

Exhibit No.
Issue: Payroll
Witness: Dale W. Harrington
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2010-0130
Date Testimony Prepared: April 2010

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

Rebuttal Testimony

of

Dale W. Harrington

April 2010

REBUTTAL TESTIMONY
OF
DALE W. HARRINGTON
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2010-0130

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 that time.

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 the Company's peers within the industry and to
6 the national marketplace as well, and why all components of executive
7 compensation should be included in Empire's test year expense. Lastly, I will
8 explain Empire's incentive compensation approach for non-executive salaried
9 employees and how certain amounts that Staff has recommended be excluded
10 from test year expense should properly be included.

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

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

21

22 Empire's executive compensation program includes three basic compensation
23 elements: (1) base salary, (2) annual (short-term) cash incentives based on

1 threshold (minimum expected), target, and maximum performance measures, and
2 (3) long-term incentives. The Compensation Committee of the Board of Directors
3 (“Compensation Committee”) has established a compensation philosophy that
4 targets a certain level of compensation based on a national market survey
5 developed by a compensation consultant employed by the Compensation
6 Committee. The last such survey was conducted in 2008. Once certain
7 benchmark compensation levels are determined, the Compensation Committee
8 compares the dollar values resulting from the benchmarking process to
9 corresponding compensation levels at an industry-specific peer group (“peer
10 group”) of companies to ensure that total direct compensation is competitive
11 within the industry and appropriate when certain levels of performance are
12 achieved. The companies in the peer group developed by the compensation
13 consultant are similar to Empire in terms of revenue, market value, growth, etc.

14 **Q. HOW DOES EMPIRE’S EXECUTIVE COMPENSATION APPROACH**
15 **COMPARE TO SIMILAR COMPANIES?**

16 A. Companies similar to Empire typically utilize the same approach as Empire by
17 incorporating a mix of base salary, short-term, and long-term incentives into a
18 total executive compensation package. This reflects a “best practices” approach
19 used by companies both inside and outside the utility industry. Rather than
20 relying solely on fixed compensation in the form of base salary, this best practices
21 approach also includes a considerable measure of variable (at risk) compensation
22 in the total compensation package. This approach is a key factor in ensuring the
23 alignment of an executive’s performance with the interests of customers and

1 shareholders. The approach is utilized by each of the peer-group companies as
2 well as all investor owned electric utilities operating in Missouri (inclusively, the
3 “comparator companies”).

4 **Q. ACCORDING TO YOUR UNDERSTANDING, HOW DOES EMPIRE’S**
5 **EXECUTIVE COMPENSATION PHILOSOPHY COMPARE WITH THE**
6 **COMPENSATION PHILOSOPHY OF OTHER COMPANIES?**

7 A. Although Empire’s approach to executive compensation is similar to other
8 companies, the philosophy behind the Company’s approach is much more
9 conservative. In terms of **base salary**, the Compensation Committee has targeted
10 the base salary midpoint between the 25th and 50th percentiles of the national
11 market survey discussed above for similarly situated executives. In so doing, the
12 Compensation Committee has set target base salary levels **significantly lower**
13 than the target base salary levels of both the comparator companies and the utility
14 industry in general. As indicated by the accompanying Rebuttal Schedule DWH-
15 1 (developed through analysis of the executive compensation section of the most
16 recently available proxy statements of several comparator companies), the
17 average target base salary level of the comparator companies was set at the 50th
18 percentile of the market, compared to Empire’s use of the midpoint between the
19 25th and 50th percentiles.

20
21 The Compensation Committee has also established **short- and long-term**
22 **incentive** target levels for Empire’s executives that are **below** those of the
23 comparator companies. For example, the target levels for short- and long-term

1 incentives utilized by Empire are each set at approximately the midpoint between
2 the 25th and 50th percentiles, compared to the comparator companies' averages for
3 short- and long-term incentive target levels, both of which are set slightly above
4 the 50th percentile. Furthermore, the target levels utilized for short- and long-term
5 incentives by the comparator companies ranged from the 50th percentile to the 75th
6 percentile.

7

8 In terms of **total compensation**, the Compensation Committee has set a target
9 level for Empire executives that also approximates the midpoint between the 25th
10 and 50th percentiles. This is substantially lower than the average total
11 compensation target level of the comparator companies, which is in **excess of the**
12 **50th** percentile. In addition, target levels for total compensation ranged from the
13 50th percentile to the 60th percentile in the comparator companies.

14 **Q. HOW DOES EMPIRE'S EXECUTIVE COMPENSATION PHILOSOPHY**
15 **IMPACT COMPENSATION AWARDS AS COMPARED TO THE**
16 **COMPARATOR COMPANIES?**

17 A. Because of Empire's conservative compensation philosophy, overall
18 compensation awards are significantly less than similar awards of the comparator
19 companies. As indicated by Rebuttal Schedule DWH-1, the base salary of
20 Empire's CEO is 39% below the comparator company average of CEO base
21 salary. The stock compensation and non-equity incentive compensation awarded
22 to Empire's CEO are 68% and 34% below the comparator company averages,
23 respectively. Finally, total compensation awarded to Empire's CEO, as reported

1 under the Security and Exchange Commission’s proxy statement regulations, is
2 54% below average total compensation awarded to comparator company CEOs.

3
4 The same observation can be made with regard to average compensation paid to
5 other Named Executive Officers (“NEOs”) listed in the Company’s proxy
6 statement. The average base salary of Empire’s NEO’s, other than the CEO, is
7 32% below the comparator company average. The average award to Empire’s
8 other NEOs for stock awards, non-equity incentive compensation and total
9 compensation is 75%, 33% and 55% below similar awards to all other NEOs of
10 the comparator companies, respectively.

11 **Q. WHAT ADJUSTMENTS DID THE STAFF’S WITNESS, MR. KEITH**
12 **FOSTER, MAKE TO EXECUTIVE COMPENSATION?**

13 A. Mr. Foster recommended the removal of several components of Empire’s total
14 compensation package from test year expense, namely those that constitute the
15 variable or at risk compensation. More specifically, the Staff has recommended
16 removal of compensation associated with performance measures under the annual
17 cash incentive plan related to control of operating and maintenance, capital, and
18 fuel and purchased power expenses, meetings with institutional investors,
19 issuances of debt, participation in Southwest Power Pool board and committee
20 activities, and various other projects and objectives.

21
22 In particular, Mr. Foster included in test year expense cash incentive
23 compensation awards paid to Mr. Gipson and Mr. Knapp associated with

1 performance measures related to operating and maintenance expense control, but
2 disallowed similar cash incentive compensation awards paid to Messrs. Beecher,
3 Colgin, Palmer, and Ms. Walters. The amount of this disallowance is \$15,650.

4
5 Likewise, Mr. Foster included in test year expense cash incentive compensation
6 awards paid to Messrs. Beecher, Colgin, and Palmer associated with performance
7 measures related to control of capital expenditures, but disallowed similar cash
8 incentive compensation awards paid to Mr. Gipson and Ms. Walters. The amount
9 of this disallowance is \$9,741.

10
11 Mr. Foster disallowed cash incentive compensation paid to Messrs. Gipson,
12 Beecher, and Colgin associated with performance measures related to control of
13 capital expenditures for construction of new base load generation and control of
14 fuel and purchased power expenses in the amounts of \$10,387 and \$32,298,
15 respectively.

16
17 Performance associated with control of operating and maintenance, capital, and
18 fuel and purchased power expenditures is measured against those expenditures
19 directly related to each executive officers' area of responsibility. To allow some
20 cash incentive compensation awards paid to certain executives while disallowing
21 similar awards paid to other executives is inappropriate, arbitrary, and capricious.

22

1 In addition, Mr. Foster disallowed cash incentive compensation awards paid to
2 Mr. Gipson and Mr. Knapp amounting to \$74,376 that are associated with
3 performance measures related to conferences with institutional investors; an
4 award of \$11,200 paid to Mr. Knapp that is associated with a performance
5 measure related to securing short-term debt at favorable interest rates; and awards
6 amounting to \$23,240 that was paid to Mr. Palmer associated with performance
7 measures related to representing customer and Company interests before the
8 Southwest Power Pool.

9

10 Mr. Foster disallowed cash incentive compensation awards paid to executive
11 officers associated with performance measures related to various other projects
12 and objectives in the amount of \$189,254.

13 **Q. DO YOU BELIEVE THESE ADJUSTMENTS TO EXECUTIVE**
14 **COMPENSATION PROVIDED BY STAFF ARE REASONABLE?**

15 A. No. The cash incentive compensation expense associated with the performance
16 measures discussed above is properly includable in cost of service. It must be
17 pointed out that no cash incentive awards are payable to an executive officer
18 unless performance is above the threshold, or minimum, level of expected
19 performance as approved by the Compensation Committee. In the case of each of
20 the disallowed amounts discussed above, performance exceeded the threshold
21 level of expected performance.

22

1 Moreover, there is no doubt that customers benefit directly from high levels of
2 executive performance with regard to effective control of operating and
3 maintenance, capital, and fuel and purchased power expenditures, the securing of
4 adequate low-cost capital, and ensuring customer and Company interests are well
5 represented in the Southwest Power Pool.

6
7 In addition, the Staff has recommended removal of the full amounts of the equity
8 compensation (performance-based restricted stock and stock options) associated
9 with the long-term incentive award. The amount of this disallowance is
10 \$344,107. Combined with the cash incentive compensation awards discussed
11 above, these recommended adjustments would remove \$710,253 from test year
12 expense. For reasons I will discuss below, these expenses should be included in
13 test year expense.

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

17 A. No. The elimination of the variable or at risk compensation incorrectly assumes
18 that such awards are **not part of the total compensation package**, but, instead,
19 are **in addition to the total compensation package** developed by Empire, and
20 therefore constitute additional compensation without a corresponding benefit to
21 Empire and its customers. Each component of variable compensation is essential
22 to complete the executive's total compensation package. Variable compensation
23 is "at risk", and standards, in the form of performance criteria, are necessary in

1 order to determine what portion of the compensation is earned. The
2 Compensation Committee has developed such performance criteria as a function
3 of placing a substantial portion of an executive's total compensation in variable
4 rather than fixed vehicles in order to encourage high levels of performance. This
5 approach is consistent with the approach utilized by the comparator companies
6 and the utility industry in general.

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

9 A. It tends to undermine the overall objectives of Empire's Compensation
10 Committee by shifting more of the emphasis to base compensation to ensure cost
11 recovery. The Compensation Committee could design an executive compensation
12 program that includes *all* short- and long-term incentive compensation amounts in
13 base salary, which Staff has approved across the board. However, the
14 Compensation Committee doesn't believe such a design philosophy serves the
15 customer or shareholder as well as the design of the compensation program
16 currently in place. Consistent with the Compensation Committee's philosophy,
17 which I discussed earlier, whereby each executive's total compensation package
18 consists of a considerable measure of variable (at risk) compensation, it is
19 necessary for the Compensation Committee to establish a set of standards, or
20 performance criteria, to determine what portion of variable pay is earned. The
21 performance criteria determined by the Compensation Committee for each
22 executive are tied to the Company's vision, goals and key business strategies
23 established at the beginning of each performance year. These performance

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

9
10 To follow Staff's recommended adjustment and remove from test year expense
11 the variable compensation expense related to short- and long-term components of
12 the executive compensation package does not recognize the compensation
13 awarded each executive for accomplishment of the core responsibilities of his or
14 her position and the benefits those accomplishments bring to Empire and its
15 electric customers. Therefore, all elements of executive compensation should
16 properly be included in test year expense.

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

21 A. Empire follows best practices in compensation structure for its non-executive
22 salaried employees by linking its performance management systems with how
23 employees are paid. This is achieved by allocating a percentage or fixed amount

1 of an employee's compensation to a variable pay program tied directly to the
2 attainment of goals and objectives set forth by management and aligned with
3 Empire's overall vision, goals and key business strategies. These goals and
4 objectives are above the regularly expected results of the non-executive salaried
5 employee's position, and, when achieved, add benefit not only to the Company
6 but to its customers as well.

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

9 A. Yes. The Staff properly included the amount of non-executive salaried
10 compensation in test year expense for non-executive salaried employees who
11 were compensated in cash. However, the Staff recommended removal of the
12 expense related to non-executive salaried compensation paid during the test year
13 to employees who elected to receive such compensation in the form of Empire
14 common stock instead of cash.

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

17 A. No, I do not. It should be of no consequence to this Commission or to the
18 Company's customers whether non-executive salaried compensation is paid in
19 cash, which was allowed in test year expense, or in Empire common stock, which
20 certain employees elected rather than cash. Moreover, Empire's approach to non-
21 executive compensation is identical to the Company's best-practice approach to
22 executive compensation described above. Therefore, the amount of non-

1 executive salaried compensation paid in Empire common stock rather than cash
2 should properly be included in test year expense.

3 **Q. PLEASE QUANTIFY THE IMPACT OF THE STAFF'S INCORRECT**
4 **PROPOSED ADJUSTMENT.**

5 A. The Staff disallowed \$380,557, or approximately 49%, of non-executive salaried
6 compensation, that was paid in Empire common stock rather than cash.

7 **Q. WHY DID EMPIRE ALLOW NON-EXECUTIVE SALARIED**
8 **EMPLOYEES TO ELECT COMPENSATION IN THE FORM OF**
9 **COMMON STOCK?**

10 A. At the time this amount of non-executive salaried compensation was payable,
11 financial market conditions had become unfavorable. Because of the unfavorable
12 financial market conditions, and taking into consideration Empire's ongoing new
13 base load generation construction program, there was an immediate need to
14 conserve cash. Qualified employees, as set forth by the terms of the Company's
15 2006 Stock Incentive Plan, were offered the opportunity to make application to
16 receive shares of Empire common stock rather than cash. Such applications were
17 accepted and approved by the Compensation Committee. Non-executive salaried
18 employees who were not qualified to receive shares of Empire common stock
19 under the terms of the 2006 Stock Incentive Plan were paid in cash. That amount
20 was properly included in test year expense by the Staff.

21 **Q. IS THERE A LEGITIMATE REASON FOR ALLOWING RECOVERY OF**
22 **COMPENSATION PAID IN CASH AND NOT ALLOWING RECOVERY**

1 **OF COMPENSATION PAID IN THE FORM OF EMPIRE COMMON**
2 **STOCK?**

3 A. No. There is no substantial difference in the manner in which non-executive
4 salaried employees qualified to receive shares of Empire common stock and non-
5 executive salaried employees not qualified to receive shares of common stock are
6 evaluated in terms of attainment of established goals and objectives. The
7 difference simply lies in the form of payment – cash or Empire common stock.
8 Staff proposes that only cash payments be included, but total non-executive
9 salaried compensation should properly be included in test year expense.

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

12 A. Yes. Mr. Foster recommended removal of \$69,972 from test year expense related
13 to the Company’s Lightning Bolt award program. This amount represents the
14 entire amount of compensation awarded through the program during the test year.

15 **Q. PLEASE EXPLAIN THIS PROGRAM.**

16 A. The Lightning Bolt program is not an incentive program. Through this program,
17 the Company provides cash awards to non-executive salaried individuals who
18 deliver results beyond those normally associated with their position, often
19 involving protracted time beyond normal work hours spent on special projects. In
20 no way does the Lightning Bolt program fully compensate the non-executive
21 salaried individual for the additional effort they put forth. However, it is the only
22 vehicle available to the Company to show appreciation to salaried individuals
23 who do not earn overtime for working beyond their normal hours during

1 prolonged projects. Payments made under the Lightning Bolt program are
2 definitely related to Empire's cost of service and should properly be included in
3 test year expense.

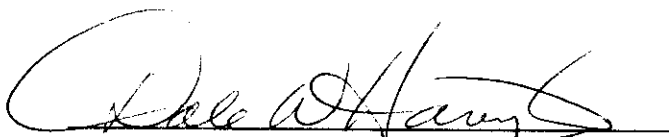
4 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

5 **A. Yes, it does.**

AFFIDAVIT OF DALE W. HARRINGTON

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 31 day of March, 2010, 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 31 day of March, 2010.


Notary Public

My commission expires
10-30-10

VICKI L. KRAMER-GIBSON
Notary Public - Notary Seal
STATE OF MISSOURI
Jasper County - Comm#06492169
My Commission Expires Oct. 30, 2010