

Exhibit No.  
Issue: Reason for Rate Case  
Witness: W. L. Gipson  
Type of Exhibit: Direct Testimony  
Sponsoring Party: Empire District  
Case No.

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DEC 28 2004

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

**Missouri Public  
Service Commission**

**Direct Testimony**

of

**W. L. Gipson**

**April 2004**

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Date 12-06-01 Rptr KF

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

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

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

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

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

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

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

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

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

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

16 A. Yes, I have presented testimony before the Missouri Public Service Commission  
17 ("Commission"), the Kansas Corporation Commission, the Oklahoma Corporation  
18 Commission, and the Arkansas Public Service Commission.

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

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

4 **Q. PLEASE DESCRIBE EMPIRE.**

5 A. Empire is a Kansas corporation with its principal office and place of business at 602 Joplin  
6 Street, Joplin, Missouri 64801. Empire is engaged in the business of providing electrical  
7 utility services in Missouri, Kansas, Arkansas and Oklahoma; water utility services in  
8 Missouri; and has a certificate of service authority issued by the Commission to provide  
9 certain telecommunications services.

10 **Q. WILL YOU PLEASE DESCRIBE THE AREA SERVED BY EMPIRE AND GIVE A**  
11 **BRIEF DESCRIPTION OF THE CUSTOMERS SERVED?**

12 A. Empire provides electric service in an area of approximately 10,000 square miles in  
13 southwest Missouri and the adjacent corners of the states of Kansas, Oklahoma, and  
14 Arkansas. Empire's operations are regulated by the utility regulatory commissions of these  
15 four states as well as the Federal Energy Regulatory Commission ("FERC"). The area  
16 embraces 120 incorporated communities in 21 counties in the four-state area.

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

20 At the end of 2003, Empire served 131,400 residential customers, 23,154 commercial  
21 customers, 362 industrial customers, 1,735 public authority customers, and four wholesale  
22 customers throughout our system. Most of the communities in the service area are small,

1 with only 29 being in excess of 1,500 population. Only 10 communities have a population  
2 in excess of 5,000, and the largest city is Joplin, Missouri, with a population of  
3 approximately 45,500.

4 In Missouri, at the end of 2003, Empire served 114,893 residential customers, 20,346  
5 commercial customers, 291 industrial customers, 1,404 public authority customers, and  
6 three wholesale customers. In addition to electric service, Empire also provides regulated  
7 water service to approximately 4,500 customers in the Missouri communities of Aurora,  
8 Marionville, and Verona.

9 **Q. EXPLAIN, GENERALLY, EMPIRE'S NEED FOR A RATE INCREASE AT THIS**  
10 **TIME.**

11 A. This filing for a rate increase is important for Empire because we need to (1) recover  
12 additional operating expenses and the return of and on existing and new investment that  
13 constitutes the used and useful rate base costs of serving the local community; and (2) re-  
14 gain financial flexibility to reliably serve our customers in the most effective manner.

15 Empire's request is due to over \$100 million in infrastructure investments, higher fuel  
16 costs, and the need to earn adequate rates of return and to properly reflect the economic cost  
17 of assets through the depreciation allowance.

18 Furthermore, Empire is operating in an increasingly complex and volatile industry  
19 while responding to increased customer demands. Empire faces the need to make  
20 significant capital investments over the next several years in order to continue to support  
21 our customers' power demand and provide reliable, high-quality service.

1 Empire, with the help of the Commission, seeks to create a forward-looking  
2 regulatory framework that benefits the customers, employees and stockholders.

3 **Q. THE SCHEDULES IN THIS FILING SUPPORT THE NEED FOR A \$52.4 MILLION**  
4 **REVENUE INCREASE. PLEASE EXPLAIN WHY THE TARIFFS FILED IN THIS**  
5 **CASE LIMIT THE INCREASE TO \$38.3 MILLION, OR AN APPROXIMATE**  
6 **14.8% INCREASE IN REVENUE.**

7 A. A \$52.4 million increase in revenue is justified and fully supported in this filing. However,  
8 the impact on our customers of a 20.2% increase in rates, however justified, would be  
9 significant. After much consideration, we determined to lessen the impact in this case by  
10 approximately \$14.1 million. Specifically, the portion of our proposed increase attributable  
11 to depreciation rates, sponsored by Empire witness Mr. Donald Roff, has been pared down  
12 to reflect only a portion of the changes recommended by Mr. Roff.

13 **Q. WHAT SIGNIFICANT INVESTMENTS HAS EMPIRE MADE TO ITS**  
14 **INFRASTRUCTURE?**

15 A. In 2001, Empire entered into an agreement to purchase two FT8 peaking units to be  
16 installed at the Empire Energy Center with generating capacity of 50 megawatts each.  
17 These units began commercial operation in April 2003 and added a total of 100 megawatts  
18 of capacity. The testimony of Mr. Brad Beecher, Vice President of Energy Supply, will  
19 elaborate further on these rate base additions.

20 Empire also continues to make substantial improvements in its distribution and  
21 transmission system in order to meet growing customer demand. In addition, last May, the  
22 Empire service territory received catastrophic damage after a tornadic supercell moved

1 through the area. Our employees worked diligently throughout the week to rebuild lines,  
2 repair substations and return power to customers. Further details are provided in the  
3 testimony of Mr. Mike Palmer, Vice President of Commercial Operations.

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

5 A. Thirty percent of the energy during the test year was generated from Empire's natural gas-  
6 fired units or purchased on the spot market. In recent years, the wholesale natural gas  
7 market has seen a substantial increase in prices. Empire actively worked to mitigate these  
8 rising prices by implementing a hedging program in 2001.

9 While less an issue during the last couple of years due to Empire's success in  
10 locking in low prices, the current long-term trend in gas prices would create substantial  
11 credit pressure if left unaddressed. Mr. Brad Beecher will describe the fuel price increases  
12 in detail and explain the elements of the hedging program in his testimony.

13 **Q. WHAT IS EMPIRE RECOMMENDING TO REGULATE THE CURRENT LONG-  
14 TERM INCREASES IN GAS PRICES?**

15 A. Empire has put forth three separate methodologies. Those include a Fuel and Purchased  
16 Power Adjustment Clause ("FAC"), an Interim Energy Charge ("IEC") and the twelve-  
17 month ending forecast that uses production cost modeling. Implementation of one of the  
18 alternatives is needed to provide a timely recovery of fuel and purchased-power expenses.  
19 This will also allow for fewer rate cases, improved credit risk and financial flexibility and  
20 continued customer protection against fuel price volatility through Empire's hedging  
21 activities. Testimony by Mr. Brad Beecher discusses these methodologies in detail.

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

3 A. The Company is proposing an ROE of 11.65 percent. This was derived from a range of 11.3  
4 percent proposed by Empire witness Dr. James H. Vander Weide to 12.0 percent proposed  
5 by Empire witness Dr. Donald A. Murry. Empire has chosen the midpoint of 11.65 percent.  
6 In their direct testimonies, Dr. Murry and Dr. Vander Weide will support their proposals.

7 The Company must meet its obligations to its customers for reliable electric power  
8 service. To meet this ongoing obligation the Company must also be able to finance  
9 significant capital projects. The Company must also have the financial performance  
10 necessary to maintain or improve its bond ratings. Despite our best efforts, the Company  
11 cannot find a way to accomplish this without earning an adequate return on common equity.  
12 It is important to note that to secure adequate financing in this more complex economic  
13 environment, investors and rating agencies increasingly look at performance as measured by  
14 the returns actually achieved. Therefore, it is also important that the Company be afforded  
15 an opportunity to actually earn its authorized return. The average return earned on common  
16 equity for the last five years has been 7.66 percent. Compared to an embedded debt cost of  
17 7.25 percent and a preferred cost of 8.93 percent, this level of earnings restricts the financial  
18 flexibility of the Company and does not fairly compensate equity investors.

19 **Q. ARE YOU RECOMMENDING ANY CHANGES TO DEPRECIATION?**

20 A. Yes. Empire contracted Deloitte & Touche LLP ("Deloitte") to conduct a depreciation study.  
21 The study resulted in a recommendation by Deloitte to change the depreciation rates. The  
22 study recommended an annual rate increase in Missouri depreciation expense of

1 approximately \$24 million. The primary reason for the substantial increase is the effect on  
2 annual depreciation expense of the relatively low existing depreciation rates. Also having an  
3 effect are the retirement dates used to calculate the depreciation rates for production plant  
4 coupled with new investment and the effect of negative net salvage. This is further  
5 discussed by Empire witness Mr. Donald S. Roff in his testimony.

6 However, Empire realizes the magnitude of this increase would be too drastic for our  
7 customers. Therefore we are recommending the depreciation rates be phased in over a  
8 period of time.

9 **Q. HOW DO YOU PROPOSE THE COMMISSION PROVIDE THE SUPPORT YOU**  
10 **HAVE REQUESTED?**

11 A. I would ask that the Commission provide such regulatory support in the form of:

- 12 (1) An interim energy charge (or fuel adjustment clause) that helps Empire manage  
13 risk and recover fuel costs;
- 14 (2) A rate of return and depreciation allowance that are more comparable to what  
15 other state regulators have allowed for Empire and other utilities;
- 16 (3) Full cost recovery for other prudent operating expenses; and
- 17 (4) Rates designed to provide a reasonable opportunity to earn the allowed return.

18 It is important the Commission support these four requests to allow Empire to regain  
19 the financial and operating flexibility needed to serve our customers both in the immediate  
20 and long-term. It will also allow Empire to bestow a fair and reasonable balance between  
21 the interest of our customers and our shareholders, a large proportion of which are Missouri  
22 residents and part of the local community.

1 **Q. WHAT AFFECT DOES MISSOURI REGULATION HAVE ON EMPIRE?**

2 A. Regulatory policies for depreciation rates, recovery of fuel cost, and allowed return all  
3 directly influence revenues and earnings. The inability for Empire to earn sufficient return  
4 impacts the Company's ability to compete for capital, and therefore, stifles cash flow.

5 In the testimony of Dr. Murry, the results of the Regulatory Research Associates study  
6 of US regulatory commissions will be presented. Missouri was described as "restrictive"  
7 with equity returns "modestly below industry averages."

8 **Q. WHAT IMPACT COULD EMPIRE'S REQUEST HAVE ON THE CREDIT RATING  
9 AND FUTURE FINANCIAL OUTLOOK?**

10 A. In order to understand where we are going, it is necessary to understand where we have  
11 been. Prior to the failed merger with UtiliCorp United, Inc., Empire was rated as A2 by  
12 Moody's and A- by Standard & Poor's ("S&P"). Since the failed merger in 2001, both  
13 rating agencies downgraded our debt to a level just above "junk" status. Empire has been  
14 able to restore its capital structure and has worked diligently to restore our financial  
15 performance.

16 **Q. PLEASE CONTINUE.**

17 A. On July 2, 2002, S&P issued the following comment: "The rating action on energy provider  
18 EDE reflects a downward trend in the company's financial profile that was not adequately  
19 stemmed in recent regulatory actions. Roughly 80% of EDE's revenues are derived in  
20 Missouri, where the regulatory environment is marked by relatively low allowed ROEs, low  
21 plant depreciation allowances, and the lack of a permanent fuel adjustment clause to help  
22 shield the company from its markedly increased dependence on natural gas."

WILLIAM L. GIBSON  
DIRECT TESTIMONY

1           In addition, on September 25, 2003 they stated that "Standard & Poor's views Empire  
2 as a well-managed, credit-conscious, and cost-effective company that tries to compensate for  
3 its sometimes difficult regulatory environment."

4           We are requesting additional regulatory support from the Commission that will allow  
5 us the opportunity to re-gain needed financial flexibility and operate more safely within the  
6 investment-grade credit rating categories.

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

8 A. Yes, I would like to reiterate the importance of receiving Commission support. It is  
9 important to our customers, shareholders and employees. Implementation of the requested  
10 rates will allow us to continue to provide exceptional service to our customers, provide an  
11 equitable rate of return to our shareholders permitting our stock to remain competitive, and  
12 provide stable employment to our employees. This will allow Empire to remain a  
13 financially sound company with a strong presence in the local economy.

14 **Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY AT THIS**  
15 **TIME?**

16 A. Yes, it does.