

Exhibit No. 133
Issue: Payroll, Vegetation Tracker,
Advertising, and Rate Comparison
Witness: Kelly S. Walters
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2014-0351
Date Testimony Prepared: March 2015

Filed
May 07, 2015
Data Center
Missouri Public
Service Commission

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

Rebuttal Testimony

of

Kelly S. Walters

March 2015



SERVICES YOU COUNT ON

Empire Exhibit No. 133
Date 4-14-15 Reporter XF
File No. ER-2014-0351

TABLE OF CONTENTS
REBUTTAL TESTIMONY OF
KELLY S. WALTERS
ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
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<u>SUBJECT</u>	<u>PAGE</u>
INTRODUCTION.....	1
INCENTIVE COMPENSATION.....	2
VEGETATION MANAGEMENT	10
ADVERTISING EXPENSE.....	11
RATE COMPARISON.....	12

REBUTTAL TESTIMONY
OF
KELLY S. WALTERS
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2014-0351

1 **INTRODUCTION**

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

3 A. Kelly S. Walters, 602 Joplin Avenue, Joplin, MO, 64801.

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

5 A. My employer is The Empire District Electric Company (“Empire” or
6 “Company”). I hold the position of Vice President-Chief Operating Officer-
7 Electric.

8 **Q. ARE YOU THE SAME KELLY S. WALTERS THAT PREVIOUSLY**
9 **FILED DIRECT TESTIMONY IN THIS CASE?**

10 A. Yes.

11 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

12 A. I have prepared this rebuttal testimony to respond to the Missouri Public Service
13 Commission Staff (“Staff”) recommendation to exclude a significant portion of
14 Empire’s ongoing compensation levels from the cost of service in this case. My
15 rebuttal testimony will explain how Empire’s executive compensation program is
16 designed and how Empire’s approach is similar to the approach utilized by
17 companies comparable to Empire. Further, I will explain how the overall
18 executive compensation program in place at Empire is reasonable and quite
19 conservative when compared to the Company’s peers within the industry and to

1 the national marketplace as well, and why all components of executive
2 compensation should be included in Empire's test year expense. I will explain
3 Empire's incentive compensation approach for non-executive salaried employees
4 and how certain amounts Staff recommends be excluded from test year expense
5 should properly be included. I will also address Empire's reaction to the position
6 taken by the Office of the Public Counsel ("OPC") on vegetation management
7 costs and the vegetation management tracker. I also will address a Staff
8 recommendation to disallow a portion of Empire's advertising expense as
9 promotional rather than customer educational, which is a category of advertising
10 that is normally included in the overall revenue requirement. Finally, I will
11 address the rate comparison between Empire and other electric utilities presented
12 by Midwest Energy Consumers Group ("MECG").

13 **INCENTIVE COMPENSATION**

14 **Q. HOW IS THE EXECUTIVE COMPENSATION PROGRAM AT EMPIRE**
15 **DESIGNED?**

16 A. Empire's executive compensation is determined and administered by the
17 Compensation Committee of Empire's Board of Directors. The Compensation
18 Committee is made up of five non-employee, independent Empire Board
19 members. Empire's executive compensation program is designed to provide a
20 competitive compensation package that will enable the Company to attract and
21 retain highly talented individuals for key positions and promote the
22 accomplishment of our performance objectives. Empire's compensation objective

1 is to be consistent with our industry peers, while providing compensation which is
2 conservative when compared to the same peer group.

3 **Q. HOW IS EMPIRE'S COMPENSATION PROGRAM STRUCTURED?**

4 A. Empire's compensation program provides a base salary coupled with the
5 opportunity to earn a higher level of total compensation utilizing incentive
6 programs that link compensation to individual and Company performance factors.
7 The Company targets total compensation, base pay, and incentive pay, at the 25th
8 percentile of an industry specific peer group. As explained below, the appropriate
9 total compensation amount is determined and then a certain portion of the
10 compensation package is put at risk.

11 Empire's executive compensation program includes three basic compensation
12 elements: (1) base salary; (2) annual (short-term) cash incentives based on
13 threshold (minimum expected), target, and maximum performance measures; and,
14 (3) long-term incentives.

15 **Q. WHAT PROCESS DOES THE COMPENSATION COMMITTEE USE TO**
16 **ESTABLISH COMPENSATION?**

17 A. The Compensation Committee retains an independent third-party consultant to
18 provide guidance on best practices within executive compensation as well as to
19 provide recommendations for the establishment of a peer group and compensation
20 levels. The Committee completed the last study with the consultant, Hay Group,
21 in October 2014.

22 **Q. HOW DOES EMPIRE'S EXECUTIVE COMPENSATION APPROACH**
23 **COMPARE TO SIMILAR COMPANIES?**

1 A. As communicated by Hay Group, companies similar to Empire typically utilize
2 the same approach as Empire by incorporating a mix of base salary, short-term
3 incentives, and long-term incentives into a total executive compensation package.
4 This reflects a “best practices” approach used by companies both inside and
5 outside the utility industry. Rather than relying solely on fixed compensation in
6 the form of base salary, this best practices approach also includes a considerable
7 measure of variable (**at risk**) compensation in the total compensation package.
8 This approach is a key factor in ensuring the alignment of an executive’s
9 performance with the interests of customers and shareholders.

10 **Q. AS YOU UNDERSTAND IT, HOW DOES EMPIRE’S EXECUTIVE**
11 **COMPENSATION PHILOSOPHY COMPARE WITH THE**
12 **COMPENSATION PHILOSOPHY OF OTHER COMPANIES?**

13 A. Although Empire’s approach to executive compensation is similar to other
14 companies, the philosophy behind Empire’s approach is much more conservative.
15 The Compensation Committee has targeted the base salary at the 25th percentile
16 of the industry specific peer group discussed above for similarly situated
17 executives. In so doing, the Compensation Committee has set target base salary
18 levels significantly lower than the median base salary levels of our peer group.
19 Empire’s actual base salary for executive officers is significantly lower than the
20 level established for the companies in our peer group.
21 The Compensation Committee has also established **short- and long-term**
22 **incentive** target levels for Empire’s executives that are consistent with and **below**
23 those of the peer group companies. In terms of **total compensation**, the

1 Compensation Committee has set a target level for Empire executives that also
2 approximate the 25th percentile.

3 **Q. HOW DOES EMPIRE'S EXECUTIVE COMPENSATION PHILOSOPHY**
4 **IMPACT COMPENSATION AWARDS AS COMPARED TO THE PEER**
5 **GROUP?**

6 A. Because of Empire's conservative compensation philosophy, the Company's
7 overall compensation awards are significantly less than similar awards of the peer
8 group.

9 **Q. WHAT ADJUSTMENT IS STAFF WITNESS JERMAINE GREEN**
10 **PROPOSING TO EXECUTIVE COMPENSATION?**

11 A. Despite the fact that Empire's compensation philosophy is very conservative as
12 compared to Empire's peer group, Staff witness Green still recommends the
13 removal of several components of Empire's total compensation package from test
14 year expense, namely those that constitute the variable, equity, or at risk portions
15 of executive compensation. Additionally, the Staff is recommending removal of
16 compensation associated with the Management Incentive Compensation Plan
17 ("MIP") -- also known as "Lightning Bolts" -- which are generally lump sum cash
18 payments to individual employees.

19 **Q. HOW DO YOU CHARACTERIZE THESE STAFF ADJUSTMENTS TO**
20 **EXECUTIVE COMPENSATION?**

21 A. They are unreasonable.

22 **Q. WHY?**

1 A. Total target compensation for Empire is significantly below the peer group
2 median, and in fact is one of the lowest in the peer group. Our program is
3 designed with consideration of best industry practices and as such, the cash
4 incentive (at risk) compensation expense associated with the performance
5 measures discussed above should be included in cost of service.

6 No cash incentive awards are payable to an executive officer unless performance
7 is above the threshold, or minimum, level of expected performance as approved
8 by the Compensation Committee. In the case of each of the disallowed amounts
9 discussed above, performance exceeded the threshold level of expected
10 performance.

11 Further, there is no doubt Empire's customers benefit directly from high levels of
12 executive performance with regard to securing adequate low-cost capital to fund
13 our capital expenditures and the oversight of jointly-owned plant through joint
14 ownership meetings.

15 **Q. WHAT ADJUSTMENT DID STAFF MAKE RELATED TO EQUITY**
16 **COMPENSATION?**

17 A. Staff recommends removal of the full amounts of the equity compensation
18 (performance-based restricted stock and stock options) associated with the long-
19 term incentive award.

20 **Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION TO**
21 **REMOVE SUCH FORMS OF VARIABLE OR AT-RISK**
22 **COMPENSATION FROM TEST YEAR EXPENSE?**

1 A. No. In essence, the elimination of the variable or at-risk compensation by the
2 Staff incorrectly assumes such awards are **not part of total compensation**, but
3 instead, are **in addition to total compensation levels** developed by Empire's
4 Compensation Committee, and therefore constitute an incremental compensation
5 benefit that has no corresponding benefit for Empire and its customers.

6 **Q. PLEASE CONTINUE.**

7 A. Each component of Empire's variable compensation is essential to complete the
8 executive's total compensation package. Variable compensation is "at risk", and
9 standards, in the form of performance criteria, are necessary in order to determine
10 what portion of the compensation is earned. The Compensation Committee has
11 developed such performance criteria as a function of placing a substantial portion
12 of an executive's total compensation in variable rather than fixed vehicles in order
13 to encourage high levels of employee performance. This approach is consistent
14 with the approach utilized by Empire's peer group and the utility industry in
15 general.

16 **Q. WHAT IS THE CONSEQUENCE OF FOLLOWING STAFF'S**
17 **RECOMMENDED ADJUSTMENTS TO EXECUTIVE COMPENSATION?**

18 A. Staff's position tends to undermine the overall objectives of Empire's
19 Compensation Committee by shifting the emphasis away from employee
20 performance and incentivizing the use of base compensation to ensure cost
21 recovery through rates. The Compensation Committee could design an executive
22 compensation program that includes *all* short- and long-term incentive
23 compensation amounts in base salary. However, the Compensation Committee

1 does not believe such a compensation design approach serves our customers or
2 Empire's shareholders as well as the compensation program Empire currently has
3 in place.

4 **Q. HOW DOES THE BOARD USE THE COMPENSATION PROGRAM TO**
5 **INFLUENCE MANAGEMENT OF THE COMPANY?**

6 A. Consistent with the Compensation Committee's philosophy, which I discussed
7 earlier, whereby each executive's total compensation package consists of a
8 considerable measure of variable (at risk) compensation, it is necessary for the
9 Compensation Committee to establish a set of standards, or performance criteria,
10 to determine what portion of variable pay is earned. The performance criteria for
11 each executive are tied to the Company's vision and goals established at the
12 beginning of each performance year. These performance criteria are different
13 than those that might be determined for other non-executive employees, but these
14 criteria form the core of each executive's responsibility and are not simply
15 accomplishments that are above regular job duties. Accomplishment of executive
16 performance criteria has a significant and positive impact on the operational and
17 financial condition of the Company. Conversely, non-accomplishment of such
18 performance criteria has a negative impact on the Company. The degree, or lack
19 thereof, of accomplishment is reflected in the variable nature of the associated
20 compensation award.

21 **Q. DOES THE STAFF RECOMMENDATION RECOGNIZE THIS**
22 **FUNCTION?**

1 A. No. The Staff's recommended adjustment, which removes from test year expense
2 the variable compensation expense related to short- and long-term components of
3 the executive compensation package, does not recognize the compensation
4 awarded each executive for accomplishment of the core responsibilities of his or
5 her position and the benefits those accomplishments bring to Empire and its
6 electric customers. In addition, the Staff's recommendation ignores the overall
7 conservative nature of Empire's compensation program. Therefore, all elements
8 of executive compensation should properly be included in test year expense.

9 **Q. HOW DOES EMPIRE APPROACH COMPENSATION WHEN IT**
10 **INVOLVES ITS NON-EXECUTIVE SALARIED EMPLOYEES, AND**
11 **HOW DOES THAT APPROACH COMPARE WITH BEST PRACTICES?**

12 A. Empire follows best practices in its compensation structure for non-executive
13 salaried employees by linking the Company's performance management systems
14 with how employees are paid. This is achieved by allocating a percentage, or
15 fixed amount, of an employee's compensation to a variable pay program tied
16 directly to the attainment of goals and objectives set forth by management and
17 aligned with Empire's overall vision, goals and key business strategies. These
18 goals and objectives are above the regularly expected results of the non-executive
19 salaried employee's position, and, when achieved, add benefit to the Company's
20 customers.

21 **Q. DID THE STAFF PROPOSE ADJUSTMENTS TO NON-EXECUTIVE**
22 **SALARIED COMPENSATION EXPENSE FOR THE TEST YEAR?**

1 A. Yes. The Staff excluded a portion of incentive compensation for non-executives
2 that was associated with goals that the Staff believed benefited shareholders and
3 not customers. The Staff's approach in this area was much like its position with
4 respect to executive compensation.

5 **Q. DOES THE STAFF RECOMMEND ADJUSTMENTS TO ANY OTHER**
6 **FORMS OF INCENTIVE COMPENSATION?**

7 A. Yes. The Staff recommends removal of the Lightning Bolt program costs from
8 test year expense. This amount represents the entire amount of compensation
9 awarded through the program during the test year.

10 **Q. PLEASE EXPLAIN THIS PROGRAM.**

11 A. The Lightning Bolt program is not an incentive program. Through this program,
12 the Company provides cash awards to individuals who deliver results beyond
13 those normally associated with their position, often involving protracted time
14 beyond normal work hours spent on special projects. In no way does the
15 Lightning Bolt program fully compensate the non-executive salaried individual
16 for the additional effort they put forth. However, it is a vehicle available to the
17 Company to show appreciation to salaried individuals who do not earn overtime
18 for working beyond their normal hours during prolonged projects. Payments
19 made under the Lightning Bolt program are closely related to Empire's cost of
20 service and should properly be included in test year expense.

21 **VEGETATION MANAGEMENT**

22 **Q. WHAT IS EMPIRE'S RESPONSE TO THE POSITIONS TAKEN BY**
23 **STAFF AND OPC CONCERNING THE ONGOING LEVEL OF**

1 **VEGETATION MANAGEMENT COSTS AND THE VEGETATION**
2 **MANAGEMENT TRACKER?**

3 A. Empire can agree with Staff's level of normalized vegetation management costs,
4 as long as the current tracker mechanism will remain in place. If the vegetation
5 management tracker mechanism is eliminated as proposed by OPC witness Roth,
6 Empire's annual normalized vegetation management costs need to be increased
7 from the proposed \$11 million with a tracker in place to the actual test year level
8 as updated through December 31, 2014 (\$11.5 million on a Missouri jurisdictional
9 basis) in order to establish a normalized level of ongoing vegetation management
10 expenses to be recovered in base rates. This annualized vegetation management
11 expense level is slightly higher than the \$11.1 million recommended by OPC
12 witness Roth at page 7, line 13 of her direct testimony.

13 **ADVERTISING EXPENSE**

14 **Q. DOES EMPIRE AGREE WITH THE STAFF'S PROPOSED EXCLUSION**
15 **OF COSTS ASSOCIATED WITH ADVERTISING?**

16 A. No. The Staff position as expressed by Staff witness Brooke Richter includes the
17 elimination of costs associated with a series of ads designed to inform and educate
18 Empire's customers about the value of our product and the impact of new
19 environmental rules on Empire's costs and, ultimately, overall customers' rate
20 levels.

21 **Q. PLEASE DESCRIBE THE SERIES OF ADVERTISEMENTS AT ISSUE?**

22 A. Attached to my testimony as schedule KSW-1 is a summary of the information
23 used in the advertisement. This information was presented to our customers

1 through various channels as described in the direct testimony of Brad Beecher. I
2 have also attached schedule KSW-2 that contains information included on our
3 website related to the advertisements.

4 **Q. WHAT WAS THIS PROGRAM DESIGNED TO DO?**

5 A. This program informed our customers about the overall value of electricity and
6 the magnitude and timing of the rate impact associated with Empire's
7 environmental compliance plan. This is of value to Empire's customers because
8 it allows them to prepare for a change in their bill well in advance of new rates
9 going into effect. Thus, this particular ad campaign was to inform and educate
10 our customers, was not "promotional" in nature, and should be included in
11 Empire's revenue requirement. If this cost is included it would increase Empire's
12 overall expenses by \$138,000 on a Missouri jurisdictional basis.

13 **RATE COMPARISON**

14 **Q. DID YOU REVIEW THE DIRECT TESTIMONY OF MECG WITNESS**
15 **KAVITA MAINI CONCERNING A COMPARISON OF EMPIRE'S**
16 **RATES TO THE RATES OF OTHER UTILITIES?**

17 A. Yes, I did.

18 **Q. HOW DO YOU RESPOND?**

19 A. I believe the comparison is somewhat misleading. It overlooks the reasons behind
20 the cost increases that have driven Empire's rate upward over the last five years
21 and ignores that many of those same factors will ultimately impact other investor-
22 owned utilities in the United States and especially those operating in Missouri.

1 Beginning at page 13, line 18 and continuing through page 15, Ms. Kavita
2 compares Empire's industrial and residential rates to other Investor Owned
3 Utilities ("IOU") located in Missouri, regional IOU averages, and national IOU
4 averages. She notes that while Empire's rates were historically lower than some
5 of these published averages in the past, during the last five years they have
6 increased to the point that Empire's industrial and residential rates are higher than
7 those of many other IOUs within the state of Missouri, many of the IOUs
8 regionally, and exceed or are very close to some published national averages.
9 Nowhere in this discussion did Ms. Kavita point out any of the factors driving
10 Empire's past cost increases that may be unique to Empire.

11 **Q. PLEASE DESCRIBE THE COST FACTORS THAT MECG WITNESS**
12 **KAVITA LEFT OUT OF THE RATE COMPARISON DISCUSSION.**

13 A. Ms. Kavita did not point out that the main cost driver in past cases had to do with
14 the mandatory replacement of a single purchase long-term power contract
15 supported by a late 1970's vintage coal plant with new facilities with a much
16 higher cost per installed kilowatt (Plum Point and Iatan 2). She also failed to
17 mention that Empire's Missouri service area has been severely impacted by at
18 least three major weather events in the recent past, two severe ice storms and the
19 Joplin tornado in June of 2011. Each of the events caused millions of dollars in
20 damages and the mandatory replacement of older facilities with new facilities
21 installed at today's higher cost.

1 **Q. DID MS. KAVITA MENTION THE MAJOR COST DRIVER IN THIS**
2 **CASE IN THE RATE COMPARISON SECTION OF HER DIRECT**
3 **TESTIOMONY?**

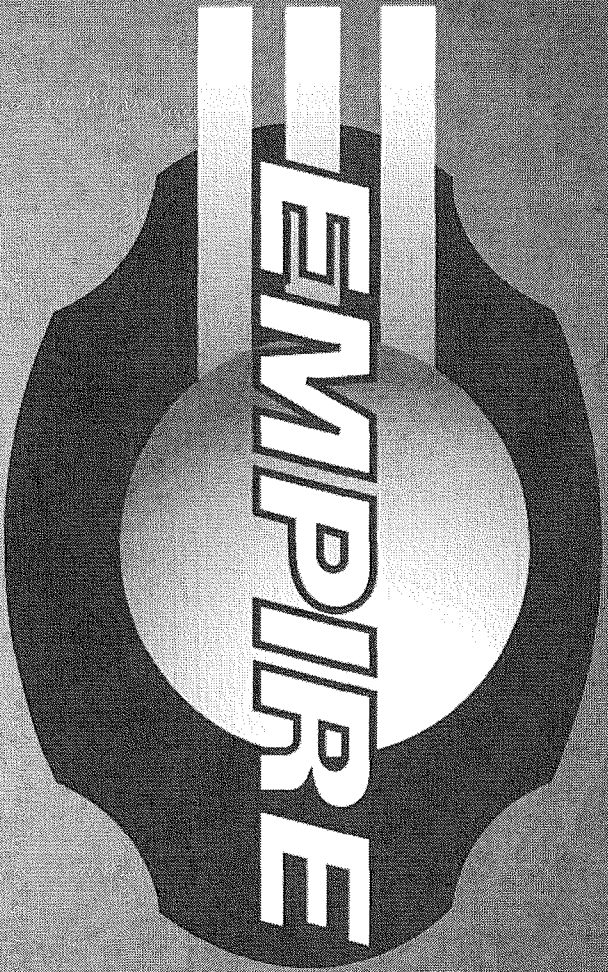
4 A. No. She did not mention the Asbury environmental retrofit and its overall impact
5 on Empire's rates in her rate comparison.

6 **Q. HOW DOES THE TIMING OF EMPIRE'S ASBURY RETROFIT AND ITS**
7 **RELATED RATE INCREASE COMPARE TO THE TIMING OF THE**
8 **KANSAS CITY POWER & LIGHT COMPANY ("KCPL") RATE**
9 **INCREASE FOR THE ENVIRONMENTAL RETRO FIT AT ITS LA**
10 **CYGNE GENERATING UNIT?**

11 A. The environmental retrofit at Asbury was complete and in service in mid-
12 December 2014, while the construction work at La Cygne is still ongoing. In
13 addition, Empire filed its rate case in Missouri to recover the cost associated with
14 the retrofit before KCPL did, so Empire's rates will reflect the increase in
15 environmental costs sooner than KCPL. Industry compliance with the new
16 environmental rules will directly impact IOU rates throughout the country, and
17 the index cited by Ms. Kavita will only reflect this on a lagging basis. To the
18 extent that the timing of Empire's environmental compliance effort is sooner than
19 the other IOUs, Empire's rates may be higher until the other IOUs are in
20 compliance.

21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes, it does.



ENERGY CHALLENGES

Keeping it Reliable, Responsible and Economical

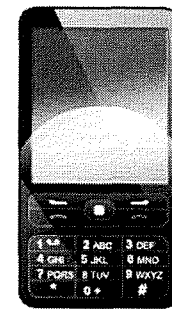
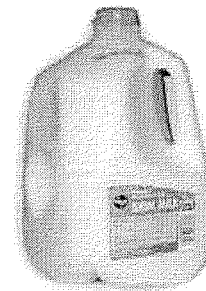
The Empire District Electric Co.

Investor-owned utility – NYSE: EDE

- Established in 1909
- 168,000 Electric customers
 - 8,100 miles of line (transmission & distribution)
 - 1,377 megawatts generating capacity
- 44,000 Natural Gas customers
 - 1,200 transmission & distribution mains
- Fiber Optic & Water Service
- 750 employees

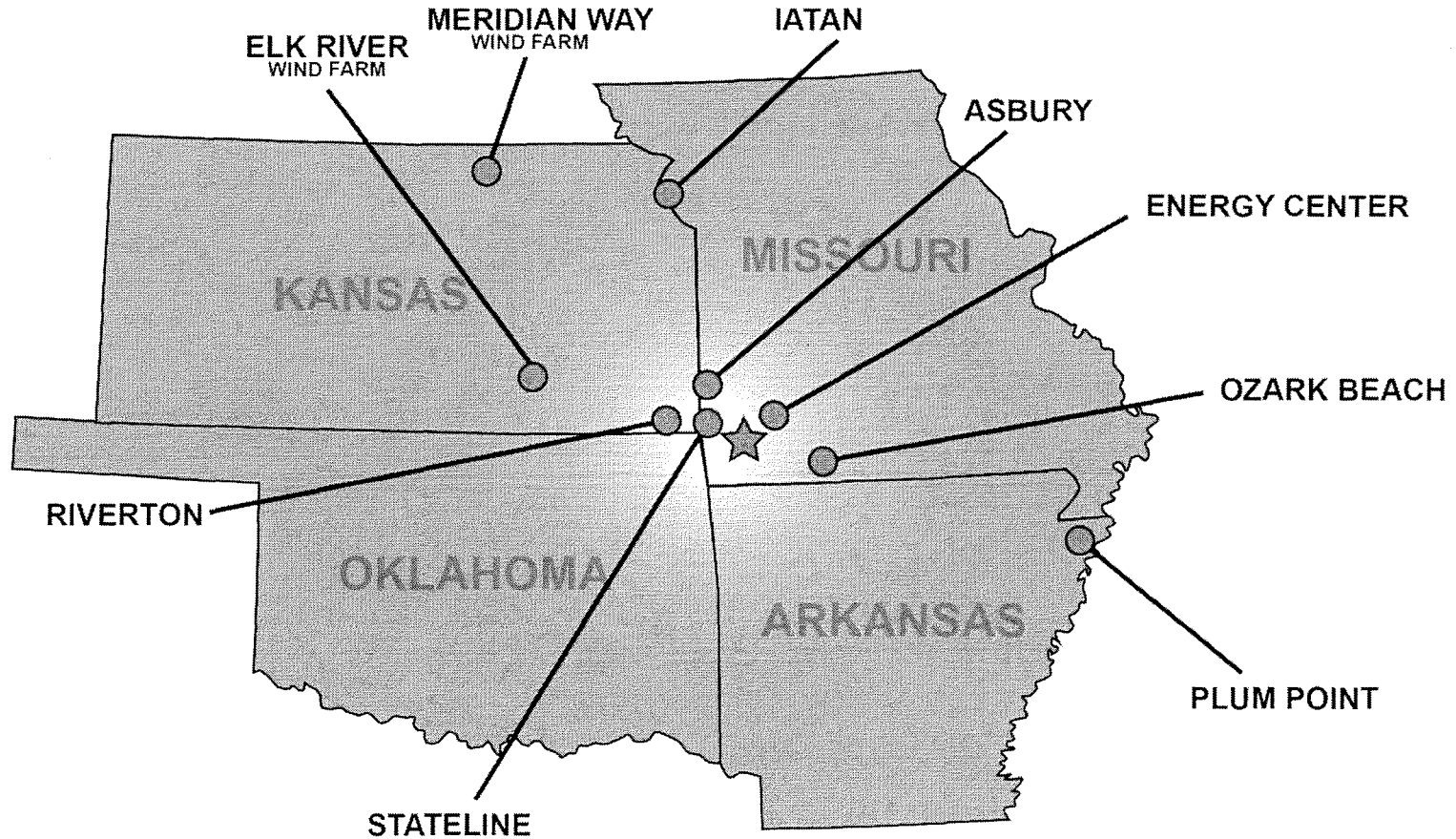
Making Lives Better Every Day

How did you use electricity today?



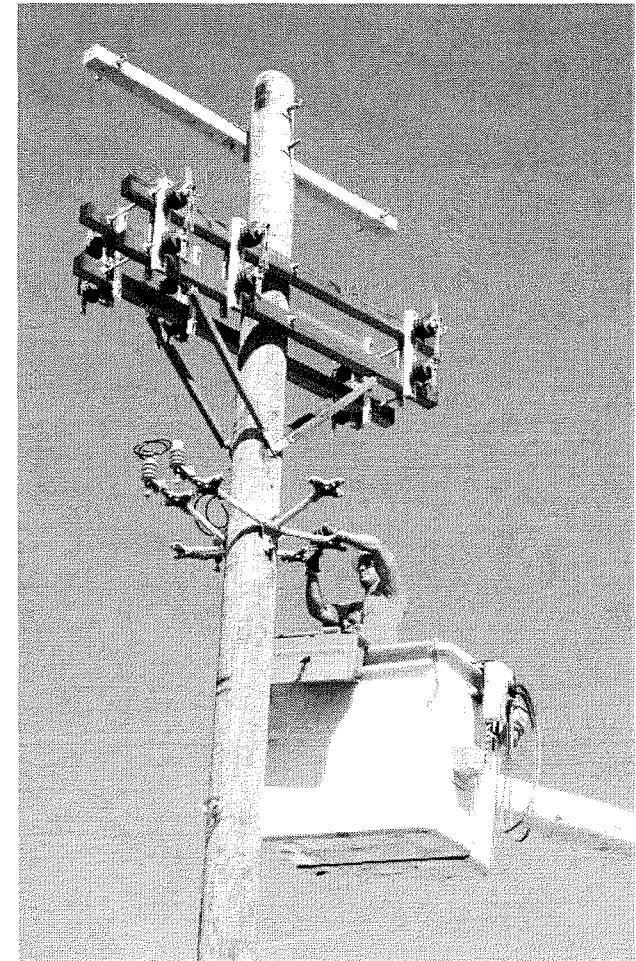
In our business, if we do our job right every day, 24/7, no one notices.
The lights are on and life is good.

Empire's Generation Resources



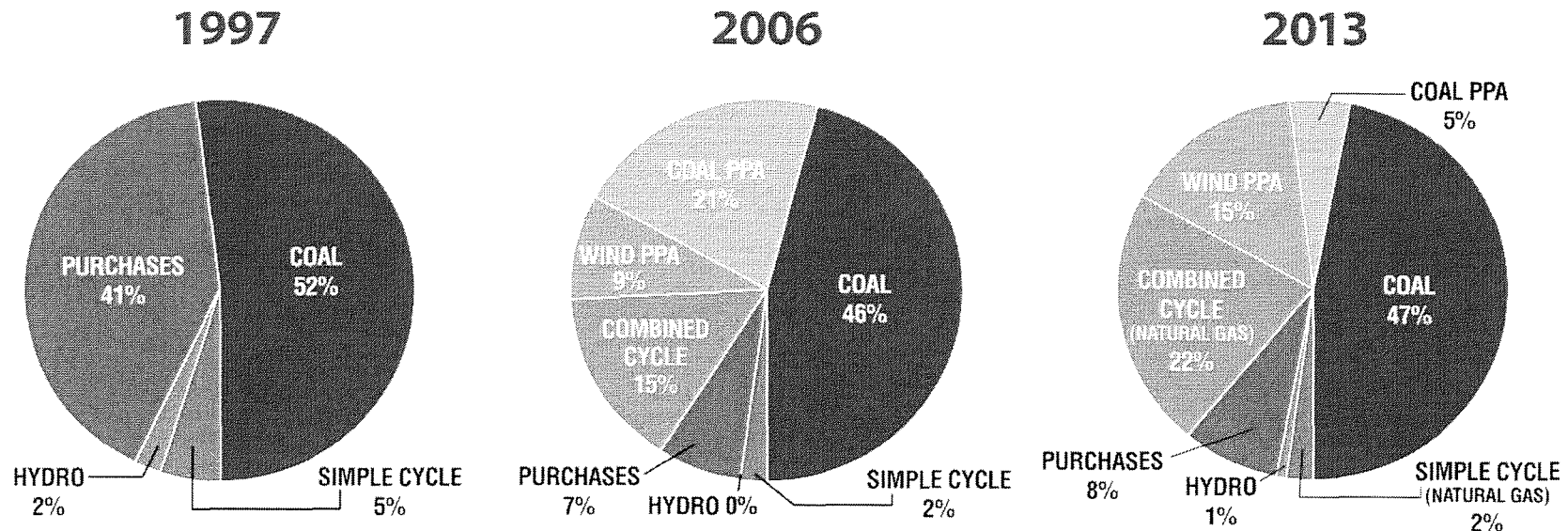
Challenges Impacting our Business

- Environmental mandates
- Renewable energy mandates
- Resource planning/diversity
- Service reliability
- Energy efficiency initiatives



Diverse Resource Mix

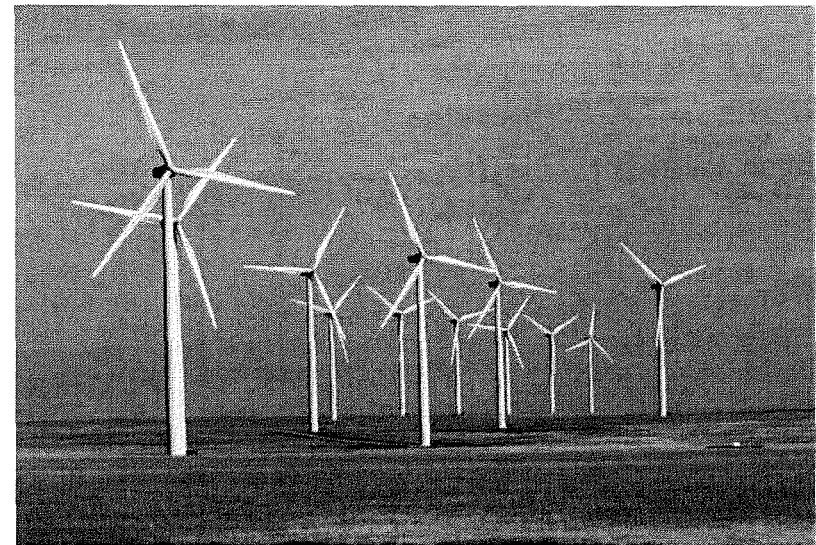
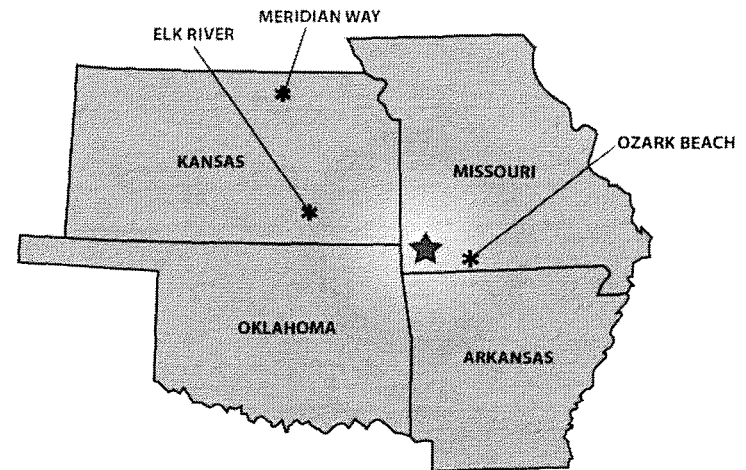
- Cost-effective
- Reduces risk
- Hedge against future environmental rules



Purchases in 1997 include contract and non-contract PP, mainly **coal** purchases.
Combined and **Simple Cycle** represent **natural gas** generation.

Renewable Energy

- Wind Energy
 - Elk River Wind Farm
 - 20-year contract (2005)
 - 150 MW (100 turbines)
 - Meridian Way Wind Farm
 - 20-year contract (2008)
 - 105 MW (35 turbines)
 - □ 67,000 homes
- Hydro Power – 1%
 - Ozark Beach Power Plant
 - Began operation in 1913



Environmental Regulations

2002

New Since 2002 and Future

AIR

- Acid Rain Program
- NAAQS
- Regional Haze
- Clean Air Act Provisions

Water

- Cooling Water Intakes I
- Effluent Guidelines for EGU
- NPDES permit

Waste

- Fossil Fuel Combustion Waste Regulations
- Toxic Substance Control Act (PCBs)

AIR

- CAIR
- NAAQS Restrictions
- CSAPR 1
- MATS Rule
- NOx SIP Call
- Tailoring Rule
- Regional Haze Phase 2
- 40 CFR Part 60 Subpart KKKK
- SSM SIP Call
- CSAPR 2
- Existing Unit Carbon Emissions

Water

- Cooling Water Intake Structures 2
- Effluent Guidelines Tightened
- WET Test Methods
- 316 (b)
- Cooling Water Intake Structures 3
- Proposed New Reclassification of Streams, Waters of the US

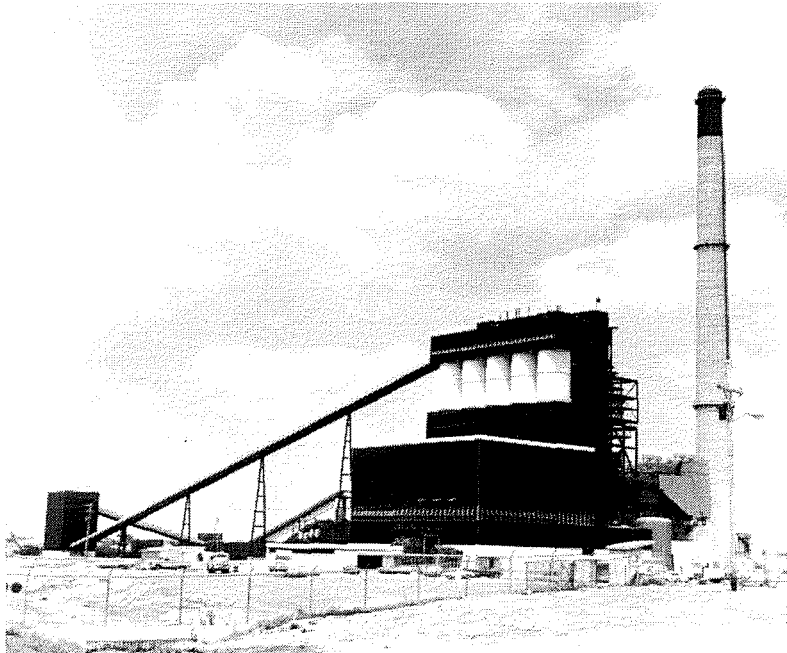
Waste

- Coal Combustion Residual (CCR) Surface Impoundments Assessment/Actions

Environmental Upgrades

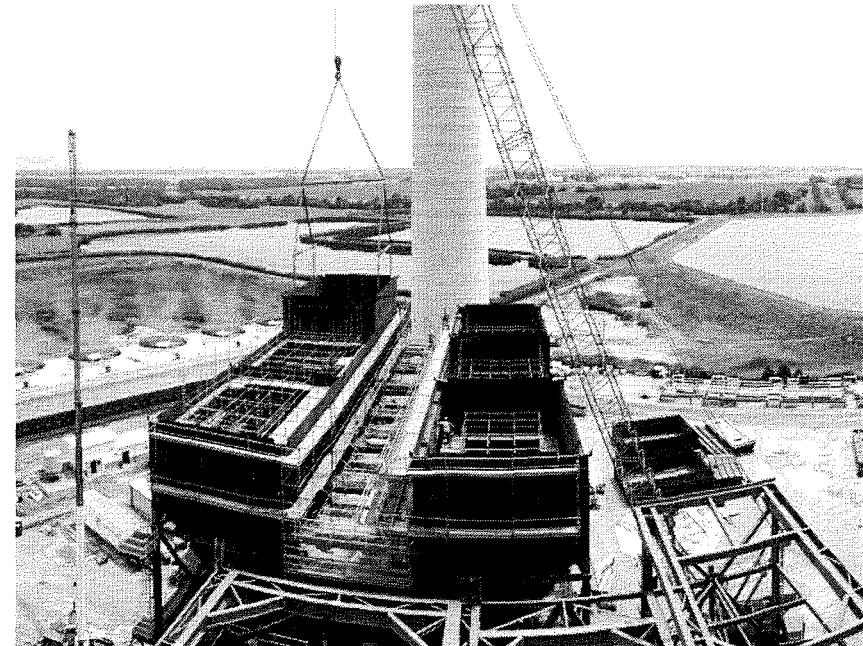
- **Asbury Power Plant**

- \$25M – 1970 original construction
- \$30M – 1990 low sulfur coal conversion
- \$32M – 2008 SCR for NOx

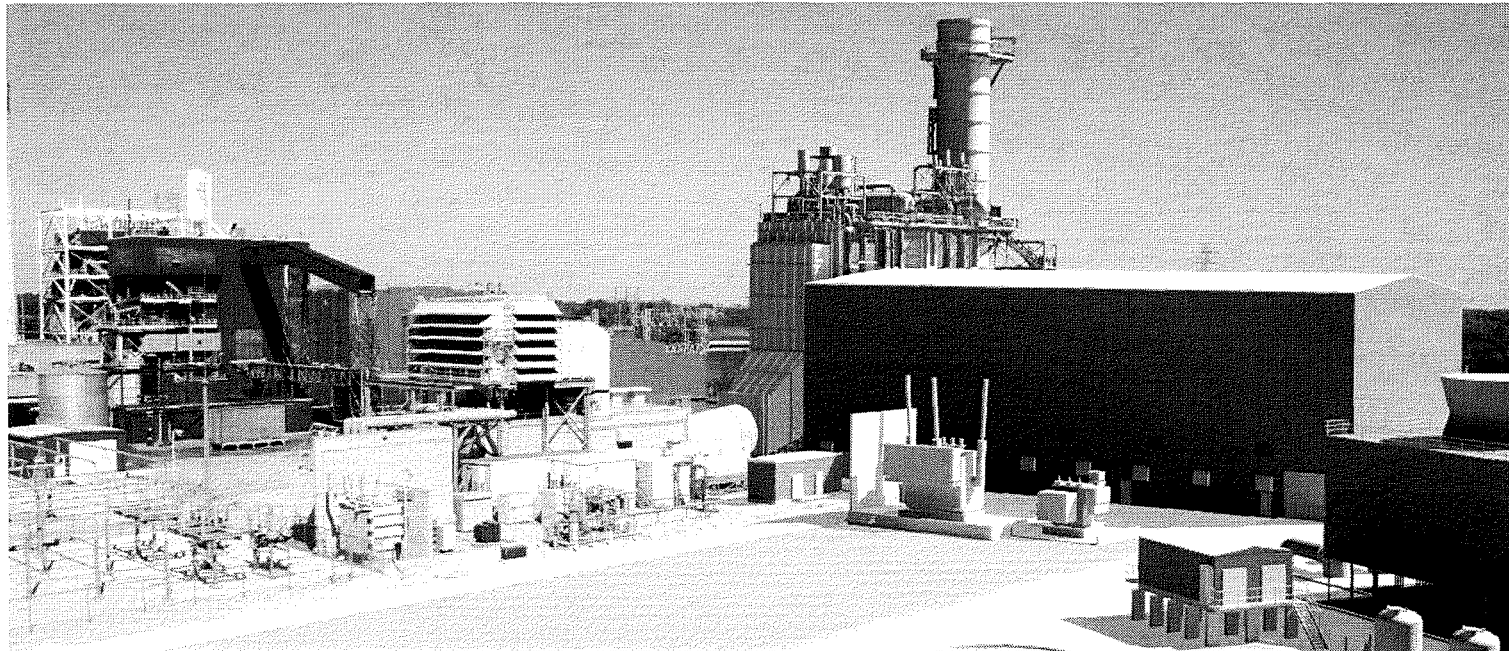


- **Air Quality Control System (AQCS)**

- Full EPA compliance
- In service by early 2015
- 140-150 jobs at peak construction
- \$112 - \$130 million



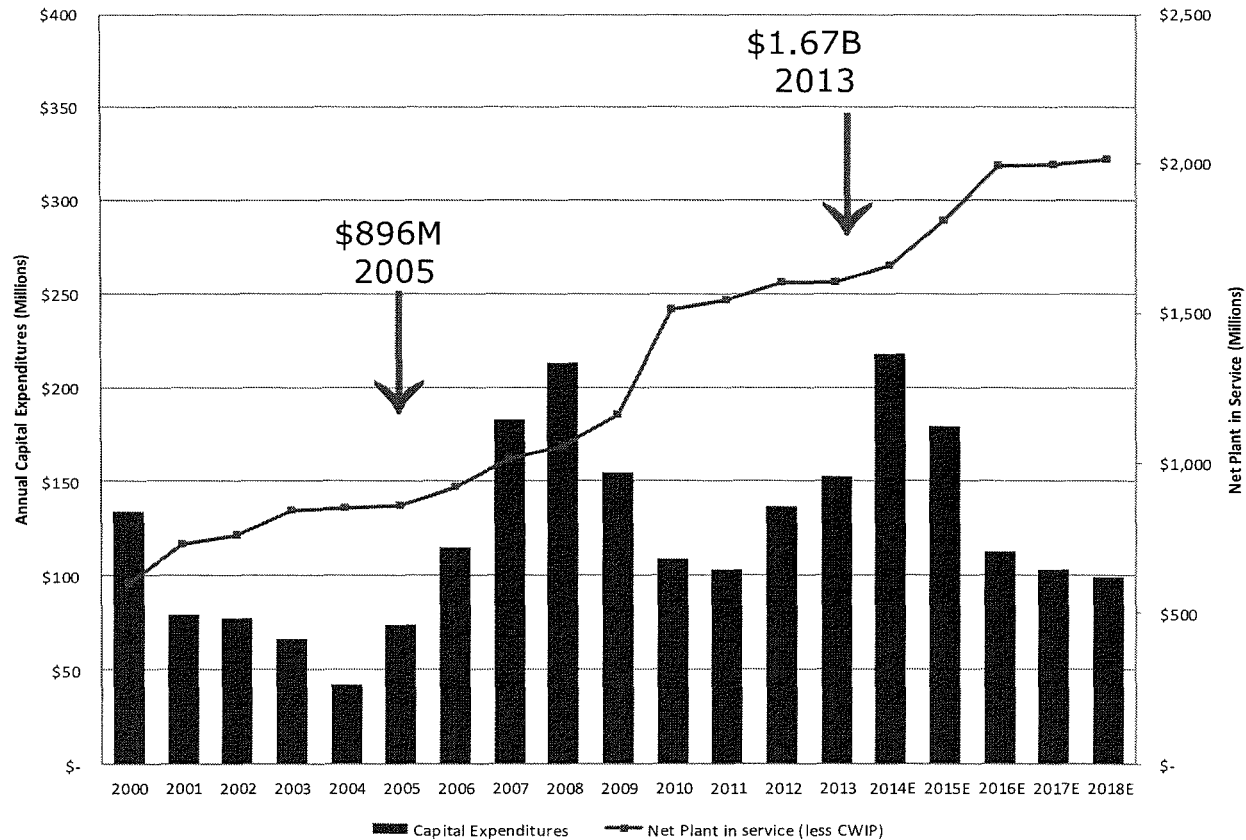
Environmental Upgrades



- Riverton Unit 12
 - Simple cycle CT
 - \$49 million - 2007
 - Combined cycle expansion
 - Replace Units 7 & 8
 - \$165 – 175 million - mid-2016
 - 140-150 jobs at peak construction

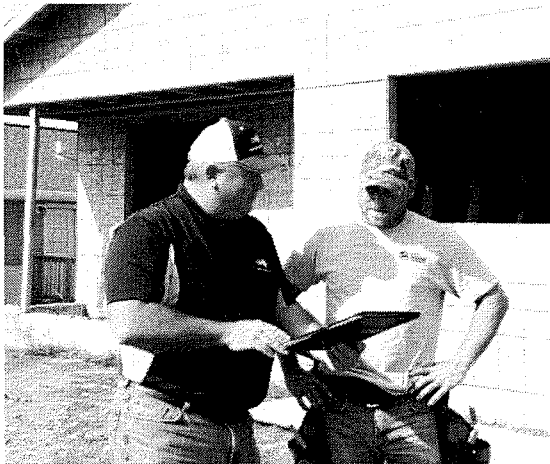
Assets Serving Customers

- \$475 million for environmental & efficiency upgrades since 2005 (includes Asbury & Riverton)
- Assets in service have nearly doubled



Environmental Stewardship

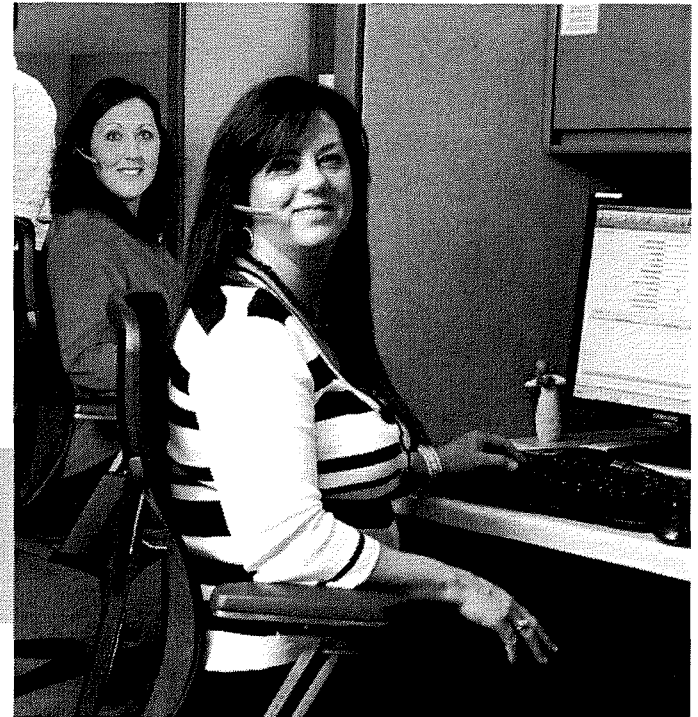
- Energy Efficiency Programs
- Energy Calculators
- Tire Collections / Tire-derived fuel
- Tree Give-away events
- Hybrid fleet vehicles

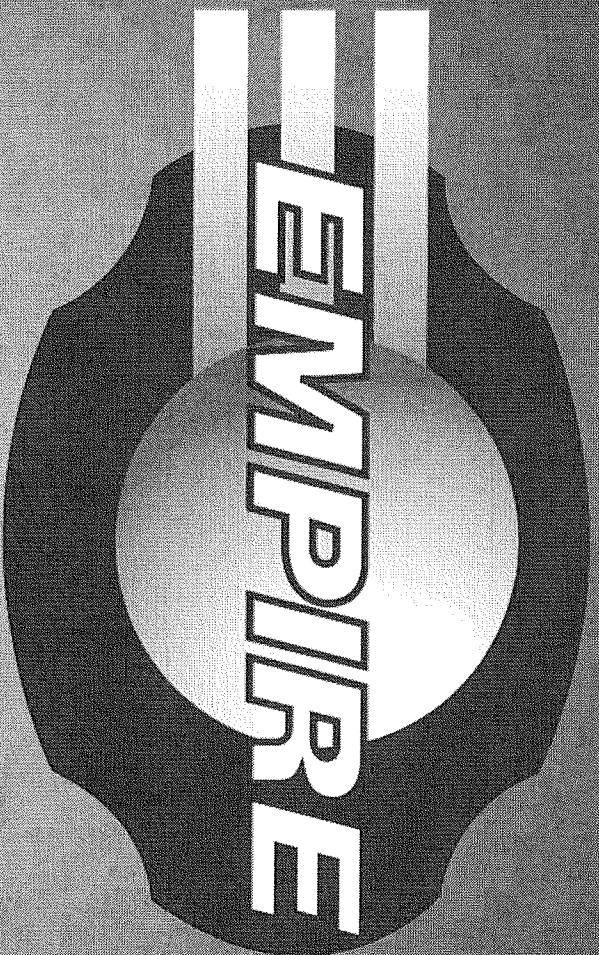


Improvements to better serve customers

- Reliability Initiative
- Vegetation Control
- Regional Transmission System Upgrades
- Kodiak Service Center
- Contact Center Improvements
- ARCOS – Automated Callout
- Online Services

In 2013, eighty percent of calls answered in 30 seconds or less.





ENERGY CHALLENGES
Keeping it Reliable, Responsible and Economical

Rev. 04/07/14



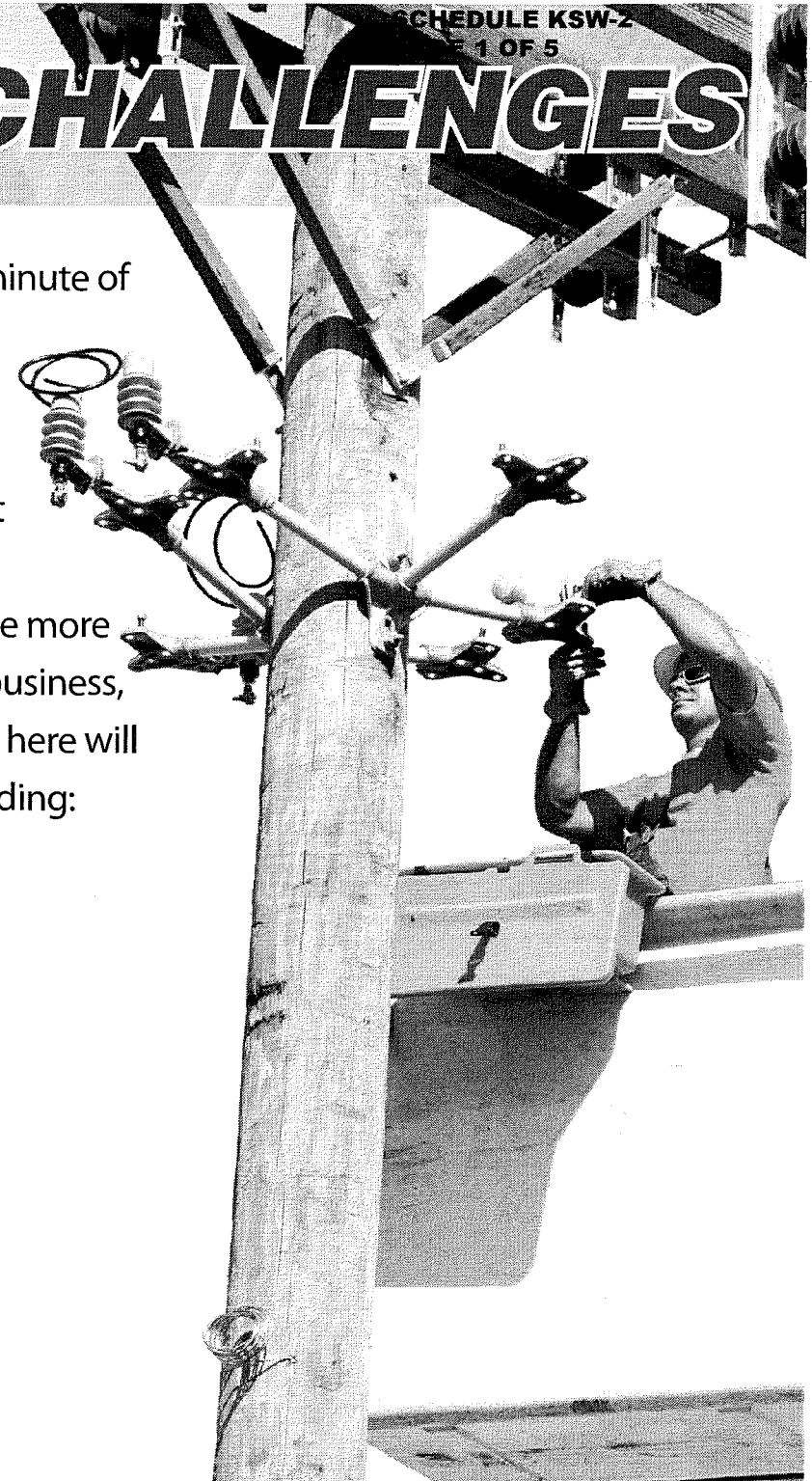
EMPIRE

ENERGY CHALLENGES

Electricity. You depend on it every minute of every day. In fact, no other product touches so many aspects of our daily lives or delivers more value than electricity. In our business, if we're doing our job right, twenty four hours a day, seven days a week, you never think about us – your lights come on at the flip of a switch.

To ensure safe, reliable energy is there when you need it, we face more challenges today than ever before. When challenges impact our business, they also affect our customers. We hope the information provided here will help explain how we are meeting today's energy challenges, including:

- Environmental mandates
- Renewable energy mandates
- Resource planning/diversity
- Service reliability
- Energy efficiency initiatives

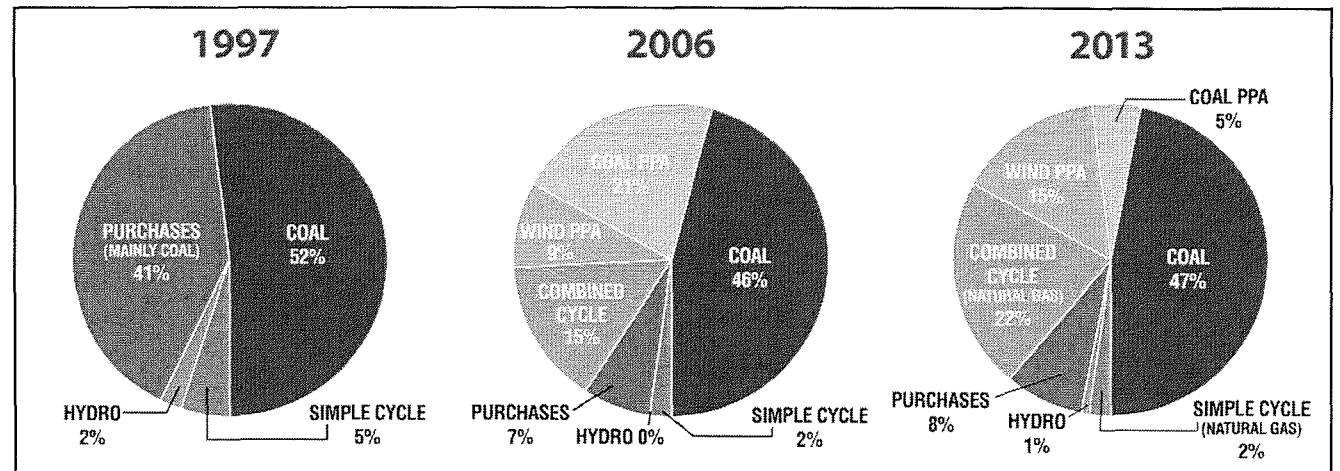
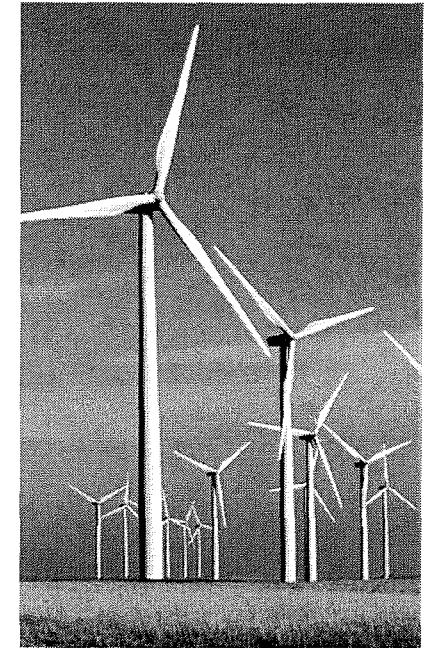
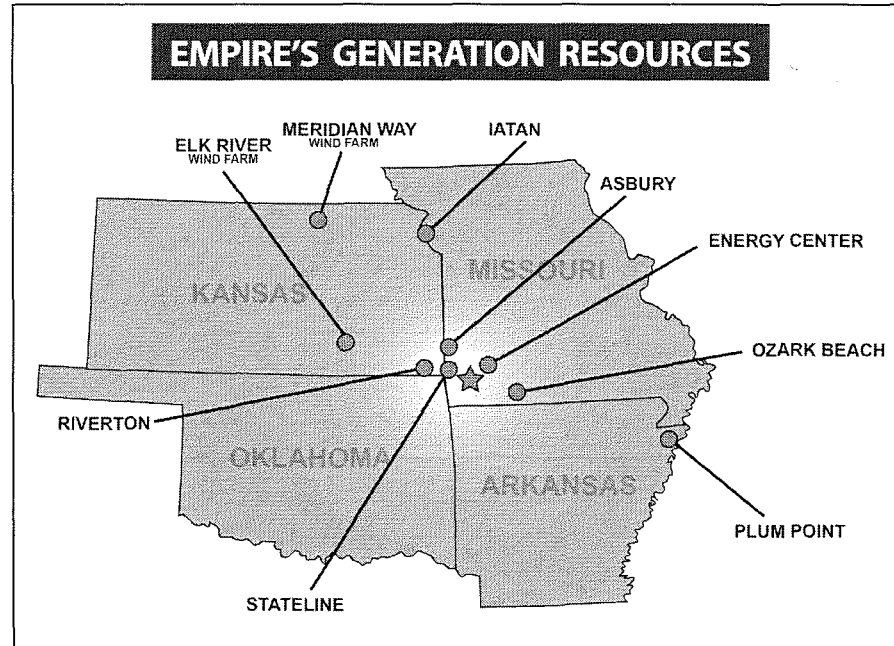


Diverse Resource Mix

Resource diversity is a key element in meeting today's energy challenges. It is cost-effective, reduces the risk of overdependence upon any one fuel source and provides a hedge against future environmental rules. We have significantly increased the diversification in our fuel mix since 1997, adding highly efficient natural gas generation and long-term contracts for wind generation.

Empire was one of the first utilities in the region to incorporate wind as a significant portion of our energy mix. We executed purchased power contracts for wind well ahead of renewable mandates because they were cost-effective as well as environmentally sound. These contracts represent about 15% of our total resource mix.

Our use of renewable energy dates back to 1913, when Empire's Ozark Beach Hydroelectric plant began operation near Forsyth, Missouri. The plant continues to provide our customers with environmentally friendly energy today.



Environmental Mandates

Some of the largest and most costly challenges we face today are related to environmental mandates. Complying with environmental standards has always been an important part of our business, however requirements continue to become more restrictive.

Since 2005, our investments in environmental and efficiency upgrades, including current projects at our Asbury and Riverton Power Plants, total nearly \$475 million. While beneficial, these upgrades do not come without a cost to ratepayers. To moderate the rate impact, we work diligently to identify least-cost options while still providing the balanced mix of resources necessary to secure a reliable and compliant energy supply.

Asbury Air Quality Control System

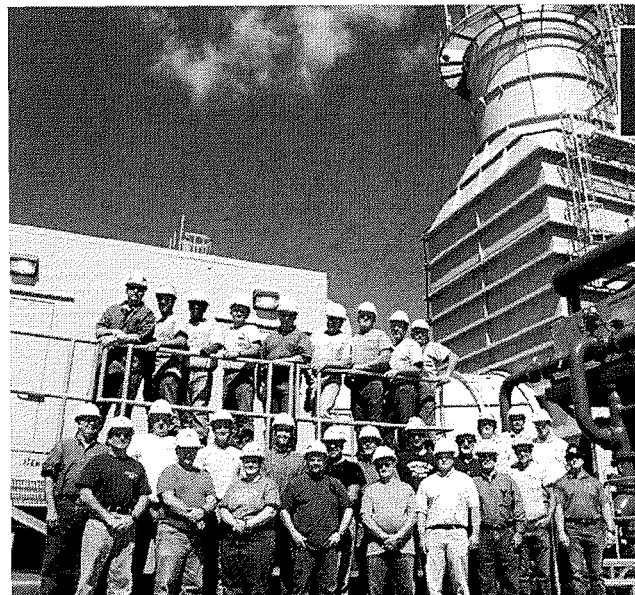
The Asbury Power Plant has been providing economical energy for our customers since 1970. When it began operation it utilized 1970's era state-of-the-art technology to control emissions. Since then it has undergone many improvements to meet changing environmental standards.



- 1970 original construction – \$25M
- 1990 low sulfur coal conversion – \$30M
 - Reduced SO₂ – 80%
- 2008 selective catalytic reduction system – \$32M
 - Reduced NO_x – 85%

Today, we are working on a new set of environmental upgrades. Collectively, this latest project is referred to as the Air Quality Control System (AQCS). This project is driven primarily by the Mercury Air Toxics Standard (MATS) set to take effect in 2015. The AQCS includes a circulating dry scrubber, a pulse jet fabric filter, and a powder-activated carbon injection system. Construction began in 2012 and will be completed in early 2015.

- Budgeted cost - \$112 – \$130 million
- Anticipated emission reductions up to:
 - SO₂ – 95%
 - Mercury – 85%
 - Particulate Matter – 99%
- 140 – 150 jobs at peak construction



**RIVERTON UNIT 12
AT COMPLETION
IN 2007.**

Riverton Combined Cycle Expansion

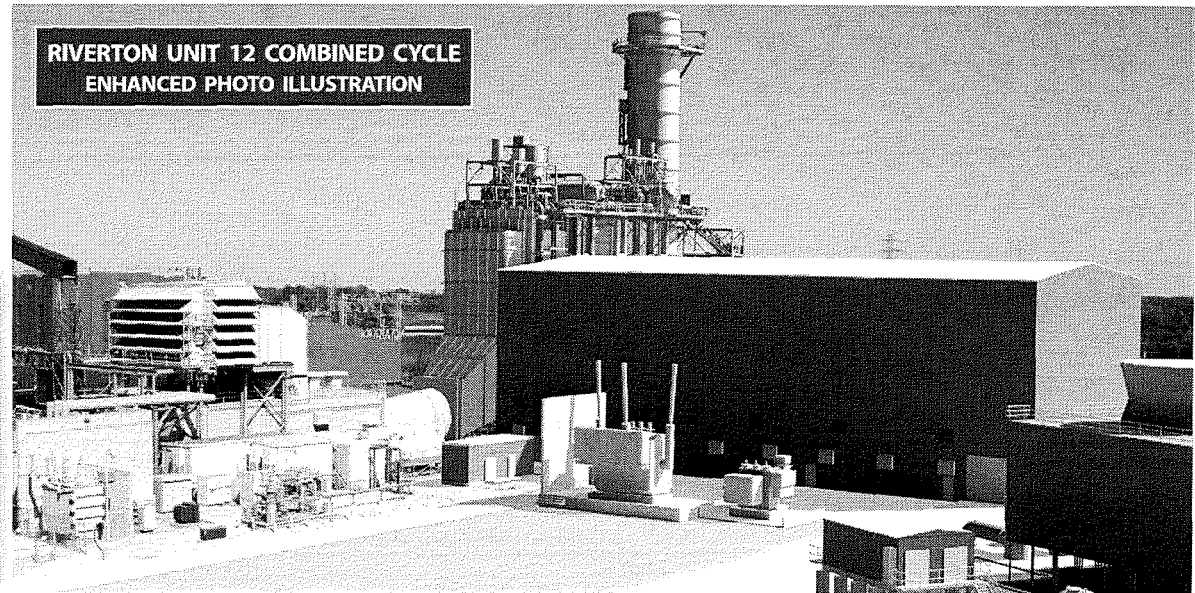
The first coal generating unit began operation at our Riverton Power Plant in 1906. Over the years, as energy demand increased, new coal and natural gas units were constructed at Riverton.

In 2012, the final remaining coal units at Riverton were transitioned to natural gas operation. The units will be fully retired in 2016. The units were originally installed in the 1950's and due to their size and age it was not cost-effective to upgrade them to comply with new environmental standards.

To replace the units, we are converting our existing Unit 12 combustion turbine, installed in 2007, to combined cycle operation. The project includes the addition of a heat recovery steam generator (HRSG) and a steam turbine. The combined cycle process utilizes the HRSG to capture

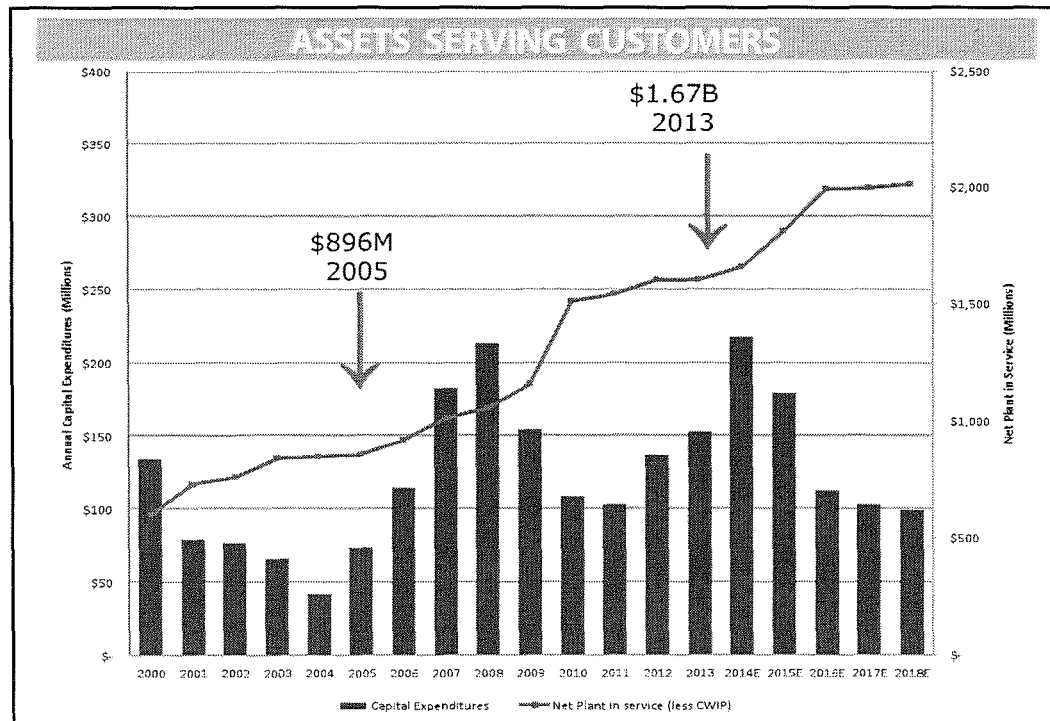
the exhaust heat from the existing unit and use it to power the new steam turbine. This adds 100 megawatts of energy capacity without additional natural gas fuel, and results in very high efficiency and low emissions.

Construction began this year and will be completed in mid-2016.



**RIVERTON UNIT 12 COMBINED CYCLE
ENHANCED PHOTO ILLUSTRATION**

- Budgeted cost - \$165-\$175 million
- Anticipated emission reductions up to: (compared to standard coal generation)
 - NOx - 95%
 - SO2 - 95%
 - CO2 - 70%
- 140-150 jobs at peak construction



Local Economic Benefits

These projects not only provide environmental improvements, but also ensure the jobs and other related economic benefits from construction and ongoing operation continue to benefit our local service area.

Assets Serving Customers

To put the size of these investments into perspective, consider the graph of Empire's "Assets Serving Customers." Since 2005, our investment in assets to serve our customers has nearly doubled from just under \$900 million to nearly \$1.7 billion at the end of 2013. Environmental and efficiency upgrades to our plants account for \$475 million.

Cost Recovery/Rates

As an investor owned utility, by law Empire isn't allowed to recover the cost of projects until they are complete and providing service to customers. Empire's investors fund the projects during construction. Once in service and approved by the public service commission, we begin recovering costs in customer rates to repay investors. In Missouri, the rate case process typically takes 11 months. The cost recovery through rates takes about 40-60 years.

Adding the value of the Asbury environmental project to the current rate base could increase retail electric rates by as much as three to five percent, assuming all other factors affecting rates remain constant.

Proposed Carbon Regulations

Recently the EPA announced plans to reduce carbon dioxide emissions. This is a proposed plan. There are a number of factors still to be determined before we know the impact to customer rates. There is a comment period prior to finalization of the rule in June 2015. Then states will begin to develop their compliance plans. They may choose to comply on an individual state basis or collaborate with other states on a regional compliance plan.

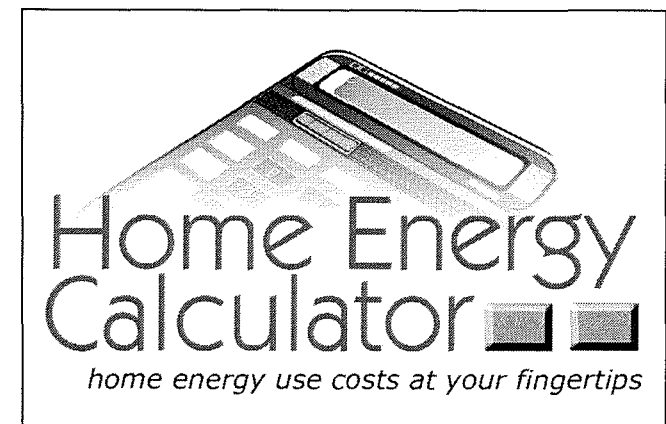
We will submit comments and work actively throughout the rulemaking process to try to secure a compliance plan resulting in the least cost for our customers. Our focus is on a regional plan to most effectively utilize the diverse resources we have across multiple states and to moderate costs for customers in each of the states we serve.

Environmental Stewardship

We practice environmental stewardship in many ways. We offer a number of rebate programs to help customers offset the cost of energy efficiency improvements for their home or business. Also our online energy calculators help customers understand their energy use and determine where they have opportunities for the most savings. Rebate program information and the energy calculators are available at www.empiredistrict.com/energysolutions. We hold annual tire collections and use tire-derived fuel (TDF) at our Asbury Power Plant. TDF reduces the use of natural resources and disposes of used tires in an environmentally safe manner.

Reliable Energy and Service

We know providing reliable energy and convenient service are important issues for our customers. Through our reliability initiative, and enhanced tree-trimming programs, we've been able to significantly reduce outage frequency and duration. We also continue to add online and mobile services to our website to make it easier to find account information, start, stop or transfer service, make online payments and access outage information. You can also connect with us at www.facebook.com/empiredistrictelectric.



Today's energy business is more challenging than ever before. We are committed to meeting these challenges with least-cost resources and ensuring reliable and responsible energy for our customers.

