

Exhibit No.
Issue: Empire Cost Allocations
Witness: Robert W. Sager
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Electric
Case No.: AO-2012-0062
Date Testimony Prepared: September 2016

**Before the Public Service Commission
of the State of Missouri**

Direct Testimony

of

Robert W. Sager

September 2016



DIRECT TESTIMONY
OF
ROBERT W. SAGER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. AO-2012-0062

1 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS**
2 **MATTER?**

3 A. I will provide a brief description of The Empire District Electric Company's
4 ("Empire" or "EDE") corporate structure and a brief history of Empire's cost
5 allocation manual ("CAM"), explain why Empire sought approval of its CAM
6 when it did, and provide support for approval of Empire's proposed CAM by the
7 Missouri Public Service Commission ("Commission").

8 **Q. PLEASE BRIEFLY DESCRIBE EMPIRE'S CORPORATE STRUCTURE.**

9 A. Empire and The Empire District Gas Company ("EDG") are Kansas corporations.
10 EDE is generally engaged in the business of providing electric and water utility
11 services to customers in its service areas. EDE is an "electrical corporation," a
12 "water corporation," and a "public utility" as those terms are defined in RSMo.
13 §386.020. EDI, a wholly owned subsidiary of EDE, provides fiber optic services.
14 EDG is also a wholly owned subsidiary of EDE. EDG provides natural gas service
15 to customers in its service area, which is entirely within the state of Missouri, and is
16 a "gas corporation" and a "public utility" as those terms are defined in RSMo.
17 §386.020. While EDE does have wholly owned subsidiaries, it is not considered a
18 "holding company" as that term is commonly used. EDE provides electricity (and

1 water) and operational services for its customers whereas a holding company
2 typically exists for the purpose of controlling other companies or managing
3 financial assets for multiple companies.

4 **Q. WHEN DID EMPIRE FIRST SEEK THE COMMISSION’S APPROVAL OF**
5 **THE CAM?**

6 A. Empire filed its CAM, attached hereto as Schedule 1, and a request for Commission
7 approval herein on August 23, 2011. That was the first time Empire sought formal
8 Commission approval of its CAM. Prior to 2011, it was common practice for
9 Missouri’s investor-owned utilities to submit their CAMs to Staff, but not seek
10 formal Commission approval of the CAM.

11 **Q. WHY DID EMPIRE FILE ITS CAM AND A REQUEST FOR APPROVAL**
12 **IN 2011?**

13 A. Paragraph six of a Global Agreement, approved by the Commission effective June
14 6, 2011, in Case No. ER-2011-0004, provides that “Empire agrees to file for
15 Commission approval of its Cost Allocation Manual (CAM).” Empire filed its
16 CAM and initiated this proceeding to comply with the 2011 rate case settlement.
17 Also, Commission Rule 240-20.015(3)(D) provides that regulated electric
18 corporations shall use a “Commission-approved CAM” for transactions involving
19 the purchase of goods or services from an affiliated entity, and Commission Rule
20 240-40.015(3)(D) provides that regulated gas corporations shall use a
21 “Commission-approved CAM” for transactions involving the purchase of goods or
22 services from an affiliated entity. EDE, EDG, and EDI are affiliates under these
23 Commission rules.

1 **Q. WHAT IS A CAM?**

2 A. Generally, a CAM is a set of documented guidelines and procedures that explains
3 the cost assignment methods and cost allocation policies and procedures used to
4 properly distribute and record costs attributable to various affiliates.

5 **Q. HOW MANY YEARS HAS EMPIRE USED THE CAM THAT WAS**
6 **SUBMITTED FOR COMMISSION APPROVAL IN 2011?**

7 A. Empire's CAM has been in place since 2001. Although Empire has added new
8 business units and also closed business units, these actions did not affect Empire's
9 methodology related to allocating various costs between its affiliates. When EDG
10 was acquired, Empire's CAM was revised to add the gas business unit, but Empire
11 continued to use the same cost allocation methodology and overall calculations.

12 **Q. DOES EMPIRE PROVIDE ITS CAM TO STAFF?**

13 A. Yes. Empire's CAM has been submitted annually to the Staff since the inception of
14 its CAM in 2001.

15 **Q. HAS STAFF SUGGESTED ANY CHANGES TO EMPIRE'S CAM?**

16 A. The first time Staff suggested changes to Empire's CAM was in this docket. Staff
17 and The Office of the Public Counsel ("OPC") also proposed certain changes in
18 Empire's cost allocation methodology in Empire's most recent rate case, Case No.
19 ER-2016-0023.

20 **Q. HAS EMPIRE'S CAM BEEN REVISED SINCE 2011?**

21 A. Yes, minor changes have been made. Empire's current CAM, which was submitted
22 to Staff on March 14, 2016, is attached hereto as Schedule 2. The CAM currently
23 being used by Empire (Schedule 2) differs from the CAM submitted for approval in

2011 (Schedule 1) only in the following respects: 1) rates have been appropriately updated each year; 2) accounts payable allocations are determined based on “lines keyed” as opposed to vouchers due to an upgrade of PeopleSoft and the ability to query for the lines; and, 3) regulated vehicles are allocated for possible non-regulated use of the vehicle.

Q. HAVE OPC AND OTHER STAKEHOLDERS HAD THE OPPORTUNITY TO REVIEW EMPIRE’S CAM?

A. Yes. The methodology used in Empire’s CAM and the various cost assignments included in the CAM have been incorporated in all of the rate cases that have been filed by Empire during the past 15 years. Staff, OPC, and other stakeholders have had the opportunity to review Empire’s CAM multiple times in these previous proceedings.

Q. HAVE STAFF, OPC, AND/OR ANY OTHER STAKEHOLDER RAISED CONCERNS REGARDING THE METHODOLOGY USED IN EMPIRE’S CAM AND THE VARIOUS COST ASSIGNMENTS INCLUDED IN THE CAM IN ANY EDE OR EDG RATE CASE?

A. The methodology used in Empire’s CAM and the various cost assignments included in the CAM have not been questioned or criticized by Staff, OPC, or any other stakeholder in an EDE or EDG rate case until EDE’s most recent rate case, Case No. ER-2016-0023.

Q. HAVE SIGNIFICANT CONCERNS BEEN RAISED BY STAFF, OPC, OR OTHER STAKEHOLDERS REGARDING EMPIRE’S ALLOCATIONS PRESENTED DURING AN EMPIRE WATER RATE CASE?

1 A. No. Costs allocated during recent Empire Water rate cases were discussed and did
2 not cause significant adjustments by Staff in determining the outcome of Empire
3 Water rate cases.

4 **Q. PLEASE QUANTIFY THE LEVEL OF COMMON CORPORATE COSTS**
5 **THAT EDE ALLOCATES TO ITS TWO AFFILIATES.**

6 A. Under its existing CAM (Schedule 2), Empire has allocated approximately \$2.3
7 million to EDG annually and approximately \$588,000 to EDI annually, for a total
8 of almost \$2.9 million annually. These costs are assigned or allocated monthly on
9 Empire's records, so any given twelve month rate case test period would reflect this
10 CAM allocation process, with Empire's electric revenue requirement being reduced
11 as a result.

12 **Q. ARE EDE AND EDG CURRENTLY IN COMPLIANCE WITH THE**
13 **COMMISSION'S AFFILIATE TRANSACTION RULES?**

14 A. Yes. The CAM, attached hereto as Schedule 2, is in compliance with the
15 Commission's electric and gas affiliate transaction rules. Also, affiliate transactions
16 involving EDE, EDG, and/or EDI are conducted in compliance with the
17 Commission's rules, including the electric and gas affiliate transaction rules.

18 **Q. HAVE OTHER PARTIES PROPOSED CAMS FOR EMPIRE'S**
19 **CONSIDERATION?**

20 A. Yes. Staff proposed a CAM for Empire's review and consideration in the context of
21 settlement discussions in this docket and later filed that CAM in EFIS. Also, in
22 EDE's most recent rate case, Case No. ER-2016-0023, OPC filed a CAM and
23 requested that the Commission order Empire to adopt it as part of that rate case.

1 OPC later filed that CAM in this docket.

2 **Q. DOES EMPIRE BELIEVE THE CAM PROPOSED BY OPC WOULD BE**
3 **APPROPRIATE FOR USE BY EMPIRE?**

4 A. No. Empire's CAM was designed to reflect the structure and characteristics of
5 Empire's operations. On the other hand, it appears that OPC's proposal was
6 basically developed by Staff for another utility operating in Missouri, whose
7 operations and organization are quite different than Empire's. In addition, to
8 Empire's knowledge, the CAM used as a template for the CAM proposed by OPC
9 has not been approved by the Commission for use by any Missouri utility.

10 **Q. HOW DOES OPC'S PROPOSAL DIFFER FROM EMPIRE'S CAM?**

11 A. OPC did not start with Empire's CAM and make changes. Instead, OPC has
12 proposed a completely different CAM for use by Empire. Empire is not aware of
13 the cost allocation changes that would result from the implementation of OPC's
14 proposal, nor is Empire aware of how the OPC proposal would impact Empire's
15 customers.

16 **Q. YOU STATED THAT OPC'S PROPOSAL WAS BASED ON A CAM**
17 **DEVELOPED BY STAFF FOR ANOTHER UTILITY. WHAT UTILITY IS**
18 **THAT?**

19 A. It is my understanding that OPC's proposal in EDE's rate case, and now in this
20 docket, is based on a draft of the CAM being developed for Kansas City Power &
21 Light Company ("KCPL"). It is my understanding that OPC's CAM has not yet
22 been approved by the Commission for KCPL.

23 **Q. WHAT IS THE PURPOSE OF THE REMAINDER OF YOUR DIRECT**

1 **TESTIMONY?**

2 A. The remainder of my direct testimony will outline what Empire believes would be
3 acceptable additions to its existing CAM compared to the CAM filed by Staff in
4 this docket.

5 **Q. WHAT SECTIONS OF STAFF’S PROPOSED CAM IS EMPIRE WILLING**
6 **TO ADD TO ITS EXISTING CAM?**

7 A. Empire has reviewed Staff’s proposed CAM and could work with the parties to add
8 language regarding the following: definitions and terms section; implementation of
9 a formal CAM team; revising the specific components of the denominator in the
10 Massachusetts formula; and formal CAM training.

11 **Q. IS EMPIRE ABLE TO ADD THE LANGUAGE DIRECTLY FROM**
12 **STAFF’S PROPOSED CAM?**

13 A. No. Staff’s proposed language is written from Staff’s perspective and includes
14 language that recites the Commission’s rules and regulations themselves, which
15 Empire believes is not necessary.

16 **Q. PLEASE EXPLAIN IN MORE DETAIL THE CONCEPTS WHERE THERE**
17 **IS AGREEMENT BETWEEN STAFF AND EMPIRE.**

18 A. Empire believes its CAM could be improved by having a more comprehensive list
19 of terms and definitions. The Staff is suggesting a formal team be established and
20 responsible for the review and any compliance filings that may be necessary.
21 Empire believes this is a reasonable request.

22 Staff has also suggested that certain allocated costs should not be included in the
23 denominator of the general allocator used in Empire’s CAM. In Empire’s CAM, a

Massachusetts formula calculation is used as the general allocator. Although there is not complete agreement between Staff and Empire on this point, Empire agrees that the exclusion of certain costs in the denominator of the Massachusetts formula would be an improvement. Based on our recent review of the revision to this calculation, this refinement in the calculation does not have a significant impact on the costs allocated to EDI or EDG.

Finally, a training section is included in Staff's proposed CAM. Empire supports the addition of language requiring training, although Empire does not support the inclusion of Staff's language. Training should be updated and revised when circumstances warrant. Putting detailed requirements in the document, as proposed by Staff, may cause unnecessary revisions to the CAM.

Q. ARE THERE SECTIONS OF STAFF'S PROPOSED CAM THAT SHOULD NOT BE INCORPORATED INTO EMPIRE'S CAM?

A. Yes. The opening section of Staff's CAM, labeled as Tab A, recites some of Empire's history and refers to and quotes some of the Commission's affiliate rules. This section is unnecessary and could be problematic. The inclusion of the history of Empire does not assist Empire with its compliance with the Commission's affiliate rules. Also, any change in the rules would require an amendment to the CAM, if the rules are quoted in the CAM.

Staff has also included a different allocation method for common costs which it refers to as the "general allocator". Staff included a brief description of the components of the general allocator calculation but did not provide an example of how the calculation would be performed. It is not clear to Empire, based on

1 Empire's discussions with Staff, why Staff believes this method is preferable over
2 Empire's current general allocator. The Massachusetts formula has been utilized by
3 Empire for more than 15 years and is commonly used in the industry. Since the
4 specific components of the Staff's method are unclear, Empire cannot be sure
5 whether Staff's general allocation method is even appropriate for Empire. As
6 previously noted, Empire's corporate structure is not similar to the other public
7 utilities in Missouri. Empire contends that the Massachusetts formula, with specific
8 changes, is still appropriate for Empire's structure and complies with the
9 Commission's rules.


10 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

11 **A.** Yes, at this time.

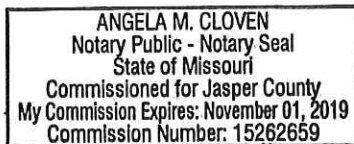
AFFIDAVIT OF ROBERT W. SAGER

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 9th day of September, 2016, before me appeared Robert W. Sager, to me personally known, who, being by me first duly sworn, states that he is the Controller, Assistant Secretary, Assistant Treasurer, and Principal Accounting Officer of The Empire District Electric Company and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.


Robert W. Sager

Subscribed and sworn to before me this 9th day of September, 2016.




Notary Public

My commission expires: 11/01/2019.