Exhibit No.:
Issue: Cost allocation, Off-system sales and Fuel and Energy costs and Amortization
Witness: W. Scott Keith
Type of Exhibit: True-up Testimony
Sponsoring Party: Empire District
Case No. ER-2006-0315

Before the Public Service Commission

of the State of Missouri

True-up Testimony

of

W. Scott Keith

FILED[3]

NOV 2 8 2006

Missouri Public Service Commission

September 2006

Empire Exhibit No. 144
Case No(s). ER-2006-0315
Date 11/20/06 Rptr MV

AFFIDAVIT OF W. SCOTT KEITH

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the _____ day of September, 2006, before me appeared W. Scott Keith, to me personally known, who, being by me first duly sworn, states that he is the Director of Planning and Regulatory of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

W. Scott Keith

W. Scott Keith

Subscribed and sworn to before me this 27th day of September, 2006.

Samantha D Sill

Notary Public

My commission expires: May 21, 2008

Samantha D Sill
Notary Public - Notary Seal
State of Missouri
County of Jasper
Expires May 21, 2008

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THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
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TRUE-UP TESTIMONY
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INTRODUCTION

Q. STATE YOUR NAME AND ADDRESS PLEASE.

A. My name is W. Scott Keith and my business address is 602 Joplin Street, Joplin, Missouri.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am presently employed by The Empire District Electric Co. ("Empire" or "the Company") as the Director of Planning and Regulatory. I have held this position since August 1, 2005. Prior to joining Empire I was Director of Electric Regulatory Matters in Kansas and Colorado for Aquila, Inc. from 1995 to July 2005.

Q. ARE YOU THE SAME W. SCOTT KEITH THAT EARLIER PREPARED AND FILED DIRECT, REBUTTAL AND SURREBUTTAL TESTIMONY IN THIS RATE CASE BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION") ON BEHALF OF EMPIRE?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. In its Order Concerning Test Year and True-Up and Adopting Procedural Schedule, the Commission ordered a true-up of fuel expense and other significant revenue requirement elements for the three-month period ending June 30, 2006. The purpose of this testimony is to present Empire's revenue deficiency trued-up as to the items specified in the Commission's order thru June 30, 2006, and to discuss Staff's recommended adjustment for the allocation of administrative and general expenses and general plant investment due to the acquisition of the gas property previously owned by Aquila, Inc.

Q. PLEASE DESCRIBE EMPIRE'S TRUE-UP DEFICIENCY THRU JUNE 30, 2006.

A. Presented as Schedule WSK-1 is a schedule that displays the calculation of Empire's revenue deficiency of $26,231,680, if the IEC is terminated as Empire has requested. This deficiency has decreased from the reconciliation as filed by Staff on August 25, 2006, at which time it was $26,799,437.

Q. HAVE ANY NEW ISSUES DEVELOPED AS A RESULT OF THE TRUE-UP POSITIONS?

A. Yes. There are at least three differences between the relative positions of Empire and Staff. These differences concern fuel and purchased power expense, off-system sales and a new item – allocation of common costs and common property due to the recent, June 1, 2006, acquisition of the Aquila, Inc. gas operations in Missouri. The parties' relative positions as to the gain on the unwinding of the hedging transaction, management incentive and customer demand programs have not changed from the quantification of those positions presented prior to the hearings held from September 5, 2006 to September 14, 2006. The rate of return on rate base also changed as a result of the update in the capital structure through June 30, 2006.

CORPORATE ALLOCATIONS

Q. PLEASE EXPLAIN THE DIFFERENCES BETWEEN STAFF AND EMPIRE AS TO THE ALLOCATION OF COMMON EXPENSES TO THE COMPANY'S NEWLY ACQUIRED GAS OPERATIONS IN MISSOURI.

A. On June 1, 2006, The Empire District Electric Company acquired the Missouri natural gas distribution operations of Aquila, Inc. As a result of this acquisition, Empire expects to realize synergies in excess of increased costs related to the common costs associated with the combined operations of the electric and gas companies. The Stipulation and Agreement in Case No. GO-2006-0205 (the case in which the acquisition was approved), directed Empire to complete an updated cost allocation manual by December 1, 2006. This cost allocation manual has not been completed at this time. There is only thirty days of historical data available and no updated cost allocation manual to indicate how the common cost allocations will be performed in the future. Accordingly, Empire and Staff are left to forecast future cost allocations in the true-up and have used different methodologies to do so.

Q. DOES EMPIRE DISPUTE THE LIKELY CREATION OF SOME SYNERGIES?

A. No. Empire acknowledges that the newly acquired gas operations should enable the Company to spread its common costs over a larger customer base, and Empire has used known and measurable costs to recognize the impact of this cost benefit in this update to the electric rate case. On the other hand, the Staff's approach to this same issue does not use a known and measurable approach to quantify these future benefits, and in doing so has inaccurately, and, I believe, overstated the benefits or synergies forthcoming from Empire's combined electric and gas operation.

Q. HOW DOES EMPIRE PROPOSE TO ANNUALIZE THE FUTURE COST ALLOCATIONS IN THIS RATE CASE TRUE-UP?

A. Empire's actual allocation of common expenses to its Missouri gas operations in June was $32,631. This cost assignment was based on Empire's existing cost allocation manual that has been previously provided to, and reviewed by, the Staff of the Missouri Public Service Commission. It reflects the same methodology Empire has historically used to allocate common cost to its non-regulated businesses. This methodology uses a quantity of items such as purchase orders and vouchers to allocate costs such as purchasing and accounts payable. This cost assignment assumes that as the level of common expenses increase in total, the volume of activity also increases as the various operating functions move to Empire from Aquila during the transition period.

Q. DOES EMPIRE HAVE ANY ADDITIONAL INFORMATION THAT WOULD SUPPORT THE AMOUNT EMPIRE WOULD PROPOSE TO ALLOCATE TO ITS MISSOURI GAS OPERATIONS?

A. Yes. The common cost assignment in June 2006 is consistent with the common cost assignments made in July and August of 2006. representing the entire period of actual operating history. As a result, Empire proposes that the June 2006 cost assignment to the Missouri gas operations be annualized for purposes of this true-up. This results in an adjustment of $391,572 to Empire's total operations and an adjustment of $324,572 to the Company's Missouri jurisdictional electric operations.

Q. WHAT ADJUSTMENT DID STAFF MAKE FOR THIS SAME ALLOCATION?

A. Staff chose to allocate selected general and administrative expenses based on a Massachusetts formula provided by Empire. This resulted in a Staff adjustment of $728,584 to the Company's Missouri jurisdictional operations.

Q. WHAT HAS CAUSED THE LARGE DISCREPANCY BETWEEN THE TWO METHODS OF COMMON COST ALLOCATION USED BY EMPIRE AND THE STAFF?

A. The Company has used the actual common expense assignment to the Missouri operations in June of 2006 to forecast the annual cost allocation. Staff has projected the future allocation based on a projected percentage of overall expense at June 30, 2006, without taking into consideration additional costs that the Company has incurred to take over the gas operations since June 30 or that it has forecasted to increase as the transition process related to the gas operation progresses. As a result, Staff's method fails to recognize that the level of common cost will increase for Empire's combined gas and electric operations. For example, Empire has added employees since the end of June to handle the increase in workload as the duties associated with the gas operation have transitioned from Aquila. These new positions and the associated increase in cost are not captured or accounted for in the Staff's recommendation. Empire anticipates its overall base payroll, excluding related benefits, to increase approximately $375,000 due to the gas acquisition. The overall level of office supplies and other miscellaneous costs related to the gas acquisition will increase as well. In addition, the Staff methodology does not appropriately classify administrative and general costs into common and direct categories. This will overstate the level of assignment to the gas operations and understate the ongoing level of administrative and general expenses that are directly related to the electric operations.

Q. CAN YOU GIVE THE COMMISSION AN EXAMPLE OF HOW THE STAFF'S FAILURE TO PROPERLY CATEGORIZE COSTS WILL LEAD TO AN UNDERSTATEMENT OF COSTS FOR EMPIRE'S ELECTRIC OPERATIONS?

A. Yes. The Staff's broad brush methodology results in an allocation of outside service expenses to the gas operations that are directly related to the electric operation. The most clear cut example of this is related to the Integrated Resource Planning process in Missouri. The cost of this activity during the 12-months ended June 30, 2006 is directly related to the electric operation and none of it should be assigned to the gas operation. There are undoubtedly other examples of this sort of problem in the update data and the Staff proposed methodology.

Q. WHY DO YOU THINK STAFF HAS NOT TAKEN THESE ADDITIONAL EXPENSES INTO ACCOUNT?

A. The Staff does not take into account the additional expenses that will occur as a result of the acquisition of the gas company due to the fact that some of these cost increases were not incurred during the month of June 2006. This reasoning does not mesh with the allocation factor the Staff used to assign projected allocated costs. For example, the Staff used an allocation factor that assumed a higher level of expenses, beyond June 30, 2006, and applied it to the twelve months ended June 30, 2006 expense level, which only included one month of data for the gas operations. As a result, the Staff's proposed adjustment is inconsistent and to some extent has used an "apples to oranges" comparison to arrive at the allocation of costs.

Q. IS THIS THE ONLY TRUE-UP ADJUSTMENT THE STAFF HAS MADE FOR THE NEWLY ACQUIRED GAS OPERATIONS?

A. No. The Staff has allocated a portion of Empire's general plant, accumulated depreciation, and depreciation expense to the newly acquired gas operations. This allocation of general plant investment has reduced the Staff's Missouri jurisdictional revenue requirement by $509,045.

Q. DID EMPIRE MAKE A SIMILAR TRUE-UP ADJUSTMENT?

A. No. Empire does not believe that there is sufficient information at this time to make this adjustment, and that the Staff proposal is fraught with inconsistencies that make it highly inaccurate. For example, included in Empire's general plant investment are office furniture, computers and other items used at the Empire generating plants and electric line departments. The investment in this property can be separated by location and function. Much of the investment in general plant is not common property and should not be allocated to the gas operations. The approach used by the Staff does not take this into account, and as a result overstates the assignment to the gas operations. Empire is working to separate these types of items for the cost allocation manual to be completed by December 1, 2006. Until that process is complete and the cost allocation manual is updated, an allocation of common general plant cannot be accurately determined.

Q. IF AN ASSIGNMENT OF COMMON GENERAL PLANT IS MADE FOR PURPOSES OF THIS TRUE-UP, DO YOU AGREE WITH STAFF'S METHODOLOGY?

A. No. As I mentioned earlier, until the common general plant balances are developed as part of the revised cost allocation manual, an accurate assignment cannot be determined as part of this true-up. This Staff cost assignment of general facilities does not take into account the investment that directly supports Empire's electric operations, and overstates the level of general plant investment that is used by the gas operations and should be rejected by the Commission.

Q. DO YOU HAVE ANY COMMENTS REGARDING THE STATUS OF THE CORPORATE COST ALLOCATIONS ISSUE?

A. Yes. Because this is an issue that arises as a result of the true-up, Staff and the Company continue to discuss and exchange information related to the appropriate level of corporate allocations.

OFF SYSTEM MARGIN NORMALIZATION

Q. PLEASE DESCRIBE THE EMPIRE TRUE-UP TO THE OFF-SYSTEM MARGIN NORMALIZATION.

A. Essentially, the same methodology used for the direct case was used for the true-up period. Empire used a five year average after the exclusion of an unusual transaction that took place with AEP, the same position that has been taken earlier in the rate case. In addition to reflecting the five-year average adjusted for the AEP transaction, Empire's update in this area reflected the refund that has been ordered by the Federal Energy Regulatory Commission ("FERC") in ER99-1757-008, et al. This analysis resulted in an increase to Missouri jurisdictional revenue of $819,916. Staff used the twelve months ended June 30, 2006 margin to normalize the level of off-system sales. This Staff approach is consistent with the position taken earlier in this rate case by the Staff. The difference between the two approaches is $1,006,463 on a Missouri jurisdictional basis.

FUEL AND PURCHASED POWER EXPENSE

Q. PLEASE DESCRIBE THE TRUE-UP TO THE FUEL AND PURCHASED POWER EXPENSES.

A. Empire updated the customer load for growth to the June 30, 2006 level. This resulted in $137,839,369 of Missouri jurisdictional fuel and purchased power expense. Staff's recommended update to fuel and purchased power expense results in approximately $135 million of Missouri jurisdictional expense or a difference between Empire and Staff of approximately $3 million in Missouri jurisdictional fuel and purchased power expenses. This difference excludes the difference in positions in fuel expense due to the unwinding of a future hedge position. The unwinding issue is the same issue that has been addressed in earlier testimony in this rate case.

AMORTIZATION

Q. IS THE COMPANY ADDRESSING AMORTIZATION IN THIS UPDATE FILING?

A. Not at this time. The Company continues to work with the parties in the case to determine the appropriate method to calculate the amortization called for in case EO-2005-0263 and may need to file supplemental testimony on this subject. Just as before, the level of amortization, if any, is dependent upon other factors in the rate case -- with one of the most important factors being the overall return on equity authorized by the Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

WSK-1

Empire District Electric Company

Revenue Requirement after June 30, 2006 True Up

	IEC Termination
Rate Base	621,453,571
Rate of Return	9.50%
Net Income Required	59,038,089
Net Income Available	42,876,391
Additional Net Income Required	16,161,698
Income Tax Factor	1.62308
Gross Revenue Requirement	**26,231,680**