

Exhibit No.
Issue: Debt Disallowance and Iatan Costs
Witness: W. L. Gipson
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

W. L. Gipson

April 2011

****Denotes Highly Confidential****

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OF
W. L. GIPSON
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2011-0004

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

1 **Q. ARE YOU THE SAME W. L. GIPSON THAT PRESENTED DIRECT**
2 **TESTIMONY PREVIOUSLY FILED IN THIS CASE ON BEHALF OF THE**
3 **EMPIRE DISTRICT ELECTRIC COMPANY (“EMPIRE” OR**
4 **“COMPANY”)?**

5 A. Yes I am.

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

7 A. First, my rebuttal testimony will address the disallowance of certain debt costs
8 presented by Missouri Public Service Commission Staff (“Staff”) in Staff’s direct
9 testimony and Staff Report Cost of Service (“SRCOS”). Second, my testimony will
10 present the steps Empire has taken to prudently manage its investments in the Iatan
11 Power Station, including Iatan 1, Iatan 2, and Iatan Common Property (Iatan
12 Common). In essence, this part of my testimony will rebut portions of the Staff
13 Report entitled *CONSTRUCTION AUDIT AND PRUDENCE REVIEW – IATAN*
14 *CONSTRUCTION PROJECT FOR COSTS REPORTED AS OF OCTOBER 31,*
15 *2010* (“Staff’s October 2010 Audit Report”).

16 **DEBT COSTS:**

1 **Q. PLEASE EXPLAIN THE NATURE OF THE COSTS THE STAFF**
2 **RECOMMENDS BE EXCLUDED FROM EMPIRE'S COST OF DEBT**
3 **CALCULATION.**

4 A. In the first quarter of 2008, Empire solicited consents from its electric mortgage
5 bondholders to amend its indenture so the basket to pay dividends would increase by
6 approximately \$10.7 million. Fees of approximately \$1.6 million were paid to
7 bondholders in order to obtain the consents needed to amend the Indenture. Staff has
8 indicated in its SRCOS (pg. 16) that these expenses should be disallowed because
9 the fees were "...associated with Empire's desire to continue to pay the current
10 dividend level to its shareholders."

11 **Q. HOW DO YOU RESPOND TO THIS DISALLOWANCE?**

12 A. I disagree.

13 **Q. WHY DO YOU DISAGREE WITH THE STAFF'S DISALLOWANCE OF**
14 **THESE EXPENSES AS PART OF THE COMPANY'S DEBT COSTS?**

15 A. The costs were incurred in order to provide support to Empire's overall financing
16 plan related to the recent (Asbury SCR, Riverton Unit 12, Iatan Unit 1 AQCS, Plum
17 Point, and Iatan Unit 2) construction build. The Staff's disallowance is based on the
18 false premise that costs related to the amendment of the indenture were solely to
19 benefit shareholders.

20 **Q. PLEASE EXPLAIN.**

21 A. Empire has completed the largest construction program in its history which required
22 significant financing from both the equity and debt markets. The equity markets are
23 attracted to Empire as an income stock, not as a growth stock. If Empire had reduced

1 or been unable to pay its dividend, the underlying stock value would likely have
2 eroded and made it even more difficult, or impossible, for the Company to raise the
3 equity funds necessary to complete the construction cycle. If Empire had been
4 unable to raise equity funds, the Company would have been required to increase its
5 debt issuances to support the construction program. Empire's debt to equity ratio
6 would then have exceeded acceptable rating agency guidelines for an investment
7 grade company had the construction been financed in an unbalanced approach. This
8 could have led to a downgrade from the rating agencies which would, in turn, have
9 raised Empire's costs associated with any future debt issuances. Therefore, the
10 amendment to the indenture was accomplished to support the Company's overall
11 financing plan which benefits its customers.

12 **Q. WHAT IS THE RELATIONSHIP BETWEEN THE \$1.6 MILLION OF**
13 **AMENDMENT COSTS AND THE FINANCING NOTED PREVIOUSLY?**

14 A. The amendment was accomplished in the first quarter of 2008, roughly half way
15 through the recent construction and financing program, in order to provide investors
16 some comfort that Empire understood the importance of the dividend to
17 shareholders. The Company's Indenture, as it previously read, did not allow Empire
18 to pay dividends with essentially a negative retained earnings balance. The
19 Company's retained earnings balance had dropped to approximately \$17.2 million
20 (12/31/07), in part because we had absorbed \$85.5 million of fuel and purchased
21 power costs in the 2003-2006 period due to the lack of a fuel adjustment clause in
22 Missouri (Staff's Cost of Service Report, Case No. ER-2008-0093). An amendment
23 to the Indenture's retained earnings clause was necessary so investors would

1 continue to be attracted to the Company's stock. Ultimately, Empire was able to
2 complete a successful equity distribution program during 2009/2010 subsequent to
3 the amendment.

4 **Q. WAS THE RATIO OF DEBT TO TOTAL CAPITAL ADDRESSED IN**
5 **EMPIRE'S REGULATORY PLAN PREVIOUSLY AUTHORIZED BY THE**
6 **COMMISSION?**

7 A. Yes. The Regulatory Plan approved by the Commission in Case No. EO-2005-0263
8 outlined three primary financial ratios at Appendix C-1. Debt to total capital was
9 one of the three financial ratios outlined. This debt ratio was to be maintained by
10 Empire through future financing during the term of the Regulatory Plan and was not
11 a component of regulatory amortization (Regulatory Plan-Appendix D). Empire
12 successfully maintained this important financial ratio during the term of the
13 Regulatory Plan through its external financing efforts and our customers benefitted.

14 **Q. HOW DOES ALL OF THIS BENEFIT EMPIRE'S CUSTOMERS?**

15 A. As previously explained, a balanced approach to Empire's financing program was
16 essential to maintaining an investment grade rating. In fact, this has been known
17 and acknowledged since the beginning of the construction program, as the
18 Regulatory Plan (Case No. EO-2005-0263) itself included the following statement:
19 "Empire understands that it is responsible to take prudent and reasonable actions to
20 maintain Empire's debt at investment grade levels and avoid actions that result in a
21 downgrade." This language was included in the Regulatory Plan as an
22 acknowledgement of how important it is to keep financing costs low for customers
23 by maintaining an investment grade rating. The actions taken in 2008 to amend

1 Empire's Indenture were prudent in order to finance the recent construction cycle,
2 and the costs associated with those actions should be included in the debt costs
3 related to the capital structure as it benefited customers and shareholders alike.

4 **IATAN POWER STATION:**

5 **INTRODUCTION**

6 **Q. PLEASE BRIEFLY DESCRIBE EMPIRE'S OWNERSHIP INTEREST IN**
7 **THE IATAN POWER STATION.**

8 A. Empire owns a 12 percent interest in Iatan Unit 1 and Iatan Common Facilities.
9 The provisions of this ownership interest are defined in the Iatan Station Ownership
10 Agreement dated July 31, 1978 ("Unit 1 Agreement"). Similarly, Empire owns 12
11 percent of Iatan Unit 2 and associated Iatan Common Facilities. The provisions of
12 this ownership interest are defined in the Iatan Unit 2 and Common Facilities
13 Ownership Agreement dated May 19, 2006 ("Unit 2 Agreement"). Empire owns 3
14 percent of the Iatan Site property that is not directly a portion of Iatan Unit 1, Unit
15 2, or Common Facilities.

16 **Q. WHAT SPECIAL EFFORTS DID EMPIRE, OR OTHERS, MAKE TO**
17 **ASSURE IATAN UNIT 2 BECAME A REALITY?**

18 A. As I mention above, Empire and KCPL have a long history of joint plant ownership
19 beginning in the late-1970s with the addition of Iatan Unit 1. Both Empire and
20 KCPL worked with the Staff, the Office of Public Counsel, the Missouri
21 Department of Natural Resources, and various industrial customers to present to the
22 Commission regulatory plans that called for the addition of Iatan unit 2.
23 Subsequently, both Empire's and KCPL's Regulatory Plans were approved by this
24 Commission.

1 **Q. WHAT GENERAL PROVISIONS FOR OPERATION OF THE IATAN**
2 **FACILITIES ARE WITHIN THE OWNERSHIP AGREEMENTS?**

3 A. As stated on pages 1 and 2 of Staff's October 2010 Audit Report, the Unit 1
4 Agreement authorizes Kansas City Power & Light Company ("KCPL") to act as an
5 Operating Agent to perform all functions as may be required for the actual
6 operation and maintenance of the site, common facilities, and each unit. The Unit 2
7 Agreement likewise authorizes KCPL to act as the exclusive Operator to perform
8 all functions as may be required for the actual design, permitting, development,
9 procurement, construction, operation and maintenance of the Iatan Unit 2 Facility,
10 the Common Facilities, and the Iatan Station Site. Under both agreements the
11 Operating Agent / Operator are subject to the direction of the respective facility
12 Management Committee. The Management Committees are comprised of
13 representatives of the respective Owners who have voting rights equal to their
14 undivided ownership interest in the facility.

15 **Q. PLEASE EXPLAIN THE SIGNIFICANCE OF THESE MANAGEMENT**
16 **COMMITTEE PROVISIONS.**

17 A. To do this one must understand the Ownership Interests of all the parties. The
18 following two tables outline said ownership interests:

19 **Iatan Unit 1 Ownership Interests**

	<u>KCPL</u>	<u>SJLP</u>	<u>Empire</u>
20 Site Property	92.5%	4.5%	3.0%
21 Common Facilities	70.0%	18.0%	12.0%
22 Unit 1	70.0%	18.0%	12.0%

23
24

25 **Iatan Unit 2 Ownership Interests**

	<u>KCPL</u>	<u>Aquila</u>	<u>Empire</u>	<u>MJMEUC</u>	<u>KEPCO</u>	
1						
2	Common Facilities	61.45%	18.0%	12.0%	6.58%	1.97%
3	Unit 2	54.71%	18.0%	12.0%	11.76%	3.53%
4						

5 As can be seen in the table above, Great Plains Energy Incorporated, which includes
6 KCPL and Aquila, owns almost 90 percent of Unit 1, approximately 73 percent of
7 Unit 2, and over 79 percent of Common Facilities. Since the voting provisions of
8 the agreements only require a simple majority of ownership interest to carry a vote,
9 KCPL, as Operator, in essence has complete decision making authority for both
10 units and all facilities.

11 **Q. PLEASE EXPLAIN HOW THESE FACTS AND CIRCUMSTANCES ARE**
12 **REFLECTED IN EMPIRE'S REGULATORY PLAN.**

13 A. As stated on page 2 of Staff's October 2010 Audit Report, Empire has a Regulatory
14 Plan as a result of Case No. EO-2005-0263, *In the Matter of the Empire District*
15 *Electric Company's Application for Certificate of Public Convenience and*
16 *Necessity and Approval of Experimental Regulatory Plan Related to Generation*
17 *Plant, Order Approving Stipulation and Agreement.* As Staff points out, a
18 provision of the Stipulation and Agreement with regard to the Regulatory Plan is as
19 follows:

20 If any party proposes the disallowance of Iatan 1 or Iatan 2 costs, Empire
21 agrees not to seek to avoid such disallowance on the ground that such
22 expenditures were the responsibility of KCPL and were not within Empire's
23 control. Empire maintains the ability to litigate prudence issues related to
24 these expenditures based on any basis.

1 As a consequence and due to Empire's inability to affect decisions through the
2 Management Committee, Empire took several steps to prudently manage its
3 interests and costs associated with the Iatan projects.

4 **Q. DOES THE STAFF STATE THAT EMPIRE WAS IMPRUDENT WITH**
5 **REGARD TO THE IATAN PROJECTS?**

6 A. Yes. On page 3, lines 9 - 20 and again on page 22, lines 22 - 27 and page 23, lines
7 1 - 5, of Staff's October 2010 Audit Report The Staff states:

8 "Staff's recommended disallowances (attached as Schedule 1) are based on
9 Empire's failure to take prudent action, where such prudent action would have
10 prevented harm to Empire's ratepayers. These instances of Empire
11 imprudence can be divided, generally, into two categories:

12 A. Empire's imprudence in failing to engage in activity to prevent from
13 inclusion in the Iatan Project costs that are unreasonable, imprudent,
14 inappropriate, or not of benefit to ratepayers, and

15 B. Empire's imprudence in failing to engage in activity such that there
16 was not a cost control system developed and in place that identifies and
17 explains any cost overruns above the definitive estimate during the
18 construction period of Iatan 2 and the environmental enhancements at Iatan
19 1".

20 **Q. DO YOU AGREE WITH THIS ASSESSMENT AND RECOMMENDATION?**

21 A. No. While Empire was unable to affect specific project decisions via the
22 Management Committee, Empire did in fact take extensive action to prudently

1 manage its interests and associated costs. These actions included but were not
2 limited to:

- 3 1. Implementation of a project management team to oversee Empire's
4 interests in this and other projects included in Empire's Regulatory Plan.
- 5 2. Implementation of an internal cost control system to track costs
6 associated with the Iatan projects.
- 7 3. Active participation in monthly joint owner's meetings related to the
8 projects.
- 9 4. Internal and construction audits of project contracts, processes, and
10 controls.
- 11 5. Placement of an on-site representative to follow day-to-day activities
12 and provide prompt updates to project management.
- 13 6. Implementation of a Request for Information process to formally ask for
14 explanation of decisions, processes, and disputed invoices.
- 15 7. Implementation of a Request for Documentation process to obtain
16 omitted invoice and cost information in joint-owner billings.
- 17 8. Challenged, via the arbitration process allowed for in the Unit 2
18 Agreement, KCPL's decision to solely take the benefits of the Advanced
19 Coal Tax Credit.
- 20 9. Challenged, via the arbitration process allowed for in the Unit 2
21 Agreement, KCPL's decision to invoice Empire for legal fees associated
22 with Schiff-Hardin.

1 the Manager of Strategic Projects (titled later changed to Associate Director of
2 Strategic Projects), a Cost Control Specialist, and an Operations & Planning
3 Analyst (title later changed to Renewables and Strategic Initiatives Manager).

4 **Q. WHO FILLED THESE POSITIONS?**

5 A. The first two positions listed above were filled by professionals within the
6 Company who had just been involved with the construction of Riverton Unit 12.
7 These individuals had spent over 2-years on-site at the Riverton plant managing
8 day-to-day demolition and construction, managing and negotiating project
9 contracts, implementing cost control systems, commissioning the unit, and
10 supporting regulatory functions associated with the project. The third position was
11 filled by an individual that has extensive experience negotiating contracts, and more
12 specifically, purchase power agreements with wind farm developers.

13 **Q. WERE OTHER EMPIRE PERSONNEL INVOLVED?**

14 A. Yes. In addition to the Strategic Projects Group, Empire's Vice-President of
15 Energy Supply was intimately involved with this group of projects. The Vice-
16 President of Energy Supply had over 30-years of operating and construction
17 experience with mainly coal-fired generation. The assembly of these individuals
18 created an experienced and robust team to manage Empire's interests in the Iatan
19 and Plum Point projects.

20 **Q. HOW WOULD YOU DESCRIBE THE MANNER IN WHICH THIS GROUP
21 HAS MANAGED THESE PROJECTS?**

22 A. While I will specifically describe some of their management strategies on the Iatan
23 projects in greater detail, I can say at the outset that they have effectively managed

1 the Riverton Unit 12, Asbury SCR, and Plum Point projects. In fact, the decisions
2 and processes, with respect to the above named projects, have been deemed prudent
3 by the Staff as well as other state regulatory agencies. These three projects
4 represent roughly \$160 million in investment (excluding AFUDC). To date and to
5 my knowledge only ** _____

6 _____ ** has been recommended for disallowance among these three projects.

7 Moreover, as part of Staff's audit and testimony in this case related to
8 Plum Point, Staff's witness, Mr. Chuck Hyneman, states on page 7 – 8 of Staff's
9 *CONSTRUCTION AUDIT AND PRUDENCE REVIEW – PLUM POINT – FOR*
10 *COSTS REPORTED AS OF OCTOBER 31, 2010* ("Staff's Plum Point Audit") "the
11 ability of Staff to get quality auditable information, and the consistent full
12 cooperation professionalism and cooperativeness of Empire personnel in
13 conjunction with based on Staff's experience in previous rate case and construction
14 audits with Empire were significant factors in affecting the audit scope for Plum
15 Point." Similar statements are repeatedly made in Staff's Plum Point Audit.

16 **Q. IN YOUR OPINION, WHAT IS STAFF REFERRING TO BY THOSE**
17 **STATEMENTS?**

18 A. While Mr. Hyneman does not specifically state which construction audits he is
19 referring to, it is likely that he means the recently completed audits on the Riverton
20 Unit 12 and Asbury SCR projects. His words speak for themselves in that he
21 believes Empire has a proven track record in cooperation and professionalism as it
22 relates to construction projects. Virtually no disallowances have been
23 recommended for the Plum Point, Riverton Unit 12, and Asbury SCR projects, and

1 the same management team for Empire was in place for these three projects that
2 was in place for the Iatan Projects. The question then must be asked, what has
3 Empire done so differently with the Iatan Projects to suggest that Empire acted
4 imprudently? The rest of my testimony will show “nothing”, and, in fact, Empire
5 even took further actions at Iatan to prudently manage the projects.

6 **IMPLEMENTATION OF EMPIRE INTERNAL COST CONTROL SYSTEM**

7 **Q. HOW HAS EMPIRE TRACKED AND MANAGED COSTS ASSOCIATED**
8 **WITH THE IATAN PROJECTS?**

9 A. Similar to the cost control systems we set up for the Riverton Unit 12, Asbury SCR,
10 and Plum Point projects, Empire set up a cost control system for Iatan 1 AQCS and
11 Iatan 2 projects. This system allowed Empire to track costs it had been charged,
12 track the adequacy of documentation provided with invoices, allow for the review
13 of invoices provided and their adherence to vendor/supplier/contractor contract
14 terms, and ultimately approve payment of invoices after adjustments had been made
15 for improper billings or clerical mistakes had been corrected.

16 **Q. HOW WOULD YOU DESCRIBE THE RESULTS OF THIS COST**
17 **CONTROL SYSTEM?**

18 A. In order to answer this, I would direct you to Empire witness, Ms. Karen Heady’s
19 Rebuttal Testimony. Ms. Heady served as the Cost Control Specialist on this and
20 the other projects previously referenced. In Ms. Heady’s Rebuttal Testimony she
21 will outline Empire’s internal cost control system and the processes employed to
22 review invoices and associated documentation. Her testimony shows how
23 information from KCPL’s cost control system relates to Empire’s internal cost

1 control system. Additionally, she outlines costs totaling about ** _____ ** to
2 date in total project costs that were deemed improperly billed to Empire as a result
3 of our review process. Empire's share of that amount is about ** _____ **,
4 which Empire has received reimbursement for or reduced its billings as a result of
5 the review process. In my opinion, Empire's cost control system has allowed for
6 effective management of Empire's costs associated with the Iatan Projects as well
7 as the other construction projects previously discussed.

8 **REQUEST FOR INFORMATION AND DOCUMENTATION PROCESSES.**

9 **Q. HOW WAS EMPIRE ABLE TO OBTAIN COST DATA TO DETERMINE IF**
10 **IT WAS BEING APPROPRIATELY INVOICED FOR ITS SHARE OF**
11 **IATAN PROJECT COSTS?**

12 A. Again I will refer you to Ms. Heady's rebuttal testimony for details, but, simply put,
13 we diligently and aggressively requested back-up documentation from KCPL to
14 support every invoice we received. In the initial billings Empire received from
15 KCPL on the project, not a great deal of back-up documentation was provided. We
16 recognized that in order for us to substantiate the billings we would basically need
17 documentation for every item we were charged. That does not mean we were able
18 to scrutinize every single invoice or time sheet charged to the project, but rather we
19 more thoroughly audited those invoices that were of greater significance.

20 **Q. WHAT PROCESSES WERE UTILIZED TO OBTAIN COST DATA?**

21 A. Again, please refer to Ms. Heady's rebuttal testimony for details, but initially much
22 of the back-up information requests were made by email or phone call requests. As
23 the review and data transfer processes became more refined, we initiated, in

1 cooperation with KCPL, Request for Documentation and Request for Information
2 processes to ask specific questions about missing documentation, potential clerical
3 errors, potential improper billings, and other miscellaneous information. These
4 processes and the associated responses from KCPL allowed us to request
5 adjustments to our billings if required.

6 **Q. WERE THESE PROCESSES SUCCESSFUL?**

7 A. In my opinion, yes. There was an apparent insurmountable amount of back-up
8 documentation associated with these billings – Ms. Heady states over 37,000 cost
9 detail transactions have been received for the Iatan Projects alone. The processes
10 implemented along with our overall cost control system allowed for systematic
11 processing of the information without overwhelming our staff. Our project
12 management staff was able to effectively and relatively quickly identify billing
13 issues, ask KCPL management to clarify any issues through a documented process,
14 and, as stated in previous sections of my testimony, receive approximately
15 **** _____ **** in reimbursements on the project.

16 **ACTIVE PARTICIPATION IN JOINT OWNER'S MEETINGS**

17 **Q. HOW DID EMPIRE KEEP APPRISED OF PROGRESS ON THE IATAN**
18 **PROJECTS?**

19 A. Joint-owner's meetings were regularly held on a monthly basis and sometimes more
20 often when budget or schedule changes were taking place. During these meetings
21 project safety, construction progress, contractor performance schedule, and budgets
22 were among the items discussed. While the meetings were led by KCPL's project
23 management team, review of the minutes from these meetings will show that

1 Empire project management was quite active during these meetings. Empire
2 management consistently questioned progress, schedule, management decisions,
3 budget updates, budget variances, and many other parameters of the project.

4 **ON-SITE OWNER REPRESENTATIVE**

5 **Q. DID EMPIRE USE ANY OTHER MEANS TO STAY APPRISED OF THE**
6 **IATAN PROJECTS?**

7 A. Initially, besides for the monthly project meetings and sporadic site visits by the
8 Strategic Project Group, the monthly-joint owners meetings and the information
9 provided in them, along with review of the monthly project reports of Burns &
10 McDonnell, ALSTOM, Kiewit, and other contractors, were the main avenues
11 Empire was informed of project progress. However, we ultimately decided to put
12 someone at the site full-time. Provisions within the Iatan Unit 2 Ownership
13 Agreement allowed us to place a Site Representative at the site to monitor activities.

14 **Q. WHEN DID EMPIRE PLACE SOMEONE FULL TIME AT THE IATAN**
15 **SITE?**

16 A. In June of 2008 Empire placed a full-time joint owner Site Representative at Iatan.

17 **Q. WHO DID EMPIRE PLACE AT THE SITE?**

18 A. Mr. John Minturn was hired as an independent contractor to be Empire's on-site
19 representative. Mr. Minturn had served as a site construction manager for Segal,
20 Inc. on Empire's Riverton Unit 12 construction project. In addition to that, Mr.
21 Minturn has over 25 years of construction experience, much of which was in the
22 utility industry. I've attached Mr. Minturn's resume as WLG Schedule 1.

23 **Q. WHAT WERE HIS RESPONSIBILITIES?**

1 A. Per the Unit 2 Ownership Agreement, Empire's Site Representative "did not have
2 the authority to direct contractor work or the Operator's operations...". Mr.
3 Minturn regularly attended project planning meetings, schedule meetings, and
4 monitored project progress. Mr. Minturn provided regular updates to Empire
5 management via telephone conversations, emails, and informal reports. Mr.
6 Minturn did not participate in budget reforecast, "Risk and Opportunity", or other
7 project budgeting meetings led by KCPL project management; he also did not
8 participate in KCPL management meetings or meetings between KCPL and its
9 contractors when discussing commercial terms. In essence, Mr. Minturn was
10 Empire's eyes and ears on the site so we knew what was taking place in a timely
11 manner.

12 **AUDITS PERFORMED**

13 **Q. DID EMPIRE PERFORM ANY AUDITS ON THE IATAN PROJECTS?**

14 A. Yes, in addition to reviewing the Ernst and Young audits directed by KCPL project
15 management, Empire completed audits on its own accord to assure not only KCPL
16 processes were sound but also our own internal systems and processes were
17 adequate. As we responded in Data Request 228, part 1, of this case, Empire
18 conducted an audit of a key contractor / contract on the project, that of Pullman
19 Power, who was contracted to construct the chimney on the project. This audit was
20 completed by an independent contractor, McDonald and Associates. In addition,
21 Empire's internal auditing department audited the processes and cost control
22 systems implemented by the Strategic Projects Group for this project.

1 Q. IS EMPIRE'S INTERNAL AUDITING DEPARTMENT AN INDEPENDENT
2 GROUP?

3 A. Yes. In fact, Internal Audit reports to the Audit Committee of the Board of
4 Directors. Empire has purposely structured this to assure their findings are not
5 influenced by any other departments within Empire or senior management.

6 Q. WERE THERE ANY KEY FINDINGS IN THE AUDITS EMPIRE'S
7 INTERNAL AUDITING DEPARTMENT CONDUCTED?

8 A. A copy of an internal audit report dated September 30, 2010 is attached for
9 reference as WLG Schedule 2. A key finding of this audit, which can be found on
10 the last page of the report, states as follows:

11 "We believe a system to provide an organized, knowledgeable, and
12 substantial review of Iatan II expenses has been designed and utilized by the
13 Strategic Projects team during the construction process."

14

15 These findings further substantiate the effectiveness and prudence of Empire's
16 processes associated with these projects.

17 ADVANCED COAL TAX CREDIT ARBITRATION

18 Q. IN ADDITION TO THE APPROXIMATELY ** _____ ** EMPIRE WAS
19 ABLE TO OBTAIN REIMBURSEMENT FOR THROUGH DIRECT
20 BILLINGS, WERE THERE ANY OTHER ACTIONS EMPIRE'S
21 MANAGEMENT TOOK TO REDUCE COSTS TO EMPIRE'S
22 CUSTOMERS ASSOCIATED WITH THE IATAN PROJECTS?

1 A. Yes. Empire was awarded about \$17.7 million in advanced coal tax credits
2 associated with Iatan 2 to the benefit of its customers as a result of an arbitration
3 proceeding initiated by Empire management.

4 **Q. CAN YOU PLEASE EXPLAIN THESE ADVANCED COAL TAX CREDITS**
5 **AND THE ARBITRATION PROCEEDING?**

6 A. These matters are discussed in considerable detail in the recent Report and Order
7 Directing KCPL and GMO to apply to the IRS to Revise the Memorandum of
8 Understanding Regarding the Advanced Coal Tax Credits for Iatan issued by the
9 Commission on Case Nos. ER-2010-0355 and ER-2010-0356, a copy of which is
10 WLG Schedule 3 X to my rebuttal testimony.

11 Again, Empire was awarded about \$17.7 million as direct result of prudent and
12 diligent management of its interests in the Iatan 2 project. These tax credits will
13 directly offset the cost Empire's ratepayers will pay for the Iatan 2 investment.

14 **ONGOING SCHIFF HARDIN ARBITRATION**

15 **Q. PLEASE DESCRIBE SCHIFF HARDIN'S ROLE IN THE IATAN**
16 **PROJECTS.**

17 A. It is my understanding that Schiff Hardin LLC provided legal services for the Iatan
18 projects to KCPL.

19 **Q. HAS EMPIRE ENTERED INTO A DEMAND FOR ARBITRATION**
20 **CONCERNING SCHIFF HARDIN MATTERS?**

21 A. Yes.

22 **Q. WHY?**

1 A. As stated in Empire's response to Staff DR 230, KCP&L entered into an agreement
2 with Schiff Hardin LLC to provide legal services. Provisions within the agreement
3 between KCP&L and Schiff Hardin state the legal services "are intended for the
4 sole benefit of KCP&L"; however, KCP&L has invoiced the Company for
5 Empire's ownership share of Schiff Hardin expenses. Empire was not and to this
6 date has not been given full access to Schiff Hardin reports, work product, and legal
7 counsel.

8 **Q. WHAT ARE THE RESULTS OF THIS ARBITRATION?**

9 A. The arbitration proceeding is still in the early steps with the arbitration panel only
10 recently being selected. The results of the arbitration are not likely to be known for
11 several months.

12 **Q. IF THE RESULTS OF THE ARBITRATION ARE NOT YET KNOWN,**
13 **WHY IS THIS ISSUE OF RELEVANCE?**

14 A. This arbitration process initiated by Empire management is yet another example of
15 Empire's diligence and prudence in assuring that the Company and its customers
16 are paying only their proper share of Iatan costs.

17 **SUMMARY**

18 **Q. PLEASE SUMMARIZE YOUR IATAN POWER STATION REBUTTAL**
19 **TESTIMONY.**

20 A. While the Staff has recommended disallowances associated with the Iatan Projects
21 as indicated previously the Staff's Reply Brief in Case No. ER-2010-0356
22 states at page 21: "Regardless that GMO was only an eight percent owner of the
23 Jeffrey Plant, it still had an obligation to ensure the project was constructed in a

1 prudent manner. The Empire District Electric Company (Empire) has proven just
2 the opposite mentality with the Iatan Construction Project. Empire is a 12%
3 (twelve percent) owner of Iatan 2, but has been actively involved in the construction
4 project. Empire's involvement was further demonstrated in its vigorous attempt to
5 secure its share of the Iatan 2 Advanced Tax Coal Investment Credit." In the final
6 consideration it is clear that Empire dutifully managed its share of the Iatan projects
7 in accordance with the Ownership Agreements to ensure our share of project costs
8 were proper. We were able to put into place an experienced and robust
9 management team that took actions and implemented processes that utilized the
10 information provided to us by KCPL, whether through the cost control system
11 KCPL implemented, project reports or additional questioning of our own, to ensure
12 prudent management of costs billed to Empire.

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

14 A. Yes, it does.

