

Exhibit No. 1
Issue: Reason for Rate Case
Witness: W. L. Gipson
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Electric
Case No.
Date Testimony Prepared: October 2007

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

Direct Testimony

of

W. L. Gipson

October 2007

Empire Exhibit No. 1
Case No(s) EP-2008-0093
Date 5-12-08 Rptr KF

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
5 the 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
8 Associate Degree in Computer Science from Missouri Southern State College (now
9 University) in Joplin, Missouri.

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

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

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

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

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

5 A. The purpose of my testimony is to give a brief description of the Company and the reasons
6 for Empire's decision to request rate relief and the implementation of a fuel adjustment
7 clause ("FAC").

8 **Q. PLEASE DESCRIBE EMPIRE.**

9 A. Empire is a Kansas corporation with its principal office and place of business at 602 Joplin
10 Street, Joplin, Missouri 64801. Empire is engaged in the business of providing electrical
11 utility services in Missouri, Kansas, Arkansas, and Oklahoma; water utility services in
12 Missouri; and has a certificate of service authority issued by the Commission to provide
13 certain telecommunications services. In addition, Empire operates a natural gas distribution
14 business in northwest, north central, and west central Missouri that provides gas service to
15 44 communities. The gas distribution business is operated by a wholly owned subsidiary,
16 The Empire District Gas Company.

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

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

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1 Most of the communities in the service area are small, with only 29 containing a population
2 in excess of 1,500. Only 10 communities have a population in excess of 5,000, and the
3 largest city, Joplin, Missouri, has a population of approximately 49,000. However, Joplin's
4 daytime population swells to about 270,000 and the population in a 40-mile radius around
5 Joplin is about 400,000.

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

9 At June 30, 2007, Empire served 139,513 residential customers, 24,357 commercial
10 customers, 360 industrial customers, 1,928 public authority customers, and four wholesale
11 customers throughout our system. In Missouri, Empire served 122,821 residential
12 customers, 21,584 commercial customers, 286 industrial customers, 1,571 public authority
13 customers, and three wholesale customers as of June 30, 2007. In addition to electric
14 service, Empire also provides regulated water service to approximately 4,500 customers in
15 the Missouri communities of Aurora, Marionville, and Verona, and through its wholly
16 owned subsidiary, The Empire District Gas Company, provides natural gas service to
17 approximately 47,000 gas customers in northwest, north central, and west central, Missouri.

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

19 A. Empire is requesting an overall increase in its Missouri retail rates of \$34.7 million,
20 approximately a 10.1 percent increase.

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

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1 A. The major factors driving the need for a Missouri rate increase at this time are the capital
2 additions we have made and will make to our electric system in 2007 (Riverton 12 &
3 Asbury SCR); the financial impact, both capital and expense, related to a catastrophic ice
4 storm that hit our service area in January 2007; and the large capital expenditures we are
5 making to participate in the construction and ownership of two new coal-fired generating
6 units, Iatan II and Plum Point. In addition, the continued volatility of both fuel and
7 purchased energy costs, coupled with the absence of an effective energy cost adjustment
8 mechanism in Missouri, leaves Empire exposed to increased fuel cost risk and so we are
9 also requesting the implementation of an FAC as part of this rate case.

10 **Q. PLEASE DESCRIBE THE MAJOR INVESTMENTS IN PRODUCTION**
11 **FACILITIES MENTIONED ABOVE.**

12 A. Empire completed its construction of a new generating unit, Riverton 12, in April 2007.
13 This unit was contemplated by our Experimental Regulatory Plan which was approved by
14 the Commission in Case No. EO-2005-0263. Riverton 12 has a capacity rating of 150MW
15 and was completed at a cost of \$40 million. In addition to the completion of Riverton 12,
16 Empire is constructing new pollution control facilities on its Asbury Power Station. The
17 new SCR system at Asbury is scheduled to go into service in November 2007. We estimate
18 that we will complete the project at a total cost of \$31 million. Empire witness Blake
19 Mertens will discuss each of these construction projects in greater detail in his direct
20 testimony.

21 **Q. PLEASE DESCRIBE THE ADDITIONAL PLANT INVESTMENT THAT EMPIRE**
22 **MADE IN 2007 TO RESTORE ELECTRICAL SERVICE IN CONNECTION WITH**
23 **THE JANUARY 2007 ICE STORM.**

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1 A. The ice storm in January 2007 destroyed extensive portions of our electric system. Empire
2 witness Mike Palmer will discuss the storm's impact and our restoration efforts in his direct
3 testimony in this rate case. In total, the ice storm cost Empire almost \$31 million.
4 Approximately \$19 million of the storm's overall cost was capitalized as additional
5 investment in our electric system.

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

8 A. Cost of capital, payroll, and various other expenses have risen somewhat. However, with
9 the addition of Riverton Unit 12, the new environmental facilities at Asbury, and the major
10 additions made to our system as a result of the ice storm, our fixed costs have increased
11 significantly and are the major cost driver in this rate case.

12 **Q. WITH REGARD TO THE FAC, IS EMPIRE UNDERTAKING ANY STEPS TO**
13 **MITIGATE THE INCREASES IN FUEL COSTS, ESPECIALLY NATURAL GAS?**

14 A. Yes. Empire is working to control the volatility associated with fuel costs through the use
15 of a natural gas hedging program which has been in place since 2001. In addition, Empire
16 began receiving wind energy from the Elk River Wind Farm in October 2005, and Empire
17 has recently signed a contract with Horizon Wind Energy to purchase 100 percent of the
18 output from a new wind farm, Meridian Way Wind Farm, located near Concordia, Kansas.
19 The new wind farm is expected to come on line in January 2009. These tools aid in
20 mitigating price volatility, mitigate our natural gas exposure and provide price stability for
21 Empire and our customers. As indicated, however, Empire is still exposed to increased fuel
22 cost risk and thus has requested an FAC.

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

A. Rating agencies have a positive view of energy cost recovery mechanisms because they allow for timely recovery of prudently incurred fuel and purchased power costs. As such, they viewed the passage of Senate Bill 179 as a very positive step for regulation in the state of Missouri. According to Standard & Poor's, "A regulatory weakness has been Missouri's lack of a permanent fuel adjustment clause (FAC), but recently enacted legislation provides for the authorization of FACs that should improve cost recovery and bolster cash flow" (RATINGSDIRECT, June 27, 2005). This analyst's view of Empire's fuel recovery opportunity is extremely important, given Empire's substantial construction program (Iatan II & Plum Point) and the associated need for access to the capital markets to finance such a program and Empire's current credit rating, which is only one notch above non-investment grade. Any uncertainty of fuel cost recovery will work to our disadvantage when we go to the market with security issuances to finance our construction program. The implementation of an FAC in Missouri would help maintain Empire's investment grade status during the completion of the construction of the Iatan II and Plum Point generating facilities.

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

A. Empire is proposing an ROE of 11.6 percent through the direct testimony of Dr. James H. Vander Weide. The Company's ability to provide its customers with reliable electric power service is directly dependant upon the allowed ROE and cost recovery. Dr. H. Edwin Overcast of Black & Veatch also discusses the additional risk Empire faces due to

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1 the lack of a fuel adjustment mechanism in Missouri and the risk associated with Empire's
2 substantial construction program. If we are to continue to provide our customers with the
3 outstanding level of service they have come to expect, the Company must be able to
4 finance significant capital projects at the lowest cost possible.

5 **Q. ARE YOU REQUESTING ANY ADDITIONAL REGULATORY AMORTIZATION**
6 **TO MEET FINANCIAL RATIO TARGETS AS PROVIDED FOR IN CASE NO.**
7 **EO-2005-0263?**

8 A. No. Robert W. Sager of Empire is presenting testimony on this topic. His testimony
9 indicates that no additional regulatory amortization is required by Empire at this time.

10 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?**

11 A. Yes, it does.