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STATE OF MISSOURI

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PUBLIC SERVICE COMMISSION

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TRANSCRIPT OF PROCEEDINGS

7

Hearing

8

September 5, 2006

Jefferson City, Missouri

9

Volume 7

10

11

In the Matter of The)

Empire District Electric)

12

Company of Joplin, Missouri,)

for Authority to File Tariffs)

13

Increasing Rates for Electric) Case No. ER-2006-0315

Service Provided to Customers)

14

in the Missouri Service Area of)

the Company)

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COLLEEN M. DALE, Presiding,

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CHIEF REGULATORY LAW JUDGE

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REPORTED BY:

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PAMELA FICK, RMR, RPR, CCR #447, CSR

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MIDWEST LITIGATION SERVICES

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0017

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0018

1 P R O C E E D I N G S

2 JUDGE DALE: Good morning. We are here
3 today on September 5th, 199 -- good grief, I don't
4 know where that came from -- 2006, in the matter of
5 the tariff filing of the Empire District Electric
6 Company of Joplin, Missouri to implement a general
7 rate increase for retail electric service provided to
8 customers in the Missouri service area of the
9 company, Case Number ER-2006-0315.

10 We will now have entries of appearance.

11 MR. SWEARENGEN: Yes. May it please the
12 Commission. On behalf of the Empire District
13 Electric Company, James C. Swearngen, Dean Cooper,
14 Janet Wheeler and Russ Mitten. We're all with the
15 firm Brydon, Swearngen & England, 312 East Capitol
16 Avenue, Jefferson City, Missouri. Thank you.

17 JUDGE DALE: Thank you.

18 MR. FREY: Representing the Staff, your
19 Honor, Staff of the Missouri Public Service
20 Commission, Dennis L. Frey, Kevin Thompson, Steve
21 Dottheim, Nathan Williams, David Meyer, Jennifer
22 Heintz, P.O. Box 360, Jefferson City, Missouri 65102.

23 JUDGE DALE: Thank you.

24 MR. MILLS: On behalf of the Office of
25 the Public Counsel and the public, my name is Lewis

0019

1 Mills. My address is Post Office Box 2230, Jefferson
2 City, Missouri 65102.

3 MR. CONRAD: On behalf of Praxair, Inc.
4 and Explorer Pipeline Company, Stuart W. Conrad of
5 the firm of Finnegan, Conrad & Peterson, 3100
6 Broadway, Suite 1209, Kansas City, Missouri 64111 and
7 David Woodsmall of the same firm, 428 East Capitol,
8 Suite 300, Jefferson City, Missouri 65101.

9 MS. WOODS: On behalf of the Missouri
10 Department of Natural Resources, Shelley Ann Woods,
11 Assistant Attorney General, Post Office Box 899,
12 Jefferson City, Missouri 65102.

13 MR. FISCHER: On behalf of the Kansas City
14 Power & Light Company, James M. Fischer, Fischer &
15 Dority, PC, 101 Madison, Suite 400, Jefferson City,
16 Missouri 65101.

17 MS. CARTER: On behalf of Aquila, Diana
18 Carter with Brydon, Swearngen & England, PC, 312
19 East Capitol Avenue, Jefferson City, Missouri 65102.

20 JUDGE DALE: Thank you. We'll go off
21 the record and mark exhibits at this time.

22 (DISCUSSION HELD OFF THE RECORD.)

23 (EXHIBIT NOS. 1 THROUGH 90 WERE MARKED
24 FOR IDENTIFICATION BY THE COURT REPORTER.)

25 JUDGE DALE: We're talking about

1 admitting into evidence those people who will not
2 take the stand because their testimony is admitted
3 pursuant to the partial settlement. Staff?

4 MR. WILLIAMS: Kofi Boateng which I believe
5 is Exhibit 34 which has been marked; Dana Eaves which I
6 believe have been marked as Exhibits 35 and 36; only a
7 portion of Janis Fischer's so she will be testifying,
8 but a portion of Exhibit 39 has been stipulated in.

9 MR. CONRAD: And if your Honor please,
10 there may be some other witnesses to be included in
11 that list, but I need to put this in before there is
12 a formal ruling. My clients did not object to the
13 stipulation. We did not file a timely objection, we
14 did not have a join in it, and we do not today have
15 objection to the content of the stipulation.

16 But there were some, shall we say,
17 irregularities with respect to the process that the
18 Commission followed in dealing with this stipulation
19 which went beyond the language of the stipulation,
20 and it was that language of the stipulation to which
21 my clients indicated that they did not object, not
22 some other on-the-fly process.

23 Therefore, I have to, at this point in
24 time, indicate on the record that any -- any attempt
25 in reception of those materials will be subject to

0021

1 our reservation. That order was issued on the 31st.
2 There is a time limit for us to file any necessary
3 pleadings with respect to that order, so you're
4 certainly free to do what you do today with respect
5 to those exhibits and those materials, but please be
6 advised that such rulings are made subject to my
7 clients' rights with respect to that order as to the
8 process that was employed by the Commission in
9 getting to that approval.

10 MR. MILLS: May I speak on this matter,
11 your Honor?

12 JUDGE DALE: Certainly.

13 MR. MILLS: Just so the record is clear,
14 I think many of the people that are involved in the
15 case are aware of this, but there may not be an
16 adequate record of it preserved with the record for
17 appeal.

18 I think what -- what Mr. Conrad is
19 referring to is the fact that the Commission had
20 communications with its Staff at the agenda session
21 with very little notice to the parties and, in fact,
22 some of the parties, Empire, for example, wasn't
23 notified until the process was well underway. I
24 believe Mr. Conrad and I were notified moments,
25 literally moments before the process began.

1 The stipulation agreement provides that the
2 Staff of the Commission will provide notice to the other
3 parties if the Commission is going to ask questions
4 of the Staff about the stipulation and agreement.

5 I later found out that the court
6 reporter had notice of about a week, so it wasn't --
7 it wasn't as though the session -- the question and
8 answer session was held on the fly; it was held well
9 in advance and the parties were simply not notified.
10 And certainly I find that objectionable.

11 Whether or not, you know, it's grounds
12 for appeal, I don't know, but certainly it's not the
13 process that's envisioned in the stipulation and
14 agreement, and I don't think it's a process that's
15 consistent with due process.

16 So just from my point of view, I have
17 the same objections. I believe that that's what
18 Mr. Conrad is talking about. If not, I have
19 objections to that process.

20 MR. CONRAD: That is correct, your Honor.

21 MR. FISCHER: Your Honor, could I speak
22 on that for just a second as well?

23 JUDGE DALE: Certainly.

24 MR. FISCHER: On behalf of Kansas City
25 Power & Light, I would just note for the record that

1 although I was in the same room with Mr. Mills and
2 Mr. Conrad at the time they were notified, we were not
3 told about the on-the-record presentation in front of
4 the Commission and so therefore, we were not in
5 attendance and was unaware of it until after the fact.

6 MR. CONRAD: I also need to inquire
7 while we're on the record, Mr. Mills correctly
8 recites because I participated in the same
9 conversation that he did with respect to the court
10 reporter, and both of us heard her indicate that she
11 had received her request and notification on the
12 24th, something in -- approximately a week, I think,
13 as Mr. Mills describes it. So there was ample time
14 to notify the parties about -- of that process,
15 number one.

16 Number two, I have asked the court
17 reporter specifically and in Mr. Mills' presence to
18 preserve her documents with respect to the request
19 and the timing of the request and from whom it came.

20 Third, a court reporter was present at
21 this session with the Commission in which these
22 communications occurred. A transcript, and I presume
23 a transcript of those communications was made. I
24 have yet, however, despite my requests to the court
25 reporter to provide me with a copy of same, received

0024

1 a copy of that.

2 So I now inquire of your Honor as to
3 what you know of the status of that transcript of
4 that session.

5 JUDGE DALE: I have not received a copy
6 of the transcript to my knowledge. If one has been
7 filed with us, it would be in EFIS. I have not
8 received an EFIS notification to my knowledge, but I
9 haven't gone through all of my e-mail this morning.

10 MR. CONRAD: Is there a plan to provide
11 a copy of that transcript in advance of the time
12 frame to file applications for rehearing of that
13 order, which I believe would be without further
14 checking, Friday?

15 JUDGE DALE: I don't know. I can -- I
16 can inquire as to when that transcript will be ready,
17 but I -- I don't know right now.

18 MR. CONRAD: Did your Honor order the
19 transcript?

20 JUDGE DALE: I asked the court reporter
21 be present pursuant to the Commission's request in
22 its prior agenda meeting in which it announced it
23 would be conducting such question and answer session
24 and asked that a court reporter be present.

25 MR. CONRAD: And was the --

1 JUDGE DALE: I don't recall whether or
2 not I ordered that it be expedited or anything along
3 those lines.

4 MR. CONRAD: Do you recall if the court
5 reporter's recitation that she received that request
6 on the 24th is correct?

7 JUDGE DALE: No. All I can tell you is
8 that the request came from my department after the
9 Commission announced in its agenda session that it
10 would be having an on-the-record question and answer
11 session and wanted to have a court reporter present.

12 MR. CONRAD: And the agenda session to
13 which your Honor is referring occurred when, ma'am?

14 JUDGE DALE: I don't remember.

15 MR. CONRAD: Would it be -- would that
16 request be reflected in the minutes of the agenda
17 session?

18 JUDGE DALE: No, not specifically. May
19 we resume with the --

20 MS. WOODS: Your Honor, if I might, just
21 for the record, I did not receive notice of this
22 question and answer session either.

23 JUDGE DALE: Now may we resume?

24 MR. WILLIAMS: I believe the next Staff
25 witness that is a part of the stipulation is Paul

1 Harrison whose testimony has been marked as...

2 JUDGE DALE: I have 42 and 43.

3 MR. WILLIAMS: Yes, 42 and 43. And
4 then --

5 JUDGE DALE: And he will not be
6 testifying at all?

7 MR. WILLIAMS: All of his testimony was
8 to be admitted under the stipulation and agreement.

9 JUDGE DALE: Thank you.

10 MR. WILLIAMS: The next witness is Paula
11 Mapeka, and all of her testimony would be admitted
12 pursuant to the stipulation and agreement, and I show
13 that marked as direct, Exhibit No. 47.

14 Portions of Amanda McMellen's testimony
15 is admissible pursuant to the stipulation agreement,
16 but not all of it --

17 JUDGE DALE: Okay.

18 MR. WILLIAMS: -- so she will testify.

19 Portions of David Elliott's testimony has been
20 admitted by -- under the stipulation and agreement,
21 but not all of it. Shawn Lange's testimony is being
22 admitted pursuant to the stipulation and agreement.

23 JUDGE DALE: So both 44 and 45?

24 MR. WILLIAMS: Yes. Erin Maloney's
25 testimony would be admitted under the stipulation and

1 agreement, her direct testimony.

2 MR. CONRAD: And again, your Honor,
3 while I have no objection to counsel referring to
4 them as being admitted pursuant to the stipulation, I
5 think a more technical approach to that right now,
6 given the objections that you've heard, may be that
7 they are offered pursuant to that stipulation and
8 agreement. And if it is necessary to do so, I will
9 do so now, that we would object to their admission on
10 the grounds previously stated.

11 JUDGE DALE: Once he's finished with his
12 list, Mr. Conrad, I will give you an opportunity to
13 state your objection.

14 MR. CONRAD: Well, I believe I've
15 already stated it, ma'am.

16 JUDGE DALE: Thank you, then. Please
17 proceed.

18 MR. WILLIAMS: The next witness would be
19 Erin Maloney whose direct testimony has been marked
20 as Exhibit No. 46.

21 JUDGE DALE: Thank you.

22 MR. WILLIAMS: William McDuffey, his
23 direct testimony which has been marked, I believe as
24 Exhibit No. 64. And the last witness would be -- for
25 Staff would be Curt Wells, all of his direct and

0028

1 rebuttal testimony, which I believe has been marked
2 as Exhibit Nos. 58 and 59. And that would be the
3 entire list for Staff.

4 JUDGE DALE: Thank you.

5 MR. WILLIAMS: Thank you.

6 JUDGE DALE: Empire?

7 MS. WHEELER: We have Scott Keith's
8 testimony, the direct testimony, which I believe has
9 been marked as Exhibit 20.

10 JUDGE DALE: All of his testimony or
11 just --

12 MS. WHEELER: All of his testimony --

13 JUDGE DALE: Okay.

14 MS. WHEELER: -- except the off-system
15 sales adjustment.

16 JUDGE DALE: Oh, so he will be taking
17 the stand?

18 MS. WHEELER: Yes.

19 JUDGE DALE: Okay.

20 MS. WHEELER: Rebuttal testimony all --
21 involving all issues except off-system sales
22 adjustments and gain on unwinding adjustment proposed
23 via the parties which was marked as Exhibit 21, both
24 HC and NP.

25 Jayna Long's testimony, the direct and

1 rebuttal testimony involving all issues other than
2 rate design which were marked, I believe respectively,
3 as Exhibits 23 and 25.

4 Empire witness Todd Tarter's rebuttal
5 testimony, NP and HC, which I believe was marked as
6 Exhibit 17 with a Staff correction of the firm
7 transportation contract only.

8 The testimony of Blake Mertens,
9 rebuttal, NP and HC, all of which I believe was
10 marked as Exhibit 29. L. J. Williams marked as
11 Exhibit 13, rebuttal testimony, including all issues
12 other than taxes pertaining to the proposed
13 amortization proposed by other parties.

14 MR. CONRAD: Excuse me, counsel. That's
15 all issues other than taxes pertaining.

16 MS. WHEELER: Thank you for the
17 correction.

18 MR. CONRAD: Would he thus be taking the
19 stand on those issues?

20 MR. SWEARENGEN: Yes.

21 MS. WHEELER: Yes. Witness Tim Wilson,
22 Exhibit 32, his rebuttal testimony. Gary Lentz,
23 Exhibit 28, rebuttal testimony.

24 JUDGE DALE: So 32 in its entirety?

25 MS. WHEELER: Yes. And all the rest I

0030

1 have, your Honor, are all in their entirety --

2 JUDGE DALE: Okay. Thank you.

3 MS. WHEELER: -- with no exceptions or
4 carved out. Gary Lentz, Exhibit 28, rebuttal
5 testimony, C. Kenneth Vogl, rebuttal testimony,
6 Exhibit 31.

7 The direct and rebuttal testimony of
8 Laurie Delano which were marked as Exhibits 26 and
9 27, and the direct testimony of Mike Palmer marked
10 as Exhibit 30. And that's all I have for the
11 company.

12 JUDGE DALE: So for Exhibits 26, 27, 28,
13 29, 30, 31, 32, 34, 35, 36, 42, 43, 44, 45, 46, 47,
14 58, 59 and 64, are there any objections to accepting
15 this testimony for the purposes of not calling these
16 witnesses to be cross-examined?

17 MR. CONRAD: And as previously stated,
18 your Honor, I reserve the objection that I have
19 mentioned. You have issued an order that is dated
20 the 31st and purports to be effective the same day
21 which itself is a problem.

22 But setting that issue aside, we do have
23 an objection that I have noted and I think others
24 have made reference to. And by the way, I'm also
25 advised over my shoulder that counsel for Aquila did

0031

1 not receive notice of the session, although she is
2 here and can certainly speak for herself.

3 JUDGE DALE: So will you be crossing
4 these witnesses?

5 MR. CONRAD: I've indicated that -- your
6 Honor, that our problem was with the procedure. I
7 will need to reconsider, or to consider, actually,
8 whether these witnesses that counsel, as they've
9 worked through, have indicated they would not be
10 offered.

11 At this point we might, but that is a
12 decision that does not need to be made until Friday
13 and the filing deadline appears. And I will reserve
14 my decision until then, ma'am.

15 JUDGE DALE: And just for the record,
16 did any of the parties who received or did not
17 receive notice of the discussion in agenda receive
18 notice of the stipulation? Mr. Mills?

19 MR. MILLS: I certainly got a copy of
20 the stipulation when it was filed and, in fact, had
21 seen drafts of it before it was filed.

22 JUDGE DALE: And did you file any
23 objection to it?

24 MR. MILLS: No.

25 JUDGE DALE: Thank you. Mr. Conrad?

1 MR. CONRAD: We received a copy of the
2 stipulation, ma'am. But the stipulation was not
3 followed, and it was that document that we received
4 to which we did not have an objection.

5 The document seems to have been altered
6 on the fly or a different procedure has been employed
7 not consistent with the document to which we had
8 expressed our nonopposition. Therefore, I consider
9 that nonopposition to be no longer viable at this
10 point.

11 JUDGE DALE: What substantive difference
12 does the order have from the stipulation and
13 agreement?

14 MR. CONRAD: Well, ma'am, it's difficult
15 for me to articulate the problem that the Commission
16 confronts when it deals with a recorded ex parte
17 session. The court across the street has held
18 several times that the Commission has to have
19 competent and substantial evidence to support its
20 record.

21 Now, as far as I know, there is no
22 competent and substantial evidence in the record
23 certainly at this point and would purport to be none
24 that would support the numbers involved in this
25 stipulation.

1 I'm not going to go into the discussion
2 of it because the matter may still, in fact, be open.
3 But if the Commission is going to purportedly attempt
4 to take evidence to support a stipulation, then it's
5 going to need to do that on the record and subject
6 those witnesses to cross-examination at the time as
7 well as questions from the Commission.

8 And that presupposes that there is
9 notice sufficient to apprise the parties of the
10 pendency of that action. Otherwise, you run into
11 problems with Malane versus Central Hanover Trust,
12 and as I think Mr. Mills aptly pointed out, you have
13 then due process issues with respect to the entire
14 process.

15 JUDGE DALE: Aside from your --

16 MR. CONRAD: Those will be -- those will
17 be raised at the appropriate time.

18 JUDGE DALE: And -- well, let's return
19 to my question, which is, aside from the due process
20 issues, do you have substantive differences between
21 the issues that were settled in the stipulation and
22 agreement and what was approved in the order?

23 MR. CONRAD: At this point I do not
24 know.

25 JUDGE DALE: Thank you. Ms. Carter?

1 MS. CARTER: Aquila did not receive
2 notice of the question and answer session, but they
3 did receive advance notice certainly of the partial
4 settlement agreement, made no objection to that
5 agreement. I do not believe Aquila was prejudiced in
6 this situation with regard to its failure to receive
7 notice.

8 JUDGE DALE: Thank you. Mr. Swearengen?

9 MR. SWEARENGEN: Your Honor, the company
10 signed the agreement. We support it, we continue to
11 support it. As far as I know, the company received
12 no advance notice as to the procedure that the
13 Commission was going to utilize at the agenda session
14 when it took up for discussion the agreement.

15 The stipulation does allow the
16 Commission Staff to make a presentation to the
17 Commission if so requested, and my memory is that the
18 agreement says that the Staff will use its best
19 efforts to notify the other parties of that request
20 at its earliest opportunity.

21 Other than that, we see no objection to
22 what has happened here because the substance of the
23 agreement has remained the same, and it hasn't been
24 modified in any respect to my knowledge. Thank you.

25 JUDGE DALE: Mr. Fischer?

1 MR. FISCHER: Your Honor, KCPL does not
2 have an objection to the admission of the evidence
3 here. We -- we were aware of the filing of the
4 stipulation and agreement, expressed no objection,
5 did not request a hearing on those issues, and KCPL
6 is not requesting a hearing on those issues at this
7 time.

8 JUDGE DALE: Thank you. Ms. Woods?

9 MS. WOODS: We were certainly aware of
10 the joint stipulation. We did not object to it and
11 we did not request a hearing. Thank you.

12 JUDGE DALE: Thank you. Having said all
13 that, I will discuss with the Commissioners how they
14 want to proceed, and in any event, we will be in
15 recess until they conclude their agenda and are able
16 to join us for the opening statements. Is there
17 anything else before we go off the record?

18 (NO RESPONSE.)

19 JUDGE DALE: Thank you. Off the record.

20 (A RECESS WAS TAKEN.)

21 JUDGE DALE: While we're waiting for the
22 remainder of the Commissioners to come down, having
23 spoken with the Commissioners about Mr. Conrad's
24 objection, the objection is overruled as untimely
25 only as pertains to the admissibility of the evidence

0036

1 of the witnesses. And I will now list the
2 objections -- or the exhibits.

3 Ms. Delano, 26 and 27; Mr. Lentz, 28;
4 Mr. Mertens, 29; Mr. Palmer, 30; Mr. Vogl, 31;
5 Mr. Wilson, 32; Mr. Boateng, 34; Ms. -- Mr. Eaves, 35
6 and 36; Mr. Harrison, 42 and 43; Mr. Lange, 44 and
7 45; Ms. Maloney, 46; and Ms. Mapeka, 47 will be
8 admitted into evidence and those witnesses are
9 excused. The remainder of Mr. Conrad's procedural
10 objection is not ruled on at this time.

11 (EXHIBIT NOS. 26, 27 28, 29, 30, 31, 32,
12 34, 35, 36, 42, 43, 44, 45, 46 AND 47 WERE RECEIVED
13 INTO EVIDENCE, WITH OBJECTIONS STATED, AND MADE A
14 PART OF THE RECORD.)

15 MR. MILLS: Your Honor, if I may, I
16 didn't realize that those -- when we were going
17 through the list of those witnesses, it wasn't my
18 understanding that either the Staff nor Empire was
19 offering that testimony.

20 Though I had not objected, even though
21 you've already ruled, just for the record, I would
22 have had -- had I had the opportunity to make an
23 objection, I would also have objected to those.

24 JUDGE DALE: Well, in that case, we'll
25 just note your objection which will also be

0037

1 overruled.

2 MR. MILLS: Thank you.

3 JUDGE DALE: All right. We're ready to
4 begin opening statements, beginning with Empire.

5 MR. SWEARENGEN: Thank you very much,
6 Judge Dale, members of the Commission. I think we're
7 running a little behind schedule here this morning,
8 so I'll try to keep my comments as brief as possible.

9 I think the Commission is aware that
10 this case began on February 1 of this year when
11 Empire filed with the Commission revised tariff
12 sheets that were designed to increase rates for the
13 retail electric service that it provides to its
14 Missouri customers.

15 The amount of the proposed increase that
16 would have been generated if the tariff sheets had
17 gone into effect was approximately 29 and a half
18 million dollars which would have been an increase of
19 a little bit over 9.6 percent over current rates.

20 As a result of events which have taken
21 place during the prehearing conference and the
22 processing of this case, Empire will now present
23 evidence in this proceeding supporting a proposed
24 increase of approximately \$26.8 million, and that's
25 reflected in the reconciliation which I believe has

1 been filed with the Commission.

2 This rate increase request is driven
3 primarily by the higher costs that the company has
4 experienced in purchasing fuel that's used for the
5 generation of electricity and also for purchased
6 power, although other costs which it has experienced
7 in providing service to its Missouri customers have
8 also increased.

9 The prehearing brief which the company
10 filed addresses all of these issues in detail. I'm
11 going to try to touch on them just briefly this
12 morning with the understanding that when the issues
13 are actually tried on an issue-by-issue basis, the
14 parties will have an opportunity to make opening
15 comments at that time.

16 The first issue I want to touch on which
17 is a very significant issue from a dollar standpoint
18 is rate of return. The Commission has heard that
19 issue in the past, and I think you're generally
20 familiar with how those issues are presented to you.
21 This case should be no different in that regard.

22 The company is requesting a return on
23 common equity of at least 11.7 percent. The Public
24 Counsel, by contrast, recommends that Empire be
25 allowed a return of 9.65 percent, and the Staff's

1 recommendation is a little bit lower than that; they
2 come in with a range of 9.2 percent to 9.5 percent.

3 The revenue requirement difference
4 between the company's position and the Staff and the
5 Public Counsel's position is approximately
6 \$12 million, so that's a very big issue in this case
7 in terms of revenue requirement.

8 We think that the evidence will show
9 that of these three recommendations, only the company
10 accurately reflects the market-based rate of return
11 expectations of investors and companies whose
12 business and financial risks are comparable to
13 Empire.

14 And in this regard, the company is
15 approaching the issue in essentially or virtually the
16 same way that it did in the last case, Case
17 ER-2004-0570 which was decided by this Commission
18 back in March of 2005.

19 In that case the Commission determined
20 that Empire's return on equity must be commensurate
21 with the returns being earned by companies of
22 comparable risk, and in so doing endorsed the process
23 of the company's expert witness, Dr. James
24 Vander Weide.

25 In that case, as in the current case,

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1 Dr. Vander Weide is basing his rate of return
2 recommendation on a discounted cash flow or DCF
3 analysis which he applied to a broad group of proxy
4 companies whose risk profiles are comparable to the
5 risk profile of Empire. He then also evaluated his
6 DCF result using other analytical methods and his own
7 reason and judgment.

8 In the last case you will recall that
9 this Commission concluded that such a method produces
10 a return on equity that is fair to the company and
11 its customers alike, and allows Empire to attract the
12 capital necessary to meet its obligations to provide
13 service. We think that the Commission should reach
14 the same conclusion in this case.

15 There's also a cost of capital/capital
16 structure issue. And traditionally, that's the other
17 component, that's cost of capital/capital structure.
18 In this case the company's capital structure by
19 agreement by Commission order will be trued up as of
20 June 30 of 2006.

21 And until that takes place, the company
22 has agreed with the Staff's proposed company
23 consolidated capital structure as of March 31, 2006.
24 And that consolidated capital structure consists of
25 43.99 percent long-term debt, 6.27 percent trust

0041

1 preferred stock and 49.74 percent common equity. So
2 there's no difference between the company and Staff
3 at the present time on the capital structure subject
4 to the true-up.

5 Both the company and the Commission's
6 Staff in making their cost -- their capital structure
7 calculations reduced the long-term debt and trust
8 preferred stock outstanding by the unamortized
9 expenses associated with the issuance of those
10 securities. And this is the same method, the same
11 practice that's been followed by the company and the
12 Staff in previous cases, and we think it should be
13 followed in this case.

14 The Public Counsel, as I understand it,
15 does not use this method and consequently supports a
16 different capital structure. The revenue requirement
17 difference is approximately \$1.4 million.

18 We have several revenue issues. One
19 involves off-system sales. The question is what
20 amount should be included in Empire's revenue
21 requirement for off-system sales.

22 It's the company's position that
23 off-system sales gross profit of approximately
24 \$1.27 million should be included in the revenue
25 requirement for rate-making purposes. This amount is

1 based on a five-year average of actual off-system
2 sales after an adjustment to remove the effects of a
3 nonrecurring transaction between Empire and American
4 Electric Power Company.

5 Other parties to this case say that the
6 AEP transaction should not be excluded, and as a
7 consequence, we have an issue there that's worth
8 about \$1.2 million.

9 There's an issue about the regulatory
10 plan that the company entered into in the prior
11 docket and the amortization that's contemplated by
12 that plan and what role that will play in this case.

13 In Case EO-2005-0263 the company entered
14 into a stipulation that called for an amortization
15 under certain circumstances to achieve the company's
16 credit metrics.

17 It's the company's position, however,
18 that this amortization as a result of the regulatory
19 plan was not designed for or intended to be a
20 replacement for the timely recovery of fuel and
21 purchased power expense or as a substitute for an
22 adjustment to rate of return in the event the company
23 does not recover those fuel and power -- purchased
24 power expenses on a timely basis.

25 Having said that, it's the company's

0043

1 position that if the calculations called for by the
2 stipulation and agreement in the regulatory plan do
3 require an amortization to maintain or achieve the
4 target ratios, then one should be approved in this
5 case.

6 There's a second issue that relates to
7 that, and that is if there is an amortization, should
8 it include a gross-up for income taxes. What this
9 means is, as in the case whenever in a rate
10 proceeding the company is given additional revenues
11 in cost of service, that creates additional income
12 tax expense for the company.

13 And we think that failure to include
14 this expense in this case to provide a gross-up of
15 income taxes will defeat the purpose of the
16 amortization which is to achieve a credit metrics set
17 out in the regulatory plan.

18 Fuel and purchased power expenses will
19 be a contentious issue, no doubt. These issues
20 involve the appropriate level of on-system fuel and
21 purchased power expense which the company should be
22 allowed to recover and also the method of that
23 recovery.

24 It's the company's position that the
25 amount of fuel and purchased power expense allowed in

0044

1 the test period cost of service for recovery through
2 rates should be at least \$166 million total company
3 which is based on reasonable and reliable projections
4 of what the cost of fuel and purchased power will be
5 during the period the rates that are established in
6 this case will be in effect. That's a total company
7 number of about 82 percent of that, or \$136 million
8 would be the Missouri jurisdictional part.

9 There is approximately a \$4.6 million
10 difference, Missouri jurisdictional difference,
11 between the company and the Staff on this issue, and
12 that's a lot of money, \$4.6 million. But in the
13 overall scheme of things when you're talking about
14 annual fuel costs, it really isn't that great of a
15 difference, the difference between the company and
16 the Staff, the \$4.6 million. And that issue is
17 driven primarily, and perhaps exclusively, on
18 differences in opinions on what natural gas prices
19 the company will have to pay.

20 I think you're aware that the company
21 now recovers its fuel costs through a combination of
22 base rates and a fixed interim energy surcharge which
23 is sometimes referred to as an IEC. About
24 103 million of fuel expense is currently recovered
25 through the base rates, and approximately 8.2 million

1 is recovered from Missouri customers through the
2 interim energy charge.

3 So the company currently is receiving on
4 an annual basis about \$111 million from its Missouri
5 customers. So you can put that in context with 136
6 million that we think we need on a going-forward
7 basis and the fact that the Staff's number is
8 something like \$4.6 million below that, so that's the
9 cost issue.

10 From the inception of the current
11 interim energy charge through June of this year, the
12 company's cost for -- at the Missouri jurisdictional
13 portion of the company's cost for its fuel and
14 purchased power was approximately \$18.9 million
15 higher than the total the company has recovered
16 through its base rates and interim energy charge.

17 These shortfalls that the company has
18 experienced we believe will only increase unless
19 something is done in this case to remedy this
20 problem.

21 Now, others will argue that Empire has
22 agreed that under any and all circumstances it is
23 stuck with its current level and method of fuel cost
24 recovery that resulted from the last case and there
25 is nothing that the Commission can or should do about

1 it.

2 It's the company's position, however,
3 that the agreement in the last rate case does not
4 provide for a moratorium on fuel cost recovery or a
5 moratorium on the recovery of any other costs for
6 that matter.

7 And the agreement, in fact, contemplated
8 that the interim energy charge could be terminated in
9 less than three years. Simply stated, the company
10 thinks it's entitled to seek great relief for these
11 increased fuel costs.

12 As far as the method of recovery is
13 concerned, once again, the traditional method is a
14 fixed amount in base rates. And in a number of cases
15 involving Empire and other companies, the Commission
16 has also established an additional fixed rate
17 surcharge or interim energy charge for an additional
18 amount of fuel cost recovery. And that's the model
19 that the company is currently operating under.

20 Well, it hasn't worked. And what we
21 want to call the Commission's attention -- and we
22 know this will be a contentious issue -- is since
23 January of this year, the Commission has been given a
24 new tool to deal with fuel cost recovery when it was
25 authorized by the Missouri legislature to implement a

0047

1 fuel cost adjustment mechanism.

2 MR. WOODSMALL: Your Honor, at this
3 point I'd like to object. The Commission has
4 previously found in its order dated May 2nd, 2006
5 that any request by Empire for a fuel adjustment
6 clause during the pendency of an IEC is inappropriate
7 and is irrelevant.

8 To the extent Mr. Swearngen wants to
9 discuss the availability of the fuel adjustment
10 clause, this Commission has already ruled on it and
11 it would be clearly irrelevant for him to do so.

12 MR. SWEARENGEN: Let me go on. If it's
13 determined, however, that a fuel cost adjustment
14 mechanism may not be allowed in this case, the only
15 alternative may be to permit the company to recover
16 its energy costs through base rates.

17 And if that's the approach the
18 Commission adopts, we believe it must reject the
19 notion that historic fuel costs will accurately
20 predict the cost that the company will incur in the
21 future. Otherwise, we'll likely be back in the same
22 position where we are today charging rates that do
23 not come close to covering the actual cost of fuel
24 and purchased power that Empire must acquire to
25 provide electric service.

1 So our view is that we think that there
2 must be some innovation to the Commission's approach
3 to determining, first, the cost of the fuel and
4 purchased power that is included in rates, and in
5 attempting to solve its problem, the Commission
6 should take a long, hard look at the method of
7 recovery that it might authorize.

8 There are several other issues in the
9 case. Let me touch on them just briefly. An issue
10 involving what they call an unwinding of a forward
11 natural gas contract. What that means is during the
12 test year, Empire canceled a forward natural gas
13 contract that it had with British Petroleum in excess
14 of \$5 million and realized a gain from that
15 transaction.

16 The question is whether or not this gain
17 should offset test year fuel and purchased power
18 expense. The company's position is that it was a
19 nonrecurring event and it should not be used to
20 offset fuel and purchased power costs.

21 To do so would, once again, understate
22 the actual amount of energy cost the company will
23 incur in the future in order to provide rates that
24 are -- and would affect the wide rates that are
25 inadequate to recover those costs. So it would just

1 contribute to the problem that we're facing now.

2 There is an incentive compensation
3 issue. You've heard those before, and I think that
4 will be the issue that will be presented to you this
5 afternoon. I'm not gonna say anything more about it
6 other than there's a million dollar revenue
7 requirement associated with it.

8 There's an issue involving the low
9 income assistance program that may or may not be
10 resolved. My understanding is the question is
11 whether Empire's experimental low-income program, the
12 ELIP, be continued, and if it's discontinued, what
13 should be done with the unspent ELIP funds.

14 The company's position is that we agree
15 with the recommendation of the Staff that the ELIP
16 program be discontinued and that any remaining funds
17 be transferred to the customer program collaborative
18 which was established in the regulatory plan docket.
19 I think the big issue in connection with this may be
20 how that should be accomplished.

21 Also there's a question about unspent
22 funds of -- from the current energy efficiency and
23 low-income weatherization programs that the company
24 has.

25 Finally, the last issue that will be

0050

1 litigated to you is a rate design issue, the
2 traditional question of how should any revenue
3 increase for the company that results from this case
4 be implemented. The company proposed an equal
5 percentage increase to all classes, and that's our
6 position. Thank you very much.

7 JUDGE DALE: Thank you, Mr. Swearengen.
8 Mr. Thompson?

9 MR. THOMPSON: May it please the
10 Commission. Starting today and continuing seven days
11 of evidentiary hearing, you will hear
12 cross-examination in the general case of the Empire
13 District Electric Company.

14 The company seeks additional revenue of
15 some 29 and a half million dollars annually, reduced
16 since the settlement conference to about \$26.8
17 million, nearly a 10 percent increase. This is
18 driven primarily, as Mr. Swearengen has told you, by
19 fuel and purchased power expense.

20 You don't need me to tell you that this
21 is an important case or that it's a complicated case
22 or that it's going to be a contentious case. It's
23 already been contentious and we've hardly been here
24 for three hours.

25 Empire was here for a rate increase not

0051

1 long ago. You will recall wrestling at that time
2 with some difficult issues. The company's marked
3 financial weakness resulted in a credit rating
4 downgrade. Its earnings per share were insufficient
5 to support the company's traditional dividend which
6 didn't stop it from giving that dividend.

7 Perhaps most difficult, its unusually
8 high reliance on natural-gas-fired generation which
9 resulted in a particular vulnerability to fuel price
10 fluctuations.

11 That particular issue was resolved at
12 that time through a stipulation and agreement which
13 allowed Empire to have something that it could not
14 have without the agreement of the other parties, an
15 interim energy charge.

16 Well, it turned out that Empire made a
17 bad bargain. It turned out that the interim energy
18 charge did not provide enough money to cover Empire's
19 actual costs in fuel and purchased power.

20 And so the biggest issue that you face
21 in this case and the most contentious issue that you
22 face in this case is what to do, what to do about
23 that interim energy charge, what to do about that
24 agreement that Empire entered into with other parties
25 some 18 months ago to resolve that point. The

0052

1 interim energy charge has a duration of three years.
2 It's only halfway done. It's only halfway done. And
3 Empire is asking you to terminate it early.

4 Staff does not agree that Empire needs
5 \$26.8 million in additional revenue per year. Later
6 today you'll hear about incentive compensation.
7 That's the first issue you'll take up. It's worth a
8 million bucks, as Mr. Swearengen told you, and that's
9 \$1 million that Staff doesn't believe Empire needs.

10 Like Mr. Swearengen, I'm not gonna talk
11 any more about that issue now because Mr. Dottheim is
12 going to tell you all about it just before the trial
13 of that issue begins.

14 Tomorrow you're gonna hear about rate of
15 return, an issue worth about \$11 million. Last time
16 around you gave Empire a high return on equity. You
17 did that in recognition that the company faced a
18 difficult financial and regulatory situation,
19 primarily because at that time Missouri did not
20 permit a fuel adjustment clause or similar way of
21 dealing with the volatility of fuel prices.

22 Well, you know that that situation has
23 changed. The passage of Senate Bill 179 means that
24 fuel recovery devices like a fuel adjustment clause
25 are now legal in Missouri.

1 Second, Empire now enjoys the benefits
2 of a regulatory plan. That plan provides for
3 amortizations in order to maintain the
4 creditworthiness of Empire's securities. In other
5 words, if Empire fails to recover sufficient money to
6 pay for its fuel and purchased power, it's going to
7 get an amortization which will assist it with that
8 shortfall.

9 That means that the circumstances in
10 which you are deciding rate of return are
11 significantly and seriously different than they were
12 18 months ago. For this reason, Staff urges you to
13 reach a different conclusion in this case.

14 Empire relies, as Mr. Swearengen told
15 you, on the expert testimony of Dr. James Vander
16 Weide. Dr. Vander Weide is a Professor of Finance at
17 Duke University. He is also what we call a hired
18 gun. He enjoys a lucrative income from testifying to
19 commissions like this one on behalf of utility
20 companies seeking higher rates of return.

21 The most noteworthy feature of
22 Dr. Vander Weide's analytical method is a 40-basis-
23 point adder. In other words, using traditional
24 financial analytical tools, Dr. Vander Weide
25 calculates what the return on equity for Empire

0054

1 should be. He then proceeds to add 40 basis points
2 to that number.

3 He supports this. He says that adder is
4 necessary because of all the debt that Empire is
5 carrying which makes it a more risky investment than
6 similar energy companies.

7 Well, think for a minute about that
8 debt. Who chose to incur it? Management did. Why
9 should the ratepayers pay extra to this company
10 because of that debt? What benefit did the
11 ratepayers get from that borrowed money?

12 This is a company, remember, that
13 consistently, year in and year out, pays a dividend
14 to its shareholders that its earnings per share
15 simply do not support. Empire is borrowing money to
16 pay this dividend and now seeks to use that debt to
17 justify higher rates. Staff states that is not
18 equitable.

19 With all the talk that you have heard
20 and are going to hear about Hope and Bluefield and
21 what they require you to do with respect to rate of
22 return, remember that the Supreme Court of Missouri
23 has also instructed this Commission from time to time
24 on its duty.

25 This Commission is required to be fair,

0055

1 fair to the shareholders and fair to the ratepayers.
2 The Supreme Court of Missouri told you that in 1925
3 in State ex rel Washington University versus Public
4 Service Commission.

5 The Missouri Supreme Court has also told
6 you that your purpose is to protect the consumer
7 against the monopoly power of the public utility and
8 that the protection given to the utility is
9 incidental to the protection given to the public.
10 Staff urges you to bear those principles in mind.

11 On Friday you're going to hear about a
12 low-income assistance program and about energy
13 efficiency and affordability programs. Staff and the
14 company are in agreement on these issues. We agree
15 that the experimental low-income program should be
16 discontinued and that any remaining funds should be
17 transferred to the customer collaborative and used to
18 help low-income customers pay their bills.

19 We also agree with the company that
20 unspent funds from the current energy efficiency and
21 low-income weatherization programs should be a
22 negative entry to the demand side program's
23 regulatory asset account. And if you have a question
24 about that, ask an accountant, please.

25 On Monday and Tuesday of next week,

0056

1 you're gonna hear about the biggest issues. The fuel
2 cost recovery mechanism, fuel and purchased power
3 expense and regulatory amortizations.

4 The big question as I told you is
5 whether the IEC should continue. Staff has no
6 position on this issue. But Staff wants you to know
7 what the impact of your decision on that issue will
8 be.

9 Praxair and Explorer Pipeline, ably
10 represented by Mr. Conrad, take the position that the
11 IEC should continue. In fact, Mr. Conrad and also
12 the Public Counsel assert that the Commission lacks
13 authority to terminate the IEC.

14 It is their view that it's a contract,
15 that the stipulation and agreement that allowed the
16 IEC is a contract that they bargained for at arm's
17 length, that it's fully supported by adequate
18 consideration, approved by this Commission, it has
19 another 18 months to run and they do not consent to
20 its early termination.

21 Empire, on the other hand, urges the
22 Commission to terminate the IEC and to allow it to
23 recover its fuel and purchased power costs in some
24 other way, either through base rates or through an
25 energy cost rider.

1 Empire states that the IEC has failed to
2 allow the company to recover its ever-increasing fuel
3 and purchased power costs. Empire contends that this
4 Commission has already, in its order of May 2nd,
5 2006, rejected the position of Praxair/Explorer
6 Pipeline and the Public Counsel. Aquila supports
7 Empire in its position.

8 The agreement reached in the last case
9 limits Empire to an annual recovery of about
10 \$103 million in Missouri jurisdictional base rates
11 and an additional \$8.2 million through the IEC, a
12 total recovery of about \$111 million. Empire
13 contends that it needs for Missouri jurisdictional
14 purposes \$136 million. There's the gap.

15 It is Staff's position that Empire is
16 under-recovering its fuel and purchased power costs.
17 However, it is Staff's position that Empire is
18 over-recovering with respect to all of its other
19 costs. Staff's revenue requirement, if the IEC
20 continues, is negative \$11.9 million. That is the
21 over-recovery that Staff asserts exists with respect
22 to Empire's other costs.

23 However, to this amount must be added
24 the regulatory amortization called for by the
25 regulatory plan. This addition results in a need for

1 additional revenue of either 8.8 million or
2 21.7 million annually, depending on whether or not
3 the amount is grossed up for income taxes. And it is
4 Staff's position that a gross-up is not required.

5 If you do terminate the IEC early, then
6 Staff's proposed revenue requirement is \$8.3 million
7 annually. That's additional revenue that the company
8 needs. When you add the amortization, it results in
9 either 16.5 million or 21.7 million. The latter is
10 the grossed-up figure.

11 The value of the fuel and purchased
12 power expense issue depends on what you do with the
13 IEC. If you choose to continue the IEC, then Staff
14 would reduce Empire's requested revenue requirement
15 by nearly \$26 million annually.

16 On the other hand, if you choose to
17 terminate the IEC, then Staff would reduce Empire's
18 requested revenue requirement by some \$4.6 million.
19 The differences in the parties' positions result from
20 differences in predicting future natural gas prices.

21 With respect to the amortization issue,
22 it is Staff's position that amortizations are
23 required under the terms of the stipulation and
24 agreement in the regulatory plan case. As I
25 mentioned, Staff believes that no gross-up for income

0059

1 taxes should be provided.

2 On Wednesday of next week, you're gonna
3 hear about gain from unwinding a forward natural gas
4 contract and off-system sales. As Mr. Swearengen
5 explained to you, a gas contract is unwound when it's
6 canceled.

7 They canceled a gas contract during the
8 test year, and they gained \$5 million from that
9 cancellation. Staff views that transaction as
10 routine hedging. However, because of its significant
11 size, Staff proposes that that amount be amortized
12 over five years. Public Counsel concurs with Staff's
13 proposal.

14 Empire, by contrast, contends that this
15 amount should be entirely excluded from
16 consideration. Mr. Conrad takes the opposite
17 position. He would include the full amount of this
18 gain as an annual offset to Empire's fuel and
19 purchased power expense.

20 The issue here is the extent to which
21 you adjust the fuel purchased power expense to
22 reflect this \$5 million transaction. Empire says,
23 "Don't reduce it at all, give us the full amount of
24 the fuel and purchased power money that we need.
25 This was a one-time transaction."

1 Praxair and Explorer Pipeline say,
2 "Reduce it by the full amount. It occurred during
3 the test year. There's \$5 million less for fuel and
4 purchased power that the company needs." Staff and
5 Public Counsel say, "Put one-fifth of it in as an
6 annual figure."

7 Empire's view is based on its
8 characterization this gain is unique and
9 nonrecurring. However, Empire did not treat this
10 gain as unique and nonrecurring for accounting
11 purposes or for purposes of reporting to the
12 Securities and Exchange Commission.

13 Empire continues to consider whether or
14 not to unwind its hedging contracts, so this sort of
15 gain could very well be realized again in the future.
16 That is hardly a nonrecurring transaction.

17 Staff's position, supported by Public
18 Counsel, appropriately shares the costs and the
19 benefits of hedging between ratepayers and
20 shareholders. Staff's position on off-system sales
21 is that the Commission should set rates in this case
22 using the actual level of off-system sales
23 experienced by Empire during the 12 months ending
24 March 31, 2006.

25 The company and the Public Counsel have

0061

1 alternate proposals. Empire proposes that the
2 Commission use a five-year adjusted average. The
3 adjustment is to exclude its transactions with AEP.
4 Empire's position is worth more than a million
5 dollars in additional revenue requirement.

6 Public Counsel proposes that the
7 Commission use a five-year unadjusted average. And
8 Public Counsel's position is worth about \$100,000
9 less than Staff's.

10 Staff and Public Counsel are opposed to
11 Empire's exclusion of the AEP transaction. Empire
12 contends that this was a one-time, nonrecurring
13 transaction. Its size was substantial, accounting
14 for more than half of Empire's gross profit in both
15 2002 and 2003.

16 However, excluding the transaction does
17 not, in fact, normalize the off-system sales figure
18 as Empire would have you believe. Instead, Staff
19 suggests it skews it to the company's benefit.

20 Finally, on Thursday, the 14th, you'll
21 hear about rate design. Staff proposes that if you
22 do you not terminate the IEC, then you should change
23 Empire's permanent rates in proportion to each
24 customer class's percentage share of current
25 permanent revenues.

1 On the other hand, if you choose to
2 terminate the IEC, then Staff proposes that you
3 should change Empire's permanent rates in proportion
4 to each customer class's percentage share of total
5 rate revenues where total rate revenues are equal to
6 current permanent revenues plus the IEC revenue.

7 Staff suggests that all rate elements
8 except the customer charge should be increased or
9 decreased proportionately to reflect whatever change
10 in revenue requirement the Commission may order.

11 There is another rate design issue.
12 That is whether or not, in calculating Empire's
13 revenues for purposes of distributing an increase
14 proportionately across the customer classes, whether
15 Empire's revenue from Praxair and Explorer Pipeline
16 should be valued at its gross figure or net of
17 special discounts.

18 Staff supports the use of the gross
19 figure because the effect of using the net figure is
20 to reduce the proportionate rate increase to Praxair
21 and Explorer Pipeline. In other words, the other
22 ratepayers would shoulder the cost of the special
23 discounts enjoyed by those industrial customers.

24 Finally, a new issue that has reared its
25 head today has to do with the procedure followed in

0063

1 adopting and approving a stipulation and agreement
2 resolving certain issues in this case. There has
3 been an objection lodged by some parties.

4 Staff would respectfully remind the
5 Commission of the case of State ex rel Fischer versus
6 Public Service Commission which provides guidance as
7 to what happens when procedures for a stipulation and
8 agreement are not scrupulously followed.

9 Staff will have all of the witnesses who
10 gave testimony in support of the issues encompassed
11 by the stipulation and agreement available to stand
12 cross-examination during the hearing in this case.
13 Thank you very much.

14 MR. MILLS: Good morning. May it please
15 the Commission. Both Mr. Swearengen and Mr. Thompson
16 have done a good job of going through all of the
17 issues that are presented for the -- for the
18 Commission's decision in this case. I am going to be
19 much briefer and just highlight a couple of the
20 issues.

21 As both Mr. Thompson and Mr. Swearengen
22 have alluded to, perhaps the biggest issue in this
23 case is whether or not the Commission determines that
24 the IEC that Empire agreed to in the last rate case
25 continues.

1 As you will have seen by now, this case
2 is essentially divided into two branches because the
3 parties at this point don't know what the
4 Commission's decision is on that. We'll see that
5 there are two on a reconciliation.

6 There are witnesses who have different
7 branches in their testimony that say if the
8 Commission decides this about the IEC, then here's
9 the result. If they decide the other way about the
10 IEC, here's the result.

11 It's made the case considerably more
12 complicated than perhaps it needs to be because the
13 parties don't know at this point whether or not the
14 IEC will continue after this case or whether the
15 Commission will accede to Empire's request to
16 terminate it.

17 The issue, as Mr. Thompson pointed out,
18 is set forth on the two reconciliations. The
19 Commission can see the dollar amount of that. It's a
20 huge issue.

21 Another huge issue is rate of return.
22 Public Counsel hired a rate of return expert for this
23 case. His testimony is that the appropriate return
24 on equity is 9.65 percent. Public Counsel has the
25 somewhat strong position of being in the middle in

1 this case. The Staff witness testifies to a much
2 lower rate of return, the company testifies to a much
3 higher rate of return. I submit that the Public
4 Counsel witness is the reasonable witness and has
5 testified to an appropriate rate of return.

6 There has been some discussion of the
7 ELIP program, the Experimental Low-Income Program.
8 The parties are not in violent disagreement over what
9 to do about that program. It is clear that in its
10 current form it should not continue quite that way.
11 Some changes need to be made. The discussions among
12 the parties continues, I believe. There is some
13 concern about the procedure on how to modify that
14 going forward and what to be done to modify it.

15 The class cost of service rate design
16 issue in this case, again, depends to a certain
17 extent on what the Commission decides to do about the
18 IEC. If the IEC continues in effect, there's one
19 proposal, and if it doesn't, there's another proposal.

20 If the IEC does not continue in effect,
21 then any rate increase that's granted to the company
22 should be distributed among the classes based on the
23 percentage of the requested increase that is due to
24 fuel increases because the parties in general bear
25 different responsibilities in current rates for fuel

1 costs as opposed to other costs, and that relationship
2 should continue. The proposal of Public Counsel
3 witness Barbara Meisenheimer is the only proposal in
4 that case that would preserve that relationship.

5 Those are the only issues I plan to
6 touch on this morning. The parties have agreed that
7 as the case continues, there will be the opportunity
8 for a brief introduction of the individual issues as
9 they come up, and I plan to take advantage of that
10 and give some more information on those issues as we
11 get to them. Thank you.

12 MR. WOODSMALL: Good morning. May it
13 please the Commission. Excuse me. Integrity. This
14 may sound like a strange way to start an opening
15 statement, but as this case will show you, much of it
16 is based on integrity or the lack thereof.

17 There's an ancient Chinese proverb which
18 goes, "To starve to death is a small thing; to lose
19 one's integrity is a great one." American Heritage
20 Dictionary defines integrity as, quote, a steadfast
21 adherence to a strict moral or ethical code.

22 Now, when you think of integrity, you
23 may think of other things. You may think of some of
24 the most basic lessons that your parents taught you:
25 Never tell a lie, do the right thing, keep your

1 promises.

2 As we go through this case, I would
3 encourage you to think about whether Empire's
4 management has done the right thing, whether Empire's
5 management has demonstrated integrity and whether
6 Empire's management has kept their promises.

7 As I was preparing this weekend, I was
8 studying a well-known treatise on contracts. The
9 very first sentence of that treatise started with the
10 following premise: Quote, historically and
11 philosophically, the most fundamental concept of
12 contracts is that promises ought to be kept.

13 The same treatise continued on to note
14 that, quote, it is therefore a most sacred precept of
15 natural law and one that governs the grace, manner
16 and reasonableness of all human life, that every man
17 keep his given word; that is, carry out his promises
18 and agreements.

19 By now you're obviously very familiar
20 with the issue regarding Empire's request to
21 terminate its three-year IEC. In an order issued
22 May 2nd, 2006, the Commission addressed the
23 stipulation and agreement which implemented this IEC.

24 In that order the Commission made
25 several findings. First, it found that the IEC was

1 freely negotiated. Secondly, it found that
2 consideration for Empire's receipt of the IEC was
3 given by the ratepayers and received by Empire.
4 Third, the Commission found that the IEC had been
5 approved by this Commission. And fourth, the
6 Commission found that the IEC is binding.

7 Now, no matter what mental manipulations
8 may be encouraged, no matter what spin may be
9 applied, this Commission has found the IEC to be a
10 binding contract. By that contract, Empire's
11 management has made promises, and by their actions in
12 this case today, Empire's management has broke those
13 promises.

14 Now, what is the nature of an IEC? Like
15 any contract, an IEC is a device to allocate risk.
16 Ratepayers took the risk that Empire might succeed in
17 driving its production costs down below the IEC
18 floor. But their refunds in such a case would be
19 limited to that IEC floor.

20 In exchange, they were purportedly
21 protected by the agreement from an escalation in fuel
22 costs above the IEC ceiling. In exchange for being
23 able to recover a higher level of fuel costs than it
24 was actually incurring at the time, Empire took a
25 corresponding risk that it might be able to control

0069

1 fuel costs to the level of the IEC ceiling. But it
2 still retained the incentive to drive its costs as
3 low as possible and keep those monies.

4 Others will stand before you today and
5 tell you about their thoughts, their beliefs, their
6 opinions. Not me. I'm here to talk to you about the
7 law, the law of contracts, the law of contracts that
8 forms a part of every lawyer's basic first-year legal
9 education.

10 I'm not talking about issues with
11 several shades of gray, I'm not talking about
12 questions with multiple answers, I'm talking about
13 the law. And as I will lay it out for you and as you
14 will clearly see, there is no basis in the law for
15 Empire's attempt to break its promise. The law is
16 the law. Empire and the Commission are bound by that
17 law.

18 So let's look at the law. Now, the law
19 does provide some reasons for a court to invalidate
20 or rescind a contract. First, a court will
21 invalidate a contract if a party is found to be
22 intoxicated or mentally impaired.

23 Second, a court will invalidate a
24 contract made under duress. So if I hold a gun to
25 your head and make you sign a contract, you will not

1 be required to follow through on that contract.

2 Third, a court will invalidate a
3 contract where there has been a misrepresentation
4 made. So if I sell you a house, tell you that there
5 are no cracks in the foundations, meanwhile I've run
6 and Sheetrocked over those cracks, you'll not have to
7 buy that house.

8 Fourth, a contract will be invalidated
9 if it is made through undue influence. So if a
10 parent had their child sign a contract giving up all
11 their future earnings or if one adult signed an
12 agreement to pay over their assets to another where
13 the receiving party exercised undue influence over
14 the donor, the court will not enforce that contract.

15 Fifth and finally, a court will
16 invalidate a contract that is based upon an obvious,
17 mutual mistake of fact. So if I sell you my 1965
18 Mustang convertible and it turns out later that the
19 car was not actually a convertible, there's been a
20 mistake of fact, and the court will not require you
21 to follow through on that contract.

22 So what reason did Empire provide for
23 breaking their promise, for breaching their contract?
24 Turning to its prehearing brief the company states,
25 quote, Empire wants to terminate the IEC because the

0071

1 IEC does not and will not allow the company to
2 recover its reasonable and prudently incurred fuel
3 and purchased power costs, unquote.

4 Thinking back to the reasons that a
5 court will invalidate a contract, this does not sound
6 like duress to me, this does not sound like
7 intoxication or mental incapacity, this does not
8 sound like misrepresentation, this does not sound
9 like undue influence and this doesn't sound like a
10 mutual mistake of fact.

11 What happened here is Empire's
12 management made a bad prediction about the future,
13 specifically about the future of natural gas prices.
14 The law is very clear, however, that poor judgment
15 and bad predictions are not the basis for rescission
16 of a contract.

17 If you went to the riverboat, could you
18 take back your let wager because you predicted that
19 the wheel would come up red instead of black? Could
20 an insurance company withhold payment on a burned out
21 house because it predicted that that house wouldn't
22 burn this year? Could you ask for your money back
23 because those shares of Enron that you purchased did
24 not go up as you predicted?

25 The answer to all these questions are

1 obviously no. The law is very clear on this subject.
2 Quote, mistake does not refer to a prediction or
3 exercise of judgment that a particular situation will
4 exist in the future.

5 Thus, in the sale of a business, both
6 buyer and seller may believe that business will earn
7 a certain amount in the ensuing year, and that
8 judgment may be the basis for a reasonable
9 prediction. If, however, the economy or other events
10 do not permit that judgment or prediction to prove
11 true, neither party has made a mistake, unquote. And
12 a court will not invalidate that contract.

13 Just a little over a year ago, Empire's
14 management stepped up to the roulette wheel hoping to
15 score big for its shareholders. Based on its
16 knowledge of its operations and its price of
17 generating electricity, Empire bet that natural gas
18 prices would stay low enough for it to make money off
19 the IEC.

20 In fact, virtually immediately after the
21 Commission approved this IEC, Empire was before Wall
22 Street analysts bragging about how the IEC ceiling
23 was \$25 million over the test year level of fuel and
24 purchased power expense.

25 Empire bet that the wheel would turn up

1 red instead of black. Empire bet that its full house
2 would hold up. Empire bet that the dealer wouldn't
3 have 21. Bad bet. But a bad bet is not the basis
4 for breaking a promise or for invalidating a
5 contract.

6 Integrity is when you make that bet and
7 you walk away from the gambling table with your head
8 held high. Empire took the money from ratepayers
9 under the IEC. In exchange for that money, Empire
10 promised these ratepayers for three years they would
11 not suffer from increases in natural gas prices.

12 Integrity demands that Empire keep its
13 promise and continue to hold these ratepayers
14 harmless from any increases in gas prices.
15 Contracts, including this contract, are sacred.

16 As Aristotle once said, quote, if
17 contracts are invalidated, the intercourse of men is
18 abolished, unquote. Ask yourself, has Empire
19 demonstrated the integrity towards its customers that
20 should be expected from a public utility?

21 Even beyond the IEC, there's another
22 example in this case where Empire's management has
23 demonstrated its lack of integrity, where Empire's
24 management has failed to keep its promise, where
25 Empire's management again seeks to break a contract.

1 Barely a year ago Empire entered into a
2 stipulation with several parties. Under that
3 contract, Empire agreed to certain regulatory
4 provisions, including regulatory amortizations in
5 order to provide it financial security for the five
6 years that Empire was spending large capital amounts
7 for the construction of Iatan 1, for environmental
8 upgrades to Iatan -- for construction of Iatan 2, for
9 environmental upgrades to Iatan 1 and Asbury, and for
10 the construction of a combustion turbine at Riverton.

11 The approved stipulation clearly states
12 that the regulatory plan, quote, will be deemed to
13 have become effective as of the date the order of the
14 Commission approving this agreement becomes
15 effective, unquote.

16 The Commission's order approving that
17 stipulation became effective on August 12th, 2005.
18 Clearly, the regulatory amortizations also became
19 effective on August 12th, 2005.

20 Today, despite the company's contract,
21 despite the company's promise and the clear language
22 of the stipulation, Empire's CEO claims that the
23 amortization mechanism, quote, should have no
24 implication in this case, unquote.

25 Like the IEC, the company does not

1 provide any rationale recognized under the law which
2 would allow it to break its promise contained in the
3 stipulation and agreement.

4 The regulatory amortization mechanism
5 was designed to provide Empire credit ratings and
6 credit metric security, yet it also means that Empire
7 would have to accelerate some recognitions to
8 implement the amortization, a prospect that Empire
9 was eager to do at the time it signed the regulatory
10 plan, but now does not want to do. This sort of
11 behavior should be strongly repudiated.

12 The reason for the company breaking its
13 promise is obvious. By disallowing the agreed-upon
14 regulatory amortization mechanism, Empire seeks to
15 box this Commission in in regards to the treatment of
16 fuel and purchased power.

17 Empire believes that without the
18 regulatory amortization mechanism at the Commission's
19 disposal, the Commission will have no choice but to
20 allow Empire out of the IEC. Again, ask yourself, is
21 this the integrity that you expect from the
22 management of one of your public utilities?

23 Interestingly, despite its repeated
24 broken promises to its customers and the Commission,
25 Empire's management believes that it should be

1 heavily compensated. During the test year, a
2 select -- a select few of Empire's senior management
3 received bonuses and stock options. Consistent with
4 20 years of Commission decisions, Staff eliminated
5 incentive compensation that was granted based upon
6 the company's financial performance.

7 As the Commission has repeatedly found,
8 such incentive compensation, quote, is driven at
9 least primarily, if not solely, by the goal of
10 shareholder wealth maximization, and it is not
11 significantly driven by the interest of ratepayers,
12 unquote.

13 One must ask, should a management which
14 has repeatedly broke its promises to the ratepayers
15 and the commissions be permitted to recover such
16 lucrative financial rewards from those same
17 ratepayers?

18 You know, over the past two and a half
19 years, I've sat in virtually every Commission agenda
20 session. I've attended numerous hearings, numerous
21 local public hearings, on-the-record presentations.
22 I've heard Commissioners discuss their thoughts on
23 utilities and on utility management and what they
24 expect.

25 Certain Commissioners had concerns

1 whether Ameren UE had been completely candid with the
2 Commission during the Metro East transfer case. In
3 another case, the Commission has expressed its
4 dissatisfaction with the -- with the management of
5 Osage Water Company for its blatant disregard of the
6 Commission and its orders.

7 Later, Commissioners pointed out
8 numerous points of concern with Aquila's handling of
9 the South Harper generating facility matter. Just
10 last week, following local public hearings, at least
11 two Commissioners expressed concerns with the
12 management of Aqua Missouri.

13 It is apparent that in all these cases,
14 the Commission expects the utility to demonstrate a
15 higher level of integrity in regards to its treatment
16 of the Commission and its customers. This
17 management, Empire's management, should be required
18 to operate with a high level of integrity and held to
19 the promises that it has made to this Commission and
20 to its ratepayers. I thank you. If you have any
21 questions, I'll be happy to answer them.

22 MS. WOODS: Your Honor, Commissioners,
23 the Missouri Department of Natural Resources
24 intervened to confirm how Empire was going to treat
25 demand side management, in particular, the

0078

1 affordability, energy efficiency and the demand
2 response programs in this rate case.

3 The department also intervened because
4 it realized, during one of the customer programs
5 collaborative meetings, that Empire was continuing to
6 collect funds from its ratepayers and shareholders
7 for certain energy efficiency programs developed as a
8 result of the joint stipulation and order entered in
9 Empire's 2004 rate case, even though Empire would not
10 be implementing those programs because of the joint
11 stipulation and agreement entered into in Empire's
12 regulatory plan case, Case Number EO-2005-0263.

13 While the department lacks the necessary
14 expertise to address how to best account for the
15 collected funds -- well, best account for the funds
16 collected in this rate case, the department believes
17 that Staff and the Office of Public Counsel do have
18 that necessary expertise.

19 The only issue that the department is --
20 has that position on in this case, just for the
21 record, is, I believe it's been denominated issue
22 No. 9, and again, our -- I believe you've already
23 heard from several of the parties, that there isn't
24 any or doesn't appear to be any great issue as to how
25 to implement the necessary changes from one way of

1 collecting the monies to the other. It's more a
2 question of the procedure. Thank you.

3 MR. FISCHER: Your Honor, Kansas City
4 Power & Light is participating on the limited issue
5 of the regulatory amortization and the gross-up
6 issue. It's particularly interested in how the
7 Commission treats income tax effects of that
8 amortization. But I'd like to reserve the
9 opportunity to make a more extended statement Monday
10 whenever we hear those particular issues.

11 JUDGE DALE: Thank you. That will be
12 fine.

13 MR. WOODSMALL: Your Honor, at this time
14 before Ms. Carter makes her opening statement, I
15 would like to point out a concern that I have.
16 Ms. Carter, in previous pleadings before this
17 Commission, has entered an appearance on behalf of
18 Empire in this case. While she pretends to be
19 counsel for Aquila now, she has filed pleadings on
20 behalf of Empire, so I question whether her opening
21 statement is appropriate.

22 MS. CARTER: I can respond to that or I
23 can just do my opening statement, whichever you
24 prefer.

25 JUDGE DALE: If you would care to

0080

1 respond and talk about whether your clients have
2 waived any conflict.

3 MS. CARTER: I would say I don't believe
4 it should be Mr. Woodsmall's issue or concern as to
5 whether or not that has been done. In fact, that
6 issue did come up at an agenda meeting recently, I
7 believe maybe regarding Mr. Woodsmall's clients and
8 many possible conflicts.

9 But in any event, Empire and Aquila are
10 both quite aware of the dual representation in this
11 case, and any opening statement I would be making
12 would be on behalf of Aquila.

13 JUDGE DALE: Thank you. Please proceed.

14 MS. CARTER: And, in fact, as I was
15 about to say, I'm here on behalf of Aquila at this
16 time, and Aquila's interest in this proceeding is
17 quite limited.

18 Aquila is interested in the possible
19 termination of Empire's existing IEC and the
20 implementation of the Senate Bill 179 fuel
21 adjustment --

22 MR. WOODSMALL: Your Honor, at this
23 point I would object. The Commission, in its May
24 2nd, 2006 order, found that any request for a fuel
25 adjustment clause under SB 179 is appropriate --

0081

1 inappropriate. Therefore, to the extent Ms. Carter
2 or Aquila want to talk about SB 179 and its
3 applicability to this case, it's clearly irrelevant.

4 MS. CARTER: If I may be entitled to
5 proceed, I actually address that about two paragraphs
6 down, and would appreciate Mr. Woodsmall's courtesy
7 in letting me finish the opening statement.

8 MR. WOODSMALL: If it's relevant.

9 JUDGE DALE: Please proceed.

10 MS. CARTER: I likely will not be asking
11 cross-examination questions of most of the witnesses.
12 Aquila is primarily interested in the implementation
13 of Senate Bill 179, the form a fuel adjustment
14 mechanism may take, conditions which may be imposed
15 and the circumstances under which such a mechanism
16 may be authorized by the Commission.

17 Even if Empire cannot seek such a
18 mechanism at this time, it is still an open question
19 whether or not such a mechanism may be authorized by
20 the Commission at the conclusion of this proceeding.

21 There are people in this room and
22 parties to this case which wish that Senate Bill 179
23 had never been passed and signed into law. But it is
24 the law, and Missouri's regulated utilities, absent
25 an express waiver of the statute, should be able to

1 avail themselves of its provisions.

2 Now, the evidence before you over the
3 coming days will show that full and timely recovery
4 of prudently incurred fuel and purchased power costs,
5 be it through base rates or some type of adjustment
6 mechanism, is vital to the economic stability of
7 Missouri's utilities.

8 And the authorization of a fuel
9 adjustment mechanism, in some circumstances, is
10 necessary for truly just and reasonable rates which
11 must be the Commission's focus.

12 You're not here to rule on issues of
13 contract law, and, in fact, no one in the back of
14 this room can contract away the Commission's right to
15 establish just and reasonable rates for the
16 ratepayers as well as Missouri's regulated utilities.
17 Thank you for your time.

18 JUDGE DALE: Before we go off the record
19 for lunch, I would like to point out to everyone that
20 the Commission's previous order determined that,
21 while Empire may seek to terminate the IEC, no other
22 fuel adjustment clause can be implemented while the
23 IEC -- can be requested, and the Commission struck
24 the underlying testimony in that matter. Just as an
25 FYI.

1 MR. WOODSMALL: Your Honor, and I agree
2 with that characterization. I would note for the
3 Commission's information, however, that to the extent
4 that you said that the Commission found that Empire
5 could seek to terminate the IEC, there is a pending,
6 a long pending rehearing on that issue that has not
7 yet been ruled upon.

8 JUDGE DALE: So noted.

9 MR. MILLS: And if I may make a note, I
10 believe the Commission sentence said that Empire may
11 have the authority to seek, not that Empire may seek,
12 may have the authority to, which is a very different
13 thing than may seek.

14 JUDGE DALE: Yes, thank you for that
15 correction, Mr. Mills.

16 MR. SWEARENGEN: Judge, before you go
17 off the record, on a unrelated topic, I would just
18 like to note Mr. Thompson noted in his opening
19 statement that the witnesses, the Staff witnesses who
20 supported the stipulation and agreement in this
21 proceeding which you approved earlier, would be
22 available to be called as witnesses, and I would like
23 to say the same would be true with respect to the
24 Empire District witnesses who are identified as being
25 excused. We will make those witnesses available

0084

1 should the Commission so desire. Thank you.

2 JUDGE DALE: Thank you. And one other

3 matter --

4 MR. CONRAD: Well, I -- well, your

5 Honor --

6 JUDGE DALE: -- is -- if I can just

7 finish my sentence, please -- is that this set of

8 opening statements and every other set of opening

9 statements do not, in fact, constitute evidence.

10 MR. FISCHER: Judge, on the subject of

11 being excused, I would like to request that I be

12 excused for portions of the hearing. We will be

13 participating beginning Monday when the amortization

14 and tax gross-up issue occur but probably not too

15 much between now and then.

16 JUDGE DALE: That will be fine.

17 MS. WOODS: And, your Honor, department

18 and I would like to make a similar request. We were

19 supposed -- going to be participating Friday, but we

20 would otherwise be requesting that we be allowed to

21 participate on a much more limited basis.

22 JUDGE DALE: That will be fine.

23 MS. WOODS: Thank you.

24 MR. CONRAD: And if your Honor please,

25 it was my understanding from a ruling the presiding

1 officer made earlier, that the witnesses that have
2 been, as Mr. Mills pointed out, listed in the
3 stipulation, partial stipulation, that their
4 testimony had been admitted.

5 And I believe the record will bear me
6 out because both Mr. Mills and I had objected to that
7 and your Honor denied or overruled that objection and
8 admitted that testimony. So I am not entirely clear
9 what purpose would be served by those witnesses
10 taking the stand on those issues. It seems that that
11 would be surplusage.

12 JUDGE DALE: It is my understanding that
13 in an abundance of caution and having raised your
14 objections, that if you do have cross-examination for
15 those witnesses, that they would be ready and able to
16 answer those questions.

17 MR. SWEARENGEN: And your Honor, my
18 thought, without trying to be presumptuous, is
19 sometimes, sometimes this Commission has been known
20 to change its mind on something and go in a different
21 direction.

22 JUDGE DALE: The entire Bench is
23 shocked, shocked by that comment. But that's --
24 that's my understanding that while they are not
25 required to appear, that their counsel has said that

0086

1 they will appear should another party require their
2 presence. Having said all that, we will now go off
3 the record for lunch, and we will reconvene at
4 precisely 1:30.

5 (The noon recess was taken.)

6 JUDGE DALE: Let's go back on the
7 record. And it was my understanding the parties were
8 going to give brief openings for segments, so once
9 again, following the order -- well, how many parties
10 will be giving openings on this, just the two?
11 Whichever one of you cares to, you may go first.

12 MR. SWEARENGEN: Judge, just as a
13 preliminary matter, I want to introduce to the
14 Commission Mr. Russ Mitten who will be trying this
15 issue on behalf of the Empire District Electric
16 Company.

17 Russ got his start here at the Public
18 Service Commission back in the 1970's and has been
19 involved in the utility business since that time.
20 He's licensed to practice in Missouri. At one time
21 he was the general counsel of the Hawaiian Telephone
22 Company, so he's also licensed and continues to
23 maintain his license in the state of Hawaii. And I'd
24 like to introduce him to the Commission.

25 JUDGE DALE: And will there be

1 challenges to this man's sanity for coming back to
2 Missouri?

3 MR. SWEARENGEN: Thank you.

4 JUDGE DALE: When the Commissioners come
5 in, feel free to interrupt what you're doing so you
6 can introduce yourself to them, or I may interrupt
7 you and introduce them, however you want to do it.

8 MR. MITTEN: That's fine. Thank you.
9 May I proceed? Judge Dale, the Empire District
10 Electric Company, like all large companies, including
11 utilities, has a compensation plan for its senior
12 executives and other key managers that consists of a
13 base salary plus one or more at-risk components that
14 are tied to the attainment of goals that further
15 business and strategic objectives of the company and
16 add significant value to it.

17 These types of compensation plans, which
18 are considered best practices for large corporations
19 today, seek to align senior managers' interests with
20 those of the company and incentivize their
21 performance so that it is focused on things that are
22 most beneficial to the company, its shareholders and
23 its customers.

24 The question facing the Commission in
25 this case is a simple one: Should Empire be allowed

1 to include in test period cost of service the
2 expenses associated with the at-risk incentive
3 compensation it pays its senior managers. Empire
4 believes the answer to that question is yes, and that
5 the evidence that will be presented overwhelmingly
6 supports that conclusion.

7 The evidence in this case will show that
8 there are three components to Empire's incentive
9 compensation program. The company's most senior
10 leaders are eligible to receive a cash bonus, an
11 award of stock options and an award of long-term
12 compensation in the form of grants of restricted
13 shares of Empire's common stock. Nonexecutive senior
14 managers are eligible to receive only the cash bonus.

15 You will hear evidence regarding the
16 types of goals that the employees must achieve to
17 earn the at-risk portion of their cash compensation.
18 These goals overwhelmingly focus on objectives such
19 as increasing revenues, controlling costs and
20 improving service to customers.

21 Senior executives can earn stock options
22 based on an annual review of their job performance by
23 Empire's board of directors, and they can earn grants
24 of restricted shares which have value only if the
25 company meets objectives related to shareholder

1 return.

2 One additional form of incentive
3 compensation will also be addressed, the lightning
4 bolt awards. These are one-time cash awards made to
5 lower level managers for exceptional performance,
6 either on special projects or on tasks that are part
7 of their normal job responsibilities.

8 Hereto, the evidence will show that the
9 achievements that are recognized through lightning
10 bolt awards are the type and quality that benefit
11 both the company and its customers.

12 Empire's incentive compensation is an
13 integral part of the company's overall compensation
14 strategy which is designed to attract, retain and
15 incentivize top quality managers and to pay them
16 fairly for the work they perform.

17 The program was developed by the
18 compensation committee of Empire's board of directors
19 who, with the assistance of knowledgeable and
20 experienced compensation professionals, developed a
21 program that embodies the best compensation practices
22 for large corporations today.

23 In setting levels of incentive
24 compensation for Empire's senior managers, the
25 committee considered data prepared by its consultant

1 showing the amounts and types of incentive
2 compensation paid by two proxy groups of companies,
3 one group that included a universe of diverse
4 corporations nationwide, and one composed exclusively
5 of electric utility companies.

6 When the compensation committee had
7 completed its task, it submitted its program to
8 Empire's full board of directors which had the
9 authority and responsibility to finally approve the
10 program. And the involvement of both the
11 compensation committee and Empire's full board
12 continues as they are responsible for annually
13 evaluating the performance of Empire's senior
14 managers and for approving incentive awards made to
15 those managers if the board believes their
16 performance warrants it.

17 The evidence presented in this case will
18 also show that in designing its compensation plan,
19 Empire has taken great care to assure that total
20 compensation paid to its employees, including
21 incentive compensation, is not excessive.

22 Empire targets total compensation for
23 its senior managers at levels that are at or below
24 the average of its peers. This assures the
25 compensation amounts that are included in Empire's

0091

1 cost of service for ratemaking purposes are fair and
2 reasonable.

3 In the past, the Commission has been
4 reluctant to allow costs associated with incentive
5 compensation to be included for ratemaking purposes.
6 There is no good reason to disallow the cost in this
7 case.

8 Empire's overall compensation expenses
9 are reasonable, and the objectives that the company's
10 senior managers must achieve to earn their incentive
11 compensation provide benefits to ratepayers.

12 Under such circumstances, the Commission
13 should defer to the decision of a company and its
14 board of directors as to how and under what
15 circumstances various parts of the company's total
16 compensation expense should be paid. Ratepayers will
17 not be harmed in any way if the Commission does so.
18 Thank you.

19 JUDGE DALE: Thank you. Mr. Dottheim?

20 MR. DOTTHEIM: First, I'd like to say
21 that it's nice to see Mr. Mitten back in Missouri.
22 When I joined the General Counsel's office in August
23 of 1979, Mr. Mitten was in the General Counsel's
24 office at the time, and unfortunately, I didn't get
25 the opportunity to work under his guidance for very

0092

1 long before he went off to work with GTE. But it's
2 nice to see him back even though I know it means even
3 more work for me.

4 May it please the Commission. Incentive
5 compensation is not a new area of Staff audit
6 activity or Commission disallowance. Empire's not
7 being singled out by the Staff for special review.
8 The Staff has filed an incentive compensation
9 adjustment in the pending Kansas City Power & Light
10 Company rate increase case.

11 An incentive compensation is one of the
12 areas that the Staff is looking at in the pending
13 management audit, Aquila, for which a report is to be
14 filed later this month.

15 Empire has three employee incentive
16 compensation plans. Staff has applied the standards
17 criteria accepted and applied by the Commission in
18 prior cases respecting incentive compensation, and
19 made disallowances for portions of incentive
20 compensation that do not meet the standards criteria.

21 The standards criteria that the
22 Commission has applied in the past are that the
23 incentive compensation should be for ascertainable
24 and reasonably related employee performance beyond
25 normal job duties that benefits utility customers

0093

1 rather than shareholders or nonutility customers.

2 Empire contends that the Commission
3 cannot make a disallowance unless there is an abuse
4 of discretion by the company's management. The case
5 law in Missouri is that there need not be a showing
6 of abuse of discretion. The standard is there must
7 be a benefit for ratepayers.

8 The case law in particular is State
9 ex rel Laclede Gas Company v. Public Service
10 Commission, 600 S.W. 2d, 229 Mo. App. 1980, and the
11 case went to the U.S. Supreme Court where the appeal
12 was dismissed in 1981.

13 The Staff has applied the standards
14 criteria as applied by the Commission in prior cases
15 to Empire's three employee incentive compensation
16 plans.

17 The first plan, the managed incentive
18 compensation plan, the MIP plan, is for the six
19 senior officers of the company. The Staff disallowed
20 cash incentives for the six senior officers in part.
21 And these disallowances were related to goals for
22 financial performance, goals related to nonregulated
23 activities and goals performance for levels below
24 what the Staff deemed to be an appropriate level of
25 expectation.

1 The Staff also has proposed disallowance
2 of long-term incentives for these six senior officers
3 on the basis that the goals are related solely to
4 financial criteria which benefit shareholders and not
5 ratepayers.

6 Regarding another incentive plan, the Staff
7 has recommended disallowance for discretionary
8 compensation awards for salaried, nonofficer employees.
9 and those disallowances are for activity on the part of
10 employees for normal job duties involving, as I
11 indicated, what the Staff has determined to be normal
12 job duties or for involvement in charitable contribution
13 campaigns or for activity that did not involve
14 traditional cost of service matters; that is, items
15 that do not directly benefit Empire's ratepayers.

16 Finally, the Staff has recommended
17 disallowance of bonuses for nonunion salaried employees
18 which are referred to as lightning bolt awards. These
19 recommended disallowances are for payments made solely
20 at the discretion of Empire management. The reason for
21 the Staff's recommendation for these disallowances are
22 the awards include for employees working on charitable
23 campaigns, working on the Aquila gas property
24 acquisition which Empire engaged in earlier this year
25 and awards for engaging in normal job duties. Thank

0095

1 you.

2 JUDGE DALE: Will Empire call its first
3 witness, please?

4 MR. MITTEN: Empire calls Dr. Gene Bauer
5 to the stand, please.

6 (The witness was sworn.)

7 DIRECT EXAMINATION BY MR. MITTEN:

8 Q. Will you please state your name and
9 business address for the record.

10 A. My name is Gene Bauer. My business
11 address is 2405 Grand, Kansas City, Missouri.

12 Q. Dr. Bauer, by whom are you currently
13 employed and what is your job title?

14 A. I work for The Hay Group, an
15 international consulting firm that focuses in the
16 area of compensation, and I am Managing Director of
17 U.S. Consulting Operations.

18 Q. I believe you have in front of you a
19 document that has been marked for identification as
20 Exhibit 1 which consists of 16 pages of questions and
21 answers. Is that your prefiled rebuttal testimony in
22 this case?

23 A. That is correct.

24 Q. Was that testimony prepared by you or at
25 your direction and under your supervision?

0096

1 A. Yes.

2 Q. Do you have any changes or corrections
3 you need to make to the testimony at this time?

4 A. None.

5 MR. MITTEN: Your Honor, at this time I
6 would offer Dr. Bauer's prefiled rebuttal testimony
7 into evidence and tender him for cross-examination.

8 JUDGE DALE: Is there any objection?

9 (NO RESPONSE.)

10 JUDGE DALE: Then his testimony is
11 accepted into evidence and parties have set out the
12 order of cross.

13 (EXHIBIT NO. 1 WAS RECEIVED INTO EVIDENCE
14 AND MADE A PART OF THE RECORD.)

15 MS. CARTER: I have no questions on
16 behalf of Aquila.

17 JUDGE DALE: Thank you. KCPL and DNR
18 are not here. For Praxair?

19 MR. WOODSMALL: Just real briefly, your
20 Honor.

21 CROSS-EXAMINATION BY MR. WOODSMALL:

22 Q. Good afternoon Dr. Bauer. How are you?

23 A. I'm good, thank you.

24 Q. You stated in your testimony that you
25 conducted a study of comparable companies; is that

0097

1 correct?

2 A. About every three years we do a salary
3 survey of comparable companies as well as companies
4 from our larger database.

5 Q. And some of those -- one of those groups
6 that was referred to by Mr. Mitten in his opening
7 statement was a group of electric utilities; is that
8 correct?

9 A. That is correct.

10 Q. Did you, in any way, attempt to review
11 any state utility commission decisions to see whether
12 those comparable companies had had disallowances made
13 in their rates for incentive compensation?

14 A. I did not.

15 Q. Okay. Do you have any evidence in this
16 case whether the salary compensation for the
17 executives of Empire would somehow be adjusted if the
18 Commission disallowed the allowances or the
19 adjustments made by Staff?

20 A. Could you rephrase the question, please?

21 Q. Do you have any evidence, have you seen
22 any documents, have you seen any evidence which would
23 tend to indicate that Empire will adjust the
24 compensation to its executives based upon the
25 adjustment made by Staff?

0098

1 A. I have not.

2 MR. WOODSMALL: Okay. I have no further
3 questions.

4 JUDGE DALE: Thank you. Public
5 Counsel -- and let me just interrupt and say,
6 counsel, if you promise to speak into the
7 microphones, you needn't come to the podium to
8 cross-examine.

9 MR. MILLS: Yee-ha. Thank you. I have
10 no questions.

11 JUDGE DALE: Thank you. Mr. Dottheim?

12 MR. DOTTHEIM: Thank you.

13 CROSS-EXAMINATION BY MR. DOTTHEIM:

14 Q. Good afternoon, Dr. Bauer. Dr. Bauer,
15 I'd like to refer you to your rebuttal testimony
16 that's been marked Exhibit No. 1. And I'd like to
17 direct you to page 1 of your testimony, lines 10 to
18 11, where you make reference to your having worked
19 for a period of time at the May Department Stores in
20 St. Louis.

21 Dr. Bauer, do you know whether the May
22 Department Stores have been a member of the Missouri
23 Retailers Association?

24 A. I do not know.

25 Q. Okay. Do you know whether the Missouri

0099

1 Retailers Association has ever intervened in rate
2 cases before the Missouri Public Service Commission?

3 A. I do not know.

4 Q. Thank you. Dr. Bauer, I'd like to refer
5 you again to your rebuttal testimony to page 6, lines
6 8 and 12, where you make reference to the
7 compensation committee of the board of directors of
8 Empire District Electric.

9 Can you identify which members of the
10 Empire board of directors comprise the compensation
11 committee?

12 A. Probably not all of them by name. I can
13 tell you the chairman is Randy Laney and has been the
14 chairman for I believe a couple of years. He
15 replaces a gentleman by the name of Mr. Jeffries who
16 was chairman also for a number of years.

17 Q. Do you recall offhand how many members
18 of the board of directors comprise the compensation
19 committee?

20 A. Not offhand, but I would assume it's
21 four or five members.

22 Q. Do you recall whether presently any of
23 the members of the compensation committee have any
24 formal training in the areas of compensation,
25 compensation plans or incentive compensation?

0100

1 A. I would not know that.

2 Q. Okay. Do you know whether there are any
3 requirements relating to formal training or training
4 in general regarding the areas of compensation,
5 compensation plans or incentive compensation for
6 being nominated or elected a member of the Empire
7 board of directors?

8 A. I'm not familiar with any formal
9 training that's required. Most of the compensation
10 committee members would be CEO's or would have been
11 senior executives in their companies for which many
12 of them might have had accountability for
13 compensation.

14 Q. But you don't know that information
15 specifically regarding the members of the
16 compensation committee of the Empire board of
17 directors?

18 A. I do not.

19 Q. Do you know that in regards to any
20 members of the Empire board of directors?

21 A. I can't say that I do.

22 Q. Again, I'd like to refer you to page 6
23 of your testimony, line 9, where you note that the
24 compensation committee of the Empire board of
25 directors meets on a scheduled basis during the year.

0101

1 Can you identify what that scheduled
2 basis is that the compensation committee meets on
3 during the year?

4 A. I believe they meet quarterly.

5 Q. Can you identify how many times you have
6 met with the compensation committee in 2004 and 2005?

7 A. I'd have to refer to my records, but I
8 have met with the board, full board and the
9 compensation committee on at least one or two
10 occasions in '04 and '05.

11 We last completed a study in '03, and I
12 would have met with them several times during that
13 particular setting, and we're in the process of
14 another study in which I'm also beginning to meet
15 with them again.

16 Q. Mr. Bauer, do you know what percentage
17 of Empire's salaried nonofficer employees received
18 discretionary compensation awards for 2005?

19 A. No.

20 Q. Okay. Do you know what -- the number of
21 Empire employees that were eligible for discretionary
22 compensation awards for 2005?

23 A. I wouldn't know the exact number.

24 Q. Do you know what percentage of nonunion
25 salaried employees were eligible for lightning bolt

0102

1 awards --

2 A. Again, I --

3 Q. -- in 2005?

4 A. No, I would not know that.

5 Q. Do you know the percentage of nonunion
6 salaried employees that were awarded lightning bolt
7 awards for 2005?

8 A. I would not know that exact percentage
9 either. All that could be provided to you or the
10 Commission.

11 Q. Mr. Bauer, do you know whether the
12 Missouri Commission has the authority to disallow
13 from recovery in rates any portion of the wages of
14 its union employees?

15 A. I would not know that.

16 MR. DOTTHEIM: Excuse me, Dr. Bauer. If
17 I've been referring to you as Mr. Bauer, I apologize.
18 Dr. Bauer, thank you for your patience. Those are
19 all the questions I have at this time.

20 THE WITNESS: You're welcome.

21 JUDGE DALE: Before we proceed to
22 redirect, did you want him to follow up with that
23 additional information?

24 MR. DOTTHEIM: No.

25 JUDGE DALE: Okay. Thank you.

0103

1 Mr. Mitten, you may proceed with redirect.

2 MR. MITTEN: I have an exhibit I would
3 like to have marked.

4 JUDGE DALE: Certainly.

5 (EMPIRE EXHIBIT NO. 91 WAS MARKED FOR
6 IDENTIFICATION BY THE COURT REPORTER.)

7 REDIRECT EXAMINATION BY MR. MITTEN:

8 Q. Dr. Bauer, you have before you what's
9 been marked for identification as Exhibit 91. Do you
10 recognize that document?

11 A. It looks like what I would call a proxy
12 statement for Empire District for March 20th, 2006.

13 MR. MITTEN: Your Honor, I would ask
14 that Exhibit 91 be admitted into evidence.

15 MR. DOTTHEIM: I object. There's been
16 no foundation laid for this -- this exhibit. I don't
17 believe I asked Dr. Bauer any questions on
18 cross-examination relating to any item respecting
19 this -- this document. I -- I object on the grounds
20 of relevance. There has been no foundation laid
21 based on -- on -- on redirect of my cross-examination
22 of Dr. Bauer.

23 MR. WOODSMALL: Your Honor, I would
24 concur in that objection. This is clearly outside
25 the scope of any direct or any cross-examination.

0104

1 The company had three rounds of testimony to put this
2 before the Commission, they failed to do so. It's
3 clearly untimely and outside the scope of
4 cross-examination.

5 MR. MITTEN: Let me withdraw the offer
6 and lay a foundation.

7 JUDGE DALE: Certainly. Could you check
8 and make sure that your microphone is on?

9 MR. MITTEN: The green light is on.
10 Does that mean it's on?

11 JUDGE DALE: Yes. It should be bright
12 green.

13 MR. MITTEN: I don't know whether it
14 qualifies as bright green or not. Is that better?

15 JUDGE DALE: Oh, my, yes.

16 BY MR. MITTEN:

17 Q. Dr. Bauer, do you recall Mr. Dottheim
18 asked you the names and backgrounds of the members of
19 the compensation committee of Empire's board of
20 directors?

21 A. I do recall the question.

22 Q. Is that information contained in the
23 company's proxy statement?

24 A. It is.

25 MR. MITTEN: I again offer Exhibit 91

1 into evidence.

2 MR. DOTTHEIM: I specifically asked -- I
3 didn't ask for general background -- excuse me. I
4 still object. Again, I think if my questions are
5 referred to -- my questions related to whether any of
6 the members of the board of directors or compensation
7 committee had formal training regarding compensation,
8 compensation plans, incentive compensation. And
9 Mr. Mitten is -- is attempting to mark as an exhibit
10 an entire proxy as a result.

11 And I would suspect that if we took a
12 minute even to take a look at those -- those pages
13 that relate to the directors, we're probably not
14 going to find anything directly related to the
15 questions I asked on cross-examination.

16 MR. WOODSMALL: Your Honor, I would
17 concur in that objection. If Mr. Mitten would like
18 to refresh the witness's recollection about who may
19 be on that committee, that's one thing, but clearly,
20 this exhibit has a surplusage of other information
21 that's not relevant here.

22 Looking at page 7, "Nominating corporate
23 governance committee," completely irrelevant.
24 There's just lots of information here that's outside
25 the scope of any cross-examination and clearly not

1 relevant.

2 MR. MITTEN: Your Honor, it would be my
3 intention to limit my questions to Dr. Bauer
4 regarding the proxy statement to the names of the
5 directors who serve on the compensation committee and
6 the information regarding their backgrounds that is
7 published in the proxy statement.

8 JUDGE DALE: In that case, I will allow
9 you to use it to refresh his memory so that you can
10 ask him those two questions, and not allow the
11 document in its entirety to be admitted into
12 evidence.

13 MR. WOODSMALL: Your Honor, when you say
14 "not in its entirety," are you admitting any of it
15 since you're going --

16 JUDGE DALE: Only -- only what he's
17 probably going to read aloud.

18 BY MR. MITTEN:

19 Q. Dr. Bauer, would you please turn to
20 page 5 of Exhibit 91, read the information there and
21 tell me if it refreshes your recollection as to the
22 identity of the members of Empire's compensation
23 committee?

24 A. It does refresh my memory.

25 Q. Could you give me the names of those

0107

1 committee members, please?

2 A. As stated on page 5, Mrs. Posner,
3 Mr. Helton, Mr. Leon and the aforementioned
4 Mr. Laney.

5 Q. Would you now please turn to pages 2 and
6 3 of Exhibit 91, read the information contained there
7 and tell me if it refreshes your recollection as to
8 the background and experience of each of the members
9 of Empire's compensation committee?

10 MR. WOODSMALL: Your Honor, at this
11 point I'd like to voir dire the witness in lieu of an
12 objection if I may.

13 JUDGE DALE: Give me just a second,
14 Mr. Woodsmall. Mr. Mitten, I see nothing in here
15 about training.

16 MR. MITTEN: Background and experience
17 was the question that I asked.

18 MR. DOTTHEIM: Excuse me --

19 JUDGE DALE: But Mr. Dottheim's question
20 was about training, whether they had any training in
21 compensation.

22 MR. MITTEN: I think --

23 MR. DOTTHEIM: My -- my question was on
24 formal training or any training regarding the areas
25 of compensation, compensation plans and incentive

0108

1 compensation.

2 MR. MITTEN: I think the witness should
3 be allowed to testify if the background and
4 experience of these individuals would be a reasonable
5 substitute for formal training. Expertise is
6 recognized as coming not only from formal training
7 but from background and experience as well.

8 MR. DOTTHEIM: That's not the question
9 that I asked on cross-examination.

10 JUDGE DALE: And you are limited in
11 redirect to those questions posed on cross.

12 MR. MITTEN: So the limitation is not to
13 the specific question rather than the area of
14 cross-examination?

15 JUDGE DALE: I think in this instance,
16 yes, because Mr. Mitten already discussed the fact
17 that these were people in managerial positions,
18 extensive experience, if I recall correctly.

19 MR. MITTEN: He did, but I should be
20 allowed to have him provide specific information that
21 would be of use to the Commission in evaluating each
22 of these committee members' background and experience
23 with regard to compensation issues in general and
24 incentive compensation in particular.

25 MR. WOODSMALL: Your Honor --

1 MR. MITTEN: And I --

2 MR. WOODSMALL: -- I would renew my
3 objection. In addition to being outside the scope of
4 cross-examination as you have indicated, this is
5 clearly an issue that if they deemed relevant, they
6 had three rounds of testimony to put this information
7 before the Commission. It is clearly not fair to
8 wait until redirect to try to put this information
9 in.

10 MR. DOTTHEIM: And I renew my objection
11 as beyond the scope of the cross-examination.

12 MR. MILLS: And if I may, I'd like to
13 join into this and pose another objection which is
14 that this witness, just a few moments ago, could not
15 even recall the names of these people. And I think
16 it goes beyond the scope of refreshing his
17 recollection to give him their bios and expect him to
18 refresh his recollection in that manner.

19 I think this is -- you've already ruled
20 that this exhibit is inadmissible, and to use it to
21 get him to read it into the record and supplement his
22 answer which he previously said he didn't know their
23 backgrounds, I think, would be improper.

24 JUDGE DALE: I will sustain the
25 objections. If you wish to ask him something very,

0110

1 very narrow pertaining to their training...

2 MR. MITTEN: I don't have any further
3 questions for Dr. -- no, I have one more question.

4 BY MR. MITTEN:

5 Q. Dr. Bauer, what role does The Hay Group
6 fill in terms of advising the compensation committee?

7 MR. DOTTHEIM: I object on the grounds
8 this is beyond the scope of the cross-examination.

9 MR. WOODSMALL: I object, your Honor, on
10 the grounds that it is cumulative. I believe that
11 information is contained in his direct testimony;
12 therefore, it's asked and answered and not necessary.

13 JUDGE DALE: Mr. Woodsmall, can you
14 point me to where you believe it's already been asked
15 and answered?

16 MR. WOODSMALL: Just a second, your
17 Honor. It's his rebuttal testimony. I'm sorry. I
18 can't -- here we go. At page 10, line 13, he talks
19 about guidance and information provided by Hay Group
20 as compensation consultants.

21 MR. DOTTHEIM: Judge Dale, also on
22 page -- page 6, line 10, there's reference to
23 guidance and information being provided to the
24 compensation committee of the company's board of
25 directors by The Hay Group as its independent

0111

1 consultants.

2 JUDGE DALE: And as I presume that your
3 testimony sets out your qualifications and education,
4 Dr. Bauer, I will again sustain the objection.

5 MR. MITTEN: I have no further questions
6 for Dr. Bauer.

7 JUDGE DALE: Are there any questions
8 from the Bench for Dr. Bauer?

9 CHAIRMAN DAVIS: No questions from me at
10 this time.

11 COMMISSIONER APPLING: Judge, I think I
12 have a couple of questions, if you don't mind.

13 QUESTIONS BY COMMISSIONER APPLING:

14 Q. How you doing, Doctor?

15 A. Good.

16 Q. How are you compensated for the work
17 that you do for Empire? Are you paid by the hour or
18 are you paid by...

19 A. We work for the board of directors and
20 more specifically the compensation committee, and we
21 generally work on a project basis whereby we would
22 quote a project fee for most of our work. We have a
23 contractual relationship with Randy Laney, the
24 chairman of the compensation committee.

25 Q. Okay. Can you -- can you tell me

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1 approximately what you're being paid for Empire --
2 for this specific project?

3 A. It will be -- this particular project in
4 terms of preparing for the testimony and that sort of
5 thing, it will be in the neighborhood of probably 15
6 to \$20,000.

7 Q. What do you do for Empire?

8 A. The Hay Group has worked for Empire for
9 probably ten or 12 years. The compensation
10 committee, we play several different roles.

11 We help them in the design of their
12 compensation plan, we help them in determining what
13 level of pay is appropriate, we help them in
14 determining how to deliver that pay to executives,
15 whether that be in the form of base salary, annual
16 incentive or long-term incentive.

17 We would help them with regulatory
18 issues, particularly as relates to the SEC, not this
19 particular Commission. But we would help them with
20 bringing data advice and the benefit of having been
21 in this business for a number of years.

22 Q. By any chance do you-all talk about the
23 ratepayers and that type of information that -- what
24 this looks like to the public with executives?

25 A. Absolutely. That is oftentimes

0113

1 discussed. In this particular case, you've got
2 shareholders and you've got other stakeholders and in
3 this case, obviously ratepayers.

4 And the design of the compensation plan
5 has attempted to try to balance that in a fair way
6 for the -- all the stakeholders that are concerned.
7 But that is something that is discussed almost every
8 time we meet with the compensation committee.

9 COMMISSIONER APPLING: Thank you very
10 much, Doctor.

11 JUDGE DALE: Is there any recross based
12 on questions from the Bench?

13 (NO RESPONSE.)

14 JUDGE DALE: Any redirect based on
15 questions from the Bench?

16 MR. MITTEN: No.

17 JUDGE DALE: Thank you, Dr. Bauer. You
18 may step down.

19 MR. DOTTHEIM: Staff would call as its
20 witness, Amanda C. McMellen.

21 (The witness was sworn.)

22 JUDGE DALE: Thank you. Please proceed,
23 Mr. Dottheim.

24 MR. DOTTHEIM: Thank you.

25 DIRECT EXAMINATION BY MR. DOTTHEIM:

0114

1 Q. Would you please state your name for the
2 record.

3 A. It's Amanda C. McMellen.

4 Q. And would you please state your place of
5 employment?

6 A. I'm employed by Missouri Public Service
7 Commission.

8 Q. And your address of employment?

9 A. It's 200 Madison Street, Suite 440,
10 Jefferson City, Missouri 65102.

11 Q. Did you cause to be filed what has been
12 marked as Exhibit 48, your direct testimony, in this
13 proceeding on incentive compensation, and Exhibit 50,
14 your surrebuttal testimony on incentive
15 composition -- on incentive compensation?

16 A. Yes, I did.

17 Q. At this time do you have any corrections
18 to make to Exhibit No. 48? And I might note that
19 Exhibit No. 48 is marked highly confidential.
20 There's also a nonproprietary version.

21 A. On -- I have two corrections to my
22 direct testimony. On page 12, lines 21 and 23, I
23 would like to eliminate the words "base salary and"
24 so that it reads, "What was the total cost to Empire
25 for the cash incentive portion of the MIP awards for

0115

1 2005?"

2 Q. And that was on lines 21 and 22?

3 A. 21 and 23.

4 Q. All right. And what you -- you just
5 read, the sentence you just read was for, again, both
6 lines 21 and 23?

7 A. Correct.

8 Q. Okay. Any other corrections to your
9 direct testimony which is marked Exhibit No. 48?

10 A. Yes, on page 15.

11 Q. Is this correction within the highly
12 confidential material?

13 A. Yes, it is.

14 MR. DOTTHEIM: I assume we will go
15 in-camera?

16 JUDGE DALE: Is there a way she can --
17 I'm sorry. Is there a way you can do it without
18 disclosing -- can you be cryptic enough or not?

19 MR. DOTTHEIM: I don't think that's
20 possible.

21 JUDGE DALE: Okay. In that case, yes,
22 we will have to go in-camera.

23 BY MR. DOTTHEIM:

24 Q. And let me -- let me ask, are there any
25 corrections in Exhibit 50, your surrebuttal, that are

0116

1 highly confidential?

2 A. No, there's not.

3 JUDGE DALE: In that case, let's go
4 in-camera so she can correct her testimony. All
5 those who are not supposed to be here pursuant to the
6 terms of the protective order need to leave the room.
7 I'll leave it to counsel to figure out who that is.

8 Give me just a minute, Mr. Dottheim.

9 I'm working on getting this.

10 You may proceed.

11 (REPORTER'S NOTE: At this point, an
12 in-camera session was held, which is contained in
13 Volume 7, pages 117 through 118 of the transcript.)

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1 BY MR. DOTTHEIM:

2 Q. Ms. McMellen, are there any other
3 corrections to what's been marked as Exhibit No. 48
4 of your direct testimony?

5 A. No.

6 Q. Are there any corrections to what's been
7 marked Exhibit No. 50, your surrebuttal testimony?

8 A. No, there are not.

9 Q. Okay. If I were to ask you the same
10 questions that are contained in Exhibit No. 48, would
11 your answers as you have corrected them be the same?

12 A. Yes, they would.

13 Q. Is the information contained therein
14 true and correct to the best of your knowledge and
15 belief?

16 A. Yes.

17 Q. And do you adopt Exhibit No. 48 as your
18 testimony in this proceeding?

19 A. Yes, I do.

20 Q. Exhibit No. 50, if I were to ask you the
21 questions that are contained therein, would your
22 answers today be the same?

23 A. Yes, they would.

24 Q. Do you adopt Exhibit No. 50 as your
25 surrebuttal testimony in this proceeding?

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1 A. Yes, I do.

2 MR. DOTTHEIM: I request that Exhibits
3 No. 48 and 50 be received into evidence and tender
4 Ms. McMellen for cross-examination.

5 JUDGE DALE: And 49 deals entirely with
6 the issues that we're -- were discussed this morning?

7 MR. DOTTHEIM: I believe so. 49 does --
8 incentive compensation is not addressed by
9 Exhibit No. 49.

10 JUDGE DALE: Okay. Is there any
11 objection to Exhibits 48, 49 and 50?

12 MR. WOODSMALL: I guess just a
13 clarification. Is 49 being offered now or is it --

14 JUDGE DALE: I only --

15 MR. WOODSMALL: I just wanted to know.

16 JUDGE DALE: The answer is, I only
17 accepted into -- accepted it into the record as
18 evidence those ones where the witnesses would not be
19 called, presuming that those who remain to be called
20 could offer their testimony at that time.

21 MR. WOODSMALL: I have no objection.

22 MR. MITTEN: The company has no
23 objection.

24 JUDGE DALE: Mr. Dottheim?

25 (NO RESPONSE.)

0121

1 JUDGE DALE: Then Exhibits 48, 49 and
2 50, HC and NP versions, all are accepted into
3 evidence.

4 (EMPIRE EXHIBIT NOS. 48-HC, 48-NP,
5 49-NP, 50-HC AND 50-NP WERE RECEIVED INTO EVIDENCE
6 AND MADE A PART OF THE RECORD.)

7 JUDGE DALE: And I believe it's Aquila.

8 MS. CARTER: I have no questions at this
9 time. Thank you.

10 JUDGE DALE: Thank you. KCPL, DNR not
11 here. Explorer/Praxair?

12 MR. WOODSMALL: No questions, your
13 Honor.

14 JUDGE DALE: Public Counsel?

15 MR. MILLS: No questions.

16 JUDGE DALE: Empire?

17 CROSS-EXAMINATION BY MR. MITTEN:

18 Q. Good afternoon, Ms. McMellen.

19 A. Good afternoon.

20 Q. On page 1 of your direct testimony, you
21 indicate that you graduated from DeVry Institute of
22 Technology in 1998 with a bachelor of science degree
23 in accounting; is that correct?

24 A. That's correct.

25 Q. Do you have any other degrees from DeVry

0122

1 or any other college or university?

2 A. No, I do not.

3 Q. Do you have any formal training in the
4 areas of compensation in general or incentive
5 compensation in particular?

6 A. No, I do not. Although I have no formal
7 training, I have --

8 MR. MITTEN: Your Honor, I object. I
9 ask her a specific question, she answers it.

10 JUDGE DALE: Yes. Please confine your
11 responses to yes/no questions to yes or no.

12 BY MR. MITTEN:

13 Q. Following graduation, your testimony
14 indicates you worked as an accounting clerk. Where
15 was that?

16 A. Conley National in Kansas City.

17 Q. Did your duties as an accounting clerk
18 include any responsibility for Conley National's
19 compensation plans?

20 A. No, it did not.

21 Q. Do you know whether the company that you
22 worked for had an incentive compensation plan?

23 A. Yes. There -- we received a small
24 Christmas bonus for the year that I worked there.

25 Q. Everyone received one?

0123

1 A. Yes. There -- but there were only four
2 employees.

3 Q. But that really wouldn't be an incentive
4 compensation plan, would it? That would just be a
5 bonus that was given to everyone?

6 A. That's correct.

7 Q. And you began work at the Public Service
8 Commission in 1999; is that correct?

9 A. That's correct.

10 Q. Were there any intervening jobs between
11 the time you left Conley and the time that you went
12 to work for the Public Service Commission?

13 A. No, there were not.

14 Q. Now, your current title at the Public
15 Service Commission is a utility regulatory auditor;
16 is that correct?

17 A. Yes, that's correct.

18 Q. What are your job responsibilities?

19 A. To perform audits and examinations of
20 regulated utilities.

21 Q. Now, on schedule 1. -- or 1-1 of your
22 direct testimony, you list the cases in which you
23 have filed testimony and the subjects on which you
24 have testified; is that correct?

25 A. That's correct.

1 Q. Is that a complete list?

2 A. Yes, it is.

3 Q. Incentive compensation does not appear
4 on that list. Would I be correct that this is the
5 first time you've ever testified on that issue?

6 A. That is correct.

7 Q. Since you don't have any formal training
8 or experience in compensation in general or incentive
9 compensation in particular, when you learned that you
10 would be testifying in this case on that issue, did
11 you read any books or articles on that -- on those
12 issues to provide you some background for your
13 testimony?

14 A. No, I did not.

15 Q. Ms. McMellen, I'm sure you're a fine
16 accountant, but given the fact that you don't have
17 any training or experience in compensation or
18 incentive compensation, do you really feel you're
19 qualified to provide expert testimony to the
20 Commission on those issues in this case?

21 A. Yes, I do.

22 Q. And the basis of that qualification
23 would be what?

24 A. I have specialized knowledge and
25 practical experience in compensation matters based on

1 the review of past case work papers, testimony, and
2 past report and orders for the Commission.

3 Q. And that's the extent of your knowledge
4 and background in compensation?

5 A. Along with guidance from senior level
6 auditors, yes.

7 Q. Let's move on to your testimony. There
8 were a couple of statements in your direct and
9 surrebuttal testimony that don't appear to square
10 with my understanding of either Dr. Bauer's testimony
11 or Empire's incentive compensation plan, and I'm
12 hoping that you can clear some things up for me.

13 Could you please first turn to your
14 surrebuttal testimony, Exhibit 50, page 6, line 21.
15 You say there that, "The triggering mechanism for
16 stock options is share price appreciation"; is that
17 correct?

18 A. Yes.

19 Q. In one of your data requests, I believe
20 it was data request 243, the company provided you a
21 copy of its 2006 proxy statement. Did you review
22 that in connection with your analysis of this issue
23 for purposes of this case?

24 A. Yes, I did.

25 MR. MITTEN: Your Honor, I believe that

1 the 2006 proxy statement has already been marked as
2 Exhibit 91, and I ask that a copy of that be given to
3 the witness.

4 BY MR. MITTEN:

5 Q. Ms. McMellen, will you please review
6 Exhibit 91 and tell me if that is the proxy statement
7 that was provided to you by the company in response
8 to one of your data requests?

9 A. Yes, it is.

10 Q. Could I ask you to please turn to
11 page 14 of the proxy statement?

12 MR. MITTEN: Your Honor, I would ask
13 that the proxy statement, Exhibit 91, be admitted
14 into evidence at this time.

15 JUDGE DALE: Any objections at this
16 time?

17 MR. WOODSMALL: Yes, your Honor. I --
18 while asking questions about it is certainly okay,
19 offering it into evidence without any foundation or
20 without any type of knowledge as to its relevance at
21 this point is clearly premature.

22 JUDGE DALE: She has admitted that she
23 relied on it.

24 MR. WOODSMALL: Can I voir dire the
25 witness in lieu of my cross -- or in lieu of my

0127

1 objection?

2 JUDGE DALE: Certainly.

3 VOIR DIRE EXAMINATION BY MR. WOODSMALL:

4 Q. Ms. McMellen, can you tell me what
5 portions of Exhibit 91 you relied upon in making your
6 adjustments?

7 A. I reviewed pages -- let's see, 13, 14
8 and 15, the ones related to the compensation
9 committee.

10 Q. You did not rely on any other pages from
11 that document?

12 A. Not regarding stock options or
13 performance shares, no.

14 MR. WOODSMALL: Your Honor, then my
15 objection would be to the receipt of any of
16 Exhibit 91 outside of pages 13, 14 and 15 indicated
17 by the witness that she relied upon in developing her
18 adjustment.

19 MR. DOTTHEIM: And at this point I would
20 raise and share the same objection.

21 JUDGE DALE: At this point then, I will
22 admit pages 13, 14 and 15, and if other pages become
23 relevant, I will admit those then.

24 (PAGES 13, 14 AND 15 OF EMPIRE EXHIBIT
25 NO. 91 WERE RECEIVED INTO EVIDENCE AND MADE A PART OF

1 THE RECORD.)

2 CROSS-EXAMINATION (CONTINUED) BY MR. MITTEN:

3 Q. Ms. McMellen, let me direct your
4 attention to page 14 of the proxy statement, the
5 second full paragraph on that page. Could you read
6 the first portion of that paragraph that relates to
7 stock options?

8 A. Would you like me to read the whole
9 paragraph?

10 Q. Just read it to yourself.

11 A. Oh, okay.

12 Q. Have you finished?

13 A. Yes, I have.

14 Q. Do you see anything in that document
15 that suggests that Empire uses stock price
16 appreciation as a trigger for the grant of stock
17 options?

18 A. No, I do not.

19 Q. Aren't you confusing the concept of
20 trigger with the fact that stock price appreciation
21 will determine whether or not there is any value to
22 the stock option to the recipient?

23 A. Could you repeat the question, please?

24 Q. Aren't you confusing the notion of
25 trigger with the fact that stock price appreciation

1 will determine whether or not the option is of any
2 value to the recipient?

3 A. Yes, I believe that's correct.

4 Q. So the testimony at page 6, line 21
5 would be in error; is that correct?

6 A. That's correct.

7 Q. In your direct testimony, Exhibit 48,
8 page 13, lines 13 and 14, you state, "The dividend
9 equivalents are intended to keep the executives
10 focused on dividend maximization."

11 A. Yes.

12 Q. Could you describe how dividend
13 equivalents work under Empire's plan?

14 A. Excuse me. Dividend equivalents are
15 amounts that are accumulated based on the stock
16 options over a three-year period and -- as if -- and
17 they're the dividends payable as if the executives
18 own those shares of stock.

19 Q. And the three-year period that you're
20 referring to is the vesting period for the option
21 grant; is that correct?

22 A. That's correct.

23 Q. Now, whether or not those options are
24 granted or whether or not those options vest, don't
25 have anything to do with dividend maximization; is

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1 that correct?

2 A. I'm sorry. Could you repeat the
3 question?

4 Q. Whether or not those stock options that
5 have been granted vest don't have anything to do with
6 dividend maximization, do they?

7 A. No.

8 Q. Again, isn't the purpose of the dividend
9 equivalent to keep the recipient of the stock option
10 grant whole during the period of time prior to the
11 vesting of those options?

12 A. That's correct.

13 Q. So would the testimony that you have on
14 page 13, lines 13 and 14 be incorrect?

15 A. Yes.

16 MR. MITTEN: Your Honor, my next line of
17 cross-examination will go into some areas that have
18 been identified as highly confidential, and I would
19 ask that the hearing be taken in-camera.

20 JUDGE DALE: Yes, we will do that. Once
21 again, if those people who are not supposed to be
22 here will clear the room.

23 MR. MITTEN: Your Honor, the first part
24 of my cross is probably not in-camera. If you would
25 like to go back on the record for that, I will let

0131

1 you know and -- when we need to go back in-camera.

2 JUDGE DALE: How long do you think it

3 will...

4 MR. MITTEN: Just a few minutes.

5 JUDGE DALE: Then let's just do it all

6 in-camera.

7 COMMISSIONER APPLING: Huh-uh.

8 JUDGE DALE: No? All right. We're not

9 in-camera. Let me know when we should be.

10 BY MR. MITTEN:

11 Q. All right. Ms. McMellen, who at Empire
12 is responsible for establishing and administering
13 compensation policies and practice for the senior
14 executives?

15 A. The compensation committee of the board
16 of directors.

17 Q. Does the board of directors itself play
18 any role?

19 A. No, I don't believe so.

20 Q. Do you know whether or not the New York
21 Stock Exchange has rules for listed companies like
22 Empire governing the duties and responsibilities of
23 the compensation committee?

24 A. I don't know.

25 MR. MITTEN: I'm gonna ask that a

0132

1 document be marked for identification.

2 (EMPIRE EXHIBIT NO. 92 WAS MARKED FOR

3 IDENTIFICATION BY THE COURT REPORTER.)

4 BY MR. MITTEN:

5 Q. Let me direct your attention to -- what
6 I've given you is an excerpt from the listed company
7 manual of the New York Stock Exchange, a copy of Rule
8 303A.05, Compensation Committee. Would you please
9 read aloud Section B(i) (a)?

10 MR. MILLS: I object. The witness has
11 just said that she has no familiarity with the New
12 York Stock Exchange rules. Simply by handing her a
13 document and asking her to read it doesn't lay any
14 foundation for it.

15 MR. MITTEN: This is cross-examination,
16 your Honor. It's for purposes of impeachment.

17 JUDGE DALE: You've -- he's merely
18 marked it. He hasn't offered it yet.

19 MR. MILLS: But he's asking her to read
20 from it. If there's no reason -- he won't need to
21 offer it if he's gonna have her read the whole thing
22 or read portions of it. And I think you get to the
23 same place whether he offers it and puts it in the
24 record or has her read it into the record.

25 My point is that she has not -- she has

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1 specifically stated that she has no familiarity with
2 these rules, and so there's been no foundation for
3 its admission or it being read into the record.

4 MR. MITTEN: Let me withdraw the
5 question and go about it a different way.

6 BY MR. MITTEN:

7 Q. Would you please read to yourself
8 subsections B (i), (a) and (b)?

9 A. (Witness complied.)

10 Q. Does it appear to you from those
11 excerpts from the New York Stock Exchange rules that
12 the compensation committee is responsible for
13 developing policies and procedures for compensation
14 for senior executives and administering those
15 procedures?

16 A. Yes.

17 MR. MITTEN: I'm gonna offer Exhibit 92
18 into evidence, your Honor.

19 JUDGE DALE: I --

20 MR. MILLS: I have the same objection.
21 There's been no foundation laid.

22 JUDGE DALE: I have to say that I agree.

23 MR. MITTEN: Fine.

24 BY MR. MITTEN:

25 Q. You were also given a copy of Empire's

0134

1 compensation committee charter in response to an
2 information request?

3 A. I don't remember that particular data
4 request or receiving the charter.

5 Q. Did you know that Empire's compensation
6 committee has a charter?

7 A. Yes.

8 Q. Would that be something that would be
9 relevant to the issue of the compensation policies of
10 the company?

11 A. Yes, that's correct.

12 Q. And you don't recall whether you ever
13 saw that?

14 A. I reviewed it on my own, but it was not
15 submitted as part of our data request response.

16 (EMPIRE EXHIBIT NO. 93 WAS MARKED FOR
17 IDENTIFICATION BY THE COURT REPORTER.)

18 MR. MITTEN: What did you say the number
19 of this exhibit was?

20 JUDGE DALE: 93.

21 BY MR. MITTEN:

22 Q. Ms. McMellen, is Exhibit 93 a copy of
23 the compensation committee charter for Empire
24 District Electric Company that you reviewed in
25 connection with your testimony in this case?

1 A. Yes, that's correct.

2 Q. The duties and responsibilities of the
3 compensation committee are stated at the bottom of
4 the first page, continuing onto the second page.
5 Could you please read aloud item No. 1?

6 A. "The committee shall, at least annually,
7 review and approve goals and objectives relevant to
8 chief executive officer, CEO, and other executive
9 officer compensation, evaluate the CEO's and the
10 other executive officers' performance in light of
11 those goals and objectives and determine and approve
12 CEO's and the other executive officers' compensation
13 level based on such evaluation or such other factors
14 as the committee deems appropriate.

15 "In determining the long-term incentive
16 component of CEO and other executive officer
17 compensation, the committee shall consider the
18 company's performance and relative shareholder
19 return, the value of similar incentive awards of
20 comparable companies and awards earned by such
21 officers in past years or such other factors as
22 committee deems appropriate."

23 Q. The standards that are stated in the
24 first sentence of the passage that you just read, do
25 you have any idea where those may have come from?

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1 A. No, I do not.

2 Q. Let me refer you back to Exhibit 92.

3 Could you please review the commentary at the bottom
4 of that exhibit, specifically the first paragraph?

5 MR. WOODSMALL: Your Honor, I object.

6 This witness has already indicated she's not familiar
7 with Exhibit 92. To the extent that they're trying
8 to draw some correlation between 93 and 92, it can't
9 be done with this witness because of her
10 unfamiliarity with this document.

11 MR. MITTEN: Your Honor, the problem I
12 have with this witness is she has no background or
13 expertise whatsoever in the areas of executive
14 compensation. And the way the testimony is filed
15 with the Commission, the company really has no
16 opportunity to respond to her surrebuttal.

17 The only chance I have to cast doubt on
18 the conclusions that she has reached is through
19 cross-examination, and I'm trying to do that. It's
20 impossible to establish a foundation of commonly
21 available documents relative to corporate
22 compensation from someone who doesn't know anything
23 about the issue.

24 JUDGE DALE: It is clear that
25 Ms. McMellen relied on Exhibit No. 93 in preparing

1 her testimony. Inasmuch as there may be a high
2 correlation between the language in 93 and 92, you
3 may point that out in your post-hearing brief.

4 MR. WOODSMALL: Your Honor, I'm a little
5 concerned when you say that they can point that out
6 in their post-hearing brief when Exhibit No. 92 was
7 not accepted. You're giving them the ability to
8 brief an exhibit that was not accepted.

9 JUDGE DALE: Because of the nature of
10 Exhibit 92 which appears to be the New York Stock
11 Exchange listed company manual.

12 MR. WOODSMALL: Again, you say, "Which
13 appears to be." There's been no foundation from
14 anybody which makes that an accurate statement. It
15 is all just conjecture at this point as to what 92
16 is.

17 JUDGE DALE: If it is what it purports
18 to be, he can certainly say in his brief, "We got 93
19 or we got the language in this policy from the New
20 York Stock Exchange's policies."

21 I don't -- I don't see a problem with
22 that, even if it isn't in evidence. Not every single
23 document that is referred to in briefs is in
24 evidence.

25 MR. WOODSMALL: Just to clarify, 92 is

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1 not in evidence?

2 JUDGE DALE: Right. 92 is not in

3 evidence.

4 MR. MILLS: But are you saying in his
5 brief he can use it to prove that their charter was
6 derived from it?

7 JUDGE DALE: I don't think he can prove
8 that their charter was derived from it. All I think
9 he can do is point out that it's consistent. If they
10 had a -- if they had the beginning of their charter
11 that was exactly the same as the preamble to the
12 Constitution of the United States, I think that they
13 could say, "Which happens to coincide with the
14 preamble to the Constitution of the United States."

15 I don't know that it's got any probative
16 value, but that hasn't been our standard in briefing
17 so far.

18 MR. WOODSMALL: I understand your
19 ruling, and I would renew my objection.

20 JUDGE DALE: Thank you. It's overruled.

21 MR. MITTEN: Your Honor, I would offer
22 Exhibit 93 into evidence. I don't believe I've done
23 that yet.

24 JUDGE DALE: It is accepted into
25 evidence.

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1 (EMPIRE EXHIBIT NO. 93 WAS RECEIVED INTO
2 EVIDENCE AND MADE A PART OF THE RECORD.)

3 MR. MITTEN: Now I'm coming to the point
4 of my cross-examination that I believe we do need to
5 go in-camera.

6 JUDGE DALE: Okay. Give me just a
7 moment, please. Please proceed.

8 (REPORTER'S NOTE: At this point, an
9 in-camera session was held, which is contained in
10 Volume 7, pages 140 through 179 of the transcript.)

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1 JUDGE DALE: We are once more streaming.

2 Do you have additional --

3 MR. MITTEN: I do, a few more questions.

4 JUDGE DALE: Please proceed.

5 BY MR. MITTEN:

6 Q. One of the main reasons that you gave
7 for disallowing incentive compensation is that you
8 didn't believe the activity provided direct benefit
9 to ratepayers; is that correct?

10 A. Yes, that's correct.

11 Q. I'm not sure I know what that means.
12 What is a direct benefit to ratepayers?

13 A. That there is some -- there has to be
14 some kind of proof that there's a benefit to the
15 ratepayers by decreasing rates or decreasing
16 expenses.

17 Q. I'm asking you what a direct benefit to
18 ratepayers is, not a benefit to ratepayers.

19 A. It would be a decrease in expense -- in
20 the cost of service expense, for example.

21 Q. Anything else?

22 A. That's all I have right now.

23 Q. Well, what criteria did you use when you
24 were making your adjustment in this case? Was that
25 the only one?

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1 A. The direct benefit to the ratepayers,
2 yes.

3 Q. No, I'm talking about decreasing
4 operating expenses equaling direct benefits to
5 ratepayers; is that the only criterion you used?

6 A. No.

7 Q. Well, what were the other criteria? I'm
8 trying to find out how you defined direct ratepayer
9 benefit for purposes of your adjustment.

10 A. I'm looking to see if there's a
11 reference in my testimony.

12 Q. I didn't find one.

13 A. I don't know.

14 Q. Do you believe the direct ratepayer
15 benefit is a standard that Staff has consistently
16 applied to expenses in this case?

17 A. With regards to incentive compensation,
18 yes.

19 Q. I'm talking about expenses generally,
20 not just incentive compensation. If direct payer --
21 ratepayer benefit is the appropriate standard for
22 incentive compensation, is it also the appropriate
23 standard for other expenses?

24 A. Yes, I would believe so.

25 Q. And do you believe that's a standard

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1 that Staff has consistently applied in this case?

2 A. Yes, I believe so.

3 Q. There are salaries included in test
4 period cost of service for janitors and secretaries.
5 Do customers receive direct ratepayer benefit from
6 the activities of those employees?

7 A. I don't know.

8 Q. Do you know if those expenses have been
9 included in the cost of service?

10 A. A portion of those expenses, yes.

11 Q. The portion that's attributable to
12 Missouri operations?

13 A. Yes, that's correct.

14 Q. The company offers paid vacations to
15 both its management and hourly employees; is that
16 correct?

17 A. Yes, that's correct.

18 Q. What's the direct ratepayer benefit
19 associated with a paid vacation?

20 A. I don't know. It's included in the
21 total cost of service.

22 Q. Were those expenses allowed for
23 ratemaking purposes by Staff?

24 A. Yes, they were as a percentage of the --
25 that's related to Missouri operations.

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1 Q. Is safe and adequate service a direct
2 ratepayer benefit?

3 A. Yes, it is.

4 Q. So if there were activities by employees
5 that related to providing safe and adequate service,
6 there would be direct ratepayer benefit to that?

7 A. Yes, that's correct.

8 Q. Are fair and reasonable rates based upon
9 levels of expense, investment, revenue, rate of
10 return a direct ratepayer benefit?

11 A. Yes, they are.

12 Q. If -- now, in setting rates for the
13 company, the Commission will determine an appropriate
14 level of revenues for ratemaking purposes; is that
15 right?

16 A. Yes, that's correct.

17 Q. If an employee works to achieve or
18 exceed that level of revenue, is there direct
19 ratepayer benefit?

20 A. Yes, I believe so.

21 Q. The Commission will also set an
22 appropriate level of expenses for ratemaking
23 purposes. If an employee devotes efforts to
24 controlling expenses, is there a direct ratepayer
25 benefit from that?

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1 A. Yes, there is.

2 Q. The Commission will also determine an
3 appropriate level of capital investment for
4 ratemaking purposes. If an employee devotes his or
5 her efforts to controlling expenses, is there a
6 direct ratepayer benefit from that?

7 A. Yes, that's correct.

8 Q. The Commission will also set an
9 appropriate rate of return for the company. If an
10 employee devotes his or her efforts to earning that
11 appropriate rate of return, is there a direct
12 ratepayer benefit from that?

13 A. Yes.

14 Q. And are those the criteria that you
15 applied in excluding incentive compensation in this
16 case?

17 A. Yes, that's correct.

18 Q. So if an employee worked to improve the
19 company's earnings, those were appropriate activities
20 because they directly benefited ratepayers?

21 A. Could you repeat the question, please?

22 Q. Efforts by the company's management to
23 improve the company's earning or its rate of return,
24 those were appropriate activities that provided
25 direct ratepayer benefit?

0185

1 A. Not all activities related to earnings.

2 Q. Well, how did you distinguish between
3 some earnings that were acceptable and other earnings
4 that weren't?

5 A. As related to incentive comp, the
6 earnings goals had to be -- there had to be some kind
7 of goal that was beneficial to the ratepayer.

8 Q. But you just told me that earning the
9 authorized rate of return was beneficial to the
10 ratepayer.

11 A. Yes. But not earnings goals relate to
12 the -- the allowed rate of return.

13 Q. Which of the earnings goals can you
14 point to as being attributable to earnings that were
15 in excess of the authorized rate of return?

16 A. I don't know. I have not done that
17 analysis.

18 MR. MITTEN: I don't have any further
19 questions for this witness. Thank you.

20 JUDGE DALE: Before we begin redirect,
21 I'd like to ask, are there any questions from the
22 Bench?

23 QUESTIONS BY CHAIRMAN DAVIS:

24 Q. Ms. McMellen, early in your testimony
25 when Mr. Mitten was questioning you about your level

1 of expertise, you said that you had received guidance
2 from senior level auditors; is that correct?

3 A. Yes, that's correct.

4 Q. What -- what guidance did you receive?

5 A. It was day-to-day guidance. If I had
6 questions on the goals or any part of the incentive
7 comp, I would ask senior level auditors.

8 Q. And what senior level auditors did you
9 consult with?

10 A. It would have been the lead auditor on
11 this case, which was Janis Fischer and the -- and
12 Mark Oligschlaeger.

13 Q. And so, in essence, is it fair to say
14 you were just doing what you were told?

15 A. I -- I did the analysis, and if I had
16 any questions, I would go to the senior-level
17 auditors, but I did it based on my opinions. I just
18 didn't do what they told me to do; I reviewed
19 everything on my own.

20 Q. Okay. So you reviewed everything on
21 your own, but obviously, this is the first case that
22 you've testified regarding incentive compensation; is
23 that correct?

24 A. Yes, that's correct.

25 Q. And did the -- did someone say, "Amanda,

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1 this is your issue, you're gonna testify on this
2 issue"?

3 A. They asked -- when I was assigned the
4 case, they asked me if there were any particular
5 issues that I wanted to do, and I requested payroll
6 and incentive compensation, and then I was assigned
7 that issue.

8 Q. Okay. And so you performed the audit
9 and then if you had any questions, then you would ask
10 either Ms. Fischer or Mr. Oligschlaeger; is that
11 correct?

12 A. Yes, that's correct.

13 CHAIRMAN DAVIS: Okay. No further
14 questions. Thank you.

15 JUDGE DALE: Commissioner Gaw?

16 COMMISSIONER GAW: Maybe just a little.

17 QUESTIONS BY COMMISSIONER GAW:

18 Q. Ms. McMellen, are you -- are you
19 testifying that you would never agree to incentive
20 compensation being included in rates?

21 A. No, I am not.

22 Q. All right.

23 A. I have actually included part of
24 incentive compensation in this case.

25 Q. Okay.

0188

1 A. Just not in total.

2 Q. And just for my benefit, could you tell
3 me your general criteria for allowing incentive comp
4 to be in?

5 A. Yes. It was based on previous
6 Commission decisions which is stated in my direct
7 testimony and my surrebuttal testimony.

8 Q. Okay. Would you summarize that for me?

9 A. Yes. There has --

10 Q. Just generally, the criteria that you
11 believe that incentive comp has to meet before it
12 should be included.

13 A. The goals have to be reasonable
14 according to the plan, and they have to be -- provide
15 a ratepayer benefit.

16 Q. Okay. Is it relevant in your mind, as
17 you look at incentive comp, what level the actual
18 base salary is for an employee?

19 A. I'm sorry?

20 Q. Is that a relevant consideration? Is it
21 relevant to you the level at which base compensation
22 is paid for an employee in deciding whether or not
23 additional incentive compensation should be allowed?

24 A. No.

25 Q. Let me -- let me ask you this: If

1 you -- if you were in a position where the base
2 salary for an employee was significantly under the
3 market for someone doing that type of job and in
4 addition to that they received some incentive pay,
5 and the two of those things totaled, even if they
6 received the maximum incentive pay possible, totaled
7 less than the amount that was -- you would consider
8 to be appropriate for that job level as a base pay
9 amount, would you consider -- would you still be
10 going through the same kind of an analysis regarding
11 the reasonableness of the incentive plan itself and
12 the other -- the other factors that you've cited in
13 your testimony?

14 A. Yes, I would.

15 Q. So you do not believe that the base pay
16 amount is -- plus the incentive pay is ever a
17 relevant consideration in regard to how it compares
18 to the market?

19 A. No. We look at each individual piece of
20 their total compensation package, base salary,
21 incentive benefits.

22 Q. In doing that type of an analysis, are
23 you not putting your -- putting a very significant
24 damper on having incentive pay in any -- in any way
25 for utilities who may be considering it?

0190

1 A. No. They just need -- they just need to
2 meet the goals that the Commission has already
3 established --

4 Q. But if I --

5 A. -- to get those -- receive those
6 incentives.

7 Q. -- if I have a base pay, what is your
8 criteria for analyzing whether or not all of that
9 should be in?

10 A. Particularly, I looked at the increase
11 from -- in each person's -- each employee's salaries
12 from the last case to this case and the increase to
13 see if that was reasonable.

14 Q. How do you determine whether it's
15 reasonable?

16 A. I talked with the company and reviewed
17 all of their analysis that they use when they go
18 through lists -- they look at the job market and I
19 believed their analysis to be reasonable and then I
20 looked at the increase and it seemed reasonable.

21 Q. So you don't look at outside -- outside
22 factors, other comparisons and what's out in the
23 marketplace for pay of that -- for that type of a
24 position?

25 A. No, I did not.

0191

1 Q. Do you think it's appropriate to do that
2 in deciding whether or not the level of pay is at an
3 appropriate level --

4 A. I don't --

5 Q. -- for purposes of including the same in
6 base rates?

7 A. That's not Staff's position to look at
8 the market.

9 COMMISSIONER GAW: Okay. No further
10 questions. Thank you.

11 JUDGE DALE: Is there recross based on
12 questions from the Bench?

13 MR. WOODSMALL: Yes, your Honor. Just
14 very briefly.

15 RE CROSS-EXAMINATION BY MR. WOODSMALL:

16 Q. Commissioner Gaw asked you about
17 incentive compensation and how you went about making
18 your adjustment and you talked about the Commission's
19 checking to see if the goals were consistent with the
20 past Commission precedent; do you recall that
21 question?

22 A. Yes, I do.

23 Q. Turning to Exhibit No. 93 -- well, first
24 off, before I get to that, can you tell me what is
25 the past Commission precedent on this issue?

1 A. There are several. They go back almost
2 20 years. There are two that I cite in my direct
3 testimony.

4 Q. And can you tell me in general what that
5 standard is?

6 A. That the goals have to be reasonable to
7 the plan and they have to provide a ratepayer benefit.

8 Q. Okay. Turning to Exhibit 93, do you
9 have that?

10 A. Yes, I do.

11 Q. Can you show me under "Duties and
12 Responsibilities" anywhere where it talks about
13 ratepayers, ratepayer benefits, consumer benefits,
14 anything along those lines?

15 A. No, I do not.

16 MR. WOODSMALL: Thank you. No further
17 questions.

18 JUDGE DALE: Any other recross based on
19 questions from the Bench?

20 (NO RESPONSE.)

21 JUDGE DALE: Then Mr. Dottheim, you're
22 free to go with redirect based on everything.

23 MR. DOTTHEIM: Okay. Thank you.

24 REDIRECT EXAMINATION BY MR. DOTTHEIM:

25 Q. Ms. McMellen, you were asked -- you were

1 asked a number of questions about peer group
2 comparisons. Is the Staff's position on
3 recoverability of consent -- consented compensation
4 in this case based upon a peer group comparison?

5 A. No, it is not. It's based on the
6 Commission criteria that was set forth in previous
7 report and orders.

8 Q. Does the Commission standard relating to
9 recoverability of incentive compensation and rates
10 require a comparison to the incentive compensation
11 offered by comparable companies?

12 MR. MITTEN: Your Honor, I'm going to
13 object to that question. I was restricted in my
14 cross-examination to the specific questions that
15 Mr. Dottheim had asked. I asked this witness no
16 questions whatsoever about previous standards that
17 this Commission had implemented regarding incentive
18 compensation.

19 MR. DOTTHEIM: I think there have been a
20 number of questions as far as the Commission's
21 standard too.

22 JUDGE DALE: There were some questions
23 from the Bench pertaining to this. However, let me
24 caution that considering the precedential value or
25 lack thereof of Commission's decisions, stare decisis,

0194

1 et cetera, on which this witness clearly is not
2 competent to testify, I'll ask you to be very
3 limited. So you may ask if you rephrase.

4 BY MR. DOTTHEIM:

5 Q. Does the Commission's standard relating
6 to recoverability of incentive compensation in rates
7 cause the Staff to perform a comparison to incentive
8 compensation offered by comparable companies?

9 A. No, it does not.

10 Q. Okay. You were asked a question
11 regarding companies that appear in the Staff rate of
12 return witness's testimony as comparable companies.
13 Do you recall the question?

14 A. Yes, I do.

15 Q. Okay. And I think there was a reference
16 to a Staff data request -- excuse me, a company data
17 request to the Staff. Do you have that Staff data
18 request?

19 A. Yes, I do. Yes, it was DR-417.

20 Q. Yes. I'd like to refer you to that data
21 request. Do you have that?

22 A. Yes, I do.

23 Q. Okay. And you've identified it as Staff
24 data request No. 417?

25 A. Company data request, yes.

0195

1 Q. Yes, excuse me. It's a company data
2 request to the Staff. And can you identify the date
3 of the request to the Staff?

4 A. Date requested was 8/29/06.

5 Q. And did the Staff respond to the
6 company?

7 A. Yes, they did.

8 Q. And when did the Staff respond to the
9 company?

10 A. Early this morning.

11 Q. Okay. And could you read the -- the
12 question and the Staff's response?

13 A. Yes. The question was, "Describe what
14 data, if any, you reviewed regarding, one, the
15 prevalence of incentive compensation plans and large
16 companies in general; and two, the prevalence of
17 incentive compensation plans in companies comparable
18 to Empire."

19 And I responded, "I reviewed the
20 information concerning executive compensation
21 included in the proxy statements for the comparable
22 companies included in Staff witness David Murray's
23 direct testimony, schedule 12: Hawaiian Electric
24 Industries, Inc.; IDACORP, Inc.; Pinnacle West
25 Capital; Puget Energy, Inc. and Southern Company."

1 Q. And this morning in responding to a
2 question from Mr. Mitten regarding your reference to
3 Mr. Murray's direct testimony, did you refer to those
4 companies as the large companies in your analysis or
5 that you looked at?

6 A. Yes.

7 Q. And was that in reference to the first
8 part of the company's data request question?

9 A. Yes, that's correct.

10 Q. I'd like to refer you to what's been
11 marked as Exhibit 95 and if I could direct you back
12 to the pages on Mr. Herrington, and the first page on
13 Mr. Herrington --

14 JUDGE DALE: Mr. Dottheim, please let me
15 know if you need to go in-camera.

16 MR. DOTTHEIM: Oh. It appears we will
17 have to go in-camera for this one item.

18 JUDGE DALE: Okay. Then give me just a
19 second.

20 MR. DOTTHEIM: I'm sorry.

21 (REPORTER'S NOTE: At this point, an
22 in-camera session was held, which is contained in
23 Volume 7, pages 197 through 199 of the transcript.)

24

25

0200

1 MR. MILLS: And until we hear more from
2 him what he learns at the hospital, all I know at
3 this point is that he will not be able to make it
4 here tomorrow. He may be able to make it in later
5 this week or next week or not at all. But I wanted
6 to let everyone know that he will not be available
7 tomorrow, and I would appreciate everyone's
8 indulgence in trying to schedule him at a later time,
9 or possibly even by telephone if he's not able to
10 travel.

11 JUDGE DALE: Out of where is he located?

12 MR. MILLS: He was traveling from Maine
13 to Washington D.C. to here, and I am not sure exactly
14 how far he got on that trip before he was waylaid.

15 JUDGE DALE: Well, certainly he is --
16 this is Mr. Gipson?

17 MR. MILLS: No, no, no. Although I
18 would be happy to have him testify for us.

19 JUDGE DALE: Oh, I'm sorry.

20 MR. MILLS: This is Charlie King --

21 JUDGE DALE: Okay. Well --

22 MR. MILLS: -- on rate of return and
23 capital structure.

24 MR. MITTEN: The company would be happy
25 to have Mr. Gipson testify for you too.

0201

1 JUDGE DALE: Certainly, we can, if he is
2 able and we can do some sort of remote testifying, we
3 will do that. If he can't make it, he can't make it.
4 And Lord knows, if he's in surgery, he won't even be
5 on the phone.

6 MR. MILLS: Right.

7 JUDGE DALE: So we will just play it by
8 ear tomorrow and see what happens and reserve him for
9 later if we need to.

10 MR. MILLS: And as I said, I don't have
11 enough information now to propose a solution. I just
12 wanted to let everyone know there's a problem.

13 JUDGE DALE: Well, is there anything
14 else that needs to be addressed before we adjourn for
15 the day?

16 MR. MITTEN: Your Honor, I had a couple
17 of brief recross questions I'd like to ask the
18 witness, if I may, based upon the redirect.

19 JUDGE DALE: We generally do not allow
20 recross, and I have to confess, I don't want to open
21 that door.

22 MR. MITTEN: Fine.

23 JUDGE DALE: Because then there will be
24 re-re-redirect and re-re-recross and we've all been
25 there before.

0202

1 MR. MITTEN: It isn't re-re. I just
2 wanted to recross.

3 JUDGE DALE: Is there anything else?

4 (NO RESPONSE.)

5 JUDGE DALE: Then we will reconvene
6 tomorrow morning at 8:30 and hopefully have an update
7 on Mr. King and go from there. Thank you. We're off
8 the record.

9 (WHEREUPON, the hearing of this case was
10 recessed until 8:30 A.M., SEPTEMBER 6, 2006.)

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1	Opening Statement by Mr. Swearengen	37
	Opening Statement by Mr. Thompson	50
2	Opening Statement by Mr. Mills	63
	Opening Statement by Mr. Woodsmall	66
3	Opening Statement by Ms. Woods	77
	Opening Statement by Ms. Carter	80
4		
5	(ISSUE) INCENTIVE COMPENSATION	
	Opening Statement by Mr. Mitten	87
6	Opening Statement by Mr. Dottheim	91
7		
8		
9	EMPIRE DISTRICT ELECTRIC COMPANY'S EVIDENCE ON INCENTIVE COMPENSATION:	
10		
11	DR. GENE BAUER	
	Direct Examination by Mr. Mitten	95
12	Cross-Examination by Mr. Woodsmall	96
	Cross-Examination by Mr. Dottheim	98
13	Redirect Examination by Mr. Mitten	103
	Questions by Commissioner Appling	111
14		
15		
16	STAFF'S EVIDENCE ON INCENTIVE COMPENSATION:	
17	AMANDA McMELLEN	
	Direct Examination by Mr. Dottheim	113
18	Cross-Examination by Mr. Mitten	121
	Voir Dire Examination by Mr. Woodsmall	127
19	Cross-Examination (Continued) by Mr. Mitten	128
	Questions by Chairman Davis	185
20	Questions by Commissioner Gaw	187
	Recross-Examination by Mr. Woodsmall	191
21	Redirect Examination by Mr. Dottheim	192
22	AMANDA McMELLEN (In-Camera)	
	Direct Examination by Mr. Dottheim	118
23	Cross-Examination by Mr. Mitten	140
	Redirect Examination by Mr. Dottheim	197
24		
25		

EXHIBITS INDEX

3	Empire Exhibit No. 1		
4	Rebuttal testimony of Gene Bauer	19	96
5	Empire Exhibit No. 2		
6	Direct testimony of Dr. James H. Vander Weide	19	**
7	Empire Exhibit No. 3		
8	Rebuttal testimony of Dr. James H. Vander Weide	19	**
9	Empire Exhibit No. 4		
10	Surrebuttal testimony of Dr. James H. Vander Weide	19	**
11	Empire Exhibit No. 5		
12	Direct testimony of W. L. Gipson	19	**
13	Empire Exhibit No. 6		
14	Supplemental direct testimony of W. L. Gipson	19	**
15	Empire Exhibit No. 7		
16	Rebuttal testimony of W. L. Gipson	19	**
17	Empire Exhibit No. 8		
18	Direct testimony of Sherrill L. McCormack	19	**
19	Empire Exhibit No. 9		
20	Rebuttal testimony of Sherrill McCormack	19	**
21	Empire Exhibit No. 10		
22	Surrebuttal testimony of Sherrill McCormack	19	**
23	Empire Exhibit No. 11		
24	Supplemental direct testimony of Steven Fetter	19	**

0205

		MARKED	RECEIVED
1			
2	Empire Exhibit No. 12		
3	Rebuttal testimony of		
	Steven Fetter	19	**
4	Empire Exhibit No. 13		
5	Rebuttal testimony of		
	L. J. Williams	19	36
6	Empire Exhibit No. 14		
7	Surrebuttal testimony		
	of L. J. Williams	19	**
8	Empire Exhibit No. 15NP		
9	Direct testimony of		
	Todd W. Tarter	19	**
10	Empire Exhibit No. 15HC		
11	Direct testimony of		
	Todd W. Tarter	19	**
12	Empire Exhibit No. 16NP		
13	Supplemental testimony		
	of Todd W. Tarter	19	**
14	Empire Exhibit No. 16HC		
15	Supplemental testimony		
	of Todd W. Tarter	19	**
16	Empire Exhibit No. 17NP		
17	Rebuttal testimony of		
	Todd W. Tarter	19	**
18	Empire Exhibit No. 17HC		
19	Rebuttal testimony of		
	Todd W. Tarter	19	**
20	Empire Exhibit No. 18NP		
21	Surrebuttal testimony of		
	Todd W. Tarter	19	**
22	Empire Exhibit No. 18HC		
23	Surrebuttal testimony of		
	Todd W. Tarter	19	**
24	Empire Exhibit No. 19NP		
25	Supplemental direct testimony		
	of Richard McCord	19	**

0206

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1			
2	Empire Exhibit No. 19HC		
3	Supplemental direct testimony of Richard McCord	19	**
4	Empire Exhibit No. 20		
5	Direct testimony of W. Scott Keith	19	**
6	Empire Exhibit No. 21NP		
7	Rebuttal testimony of W. Scott Keith	19	**
8	Empire Exhibit No. 21HC		
9	Rebuttal testimony of W. Scott Keith	19	**
10	Empire Exhibit No. 22		
11	Surrebuttal testimony of W. Scott Keith	19	**
12	Empire Exhibit No. 23		
13	Direct testimony of Jayna R. Long	19	**
14	Empire Exhibit No. 24		
15	Supplemental direct testimony of Jayna Long	19	**
16	Empire Exhibit No. 25		
17	Rebuttal testimony of Jayna Long	19	**
18	Empire Exhibit No. 26		
19	Direct testimony of Laurie Delano	19	***36
20	Empire Exhibit No. 27		
21	Surrebuttal testimony of Laurie Delano	19	***36
22	Empire Exhibit No. 28		
23	Rebuttal testimony of Gary Lentz	19	***36
24	Empire Exhibit No. 29NP		
25	Rebuttal testimony of Blake Mertens	19	***36

0207

		MARKED	RECEIVED
1			
2	Empire Exhibit No. 29HC		
3	Rebuttal testimony of Blake Mertens	19	***36
4	Empire Exhibit No. 30		
5	Direct testimony of Mike Palmer	19	***36
6	Empire Exhibit No. 31		
7	Rebuttal testimony of Kenneth Vogl	19	***36
8	Empire Exhibit No. 32		
9	Rebuttal testimony of Tim Wilson	19	***36
10	Staff Exhibit No. 33		
11	Staff accounting schedule	19	**
12	Staff Exhibit No. 34		
13	Direct testimony of Kofi Agyenim Boateng	19	***36
14	Staff Exhibit No. 35		
15	Direct testimony of Dana E. Eaves	19	***36
16	Staff Exhibit No. 36		
17	Rebuttal testimony of Dana Eaves	19	***36
18	Staff Exhibit No. 37		
19	Direct testimony of David W. Elliott	19	**
20	Staff Exhibit No. 38		
21	Supplemental direct testimony of David W. Elliott	19	**
22	Staff Exhibits No. 39NP		
23	Direct testimony of Janis Fischer	19	**
24	Staff Exhibits No. 39HC		
25	Direct testimony of Janis Fischer	19	**

0208

		MARKED	RECEIVED
1			
2	Staff Exhibit No. 40NP		
3	Rebuttal testimony of Janis Fischer	19	**
4	Staff Exhibit No. 40HC		
5	Rebuttal testimony of Janis Fischer	19	**
6	Staff Exhibit No. 41NP		
7	Surrebuttal testimony of Janis Fischer	19	**
8	Staff Exhibit No. 41HC		
9	Surrebuttal testimony of Janis Fischer	19	**
10	Staff Exhibit No. 42NP		
11	Direct testimony of Paul R. Harrison	19	**
12	Staff Exhibit No. 42HC		
13	Direct testimony of Paul R. Harrison	19	***36
14	Staff Exhibit No. 43		
15	Rebuttal testimony of Paul Harrison	19	***36
16	Staff Exhibit No. 44		
17	Direct testimony of Shawn E. Lange	19	***36
18	Staff Exhibit No. 45		
19	Rebuttal testimony of Shawn E. Lange	19	***36
20	Staff Exhibit No. 46		
21	Direct testimony of Erin L. Maloney	19	***36
22	Staff Exhibit No. 47		
23	Direct testimony of Paula Mapeka	19	***36
24	Staff Exhibit No. 48NP		
25	Direct testimony of Amanda C. McMellen	19	121

0209

		MARKED	RECEIVED
1			
2	Staff Exhibit No. 48HC		
3	Direct testimony of Amanda C. McMellen	19	121
4	Staff Exhibit No. 49		
5	Rebuttal testimony of Amanda C. McMellen	19	121
6	Staff Exhibit No. 50NP		
7	Surrebuttal testimony of Amanda McMellen	19	121
8	Staff Exhibit No. 50HC		
9	Surrebuttal testimony of Amanda McMellen	19	121
10	Staff Exhibit No. 51		
11	Direct testimony of David Murray	19	**
12	Staff Exhibit No. 52NP		
13	Rebuttal testimony of David Murray	19	**
14	Staff Exhibit No. 52HC		
15	Rebuttal testimony of David Murray	19	**
16	Staff Exhibit No. 53NP		
17	Surrebuttal testimony of David Murray	19	**
18	Staff Exhibit No. 53HC		
19	Surrebuttal testimony of David Murray	19	**
20	Staff Exhibit No. 54		
21	Direct testimony of Mark L. Oligschlaeger	19	**
22	Staff Exhibit No. 55		
23	Supplemental direct testimony of Mark L. Oligschlaeger	19	**
24			
25	Staff Exhibit No. 56		
	Rebuttal testimony of Mark L. Oligschlaeger	19	**

0210

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1			
2	Staff Exhibit No. 57		
3	Surrebuttal testimony of Mark L. Oligschlaeger	19	**
4	Staff Exhibit No. 58		
5	Direct testimony of Curt Wells	19	**
6	Staff Exhibit No. 59		
7	Rebuttal testimony of Curt Wells	19	**
8	Staff Exhibit No. 60		
9	Direct testimony of James A. Busch	19	**
10	Staff Exhibit No. 61		
11	Supplemental direct testimony of James A. Busch	19	**
12	Staff Exhibit No. 62		
13	Rebuttal testimony of James A. Busch	19	**
14	Staff Exhibit No. 63		
15	Surrebuttal testimony of James A. Busch	19	**
16	Staff Exhibit No. 64		
17	Direct testimony of William McDuffey	19	**
18	Staff Exhibit No. 65		
19	Direct testimony of David C. Roos	19	**
20	Staff Exhibit No. 66		
21	Supplemental direct testimony of Lena M. Mantle	19	**
22	Staff Exhibit No. 67		
23	Rebuttal testimony of Lena M. Mantle	19	**
24	Staff Exhibit No. 68		
25	Supplemental direct testimony of Henry E. Warren	19	**

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Staff Exhibit No. 69
rebuttal testimony of
Kwang Y. Choe

19 **

Staff Exhibit No. 70
Rebuttal testimony of
Janis Pyatte

19 **

OPC Exhibit No. 71
Supplemental direct
testimony of Ryan Kind

19 **

OPC Exhibit No. 72
Direct testimony of
Charles King

19 **

OPC Exhibit No. 73
Rebuttal testimony of
Charles King

19 **

OPC Exhibit No. 74
Surrebuttal testimony
of Charles King

19 **

OPC Exhibit No. 75
Direct testimony of
Barbara Meisenheimer on
revenue requirements

19 **

OPC Exhibit No. 76
Direct testimony of
Barbara Meisenheimer on
rate design

19 **

OPC Exhibit No. 77
Rebuttal testimony of
Barbara Meisenheimer

19 **

OPC Exhibit No. 78
Direct testimony of
Ted Robertson

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OPC Exhibit No. 79
Rebuttal testimony of
Ted Robertson

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0212

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1			
2	OPC Exhibit No. 80		
3	Surrebuttal testimony		
	of Ted Robertson	19	**
4	OPC Exhibit No. 81NP		
5	Direct testimony of		
	Ralph Smith	19	**
6	OPC Exhibit No. 81HC		
7	Direct testimony of		
	Ralph Smith	19	**
8	OPC Exhibit No. 82		
9	Rebuttal testimony of		
	Ralph Smith	19	**
10	OPC Exhibit No. 83		
11	Surrebuttal testimony of		
	Ralph Smith	19	**
12	OPC Exhibit No. 84		
13	Supplemental direct		
	testimony of Russ Trippensee	19	**
14	Praxair Exhibit No. 85NP		
15	Direct testimony of		
	Maurice Brubaker		
16	on revenue requirement	19	**
17	Praxair Exhibit No. 85HC		
18	Direct testimony of		
	Maurice Brubaker on		
	revenue requirement	19	**
19	Praxair Exhibit No. 86		
20	Direct testimony of		
	Maurice Brubaker on		
	rate design	19	**
21	Praxair Exhibit No. 87		
22	Rebuttal testimony of		
23	Maurice Brubaker on rate		
	design, fuel and purchased		
	power expense	19	**
24			
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0213

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1			
2	Praxair Exhibit No. 88NP		
3	Surrebuttal/cross		
4	surrebuttal on rate design,		
5	fuel and purchased power		
6	testimony of Maurice Brubaker	19	**
7	Praxair Exhibit No. 88HC		
8	Surrebuttal/cross		
9	surrebuttal on rate design,		
10	fuel and purchased power		
11	testimony of Maurice Brubaker	19	**
12	DNR Exhibit No. 89		
13	Direct testimony of		
14	Brenda Wilbers	19	**
15	KCPL Exhibit No. 90		
16	Surrebuttal testimony of		
17	Bryan Weiss	19	**
18	Empire Exhibit No. 91		
19	Proxy statement for		
20	Empire District for		
21	March 20th, 2006	103	* 127
22	Empire Exhibit No. 92		
23	Excerpt from the listed		
24	company manual of the New		
25	York Stock Exchange,		
26	a copy of Rule 303A.05,		
27	Compensation Committee	132	**
28	Empire Exhibit No. 93		
29	Copy of the compensation		
30	committee charter for		
31	Empire District Electric		
32	Company	134	139
33	Empire Exhibit No. 94		
34	Copy of the goals for		
35	2005 for Empire's senior		
36	executives	151	161
37			
38			
39			
40			

0214

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Empire Exhibit No. 95
Performance planning sheets
for 2005

162 170

Empire Exhibit No. 96
Listing of lightning
bolts awards made by
Empire during 2004, 2005
and 2006

171 175

* Only pages 13, 24 and 15 of this exhibit were
received into evidence.

** Not yet received into evidence.

*** Admitted with objections regarding stipulation
procedure.