

**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-2009-0180**

**STAFF RECOMMENDATION TO CONDITIONALLY AUTHORIZE
THE EMPIRE DISTRICT ELECTRIC COMPANY TO ISSUE DEBT SECURITIES**

Comes now the Staff of the Missouri Public Service Commission and recommends the Commission, subject to conditions, grant The Empire District Electric Company's (Empire) application for authority to issue debt securities as follows:

1. On November 13, 2008, The Empire District Electric Company filed an application seeking authority to issue and sell up to and including \$250,000,000 principal amount of its First Mortgage Bonds under its existing Indenture of Mortgage and Deed of Trust through December 31, 2011.

2. The Commission has jurisdiction over Empire's issuance of debt. Sections 393.180 and 393.200 RSMo 2000.

3. In the attached Memorandum (Appendix A), the Missouri Public Service Commission's Financial Analysis Department Staff recommends the Commission conditionally authorize Empire to issue First Mortgage Bonds in an amount up to and including \$250,000,000 through December 31, 2011, pending receipt of the definite terms of issuance and subject to the following nine conditions:

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1. That the Company shall be authorized to issue up to and including of \$250 million in First Mortgage Bonds under its existing Indenture of Mortgage and Deed of Trust. The Company shall not be authorized to use any portion of the debt securities for any purpose other than to discharge long term indebtedness by the payment of principal at maturity, to refinance outstanding indebtedness, including the payment of applicable redemption premiums, for construction identified as Projected Infrastructure Investments in Appendix A of the Experimental Regulatory Plan in Case No. EO-2005-0263, for construction associated with the Plum Point Power Plant and for other incidental electric utility construction projects.
2. That the Company shall submit to the Financial Analysis Department of the Commission the three key financial ratios (i.e. Adjusted Total Debt to Total Capitalization, Adjusted Funds From Operations Interest Coverage, and Adjusted Funds From Operations as a percentage of Average Total Debt) that were agreed to and defined in the Stipulation and Agreement in Case No. EO-2005-0263. The financial ratios shall be submitted on a quarterly calendar year basis and after each issuance of long-term debt and/or common stock identified in Appendix 5 of the Application. The ratios shall be calculated for Empire on a consolidated basis and for Empire's Missouri jurisdictional electric utility operations.
3. That the Company's consolidated Adjusted Total Debt to Total Capitalization Ratio objective shall be 56.5% during the period of the Experimental Regulatory Plan approved by the Commission in Case No. EO-2005-0263. If the consolidated Adjusted Total Debt to Total Capitalization Ratio exceeds 56.5% based on a rolling twelve month average for the period subject to review in a rate case during the period of the Experimental Regulatory Plan, then this will be considered in the amount of amortization necessary in any future rate cases in which the Experimental Regulatory Plan is still in effect.
4. 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.
5. 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.
6. That the rate be consistent with similar securities of comparable credit quality and maturities issued by other issuers.

7. 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).
8. 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.
9. That the Company shall file with 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.

Wherefore, the Staff recommends the Commission conditionally authorize The Empire District Electric Company to issue new debt securities through December 31, 2011 in principal amount up to and including \$250 million, pending receipt of the definite terms of issuance, and subject to the nine conditions stated in the Staff's memorandum and restated above.

Respectfully submitted,

/s/ Sarah Kliethermes
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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 13th day of January, 2009.

/s/ Sarah Kliethermes

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EF-2009-0180, The Empire District Electric Company

FROM: David Murray, Financial Analysis Department

/s/ David Murray 01/13/09
Project Coordinator / Date

/s/ Sarah Kliethermes 01/13/09
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: January 13, 2009

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 6.50%. However, Paragraph 8 of Empire's Application indicates that it is requesting Commission authority to issue the Bonds at an interest rate of up to 12%.
- (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 December 31, 2011.
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. More specifically, Empire may use the proceeds for purposes of financing its ongoing construction program, which includes proposed construction under its Experimental Regulatory Plan approved by the Commission in Case No. EO-2005-0263.

(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 87% of gross operating revenues in 2007). Missouri comprised 89% of Empire's 2007 retail electric revenues. Empire also distributes natural gas through its subsidiary, The Empire District Gas Company (EDG), which comprised 12.2% of Empire's 2007 gross operating revenues.

Empire filed a Registration Statement with the Securities and Exchange Commission (SEC) on August 1, 2008, for a \$400 million universal shelf registration of common stock, preference stock, unsecured debt securities and first mortgage bonds and preferred securities of Empire District Electric Trust II or Empire District Trust III guaranteed by Empire. The Registration Statement was declared effective by the SEC on August 15, 2008.

On November 13, 2008, 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.

The Company's Application respecting the purpose of the Bonds stated that the proceeds from the sale of each series of the Bonds may be used to provide financing for its construction program, including the Projected Infrastructure Investments as detailed in Appendix A (see Attachment A to this Memorandum) of the Experimental Regulatory Plan that was approved by the Commission in Case No. EO-2005-0263. The Application also stated that Empire plans 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 5 attached to the Application, approximately \$150 million of the proposed Bonds will be used to refinance \$50 million of Trust Preferred Securities in 2009, refinance \$50 million of 6.50% of First Mortgage Bonds due to mature in 2009 and refinance \$49 million of unsecured 7.05% notes, which are due to mature in 2022, but may be redeemed at any time for 100% of the principal amount, plus accrued and unpaid interest to the redemption date. The Application does not identify the specific projects that may be funded by the remaining \$100 million in proposed Bonds, other than a reference to Projected Infrastructure Investments identified in the Experimental Regulatory Plan. Appendix 5 shows that the additional \$100 million in proposed Bonds will be used to refinance existing short-term debt. The specific use of the funds acquired through the issuance of this short-term debt is not identified in the Application.

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. Because the funds may be used to refinance short-term debt and short-

term debt may be used for virtually any purpose, it is impossible to specifically earmark the actual funds to expenditures associated with the electric utility operations. Regardless, Staff believes it is prudent to limit the use of the remaining amount of \$100 million of funds in this request to projects detailed in Appendix A of Empire's Experimental Regulatory Plan, to investments necessary for Empire's participation in the coal-fired Plum Point Power Plant (Plum Point) and for other incidental electric utility projects. Based on Empire's response to Staff Data Request No. 4, Empire projects to spend \$105 million on Iatan II alone during the next two years. Therefore, the planned amount of capital expenditures on the projects proposed in the Experimental Regulatory Plan should exceed the amount of requested collateralization.

Further, Staff believes if any of the proceeds intended to be used for refinancing of existing securities are not ultimately used for this purpose, the amount of funds should also be limited to uses associated with Empire's construction plans described in the previous paragraph. If Empire encounters the need to use the funds for purposes other than those outlined in the above paragraph, then Empire should be required to file another Application seeking Commission authority to do so.

In its Application, the Company seeks authority to issue long-term indebtedness at interest rates not to exceed 12.0%. The pro forma financial statements provided in response to Staff Data Request No. 1 assume an interest rate of 6.5% for all debt issued through 2011. Empire estimated this cost based on interest rates of recently issued debt and the belief that Empire's cost to issue debt was trending upward. Empire's request to be able to issue Bonds at interest rates of up to 12.0% is not consistent with the Empire's assumed interest rate of 6.5% in its pro forma financial statements. While Staff does not believe Empire will have to issue Bonds at interest rates as high as 12.0%, Staff does recognize the need for flexibility because of the variability in the cost of debt due to market related factors. This is especially true in the current credit environment. Therefore, Staff believes it is appropriate for the Commission to allow Empire to issue the Bonds as long as the rates are consistent with rates for similar securities of comparable credit quality and maturities issued by other issuers. Staff's proposed conditions address this matter.

Staff has reviewed the pro forma financial statements that were provided by Empire in response to Staff Data Request No. 1. 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 2011. Because Empire is a Kansas Corporation, based on the opinions of the Company's counsel and the Commission's General Counsel Office, it is required to request Commission approval to issue financing only when it seeks authority to pledge its 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. Specifically, Empire anticipates issuing \$100 million of debt and \$150 million of common equity in 2009; \$100 million of debt in 2010; and \$50 million of debt in 2011. 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. Staff discusses a proposed condition later in its recommendation that should provide some protection on the maximum amount of debt leverage that Empire may employ over the term of the financing.

The Experimental Regulatory Plan in Case No. EO-2005-0263 specifically indicated that the Adjusted Total Debt to Total Capitalization ratio would be addressed in future Empire financing cases. Pursuant to this provision, Staff evaluated Empire's pro forma financial statements over the term of the proposed financing to determine how Empire's financing plan may affect its capital structure. Staff also analyzed the pro forma financial statements to determine how Empire's financing plan may affect its Adjusted Funds from Operations (FFO) Interest Coverage ratio and Adjusted FFO as a Percentage of Average Total Debt (Adjusted FFO to Average Total Debt) ratio. These two ratios were agreed to be used in Empire rate cases filed during the term of Experimental Regulatory Plan to determine if additional cash flow is necessary from its Missouri electric jurisdictional operations. All three of the ratios were specifically defined in Appendix C (see Attachment B to this Memorandum) of the Experimental Regulatory Plan. The Experimental Regulatory Plan allows for Adjusted FFO Interest Coverage to be at least 3.2x for Missouri jurisdictional operations and Adjusted FFO to Average Total Debt to be at least 19.5% (see Attachment C to this Memorandum for all ratio targets and methodology). As stated in the Experimental Regulatory Plan, if any of the amounts used in calculating these ratios are considered to be imprudent, the ratios shall be adjusted as necessary at the time of future rate cases.

Staff compared Empire's September 30, 2008 actual capital structure to its pro forma capital structures from 2009 through 2011 (see Attachment D). These capital structures have not been adjusted for off-balance sheet debt such as operating leases and purchased power agreements. As can be seen on Attachment D, if Empire executes its financing plan as shown in its pro forma financial statements, then Empire's common equity ratio should increase from the September 30, 2008 quarter-ended level of 44%. Empire assumed a \$22 per share price for its public offering of common stock in 2009 for purposes of the pro forma financial statements. If Empire's share price should remain somewhere in last month's trading range of approximately \$16 to \$18 per share, Empire may feel pressure to issue less common equity in 2009 than originally planned. If so, this may cause Empire's capital structure to continue to be more leveraged.

A recent November 18, 2008 Standard & Poor's (S&P) research report on Empire provided the results of S&P's calculations of the three ratios that are used as benchmarks in the Experimental Regulatory Plan. Staff compared these results to the pro forma calculations of these ratios for 2009 through 2011 provided by Empire in response to Staff Data Request No. 1 (see Attachment E). Staff reviewed these calculations and believes they are generally consistent with S&P's methodology. Regardless, Staff notes that the parties agreed to the calculation methodology in Empire's last rate case.

As of September 30, 2008, the consolidated Adjusted FFO Interest Coverage ratio exceeded the benchmark set in the Experimental Regulatory Plan. However, the consolidated Adjusted FFO to Average Total Debt and the consolidated Adjusted Total Debt to Total Capitalization did not meet the benchmarks set out in the Experimental Regulatory Plan. Because these ratios were based on financial information for the twelve months-ended September 30, 2008, the revenues from Empire's recent Missouri rate case were not fully captured. Assuming expenses were held constant, this would improve both the Adjusted FFO Interest Coverage ratio and Adjusted FFO to Average Total Debt ratio.

If Empire is to continue to improve its consolidated FFO to Average Total Debt ratio, then it needs to improve its FFO and/or reduce the amount of debt leverage it uses. The rates approved in Empire's last two rate cases, Case Nos. ER-2006-0315 and ER-2008-0293, have included additional amortizations of \$10,168,615 and \$4,463,535 respectively. The need for additional amortization amounts in rates was driven by the FFO to Average Total Debt ratio for Empire's Missouri electric utility operations. Consequently, Empire's regulated operations in Missouri have contributed cash flow to help Empire achieve these ratios, but apparently these increases have not been sufficient for Empire's consolidated ratios to meet the minimum benchmark because Empire's consolidated FFO to Average Total Debt was 18.1% in 2007. This ratio deficiency does not necessarily provide support for additional rate increases for Empire's Missouri electric operations because Empire's other operations may not be contributing sufficient cash flow to meet these benchmarks. Additionally, the risk profile of some of the other operations may be different from that of Empire's Missouri electric utility operations. For example, Empire's natural gas distribution system in Missouri may have a lower business risk profile than Empire's Missouri electric utility operations, which may justify the use of more debt. However, to Staff's knowledge, the credit rating agencies have not reduced Empire's overall business risk profile due to Empire's natural gas distribution operations.

Attachment D indicates that Empire's consolidated Adjusted Total Debt to Total Capitalization at the end of the third quarter of 2008 exceeded the maximum benchmark set out in the Experimental Regulatory Plan. However, Empire's quarterly report for the third quarter of 2008 submitted to the Financial Analysis Department in accordance with the conditions in the last Empire finance case, Case No. EF-2006-0263, shows that the Missouri jurisdictional Adjusted Total Debt to Total Capital was 53.9%, which is below the benchmark of 56.5%. In Empire's most recent rate case, the Missouri jurisdictional Adjusted Total Debt to Total Capital ratio was 52.1% in the additional amortization calculation.

While the Experimental Regulatory Plan focuses on the Missouri jurisdictional ratio calculations for purposes of determining the need for an additional rate increases beyond the normal cost of service, Staff recognizes that the Experimental Regulatory Plan indicated that the Adjusted Total Debt to Total Capital ratio would be addressed in future finance cases. The Experimental Regulatory Plan indicates "Empire understands that it is responsible to take prudent and reasonable actions to maintain Empire's debt at investment grade levels and avoid actions that result in a downgrade." Staff believes this means Empire should take actions at the consolidated level to maintain Empire's debt at an investment grade level. Therefore, Empire should be capitalized on a consolidated basis consistent with the benchmark outlined in the Experimental Regulatory Plan. If Missouri ratepayers are required to pay higher rates to assist in maintaining these financial ratios,

then Staff believes Empire should capitalize itself on a consolidated basis in a manner that shows its commitment to the benchmarks outlined in the Experimental Regulatory Plan.

Appendix 5 attached to Empire's Application shows an anticipated common equity issuance of \$150 million in 2009, which should at least initially rebalance Empire's consolidated capital structure back to a level below the benchmark in the Experimental Regulatory Plan. Although the pro forma ratios do not exceed the 56.5% benchmark, it is possible that as actual events occur, this benchmark may be breached. Staff believes that it is prudent, therefore, to condition the approval of this financing on Empire's commitment to ensure that Empire's consolidated ratio is below the benchmark on the basis of a rolling twelve month average. Staff also believes that if this consolidated ratio should exceed the benchmark based on a rolling twelve month average during the period subject to review in a rate case, then this will be considered in the amount of amortization necessary in any future rate cases in which the Experimental Regulatory Plan is still in effect.

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 the Company shall be authorized to issue up to and including of \$250 million in First Mortgage Bonds under its existing Indenture of Mortgage and Deed of Trust. The Company shall not be authorized to use any portion of the debt securities for any purpose other than to discharge long term indebtedness by the payment of principal at maturity, to refinance outstanding indebtedness, including the payment of applicable redemption premiums, for construction identified as Projected Infrastructure Investments in Appendix A of the Experimental Regulatory Plan in Case No. EO-2005-0263, for construction associated with the Plum Point Power Plant and for other incidental electric utility construction projects.
2. That the Company shall submit to the Financial Analysis Department of the Commission the three key financial ratios (i.e. Adjusted Total Debt to Total Capitalization, Adjusted Funds From Operations Interest Coverage, and Adjusted Funds From Operations as a percentage of Average Total Debt) that were agreed to and defined in the Stipulation and Agreement in Case No. EO-2005-0263. The financial ratios shall be submitted on a quarterly calendar year basis and after each issuance of long-term debt and/or common stock identified in Appendix 5 of the Application. The ratios shall be calculated for Empire on a consolidated basis and for Empire's Missouri jurisdictional electric utility operations.
3. That the Company's Consolidated Adjusted Total Debt to Total Capitalization Ratio objective shall be 56.5% during the period of the Experimental Regulatory Plan approved by

the Commission in Case No. EO-2005-0263. If the consolidated Adjusted Total Debt to Total Capitalization Ratio exceeds 56.5% based on a rolling twelve month average for the period subject to review in a rate case during the period of the Experimental Regulatory Plan, then this will be considered in the amount of amortization necessary in any future rate cases in which the Experimental Regulatory Plan is still in effect.

4. 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.
5. 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.
6. That the rate be consistent with similar securities of comparable credit quality and maturities issued by other issuers.
7. 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).
8. 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.
9. That the Company shall file with 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.

Attachments: A Projected Infrastructure Investments
 B Financial Ratio Definitions
 C Process Illustration
 D Changes in Capitalization for 2008-2011 for The Empire District Electric Company
 E Comparison of Empire's Actual and Pro-Forma Financial Ratios to the Benchmark Financial Ratios from Empire's Experimental Regulatory Plan

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AFFIDAVIT OF DAVID MURRAY

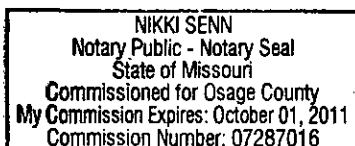
STATE OF MISSOURI)	
)	ss.
COUNTY OF COLE)	

David Murray, of lawful age, on his oath states: that he 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 him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.



David Murray

Subscribed and sworn to before me this 13th day of January, 2009.





Notary Public

ATTACHMENT A

HAS BEEN DEEMED

HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

Appendix C

Financial Ratios

Credit Ratio Ranges & Definitions – Standard & Poor's – Business Risk Level 6

	BBB		
	Min	Middle 1/3	Max
Adjusted Total Debt to Total Capitalization ⁽¹⁾	48%	51% - 55%	58%
Adjusted Funds From Operations Interest Coverage ⁽²⁾	3.0x	3.4x - 3.8x	4.2x
Adjusted Funds From Operations as % of Average Total Debt ⁽³⁾	18%	21% - 25%	28%

Ratio Definitions * :

(1) "Adjusted Total Debt to Total Capitalization" is calculated as Adjusted Total Debt ÷ Total Capitalization where Adjusted Total Debt and Total Capitalization are defined as below:

- Adjusted Total Debt is calculated as:
 - Notes Payable + Current Maturities of Long-Term Debt + Current Capitalized Lease Obligations + Long-Term Debt + Capitalized Lease Obligations + Total Off-Balance Sheet Debt
 - Total Off Balance Sheet Debt includes off-balance sheet financings such as:
 - Operating leases and purchase power debt-equivalent
- Total Capitalization is equal to:
 - Total Debt + Common Stock Equity

(2) "Adjusted Funds From Operations Interest Coverage" is calculated as (Funds From Operations + Cash Interest Paid + AFUDC Debt + Interest on OBS Debt) ÷ Interest Expense where Funds From Operations and Interest Expense are defined as below:

- Funds From Operations is calculated as:
 - Net Income + Depreciation and Amortization + Pension Expense – AFUDC + Deferred taxes
- Interest Expense is calculated as:
 - Interest Expense (net) + Allowance for Funds Used During Construction (debt) + Interest on OBS debt

(3) "Adjusted Funds From Operations as a % of Average Total Debt" is calculated as (Funds From Operations – Depreciation Adjustment for Operating Leases) ÷ Adjusted Average Total Debt where Funds From Operations and Adjusted Total Debt are defined as above.

- Adjusted Total debt is the average of two years

* Information based upon Standard & Poor's Ratings Services Utility Financial Ratio Definitions updated January 13, 2005.

Appendix C-1

Attachment B

Attachment B

APPENDIX D

PROCESS ILLUSTRATION

Adjustment of Amortization Amounts

Explanation of the Method Used to Determine the Adjustment to Amortization Amounts Required for Empire to Meet the Financial Ratio Targets.

Method:

For this illustration, the adjusted rate base as used in ER-2004-0570 provides the base financial information used in these calculations. Empire made adjustments to this base financial information to include certain off balance sheet items. These adjustments were to conform with rating agency methods for balance sheet re-statement. Empire identified these accounting adjustments, such as the equivalent debt treatment of operating leases and capacity contracts. The equivalent debt treatment of these off balance sheet items was determined by calculating the net present value of the future stream of lease or contract payments, discounted at 10%.. The base financial information was then adjusted by the equivalent debt balances and the interest expense associated with the equivalent debt balances. From this adjusted information, Empire then calculated the three guideline ratios defined in Appendix C for total regulated company and as allocated to the Missouri jurisdiction. If either of the two financial ratios failed to meet the required criteria below, then Empire determined the amount of additional funds from operations that would be required for Empire to meet the financial metric target.

Financial Ratio Targets for Additional Amortization Calculation:

- a. 3.2x Adjusted Funds from operations interest coverage (an operational guideline)
- b. 19.5% Adjusted Funds from operations as a percentage of average total debt (an operational guideline)

The Signatory Parties acknowledge a 56.5% Adjusted Total Debt to Total Capital objective. This objective will not be addressed through this amortization but will be satisfied through future Empire financing requests before the Commission during the term of this Agreement.

Explanation of Attachment to Appendix D:

This illustration is based on EDE financial information consisting of information filed in case ER-2004-0570 and other EDE financial documents. This illustration assumes that the Commission has found all expenditures to be prudent and reasonable and has

Appendix D-1

Attachment C-1

Attachment C-1

accepted the jurisdictional allocation factor. For this illustration, EDE statements were placed on a jurisdictional basis by applying an allocation factor to the EDE balances. The base jurisdictional information was used to calculate the three (3) financial ratios. In this illustration, the Missouri electric jurisdictional adjusted funds from operations (FFO) as a percent of average debt was found to be 17.59%, which is below the financial ratio target of 19.5%. In order for the target to be achieved, \$6,399,213 of additional FFO would be needed from Missouri. The additional FFO was then studied to determine if there would be any additional tax impacts on cash flow resulting from the additional FFO. This illustration assumes that the entire additional FFO would have negative tax cash flow impacts, thereby resulting in an additional amortization of \$3,987,265 needed in order to meet the target. The Signatory Parties have not agreed to a methodology to determine the tax impacts related to additional FFO. In this illustration, the revenue requirement amount equals the amortization amount. The overall impact on Missouri customers would be a 2.58% increase in revenue requirement. This example is an illustration only. The actual amount of amortization needed will be determined in Empire's next rate case.

Explanation of Adjustments to balance sheet for rating agency methodology:

- Operating Lease Debt Equivalent - Present value of future lease payments for the operating lease for the aluminum railcars using a 10% discount rate.
- Purchase Power Debt Equivalent - Present value of future capacity payments of purchased power capacity obligation using a 10% discount rate. A portion of this amount is then treated as debt-equivalent, based on the risk factor (10-20%, 30%, or 50%) assigned to each contract.

Transactions included in the amounts above are subject to review by the Commission for prudence. Amounts determined to be not prudent will not be included in the calculation of the financial ratios for purposes of adjusting the amortization amount. The prudence and reasonableness of these transactions will be determined in Empire's next general rate case.

The illustration does not include the effect of SO₂ sales on cash flow because currently these sales have not occurred. To the extent actual SO₂ sales occur, these sales will be included as cash flow for purposes of Appendix D and whether the resulting projected cash flow meets the targets.

Appendix D-2

Attachment C-2

Attachment C-2

Changes in Capitalization for 2009-2011 for The Empire District Electric Company

(dollars in thousands)

<u>Capital Components</u>	2008 Actual	2009 Pro-Forma	2010 Pro-Forma	2011 Pro-Forma
Common Equity	\$539,775	\$698,794	\$703,276	\$721,201
Preferred Stock	0	0	0	0
Long-Term Debt	631,654 ¹	611,654 ²	711,654 ²	712,365 ²
Short-Term Debt	55,400	28,312	36,480	23,020
Total	<u>\$1,226,829.0</u>	<u>\$1,338,760.0</u>	<u>\$1,451,410.0</u>	<u>\$1,456,586.0</u>

(in percentages)

<u>Capital Structure</u>	2008 Actual	2009 Pro-Forma	2010 Pro-Forma	2011 Pro-Forma
Common Equity	44.00%	52.20%	48.45%	49.51%
Preferred Stock	0.00%	0.00%	0.00%	0.00%
Long-Term Debt	51.49% ¹	45.69% ²	49.03% ²	48.91% ²
Short-Term Debt	4.52%	2.11%	2.51%	1.58%
Total	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>	<u>100.00%</u>

Notes:

1. Includes trust preferred stock, current maturities on long-term debt and current obligations on capital lease.

2. Includes current maturities on long-term debt and current obligations on capital lease.

Source: The Empire District Electric Company's September 30, 2008 SEC Form 10Q Filing and response to Staff Data Request 0001.

Benchmark Financial Ratios from Empire's Experimental Regulatory Plan

	3rd Qtr. 2008 Actual	2009 Pro-Forma	2010 Pro-Forma	2011 Pro-Forma
Adjusted Funds From Operations Interest Coverage:	3.50 x	2.70 x	2.80 x	3.80 x
Adjusted Funds From Operations to Average Total Debt:	13.40%	14.60%	14.00%	18.10%
Adjusted Total Debt to Total Capitalization:	58.40%	51.40%	54.80%	53.70%

Guidelines from Experimental Regulatory Plan

	<u>Min.</u>	<u>Middle of Bottom 1/3</u>	<u>Max.</u>
Adjusted Funds From Operations Interest Coverage:	3.0 x	3.2 x	4.2 x
Adjusted Funds From Operations to Average Total Debt:	18 %	19.5 %	28 %
Adjusted Total Debt to Total Capitalization:	48 %	56.5 %	58 %

Sources:

1. Company response to Staff Data Request 0001.
2. Appendix C from the Stipulation and Agreement in Case No. EO-2005-0263.
3. November 18, 2008 Standard & Poor's Research Report on Empire.