

EMPIRE DISTRICT ELECTRIC COMPANY

PROPOSED PROCEDURE

Case No.

January 2006

The intent of this procedure is to ensure that the amount collected in rates is based on the FAS 106 cost recognized by the Company for financial reporting purposes. To accomplish these goals, the following items are part of this procedure:

1. FAS 106 costs will be calculated based on the methodology used by the Company for financial reporting purposes.
2. FAS 106 cost recognized for financial reporting purposes will also be recognized in rates.
3. A regulatory asset or liability will be established on the Company's books to track the difference between the level of FAS 106 expense during the rate period and the level of expense built into rates for that period. If the FAS 106 expense during the period is more than the expense built into rates for the period, the Company will establish a regulatory asset, but only to the extent that such expense is not used to reduce a regulatory liability maintained pursuant to item 4. If the FAS 106 expense during the period, adjusted for any amount of such expense used to reduce a regulatory liability maintained pursuant to item 4, is less than the expense built into rates for the period, the Company will establish a regulatory liability. If the FAS 106 expense becomes negative, the regulatory liability will increase by the difference between the level of expense built into rates for that period and \$0. Since this is a cash item, the regulatory asset or liability will be included in rate base and amortized over 5 years at the time of the next rate case.

4. If the FAS 106 expense becomes negative, the Company is ordered to set up a regulatory liability to offset the negative expense. The regulatory liability will increase by the amount of negative expense, or decrease by the amount of positive expense, in each subsequent year. Positive expense in such subsequent year will be used to reduce this regulatory liability before being used to establish a regulatory asset pursuant to item 3. If the cost is negative at the time of the next rate case, the amount included in rates will be zero. If the cost is positive at the time of the next rate case, the positive expense will not be included in rates until the regulatory liability has been reduced to \$0. This regulatory liability is a non-cash item and should be excluded from rate base in future years.
5. Any future FAS 106 prepaid asset will not be included in Rate Base in any future rate case. The regulatory assets/liabilities identified in this settlement will address all Rate Base amounts.