Exhibit No.:
Issue: Accounting Schedules, True-up period and Fuel Adjustment
Witness: W. Scott Keith
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Electric
Case No.
Date Testimony Prepared: October 2007

Before the Public Service Commission of the State of Missouri

Direct Testimony

of

W. Scott Keith

October 2007

TABLE OF CONTENTS
OF
W. SCOTT KEITH
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY
OF
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<u>INTRODUCTION</u>

Q. STATE YOUR NAME AND ADDRESS PLEASE.

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

<u>POSITION</u>

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. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND FOR THE COMMISSION.

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 of 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 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 included in this filing, which support the Company's proposed rate increase. In addition, I will describe the Company's fuel adjustment clause ("FAC") proposal, proposal to implement a tracking mechanism to recover the incremental cost associated with the implementation of new Commission vegetation management rule and discuss the Company's proposed "True-up" period.

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 are based on the twelve months ending June 30, 2007, adjusted for known and measurable changes.

SUPPORTING SCHEDULES

Q. WHAT SCHEDULES ARE YOU SPONSORING?

A. I am sponsoring the following portions of the filing:

- Section C, Schedule 1, Comparative and Summary Information
- Section D, Schedule 1, Rate Base and Rate of Return
- Section E, Schedule 1, Electric Plant in Service by Primary Plant Account

- Section F, Schedule 1, Accumulated Provision for Depreciation of Electric Plant in Service
- Section G, Schedule 1, Page 1, Working Capital
- Section G, Schedule 1, Page 2, Materials and Supplies without Adjustments
- Section G, Schedule 1, Page 3, Prepayments with Adjustments
- Section G, Schedule 1, Page 4, Prepaid Interest
- Section G, Schedule 2, Cash Working Capital
- Section G, Schedule 3, Page 1, Income Tax Gross-up Factor
- Section G, Schedule 3, Page 2, Income Tax Lag
- Section G, Schedule 3, Page 3, Interest Expense Lag Calculation
- Section G, Schedule 3, Page 4, Calculation of Interest Offset and Income Tax Offset
- Section H, Schedule 1, Capital Structure
- Section H, Schedule 2, Preferred Capital Stock
- Section H, Schedule 3, Long Term Debt
- Section H, Schedule 8, Capital Costs
- Section J, Schedule 1, Test-Year Utility Operating Income Statements and Adjustments
- Section J, Schedule 2, Explanation of Adjustments to Test-Year Revenues and Expenses
- Section K, Schedule 1, Depreciation Rates and Accruals
- Section K, Schedule 2, Page 1, Normalized Depreciation Expense

- Section K, Schedule 2, Page 4, Summary of Depreciation and Amortization
- Section L, Schedule 1, Taxes Charged to Electric Operations
- Section L, Schedule 2, Page 1, Calculation of Provision for Income Taxes Payable for Twelve Months Ended June 30, 2007
- Section L, Schedule 2, Page 2, Calculation of Deferred Income Taxes for Twelve Months Ended June 30, 2007
- Section M, Schedule 1, Jurisdictional Allocation of Property and Expenses
- Section M, Schedule 2, Page 1, Jurisdictional Allocation of Rate Base
- Section M, Schedule 2, Page 4, Jurisdictional Allocation of Revenue and Expenses

Q. WERE THESE SCHEDULES PREPARED UNDER YOUR SUPERVISION AND DIRECTION?

A. Yes, they were.

Q. PLEASE DESCRIBE SECTION C, SCHEDULE 1.

A. Section C, Schedule 1 is a summary of certain key data for the test year and comparison of this data with similar data from Empire's most recent electric rate case, Case No. ER-2006-0315. As indicated, Empire is requesting an increase of $34.7 million in Missouri jurisdictional revenue, or 10.1 percent above current rate revenues, in this rate case. This increase will result in an overall rate of return of 9.36 percent and a return on equity of 11.6 percent. By far the biggest factor driving the rate case is the increase in investment in production plant at Riverton and Asbury that has taken place since the last rate case. In addition, this rate case includes a request for recovery of the expenses the Company incurred as a result of the massive ice storm in early 2007. The increase in production plant investment is associated with the completion of a new generating unit at Riverton, Unit 12 and the installation of Selective Catalytic Reduction ("SCR") at our Asbury generating unit. The investment in the new unit at Riverton totaled around $40 million and the investment associated with the SCR at Asbury is expected to be $31 million. In addition to the major investment in production facilities the Company made in 2007, the Company was forced to make an investment in new transmission and distribution facilities of in excess of $19 million as a result of the ice storm that hit Empire's service area in January 2007. The Company also continues to make substantial investments in the construction of new coal fired generating stations, Iatan II and Plum Point. As of the end of the test year the investment in these two projects was $61.8 million. Finally, the Commission's rules require the Company to file a general rate case when the Company requests the implementation of a fuel adjustment clause, 4 CSR 240-3.161, and Empire is seeking to implement an FAC mechanism as part of this rate case.

Q. PLEASE DESCRIBE SECTION D, SCHEDULE 1, RATE BASE AND RATE OF RETURN.

A. Section D, Schedule 1 details the Company's electric rate base and rate of return before and after the proposed rate increase. For the test year ending June 30, 2007, end of period balances are used for electric plant in service and reserve for depreciation, adjusted for the addition of the SCR at Asbury. Materials and supplies and prepayments are the average of the thirteen consecutive month-end balances ending June 30, 2007. Regulatory assets adjusted for known and measurable changes were included. This includes a regulatory asset for the 2007 Ice Storm expenses. 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 Section D, Schedule 1. These include: deferred income taxes, Investment Tax Credit balances pre-1971, customer deposits, customer advances, interest synchronization offset, and an income tax offset.

The total original cost electric rate base is $733,148,974 (Line 14) which is multiplied by the required rate of return of 9.36% to arrive at an after tax operating income requirement of $68,622,744 (Line 20). This operating income requirement is subtracted from the Company's adjusted operating income of $47,228,069 (Line 15) and results in the after tax operating income deficiency of $21,394,675 (Line 17) or the pre-tax revenue deficiency of $34,725,203 (Line 19) which was requested in the filing with the Commission.

Q. PLEASE DESCRIBE SECTION E, SCHEDULE 1, ELECTRIC PLANT IN SERVICE BY PRIMARY PLANT ACCOUNT.

A. Section E, Schedule 1, Pages 1 and 2 display by classified functional electric plant in service groups, the original cost of electric plant used and useful at June 30, 2006 and 2007. Total electric plant in service at June 30, 2007, is $1,403,936,496 (Column E) and $1,205,543,927 for the portion representing Empire's Missouri retail jurisdiction (Column F). This balance includes an adjustment to include the new SCR at the Asbury generating station that is scheduled to be completed and go into service in November 2007. This adjustment is displayed in column D. In addition, column D displays the adjustment made to reflect the allocation of common plant to the Empire District Gas Company of $1,697,159.

Q. PLEASE DESCRIBE SECTION F, SCHEDULE 1.

A. Section F, Schedule 1 is a statement of accumulated provision for depreciation of electric plant in service showing balances by functional plant groups at June 30, 2006 and 2007. The total accumulated provision for depreciation of electric plant in service at the end of the test year is $501,225,243 (Column E) and $432,592,741 for our Missouri jurisdiction (Column F). These balances have been adjusted to reflect the impact of the ice storm ($1,887,636) and the allocation of common general plant to the Empire District Gas Company ($787,144). Both of these adjustments are displayed in Column D.

Q. PLEASE EXPLAIN SECTION G, SCHEDULE 1 THROUGH SCHEDULE 3.

A. Section G, Schedule 1 computes test year amounts of materials and supplies using a 13-month average. Prepayments are also calculated based on a 13-month average. Section G, Schedule 2 computes projected cash working capital for the twelve months ended June 30, 2007. The expense and revenue lag for each component is the same as used by the Staff in the most recent Empire electric rate case, Case No. ER-2006-0315. The computation, using normalized test year expenses and revenues, results in a cash working capital requirement of $3,668,671. Section G, Schedule 3 calculates the Company's income tax gross-up factor as well as cash working capital associated with income taxes and interest expense. In addition, the calculations are shown for interest and income tax offsets to rate base.

Q. PLEASE DESCRIBE SECTION H, SCHEDULE 1.

A. Section H, Schedule 1 displays a summary of the capital structure of the Company as of June 30, 2007 and an adjusted capital structure using 51.31 percent equity, 44.15 percent long-term debt and 4.53 percent Trust Preferred Securities. The adjusted capital structure includes the impact of the capital market transactions that are scheduled to take place prior to the end of calendar year 2007. The return on common equity has been set at 11.6 percent which is proposed by Empire witness Dr. James H. Vander Weide. Based on an 11.6 percent return on equity and the Company's adjusted capital structure, the Company's overall requested return on rate base is 9.36 percent.

Q. PLEASE DESCRIBE SECTION H, SCHEDULE 2.

A. Section H, Schedule 2 lists the Company's trust preferred stock, which was issued March 1, 2001.

Q. PLEASE EXPLAIN SECTION H, SCHEDULE 3.

A. Section H, Schedule 3 lists each series of the Company's first mortgage bonds outstanding along with any associated unamortized expense, discount and premium at June 30, 2007.

Q. WHAT IS CONTAINED IN SECTION H, SCHEDULE 4?

A. Section H, Schedule 4, details Empire's capital structure for first mortgage bonds and trust preferred securities. It shows an embedded rate of 6.81 percent for first mortgage bonds. The rate for the trust preferred series is 8.89 percent.

Q. PLEASE DECRIBE SECTION J, SCHEDULE 1.

A. Section J, Schedule 1 is a test year income statement with adjustments to normalize test year electric operations. Column A reflects total Company results for the twelve months ending June 30, 2007. Column B summarizes adjustments to total

Company electric operations. Column C is the total Company income statement as adjusted for purposes of this rate case. Column D reflects the as recorded Missouri jurisdictional results for twelve months ending June 30, 2007. Column E displays the Missouri jurisdictional electric operating statement adjustments and Column F summarizes the as adjusted Missouri jurisdictional income statement. As indicated, after the posting of the various adjustments to the Missouri jurisdictional operations, the current rates are expected to produce $47,228,069 in Net Operating Income ("NOI") or an overall return on rate base of 6.44 percent.

Q. PLEASE DISCUSS SECTION J, SCHEDULE 2.

A. Section J, Schedule 2 summarizes the following adjustments to the electric operations test year amounts as shown on Section J, Schedule 1: Total Company and Missouri revenues are adjusted to reflect customer numbers at June 30, 2007, normal weather for the test year, to exclude water related revenues, to eliminate a discount given to a large industrial customer, to annualize excess facilities revenue, to reclassify the gain associated with the sale of emission allowances, eliminate the impact of franchise fees and to reflect a full year of the rate increase granted by the Commission in ER-2006-0315. In addition, off-system sales revenue has been adjusted to reflect a five-year average. The year-end customer adjustment annualizes the revenues to reflect what would have been received if the year-end level of customers had been served by the Company for the entire test year. Mr. Mark Quan of Itron will describe the weather normalization adjustment in greater detail in his direct testimony and Ms. Jayna Long of Empire will explain the retail revenue adjustments in greater detail in her direct testimony including the process used to adjust the Missouri jurisdictional sales for customer growth and weather.

ADJUSTMENTS TO COST OF SERVICE

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO EXPENSES.

A. Total Company production costs have been increased by $15,540,804 which factors down to $12,855,204 for the Missouri retail jurisdiction. Included in this total are several adjustments related to the normalization of production operating and maintenance related to Asbury and Riverton 12 for $3,096,430 and Operating Plant Service Agreement ("OPSA") amortization of $151,484. Empire witness Mr. Mertens will explain these adjustments in detail in his testimony. Also included is an adjustment to normalize test year payroll costs. This adjustment increases the pro forma production expense for the Company by a total of $285,100 with $235,646 related to the Missouri jurisdictional portion of production expenses. The adjusted payroll expense included in the filing reflects the wages at June 28, 2007, adjusted for known changes, positions that are currently authorized but unfilled and the union increase that will occur in October 2007. Fuel and purchased power costs have been normalized to reflect customer growth, weather, and future fuel and energy prices. Mr. Tarter will discuss this adjustment in greater detail in his direct testimony. The fuel and purchased power energy adjustment resulted in an increase in total production expense of $12,007,791 with $9,924,906 attributable to the Company's Missouri jurisdictional operations. As I noted at the outset, the fuel and energy costs are an important part of this rate case due to our request to implement an FAC. In total, Empire's fuel and purchased power expenses represent the most significant operating costs that Empire faces. These two expense categories represent approximately 64 percent of total operating expenses on an as adjusted basis.

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

A. The Missouri jurisdictional transmission expenses were increased by $37,500 to reflect the annualized payroll costs.

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

A. Missouri jurisdictional distribution expenses were increased by $189,644 to reflect the annualized payroll costs. In addition, the distribution expenses were adjusted to reflect Empire's request for a five-year amortization of the expenses related to the January 2007 ice storm. The adjustment related to Empire's ice storm amortization proposal was a reduction to distribution expense of $2,058,623 on a total company basis and a reduction in distribution expenses of 1,847,899 on a Missouri jurisdictional basis.

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 of $83,401. In addition, Missouri jurisdictional customer accounts expense was increased to reflect the recent increase in postage costs of $36,850.

Q PLEASE DESCRIBE THE ADJUSTMENT 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. Specifically, Missouri jurisdictional customer assistance was increased by $20,948 and Missouri jurisdictional sales expense was increased by $5,688. In addition, the Customer assistance operating expenses have been adjusted to annualize the cost and accounting treatment associated with Empire's currently authorized demand-side management programs and the changes requested in the current Experimental Low Income Program ("ELIP"). The adjustment related to DSM and ELIP is a reduction in operating expenses of $296,201. Empire witness Ms. 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 decreased by a total of $1,069,689 through a series of ten (10) adjustments. Of the total, $96,311 was associated with decrease in 401(k) costs. In addition, the ongoing FAS 87 and FAS 106 costs based upon the tracking accounting agreed to in the last rate case resulted in a decrease in Missouri jurisdictional costs of $1,777,899. The method used to calculate the adjustments for FAS 87 and FAS 106 are discussed in the direct testimony of Empire witness Ms. Delano. Common stock expenses were amortized over three years resulting in an increase in Missouri expenses of $900,657. Missouri jurisdictional administrative and general expenses have been increased by $167,945 to reflect adjusted payroll expense. Missouri jurisdictional administrative and general expenses were increased by $55,328 to reflect the current level of the Commission's annual assessment. Missouri jurisdictional outside services expenses were increased $8,990 to reflect the impact of Empire's 2007 Integrated Resource Plan ("IRP") and Empire's request to amortize IRP costs over three years. This adjustment reflects an estimated 2007 IRP cost of $215,000 and a three year amortization period. This adjustment also involves the establishment of a deferred asset account to capture the actual cost of the periodic IRP filings so that they can be amortized over a three-year period. Empire is requesting authorization from the Commission to establish this IRP deferral account and permission to amortize IRP costs over three years. In addition, Missouri jurisdictional administrative and general expenses have been increased $24,947 to reflect Empire's new employee dental and vision insurance program. The Missouri jurisdictional administrative and general expenses have been reduced by $144,904 to annualize the impact of Empire's common cost allocations to the Empire District Gas Company. Rate case expenses were also decreased by $208,443 to reflect the costs associated with the current rate case and an amortization period of two years for the cost of the current rate case.

Q. WHY IS A TWO-YEAR AMORIZATION PERIOD FOR THE RATE CASE EXPENSES APPROPRIATE IN THIS RATE CASE?

A. A two-year amortization period closely reflects the period in which the rates coming out of this case will be in effect. This is due to the expected start-up of the Iatan II and Plum Point generating stations in the summer of 2010. The start-up of these units will trigger the filing of a general rate case in 2009 with an operation of law date planned to coincide with the start-up of the new generating stations, the early summer of 2010. The rates coming out of this rate case will go into effect around September 1, 2008 and are expected to remain in place until June of 2010, or approximately 21 months.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO DEPRECIATION EXPENSE.

A. The Depreciation expense adjustment resulted in an increase of $4,577,603 and $3,931,368 for the total Company and the Missouri jurisdiction, respectively. The increase incorporates the results of the depreciation study performed for Empire by Mr. Donald Roff of Depreciation Specialty Resources, and the depreciation expense increase associated with the major increase in investment made by Empire during 2007 (Riverton 12, Asbury SCR and Ice Storm costs). Mr. Roff discusses the results of a new depreciation study that the Company has commissioned so that Empire will remain in compliance with the Commission's rules on periodic depreciation studies, in his direct testimony in this rate case. In addition to the depreciation expense, the amortization expense has been increased by $5,234,614 to reflect a full year of the Regulatory Amortization authorized in ER-2006-0315.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF SECTION J, SCHEDULE 2.

A. Taxes other than income taxes have been increased by $722,451 for the total Company or $620,360 for the Missouri jurisdiction to reflect the impact of plant in service at June 30, 2007 on ad valorem taxes. In addition Missouri jurisdictional taxes other than income have been adjusted upward by $207,461 to include the impact of the projected change in payroll taxes due to the annualized payroll expense. Lastly, 100 percent of the Franchise Fees Empire pays have been eliminated from taxes other than income.

The next five adjustments to the statement of operations are related to income taxes as a result of the adjustments that were made above and also to adjust book income taxes to income taxes calculated on a Missouri regulatory basis.

The last adjustment involves interest on customer deposits and is made to move the interest associated with these deposits above the line, which is consistent with past practices in Empire's rate cases in Missouri.

Q. IN SOME INSTANCES, THE ADJUSTMENTS FOR THE MISSOURI JURISDICTION AND TOTAL COMPANY ARE THE SAME; WOULD YOU PLEASE EXPLAIN?

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

Q. WILL YOU PLEASE DESCRIBE SECTION K, SCHEDULE 1?

A. Section K includes the plant investment information and related depreciation rates used to calculate the adjustment associated with depreciation expense. Section K, Schedule 1, Column A lists, by plant account number, the authorized depreciation rates. Columns B and C show the total Company and Missouri jurisdictional test year depreciation accruals.

Q. PLEASE DESCRIBE SECTION K, SCHEDULE 2.

A. Section K, Schedule 1 displays the depreciation accrued during the test year. Section K, Schedule 2 displays Empire's normalized depreciation expense using electric plant in service at June 30, 2007 and the proposed depreciation rates. Page

3 of Section K, Schedule 2 is a summary of the depreciation accruals and expense adjustments. It shows the proposed Missouri jurisdictional depreciation expense adjustment of $3,931,368. The proposed depreciation rates are being supported by Empire witness Mr. Roff.

JURISDICTIONAL ALLOCATIONS

Q. PLEASE DESCRIBE SECTION L OF THE SUPPORTING SCHEDULES.

A. Section L displays the information necessary to properly reflect the ongoing level of income taxes for purposes of this rate case. It consists of one summary schedule, Schedule 1 and two detail schedules, Schedule 2, page one and page 2, which contain the information necessary to develop the ongoing income tax levels. Schedule 1 is a statement of taxes charged to electric operations including the effects of the pro forma adjustments on the test year operations. In Schedule 2 income taxes have been added to net income to arrive at net operating income before income taxes. From this point, the income before income taxes is adjusted to take into account various additions and deductions from income to arrive at taxable income. In addition, Schedule 2 displays the calculation of federal and Missouri income taxes payable for the twelve months ending June 30, 2007, the test year Empire has utilized in this filing. Lines 22 and 26 (Column F) include the current portion of total federal and Missouri state income taxes charged to electric operations for determining the rate of return.

Q. PLEASE DESCRIBE THE JURISDICTIONAL ALLOCATION FACTORS DISPLAYED IN SECTION M OF THE SUPPORTING SCHEDULES.

A. Section M, Schedule 1 contains a summary description of the Empire jurisdictional allocation process and some of the basic reasons a particular allocation factor is utilized. It explains what allocations are necessary and defines the allocation factors used for allocating rate base, revenue and expense. In general, the types of jurisdictional allocation factors used in this rate case are identical to those used in ER-2006-0315, the most recent rate case. Of course, the values used to derive the jurisdictional allocation factors have been updated to reflect the current test year values. In addition, the impact of the June 2006 acquisition of the Aquila gas properties in Missouri, including the current cost allocation process used to allocate Empire common expenses between operations, primarily electric and natural gas, have been taken into account in this rate case.

Q. WHAT METHOD WAS USED TO DERIVE EMPIRE'S JURISDICTIONAL DEMAND ALLOCATION FACTORS?

A. The average of twelve monthly coincident peak demands by jurisdiction was used to jurisdictionally allocate production and transmission costs.

Q. WHY HAS THE COMPANY ELECTED TO USE THIS METHOD FOR JURISDICTIONAL DEMAND ALLOCATIONS?

A. During prior rate proceedings, as well as in our last electric rate proceeding, the Commission accepted the use of the average monthly coincident peaks for jurisdictional allocations. Additionally, this method has been used by our other four jurisdictions for jurisdictional allocations. The Company needs to keep the jurisdictional allocations consistent between our service territories to ensure full allocation of production and transmission costs.

Q. PLEASE GIVE A BRIEF DESCRIPTION OF THE AVERAGE OF

TWELVE MONTHLY COINCIDENT PEAK DEMAND ALLOCATION METHOD.

A. The monthly coincident peak (CP) demands for the test year are determined for the following jurisdictions: (a) Missouri wholesale; (b) Kansas wholesale; (c) Missouri retail; (d) Kansas retail; (e) Oklahoma retail; and (f) Arkansas retail. An average of the monthly CP demands is calculated for each of the above jurisdictions. These average monthly CP demands are then used to allocate production and transmission costs to each of the Company's jurisdictions, see Section M Schedule 2 attached to this testimony.

Q. HOW WERE THE MONTHLY COINCIDENT DEMANDS BY JURISDICTION OBTAINED?

A. In 1980, the Company installed metering at points where transmission and distribution lines crossed state boundaries. The demand readings at the time of monthly system peak for each of the metering points are combined with generation and tie line data to calculate the jurisdictional demands.

Q. PLEASE DESCRIBE SECTION M, SCHEDULE 2.

A. Empire operates as an integrated company in contiguous areas of Kansas, Missouri, Oklahoma and Arkansas. With very few exceptions, the Company's operations and costs are uniform throughout its service area and allocations of property and expenses are made only for the purpose of presenting the results of operations by individual state. These allocations are consistent with prior rate cases filed by the Company.

Section M, Schedule 2 shows the many components of rate base, revenue and expense as they are allocated to the various ratemaking jurisdictions under which we operate. The dollar amounts and percentages applicable to each jurisdiction are shown for each item, as well as a reference to the item number in this schedule that serves as the basis for allocation of the total Company dollar amount. Such allocations are necessary for a determination of net electric operating income by state in order to derive a rate of return on rate base for each state.

LOSS STUDY

Q. HAS THE COMPANY CONDUCTED A STUDY TO DETERMINE LOSS PERCENTAGES AT THE VARIOUS VOLTAGE LEVELS?

A. Yes, the Company retained the services of Management Applications Consulting, Inc., to perform a loss study in 2006. The results of this study were reported to us in March of 2007. This loss study derived losses for the following service levels by jurisdiction: (a) transmission/substation load and no-load; (b) distribution primary load and no-load; and (c) distribution secondary load and no-load. The results of this study were used to develop separate FAC factors for the customers served at and above primary voltage and those customers served below primary voltage.

PROPOSED TARIFFS

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

A. Due to the very short life of the rates coming out of the last rate case, ER-2006-0315, Empire has proposed to spread the rate increase to all of the charges in its tariffs in the form of an across-the-board increase, with an equal percentage increase to each rate class. The across-the-board approach to rate design in this rate case also fits in with the plan to file a class cost of service study in our 2009 rate application and address rate design as part of the 2010 filing.

FUEL ADJUSTMENT CLAUSE

Q. PLEASE DESCRIBE THE FAC TARIFF THE COMPANY IS PROPOSING IN THIS CASE.

A. The Company's proposed FAC tariff has been included in the proposed tariffs as Section 4 – Riders, Sheet 17. As indicated, the tariff sheet describes just how the proposed FAC mechanism will work. I have attached a copy of the proposed FAC tariff sheet to my testimony as Schedule WSK-3. 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;
- 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 be established at $0.03075 per kilowatt-hour sold;
- 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.xxx. This will 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 restricted the recovery and refund of over/under recoveries to 95 percent of the total difference. This is patterned after the findings the Commission made in the latest Aquila, Inc. rate case in Missouri.
- Carry costs on energy costs deferred as part of the operation of the FAC will be calculated on a monthly basis using Empire's embedded cost of short-term debt as the interest rate starting the first month the FAC tariff is in effect, and will be applied during both the accumulation period and the recovery period.

Q. HOW IS THE FAC BEING PROPOSED BY EMPIRE IN THIS RATE CASE

AND THE INFORMATION BEING SUBMITTED WITH THE FAC IN THIS RATE CASE DESIGNED?

A. Empire has designed its proposed FAC to comply with Section 386.266 of the Missouri statutes, which some may refer to as Senate Bill 179, and the Commission's rule governing the fuel adjustment process. Attached to this testimony as Schedule WSK-6 is a list of the nineteen (19) 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 THE COMMISSION'S RULE.

A. We have included information associated with the following:

- Proposed FAC tariff, (Schedule WSK-3)
- An example customer billing with a separate line item for the FAC factor, (Schedule WSK-4)
- Customer notice of proposed implementation of the FAC, (Schedule WSK-5)
- Testimony regarding business risk and the FAC (Overcast)
- 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 for the next four years (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. Yes, Empire agrees to release the last five years of historical surveillance information to the Commission Staff. 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, Aquila 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 then Empire would agree to an overall release of five-years of the surveillance information to the parties in this rate case.

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

A. I believe so. The adjustment mechanism Empire has proposed is a significant improvement over the current fuel and energy cost recovery mechanism Empire uses in Missouri, which is to recover 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 only reimburse Empire for a significant portion of its actual prudently incurred fuel and energy costs.

Q. IS THE FAC PROPOSED BY EMPIRE 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 will involve an audit trail that should facilitate the audit process associated with those periodic prudence reviews.

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

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

Q. WERE OFF-SYSTEM SALES REVENUES CONSIDERED AS A COMPONENT OF THE PROPOSED FAC?

A. No. Off-system sales have been addressed entirely as a component of base electric rates. Empire is not opposed to including 100 percent of its actual Missouri jurisdictional off-system sales margins as a component of the FAC. Either treatment, base rate or as a component of the FAC, appears to be acceptable under the terms of Empire's approved regulatory plan.

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

A. Yes. In addition, to the normal notice requirements that go with any general rate filing, Empire has prepared a notice that describes the request to implement the FAC. I have attached a copy of this notice as Schedule WSK-5.

Q. PLEASE DESCRIBE HOW THE PROPOSED FAC WILL WORK.

A. A copy of the proposed FAC is attached to my direct testimony as Schedule WSK-3. As shown on that schedule, the application of the proposed 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. As outlined in Schedule WSK-3, 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. This procedure is different from the tariff procedure authorized by the Commission in the recent Aquila case where over/under recoveries are passed on to the customer over a 12-

month billing period. We believe the use of a six-month recovery period is an improvement over the Aquila process and will decrease the administrative burden associated with the FAC and potential customer confusion as our proposal results in a single FAC factor being applied to a customer's bill while the Aquila process results in multiple FAC factors being applied to a customer's monthly bill. In addition, our proposal will have a tendency to reduce the interest expense a customer will pay due to a quicker recovery period. Finally, our proposal also produces a more accurate price signal due to the shortened recovery period. The process envisioned 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. The timing of the filings would also enable Empire to notify its Missouri customers of the energy cost recovery factor in advance of its actual application to customer billings. In other words, the customer would receive a price signal for the cost of electric energy prior to the start of the winter and summer seasons, seasons in which customer usage tends to peak.

Q. DO THE ENERGY COSTS ELIGIBLE FOR RECOVERY THROUGH THE FAC INCLUDE THE COSTS AND/OR BENEFITS ASSOCIATED WITH EMPIRE'S FUEL RISK MANAGEMENT (HEDGING) PROGRAM?

A. Yes. As indicated on Schedule WSK-3, 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 AS PROPOSED IN THE FAC TARIFF?

A. The tariff, as proposed, incorporates the following timing of actions:

- Filing for a change in the cost adjustment factor ("CAF") on April 1^{st} and October 1^{st} each year
- Staff recommendation on the filed CAF by May 1^{st} and November 1^{st} each year
- Commission Approval of the CAF by June 1^{st} and December 1^{st} or CAF as filed is allowed to go into effect on June 1^{st} and December 1^{st} 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 WILL THE TRUE-UP OF ENERGY COST RECOVERY TAKE PLACE AND PRUDENCE REVIEWS BE SCHEDULED ACCORDING TO THE PROPOSED 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 a FAC. The proposed FAC tariff specifies that prudence reviews will take place no less than every eighteen (18) months There is ample time in which to schedule the required prudence review, and with input from the other parties in this case, the exact timing of the prudence reviews could easily be included in the tariff itself.

Q. DOES THE FAC INCLUDE ANY EXPLICIT INCENTIVE MEASURES?

A. As I mentioned earlier, we have patterned our FAC proposal after the FAC authorized by the Commission in the last Aquila rate case. This includes limiting Empire's recovery of energy cost changes to 95 percent of the overall change in energy costs. This would mean that Empire would retain 5% of any decrease in energy costs during the accumulation period or absorb 5% of any increase in energy costs during the accumulation period.

Q. DOES THE 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.

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 a Risk Management Policy ("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. Historically, the Staff and the Office of Public Counsel have reacted favorably to Empire's RMP. As of August 2007, Empire had hedged or price protected the following percentages of expected natural gas usage for its electric operations:

Year	Percentage Hedged	Dekatherms	Average Price
2008	82%	7,826,000	$6.852
2009	45%	4,696,000	$6.060
2010	39%	3,696,000	$5.422
2011	40%	3,696,000	$5.422
2012	13%	1,200,000	$7.295
2013	13%	1,200,000	$7.295

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 output 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 test year ending June 30, 2007, Empire received approximately 9.1 percent or 494,000 Mwh of its overall energy supply via the contract with Elk River. The wind energy is purchased at a fixed annual cost and is typically used to offset the energy from higher cost resources, such as those using natural gas. Empire has recently 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.

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 have implemented IRP rules. Empire has used the IRP it developed for filing in Missouri as the basis for its 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. Demand-side management programs are also considered as potential resources as part of the IRP process. Empire filed its latest IRP plan in Missouri on September 5, 2007.

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 weather, number of customers, fuel prices, purchased power prices, rail transportation delays, and coal availability.

As these refinements are made to the near term forecasts, Empire adjusts its fuel procurement plans as necessary.

Q. IS THE 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 mechanism we have proposed is based upon the information coming from the periodic line loss studies performed by the Company.

Q. HOW WERE THE FACTORS USED TO ADJUST THE CAF FOR PRIMARY AND SECONDARY CUSTOMERS DEVELOPED USING THE LATEST LINE LOSS STUDY?

A. The results of the latest line loss study were used to develop expansion ratios for two broad groups of customers, those taking electric service and primary voltage and higher and those taking service at secondary voltage. The following table contains the sales and inputs statistics used to develop the expansion ratios.

Voltage Level	System Input	Sales	Ratio	Expansion Ratio
Secondary	3,497,669	3,232,161	1.0821	1.01
Primary & Higher	1,186,361	1,133,869	1.0463	.98
Total MO System	4,684,030	4,366,030	1.0728	

As indicated in the table, those customers taking service at primary and above voltages will have a CAF factor adjusted by an expansion factor of .98 while those customers taking service at secondary voltage will have a CAF factor adjusted by an expansion factor of 1.01. Both of these factors were developed by comparing the system input and sales of the customer groups to that of the total Missouri system.

Q. ARE THERE BENEFITS ASSOCIATED WITH THE USE OF AN EXPANSION FACTOR TO ADJUST THE CAF?

A. Yes. It is simple and it is fair to the two groups of customers, and the administration of the tariff will be much easier. By using an expansion factor rather than attempting to allocate accumulation period costs between these two groups of customers, Empire will only have to track one over/under account, not two as the recently approved Aquila FAC tariff appears to require.

Q. WHAT BENEFITS DO YOU SEE ASSOCIATED WITH THE USE OF THE FAC PROPOSED BY EMPIRE?

A. I believe the benefits are significant for all of the stakeholders. First, Empire will benefit by being able to recover the overwhelming portion its actual fuel and energy costs through the FAC. This will strengthen its financial profile and ability to attract the financing necessary to meet its growing customer needs at the best rates possible. In addition, the need to file general rate cases for the primary purpose of reflecting ongoing fuel and energy costs in base electric rates will be eliminated. A reduction in the number of general rate cases will ultimately lower Empire's costs and the cost to serve Empire's customers.

Q. HOW WILL THE COMMISSION BENEFIT?

A. The Commission will benefit in a couple of areas. First, the number of rate cases should decline as fuel and energy costs should 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 will enable the Commission to track overall earnings trends of the utilities using an FAC and guard against excessive utility earnings.

Q. HOW WILL 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 will be no over reimbursement of cost, and no winners and losers. Empire will have 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 will convey the true cost of electric energy to Empire's customers. If energy costs escalate the customer will know immediately and be in a position to make an informed decision concerning any energy efficiency measures that could be implemented in an effort to lower consumption. Since Missouri has not had a fuel adjustment mechanism in place for many years, fixed energy pricing has been used. This has tended to shield the customer from the true cost of electric energy and in my mind has hampered the implementation of meaningful 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.

VEGETATION MANAGEMENT AND INFRASTRUCTURE COSTS

Q. DOES EMPIRE HAVE A RECOMMENDATION ASSOCIATED WITH THE COMMISSION'S NEW VEGETATION MANAGEMENT AND INFRASTRUCTURE STANDARDS RULES?

A. Yes. As outlined in Empire witness Palmer's testimony, the implementation of new Commission vegetation management and infrastructure standards could have a significant financial impact upon Empire, with vegetation management expenditures increasing by over six times depending upon the final draft of the rule and infrastructure management costs increasing from $6.6 million to $12.8 annually. Since the outcome of the rulemaking process has yet to be completed, Empire was not able to propose an adjustment to its vegetation management or infrastructure expenses in this rate case to reflect the impact of the Commission's new rules. An adjustment to account for the financial impact of the new vegetation management and infrastructure rules may become more apparent during the true-up Empire is requesting in this case. In the alternative, Empire is seeking Commission approval of a cost tracking mechanism that would authorize it to defer the additional vegetation management and infrastructure expenses associated with the new rules until these costs can be considered as part of a general rate case.

Q. PLEASE DESCRIBE HOW THIS ALTERNATIVE PROPOSAL WOULD WORK.

A. A regulatory asset or liability would be established on Empire's records to track any increases or decreases in vegetation management and infrastructure costs from the cost levels included in this rate case. This account would be maintained until the next rate case at which time it would be amortized and recovered in rates over a period not to exceed five years. For example, if annual vegetation management and infrastructure expenses increased from a current level of around $6 million to $26 million, Empire would record the annual increase of $20 million as a regulatory asset until it can be reflected in rates in the next general rate case. If an increase of this same magnitude occurred for a number of years before the next general rate case, this account would capture more than one year of the cost increase associated with the new vegetation management and infrastructure rules. Once this regulatory asset is reflected in rates, the balance in the regulatory asset would be reduced to reflect that portion of costs being collected from the customers. For example, if the Commission decided to amortize the accumulated balance over more than one year then the balance in the regulatory asset would reflect the amortization levels allowed in rates.

<u>TRUE-UP</u>

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, 2007.

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, 2007?

A. The revenue requirement should be updated to recognize all of the significant changes that have occurred through December 31, 2007. Among those areas where significant changes can occur are:

- Net Plant in Service
    - Including the investment in SCR at Asbury
- Construction Investment at Iatan II and Plum Point
- Revenue
- Fuel and Purchased Power Cost
- Payroll Cost including Benefits
- Depreciation
- Capital Cost
- Capital Structure
- Commission Vegetation Management and Infrastructure Standards Rules

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

Schedule No.	Description
WSK-1	Schedules Supporting Revenue Requirement
WSK-2	Proposed ECR Base
WSK-3	Energy Cost Recovery Tariff
WSK-4	Example Customer Bill with an ECR factor
WSK-5	Notice
WSK- 6	FAC Minimum Filing Requirements

INDEX TO WSK-1

AFFIDAVIT OF W. SCOTT KEITH

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 1st day of October, 2007, 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 1st day of October, 2007.

Sherri J. Blalock

Notary Public

My commission expires: Nov. 16, 2010

SHERRI J. BLALOCK
Notary Public - Notary Seal
State of Missouri
Commissioned for Newton County
My Commission Expires: November 16, 2010
Commission Number: 06969626