

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EF-2011-0393, The Empire District Electric Company

FROM: Shana Atkinson, Financial Analysis Department

/s/ Shana Atkinson 08/04/11
Project Coordinator / Date

/s/ Steven Dottheim 08/04/11
General Counsel's Office / Date

SUBJECT: Staff's Recommendation for Approval with Conditions of the Application of The Empire District Electric Company (Empire or Company) for Authority to Issue Debt in the Form of First Mortgage Bonds.

DATE: August 4, 2011

The Empire District Electric Company's Proposed Transaction

1. (a) **Type of Issue:** First Mortgage Bonds (hereinafter referred to as "Bonds").
- (b) **Amount:** Up to and including \$250 million.
- (c) **Rate:** The interest rate used for purposes of creating the pro forma financial statements was 7.00 percent. However, Paragraph 8 of Empire's Application indicates that it is requesting Commission authority to issue the Bonds at an interest rate consistent with similar securities of comparable credit quality.
- (d) **Other Provisions:** Empire will late-file documents setting forth the aggregate principal amount to be sold, price information, and other terms and provisions concerning each issuance of Bonds.
2. **Proposed Date of Transactions:** Through February 7, 2014.
3. (a) **Statement of Purpose of the Issue:** The net proceeds from the sale of each series of the Bonds will be added to Empire's general funds for use in connection with the acquisition of property, business or entities; the construction, completion or improvement of its plant or system; the improvement or maintenance of service; the discharge or lawful refunding of its obligations, or the reimbursement of moneys actually expended from income or any other moneys in the treasury not secured or obtained from the issuance of stocks, bonds, notes or other evidences of indebtedness. Approximately \$111.2 million of the proposed Bonds will be used to refinance \$98 million of unsecured notes and \$13.2 million of Pollution Control secured Bonds. Although not specifically stated in the Application, it appears that the main driver for the remaining amount of funds is future capital expenditures associated with the Asbury coal-fired generating station.

(b) From a financial perspective, does Staff deem this purpose reasonable?

Yes **X** No ____

4. **Type of Transaction:** Empire anticipates it will issue and sell each new series of Bonds in any of the following ways: (a) in a public offering through an underwriter or underwriters or dealer or dealers, (b) in a private placement directly to a limited number of purchasers or a single purchaser, or (c) in an offering through agents.

5. **Copies of executed instruments defining terms of the proposed securities:**

____ (a) If such instruments have been previously filed with the Commission, a reference to the Case Number in which the instruments were furnished.

X (b) If such instruments have not been executed at the time of filing, a statement of the general terms and conditions to be contained in the instruments that are proposed to be executed.

____ (c) If no such instruments are either executed or to be executed, a statement of how the securities are to be sold.

6. **Certified copy of resolution of the directors of applicant, or other legal documents authorizing the issuance of the securities reviewed:**

Yes **X** No ____

7. **Pro-forma Balance Sheet and Income Statement reviewed:**

Yes **X** No ____

8. **Capital expenditure schedule reviewed:**

Yes **X** No ____

9. **Journal entries are required to be filed by the Company to allow for the Fee Schedule to be applied:**

Yes No **X**

10. **Recommendation of the Financial Analysis Department:**

____ Grant by session order (see Comments)

X Conditional Approval granted pending receipt of definite terms of issuance (see Comments)

____ Require additional and/or revised data before approval can be granted (see Comments)

____ Formal hearing required (see Comments)

____ Recommend dismissal (see Comments)

COMMENTS:

The Empire District Electric Company (Empire or Company) is a public utility engaged primarily in the business of generating, purchasing, transmitting, distributing and selling electric energy in Missouri, Kansas, Arkansas and Oklahoma (approximately 89.6% of gross operating revenues in 2010). Empire's Missouri electric utility operations comprised 88.9% of its 2010 retail electric revenues. Empire also distributes natural gas through its subsidiary, The Empire District Gas Company (EDG), which comprised 9.4% of Empire's 2010 gross operating revenues.

Empire filed a Registration Statement with the Securities and Exchange Commission (SEC) on January 28, 2011, for its \$400 million universal shelf registration of common stock, preference stock, unsecured debt securities and first mortgage bonds. The Registration Statement was declared effective by the SEC on February 7, 2011.

On June 16, 2011, the Company filed an Application requesting that the Missouri Public Service Commission (Commission) authorize Empire to issue and sell under its existing Indenture of Mortgage and Deed of Trust up to and including \$250 million principal amount of its First Mortgage Bonds in one or more series. Because Empire has yet to execute the First Mortgage Bonds in which it requests Commission Authority to issue, Empire's Application does not provide specific terms and conditions of the proposed financing. While Staff believes it is reasonable for the Commission to provide Empire the authority to issue First Mortgage Bonds without the specific terms and conditions, Staff recommends the Commission require that these final terms and conditions be subsequently filed with the Commission in this case, not merely submitted to Staff. Staff notes this because the Commission recently merely required Ameren Missouri to submit this information to Staff in Case No. EF-2011-0266. Merely requiring that this information be submitted to Staff, does not provide a failsafe permanent record at the Commission of the final terms and conditions of the financing authorized by the Commission. Staff notes 4 CSR 240-3.120(2) states that companies must submit final terms and conditions before final Commission authority will be granted. Empire's Application in this case states that the Company will file the final terms and conditions with the Commission as a late-filed exhibit.

The Company's Application respecting the purpose of the Bonds states that the proceeds from the sale of each series of the Bonds may be used to provide financing for its construction program, to discharge long-term indebtedness by the payment of principal at maturity, to refinance outstanding indebtedness, including the payment of applicable redemption premiums, and for other corporate purposes.

According to Appendix 4 attached to the Application, approximately \$111.2 million of the proposed Bonds will be used to refinance \$98 million of unsecured 4.50% notes due to mature in 2013 and \$13.2 million of Pollution Control secured Bonds (\$5.2 million at 5.20% and \$8.0 million at 5.30%) due to mature in 2013. The Application does not identify the specific projects that may be funded by the remaining \$138.8 million in proposed Bonds, other than a construction budget summary provided in response to Staff Data Request No. 0004, which provides potential uses for the Bonds.

One of the major construction projects represented in the construction budget is Asbury which accounts for about \$130.3 million of the construction budget for the years 2011-2013.

Empire's Application requests the financing be approved for use for a broad set of circumstances. If the financing is approved to be used for "other corporate purposes," as stated in the Application, then this could apply to virtually any use. Because the financing request proposes to use Empire's Missouri electric utility properties to secure the debt, it is prudent to require that the amount of funds from this financing authority only be used for purposes that benefit Empire's electric utility properties.

In its Application, the Company seeks authority to issue long-term indebtedness at interest rates consistent with similar securities of comparable credit quality and maturities issued by other companies. The pro forma financial statements provided in response to Staff Data Request No. 0001 assume an interest rate of 7% for debt issued in 2013. Empire estimated this cost based on interest rates of recently issued debt and Empire's belief that the cost to issue debt will increase by 2013. Staff looked at Reuters Corporate Spreads for Utilities from BondsOnline and found the average for the last three months for "BBB-" rated, 30-year public utility bond yields to be 6.29%. Therefore Empire's assumed interest rate of 7% in its pro forma financial statements appears to be reasonable.

Staff has reviewed the pro forma financial statements that were provided by Empire in response to Staff Data Request No. 0001. Staff relied on Empire's representations made in those financial statements when analyzing the effect of the \$250 million in proposed financing. The pro forma financial statements anticipate the issuance of a maximum of \$250 million in debt, whether secured or unsecured, through 2013. Because Empire is a Kansas Corporation, based on the opinions of the Company's counsel and the Commission's Staff Counsel's Office, it is required to request Commission approval to issue financing only when that financing includes the pledging, assigning, leasing, transferring, mortgaging, or otherwise encumbering of Empire's Missouri utility properties to secure such financing. Consequently, to the extent that Empire also issues unsecured financing over the next three years, that debt would not reduce the \$250 million capacity that may be granted under this Application.

Staff's recommendation for approval of this financing is based on the capital mix that is currently projected to be employed by Empire in its pro forma financial statements. Currently, Empire anticipates issuing \$250 million of debt and \$150 million of common equity in 2013. If Empire were to deviate significantly from these projections, then the capital structures that Staff analyzed in the pro forma financial statements may be different. Empire has represented to Staff that although it does not anticipate issuing the secured debt requested in the Application until 2013, it is possible that they may need to issue secured debt before 2013. Considering that Empire has ongoing capital expenditures associated with its regulated utility operations and Empire's operations are primarily limited to these regulated utility operations, Staff considers this request to be reasonable. Staff also evaluated the impact of the proposed financing on three financial ratios in which benchmarks were published in the May 27, 2009 Standard and Poor's (S&P) article, "Criteria Methodology: Business Risk/Financial Risk Matrix Expanded" (see Attachment 1). These three ratios are the Funds From Operations (FFO) to Total Debt ratio, the Total Debt to Total Capital ratio and the

Total Debt to EBITDA ratio. Empire's current S&P credit rating of "BBB-" is based on S&P's current classification of Empire's Business Risk Profile ("BRP") as "Excellent" and its Financial Risk Profile ("FRP") as "Aggressive".

A recent March 17, 2011 S&P research report on Empire provided the necessary information required to determine Empire's 2010 FFO to Total Debt, Total Debt to Total Capital and Debt/EBITDA ratios. Staff compared this information to Empire's pro forma calculations of these ratios for 2011 through 2013 provided in response to Staff Data Request No. 0001 (see Schedule 1). Staff believes these calculations are generally consistent with S&P's methodology.

As of December 31, 2010, the consolidated Adjusted FFO to Total Debt, the consolidated Adjusted Total Debt to Total Capitalization and Debt/EBITDA ratios are all within the FRP range of "Aggressive" and because Empire has a BRP of "Excellent", this is consistent with the benchmark for a BBB credit rating under S&P's matrix.

Empire's pro-formas for fiscal year 2011 illustrate that the FFO to Total Debt and Total Debt to Total Capital ratios are both within the FRP range of "Aggressive" and the Debt/EBITDA ratio is within the FRP range of "Significant". Staff found all three of these ratios to be within the FRP range of "Significant" after analyzing Empire's fiscal year 2012 pro-formas. Assuming Empire would continue to have an "Excellent" BRP in 2012, this would be consistent with an "A-" credit rating under S&P's matrix. Empire's fiscal year 2013 pro-formas show all three ratios to be within the FRP range of "Aggressive". However, with a BRP of "Excellent", this would still be consistent with the benchmark for a "BBB" credit rating under S&P's matrix.

Consequently, it appears that Empire's proposed financing will not jeopardize its investment grade credit rating.

OTHER ISSUES:

The Staff has verified that the Company has filed its annual report and is not delinquent on any assessment.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve the Application submitted by Empire in this case subject to the following conditions:

1. That Empire shall make available to the Staff sufficient documentation to ensure that the amount of the funds acquired through issuance of securities under this Application shall be used exclusively for the benefit of Empire's regulated electric utility operations, and not for the other operations of Empire or any of its affiliates or non-regulated activities.

2. That the Company shall be required to file with the Commission all final terms and conditions on this financing including, but not limited to, the aggregate principal amount to be sold or borrowed, price information, estimated expenses, and the loan or indenture agreement concerning each issuance.
3. That the rate be consistent with similar securities of comparable credit quality and maturities issued by other issuers.
4. That the Company shall submit to the Financial Analysis Department of the Commission any information concerning communications with credit rating agencies in connection with this issuance(s).
5. That nothing in the Commission's order shall be considered a finding by the Commission of the value of these transactions for rate making purposes, and that the Commission reserves the right to consider the rate making treatment to be afforded these financing transactions and their results in cost of capital, in any later proceeding.
6. That the Company shall submit to the Financial Analysis Department of the Commission any information concerning use of the funds from the issuance(s) with regard to redemption of any outstanding long-term debt, including Net Present Value calculations indicating the amount of interest cost savings.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of The)
Empire District Electric Company for)
Authority to Issue and Sell Under its Existing)
Indenture of Mortgage and Deed of Trust)
Dated as of September 1, 1944, as Amended)
and Supplemented, up to and Including)
\$250,000,000 Principal Amount of its First)
Mortgage Bonds, in One or More Series and)
to, Among Other Things, Execute and
Deliver a Supplemental Indenture or
Indentures to Provide for the Terms of Said
Bonds

Case No. EF-2011-0393

AFFIDAVIT OF SHANA ATKINSON

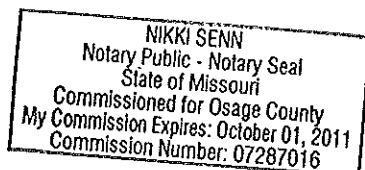
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)


Shana Atkinson, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by her; that she has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of her knowledge and belief.



Shana Atkinson

Subscribed and sworn to before me this 4th day of August, 2011.





Notary Public