously object to that.

MR. SWEARENGEN: Well, your Honor, it's an interlocutory order and until the Commission finally decides this case, we really don't have anything that we can appeal from. I understand the Bench's ruling and we're content to live with that, so long as under 4 CSR 242.130, subsection 3 that that evidence be preserved in the record.

JUDGE DALE: And it will be.

MR. SWEARENGEN: Thank you.

JUDGE DALE: Praxair/Explorer Pipeline, do you have cross?

MR. WOODSMALL: Yes, your Honor, just

very, very briefly.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Good morning, sir, how are you?

A. Good morning.

Q. My name is David Woodsmall. I represent Praxair and Explorer Pipeline. Very briefly, you conducted in schedule JBW-1 a DCF analysis of what you call comparable electrical energy companies; is that correct?

A. Yes.

Q. And your DCF analysis for those comparable electrical companies turned out a result of 9.9 percent; is that correct?

A. At the time of my direct testimony it produced a result of 9.9. In my --

Q. That -- thank you, sir --

A. -- rebuttal testimony, I --

Q. -- that answered my question.

JUDGE DALE: Sir, once you've actually answered a yes/no question, you should cease to speak. Your attorney can ask you a follow-up question when it's his turn for redirect.

MR. WOODSMALL: Thank you, your Honor.

BY MR. WOODSMALL:

Q. Turning to schedule JBW-2, you've

conducted a DCF analysis for what you considered comparable natural gas companies; is that correct?

A. Yes.

Q. And at the time you conducted that analysis, your analysis came up with a result of 9.6 percent; is that correct?

A. Yes.

Q. And would you agree that Empire now, with its acquisition of the gas properties of Aquila, is a diversified, natural gas and electric utility?

A. Yes.

MR. WOODSMALL: Thank you. No further questions.

JUDGE DALE: Mr. Mills?

MR. MILLS: Thank you.

CROSS-EXAMINATION BY MR. MILLS:

Q. Good morning, Dr. Vander Weide. I am Lewis Mills. I represent the Public Counsel in this proceeding.

First I'd like to talk about your financial risk adjustment. Is that -- is that a fair way to describe the 40-basis-point adder that you recommend in your testimony?

A. Yes.

Q. Is it correct that your testimony is based on this notion that this adjustment is appropriate because Empire's rate of return is applied to book capital structure while the derivation of that return is based on the market capital structure?

A. That isn't quite how I would characterize it. It's -- it's based on the market value capital structure of a set of proxy companies, not Empire's market value capital structure, and hence, it's based on the financial risk implied by that market value capital structure.

Q. Okay. Is this an adjustment that you've sought in other rate of return proceedings?

A. Yes.

Q. Can you tell me what regulatory bodies and in what jurisdictions those proceedings were?

A. Not off the top of my head.

Q. Do you know any of them off the top of your head?

A. It's been over the last several years. I -- I don't recall the -- the jurisdictions at this time. I believe that was -- it was a data request on that.

Q. Okay. Can you tell me in which of -- in which of these proceedings the regulatory Commission accepted your adjustment?

A. I believe I've answered that question in data requests as well, that I normally don't either receive or maintain copies of the orders in rate proceedings.

Q. Okay. To your knowledge has any regulatory Commission accepted this adjustment?

A. I have recently heard that it was accepted in the state of Minnesota -- of Pennsylvania in a water case.

Q. So now you do remember that you'd proposed this adjustment in Pennsylvania?

A. I was just recently told -- I didn't propose it in Minnesota -- in Pennsylvania, no.

Q. Ah.

A. But another witness proposed it in Pennsylvania and I was recently told that it was accepted in Pennsylvania.

Q. Okay. Do you have knowledge that that's true or is this hearsay? Do you have direct knowledge that it was accepted by the Pennsylvania Commission?

A. I do not have direct knowledge but I feel --

MR. MILLS: Your Honor, I object to the previous answer on the basis that it's hearsay and ask that it be stricken.

JUDGE DALE: Yes, it shall be stricken.

MR. MILLS: Thank you.

BY MR. MILLS:

Q. Other than that, do you have any direct knowledge of any regulatory Commission accepting this adjustment?

A. Well, I have neither knowledge -- I don't have knowledge one way or the other.

Q. Okay. So you don't know of any regulatory Commission that has accepted this --

A. That's correct.

Q. -- adjustment? Thank you. On page 10 of your direct testimony at line 22, you make the comment that, "Regulators have traditionally defined the weighted average cost of capital using embedded cost of debt and book values of debt and equity"; is that your testimony?

A. Yes.

Q. Do you object to this use of book value capital structure by regulators?

A. I don't know if object is the correct word. It's not consistent with financial theory, and as I explained at this point in my testimony, investors use market value structures to determine the cost of capital of the company.

Q. Do you have any idea why regulators typically use book value capital structures and calculated rate of return?

A. No, I don't.

Q. If the regulators allowed rate of return on market capital structures, wouldn't the result be circular?

A. I don't believe so.

Q. Wouldn't a high allowed return increase market equity which in turn would increase the rate of return leading to a still higher market value for the equity?

A. Would you repeat that question, please?

Q. Wouldn't a higher allowed rate of return increase market equity which in turn would increase the rate of return which would lead to a still higher market value for the equity?

A. I don't believe that that sequence is correct. I don't know how a higher allowed rate of return would increase market equity.

Q. Okay. Aren't the market values of almost every regulated utility, including Empire, higher than the book value?

A. Today that's correct. It hasn't -- it's not necessarily correct, but today that's correct, yes.

Q. Has it been correct for some years?

A. Yes, it has.

Q. But Empire in recent years has not earned its authorized rate of return; is that correct?

A. That's correct.

Q. Why do you suppose investors are willing to pay more than book value for Empire's stock?

A. I don't know.

Q. Is one explanation possibly that Empire's higher market value -- because the allowed rate of return incorporates an allowance for future growth and earnings?

A. No.

Q. You don't believe that the allowed rate of return incorporates an allowance for a future growth in earnings?

A. I believe that the DCF method incorporates a expected growth rate, but that's not the reason for a stock price being higher than book value. The stock price being higher than book value has nothing to do with the fact that the DCF model incorporates an expected growth rate DCF.

Q. Okay. Still on page 10 of your direct testimony at line 11, you state that, "From the view of investors, the historical cost or book value of their investment is entirely irrelevant to the current risk and return on their portfolios." Is that true of a heavily regulated company such as Empire?

A. Yes.

Q. So you would not agree that the existence of regulation makes Empire's allowed rate of return heavily dependent on the historical or book value of its equity?

A. May I ask a clarifying question?

Q. Certainly.

A. When you said -- when you began your question with "so," does that mean that it follows from a statement you made previous to that?

Q. Let me rephrase the question. Would you agree that the existence of regulation makes Empire's allowed rate of return heavily dependent on the historical or book value of its equity?

A. The allowed rate of return is applied to book value. The allowed rate of return -- I don't know whether it's dependent on the book value of equity. It's applied to the book value of equity.

Q. Okay. And extending that concept beyond Empire, wouldn't it be true for any company subject to a rate-based rate of return regulation?

A. If you're -- if you're speaking about the allowed rate of return --

Q. Yes, I am.

A. -- which I wasn't at this point in my testimony --

Q. Uh-huh.

A. -- the same statement that I just made, that the allowed rate of return would be normally applied to the book value of equity is -- would hold. That's not what I was talking about here.

Q. Okay. Let's skip ahead and let's talk about your surrebuttal testimony, page 25, lines 8 through 11. You state that if the market value of Empire's stock increases, its estimated cost of equity declines, and that decline will be passed through to ratepayers. Is that a correct way to paraphrase your testimony?

A. Yes.

Q. In this case you've identified Empire's cost of equity by the means of four tests: DCF, CAPM and the two risk premium methods; is that correct?

A. Yes.

Q. Would you -- and for the record, CAPM is the capital asset pricing model and DCF is the discounted cash flow test. Would you recommend that any future estimation of the cost of Empire's equity be based on these same four tests?

A. I would have to apply my judgment to indicate -- to determine whether the economic conditions were consistent with the assumptions of those methods before I would decide whether they should apply to determine the cost of equity.

Q. Have you typically used these four methods in the recent past?

A. Yes.

Q. Do you have any reason to think that in the near future that they would be inapplicable?

A. I would always reserve the right to -- as a professional economist to judge whether the assumptions of those models were reasonably true of the -- of the then current economic environment. I would not make a blanket statement that they should be applied in all future -- in any future situation because they're based on certain assumptions.

Q. Do you foresee any changes that would make those assumptions invalid?

A. Frankly I haven't thought of it, thought about it.

Q. Okay. Well, let's talk about the DCF procedure. Do you base your DCF test on the market value of Empire's equity?

A. No. I base it on the market values -- the stock prices of my proxy group.

Q. That's the 34 electric utilities, correct?

A. And the natural gas companies.

Q. If the market value of Empire's stock increased, how would that show up in your DCF analysis of the 34 other electric utilities?

A. It -- if market value of Empire's stock increased and Empire was not one of my comparable -- was not one of my proxy companies, it would not show up.

Q. And Empire was not one of your proxy companies, was it?

A. No.

Q. Let's look at your capital asset pricing model analysis. Is it true that you base your CAPM test on the average Value Line data of your proxy group of 34 electric companies?

A. Yes.

Q. If the market value of Empire stock increased, how would that show up in your CAPM analysis?

A. That would show up because investors would view those companies as having lower financial risk. If -- if the market price of their stock went up, they would have less financial leverage measured in market value terms.

Q. But my question was if Empire's stock value increased, how would that show up in your CAPM analysis?

A. It would not show up in my analysis of the proxy companies.

Q. Okay. Now, your risk premium test, you did two versions and I'm talking about your Ex-Ante Risk premium test. Is that based on the difference between the yield in government bonds and your DCF results for the proxy companies?

A. Yes.

Q. How would an increase in the market value of Empire's stock show up on your Ex-Ante Risk premium test?

A. It wouldn't.

Q. Okay. And looking at your Ex-Post Risk premium test, is it based on the historical risk premium S&P's 500 stock and S&P's utilities?

A. Yes.

Q. And finally, how would an increase in the market value of Empire's stock show up in this test?

A. It would not.

Q. Now, let's turn back to the DCF analysis that you did. On page 30 of your direct testimony at line 15, you state that the DCF results have displayed considerable volatility in recent years; is that your testimony?

A. I'm turning to it now. It was page 30, line 15?

Q. Line 15.

MR. SWEARENGEN: Excuse me, Lewis. Was that the direct you're referring to?

MR. MILLS: That's direct, yes.

MR. SWEARENGEN: Thank you.

THE WITNESS: That's what I say on lines 15 through 17, yes.

BY MR. MILLS:

Q. Okay. And is schedule JBW-3 to that -- to that testimony the document on which you base the assertion that the DCF results are volatile?

A. Yes.
Q. Okay. And which particular column on that schedule shows the volatility?
A. The column titled "DCF."
Q. Okay. And if you look at that column, isn't there a steady decline in DCF results beginning in March 2000 when the return was 12.15 to August of 2005 when the result was 9.95?
A. Looking only at schedule 3 in my direct testimony as opposed to my updated DCF results, that's correct.
Q. Okay. Now, back on page 30 of your testimony at lines 20 through 23, you compare the standard deviation of the DCF returns with that of interest rates?
A. Yes.
Q. When you did that calculation, did you first fit a trend line to the DCF results and compute the standard deviation from that trend line?
A. No. And I didn't do it with the interest rates either.
Q. Okay. Had you done it that way, would the standard deviation be somewhat lower than you show on page 30?
A. I don't know.

Q. Okay. In your Ex-Post Risk premium analysis, is that based on the average of the annual differences between the columns on JWV-5 titled "Stock return and bond rate of return"?

A. It's based on schedules 5 and 6.

Q. Okay. And it's based on the average of the annual differences between stock return and bond rate of return; is that correct?

A. Yes.

Q. Would you describe the data in the stock return column as volatile or not volatile?

A. I would describe it as volatile.

Q. Would you describe the data in the bond rate of return column as volatile or nonvolatile?

A. I would describe them as volatile.

Q. Okay. If you were to calculate the annual difference between those columns, would you describe the annual difference between the two columns year to year as volatile or nonvolatile?

A. It would be volatile.

Q. Now, let's turn to your selection of proxy companies. You selected a group of companies, and then after you had done your analysis, concluded that Empire had a greater financial risk than that group as a whole; is that correct?

A. Yes.

Q. Could you have selected a list of companies that had a similar financial risk to Empire?

A. Well, I think I spoke too fast in response to the previous question. When I -- when I talked -- when you -- when I talked -- when I referred to the financial risk of Empire, is where I spoke too fast.

What the difference is, is between the financial risk as seen by investors in the cost of equity for the proxy companies and the financial risk embodied in the recommended capital structure for Empire. That is, that the cost -- the financial risk embodied in the cost of equity is not consistent with the financial risk embodied in the recommended capital structure for Empire.

Q. Okay. So to answer my question, could you have constructed a list of companies that had a comparable financial risk to Empire?

A. I don't believe so.

Q. It's just not possible?

A. I didn't try to do that, but I don't think that it would have been possible given that I looked at virtually all of the electric companies followed by Value Line and the average market value capital structure of that entire list was considerably higher than the -- than the percentage of equity in the recommended capital structure for Empire.

It's unlikely that I could have found some companies that -- that had identical financial risk, and that -- even if I had, that wouldn't have assured that they had identical total risk.

Q. And so the reason for that is because Empire's capital structure is so different from the rest of the electric utilities that you couldn't come -- the electric utility industry, that you could not come up with a list that had a financial profile similar to Empire's?

A. That would be one way to characterize it, that the recommended capital structure for Empire contains more debt and less equity than the average of the proxy companies.

MR. MILLS: Thank you. That's all the questions that I have.

JUDGE DALE: Mr. Thompson?

MR. THOMPSON: Thank you, Judge.

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Dr. Vander Weide.

A. Good morning, Mr. Thompson.

Q. My name is, in fact, Kevin Thompson and I'm here for the Staff of the Commission. Doctor, I understand that you're employed as a professor at Duke University?

A. Yes.

Q. And how long have you been so employed?

A. 34 years.

Q. And you have also given testimony in, I believe some 360 proceedings; is that correct?

A. Yes.

Q. Is it, in fact, more than that now?

A. Yes, it is.

Q. How many would you say?

A. I haven't -- I haven't counted them, but I believe it's more than 360.

Q. Okay. And how many years have you been doing that?

A. I did a few cases in 1974 and '75 and then I think there were several years where there weren't any cases and then I started doing cases again in '79 or '80.

Q. Okay. So at least 25 years?

A. Yes.

Q. And would you agree with me that 360

divided by 25 is -- that's more than one a month, is it not?

A. That's a lot of cases.

Q. Okay. And are you being paid for your testimony today, sir?

A. Yes, I am.

Q. How much are you being paid, sir?

A. I'm being paid at the rate of $375 an hour.

Q. Okay. And what percentage of your annual income does your income from your testifying work compose?

A. It varies from year to year, but it is less than half.

Q. Less than half. And it's true, is it not, that in utility rate cases, you have only testified on behalf of utility companies?

A. Yes.

Q. Now, Doctor, the testimony that you have sponsored describes a two-step method of analysis in which the second step has been referred to by the Public Counsel as a 40-basis-point adder; isn't that correct?

A. It is a two -- it is correct, it's a two-step. I don't know if I would characterize it as an adder. It's a financial -- it's an adjustment required to account for the greater financial risk as seen by investors in the estimated cost of equity compared to the financial risk embodied in the recommended capital structure for Empire.

Q. And isn't it true, Doctor, that that second step, however you characterize it, is not commonly employed in the financial analysis field?

A. Are you talking about regulated utilities or financial analysis fields? In the financial analysis field which I believe was your question --

Q. That was my question.

A. -- it's commonly applied. Everyone that -- well, it's very, very common. In fact, it's almost universal for investors and estimators of the cost of capital to estimate -- to -- to estimate the cost of capital using a market value capital structure.

Q. Let me see if I understand what you just testified to, Doctor. Are you saying that it is so common as to almost be universal that in estimating the cost of equity capital that an adjustment is made to reflect the relative risk?

A. Let me clarify my statement so we both understand. First one estimates the cost of equity for a particular company using a proxy group of companies.

Q. Correct.

A. And for that proxy group of companies, it is almost universal to estimate the weighted average cost of capital using a market value capital structure. And it's universally recognized that the financial risk that is included in the cost of equity depends on the market values of debt inequity and the capital structure of the proxy companies.

Then if the target company has a different capital structure or if they're considering a different capital structure, then in the proxy companies, a financial risk adjustment would be made.

MR. THOMPSON: Thank you, Doctor. I have no further questions.

JUDGE DALE: Are there questions from the Bench?

COMMISSIONER APPLING: I have a few --

JUDGE DALE: Good.

COMMISSIONER APPLING: -- if the junior guy's allowed to.

QUESTIONS BY COMMISSIONER APPLING:

Q. Good morning.

A. Good morning.

Q. I want you to find your JVW-1 for your direct testimony --

A. Yes.

Q. -- and your rebuttal testimony, okay?

A. Yes.

Q. Those are one of my few questions, mainly the one in your rebuttal testimony. If you go back to your direct testimony, No. 5 and 12 which is FPL Group and Constellation. And Constellation shows up in your direct testimony, but it doesn't show in your rebuttal testimony. Help me out. How did -- what happened there?

A. Yes. In my rebuttal testimony I was looking at the DCF results of Mr. Murray, and I was -- to make a comparison, I updated my procedure for applying the DCF results to the current time. And I have a set of criteria for selecting companies, and so I applied that same set of criteria that I had in my direct testimony to a later point in time; that is, the time of my rebuttal testimony.

At the time of my rebuttal testimony, one of my criteria was that a company could not be in the process of merging or having announced a merger that was not yet completed and Constellation was one of the companies that had announced a merger that had not yet been completed in my rebuttal testimony. But when I applied that criteria in my direct testimony, they were not in the process of merging.

Q. Do you recall the date in which they announced that merger?

A. No, I don't. All I know is that it was -- it was, at least to my understanding, I was not aware that they had announced it at the time of my direct and I'm usually pretty careful on that, so I don't believe that it had been announced at the time I did my -- my direct testimony.

Q. Second question, sir, what is the market weight average cost of equity if you eliminate in your surrebuttal testimony Dominion, PNM and TXU, which is 4, 22 and 26, if you took those away from that chart, what would be your market weight value? Do you have any idea?

A. I'm trying to find the schedule. What -- it's in my rebuttal testimony or surrebuttal testimony?

Q. I think it's in your surrebuttal -- or your rebuttal testimony. I'm sorry. All the questions I'm going to be asking you is coming from the rebuttal testimony. I picked that up on the --

and the reason I say that is because of your JVW-1 indicates all three of those companies is from 15.1 to 15.9 return. And I'm just -- and I'm curious about why you would put them in there, first of all because of them being so high above the rest of it.

If I can get to the total weight after you take those three away, I think it kind of points up a theory for me.

A. I believe your first question was why did I include those companies?

Q. Right.

A. And the answer to that is that they met my criteria for inclusion which was that they be an electric utility followed by Value Line, that they not have -- that they have paid a -- consistently paid a dividend within the last two years and not decreased their dividend, and that they have a safety rank of one, two or three and a -- and a investment grade bond rating, and that they not be involved in a merger that has been announced but not yet completed.

So I didn't -- other than that, I didn't -- I didn't attempt in any way to find out which companies had the highest or the lowest results and take out companies because they had high and low results.

I realized there would be some companies that because of the uncertainties in applying the DCF model to any one company or any other cost of equity method, would have either unusually high or unusually low results.

So I included all the companies, but I based my results on the average which tends to smooth out the extremes of the high and the low companies.

Q. Would those three companies drive you to the point of your recommendation, which is 11.7, would those three companies help that or raise that number?

A. Well, yes. Any time you take out companies that are above the average, that would raise the number. If you took out companies that were below the average, that would lower the number.

Q. So if we get back to my original question, if you take those three companies out, give me just an estimate of where we would be at.

A. I wouldn't be able to calculate that in my head, but I believe --

Q. Certainly would be below 11.7, though, wouldn't it?

A. Yes.

Q. Okay. Would it probably be closer, you say, than your own estimate, that it would be closer to what Staff or OPC is recommending?

A. Well, my DCF alone wasn't actually 11.7. It was 10.9 in my rebuttal testimony, and it was the other methods in combination which led me to the 11.7.

The DCF result would have been a little lower than 10.9, and that's about all I can say without doing a calculation. But again, I don't think it would be reasonable to just take out companies whose results were higher than the average without also taking out companies that were lower than the average.

Q. I understand, sir. I'm just an old country boy that don't do too well with figures. Just trying to follow what you have here. All right. My next question, are there exchange trade options for any of your comparables?

A. I haven't investigated that, but I'm sure that there are traded options for many of these companies.

Q. Which of your comparables, sir, have a similar percentage of shares held by institutions invested by Empire? Do you have an idea about how many?

A. No, I don't. I haven't investigated

that.

Q. Okay. Which of your comparables is similar to Empire in terms of market capitalization?

A. None of them. Empire is the smallest company, smallest of any of the companies in my proxy group, and I discussed that issue in my rebuttal testimony and that it would cause -- if one recognized the small size of Empire, it would, in the capital asset pricing model framework, lead to an increase in Empire's cost of equity.

Q. Last question, sir: You are making the recommendation for 11.7 for Empire?

A. Yes, I am.

COMMISSIONER APPLING: Okay. Thank you very much.

QUESTIONS BY JUDGE DALE:

Q. Before we move on to other questions from the Bench, I just wanted to clarify one thing. When you were talking about inclusion of numbers that are higher than an average, if you remove numbers that are higher than the average, what will it do to the average?

A. It will lower the average -- it will raise the average, I'm sorry. Let me get this straight. If you remove --

Q. If you remove the higher --
A. -- companies that are higher than the average, it lowers the average. Did I misspeak earlier?
Q. I believe so.
A. I'm sorry if I did.
JUDGE DALE: Okay. I just wanted to clarify that as we went forward. Thank you. Commissioner Gaw?
COMMISSIONER GAW: Commissioner Davis, do you have any questions?
CHAIRMAN DAVIS: Not at this time.
COMMISSIONER CLAYTON: Judge, I don't have any questions at this time. What I wanted to see is if we move on to other witnesses, whether Mr. Vander Weide will be available for the rest of the day or if he's hopping a plane here pretty soon?
THE WITNESS: I can be available if you'd like me to be available.
COMMISSIONER CLAYTON: Well, I'm not gonna -- I'm not gonna promise you that I'm gonna want you available. I'm just wondering if you were gonna be around today or if -- because I know today is the only day, or if your flight is at a certain time. I can certainly make that decision sooner rather than later. I guess I'm just checking on the

schedule.

THE WITNESS: For my schedule it would be nice if I knew by noon whether there were to be additional questions.

CHAIRMAN DAVIS: I'll do my very best.

THE WITNESS: Thank you.

CHAIRMAN DAVIS: But no questions at this time.

COMMISSIONER GAW: And really, I would just wonder if you might be able to do those calculations for Commissioner Appling and maybe come back and tell us what those answers were.

THE WITNESS: Okay. And to be specific, it was to remove --

COMMISSIONER GAW: I'll have to defer to him because I don't --

COMMISSIONER APPLING: You had three numbers there, 15.1 to 15.9, those three. My question was if you took those out, how close would we be to OPC's recommendation.

THE WITNESS: I will try to do that calculation before I leave.

QUESTIONS BY COMMISSIONER GAW:

Q. That would be great. And just to follow up on Mr. Thompson's questions, in the time that you have been testifying on behalf of utilities in these types of cases, how many times have you -- have you had a -- an ROE that was less than that recommended by either the public advocate or if Staff was a party in those other cases, the Staff?

A. I wouldn't be able to count the number of times, but it would be an unusual circumstance.

Q. Okay. Do you think that there's ever been a circumstance where that's occurred?

A. I think it could have occurred but I just --

Q. You can't recall one off the top of your head?

A. Not over the last 25 years, I can't.

COMMISSIONER GAW: All right. Thank you, sir.

QUESTIONS BY CHAIRMAN DAVIS:

Q. Mr. Vander Weide, when you're calculating those numbers for Commissioner Appling, and I believe he wanted you to take out Dominion Resources, PNM Resources and TXU, which were the utilities that had a cost of equity above 15 percent --

A. Yes.

Q. -- I would like for you to calculate --

make one more calculation, and that's to take out AEP which had a cost of equity of 7.5 percent, Hawaiian Electric, because they had a cost of equity of 8.3 percent, and First Energy Corporation that had a cost of equity of 8.2 percent.

So take out the top three like Commissioner Appling wanted and do that analysis, but then I want you to do an additional analysis taking out those top three as well as the bottom three.

A. Okay. With one clarification. I notice in my rebuttal schedule I, that NiSource had a 7.9 which --

Q. Right.

A. -- would have put it as one of the lowest three.

Q. Okay. Take NiSource -- just take the top three and the bottom three out for me.

A. Okay.

MR. SWEARENGEN: And just so I'm understanding what he's supposed to do, are we working off the rebuttal schedule, then? Is that your understanding?

CHAIRMAN DAVIS: Yes. I apologize. I missed the NiSource.

JUDGE DALE: Is there any recross based

on questions from the Bench?

MR. MILLS: I'm not sure that this really qualifies as recross. It's more of a clarifying question. So we are to expect Dr. Vander Weide to do two separate calculations when he comes back: One that removes just the top three and a second calculation that removes the top three and the bottom three?

JUDGE DALE: Yes.

MR. MILLS: Okay. That's all I had. Thank you.

MR. THOMPSON: Well, Judge, if he's gonna be coming back, will we not get a chance to do recross at that time?

JUDGE DALE: You'll get a chance to do recross on what he talks about at that time.

MR. THOMPSON: Okay. In that case, I don't have any recross at this time. Thank you.

JUDGE DALE: Thank you. Redirect?

MR. SWEARENGEN: If it's agreeable, I will just simply wait until he's back on the stand and then just do my redirect one time.

MR. WOODSMALL: Your Honor, I believe just as we are required to do recross at this point, he should have to do redirect, and then any redirect needed based upon what he says at that point would be appropriate. I don't think that he should get an opportunity to consult with his witness and then do redirect.

JUDGE DALE: Assuming the best motives, I think it would be better to do the redirect of what he said now since it's all fresh in everybody's mind.

MR. SWEARENGEN: Be glad to do that. No problem at all. But I will get an opportunity again later, I understand?

JUDGE DALE: Absolutely.

REDIRECT EXAMINATION BY MR. SWEARENGEN:

Q. I think it was Commissioner Appling that was -- that was discussing -- that brought up these questions about your DCF study in your rebuttal and removing the three companies that had the highest ROE; is that correct?

A. Yes, it was.

JUDGE DALE: Mr. Swearengen, is your mic on?

MR. SWEARENGEN: Yes, I believe so. Thank you. I'm sorry.

JUDGE DALE: There you go.

BY MR. SWEARENGEN:

Q. And I think you indicated that in your update, in your rebuttal update, your DCF calculation at that point was 10.9; is that right?

A. Yes, I did.

Q. And referring back to your DCF calculation for your proxy group in your direct testimony, was that 9.9?

A. Yes.

Q. And can you explain the 100-basis-point increase between the time you filed your direct and your rebuttal?

A. Yes. First of all, interest rates went up from the time that I filed my direct and the time I filed my rebuttal.

And secondly, there were -- there was some decline in utility stock prices and some increase in utility expected growth rates so that the calculated DCF result, which is the dividend yield plus the growth rate, went up by 100 basis points from the time of my direct to the time of my rebuttal.

Q. Thank you. In response to a question from Mr. Mills, you referred to your proxy group of 34 electrics, he was asking you about that, and you said, "and the natural gas companies." Do you recall that?

A. Yes, I do.

Q. There are natural gas companies in your proxy group; is that correct?

A. Yes. Proxy group can really consist of two groups of companies, a group of 34 electrics shown on schedule I of both my direct and rebuttal, and then a group of 13 natural gas companies shown on schedule II of my direct.

Q. And why did you include natural gas companies?

A. I included natural gas because I have a very strong belief that it's important to use as large a group of companies that are of comparable risk as is possible because the result of applying the -- either the DCF or the CAPM or the risk premium to any one company is highly uncertain.

As we see with the individual DCF results, for an individual company it could be low or it could be high but that's not an indication of that company's cost of equity. That has a lot of random error in it.

And so the only way to reduce that random error is to not look at the individual DCF results but to look at the average over the entire group and use a large group of companies.

There can be no doubt that the natural gas companies that I -- that I used are comparable in risk if not conservative as proxies because they have an A minus average bond rating and a Value Line safety rank of two. And Empire has a bond rating of triple B minus and a Value Line safety rank of three. So the two groups are certainly --

MR. MILLS: Your Honor, I'm gonna object here. I didn't ask any questions about natural gas utilities. I was willing to let this go on briefly, but I specifically limited all my questions to electric utilities. I didn't ask a single question about natural gas. I don't believe I even mentioned the phrase natural gas.

So I believe this is well outside the scope of what I asked on cross-examination.

JUDGE DALE: Mr. Swearengen?

MR. SWEARENGEN: Well, my response is, is that when he asked the question, the answer came about the natural gas companies, and so I think it's appropriate for me to be able to inquire in that area. Now, having done that, I'm prepared to move forward with my final two questions.

JUDGE DALE: Thank you.

BY MR. SWEARENGEN:

Q. In your response to Mr. Mills, you indicated that Empire was not in your proxy group, was not a proxy company; do you recall that?

A. Yes. Yes.

Q. And why is that?

A. Because they didn't meet my criteria for inclusion in a proxy group, and I believe that was because they didn't have a sufficient analyst growth forecast to be included.

Q. Fine. And then one last question. I was a little bit confused about your response about your knowledge of whether or not the Pennsylvania Public Service Commission may or may not have accepted the financial risk adjustment or the type of financial risk adjustment that you were proposing in this case, and I think you said you had no direct knowledge of that; is that true?

A. Yes.

Q. What knowledge of that do you have, if any?

A. I'm also in the Ameren case in Missouri and another witness, Kathy MacShane, on behalf of Ameren responded in a data request that the Pennsylvania Public Utility Commission had accepted such -- such that --

MR. MILLS: Your Honor, I'm gonna object here. This is -- this is clearly hearsay. He's talking about what some other witness in some other case who is not here for cross-examination responded to in discovery to which other parties are not even privy. So I object on the basis this is hearsay.

MR. SWEARENGEN: It doesn't go to the admissibility, it goes to the weight, and I just wanted to clarify that he didn't make this up. He did have some knowledge of it even though it wasn't direct knowledge.

JUDGE DALE: I think -- I think as to the fact that he didn't completely make it up we'll take from there, but the answer itself is hearsay.

MR. SWEARENGEN: That's fine. Thank you. That's all I have. Thanks.

JUDGE DALE: Thank you, then, Mr. Vander Weide. You may step down and we will recall you later. At this point let's take a -- looks like 12-minute break and reconvene at ten o'clock.

(A RECESS WAS TAKEN.)

JUDGE DALE: Mr. Swearengen, I believe you have another witness at this time.

MR. SWEARENGEN: I do. I'll call Mr. Gipson at this time.

(The witness was sworn.)
DIRECT EXAMINATION BY MR. SWEARENGEN:
Q. Would you state your name for the record, please.
A. William L. Gipson.
Q. Mr. Gipson, by whom are you employed and in what capacity?
A. I'm employed by the Empire District Electric Company, and I'm Chief Executive Officer.
Q. Did you cause to be prepared for purposes of this case certain direct -- supplemental, direct and rebuttal testimonies in question and answer form?
A. Yes, I did.
Q. And do you have copies of that testimony with you on the witness stand today?
A. I do.
Q. Your direct testimony has been marked for identification as Exhibit No. 5. Are there any changes that you need to make with respect to that testimony?
A. No, I do not.
Q. With respect to your supplemental direct testimony, Exhibit 6, are there any changes that need to be made with respect to that testimony?

A. No, there are not.

Q. And the same question with respect to Exhibit 7, your rebuttal testimony?

A. No changes.

Q. And if I asked you the questions that are contained in Exhibits 5, 6 and 7, would your answers today under oath be the same?

A. Yes, they would.

Q. And would they be true and correct to the best of your knowledge, information and belief?

A. Yes, they would.

Q. Now, you understand, Mr. Gipson, the issue before the Commission this morning is rate of return?

A. Yes, I do.

Q. And where in your testimony do you discuss that issue?

A. In my direct testimony, on page 9 beginning with line 5, ending with line 12.

Q. Do you discuss the subject of rate of return in your supplemental direct testimony or your rebuttal testimony?

A. No, I do not.

MR. SWEARENGEN: Mr. Gipson will be back on the stand later in this case with respect to other issues, and so at this time I will not offer his testimony, but I will tender him for cross-examination on the rate of return issue.

JUDGE DALE: That would be fine.

MR. SWEARENGEN: Thank you.

JUDGE DALE: Mr. Woodsmall?

MR. WOODSMALL: Your Honor, no questions subject to, I believe a portion of his direct testimony had been stricken earlier regarding the request for an ECR, but subject to that, I have no questions.

JUDGE DALE: Thank you. Mr. Mills?

MR. MILLS: I have no questions for this witness on this issue.

JUDGE DALE: Mr. Thompson?

CROSS-EXAMINATION BY MR. THOMPSON:

Q. Good morning, Mr. Gipson.

A. Good morning.

Q. I'm Kevin Thompson and I'm here for the Staff today. I'm looking at your direct testimony, page 9, lines 5 through 12, and I think you indicated that's the only place in your three pieces of testimony where you say anything about return of equity; is that correct?

A. You know, I might -- let me check the summary on the direct. I believe that's correct, Mr. Thompson.

Q. Okay.

A. Did you find something that I've -- that you believe indicates otherwise?

Q. No, sir.

A. Okay.

Q. Normally I ask the questions and you answer, but we'll let that one pass. Did you perform any independent analysis with respect to this proposed ROE of 11.7 percent that you refer to in this testimony?

A. No. I relied on Dr. Vander Weide.

MR. THOMPSON: Judge, I'm going to move that Mr. Gipson's direct testimony, page 9, lines 5 through 12 be stricken as improper bolstering. All it is is a simple repeat of what Dr. Vander Weide testified to as a result of his, Dr. Vander Weide's, analysis. It has no independent value or weight.

MR. SWEARENGEN: Well, your Honor, I think the witness is certainly entitled to testify on this topic, and I think the objection would go to the weight to be afforded his testimony, not its admissibility. Thank you.

JUDGE DALE: Let me ask, since you

have -- I think you have the answer ready, Mr. Woodsmall. Has -- how much of this particular testimony was stricken pursuant to your motion earlier?

MR. WOODSMALL: I don't have the answer ready, but I can find it for you.

JUDGE DALE: Oh, darn.

MR. SWEARENGEN: And Judge, I would point out that that testimony deals with other issues that will be heard later in this proceeding, and we would like to deal with it at that time.

MR. WOODSMALL: Along those lines I believe Mr. Swearengen is correct. Portion, subject to Mr. Thompson's objection, is not part of what was stricken by the previous order.

JUDGE DALE: Thank you. Somebody had the answer ready.

MR. THOMPSON: Judge, if I can respond to what Mr. Swearengen said. This doesn't go to weight at all. It goes to admissibility. Otherwise, every party could put a string of witnesses on who could testify that they had read the testimony of the chief witness of their side on any given issue and that they agreed with it.

JUDGE DALE: Is there any conclusion

based on your personal knowledge or work contained in those few lines of your testimony?

THE WITNESS: Well, I believe the last sentence is a conclusion, the last sentence in that paragraph.

JUDGE DALE: And it's a conclusion based on your personal knowledge?

THE WITNESS: Yes.

JUDGE DALE: Then the last sentence.

MR. THOMPSON: We're willing to live with the last sentence, Judge.

JUDGE DALE: Thank you.

MR. SWEARENGEN: Your Honor, I would think the sentence that immediately precedes that, "The company's ability to provide its customers with reliable electric power service" is directly dependent upon the allowed ROE cost recovery, and I think that's true with respect to any legitimate cost of service. And he's the -- he's the chief executive officer of the company. He can certainly offer that opinion.

JUDGE DALE: Well, when I asked him what he had personal knowledge of, he said only the last sentence.

MR. SWEARENGEN: Well, why don't you ask

him again.

THE WITNESS: My answer would be the same, probably over the objection of my counsel, because I believe the last sentence does, in some way, repeat the second sentence. You know, we talk about outstanding level of customer service and reliable electric power service directly dependent upon allowed ROE and cost recovery.

I think those two sentences are pretty synonymous. The important thing to me with respect to the last sentence is the capacity or the ability to finance significant capital projects, and that's why I chose that sentence as the most relevant of the two.

JUDGE DALE: Thank you. Then since the witness has personal knowledge of that last sentence, let that one in.

MR. THOMPSON: Thank you, Judge.

MR. SWEARENGEN: And I assume that we can preserve the rest of it pursuant to the Commission rule?

JUDGE DALE: Yes.

MR. SWEARENGEN: Thank you.

MR. WOODSMALL: Your Honor, would you clarify for me what has been stricken, then?

JUDGE DALE: The -- hold on a minute, let me grab a different book here. In the question and answer that begins on line 5, beginning on line 7 through the period after "cost recovery" on line 10.

MR. WOODSMALL: Then, your Honor, I would move for -- to strike the remainder of that paragraph on the basis that it is nonresponsive to the question before it.

MR. SWEARENGEN: And did I understand you're striking that answer that we're proposing an ROE of 11.7 percent? I didn't understand that that was being stricken.

JUDGE DALE: You are correct, Mr. Swearengen. The first sentence that just says, "Empire is proposing an ROE of 11.7 percent" is not stricken. Then it begins, "In his direct testimony" there's the regurgitation that he has no personal knowledge of, and then we pick up with, "If Empire is to continue..."

MR. SWEARENGEN: Thank you.

MR. WOODSMALL: And your Honor, I would renew my objection. The first sentence is responsive. The second sentence as it stands now which begins on line 10, "If Empire," is not responsive to the question.

JUDGE DALE: It may not be directly responsive, but I believe that it should be allowed in. It is an attempt to explain why, and he does have personal knowledge of that, so I'll let it in.

MR. THOMPSON: So to recap, your Honor --

JUDGE DALE: To recap, the question --

MR. THOMPSON: Of the four sentences, two are out and two are in; is that correct? Sentence No. 1 and sentence No. 4 are in, and sentence 2 and 3 are out?

JUDGE DALE: Yes.

MR. THOMPSON: Thank you, your Honor.

MR. SWEARENGEN: And for the record, the two that are out are still preserved pursuant to the Commission rule in the Administrative Procedure Act; is that right?

JUDGE DALE: Absolutely.

MR. SWEARENGEN: Thank you.

BY MR. THOMPSON:

Q. Well, with respect to that first sentence, Mr. Gipson, I think you told me at the start of this whole thing that you did not perform any independent analysis to arrive at that 11.7 percent number; isn't that correct?

A. That's correct.
Q. And you take that, you rely on that entirely upon the testimony of your company's expert witness, Dr. James H. Vander Weide; isn't that correct?
A. That is correct.
Q. With respect to the fourth sentence which is also coming in, you make a comment about "outstanding level of service." Do you see that, sir?
A. I do.
Q. What do you mean by that phrase?
A. You know, we survey our customers on a regular basis. In fact, we're preparing to complete another customer service survey yet this fall.
And the results of that survey, surveys over the years point to what I believe is an outstanding level of customer service. And I would follow up on that with, you know, with respect to, you know, the kind of individuals we hear and attend the local public hearings in rate cases.
I believe in our last rate case there was some six people out of our 135,000 or so Missouri customers that attended that local public hearing. I believe in our water case, which is the case

preceding this one --
Q. If I could, we're not doing water today, are we, sir?
A. Okay. Well, no. I was just pointing -- just using that as an illustration, Mr. Thompson.
Q. I appreciate that, Mr. Gipson.
A. And then in this case we had three local public hearings and we had a total of 13 people show up. And I'm not trying to diminish the importance of, you know, customer interaction at the local public hearings.
I think if you put it in contrast with some of my peers in the state, that we do a pretty darn good job in meeting the levels of expectations of our customers. And that's what I mean by outstanding level of customer service that they've come to expect.
Q. Thank you for your very complete answer, Mr. Gipson. If I understand correctly, then, what you're referring to is a high level of customer satisfaction; is that correct?
A. I don't think you get customer satisfaction without good customer service.
Q. But nonetheless, the objective indications that you're relying on are a high level

of customer satisfaction; isn't that correct?
A. I think I've answered the question, Mr. Thompson. I don't think you get --
MR. THOMPSON: Could I get a yes or no, Judge?
JUDGE DALE: Ask it again.
BY MR. THOMPSON:
Q. Isn't it true that what you're relying on is a high level of customer satisfaction, yes or no?
A. Yes.
Q. Thank you. As far as you know, the lights don't come on any quicker in your service area than they do in, say, Kansas City Power and Light's, do they?
A. No.
Q. Okay. Now, when you talk about financing significant capital projects, what you're referring to, if I'm correct, is building new assets to be used in providing service to your customers; is that correct?
A. That is correct.
Q. And to do that you need to have money; isn't that what this sentence is saying?
A. We have to generate money from a number

of sources, internally generated funds. And to the extent that those funds aren't sufficient to finance our capital projects, we have to finance externally.

Q. With respect to your internally generated funds, are you familiar with the dividend policy currently being followed by Empire?

A. I'm quite familiar, thank you.

Q. And if you know, how many years has Empire followed that dividend policy?

A. Maybe I should have qualified the last question. I don't know that's so much of a policy as it is a practice. And with that exception, I've got -- it's not a short answer, Mr. Thompson.

Q. Please, take your time.

A. Okay. Our company has paid a dividend, I believe, since 1946, each quarter since 1946. For a period of time it showed a significant -- or not a significant, but a steady increase in the level of dividend over time. In 1992, I believe, was the last time we raised the dividend.

Since 1992 we've -- or since 1993 after it was raised, we paid the same dividend per quarter each year. The way that that comes about is management makes a recommendation to our board of directors each quarter based on the immediate results of operations of that quarter and the anticipated results going forward, the level of concern or interest that we may have picked up in our work with the capital markets with respect to, you know, meeting with sell-side and buy-side equity analysts and their expectations, reading their reports.

And we make a recommendation to the board of directors, and like I said, you know, we've paid that dividend continuously for some period of time.

I will tell you in April of 2005, we took a little different look at the dividend and took a look at what it was -- what was necessary for us to move forward to most efficiently, what we believe most efficiently finance our capital projects.

And the board did make a statement about that. It is not -- it's not a public statement. If you want me to read it onto the record, and I'd be pleased to, I'd ask the judge that we go in-camera to do so because I don't know who's listening out there --

MR. THOMPSON: I would like to hear that statement. Can we go in-camera, your Honor?

JUDGE DALE: Certainly. I will leave it to counsel to ascertain whether everyone is...

MR. THOMPSON: The door behind you is open, your Honor.

JUDGE DALE: You may proceed.

(REPORTER'S NOTE: At this point, an in-camera session was held, which is contained in Volume 10, pages 288 through 290 of the transcript.)

MR. THOMPSON: And if I may, I believe that last answer was not highly confidential.

THE WITNESS: That one is not. No, that's a fact.

MR. THOMPSON: Can we -- can we make --

JUDGE DALE: Okay. If -- hold the phone here.

THE WITNESS: I'm sorry.

JUDGE DALE: If I can get everything going back on and we can have the court reporter read back the question and the answer so that it's hearable.

MR. THOMPSON: Thank you, your Honor.

JUDGE DALE: You're welcome. And now, if the court reporter will read back that last question and answer.

THE COURT REPORTER: "Mr. Gipson, are you aware that testimony has been offered in this case that suggests that Empire's earnings per share are lower than the dividend that it's paying?

Answer: I'm aware of the testimony. I'm aware of the fact.

Question: And is that, in fact, the fact?

Answer: That is a fact."

JUDGE DALE: Thank you.

MR. THOMPSON: Thank you, your Honor. I have no further testimony. Thank you very much, Mr. Gipson.

THE WITNESS: Thank you.

MR. THOMPSON: No further questions, I should say.

JUDGE DALE: Do you have any questions, Commissioner Appling?

QUESTIONS BY COMMISSIONER APPLING:

Q. I wouldn't want to pass up Mr. Gipson. How are you doing, sir?

A. I'm doing well, Commissioner. Kind of tired this morning, but doing well.

Q. Get up and exercise this morning?

A. No, no. Got up and prepared.

Q. Okay. How many shares of stock in Empire's are issued?

A. We have about -- how many shares of stock do we have outstanding currently?

Q. Right.

A. About 30 million shares.

Q. Between 30 and 33 you would say?

A. No, about 30 million.

Q. About 30 million. How many shares trade each day?

A. Our average volume in the recent months has been running about 120,000 shares a day, pretty thinly traded.

Q. What's your number of shareholders?

A. The number of shareholders -- that's a little difficult to come up with --

Q. Uh-huh.

A. -- because a lot of it's held in street name, but we believe it's about 17,000 shareholders.

Q. Okay. So tell me what your percentage of breakdown of your sales is in industry, in households and what do you -- do you have a feel for that?

A. Yeah, ours -- ours is not a lot different than most of the other utilities in the state. We run about, you know, on the -- the last numbers I saw were about 15 to 17 percent industrial consumption or usage, about 30 percent what we would classify as commercial, you know, shopping centers, grocery stores, convenience stores and the remainder is residential.

Q. 11.7 is a high number. You know that, don't you?

A. I do know that.

Q. You know how many people in your area that has received a pay raise of 11.7? How many, just a good estimate? I would say that's a pretty small number, wouldn't you?

A. I guess if I classified -- the number of people who have received a pay raise of 11.7 percent? That is a small number. Are you -- the 11.7, are you referring to the ROE requested?

Q. Yeah.

A. Yeah, the 11.7 is seven-tenths of a percent greater than what this Commission allowed in our last case. So it's --

Q. Uh-huh. And when was that, 18 months ago?

A. It was, unfortunately, about 18 months ago.

Q. Come back here pretty fast?

A. I just told Mr. Robertson at the back of the room, I'd rather be about anywhere than right here.

Q. Yeah, I understand. Talk to me a little bit about how your company is doing. I know you talked about outstanding service and all that. It's not very often that you and I talk. So how is your company doing?

A. You know, I think we're doing pretty well. Our -- we set out a few years ago after the -- after the failed merger with UtiliCorp United to do a number of things and we've accomplished a great deal in terms of getting the company on the kind of financial footing and service to our customers that we wanted to get to. What we've been plagued with is not being able to recover our fuel and purchased power cost. That is not a new subject for this company.

Q. Are you able to, are your management able to hold on to the experienced people that you have in your company? A lot of peoples have retired these days.

A. We have a number of people that have -- that are retiring. We have -- ours is not a -- if you look at our work force, it doesn't look a lot different in terms of demographics than other utility companies or probably any other service company.

The thing that might be different with us is we have traditionally long-term employees. We've had some -- I wouldn't say -- I wouldn't want to characterize them as critical individuals to leave the company, but we've had a couple over the past month or so that have left the company to go on to seek other opportunities that were pretty important to us.

I don't take that as a sign of any problems internally with the organization; it's just these individuals, they saw greener pastures elsewhere and they're going to graze there.

Q. As the CEO of this organization, I don't want you to leave Jefferson City -- 11 percent is pretty high, and I just wanted to remind you of that as you depart here today and go home. That's a high number taking into consideration what's going on in this country right now. There's a lot of poor people out there --

A. Commissioner, I --

Q. -- that's struggling.

A. -- I concur with you, and we've -- I'd remind the Commissioner that at our last local public hearing, the representative from the Economic Security Corporation who asked the Commission to consider additional funds for LI HEAP programming, I just remind you that she did speak pretty highly of our company in terms of the utility companies with which she works.

You know, I said it before, this is the last place I want to be today, and had we not had the kind of dramatic increase in the cost of fuel and purchased power over what we collect in rates and frankly, over what was in, you know, year over year increases in fuel and purchased power costs -- if I look at 2004 compared to 2005, it was a $50 million increase in fuel and purchased power costs year over year. And that leaves a mark.

And you know, this Commission authorized us an 11 percent return on common equity in the last case and we have been unable to earn that principally because of fuel and purchased power costs. We have done everything that we know to do to control that and frankly, have come up short.

Q. I understand, sir, and it's not really that I don't. But it's just that somewhere in the middle we all have to try to tighten our belts as much as we can to help the people that is paying for your -- your products. Thank you very much. Good to see you.

A. Good to see you, thank you.

JUDGE DALE: Is there any cross based on questions from the Bench?

MR. WOODSMALL: Very briefly, your Honor.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. You were asked a question by Commissioner Appling regarding your service territory. I believe it was your service territory. You made a statement regarding that you believe you had an average level of industrial customers in that territory; do you recall that?

A. I think I said it was pretty typical with the other companies in the state.

Q. Okay. Do you know whether S&P evaluates or gives reports on Empire?

A. Oh, yes. Yes, they do.

Q. And do you see those reports?

A. Yes, I do.

Q. Okay. I'm just gonna read a section out of David Murray's testimony and ask you if you are familiar with that. Schedule 21-1, the third paragraph states, "Empire's satisfactory business risk profile benefits from a service territory that has limited industrial concentration."

Are you familiar with that statement? It's appeared many times in their reports.

A. I'm familiar with their opinion, yes.

Q. Okay. And would you agree that you have limited industrial concentration?

A. I don't know that I'd classify it as

limited. I'd classify -- I think I classified it as pretty typical with the other utilities in the state.

MR. WOODSMALL: Okay. No further questions.

CROSS-EXAMINATION BY MR. MILLS:

Q. And in that same line of questions from Commissioner Appling, you gave some percentages. I think you said 17 percent industrial. Those are percentages based on customer numbers rather than volumes; is that correct?

A. No. I believe that's based on kilowatt hour -- no, that's -- that's revenue, Mr. Mills.

Q. So that's by revenue --

A. By revenue, yes.

Q. -- rather than customer numbers or volumes? By revenues?

A. By revenues.

MR. MILLS: Thank you. That's all I have.

MR. THOMPSON: No recross.

JUDGE DALE: Redirect?

MR. SWEARENGEN: Just one.

REDIRECT EXAMINATION BY MR. SWEARENGEN:

Q. I think in response to a question from Mr. Thompson in your direct testimony that we've drilled down on pretty deeply here, you talked about providing your customers with an outstanding level of service.

And in response to a question from Mr. Thompson you indicated that that was -- you were talking about customer satisfaction there; is that correct? Do you recall that?

A. I do recall that.

Q. And my question is what is necessary on the part of the company to get a high level of customer satisfaction?

A. And I believe I tried to answer that with Mr. Thompson. I don't believe you can get a high level of customer satisfaction without a high level of customer service.

Q. And what does it take to do that in terms of -- as it relates back to the rate of return issue?

A. You know, I think it takes a real commitment on behalf of the organization as a whole to recognize that we're in business to serve those customers, and without the customers we don't have a business.

Q. And to the extent that you need to finance capital projects or investments to continue that level of service, how does that relate to the return on equity?

A. I think -- I think if we'd have had 300 people at a local public hearing, I don't think this Commission would have been very proud of the kind of company that we're running in southwest Missouri. And I think that would have a negative impact on their view of how to reward this company with respect to its allowed authorized return on common equity.

MR. SWEARENGEN: Thank you. That's all I have.

JUDGE DALE: Thank you, Mr. Gipson.

THE WITNESS: Judge, may I be excused for the day? We have a local public hearing in Joplin I'd like to get to.

JUDGE DALE: I'll be here for it, so, yes, you may. And then if there were any other Commissioner questions relating to these very few lines of testimony, we can have them ask them later.

THE WITNESS: Thank you.

(DISCUSSION HELD OFF THE RECORD.)

(EMPIRE EXHIBIT NO. 97 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

DIRECT EXAMINATION RESUMED BY MR. SWEARENGEN:

Q. Dr. Vander Weide, you're back on the

witness stand, and you understand you're still under oath?

A. Yes, I do.

Q. You have in front of you for purposes of identification Exhibit 97.

A. Yes.

Q. Can you explain what that is, please?

A. Yes. This is my response to a question raised earlier with regard to the effect of the removal of the highest three DCF results and the lowest three DCF results on my recommendation in this proceeding.

Q. And excuse me. Right there when you say your recommendation, are you talking about your recommendation in your rebuttal testimony?

A. Yes, I am.

Q. Okay. Thank you. Go ahead.

A. And as shown on the top with regard to the DCF results, only the removal of the highest three would lower the DCF results as updated in my rebuttal to 9.9 percent, and the exclusion of the three highest and the three lowest would reduce my DCF results average to 10.2 percent.

When those are combined with my other updated results that I reported in my rebuttal testimony, the average had been 11.6 percent. With the removal of the three highest and the three lowest, it would be 11.5 percent. And with the removal of just the three highest, it would be 11.4 percent.

This is without my financial risk adjustment, so the proper comparison would be to the 11.37 percent that I -- a result that I obtained in my direct testimony. In short, it wouldn't cause me to change my recommendation in this proceeding.

MR. SWEARENGEN: And with that, I would offer Exhibit 97 into evidence.

JUDGE DALE: Are there any objections?

(NO RESPONSE.)

JUDGE DALE: Then Exhibit 97 is admitted into evidence.

(EMPIRE EXHIBIT NO. 97 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

QUESTIONS BY JUDGE DALE:

Q. Dr. Vander Weide, if I could just get you to look down under the "Summary of all costs/ equity results updated," there are three columns.

A. Yes.

Q. If you were to label those columns, what would they be labeled?

A. The one on the right would be "Updated results from the rebuttal." The one on the left would be "Updated results without three highest and three lowest DCF results." And the one in the center would be "Updated results without the three highest DCF results."

JUDGE DALE: Thank you. Is there any cross concerning Exhibit 97?

(NO RESPONSE.)

JUDGE DALE: Are there any questions from the Bench?

COMMISSIONER APPLING: Not on my part.

QUESTIONS BY CHAIRMAN DAVIS:

Q. Mr. Vander Weide, did I pronounce that right?

A. Vander Weide.

Q. Vander Weide. Okay. I apologize. DCF CAPM, DCF CAPM, in the summary of all costs of equity results updated, you know, could you -- could you define a little more what Ex-Ante and Ex-Post are?

A. Yes. Of the methods that I used, those two are the risk premium methods. The Ex-Ante is the forward-looking risk premium which is based on the comparison of the DCF cost of equity and the interest rate on A-rated utility bonds in each month over the sample period.

And the Ex-Post is the historical or experienced risk premium which looks at the experienced returns on stock and bond investments from 1937 to the present, and compares that to the interest rate on A-rated utility bonds.

Q. Okay. Of the -- of the 31 utilities that you listed in your peer group here in your rebuttal testimony --

A. Yes.

Q. -- are you aware of how many of those utilities have fuel adjustment versus how many do not?

A. I haven't done that calculation but I believe all of them would have fuel adjustment in at least one of their states. There are only, I think, three states or so in the country that do not have fuel adjustment clauses. Virtually all the states do have fuel adjustment clauses.

Q. That's just of the states that haven't restructured, right?

A. I'm not sure whether they are states that have or have not restructured.

Q. Right.

A. These -- there are only several states in the country that do not have fuel adjustment clauses.

Q. Right.

A. And I believe that all of these would have fuel adjustment clauses with the possible exception that one or two of the companies may operate in one state among the various states that they operate in that does not. But on a consolidated basis they would represent the results of having fuel adjustment clauses.

Q. Okay. Well, let me rephrase this question then. For instance, you know Empire Electric operates in four states, correct?

A. Yes.

Q. They operate in Arkansas, Oklahoma, Kansas and Missouri; is that correct?

A. That's correct.

Q. And to the best of my knowledge, they have fuel adjustment in Arkansas, Oklahoma and Kansas, correct?

A. Correct.

Q. And do you know, I mean, what -- can you refresh for my recollection, I mean, what -- what portion of Empire's revenues and what -- you know, what portion of their business is in Missouri versus what portion is in those other three states?

A. Yes. The vast majority of their business is in Missouri. I believe it's -- I may be wrong but I believe it's something like 87 percent is in Missouri of their revenues.

Q. Okay. So would it be fair to say that, you know, a company like Empire that doesn't have fuel adjustment and, you know, a significant portion of its territory would have greater risk than utilities that are operating wholly or mostly in states that do have fuel adjustment?

A. Yes, that would certainly be fair to say.

Q. Can you, in terms of an ROE recommendation, can you quantify what you think that would be worth?

A. I think it would certainly, in and of itself, be worth 25 or 30 basis points in the cost of equity.

CHAIRMAN DAVIS: Okay. Thank you, Mr. Vander Weide.

JUDGE DALE: Other questions from the Bench?

QUESTIONS BY COMMISSIONER CLAYTON:

Q. Mr. Vander Weide -- Dr. Vander Weide. It's not easy to say.

A. Well, we have a coach called Krzyzewski at Duke as well. You have to have a hard-to-pronounce-name to work at Duke, I think.

Q. I understand. It's worth a couple of basis points extra in pay, anyway.

I was wondering, looking on the list on Exhibit 97, and this may have been stated earlier but I've been in and out and I've had several things on my mind. Can you -- is it possible to identify the companies on the list that operate in restructured versus not restructured states, or can you say with certainty that the companies are all nonrestructured company -- or companies that operate in nonrestructured states? You may have taken that into consideration in including those companies.

A. I did not specifically do that because even like California, which was originally -- it's kind of hard to say because even California, which was originally a restructured state, now has basically undone their restructuring, and I think it would be fair to say that they're unrestructured now.

Q. Is their regulatory scheme similar, then, to what Missouri's regulatory scheme would be?

A. In terms of rate of return regulation, it would be similar to Missouri. Other than that, they would have a fuel adjustment clause.

Q. Okay. So would it be a fair statement that of the 31 companies listed on Exhibit 97 that the list includes companies operating in both restructured and nonrestructured states?

A. I would say that it does include both, yes.

Q. Can you answer a general question that, are companies operating -- among the companies operating in the different types of regulatory schemes, is the cost of equity higher in restructured states or in nonrestructured states?

I guess I'll ask the first question: Is it possible to make that generalization and if so, how does the cost of equity compare?

A. I don't know how one would go about precisely estimating the difference in the cost of equity because my general view of the electric utility industry is that there's been a pull-back to undo the effects of the restructuring.

And in addition, the level of the deregulated companies that had operated in the restructured states has somewhat declined. There was a lot of excitement about restructuring in the late 1990's and the early 2000's.

That excitement, I think, has waned considerably, and so I don't think that even if a state were labeled restructured, the impact would be nearly as large as it was until late 1990's and early 2000's.

Q. Are you familiar with each of the utilities on your list on whether they're operating in a restructured or nonrestructured state?

A. It would be fairly easy for me to determine but I haven't made that determination.

Q. Okay. And I think the question earlier about -- when I asked in general, can you -- can you make a generalized statement about the nature of utilities operating in different regulatory schemes, I think your answer was no, that you weren't able to make that generalization; is that correct?

A. Yes, that's correct.

Q. Okay. So the answer is yes, that it was no?

A. Yes.

Q. Yeah. Glad we cleared that up. My last line of question regarding the summary of all cost of equity results updated on Exhibit 97 --

A. Yes.

Q. -- which I'll identify as lines 1

through 6 at the bottom of the page where you -- and you prepared Exhibit 97, correct?

A. Yes.

Q. Yes. Lines 1 through 5 indicate a different method of establishing a cost of equity, and then the three associated columns would be variations of the data placed within those formulae, correct?

A. Yes. And just to be clear, it would be similar to a table in my direct testimony which summarizes those, on page 49 of my direct testimony, table 4.

COMMISSIONER APPLING: 49?

THE WITNESS: Page 49, table 4.

BY COMMISSIONER CLAYTON:

Q. Aside from these lines -- I'm gonna come back to these lines, but just to make sure that I understand your analysis, or the result of your analysis is that the cost of equity for Empire would be 11.3 percent plus 40 basis points as a risk adjustment adder?

A. Yes.

Q. Is that a fair representation of what your rebuttal or your surrebuttal, your most recent position has been?

A. That was my position in my direct

testimony.

Q. Okay.

A. In my rebuttal testimony I updated my results but did not change my recommendation.

Q. Okay. So the recommendation -- that is your recommendation here today, is the 11.3 plus 40 basis points?

A. That's correct.

Q. So 11.7 percent is what you're claiming the cost of equity to be for Empire?

A. That's correct.

Q. All right. I got a yes answer, right?

A. Yes.

Q. Right. Good. So in coming up with that 11.7 percent, are you basically taking the average of the three figures -- are they -- excuse me, the five different methods of establishing the cost of equity?

A. Yes. If you look at table 4 in my direct which is on page 49 --

Q. I've got page 49 out.

A. -- there you see the 11.3 at the bottom --

Q. I see.

A. -- which is an average of the five methods above, and if you add the 40 basis points to that, you get 11.7.

If I had -- updating the results rather than 11.3, it would be in the range 11.4 to 11.6. So it's slightly higher in total than it was at the time of my direct testimony, but I'm not changing my recommendation. It's very close but slightly higher.

COMMISSIONER CLAYTON: Okay. Thank you very much for your time, Doctor.

QUESTIONS BY COMMISSIONER GAW:

Q. Just to follow up on that for clarification. Dr. Vander Weide, if -- just to verify, the numbers which you provided us on this latest filed exhibit which is Exhibit what, Judge, 97? Are those numbers in that third column down there at the bottom under the word "result," are those numbers from your rebuttal?

A. Those numbers are from my rebuttal, yes.

Q. Okay. And that would be the same in regard to the numbers up above there in the lines 1 through --

A. When you see --

Q. -- 31?

A. 32.

Q. 32, excuse me.

A. Would be the same as in my rebuttal.

Q. Okay. And to clarify, when you're averaging all of these on page 49 of your direct, is that just purely an equal weighted average of all of those end results?

A. Yes.

Q. And that methodology of -- coming up with a -- with an average or with an equity cost, is that something that you have done before?

A. Yes.

Q. Have others done that, others done that same kind of calculation?

A. Yes.

Q. And is that something that's accepted in some treatise somewhere?

A. I don't think it's in a treatise. If we're thinking about a research treatise, they usually don't get into the detail of talking about how you ought to weight different methods and research treatises.

This would -- I think various witnesses might weight these results differently and they might -- most of them would use a variety of methods but they might not have exactly the same methods that I do. That would be based on their own professional judgment.

COMMISSIONER GAW: Okay. Thank you, sir.

JUDGE DALE: Is there any recross based on questions from the Bench?

MR. WOODSMALL: Yes, your Honor. I believe I'm first.

JUDGE DALE: Yes.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. You were asked several questions. We'll start off with the bottom of Exhibit No. 97 talking about "Summary of all costs of equity end results updated." Under the DCF analysis, you show 10.2 percent, is that correct, for the -- after you dropped the three highest and the three lowest; is that correct?

A. Yes.

Q. And that merely reflects the change that you made requested by the Commission to your electric utility comparable company analysis; is that correct?

A. In my comparable company DCF analysis?

Q. For electric utilities.

A. Right, yes.

Q. Okay. You have not provided an update for gas utilities in your DCF? For those are still

9.6 percent; is that correct?
A. No, it's not -- it's not 9.6. I forgot to update those natural gas results.
Q. As far as the evidence in the record today, your only analysis for gas utilities is a DCF of 9.6 percent; is that correct?
A. That's correct.
Q. Thank you. You did not average that 9.6 with your updated 10.2 for electric utilities; is that correct?
A. No. Because in my --
Q. Thank you, sir, that was a yes no question. And you agreed with me earlier that Empire District is both an electric and a gas utility; is that correct?
A. Yes.
Q. Okay. Would you agree with me -- you were asked several questions about the DCF. Would you agree with me that there's different versions of the DCF?
A. Yes.
Q. Okay. Could you tell us some of those versions?
A. Well, I'm not sure entirely how you would refer to versions, but I might refer to

versions by the timing of the dividends.

Q. Okay. And I believe you characterized the Ex-Ante and the Ex-Post both as risk premium methods; is that correct?

A. Yes.

Q. And both of those led to higher results than the DCF; is that correct?

A. Yes.

Q. Would you agree that if you used different versions of a test that has higher results, it will skew the average higher?

A. I was beginning to agree with you until you used the word "skew." The word skew seems to have some devaluative association with it which I would not agree with that word.

Q. Okay. I'll change that word. Would you agree that if you used methodologies that lead to higher results and used different versions of that methodology, that the use of those versions will cause the average to go higher?

A. Compared to what?

Q. Compared to if you'd only used one version of that analysis?

A. I'm not understanding the question.

Q. Okay. Let's try it from another angle.

If you had used the other version of the DCF using the different growth, would it have given a number lower than the risk premium?

A. I'm still not understanding.

Q. I --

A. I didn't use different growth rates. I only used one growth rate.

Q. And that's what I'm attempting to criticize you for. If you had done that and you had added that version of the DCF to this averaging, you would have received a lower average; is that correct?

A. If I had -- when you said if I had done that, what do you mean by I had done that?

Q. If you had done the other versions of the DCF that you acknowledge exist?

A. Well, just to clarify, the versions that I acknowledged exist didn't have to do with growth rates; it had to do with the timing of the dividends.

And with regard to the annual DCF versus the quarterly, and the way that the model leads to an annual DCF equation, and namely, the way I would implement the annual DCF result, it would not be very different from a quarterly DCF result, and it would not have any impact on my average of the results of the group.

Q. You acknowledge that there's two risk premium methods there; is that correct?

A. Yes.

Q. There are two CAPM methods there; is that correct?

A. Yes.

Q. There is one DCF method there; is that correct?

A. There are -- there's a difference. There's --

Q. In your analysis there is one DCF method included in the average?

A. That is not correct.

Q. Would you please explain that?

A. Yes. To arrive at the -- well, it is correct with regard to the updated. With regard to the originals shown on page 49 of my direct testimony, the DCF result was already an average of a DCF result for electric companies and a DCF result for natural gas companies. So that was already averaged in, and so there were two DCF results, one for electric, one for gas.

Q. You averaged your two DCFs before you averaged it with the other analysis; is that correct?

A. That's correct.

Q. Okay. You did not average the CAPM with the DCF prior to averaging with the others; is that correct?
A. Because they were --
Q. You're --
A. That's correct.
Q. I'm asking -- thank you. That's all I have on that.
A. And there's a good reason for it.
Q. And you did not average your risk premium analysis prior to averaging with the other methodologies; is that correct?
A. Correct.
Q. If you had not averaged the DCF of the gas and the electric together, you would have a sixth result here, and that would be 9.6 percent; is that correct?
A. No.
Q. You told me previously that you averaged the gas and the electric and what we see here is the electric number; is that correct?
A. Correct.
Q. And there is a gas number that did not get averaged; is that correct?
A. There is a gas number but there is not

an updated gas number.

Q. You told me that --

A. The updated gas number is higher than the original gas number.

Q. The only number that you said was in evidence is the 9.6 percent DCF per gas; is that correct?

A. I did say that, yes.

Q. Thank you. And you did not include that as a separate entry when you did this averaging, did you?

A. Because I did not --

Q. Yes or no question. You did not include the 9.6 percent when you did this averaging?

A. No, I did not.

Q. Thank you. Going on to the companies listed above, you were asked a number of questions regarding whether those companies operate in restructured environments; do you recall those questions?

A. Yes, I do.

Q. Would you explain to me in general how a restructured state differs from a vertically integrated state like Missouri?

A. I don't understand the distinction you make between restructured and vertically integrated. To me those are two different concepts.

Q. And I'm asking you to describe the differences. I'll do it for you. In a vertically integrated state would you agree that distribution transmission and generation are all integrated in a single company?

A. Yes. And I wouldn't say that's a state issue, it's a company issue. A vertically integrated company is one where electric transmission and distribution are all activities of one company.

Q. Okay. And in a restructured state in general, the generation and the transmission has been split off, separated from the distribution function; is that correct?

A. I don't think the distinction is that clear.

Q. Can you tell me then, provide me a definition when you talk about a restructured state, tell me how you are defining that term.

A. Restructured state would be one where there is wholesale competition and, hence, there's -- there are nonregulated companies in the wholesale market.

Q. In the wholesale market, are you

referring to the generation function?
A. They -- normally it would be generation but they could also have some transmission.
Q. Okay. But in general, the competition in a restructured state has been introduced at the generation and/or the transmission level; is that correct?
A. Yes.
Q. The distribution company does not generate its own electricity; is that correct?
A. That part is not correct. In some restructured states, in my mind, the regulated utilities still might have some generation and transmission and distribution even though they compete with another company that's not regulated.
Q. Okay. Let's look at a state like Illinois. Are you familiar with Illinois?
A. Somewhat.
Q. Would you agree that the distribution companies consolidated Edison and Ameren SIPS, Ameren CILCO, those companies are primarily distribution companies; that is, they do not generate electricity?
A. By distribution you mean distribution and transmission or do you mean just distribution?
Q. I'm --

A. I understand --

Q. I'm saying they do not generate electricity.

A. That's my understanding.

Q. Okay. And in order to provide the service that they must provide to their customers, they are forced to look elsewhere for the generation of electricity; is that correct?

A. Yes.

Q. They procure that electricity elsewhere on behalf of their customers; is that correct?

A. Yes.

Q. Those companies would not have -- those companies, being the distribution company, would not have fuel expense; is that correct? They do not procure their own fuel?

A. When I use the word -- they don't procure their own fuel. When I use the word "fuel," I mean fuel and purchased power. Fuel is the shorthand.

Q. Okay.

A. And for those companies they would purchase power.

Q. Okay. Exactly. Those companies, in order to procure the power that they need to provide to their customers, they would do that via a power purchase agreement?

A. Yes.

Q. And in general, would you agree that that power purchase agreement would provide a set price for electricity?

A. No.

Q. You would say that it provides when -- when a distribution company such as Ameren and Illinois puts out for bid its generation needs, there is not a set price for that?

A. There is not a single pattern. And the company may have some long-term contracts, it may have some short-term contracts.

Q. Okay. Can you tell me, company No. 7 on your list, Great Plains Energy, are you familiar with that?

A. I'm familiar from an investment point of view, not necessarily the details of their operations.

Q. Do you know the name they operate under as an electric utility?

A. I believe that's Kansas City Power & Light.

Q. Okay. And they operate where?

A. In Kansas.
Q. In Kansas?
A. Yes.
Q. Do you know if they have a fuel adjustment clause in Kansas?
A. I believe they do.
Q. You believe that Kansas City Power & Light has a fuel adjustment clause in Kansas; you're not aware of the position they've taken in their rate case before the Kansas Commission currently?
A. No, I'm not.
Q. Okay. So you're not -- you're not knowledgeable about whether they do have a fuel adjustment clause in Kansas?
A. You asked me for my belief. I'm not -- I'm not certain of that belief.
MR. WOODSMALL: Okay. I have no further questions. Thank you.
JUDGE DALE: Mr. Mills?
MR. MILLS: Yes, thank you.
RECROSS-EXAMINATION BY MR. MILLS:
Q. Commissioner Clayton asked you some questions about the bottom of Exhibit 97. You -- for line No. 1 there at the bottom, you've adjusted the

results based on -- in two of the columns in line 1, you've adjusted the results based on the elimination of three or six companies from your proxy group; is that correct?

A. Yes.

Q. Do lines 2, 3, 4, 5 of the bottom of Exhibit 97 still rely on the entire 31 companies in your proxy group?

A. Certainly, lines 2 and 3 represent -- have the average betas for all of the companies. The -- lines 4 and 5 do not have 31 companies. Those are -- those are different companies. And at the Ex-Post was the S&P utilities, for example, going back to 1937. And the Ex-Ante was a group that was a varying group that met my criteria in each of the months of the study.

Q. Okay. But to the extent that your two CAPM studies rely on the same proxy group, if you were to make the same adjustments to that group as you did for line 1, would the results in lines 2 and 3, to a certain extent, mirror the change in results that line 1 has?

A. No, I don't believe they would. I believe they would go in the other direction.

Q. So you think if you took out the

companies with the highest ROE from your CAPM, that that would drive your CAPM results higher?

A. Oh, if you just took out the highest, yeah, that would necessarily drive it lower as an arithmetic thing, but that wouldn't be appropriate to take out the highest without taking out numbers on the low side.

Q. Okay. But when you did that for column -- I'll call it the middle column at the bottom for your DCF method, that dropped your DCF result. If you did the same exercise with your two CAPM studies, would that have the same result?

A. I would necessarily, if one were to take out the companies with the highest betas, as a pure arithmetic thing, it's undoubtedly true: You take out numbers that are above the average, you're gonna reduce the average.

Q. Right. And if you were to do that, then the result on line 6 would also drop, would it not?

A. It would, as a matter of arithmetic, go down.

Q. Okay.

A. I don't believe it's appropriate, but it would go down.

Q. So you believe it's appropriate to use a different proxy group for the CAPM as you do for the DCF?

A. No. What I was referring to is I don't believe it's appropriate to look at a list of numbers, take out the three highest and recalculate an average and say that's an estimate of the cost of equity.

Q. But if you were trying to do an illustration of the results of removing the highest three ROE companies, to be consistent, wouldn't you also remove the highest three ROE companies from your CAPM studies as you would from the DCF?

A. Not really because I didn't do the CAPM by individual company, I did it as a group. That is, I just took the average beta for all the companies and I didn't use a different interest rate or a different risk premium; I just applied that average beta to the risk premium on the market to get -- to get a CAPM. I didn't do it by individual company.

Q. Would the companies with the highest ROE's have the highest betas?

A. Yes.

Q. So if you were to take out those companies in your CAPM study, wouldn't your CAPM result be lower?

A. It would no longer be my study but it would be an arithmetically lower result.

Q. Right. And would it not be more in line with the kinds of questions that the Commission was asking you that this exhibit is intended to illustrate, if you were to take the same approach to your CAPM study that the Commission asked you to take of your DCF study?

A. I just don't know.

Q. Okay. Let me ask you another question. The Commission asked you to recast your DCF study; is that correct?

A. Yes.

Q. The Commission did not ask you to average that recast and DCF number with the results of your other studies, did they?

A. I don't know. I understood the question to be what would be the impact of -- on my recommendation and the impact on my recommendation would -- was since my recommendation was based on the average of these results, the only way to address the question of what -- of what would be the impact on my recommendation would be to average it with the other methods.

Q. Okay. But when you recast your DCF

method, you did not similarly recap your CAPM method based on the same criteria that the Commission set for you; is that correct?

A. I didn't see any reason to recast the CAPM method because I did not calculate a CAPM result by each company.

Q. But had you done that, the average that you're showing at the bottom and which you have testified to, would have gone down, would it not?

A. It seems to me that you're testifying that it went down. I didn't do that calculation and I don't believe it's appropriate.

Q. If the Commission were to have asked you to do the same thing with your CAPM models that they asked you to do with your DCF model, the results for your CAPM studies would have gone down, would they not?

A. Again, I don't know what you mean by the same thing because they would have had to see a schedule where you showed a CAPM result by company for all 31 companies, and then have said take out three of those 31. I never did calculate it by companies and show a schedule where you had 31 company CAPM results.

MR. MILLS: Okay. No further questions.

MR. THOMPSON: No questions.
QUESTIONS BY COMMISSIONER CLAYTON:
Q. Before we go to redirect, I'm confused about something and I want to make sure I understood -- I think I understand what the line of questioning was, but I'm looking at Exhibit 97 and the summary lines 1 through 6 down at the bottom of the page.
A. Yes.
Q. And I suppose I want to ask the question this way: On line 2 and 3, the two CAPM studies and in columns 1 and 2, the data that was run with suggested changes by Commissioners, the data in those items under CAPM, row 1 and 2, use different data than -- than the line 1 which actually modified the input data, correct? So would you agree that we have an apples-to-oranges comparison in cost of equity numbers?
A. No.
Q. Okay. Why?
A. Because the question that was put to me was to take out either three or six DCF results and what would the impact be on my recommended cost of equity based on my rebuttal testimony. And the only place where I'd look at individual company results is

in the DCF method, and so you would see three or six results that you could take out.

Q. Now, you suggested that in the CAPM model, didn't you say you took an average of the beta?

A. Yes, I did.

Q. And the beta includes a calculation of the cost of equity from other companies; is that correct?

A. No. The beta doesn't include an estimate of the cost of equity; it's just a number that goes into the estimate of the cost of equity.

Q. A number that goes into the cost -- tell me what the beta is. Why don't we -- let me ask that question.

A. All right. Well, if I could step back, I would tell you what the CAPM is and then I could explain what the beta is.

Q. Pretend I'm a student.

A. Okay. The CAPM is based on the assumption that the cost of equity is the sum of the risk-free rate, plus a term beta times the risk premium on the market as a whole.

So it's the sum of two terms and the second term is a product of two terms. So beta is one of the three inputs into the CAPM result.

Q. Okay.

A. And when I calculated the CAPM for electric companies, I took the -- oh, you asked me what beta was. I'm sorry, I didn't --

Q. Yeah, go ahead and define beta for me.

A. So beta --

Q. I know it's somewhere in the testimony but I'm not -- just tell me what it is.

A. Sure. Beta is the measure of the risk of the utility compared to the market as a whole.

Q. Okay. What is the formula for beta?

A. That's a little harder to --

Q. Okay. Then I'll take that back. The risk of the utility compared to the rest of the market?

A. Right.

Q. So when you assess the risk of a utility, how do you determine that component?

A. Okay. What is normally done is you look at 60 months of data, historical data, so you take the return on the market index, say the S&P 500, over the last 60 months and you take the return on the -- on a company.

Q. On a utility --

A. On a utility.
Q. -- on a given subject utility?
A. Right. And you see what the relationship is --
Q. I understand that, but the first part, the actual data of the specific utility, the specific company, what component, what data are you using there?
A. 60 months of returns, which -- and a return is dividend plus a price gain or loss in that month. That is, if you bought -- if you bought the utility on the first day of the month and you sold it on the last day of the month, what return would you have gotten.
Q. Okay. So nowhere in that risk of utility is included a cost of equity component --
A. That's correct.
Q. -- or a return component? It's a dividend --
A. Well, the cost of equity is the result of three inputs, one of which is beta. The beta is not a result of the cost of equity. The cause and effect goes from getting a beta and then estimating the cost of equity.
Q. So you don't use a cost of equity to

determine the beta, you use the beta to determine the cost of equity?

A. Correct.

Q. So in anywhere in lines 2 and 3, the CAPM methods, it's your testimony that there's no way to modify the analysis under those lines with corrected or amended data as you did in line 1?

A. There would -- there would be a way to do it. I didn't -- I didn't -- that wasn't the way I calculated it in either my direct or my rebuttal.

Q. I understand -- I understand that.

A. Yes.

Q. I'm just trying to -- I'm trying to determine whether the comparisons in the columns are fair comparisons. You used different input data on line 1 --

A. I believe the other --

Q. -- than you did -- than you did in line 2?

A. No. Well, yes, because there are two different methods. You would use different input data. But I believe it's a fair comparison because this is -- this is the way I -- this is the way I implemented my methods. This --

Q. So if you would have had a clairvoyant ability to know that the question would be raised of excluding the three highest subject companies and the three lowest cost of equity subject companies in your rebuttal testimony, and you would have run your analysis based on that data, would line 2 and line 3 entries for columns 1 and 2 be different?

A. My first reaction would have been to leave them the same, and that's why I guess I did leave them the same. It didn't even occur to me to do them differently.

If I had been asked to do them differently, in column 1 where you would take out -- you would look at an individual company's CAPM and take out the three companies with the highest betas and the three companies with the lowest betas, I believe that would have led to a higher CAPM result because the --

Q. Well, I think you're going -- you're answering more advanced than what my question is suggesting. Let me ask first, would the -- line 2, column 1 and 2, if you would have excluded the same six companies as you did -- or the same three companies or the same six companies, would the numbers come out differently, the 12.2 percent under line 2?

A. I don't know the answer to that because the same six companies that had the highest and lowest DCFs don't necessarily have the highest and lowest CAPMs. And I didn't do it by company, so I don't know what the CAPMs were for those six companies.

Q. Would it be a better comparison, then, rather than excluding the same six companies as you did on this first column, would it be better to say exclude the three lowest betas and the three highest betas in finding the result for line 2, column 1 on CAPM?

A. That would be a -- a fairer comparison. It's not one that would have been natural to me to do.

Q. To eliminate the extremes?

A. No, to do the -- to do the CAPM by individual company and --

Q. But you take an average of the beta, right?

A. Right.

Q. So I mean, you're changing an average of the beta by eliminating certain companies that are -- certain companies' betas that's being used to determine the average beta?

A. Right. But the betas one, didn't show as wide a dispersion as the DCF results, which there was quite a wide dispersion of DCF results from the lowest to the highest.

They tended to cluster quite a bit more closely to the average beta result and you didn't see some that were way out on one side and way out on the other side. So it wouldn't have been -- it wouldn't have been as natural to say, well, let's take out these highs or these lows.

Q. Now, is that the same for the DCF CAPM, the same -- your answer is the same for both the CAPM and the DCF CAPM?

A. Yes.

Q. Could you quickly -- and this will be my last question. Can you explain to me briefly what the -- you've explained CAPM -- what the DCF CAPM is?

A. Yes. In the CAPM I mention that one had to estimate the risk premium on the market portfolio, and there are two ways to do that. One is to use historical data and look at -- estimate the risk premium on the market portfolio based on the historical difference between the return on the market and an interest rate.

Another way is to estimate the risk

premium on the market by calculating the DCF result for the market as a whole.

Q. Which is more forward-looking?

A. Is more forward-looking?

Q. Yeah.

A. And comparing that to the interest rate.

Q. Okay. And that's used for both -- you look at forward -- forward-looking data for both the subject company as well as the market as a whole?

A. Right.

Q. Okay. I hope you agreed on a bell curve; keep it fair for folks. Thank you.

JUDGE DALE: Commissioner?

COMMISSIONER GAW: Thank you. I didn't have questions but now I do, so I apologize.

QUESTIONS BY COMMISSIONER GAW:

Q. And these are just very basic questions and I think I'm going to ask you to repeat answers that you've already given in your written testimony. But in regard to the last column that is on your Exhibit 97 on the cost of equity, would you -- would you mind saying again how you come up with those numbers?

A. Yes. They -- and maybe again, comparison to that table 4 on 49.

Q. Yes, I have that on your direct.

A. Those were the results of my five methods as of the date of my direct testimony.

Q. Yes.

A. The third column of numbers in 97, it would be the results of my five methods as of the time of my rebuttal testimony.

Q. Okay. Actually, I think I'm asking you for something different than what you're -- what you're giving me an answer for and it's my fault. The -- I'm just exclusively talking about cost of equity on the top portion for each of the companies on 97, on Exhibit 97.

A. Okay. So you're looking at the top rather than --

Q. At the top, yes, sir. I apologize for not making that clear. Tell me how you came up with those -- those figures for each company.

A. Okay. There the appropriate place to look would be in my rebuttal exhibits, and particularly rebuttal schedule JVW-1.

Q. Okay. Do you want to explain to me that calculation?

A. Right. So in the ten nine that's shown on line 32 is just -- is just the average as it was reported in schedule -- rebuttal schedule JVW-1. The 99 is a recalculation of the results in rebuttal schedule JVW-1, taking out the three highest numbers.

Q. Yes, sir. But I want to -- I want to stop you for a moment.

A. Okay.

Q. Because what I want you to do is just very briefly, if it's possible to do that, walk me through your calculation on JVW-1.

A. Yes.

Q. And explain to me how you come up with, for instance, the cost of equity for AEP.

A. Okay. That's -- that's the -- that's a DCF equation which is given on the notes in the next page.

Q. All right.

A. And it basically requires that you have estimates of the next four quarterly dividends and you have a stock price and you have an estimate of growth.

And so that's just -- that's just a DCF model estimate of the cost of equity as applied to data for American Electric Power.

Q. Okay. Now, you've looked at -- obviously looked at other testimony from the other

witnesses here on this subject matter.
A. Yes.
Q. Is there disagreement in regard to this portion of the calculation -- of your calculation?
A. Yes, there is.
Q. Okay. Explain to me your viewpoint on that disagreement on calculation of cost of equity on -- as you've done on JVW-1.
A. Yes. Every DCF equation for the cost of equity which I use in this exhibit depends on a DCF equation for the price of the stock. In my DCF equation I'm assuming that the price of the stock is the present value of this future stream of dividends which I received on a quarterly basis.
The -- Mr. Murray and Mr. King assumed that the price of the stock is the present value of a future stream of dividends, but they're assuming that the dividend occurs -- is an annual dividend and that it occurs at the end of the year.
Q. Okay. Is there any other disagreement in regard to the calculation on this part?
A. I think that would -- that's all there is between the DCF model.
Q. Okay. Now, if I go to the -- let me go back to your Exhibit 97 for a moment. On the CAPM

calculation, I need you to give me a little bit better description, at least from my vantage point, on the way you're calculating beta for Empire.

A. Oh, I didn't calculate beta myself. I accepted the data from Value Line. Value Line estimates the betas --

Q. Okay. All right.

A. -- for each of the companies.

Q. Now, you were discussing averaging betas earlier.

A. Yes.

Q. How does that averaging a beta play into line No. 2 down at the bottom of Exhibit 97?

A. Okay.

Q. If at all?

A. It does enter into line 2.

Q. All right.

A. It's well-established that the betas for individual companies are very inaccurate measures for their risks. When one estimates it statistically, one gets very poor statistical results.

And it's also well-established that when you estimate a beta, you ought to do it -- you get much greater accuracy when you estimate it for a portfolio of companies than you do for any single company.

So based on those two observations, I looked at the betas reported by Value Line, and to get an estimate of the -- of the beta for a typical electric company, I averaged the reported Value Line betas shown from Value Line.

Q. And were the -- were the averages that you used the averages of the same companies that you have listed?

A. Yes, they were.

Q. On Exhibit 97?

A. Yes.

Q. Now, just -- you've already told me that you wouldn't do this I think, but what -- what would the CAPM amount be if you just placed in the beta for Empire?

A. It would be lower because Empire happens to have a lower beta. But again, I wouldn't do that because --

Q. Well, I understand you wouldn't do it.

A. Yeah, okay.

Q. But what would the number be, do you know?

A. I haven't done that calculation.

Q. Maybe someone else will do it before

they get up here and I'll get that answer.

A. Well, I could probably do it with my calculator if we have time.

Q. I thought you might change your mind about how easy we could get it done.

A. If you put in Empire's beta, and recognizing that I had to do this pretty rapidly --

Q. Yes, sir.

A. -- I believe you would get a result of nine eight.

Q. Nine eight. Okay.

A. And again, the beta for Empire would be a highly uncertain number. It's not statistically significant.

Q. Would it -- would it be -- just looking across line No. 12 on 97 which is up above there for Empire and again, there are some similarities in regard to the inputs into the CAPM and DCF; would that -- would that be correct? There are some similar figures that go into the calculation that are not the same but there are some similar things such as dividends?

A. It's kind of hard to say. In the CAPM the equation doesn't -- you don't see dividends anywhere.

Q. It impacts the beta though?
A. But it impacts -- it impacts the beta because it impacts the return over the last 60 months --
Q. Yes, sir.
A. -- in calculating beta.
Q. Okay. Well, in just looking at line 12 in that cost of equity for Empire at 9.2 percent, what drove -- in that calculation that you would have explained that you made in your rebuttal, I believe you said.
What drove that number to be 9.2 percent? was there a particular portion or factor inputs that you would attribute that number to, or was it just a combination of everything in the calculation.
A. I believe it was a combination of everything, and my philosophy is to regard the result of applying any one of these methods to one company with a high degree of skepticism.
Q. Yes, sir.
A. Because one has to estimate things like the growth rate and it's very hard to do.
Q. Okay. The growth rate being defined as?
A. The growth in dividends in the DCF approach.

Q. Okay. And this is also something Commissioner Clayton asked about. If you wouldn't mind walking me through briefly the DCF/CAPM calculation.

First of all, let me ask you, when you use DCF on line 3 down below there, that -- that calculation of the DCF portion if that can be even stated, is that a different methodology of calculating the DCF portion than the DCF calculation in No. 1?

A. It's the same methodology but for a different set of companies.

Q. Okay.

A. And the companies are the market as a whole.

Q. All right.

A. Because we're trying to estimate the expected return on the market as a whole in the capital asset pricing model.

Q. Okay. And what was the number for the DCF as a market -- of the market as a whole, do you recall?

A. What it is right now.

Q. Okay. It was higher than the DCF that you found in line 1?

A. Yes. It was approximately 13.
Q. Approximately 13?
A. Plus or minus a little bit.
Q. And when you say "the market as a whole," what companies are included in that?
A. That would be the S&P 500.
Q. So we're talking about companies that are not regulated?
A. Yes. And that's what the CAPM requires and it adjusts that by multiplying that number by the beta to get the risk of the individual company.
Q. So it gets that number. And then the CAPM portion, is that the same as 2 or not, line 2?
A. The result of applying the CAPM is line 2 using data at the time of my rebuttal testimony.
Q. Let me -- I'm just really trying to focus in on just general methodology here.
A. Okay.
Q. Is the CAPM portion on line 3 the same as the CAPM in line 2 or is it a different set of betas there as well?
A. It's the same betas.
Q. Same betas, okay.
A. It's the same risk-free rate.

Q. Okay.

A. It's a different approach for estimating the required risk premium on the market as a whole.

Q. Can you describe the difference?

A. Yes. In line 2 I estimated the required risk premium on the market as a whole using historical data. In line 3 I estimated the required risk premium on the market as a whole using the DCF model applied to the market as a whole.

Q. I lost you at the last part of that.

A. Okay. So they both have the same betas, they both have the same risk-free rate.

Q. All right.

A. They use a different method to estimate the required risk premium on an investment in the S&P 500.

Q. Okay.

A. The first one uses historical data.

Q. When you say "the first one," are you talking about line 2?

A. Line 2.

Q. Go ahead.

A. And I believe that -- that one was pretty clear.

Q. Okay.

A. In line 3, rather than using historical data to estimate the risk premium on the S&P 500 on an investment in the S&P 500, I used the DCF method which is forward-looking to estimate the return and, hence, the risk premium on the S&P 500.

Q. Okay. Is that why DCF is in front of CAPM on line 3?

A. Yes. It's not a DCF applied to electric utilities.

Q. Yes.

A. It's a DCF applied to the S&P 500 --

Q. Okay.

A. -- before it's multiplied by the beta of the utilities.

Q. Okay. So is it CAPM -- I'm sorry I keep belaboring this. Is the CAPM a portion of the numbers in that portion of line 3, just the CAPM portion, is that basically the same as CAPM inputs in line 2 except for the DCF insert in the -- in line 3?

A. Yes. The -- the CAPM is three inputs.

Q. Yes.

A. The risk-free rate, the beta and the risk premium on the S&P 500.

Q. Yes, sir.

A. Two of the inputs are the same, the

third input, the risk premium on the market, the S&P 500 is different.

COMMISSIONER GAW: Yes, sir, I think I follow that. And that's all I have. Thank you. I apologize for belaboring that, Judge. Thank you.

JUDGE DALE: Did you have more questions?

CHAIRMAN DAVIS: Sure, just a couple.

QUESTIONS BY CHAIRMAN DAVIS:

Q. Doctor, I'm not even gonna try to pronounce your last name this time. I'm just gonna skip it. The cost of equity numbers in your last column in this testimony as well as in your surrebuttal testimony, those aren't the Commission-awarded numbers for equity, are they?

A. They are not.

Q. Do you know what the last Commission number -- numbers awarded for equity in -- for each of those utilities are?

A. I do not. I know what the average allowed return was in the last year but I don't know -- I don't have it by each of these companies.

Q. Okay. What was the average allowed return in the last year?

A. I believe it was about 10.6.

Q. And do you think that's a statistically significant number?

A. It's statistically significant for the -- for allowed rates of return. That is, it's not a DCF result or a CAPM result, it's an average of what was allowed across the country.

Q. It's just an average of what was allowed? And do you think that Empire Electric has more risk or less risk than the average utility?

A. It has more risk as evidenced by the fact that it's the average bond rating for the -- for the electric utilities is triple B plus, and for natural gas companies it's A minus.

Empire's is triple B minus which is two grades below the average of the electric companies. And the Value Line safety rank is an average of two on a scale of one to five, where one is the safest and five is the least safe.

It's an average of two for both the electrics and the natural gas, and it's a three for Empire. So both the measures for Empire are -- show more risk than for the average electric or natural gas company.

Q. Doctor, are you aware -- I mean, is there any -- are you aware of any statistical research out there that show -- that shows how many utilities actually earned their commission, allowed return on equity, what portion of them do, what portion of them over-earn, what portion of them under-earn?

A. I don't think there's any research, but I have an impression of that since I follow the utilities on a regular basis.

Q. Would you care to give us your mental impression?

A. Okay. My mental impression is that for the majority of electric utilities, they earn their allowed returns and they are expected to earn their allowed returns.

Empire has been unable to earn its allowed return and it's partly at least because they do not have a fuel adjustment clause because they're -- their purchased power cost and their fuel costs have been higher than they've been able to recover in rates.

Q. Okay. Doctor, this is my last question. You referenced a number for 10.6 for what you cited as a national average for return on equity rate case decisions?

A. Yes.

Q. If that's from a document, can you find that document and produce it? Maybe it's in a publication or some kind --

A. There's a publication called "Regulatory Research Associates" which regularly tracks allowed rates of return across the country for electric, gas and water cases.

Q. Uh-huh.

A. And I don't know if I have it. I certainly --

Q. We can -- we have a subscription here at the Commission. We might be able to find it.

A. All right. Well, that's where it is.

CHAIRMAN DAVIS: Thank you, Doctor.

JUDGE DALE: I know that Dr. Vander Weide would like to catch a plane, so if people are willing, instead of breaking for lunch at this time, if we can conclude his testimony, is that all right with everyone who's here?

MR. SWEARENGEN: Let me say this: It may turn out that he does need to take a break and redo that calculation because I want to make sure I understand first of all the question that Commissioner Gaw put to the witness on the stand about the calculation that he made on the fly while he was sitting up there and make sure that the inputs are right.

That's one of the risks of trying to do one of these things when you're sitting there. We want to make sure that we understand, first of all, the question that was asked and the inputs that went into it and it may turn out that he needs to redo that.

JUDGE DALE: If he does need to redo it or if he looks at it cooly at a later time and determines that he has made an incorrect calculation, he can always --

MR. SWEARENGEN: Submit that.

JUDGE DALE: -- submit a substitute and clarify -- explain in prose what was wrong with it and --

MR. SWEARENGEN: That would be fine. We can certainly -- that would be acceptable.

MR. MILLS: Well, that may not be acceptable to me. I mean, I -- if he's going to offer more evidence that we have no opportunity to cross-examine him on, then I think there's a real problem there. He certainly didn't indicate that he had any question. If his counsel is hinting that maybe he did it wrong, then I think that's improper as well. If Dr. Vander Weide thinks his calculation was accurate, then I think we're done.

MR. SWEARENGEN: Well, I just want to make sure he understood the question and the inputs and I would ask him those questions on redirect.

JUDGE DALE: Well, then --

MR. MILLS: I think that's appropriate redirect. I think it's inappropriate for coaching. I think if Mr. Swearengen wants to ask him that redirect question on the record, I think that's fine. I think if we want to have some input to tell Dr. Vander Weide that he's done it wrong, I think that's inappropriate.

JUDGE DALE: First, let me get an answer to my question, which is, shall we break for lunch or shall we continue with this witness until he is finished?

MR. MILLS: I suggest we continue.

JUDGE DALE: From the Bench?

COMMISSIONER APPLING: Press on.

JUDGE DALE: Press on. Okay. Then we will move on to recross based on questions from the Bench.

MR. WOODSMALL: Very, very briefly, your Honor.

JUDGE DALE: Thank you.

RECROSS-EXAMINATION BY MR. WOODSMALL:

Q. You were asked some questions by Commissioner Gaw regarding the last column of your summary at the bottom of Exhibit 97. Do you recall that?

A. Yes.

Q. And at the bottom of that you have an average which is your updated rebuttal result of 11.6; is that correct?

A. Yes.

Q. If you were doing your ROE analysis for Empire at this time, it would be your opinion that ROE -- that Empire should be authorized a 12.0 return on equity; is that correct?

A. I think we asked -- I suggested earlier that I have not updated -- I've not changed my recommendation.

Q. If you were doing an updated study using your 40-basis-point adjustment that you stated earlier, you would take the 11.6, add 40 basis points, and you would be at 12.0 ROE; is that correct?

A. Yes.

Q. Can you tell me when the last time in your knowledge any state public utility commission authorized a 12 percent ROE?

A. Not off the top of my head.

Q. You can't -- any time in the last five years?

A. Yes, I believe there was a 12 percent for -- in Wisconsin, and I know in Iowa there was an 11.9 for MidAmerican which is virtually equal to 12. And I believe in the last five years there have been electric transmission proceedings before the FERC in which there were numbers in excess of 12 percent.

MR. WOODSMALL: The only other question I'd have, your Honor, to the extent that this witness, in response to a question from Chairman Davis, used the 10.6 national average and Chairman Davis indicated that the RRA subscription was available to the Commission, I would ask that that -- since that has been spoken and put into the record, I would ask that that be made an exhibit either by this witness or perhaps by the Commission so it is available for everybody to look at and understand what the basis of that 10.6 is.

JUDGE DALE: We will reserve No. 98 for that exhibit. Dr. Vander Weide, to the extent that you happen to recall volume or page, that would be most helpful.

Otherwise, Mr. Murray, do you think you can find that?

MR. MURRAY: Well, actually I have something in my testimony -- I hate to speak for my attorney, but I have ROE information in my testimony right now, my direct testimony. Now, it's through the first quarter of 2006, I believe.

JUDGE DALE: Would that be the same as what you would be providing?

THE WITNESS: I don't recall whether -- whether the number I had in mind was through the second quarter or not. I can't ask a question, but try and do -- the only way I'd be able to tell was if I recalled what number was in his testimony.

JUDGE DALE: Then, in any event, we will reserve No. 98 and if you -- once we go off the record, if you can check what he has and see if it's the same thing and we can either remove No. 98 and just take it in your direct testimony or find it and put it in so everybody can see it. Any other questions?

MR. WOODSMALL: No, thank you, your Honor.

JUDGE DALE: Mr. Mills?

MR. MILLS: Yes, just briefly. And I appreciate Commissioner Clayton trying to follow up with my questions, and I'm gonna follow up just briefly, and I think I can make the point with just a couple of questions.

RECROSS-EXAMINATION BY MR. MILLS:

Q. Looking at Exhibit 97, and I'm focusing entirely on the middle column, if you were -- first of all, in lines 2 and lines 3, the 12.2 percent number and the 12.7 percent number are based in part on data from the three companies that had been removed with the calculation in line 1; is that correct?

A. Yes.

Q. Okay. If you were to take out the data relative to those companies and recast those numbers, the 12.2 and 12.7, is it your expectation that those numbers would be lower?

A. I don't know the answer to that question.

Q. Okay. The three companies have the highest ROE's, the three that were removed?

A. The highest DCF results.

Q. Right.

A. They don't necessarily have the highest

CAPM results.

Q. Would you not expect those to have higher than average betas, those three companies?

A. Not necessarily. Again, the results of applying any of these methods to one company is highly uncertain, so just because a company has a high or low DCF result does not necessarily mean that they have a high CAPM result.

Q. Are the betas for those three companies in your testimony?

A. Not the updated betas, no. Well, let me look in my rebuttal testimony. Let's -- they are in schedule JVW -- rebuttal schedule JVW-1.

Q. Okay. TXU has a beta of 1.1?

A. Right.

Q. Is that higher than the average?

A. The average was .95.

Q. Okay. So that is higher than the average?

A. Yes.

Q. TNM has a beta of 1?

A. Yes.

Q. Higher than the average?

A. Yes.

Q. Dominion Research?

A. .95.
Q. Right at the average?
A. Right.
Q. So if you remove the two that are higher than the average and the one that's on the average, your overall beta would go down?
A. Yes.
Q. Okay. So if your average beta goes down, then the results of both lines 2 and lines 3 would go down; is that correct?
A. That would be correct.
Q. Okay. So a moment ago when you said you didn't know the answer, now you do know the answer, and the answer is they will go down?
A. Solely for the middle column, yes.
Q. For the middle column, correct?
A. Right.
Q. And having done that, the number on line 6, the average of all of the above numbers would also go down?
A. Yes.
MR. MILLS: Okay. Thank you. That's all the questions I have.
RECROSS-EXAMINATION BY MR. THOMPSON:
Q. Dr. Vander Weide, do you believe that

the market risk premium is equal to the equity risk premium?

A. I don't understand the question. I don't understand how in that question you're using the phrase "equity risk premium."

Q. In terms of the CAPM.

A. In terms of the CAPM the word equity risk premium would very likely be a synonym for market risk premium because there's only one risk premium that comes up in the CAPM.

MR. THOMPSON: Thank you. No further questions.

JUDGE DALE: And redirect?

MR. SWEARENGEN: I have a few now, yes. Thank you.

REDIRECT EXAMINATION BY MR. SWEARENGEN:

Q. Dr. Vander Weide, I think Chairman (sic) Gaw asked you some questions and you referred him to page -- table 4 which is on page 49 of your direct testimony?

A. Yes.

Q. And he had some questions about comparing that table 4 to some of the information on Exhibit 97; is that correct?

A. Yes.

Q. Do you follow that? Did I understand you to say that the method or methods that you used to make the calculations shown on table 4 are the same methods that you used to make the calculations on Exhibit 97?

A. Yes.

Q. And are those the same methods to make the calculations that you made for Empire in its last electric rate case?

A. Yes.

Q. Now, there were some questions put to you about the methods that you used in making your -- calculating your averages in using the averages of the results. Do you recall those questions?

A. Yes, I do.

Q. And I think Mr. Woodsmall asked you whether or not you used the average of the gas DCF in your update. Do you recall that question?

A. Yes, I do.

Q. And your answer was you did not?

A. Yes.

Q. And what was your reason for that?

A. In the -- these numbers were in the rebuttal and Mr. Murray had only used electric companies, and so I was just updating the results for the electric companies to be comparable to his electric company results.

Q. Okay. I think also in response to a question from Mr. Woodsmall you mentioned a 9.6 percent rate that was not included when you did your averaging. Do you recall that?

A. Yes.

Q. And why did you not include that?

A. Because that was the DCF results for the natural gas companies at the time of my direct testimony. Since the natural gas DCF tend to mirror quite closely the electric DCFs, and the electric company DCFs had gone up by 100 basis points, it would be likely that the gas DCF results will also have gone up significantly if I had updated them.

Q. And you said there was a good reason for the way you did your averaging. Do you recall that?

A. Yes.

Q. And can you tell us what that reason or reasons are, please?

A. With regard to the DCF results or -- yeah. The -- the DCF method is one method but I applied it to two different companies, two different groups of companies.

But it's really only one of -- it's one

of five methods, so I only weighted the DCF model once because I didn't have two versions of the DCF model. I just averaged it between the two groups of companies to get the one DCF approach.

With regard to the CAPM and the risk premium, there were actually two different approaches of each of those. There were two different CAPM approaches and two totally different risk premium approaches, so there are really five methods of estimating the cost of equity. Even though two may have the word "risk premium" in them, they aren't the same risk premium.

Q. Let me ask you in response to a question from Commissioner Gaw. You first said you couldn't make the calculation and then you said, I believe, well, that's not the type of calculation you would make. And then finally I think you went ahead and made the calculation.

Let me ask you first of all, why did you say it was not a calculation that you would make? And explain your understanding of the calculation you were asked to make.

A. Yes. It was my understanding that he asked me to use the beta for Empire District alone in combination with the risk premium on the market and the risk-free rate to calculate a CAPM result. That's my understanding of it.

Now, the reason that I -- I said it was a calculation I would never make is that the beta results for individual companies just -- you can hardly attach any meaning to them. And statistical terminology, you measure the adequacy of a beta calculation either with a T statistic or an R-squared statistic.

And both of those show no statistical significance for the beta calculation for an individual company, mainly that it could be just about any number. It's only by averaging across a group of companies of the same risk that you can get a meaningful measure of the risk for the group.

And then you would assign that measure of risk to all the companies in the group because it's just not possible to get an accurate measure of the risk for individual companies.

And so I would only calculate an industry beta as opposed to an individual beta and would never attach any meaning to a CAPM equation based on an individual company beta.

Q. Okay. Thank you. Nonetheless, you went ahead and made the calculation; isn't that true?

A. Yes.

Q. And can you walk through that calculation one more time, please, telling us what your inputs are?

A. Yes. I -- if I recall right, and, you know, I don't have the Value Line with me, but if I recall right, the beta for Empire is .6. It could be .65. I'm not entirely sure, but it's about --

MR. WOODSMALL: Your Honor, I object to the extent that counsel is looking elsewhere for information to provide to this witness.

MR. SWEARENGEN: Well, I can certainly hand him a document if I had it. I don't know that I have it.

THE WITNESS: I was calculating on the best information I had even though I hadn't actually made that calculation.

BY MR. SWEARENGEN:

Q. Right.

A. And so I had to recall an input which I don't know precisely.

Q. Okay. So what was the input that you used?

A. I used the beta of .6.

Q. For Empire?

A. For Empire.

Q. Okay. And what other inputs did you use?

A. I used a risk premium on the market of 7.2 and I used the risk-free rate of 5.5, and when I multiply the beta times the risk premium on the market, I got 4.32 and I added that to the 5.5 to get a 9.8. Again, I wouldn't place any significance whatsoever on that number because the beta number is not a statistically significant number.

Q. And you're not even sure if it's the right number?

A. I'm not even sure it's the right number.

Q. Thank you. In response to a question, I think, from the Chairman, you were asked to quantify an increase in your recommended ROE if Empire did not secure a fuel adjustment clause in this case. Do you remember that answer?

A. Yes.

Q. And I think your answer was approximately 25 to 30 basis points?

A. Yes.

Q. And so to make sure I understand, would that be added to the 11.7 percent recommendation?

A. Yes.

Q. And your 11.7 percent recommendation, then, assumes and it's based on the fact that you believe your proxy group companies all have fuel adjustment clauses; is that your --

A. Yes.

Q. Now, you also mentioned that there's different DCF methods that can be used and I said -- and I think you said they're based on the timing of dividends. Do you recall that?

A. Yes, I do.

Q. And then you mentioned an annual method; is that true?

A. Yes.

Q. And can you describe that?

A. Yes. The annual DCF model starts with the assumption that the price of the stock is the present value of the future dividends and that dividends grow at a constant rate forever and that you only receive one dividend at the end of each year starting from the time you do your analysis.

And so the cost of equity is then equal to the current annualized dividend times one plus the growth rate, divided by the current price plus the growth rate. That would be the annual DCF model.

And the quarterly DCF model, you would

start from the assumption that dividends are paid quarterly and from the algebra of it, you'd get a slightly different equation.

Q. Okay. Which method did you use?

A. The quarterly DCF model.

Q. And which method did the other cost of capital witnesses use in this case, do you know?

A. They used an annual DCF model.

Q. Is Empire paid dividends quarterly or annually?

A. Quarterly.

MR. SWEARENGEN: I believe that's all I have.

MR. MILLS: Do we have the opportunity for recross? If so, I'd like to request recross.

JUDGE DALE: No, I'm sorry.

MR. MILLS: Okay. Empire requested recross yesterday. I didn't want them to be able to argue that they were the only people in the case that were turned down the opportunity to recross witnesses. So thank you for denying my request.

JUDGE DALE: Everyone in this room is grateful that I denied your request.

MR. THOMPSON: Amen.

JUDGE DALE: With that,

Dr. Vander Weide, thank you very much, and you are excused.

THE WITNESS: Thank you very much.

JUDGE DALE: We are off the record. We're adjourning for lunch and be back at 2:00.

(The noon recess was taken.)

JUDGE DALE: Let's go back on the record. We are ready for the testimony of David Murray from Staff.

(The witness was sworn.)

JUDGE DALE: Thank you. Please be seated. You may proceed.

MR. THOMPSON: Thank you, your Honor.

DIRECT EXAMINATION BY MR. THOMPSON:

Q. State your name, please.

A. My name is David Murray.

Q. And are you the same David Murray that filed or caused to be filed testimony in this case including direct testimony that has been marked as Exhibit 51, rebuttal testimony which has been marked as Exhibit 52 HC and NP, and surrebuttal testimony which has been marked as Exhibit 53 HC and NP?

A. Yes.

Q. Do you have any corrections for your direct testimony?

A. Yes, I do.
Q. What are those, please?
A. Page 18, line 3, just a small grammatical error. Insert the word "the" after "with" after the first word in that line. On page 22, line 14, for whatever reason I believe the schedule that I had had which had been updated and I had the old number in the testimony. So that should now be -- instead of 7.11, it should be 6.74 and again, that's based on schedule 16. And I'll tell you the specific column, column 5 and page 25.
MR. SWEARENGEN: Excuse me. Did you change the number on schedule 16 or was it correct?
THE WITNESS: The number on schedule 16 is correct.
MR. SWEARENGEN: Okay. Thank you.
THE WITNESS: Then on page 25, line 7 through 10, I have several numbers that -- that apparently I looked at an older version of that schedule and that's on schedule 17-1. And instead of 10.26 percent, it should be 10.33 percent based on column 6 on schedule 17-1.
On line 9, the same page, instead of 8.98 percent, it should be 9.03 percent based on column 7.

And then on line 10 it should be 6.26 percent rather than the 6.24 percent, and that's based on column 8 of the same schedule.

And one other item. On schedule 18, for some reason I had 2006 projected return on common equity for column 6. That is 2005 return on common equity which are actual numbers except for Southern Company which has an asterisk because at that time Value Line did not have all the information, so that was estimated.

And those are all the corrections, but I do want to talk about the capital structure issue because apparently there was some confusion there.

MR. SWEARENGEN: We don't care. That's fine.

MR. THOMPSON: Any objections? This is kind of a late-breaking issue.

MR. MILLS: It depends on what he has to say.

MR. THOMPSON: You mean I can't get a blanket waiver from the start, Mills?

MR. MILLS: No, you can't. But I certainly don't object to having him start down that path.

MR. THOMPSON: Thank you, Mr. Mills.

BY MR. THOMPSON:

Q. Tell me about the capital structure issue.

A. It was an error and there's also clarification. On page 4, lines 3 to 4, I indicated that there was an agreement to use Empire's consolidated capital structure by Empire, Staff and OPC.

That is true, but evidently there was a nonagreement on the amounts that should be included in that consolidated capital structure. And if an explanation is -- if I can give an explanation on the record right now as to why I used the capital structure I did, I will give that.

Q. Why don't you go ahead and give that explanation.

A. The reason why Staff used the net amount of debt on preferred stock is because that is the amount that is used to calculate the embedded cost of those capital components, and it is Staff's belief that it's a matching principal. If you're going to use those amounts to calculate the embedded cost, it's important to use those same amounts in the capital structure.

Q. Thank you. Do you have any corrections for your rebuttal testimony?

A. Well, that was rebuttal.

Q. That was rebuttal?

A. I apologize. That was page 4, lines 3 through 4.

Q. Very good. Was that the only correction to your rebuttal?

A. Yes.

Q. How about your surrebuttal testimony?

A. No, I have no corrections for surrebuttal.

Q. With the corrections and the explanations that we've just gone over, if you were asked the same questions now as you were asked in this prefiled testimony, would your answers today be the same with those adjustments that we've just gone over?

A. Yes.

Q. And are your answers true and correct to the best of your knowledge, information and belief?

A. Yes.

MR. THOMPSON: At this time I would offer Exhibits 50, 51 -- excuse me, 51, 52 and 53.

JUDGE DALE: Is there any objection?

MR. SWEARENGEN: We have none.

MR. MILLS: No objection.

JUDGE DALE: Then Exhibits 51, 52 and 53 are admitted into evidence.

(STAFF EXHIBIT NOS. 51, 52-NP, 52-HC, 53-NP, AND 53-HC WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. THOMPSON: At this time I'll tender the witness for cross-examination. Thank you, Judge.

JUDGE DALE: Ms. Woods, I assume you're just observing?

MS. WOODS: Just trying to see where everybody is. Thank you, your Honor.

JUDGE DALE: Thank you. Then Explorer/Praxair.

MR. WOODSMALL: Thank you, your Honor.

CROSS-EXAMINATION BY MR. WOODSMALL:

Q. Good afternoon, Mr. Murray.

A. Good afternoon, Mr. Woodsmall.

Q. Did you testify in the last Empire case?

A. Yes, I did.

Q. And at that time that case was concluded, did you read the Commission's Report and Order?

A. Yes.

Q. And any concurring opinions and

descending opinions attached to that order?
A. Yes, I did.
Q. Okay. Do you recall in that case discussion regarding what the authorized returns were for other companies?
A. I recall very specifically a mention of one quarter where the authorized returns were on average 11 percent. I don't recall the exact quarter that was.
Q. And you heard some testimony this morning just regarding what comparable companies or what authorized returns are today; is that correct?
A. Yes.
Q. And, in fact, in your testimony at page 32, your direct testimony, Exhibit 51, you make some discussion of that; is that correct?
A. Yes, that's correct.
Q. Okay. Turning to -- well, I guess I would read for you. There seemed to be some confusion coming out of the last case as to the parties' ability to cite to cases from other jurisdictions or whether those cases had to be in the record.
In fact, I note Commissioner Appling's descent, he said, "If the record did not include

information of appropriate geographic or temporal proximity, that is the fault of the parties. Perhaps they will do better next time."

So it appeared at that time that the parties were being invited to at least put into the record for the Commission's analysis other decisions that were proximate or geographic in nature. Would you agree with that statement?

A. Yes. That's exactly why I included this. I don't have any opinion on these authorized returns, but I was very well aware that the Commission was interested in this information, and that's why I included it in this testimony as well as the last Aquila rate case.

MR. WOODSMALL: Your Honor, I guess to cut through this and go as rapidly as possible, I have three cases that I would just ask -- I will hand them out, the pertinent portions, but I would just ask the Commission to take judicial notice of those cases. They're clearly relevant given the standard and I believe that they should be accepted.

JUDGE DALE: I --

MR. WOODSMALL: The question is all a matter of do you believe that those cases have to be in the record or can we cite you other Commission decisions just in the brief?

MR. THOMPSON: Decisions of this Commission?

MR. WOODSMALL: No, of other authorized returns issued by other commissions. It's your pleasure entirely.

MR. SWEARENGEN: Judge, if I could just speak to that a minute. I always understood we could take official or administrative notice of decisions of this Commission without the necessity of putting those into evidence, as it were. I've also always felt that published cases and decisions in other jurisdictions could be cited as authority in briefs, for that matter. So I don't know how you --

MR. WOODSMALL: Well, I would like to mark them as exhibits.

JUDGE DALE: Are you going to question him on these?

MR. WOODSMALL: I may.

JUDGE DALE: Because that's -- that's my confusion is that I'm at a loss to understand how this is cross.

MR. WOODSMALL: Let's start off down that road then. I'd like to mark an exhibit. I guess it would be Exhibit 99.

(PRAXAIR EXHIBIT NO. 99 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

MR. WOODSMALL: Are we ready, your Honor?

JUDGE DALE: Yes.

BY MR. WOODSMALL:

Q. I've handed you what's been marked as Exhibit 99. Are you familiar with the Illinois Commerce Commission?

A. Yes.

Q. And are you familiar with a company regulated by that utility company called Commonwealth Edison Company?

A. I believe that's part of Exxon.

Q. Okay. This document was issued July 26th, 2006, it's a rate case decision. Do you have any familiarity with this case?

A. Not the specifics of this case, no.

Q. Are you aware of the case or anything about this case?

A. I have to look at DR responses that I had given to Empire that listed cases since 2004, the authorized returns, and I can promptly tell from looking at that whether or not that was one of the cases in the data that I provided. I believe -- was the decision handed down July 2006?

Q. July 26th, 2006, correct.

A. That's not gonna be captured in the data that I provided, so no, I don't have any specific knowledge of this case.

Q. This has been issued after the time in which you stopped looking at comparable companies; is that what you're saying?

A. Yes. The information I provided to Empire in response to the -- I'll tell you the data request number specifically. 0312 went through the first quarter of 2006.

Q. Would you find such a Report and Order to be informative, however?

A. Yes. The idea of compiling the data on a quarterly basis from -- from RRA is to give the Commission some information as to what the authorized return on equities are throughout the country.

I just think that if the Commission wants to rely on that type of information to support its decision, I think they should have all the information that they can have at their disposal.

Q. Including information after the first -- after the second quarter of 2006?

A. I would -- I would prefer to have a full quarter of information before we try to draw any comparisons or try to draw any conclusions on what has happened in the third quarter, and that would be in the third quarter of 2006.

Q. So we define this decision to be relevant given the Hope and Bloomfield standard?

MR. SWEARENGEN: Well, your Honor, I'm gonna object to that. That calls for a legal conclusion; and second, this witness has said he doesn't really know anything about this case, he didn't participate in it.

Third, I have no objection if Mr. Woodsmall in his brief wants to cite other published decisions around the country and the returns that were authorized. That's fine, but to waste our time --

MR. WOODSMALL: I'll move on from this exhibit.

MR. SWEARENGEN: -- with this witness --

JUDGE DALE: Okay. Thank you.

BY MR. WOODSMALL:

Q. Before I mark my next exhibit, let me ask you, are you familiar with a decision handed down in December of 2005 by the Kansas Corporation Commission regarding West Star Energy?

A. Yes, I did read portions of that decision.

MR. WOODSMALL: Okay. I'd like to mark an exhibit.

(PRAXAIR EXHIBIT NO. 100 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. WOODSMALL:

Q. Would you take a moment and review what I've handed you as Exhibit 100? Are you familiar with this Report and Order?

A. Yes.

Q. And can you tell me, given your review, what was the ROE that the Kansas Commission authorized for West Star?

A. The authorized ROE in this case was 10 percent, and that's on the last page under item six -- excuse me. It's under part C, "Conclusion" at the very end of this -- of this document.

Q. 10.00 percent?

A. Yes.

MR. WOODSMALL: Your Honor, I'd offer Exhibit No. 100.

JUDGE DALE: Is there any objection?

MR. MILLS: Can I ask a clarifying question? Is this the entire decision or are there some pages missing?

MR. WOODSMALL: No. And I certainly have no problems if someone wants to provide the entire order. This order was monstrous.

MR. MILLS: Yeah, I don't want the whole order. I just wanted to make sure I was following along that I wasn't following along.

MR. WOODSMALL: As you can see on page 2, I've provided everything under rate of return/cost of capital.

MR. MILLS: Okay. I have no objection.

MR. THOMPSON: No objection.

JUDGE DALE: In that case, Exhibit No. 100, the portion of the Kansas case dated December 28th, 2005, is admitted.

(PRAXAIR EXHIBIT NO. 100 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

BY MR. WOODSMALL:

Q. Mr. Murray, you referred earlier to a data request response that you had provided to Empire. Do you recall that?

A. Yes.

Q. And can you tell me what the nature of that request and response was?

A. I'll read you specifically the request question and data request. It indicates on page 32, lines 1 through 11 of Mr. Murray's direct testimony, "Please provide a copy of the regulatory research associates data used to support the allowed returns recorded in the testimony."

And what I had provided was just the information from a spreadsheet in which Staff has some information compiled since the beginning of 2004 on information taken from the RRA survey.

Q. And can you tell me if one of the orders referred to in your response or in the RRA survey was an Arkansas decision on CenterPoint Energy ARKLA?

A. What was the date on that?

Q. September 19th, 2005.

A. That's not in here. There may be some -- I don't know what the exact rate increase request was on that, but there's a limitation of, I think, five million for the RRA information, so that may be why that's not in there. I don't know. It's not in the data that I provided to Empire.

Q. Are you familiar, by any chance, with the CenterPoint Energy ARKLA decision?

A. I talked to my counterpart down in Arkansas briefly about it. I don't recall all the specifics. I do recall him telling me that the authorized return was I think in the high single digits, but I don't recall the specifics.

Q. If I handed you a copy of the order, would that refresh your recollection?

A. As far as the authorized ROE, yes, that would refresh my recollection.

MR. WOODSMALL: I'd like to mark another exhibit, your Honor.

(PRAXAIR EXHIBIT NO. 101 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. WOODSMALL:

Q. Have you had a chance to review Exhibit No. 101?

A. Yes.

Q. And does that reflect the Arkansas Public Service Commission that you previously discussed?

A. Yes. I discussed this with Mr. Johnny Brown at the Staff at the Arkansas Public Service Commission, and the authorized ROE in that case was 9.45 percent. And also I regret to say that Johnny Brown has moved on to greener pastures.

MR. WOODSMALL: Your Honor, I'd offer Exhibit No. 101.

JUDGE DALE: Is there any objection?

MR. THOMPSON: No objection.

JUDGE DALE: Then Exhibit No. 101, the Arkansas case dated 9/19/05 is admitted.

(PRAXAIR EXHIBIT NO. 101 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

MR. WOODSMALL: I have no further questions, your Honor.

MR. MILLS: I have no questions. Thank you.

JUDGE DALE: Mr. Swearengen?

MR. SWEARENGEN: Oh, I do have a few. Thank you, your Honor.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Good afternoon.

A. Good afternoon, Mr. Swearengen.

Q. This last case that was just put into evidence, Exhibit 101, you regretted to say that the Arkansas employee had gone on -- what, gone on to, what did you say, greener pastures?

A. Yes, he took another position.

Q. Why do you regret that?

A. Because I enjoyed the relationship I had with Mr. Brown. He was a very pleasant individual to discuss rate of return issues with, and we had a pretty good rapport. Actually, if anybody goes to the DFRI, he attended the DFRI sessions here in Columbia. He's a very nice person.

Q. I just happened to look at that last page of the exhibit and before they decided to award the 9.45 percent, they -- the Commission recited in its order that apparently ARKLA was having some service problems, failed to retain data required, noncompliance with standard accounting practices and Commission rules and regulations and things of that sort.

So there may have been a history here as to why this return was set where it was; is that fair to say?

A. Well, obviously there's details in this case --

Q. Sure.

A. -- that I'm not aware of.

Q. You don't know anything about this?

A. No, not the specifics.

Q. Let me ask you just to try a couple of housecleaning matters here, if I can, at the outset. You were in the hearing room this morning, I think, when Dr. Vander Weide testified and made a calculation that was done at the request of Commissioner Gaw. Do you recall that?

A. I do.

Q. And if you would take a look, please, at your schedule 17-1 which I believe is attached to your direct testimony. Do you have that?

CHAIRMAN DAVIS: Is that 17-1?

MR. SWEARENGEN: Yes.

CHAIRMAN DAVIS: Got it.

BY MR. SWEARENGEN:

Q. Do you see that?

A. Yes.

Q. And about a third of the way down the page, you indicate Empire District Electric Company, under the column numbered 2, the company's Value Line data; do you see that?

A. Yes, I do.

Q. And you show a .75; is that correct?

A. That's correct.

Q. And did you hear Dr. Vander Weide had testified this morning that when he made his calculation, he used a .6 --

A. Yes.

Q. -- data? You heard that?

A. Yes, I did.

Q. And would it be your opinion that that .6 that he utilized was incorrect?

A. Yes. I hope that the information I have in my testimony is correct.

Q. So it would be your testimony that it should be .75; is that right?

A. Yes.

Q. Okay. And then if I could approach the witness, I'd like to hand you Dr. Vander Weide's rebuttal schedule JVW-1 which shows the same information for Empire. Are you familiar with that schedule? I mean, have you seen it before?

A. Yes, it's in his rebuttal testimony.

Q. And it's been introduced into evidence in this proceeding as far as you know?

A. As far as I know it's attached to his rebuttal testimony.

Q. And what does it show as the beta for Empire there?

A. It's .8.

Q. And so Dr. Vander Weide's own testimony that was put in this morning, he would have testified that .8 is the beta for Empire; is that correct?

A. If he was to follow his own testimony, that's correct.

Q. So to the extent that in doing that calculation this morning, he used a .6 beta for

Empire, that would have been in error; is that correct?

A. Yes.

Q. Thank you. Let me ask you, if you turn to your rebuttal testimony, please, I want to make sure I understand the additional testimony you put in this afternoon concerning the capital structure question.

A. Yes.

Q. And I think you were modifying the answer on lines 3 and 4 of page 4 of that testimony?

A. Yes.

Q. Based on what you said, would I be correct if I thought that the Staff and Empire were both using the same capital structure in this case?

A. Yes. Yes, we are.

Q. And what capital structure is that?

A. It's the capital structure as of the update period, and I can tell you specifically the portions of capital in that capital structure. It's 49.7 -- excuse me, 49.74 percent common equity, 6.27 percent preferred stock, which that's trust preferred stock, 43.99 percent long-term debt.

Q. And as far as you know, the company is in agreement with that; is that true?

A. Yes.

Q. Is there an issue with the Public Counsel on the capital structure question as far as you know?

A. Yes, there is.

Q. And what is that issue, could you describe?

A. Public Counsel is using the face value of the debt that's indicated on Empire's financial statements that are filed with the SEC. Those amounts do not deduct for unamortized interest -- excuse me. Unamortized issuance expenses, unamortized discounts and any other types of expenses that may have been incurred at the time of the issuance of the debt.

Q. And how does the Staff approach that?

A. We do -- Staff deducts these amounts from the face value of the debt to determine what, you know, basically what proceeds are available to Empire and what, you know, what amount is used to calculate the embedded cost of debt. We believe that it's important to match the debt cost with the amount that's used to calculate that debt cost.

Q. Is that a method that the Staff has traditionally used to the best of your knowledge?

A. Since I've been here, so, yes, to the best of my knowledge, it's been used for some time.

Q. And has that method or approach ever been an issue in any other case that you're aware of?

A. Not that I'm aware of.

Q. And I think Mr. Woodsmall asked you whether or not you were familiar with Empire's last rate case, the ER-2004-0570 case which was decided in March of last year, and I think you said yes; is that true?

A. Yes.

Q. And you were, in fact, the witness for the Staff on the subject of rate of return in that case; is that true?

A. Yes.

Q. And would I be correct if I stated in that case you utilized a company-specific DCF method as the primary means or tool to determine the cost of common equity for Empire?

A. Yes.

Q. And your ultimate recommendation in that case was a return on equity in a range of 8.29 percent to 9.29 percent; is that correct?

A. Yes.

Q. And Dr. Vander Weide testified for the company in that case; is that true? That's your memory?

A. He did and then -- well, of course they had two witnesses in the last case.

Q. Right, and Dr. Vander Weide's recommended return for Empire in that proceeding was 11.3 percent; is that true? Do you remember that?

A. I don't remember exactly what the recommendation was. It was 11.3 or 11.35, I can't remember for sure. Within five basis points.

Q. And you've read the Commission's decision in that proceeding? I think you indicated that to Mr. Woodsmall.

A. Yes.

Q. Would you recall if the Commission in that decision found that Dr. Vander Weide, in contrast to the company-specific DCF method or approach that he utilized, he used a method known as the comparable company approach in making his recommendation; do you recall that?

A. I recall that being written in the Report and Order, yes.

Q. And do you also recall within that decision the Commission found that of the rate of return witnesses who testified in that proceeding, including yourself, only Dr. Vander Weide used the comparative analytical strategy in which Empire's cost of common equity was determined by examining a proxy group selected on the basis of comparable risk. Do you remember that?

A. I don't remember exact terminology used by the Commission, but that sounds what -- sounds like what the Commission was trying to convey in their Report and Order, yes.

MR. SWEARENGEN: May I approach the witness, please?

JUDGE DALE: Certainly.

BY MR. SWEARENGEN:

Q. With regard, Mr. Murray, to that last question that I just asked you, I've handed you a copy of the Commission's Report and Order from that Empire case that we've been talking about, and on page 44 of the Report and Order, did not the Commission indicate the statement that I just asked you earlier?

A. Yes. It indicates specifically of the expert witnesses, only Vander Weide used a comparative analytical strategy in which Empire's cost of common equity was determined by examining a proxy group selected on the basis of comparable risk.

Q. And do you remember in that case that his proxy group consisted of approximately 39 or so companies? Do you recall that?

A. It was quite similar to the number of companies he has in this case that -- that sounds like it's fairly accurate.

Q. And also on page 44 of that Report and Order, am I correct that the Commission found that the other cost of capital witnesses depended primarily upon a company-specific DCF analysis and used a comparative analysis only incidentally to check the reasonableness of their primary results?

A. Excuse me while I read through this. It indicates that the company-specific DCF was used by all other experts which includes Dr. Murray, myself and Travis Allen who was the witness for OPC at the time and used the comparative analysis only to check the reasonableness of the results, and to my recollection that was true for the other witnesses. I know it was definitely true for myself.

Q. Okay. Thanks. And finally, with respect to that decision, if you'd look at page 45 of the Report and Order, would I be correct in saying that the Commission found that because only Dr. Vander Weide performed the sort of risk-based comparative analysis required by the Hope and Bluefield cases, that the Commission adopted his 11.3 ROE as a starting point for determining Empire's cost of equity in that case?

A. Yes.

Q. And ultimately the Commission concluded in that case that the cost of common equity for Empire should be 11 percent; is that right?

A. That's correct.

Q. Now, yesterday in his opening comments, Mr. Thompson, your counsel, noted that while Empire got an 11 percent ROE in the last case, that circumstances are now different than they were 18 months ago. He said we now have Senate Bill 179. Are you aware that he said that?

A. Unfortunately, I missed that part of the opening statement.

Q. Are you aware that Senate Bill 179 authorizes a fuel adjustment clause?

A. Yes, I am.

Q. Is it your understanding that Dr. Vander Weide's 11.7 percent ROE recommendation in this case reflects the lower risk of Empire having a fuel adjustment clause?

A. Let me refer specifically to his

testimony. I do recall that, but I just want to make sure. Could you repeat the question for me, please?

Q. That Dr. Vander Weide's 11.7 percent recommendation assumes that the company receives a fuel adjustment clause in this proceeding?

A. Yes.

Q. And I think -- were you here in the hearing room earlier today when he testified and said that if Empire did not receive a fuel adjustment clause, that his ROE recommendation should be increased 25 to 30 basis points?

A. I heard him quantify some amount. I can't remember a specific amount that he suggested.

Q. Does your recommendation, your ROE recommendation in this case, assume that Empire will get a fuel adjustment clause?

A. My recommendation contemplates the concern that investors have with the uncertainty as to whether or not Empire will receive a fuel adjustment clause.

If you understand the adjustment I made to my proxy group cost of equity estimate, the initial estimate of 9.3 to 9.4, and when I adjusted that to -- by 20 basis points, 9.5 to 9.6 and that's my final estimate, that 20-basis-point adjustment was based on Empire's current triple B minus credit rating that S&P has assigned to them.

So my recommendation currently contemplates the uncertainty I believe that investors have about what will happen in this proceeding and what will happen with the fuel adjustment clause of rulemaking and how that will turn out.

Q. So you made a 20-basis point adjustment; is that what you're saying?

A. Yes.

Q. And could I characterizes that as a risk adjustment? Would that be fair?

A. Yes.

Q. Now, is it true that in this case, instead of relying on the company-specific DCF approach, you've done an analysis of the cost of common equity, in your words the comparable group of vertically integrated electric utility companies, and I think you say that on page 20 of your direct testimony. Is that your testimony?

A. Yes, that's correct.

Q. And I think you just indicated that your initial recommendation was a range of 9.2 to 9.5 percent, that you have added to that a risk adjustment and raised it to 9.5 to 9.6 percent?

A. I think we need to make sure this is fairly clear because I think this was confused in opening statements as well. My recommendation in direct testimony was 9.2 to 9.5.

However, after discussions during the prehearing conference in this case, I discovered that I had not used 2006 and 2007 estimated dividends per share. I was stuck back with the 2005, 2006.

So as a result of making that change, my -- this is -- let me refer you to the page this is on in my testimony. It's on page 3, my rebuttal testimony under direct testimony revisions. "Do you have any revisions to make to your direct testimony?" And I indicate, "Yes." And I indicate there's a change in the growth rates and also a change in the dividend yield.

And as a result, my proxy group cost of common equity now ranges from 9.3 to 9.4. And after I made the 20-basis-point adjustment, my recommendation is now 9.5 to 9.6.

Q. Okay. Now, thank you for clarifying that. Would I be correct in understanding that your current recommendation is only 31 basis points above the high end of your recommended range in the last case?

A. That's correct.

Q. And would I also be correct if I said that this is the first time that you have ever relied primarily on a comparable company approach for determining rate of return?

A. No.

Q. Okay. You've done that in other proceedings?

A. Yes.

Q. You said that five companies make up your comparable group; is that right?

A. Yes.

Q. And that's -- you haven't revised or changed that, have you?

A. No, I have not.

Q. Okay. And I think on page 20 of your direct testimony, you start to explain how you select your comparable companies; is that right? I'm looking at line 9, page 20 of your direct testimony.

A. Yes.

Q. And you mentioned a publication by Standard & Poor's, its Credit Stats?

A. That's correct.

Q. It was published on August 11, 2005?

A. Yes.

Q. And that's the source document where you went to get your -- to start to get your comparable group; is that a fair statement?

A. That's a fair statement.

Q. Would you agree that the -- that the group of 11 companies that are listed in that document is only a sample of the companies that generate and distribute electricity that are followed by Standard & Poor's?

In other words, Standard & Poor's follows more companies than just those 11; isn't that a fair statement? And when I say "companies," I'm talking about companies that generate and distribute electricity.

A. I'm not sure that I can agree with that statement. If you want me to explain, I will.

Q. Well, let me ask you this: Is it your testimony that Standard & Poor's only follows 11 generation and distribution electric utilities?

A. These -- these companies are the only vertically integrated electric utilities that they follow, that they've classified as vertically integrated electric utility companies.

It's quite possible that with some restructured companies that there may be some nonregulated generation that may not be classified as vertically integrated electric utilities by S&P.

Q. Would you agree that a vertically integrated electric utility is a company that both produces and distributes electricity?

A. Yes.

Q. Is it your testimony that you have identified all of the publicly traded companies that generate and distribute electricity?

A. No. I relied on S&P for this categorization. If S&P had made any errors in identifying vertically integrated electric utilities, that would be a problem with, you know, S&P's categorization. But I believe S&P is a reliable source to use for this categorization.

Q. So then, your testimony would be that you think you have identified all of the publicly traded electric utilities that generate and distribute electricity; is that what you're saying?

A. If S&P has done so, yes, I have.

Q. So you just rely on what they -- they publish; is that correct?

A. Third-party source, that's correct.

Q. And if you'd turn to your surrebuttal testimony, please. Page 13, down around line 15, in that area, you state, "The business risk of an entity is driven by the dominant operations of the company."

A. Yes.

Q. "The purest way to select companies that face similar business risks is to select companies that are predominantly in the same business as the operations being evaluated."

A. Yes.

Q. And that's still your testimony?

A. Yes.

Q. And would you agree that in this rate case that's before the Commission, we were concerned with Empire's electric generation and distribution operations?

A. We're concerned with all of end buyers' electric regulated operations which includes a generation and distribution, that's correct.

Q. Now, you indicated that you were familiar with the proxy -- the group of proxy companies that Dr. Vander Weide had used in Empire's last rate case?

A. Yes.

Q. And are you familiar with his electric proxy group in this proceeding?

A. Yes.

Q. And would you agree that he's used about 47 companies in his comparable group?
A. 47 with the natural gas companies, is that what you're asking? I'm sorry.
Q. Well, that's correct, 47 companies in this group. Is it your understanding that he used 47 electric companies or --
A. He used 34 electric companies and he used 13 natural gas companies.
Q. Okay. Thank you. And would you agree that all the companies in any electric proxy group generate and distribute electricity?
A. There may be some generation and distribution in some of those companies but I'm not -- I would not agree that that's the predominant operations because a lot of these companies, about half of them are classified as diversified energy companies by S&P.
Q. Well, that really wasn't my question. My question was, would you agree that all of the companies in this alleged group generate and distribute electricity?
A. I'd have to evaluate each and every company to ensure that that's the case, so I don't know for sure.

Q. Okay. Thanks. Do you recall what the test year was in Empire's last rate case?
A. I don't recall.
Q. I think you testified earlier, though, that the Commission issued its decision in that case in March of 2005; is that right?
A. That's correct.
Q. So would you assume that the test year would have been something prior to that date?
A. Yes.
Q. And would you agree that since then there have been various events in the life of Empire? For example, March 14th of this year the company announced that it had signed a contract to be a part owner of the 665-megawatt coal-fired Plumb Point Power Plant located in Arkansas? Are you aware of that?
A. I believe it's March. Actually, I think it's in my testimony as to when that was announced.
Q. And you're aware of that transaction?
A. Yes, I'm aware of that transaction.
Q. And are you also aware that Empire will initially own about 50 megawatts of that plant at a cost of about $87 million?
A. I'm aware that they'll own 50 megawatts.

I don't remember the exact cost.

Q. Are you aware that Empire's entered into a contract regarding an Iatan II?

A. Yes.

Q. And what do you know about that?

A. That's part of the agreement under -- well, we have a rate authority plan that covers their participation in the Iatan 2 project and under that agreement they are to have 100 megawatts available to them through that project.

Q. And is that about 12 percent of the plant roughly?

A. I believe it's 12 percent, 18 percent for Aquila and then, of course, you have the rest of them, KCPL making up the biggest portion.

Q. Are you aware that in the year 2005 Empire's fuel expenses increased by about 75 percent?

A. I'm aware that the fuel expense increased significantly. I don't know the exact percentage.

Q. Are you aware that the main cause of these -- of this fuel price increase was higher natural gas prices?

A. That's my understanding, yes.

Q. And is it your understanding that the higher natural gas prices were currently the result of Hurricane Katrina?

A. I'm not --

Q. You don't know?

A. I'm not an expert. I can't tell you exactly what caused the natural gas prices to increase to that level. That's -- no, I'm not going to answer that one.

Q. Are you aware that in May of this year Empire's corporate credit rating was downgraded?

A. Yes.

Q. And would you also agree that since the last rate case, interest rates have increased; is that true?

A. Yes. Since the last rate case?

Q. Uh-huh.

A. Hold on a second. Let me review that to make sure we're very clear on this topic. I would not necessarily agree with that.

Q. Okay. Let me ask you this: On page 3 of your surrebuttal testimony, if you could turn to that, please?

A. Yes.

Q. On that page in response to Dr. Vander Weide's comment that long-term interest rates have been trimming up for at least the last year, you state on page 3 of your surrebuttal, and I quote, that, "One can find short-term periods of interest rate increases in the past 25 years, but the stronger, more permanent trend has been that of falling interest rates"; is that correct?

A. Yes.

Q. And that's your testimony?

A. Yes, it is.

Q. By that statement are you suggesting that one must wait for 25 years to determine whether there's been an upward trend in long-term interest rates?

A. I -- my opinion, it is more important to look at what has been the more -- the permanent -- as I indicated in the testimony, the permanent trend. This is one of those areas where somebody can, you know, come up with their own definition of trend. If you want to say a week is a trend, I guess somebody could do that.

But I'm more interested in looking at what has happened over the long-term and I want to make sure that nobody gets into, you know, a mindset where this is gonna be some sustainable increase in interest rates because I think a lot of economists will not be able to agree on that and they won't agree on that.

Q. Well, let me ask you this question: Do you think it would be reasonable to assume that an investor would be far more interested in what interest rates have done over the last year or two rather than that pattern for over the last 25 years?

A. No, not necessarily.

Q. Do you have any knowledge of what long-term interest rates have done in the last year or so?

A. They have increased slightly since -- since the middle of 2005.

Q. If you'd turn back to your direct testimony, please. Do you have that?

A. Yes.

Q. On page 9, down on line 17, you refer to a publication entitled "Value Line Investment Survey Selection and Opinion."

A. Yes.

Q. And what is that publication?

A. That's a publication that's available through the Value Line -- well, obviously, the Value Line Investment Survey, the Value Line Investment Analyzer publication, it's a subscription-based service, and the Selection Opinion provides all sorts of information on the capital markets, the economy, interest rates, and obviously the various indexes in the stock market.

Q. So you're generally familiar with that publication; would that be a fair statement?

A. I'm -- yes, certain issues. Not every issue but certain issues, that's correct.

Q. Which issues are you not familiar with so --

A. The ones I haven't read.

Q. When you say "issues," I understand. Do you consider it an authoritative source of financial information?

A. Yes.

MR. SWEARENGEN: Could I have an exhibit marked, please?

JUDGE DALE: Sure.

(EMPIRE EXHIBIT NO. 102 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. SWEARENGEN:

Q. Mr. Murray, I've just handed you what has been marked for identification as Exhibit 102, a document that's entitled "The Value Line Selection and Opinion," and it's got in the upper left-hand

corner the date of July 7, 2006, page 1047 in the right-hand corner. Are you familiar with that document?
A. Not this specific document. I'm familiar with some of the data that is published by Value Line but I've seen data on interest rates before.
Q. Okay. Well, I have highlighted on that document a couple of items in the upper left-hand corner or the upper left-hand side, the prime rate as of June 30, 2005; do you see that?
A. Yes, I do.
Q. And that's 6.25 percent; is that correct?
A. That's correct.
Q. And further down on the left-hand side, the 30-year United States Treasury security interest rate as of June 30, 2005 is 4.19; is that correct?
A. That's correct.
Q. And then if you'd look over on the right-hand side of that document, for June 30 -- excuse me, June 30, 2005, it shows utility A-rated bonds at an interest rate of 5.03 percent; is that correct?
A. That's correct.

Q. And the utility EAA, BBB bonds for the same time at 5.37 percent; is that correct?

A. Yes.

MR. SWEARENGEN: I'd like to have another exhibit marked.

(EMPIRE EXHIBIT NO. 103 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. SWEARENGEN:

Q. Now, Mr. Murray, I've handed you what has been marked for identification as Exhibit 103. Can you identify that, please?

A. Yes. It is the Value Line selection opinion selected yields, and it looks like it's identical to the data that's on the previous exhibit except for different time periods, of course.

Q. Thank you. And what the exhibit show -- what does Exhibit 103 show for the time period August 17, 2006 as far as the prime rate is concerned?

A. 8.25.

Q. And what does it show for 30-year U.S. Treasuries at that point in time?

A. 5 percent.

Q. And over on the right-hand side, what does it show for utility A-rated bonds at August 17, 2006?

A. 5.03. You said -- I'm sorry. What was date you said on that?

Q. The August 17 --

A. I apologize. 6.07.

Q. Okay. And then right below that, what does it show for the BAA triple B-rated bonds?

A. 6.46.

Q. And that's also for August 17; is that true?

A. Yes.

Q. August 17, 2006?

A. That's correct.

MR. SWEARENGEN: I'd like to have another exhibit marked, please.

(EMPIRE EXHIBIT NO. 104 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

BY MR. SWEARENGEN:

Q. Now, Mr. Murray, I've handed you an exhibit that's been marked for identification as 104. If you could take a look at that and tell me whether or not you agree that it summarizes the information we talked about on Exhibits 102 and 103 in the first two columns?

A. Yes, it summarizes the highlighted

portions.

Q. Thank you. And would you agree that in the third column, the exhibit indicates a percentage change?

A. Yes. It's a percentage increase. I wouldn't classify it as a percentage change.

Q. Okay. Percentage increase?

A. Yes.

Q. And would you have any reason to dispute or -- that -- the validity of that calculation in the third column?

A. No, it looks like it's done accurately.

MR. SWEARENGEN: I would offer into evidence at this time Exhibits 102, 103 and 104.

JUDGE DALE: Are there any objections?

MR. MILLS: I have no objection to Exhibit 102 and 103, but I don't believe a proper foundation has been laid for 104. This witness hasn't done that calculation, and the best he could offer was he doesn't have any reason to dispute that that might be accurate. I don't think that adequately lays a foundation for its admissibility.

MR. SWEARENGEN: I can certainly ask him to make the calculation while he's sitting there on the witness stand, and I will.

JUDGE DALE: Mr. Thompson?

MR. THOMPSON: I have no objection.

JUDGE DALE: Well, hand the man a calculator.

THE WITNESS: No, I don't need a calculator.

JUDGE DALE: Okay.

THE WITNESS: 5 percent minus 4.19 is .81 percent. 6.07 minus 5.03 is 1.04 percent. 6.46 minus 5.37 is 1.09 percent. 8.25 minus 6.25 is 2 percent. The average -- I'd have to use a calculator. And I have one, so...

JUDGE DALE: Okay. Cool.

THE WITNESS: Thank you. Yes. You rounded that up to 1.24 percent which is fine. The exact number is 1.235.

MR. SWEARENGEN: Thank you.

MR. MILLS: Can I ask a clarifying question?

JUDGE DALE: Certainly.

MR. MILLS: Is it your understanding that the third column labeled "Change" is not a percent change but an absolute change, the difference between the 2 percentages?

THE WITNESS: Yes, that's why I

clarified. Mr. Swearengen appeared to be indicating that it was a percent change and after review, if my -- if my calculations were correct, it was just a difference.

MR. MILLS: Okay.

MR. SWEARENGEN: And that's fine.

MR. MILLS: I have no further objection.

JUDGE DALE: Then Exhibits 102, 103 and 104 are accepted into evidence.

(EMPIRE EXHIBIT NOS. 102, 103 AND 104 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

BY MR. SWEARENGEN:

Q. Let me ask you this, Mr. Murray: If a rating agency such as Standard & Poor's downgrades a utility, would you consider that to not be a good thing?

A. Depends on the perspective. Obviously, they're evaluating things from the bondholder's perspective, that's their clients. So it's not a good thing for bondholders.

Now, whether or not there's a downgrade for reasons that, you know, that a ratepayer shouldn't be, you know, put on the hook for, it's always -- just like with Aquila, there's ways to adjust that cost if the downgrade was for actions that are not -- that's not appropriate to pass on to ratepayers.

Q. Well, let me ask you that question. Would you agree that a downgrade from a rating agency can result in a higher cost of capital to utility companies such as Empire?

A. It depends on the reason for the downgrade.

Q. But it is possible that that could happen?

A. It's possible depending on the reason for the downgrade.

Q. And if that occurred, is it possible that those higher costs of capital could be passed on to customers?

A. If they're reflected in the rate of return, that's correct.

Q. And I think you indicated earlier that since Empire's last rate case, it has experienced a downgrade by Standard & Poor's; is that your...

A. Yes, it was triple B at the time of Empire's last rate case and as of May of this year they've been down -- by S&P to triple B minus. They have not been downgraded by Moody's or Fitch.

Q. And I think you talk about that S&P downgrade at page 14 of your direct testimony; is that true?

A. Yes, that is correct.

Q. And I believe it's schedule 21 to your direct testimony where you actually attach the report from S&P; is that right?

A. Schedule 21 and 22, that's correct. But yeah, for the downgrade, that is schedule 21.

Q. And that's dated -- the publication date is February 13, 2006?

A. For schedule 22, that's correct.

Q. Excuse me. And what's the date on schedule 21?

A. May 17th, 2006.

Q. Thank you. Thank you for correcting me. With respect to that May 17, 2006 report, S&P provides the following explanation for its downgrade of Empire's bonds: "Downgrade reflects Standard & Poor's view that Empire's financial measures will be constrained over the next several years by fuel and power costs that continue to exceed the level recoverable in rates, and by Empire's higher than historical level of capital spending, including the acquisition of a Missouri gas utility"; is that correct?

A. That's correct.

Q. Let me ask you this question: Is it your testimony that this May 17, 2006 report, a research update, misstates Standard & Poor's reasons for why it lowered or downgraded its bond rating from Empire to triple B to triple B minus?

A. No.

Q. You stated on page, I think 14 of your direct testimony that you did not think what Standard & Poor's said in their research update was a good explanation; is that correct?

A. That's correct.

Q. If you'd look back at that schedule 22 -- excuse me, 21 of the May 17, 2006 report, it says that, "Empire's financial measures will be constrained over the next several years by fuel and power costs that continue to exceed the level of recoverability in rates." Do you agree that that is a stated reason?

A. Well, let me clarify something on page --

Q. Well, let me -- can you answer that question and I'll let you --

A. Well, I think you're taking it out of context, and I think I tried to make this clear in my response to Dr. Vander Weide's rebuttal testimony.

MR. SWEARENGEN: Your Honor, I'm gonna object. That called for a yes or no answer whether or not that is a stated reason in the publication, and if his counsel wants to go back and redirect him on that, that's fine. But he ought to answer that yes or no.

JUDGE DALE: It's a yes/no question.

THE WITNESS: Okay. Repeat the question, please.

BY MR. SWEARENGEN:

Q. The question is, the report says that "Empire's financial measures will be constrained over the next several years by fuel and power costs that continue to exceed the level recoverable in rates." And my question is, do you agree that that is a stated reason?

A. Yes, that is a stated reason.

Q. And let me ask you this, sir: Is it your understanding that Empire currently is not recovering all of its fuel and purchased power costs? If you know, fine. If you don't know --

A. Historically that's been the case, but this second quarter, I'm not sure -- I know the gas prices have come down somewhat, so I don't recall exactly what -- how much the recovery may or may not have been in the second quarter. I believe the second quarter, the gas prices were lower.

Q. Okay. But you would be -- it would be your testimony that Empire is under-recovering in its fuel and purchased power cost, you just don't know the amount; is that right?

A. I would say they definitely have been under-recovering. Now, whether or not that continues into the future is going to depend on gas prices and the price of purchased power.

Q. And also on what this Commission does in this case?

A. Oh, exactly.

Q. Okay. Do you disagree with Standard & Poor's belief that Empire will not recover through rates its fuel and power costs for the next several years?

A. Yes.

Q. The second stated reason in the May 2006 publication, the second stated reason for the downgrade is, "Empire's higher than stated historical level of capital spending." Do you agree that Empire's level of capital spending is higher than its historical level?

A. Recent historical, yes.

Q. And part of that second reason provided by S&P is the acquisition of a Missouri gas utility by Empire; is that correct?

A. Yes.

MR. SWEARENGEN: Could I have just a moment, please?

JUDGE DALE: Sure.

BY MR. SWEARENGEN:

Q. Let me ask you this question: You don't dispute the fact that Empire did recently acquire a Missouri gas utility --

A. No.

Q. -- is that true?

A. I don't dispute that, no.

Q. Okay. And that would be the gas utility operations of Aquila; is that right?

A. Previously Aquila, yes.

Q. Thank you. Now, in addition to Standard & Poor's, have any other credit rating agencies expressed concern about Empire's financial situation?

A. Concern has been expressed in the reports, yes.

Q. And if you would turn to your

surrebuttal testimony, please. And I'm looking, I think, at page 6. Do you have that in front of you?

A. Yes, I do.

Q. There on lines 15 through 18, you state, "These analysts indicated that they are more or less in a hold pattern because of uncertainties surrounding one, the current rate case proceeding; two, the rulemaking process for a fuel adjustment clause mechanism in Missouri: And three, the integration of the natural gas distribution operation into Empire's existing operations"; is that correct?

A. Yes.

Q. And from that could one reasonably conclude that if Empire is not given a reasonably -- or excuse me, a reasonable allowed rate of return on equity and/or timely recovery of its fuel costs in this case, that Moody's and Fitch will re-evaluate their ratings for Empire?

A. That's possible, yes.

Q. Would it be reasonable to conclude that Moody's and Fitch analysts would downgrade Empire if the Commission were to lower Empire's allowed rate of return on common equity to your recommended level of the 9.5 to 9.6 from the currently allowed 11 percent when interest rates are currently higher than they were at the time of the Commission's order in Empire's last rate case, Case ER-2004-0570?

MR. WOODSMALL: Your Honor, I object. I believe that's speculative. To ask this witness what Moody's and Fitch may or may not do would be entirely speculation on this witness's part.

MR. THOMPSON: I join in that objection, your Honor.

JUDGE DALE: Sustained.

BY MR. SWEARENGEN:

Q. Would you agree that if there is a 150-basis decrease in Empire's cost of equity and/or a refusal to allow timely fuel cost recovery, that the Moody's and Fitch analysts would likely lower Empire's bond ratings as Standard & Poor's has already done?

MR. THOMPSON: Your Honor, same objection.

MR. WOODSMALL: Objection, the same.

JUDGE DALE: Also sustained.

MR. SWEARENGEN: That's all I have at this time. Thank you.

JUDGE DALE: Thank you. The Commission has an agenda session that is going to begin in five minutes. We will break for approximately 25 minutes so that they can have their 20-minute agenda and come back and we will start with questions from the Bench.

(A RECESS WAS TAKEN.)

(EMPIRE EXHIBIT NO. 98 WAS MARKED FOR IDENTIFICATION BY THE COURT REPORTER.)

JUDGE DALE: Okay. We are back on the record and ready to begin Commissioner questions for Mr. Murray.

COMMISSIONER APPLING: I just have a list of questions. David, I just have a list of questions, and if you could get somebody on your Staff to prepare answers to these and submit them to us sometime later on this week would be fine, okay? Just a number comfortable that you have.

MR. WOODSMALL: Could we have those read into the record just so we know what's going on, please?

COMMISSIONER APPLING: You're gonna be furnished a copy of it as soon as he's finished the -- putting the numbers on it. You're gonna be furnished with a copy.

JUDGE DALE: If you -- we have the questions without the answers, but what we were anticipating is reserving an exhibit number for it, making sure that you-all have copies of it no later than Friday morning, and then allowing people an opportunity to cross on it on Friday if you have questions.

MR. MILLS: I would like to see a copy of the questions before we get to them on Friday. I don't mean right this second, but sometime --

JUDGE DALE: We have right this second and since we have no other Commissioners here, let's look at them.

MR. MILLS: Okay.

MR. MURRAY: And I may have some -- I may need some clarification on at least one of the questions. I'd have to see.

COMMISSIONER APPLING: It's the same question we asked the witness this morning, Mr. Vander Weide. Same question.

MR. MURRAY: I do want to point out that there's --

COMMISSIONER APPLING: Go ahead.

MR. MURRAY: I think there's two of these questions that it may be hard to find information on. First of all, in this percent of shares held by institutional investors, there may be a source I can go to to find --

COMMISSIONER APPLING: If you can't find

it, David, just tell me you can't find it and that will be fine. I'm not gonna make a big fuss out of it.

MR. MURRAY: The first three I don't think -- and as far as the comparables, are you referring to my comparables or --

COMMISSIONER APPLING: Just the comparables you had, the five companies that you --

MR. MURRAY: Fine. Okay.

JUDGE DALE: Has everyone -- have all counsel had a chance to see this?

MR. MILLS: (Shook head.)

MR. WOODSMALL: Just a brief question. At the top it says, "Witness Murray." It says, "Breach comparable of each witness."

JUDGE DALE: It's -- that "for each witness" should just be stricken. It's just for each comparable --

MR. WOODSMALL: Okay.

JUDGE DALE: -- his --

MR. WOODSMALL: Right. Thank you.

JUDGE DALE: And then if you could -- have you seen it, Mr. Swearengen?

MR. SWEARENGEN: Well, I'll just briefly --

COMMISSIONER APPLING: Same question that I asked your witness this morning.

MR. SWEARENGEN: Sure. That's fine.

MR. MURRAY: And actually, I might converse with Mr. Vander Weide if we're having problems finding this information.

MR. SWEARENGEN: As long as he can send the bill to you.

MR. THOMPSON: No conversing.

MR. MURRAY: Because he has extensive research.

MR. SWEARENGEN: We'll try to help you to the extent we can answer these.

MR. MURRAY: Okay. Appreciate it.

COMMISSIONER APPLING: I'm the junior guy on this so I have no idea. I think they had planned to come back down, but let me check on it up there, okay?

MR. SWEARENGEN: Do you want to go ahead and get this stuff offered?

JUDGE DALE: Yes, please, let's go ahead and --

MR. SWEARENGEN: While we're on the record, I think my understanding from comments that were made earlier today that Empire was to supply the

Commission as late-filed as Exhibit 98, the Regulatory Research Associates July 6th, 2006 regulatory study which is a, as I understand it, a four-page document that's been marked as Exhibit 98, and we have that. We've provided it to the reporter and I would offer it at this time.

JUDGE DALE: Are there any objections?

MR. THOMPSON: I haven't seen it.

MR. SWEARENGEN: Oh, you haven't? I'm sorry. That's mine.

MR. THOMPSON: Well, do you have one for me? May I approach? Thank you.

JUDGE DALE: You're welcome.

MR. SWEARENGEN: I have another housekeeping matter, too, if --

MR. THOMPSON: Let me just jump in and say I have no objection to this.

MR. SWEARENGEN: Oh, I'm sorry.

MR. THOMPSON: In case you care.

JUDGE DALE: I do care. Exhibit 98 is admitted into evidence.

(EMPIRE EXHIBIT NO. 98 WAS RECEIVED INTO EVIDENCE AND MADE A PART OF THE RECORD.)

JUDGE DALE: Mr. Swearengen?

MR. SWEARENGEN: Yes. I'd asked the

witness quite a few questions about the Report and Order in Empire's last rate case, and I didn't propose to offer it into evidence, but I would ask that the Commission take administrative notice of its Report and Order in Case ER-2004-0570 that was issued March 10, 2005.

COMMISSIONER APPLING: That number again, please?

MR. SWEARENGEN: It's ER-2004-0570, and the date of issue was March 10, 2005.

JUDGE DALE: Administrative notice will be taken.

MR. SWEARENGEN: Fine. And also, I'd asked the witness a couple of questions about the Empire transaction whereby it acquired the gas properties of Aquila, the Missouri gas properties of Aquila.

And I'd like the Commission to take administrative notice of its order approving unanimous stipulation and agreement in that case which was GO-2006-0205.

And that order was issued on April 18, 2006, and since it's an order approving a stipulation, the stipulation is a part of that that I would ask the Commission to take notice of as well.

JUDGE DALE: Administrative notice will be taken.

MR. SWEARENGEN: Thank you.

MR. MILLS: While we're on that topic, can I ask that the Commission also take administrative notice of any decisions on the appeal of the Commission's decision in ER-2004-0570?

COMMISSIONER APPLING: 70?

MR. THOMPSON: That's kind of open-ended. Do you have specific decisions in mind?

MR. MILLS: Well, as it relates to this issue, I'm thinking about the Western District decision having to do with the qualifications of that expert witnesses on rate of return. And, in fact, it's not that open-ended. There are only two. There's a Circuit Court decision and a Western District decision.

MR. THOMPSON: The Western District decision can just be cited. I mean, why would you take notice of that?

MR. MILLS: Well, we can simply cite the Commission's decision as well, but if we're gonna take notice on a decision, I think we ought to take notice of any decisions on appeal.

JUDGE DALE: Well, we'll take

administrative notice of that.

MR. MILLS: And it may be that I am confusing this case with a different case and there may not be decisions on appeal of the 0570 Report and Order, in which case --

MR. THOMPSON: Does that make the notice void?

MR. MILLS: In case --

JUDGE DALE: No, we'll just not notice anything.

MR. SWEARENGEN: The Empire case was appealed to the Circuit Court of Cole County, I think both by the Public Counsel and the company, and I think the court affirmed that Commission's decision and that ended it, didn't it?

MR. MILLS: I think that is correct.

MR. SWEARENGEN: And I think the case you're thinking about might be a Missouri Gas Energy gas rate case.

MR. MILLS: And I think that's also correct.

MR. THOMPSON: Do you want to take notice of that?

JUDGE DALE: On that note, we have another Commissioner present who may have questions.

COMMISSIONER GAW: I do not right now.

CHAIRMAN DAVIS: He's on his way down right now and I don't know if he has any or not.

COMMISSIONER GAW: Well, why don't we just fill in the time.

QUESTIONS BY COMMISSIONER GAW:

Q. Give me some perspective on the reason that you believe your particular -- the companies that you used in your analysis were preferable to those that were used by Dr. Vander Weide.

A. Vander Weide.

Q. Vander Weide?

A. Yeah.

Q. Thank you.

A. The reason why I believe my companies are preferred to be used to estimate the cost of capital and specifically the cost of equity for Empire is, first of all, they're classified as vertically integrated electric utilities by S&P, and I believe it was very important to select companies that had similar business risk profiles.

And when I say similar business risk profiles, I mean comes in predominantly in the same type of business. There's no peer play company out there. Actually, Empire is as close as you get as far as a company that is in regulated utilities. I know they just acquired the gas operations, but they're still regulated utility operations.

But if you look at -- actually, I'll refer you to my direct testimony on page -- actually, I'll look for the schedule. On schedule 18 you'll find that three of the five comparable companies I have are not earning significant ROE's so that makes them similar to the Empire situation where they have a continuous under-earnings situation.

Another thing is Hawaiian Electric, although it has had fuel adjustment type clauses, it is by no means a certain thing. There is some -- there's some leeway in Hawaii as to whether or not a fuel adjustment clause will be kept in place. It appears to be a case by case process.

Q. Just to speak of fuel adjustment provisions in states, would it be accurate to say that just because there's authorization for fuel adjustment to be used in a state that a utility is always entitled to a fuel adjustment or not?

A. I can't speak for all states, I can just speak for some of the states that I've looked at. Some -- Kansas is an example. I believe there's been some negotiated fuel adjustment clause type of energy cost riders for certain utility companies in that state.

There's -- Pinnacle West is actually another company in my comparable group where they don't -- they have a weak fuel adjustment clause. There is recovery but they have to defer these costs over time. And then there's, obviously, just like here, there's a few disputes as to how much should be recovered but it's done in a deferral basis.

And there's also -- I believe two of the companies that tend to have a fairly significant amount of purchased power. And so the business risk profile of these companies I feel is quite similar to Empire.

Q. When you say "these companies," which companies are you referring to?

A. My comparable companies, Hawaiian Electric, IDACORP, Pinnacle West, Puget Energy and Southern Company. And the primary selection criteria that I thought was important was to attempt to select vertically integrated electric utility companies.

Actually, when you're estimating the cost of capital, there are many third-party risk indicators you can look at, but I don't believe that, just as Dr. Vander Weide was talking about beta earlier this morning, I don't believe that that is the best way to go about selecting comparable companies because there is a certain amount of subjectivity decision-making by, you know, the analysts as far as the Value Line safety rank, how often is that updated, what have you. It's not necessarily going to be an up-to-date, necessarily completely reliable selection method. That's my opinion.

One of the primary things in many of the, you know, texts that I've read and just studying I have done is to try to attempt to estimate the cost of capital to that specific enterprise. Even if it's a project within the enterprise, you would want to try to find a company that trades in the public market that is confined as much as possible to that business. And therefore, you ensure that you are going to have a company that faces the same type of business risk.

There are so many things that can go on whether the credit rating's the same or not. There are so many things that can go on such as high growth rates.

One of the things that I noticed in Dr. Vander Weide's comparable companies is the wide range of growth rates. And if you see a growth rate above double digits, I think you have to start questioning whether or not that's a regulated utility.

Regulated utilities are going to grow, in my opinion, maximum 5 percent. It's not a growth industry, it's a mature industry. There may be some, you know, short-term periodic times where they'll have a little bit more growth than what their sustainable sustained growth is, but in perpetuity, you're going to find that utility companies grow 2 to 3 percent long-term.

Q. Barring acquisition of additional territory by regulated utility, would it be accurate to say that most of the growth that's attributable to a utility has to do with growth in load or is it more than that?

A. Growth in load, yeah, demand growth that's organic growth. I agree with you. If you're looking at a captive entity, whether or not growing through acquisitions, their growth is going to be driven by the amounts of demand increase for their service or their product.

Q. Would it also be accurate to say that because of the nature of it being as it is in regard to being fairly dependent upon the amount of load or demand that it has, that it also has a low likelihood of seeing a large degree of diminished revenues because -- because there is a pattern of -- generally of small growth for that type of business?

A. Yeah, as far as the volatility, the revenues as far as them diminishing over time. I think you have your energy efficiency programs that may decrease some of the demand, but more often than not, the growth in population, you know, through additional customers, whatever, the service territory.

And this can vary quite a bit obviously, in the various service territories for companies around the United States. For instance, Empire in the '80's with Branson, they experienced tremendous growth. So you can see that higher growth for short periods of time but, you know, you would not expect that growth or the growth in demand to drop off precipitously.

Q. And if you were looking at some other kinds of industry outside the electric industry unregulated in businesses, for example, would you expect that same degree of security necessarily to be there?

A. In competitive markets not at all.

Obviously if your costs, the cost of your service exceeds your competitors, you're gonna lose market share. The quality of service is important, the quality of the product is important, but we're all very cost-conscious people. We're consumers that are trying to, you know, keep money in our own wallets.

Q. In evaluating the factors overall that go into determining risk generally of different kinds of industries, would you say that generally electric utilities in vertically integrated regulated states are more risky or less risky than businesses in general?

A. As far as businesses in general, I'll -- when I think about businesses in general, I think about the S&P 500. That's the market in general. When people discuss returns on the market, they refer to the S&P 500, and that is actually one of the fundamental concepts of the capital asset pricing model with beta.

And if you -- even with a portfolio of companies, utility companies, you're gonna find the betas and the electric utility industry are, in my opinion, in the .8 to .85 range for vertically integrated, regulated electric utilities, not close to one. So if you accept -- if you accept that that is an accurate indicator, then it is less risky than the entire market.

Q. Because the lower beta means generally less risk?

A. Yes, exactly. It means that the stock price of the company is less volatile than the overall market. I know Dr. Vander Weide didn't want to get into this earlier, but beta is a measure of the volatility of the stock as it measures -- as it compares to the volatility of the entire market.

Q. Okay. And in regard to how that -- if all other factors are stationary, is there a relationship between lower risk and expectation on return on equity?

A. Without a doubt.

Q. And what is that relationship?

A. If there isn't as much risk associated with the investment, once again I'll take an S&P 500 as an example, you're gonna expect, require -- when I say expect -- and sometimes these words are used interchangeably, and I don't do it to try to confuse anybody, but the investor's going to require a lesser return because there's less risk.

COMMISSIONER GAW: Okay. That's all I

have. Thank you, Judge.

JUDGE DALE: We have two minutes.

QUESTIONS BY CHAIRMAN DAVIS:

Q. Okay. Mr. Murray, do you know what Anheuser-Busch's ROE is?

A. No, I haven't researched Anheuser-Busch.

Q. So it wouldn't surprise you if Anheuser-Busch had an ROE of 25 or even more?

A. I --

Q. You wouldn't know?

A. I don't know.

CHAIRMAN DAVIS: Okay. No further questions at this time.

JUDGE DALE: Are there any questions based on the questions from the Bench?

MR. SWEARENGEN: I have one.

MR. MILLS: I have a couple.

JUDGE DALE: Okay. Go, Mr. Mills, quickly.

CROSS-EXAMINATION BY MR. MILLS:

Q. Commissioner Gaw asked you about the betas for regulated utilities and I believe specifically about Empire. You looked at a portion of your testimony where you found a beta of .75 for Empire, and in Dr. Vander Weide's testimony it's .80;

is that correct?

A. That's what Mr. Swearengen showed me, yes.

Q. Okay. How is it that those -- that that variation exists; is that simply a timing thing?

A. I believe he probably just referenced an updated Value Line sheet.

Q. Okay.

A. If I was asked to produce my source document, I could provide the Value Line sheet that showed the .75. And Dr. Vander Weide updated his -- his cost to equity study in rebuttal testimony which was after the time I filed my direct. So I presume it's an updated tariff sheet from Value Line.

Q. And if you were to look at an even more recent tariff sheet from Value Line, you could find that the value had changed yet again?

A. It may, or may be the same.

Q. Could be higher, could be lower; we just don't know what it is right now?

A. It may not even be out yet.

MR. MILLS: That's all I have. Thank you.

JUDGE DALE: Yes, Mr. Swearengen?

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Yes, my question, I think -- in response to a question from Commissioner Gaw, you said that the gas operations which the Empire District Electric Company acquired from Aquila were still regulated operations. Do you remember that?

A. Yes.

Q. And in that sense, would you say that the gas utilities are very similar to electric utilities?

A. From a regulated perspective, yes.

Q. And are the returns that are authorized for electric utilities comparable to the returns authorized for gas utilities just generally?

A. I don't know. I haven't studied that.

MR. SWEARENGEN: That's all. Thanks.

JUDGE DALE: We need to cease streaming. We can continue on the record if you think that your redirect will be fairly brief or we can continue it on Friday morning.

MR. THOMPSON: Well, I'd prefer to continue on Friday morning.

JUDGE DALE: Then that's what we'll do.

MR. SWEARENGEN: My problem is I'm not available Friday morning and I'm responsible for this issue.

JUDGE DALE: But you don't get to ask any more -- oh, you'd get to object.

MR. SWEARENGEN: I'd find something to do.

MR. WOODSMALL: Your Honor, we could take it up when we do Mr. Mills' --

MR. MILLS: Yeah, we're not going to be doing Public Counsel witness on this issue until sometime next week. If we want to just do the rest of this issue when we do him, then that would be fine with me.

MR. SWEARENGEN: I would appreciate that, because I don't really want to ask somebody else in my office to step in here.

JUDGE DALE: Yeah, that makes sense.

MR. SWEARENGEN: So thank you. I appreciate that. Thanks.

JUDGE DALE: Yeah, we'll all -- so you are excused until at least Monday, and Monday we'll tell you, hopefully, with some certainty when we'll need you back when you will have redirect.

MR. MURRAY: So I have to call off my trip to Hawaii?

MR. THOMPSON: Was this a research --

JUDGE DALE: Okay. So this hearing will be adjourned then until 8:30 on Friday morning.

(WHEREUPON, the hearing of this case was recessed until September 8, 2006, at 8:30 A.M.)

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*   Only pages 13, 24 and 15 of this exhibit were received into evidence.

**   Not yet received into evidence.

*** Admitted with objections regarding stipulation procedure.