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MISSOURI PUBLIC SERVICE COMMISSION
FINANCIAL AND BUSINESS ANALYSIS DIVISION

REBUTTAL TESTIMONY
OF
MARK L. OLIGSCHLAEGER

THE EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. ER-2019-0374

Jefferson City, Missouri
March 2020

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1 **REBUTTAL TESTIMONY OF**

2 **MARK L. OLIGSCHLAEGER**

3 **THE EMPIRE DISTRICT ELECTRIC COMPANY**

4 **CASE NO. ER-2019-0374**

5 Q. Please state your name and business address.

6 A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

7 Q. Have you previously contributed to Staff's Cost of Service Report filing in this
8 case dated January 15, 2020?

9 A. Yes, I have.

10 Q. What is the purpose of your rebuttal testimony?

11 A. The purpose of this testimony is to respond to the direct testimony filed in this
12 case by the Office of the Public Counsel ("OPC") witness Robert E. Schallenberg regarding the
13 issue of affiliated transactions.

14 **EXECUTIVE SUMMARY**

15 Q. Please summarize your rebuttal testimony in this proceeding.

16 A. Staff does not agree that the adjustments proposed by OPC to The Empire
17 District Electric Company's ("Empire") affiliated transactions costs in this proceeding are
18 justified or appropriate at this time.

19 **EMPIRE'S MISSOURI AFFILIATED TRANSACTIONS/ BACKGROUND**

20 Q. What are affiliated transactions?

21 A. Affiliated transactions are exchanges of good and services between a regulated
22 utility and another entity sharing common ownership with the utility. Because affiliated
23 transactions are often made between a regulated entity and an unregulated entity, affiliated

1 transactions are a concern to regulators because of the prospect of the regulated entity's
2 customers providing a "cross-subsidy" to the non-regulated operations of the firm owning both
3 entities, either through paying excessive prices or receiving insufficient revenues for affiliated
4 goods and services. The danger of cross-subsidy arises in affiliated transactions because such
5 exchanges of goods and services are by definition not "arms-length" in nature; that is, they are
6 not conducted by two independent third parties each looking out for its best interest.

7 Q. Has the Commission established any rules to govern affiliate transactions in
8 order to prevent detrimental effects on utility ratepayers?

9 A. Yes. For approximately 20 years, affiliated transaction rules ("ATRs") have
10 been put in place to govern utility affiliated transactions to guard against the possibility of
11 ratepayer harm. One such rule concerns electric utility affiliated transactions, including those
12 entered into by Empire. Two primary features of the ATRs are its asymmetric pricing
13 provisions, and the requirement for utilities to maintain cost allocation manuals.

14 Q. Please describe the asymmetric pricing provisions within the ATRs.

15 A. When a utility chooses to enter into an affiliated transaction, the ATRs require
16 the utility to calculate the fully distributed cost ("FDC")¹ associated with each good or service
17 it either purchases from an affiliate or sells to an affiliate. The FDC value represents the "cost"
18 of the good or service in question, and then is compared to a "market" price for the good or
19 service to determine the appropriate price to pay for or to sell the product.

20 Under the ATRs, when a utility sells a good or service to an affiliate, the good
21 or service must be priced at the higher of the product's FDC or fair market price. When a utility

¹ FDC is a costing method that examines all of the costs of a utility in relation to all of the goods and services that are produced by the utility. The FDC costing method attempts to ensure that all of the direct, indirect and common costs of a utility are appropriately and proportionately accounted for in the assignment of costs to all of a utility's goods and services.

1 purchases a good or service from an affiliate, the good or service must be priced at the lower of
2 the product's FDC or fair market price.

3 Q. What is a cost allocation manual ("CAM")?

4 A. A CAM is a document that details a utility's approaches to properly assigning
5 costs to regulated and unregulated entities when entering into affiliated transactions.

6 Q. What kind of corporate structure is Empire a part of?

7 A. Empire is part of a multi-layered corporate structure. It is directly owned by
8 Liberty Utilities Co., which in turn is owned by a string of affiliated companies, and ultimately
9 by Algonquin Power & Utilities Corp ("Algonquin"). Empire receives a variety of corporate,
10 administrative and support services from a number of upstream affiliated entities (collectively,
11 "Algonquin upstream affiliates"). In addition, Empire also receives support services from
12 Liberty Utilities Services Corp. ("LUSC").

13 Q. What types of affiliated transactions does Empire commonly enter into?

14 A. By far the largest number of affiliated transactions entered into by Empire,
15 measured by both volume of transactions and dollar value, is its receipt of support services from
16 various affiliates, including LUSC.

17 Q. Have there been any recent or current non-rate case dockets opened by the
18 Commission to review, in detail, Empire's affiliated transactions?

19 A. Yes. On June 30, 2017, Case No. AO-2017-0360 was opened to enable a
20 detailed and thorough review of Empire's, and certain regulated sister companies', affiliated
21 transactions. As part of that proceeding, Empire has requested that its CAM be approved by
22 the Commission.

23 Q. What has been the procedural history of Case No. AO-2017-0360 to date?

1 A. Data requests have been issued and responded to in this docket, and meetings
2 have occurred between Empire, Staff and OPC. However, on January 10, 2020, the proceedings
3 for this case were stayed by the Commission at the request of the parties.

4 Q. Why was Case No. AO-2017-0360 stayed at that time?

5 A. On July 11, 2018, Case No. AW-2018-0394 was opened by the Commission to
6 consider changes to the Commission's existing ATRs for electric and other categories of major
7 utilities, as well to consider promulgation of new ATRs to cover major water and sewer utilities
8 operating in Missouri. To take into account the possibility that substantive changes to the ATRs
9 may be ordered by the Commission in the future, the parties to Case No. AO-2017-0360 agreed
10 to suspend the proceedings in that case until it would be known what changes might be made
11 to the ATRs as a result of Case No. AW-2018-0394.

12 It should be noted that similar affiliated transactions/CAM approval dockets for
13 major utilities are also currently suspended for the same reason.²

14 **OPC AFFILIATE TRANSACTION ISSUES**

15 Q. What affiliated transaction issues are raised in Mr. Schallenberg's direct
16 testimony in this proceeding?

17 A. Mr. Schallenberg makes various broad and general allegations of violations of
18 the ATRs by Empire in his direct testimony. As a consequence of the alleged ATR violations,
19 OPC appears to take a position that a material adjustment should be made in this case to disallow
20 affiliate transactions expenses, but does not offer any detailed quantification of what that
21 amount might be.

² See Commission Case Nos. GO-2012-0322 (*In the Matter of the Application of Summit Natural Gas of Missouri, Inc. for Approval of its Cost Allocation Manual*) and EO-2017-0176 (*In the Matter of a Union Electric Company d/b/a Ameren Missouri's Cost Allocation Manual (CAM)*).

1 An implicit assumption underlying Mr. Schallenberg’s testimony on this issue
2 is that all affiliate transactions present the same level of regulatory concerns, and should be
3 handled in the same manner for ratemaking purposes. Staff disagrees with this assumption.

4 Q. Are there different types of affiliated transactions?

5 A. Yes. In Staff’s view, there are three primary categories of affiliated transactions.
6 The first is an exchange of goods and services between a regulated entity and unregulated
7 affiliate (“regulated – nonregulated transactions”). The second type is an exchange of goods
8 and services between two regulated affiliates (“regulated – regulated transactions”). The third
9 category of affiliated transactions is the provision of services to a regulated affiliate by a
10 nonregulated affiliated service company (“regulated – service company transactions”).

11 Q. Should all three types of affiliate transactions present the same level of
12 regulatory concern?

13 A. No. Generally speaking, regulated – nonregulated transactions present more
14 serious regulatory concerns than either regulated – regulated³ or regulated – service company
15 transactions.

16 Q. Please discuss why regulated – nonregulated transactions present serious
17 concerns to regulators.

18 A. Regulated – nonregulated transactions should be subject to very strict scrutiny
19 by regulators given the perverse incentives they offer to the corporate parent. The parent can
20 derive greater profits overall if a regulated utility overpays for a good or service from an
21 unregulated affiliate, and the excessive expense amount is then included in a utility’s rate levels.

³ Empire’s regulated – regulated affiliate transactions are not discussed in Mr. Schallenberg’s direct testimony, and will not be further addressed here.

1 Conversely, a corporate parent can also derive greater profits overall if a nonregulated affiliate
2 underpays for a good or service from a regulated affiliate, and the lower level of revenue is then
3 reflected in the utility's rate levels. Either course of action, if it occurs, results in the
4 unregulated entity receiving a cross-subsidy from the captive customers of the regulated entity,
5 which is unacceptable.

6 Q. Please explain why regulated - service company transactions are not necessarily
7 as prone to potential abuse as regulated - nonregulated affiliate transactions.

8 A. The provision of corporate services to a number of affiliates on a centralized
9 basis, as is done for Empire by the Algonquin upstream affiliates, should be expected to be
10 inherently more cost-effective than having each affiliate, including regulated utilities, provide
11 the services for themselves. For this reason, Staff supports the concept of centralized provision
12 of services to utilities in the situation where multiple affiliated entities exist under the corporate
13 umbrella, as is the case with Empire.

14 Q. Are there other reasons why service company charges are unlike other types of
15 affiliated transactions?

16 A. Yes. All of the Algonquin upstream affiliate charges are calculated at cost, with
17 no profit margin included in the charges to affiliates. It can be presumed that regulated –
18 nonregulated affiliated transactions, as well as transactions with unaffiliated third parties,
19 involve charging of a profit margin to the buyer of the goods and services.

20 Q. In general, what types of affiliated transaction does Empire typically engage in?

21 A. They appear to be almost entirely in the nature of regulated – service company
22 transactions.

1 Q. Mr. Schallenberg implies in his direct testimony that the ATRs requires Empire
2 to competitively bid for all services received from the Algonquin upstream affiliates. Does
3 Staff agree?

4 A. No. The ATRs requires utilities to either competitively bid for goods and
5 services otherwise obtainable from affiliates, or demonstrate good cause why competitive
6 bidding is not needed. Given the inherent cost advantages and efficiencies associated with
7 service company structures, Staff views the prospect of mass competitive bidding for
8 Algonquin upstream services to be very likely to be non-productive and not cost effective.
9 In Staff's view, good cause exists for Empire not to primarily rely on competitive bidding
10 procedures to determine the reasonableness of obtaining services from the upstream affiliates.

11 Q. Did Staff perform a review of the costs allocated from the Algonquin upstream
12 affiliates in this case?

13 A. Yes. Regulatory concerns regarding this type of cost has long pre-dated the
14 ATRs. These concerns include the fundamental questions of whether the allocated costs
15 reasonably relate to the regulated operations of the utility and are incurred to benefit the utility
16 and its customers, and are not excessive given their intended benefit.

17 Where the ATRs may be considered to go beyond the parameters of Staff's
18 standard corporate allocations review is if the ATRs are interpreted as requiring that market
19 values be determined for all goods and services obtained by utilities from nonregulated service
20 company affiliates. However, given the inherent cost efficiencies embedded within the shared
21 services model employed for Empire and also commonly found with other utilities, Staff's
22 position is that transfer of services at cost is generally a reasonable alternative to employment

1 of competitive bidding or other market pricing methodology for services received by regulated
2 utilities from service company affiliates.

3 Q. On page 7 of his direct testimony, one of Mr. Schallenberg's criticisms of
4 Empire is its alleged participation in "prohibited non-compliant affiliated transactions" due to
5 failure to receive approval from the Commission of variance requests from the ATR. Does
6 Staff concur?

7 A. No. Empire currently has one ATR variance request outstanding in the context
8 of Case No. AO-2017-0360. As that docket progresses, Staff expects that other variance
9 requests may ultimately be made to the Commission as well.

10 In addition, the current ATR language is considered by Staff to be ambiguous
11 concerning application of the ATRs to affiliated service company transactions. One of Staff's
12 goals in the potential promulgation of new affiliated transaction rules is to better clarify how
13 regulated – service company transactions, as well as regulated – regulated transactions, are to
14 be treated on a going-forward basis. Once that clarity is achieved, it will be easier to determine
15 exactly what variances might be appropriate for Empire under the ATRs.

16 Q. At pages 5 - 6 of his direct testimony, Mr. Schallenberg objects to Algonquin's
17 decision to transfer all Empire employees to LUSC in 2017. He states that: 1) Empire did not
18 seek approval of the employee transfer from the Commission; 2) Empire's action has led to all
19 of Empire's labor expenses to be affiliated transactions; and 3) consequently, that Empire is not
20 complying with the ATRs for the labor-based services received from affiliates. Please respond.

21 A. First, Staff is not aware of any statute, rule or other requirement that obligated
22 Empire to obtain advance approval from the Commission for the employee transfer to LUSC.

1 Second, while receipt of labor services from LUSC may be technically an
2 affiliated transaction, in reality Empire is still to a large degree receiving the same services from
3 the same employee positions as it did prior to the LUSC transfer. Accordingly, there should be
4 no appreciable difference in cost between Empire's current receipt of such services from LUSC
5 and its former arrangement of having in-house employees perform the services, except in the
6 case of some employee positions that were 100% charged to Empire prior to the LUSC transfer
7 that are now allocated in part to other non-Empire affiliates under LUSC. As such, the transfer
8 of employees from Empire to LUSC did not necessarily mean that there was any fundamental
9 change in either the nature of the services provided or an increase in its cost to Empire.

10 Q. Have other Missouri utilities similarly operated in Missouri with no direct
11 employees?

12 A. Yes. After the 2008 merger between Kansas City Power & Light Company
13 ("KCPL") and Aquila United, Inc. ("Aquila"), the former employees of Aquila were all
14 transferred to KCPL. From that point forward, in subsequent rate cases for the former Aquila
15 properties (later renamed KCPL Greater Missouri Operations ("GMO"), all of the labor expense
16 included in GMO rates was assigned or allocated from KCPL employees.

17 Q. Should the position taken by Staff concerning affiliated transaction matters in
18 this case be taken as implying that Empire or other regulated utilities have no responsibility to
19 monitor costs charged to it by service company-type structures?

20 A. No. While provision of services on a centralized basis is generally expected to
21 be more cost-effective than a utility either receiving the services from unaffiliated third parties
22 or from providing the services for itself, there may be instances in which a regulated utility
23 could obtain specific services at less cost through either obtaining the service unaffiliated third

1 party vendors or by providing the service for itself. On an ongoing basis, Empire should be
2 monitoring its costs charged from upstream affiliates to verify whether the affiliated companies
3 are providing such services at reasonable and economic prices.⁴

4 Q. Starting at page 11 of his direct testimony, Mr. Schallenberg alleges at length
5 that a violation of the ATR occurred in the context of debt refinancing costs charged to Empire
6 by an affiliated company. What is Staff's position regarding this particular allegation?

7 A. Staff agrees that this transaction may constitute a violation of the ATR. This
8 issue will be further addressed in the rebuttal testimony of Staff witness Kimberly A. Bolin.

9 Q. Should OPC's proposed adjustment disallowing affiliated transaction costs be
10 adopted in this proceeding?

11 A. No. Mr. Schallenberg appears to be proposing a material disallowance in this
12 case based upon quite broad and general assertions regarding Empire's alleged noncompliance
13 with the ATRs. Moreover, OPC seems to be seeking to impose a more stringent regulatory and
14 ratemaking standard on regulated – service company affiliated transactions than has been
15 sought by any party in general rate proceedings in the approximate twenty years the ATR has
16 been in effect. In Staff's view, OPC has not sufficiently supported or justified this new position
17 on service company costs in this case.

18 Q. Should questions of compliance by Empire with the ATRs continue to be
19 reviewed in subsequent rate cases?

20 A. Certainly. However, Staff suggests that Empire specific issues would be better
21 addressed after resolution of Case Nos. AW-2018-0394 (ATR Revisions) and AO-2017-0360

⁴ One concern Staff has with the transfer of Empire employees to LUSC in 2017 is that it is not clear what employees within the current Algonquin corporate structure would have this responsibility.

1 (Empire CAM Approval Application). Resolution of these dockets would allow the
2 Commission the opportunity to clarify its position regarding various current conflicting
3 interpretations of the ATRs, and thus provide a more accurate and informed foundation for
4 judging Empire's ATR compliance. This course of action would also provide an opportunity
5 for all parties to give further input into any necessary changes in Empire's current affiliated
6 transaction policies and practices, and allow Empire to seek further variances from the ATR as
7 necessary on the basis of good cause in order to comply with the ATRs.

8 Q. Does OPC have other avenues to seek enforcement of the current versions of the
9 ATRs in regard to Empire compliance issues?

10 A. Yes. My understanding is that OPC could file a complaint against Empire
11 alleging non-compliance with the ATRs, and seek monetary penalties if such violations are
12 found by the Commission.

13 Q. Does this conclude your rebuttal testimony?

14 A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of The Empire District Electric)
Company's Request for Authority to File) Case No. ER-2019-0374
Tariffs Increasing Rates for Electric Service)
Provided to Customers in its Missouri)
Service Area)

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

COMES NOW MARK L. OLIGSCHLAEGER and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing *Rebuttal Testimony*; and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

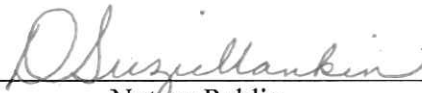


MARK L. OLIGSCHLAEGER

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the County of Cole, State of Missouri, at my office in Jefferson City, on this 2nd day of March 2020.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
Commissioned for Cole County
My Commission Expires December 12, 2020
Commission Number: 12412070



Notary Public