

Exhibit No.
Issue: Operations, Integration,
Gas Supply, Environmental and
Miscellaneous
Witness: Ronald F. Gatz
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District
Case No: GO-2006-0205
Date Testimony Prepared: November 2005

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

Direct Testimony

Of

Ronald F. Gatz

November 2005

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OF
RONALD F. GATZ
ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION**

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DIRECT TESTIMONY
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ON BEHALF OF
THE EMPIRE DISTRICT ELECTRIC COMPANY
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MISSOURI PUBLIC SERVICE COMMISSION
CASE NO: GO-2006-0205

1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Ronald F. Gatz and my business address is 602 Joplin Street, Joplin,
4 Missouri 64801.

5 **Q. WHO IS YOUR EMPLOYER AND WHAT POSITION DO YOU HOLD?**

6 A. I am employed by The Empire District Electric Company (“Empire” or
7 “Company”) as Vice President-Strategic Development.

8 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.**

9 A. I hold a Bachelor of Science Degree in Agricultural Economics from Kansas State
10 University, Manhattan, Kansas and a Graduate Degree in Banking from The
11 Stonier Graduate School of Banking, University of Delaware.

12 **Q. PLEASE INDICATE YOUR PROFESSIONAL EXPERIENCE.**

13 A. Prior to joining Empire I worked in the banking industry and most recently as
14 Executive Vice President, Senior Credit Officer and Chief Financial Officer of a
15 regional bank. I also was Chief Administrative Officer of a national specialty
16 carrier. I joined Empire as General Manager Non-regulated Services in 2001.

1 **PURPOSE**

2 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

3 A. My testimony will describe the process Empire used to acquire the Aquila, Inc.
4 Missouri natural gas assets (the “Business”) and describe how Empire plans to
5 integrate and operate the natural gas system, replace the service functions
6 currently provided by Aquila on a centralized basis, discuss Empire’s plan for gas
7 procurement and management, discuss environmental issues and outline what
8 Empire and Aquila are asking the Missouri Public Service Commission
9 (“Commission”) to approve in this case.

10 **ACQUISITION PROCESS**

11 **Q. WHAT WAS YOUR ROLE IN THE ACQUISITION OF THE BUSINESS?**

12 A. I was in charge of leading a team that analyzed the Business and negotiated the
13 Asset Purchase Agreement with Aquila. I currently serve as Empire’s primary
14 point of contact for the transaction. My duties also include leading the transition
15 efforts and leading a team that will integrate the Business with Empire’s existing
16 regulated operations.

17 **Q. PLEASE DESCRIBE THE SALE PROCESS USED BY AQUILA.**

18 A. Aquila announced its interest in selling the Business in March of 2005. After
19 receiving this proposal from Aquila, which included some limited financial
20 information covering Aquila’s Missouri gas operations, Empire retained UBS as a
21 financial advisor for the project and proceeded to formulate, with UBS assistance,
22 its initial non-binding offer on the Business. The initial offers were used by
23 Aquila to identify finalists in the bidding process. Empire was one of the finalists

1 selected by Aquila. As a finalist in the bidding process, Empire was given access
2 to additional Business financial information, participated in a management
3 presentation given by Aquila and conducted additional due diligence. After
4 completing this additional analysis, Empire submitted its final bid on the property
5 in August 2005. After receiving the Empire bid in August, Aquila entered into
6 negotiations with Empire concerning the sale of the Business. The Asset
7 Purchase Agreement (“APA”) was signed on September 21, 2005.

8 **TRANSACTION**

9 **Q. PLEASE DESCRIBE THE TRANSACTION.**

10 A. The transaction is valued at \$84 million plus closing adjustments per the APA.
11 The transaction is structured as a cash purchase of assets plus the assumption of
12 selected liabilities. We believe the purchase price is reasonable as it is within the
13 valuation range recommended by Empire’s financial advisor based upon industry
14 accepted multiples and transaction comparables. Empire has the financial
15 wherewithal and operating abilities that are necessary to absorb the Business
16 without any negative financial or operating impact to our existing electric
17 operations or the newly acquired natural gas customers.

18 **EFFICIENCIES**

19 **Q. DID EMPIRE IDENTIFY AREAS IN THE BUSINESS OPERATIONS**
20 **WHERE IT CAN REALIZE EFFICIENCIES?**

21 A. Yes. Empire estimated the number of staff additions required by Empire to
22 replace the central services and corporate functions not being transferred. This
23 method focused Empire’s analysis on real costs anticipated to effectively operate

1 the gas utility. This approach led to the conclusion that Empire can spread its
2 overhead costs over a larger customer and asset base to the benefit of both the
3 electric and gas customers. Empire does not expect that the level of incremental
4 overhead costs to be added due to the acquisition of the Business will have any
5 detrimental consequences for its electric operations or the customers of the
6 Business.

7 **BUSINESS STRUCTURE**

8 **Q. HOW DOES EMPIRE PLAN TO OPERATE THE BUSINESS AFTER IT**
9 **IS ACQUIRED?**

10 A. Empire has incorporated a wholly owned subsidiary, The Empire District Gas
11 Company (“EDG”) to own, operate and provide natural gas service in the three
12 gas service areas of the Business. As stated in the Application, EDG has
13 requested authorization from the Commission to adopt the gas tariffs of the
14 Business without any changes. This structure will provide for a basic separation
15 of Empire’s electric and gas operations. Certain central services or support
16 functions will be provided by Empire to both electric and gas operations. This
17 will enable Empire to capture the benefits of its low cost corporate overhead
18 structure for the benefit of its electric and natural gas customers.

19 **Q. PLEASE DESCRIBE THE RESOURCES TO BE TRANSFERRED TO**
20 **EDG.**

21 A. Empire or EDG will offer jobs to all of the current Aquila field employees. These
22 employees represent an experienced and qualified field operations workforce.
23 This workforce includes experienced management, engineering and service center

1 personnel. All employees that accept jobs with EDG are to continue operating the
2 business and serving customers. No employees in central support functions at
3 Aquila will be transferred to Empire as a result of the acquisition. In addition,
4 none of Aquila's central support systems, such as general ledger accounting or
5 billing are part of the transaction. Therefore, all central support functions
6 currently provided to the Business must be provided by Empire. These services
7 include customer care, information technology, insurance, tax, environmental,
8 legal, regulatory, human resources, finance and accounting, treasury, facilities,
9 purchasing and gas supply services.

10 **Q. HOW MANY EMPLOYEES DOES EMPIRE ESTIMATE WILL BE**
11 **ADDED TO ITS OPERATIONS AS A RESULT OF THE ACQUISITION?**

12 A. Our initial analysis of the Business indicates that between 25 and 30 new
13 positions will need to be added primarily due to the elimination of the central
14 support services provided by Aquila. These new positions, among others, include
15 positions in the call center, gas supply and transportation management, accounting
16 and regulatory areas.

17 **Q. WHERE WILL THE NEW POSITIONS BE LOCATED?**

18 A. At this time, it appears that some of the positions will be located on the gas
19 system in the communities served by the Business, with the balance of the jobs
20 located in Joplin at our headquarters facilities.

1 **TRANSITION SERVICES**

2 **Q. HOW WILL THE TRANSFER OF CENTRAL SUPPORT FUNCTIONS**
3 **AND SYSTEMS BE HANDLED AND HOW WILL THE CUSTOMER BE**
4 **IMPACTED?**

5 A. The APA includes terms and conditions related to transition services to be
6 provided by Aquila to Empire in the event Empire finds them necessary. As part
7 of this process, Empire and Aquila are working together on transition planning
8 and specific projects that will ultimately transition all central support functions to
9 Empire or EDG in an effective and efficient manner. This process is designed to
10 eliminate any disruptions in the Business. A transition services agreement is
11 provided for in the APA to continue utilizing existing Aquila services as
12 necessary post closing for any function that cannot be efficiently transferred to
13 Empire prior to closing. In addition, Empire is to receive all historical and
14 planning records and data related to the Business. Both companies are committed
15 to providing superior customer service during and after the transition period to
16 minimize customer impact.

17 **GAS SUPPLY**

18 **Q. HOW WILL EMPIRE MANAGE GAS SUPPLY FOR THE BUSINESS?**

19 A. Empire has had extensive experience procuring and hedging natural gas for its
20 generating units. Historically, our risk management policy has been successful in
21 dampening natural gas price volatility. Furthermore, our risk management policy
22 has resulted in an average cost of natural gas that has been lower than could be
23 acquired on the spot market, due to the constant increase in natural gas prices

1 during the last few years. Our success in mitigating natural gas price volatility is
2 directly related to our natural gas purchasing and risk management policies, which
3 employ a multi-year view of the natural gas markets. We intend to use our
4 procurement expertise and employ the similar risk management tools when we
5 acquire natural gas for the Business.

6 **Q. HOW MUCH NATURAL GAS DOES EMPIRE CONSUME ON AN**
7 **ANNUAL BASIS?**

8 A. We currently manage the purchase and delivery of approximately 9 Bcf of natural
9 gas to our power plants annually.

10 **Q. HOW DO THE NATURAL GAS VOLUMES PURCHASED FOR THE**
11 **EMPIRE POWER PLANTS COMPARE TO THE VOLUMES USED BY**
12 **THE BUSINESS?**

13 A. This volume is essentially equal to the total volume of natural gas transported for
14 delivery by the Business, and is approximately double the gas volume purchased
15 for the Business and resold to customers.

16 **Q. WHAT RESOURCES WILL EMPIRE NEED TO ADD TO ITS FUEL**
17 **PROCUREMENT DEPARTMENT DUE TO THE TRANSACTION?**

18 A. Although Empire is experienced in managing natural gas transportation contracts
19 to deliver natural gas to its generating units, we do not have experience managing
20 natural gas storage, third-party gas brokers (“aggregators”) and multiple natural
21 gas transportation customers and we will have to add resources to manage these
22 aspects of the Business.

1 **Q. IS THIS ONE ASPECT OF THE BUSINESS THAT MAY REQUIRE**
2 **TRANSITION SERVICES FROM AQUILA?**

3 A. Yes. It will depend upon what progress we can make in this area prior to the
4 actual closing date of the transaction. We intend on adding people or resources
5 experienced in the gas management functions as necessary, and we will be
6 installing the other systems that are required to replace the gas management
7 services currently provided by Aquila on a centralized basis. It may also be
8 possible to find a qualified outsource provider for some of these gas management
9 services. This is one of the key areas of the Business that will be addressed by the
10 Empire and Aquila transition teams.

11 **Q. WILL EXISTING NATURAL GAS TRANSPORTATION AND STORAGE**
12 **CONTRACTS BE TRANSFERRED TO EMPIRE WHEN THE**
13 **TRANSACTION CLOSES?**

14 A. Yes. The APA provides for all transportation and storage contracts currently
15 serving the Business to be assigned to EDG at closing.

16 **ENVIRONMENTAL**

17 **Q. ARE THERE ENVIRONMENTAL ASSETS AND LIABILITIES BEING**
18 **TRANSFERRED TO EMPIRE AS PART OF THIS TRANSACTION?**

19 A. Yes.

20 **Q. IS EMPIRE REQUESTING SPECIFIC ACCOUNTING TREATMENT**
21 **RELATED TO THIS ENVIRONMENTAL LIABILITY?**

22 A. Yes. Aquila currently has a liability and corresponding asset that is to be
23 transferred to EDG related to three former manufactured gas plant sites. The

1 estimates for future investigation and remediation costs at the sites were
2 calculated according to the generally accepted accounting principles set forth in
3 GAAP Statement of Position 96-1. EDG is requesting authority to continue to
4 account for these remediation costs in the same manner, in accordance with
5 Statement of Position 96-1 and that to the extent any of these estimated costs are
6 *actually funded* in future periods that they are taken into consideration in future
7 rate cases.

8 **COMMISSION ACTION**

9 **Q. WHAT OTHER COMMISSION APPROVALS ARE THE JOINT**
10 **APPLICANTS REQUESTING IN THE APPLICATION FOR APPROVAL**
11 **OF THE TRANSACTION?**

12 A. There are several. Empire witness Bill Gipson has listed them in his direct
13 testimony. My testimony will explain just what is being requested. In addition,
14 we will present testimony from Don Schisler of Towers Perrin, Empire's actuary,
15 that will provide a detailed explanation of our accounting requests related to
16 pension benefits, Financial Accounting Standard 87 ("FAS 87") and the
17 accounting request related to employees and retirees postretirement welfare
18 benefit cost, Financial Accounting Standard 106 ("FAS 106").

19 **Q. PLEASE CONTINUE.**

20 A. Empire and Aquila are seeking Commission authorization to perform in
21 accordance with the terms of the APA negotiated by the parties. This is required
22 if the APA is to have the meaning the parties intended. In addition, the parties are

1 seeking Commission authorization of the sale, transfer and assignment of the
2 Business as fully outlined in the APA.

3 **Q. IS EMPIRE REQUESTING A CERTIFICATE OR CERTIFICATES OF**
4 **CONVENIENCE AND NECESSITY TO PROVIDE NATURAL GAS**
5 **SERVICE AS PART OF THE APPLICATION?**

6 A. Yes. The Joint Applicants are requesting that the Commission grant EDG, a
7 wholly owned subsidiary of Empire, a Certificate or Certificates of Convenience
8 and Necessity and the necessary authority to provide natural gas service as a gas
9 corporation and public utility subject to the jurisdiction of the Commission. This
10 authority to operate is limited to the service areas, of which there are three, in
11 which Aquila presently operates the Business. In connection with this request, we
12 are also asking the Commission to waive the requirements of 4 CSR 240-3.205
13 since the areas are already receiving natural gas service from Aquila.

14 **Q. PLEASE CONTINUE.**

15 A. The Joint Applicants are also seeking Commission approval of EDG's proposed
16 adoption of the existing Aquila natural gas tariffs, without modification. This
17 would include the Rules and Regulations that pertain to natural gas service, the
18 rates charged for natural gas sales service and the rates charged for natural gas
19 transportation service. Finally, this overall adoption of the Aquila tariff also
20 includes the adoption of the Aquila Purchased Gas Adjustment ("PGA") tariff (s).

21 **Q. DOES EDG INTEND TO OPERATE THE BUSINESS AS THREE**
22 **SEPARATE SERVICE TERRITORIES AS AQUILA DOES AT THE**
23 **PRESENT TIME?**

1 A. Yes. There is no proposed change to this method of operation.

2 **Q. PLEASE CONTINUE.**

3 A. EDG as part of this application has requested that the Commission authorize
4 EDG's adoption of the Aquila depreciation rates related to the Business and the
5 assets being transferred as part of the transaction. This simply means that upon
6 closing EDG would record depreciation expense on the assets that are part of the
7 transaction in exactly the same manner as Aquila.

8 **Q. IS EMPIRE SEEKING COMMISSION AUTHORITY TO PLEDGE THE**
9 **ASSETS OF THE BUSINESS BEING ACQUIRED?**

10 A. Yes. We are seeking authority to pledge the assets of the Business being acquired
11 as security to obtain financing for the transaction if necessary and the authority to
12 enter into all necessary related transactions.

13 **Q. PLEASE EXPLAIN WHAT EMPIRE IS REQUESTING WITH RESPECT**
14 **TO FAS 87 AND FAS 106.**

15 A. Don Schisler will discuss these two issues in greater detail in his direct testimony.
16 Basically, Empire is requesting authorization to continue certain accounting
17 treatment related to regulatory assets and liabilities, and authority to adopt the
18 FAS 87 pension accounting treatments consistent with the methodology approved
19 for Empire' electric operation. This particular pension accounting methodology
20 was approved by the Commission in Case No. ER-2004-0570. In addition,
21 Empire is seeking Commission authority to adopt Aquila's existing accounting
22 methodology concerning the Missouri gas employees and retirees postretirement
23 welfare benefit cost.

1 **Q. PLEASE CONTINUE WITH AN EXPLANATION OF THE ADDITIONAL**
2 **ITEMS THE JOINT APPLICANTS ARE REQUESTING FROM THE**
3 **COMMISSION.**

4 A. Aquila seeks authority from the Commission to terminate its responsibilities as a
5 gas corporation in Missouri, effective with the closing of the transaction.

6 **Q. ARE THERE ANY OTHER COMMISSION ACTIONS REQUESTED IN**
7 **THE APPLICATION?**

8 A. Yes. The Joint Applicants are seeking authority from the Commission to enter
9 into, execute and perform in accordance with the terms of all other documents
10 which may be reasonably necessary and incidental to the performance of the
11 transactions, which are the subject of the APA. Finally, we are seeking as part of
12 the application such other Commission authorizations as may be required to
13 accomplish the purposes of the APA, this Application and to consummate the
14 sale, transfer and assignment of the related transactions pursuant to the APA.

15 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?**

16 A. Yes, it does.

AFFIDAVIT

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 9th day of November, 2005, before me appeared Ronald F. Gatz, to me personally known, who, being by me first duly sworn, states that he is the Vice President of Strategic Development of The Empire District Electric Company and acknowledged that he has read the above and foregoing document entitled "Direct Testimony of Ronald F. Gatz" and that the statements therein were prepared by him or under his direction and are true and correct to the best of his information, knowledge and belief.

Ronald F. Gatz

Ronald F. Gatz

Subscribed and sworn to before me this 9th day of November, 2005.

Samantha D. Sill

Samantha Sill, Notary Public

My commission expires: May 21, 2008.

