Exhibit No.:
Issue: Accounting Schedules and Fuel Adjustment Clause
Witness: W. Scott Keith
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2011-004
Date Testimony Prepared: September 2010

Before the Public Service Commission of the State of Missouri

Direct Testimony

of

W. Scott Keith

September 2010

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THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

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INTRODUCTION

Q. STATE YOUR NAME AND ADDRESS PLEASE.

A. My name is W. Scott Keith and my business address is 602 S. Joplin Avenue, Joplin, Missouri.

POSITION

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am presently employed by The Empire District Electric Company. ("Empire" or the "Company") as the Director of Planning and Regulatory. I have held this position since August 1, 2005. Prior to joining Empire, I was Director of Electric Regulatory Matters in Kansas and Colorado for Aquila, Inc., from 1995 to July 2005.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. In August 1973, I received a Bachelor of Business Administration degree with a major in Accounting at Washburn University, Topeka, Kansas.

Q. WHAT EXPERIENCE HAVE YOU HAD IN THE FIELD OF PUBLIC UTILITIES?

A. In 1973, I accepted a position in the firm of Troupe Kehoe Whiteaker & Kent as a staff accountant. I assisted in or was responsible for fieldwork and preparation of exhibits for rate filings presented to various regulatory commissions and audits leading to opinions on financial statements for various types of companies including utility companies.

In September 1976, I accepted a position with the staff of the Kansas Corporation Commission ("KCC"). My responsibilities at the KCC included the investigation of utility rate applications and the preparation of exhibits and presentation of testimony in connection with applications that were under the jurisdiction of the KCC. The scope of the investigations I performed on behalf of the KCC included the areas of accounting, cost of service, and rate design.

In March of 1978, I joined the firm of Drees Dunn & Company and continued to perform services for various utility clients with that firm until it dissolved in March of 1991.

From March of 1991 until June of 1994, I was self-employed as a utility consultant and continued to provide clients with analyses of revenue requirements, cost of service studies, and rate design. In connection with those engagements, I also provided expert testimony and exhibits to be presented before regulatory commissions.

As I mentioned earlier, I was employed by Aquila, Inc., as the Director of Regulatory for its electric operations in Kansas and Colorado from 1995 to July 2005.

Q. HAVE YOU PREVIOUSLY PARTICIPATED IN ANY REGULATORY PROCEEDINGS?

A. Yes, I have. I have testified before regulatory commissions in the states of Kansas, Colorado, Indiana, Missouri, Oklahoma, and West Virginia. I have also testified before the Federal Energy Regulatory Commission ("FERC").

PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will support various schedules containing financial and other information, all of which support the Company's proposed rate increase. In addition, I will describe the Company's request to continue using the fuel adjustment clause ("FAC"). Finally, I will directly support specific adjustments that the Company is making to the test year statement of operating income and outline Empire's request for a true-up process in this case.

Q. WHAT TEST YEAR DID THE COMPANY USE IN DETERMINING RATE BASE, OPERATING INCOME AND RATE OF RETURN?

A. The schedules included in this filing use the Missouri Public Service Commission Staff's ("Staff") final EMS run in Case No. ER-2010-0130 as a starting point for purposes of adjustment and update the Staff's EMS rate base items to reflect Empire's balances at June 30, 2010. The Staff's final EMS run in Case No. ER-2010-0130 did not include the Plum Point and Iatan 2 generating units so additional rate base adjustments were made to the Staff's EMS rate base balances to include these new units in rate base in this case. In addition, Empire has adjusted the Staff's EMS statement of operations for specific items, the most significant of which deal with the Plum Point and Iatan 2 generating units. For example, the

Staff's EMS statement of operations has not been adjusted to reflect the Entergy transmission charges currently being incurred to move the Plum Point output into the Southwest Power Pool. Other significant adjustments Empire has made to the Staff's EMS statement of operations, include the reflection of increased revenue as a result of the new rates coming out of Case No. ER-2010-0130. The addition of the new Iatan 2 and Plum Point generating units, new depreciation rates and the amortization of a depreciation reserve deficiency related to Empire's coal fired units at Riverton that are scheduled for retirement in 2018. This retirement is due for the most part to expected changes in Environmental Protection Agency ("EPA") regulations and the age of the units. Finally, the regulatory amortization expense associated with Empire's Regulatory Plan has been completely eliminated from the Staff's EMS statement of operations due to the conclusion of Empire's Regulatory Plan.

SUPPORTING SCHEDULES

Q. WHAT SCHEDULES ARE YOU SPONSORING?

A. I am sponsoring the following schedules which were prepared under my supervision and direction:

- Schedule WSK-1, which displays the Missouri jurisdictional rate base and the overall increase in revenue Empire is requesting as well as the overall rate of return;
- Schedule WSK-2, which displays Empire's rate base in this case;
- Schedule WSK-3, which displays Empire's adjusted statement of operations for this case;

- Schedule WSK-4, which the adjustments Empire has made to the statement of operations;
- Schedule WSK-5, which is a copy of Empire's existing Fuel Adjustment Clause;
- Schedule WSK-6, which is an example of a customer bill, including how the fuel adjustment is displayed on a customer's bill;
- Schedule WSK-7, which is an example copy of Empire's notice of the change in rates, including the a notice of Empire's intent to request Commission approval of a continuation of the existing fuel adjustment clause; and
- WSK-8, which displays where the information required by 4 CSR 240.3.161 is located in Empire's testimony and supporting schedules.

Q. PLEASE DESCRIBE EMPIRE'S OVERALL MISSOURI REVENUE DEFICIENCY.

A. Empire is requesting an overall increase in Missouri jurisdictional revenue of $36.5 million, or 9.2 percent above current rate revenue. This increase is based upon an overall rate of return of 8.82 percent and a return on equity of 10.6 percent. By far the biggest factor driving the rate case is the increase in investment in production plant at Iatan 2 that has taken place since the last rate case. Iatan 2 will be in service by the time the rates coming out of this case are made effective. Empire's investment in Iatan 2 is expected to be $269 million. Finally, the Commission's rules require a Company with a Missouri FAC to file for a continuation or discontinuation of the FAC when a general rate case is filed in Missouri. Empire is requesting a continuation of the existing FAC mechanism as part of this rate case, and the various Empire witnesses are providing the supporting documentation required for a continuation of the existing FAC as part of this case.

Q. PLEASE DESCRIBE SCHEDULE WSK-1, REVENUE REQUIREMENT.

A. Schedule WSK-1 is a summary comparison of the results of the Staff's EMS run in Case No. ER-2010-0130 to Empire's updated electric rate base, net operating income and required rate of return before and after the proposed rate increase in this case. For the test year in this case, Empire has used the rate base balances from the Staff's EMS run in Case No. ER-2010-0130 and updated them to reflect the Empire balances at June 30, 2010 in addition to adjusting rate base for Plum Point and Iatan 2. As indicated, the total original cost Missouri jurisdictional electric rate base is $1,067,907,990 (Line 1) which is multiplied by the required rate of return of 8.82% to arrive at a Missouri jurisdictional after tax operating income requirement of $94,202,901 (Line 3). This operating income requirement is subtracted from the Company's Missouri jurisdictional adjusted operating income of $71,699,546 (Line 4) and results in a Missouri jurisdictional after tax operating income deficiency of $22,503,355 (Line 5) or a Missouri jurisdictional pre-tax revenue deficiency of $36,524,680 (Line 8) which was requested in the filing with the Commission.

Q. PLEASE DECRIBE SCHEDULE WSK-2 RATE BASE.

A. Schedule WSK-2 is a comparison of the various rate base items used by the Staff in Empire's last rate case ER-2010-0130 to Empire's updated and adjusted rate base balances at June 30, 2010. As indicated, the updated rate base components have also been adjusted for the addition of the Iatan 2 and Plum Point generating units.

Materials and supplies and prepayments are the average of the thirteen consecutive month-end balances ending June 30, 2010. Regulatory assets adjusted for known and measurable changes were included. In addition, the cash working capital requirement that is based on adjusted income has been added to rate base. Offsets to the rate base are also displayed on Schedule WSK-2. These include: deferred income taxes, customer deposits, customer advances, interest synchronization offset, an income tax offset and Accumulated Regulatory Amortization.

Q. PLEASE DESCRIBE SCHEDULE WSK-3 SUMMARIZED INCOME STATEMENT.

A. Schedule WSK-3 is a comparison of Empire's functional income statement with specific adjustments to normalize test year electric operations for the impact of Plum Point, Iatan 2 and other specific adjustments to the Staff's functional income statement in its final EMS run in Case No. ER-2010-0130. A limited number of adjustments have been made to reflect the customer growth since the last rate case, normal weather conditions, rate case expense, the recent rate increase authorized by the Commission, normalized fuel and energy costs for the FAC, depreciation and amortization expense, infrastructure inspection expense, payroll costs, common stock expense and uncollectible account expense. Columns B and C reflect total Company and Missouri jurisdictional results from the Staff's final EMS run in Case No. ER-2010-0130. Columns D and E reflect Empire's total Company and Missouri jurisdictional operational results as updated and adjusted for purposes of this case. As indicated, after the posting of the various adjustments to the Missouri jurisdictional operations, current rates are expected to produce $71,699,546 in Net Operating Income ("NOI"). This level of NOI produces an overall return on Missouri jurisdictional rate base of 6.71 percent.

Q. PLEASE DISCUSS SCHEDULE WSK-4.

A. Schedule WSK-4 summarizes the adjustments Empire has made to the statement of operations in this case. As summarized in schedule WSK-4, among the adjustments to Total Company and Missouri revenues are: (1) reflect customer numbers at June 30, 2010; (2) reflect normal weather for the test year: (3) update unbilled related revenues; (4) reflect a full year of the rate increase granted by the Commission in Case No. ER-2010-0130 and (5) reflect an increase in FAC revenue due to a reduction in sales levels versus the Staff's Plum Point ECA base calculation that was included in the Stipulation and Agreement reached in ER-2010-0130. Empire has not requested a change in its FAC base costs in this case. The year-end customer adjustment annualizes the revenues to reflect what would have been received if the level of customers served at June 30, 2010 had been served by the Company for an entire year Empire witness Aaron Doll will describe the weather normalization and unbilled revenue adjustments in greater detail in his direct testimony, and Kelly Emanuel of Empire will explain the remaining retail revenue adjustments in greater detail in her direct testimony.

<u>ADJUSTMENTS TO COST OF SERVICE</u>

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO EXPENSES.

A. Total Company costs, excluding the impact of income taxes, have been increased by $24,904,028, which factors down to $21,931,731 for the Missouri retail jurisdiction. Included in this total is an adjustment related to the normalization of production operating and maintenance related to Iatan 2 and Plum Point for $5.3 million. Empire witness Blake Mertens will explain this adjustment in his direct testimony. Also included is an adjustment to normalize test year payroll costs. The payroll adjustments results in a net increase in annual payroll expense of $2.9 million on a Missouri jurisdictional basis. We have also adjusted Empire's payroll costs to eliminate the Staff payroll adjustment that was included in the Staff's EMS run in Case No. ER-2010-0130. Empire witness Jayna Long explains the payroll adjustments in greater detail in her direct testimony. Fuel and purchased power costs have been normalized to reflect the current base costs established in the Missouri FAC as part of the Stipulation and Agreement in Case No. ER-2010-0130. Empire witness Todd Tarter will also discuss the fuel and energy costs in greater detail in his direct testimony. The fuel and purchased power energy adjustment resulted in an increase in total production expense of $7.0 million attributable to the Company's Missouri jurisdictional operations. The fuel and energy costs are an important part of this rate case due to their significance in terms of cost and due to Empire's request to continue the Missouri FAC. In addition to the adjustment to ongoing energy costs, we have adjusted the ongoing purchase power demand charges to reflect the expiration of a purchase power contract with Westar, Inc, and a new purchase power contract that Empire has executed with Plum Point Energy Associates, LLC. In total we have decreased overall ongoing demand charges by

$7.0 million, with $5.8 million of the reduction going to the Missouri jurisdiction. Empire's fuel and purchased power expenses represent the single most significant component of Empire's operating costs. These two expense categories represent approximately 48 percent of total ongoing operating expenses on an as adjusted basis.

Q. WERE THE FUEL AND ENERGY COSTS IN THIS CASE ADJUSTED TO REFLECT THE BASE COST IN THE EXISTING MISSOURI FAC TARIFF?

A. Yes. As I mentioned earlier, we used the Staff's FAC base calculation in the Stipulation and Agreement in the last rate case, Case No. ER-2010-0130, to establish the ongoing cost of fuel and energy in this case.

Q. HOW WAS THE ADJUSTMENT TO FUEL AND ENERGY COST DEVELOPED?

A. The Staff's Plum Point FAC base agreed to in the Stipulation and Agreement reached in Case No. ER-2010-0130 was used to establish the ongoing cost of fuel, purchased power energy, fuel transportation costs and Air Quality Control System ("AQCS") costs. This cost level was compared to the energy and purchased power energy costs included in the Staff's final EMS run in Case No. ER-2010-0130 to arrive at the adjustment needed in this case. This process resulted in a normalized fuel and energy cost in this rate case that equaled the cost built into the existing Missouri FAC base calculation and the rates ultimately authorized by the Commission in Case No. ER-2010-0130. As a result of this adjustment process, the ongoing Missouri FAC revenue (base and incremental) and ongoing base energy costs are equal at $161,379,523 on a total Company basis and $133,477,003 on a Missouri jurisdictional basis.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO THE TRANSMISSION EXPENSE LEVELS.

A. The Missouri jurisdictional transmission expenses were increased to reflect the annualized payroll costs and by $1.35 million to reflect the Missouri jurisdictional portion of a new transmission contract Empire has with Entergy to deliver the Plum Point capacity and energy into the Southwest Power Pool. In addition, transmission expenses have been adjusted to normalize infrastructure remediation costs. Empire witness Jayna Long will cover this adjustment in her testimony.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO THE DISTRIBUTION EXPENSES.

A. Missouri jurisdictional distribution expenses were increased to reflect annualized payroll costs. Empire witness Jayna Long discusses all of these adjustments in greater detail in her direct testimony.

Q. PLEASE CONTINUE WITH AN EXPLANATION OF THE ADJUSTMENTS MADE TO CUSTOMER ACCOUNTS EXPENSE.

A. Missouri jurisdictional customer accounts expense was adjusted to reflect an increase in payroll expense. In addition, Missouri jurisdictional customer accounts expense was increased to reflect an increase of $511,420 in bad debts expense. Empire witness Jayna Long addresses the adjustment to payroll and bad debt expense in her direct testimony.

Q PLEASE DESCRIBE THE ADJUSTMENTS MADE TO CUSTOMER ASSISTANCE AND SALES EXPENSES.

A Each of the expense levels in these areas was increased to reflect the ongoing level of payroll costs. Although the adjustment for Missouri DSM amortization was not included in Sales expense, the adjustment related to DSM amortization is an increase in Missouri jurisdictional operating expenses of $563,596. Empire witness Sherry. McCormack will explain this adjustment in detail in her direct testimony.

Q. PLEASE DESCRIBE THE ADJUSTMENTS MADE TO ADMINISTRATIVE AND GENERAL EXPENSES.

A. Missouri jurisdictional administrative and general expenses were increased by a total of $3.42 million through a series of five (5) adjustments. Of the total, $16,121 was associated with an increase in 401(k) costs due to the increase in overall payroll expense. In addition, the ongoing FAS 87 and FAS 106 costs have been adjusted based upon the tracking accounting agreed to in Case No. ER-2010-0130. This resulted in an increase in Missouri jurisdictional costs of $1,952,310 over the level included in the final Staff EMS run in Case No. ER-2010-0130. The method used to calculate the adjustments for FAS 87 and FAS 106 are discussed in the direct testimony of Empire witness Laurie Delano. Missouri jurisdictional administrative and general expenses have been increased by $544,616 to reflect adjusted payroll expense. Rate case expenses were also decreased by $69,792 to reflect the costs associated with the current rate case and a requested amortization period of four years for the cost of the current rate case. The Missouri jurisdictional administrative and general expense levels have also been adjusted upward by $981,162 to reflect the ongoing impact of the operating agreements Empire has with the owner operators of the Plum Point and Iatan 2 generating units. Empire witness Blake Mertens discusses the adjustment for Iatan 2 operating costs in his direct testimony.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO DEPRECIATION EXPENSE.

A. The depreciation expense adjustment resulted in an increase of $10,040,130 and $9,064,330 for the total Company and the Missouri jurisdiction, respectively. The majority of this increase is directly related to the additional investment in generation facilities at Iatan 2 and Plum Point. The case also includes a request for new depreciation rates, which contribute to this increase in depreciation. In addition, depreciation expense has been increased by $1,119,127 to reflect the recovery of a depreciation reserve deficiency at the Riverton generation facility (coal units) over an eight year period. The depreciation adjustments, including the Riverton reserve deficiency are discussed in greater detail in the testimony of Empire witness Thomas Sullivan. In addition to the depreciation expense, Empire's amortization expense has been adjusted in this case through a series of five (5) adjustments. The most significant adjustment eliminates all of the Missouri Regulatory Amortization contained in the final Staff EMS run in ER-2010-0130, and reduces amortization expense by $4.5 million on a Missouri jurisdictional basis. Empire witness Kelly Walters will discuss this adjustment in more detail in her direct testimony. The next adjustment, which is associated with a change in stock issuance costs, increases Missouri jurisdictional amortization expense by $214,210. Empire witness Robert Sager will discuss this adjustment in his direct testimony. Amortization expense has also been increased by $563,596 to take into account Empire's request to decrease the amortization period related to deferred Missouri energy efficiency costs from ten (10) years to three (3) years. The 10-year amortization period used for Missouri energy efficiency costs was established in the Stipulation and Agreement reached in Case No. EO-2005-0263. This agreement will expire at the end of this rate case. Empire witness Sherry McCormack will address this adjustment in greater detail in her direct testimony. The next two adjustments to amortization are being supported by Empire witness Laurie Delano. In total these two adjustments decrease ongoing amortization expense by $600,971 and reflect an annual write-off of the accumulated Regulatory Amortization balance and an update of Iatan carrying costs.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF SCHEDULE WSK-4.

A. Taxes other than income taxes have been increased by $2.4 million for the total Company, or $2.2 million for the Missouri jurisdiction, to reflect the impact of Empire's adjusted plant in service balances. In addition, Missouri jurisdictional taxes other than income have been adjusted upward by $59,538 to include the impact of the projected change in payroll taxes due to the annualized payroll expense. Empire witness Jayna Long discusses each of these adjustments in greater detail in her direct testimony.

Empire's statement of operations has also been adjusted to reflect the impact that the various revenue and expense adjustments have on income taxes.

Q. PLEASE EXPLAIN WHY THE ADJUSTMENTS FOR THE MISSOURI JURISDICTION AND TOTAL COMPANY ARE THE SAME IN SOME INSTANCES.

A. Several of the adjustments are calculated for the Missouri jurisdiction only for purposes of this case. For example, rate case expense was calculated for the Missouri jurisdiction only.

<u>JURISDICTIONAL ALLOCATIONS</u>

Q. PLEASE DESCRIBE THE JURISDICTIONAL ALLOCATION PROCESS USED IN EMPIRE'S FILING.

A. The jurisdictional allocation factors used in this rate case are identical to those used by the Staff in Case No. ER-2010-0130, Empire's most recent Missouri rate case.

<u>PROPOSED TARIFFS</u>

Q. HOW IS THE COMPANY PROPOSING TO SPREAD THE REQUESTED INCREASE AMONG ITS CURRENT RATES?

A. Empire will file a class cost of service study in this case. This cost of service study will be used as a guide in the development of new rates and the allocation of Empire's overall revenue requirement. Empire witness Overcast's direct testimony will support the cost of service study.

<u>FUEL ADJUSTMENT CLAUSE</u>

Q. PLEASE DESCRIBE THE FAC TARIFF THE COMPANY IS PROPOSING

TO CONTINUE IN THIS CASE.

A. The Company's existing Missouri FAC tariff has been included in the existing tariffs as Section 4 – Riders, Sheet 17. The FAC tariff describes just how Empire's FAC mechanism operates. I have attached a copy of the existing FAC tariff sheet to my testimony as Schedule WSK-5. Several of the major features of the tariff are:

- Changes in the FAC factor will be based upon 95 percent of the difference between the cost of fuel and energy that is built into base rates and the actual cost of fuel and energy;
- Costs included in the FAC calculation will be based upon the actual Missouri jurisdictional historical expenses recorded in FERC accounts 501, 547 and 555, including the cost/benefits associated with Empire's fuel hedging program. In addition, the FAC will include the recovery of emission allowance costs (sulfur dioxide) recorded in FERC account 509, the REC revenue actually earned by Empire and the cost of consumables associated with Air Quality Control Systems ("AQCS") at Empire's generating units;
- Costs included in the FAC calculation will exclude the capacity charges associated with purchased power contracts;
- Only two changes in the FAC factor will be made each year, one in June and one in December;
- The Missouri jurisdictional base cost of energy under the FAC will continue to be established at $0.03182 per kilowatt-hour ("kWh") for the summer months (June-September) and $0.02857 per kWh for the non-summer months;

- Over/under recoveries of Missouri jurisdictional energy costs will be refunded/collected periodically (every six months) from Missouri retail customers through the operation of the tariff;
- Over/under recoveries of Missouri jurisdictional energy costs will be recorded on the books of the Company in FERC accounts using an asset/liability account to track over/under recoveries of energy costs on the balance sheet, Account No. 182.xxx/254.xxx and an offsetting expense account to reflect the over/under recoveries of energy costs on the income statement, Account No. 501. This will continue to ensure that net operating income is not distorted by over/under recoveries of Missouri jurisdictional energy costs. In addition, this accounting process will leave an audit trail for internal and external auditors. This audit trail will be very useful during the periodic prudence reviews that are required under the Commission's rules governing the fuel adjustment process. Empire has continued to restrict the recovery and refund of over/under recoveries to 95 percent of the total difference that was established in the last rate case.
- Carrying costs on energy costs deferred as part of the operation of the FAC will continue to be calculated on a monthly basis using Empire's embedded cost of short-term debt, and will be applied during both the accumulation period and the recovery period.

Q. DID EMPIRE ANALYZE ITS FUEL AND ENERGY COSTS TO WHAT THE IMPACT OF IATAN 2 HAD ON THE AVERAGE COST OF ENERGY?

A. Yes. Empire witness Todd Tarter analyzed Empire's future energy costs assuming a full year of normal Iatan 2 plant operations. As indicated in Mr. Tarter's testimony, the annual average energy costs were forecast to be $0.03028 in 2011.

Q. HOW DID EMPIRE'S FORECAST OF FUTURE ENERGY COSTS COMPARE TO THE EXISTING FAC BASE?

A. There was very little difference. The annual average cost included in the existing FAC base is $0.02975 per kilowatt-hour ("KWH"). Empire's forecast of average annual power costs including a full year of Iatan 2 operation is $0.03028 per KWH. The difference of $0.0005 per KWH is approximately 1.7 percent. This difference in average energy costs is not significant, and Empire recommends that the existing FAC base in Missouri stay in place. By maintaining the same FAC base, Empire will also be able to avoid revising its existing FAC tariff sheets and potential customer confusion surrounding the implementation of another FAC base within 12 months of the last change.

Q. DOES EMPIRE'S REQUEST TO CONTINUE ITS FAC COMPLY WITH THE COMMISSION'S RULES?

A. Yes. Empire has designed its FAC continuation request to comply with the Commission's rule governing the fuel adjustment process. Attached to this testimony as Schedule WSK-8 is a list of the twenty (20) minimum filing requirements and where this information can be found in supporting exhibits and testimony.

Q. PLEASE DESCRIBE THE ADDITIONAL INFORMATION THAT HAS

BEEN INCORPORTATED IN THE FILING TO COMPLY WITH 4 CSR 210-3.161 (3) (T).

A. We have included information associated with the following:

- Proposed FAC tariff, (Schedule WSK-5)
- An example customer billing with a separate line item for the FAC factor, (Schedule WSK-6)
- Exemplar Customer notice of proposed continuation of the FAC, (Schedule WSK-7)
- Testimony regarding business risk and the FAC (Vander Weide & Keith)
- Testimony concerning the resource mix that Empire expects to use to meet its customers electric requirements over the next four years (Tarter)
- Testimony describing Empire's long-term resource planning process (Tarter)
- Testimony describing Empire's current generation testing procedures concerning unit heat rates and efficiency (Mertens)
- Testimony concerning emission allowance costs/revenues (Mertens)
- Testimony authorizing the Commission staff to release Empire's previous five years of historical surveillance reports to all of the official parties to this rate case (Keith)

Q. DOES EMPIRE AUTHORIZE THE COMMISSION TO RELEASE THE LAST FIVE YEARS OF HISTORICAL SURVEILLANCE REPORTS TO THE PARTIES IN THIS CASE?

A. Empire agrees to release the last five years of historical surveillance information to the Commission Staff and to OPC. If other parties to this case desire to receive that information, Empire will provide it subject to the protections to confidential information that are afforded by 4 CSR 240-2.135. At this point, we are concerned about other utilities operating in Missouri that compete with Empire, such as KCPL and Ameren, gaining unrestricted access to our surveillance information as a result of intervening in this rate case. It would be unfair to Empire to require a complete release of this information to competitors without safeguards as to the access by competitors and the extent to which employees of competitors may view the information. Assuming these concerns can be addressed satisfactorily, Empire would agree to an overall release of five-years of the surveillance information to the parties in this rate case.

Q. DOES THE EXISTING FAC TARIFF AND THE RECOVERY/REFUND MECHANISM PROVIDE EMPIRE SUFFICIENT OPPORTUNITY TO EARN A FAIR RETURN ON EQUITY?

A. Yes, I believe so. The existing FAC mechanism is a significant improvement over the recovery of these costs through base rates. During periods of extreme fuel and energy price fluctuations, the FAC will recover 95 percent of the changes in energy costs, which means that the Missouri retail customers will reimburse Empire for a significant portion of its actual prudently incurred fuel and energy costs. In the event that fuel and energy costs stabilize at or near the base established in the FAC, which has been the case since the FAC was originally implemented, the energy cost changes that pass through to the customer through the FAC would be minimal. For example, since September of 2008, Empire has requested to pass on to its Missouri customers around $4.2 million of increased fuel and energy costs through the FAC. This represents a change in Missouri jurisdictional fuel costs of slightly over 2 percent during the past year and a half, and an overall change in retail revenue of less than 1 percent during the last 18 months.

Q. IS THE FAC DESIGNED TO COMPLY WITH THE PRUDENCE REVIEW PROCEDURES PRESCRIBED BY THE COMMISSION'S RULES?

A. Yes. The proposal is flexible and will allow the Commission to adjust the amount of FAC recovery if any cost is disallowed as the result of a prudence review. As I mentioned earlier, the accounting procedures used by Empire will involve an audit trail that should facilitate the audit process associated with those periodic prudence reviews.

Q. DOES THE ACCOUNTING AND BILLING PROCESS IN THE FAC PROPOSAL ENABLE EMPIRE TO TRACK FAC REVENUES AS A DISCRETE REVENUE STREAM?

A. Yes. FAC revenue have been and will continue to be billed as a separate line item on each customer's bill and the FAC revenue will continue to be segregated on the Empire books and records to facilitate the accounting and audit process.

Q. HAVE EMPIRE'S CUSTOMERS BEEN NOTIFIED OF THE REQUEST TO CONTINUE THE FAC?

A. Yes. In addition, to the normal notice requirements for a general rate filing, Empire has prepared a notice that describes the request to continue the FAC. I have attached an exemplar copy of this notice as Schedule WSK-7.

Q. PLEASE DESCRIBE HOW THE FAC WORKS.

A. A copy of the existing FAC tariff is attached to my direct testimony as Schedule WSK-5. As shown on that schedule, the application of the tariff involves the accumulation of actual Missouri jurisdictional energy costs over a six-month period, comparing that cost accumulation to the base cost of energy built into the Missouri jurisdictional rates and then determining the amount of over/under recovery of energy costs. Ninety-five percent (95%) of this over/under recovery balance is then billed/credited to the Missouri retail customers over a six-month billing period that immediately follows the six-month accumulation period. In addition, 95 percent of the actual Missouri jurisdictional off-system sales are flowed through the FAC as well as the Missouri jurisdictional portion of REC sales. As outlined in Schedule WSK-5, the first six-month accumulation period is September through February and the recovery or billing period associated with this accumulation period is the following June through November. The process in the FAC involves changing the energy cost recovery factor twice each year, once in June, the beginning of the summer season, and again in December, the beginning of the winter season. Empire has filed for three energy cost recovery changes under the FAC, one in April of 2009, the second in October of 2009 and the third in April of 2010.

Q. DO THE ENERGY COSTS ELIGIBLE FOR RECOVERY THROUGH THE EXISTING FAC INCLUDE THE COSTS AND/OR BENEFITS

ASSOCIATED WITH EMPIRE'S FUEL RISK MANAGEMENT (HEDGING) PROGRAM?

A. Yes. As indicated on Schedule WSK-5, the costs eligible for recovery through the tariff include Empire's fuel risk management costs, which are recorded in FERC accounts 501, 547 and 555.

Q. **WHAT IS THE TIMING OF THE SEMI-ANNUAL FAC FILINGS IN THE FAC TARIFF?**

A. The existing tariff incorporates the following timing of actions:

- Filing for a change in the cost adjustment factor ("CAF") on April 1st and October 1st each year;
- Staff recommendation on the filed CAF by May 1st and November 1st each year;
- Commission Approval of the CAF by June 1st and December 1st or CAF as filed is allowed to go into effect on June 1st and December 1st each year.

Q. **IS THE TIMING OF THESE ACTIONS IN ACCORDANCE WITH THE COMMISSION'S RULES GOVERNING THE FILING OF PERIODIC ADJUSTMENTS TO THE FAC?**

A. Yes. The Staff has thirty days from the date of a CAF filing to make its recommendation and the Commission has sixty days from the CAF filing date in which it can render a decision concerning the cost recovery factor or allow it to go into effect by operation of law.

Q. **HOW DOES THE TRUE-UP OF ENERGY COST RECOVERY TAKE PLACE AND HOW ARE PRUDENCE REVIEWS SCHEDULED**

ACCORDING TO THE EXISTING FAC TARIFF?

A. The true-up of energy costs and their recovery takes place every six months. The exact timing of the prudence review has not been explicitly set out in the tariff, due to the consultation that needs to be taken with the Commission staff concerning the scheduling of the prudence reviews associated with other Missouri electric utilities using an FAC. The proposed FAC tariff specifies that prudence reviews will take place no less than every eighteen (18) months. The Staff of the Commission has completed its initial prudence review of Empire's first year of energy costs under the existing Empire FAC and recommended no cost disallowances. The Commission agreed with the Staff's recommendations.

Q. DOES THE FAC INCLUDE ANY EXPLICIT INCENTIVE MEASURES?

A. Yes. As I mentioned earlier, Empire's Missouri FAC limits Empire's recovery of energy cost changes to 95 percent of the overall change in energy costs. This means that Empire retains 5% of any decrease in energy costs during the accumulation period or absorbs 5% of any increase in energy costs during the accumulation period. This incentive feature in Empire's FAC has been adopted by the Commission in FAC's approved for other Missouri electric utilities as well.

Q. DOES THE EXISTING FAC INCLUDE ANY RATE VOLATILITY MITIGATION FEATURES?

A. Yes, the energy cost changes that occur during the accumulation period will be spread over six months. This feature will fix the FAC component of a customer's bill for six months and will tend to smooth out energy price volatility.

Q. HAS EMPIRE CONDUCTED ANY HEAT RATE TESTING ON ITS GENERATION UNITS DURING THE TEST YEAR?

A. Yes. Empire witness Blake Mertens discusses the unit heat rate testing that Empire has performed recently.

Q. DO YOUR RESPONSES TO THE INFORMATION REQUIRED BY 4 CSR 240.3.161 (3) FILED IN THIS CASE DIFFER FROM THE INFORMATION FILED IN RESPONSE TO THE INFORMATION AND RESPONSES REQUIRED BY 4 CSR 240.3.161 (2)?

A. Not materially, in the initial case authorizing the FAC some of the information Empire submitted dealt with the FAC tariff proposed by Empire in Case No. ER-2008-0093. In this case, the FAC tariff is in existence so the responses and information requirements are tailored to meet the needs of the existing FAC.

FUEL PLANNING AND PROCUREMENT

Q. DOES EMPIRE HAVE PROCEDURES IN PLACE THAT ENSURE THAT ITS FUEL PURCHASING IS PRUDENT?

A. Yes it does. Empire plans it fuel procurement activity using long-term planning and maintains an active Risk Management Policy ("RMP").

Q. PLEASE DESCRIBE EMPIRE'S RMP.

A. Empire implemented its RMP in 2001 to manage natural gas price volatility. The RMP outlines the instruments that may be used to help manage volatility. In general terms, Empire's RMP allows the use of financial and physical transactions to help manage price volatility. In addition, the RMP establishes minimum quantities of natural gas in future calendar years that are required to be price protected by a certain date.

Q. DOES EMPIRE ALSO HAVE ACCESS TO OTHER SOURCES OF ELECTRIC ENERGY THAT CAN BE USED TO OFFSET NATURAL GAS PRICE VOLATILITY?

A. Yes. In addition to its coal fired generating units, Empire also owns and operates the Ozark Beach hydro facility. It has a capacity of about 16 MW and averages about 63,000 MWh's of output per year. The output of this unit is limited by the water released from Table Rock Lake and the level of water maintained on Bull Shoals Lake.

At the end of 2005, Empire began receiving electricity from the Elk River Wind Project owned by PPM Energy. Empire has a contractual commitment to purchase 100% of the output from this project for the next 20 years. Empire expects to receive about 550,000 MWh's per year from this project or about 10% of its overall energy supply. During the 12-month period ending June 30, 2010, Empire received slightly less than 10 percent or 512,307 Mwh of its overall energy supply via the contract with Elk River. The energy under this contract is purchased at a predetermined cost and is typically used to offset the energy from higher cost resources, such as those using natural gas. Empire also entered into an agreement with Cloud County Windfarm, LLC, owned by Horizon Wind Energy, to purchase all of the output from Meridian Way Wind Farm beginning about January 1, 2009. Empire anticipates purchasing approximately 350,000 megawatt-hours of energy under this contract annually. During the 12-month period ended June 30, 2010, Empire purchased around 244,441 Mwh from this wind farm or over 4 percent of our customers energy requirements.

Q. HOW DOES EMPIRE ACQUIRE THE FUEL AND PURCHASED POWER USED TO SUPPLY ELECTRICITY TO ITS CUSTOMERS?

A. Empire's fuel and purchased power acquisition planning is performed using a three-step process. The steps in this process are:

- Long-term Integrated Resource Plan ("IRP");
- An annual and five-year business plan;
- Updates to the annual and five-year business plans as conditions change.

Q. PLEASE DESCRIBE THE IRP PROCESS.

A. Empire utilizes the IRP process to develop a long-term strategy to reliably serve its customers at the lowest possible cost. This planning process uses Empire's entire load in all five of its jurisdictions. This formal IRP process has been in place since the early 1990's when Missouri implemented a formal IRP rule. Since that time Oklahoma and Arkansas also have implemented IRP rules. Empire has thus far been allowed to use the IRP developed for filing in Missouri as the basis for the IRP filings in Oklahoma and Arkansas. The IRP process that Empire uses results in a target list of future resources designed to serve Empire's projected usage and customer levels in all jurisdictions. The resource plan selected by Empire as a result of this process includes base load, intermediate, and peaking resources using a mix of fuels from coal to natural gas and renewable resources. Demand-side management programs are also considered as potential resources as part of the IRP process. Empire filed its latest IRP in Missouri on September 3, 2010.

Q. HOW DOES THE SECOND STEP OF THE PLANNING PROCESS WORK?

A. In addition to the long range planning, Empire conducts annual financial and operational planning, which is used to develop a five-year business forecast. This planning process includes detailed load forecast, detailed generation unit modeling, detailed O&M and capital budget planning, and revenue forecast. This plan is used to assess many things including the ability to raise capital, debt and equity, and the near term impact on the overall cost of service. The detailed generation unit modeling developed in this phase of the planning process is used as the primary source of information for the development of the fuel and purchased power procurement plan.

Q. ARE THE ANNUAL AND FIVE-YEAR BUSINESS PLANS ADJUSTED TO REFLECT CHANGES IN THE BUSINESS ENVIRONMENT?

A. Yes. The annual and five-year business plans are periodically refined to take into account changes that have occurred since the plans were initially developed. Empire takes into account changes in such things, as load growth, weather, the number of customers, fuel prices, purchased power prices, rail transportation delays, and fuel availability. As these refinements are made to the near term forecasts, Empire adjusts its fuel procurement plans as necessary.

Q. IS THE EXISTING FAC DESIGNED TO PRODUCE A DIFFERENT COST ADJUSTMENT FACTOR ("CAF") FOR DIFFERENT VOLTAGE

LEVELS?

A. Yes. The FAC includes a feature that reduces the cost adjustment factor to those customers taking service at primary voltage or higher. The existing expansion factors were based upon the information coming from the periodic line loss studies performed by the Company.

Q. WHAT BENEFITS DO YOU SEE ASSOCIATED WITH THE CONTINUED USE OF THE EXISTING EMPIRE FAC?

A. I believe the benefits are significant for all of the stakeholders. First, Empire benefits by being able to recover almost all of its actual fuel and energy costs through the FAC. This strengthens Empire's financial profile and enhances its ability to attract the financing necessary to meet its customers' needs at the best rates possible. In addition, the need to file general rate cases for the purpose of recovering ongoing fuel and energy costs in base electric rates has essentially been eliminated. Over time, this will reduce the overall number of electric rate cases in Missouri. A reduction in the number of general rate cases will ultimately lower Empire's regulatory costs and ultimately the cost to serve Empire's Missouri customers.

Q. HOW WILL THE COMMISSION BENEFIT?

A. The Commission will benefit in a couple of ways. First, the number of rate cases will decline as fuel and energy costs no longer drive the filing of rate cases. The result is an FAC process that is ultimately fair to all sides. The utility will collect its actual cost of fuel and energy, and the customer will pay for no more than the actual, prudently incurred fuel and energy cost. The customer will benefit automatically if prices decline. In addition, the FAC rule enacted by the Commission includes an enhanced surveillance reporting requirement that enables the Staff and OPC to track overall earnings trends of the utilities using an FAC and guard against excessive utility earnings.

Q. HOW DOES THE FAC BENEFIT THE CUSTOMER?

A. In the long run the customer will benefit from the implementation of a properly designed FAC. The customer will only reimburse Empire for the actual cost of fuel and energy, not an estimate of future energy costs. Thus, there is no over or under reimbursement of cost. Empire also has a stronger financial profile and an enhanced ability to attract the capital necessary to operate its utility system at the best rates possible. Ultimately, this will lower the cost of operations from where it would have been without the FAC. Over the long run, the reduction in the number of general rate proceedings and the lower financing costs will lower Empire's cost of doing business and lower the electric rates it needs to charge to operate the system from what it otherwise would be without the FAC. In addition, the FAC conveys a more accurate cost of electric energy to Empire's customers. If energy costs escalate the customer will know within six months and will be in a position to make an informed decision concerning any energy efficiency measures that could be implemented in an effort to lower consumption. The fixed energy pricing system that Missouri used prior to the FAC tended to shield the customer from the true cost of electric energy, and in my mind hampered the customers' adoption of or participation in energy efficiency programs. When the customer can purchase his electric energy at rates lower than the cost of producing it, the true economics are concealed and the customer will have a much harder time deciding between adding additional insulation to the house versus turning up the thermostat.

TRUE-UP

Q. IS EMPIRE REQUESTING A TRUE-UP IN THIS CASE?

A. Yes. Empire is requesting that the financial information be updated as of December 31, 2010.

Q. WHAT IS THE PURPOSE OF A TRUE-UP?

A. The true-up will enable all of the parties to the proceeding to use financial information that is closer to the effective date of the new tariffs that will become effective as part of this rate case. All of the major components used to develop the new revenue requirement should be updated, including rate base, operating revenues and operating expenses.

Q. WHAT AREAS OF THE EMPIRE REVENUE REQUIREMENT SHOULD BE UPDATED THROUGH DECEMBER 31, 2010?

A. The revenue requirement should be updated to recognize all of the significant changes that have occurred through December 31, 2010. Among those areas where significant changes can occur are:

- Net Plant in Service
  - Including the investment in the Plum Point and Iatan units
- Revenue

- Payroll Cost including Benefits
- Depreciation
- Vegetation Management Costs

Q. IS THIS A COMPLETE LIST OF ALL OF THE ITEMS THAT MAY BE INVOLVED IN THE TRUE-UP?

A. No. Empire anticipates working with all of the parties that become involved in the rate case to develop a complete list of items that will be included in the true-up.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

LIST OF SCHEDULES

AFFIDAVIT OF W. SCOTT KEITH

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 21st day of September, 2010, before me appeared W. Scott Keith, to me personally known, who, being by me first duly sworn, states that he is the Director of Planning and Regulatory 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.

W. Scott Keith

W. Scott Keith

Subscribed and sworn to before me this 21st day of September, 2010.

Vicki L. Kramer-Gibson

Notary Public

My commission expires: 10-30-10.

VICKI L. KRAMER-GIBSON
Notary Public - Notary Seal
STATE OF MISSOURI
Jasper County - Comm#06482169
My Commission Expires Oct. 30, 2010