EXECUTIVE SUMMARY
FOR THE DIRECT TESTIMONY OF W. SCOTT KEITH
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO.

Purpose of Testimony:
This section describes the topics addressed by the testimony. The topics include: financial information supporting the rate increase, the Company's request to implement an Energy Cost Recovery (ECR) tariff due to SB 179, list of other witnesses providing testimony on behalf of the Company, rate design proposals and the request for a True-up period.

Summary:
This fist section describes the financial information filed by the Company in support of its request for an increase in Missouri retail revenue of $29.5 million, an overall increase in Missouri revenue of 9.63 percent. As discussed in this section of the testimony, the largest single cost increase driving the need for rate relief is the increase in fuel and energy prices. Fuel and energy cost increases comprise approximately 64 percent, or $19.0 million of the overall increase in revenue being requested by the Company. This section of the testimony also discusses the difference in energy cost recovery under the existing Interim Energy Charge (IEC) and the Company's proposed ECR. This section of the testimony also describes each of the components of rate base, capital structure and the statement of net operating income, as adjusted by the Company and how these components were allocated to the Missouri retail jurisdiction.

This next section of the testimony discusses the Company's proposed changes in rates. This includes how the proposed increase was divided among the various rate schedules, discussion of the major features included in the Company's proposed ECR and the elimination of the experimental Green tariff sheet (s). The benefits associated with the implementation the ECR proposed by the Company is also discussed in this area of the testimony.

This final section of the testimony describes the "True-up" period proposed by the Company.

Conclusion:
The testimony contains an explanation of the schedules supporting Empire's request of $29.5M and a detailed explanation of the ECR tariff proposed in this case. Empire is also recommending a true-up through March 31, 2006.

Exhibit No.:
Issue: Accounting Schedules, True-up period, Rate Design and Fuel Adjustment
Witness: W. Scott Keith
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District
Case No.
Date Testimony Prepared: February 2006

Before the Public Service Commission

of the State of Missouri

Direct Testimony

of

W. Scott Keith

February 2006

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OF
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DIRECT TESTIMONY
OF
W. SCOTT KEITH
THE EMPIRE DISTRICT ELECTRIC COMPANY
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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. 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. I have been involved in the public utility industry for over thirty years.

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.

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 Energy Cost Recovery rider ("ECR") proposal, list the other witnesses presenting direct testimony on behalf of Empire in this proceeding, explain how the Company intends to work with the Staff to move forward with the implementation of a new facilities charge in its larger commercial and industrial rate classes to recover the fixed costs associated with the demand related components of its distribution system, and explain the proposed elimination of the Experimental Green Power Rate Schedule. I will also discuss the Company's proposed "True-up" period.

Q. PLEASE LIST THE OTHER WITNESSES THAT WILL BE PRESENTING DIRECT TESTIMONY ON BEHALF OF THE COMPANY IN THIS RATE CASE.

A. In total, eight (8) witnesses will present direct testimony on behalf of the Company in this rate case. In addition to me, the following witnesses will present direct testimony on the topics as shown in the table below:

WITNESS	TOPIC
William G. Gipson-Chief Executive Officer[1]	General Overview
Michael E. Palmer-Vice President Commercial Operations[1]	Tree Trimming, Storms & Street Lighting
Todd Tarter-Manager of Strategic Planning[1]	Fuel and ECR
James H. Vander Weide-Financial Strategy Associates	Cost of Common Equity
Sherry McCormack-Planning Analyst[1]	Demand Side Management

Jayna Long-Regulatory Analyst[1] Laurie Delano-Controller[1]	Missouri Retail Revenue FAS 87,FAS 106 & ADIT

[1]Employee of The Empire District Electric Company

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 September 30, 2005 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 at September 30, 2005
- 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 September 30, 2005
- Section L, Schedule 2, Page 2, Calculation of Deferred Income Taxes for Twelve Months Ended September 30, 2005
- 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 previous electric rate case, Case No. ER-2004-570. As indicated, Empire is requesting an increase of $29.5 million in Missouri jurisdictional revenue, or 9.63 percent above current rate revenues, in this rate case. This increase will result in an overall rate of return of 9.55 percent and a return on equity of 11.7 percent. By far the biggest factor driving the rate case is the increase in the price of natural gas used in electricity generation and the cost of wholesale energy purchased on the open market for use by our customers. The increases in fuel and energy costs account for approximately 64 percent, or $19.0 million, of the overall increase of $29.5 million being requested in this rate filing. The current Interim Energy Charge (IEC) mechanism used in Missouri has not enabled Empire to recover the actual cost of energy used to supply its retail electric customers during a period of fuel and energy cost volatility. As a direct result of that, Empire does not have a reasonable opportunity to earn its authorized return on equity. This is evident if the history of the Empire IEC mechanism is reviewed. If there had been a mechanism in place for Empire to recover fuel and energy cost changes on a timely basis in Missouri, similar to those it has in Kansas, Oklahoma, Arkansas and the FERC, it is unlikely that this general

Missouri rate filing would have been necessary.

Q. HOW HAS THE IEC FOR EMPIRE RECOVERED ENERGY COSTS HISTORICALLY?

A. Neither of the IECs that have been used by Empire historically has resulted in the recovery of actual energy costs. Specifically, the first IEC authorized in Case No. ER-2001-299 resulted in a 100 percent refund of the actual IEC revenue collected, and the current IEC has resulted in a significant under recovery of actual energy costs, driving the need to file this rate case.

Q. WHAT WAS EMPIRE'S EXPERIENCE WITH THE FIRST IEC AUTHORIZED IN ER-2001-299?

A. It was only in place for 14 months. The IEC established in ER-2001-299 included a base cost of energy of $25.20 per megawatt-hour ("Mwh") sold. It also established a ceiling cost of energy of $30.60 per Mwh sold. This IEC was implemented on October 2, 2001 and discontinued on December 1, 2002. The first IEC was somewhat different than the current IEC in that it included the capacity charges associated with power purchased from third parties.

Q. WHY WAS THE IEC DISCONTINUED?

A. Subsequent to the implementation of the IEC, energy prices declined and Empire refunded 100 percent of the IEC revenue it had recovered from the customers during its term with interest. The discontinuance of the IEC meant that Empire recovered the floor cost in its base electric rates, and to the extent it was able to produce or acquire electricity at a cost below the floor of $25.20 per Mwh, it retained the added profit, essentially the same process that had been in place prior to the advent of the IEC.

Q. HOW MUCH OF AN ENERGY COST UNDERRECOVERY HAS OCCURRED UNDER THE CURRENT IEC?

A. The current IEC charge of $0.002131 per kilowatt-hour ("kWh'), which was authorized in Case No. ER-2004-507, has resulted in an under recovery of Missouri retail energy costs of approximately $13.5 million for the period beginning March 27, 2005, through December 31, 2005. During the suspension period of this rate case, the shortfall in annual energy cost recovery is projected grow and could reach $19.0 million on an adjusted test year basis (See the direct testimony of Todd W. Tarter). This level of annual energy cost under-recovery is very significant and if the adjusted test year levels are actually incurred, would represent approximately 58 percent of the $32.9 million annual return on equity authorized by the Commission in ER-2004-570. We cannot continue to have actual fuel and purchased power expenses used to supply our customers significantly exceed the assumed level of the expenses that are built into the rates we are allowed to charge if we are to be given a reasonable opportunity to earn our authorized return on equity. Obviously, this level of under-recovery of energy costs cannot be sustained by the Company for an extended period of time.

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 September 30, 2005, end of period balances are used for electric plant in service and reserve for depreciation. Materials and supplies and prepayments are the average of the thirteen consecutive month-end balances ending September 30, 2005. 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 Section D, Schedule 1. These include: injuries and damages, 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 $625,454,772 (Line 15) which is multiplied by the required rate of return of 9.55% (Line 22) to arrive at an after tax operating income requirement of $59,730,931 (Line 21). This operating income requirement is subtracted from the Company's adjusted operating income of $41,547,126 (Line 16) and results in the after tax operating income deficiency of $18,183,804 (Line 17) or the pre-tax revenue deficiency of $29,513,713 (Line 20) 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 September 30, 2004 and 2005. Total electric plant in service at September 30, 2005, is $1,250,722,687 (Column E) and $1,065,089,423 for the portion representing Empire's Missouri retail jurisdiction (Column F).

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 September 30, 2004 and 2005. The total accumulated provision for depreciation of electric plant in service at the end of the test year is $439,468,210 (Column E) and $375,326,329 for our Missouri jurisdiction (Column F).

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 September 30, 2005. The expense and revenue lag for each component is the same as used by the Staff in Case No. ER-2004-570. The computation, using normalized test year expenses and revenues, results in a cash working capital requirement of $2,539,620. Section G, Schedule 3 and Schedule 4, calculate 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 September 30, 2005 and an adjusted capital structure using 51.45 percent equity, 42.45 percent long-term debt and 6.11 percent Trust Preferred Securities. The return on common equity has been set at 11.7 percent which is proposed by

Empire witness Dr. James H. Vander Weide. Based on an 11.7 percent return on equity and the Company's current capital structure, the Company's overall requested return on rate base is 9.55 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 September 30, 2005, in columns A and B. Columns C and D reflect the first mortgage bonds that would be necessary to meet the adjusted capital structure as reflected in Section H, Schedule 1.

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 7.04 percent for first mortgage bonds. The rate for the trust preferred series is 8.91 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 September 30, 2005. 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 September 30, 2005. 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 $41,547,126 in Net Operating Income ("NOI") or an overall return on rate base of 6.64 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 September 30, 2005, normal weather for the test year, to exclude water related revenues, to eliminate a discount given to a large industrial customer, to eliminate the impact of prior period billing corrections and to reflect a full year of the rate increase granted by the Commission in ER-2004-570. 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. Ms. Jayna Long of the Company will describe the retail revenue adjustments in greater detail in her direct testimony including the process used to adjust the Missouri jurisdictional revenue for customer growth, the recently authorized Missouri electric rates and weather normalization.

Q. PLEASE EXPLAIN THE ADJUSTMENTS TO EXPENSES.

A. Total Company production costs have been increased by $24,953,037 which factors down to $20,516,120 for the Missouri retail jurisdiction. Included in this total are two adjustments related to amortization, the Asbury Relocation Cost for $135,420 and Operating Plant Service Agreement ("OPSA") amortization of $151,484. 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 $260,344 with $214,052 being for the Missouri jurisdictional portion of production expenses. The adjusted payroll expense included in the filing reflects the wages at October 16, 2005, adjusted for known changes, positions that are currently authorized but unfilled, the union increase that occurred in November 2005, and non-union payroll increases scheduled to go into effect in the spring of 2006. 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 $24,405,789 with $20,066,179 of that attributable to the Company's Missouri jurisdictional operations. As I noted at the outset, the increase in fuel and energy prices is the primary factor driving the need for Empire to file this general rate case.

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

A. The Missouri jurisdictional transmission expenses were increased by $27,465 to reflect the annualized payroll costs. Missouri jurisdictional transmission expenses were also reduced $195,175 to remove a Flint Creek billing. This represents a billing for work performed in a prior period.

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

A. Missouri jurisdictional distribution expenses were increased by $167,484 to reflect the annualized payroll costs.

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 $73,424. In addition, Missouri jurisdictional customer accounts expense was increased to reflect the recent increase in postage costs of $35,223 and an increase in the billing costs associated with customer growth of $5,987.

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 $18,312 and Missouri jurisdictional sales expense was increased by $5,768.

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

A. Missouri jurisdictional administrative and general expenses were increased by a total of $1,826,994 through a series of ten (10) adjustments. Of the total, $7,956 was associated with increased 401(k) costs. The amortization of the FAS 87 tracking asset resulted in an increase in costs of $194,077. The method used to calculate the adjustment for FAS 87 and the Company's recommendation concerning future FAS 106 costs are discussed in the direct testimony of Company witness Ms. Laurie Delano. Common stock expenses were amortized over three years resulting in an increase in expenses of $1,161,284. Missouri jurisdictional administrative and general expenses have been increased by $148,236 to reflect adjusted payroll expense. Missouri jurisdictional property insurance expenses were reduced by $109,399 to reflect ongoing property insurance costs. Missouri jurisdictional administrative and general expenses were reduced by $5,520 to reflect the current level of the Commission's annual assessment. Missouri jurisdictional administrative and general expenses have been reduced $56,745 to reflect a reduction in the banking fees associated with the Company's new Line-of-Credit ("LOC"). Missouri jurisdictional outside services expenses were increased $50,000 to reflect the consulting expenses expected to be incurred in connection with the Company's upcoming Integrated Resource Plan ("IRP"). In addition, administrative and general expenses have been increased $5,300 to reflect the amortization of a regulatory asset that is associated with the Company's authorized Demand-Side Management programs. Ms. Sherry McCormack of the Company will address the DSM adjustment in more detail in her direct testimony. Rate case expenses were also increased by $431,805 to reflect the costs associated with the current rate case and a proposal to shorten the amortization period from three years to two years. In addition, the rate case expenses and associated amortization expense associated with the prior rate case, ER-2004-570 have been adjusted to reflect a two-year amortization period instead of the three-year amortization period included in the last rate case.

Q. WHY IS IT NECESSARY TO ADJUST THE AMORIZATION PERIOD FOR THE RATE CASE EXPENSES ASSOCIATED WITH THE PRIOR RATE CASE?

A. The adjustment to the amortization period is needed to more accurately reflect rate case expenses on a going forward basis. Without this adjustment the amortized rate case expenses would reflect a three-year amortization period for the prior rate case and two-year amortization period for the current rate case. By making the remaining amortization period consistent for each rate case the Company can simplify its amortization accounting related to rate case expense and better match rate case expense recovery with the rates coming out of this rate case. The two-year amortization proposal is conservative given the projected completion date associated with the Company's new generation unit at Riverton. The new unit is expected to be in service by the late spring of 2007 and in all likelihood this investment will necessitate a new general rate filing to reflect the substantial new investment in the Company's cost of service. This would mean that the rates coming out of this filing, assuming an effective date of December 2006, could be in place less than one year.

Q. PLEASE DESCRIBE THE ADJUSTMENT TO DEPRECIATION EXPENSE.

A. The Depreciation expense adjustment resulted in an increase of $3,466,844 and $3,065,531 for the total Company and the Missouri jurisdiction, respectively. The increase incorporates the results of the depreciation rates authorized by the Commission in ER-2004-570 and the plant in service balances at September 30, 2005.

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

A. Taxes other than income taxes have been increased by $246,547 for the total Company or $209,674 for the Missouri jurisdiction to reflect the impact of plant in service at September 30, 2005 on ad valorem taxes, and to include the impact of the projected change in payroll taxes due to the annualized payroll expense.

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 Missouri Staff adjustments.

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 2 displays Empire's normalized depreciation on electric plant in service at September 30, 2005. Page 4 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 $3,065,531.

Q. PLEASE DESCRIBE SECTION L OF THE SUPPORTING SCHEDULES.

A. Section L of the Supporting Schedules reflects the information necessary to properly reflect the ongoing level of income taxes for purposes of this rate case. It is comprised of two schedules 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. Schedule 2 starts with net income. Income taxes have been added 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 September 30, 2005, the test year Empire has utilized in this filing. Lines 24 and 28 (Column D) 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 SCHEUDLES.

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-2004-570, 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.

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 our last electric rate proceeding, the Commission accepted the use of the average monthly coincident peaks for jurisdictional allocations. Additionally, this method was 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, CONSISTING OF EIGHT PAGES.

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.

<u>LOSS STUDY</u>

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

A. Yes, the Company conducted a loss study on April 12, 2004. This loss study derived losses for the following service levels: (a) transmission/substation load and no-load; (b) distribution primary load and no-load; and (c) distribution secondary load and no-load.

PROPOSED TARIFFS

Q. IS THE COMPANY RECOMMENDING OTHER CHANGES TO THE TARIFF SHEETS?

A. Yes. In addition to the implementation of an ECR, the Company is recommending that the Green tariff be eliminated. Finally, the Company is recommending that the existing Street Lighting tariffs be reviewed to reflect the impact of competition from non-regulated rural electric cooperatives ("REC's"). Mike Palmer of Empire will address this situation in his direct testimony.

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-2004-507, 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.

Q. IS THE COMPANY PROPOSING ANY FUNDAMENTAL CHANGES IN ITS CAPACITY CHARGES IN THIS PROCEEDING?

A. Not in its initial filing. Empire has retained an outside consultant, Mr. Ed Overcast of R.J. Rudden & Associates, to assist in the analysis of its embedded distribution costs and the propriety of instituting a separate demand/facilities charge to recover a portion of these distribution costs. This process was agreed to by Empire in its last general rate proceeding, but the timing of the next rate case was expected then to occur near the end of 2006, not the beginning. The timing of this general rate filing has not allowed Empire to complete its distribution facilities charge analysis and include the results in its initial rate filing. We expect our analysis to be completed by the second quarter of 2006 and will make the results available to the various parties that become involved in this case and express an interest in reviewing the results. The timing of the completion of our analysis should enable it to be used in the design of the final rates that come out of this proceeding.

ENERGY COST RECOVERY (ECR)

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

A. The Company's proposed ECR tariff has been included in the proposed tariffs as Sheet __ of Sheet __. As indicated, the tariff sheet describes just how the proposed ECR mechanism will work. I have attached a copy of the proposed ECR tariff sheet to my testimony as Schedule WSK-3. Several of the major features of the tariff are:

- Changes in the ECR factor will be based upon the historical 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 ECR calculation will be based upon the actual historical expenses recorded in FERC accounts 501, 547 and 555. In addition, the ECR will include the recovery of emission allowance costs (sulfur dioxide) recorded in FERC account 509.
- Costs included in the ECR calculation will exclude the capacity charges

associated with purchased power contracts whose term is greater than one year in length.

- Only two changes in the ECR factor will be made each year, one in June and one in December.
- The base cost of energy under the ECR will be established at $0.02999 per kilowatt-hour sold
- Over/under recoveries of energy costs will be refunded/collected automatically from Missouri retail customers through the operation of the tariff
- Over/under recoveries of 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 and an offsetting revenue account to reflect the over/under recoveries of energy costs on the income statement. This will ensure that net operating income is not distorted by over/under recoveries of energy costs. In addition, this accounting process will leave an audit trail for internal and external auditors. This feature will be very useful if any periodic prudence reviews are included as part of the Commission's final fuel adjustment rule.

Q. WAS THE ECR BEING PROPOSED BY EMPIRE IN THIS RATE CASE AND THE INFORMATION BEING SUBMITTED WITH THE ECR DESIGNED TO COMPLY WITH MISSOURI LAW?

A. I believe they were. Empire has designed its proposed ECR to comply with Section 386.266 of the Missouri statutes, which some may refer to as Senate Bill 179, and what we understand will be the Commission rules implementing the new law. To the extent that changes take place between now and the approval of a final version of the rules, Empire intends to modify its ECR proposal to comply.

Q. PLEASE DESCRIBE THE ADDITIONAL INFORMATION THAT HAS BEEN INCORPORTATED IN THE FILING TO COMPLY WITH EMPIRE'S UNDERSTANDING OF THE COMMISSION'S RULE.

A. We have included information associated with the following:

- Proposed ECR tariff, Schedule WSK-3
- An example customer billing with a separate line item for the ECR factor, Schedule WSK-4
- Customer notice of proposed implementation of an Energy Cost Recovery rider, Schedule WSK-5
- Testimony regarding business risk and the ECR
- Testimony concerning the resource mix that Empire expects to use to meet its customers electric requirements over the next four years
- Testimony describing Empire's long-term resource planning process

Q. WILL THE ECR 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, the IEC. During periods of extreme fuel and energy price fluctuations, the ECR will recover increases in energy costs and refund decreases in energy costs in such a way that the Missouri retail customers will only reimburse Empire for its actual prudently incurred fuel and energy costs.

Q. WAS THE ECR PROPOSED BY EMPIRE DESIGNED TO WORK WITH ANY PRUDENCE REVIEW PROCEDURES ENACTED BY THE COMMISSION?

A. Yes. The proposal is flexible and will allow the Commission to adjust the amount of ECR recovery if any cost disallowances are made 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 prudence reviews.

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

A. Yes. ECR revenue will be billed as a separate line item on each customer's bill and the ECR 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 ECR?

A. No. Off-system sales have been addressed entirely as a component of base electric rates.

Q. HAVE THE EMPIRE CUSTOMERS BEEN NOTIFIED OF THE REQUEST TO IMPLEMENT AN ENERGY COST RECOVERY RIDER?

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 an ECR. I have attached a copy of this notice as Schedule WSK-5.

Q. WAS THE ECR DESIGNED TO PRODUCE A DIFFERENT ECR FACTOR FOR EACH RATE OR CUSTOMER CLASS?

A. No. Each customer class will have the same ECR factor under the Empire proposal. This will greatly simplify the process in terms of calculation, the true-up of any over or under recovery balances and customer notification requirements. In addition, this represents no change from the current IEC process. There is only one IEC to track, not multiple IECs.

Q. DOES THE IEC AS CURRENTLY CONFIGURED RECOVER THE ACTUAL COST OF PRUDENTLY INCURRED FUEL AND ENERGY COSTS?

A. No. The mechanism is inflexible. Energy costs recovered in rates are essentially fixed, although within a spectrum, and it does not track the changes in energy costs as they are incurred. History shows that energy costs are volatile and the IEC does not properly account for that fact. The IEC as currently authorized for use by Empire does not recover 100 percent of prudently incurred fuel and purchased power costs. It does not necessarily enable Empire to recover 100 percent of the increases in energy costs and it has the potential to only partially refund 100 percent of decreases in energy costs if energy costs decline.

Q. COULD YOU ELABORATE ON THAT?

A. The current IEC has not allowed Empire to recover all of the increases in energy costs that have occurred since March of 2005, thus driving the need for the current general rate filing. The current IEC mechanism and its recovery of energy costs is not that much different from base rate recovery of fuel and energy costs.

Q. PLEASE COMPARE THE IEC AND IT RECOVERY OF ENERGY COSTS TO THE ENERGY COST RECOVERY IN PLACE PRIOR TO THE IMPLEMENTATION OF THE IEC.

A. Prior to the implementation of the IEC, base electric rates were designed to recover a certain level of fuel and energy costs in each rate case. Various parties to a rate case each presented their estimates of future fuel and energy costs and the Commission was usually forced to choose between one or a combination of the various positions unless a settlement of this issue was reached between the various parties. Thus, the average level of energy costs recovered per kWh was fixed until the next general rate proceeding. Any variation in the average cost of energy was absorbed by the utility. The current IEC mechanism is not that much different. It establishes a floor and a ceiling in the average cost of energy collected in base electric rates within the context of a general rate proceeding. To the extent the average cost of energy exceeds the ceiling, the utility still absorbs the increase as it did prior to the implementation of the IEC and to the extent average costs decline below the floor the utility retains the added margin, just as it did prior to the IEC. It is only when the actual cost of energy incurred by the utility is between the floor and the ceiling that the IEC results in the recovery of the actual average cost of energy. During periods of extreme price volatility, the recovery of a utility's actual energy cost through an IEC is unlikely, while the ECR proposed by Empire matches rate recovery with the actual cost incurred. The fact that the ECR only recovers the actual cost of energy can produce benefits for all parties, including the Missouri retail customer.

Q. DOES THE USE OF AN IEC IN MISSOURI ELIMINATE THE NEED TO FORECAST AN AVERAGE COST OF ENERGY IN A GENERAL RATE PROCEEDING?

A. No. In fact, the IEC has the potential to double this forecasting requirement. The Commission must not only establish the base cost of energy to be recovered in base electric rates, the floor, the Commission must establish a reasonable energy cost ceiling in the IEC rate if the utility is to have any reasonable chance to earn the rate of return authorized in the rate case. Thus, the need to forecast future changes in energy costs is in no way diminished by the use of an IEC. During periods of extreme fuel and energy price volatility, the accurate forecast of future energy costs and prices is extremely difficult if not impossible. This fact was brought out in the testimony of the Commission Staff during the last Empire rate case, as mentioned in the direct testimony of Mr. Tartar.

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

A. I believe the benefits are significant for all of the stakeholders. First, Empire will benefit by being able to recover its actual fuel and energy costs through the ECR. 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 recovering increases in fuel and energy costs will be eliminated. A reduction in the number of general rate cases will ultimately lower the cost of service to the customer.

Q. HOW WILL THE COMMISSION BENEFIT?

A. The Commission will benefit in a couple of areas. First, the need to forecast fuel and energy expenses during periods of extreme price volatility in a general rate proceeding will be eliminated. This will eliminate one of the most contentious issues that can arise during rate proceedings, and produce protracted levels of direct, rebuttal and surrebuttal testimony, with everyone trying to guess the future accurately. Eliminating that aspect with the ECR means all parties to the rate proceeding will save time and money. The result is a 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. We understand the rule proposed by the Commission will include an enhanced surveillance reporting requirement that will enable the Commission to track overall earnings trends of the utilities using an ECR and guard against excessive utility earnings.

Q. HOW WILL THE ECR BENEFIT THE CUSTOMER?

A. In the long run the customer will benefit from the implementation of a properly designed ECR. 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 or under reimbursement of cost, and no winners and losers. Empire will have a stronger financial profile and be able 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 ECR. 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 ECR.

Q. IS EMPIRE PROPOSING THE ELIMINATION OF THE GREEN POWER SCHEDULE, RIDER EGP, IN THIS RATE CASE?

A. Yes. Empire is proposing to remove the Experimental Green Power Schedule, Rider EGP, from the electric tariff. According to that schedule, in order for it to become effective, a minimum of 1,000 blocks of Green Power had to have been requested by April 1, 2005, or the tariff would be discontinued effective May 1, 2005. This minimum level of participation was not reached and the program was discontinued, so there is no need for the schedule. In addition, Empire is now purchasing 150 megawatts of wind power for its system on a regular basis. This means that a portion of our customer's usage will be provided from this renewable or "green" resource, anyway. We are proposing to remove the rider and make the tariff sheets blank.

Q. IS EMPIRE REQUESTING A TRUE-UP PERIOD AS PART OF ITS REQUEST IN THIS CASE?

A. Yes. Empire is requesting that the financial information be updated as of March 31, 2006.

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 MARCH 31, 2006?

A. The revenue requirement should be updated to recognize all of the significant changes that have occurred through March 31, 2006. Among those areas where significant changes can occur are:

- Net Plant in Service
- Revenue
- Fuel and Purchased Power Cost
- Payroll Cost
- Depreciation
- Capital Cost

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

<u>**AFFIDAVIT OF W. SCOTT KEITH**</u>

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 31st day of January, 2006, 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 31st day of January, 2006.

Patricia A Settle

Pat Settle, Notary Public

My commission expires: ____________

Patricia A. Settle
Notary Public - Notary Seal
State of Missouri
County of Jasper
Expires February 09, 2008