

Exhibit No.:
Issues: *Rate Case Expense*
Energy Center 3 & 4
Witness: *Roberta A. McKiddy*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *ER-2004-0570*
Date Testimony Prepared: *November 24, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

ROBERTA A. McKIDDY

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

Jefferson City, Missouri
November 2004

****Denotes Highly Confidential Information****

NP

1
2
3
4
5
6
7
8
9

**TABLE OF CONTENTS OF
SURREBUTTAL TESTIMONY**

OF

ROBERTA A. McKIDDY

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

RATE CASE EXPENSE	1
ENERGY CENTER 3 & 4 (EC 3 & 4).....	7

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In The Matter of the Tariff Filing of The Empire)
District Electric Company to Implement a)
General Rate Increase for Retail Electric)
Service Provided to Customers in its Missouri)
Service Area.)
Case No. ER-2004-0570

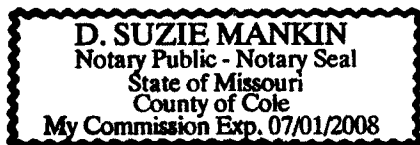
AFFIDAVIT OF ROBERTA A. MCKIDDY

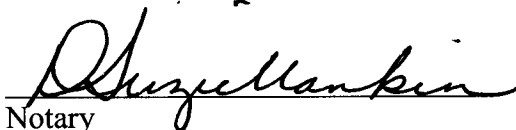
STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Roberta A. McKiddy, being of lawful age, on her oath states: that she has participated in the preparation of the following surrebuttal testimony in question and answer form, consisting of 17 pages to be presented in the above case; that the answers in the following surrebuttal testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.


Roberta A. McKiddy

Subscribed and sworn to before me this 23rd day of November 2004.




Notary

1 A. No. Although Ms. Walter's is correct that the Commission allowed
2 expenses associated with types of witnesses not previously utilized by a company in a
3 rate case or for allowing multiple witnesses for a single topic, she fails to elaborate on the
4 case-specific reasons stated by this Commission to support such allowance or the level of
5 expenses ultimately allowed in rates.

6 Q. Please explain.

7 A. The Commission's Report and Order in the Missouri Gas Energy (MGE)
8 rate case, Case No. GR-2004-0209, specifically states at page 18 and 19:

9 Not surprisingly, the low rates of return on equity espoused
10 by the witnesses for Staff and Public Counsel led MGE to
11 aggressively challenge the credibility of Murray and Allen. MGE
12 engaged the services of Dr. Roger Morin to challenge the
13 recommendation of Murray. Dr. Morin is a Professor of Finance
14 for Regulated Industry at the Center for the Study of Regulated
15 Industry at Georgia State University. He has a Ph.D. in Finance
16 and Econometrics at the Wharton School of Finance, University of
17 Pennsylvania. Dr. Morin wrote the textbook, Regulatory Finance,
18 upon which the other witnesses rely in their own testimony.
19 Dr. Morin's rebuttal testimony cites 15 specific criticisms of the
20 methods Murray used to arrive at his recommendation and
21 concludes that "Mr. Murray employs inappropriate and stale model
22 inputs throughout his analysis, which causes him to recommend
23 returns that are well below investors' required returns." Dr. Morin
24 did not, however, offer his own recommendation regarding an
25 appropriate return on equity.

26 Ms. Walters fails to recognize that the testimony provided by Dr. Morin in
27 the MGE rate case was not duplicative of the Company's primary rate of return witness,
28 John Dunn. Instead, Dr. Morin's testimony was offered to challenge the application of
29 the models used by Staff witness David Murray to arrive at his recommendation. Since
30 Dr. Morin is the author of one of the sources relied upon by Staff for its methodology,
31 this Commission found Dr. Morin's testimony to be an appropriate expense in the MGE
32 proceeding. In its Report & Order, the Commission also stated, "Dr. Morin is a highly

1 respected expert in his field. His \$30,000 fee is not excessive and will be allowed as a
2 rate case expense.”

3 The expenses associated with Empire’s additional rate of return witness in
4 this proceeding, Dr. Vander Weide, were disallowed by Staff because Dr. Vander
5 Weide’s testimony is duplicative of the Company’s primary rate of return witness,
6 Dr. Donald Murry. Here in lies the difference between the MGE case and the Empire
7 case. In addition, no other witnesses in this proceeding have used Dr. Vander Weide or
8 his work as an authoritative reference. Accordingly, Staff continues to support the
9 disallowance of rate case expense associated with Dr. Vander Weide as an inappropriate
10 expense to be included in rates. Instead, the shareholders of the Company should accept
11 responsibility for this expense.

12 Ms. Walters also fails to recognize that the Commission did not allow the
13 rate case expense associated with the services of MGE’s New York law firm, Kasowitz,
14 Benson, Torres & Friedman, LLP, at the full amount billed by the firm. Instead, the
15 Commission allowed a level of expense for the New York law firm based on the hourly
16 rate of MGE’s local counsel (i.e., \$200/hr vs. \$690/hr). The Commission specifically
17 stated:

18 Eric Herschmann and Michael Fay of the Kasowitz firm
19 did a good job of representing their client at the hearing. But the
20 firm charged up to \$690 per hour for its work. That rate is far
21 higher than the typical rates charged by lawyers appearing before
22 this Commission. The company is certainly entitled to hire
23 lawyers with whom it is comfortable, but it would not be fair to
24 require ratepayers to pay such high rates. The Commission will
25 reduce the rate to \$200 per hour, which is the rate charged by
26 MGE’s local counsel.

27 Q. Do you agree with Ms. Walters’ reasoning for including the costs
28 associated with the services of Mr. Johannes Pfeifenberger?

1 A. No. Ms. Walters again cites the MGE Order as precedent for employing
2 Mr. Pfeifenberger. However, the Staff continues to believe the expense associated with
3 the services of Mr. Johannes Pfeifenberger should also be disallowed. As stated in my
4 direct testimony, the primary reason Staff excluded the cost associated with the services
5 provided by Johannes Pfeifenberger was Empire's lack of documentation supporting the
6 need for such services. The Staff requested justification for the services
7 Mr. Pfeifenberger would provide, but found the Company's explanation inadequate to
8 support the inclusion of such rate case expense in rates. Staff Data Request No. 208.4
9 specifically requested the following information:

10 Please discuss in detail the rationale and justification for
11 hiring Johannes P. Pfenberger (sic.) of the Brattle Group. Provide
12 a detailed explanation of the scope of work to be performed, the
13 process relied upon for selection and the method used to determine
14 the reasonableness of the cost. Also, provide a copy of any reports
15 and/or analyses generated by this entity and an explanation of how
16 such reports and/or analyses were or will be utilized for purposes
17 of Empire's pending rate case.

18 Staff received the following response:

19 Subject to the Empire District Electric Company's
20 objections regarding information which is protected from
21 disclosure by the attorney-client privilege and/or the work product
22 doctrine, and without waiving the same, Empire responds as
23 follows:

24 Mr. Pfenberger (sic.) was retained based on the belief that
25 his representation is reasonable and prudent for an effective
26 presentation of Empire's case and that Mr. Pfenberger (sic.) is
27 well qualified for the assigned tasks. In selecting Mr. Pfenberger
28 (sic.), Empire relied on outside recommendations, used its
29 professional judgment, and evaluated costs in light of
30 Mr. Pfenberger's (sic.) qualifications, experience, and skill. As
31 stated in response to DR 208.7, it is Empire's policy to employ
32 only those experts who will help to properly evaluate and explain
33 the issues that arise in the context of a rate case.

1 Mr. Pfenberger (sic.) has assisted with testimony
2 preparation, but has not generated any reports and/or analyses for
3 this case. Mr. Pfenberger's (sic.) work may be used to support
4 Empire's positions on various issues, but the complete and final
5 scope of his work is not yet determined.

6 Since receiving Company's response, Staff has learned that
7 Mr. Pfeifenberger possesses expertise in the areas of incentive regulation and return on
8 equity. Based on his areas of expertise, Staff concludes that Mr. Pfeifenberger might
9 participate in preparation of rate of return testimony or testimony related to incentive
10 regulation. However, incentive regulation is not an issue in this case and
11 Mr. Pfeifenberger would represent the third rate of return witness employed by Empire in
12 this case. As such, Staff continues to support the disallowance of rate case expense
13 associated with Mr. Pfeifenberger as an inappropriate expense to be included in rates.
14 Until such time as the Company provides adequate justification to support the inclusion
15 of this expense in rate case expense, Staff must recommend that shareholders of the
16 Company accept responsibility for this expense.

17 Q. Please indicate the current level of rate case expense incurred to date by
18 Empire in this proceeding.

19 A. Based on Company's response to Staff Data Request No. 208.9, Empire
20 has incurred rate case expense in the amount of \$612,202 as of October 31, 2004.

21 Q. How does this compare with previous Empire rate cases?

22 A. In Case No. ER-2001-299, a partially litigated case, Empire spent
23 \$627,609. The \$612,202 spent for this case does not even include the cost associated
24 with rebuttal, surrebuttal and the hearing. It is obvious that Empire has drastically
25 increased the rate case cost burden on ratepayers in this case.

1 Q. What is the total rate case expense incurred as of October 31, 2004
2 associated with the services of Dr. James Vander Weide and Mr. Johannes Pfeifenberger?

3 A. Rate case expense associated with Dr. Vander Weide and
4 Mr. Pfeifenberger are \$15,750 and \$8,800, respectively. However, Empire has projected
5 that Dr. Vander Weide's fees will total \$50,750 assuming full litigation of this case.

6 Q. Do you agree with Ms. Walters' statement on page 6, that the Company
7 has not taken a "cost is no object approach" approach to this case?

8 A. To the contrary, based on the following statements of Mr. William Gipson,
9 Empire's CEO, at page 34, lines 8-17 of his deposition on November 8, 2004, the
10 Company has shown little concern for controlling the cost of this case:

11 Q. And so would you justify charging customers for
12 additional costs related to those additional witnesses?

13 A. I think the – I think the company has the
14 responsibility and, furthermore, the right, if you will to present its
15 case before the Commission. And I think that the Commission has
16 consistently treated rate case expense in that manner.

17 Q. Do you think it would be appropriate for
18 shareholders to pick up some of the additional cost?

19 A. No.

20 Apparently, Mr. Gipson believes Empire has the "right" to spend whatever
21 it wants to present its case before the Commission and that this cost should be borne
22 solely by ratepayers. Even though Mr. Gipson believes the Commission has consistently
23 treated rate case expense in this manner, one must look no farther back than the most
24 recent MGE case to see that the Commission has, in fact, disallowed rate case expense.

25 Q. Please respond to Ms. Walters' statements regarding cost controls on
26 page 7 of her rebuttal.

1 A. Ms. Walters states that the Company maintains contact with hired
2 consultants and reviews and approves invoices prior to payment. The Staff would expect
3 these practices as the bare minimum of control Empire should exert over its consultants.
4 However, the Company has no formal practice or procedure for the hiring of consultants.
5 In addition, although it has employed six consultants as well as two law firms, Empire
6 used a competitive bidding process for only one consultant.

7 **ENERGY CENTER 3 & 4 (EC 3 & 4)**

8 Q. On page 16 at lines 9 through 11 of Mr. Beecher's rebuttal testimony, he
9 states: "Energy Center 3 & 4 was a \$55 million project, which came in only \$220,301
10 over budget, a variance of only 0.4%." Do you agree with Mr. Beecher's characterization
11 of this cost variance associated with the construction of EC 3 & 4?

12 A. No.

13 Q. Please explain.

14 A. While the overall cost of the project came in only \$220,301 over the
15 amount approved by Empire's Board of Directors in October 2001, it is not appropriate to
16 view the \$55 million as a definitive budget for cost control or project cost comparison.
17 Even the component itemization later developed by Empire appears to be an exercise in
18 allocating the \$55 million among various individual components rather than an attempt to
19 determine the expected cost of the overall project.

20 Q. How would you characterize the \$55 million?

21 A. Staff stated in its response to Empire's Data Request No. 471:

22 The Staff's determination of prudence focused on the
23 decisions made and the actions taken by the Company in
24 management of the project and the general contractor. The Staff
25 believes that the Company's determination of \$55 million was an

1 acceptable amount to use to gain approval from Empire's Board of
2 Directors for the construction of Energy Center Units 3 & 4.
3 However, the Staff believes this amount was not appropriate for
4 project control, since the expanded budget, by component, appears
5 to have been tailored to equal the original \$55 million estimate.

6 Q. Why does the Staff hold this view of the \$55 million?

7 A. This view is supported by the Company's response to the Staff's inquiry
8 regarding the development of the \$55 million. In response to Staff Data Request
9 No. 420, the Company states:

10 The \$55 million budget for Energy Center 3 & 4 was
11 arrived at in two different ways. First, it was estimated that the
12 cost to purchase and construct 100 MW of aero-derivative
13 combustion turbines would be \$500/kW (\$50 million). This was
14 purely based on estimates from historical industry data that had
15 been seen in different publications. This number can be seen in
16 Brad Beecher's Board Presentation from July 2001 and attached as
17 part of DR 0418. Because this number was of generic form, it was
18 thought that a 10 percent contingency (\$5 million) should be added
19 and thus the total project budget of \$55,000,000.

20 After this generic estimate was arrived at, Empire
21 proceeded with evaluations of different aero-derivative turbines
22 and eventually decided that the Pratt & Whitney FT8 Twin Pac
23 was the turbine of choice (see attachment to DR 0423 for
24 justifications). The cost for two of these turbines (50 MW each)
25 was a total of ** _____ **. Informal discussions with Pratt
26 & Whitney about prior projects provided information that an
27 estimate of \$9 million per turbine (\$18 million total) for
28 installation and balance-of-plant (BOP) equipment was reasonable.
29 This installation and BOP cost plus the cost of the turbines totaled
30 \$53 million. An additional \$2 million for contingency verified the
31 total project budget of \$55 million.

32 This response illustrates the purely generic nature of the \$55 million figure
33 that was used to gain approval to construct EC 3 & 4. The \$55 million is not a definitive
34 budget or a tool for cost control.

35 Q. You stated earlier that the component itemization later developed by
36 Empire appears to be an exercise in allocating the \$55 million among various individual

1 components rather than an attempt to determine the expected cost of the overall project.

2 Why does Staff hold this view?

3 A. The component itemization contains seven (7) components, each of which
4 were estimated at 80% above the actual final cost. The aggregate amount by which
5 these seven items exceeds the actual cost is \$3,360,519.00 (see Schedule 1 attached).
6 For several of these items, such as fire protection, the amounts were described to the Staff
7 as “place holders” and the Company acknowledged that they knew at the time that the
8 actual expenditures would be far less. In addition, the final contingency which appeared
9 on the component itemization was described as “remaining board approved budget after
10 above estimates were made” [Company’s response to Staff DR 356. See Schedule 2
11 attached]. Using more accurate estimates for these items would have reduced the
12 expected cost of the project, prior to the contingency, to approximately \$49.7 million.

13 Q. What is the Staff’s opinion regarding the amount of the contingency?

14 A. There should be little, if any, contingency associated with the cost of the
15 Pratt and Whitney (P&W) components. After receiving the P&W bid, the cost of this
16 equipment would have been a fixed component of the project. Therefore, a
17 contingency of approximately \$1.5 million would have been appropriate using the
18 Company’s 10% factor and the correct cost for the project excluding the
19 P&W component ** _____ **.

20 Q. Based on these calculations, what does the Staff believe the budget for this
21 project should have been?

22 A. A realistic budget for this project, one that represented an accurate
23 expectation of the cost plus a contingency, would have been approximately

1 \$51.2 million ($\$49.7 + \$1.5 = \51.2). As a result, the final actual cost of \$55.2 million
2 was approximately \$4 million over budget. Furthermore, the Board of Directors'
3 approval of a "generic" cost of \$55 million did not relieve the individuals managing the
4 project from their duty to reduce that amount, if possible, and to develop appropriate
5 budgeting tools for cost control.

6 Q. On page 21, lines 18 through 21, of his rebuttal testimony, Mr. Beecher
7 criticizes the Staff for not giving Empire credit for line items that out performed the
8 budget, such as Start-up Fuel and Fire Protection. Are these items part of the "80% under
9 budget" items you discuss above?

10 A. Yes. However, the reductions in cost did not result from Empire's shrewd
11 management of the project. Therefore, no "credit" is necessary. For example, Empire
12 personnel described the amount estimated for Fire Protection to the Staff as a placeholder
13 and an amount the Company knew it would not spend for that particular component of
14 the project. This unrealistic amount should have been replaced at the beginning with an
15 amount more reflective of the true estimated cost for this component. As another
16 example: the original amount of start-up fuel was based on the Company's cost of fuel
17 for testing and did not include the offsetting value associated with selling the power
18 generated during testing. When the value of test power was included, this component
19 became a negative amount. Empire could and should have accounted for such factors
20 when it created the initial budget. Therefore, Empire deserves no "credit" for its failure
21 to include realistic estimates and consider offsetting items.

22 Q. You have been discussing the Company's cost estimates and the
23 determination of these amounts. Is this the basis of the Staff's partial disallowance?

1 A. No. Regardless of the adequacy or inadequacy of Empire's techniques for
2 estimating the project cost, Staff's disallowance is based on the imprudent actions taken
3 by Empire related to the contract awarded to Patch Construction LLC (Patch) for the
4 engineering, installation and procurement of the EC 3 & 4 construction project, a
5 component of the itemized budget developed by Empire to which the Company allocated
6 an amount of \$12,000,000. More specifically, Staff's disallowance is based on Empire's
7 failure to enforce its own contract provision requiring Patch to obtain a performance
8 bond. The original contract amount (including Empire-approved change orders) Empire
9 agreed to pay for Patch's services was \$11,365,382.00. Empire had already paid this
10 amount by the time it terminated its relationship with Patch prior to the project's
11 completion. To complete the project, Empire incurred an additional cost of
12 \$4,321,356.26. This additional cost brought the total cost associated with the
13 engineering, installation and procurement of EC 3 & 4 to \$15,686,738.26. This
14 additional cost incurred to complete the project translates into a variance of 38% over the
15 original Patch contract amount (including Empire approved change orders). This
16 variance amount is the subject of Staff's disallowance.

17 Q. Why is the Patch contract the only component of the EC 3 & 4 project
18 budget that the Staff addresses in its partial disallowance determination?

19 A. In the Staff's opinion, additional costs incurred regarding this particular
20 component of the EC 3 & 4 project were due to the imprudent actions taken by Empire
21 that exposed the Company to an unnecessary level of financial risk, specifically,
22 Empire's failure to enforce its own contract provision requiring Patch to obtain a
23 performance bond.

1 Q. Please explain.

2 A. When Empire decided to contract with Patch, the Company appropriately
3 covered its financial risk that Patch would “fail to perform” through the contractual
4 requirement for Patch to acquire a performance bond. However, Empire exposed itself to
5 the financial risk associated with the additional costs incurred to complete the EC 3 & 4
6 project when Empire made the decision not to enforce this contractual requirement.

7 Q. How has Mr. Beecher characterized the Company’s actions to minimize
8 its exposure to additional financial risk in his rebuttal testimony?

9 A. Beginning at page 16 at lines 21 through 23 and continuing on page 17 at
10 lines 1-7 of his rebuttal testimony, Mr. Beecher states:

11 The contract with Patch required them to provide a
12 performance bond for the work that was to be performed under the
13 contract within 21 days of contract signing. Patch was unable to
14 meet this requirement. In an attempt to finish the project in a cost
15 and time effective manner Empire entered into Amendment 1 to
16 the contract with Patch. Ultimately, Patch was unable to meet its
17 obligations under the original contract or Amendment 1 and was
18 terminated as a contractor on the project. Empire personnel took
19 over management duties of the construction and completed the
20 project. The final cost to complete the activities associated with
21 Patch’s contract was higher than the contract amount. Staff
22 contends that a portion of these costs above the contract amount
23 should be disallowed as plant-in-service.

24 Q. Do you agree with Mr. Beecher’s characterization of the circumstances
25 leading to Staff’s disallowance?

26 A. No. Staff agrees with Mr. Beecher that Amendment 1 was entered into.
27 However, Mr. Beecher understates the events leading up to entering into Amendment 1.

28 Patch was required to provide a performance bond within 21 business days
29 of the contract signing or by March 15, 2002. A performance bond would have provided
30 a safeguard for Empire against the financial risk associated with cost over-runs caused by

1 the contractor's failure to perform as agreed to by contract. A performance bond would
2 have reimbursed Empire for the additional cost incurred when Patch failed to complete
3 the installation of EC 3 & 4 at the contract price. Patch, however, did not provide a
4 performance bond. As previously stated in my direct testimony, it also appears that the
5 Company did not diligently pursue Patch's obtaining the bond. The Company provided
6 only two electronic mail messages dated March 21, 2002 and July 3, 2002, regarding its
7 correspondence with Patch concerning the obtaining of the performance bond. By the
8 date of the first correspondence, Patch was already beyond the 21-day requirement for
9 obtaining a bond.

10 Q. Did the Amendment 1 mentioned by Mr. Beecher in his rebuttal testimony
11 provide the same level of protection as a performance bond?

12 A. No. Amendment 1 was intended to minimize the Company's exposure to
13 increased financial risk. The amendment was intended to provide a personal guarantee
14 whereby Patch Construction LLC, Patch Inc., Chester J. Patch III and Patricia M. Patch
15 would become personally liable for any unapproved costs above the original contract
16 amount. However, the amendment's protection is dependent on the financial strength of
17 the individuals and entities that assumed liability for non-performance. The Staff's
18 review of the financial statements provided by Patch as a condition of Amendment 1
19 prior to the filing of Staff's direct testimony revealed that essentially all of the assets of
20 Patch were pledged for its line of credit making Patch incapable of pledging its assets as a
21 requirement of Amendment 1.

22 Q. Do you have further information regarding Amendment 1?

1 A. Yes. During the deposition of Mr. Beecher, Staff learned Patch was
2 initially asked by Empire to sign a secured personal guarantee as a condition of
3 Amendment 1. However, Patch refused to sign such a guarantee. As a result, Empire
4 entered into Amendment 1 with an unsecured personal guarantee from Patch.

5 Q. Does an unsecured personal guarantee provide the same protection as a
6 performance bond?

7 A. No. The following information was obtained during the deposition of
8 Mr. Beecher beginning on page 44 at line 4 and continuing through page 45, line 22:

9 Q. Did Empire request proof of financial viability from
10 Patch after it was determined that Patch could not secure a
11 performance bond?

12 A. Yes.

13 Q. And what proof was that?

14 A. We received financial statements from Patch Inc.,
15 Patch Construction and Joe Patch personally.

16 Q. And what financial analysis did Empire perform on
17 those financial statements?

18 A. Mr. Knapp, Mr. Gatz and myself reviewed those
19 financial statements.

20 Q. And what was the result of your financial analyses
21 of those statements?

22 A. I believe I said this at some other point. Maybe not.
23 There wasn't a whole lot of financial assets available from any of
24 the Patch entities. And I'll just read the word Patch entities for
25 Patch Construction, Patch Engineering and Joe Patch, if that's
26 okay with you guys. As we go forward, when I say Patch entity, it
27 will mean all three of them.

28 Q. Were there any written results of your analyses,
29 your personal ones or anyone else's, to your knowledge?

30 A. Not to my knowledge.

31 Q. Did Empire have any concerns about the results of
32 those analyses?

33 A. We understood and knew that there were not a lot of
34 assets in the Patch entities.

35 Q. Would that be something that you would consider a
36 concern?

1 A. It was a concern on par with schedule. It was a
2 concern on par with how can we complete this at the lowest cost.
3 It was one of the many factors that we were trying to weigh.

4 Q. How did Empire reconcile its concerns or how did
5 you as the management reconcile your concerns with Patch's
6 financial situation?

7 A. We got as much guarantee, including a personal
8 guarantee, unsecured, which is what we could get Patch to agree to
9 sign, because other – their lines of credit had unsecured priority
10 security interest in the proj—in their entities, I guess, is my
11 memory. Beyond that, we figured we had to limit their financial
12 involvement as much as we could.

13 Additional information obtained through the deposition of Mr. Beecher
14 begins on page 50 at line 23 and continues through page 51, line 22.

15 Q. Do you believe that Empire believed that
16 Amendment 01 would provide the same protection as that afforded
17 by a performance bond?

18 A. No, Amendment 01 did not provide the same
19 protection as a performance bond....

20 Q. Why didn't you believe that Amendment 01 did not
21 provide the same protections as a performance bond?

22 A. A performance bond correctly would have made
23 sure the scope of work was performed at the cost they bid.
24 Without the performance bond, that guarantee or cap was not there.

25 Q. Other than Amendment 1, did Empire pursue any contingency planning
26 between March 15, 2002 and July 22, 2002 to address the possibility that Patch would be
27 unable to complete the EC 3 & 4 construction project?

28 A. No.

29 Q. Do you believe the Staff has applied a new standard with regard to its
30 disallowance of the costs related to Patch's failure to complete the construction project?

31 A. No. These projects were managed differently.

32 For the construction of the State Line Combined Cycle Unit (SLCC)
33 construction project (the subject of review in Case No. ER-2001-0299), Empire acted as
34 the operating partner, which can be thought of as the general contractor. Empire hired

1 Black and Veatch Corporation (Black & Veatch) to provide management and oversight to
2 the construction of the Combined Cycle Unit, but Empire took a hands-on approach to
3 the construction of the generating unit. It was Empire's responsibility to obtain the
4 equipment and the installation contractors needed to get the new unit operational on
5 schedule and within budget. Any amount over budget was the responsibility of Empire
6 as the general contractor of the project.

7 In contrast, in the project at issue in the current case, Empire chose to
8 construct the EC 3 & 4 using a "turn-key" approach. This contract made Patch
9 responsible for ensuring the units were installed on schedule and within budget. To
10 ensure that Patch would perform and that Empire would not be responsible for the cost
11 overruns of the general contractor, Empire's contract with Patch required a performance
12 bond.

13 Q. Do you believe the Staff has applied an inappropriate standard in this case
14 regarding its disallowance?

15 A. No. It is important to remember that the EC 3 & 4 project consisted of
16 only two main cost items, the P&W equipment and the Patch contract. These two
17 components were ** _____ ** generic estimate. Because the P&W
18 component consisted of purchase and delivery of equipment, the Staff's examination of
19 this item was less extensive. Therefore, I believe an examination, which focused of the
20 other main project component was entirely appropriate.

21 Q. Was Patch able to complete the installation of EC 3 & 4 for the contract
22 amount?

23 A. No.

1 Q. Did Empire expose itself and ratepayers to additional financial risk by not
2 enforcing the contract provision that required Patch to acquire a performance bond?

3 A. Yes.

4 Q. Do you disagree with Mr. Beecher about who should be responsible for
5 the additional costs resulting from Empire's decision not to enforce this contract
6 provision?

7 A. Yes. Empire and its shareholders, not ratepayers, should be responsible
8 for the additional cost resulting from Empire's decision not to enforce the contract
9 provision that required Patch to acquire a performance bond.

10 Q. Does this conclude your surrebuttal testimony?

11 A. Yes, it does.

SCHEDULES 1 and 2

HAVE BEEN DEEMED

HIGHLY CONFIDENTIAL

IN THEIR ENTIRETY