

Exhibit No. 17
Issue: Payroll
Witness: Dale W. Harrington
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2008-0093
Date Testimony Prepared: April 2008

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

Rebuttal Testimony

of

Dale W. Harrington

April 2008

Empire Exhibit No. 17
Case No(s) ER-2008-0093
Date 5-12-08 Rptr 46

REBUTTAL TESTIMONY
OF
DALE W. HARRINGTON
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2008-0093

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

2 A. Dale W. Harrington, 602 Joplin Avenue, Joplin, MO 64801.

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

4 A. My employer is The Empire District Electric Company ("Empire" or
5 "Company"). I hold the position of Assistant Director of Human Resources.

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

7 A. I hold a Bachelor of Science Degree in Business Administration with a major in
8 Accounting from Missouri Southern State University in Joplin, Missouri.

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

10 A. Prior to joining Empire, I worked for a large national roofing manufacturing
11 company. I joined Empire in 1989 as an internal auditor. I have held positions in
12 Internal Auditing, Financial and Regulatory Accounting, and Human Resources.
13 I left Empire in 2001 to join a nationwide trucking company. I rejoined Empire in
14 2002 and have worked there continuously since.

15 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

16 A. I have prepared this rebuttal testimony to respond to the Missouri Public Service
17 Commission Staff ("Staff") recommendation to exclude a significant portion of
18 Empire's ongoing compensation levels from the cost of service in this case. My

1 testimony will explain how Empire's executive compensation program is
2 designed and how Empire's approach is similar to the approach utilized by
3 companies that are comparable to Empire. Further, I will explain how the overall
4 executive compensation program in place at Empire is reasonable and quite
5 conservative when compared to our peers within the industry, and why Staff
6 should include all components of executive compensation in Empire's test year
7 expense. Lastly, I will explain Empire's incentive compensation approach for
8 non-executive salaried employees and how certain amounts that Staff has
9 recommended be excluded from test year expense should properly be included.

10 **Q. HOW IS THE EXECUTIVE COMPENSATION PROGRAM AT EMPIRE**
11 **DESIGNED?**

12 A. Empire's executive compensation program is designed to provide a competitive
13 compensation package that will enable us to attract and retain highly talented
14 individuals for key positions and promote the accomplishment of our performance
15 objectives. Our overall compensation program is conservative when compared to
16 our peers. It provides a secure base salary with the opportunity to earn a higher
17 level of total compensation under incentive programs that link compensation to
18 individual and Company performance factors.

19
20 Our executive compensation program includes three basic compensation
21 elements: (1) base salary, (2) annual (short-term) cash incentives, and (3) long-
22 term incentives. The Compensation Committee of the Board of Directors
23 ("Compensation Committee") has established a compensation philosophy that

1 targets a certain level of compensation based on a national market survey
2 developed by a compensation consultant employed by the Compensation
3 Committee. Once certain benchmark compensation levels are determined, the
4 Compensation Committee compares the dollar values resulting from the
5 benchmarking process to corresponding compensation levels at an industry-
6 specific peer group ("peer group") of companies to ensure that total direct
7 compensation is competitive within the industry and appropriate when certain
8 levels of performance are achieved. The peer group developed by the
9 compensation consultant is similar to Empire in terms of revenue, market value,
10 growth, etc.

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

13 A. Companies similar to Empire typically utilize the same approach by incorporating
14 a mix of base salary, short-term, and long-term incentives into a total executive
15 compensation package. Rather than relying solely on fixed compensation in the
16 form of base salary, these companies also include a considerable measure of
17 variable (at risk) compensation in their total compensation package. This
18 approach is considered a best practice in executive compensation and is a key
19 factor in ensuring the alignment of an executive's performance with the interests
20 of customers and shareholders. This approach is utilized by each of the peer-
21 group companies as well as all investor owned electric utilities operating in
22 Missouri (inclusively, the "comparator companies").

1 **Q. ACCORDING TO YOUR UNDERSTANDING HOW DOES EMPIRE'S**
2 **EXECUTIVE COMPENSATION PHILOSOPHY COMPARE WITH THE**
3 **COMPENSATION PHILOSOPHY OF OTHER COMPANIES?**

4 A. While Empire's approach to executive compensation is similar to other
5 companies, the Company's philosophy behind the approach is much more
6 conservative. In terms of **base salary**, the Compensation Committee has targeted
7 the 25th percentile of the national market survey discussed above for similarly
8 situated executives. In so doing, the Compensation Committee has set target base
9 salary levels **significantly lower** than the target base salary levels of the
10 comparator companies and industry in general. As indicated by the
11 accompanying Schedule DWH-1 (developed through analysis of the executive
12 compensation section of the most recently available proxy statements), the
13 average target base salary level of the comparator companies was set at the 50th
14 percentile of the market, compared to Empire's use of the 25th percentile.

15
16 The Compensation Committee has also established **short- and long-term**
17 **incentive** target levels for Empire executives that are **below** those of the
18 comparator companies. For example, the target levels for short- and long-term
19 incentives utilized by Empire are set at approximately the 43rd and 44th
20 percentiles, respectively, compared to the comparator companies' averages for
21 short- and long-term incentives target levels of the 53rd and 52nd percentiles,
22 respectively. Furthermore, the target levels utilized for short- and long-term

1 incentives by the comparator companies ranged from the 50th percentile to the 75th
2 percentile.

3
4 In terms of **total compensation**, the Compensation Committee has set a target
5 level for Empire executives at approximately the 37.5th percentile. This is
6 substantially lower than the average total compensation target level of the
7 comparator companies, which is in **excess of the 50th** percentile. In addition,
8 target levels for total compensation ranged from the 50th percentile to the 60th
9 percentile in the comparator companies.

10 **Q. HOW DOES EMPIRE'S EXECUTIVE COMPENSATION PHILOSOPHY**
11 **IMPACT COMPENSATION AWARDS AS COMPARED TO THE**
12 **COMPARATOR COMPANIES?**

13 A. Because of Empire's conservative compensation philosophy, overall
14 compensation awards are significantly less than similar awards of the comparator
15 companies. As indicated by the table, the base salary of Empire's CEO is 43%
16 below the comparator company average of CEO base salary. The stock
17 compensation and non-equity incentive compensation awarded to Empire's CEO
18 are 56% and 61% below the comparator company averages, respectively. Finally,
19 total compensation awarded to Empire's CEO, as reported under the Security and
20 Exchange Commission's proxy statement regulations, is 50% below average total
21 compensation awarded to comparator company CEO's.

1 The same observation can be made with regard to average compensation paid to
2 other named executive officers ("NEOs"). The average base salary of Empire's
3 NEO's, other than the CEO, is 39% below the comparator company average. The
4 average award to Empire's other NEOs for stock awards, non-equity incentive
5 compensation and total compensation is 77%, 68% and 59% below similar awards
6 to all other NEOs of the comparator companies, respectively.

7 **Q. WHAT ADJUSTMENTS DID THE STAFF'S WITNESS MS. PAULA**
8 **MAPEKA MAKE TO EXECUTIVE COMPENSATION?**

9 A. Ms. Mapeka recommended the removal of several components of Empire's total
10 compensation package from test year expense, namely those that constitute the
11 variable or at risk compensation. More specifically, the Staff has recommended
12 removal of compensation associated with performance measures under the annual
13 cash incentive plan related to meetings with institutional investors, issuances of
14 debt and equity, reliability measures at the Company's State Line Combined
15 Cycle generating station, jurisdictional approval of the Southwest Power Pool
16 Regional Transmission Organization, and the completion of an Automated Meter
17 Reading development study and pilot program.

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

19 A. The compensation expense associated with these performance measures is
20 properly includable in cost of service. In addition, the Staff has recommended
21 removal of the full amount of the compensation associated with the long-term
22 incentive award. Combined, these recommended adjustments would remove

1 \$482,395 from test year expense. For reasons I will discuss below, these
2 expenses should be included in test year expense.

3 **Q. DO YOU AGREE WITH THE STAFF'S RECOMMENDATION TO**
4 **REMOVE SUCH FORMS OF VARIABLE OR AT RISK**
5 **COMPENSATION FROM TEST YEAR EXPENSE?**

6 A. No. The elimination of the variable or at risk compensation includes the incorrect
7 assumption that such awards are not part of the total compensation package, but in
8 addition to the total compensation package developed by Empire and constitute
9 additional compensation without a corresponding benefit to Empire and Empire's
10 customers. Each component of variable compensation is essential to complete the
11 executive's total compensation package. Variable compensation is at risk and
12 standards in the form of performance criteria are necessary in order to determine
13 what portion of the compensation is earned by Empire's employees. The
14 Compensation Committee has developed such performance criteria as a function
15 of placing a substantial portion of an executive's total compensation in variable
16 rather than fixed vehicles in order to encourage high levels of performance. This
17 approach is consistent with the approach utilized by the comparator companies
18 and industry in general.

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

21 A. It tends to undermine the overall objectives of Empire's Compensation
22 Committee by shifting more of the emphasis to base compensation to ensure cost
23 recovery. The performance criteria determined by the Compensation Committee

1 for each executive are tied to the Company's vision, goals and key business
2 strategies established at the beginning of each performance year. Such
3 performance criteria are different than those that might be determined for other
4 non-executive employees. These performance criteria form the core of each
5 executive's responsibility and are not simply accomplishments that are above
6 regular job duties. Accomplishment of executive performance criteria has a
7 significant positive impact on the operational and financial condition of the
8 Company. Conversely, non-accomplishment of such performance criteria has a
9 negative impact on the Company. The degree, or lack thereof, of accomplishment
10 is reflected in the variable nature of the associated compensation award.

11
12 To follow Staff's recommended adjustment and remove the variable
13 compensation expense related to short- and long-term components of the
14 executive compensation package from test year expense does not recognize the
15 compensation awarded the executive for accomplishment of the core
16 responsibilities of their position and the benefits those accomplishments bring to
17 Empire and its electric customers. Therefore, all elements of executive
18 compensation should properly be included in test year expense.

19 **Q. HOW DOES EMPIRE APPROACH COMPENSATION WHEN IT**
20 **INVOLVES ITS NON-EXECUTIVE SALARIED EMPLOYEES AND HOW**
21 **DOES THAT APPROACH COMPARE WITH BEST PRACTICES IN THE**
22 **COMPENSATION FIELD?**

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1 A. Empire follows best practices in compensation structure for its non-executive
2 salaried employees by linking its performance management systems with how
3 employees are paid. This is achieved by allocating a percentage or fixed amount
4 of an employee's compensation to a variable pay program tied directly to the
5 attainment of goals and objectives set forth by management and aligned with
6 Empire's overall vision, goals and key business strategies. These goals and
7 objectives are above the regularly expected results of the non-executive salaried
8 employee's position, and, when achieved, add benefit not only to the Company
9 but its customers as well.

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

12 A. Yes. The Staff recommended removal of \$273,176.67, or nearly 43%, of the
13 expense related to non-executive incentive compensation. Ms. Mapeka developed
14 this amount by sampling non-executive salaried employee performance
15 evaluations. Ms. Mapeka made a judgment as to what percentage of the total
16 number of incentive goals identified from the sample were not cost of service
17 related, then applied this percentage to the total test-year non-executive salaried
18 incentive compensation expense to arrive at an amount to exclude from test year
19 expense.

20 **Q. DO YOU AGREE WITH THE STAFF'S APPROACH TO THIS ISSUE OR**
21 **THE STAFF'S RECOMMENDATION?**

22 A. No, I do not. In an effort to determine a percentage of non-executive salaried
23 incentive compensation expense to disallow from Empire's cost-of-service, Ms.

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1 Mapeka inappropriately used some specific incentive goals and then projected
2 their impact over the entire non-executive salaried population. For instance, Ms.
3 Mapeka's sample employees included two employees who deal almost
4 exclusively with shareholder issues, which were categorized by Staff as non-
5 recoverable from customers. However, these particular incentive goals are
6 exclusive to these two individuals and should not be projected over the entire
7 population of salaried employees. In addition, Ms. Mapeka incorrectly projected
8 a number of incentive goals that were not achieved over the entire non-executive
9 salaried population. By design, the non-executive salaried employee incentive
10 approach eliminates any compensation for incentive goals that were not achieved.
11 Thus, there was no compensation included in the test year associated with non-
12 achieved incentive goals. The Staff's incorrect proposed adjustment would
13 penalize the Company for an expense that didn't occur.

14 **Q. PLEASE QUANTIFY THE IMPACT OF THE STAFF'S INCORRECT**
15 **PROPOSED ADJUSTMENT.**

16 A. Approximately 46% of the incentive goals included in Ms. Mapeka's evaluation
17 sample were incorrectly attributed to the entire non-executive salaried employee
18 population. This results in an inappropriate disallowance of \$125,666. This
19 amount should properly be included in test year expense.

20 **Q. DID THE STAFF RECOMMEND ADJUSTMENTS TO ANY OTHER**
21 **FORMS OF INCENTIVE COMPENSATION?**

22 A. Yes. Ms. Mapeka recommended removal of \$168,000 from test year expense
23 related to the Company's Lightning Bolt award program. This amount

1 represented the entire amount of compensation awarded through the program
2 during the test year.

3 **Q. PLEASE EXPLAIN THIS PROGRAM.**

4 A. The Lightning Bolt program is not an incentive program. Through this program,
5 the Company provides cash awards to individuals who deliver results beyond
6 those normally associated with their position. In particular, the majority of the
7 awards from the Lightning Bolt program distributed during the test year were
8 related to ice storm recovery efforts. Many salaried employees worked extremely
9 long and difficult hours during the storm recovery efforts answering customer
10 calls and questions, providing logistical assistance to work crews, delivering
11 meals, laundering work clothes, etc. In no way does the Lightning Bolt program
12 fully compensate the non-executive salaried individual for the actual overtime
13 they work. However, it is the only vehicle available to the Company to show
14 appreciation to salaried individuals who do not earn overtime for working beyond
15 their normal hours during the storm recovery. The proposed Staff disallowance in
16 this area is most definitely related to Empire's cost of service and should properly
17 be included in test year expense.

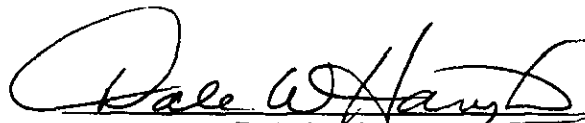
18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 A. Yes, it does.

AFFIDAVIT OF DALE W. HARRINGTON

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

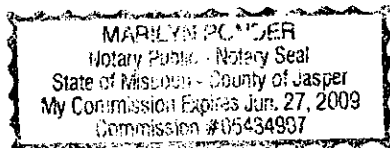
On the 2 day of April, 2008, before me appeared Dale W. Harrington, to me personally known, who, being by me first duly sworn, states that he is the Assistant Director of Human Resources of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.


Dale W. Harrington

Subscribed and sworn to before me this 2 day of April, 2008.


Marilyn Ponder
Notary Public

My commission expires: June 27, 2009.



Comparison of Empire to Peer Group Executive Compensation
(most recently available Proxy Statements)

Rebuttal Schedule DWH-1

| Company | Target Benchmarking Percentiles | | | | CEO Compensation | | | | Avg Compensation - all other NEOs | | | |
|------------------------------------|---------------------------------|----------------------|---------------------|--------------------|------------------|--------------|---------------------------|--|-----------------------------------|--------------|---------------------------|--|
| | Base Salary | Short Term Incentive | Long Term Incentive | Total Compensation | Base Salary | Stock Awards | Non-Equity Incentive Comp | Total (incl. bonus, options, pension val, other) | Base Salary | Stock Awards | Non-Equity Incentive Comp | Total (incl. bonus, options, pension val, other) |
| Empire District | 25 | 43 | 44 | 37.5 | 315,000 | 239,075 | 155,626 | 925,906 | 168,875 | 46,799 | 48,427 | 316,618 |
| <u>MO Investor owned</u> | | | | | | | | | | | | |
| Aquila | 50 | 50 | 50 | 50 | 990,000 | 0 | 742,500 | 1,879,619 | 273,600 | 70,084 | 246,000 | 725,600 |
| Ameren | 50 | 50 | 50 | 50 | 900,000 | 2,766,129 | 696,701 | 4,709,935 | 437,500 | 653,553 | 256,563 | 1,485,126 |
| Great Plains | 50 | 75 | 50 | 60 | 725,000 | 1,553,694 | 0 | 3,207,399 | 392,500 | 580,975 | 123,750 | 1,364,355 |
| <u>Peer Group</u> | | | | | | | | | | | | |
| Black Hills (2006) | 50 | 50 | 50 | 50 | 524,059 | 327,766 | 551,250 | 1,707,710 | 278,250 | 206,315 | 184,258 | 820,458 |
| Central Vermont | 50 | 50 | 50 | 50 | 370,981 | 154,422 | 163,000 | 845,508 | 205,505 | 34,796 | 52,775 | 345,720 |
| CH Energy | 50 | 50 | 50 | 50 | 525,000 | 180,636 | 390,075 | 1,404,659 | 269,750 | 50,917 | 133,683 | 511,510 |
| Cleco * | 50 | 62.5 | 50 | 55 | 449,327 | 669,831 | 358,909 | 1,775,864 | 238,813 | 198,338 | 140,211 | 680,864 |
| El Paso | 50 | 50 | 50 | 50 | 298,077 | 404,175 | 263,606 | 1,078,390 | 256,375 | 140,229 | 153,677 | 634,821 |
| Edison (2006) | 50 | 50 | 50 | 50 | 436,538 | 291,968 | 331,726 | 1,420,655 | 267,692 | 95,908 | 147,678 | 715,783 |
| GE Energy (2006) | | | N/A | | 423,476 | 0 | 190,000 | 775,427 | 198,378 | 0 | 86,250 | 338,933 |
| Great River | 50 | 50 | 50 | 50 | 453,500 | 799,264 | 408,016 | 2,209,320 | 305,313 | 331,400 | 168,144 | 1,124,035 |
| JIL Holdings (2006) | 50 | 50 | 50 | 50 | 481,250 | 278,554 | 433,125 | 1,320,741 | 256,700 | 363,196 | 158,147 | 1,024,514 |
| Unisource | 50 | 50 | 75 | 60 | 694,438 | 97,755 | 791,000 | 2,164,765 | 285,200 | 59,460 | 201,722 | 706,849 |
| Unitil | 50 | 50 | 50 | 50 | 424,212 | 116,171 | 263,011 | 1,179,819 | 189,661 | 26,978 | 78,360 | 358,841 |
| Avg. of comparators | 50 | 53 | 52 | 52 | 549,704 | 545,740 | 398,780 | 1,834,272 | 275,374 | 200,868 | 152,230 | 774,101 |
| Empire percentage below Comparator | 50% | 19% | 15% | 28% | 43% | 56% | 61% | 50% | 39% | 77% | 68% | 59% |

* CEO in office partial year. Annualized salary would equal approximately \$447,000.