

Exhibit No.:

Issues:

*Rate Base & Related Items,
Retired Plant, Depreciation
& Amortization Expense,
Property & Liability
Insurance, Property Tax,
Banking Fees, Flotation
Costs, PSC Assessment,
Rate Case Expense*

Witness:

Roberta A. McKiddy

Sponsoring Party:

MoPSC Staff

Type of Exhibit:

Direct Testimony

Case Nos.:

ER-2004-0570

Date Testimony Prepared:

September 20, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

ROBERTA A. MCKIDDY

FILED

DEC 28 2004

**Missouri Public
Service Commission**

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2004-0570

*Jefferson City, Missouri
September 2004*

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

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Exhibit No. 65 NP
Case No(s). ER-2004-0570
Date 12-08-04 **Rptr** KF

BEFORE THE PUBLIC SERVICE COMMISSION

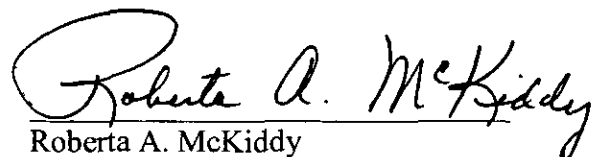
OF THE STATE OF MISSOURI

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

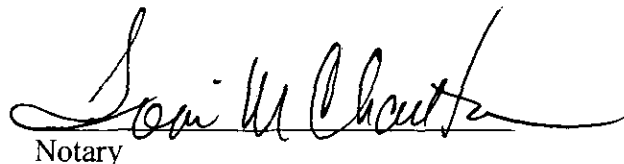
AFFIDAVIT OF ROBERTA A. MCKIDDY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Roberta A. McKiddy, being of lawful age, on her oath states: that she has participated in the preparation of the following direct testimony in question and answer form, consisting of 32 pages to be presented in the above case; that the answers in the following direct 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 15th day of September 2004.


Notary



TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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ROBERTA A. MCKIDDY
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1 **DIRECT TESTIMONY OF**

2 **ROBERTA A. MCKIDDY**

3 **EMPIRE DISTRICT ELECTRIC COMPANY**

4 **CASE NO. ER-2004-0570**

5 Q. Please state your name and business address.

6 A. My name is Roberta A. McKiddy. My business address is 1845 Borman
7 Court, Suite 101, St. Louis, Missouri 63146.

8 Q. By whom are you employed and in what capacity?

9 A. I am employed by the Missouri Public Service Commission (MoPSC or
10 Commission) in the Utility Services Division, Auditing Department, as a Utility Regulatory
11 Auditor III.

12 Q. Please describe your educational background?

13 A. I earned a Masters of Business Administration degree from William Woods
14 University on June 8, 2000. I earned a Bachelor of Science degree in Business
15 Administration with an emphasis in Finance from Columbia College in July 1997 and
16 obtained an emphasis in Accounting in October 2002.

17 Q. Please describe your work background.

18 A. Prior to employment with the Commission, I was employed by the State
19 Emergency Management Agency for the state of Missouri. I also have previous experience
20 in the areas of accounting, insurance, real estate lending and consumer protection.

21 Q. Please describe your duties while employed by the Commission.

22 A. I am currently employed as a Utility Regulatory Auditor III in the
23 Commission's Auditing Department. From August 1, 2002 through February 2003, I was

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1 employed as a Utility Regulatory Auditor III in the Financial Analysis Department. From
2 May 1998 to July 2002, I was employed as a Financial Analyst in the Financial Analysis
3 Department. Prior to my appointment to the Financial Analysis Department, I served in an
4 administrative support position with the Utility Services Division, Accounting Department.
5 In total, I have been with the Commission over nine years.

6 Q. Have you previously filed testimony before this Commission?

7 A. Yes. Schedule 1 attached to this testimony lists the cases in which I have filed
8 testimony. Schedule 1 also lists the issues I was responsible for in each of those cases.

9 Q. Did you make an examination and analysis of the books and records of
10 Empire District Electric Company (Empire or Company) in regard to issues raised in this
11 case?

12 A. Yes, in conjunction with other members of the Commission's Staff (Staff), I
13 specifically examined and analyzed the following documentation: Company's responses to
14 Staff data requests, select general ledger information related to my assigned issues and
15 Company workpapers.

16 Q. What issues will you address in your testimony?

17 A. I will address the following areas: plant-in-service, depreciation expense,
18 depreciation and amortization reserves, amortization expense, property and liability
19 insurance, property tax, MoPSC assessment, rate case expense, banking fees, flotation costs,
20 cash working capital, materials and supplies, prepayments, customer deposits, interest
21 expense on customer deposits and customer advances.

22 Q. What knowledge, skill, experience, training or education do you have in these
23 matters?

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1 A. I acquired general knowledge of these topics prior to joining the Auditing
2 Department through participation in prior rate cases before this Commission. Since joining
3 the Auditing Department, I have reviewed in-house training materials on these topics. I have
4 also acquired extensive knowledge of these topics through review of Staff workpapers and
5 testimony from prior rate cases brought before this Commission relating to Empire, as well
6 as the Company's testimony in the current case. My immediate supervisor, in coordination
7 with other senior auditors, has provided guidance and training in these areas and oversight of
8 my work. In addition, I obtained an emphasis in Accounting from Columbia College in
9 October 2002 that provides me with a broad overview of accounting and auditing. I have
10 also reviewed prior Commission decisions with regard to these areas.

11 Q. What is the purpose of your testimony?

12 A. The purpose of my testimony is to explain and sponsor the following
13 schedules and adjustments:

14	Accounting Schedule 2	Rate Base
15	Accounting Schedule 3	Plant-in-Service
16	Accounting Schedule 4	Adjustments to Plant-in-Service
17	Accounting Schedule 5	Depreciation Expense
18	Accounting Schedule 6	Depreciation Reserve
19	Accounting Schedule 7	Adjustments to Depreciation Reserve
20	Accounting Schedule 8	Cash Working Capital
21	Adjustment Nos.	P-38.1, P-41.1, P-67.1, P-68.1, P-71.1,
22		P-71.2, P-72.1, P-73.1, P-76.1, P-76.2
23		and P-79.1;

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1 R-11.1, R-12.1, R-14.1, R-15.1, R-16.1,
2 R-24.1, R-25.1, R-26.1, R-28.1, R-33.1,
3 R-38.1, R-40.1, R-41.1, R-43.1, R-64.1,
4 R-67.1, R-67.2, R-68.1, R-68-2, R-69.1,
5 R-70.1, R-71.1, R-71.2, R-72.1, R-72-2,
6 R-73.1, R-73.2, R-74.1, R-75.1, R-76.1,
7 R-76-2, R-77.1, R-78.1, R-79.1, R-79-2,
8 R-80.1, R-81.1, R-82.1, R-83.1, R-86.1,
9 R-88.1, R-89.1, R-90.1 and R-91;
10 S-10.2, S-10.3, S-13.2, S-13.3, S-13.4,
11 S-14.6, S-14.16, S-15.1, S-16.1, S-17.1,
12 S-17.2 and S-21.1

13 The adjustments related to expense, designated as Adjustment Nos. S-10.2, S-10.3,
14 S-13.2, S-13.3, S-13.4, S-14.6, S-14.16, S-15.1, S-16.1, S-17.1, S-17.2 and S-21.1 can be
15 found on Accounting Schedule 10 - Adjustments to the Income Statement. The adjustment
16 related to plant-in-service, designated as Adjustment Nos. P-38.1, P-41.1, P-67.1, P-68.1,
17 P-71.1, P-71.2, P-72.1, P-73.1, P-76.1, P-76.2 and P-79.1, and depreciation reserve,
18 designated as Adjustment Nos. R-11.1, R-12.1, R-14.1, R-15.1, R-16.1, R-24.1, R-25.1,
19 R-26.1, R-28.1, R-33.1, R-38.1, R-40.1, R-41.1, R-43.1, R-64.1, R-67.1, R-67.2, R-68.1,
20 R-68-2, R-69.1, R-70.1, R-71.1, R-71.2, R-72.1, R-72-2, R-73.1, R-73.2, R-74.1, R-75.1,
21 R-76.1, R-76-2, R-77.1, R-78.1, R-79.1, R-79-2, R-80.1, R-81.1, R-82.1, R-83.1, R-86.1,
22 R-88.1, R-89.1, R-90.1 and R-91, can be found on Accounting Schedule 4 and 7,
23 respectively.

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RATE BASE

Q. Please describe Accounting Schedule 2, Rate Base.

A. This accounting schedule represents the investment upon which the Company is allowed to earn a rate of return. The Schedule includes the Company's adjusted jurisdictional plant-in-service balance from Accounting Schedule 3, Total Plant-in-Service, and deducts the Company's adjusted jurisdictional depreciation reserve from Accounting Schedule 6, Depreciation Reserve, and the amortization reserve, to compute the net plant-in-service. Added to net plant-in-service are amounts for cash working capital, materials and supplies, prepayments, fuel stock, and prepaid pension asset. Rate base deductions include the federal income tax offset, state income tax offset, interest expense offset, customer advances for construction, customer deposits, injuries and damages reserve and deferred income taxes. The mathematical total of these items is the rate base amount incorporated in the gross revenue requirement recommendation shown on Accounting Schedule 1, Revenue Requirement.

Q. What components of rate base are you sponsoring in this proceeding?

A. I am sponsoring Total Plant-in-Service from Accounting Schedule 3, Depreciation Reserve from Accounting Schedule 6 and Cash Working Capital from Accounting Schedule 8, which I will explain in detail later in this testimony. In addition, I am sponsoring the following items, which are not supported by a separate schedule: amortization reserve, materials and supplies, prepayments, customer deposits, customer advances, federal and state income tax offsets and interest expense offset. A discussion of the federal income tax offset, state income tax offset and interest expense offset can be found within the Cash Working Capital section of this direct testimony. Staff witness Sean Devore of the Auditing Department will discuss injuries and damages reserve, Staff witness

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Doyle Gibbs of the Auditing Department will discuss the prepaid pension asset and Staff witness John Cassidy of the Auditing Department will discuss fuel stocks and deferred income taxes in their respective direct testimonies.

PLANT-IN-SERVICE

Q. Please explain Accounting Schedule 3.

A. Accounting Schedule 3, Plant-in-Service, lists Empire's total plant balances by account through the update period ending June 30, 2004 in "Column C." The Staff's total company and Missouri jurisdictional adjustments detailed in Accounting Schedule 4, Adjustments to Total Plant, are listed in "Column D" and "Column F," respectively. The Missouri jurisdictional allocation factors appear in "Column E" and the Staff's adjusted Missouri jurisdictional plant-in-service balances are shown in "Column H."

Q. Please explain Accounting Schedule 4.

A. Accounting Schedule 4, Adjustments to Plant-in-Service, details the Staff's individual adjustments listed in "Column D" and "Column F" of Accounting Schedule 3. Adjustment Nos. P-38.1, P-41.1, P-67.1, P-68.1, P-71.1, P-71.2, P-72.1, P-73.1, P-76.1, P-76.2 and P-79.1 were necessary to record the retirement of plant related to the May 2003 tornado. Adjustment Nos. P-71.1 and P-76.2 were necessary to adjust plant for insurance recovery related to the May 2003 tornado.

Q. Are there additional Staff adjustments to plant-in-service?

A. Yes. I am sponsoring the Staff's disallowance of a portion of the cost associated with the installation of Energy Center Units 3 and 4 (EC3&4). It is the Staff's opinion that the Company acted imprudently by exposing Empire to an unnecessary level of financial risk. This unnecessary financial risk resulted from Empire's decision to waive the

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1 contract provision that required the contractor, Patch Construction L.L.C. (Patch), to obtain a
2 performance bond. Empire's decision resulted in additional unnecessary costs being incurred
3 to complete the construction of EC3&4, which the Company seeks to recover from its
4 customers in this rate case.

5 Q. Was there an unnecessary risk associated with Empire's decision to hire
6 Patch?

7 A. No. Patch was hired for the installation of two FT-8 gas turbines and
8 engineering for EC3&4. When Empire decided to contract with Patch, the Company
9 appropriately covered its financial risk that Patch would "fail to perform" through the
10 contractual requirement for Patch to acquire a "performance bond." However, Empire
11 exposed itself to the financial risk associated with cost over-runs caused by the contractor's
12 failure to perform when the Company made the decision not to enforce its contractual
13 requirement.

14 Q. Please discuss the original safeguard Empire incorporated in its contract with
15 Patch to address this risk.

16 A. As discussed and explained in the testimony of Staff witness David Elliot of
17 the Engineering Department, Patch was required to obtain a performance bond within 21
18 business days of the signing of the original contract. (See Schedule 3.) This performance
19 bond would have provided a safeguard for Empire against the financial risk discussed above.
20 The performance bond would have reimbursed Empire for the additional cost incurred due to
21 the failure of Patch to complete the installation of EC3&4 at the contract price. (See
22 Schedule 4.) By waiving this requirement, Empire exposed itself to increased financial risk
23 and potential increase in cost. This contract requirement was important because Empire had

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1 evidence in its possession that Patch might fail to perform under the contract. The Company
2 had this evidence prior to the signing of the original contract with Patch on
3 February 15, 2002.

4 Q. Please discuss the information that was available to Empire, prior to the
5 signing of the original contract, relating to the risk associated with hiring Patch.

6 A. In response to Staff Data Request No. 429, the Company provided two
7 memorandums dated August 17, 2004 written by Empire's Blake Mertens, Planning
8 Engineer-Energy Supply. These memorandums were based on notes compiled by
9 Mr. Mertens during telephone interviews he conducted on January 11, 2002 with
10 representatives of Lockport Cogeneration (Lockport) and Puget Sound Energy (PSE),
11 previous clients of Patch, for purposes of obtaining a background and reference check on the
12 contractor.

13 Q. What experience did Lockport have with Patch?

14 A. Lockport's experience with Patch's work was very limited since only the
15 foundation construction was completed prior to the entire project being suspended.

16 Q. Was Lockport satisfied with Patch?

17 A. Yes.

18 Q. What was PSE's response?

19 A. Attached as Schedule 2 to my testimony is the memorandum summarizing the
20 PSE reference check. ** _____
21 _____
22 _____
23 _____

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Q. Were the reference checks performed by Empire for Patch adequate?

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A. Yes. The Company spoke with two prior Patch clients. One of these references had very limited experience in dealing with Patch while the other outlined

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**, the Company did not require proof of Patch's financial stability or enforce the contract provision, which required Patch to obtain a performance bond.

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Q. What documentation did the Staff receive regarding Empire's diligence in obtaining a performance bond?

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A. Company has provided two electronic mail messages dated March 21, 2002 and July 3, 2002. The electronic mail message dated March 21, 2002 indicated Patch was experiencing difficulty in obtaining a performance bond and needed a letter from Empire in order to satisfy a requirement imposed by the issuer of the bond. The electronic mail message dated July 3, 2002 indicated Patch was unable to obtain a performance bond. Empire decided to expose itself to the risk of Patch's non-performance by failing to obtain the protection that a performance bond would have afforded the Company.

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Q. What, if anything, did Empire do at this point in an attempt to minimize the Company's exposure to a potential increase in financial risk?

23

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1 A. Empire began pursuing an alternative solution to minimize the Company's
2 exposure to increased financial risk. As a result, Patch and Empire agreed to amend the
3 original contract, (i.e., Amendment 1 attached to this testimony as Schedule 5) whereby
4 Patch Construction L.L.C., Patch Inc., Chester J. Patch, III and Patricia M. Patch became
5 personally liable for any unapproved costs above the original contract amount. (See
6 Schedule 6 attached to this testimony.) Empire and Patch signed this amendment on July 22,
7 2002.

8 Q. Did this amendment satisfactorily reduce Empire's exposure to the potential
9 increase in cost and financial risk that resulted from the Company's failure to enforce the
10 contract provision requiring Patch to obtain a performance bond?

11 A. No. This amendment's protection is dependent on the financial strength of the
12 individuals and entities that assumed liability for non-performance. Patch was required to
13 submit financial statements to Empire as a condition of approval prior to the signing of
14 Amendment 1. Company provided copies of these financial statements to the Staff in
15 response to Staff Data Request No. 425. These financial statements contain sufficient
16 evidence of Patch's financial difficulties that existed prior to the signing of Amendment 1.
17 The proposed amendment to the contract did not satisfactorily address Empire's exposure to
18 the increase in financial risk that resulted from the Company's waiver of the contract
19 provision requiring Patch to obtain a performance bond.

20 Q. Were Chester J. Patch, III and Patricia M. Patch, as well as the companies
21 they controlled, ultimately able to provide sufficient funds to cover any personal liability for
22 failure to perform?

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1 A. No. In fact, Patch Inc. and Patch Construction L.L.C. filed for bankruptcy
2 simultaneously on November 11, 2003. Chester J. Patch, III and Patricia M. Patch filed for
3 bankruptcy on June 2, 2004. The court relieved Patch Inc. and Patch Construction L.L.C. of
4 their debt owed to Empire as of August 1, 2004. Additionally, court documents from the
5 bankruptcy proceeding reveal that Chester J. Patch, III and Patricia M. Patch do not have
6 sufficient assets to pay the liability owed to Empire.

7 Q. What additional cost was incurred by Empire as a result of its imprudence?

8 A. Staff witness Elliott has identified \$4,321,356 as the amount of additional cost
9 incurred by Empire to complete the installation of EC3&4 as a result of Patch's failure to
10 perform. This is the maximum amount that could be considered for a disallowance as a
11 result of Empire's imprudence.

12 Q. Is the Staff proposing to disallow the entire \$4,321,356?

13 A. No. Empire had narrowed its consideration of contractors to Patch and Sega.
14 Based on Empire's evaluation of the bid proposals, the elimination of Patch from
15 consideration would have resulted in Sega being awarded the contract to install EC3&4.
16 However, since Sega's bid was \$1,166,000 higher than Patch's, Empire would have incurred
17 this additional amount for the installation of EC3&4. Therefore, the Staff is recommending a
18 disallowance of \$3,155,356 (\$4,321,356 - \$1,166,000).

19 Q. What accounts has the Staff adjusted?

20 A. The Staff divided its adjustment evenly, reducing both plant in service
21 Accounts 341.300 and 344.300 by \$1,577,678 in adjustments P-38.1 and P-41.1,
22 respectively. The Staff has made a related adjustment to eliminate the depreciation, which

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1 has accumulated on this plant. Both depreciation reserve Accounts 341.300 and 344.300
2 were reduced by \$33,499 in adjustments R-38.1 and R-41.1, respectively.

3 **DEPRECIATION EXPENSE**

4 Q. Please explain Accounting Schedule 5 and the associated adjustments to
5 depreciation expense.

6 A. Accounting Schedule 5, Depreciation Expense, lists in "Column C" the
7 adjusted Missouri jurisdictional plant-in-service balances from Accounting Schedule 3,
8 "Column F." "Column D" lists the depreciation rates recommended by Staff witness
9 Greg Macias of the Engineering and Management Services Department. The rates in
10 "Column D" are then applied to the adjusted Missouri jurisdictional plant balances in
11 "Column C" to determine the annualized level of depreciation expense, on a Missouri only
12 basis, that appears in "Column E." The total depreciation expense, less the amount recorded
13 in the test year, is the basis for Adjustment Nos. S-15.1, S-16.1 and S-17.1, which appear on
14 Accounting Schedule 10, Adjustments to Income Statement.

15 Q. Please explain why several of the accounts on Schedule 5 have not been
16 assigned a depreciation rate.

17 A. Based on the analysis of Staff Witness Macias, Account Nos. 315.200,
18 342.300 and 346.800 have plant-in-service balances that are exceeded by their related
19 depreciation reserve balances. Therefore, he has recommended a zero depreciation rate for
20 these accounts, as the Company has already over-recovered its original plant investment.

21 Since Accounts 301, 302, 303, 310.2, 310.6, 330, 340.2, 340.3, 340.8, 350, 360, and
22 389 contain non-depreciable intangible plant, land and land rights, the depreciation rate listed

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1 is also zero. Finally, since the expense associated with the Accounts 391 and 397 is reflected
2 in lease expense, the depreciation rate listed for these leased plant items is also zero.

3 Q. Please explain Income Statement Adjustment No. S-17.2.

4 A. Adjustment No. S-17.2 removes annualized depreciation expense associated
5 with Accounts 392, Transportation Equipment, and 396, Power Operator Equipment. The
6 depreciation associated with these accounts is normally charged to a clearing account. The
7 amounts in the clearing account are then charged back to the various operating expense
8 accounts and plant accounts based on how the assets are used. This adjustment is necessary
9 so that this expense will not be recovered twice.

10 Q. Please explain Accounting Schedule 6.

11 A. Accounting Schedule 6, Depreciation Reserve, lists Empire's total
12 depreciation reserve balances by account as of update period ending June 30, 2004 in
13 "Column C." The Staff's total company and Missouri jurisdictional depreciation reserve
14 adjustments detailed in Accounting Schedule 7, Adjustments to Depreciation Reserve, are
15 listed in "Column D and F," respectively. The Missouri jurisdictional allocation factor in
16 "Column E" are used to determine the Staff's adjusted Missouri jurisdictional balances
17 shown in "Column H."

18 Q. Please explain Accounting Schedule 7.

19 A. Accounting Schedule 7, Adjustments to Depreciation Reserve, details the
20 Staff's individual adjustments making up the total company and Missouri jurisdictional
21 adjustments listed in "Column D and F" of Schedule 6.

22 Q. Please explain the adjustments found in Accounting Schedule 7, Adjustments
23 to Depreciation Reserve.

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1 A. Adjustment Nos. R-11.1, R-12.1, R-14.1, R-15.1, R-16.1, R-24.1, R-25.1,
2 R-26.1, R-28.1, R-33.1, R-38.1, R-40.1, R-41.1, R-43.1, R-64.1, R-67.1, R-68.1, R-69.1,
3 R-70, R-71.1, R-72.1, R-73.1, R-74.1, R-75.1, R-76.1, R-77.1, R-78.1, R-79.1, R-80.1,
4 R-81.1, R-82.1, R-83.1, R-86.1, R-88.1, R-89.1, R-90.1 and R-91.1 to depreciation reserve
5 reflect a reversal of the actual amounts previously booked to depreciation reserve for cost of
6 removal and salvage since October 1, 2001.

7 Q. Why is it necessary for Staff to make these adjustments?

8 A. In Case No. ER-2001-0299, Company was ordered by the Commission to
9 begin expensing cost of removal and salvage on a going forward basis. However, Empire
10 has continued to book such amounts to depreciation reserve. These adjustments are
11 necessary to reflect the Commission Order in the 2001 case.

12 Q. Are there any additional adjustments to depreciation reserve?

13 A. Yes. Adjustment Nos. R-67.2, R-68.2, R-71.2, R-72.2, R-73.2, R-76.2 and
14 R-79.2 are necessary to record the retirement of plant related to the May 2003 tornado.

15 **AMORTIZATION RESERVE**

16 Q. Please describe the Staff's adjustment for amortization reserve.

17 A. Accounting Schedule 2, Rate Base, lists Empire's total amortization reserve
18 balance as of the update period ending June 30, 2004 on Line 4.

19 **MATERIALS AND SUPPLIES, AND PREPAYMENTS**

20 Q. Please describe the Staff's treatment of materials and supplies, and
21 prepayments.

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1 A. Materials and supplies, and prepayments are represented in the Staff's rate
2 base by thirteen-month averages. Due to the cyclical nature of these two items, thirteen-
3 month averages are developed to smooth out seasonal variations.

4 Q. What are materials and supplies?

5 A. Materials and supplies are miscellaneous items that are stored by the
6 Company in inventory for use in day-to-day routine maintenance and operational projects.
7 These items are also stored in inventory for the Company's construction projects.

8 Q. What are prepayments?

9 A. Prepayments relate to items that the Company "prepaid" so that the services
10 will be on hand during the normal course of the utility's operations. These types of items
11 include the prepayment of postage meters, insurance that is paid in advance of coverage,
12 prepaid rents, etc.

13 **CUSTOMER DEPOSITS**

14 Q. Please describe the customer deposits amount that is deducted from rate base.

15 A. Customer deposits generally represent funds received from customers as
16 security against potential loss arising from failure to pay for service. The deposit represents a
17 liability to repay the funds received after a specified period or upon satisfaction of certain
18 requirements. Since customers supply these funds to the Company, a representative level is
19 included as an offset to the rate base investment. This treatment allows customers to receive
20 a "return" on the customer deposit amounts maintained by the Company, which is equal to
21 the return ratepayers are charged on the rate base investments. In the previous case, the
22 amount of customer deposits represented a thirteen-month average. However, Empire has
23 been experiencing an upward trend in customer deposits during the last 18 months.

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1 Therefore, the Staff has determined the balance at June 30, 2004 to be most representative of
2 the ongoing level of customer deposits for purposes of this proceeding.

3 **INTEREST EXPENSE ON CUSTOMER DEPOSITS**

4 Q. Please explain Income Statement Adjustment No. S-10.3.

5 A. Staff's adjustment S-10.3 annualizes interest expense related to customer
6 deposits. Customer deposits are interest bearing, so the liability is included as an expense in
7 the cost of service. To calculate this adjustment, I used a 5.00% interest rate (prime + 1%)
8 multiplied by the balance in customer deposits discussed earlier in my direct testimony.
9 [SOURCE: Prime Rate as reported on June 30, 2004 by the Federal Reserve at
10 <http://www.federalreserve.gov/releases/H15/prime.txt>] This calculation of interest expense
11 on customer deposits is specified in the Company's tariffs.

12 **CUSTOMER ADVANCES**

13 Q. Please describe this item that is deducted from rate base.

14 A. Customer advances are funds provided by customers of the Company to assist
15 in the costs associated with the provision of electric service. These funds represent interest-
16 free money to the Company. Therefore, it is appropriate to include these funds as an offset to
17 rate base. In the previous case, the amount of customer advances represented a thirteen-
18 month average. However, as with customer deposits, Empire has been experiencing an
19 upward trend in customer advances. Therefore, Staff has determined the balance at June 30,
20 2004 to be most representative of the ongoing level of customer advances for purposes of this
21 proceeding. This is supported by Company's response to Staff Data Request No. 444 that
22 states,

23 The upward trend in customer advances is primarily the result of a
24 Missouri Commission approved policy change that occurred in

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1 November 2002. A grace period was given to developers so that it
2 was not effective except on work started after May 1, 2003. The
3 change, which allowed the Company to charge new subdivisions the
4 total cost of installation, is refundable over a five-year period.

5 The Company also stated, "the trend will continue to increase until the five-year mark is
6 reached. At that point, the balance will stabilize."

7 **CASH WORKING CAPITAL**

8 Q. How did the Staff determine the cash working capital (CWC) requirement?

9 A. Staff calculated the CWC requirement by performing a lead/lag study
10 consistent with the method used by the Staff and adopted by the Commission in numerous
11 rate cases.

12 Q. What is the purpose of a lead/lag study?

13 A. A lead/lag study determines the amount of cash that is necessary on a day-to-
14 day basis in order for a utility to provide service to its ratepayers. A lead/lag study also
15 determines who supplies the needed cash.

16 Q. What are the sources of CWC?

17 A. The shareholder and the ratepayer are the sources of CWC.

18 Q. How does the shareholder supply CWC?

19 A. When a utility spends cash to pay for an expense before the ratepayer provides
20 the cash, then the shareholder must supply the necessary CWC. This CWC represents a
21 portion of the shareholder's total investment in a utility. The shareholder is compensated for
22 the funds provided by the inclusion of the associated CWC requirement in rate base, thereby
23 providing a return on the shareholder's investment.

24 Q. How does the ratepayer provide CWC?

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1 A. Ratepayers supply CWC when they pay for the service provided by a utility
2 before a utility must pay for expenses that it incurs in providing that service. The ratepayer is
3 compensated for the funds through a reduction to rate base for the associated CWC
4 requirement. This allows the general body of ratepayers to be credited for a rate of return
5 equivalent to that earned on a utility's investment.

6 Q. How are the results from a lead/lag study interpreted?

7 A. A negative CWC requirement indicates that the ratepayer provides the cash
8 working capital in the aggregate during the test year. A positive CWC requirement indicates
9 that the shareholder provides cash working capital in the aggregate during the test year.

10 Q. Please explain the components of the Staff's calculation of CWC, which
11 appear on Accounting Schedule 8, Cash Working Capital.

12 A. The components of the Staff's calculation are as follows:

13 Column A (Account Description) lists the types of cash expenses that the Company
14 pays on a day-to-day basis.

15 Column B (Test Year Expenses) shows the amount of annualized expense associated
16 with cash expenses listed in Column A.

17 Column C (Revenue Lag) is the number of days between the midpoint of the
18 provision of service by a utility and the payment for the service by the ratepayer. The
19 revenue lag addressed in this case is explained in more detail later in this direct testimony.

20 Column D (Expense Lag) is the number of days between the receipt of and the
21 payment for, the goods and services (i.e., cash expenditures) used to provide service to the
22 ratepayer.

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1 Column E (Net Lag) results from the subtraction of the Expense Lag (Column D)
2 from the Revenue Lag (Column C).

3 Column F (Factor) expresses the CWC lag in days as a fraction of the total days in the
4 test year. This is accomplished by dividing the Net Lags in Column E by 365.

5 Column G (CWC Requirement) represents the average amount of cash necessary to
6 provide service to the ratepayer. This is computed by multiplying the annualized amount in
7 the Test Year Expenses column by the CWC Factor (Column F).

8 Q. Please describe the revenue lag.

9 A. The revenue lag is defined as the amount of time between the provision of
10 service by a utility and the utility's receipt of the payment for that service from the
11 ratepayers. The revenue lag is the sum of three subcomponent lags. They are defined as
12 follows:

13 Usage Lag The midpoint of the average time elapsed from the beginning
14 of the first day of a service period through the last day of that service period.

15 Billing Lag The period of time between the end of the last day of a service
16 period and the day the bill is placed in the mail by a utility.

17 Collection Lag The period of time between the day the bill is placed in the
18 mail by a utility and the day the utility receives payment from the ratepayer for services
19 performed.

20 Q. Please define how you are using the term "service period" in this testimony.

21 A. In reference to the revenue lag, a service period is merely the amount of time,
22 in days, in which the customer receives utility service for billing purposes. In discussion of
23 expense lags, this term denotes the period in which a utility receives materials or services

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1 from its suppliers. The Staff adopted the revenue and expense lags utilized in Case
2 No. ER-2002 0424 since, based on the response to Staff Data Request No. 194, there have
3 been no significant changes in Company's operations since the last rate case that would
4 affect these lags.

5 Q. Please explain the payroll related expense lags listed on Accounting
6 Schedule 8.

7 A. The expense items listed on Accounting Schedule 8, Lines 2 through 8, relate
8 to payroll. Payroll has been subdivided into the following components: base payroll,
9 FICA-employee portion, federal income tax withholding, state income tax withholding,
10 401K-employee portion, medical care and vacation payroll.

11 Q. Please explain the base payroll expense lag calculation on Line 2 of
12 Accounting Schedule 8.

13 A. The base payroll expense lag is the time elapsed between the midpoint of the
14 period in which employees earn wages (i.e., weekly, bi-weekly - the payroll period) and the
15 date the wages are paid by Empire. For purposes of this proceeding, Staff adopted the base
16 payroll expense lag utilized in Case No. ER-2002-0424 since there has been no significant
17 change in Company's operations since the last rate case. The base payroll expense lag
18 utilized in that case was 12.0264 days.

19 Q. What is the basis for the expense lag days assigned to tax withholdings?

20 A. The expense lag days for tax withholdings are based upon the same payroll
21 periods used for base payroll. The respective expense lag day computations consider the
22 time elapsed between the average date the respective payroll is earned by the employee and
23 the tax due dates.

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1 Q. Please explain the expense lag calculation for 401K-employee portion and
2 medical care.

3 A. The expense lag for the employee portion of 401K and medical care are based
4 on the same payroll periods as base payroll, the time elapsed between the midpoint of the
5 period in which employees earn wages and the date the wages are paid by Empire. It also
6 takes into consideration the time elapsed between the date wages are paid by Empire and the
7 date the funds withheld for 401K and medical care are deposited and paid to providers.

8 Q. Please explain the vacation expense lag.

9 A. The vacation expense lag attempts to reflect the time period from when
10 employees "earn" vacations and when Empire has to actually "pay" out the cash to these
11 employees for vacations. Because the Company records vacation to an employee's account
12 at the beginning of the year for work preformed in the previous year and allows an employee
13 to carryover a portion of each year's vacation time from one year to the next plus the fact that
14 vacation is not taken evenly throughout the year based on Company's response to Staff Data
15 Request No. 118, the Staff utilized an expense lag of 365 days as a conservative estimate of
16 the time elapsed between when vacation was "earned" and actually "paid" to the employee
17 by Empire.

18 Q. Please explain the expense lag for purchased power as found on Accounting
19 Schedule 8 at Line 12.

20 A. The expense lag for purchased power is the time elapsed from the midpoint of
21 the period when Empire receives purchased power from suppliers and the date payments for
22 such services are due.

23 Q. Please explain the expense lags for fuels (i.e., coal, gas and oil).

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1 A. The expense lag for fuels is the time elapsed between the midpoint of the
2 period when Empire receives the fuels from suppliers and the date on which payments for
3 such fuels are due. Empire uses three different types of fuel: coal, gas and oil.

4 Q. Please explain the cash voucher expense lag on Accounting Schedule 8 at
5 Line 14.

6 A. The cash vouchers line item is designed to include all Operation and
7 Maintenance (O&M) expenses within the study that are not specifically analyzed in a
8 separate line item. The expense lag represents the amount of time elapsed between the
9 receipt of and payment for goods and services necessary to provide service to ratepayers.

10 A. Please explain the expense lag for the employer's portion of FICA tax on
11 Accounting Schedule 8 at Line 17.

12 A. The employer's portion of FICA taxes is the amount of taxes paid by the
13 employer on payroll paid to the employees. The expense lag is calculated using the same
14 method that is used to calculate the lag for the employee's portion of FICA taxes.

15 Q. Please explain the expense lag for federal and state unemployment tax on
16 Accounting Schedule 8 at Lines 18 and 19, respectively.

17 A. The expense lags for federal and state unemployment taxes represent the
18 length of time between the average day services are rendered by the employee and the date
19 Empire pays the tax associated with that service.

20 Q. Please explain the expense lag for property taxes as shown on Accounting
21 Schedule 8 at Line 20.

22 A. The property tax lag days were calculated by using the midpoint of the service
23 period (a calendar year) and the required due date for property taxes paid by Empire.

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1 Q. Please explain the expense lag for corporate franchise tax.

2 A. Corporation franchise taxes are paid annually. The expense lag considers the
3 time elapsed between the midpoint of the taxable period (a calendar year) and the statutory
4 due date (April 15 of the following year). Staff determined the expense lag for corporation
5 franchise taxes is 287.50 days.

6 Q. Please explain the expense lag for gross receipts tax on Accounting
7 Schedule 8 at Line 24.

8 A. Gross receipts taxes are paid based upon the individual requirements of the
9 taxing entities. The lag for this item must include the appropriate time span between the
10 midpoint of the tax period and the time Empire pays the gross receipts taxes to the taxing
11 entities.

12 Q. Please explain the sales and use taxes expense lag on Accounting Schedule 8
13 at Line 25.

14 A. The expense lag for sales and use taxes takes into consideration the time
15 elapsed between the midpoint of the taxable month and the date sales tax is required to be
16 paid to the State of Missouri.

17 Q. Why does the revenue lag for sales and use taxes and gross receipts taxes
18 differ from the revenue lag you discussed above?

19 A. Empire acts solely as an agent of the taxing authority in collecting sales and
20 use taxes and gross receipts taxes from the ratepayer and in paying the proper institution on a
21 timely basis. Empire does not provide any service to the ratepayer associated with these
22 taxes. Since the expense lags for gross receipts taxes is measured from the date of billing,
23 the revenue lag equals only the period of time required to collect revenues, the collection lag

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1 of 18.66 days. Since the expense lag for sales and use taxes is measured from the date sales
2 and use taxes are collected, there is no lapse in time for the collection of revenues.
3 Therefore, the revenue lag for sales and use taxes is zero.

4 Q. Please identify any other components of CWC that do not directly appear in
5 the Staff's Accounting Schedule 8.

6 A. The federal income tax offset, state income tax offset and interest expense
7 offset do not directly appear in the Staff's Accounting Schedule 8, Cash Working Capital.
8 These items appear as separate line items in the Staff's Accounting Schedule 2, Rate Base.
9 They are known and certain obligations of Empire with payment periods and payment dates
10 established by statute or bond indentures. Staff believes amounts collected from ratepayers,
11 which the Company intends to use for the payment of taxes and interest, represent a source of
12 cash for Empire and has use of such funds until they are passed on to the appropriate taxing
13 authority or bondholder. Therefore, Staff believes it is appropriate to include taxes and
14 interest as offsets in a lead/lag analysis.

15 Q. Why are the federal income tax offset, state income tax offset and interest
16 expense offset included in the Staff's Accounting Schedule 2, Rate Base, rather than
17 Accounting Schedule 8, Cash Working Capital?

18 A. The expense component used for these offsets is tied directly to the
19 mechanical computation of the revenue requirement. The Staff's computer-generated
20 revenue requirement is based on a computer program with the capability of extracting
21 appropriate amounts for federal income tax, state income tax and interest expense based on
22 amounts obtained from Accounting Schedule 11, Income Tax. The computer program

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1 applies the CWC factor for each respective component and places the CWC revenue
2 requirement directly in Accounting Schedule 2.

3 Q. Please explain the federal and state income tax offsets.

4 A. The federal and state income tax offsets represent the period of time between
5 the midpoint of the taxable period (a calendar year) and the required dates taxes are due to
6 the federal and state taxing authorities. Currently, 100% of the estimated federal tax must be
7 paid during the year in four quarterly installments, which are due by the 15th day of April,
8 June, September and December. However, based on the timing of the receipt of Empire's
9 revenues, the Company makes a significantly larger tax payment in the fourth quarter than it
10 does in the first, second, and third quarters. As a result, the expense lag is longer than it
11 would be if Empire made equal quarterly installments.

12 For state income tax, 90% of the estimated state income tax must be paid during the
13 year in four quarterly installments, which are due by the 15th day of April, June, September
14 and December. The remaining 10% is due by March 15th of the following year. The
15 payments made on April 15 and June 15 are considered paid in advance, while payments
16 made on September 15, December 15 and March 15 of the following year are considered
17 paid in arrears.

18 The federal and state income tax expense lags are 90.35 days and 62.05 days,
19 respectively. The Staff subtracted these expense lags from the revenue lags to produce net
20 CWC lags, which when divided by 365 days, produce the CWC factors used for calculating
21 the federal and state income taxes offsets appearing on Accounting Schedule 2, Rate Base.

22 Q. Please explain the interest expense offset.

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1 A. The interest expense lag is computed by determining the time elapsed between
2 the midpoint of the interest period and the required due date for the payment of interest on
3 long-term debt. A similar calculation is performed for short-term debt and trust preferred
4 stock. Staff then calculated a dollar-weighted average to derive an overall interest expense
5 lag of 80.337 days. This expense lag was subtracted from the revenue lag and then divided
6 by 365 days to determine the CWC factor used for calculating the interest offset appearing on
7 Accounting Schedule 2, Rate Base.

8 Q. What was the result of the Staff's lead/lag calculation?

9 A. The aggregate of the individual calculations, result in a total net
10 ratepayer-supplied funds and illustrate the excess of CWC supplied by the ratepayer over the
11 amount supplied by the shareholder. The CWC component, including the offsets for interest
12 and income taxes is deducted from rate base to compensate the ratepayer for the use of their
13 funds.

14 **AMORTIZATION EXPENSE**

15 Q. Please explain Adjustment No. S-18.1.

16 A. Adjustment No. S-18.1 increases expense to reflect the annualized
17 amortization expense associated with Account 404.000, Amortization-Limited Term Electric
18 Plant.

19 **PROPERTY AND LIABILITY INSURANCE**

20 Q. Please explain Adjustment No. S-14.16.

21 A. Adjustment No. S-14.16 adjusts property and liability insurance to reflect the
22 premiums for policies in effect at the June 30, 2004 update cut-off date.

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PROPERTY TAX EXPENSE

Q. Please explain Adjustment No. S- 21.1.

A. Adjustment No. S-21.1 annualizes property tax expense. This adjustment was calculated by developing a property tax rate to be applied to total electric plant-in-service at December 31, 2003. To develop the property tax rate, Staff divided the amount of total property taxes due in 2003 (LESS: Unit Trains) by the total plant-in-service on January 1, 2003 (LESS: Unit Trains). This property tax rate was then applied to total electric plant-in-service on December 31, 2003 to arrive at annualized property taxes. The annualized property tax expense was then subtracted from test year property tax expense to arrive at the adjustment. Staff's adjustment is \$1,092,453.68.

PSC ASSESSMENT

Q. Please explain Adjustment No. S-13.2.

A. Adjustment No. S-13.2 annualizes expenses for the most current Commission Assessment.

Q. Is Empire current on its payments to the Commission relating to its PSC Assessment obligation?

A. It is my understanding that the Company is current on payments for its PSC assessment for the first quarter of the current fiscal year beginning July 1, 2004.

RATE CASE EXPENSE

Q. Please describe Adjustment No. S-13.3.

A. This adjustment normalizes rate case expense over a two-year period.

Q. How was rate case expense adjusted for Case No. ER-2004-0570?

A. The total amount of rate case expense incurred by Empire through June 30, 2004 and adjusted by the Staff is being allowed at this time with the exception of costs

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1 associated with the Brattle Group (i.e., Johannes Pfeifenberger, Rate Case Coordinator) and
2 Financial Strategy Associates (i.e., James Vander Wiede, ROR/ROE). Some rate case costs,
3 such as consulting fees, employee travel expenditures and legal representation, are directly
4 associated with the length of the case and complexity of the issue pursued through the
5 prehearing and hearing process. As such, Staff has utilized the rate case expenses incurred in
6 the Company's last fully litigated rate case, Case No. ER-2001-0299, as a baseline cost in an
7 attempt to estimate a normalized level of rate case expense for this proceeding assuming full
8 litigation is again pursued. The Staff will work with the Company to establish an ongoing
9 normalized level of rate case expense for inclusion in rates.

10 In addition, the Staff has also excluded the cost associated with the Electric System
11 Losses Study performed by Shaw Power Technologies from rate case expense in this
12 proceeding. Since this item is an expense that is incurred only periodically (i.e., every five to
13 ten years), the Staff has reflected the cost associated with the Electric System Losses Study
14 as a separate adjustment normalized over a five-year period. Total cost of the Electric
15 System Losses Study is \$92,458.67 and a five-year normalized amount of \$18,491.73 is
16 reflected in Adjustment No. S-13.4.

17 Q. Why have you excluded the costs associated with the services provided by
18 Johannes Pfeifenberger and Dr. James Vander Weide?

19 A. The primary reason Staff excluded the cost associated with the services
20 provided by Johannes Pfeifenberger was the lack of documentation supporting the need for
21 such services. To Staff's knowledge, Empire has never utilized a consultant for rate case
22 coordination and provided insufficient evidence in this proceeding to support the need for

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1 utilizing such a consultant. In Company's response to Staff Data Request No. 208.4,

2 Company responded as follows:

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

7 Mr. Pfenberger (sp.) was retained based on the belief that his
8 representation is reasonable and prudent for an effective presentation
9 of Empire's case and that Mr. Pfenberger (sp.) is well qualified for the
10 assigned tasks. In selecting Mr. Pfenberger (sp.), Empire relied on
11 outside recommendations, used its professional judgment, and
12 evaluated costs in light of Mr. Pfenberger's (sp.) qualifications,
13 experience, and skill. As stated in response to DR 208.7, it is
14 Empire's policy to employ only those experts who will help to
15 properly evaluate and explain the issues that arise in the context of a
16 rate case.

17 Mr. Pfenberger (sp.) has assisted with testimony preparation, but has
18 not generated any reports and/or analyses for this case.
19 Mr. Pfenberger's (sp.) work may be used to support Empire's
20 positions on various issues, but the complete and final scope of his
21 work is not yet determined.

22 The same holds true for Staff's exclusion of the cost associated with the services
23 provided by Dr. James Vander Weide. Company has already employed the services of
24 Dr. Donald Murry to provide testimony on the issues of rate of return/return on equity and to
25 Staff's knowledge, Empire has never utilized a second consultant for rate of return/return on
26 equity in the context of a rate case proceeding. In addition, Company provided insufficient
27 evidence in this proceeding to support the need for utilizing an additional rate of return/return
28 on equity consultant. In Company's response to Staff Data Request No. 208.8, Company
29 responded as follows:

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

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1 Vander Weide was retained as a second rate of return
2 consultant/witness based on the belief that his representation is
3 reasonable and prudent for an effect presentation of Empire's position
4 on the issue and that he is well qualified for the assigned task. In
5 selecting Mr. Weide (sp.), Empire relied on outside recommendations,
6 used its professional judgment, and evaluated costs in light of
7 Mr. Weide's (sp.) qualifications, experience, and skill. As stated in
8 response to DR 208.7, it is Empire's policy to employ only those
9 experts who will help to properly evaluate and explain the issues that
10 arise in the context of a rate case.

11 Q. Does Staff have any concerns regarding the amount of rate case expense
12 estimated by Company for this proceeding?

13 A. Yes. According to Company's workpapers, Empire estimates total rate case
14 expense of \$750,000 for this proceeding to be normalized over a three-year period
15 (\$250,000/year). This estimate represents a 19.50% increase in rate case expense over the
16 total "actual" rate case expense incurred in Empire's last fully litigated rate case, Case
17 No. ER-2001-0299 (\$627,609.28). When asked in Staff Data Request No. 208.7 to provide
18 and explain the policies and procedures employed by Company to establish and control the
19 parameters for a reasonable level of rate case expense, Company replied as follows:

20 Empire's policy is to employ the experts that are necessary to properly
21 evaluate and explain the issues that arise in the context of a rate case.
22 Only those that are deemed to be necessary are utilized during a rate
23 case. This should result in a balance for all interests that are
24 represented in a rate case.

25 Q. What is Staff's primary concern with the manner in which Empire retained
26 outside consultants for purposes of this proceeding?

27 A. The Staff's concern is with the lack of internal controls employed by Empire
28 over the amounts paid for services provided by outside consultants. Work performed by an
29 outside consultant can provide an opportunity for abuse of company resources. As such, the
30 process used by a utility to contract for services provided by an outside consultant should

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1 attempt to ensure that costs paid for outside services are not only competitive in the market,
2 but that charges incurred for the work are commensurate with the quality and quantity of
3 work performed. Therefore, Staff believes a reasonable internal control such as competitive
4 bidding should be employed by Empire to protect company resources and ensure prices paid
5 for outside services are reasonable. In addition, Company should require that there is
6 detailed documentation supporting the costs charged by each consultant for services
7 performed that is adequate to justify the costs incurred and to ensure that the services
8 rendered are commensurate with the quality and quantity of work performed.

9 Q. Did Empire employ either of these internal controls, competitive bidding and
10 adequate documentation, in relation to the costs incurred for all of the outside consultants
11 utilized for purposes of this proceeding?

12 A. No.

13 Q. Did Staff receive information from Company that supports Staff's concern
14 about the policies and procedures employed by Company to establish and control the
15 parameters for a reasonable level of rate case expense?

16 A. Yes. In Staff Data Request No. 174, Staff asked Company to provide a copy
17 of the Company's policies and procedures used to acquire the services of each of the
18 consultants. In response to this request, Company indicated it did not employ any internal
19 policies and procedures for the hiring of Dr. Donald Murry, Dr. James Vander Weide,
20 Jill Tietjen, Ken Vogl, Ed Overcast and Johannes Pfeifenberger. Instead, Company relied
21 solely on established relationships with the consultants utilized for purposes of this
22 proceeding with the exception of Johannes Pfeifenberger and Dr. James Vander Wiede. The

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1 only consultant subjected to a competitive bidding process was Donald Roff, who provided a
2 depreciation study for purposes of this proceeding.

3 **BANKING FEES**

4 Q. Please explain Adjustment No. S-10.2.

5 A. The Staff made Adjustment No. S-10.2 to annualize the cost associated with
6 banking fees paid by the Company for its commercial lines of credit. The Staff annualized
7 the cost of the banking fees based upon the current contract for the syndicated bank line of
8 credit as provided by the Company in response to Staff Data Request No. 213. The Staff
9 further offset the cost of these banking fees by the amount of interest earned on overnight
10 investments made by the Company during 2003. Staff has followed this methodology in
11 previous cases.

12 **FLOTATION COSTS**

13 Q. Are you sponsoring any other adjustments to Staff's revenue requirement run?

14 A. Yes. In 2001, 2002, 2003 and 2004, Empire issued 2,012,500 shares of
15 common stock, 2,500,000 shares of common stock, 2,000,000 shares of common stock and
16 300,000 shares of common stock, respectively. In doing so, the Company incurred costs
17 totaling \$6,810,657. It is Staff's position that these costs be recovered through rates as an
18 above-the-line adjustment to operating expenses. I recommend these costs be normalized
19 over a five-year period for purposes of this proceeding. As such, I am sponsoring
20 Adjustment No. S-14.6 in the amount of \$1,362,131 to reflect the normalization of this
21 expense.

22 Q. Does this conclude your direct testimony?

23 A. Yes, it does.

ROBERTA A. MCKIDDY
SUMMARY OF PREPARED TESTIMONY

Issue	Case Number	Case Name
Electric Utility Industry Merger History	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
Financial Theory of Utility Mergers	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
History of the UtiliCorp United / St. Joseph Light and Power Merger	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
Merger Overview	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
Merger Rationale	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
Surveillance Data Reporting	EM-2000-292	UtiliCorp United Inc. / St. Joseph Light and Power
Electric Utility Industry Merger History	EM-2000-369	UtiliCorp United Inc. / Empire District Electric
Financial Theory of Utility Merger	EM-2000-369	UtiliCorp United Inc. / Empire District Electric
History of the UtiliCorp United Inc. / Empire Electric Company Merger	EM-2000-369	UtiliCorp United Inc. / Empire District Electric
Merger Overview	EM-2000-369	UtiliCorp United Inc. / Empire District Electric
Surveillance Data Reporting	EM-2000-369	UtiliCorp United Inc. / Empire District Electric
Cost of Capital	ER-2001-299	The Empire District Electric Company
Cost of Capital	ER-2002-217	Citizens Electric Corporation
Evaluation of Transaction	GM-2001-585	Gateway Pipeline Company Inc., et al
Standard of Public Detriment	GM-2001-585	Gateway Pipeline Company Inc., et al
Evaluation of Transaction	GM-2001-585	Gateway Pipeline Company, Inc.
Standard of Public Detriment	GM-2001-585	Gateway Pipeline Company, Inc.
Rate of Return	GR-2000-512	Union Electric Co d/b/a AmerenUE
Cost of Capital	GR-2001-629	Laclede Gas Company
Cost of Capital	GR-2002-356	Laclede Gas Company
Capital Structure, Cost of Capital, Embedded Cost, Return on Equity	SR-2000-282	Missouri-American Water Company
Surveillance Data Reporting	TM-2002-232	Verizon/CenturyTel
Surveillance Data Reporting	WM-2001-309	Missouri-American Water Company, et al
Capital Structure, Cost of Capital, Embedded Cost, Return on Equity	WR-2000-281	Missouri-American Water Company
Capital Structure, Cost of Capital, Embedded Cost, Return on Equity	WR-2000-844	St. Louis County Water Company
Cash Working Capital, Tank Painting Expense, Main Incident Expense, Facility Locates Expense and Advertising Expense	WR-2003-500	Missouri-American Water Company

SCHEDULE 2
HAS BEEN
DEEMED
HIGHLY CONFIDENTIAL
IN ITS
ENTIRETY

already performed, upon the failure of Owner to make an undisputed payment to Contractor within thirty (30) days of the date such payment was due, by so notifying Owner in writing seven (7) Business Days in advance. Disputes will be handled according to Exhibit F.

5.5 Contractor shall procure a performance bond within twenty-one (21) business days after the execution of the Agreement and provide Owner evidence in the form of Exhibit G.

ARTICLE 6 START-UP AND TESTING

6.1. Mechanical Completion.

6.1.1 Contractor shall perform the Work so that Mechanical Completion shall occur not later than the Scheduled Mechanical Completion Date. Contractor shall, whenever it has cause to anticipate any delay in or impediment to proper and timely performance of the Work, on its part, promptly notify Owner in writing and Contractor shall take reasonable steps, in accordance with this Agreement, to alleviate or mitigate such effects.

6.1.2 Contractor shall provide written notice to Owner that Contractor deems the Work to meet the requirements of Mechanical Completion. Within ten (10) Business Days after receiving notice of Mechanical Completion, Owner shall advise Contractor in writing of any known defects or deficiencies in the Project or discrepancies between installed Equipment, Bulk Materials and Supplies and as represented by the Specifications and Drawings. Contractor shall then take appropriate corrective action and again notify Owner in writing that the Project has achieved Mechanical Completion. Owner shall have three (3) Business Days after such notification to advise Contractor of any remaining known defects, deficiencies and discrepancies. If Owner fails to notify Contractor of any such known defects, deficiencies or discrepancies within the allocated time, the Project shall be deemed to have achieved Mechanical Completion.

6.1.3 If due to the fault of Owner or Owner's representatives, Mechanical Completion is not accomplished within thirty (30) days of the Scheduled Mechanical Completion Date, Contractor shall be entitled to reimbursement of all expenses incurred for the demobilization and remobilization on a cost plus fifteen (15%) percent basis.

6.2 Performance Tests. As soon as practical after Mechanical Completion, Contractor shall conduct the Performance and Emission Tests (as described in Section 9 of Exhibit D) to ensure CEMS meets EPA standards and requirements and that emission limits are met as described in Revised Exhibit 4 (dated January 30, 2002) of Exhibit D.

ARTICLE 13 ASSIGNMENT

13.1 Assignment. Except as set forth in this Article 13.1 no interest in this Agreement shall, in whole or in part, be assigned or encumbered by either party without the prior written consent of the other party, which consent shall not be unreasonably withheld. Owner shall have the right to assign this Agreement in whole or in part to (i) an entity established to own, operate and to obtain funds for the construction and operation of the Project, and (ii) the Lender. Any such assignment shall not relieve the assigning party of any obligation under this Agreement. Upon the assignment of this Agreement to a Lender, Contractor shall, at the request of Owner, enter into a consent agreement with Lender pursuant to the terms of Article 19.7.

13.2 Succession. This Agreement shall inure to the benefit of and be binding upon the successor and permitted assigns (as provided for by Article 13.1) of the parties. Owner agrees that any assignees or transferee of its interest or any portion thereof in this Agreement or in the Project, including any lienholder or party holding a security interest with respect thereto will be bound by the releases and limitations of liability set forth in this Agreement such that the total aggregate liability of Contractor to Owner and such assignees or transferee shall not in the aggregate exceed the limits of liability set forth in this Agreement.

ARTICLE 14 SUBCONTRACTORS AND LABOR RELATIONS

14.1 Subcontractors. Contractor shall have the right to enter into purchase orders for the provision of Equipment, Start-up Spare Parts, Bulk Materials and Supplies, and to subcontract a portion of the Work. The issuance of any purchase order or subcontract shall not relieve Contractor of any of its obligations under this Agreement, including, but not limited to, the obligation to properly supervise and coordinate the tasks of Subcontractors and Vendors so as to ensure that all tasks performed by Subcontractors and Vendors conform to the standards set forth in this Agreement.

14.2 Labor Relations. Contractor shall promptly undertake all reasonable efforts to resolve any labor disputes among its employees. If a labor disturbance occurs, Contractor shall take all reasonable actions to minimize any resulting disruption of the progress of the Work. Contractor shall advise Owner promptly in writing of any known actual or anticipated or threatened labor dispute that might affect the performance of the Work.

ARTICLE 15 SUSPENSION AND TERMINATION

15.1 Right of Owner to Suspend Work

15.1.1 Owner may suspend the performance of the Work by Contractor, in whole or in part, at any time and from time to time upon thirty (30) days' prior written notice of such suspension. The notice of suspension shall state the reason for suspension and the anticipated term of suspension. Thereafter, Contractor shall resume performance of the Work when directed to do so upon reasonable notice by Owner. Notice of suspension does not relieve Owner from making payments for milestone events already completed at the time of suspension or milestones scheduled for completion within thirty (30) days of the notice of suspension.

15.1.2 In the event of suspension of the performance of the Work at Owner's request, Contractor shall be entitled to a reimbursement of direct and indirect expenses and costs which were incurred by Contractor as a result of the suspension plus ten (10%) percent. Such expenses and costs shall include, but not be limited to, the costs of stopping the Work, preparing the Equipment, Construction Equipment, Start-up Spare Parts, Supplies and Bulk Materials for storage, moving such items to a storage facility, the cost of storage and insurance, cost increase in material and labor incurred during the suspension period, costs of removing such items from storage and transportation back to the manufacturing facility or Project Site, and costs of restarting the Work. The Scheduled Mechanical Completion Date and all other dates by which Contractor's responsibilities are measured shall be equitably adjusted to reflect any delays resulting from such suspension.

15.1.3 In the event suspensions by the Owner pursuant to Article 15.1.1 in the aggregate exceed ninety (90) days, Contractor may terminate its obligations under the Agreement by so notifying Owner in writing and the provisions of this Article 15.1 shall apply to such termination as if the termination were made by Owner without cause under Article 15.2.

15.2 Termination. Owner may terminate the Work with or without cause at any time by giving thirty (30) days written notice of termination to Contractor. Owner may terminate Contractor for cause should Contractor commit a material breach of or default under this Agreement, abandon the Project, make an assignment for the benefit of creditors, admit in writing its inability to pay its debts as they become due, file a voluntary petition in bankruptcy, be adjudicated as bankrupt or insolvent, file a petition or answer seeking for itself any reorganization, arrangement, composition, readjustment, liquidation, dissolution, or similar relief under any present or future statute, law or regulation, file any answer admitting or not contesting the material allegations of a petition filed against Contractor in any such proceeding, or seek, consent to or acquiesce in, the appointment of any trustee, receiver, custodian or liquidator of Contractor or of all or any substantial part of the properties of Contractor, or if Contractor, its directors or shareholders take action to dissolve or liquidate Contractor. In the case of a termination for material breach of or default under this Agreement, Owner may not terminate this Agreement for cause if after notice of such breach or default which identifies in detail the acts or omissions of Contractor causing such breach or default and prior to expiration of the thirty (30) day period set forth above, Contractor has commenced and is diligently pursuing efforts to cure such breach or default.

15.3 Payments upon Termination. In the event of termination as provided in Article 15.2 without cause, Owner shall pay to Contractor a pro rata portion of the Agreement Price consistent with the Project Schedule up to thirty (30) days following the date of notice of termination, plus any costs directly or indirectly attributable to, and reasonably incurred in terminating the Work, including, without limitation, cancellation charges owed to third parties. Contractor shall provide Owner with invoices of all such costs. In the event of termination as provided in Article 15.2 for cause, Owner shall pay to Contractor for a pro rata portion of the Agreement Price consistent with the Project Schedule up to the date of notice of termination but Owner shall have no obligation to make such payment to Contractor until the amount of Owner's offset rights for any reasonable and necessary expenses incurred by Owner to complete the Project under substantially similar terms and conditions are agreed upon by Owner and Contractor. Upon termination, Contractor shall deliver to Owner possession of the Work in its then condition, including without limitation all Drawings and Specifications, contracts with Vendors and Subcontractors, all other documentation associated with the Project, and all construction supplies and aids dedicated solely to construction of the Project. In the event of

termination neither party shall be liable to the other except to the extent obligations, by their terms, expressly survive termination.

15.4 Assumption of Obligations. In the event of termination, Owner shall assume and become liable for any written obligations and commitments that Contractor may have undertaken with Vendors and Subcontractors in connection with the Work, and any other obligations Owner chooses to assume which are by law or by their terms assumable by Owner and are not covered by the payments made to Contractor under Article 15.3. Such obligations include, without limitation, any leases or rentals of Construction Equipment utilized in connection with construction of the Work. Contractor shall execute all papers and take all other reasonable steps requested by Owner which may be required to vest in Owner all rights, setoffs, benefits and titles necessary to such assumption by Owner of such obligations described in this Article 15.4. Owner agrees to indemnify and hold Contractor harmless against any liability under any obligations assumed by Owner pursuant to this Article 15.4 arising after the assumption by Owner.

15.5 Liability Limitations. Notwithstanding anything in this Agreement to the contrary, in no event shall the maximum liability under this Agreement of Contractor, its corporate affiliates, and their employees, agents, partners, officers and directors (referred to as the "Released Parties") to Owner, its partners, Lender, their affiliates, employees, agents, partners, officers and directors (referred to as the "Releasing Parties") with respect to all claims, including those of third parties, however caused, arising out of the performance or non-performance of the Work and obligations under this Agreement, warranty, tort (including negligence), strict liability, or otherwise, including without limitation, liability for liquidated damages, pursuant to Article 6 exceed in the cumulative aggregate the sum of five (5%) percent of the Agreement Price and the Releasing Parties hereby release, indemnify and hold harmless the Released Parties from any excess liability. No claim shall be asserted against the Released Parties unless the injury, loss or damage giving rise to the Claim is sustained prior to the expiration of one (1) year from the date of Mechanical Completion.

15.6 Liability Limitation for Empire District Electric Company. Notwithstanding anything in this Agreement to the contrary, in no event shall the maximum liability under this Agreement of Owner, its corporate affiliates, and their employees, agents, partners, officers and directors (referred to as the "Released Parties") to Contractor, its partners, Lender, their affiliates, employees, agents, partners, officers and directors (referred to as the "Releasing Parties") with respect to all claims, including those of third parties, however caused, arising out of the performance or non-performance of the Work and obligations under this Agreement, warranty, tort (including negligence), strict liability, or otherwise, including without limitation, liability for liquidated damages, pursuant to Article 6 exceed in the cumulative aggregate the sum of five (5%) percent of the Agreement Price and the Releasing Parties hereby release, indemnify and hold harmless the Released Parties from any excess liability. No claim shall be asserted against the Released Parties unless the injury, loss or damage giving rise to the Claim is sustained prior to the expiration of one (1) year from the date of Mechanical Completion.

15.7 Consequential Damages. The Released Parties shall not be liable to the Releasing Parties for incidental, indirect, punitive, exemplary, special or consequential loss or damage, including, but not limited to loss of use, loss of profit, loss of revenue, loss by reason of plant shutdown or inability to operate at rated capacity, increased costs of purchasing or providing the Equipment or other materials, supplies or services, debt service, rental payments or contractual damages incurred by Owner to others, resulting from any cause whatsoever.

including but not limited to any delay, act, error or omission of Contractor, whether or not involving the sole or concurrent fault or negligence of Contractor

15.8 Exclusivity. The remedies described in Articles 5.1.4, 5.3.1 and 5.3.2, subject to the limitation of liability specified in Article 15.5, shall constitute Owner's sole and exclusive remedies for liabilities of Contractor arising from the failure of Contractor to achieve Mechanical Completion by the Scheduled Mechanical Completion Date and failure of the Project to meet the Performance Guarantees.

ARTICLE 16

FORCE MAJEURE

16.1 Events Constituting Force Majeure. Force Majeure means the occurrence of any event or circumstance or combination of any event or circumstance beyond the reasonable control of either party which materially and adversely affects the ability of either party to perform its obligations under the Agreement. Neither party shall be excused from timely payment of any amounts due under this Agreement due to an event of Force Majeure.

Without limiting the generality of the foregoing, events constituting Force Majeure shall include, but not be limited to the following events and circumstances to the extent they satisfy the above requirements:

- (a) Acts of war, terrorism, hostilities (whether war be declared or not), invasion, act of foreign enemies.
- (b) The making or changing of any statute, ordinance, order, law, regulation or by-law by any branch of the government or any political subdivision thereof which has the effect of prohibiting or rendering unlawful the performance of the Agreement.
- (c) Rebellion, revolution, insurrection, military or usurped power or civil war.
- (d) Riot, civil commotion or disorder.
- (e) Epidemic or plague.
- (f) Any material effect of the natural elements, including lightning, fire, earthquake, flood, storm, blizzards, hail, cyclone, typhoon, or tornado.
- (g) Strikes, works to rule or go slows which are either widespread, nationwide, regional or local or of a political nature.
- (h) Change, denial, delay or failure to renew licenses or permits required for the Project.
- (i) Subsurface or latent physical conditions at the Project Site.
- (j) Delays or accidents in transportation (including delays in customs).
- (k) Partial or entire delays or failures in the provision of any necessary utilities at the Project Site.

EXHIBIT G**PERFORMANCE BOND**

KNOW ALL MEN BY THESE PRESENTS that we, the undersigned _____ of PATCH CONSTRUCTION LLC, hereinafter referred to as "Contractor", and _____ a corporation organized under the laws of the state of _____ and authorized to transact business in the states of Missouri and Kansas as "Surety," are held and firmly bound unto THE EMPIRE DISTRICT ELECTRIC COMPANY, hereinafter referred to as "Owner," in the penal sum of _____ US DOLLARS (US\$ _____), lawful money of the United States of America, for the payment of which sum, well and truly to be made to the Owner, we bind ourselves and our heirs, executors, administrators, successors, and assigns, jointly and severally, by these presents:

WHEREAS, on the _____ day of _____, 2002, the Contractor entered into a written Agreement with the Owner for furnishing materials, supplies, and equipment not furnished by the Owner, construction tools, equipment, and plant, and the performance of all necessary labor, for and in connection with the construction of certain improvements designated, defined, and described in the said Agreement and the conditions thereof, and in accordance with the Agreement documents therefor, a copy of the said Agreement being attached hereto and made a part hereof, and

WHEREAS, it was a condition of the Agreement award by the Owner that these presents be executed by the Contractor and Surety;

NOW THEREFORE, if the said Contractor shall, in all particulars, well, duly, and faithfully observe, perform, and abide by each and every covenant, condition, and part of the said Agreement, and the conditions, specifications, guarantees (including those of equipment performance), drawings, and other Agreement documents thereto attached or, by reference, made a part thereof, according to the true intent and meaning in each case, then this obligation shall be null and void; otherwise, it shall remain in full force and effect, and

PROVIDED, that in the event the Contractor shall be in default under the Agreement or the Agreement shall be terminated by the Owner under the provisions of the Agreement, the Surety shall promptly remedy the default or shall promptly (1) complete the Agreement in accordance with its terms and conditions, or (2) arrange for a contract between the Owner and a mutually acceptable contractor to complete the original contract in accordance with its terms and conditions; and in the event the Surety does not commence performance within thirty (30) days after notice of default or termination, the Owner may take over and prosecute the work to completion by Agreement or otherwise and the Surety shall pay to the Owner the cost of completion less the unpaid balance of the Agreement price. (The "unpaid balance of the Agreement price" shall mean the total Agreement price less the amount paid to the Contractor under the terms of the Agreement)

PROVIDED FURTHER, that if the Contractor shall fail to pay all just claims and demands by, or in behalf of, any employee or other person, or any firm, association, or corporation, for labor performed or materials, supplies or equipment furnished, used or consumed by the Contractor or his, their or its subcontractor or subcontractors in the performance of the work, then the Surety will pay the full value of all such claims or demands in

any total amount not exceeding the amount of this obligation, together with interest as provided by law.

THE UNDERSIGNED SURETY, for value received, hereby agrees that no extension of time, change in, addition to, or other modification of the terms of the Agreement or work to be performed thereunder, or of the specifications or other Agreement document, shall in any way affect its obligation on this bond, and the Surety does hereby waive notice of any such extension of time, change, addition, or modification.

IN TESTIMONY WHEREOF, the Contractor has hereunto set his hand and the Surety has caused these presents to be executed in its name and its corporate seal to be affixed by its attorney-in-fact at _____ on this _____ day of _____, 2002.

(Contractor)

By: _____

(Surety Company)

By: _____
(Attorney-in-Fact)

By: _____
(State Representative)

**AGREEMENT FOR INSTALLATION OF TWO FT-8 TWIN PAC'S
AND ENGINEERING, PROCUREMENT
AND CONSTRUCTION OF BOP EQUIPMENT
NEAR SARCOXIE, MISSOURI**

By and Between

THE EMPIRE DISTRICT ELECTRIC COMPANY

And

PATCH CONSTRUCTION LLC AND PATCH INC.

AMENDMENT – 01

week. As these costs are prepared on a weekly estimated basis, each request for payment will be supported with documents for the preceding week and the payment request reconciled as necessary.

5.4 Payment of Change Order Price: The payment of Change Orders shall be made by Owner in accordance with the provisions of the Change Orders approved by Owner.

5.5 Interest: Any portion of the Agreement Price not paid by Owner when due in accordance with this Article 5 may incur Interest charges from the Suppliers. Any such additional costs caused solely by delay of Owner, including Contractor's costs resulting from late payments shall be to the Owner's account. Any such additional costs caused by delay of Contractor, shall be to the Contractor's account. Provided Contractor is not in default under the Agreement or this amendment, any portion of the Agreement Price due directly to the Contractor and not paid by Owner when due in accordance with this Article 5 shall bear interest from the date payment was due to the date of payment at a rate per annum equal to the lesser of the maximum lawful rate or the prime rate as then published by Bank of America in Houston, Texas plus three (3%) percent.

5.6 Contractor's Right for Non-Payment by Owner: Notwithstanding the provisions of Article 5.5 above, and provided Contractor is not in default of its obligations under the Agreement or this amendment, Contractor shall have the right to terminate this agreement in its entirety, and to be released from any liability except with respect to its warranty obligations for Work already performed, upon the failure of Owner to make an undisputed payment to Contractor within thirty (30) days of the date such payment was due, by so notifying owner in writing seven (7) Business Days in advance. Disputes will be handled according to Exhibit F.

A1.2 Exhibit B: Payment Terms and Values

Exhibit B: Payment Terms and Values is deleted in its entirety and replaced with the following provisions:

- 1 Attached as Exhibit J is Contractor's Project Cost Report as of the date of this Amendment 01, disclosing in full the Original Budget, Current Budget, Current Commitments and the Forecast to Complete.

2. The latest Cost Report referred to above contains the forecast costs at Project completion based on actual order values and quantity take-offs at over 80% Engineering completion. The economies achieved by Contractor have enabled Contractor to create a First Tier Contingency (FTC) in the amount of \$915,258.
3. Contractor hereby assigns the First Tier Contingency to Owner's control. This contingency will be re-allocated to and from estimated areas of the project to maintain the project budget at \$10,450,124 or less. (\$11,365,382 - \$915,258). Contractor shall not be required to provide a Performance Bond.
4. The Cost Report also defines Contractor's originally planned Overhead, Profit and Contingency. The Original Budget for Profit and Contingency was \$1,067,011. This amount shall be defined as the Second Tier Contingency. Owner has in effect paid this amount as part of the Notice to Proceed payment of \$ 1,136,000. Should the First Tier Contingency be exhausted, Contractor shall reimburse Owner for all costs above \$10,450,124 within seven (7) working days, provided such costs have been invoiced to Owner by Contractor and provided Owner has paid the invoiced amounts.
5. Should both the First and Second Tier Contingency's be exhausted (i.e. the cost of the project exceeds \$11,365,382) then Contractor will make assets from Patch LLC, Patch Inc, and the personal assets of Mr. C J Patch III, PE available as collateral to insure completion of the project at the contracted value of \$11,365,382 pursuant to Exhibit M.
6. Unused First Tier Contingency will be allocated as follows: In recognition of the Owner's increased accounting and administrative functions, the first \$60,000 of remaining First Tier contingency will be retained by the Owner. The remaining First Tier contingency is payable by Owner to Contractor progressively as noted below:

Event	Anticipated Date	% FTC
Mechanical Completion of Unit 3	11-Feb-03	25%
Mechanical Completion of Unit 4	26-Feb-03	25%
Achieve Commercial Operation Unit 3	01-Apr-03	25%
Achieve Commercial Operation Unit 4	15-Apr-03	25%

Owner shall release to Contractor the payments as referred to above for achieving Commercial Operation by the dates specified, irrespective of whether Commercial Operation had been achieved or not, provided however, any delay to achieving Commercial Operation is not in whole or in part attributable to any deficiency in the work performed by Contractor, and provided that Contractor is in not in breach of the Agreement or this amendment and all lien waiver releases have been provided by owner.

A1.3 EXHIBIT C: PROJECT SCHEDULE

The Project Schedule, Run Date 05 Feb 02 is replaced with a new Schedule, Run Date 19 July 02, reflecting Owner's request to bring forward Unit 4 completion.

A1.4 EXHIBIT E: CONTRACTOR'S PARTIAL RELEASE OF CLAIMS

Contractor confirms receipt of payments from Owner in the sum of \$3,442,774 (Three million, four hundred forty two thousand, seven hundred seventy four), through the invoice dated June 7, 2002, covering all work performed up to and including May 31, 2002, and further confirms that Contractor has satisfactorily fulfilled his obligations with respect to Exhibit E: CONTRACTOR'S PARTIAL RELEASE OF CLAIMS for all payments made to date. The provisions of the Exhibit E referenced herein shall apply as described in section A 1.1 (5.3.3) described above.

A1.5 EXHIBIT G: PERFORMANCE BOND

Exhibit G: PERFORMANCE BOND, to the Agreements deleted in its entirety, pursuant to section A1.2 above.

A1.6 Contractor has furnished Owner with the following Financial Statements and the Owner has reviewed the same and Owner's requirements, resulting from this review, are incorporated in this AMENDMENT-01:

- Operating Statement for Patch LLC
- Operating Statement for Patch Inc
- Personal Statement for Mr. C J Patch III, PE

A1.7 EXHIBIT H: EXAMINATION OF RECORDS

IN WITNESS WHEREOF, the parties have caused this AMENDMENT 01 to "The ENGINEERING, PROCUREMENT AND CONSTRUCTION AGREEMENT" made and entered into February 15, 2002 by and between The Empire District Electric Company ("Owner") and Patch Construction LLC ("Contractor") to be executed as of the date first above written:

CONTRACTOR

OWNER

Patch Construction L.L.C.

The Empire District Electric Company

By: C.J. Patch

By: Brad Beecher

Printed Name: C.J. Patch III

Printed Name: BRAD BEECHER

Title: PRESIDENT

Title: VP ENERGY SUPPLY

CONTRACTOR

Patch Inc.

By: C.J. Patch

Printed Name: C.J. Patch III

Title: PRESIDENT

EXHIBIT M

GUARANTY AGREEMENT

DATE AND PARTIES. The date of this Guaranty Agreement ("Guaranty") is July 23, 2002 [date of amendment], and the parties are as follows:

Name	Street Address, City, State, Zip of Residence or Registered Agent Address in Missouri	SSN or Tax ID #
C. J. Patch, III, Individually	5310 GREENHURST LN SPRING, TX 77379	034-30-6785
[<u>PATRICIA H. PATCH</u>], Individually [spouse's name]	5310 GREENHURST LN SPRING, TX 77379	021-34-5101
Patch, Inc., a [<u>TEXAS</u>] corporation [state of incorporation]	3663 N. SAN HOUSTON PKWY EAST SUITE 300 HOUSTON, TX 77032	760513353
Patch Construction, L.L.C., a [<u>TEXAS</u>] limited liability company [state of organization]	7285 PEPPERWILL PKWY N. CHARLESTON, SC 29418	760655399

[GUARANTORS] (Collectively)

The Empire District Electric Company, a Kansas corporation
602 Joplin St
Joplin MO 64801
[HOLDER]

1. AGREEMENT TO GUARANTEE.

- A. To induce HOLDER to enter into an amendment to that certain Engineering, Procurement and Construction Agreement dated February 15, 2002 (the "Agreement"), GUARANTORS, jointly and severally, absolutely and unconditionally, promise to perform in accordance with the Obligations (as hereinafter defined) under this Guaranty, the Agreement, and the Amendment and to pay and guarantee prompt remittance of all payments to be made by Contractor under the Agreement and the Amendment to any third party supplier of labor, materials and services, or any other payment due by Contractor under the Agreement and the Amendment. Upon full performance by GUARANTORS of all of their respective obligations hereunder, this Guaranty, the Agreement, and the Amendment shall terminate.
- B. The term "Obligations" shall mean: (i) the obligations of GUARANTORS under this Guaranty; (ii) the obligations of GUARANTORS under the Agreement or under the Amendment; (iii) all existing and future indebtedness, liabilities, and obligations of GUARANTORS to HOLDER.
- C. GUARANTORS, jointly and severally, absolutely and unconditionally, guarantee and promise unto HOLDER that they will faithfully perform and fulfill all of their covenants under the Agreement and the Amendment and the Obligations at the time and in the manner provided for therein.
- D. GUARANTORS, jointly and severally, absolutely and unconditionally, further promise and guarantee prompt payment when due of all attorney fees, including paralegal fees, and all other costs and expenses incurred by HOLDER in enforcing HOLDER's rights under this Guaranty, the Agreement, and the Amendment.

2. **PRIMARY LIABILITY.** GUARANTORS are primarily liable under this Guaranty; regardless of whether or not HOLDER pursues any of its remedies under the Agreement or the Amendment or against any other surety, guarantor or endorser under said Agreement or Amendment.

3. **NO OTHER CONDITIONS.** The liability of GUARANTORS is not conditioned on the signing of this Guaranty by any other person and further is not subject to any condition not expressly set forth herein.
4. **EVENTS OF DEFAULT.** GUARANTORS shall be in default upon the occurrence of any of the following events, circumstances or conditions:
- A. Failure by any person or entity obligated to make payment on behalf of Contractor under the Agreement or the Amendment.
 - B. A default or breach under any of the terms of this Guaranty, the Agreement or the Amendment.
 - C. The reasonable determination by HOLDER that any warranty, covenant, representation or statement made herein or in the Agreement or Amendment to induce HOLDER to enter into this Guaranty, the Agreement, and the Amendment, and all other documents executed in conjunction therewith, if any, and to accept this Guaranty, prove to be false when made or furnished.
 - D. Entry of a decree or order for relief by a court having jurisdiction of the premises in respect of any of GUARANTORS, or any guarantor or surety of them, in any involuntary case under Federal Bankruptcy Laws, as now or hereafter constituted, or any other applicable federal or state bankruptcy, insolvency or similar law, or the appointing of a receiver, a liquidator, assignee, custodian or other similar office of any of GUARANTORS, or any guarantor or surety of them, or for a substantial part of their property, or the ordering or winding up liquidation of affairs and the continuance of any such decree or order unstayed in effect for a period of sixty (60) days.
 - E. Commencement by any of GUARANTORS or by any guarantor or surety of them of a voluntary case under Federal Bankruptcy Laws, as now constituted or hereafter amended, or any other applicable federal or state bankruptcy, insolvency or similar law, or the consent by any of them to the appointment of or taking into possession by a receiver, a liquidator, assignee, custodian or other similar official of GUARANTORS or any guarantor or surety of them, or for a substantial part of their property, or the making by them or by any guarantor or surety of them of any assignment for the benefit of creditors, or the failure of any of them generally to pay their debts as such debts become due or the taking of any action by any of them or any guarantor or surety of them in furtherance of any of the foregoing.
 - F. Dissolution, termination of existence, or business failure of PATCH CONSTRUCTION, L.L.C. or PATCH, INC.
 - G. If any guaranty of the Agreement or the Amendment shall at any time, for any reason, cease to be in full force and effect or shall be declared to be null and void by a court of competent jurisdiction, or if the validity or enforceability thereof shall be contested or denied by any party thereto, or if any party thereto shall deny that he, she or it has any further liability or obligation thereunder, or if any party thereto shall fail to comply with or observe any of the terms, provisions or conditions contained in any such guaranty.
 - H. A transfer of a substantial part of any of GUARANTORS' money, property, or **business interests**, except in the ordinary course of business.
5. **REMEDIES ON DEFAULT.** At the option of HOLDER, all or any part of the Obligations under this Guaranty, the Agreement, or the Amendment, shall become immediately due and payable without notice or demand, upon the occurrence of an Event of Default or at any time thereafter. In addition, upon the occurrence of any Event of Default, HOLDER, at its option, may immediately invoke any or all other remedies provided in this Guaranty, the Agreement, or the Amendment, or any other instrument evidencing the Obligations, and any documents securing or otherwise relating to the Obligations. All rights and remedies are cumulative and not exclusive and HOLDER is entitled to all remedies provided by law or equity, whether or not expressly set forth.
6. **WAIVER AND CONSENT BY GUARANTORS AND OTHER SIGNERS.** Regarding this Guaranty, the Agreement, and the Amendment, to the extent not prohibited by law, GUARANTORS and any other signers:
- A. Consent to any waiver granted by HOLDER and agree that any delay or lack of diligence in the enforcement of the Obligations or any failure to file a claim or otherwise protect any of the Obligations in no way affects or impairs GUARANTORS' liability.
 - B. Waive notice of acceptance hereof, notice of any action taken or omitted by HOLDER in reliance thereon, any requirement that HOLDER give notice of default or asserting any other right of HOLDER hereunder.
 - C. Waive protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate and notice of dishonor.

- D. Consent to any renewals and extensions agreed to by HOLDER, regardless of the number of such renewals or extensions;
- E. Consent to HOLDER's release of any endorser, guarantor, surety, accommodation or any other co-signer.

7. **BANKRUPTCY.**

- A. If a bankruptcy petition should at any time be filed by or against the GUARANTORS, the maturity of the Obligations, so far as GUARANTORS' liability is concerned, shall be accelerated and the Obligations shall be immediately payable by GUARANTORS.
- B. GUARANTORS acknowledge and agree that this Guaranty shall remain in full force and effect at all times, notwithstanding any action or undertakings by or against HOLDER in connection with any obligation in any proceeding in the U.S. Bankruptcy Courts, including without limitation, election of remedies or imposition of any status upon claims by HOLDER, pursuant to the U.S. Bankruptcy Code, as amended.
- C. In the event that any payment under this Guaranty is deemed, by final order of a court of competent jurisdiction, to have been a voidable preference under the bankruptcy or insolvency laws of the United States or otherwise, then GUARANTORS' obligation shall remain as an obligation to HOLDER and shall not be considered as having been extinguished.

8. **RELIANCE BY HOLDER.** GUARANTORS acknowledge that HOLDER is relying on this Guaranty in entering into the Agreement and Amendment and that GUARANTORS have signed this Guaranty to induce HOLDER to enter into said Agreement and Amendment.

9. **JOINT AND SEVERAL.** GUARANTORS and all other guarantors, endorsers, co-signers, and sureties shall be jointly and severally liable under this Guaranty, the Agreement, and the Amendment. This Guaranty shall be in addition to any other guaranty or other security for the Obligations of HOLDER under the Agreement and the Amendment, which shall not be prejudiced or rendered unenforceable by the invalidity of any such other guaranty or security.

10. **GENERAL PROVISIONS.**

- A. **FINANCIAL STATEMENTS.** Until such time as the Obligations and payments due under the Agreement and the Amendment are performed and paid in full, GUARANTORS shall furnish HOLDER with such audited and unaudited balance sheets, income statements and financial statements as HOLDER may from time to time request, all of which financial statements shall be certified by GUARANTORS or GUARANTORS' accountants to be true, correct and complete.
- B. **TIME IS OF THE ESSENCE.** Time is of the essence in GUARANTORS' performance of all duties and Obligations imposed by this Guaranty.
- C. **NO WAIVER BY HOLDER OR GUARANTORS.** HOLDER's course of dealing, or HOLDER's forbearance from, or delay in, the exercise of any of HOLDER's rights, remedies, privileges or right to insist upon GUARANTORS' strict performance of any provisions contained in this Guaranty, the Agreement, or the Amendment, shall not be construed as a waiver by HOLDER, unless any such waiver is in writing and is signed by HOLDER.
- D. **AMENDMENT.** The provisions contained in this Guaranty may not be amended, except through a written amendment which is signed by HOLDER and GUARANTORS.
- E. **INTEGRATION CLAUSE.** This Guaranty and the Amendment to the Agreement, executed concurrently herewith, represent the entire understanding of the parties hereto as to the Obligations, whether prior, contemporaneous or subsequent, and may not be contradicted by evidence of prior, contemporaneous, or subsequent oral agreements of the parties.
- F. **GOVERNING LAW.** This Guaranty shall be governed by the laws of the State of Missouri, regardless of that state's conflict of laws provisions, and provided that such laws are not otherwise preempted by federal laws and regulations.
- G. **FORUM AND VENUE.** In the event of litigation pertaining to this Guaranty, the exclusive forum, venue and place of jurisdiction shall be in the State of Missouri, County of Jasper, unless otherwise required by law.
- H. **SUCCESSORS AND LIABILITY OF GUARANTORS.** This Guaranty shall inure to the benefit of and bind the heirs, personal representatives, successors, assigns of the parties and subsequent holders of the Obligations and the Note;

provided however, that GUARANTORS may not assign, transfer or delegate any of its rights or Obligations under this Guaranty.

- I. **NUMBER AND GENDER.** Whenever used, the singular shall include the plural, the plural the singular, and the use of any gender shall be applicable to all genders.
- J. **DEFINITIONS.** The terms used in this Guaranty, if not defined herein, shall have their meanings as defined in the other documents executed contemporaneously, or in conjunction, with this Guaranty.
- K. **PARAGRAPH HEADINGS.** The headings at the beginning of any paragraph, or any subparagraph, in this Guaranty Agreement are for convenience only and shall not be dispositive in interpreting or construing this Guaranty Agreement.
- L. **IF HELD UNENFORCEABLE.** If any provision of this Guaranty shall be held unenforceable or void, then such provision to the extent not otherwise limited by law shall be severable from the remaining provisions and shall in no way affect the enforceability of the remaining provisions nor the validity of this Guaranty. This Guaranty is valid despite the genuineness, validity or enforceability of any documents executed in conjunction with the transaction described in Section 2 hereof.
- M. **NO LEGAL EXISTENCE.** If for any reason PATCH CONSTRUCTION, L.L.C. or PATCH, INC. has no legal existence or is under no legal obligation to discharge any of its responsibility undertaken in the Agreement or purported to be undertaken by it or on its behalf, this Guaranty shall nevertheless be binding on GUARANTORS to the same extent as if GUARANTORS at all times had been principal parties obligated to perform under the terms and conditions of the Guaranty and the Agreement.

ORAL AGREEMENTS OR COMMITMENTS TO LOAN MONEY, EXTEND CREDIT, OR TO FORBEAR FROM ENFORCING REPAYMENT OF A DEBT INCLUDING PROMISES TO EXTEND OR RENEW SUCH DEBT ARE NOT ENFORCEABLE. TO PROTECT YOU (GUARANTORS) AND US (HOLDERS) FROM MISUNDERSTANDING OR DISAPPOINTMENT, ANY AGREEMENTS WE REACH COVERING SUCH MATTERS ARE CONTAINED IN THIS WRITING, WHICH IS THE COMPLETE AND EXCLUSIVE STATEMENT OF THE AGREEMENT BETWEEN US, EXCEPT AS WE MAY LATER AGREE IN WRITING TO MODIFY IT.

[SIGNATURES TO FOLLOW ON NEXT PAGE]

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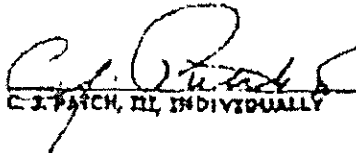
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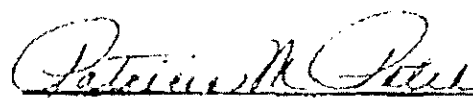
ENERGY CENTER

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IN WITNESS WHEREOF, the undersigned have executed this instrument, upon proper authority, as of the date first above written.


 07/22/02
C.J. PATCH, III, INDIVIDUALLY

 7/22/02
Patricia H. Patch INDIVIDUALLY, HUSBAND


ATTEST:

PATCH, INC.


SIGNATURE OF SECRETARY
PATRICIA H. PATCH
PRINTED NAME


SIGNATURE OF PRESIDENT
C.J. PATCH III
PRINTED NAME

PATCH CONSTRUCTION, L.L.C.


SIGNATURE OF MANAGING MEMBER
C.J. PATCH III
PRINTED NAME

GUARANTORS

COLLECTED BY THE QUALITY ASSOCIATION
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