Exhibit No.:
Issue: Fuel Adjustment, Off-system Sales, Commission Rules Tracker, Regulatory Plan
Witness: W. Scott Keith
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2008-0093
Date Testimony Prepared: April 2008

Before the Public Service Commission

of the State of Missouri

Surrebuttal Testimony

of

W. Scott Keith

April 2008

****Denotes Highly Confidential****

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OF
W. SCOTT KEITH
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 Joplin Street, Joplin, Missouri.

POSITION

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

A. I am presently employed by The Empire District Electric Co. ("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. ARE YOU THE SAME W. SCOTT KEITH THAT EARLIER PREPARED AND FILED DIRECT AND REBUTTAL TESTIMONY IN THIS RATE CASE BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION") ON BEHALF OF EMPIRE?

A. Yes.

PURPOSE

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. My surrebuttal testimony will discuss issues that have been raised by several of the other parties in this case in their rebuttal testimony. Specifically, I will address the following:

- Components of the Southwest Power Pool's ("SPP") Energy Imbalance Service ("EIS") that should be included in the Fuel Adjustment Clause ("FAC")-Staff of the Missouri Public Service Commission ("Staff")
- Off-system Sales and the FAC-Staff and The Office of the Public Counsel ("OPC")
- Emission Costs/Revenue and FAC-Staff and OPC
- Vegetation and Infrastructure Tracker-Staff and OPC
- Depreciation/Regulatory Amortization-Staff

FUEL ADJUSTMENT CLAUSE AND ENERGY IMBALANCE CHARGES

Q. HAVE YOU REVIEWED THE FUEL ADJUSTMENT CLAUSE ("FAC") REBUTTAL POSITION TAKEN BY THE STAFF WITH RESPECT TO THE SPP'S EIS MARKET IN THIS CASE?

A. Yes. I reviewed the rebuttal testimony of Staff witness Mantel.

Q. DO YOU HAVE CONCERNS WITH THE EIS/FAC RECOMMENDATION MADE BY STAFF.

A. Yes.

Q. PLEASE DESCRIBE YOUR CONCERNS.

A. At page 4 of her rebuttal testimony, Staff witness Mantel recommends that two separate EIS charges or credits be included in the FAC. These charges/credits are related to the Daily EIS market settlements and the SPP Revenue Neutrality Uplift

("RNU"). Empire is concerned that this recommendation excludes several SPP charges that are directly related to the EIS market.

Q. PLEASE EXPLAIN.

A. Specifically, this Staff recommendation ignores the SPP charges related to Over/Under Scheduling Charges, Uninstructed Deviation Charges, Line Loss Charges, and other miscellaneous charges. Empire records each of these charges as a component of monthly purchased power cost in FERC account 555, and the exclusion of these charges from the FAC will contribute to an increase in the cost of tariff administration due to the maintenance of an ongoing reconciliation of differences between purchased power expenses on Empire's books and records and those expenses included in the Missouri FAC. In addition, the Over/Under Scheduling and Uninstructed Deviation Charges are directly related to SPP's EIS market, part of which Staff has recommended be included in the Missouri FAC. Each of the authorized SPP EIS market charges are displayed in the SPP tariff at tariff sheets 1040 through 1048 (Attachment AE). The following is a list of the SPP EIS charges/credits that are displayed on SPP's fifth revised tariff at Original Sheet No. 979:

Section	Description	Tariff Sheet
5	EIS Settlement Activities	Original Sheet No. 979
5.1	Calculation of EIS Market Settlement Quantities	Original Sheet No. 1040
5.2	Energy Imbalance Service Charges/Credits	Original Sheet No. 1042
5.3	Under Scheduling Charges	Original Sheet No. 1042
5.4	Over Scheduling Charges	Original Sheet No. 1044
5.5	Uninstructed Deviation Charges	Original Sheet No. 1047
5.6	Revenue Neutrality	Original Sheet No. 1048

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As indicated in the above table, the Staff's FAC/EIS proposal only refers to two of the five SPP charges that are directly related to the EIS market, 5.2 Energy Imbalance Service Charges/Credits and 5.6 Revenue Neutrality.

Q. WHAT DOES THE STAFF'S PROPOSAL ON THIS POINT DO TO THE STAFF'S OVERALL FAC/EIS RECOMMENDATION?

A. The exclusion of SPP charges directly related to the EIS market makes the Staff's FAC recommendation with respect to the EIS market inconsistent.

Q. WHAT IS YOUR CONCERN WITH THE EXCLUSION OF SPP CHARGES FOR LINE LOSSES AND MICELLANEOUS ITEMS FROM THE STAFF'S FAC RECOMMENDATION?

A. It is primarily related to ongoing tariff administration. While the charges Empire has incurred to date for line losses and miscellaneous items has been minor, the exclusion of these items would still necessitate an ongoing reconciliation between costs in the general ledger and those authorized for recovery in the Missouri FAC. In order to make the Missouri FAC tariff administration as efficient and straightforward as possible, Empire recommends that the following SPP charges be included for recovery in the FAC: EIS Charges/Credits, Under/Over Scheduling Charges, Uninstructed Deviation Charges, Revenue Neutrality Uplift, Losses and Miscellaneous Charges.

<u>**FAC AND OFF-SYSTEM SALES**</u>

Q. WHAT OTHER AREAS OF THE STAFF FAC REBUTTAL RECOMMENDATION ARE OF CONCERN TO EMPIRE?

A. At page 5 of Staff witness Mantel's rebuttal testimony, Staff recommends that a base level of off-system sales be included as a component of the FAC base, and that the actual off-system sales margins be reflected as a component of the FAC in future periods. In general Empire is not opposed to this treatment as long as the off-system sales margin included as a component of base rates in this case is used to reduce the base cost of energy in the FAC. This would mean that if in the future off-system sales margins do not exceed the base level established in this case, the average cost of energy would increase, all other FAC components remaining constant, and that the Missouri customers would see an increase in the FAC factor applied to their electric bills due to the decline in off-system sales activity.

Q. CAN YOU PROVIDE AN EXAMPLE OF HOW TO TAKE INTO ACCOUNT THE LEVEL OF OFF-SYSTEM SALES MARGINS IN THE DEVELOPMENT OF THE FAC BASE?

A. Yes. The following table includes the fuel and energy cost and off-system sales levels included in the Staff recommendation in this case. Empire has not contested the Staff's energy cost recommendation in this case. In addition, Empire has not contested the Staff's forecast of off-system sales in this case.

Description	Total Company	Incl. Pur Pwr Dmd Missouri Juris	Excl. Pur Pwr Dmd Missouri FAC Base
Fuel	$108,245,031		
Fuel Related	1,355,945		
Total Fuel	109,600,977	90,727,689	90,727,689
Purchase Power:			
Demand	16,193,520	13,435,764	
Energy	48,522,113	40,166,605	40,166,605
Total Pur. Pwr.	64,715,633	53,602,369	40,166,605
Total Fuel/Pur. Pwr	$174,316,610	$144,330,058	130,894,294
Less:			
Pur. Pwr-Demand	(16,193,520)		

Off-system Margin	(4,415,779)	(3,663,772)	(3,663,772)
Net Cost	$153,707,311	$140,666,286	$127,230,522
Mo. Mwh Sales		4,184,124	4,184,124
Mo. cost/Mwh		$33.62	$30.41

As indicated in the above table, the FAC average base cost of $30.41 per megawatt-hour includes the Missouri jurisdictional off-system sales margin reflected in the current case as a reduction in the base cost of energy built into the FAC. During the future application of the FAC tariff, the off-system sales margins actually earned will be used to reduce Empire's overall average energy cost. Variations in off-system sales margins from those established in this case will contribute to increases/decreases in the average energy cost actually passed on to the Missouri retail customers through the FAC.

Q. HAVE YOU REVIEWED THE REBUTTAL TESTIMONY OFFERED BY THE OPC ON OFF-SYSTEM SALES AND THE FAC?

A. Yes. The rebuttal testimony on this topic was sponsored by OPC witness Kind. Although OPC witness Kind is recommending that a higher level of off-system sales margin be used to establish base rates in this proceeding, he does recommend, at page 12 of his rebuttal testimony, that if the Commission authorizes the implementation of a FAC for Empire variations in off-system sales levels be reflected in the FAC.

Q. HOW DO YOU RESPOND?

A. The process I outlined in the above table will do just that. If the off-system sales levels continue at the levels sponsored by witness Kind at page 12 of his rebuttal testimony, $5.9 million, they will be reflected future FAC factors, and the Missouri

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jurisdictional portion of the sales will be flowed through to the Missouri customers. If the off-system sales levels sponsored by witness Kind do not reach the $5.9 million level due to the expiration of the contract with the Board of Public Utilities, then a lower level of off-system sales activity will be reflected in the FAC. By using the FAC to capture the actual benefits related to off-system sales, the need for the Commission to choose between competing off-system sales projections is greatly reduced as the actual off-system sales levels will ultimately be reflected in the customers' rates for electric service, not the forecast of off-system sales levels coming out of this case. This result is fair to both Empire and its customers.

Q. IF THE COMMISSION DECIDES TO EXCLUDE OFF-SYSTEM SALES FROM THE FAC, DO YOU AGREE WITH THE HIGHER LEVEL OF OFF-SYSTEM SALES LEVELS THAT OPC RECOMMENDS IN THIS CASE?

A. No. OPC witness Kind has recommended that the most recent year of off-system sales activity be used to set base rates in this case. In the event that the Commission decided to exclude off-system sales as a component of the FAC, this would mean that Empire base rates would reflect an unrealistically high level of margin based upon a single year of off-system sales activity.

Q. WAS THIS SAME ISSUE FULLY LITIGATED IN EMPIRE'S LAST RATE CASE, CASE NO. ER-2006-0315?

A. Yes. This same issue was fully litigated in the last rate case, and the Commission found that a five-year average of off-system sales activity was a reasonable way to estimate future off-system sales margins for the purpose of setting base rates. Interestingly, the OPC recommended the five-year average approach to this issue in the last rate case, and the Commission agreed with the OPC's recommendation.

Q. HOW DO YOU CHARACTERIZE THE USE OF A SINGLE YEAR OF OFF-SYSTEM SALES LEVELS TO PREDICT FUTURE OFF-SYSTEMS SALES?

A. It is unreasonable.

Q. WHY?

A. A single year of off-system sales is not an accurate prediction of what will occur the very next year. Empire's history in this area indicates that the margins produced by this activity can vary significantly from year to year. In addition, a substantial portion, around ** **, of the margin OPC will capture with its recommendation in this case is tied to a single bilateral contract for capacity that is scheduled to expire in September of 2008. Thus, a significant portion of the off-system sales margin in the OPC recommendation will be gone one month after the rates coming out of this rate case go into effect. Empire has no plans to replace this contract with another off-system sale of capacity in 2009. The growth in native system load is expected to use this capacity by 2009.

Q. HOW HAS THE OFF-SYSTEM SALES MARGIN VARIED OVER THE LAST FIVE YEARS?

A. During the five year period ending June 30, 2007, the off-system sales margins have varied from a low of $1.9 million to a high of $5.6 million. The following table displays the actual off-system sales margins for each of the twelve-month periods ending June 30.

Twelve Months Ended	Gross Profit (Margin)
June 30, 2003	$5,645,701
June 30, 2004	$2,023,298
June 30, 2005	$1,903,970
June 30, 2006	$3,798,127
June 30, 2007	$3,920,823

Q. DID THE STAFF USE A FIVE-YEAR AVERAGE OF OFF-SYSTEM SALES ACTIVITY TO ARRIVE AT ITS RECOMMENDATION FOR THIS ISSUE IN THE CURRENT CASE?

A. No. However, the Staff's overall off-system sales recommendation was close to the five-year average so Empire chose not to dispute the Staff's approach. If the impact of off-system sales is captured through the FAC, then the issues surrounding the method used to forecast off-system sales essentially goes away.

<u>FAC AND EMISSION COSTS</u>

Q. HAVE YOU REVIEWED THE STAFF AND OPC REBUTTAL TESTIMONY CONCERNING THE RECOVERY OF EMISSION COSTS THROUGH THE FAC?

A. Yes. Staff witness Mantel addresses this issue beginning at page 5 of her rebuttal testimony, and OPC witness Kind addresses this topic at page 10 of his rebuttal testimony. Staff proposes to include the net cost of emission allowances in the Empire FAC. OPC, on the other hand, recommends that the cost and revenue associated with emission allowances be excluded from the Empire FAC due to the Stipulation and Agreement reached in Case No. EO-2005-0263.

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Q. DO YOU AGREE WITH STAFF'S RECOMMENDATION THAT EMISSION COSTS NET OF ANY REVENUE EARNED FROM THE SALE OF ALLOWANCES BE INCLUDED IN EMPIRE'S FAC?

A. Yes. As Staff witness Mantel has noted at page 5 of her rebuttal testimony, this would make Empire's FAC in this area consistent with the FAC authorized for Aquila, Inc. Consistency in the FAC treatment between the various Missouri jurisdictional utilities is, in general, good for all of the stakeholders in the process, the customers, Staff, OPC, Commission and utilities. In addition, as noted by Staff witness Mantel, emission costs can vary with the amount of coal consumed and the market prices of the allowances themselves. This makes these types of costs a good fit with the fuel adjustment mechanism in Missouri.

Q. DO YOU AGREE WITH THE OPC'S RECOMMENDATION TO EXCLUDE EMISSION ALLOWANCE COST AND ALLOWANCE REVENUE FROM THE FAC?

A. No. OPC witness Kind, at page 10 of his rebuttal testimony, cites language from the stipulation in Case No. EO-2005-0263 concerning emission allowance revenue and rate base treatment as support to exclude both the cost of emission allowances and revenue associated with the sale of emission allowances from the FAC. In fact, the language cited by OPC witness Kind does not support any sort of exclusion related to the cost of emission allowances from the FAC. The language cited by OPC is related to a specific method of emission revenue accounting until a Commission decision is reached concerning the accounting for this revenue in a

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future rate case. Once the Commission reaches a decision regarding this revenue stream in a rate case the accounting method specified in the stipulation can be changed. In fact, the flow through of the revenue associated with emission allowance sales through the FAC, as recommended by Staff, is a specific accounting recommendation that, if accepted by the Commission, will supersede the temporary accounting method outlined in Case No. EO-2005-0263.

COMMISSION RULES TRACKER

Q. HAVE YOU REVIEWED THE REBUTTAL TESTIMONY FILED BY THE STAFF AND OPC CONCERNING THE IMPLEMENTATION OF A MECHANISM THAT WOULD GIVE EMPIRE A REASONABLE OPPORTUNITY TO RECOVER THE INCREMENTAL COSTS ASSOCIATED WITH THE NEW COMMISSION RULES ON VEGETATION AND INFRASTURCTURE MANAGEMENT?

A. Yes. I reviewed the rebuttal testimony of Staff witness Oligschlaeger and OPC witness Robertson that was filed in this case.

Q. DO YOU AGREE WITH THE RECOMMENDATION MADE BY STAFF?

A. For the most part I agree with the recommendation made by Staff witness Oligschlaeger, but I suggest that a couple of changes be made to his recommendation to facilitate Empire's implementation of the Commission's new rules on vegetation and infrastructure management.

Q. PLEASE GENERALLY DESCRIBE THE MAJOR POINTS OF STAFF'S TRACKER RECOMMENDATION AS YOU UNDERSTAND THEM.

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A. Mr. Oligschlaeger outlines the Staff proposal in this area at pages 9 through 10 of his rebuttal testimony. Basically, Staff recommends that the total Empire revenue requirement in this case be increased by $5.5 million to assist Empire in becoming compliant with the new Commission rules as soon as possible. The additional $5.5 million represents a total cost to Empire, and the direct impact on Missouri electric rates in this case would be approximately $5.0 million. Empire's actual expenditures in this area would be tracked and any shortfall in expenditures would roll over and add to the required expenditures in this area for the next year. In addition, Empire would be required to record an interest component on any expenditure shortfall and spend it on vegetation and infrastructure maintenance the following year. There is no mechanism in the Staff proposal to defer any expenditure that Empire may have in this area that exceed the cap of $5.5 million. Finally, the Staff proposal has coupled the $5.5 million for compliance with the Commission rule with ongoing total Company tree trimming expenses of $6.8 million, and also would require Empire to track expenditures in both areas - Rule compliance and ongoing tree trimming - against an overall expenditure cap of $12.3 million.

Q. WHAT IS EMPIRE'S RESPONSE TO THIS STAFF RECOMMENDATION?

A. First, Empire notes that the Staff recommendation in this area is all outlined in terms of total Company cost and not Missouri jurisdictional cost. Missouri customers do not pay for 100 percent of Empire's cost in this area, so the interest

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provision recommended by Staff should only apply to Missouri jurisdictional costs. Furthermore, it will take some time to implement the new processes and procedures required to comply with the Commission's new rules in this area, and annual expenditures may not immediately hit the levels envisioned in the Staff proposal, $12.8 million. The lower expenditure levels would trigger the interest calculation under the Staff recommendation.

Q. WHAT CHANGES TO THE STAFF RECOMMENDATION DOES EMPIRE SUGGEST?

A. Because Empire will be before the Commission with another rate case two years from now, and the expenditure targets in this area can be revisited at that time, we recommend that the overall annual expenditure target be initially set at $9.9 million on a total Company basis. This equals $8.9 million on a Missouri jurisdictional basis and consists of $6.1 million for ongoing tree trimming and $2.8 million for compliance with the new Commission rules on vegetation and infrastructure management. If Missouri jurisdictional expenditures in the combined areas did not reach $8.9 million, then in the following year Empire would agree to spend $8.9 million plus the shortfall in expenditures from the prior year, including an interest component calculated using the Company's short-term interest rate. Other than reducing the near term expenditure target in these areas to a lower level and outlining the Missouri jurisdictional amounts, this proposal is very similar to the recommendation outlined by Mr. Oligschlaeger at page 10 of his rebuttal testimony. In addition to the changes suggested above, Empire recommends that if actual

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Missouri jurisdictional expenditures exceed $8.9 million in these areas that Empire be authorized to record these costs as a regulatory asset until it can be considered for recovery in the rate case that is scheduled to be filed in late 2009. As part of its recommendation, Empire has not requested that it be allowed to record any interest on any expenditure in excess of the annual Missouri jurisdictional target of $8.9 million.

Q. HOW DOES YOUR PROPOSAL IN THIS AREA AFFECT THE OVERALL MISSOURI JURISDICTIONAL REVENUE REQUIREMENT IN THIS CASE?

A. It would increase the current revenue requirement by $2.8 million annually. In addition, since the regulatory asset treatment is confined to expenditures that are in excess of the specific expenditure target, the potential impact on future rate base issues is minimal.

Q. DO THE COMMISSION'S NEW RULES ON VEGETATION AND INFRASTURCTURE MANAGEMENT INCLUDE REFERENCE TO DEFERRED ACCOUNTING TREATMENT OR A TRACKING MECHANISM TO ENABLE THE UTILITIES AN OPPORTUNITY TO RECOVER THE COSTS ASSOCIATED WITH THE NEW RULES?

A. Yes. For example, at paragraph (4) of the new rule on infrastructure standards, the rule indicates that a utility may submit a request to the Commission regarding the deferral and tracking of the additional costs associated with the rule. I believe the tracking/deferral mechanism Empire has proposed in this area is compatible with

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the cost recovery procedures envisioned in the Commission's new rules.

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE OPC REBUTTAL TESTIMONY RELATED TO VEGETATION AND INFRASTRUCTURE MANAGEMENT COST AND COMPLIANCE?

A. The rebuttal testimony in this area was provided by OPC witness Robertson, and Mr. Robertson' rebuttal was focused on Empire's original proposal, which was more of a traditional request to defer the costs associated with the new rules, not the tracking mechanism proposed by the Staff in its rebuttal testimony. Mr. Robertson recommended that the Commission not address the cost of complying with the new rules as part of this rate case.

Q. DO YOU AGREE WITH THE OPC'S RECOMMENDATION IN THIS AREA?

A. No. There is no better time than a rate case for the Commission to take on this issue, and given the timing of the new rules (this summer); the issue is ripe for decision in this Empire rate case. There is no doubt that the Commission's new rules on vegetation and infrastructure management will result in cost increases for Empire, and the alternative proposal I have outlined above will ensure that the Missouri customers only pay for the actual costs associated with the Commission's rule, nothing more. The cost concerns noted by Mr. Robertson at page 6 of his rebuttal testimony have been addressed by this alternative tracking proposal.

<u>**REGULATORY AMORTIZATION/DEPRECIATION**</u>

Q. HAVE YOU REVIEWED THE REBUTTAL TESTIMONY OF STAFF

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WITNESS SCHAD CONCERNING DEPRECIATION VERSUS REGULATORY AMORTIZATION?

A. Yes. At pages 2 and 3 of her rebuttal testimony, Ms. Schad recommends that Empire's depreciation rates not be changed at this time due to the Regulatory Plan and the related Regulatory Amortization. In support of this position Ms. Schad cites a Commission order in Case No. ER-2006-0314.

Q. DO YOU AGREE WITH MS. SCHAD'S RECOMMENDATION IN THIS AREA?

A. No. The Regulatory Amortization calculation agreed to in Case No. EO-2005-0263 was not designed as a substitute for legitimate cost recovery. It was designed to address credit metric shortfalls during the construction of Iatan 2, not recovery of costs that are part of the traditional revenue requirement. Moreover, the Regulatory Amortization calculation is made after the determination of the traditional revenue requirement, and the development of ongoing depreciation rates for existing plant in service are a normal part of this process, and in fact the Commission's own rules require the filing of periodic depreciation studies. The use of regulatory amortization to recover costs that are part of the Company's traditional ongoing cost of service represents a mishandling of the funds coming from the Regulatory Plan, and in this case, given the recommendation of our depreciation consultant Mr. Roff, overstates Empire's Regulatory Amortization requirement.

Q. DOES THE STIPULATION AND AGREEMENT ("S&A") REACHED IN CASE NO. EO-2005-0263 INCLUDE A PROHIBITION ON CHANGING

DEPRECIATION RATES BETWEEN 2005 AND 2010?

A. No. In fact, the S&A contains specific language that indicates any of the parties to the S&A can request changes in depreciation rates during the duration of the Regulatory Plan.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.