

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

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**ROBERTA A. McKIDDY**

**FILED**

DEC 28 2004

Missouri Public  
Service Commission

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

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

*Jefferson City, Missouri  
November 2004*

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

**NP**

Exhibit No. 66 NP  
Case No(s). ER-2004-0570  
Date 12-08-04 Rptr KF

1  
2  
3  
4  
5  
6  
7  
8  
9

**TABLE OF CONTENTS OF  
SURREBUTTAL TESTIMONY  
OF  
ROBERTA A. McKIDDY**

**THE EMPIRE DISTRICT ELECTRIC COMPANY**

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

<b>RATE CASE EXPENSE .....</b>	<b>1</b>
<b>ENERGY CENTER 3 &amp; 4 (EC 3 &amp; 4).....</b>	<b>7</b>

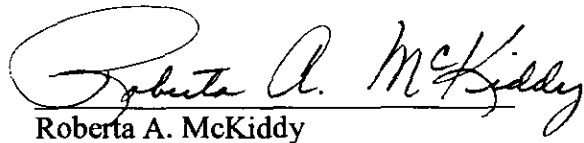
**BEFORE THE PUBLIC SERVICE COMMISSION**  
**OF THE STATE OF MISSOURI**

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

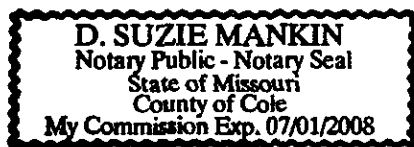
**AFFIDAVIT OF ROBERTA A. MCKIDDY**

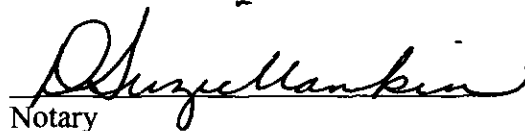
STATE OF MISSOURI     )  
                                  )  
COUNTY OF COLE     )     ss.

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

  
Roberta A. McKiddy

Subscribed and sworn to before me this 23<sup>rd</sup> day of November 2004.



  
Notary



Surrebuttal Testimony of  
Roberta A. McKiddy

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

6           Q.     Please explain.

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

18           Staff received the following response:

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

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



Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

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

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

19 A. No.

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

12          A.     No.

13          Q.     Please explain.

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

2 Why does Staff hold this view?

3 A. The component itemization contains seven (7) components, each of which  
4 were estimated at 80% above the actual final cost. The aggregate amount by which  
5 these seven items exceeds the actual cost is \$3,360,519.00 (see Schedule 1 attached).

6 For several of these items, such as fire protection, the amounts were described to the Staff  
7 as "place holders" and the Company acknowledged that they knew at the time that the  
8 actual expenditures would be far less. In addition, the final contingency which appeared  
9 on the component itemization was described as "remaining board approved budget after  
10 above estimates were made" [Company's response to Staff DR 356. See Schedule 2  
11 attached]. Using more accurate estimates for these items would have reduced the  
12 expected cost of the project, prior to the contingency, to approximately \$49.7 million.

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

1 Q. Please explain.

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

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

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

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

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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



Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

12                  A.    Yes.

13                  Q.    And what proof was that?

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

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

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

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

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

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

30                  A.    Not to my knowledge.

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

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

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

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

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

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

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

28 A. No.

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

31 A. No. These projects were managed differently.

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

Surrebuttal Testimony of  
Roberta A. McKiddy

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

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

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

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

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

23 A. No.

NP

Surrebuttal Testimony of  
Roberta A. McKiddy

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

3           A.    Yes.

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

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

10          Q.    Does this conclude your surrebuttal testimony?

11          A.    Yes, it does.

**SCHEDULES 1 and 2**

**HAVE BEEN DEEMED**

**HIGHLY CONFIDENTIAL**

**IN THEIR ENTIRETY**