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Before the Public Service Commission
of the State of Missouri

Direct Testimony

of

Jill Schwartz

on behalf of

The Empire District Electric Company

May 2021

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THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
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I. INTRODUCTION AND PURPOSE OF TESTIMONY

Q. Please state your name and business address.

A. My name is Jill Schwartz. My business address is 602 South Joplin Avenue, Joplin, MO, 64802.

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

A. I am employed by Liberty Utilities Service Corp. ("LUSC") as the Director of Regulatory Shared Services. LUSC is a direct subsidiary of Liberty Utilities Co. ("Liberty Utilities").

As Director of Regulatory Shared Services, I am responsible for leading a small team in the development of the regulatory strategy and evidentiary support for the corporate shared services costs charged to the operating utilities in accordance with the Algonquin Power & Utilities Corp. ("APUC") Cost Allocation Manual ("CAM"). In addition, the Regulatory Shared Services team provides project management support for corporate initiatives, as well as to the local and regional regulatory teams for rate cases and other regulatory matters.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of The Empire District Electric Company ("Empire" or "Company"), which is a wholly owned indirect subsidiary of Liberty Utilities. Liberty Utilities is an indirect subsidiary of Liberty Utilities (Canada) Corp. ("Liberty Canada" or "LUCC"). Liberty Canada is a wholly owned indirect subsidiary of APUC.

Q. Please describe your educational and professional background.

A. In 2001, I completed my Bachelor of Science in Accounting from the John E. Simon School of Business at Maryville University in St. Louis, Missouri. From May 2001 to February 2015, I was employed by The Boeing Company in a variety of accounting capacities, ensuring compliance with the Federal Acquisition Regulation Mandatory Disclosure rule and developing and delivering labor compliance training for all Boeing employees. I joined Liberty Utilities in February 2015 as the Manager of Rates and Regulatory Affairs for Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty Midstates"). In February 2017, I was promoted to Senior Manager of Rates and Regulatory Affairs for Liberty Utilities Central Region, where I was responsible for the regulatory matters involving the electric, natural gas and water utilities in Missouri, Arkansas, Illinois, Iowa, Kansas and Oklahoma. In August 2019, I transitioned to the Corporate Regulatory department, where I provided support for the cost allocation manual and corporate costs to other Liberty Utilities operating utilities across the U.S. and Canada. In December 2020, I was promoted to my current position.

Q. Have you previously testified before the Missouri Public Service Commission ("Commission") or any other regulatory agency?

A. Yes. I have provided written and oral testimony before the Commission in numerous cases including but not limited to the most recent rate cases for Empire (Case No. ER-2019-0374), Liberty Midstate (Case No. GR-2018-0013), and Liberty Utilities (Missouri Water) LLC ("Missouri Water") (Case No. WR-2018-0170). I have also testified before public utility commissions in Arizona, Illinois, and Iowa, as well as the New Brunswick Energy and Utilities Board in Canada.

Q. What is the purpose of your Direct Testimony in this proceeding?

A. The purpose of my direct testimony is to address the Company's corporate allocations and compliance with stipulations and agreements from Case No. EM-2016-0213 relating to affiliate transactions and corporate costs. More specifically, I support the Company's request for new rates by addressing the corporate costs and allocation methods across the APUC organization, including Empire. I explain the APUC and Liberty Utilities corporate cost allocation model and the benefits of our shared service model to Empire and the other regulated utilities owned by Liberty Utilities. In my testimony, I also demonstrate Empire's compliance with stipulations related to affiliate transaction costs and cost allocation matters ordered by the Commission in Liberty Utilities' acquisition of Empire (Case No. EM-2016-0213). I also address Empire's compliance with the Commission's Affiliate Transactions Rules in 20 CSR 4240-20.015 and 20 CSR 4240-40.015.

II. OVERVIEW OF THE CORPORATE COSTS AND ALLOCATION MODEL

A. APUC/Liberty Corporate Structure

Q. Please summarize the APUC/Liberty corporate structure?

A. APUC is a publicly traded utility holding company and is the ultimate corporate parent of a widely diversified portfolio of independent power/electricity production facilities and regulated utilities consisting of electric, natural gas, water distribution, and wastewater treatment utilities, including Empire. APUC has two major operating units in North America, Liberty Utilities and Liberty Power.

Algonquin Power Co. d/b/a Liberty Power is an unregulated entity that provides renewable power generation from facilities owned throughout the United States and Canada. Liberty Utilities owns and/or operates regulated water, wastewater, natural gas and electric utilities in thirteen states[1] in the United States and one Canadian province (New Brunswick), divided into three operating regions (East, Central and West). In addition to Liberty Power and Liberty Utilities, APUC owns a water and wastewater utility in Chile and an electric utility in Bermuda.

Q. What is Liberty Utilities' approach to operating its regulated utilities?

A. Liberty Utilities uses a decentralized approach to operating its regulated utility business, which emphasizes the importance of local management and local control of day-to-day business operations. This approach is premised on a belief that utility services are best delivered locally, and this is especially true for customer service, operations, employee and regulatory functions and community outreach activities.

Q. Please explain the shared services and corporate cost allocation model.

A. Through the shared services and corporate cost allocation model, APUC, LUCC, and LUSC provide a range of services across the organization, which I describe later in my testimony. The centralized provision of services promotes consistency, maximizes economies of scale and minimizes redundancy across all affiliates. Furthermore, through this model, the 27 regulated utilities owned and operated by Liberty Utilities are able to access maximum expertise at lower costs. Put simply, Liberty's shared services business model allows our regulated utilities, including Empire, to leverage economies of scale and other efficiencies through shared corporate support services. For example, and as I note below, treasury, information technology, insurance, and risk management are provided centrally, which provides the benefits of relying on a service

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[1] Liberty Utilities owns and operates regulated and unregulated utilities in Arizona, Arkansas, California, Illinois, Iowa, Georgia, Kansas, Massachusetts, Missouri, New Hampshire, New York, Oklahoma and Texas.

group with broad experience, delivers economies of scale, and facilitates the standardization of these activities.

Q. What affiliates provide corporate services under this model?

A. Shared corporate services are provided to the operating utilities, including Empire, by three affiliates, APUC, LUCC and LUSC, in four buckets of affiliate services: (1) APUC, (2) Liberty Utilities corporate services, (3) Liberty Algonquin Business Services ("LABS"), and (4) regional services. Pursuant to this shared services model, certain services are provided to Empire from affiliates and charged based on a direct charge or a defined cost allocation methodology set forth in APUC's CAM, depending on whether a single, or multiple affiliates benefit from the service provided.

B. <u>Description of Shared Services</u>

Q. Please describe the shared services provided by APUC.

A. As the ultimate corporate parent, APUC provides financial management, strategic management, corporate governance, and administrative and support services to all of its subsidiaries. As a publicly traded holding company, APUC has access to the capital markets through the issuance of long-term debt and equity, as well as access to short-term credit facilities, which provides substantial benefits to its regulated utilities and generation facilities for capital projects and operations. APUC incurs and allocates the following types of costs: (i) strategic management costs associated with the board of directors, outside legal services, accounting services, tax planning and filings, insurance, and required auditing; (ii) capital access costs including communications, investor relations, trustee fees, escrow and transfer agent fees; (iii) financial control costs for audit and tax expenses; and (iv) administrative costs related to rent, depreciation, general office expenses.

Q. Please discuss the shared services provided by LUCC.

A. In general, LUCC is the legal employer of employees based in Canada who provide various corporate services that can be divided into three categories – (1) specific services to Liberty Utilities, (2) specific services to Liberty Power or (3) shared services to the entire organization. Services found within the following departments are charged to the regulated utilities: executive, regulatory strategy, energy procurement, operations, utility planning, administration, and customer experience. LUCC employees also provide other administrative and support services shared by both the regulated and unregulated parts of the organization through the LABS business unit. These include the following departments: information technology, human resources, training, environment, health, safety and security, procurement, executive and strategic management, technical services, risk management, financial reporting, planning and administration, treasury, internal audit, external communications, legal, and compliance.

Q. How does LUSC fit into this business model?

A. The purpose of LUSC is simple—LUSC is the legal employer of most US-based employees who provide support to regulated utilities. LUSC employees generally can be placed into four categories – (1) utility dedicated employees, (2) employees who provide shared services to Liberty Power and Liberty Utilities, (3) employees who provide corporate support to all Liberty Utilities affiliates, and (4) regional employees who provide shared services to support the utilities within one of the operating regions (East, Central or West). Like its Canadian counterpart LUCC, certain LUSC employees who provide shared services to Liberty Utilities and Liberty Power do so through the LABS business unit.

Q. Please further describe the shared services provided by LABS.

A. As stated above, LABS is a business unit within both LUCC and LUSC that serves both regulated and unregulated entities. Specific examples of these services include: (i) budgeting, forecasting, and issuing consolidated and stand-alone financial statements; (ii) treasury functions including cash management (including electronic fund transfers, cash receipts processing), and managing short-term borrowings and investments with third parties; (iii) development of human resource policies and procedures; (iv) selection of information systems and equipment for accounting, engineering, administration, customer service, emergency restoration and other functions and implementation thereof; (v) development, placement and administration of insurance coverages and employee benefit programs, including group insurance and retirement annuities, property inspections and valuations for insurance; (vi) internal audit providing assurance and advisory services in the areas of governance, risk management and internal control, and (vii) purchasing services including preparation and analysis of product specifications, requests for proposals and similar solicitations, and vendor and vendor-product evaluations.

Q. Please explain Liberty Utilities' regional operating structure.

A. In addition to APUC, Liberty Utilities, and LABS, the various operating utilities are organized under a regional structure. This regional organization acts as a "connective tissue" between the corporate entities and individual local operating utilities to provide a more effective management and reporting hierarchy. This "matrix" regional structure offers several benefits. First, it allows the regional Presidents and state Presidents or commodity Vice Presidents to focus on overall local utility operations, state utility commission processes, customer satisfaction and community relations rather than managing individuals with a wide range of functional responsibilities. Second, this regional structure allows for a sharing of expertise across state lines and provides for some common support functions that would be too cumbersome to provide at a corporate level and too costly to support at an individual state/utility level. Lastly, the regional structure provides for a manageable span of control for the number of individuals reporting to a single manager.

Empire is included in Liberty Utilities' Central operating region, which consists of electric, natural gas, water and wastewater utilities located in Missouri, Illinois, Iowa, Arkansas, Kansas, and Oklahoma.

Q. What benefits does Empire receive from this shared service model?

A. As discussed earlier, Empire receives numerous benefits from the shared services provided under this model.

1. *Access to Skilled Strategic Management*. This means Empire enjoys access to wide ranging expertise and resources at lower costs. That is a direct result of the nationwide utility footprint of Liberty Utilities and is a direct result of our shared services model.
2. *Controls and Processes*. Through this business model, controls and processes are in place to ensure that accounting methodologies are consistent with generally accepted accounting principles. That means that Empire benefits from sound accounting, capital investment and operational expertise.
3. *Economies of Scale*. By sharing nationwide and regional resources with other utilities, Empire enjoys the benefits of lower overall cost structures while at the same time maintaining a local flavor in its day-to-day operations and customer contact. Further, as the Liberty Utilities portfolio grows, its overall costs will

increase proportionally less than they would if Empire was operating without this support.

4. *Access to Capital*. APUC is the entity that is traded on the Toronto Stock Exchange and New York Stock Exchange and ensures that Empire has uninterrupted access to capital. Through this business model, Liberty Utilities and its regulated utilities (including Empire) have substantial access to capital (both debt and equity) to fund utility operations, improvements and acquisitions.

Q. Have you prepared a Schedule demonstrating the services provided by this shared services model?

A. Yes, attached as **Direct Schedule JMS-1** is a narrative and pictorial explanation of the shared services provided by APUC and Liberty Utilities to Empire. As set forth in that narrative, corporate services are provided by APUC executives, along with the finance, treasury, information technology, legal, governance, compliance, human resources, and operations departments within LUCC and LUSC. **Direct Schedule JMS-1** provides a summary of the various services provided to Empire and the other regulated utilities from each department.

C. Cost Allocation Manual

Q. What is the purpose of the CAM?

A. The CAM is intended to govern all affiliate transactions and provide transparency into the requirements, processes, procedures and methodologies used to determine, define, and assign costs to regulated utilities, including Empire. The CAM defines pricing and processes for affiliate charges and is designed to prevent regulated utilities from subsidizing unregulated operations. The fundamental premise of the CAM is to direct charge costs as much as possible and to use reasonable allocation factors when costs cannot be directly assigned.

Q. Can you please generally describe the CAM?

A. The CAM outlines the services provided by APUC, LUCC, and LUSC and prescribes the methods used to distribute the costs for those services. Costs include both direct charges to specific entities and the allocation of indirect costs for services that benefit the entire organization. Specifically, the CAM outlines the methods of direct charge and indirect cost allocations between (1) APUC and Liberty Power, Liberty Utilities and its international subsidiaries in Chile and Bermuda; (2) LUCC and Liberty Power/Liberty Utilities; (3) LUCC and the regulated utility subsidiaries; (4) LUSC and Liberty Power/Liberty Utilities; (5) LUSC and its the regulated utility subsidiaries; and (6) regional allocations.

The CAM is based on the National Association of Regulatory Utility Commissions ("NARUC") Guidelines for Cost Allocations and Affiliate Transactions. The NARUC Guidelines are attached as Appendix 1 to the CAM. The APUC CAM is attached to my testimony as **Direct Schedule JMS-2**.

Q. Can you summarize the key principles from the NARUC Guidelines that are embodied in the CAM?

A. Yes. The CAM utilizes the following cost allocation principles as stated in the NARUC Guidelines:

1. To the maximum extent practicable, costs should be directly assigned (NARUC Guidelines at 2, § B.1).
2. The general method for charging indirect costs should be on a fully allocated cost basis (NARUC Guidelines at 2, § B.2).

3. To the extent possible, all direct and allocated costs should be traceable on the books of the applicable regulated utility to the applicable Uniform System of Accounts and documentation should be available to the appropriate regulatory authority upon request (NARUC Guidelines at 2, § B.3).
4. Allocation methodologies should prevent subsidization and ensure equitable cost sharing among regulated and unregulated affiliates (NARUC Guidelines at 2-3, § B.4).
5. All costs should be classified as regulated, non-regulated, or common to both (NARUC Guidelines at 3, § B.5).
6. The primary cost driver of common costs should be identified and used to allocate the cost between regulated and non-regulated affiliates (NARUC Guidelines at 3, § B.6).
7. The indirect costs of each business unit, including the allocated costs of shared services, should be spread using relevant cost allocators (NARUC Guidelines at 3, § B.7).

Q. Is there a Missouri specific Appendix that is part of the APUC CAM?

A. Yes, a Missouri-specific Appendix is attached to APUC's CAM, which contains additional terms and conditions applicable to Empire, The Empire District Gas Company ("Empire Gas"), Liberty Midstates and Missouri Water (collectively, the "Missouri Regulated Utilities"). The Missouri-specific Appendix must be read and followed in conjunction with the entire APUC CAM. The APUC CAM applies to all subsidiaries of APUC, including the Missouri Regulated Utilities. The Missouri-specific Appendix only applies to APUC and its affiliates, other than the Missouri Regulated Utilities, to the extent required by the Commission's affiliate transaction rules or as specifically stated in the Appendix. For clarity, when I use "CAM" throughout this testimony, I am referring to the APUC CAM, including the Missouri-specific Appendix.

D. <u>Cost Allocation Methodologies</u>

Q. How are APUC costs assigned to the operating units?

A. APUC costs are pooled and allocated to Liberty Utilities, Liberty Power and the Chile and Bermuda subsidiaries using the "multi-factor" methodologies for the various types of costs shown below and summarized in Table 1 of the CAM.

Cost Type	Allocation Methodology	
	Allocation Factor	Weighting
Legal Costs	Net Plant Number of Employees O&M Expenses	33.3% 33.3% 33.3%
Tax Services	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Audit	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Investor Relations	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Director Fees & Insurance	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Licenses, Fees & Permits	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Escrow and Transfer Agent Fees	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Other Professional Services	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Other Administration Costs	# of Oakville Employees # of Total Employees	50.0% 50.0%
Executive & Strategic Management	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%

The portion of APUC costs attributable to Liberty Utilities is further allocated to the regulated utilities based on the Utility Four-Factor Methodology defined in Table 2 of the CAM.

Utility Four-Factor	
Allocation Factor	**Weighting**
Customer Count	40%
Utility Net Plant	20%
Non-Labor Expenses	20%
Labor Expenses	20%
Total	**100%**

Q. How are LUCC costs incurred for regulated utilities charged to Liberty Utilities, including Empire?

A. In cases when LUCC provides corporate services for the direct benefit of Empire, the associated costs are directly assigned to Empire. When LUCC costs are incurred for the benefit of all regulated utilities, however, those costs are allocated to the regulated utilities, including Empire, using the Utility Four-Factor Methodology defined in the CAM and reflected above.

Q. How are shared services costs incurred through the LABS business unit within LUCC and LUSC charged to the regulated operating utilities, including Empire?

A. Business and corporate services provided through the LABS business unit within LUCC and LUSC are direct charged to the benefiting affiliate whenever possible. Again, however, when shared services provided through LABS are incurred for the benefit of more than one entity, those costs are first allocated between Liberty Utilities and Liberty Power in accordance with the factors and weightings defined in Tables 4a and 4b of the CAM and summarized below.

Cost Type	Allocation Methodology	
	Allocation Factor	Weighting
Business Services		
Information Technology	# of Employees O&M Expenses	90% 10%
Human Resources	# of Employees	100%
Training	# of Employees	100%
Facilities & Building Rent	# of Oakville Employees	100%
EHS&S	# of Employees	100%
Procurement	O&M Expenses Capital Expenditures	50% 50%
Executive & Strategic Management	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Technical Services	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Utility Planning	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Corporate Services		
Risk Management	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Financial Reporting, Planning & Administration	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%
Treasury	Capital Expenditures O&M Expenses Net Plant	25% 50% 25%
Internal Audit	Net Plant O&M Expenses	25% 75%
External Communications	# of Employees	100%
Legal Costs	Net Plant # of Employees O&M Expenses	33.3% 33.3% 33.3%
Compliance	Revenue O&M Expenses Net Plant	33.3% 33.3% 33.3%

Then, the portion of the costs allocated to Liberty Utilities is further apportioned among the regulated operating utilities, including Empire, based on the Utility Four-Factor Methodology.

Q. How are LUSC costs charged to operating utilities?

A. All employee costs, such as salaries, benefits, insurance, etc. are paid by LUSC and direct charged to the extent possible to the regulated utility for which the employee performs work. LUSC employees who provide regulated services in support of all the regulated utilities may directly assign or allocate, based on the Utility Four-Factor Methodology described above, to the operating utilities including Empire. In addition, regional shared services costs (e.g., finance, legal, regulatory, government relations) may be direct charged to Empire, or allocated based on the regional four-factor methodology defined in section 6 the CAM and summarized below.

Regional Four-Factor	
Allocation Factor	**Weighting**
Customer Count	25%
Utility Net Plant	25%
Non-Labor Expenses	25%
Labor Expenses	25%
Total	**100%**

Q. Are shared services models like this common in the utility industry?

A. Yes, based on my knowledge and experience, use of service companies and shared services models are common and widely used in the utility industry.

Q. Why is this approach common in the industry?

A. Because shared services models allow regulated utilities to benefit from economies of scale rather than incurring those costs separately. Fundamentally, shared services models allow regulated utilities to benefit from more services at lower costs.

Q. Has the Commission reviewed and acknowledged the benefits of affiliate transactions under Liberty's shared services model?

A. Yes, in Empire's most recent rate case, the Commission issued an Amended Report and Order in Docket No. ER-2019-0374 dated July 23, 2020 with detailed findings of fact relating to the benefits of Liberty's shared service model. In that decision, the Commission found that "Empire is part of a multi-layered corporate structure. It is directly owned by LUCo, which in turn is owned by a string of affiliated companies, and ultimately by APUC. Empire receives a variety of corporate, administrative and support services from a number of upstream affiliated entities, as well as support services from Liberty Utilities Service Corp (LUSC).[2] In turn, the Commission then made the following findings in that decision among others:

> 333. Liberty Utilities, through LUSC and Liberty Utilities (Canada) Corp., provides some services on a shared basis to Empire where there is an opportunity to realize economies of scale or other efficiencies. These services are provided and charged based on a direct charge or a defined cost allocation methodology as set forth in APUC's Cost Allocation Manual (CAM).
>
> 334. APUC's CAM is based on the National Association of Regulatory Utility Commissions (NARUC) Guidelines for Cost Allocations and Affiliate Transactions. The fundamental premise of those guidelines and the CAM is to directly charge costs as much as possible and to use reasonable allocation factors where allocation of indirect costs is necessary and direct charging is not possible.
>
> 335. All costs incurred that are directly related to a specific affiliate company or business unit are directly charged to that company or business unit. Costs that are not directly related to a specific utility are indirectly allocated between the regulated and unregulated business units using two Corporate Allocation Methods for business services and corporate services as described in the CAM.
>
> 338. APUC provides benefits to its subsidiaries by providing financing, financial control, legal, executive and strategic management and related services. The services provided by APUC are necessary for all affiliates to have access to capital markets for funding of capital projects and operations.
>
> 345. Providing corporate services to a number of affiliates on a centralized basis, as is done for Empire by the APUC upstream affiliates, is expected to be inherently more cost-effective than having each affiliate, including regulated utilities, provide the services for themselves.

[2] Amended Report and Order at p. 129, ¶ 332.

346. For affiliate transactions between regulated and service companies, APUC upstream affiliate charges are calculated at cost, with no profit margin included in the charges to affiliates.

347. Staff supports the concept of centralized provision of services to utilities in the situation where multiple affiliated entities exist under the corporate umbrella, as is the case with Empire.

358. The regulatory concerns when reviewing affiliate transactions include whether the allocated costs reasonably relate to the regulated operations of the utility and are incurred to benefit the utility and its customers, and are not excessive given their intended benefit.

360. The inherent cost efficiencies embedded within the shared services model employed for Empire, and also commonly found with other utilities, is that transfer of services at cost is generally a reasonable alternative to employment of competitive bidding or other market pricing methodology for services received by regulated utilities from service company affiliates. [3]

Q. What was the Commission's conclusion on affiliate costs in that decision?

A. The Commission found that "the affiliate transactions presented under this case, with the exception of the $90 million promissory note as addressed in issue nine, were prudent and complied with the requirements of Commission Rule 20 CSR 240-20.015."[4] ¶ In addition, the Commission concluded that there was "no need for any adjustments to Empire's revenue requirement aside from those identified in issue nine."[5] I also would note that the Commission directed that "Empire's interactions with its affiliates should be reviewed as part of the next rate case" [6] and that "Staff should conduct an audit of the various types of affiliate transactions as part of this review and provide testimony to support its findings."

Q. Did the Company address the issues raised by the question in “"issue 9” described above?

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[3] Amended Report and Order at p- 129-135, ¶¶ 333-360.
4 Id. at p. 135.
5 Id.
6 Id.

A. Yes. As described in the Direct Testimony of Todd Mooney, the Company refinanced the $90 million promissory note from the initial interest rate of 4.53% to 2.079%, thereby addressing the Commission's concerns.

Q. Do you have any further observations regarding the Company's corporate costs?

A. Yes. Since the Commission made its above-referenced findings and conclusions, the principles and logistics underlying corporate costs and affiliate transactions continue to hold true today, and we look forward to working with Staff on its audit of those transactions in this case.

III. <u>ALLOCATIONS TO EMPIRE</u>

Q. What is the amount of corporate costs assigned to Empire during the test year in accordance with the CAM as discussed above?

A. During the test year, Empire received approximately $25.6 million in directly assigned costs from APUC, LUCC and LUSC. The Company also received approximately $22.2 million of indirect allocations from APUC, LUCC and LUSC for shared services allocated and billed from October 2019 through September 2020 in accordance with the methodologies defined in the CAM and discussed in my testimony.

Q. What steps does the Company take to ensure the reasonableness of corporate costs charged to Empire and other regulated utilities under the CAM?

A. As part of the preparation of this application, test year costs collected and allocated by APUC, LUCC and LUSC, including LABS and the Central Region, were reviewed and an adjustment was made to remove approximately $0.1M from the revenue requirement for costs that we do not believe should be borne by our electric customers in Missouri. Specifically, this adjustment removed costs associated with donations, gifts, and corporate engagement activities. While we believe these costs are reasonable and were prudently incurred in the normal course of our businesses and as part of being a good corporate citizen, we believe shareholders should bear the responsibility for these costs.

Q. Is it practical for the Commission to review and approve each and every transaction between Empire and affiliated companies?

A. No. A detailed review of each transaction between Empire and its affiliates would be inefficient for the Commission and the Company given the volume and variety of annual transactions. In a given year, the number of transactions would be in the tens of thousands and involve a myriad of subtypes. The CAM establishes appropriate safeguards, and the Commission has the opportunity to review affiliate costs and associated allocation factors in rate proceedings.

IV. <u>COMPLIANCE WITH THE COMMISSION'S AFFILIATE TRANSACTIONS RULES</u>

Q. Are there Missouri regulations that govern a utility's transactions with affiliates?

A. Yes, 20 CSR 4240-20.015 and 20 CSR 4240-40.015 of the Missouri Code of State Regulations address affiliated transactions for electric and gas utilities, respectively. Here, the APUC CAM applies to both Empire Electric and Empire Gas. Those regulations are intended to prevent regulated utilities from subsidizing nonregulated operations. Put simply, the regulations are designed to prevent unfair or preferential treatment of affiliates to the detriment of the Company's customers and other competitive market participants. To accomplish this, the Rules set forth financial and evidentiary standards and recordkeeping requirements applicable to affiliate services and transactions. The rules are intended to provide the public and utility customers assurance that rates are not adversely impacted by unregulated activities.

Q. Has the Commission described the intent of the affiliate transaction rules in prior decisions?

A. Yes, in its July 1, 2008 Report and Order in Docket EM-2007-0374, the Commission granted Kansas City Power & Light ("KCP&L") and KCP&L Greater Missouri Operations ("GMO") a variance from the Affiliate Transactions Rule for all transactions between GMO and KCP&L, except for wholesale power transactions, which would be based on rates approved by the FERC. At page 264 of the Commission's Report and Order, the Commission noted that "the purpose of the Commission's Affiliate Transactions Rule is to prevent cross subsidization of regulated utility's non-regulated operations, not to prevent transactions at cost between two regulated affiliates." In the amended decision in Empire's most recent rate case, the Commission also stated that "[a]ffiliated transactions are of concern to the Commission because of the prospect of a regulated utility's customers providing a 'cross-subsidy' to the non-regulated operations of the firm owning both entities, by either paying excessive prices or receiving insufficient revenues from affiliated goods and services." Here, all services provided under the APUC CAM are provided at cost, and the CAM employs methodologies and protocols designed to prevent cross-subsidization of unregulated operations.

Q. Does the CAM satisfy the Commission's Affiliate Transactions Rules?

A. Yes. The APUC CAM, which includes the Missouri-specific Appendix, satisfies the Commission's affiliate transaction rules. The Missouri Appendix satisfies the requirements of Commission Rules 20 CSR 4240-20.015 and 20 CSR 4240-40.015 by providing the criteria, guidelines, and procedures the Missouri Regulated Utilities will follow when engaging in affiliate transactions. The Missouri Rules are intended to prevent regulated utilities from subsidizing non-regulated operations. To do that, the Missouri Rules set forth financial standards and record keeping requirements applicable to any Missouri Public Service Commission regulated electric utility whenever such utility participates in transactions with affiliated entities. Here, Empire participates in corporate transactions with APUC, LUC, Liberty Utilities and LUSC pursuant to the CAM in accordance with the Missouri Rules.

Q. Can you provide an overview of the Commission's Affiliate Transaction Rules.

A. Rule 4240-20.015(3)(D) provides that each regulated electric corporation shall use a "Commission-approved CAM" for transactions involving the purchase of goods or services from an affiliated entity. As noted above, the APUC CAM is applicable to APUC and its subsidiaries, including LUCC, Liberty Utilities, LUSC and Empire. Appendix 9 of the APUC CAM is specific to Empire. Rule 20 CSR 4240-20.015 for Electric Utilities dictates affiliate transaction requirements and restrictions for regulated electric companies.

Rule 4240-20.015(2) contains the operational standards for affiliate transactions. Unless a variance or waiver is obtained, regulated utilities shall not participate in any affiliated transactions that are not in compliance with the Commission's Rules. Except for corporate support functions, a regulated utility shall not provide a financial advantage to an affiliate, meaning that a regulated utility shall not compensate an affiliate for goods or services above the lesser of the fair market price ("FMP") or the fully distributed cost ("FDC") to the regulated utility to provide the goods or services for itself and shall not transfer information, assets, goods, or services of any kind to an affiliate below the greater of the FMP or the FDC. See 20 CSR 4240-20.015(2)(A),(B) and (D).

Further, customer information shall be shared only with consent of the Customer or as otherwise provided by law or commission rules or orders. 20 CSR 4240-20.015(2)(C). Certain disclosures and disclaimers regarding affiliate relationships are required. 20 CSR 4240-20.015(2)(E) and (F). Subsection three contains the evidentiary standards for affiliate transactions. Specifically, when the regulated utility purchases from an affiliate, competitive bids should be obtained or it must be demonstrated why competitive bids are neither necessary nor appropriate, there must be documentation of the same, and a Commission-approved CAM must be used. 20 CSR 4240-20.015(3)(A), (B), and (D). When the regulated utility provides to an affiliate, the regulated utility must consider, calculate, allocate, and document costs and the fair market price. 20 CSR 4240-20.015(3)(C).

Subsection four contains record keeping requirements for the regulated utilities, including the requirement that regulated utilities keep their books and records separate from those of its affiliates and that affiliate transaction reports be provided yearly to the Staff of the Commission and the Office of the Public Counsel.

Subsection five contains record keeping requirements for parent corporations and other affiliates, and subsection six deals with access to the records of affiliates.

Subsection seven provides that affiliate transaction records shall be maintained for a period of not less than six years, and subsection eight provides for enforcement of the Commission's Rules. Subsection nine provides that each regulated utility must train and advise its personnel as to the requirements of the affiliate transaction rules.

Q. What are Missouri's requirements for the pricing of services between an electric company and its affiliates?

A. 20 CSR 4240-20.015(2) requires that:

> (A) A regulated electrical corporation shall not provide a financial advantage to an affiliated entity. For the purposes of this rule, a regulated electrical corporation shall be deemed to provide a financial advantage to an affiliated entity if—1. It compensates an affiliated entity for goods or services above the lesser of: A. The fair market price; or B. The fully distributed cost to the regulated electrical corporation to provide the goods or services for itself; or 2. It transfers information, assets, goods or services of any kind to an affiliated entity below the greater of: A. The fair market price; or B. The fully distributed cost to the regulated electrical corporation. The requirement that goods or services be provided by the regulated utility to an unregulated affiliated company at the greater of fair market price or the utility's fully distributed cost, while the services provided by the unregulated affiliated company to the regulated utility at the lesser of fair market price or the utility's fully distributed cost is also commonly referred to as "asymmetrical pricing."

Q. Are the services provided to Empire at the fully distributed cost of providing those services?

A. Yes.

Q. Do 20 CSR 4240-20.015 and 20 CSR 4240-40.015 define fully distributed cost?

A. Yes. Section (1)(F) of each rule defines fully distributed cost as "a methodology that examines all costs of an enterprise in relation to all the goods and services that are produced. Fully distributed cost requires recognition of all costs incurred directly or indirectly used to produce a good or service. Costs are assigned either through a direct or allocated approach. Costs that cannot be directly assigned or indirectly allocated (e.g., general and administrative) must be included in the fully distributed cost calculation through a general allocation."

Q. Are costs allocated to Empire through the CAM market based?

A. Yes. APUC and the other affiliates provide shared services at cost, without mark-up or profit, where the costs consist primarily of the wages, salaries and benefits of APUC and Liberty employees. The cost allocations are based, in part, on the wages, salaries and benefits APUC and Liberty pays to its employees. Those wages, salaries and benefits are set in a competitive environment and are market based. Therefore, it is reasonable to conclude that the allocated costs are market based.

The cost of goods and services provided by APUC and Liberty to its affiliated companies, including Empire, consists of two primary cost components – (1) wages and benefits of shared services employees and (2) goods and materials. As noted above, with regard to wages and benefits, employees of APUC subsidiaries receive market-based salaries. wages and benefits. To ensure that the employees are provided a reasonable compensation package, the Human Resources department routinely benchmarks total compensation packages (i.e., wages and benefits) against local, regional and national companies.   We closely monitor salaries, wages and benefits in the marketplace to ensure we are competitive and fair in the market.

In addition, APUC, LUCC and other affiliates procure labor and other goods and services from contractors at market prices and using competitive bidding processes. In turn, subsequent charging for those services at cost means that the cost of goods and services provided to Empire can reasonably be concluded to be both priced at or below market and priced at cost. This is because the wages and benefits paid to employees are routinely benchmarked and, similarly, APUC and its subsidiaries use procurement policies and procedures for non-employee-related costs that are also designed to ensure that good and services are obtained at market prices.

Q. Do APUC, LUCC or any of their affiliates profit from the affiliate services provided to Empire?

A. No. APUC, LUCC and other affiliates provide goods and services to Empire at cost, without mark-up or profit. There is no profit margin for APUC, LUCC or any of our other affiliates included in the cost allocations.

Q. Are the costs of services the same as if Empire were to self-provide the services?

A. No, it is highly likely that due to the economies of scale realized by centralizing the shared services from APUC, LUCC, LUSC, LABS and the regions, the services are provided at a cost lower than if Empire were to self-provide the services on a standalone basis.

Q. Please explain.

A. There are inherent efficiencies realized by sharing costs across Empire and all of our regulated utilities, as opposed to requiring each operating company to individually perform each service. Given that APUC, LUCC, LABS, LUSC and the regions provides services to affiliated companies, APUC, LUCC, LABS and LUSC are likely able to perform those services with fewer people, and thus at a lower cost, than if Empire and each utility were to be individually fully staffed to provide all of those services. In other words, there are economies of scale realized by consolidating similar functions across our entire footprint.

Q. Is it possible that Empire could potentially be subsidizing non-regulated affiliates?

A. No, as previously mentioned, our corporate services are provided at cost, which is determined by prevailing wages/benefits and actual incurred expenses. Further, we take numerous steps to prevent subsidization by utility customers to unregulated affiliates. The pricing of affiliated services has a material effect on which jurisdiction's customers are responsible for, and benefit from, the cost of providing a service. Put another way, the cost standard for affiliate transactions under our CAM is reasonable and appropriate and avoids cross subsidizations.

Q. Please further explain the purpose of the Missouri-specific Appendix and how it satisfies the requirements of Commission's Affiliate Transaction Rules.

A. The CAM attached hereto, including Appendix 9, was designed to comply with the Commission's affiliate transaction rules and prevent Empire from subsidizing its non-regulated affiliates.

Boiled down, the Missouri-specific appendix to the APUC CAM provides additional criteria, guidelines and procedures for the Missouri Regulated Utilities when engaging in affiliate transactions and prevents these entities from subsidizing their non-regulated operations. In Empire's case, this provision ensures that costs are appropriately allocated between Empire and its unregulated fiber subsidiary, Empire District Industries, Inc. In addition, the Missouri-specific appendix prescribes the cost assignment and allocation methodologies for the direct and indirect assignment and allocations of costs to the relevant regulated business functions and non-regulated business functions.

Q. Has the CAM been previously filed with the Commission?

A. Yes. On August 23, 2011, The Empire District Electric Company and The Empire District Gas Company requested the Commission's approval of their then-current CAM (Case No. AO-2012-0062) following the approval of a global agreement in the 2011 general rate case (Case No. ER-2011-0004). On October 20, 2016, the Commission granted a request to suspend the procedural schedule in Case No. AO-2012-0062 on the condition that the utilities file a new CAM application within six months of the closing of the merger with Liberty Utilities Sub Corp. In compliance with the Commission's condition, on June 30, 2017, the Missouri Regulated Utilities filed an application seeking approval of their then-current CAM (Case No. AO-2017-0360) along with requesting a variance from one component of Rules 20 CSR 4240-

20.015(2)(A) and 20 CSR 4240-40.015(2)(A). The Company's application currently is pending before the Commission.

V. <u>COMPLIANCE WITH PRIOR STIPULATIONS AND AGREEMENTS RELATING TO LIBERTY'S ACQUISITION OF EMPIRE</u>

Q. Can you please explain the Stipulation and Agreement in Case No. EM-2016-0213 relating to Liberty's acquisition of Empire and its impact on these cost allocation and affiliate transaction issues?

A. Yes. In Docket EM-2016-0213, Empire, Liberty Utilities (Central) Co., Liberty Sub Corp., and APUC ("Liberty") filed an application for approval of Liberty's acquisition of Empire. During those proceedings, Liberty entered a separate Stipulation and Agreement with Commission Staff, the Office of Public Counsel and other parties, each as a comprehensive settlement of all issues for those parties pertaining to Liberty's application for approval of its acquisition of Empire. In my testimony, I address the relevant portions of those agreements that relate to affiliate services and cost allocations.

Q. Has Empire complied with paragraph E(1) of the Stipulation and Agreement with Staff which provides: "Empire is to be operated after the purchase in compliance with the affiliate transaction rule, or will obtain any necessary variances from the MoPSC's affiliate transaction rule as defined in 4 CSR 240-20.015(10) and 4 CSR 240-40.015(10)"?

A. Yes, Empire has complied with that condition. As stated above, the APUC CAM and shared services model complies with the Commission's affiliate transaction rules and the Commission made that finding in the July 20, 2020 Amended Report and Order in Docket No. ER-2019-0374.

Q. Paragraph E(2) of the Staff Agreement states that "Algonquin Power & Utilities Corp. and its subsidiaries will commit that all information related to an affiliate transaction consistent with 4 CSR 240-20.015(5)(A)(1)-(2) and 4 CSR 240-40.015(5)(A)(1)-(2) charged to Empire will be treated in the same manner as if that information is under the control of Empire." Has that condition been met?

A. Yes. All affiliate transaction information relating to the CAM and corporate allocations from APUC and its affiliates is available and accessible to Empire as if such information was under the control of Empire.

Q. Paragraph E(3) of the Stipulation and Agreement with Staff states that "Empire will provide no preferential service, information, or treatment to an affiliated entity over another party at any other time, consistent with 4 CSR 240-20.015(2) and 4 CSR 240-40.015(2)." Has that condition been met?

A. Yes, Empire does not and has not provided any preferential treatment to an affiliate over another party.

Q. Are shared services costs charged directly to the extent practicable in accordance with paragraph 12 of the Stipulation and Agreement with OPC?

A. Yes. In accordance with the CAM, and the underlying NARUC guidelines, costs are direct charged to the extent practicable. In the event that costs cannot be direct charged, they are allocated to Empire in accordance with the methodologies defined in the CAM.

Q. Has Empire provided copies of all external audit reports performed for APUC and Liberty Utilities shared services pertaining directly or indirectly to determinations of direct billings or cost allocations to Empire, as required by paragraph 13 of the OPC Agreement?

A. Yes. Empire has provided copies of its reports for indirect overhead capitalization studies prepared and reviewed by an independent third-party, which are the only external audit reports that meet this criteria.

Q. Paragraph 14 of the Stipulation and Agreement with OPC states: "Within Empire's next general rate case, Empire will provide upon request a list of proceedings, if any, where Liberty Utilities Co's cost allocation practices have been audited in any other jurisdictions. Has Empire complied with this requirement?

A. Yes. Empire is compliant with this stipulation. At the time of Empire's "next general rate case" following the acquisition by Liberty (Case No. ER-2019-0374) Liberty's allocation practices had not been audited by a third party in any other jurisdiction. In April 2021, however, Liberty engaged PricewaterhouseCoopers ("PwC") to perform an independent review of the CAM. Within thirty (30) days of the conclusion of the review, Empire will provide a copy of PwC's final report.

Q. Has Empire complied with paragraph 15 of the OPC Stipulation which provides "Applicants will notify the Commission Staff and the OPC within thirty days anytime there 1) is an addition or deletion of an affiliated entity that provides services to, or receives services from, Empire; 2) an addition or deletion of an unregulated service provided by Empire; or 3) an addition or deletion of a regulated service by Empire for which a tariff has not been approved"?

A. Yes. In March and May 2020 and February 2021, Empire provided notice to Staff and OPC of affiliated interest agreements regarding the Company's wind generation projects.

Q. Finally, paragraph 16 of the OPC Agreement states "Either the Staff or the OPC can request an independent attestation agreement of the CAM related to non-regulated affiliates and activities." Have the Staff or the Commission or OPC requested an independent attestation engagement of the CAM related to non-regulated affiliates and activities?

A. No.

VI. CONCLUSION

Q. Please briefly summarize your Direct Testimony.

A. The shared services model serves an important role in the efficient and cost-effective administration and operation of Empire. Through that model, Empire receives services vital to the day-to-day operations of the utility. APUC provides benefits to its subsidiaries by providing financing, financial control, legal, executive and strategic management and related services. The services provided by APUC are necessary for all affiliates, including Empire, to have access to capital markets for funding of capital projects and operations. In addition, the allocation of shared services from APUC, LUCC, and LUSC maximizes economies of scale and expertise while minimizing redundancy. Further, the APUC CAM is comprehensive, logical and transparent in its methodologies for application of affiliate chargers. The CAM complies with the Commission's Affiliate Transaction Rules and provides necessary and adequate safeguards to protect Empire's customers from potential harm from affiliate transactions. Commissions and stakeholders typically are concerned about (i) issues relating to customer protections from affiliate transactions, (ii) pricing of affiliates services, (iii) potential subsidization or preferential treatment of unregulated businesses, and (iv) appropriate recording keeping and affiliate training, among other issues. APUC's CAM addresses each of those issues appropriately.

Q. Does this conclude your Direct Testimony at this time?

A. Yes.

VERIFICATION

I, Jill Schwartz, under penalty of perjury, on this 28th day of May, 2021, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Jill Schwartz