

Exhibit No.
Issue: Payroll
Witness: Dale W. Harrington
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2011-0004
Date Testimony Prepared: April 2011

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

Rebuttal Testimony

of

Dale W. Harrington

April 2011

REBUTTAL TESTIMONY
OF
DALE W. HARRINGTON
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2011-0004

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 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 Staff recommends be excluded from test year
10 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 promote the accomplishment of our
16 performance objectives. Empire's overall compensation program is conservative
17 when compared to our peers. Empire's compensation program provides a secure
18 base salary with the opportunity to earn a higher level of total compensation under
19 incentive programs that link compensation to individual and Company
20 performance factors. As explained below, the appropriate total compensation
21 amount is determined and then a certain portion is put at risk.

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

1 based on threshold (minimum expected), target, and maximum performance
2 measures, and (3) long-term incentives. The Compensation Committee of the
3 Board of Directors (“Compensation Committee”) has established a compensation
4 philosophy that targets a certain level of compensation based on a national market
5 survey developed by a compensation consultant employed by the Compensation
6 Committee. The last such survey was conducted in 2010. 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 total direct compensation is competitive within
11 the industry and appropriate when certain levels of performance are achieved.
12 The companies in the peer group developed by the compensation consultant are
13 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 within a range surrounding the midpoint between the 25th and 50th
11 percentiles of the national market survey discussed above for similarly situated
12 executives. In so doing, the Compensation Committee has set target base salary
13 levels **significantly lower** than the target base salary levels of both the
14 comparator companies and the utility industry in general. As indicated by the
15 accompanying Rebuttal Schedule DWH-1 (developed through analysis of the
16 executive compensation section of the 2010 proxy statements of the comparator
17 companies), the average target base salary level of the comparator companies was
18 set at the 50th percentile of the market, compared to Empire’s use of the midpoint
19 between the 25th and 50th percentiles.

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

1 the 25th and 50th percentiles, compared to the comparator companies' averages for
2 short- and long-term incentive target levels of the 53rd percentile and 52nd
3 percentile, respectively. Furthermore, the target levels utilized for short- and
4 long-term incentives by the comparator companies ranged from the 50th percentile
5 to the 75th percentile.

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

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

15 A. Because of Empire's conservative compensation philosophy, overall
16 compensation awards are significantly less than similar awards of the comparator
17 companies. As indicated by Rebuttal Schedule DWH-1, the base salary of
18 Empire's CEO is 33% below the comparator company average of CEO base
19 salary. The stock compensation and non-equity incentive compensation awarded
20 to Empire's CEO are 65% and 27% below the comparator company averages,
21 respectively. Finally, total compensation awarded to Empire's CEO, as reported
22 under the Security and Exchange Commission's proxy statement regulations, is
23 40% below average total compensation awarded to comparator company CEOs.

1 The same observation can be made with regard to average compensation
2 paid to other Named Executive Officers (“NEOs”) listed in the Company’s proxy
3 statement. The average base salary of Empire’s NEO’s, other than the CEO, is
4 22% below the comparator company average. The average award to Empire’s
5 other NEOs for stock awards, non-equity incentive compensation and total
6 compensation is 87%, 17% and 45% below similar awards to all other NEOs of
7 the comparator companies, respectively.

8 **Q. WHAT ADJUSTMENTS DID THE STAFF’S WITNESS, CASEY**
9 **WESTHUES, MAKE TO EXECUTIVE COMPENSATION?**

10 A. Ms. Westhues recommends the removal of several components of Empire’s total
11 compensation package from test year expense, namely those that constitute the
12 variable or at risk compensation. More specifically, the Staff is recommending
13 removal of compensation associated with performance measures under the annual
14 cash incentive plan pertaining to the financing (long-term debt, common equity
15 and line of credit) activities for capital expenditures tied to our 2005 Experimental
16 Regulatory Plan, meetings among the joint owners at Iatan and Plum Point, record
17 management, fleet evaluation and IT disaster recovery plan.

18 In total, Ms. Westhues proposes to disallow cash incentive compensation paid to
19 executive officers in the amount of \$312,926.

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

22 A. They are unreasonable.

23 **Q. WHY?**

1 A. The cash incentive (**at risk**) compensation expense associated with the
2 performance measures discussed above is properly includable in cost of service.

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

8 Second, there is no doubt Empire's customers benefit directly from high
9 levels of executive performance with regard to securing adequate low-cost capital
10 to fund our capital expenditures tied to the Regulatory Plan and the oversight of
11 jointly-owned plant through joint ownership meetings.

12 In addition, the Staff recommends removal of the full amounts of the
13 equity compensation (performance-based restricted stock and stock options)
14 associated with the long-term incentive award. The amount of this disallowance
15 is \$473,638. Combined with the cash incentive compensation awards discussed
16 above, these recommended adjustments would remove \$786,564 from test year
17 expense. For reasons I will discuss below, these expenses should be included in
18 test year expense.

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

22 A. No. The elimination of the variable or at risk compensation incorrectly assumes
23 such awards are **not part of the total compensation package**, but, instead, are in

1 **addition to the total compensation package** developed by Empire, and therefore
2 constitute additional compensation without a corresponding benefit to Empire and
3 its customers. Each component of variable compensation is essential to complete
4 the executive's total compensation package. Variable compensation is "at risk",
5 and standards, in the form of performance criteria, are necessary in order to
6 determine what portion of the compensation is earned. The Compensation
7 Committee has developed such performance criteria as a function of placing a
8 substantial portion of an executive's total compensation in variable rather than
9 fixed vehicles in order to encourage high levels of performance. This approach is
10 consistent with the approach utilized by the comparator companies and the utility
11 industry in general.

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

14 A. Staff's position tends to undermine the overall objectives of Empire's
15 Compensation Committee by shifting more of the emphasis to base compensation
16 to ensure cost recovery. The Compensation Committee could design an executive
17 compensation program that includes *all* short- and long-term incentive
18 compensation amounts in base salary, which Staff has approved across the board.
19 However, the Compensation Committee doesn't believe such a design philosophy
20 serves the customer or shareholder as well as the design of the compensation
21 program currently in place. Consistent with the Compensation Committee's
22 philosophy, which I discussed earlier, whereby each executive's total
23 compensation package consists of a considerable measure of variable (at risk)

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

14 The Staff's recommended adjustment which removes from test year
15 expense the variable compensation expense related to short- and long-term
16 components of the executive compensation package, does not recognize the
17 compensation awarded each executive for accomplishment of the core
18 responsibilities of his or her position and the benefits those accomplishments
19 bring to Empire and its electric customers. Therefore, all elements of executive
20 compensation should properly be included in test year expense.

21 **Q. HOW DOES EMPIRE APPROACH COMPENSATION WHEN IT**
22 **INVOLVES ITS NON-EXECUTIVE SALARIED EMPLOYEES AND**

1 **HOW DOES THAT APPROACH COMPARE WITH BEST PRACTICES**
2 **IN THE COMPENSATION FIELD?**

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

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

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

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. It should be of no consequence to this Commission or to the
23 Company's customers whether non-executive salaried compensation is paid in

1 cash, which was allowed in test year expense, or in Empire common stock, which
2 certain employees elected rather than cash. Moreover, Empire's approach to non-
3 executive compensation is identical to the Company's best-practice approach to
4 executive compensation described above. Therefore, the amount of non-
5 executive salaried compensation paid in Empire common stock rather than cash
6 should properly be included in test year expense.

7 **Q. PLEASE QUANTIFY THE IMPACT OF THE STAFF'S INCORRECT**
8 **PROPOSED ADJUSTMENT.**

9 A. The Staff disallowed \$110,243 of non-executive salaried compensation paid in
10 Empire common stock rather than cash.

11 **Q. WHY DID EMPIRE ALLOW NON-EXECUTIVE SALARIED**
12 **EMPLOYEES TO ELECT COMPENSATION IN THE FORM OF**
13 **COMMON STOCK?**

14 A. Qualified employees, as set forth by the terms of the Company's 2006 Stock
15 Incentive Plan, were offered the opportunity to make application to receive shares
16 of Empire common stock rather than cash. Such applications were accepted and
17 approved by the Compensation Committee. Remaining non-executive salaried
18 employees who were not qualified, or were qualified but elected not to receive
19 shares of Empire common stock under the terms of the 2006 Stock Incentive Plan,
20 were paid in cash. That amount was properly included in test year expense by the
21 Staff.

22 **Q. IS THERE A LEGITIMATE REASON FOR ALLOWING RECOVERY OF**
23 **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 the employees in
4 question are evaluated in terms of attainment of established goals and objectives.
5 The difference simply lies in the form of payment – cash or Empire common
6 stock. Staff proposes that only cash payments be included, but total non-
7 executive salaried compensation should properly be included in test year expense.

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

10 A. Yes. Ms. Westhues recommends removal of \$47,500 from test year expense
11 related to the Company’s Lightning Bolt award program. This amount represents
12 the entire amount of compensation awarded through the program during the test
13 year.

14 **Q. PLEASE EXPLAIN THIS PROGRAM.**

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

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

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

4 **A. Yes, it does.**

Comparison of Empire to Peer Group Executive Compensation
(2010 Proxy Statements - 2009 Actual Data)

Schedule DWH-1
October 2010

Company	Target Benchmarking Percentiles			CEO Compensation					Avg. Compensation - all other NEOs				
	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	37.5	37.5	37.5	350,000	208,568	291,386	1,267,151	204,500	29,148	107,319	458,595 ⁽²⁾		
MO Investor owned													
Ameren	50	50	50	660,733	412,584	484,604	1,807,585	399,067	310,086	219,508	1,110,525 ⁽²⁾		
Great Plains	50	75	60	800,000	2,011,587	1,054,400	4,780,197	412,500	846,710	331,666	1,901,689 ⁽²⁾		
Peer Group													
Black Hills	50	50	50	564,000	674,723	221,088	1,873,600	300,331	355,665	78,995	962,627 ⁽²⁾		
Central Vermont ⁽¹⁾	50	50	50	402,000	200,550	246,000	1,079,823	220,394	68,760	81,150	477,638		
CH Energy	50	50	50	525,000	547,119	412,650	2,308,319	205,063	396,844	87,780	851,133 ⁽²⁾		
Cleco	50	62.5	55	540,462	967,500	391,208	3,338,478	276,547	264,454	143,604	985,287 ⁽²⁾		
El Paso	50	50	50	500,000	695,432	505,000	1,866,043	262,496	123,323	179,437	707,631 ⁽²⁾		
Idacorp ⁽¹⁾	50	50	50	623,077	683,176	809,904	3,717,968	279,327	160,897	188,396	1,030,843 ⁽²⁾		
MGE Energy ⁽¹⁾	50	Does not establish	50	469,884	140,994	215,000	1,176,947	228,126	67,355	97,500	550,233		
Other Tail	50	50	50	490,000	1,214,157	0	2,372,658	343,500	496,920	16,200	1,310,308		
UJL Holdings	50	50	50	625,000	793,259	485,625	1,927,604	302,000	240,700	166,195	847,039		
Unisource	50	50	75	593,327	245,995	599,800	1,961,946	324,813	161,805	191,650	886,024 ⁽²⁾		
Unitil ⁽¹⁾	50	50	50	456,601	89,250	196,338	1,306,751	204,319	21,315	61,623	394,137		
Chesapeake Utilities ⁽¹⁾	50	50	50	398,775	324,715	158,430	1,082,235	221,039	114,158	108,011	509,981 ⁽²⁾		
LaClede Group	50	Does not indicate	50	623,333	991,049	702,116	3,967,475	264,708	303,184	168,158	1,154,745		
Northwestern Corp	50	50	50	519,231	433,972	378,000	1,523,751	269,994	121,363	115,410	591,829 ⁽²⁾		
South Jersey Industries	50	50	50	574,999	425,846	287,500	1,997,665	228,099	111,754	97,779	745,822		
Avg. of Peer Group	50	51	52	527,046	561,849	373,911	2,100,084	262,050	200,566	118,793	800,352		
Avg. of Peers and IOUs	50	53	52	520,357	602,884	397,092	2,116,058	263,462	231,405	129,626	834,305		
Empire executive compensation percentage below Peer Group Avg.	25%	26%	28%	34%	63%	22%	40%	22%	85%	10%	43%		
Empire executive compensation percentage below Peer Group and MO IOU Avg.	25%	29%	27%	33%	65%	27%	40%	22%	87%	17%	45%		

⁽¹⁾ Empire is a member of the peer / comparator group used by these companies in their executive compensation benchmarking process.

Peer groups not disclosed by every company.

⁽²⁾ Changes to listed Named Executive Officers from previous year.

AFFIDAVIT OF DALE W. HARRINGTON

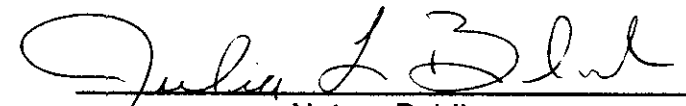
STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 12th day of April, 2011, before me appeared Dale W. Harrington, to me personally known, who, being by me first duly sworn, states that he is 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 12th day of April, 2011.

JULIA L. BLACKBURN
Notary Public - Notary Seal
State of Missouri
Commissioned for Newton County
My Commission Expires: August 26, 2011
Commission Number: 07216221


Notary Public

My commission expires