

Exhibit No.
Issues: Capital Structure
Witness: Robert W. Sager
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Empire District Electric
Case No. ER-2016-0023
Date Testimony Prepared: April 2016

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

Rebuttal Testimony

of

Robert W. Sager

April 2016



REBUTTAL TESTIMONY
OF
ROBERT W. SAGER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2016-0023

1 **INTRODUCTION**

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

3 A. Robert W. Sager, 602 Joplin Street, Joplin, Missouri 64801.

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

5 A. The Empire District Electric Company ("Empire" or "Company") is my employer. I
6 hold the position of Controller, Assistant Treasurer, Assistant Secretary, and
7 Principal Accounting Officer.

8 **Q. ARE YOU THE SAME ROBERT W. SAGER THAT PROVIDED DIRECT**
9 **TESTIMONY IN THIS CASE?**

10 A. Yes, I am.

11 **Q. PLEASE EXPLAIN THE PURPOSE OF YOUR REBUTTAL TESTIMONY.**

12 A. My testimony responds to Staff's direct testimony filed regarding Empire's debt
13 costs as it relates to the capital structure.

14 **Q. PLEASE EXPLAIN THE NATURE OF THE COSTS THE STAFF**
15 **RECOMMENDS BE EXCLUDED FROM EMPIRE'S COST OF DEBT**
16 **CALCULATION.**

17 A. In the first quarter of 2008, Empire solicited consents from its electric mortgage
18 bondholders to amend its Indenture of Mortgage and Deed of Trust ("Indenture") so
19 the basket to pay dividends would increase by approximately \$10.7 million. Fees

1 were paid to bondholders in order to obtain the consents needed to amend the
2 Indenture. Staff has argued in its Staff Report - Cost of Service that these expenses
3 should be disallowed.

4 **Q. HOW DO YOU RESPOND TO THIS PROPOSED DISALLOWANCE?**

5 A. I disagree with the disallowance proposed by Staff.

6 **Q. WHY DO YOU DISAGREE WITH THE STAFF'S PROPOSED**
7 **DISALLOWANCE OF THESE EXPENSES AS PART OF THE COMPANY'S**
8 **DEBT COSTS?**

9 A. The Staff's proposed disallowance is based on the premise that costs related to the
10 amendment of the Indenture were solely to benefit shareholders. This is incorrect.
11 The costs of the amendment were incurred in order to provide support to Empire's
12 overall financing plan related to the Asbury SCR, original Riverton Unit 12
13 installation, Iatan Unit 1 AQCS, Plum Point, and Iatan Unit 2 construction builds.

14 **Q. PLEASE EXPLAIN.**

15 A. Empire completed the largest construction program in its history in 2010 which
16 required significant financing from both the equity and debt markets. The equity
17 markets were attracted to Empire as an "income" stock. Had Empire reduced or
18 been unable to pay its dividend, the underlying stock value likely would have
19 eroded. This would have made it difficult for the Company to raise sufficient equity
20 funds necessary to complete the construction cycle and driven it to increase its debt
21 issuances to support the construction program. The resulting higher debt-to-equity
22 ratio would have exceeded acceptable rating agency guidelines for an investment
23 grade company. This could have led to a downgrade from the rating agencies which

1 would, in turn, have raised Empire's costs associated with any future debt issuances.
2 Therefore, the amendment to the Indenture was undertaken to support the
3 Company's overall financing plan which benefits its customers.

4 **Q. WAS THE RATIO OF DEBT TO TOTAL CAPITAL ADDRESSED IN**
5 **EMPIRE'S REGULATORY PLAN PREVIOUSLY AUTHORIZED BY THE**
6 **COMMISSION?**

7 A. Yes. The Regulatory Plan approved by the Commission in Case No. EO-2005-0263
8 outlined three primary financial ratios at Appendix C-1. Debt to total capital was
9 one of the three financial ratios outlined. The Company agreed to maintain the debt
10 ratio through future financing during the term of the Regulatory Plan. The debt ratio
11 was not a component of regulatory amortization. Empire carried out its commitment
12 to maintain this important financial ratio during the term of the Regulatory Plan
13 through its external financing efforts and our customers benefitted.

14 **Q. WHAT IS THE RELATIONSHIP BETWEEN THE INDENTURE**
15 **AMENDMENT COSTS AND THE FINANCING NOTED PREVIOUSLY?**

16 A. The Company's retained earnings balance had dropped to approximately \$17.2
17 million by year-end 2007, in part because it had absorbed \$85.5 million of fuel and
18 purchased power costs in the 2003-2006 period due to the lack of a fuel adjustment
19 clause in Missouri (Staff's Cost of Service Report, Case No. ER-2008-0093). Prior
20 to 2008, the Company's Indenture did not allow Empire to pay dividends with
21 essentially a negative retained earnings balance. An amendment to the Indenture's
22 retained earnings clause was necessary so investors would continue to be attracted to
23 the Company's stock. The amendment to the Company's Indenture in the first

1 quarter of 2008, roughly half way through the construction and financing program,
2 was undertaken to assure investors that dividend payments would continue in
3 support of the investment they had made in Empire despite a low retained earnings
4 balance.

5 **Q. WAS THE OBJECTIVE OF THE AMENDMENT TO THE COMPANY'S**
6 **INDENTURE ACHIEVED?**

7 A. Yes. Empire was able to complete a successful equity distribution program during
8 2009/2010 subsequent to the amendment.

9 **Q. HOW DID THIS BENEFIT EMPIRE'S CUSTOMERS?**

10 A. As previously explained, a balanced approach to Empire's financing program was
11 essential to maintaining an investment grade rating. In fact, this was known and
12 acknowledged at the outset of the construction program. The Regulatory Plan (Case
13 No. EO-2005-0263) included the following statement: "Empire understands that it is
14 responsible to take prudent and reasonable actions to maintain Empire's debt at
15 investment grade levels and avoid actions that result in a downgrade." This language
16 was included in the Regulatory Plan as an acknowledgement of how important it is
17 to keep financing costs low for customers by maintaining an investment grade rating.
18 The actions taken in 2008 to amend Empire's Indenture were necessary and prudent
19 in order to finance the recent construction cycle in accordance with the terms of the
20 Commission-approved Regulatory Plan. Accordingly, the costs associated with those
21 actions should be included in the debt costs related to the capital structure as it
22 benefited customers and shareholders alike.

23 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

1 A. Yes, it does.

AFFIDAVIT OF ROBERT W. SAGER

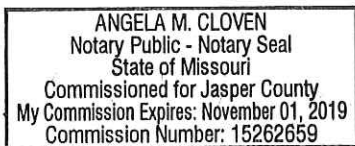
STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 25th day of April, 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 25th day of April, 2016.





Notary Public

My commission expires: 11/01/2019.