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Witness: Robert Sager
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Sponsoring Party: Empire District Electric
Case No. EO-2017-0065
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Before the Public Service Commission

of the State of Missouri

Rebuttal Testimony

of

Robert Sager

June 2017

Empire District
A Liberty Utilities Company

REBUTTAL TESTIMONY
OF
ROBERT SAGER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. EO-2017-0065

INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Rob Sager. I am the Vice President of Finance and Administration for The Empire District Electric Company ("Empire"). My business address is 602 South Joplin Avenue, Joplin, Missouri.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I am a licensed Certified Public Accountant and hold a Bachelor of Science Degree in Accounting from Pittsburg State University, Pittsburg, Kansas. I have been employed by Empire since October of 2006. Prior to assuming my current position, I was the Controller, Principal Accounting Officer, Assistant Treasurer, and Assistant Secretary. Prior to joining Empire, I worked for a regional public accounting firm for approximately ten years. While practicing public accounting, I was a senior manager providing auditing and consulting services to various clients including corporations that filed with the Securities & Exchange Commission ("SEC").

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION ("COMMISSION")?

A. Yes. I have presented testimony in several Empire rate cases.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS CASE?

A. My Rebuttal Testimony responds to the Direct Testimonies of the Office of the Public Counsel (“OPC”) witnesses John Riley and Charles Hyneman by explaining the structure of Empire’s Risk Management Oversight Committee (“RMOC”) and providing the history, context, and strengths of Empire’s Risk Management Policy (“RMP”) provided in Appendix RS-1.

Q. WHAT OTHER REBUTTAL TESTIMONIES WILL BE PROVIDED BY EMPIRE?

A. Empire witness Aaron Doll will address discrepancies in OPC direct testimonies related to the implementation of Empire’s hedging practices, and Blake Mertens will discuss the hedge performance evaluation.

Q. DO THE DIRECT TESTIMONIES OF OPC WITNESSES RILEY AND HYNEMAN ACCURATELY PORTRAY EMPIRE’S RMOC AND RMP?

A. No.

Q. WHAT IS THE RMOC?

A. The RMOC is the committee formed of Empire’s management team that are central in the oversight of risk activities of Empire’s fuel and power procurement efforts.

Q. ARE YOU A MEMBER OF RMOC?

A. Yes. I have been a member since 2011 and currently preside as chair of the committee. Attached to this testimony is the current RMP which includes the composition of the RMOC on pages 5-6.

Q. WHAT ARE THE RESPONSIBILITIES OF THE RMOC?

A. As defined in the RMP, the RMOC is charged with monitoring aggregate risks and ensuring they are managed in accordance with the RMP. Additionally, the RMOC is to meet periodically to assess aggregate risks and review Empire’s market positions, exposures, and strategy. To meet these obligations, RMOC approves hedging strategies, approves authorized individuals to perform trading activities, sets transaction exposure limits, ensures credit approval and documentation, establishes procedures and reporting systems, and establishes approved counterparty lists.

Q. HOW OFTEN DOES RMOC MEET?

A. The RMOC typically meets quarterly and more often if conditions warrant.

Q. WHAT ARE THE GOALS OF THE ELECTRIC HEDGING STRATEGY AS SET FORTH BY THE RMOC AND THE RMP?

A. The RMP defines the goals of Empire's hedging strategy as the provision of predictable fuel and purchased power costs over a multi-year period and the framework to allow for management of its risk positions. The framework includes a comprehensive set of tools to mitigate the adverse impacts associated with changing natural gas or wholesale electricity prices. In effect, the strategies set out to determine the reasonable amount of market risk to balance costs and volatility while still providing the electric customers with reasonable fuel costs.

Q. HOW OFTEN IS THE RMP REVIEWED?

A. It is continuously reviewed. Since the beginning of the audit period, the RMP has been revised three separate times and is currently undergoing another round of proposed revisions.

Q. MR. HYNEMAN CLAIMS IN HIS TESTIMONY THAT EMPIRE DID NOT FOLLOW THROUGH WITH ITS COMMITMENT TO "MODIFY EMPIRE'S HEDGING ACTIVITIES IN RESPONSE TO CHANGES IN THE NATURAL GAS MARKET." IS THIS TRUE?

A. No. The 2004 testimony of Empire witness Brad Beecher, as cited by Mr. Hyneman, mentions specifically that "…revisions would be made approximately annually to reflect lessons learned and changes in markets and financial instruments." The RMP at its inception extended beyond natural gas exposure by seeking to also mitigate power price exposure, coal price exposure, emission exposure, counterparty exposure, and credit risk exposure. At the time of Mr. Beecher's testimony (April, 2004), the RMP was in its third year of existence, was approximately 19 pages long, and was still undergoing developments to better manage Empire's risk positions. It is clear that the individuals approving the first draft of the RMP in 2001 were self-aware that the nascent document would need to be reviewed systematically to bolster the document with the lessons learned since its initial deployment.

Q. PLEASE CONTINUE WITH YOUR DESCRIPTION OF THE CHANGES TO THE RMP AND THE MODIFICATION OF EMPIRE'S HEDGING ACTIVITIES IN RESPONSE TO CHANGES IN THE NATURAL GAS MARKET.

A. By 2007, the RMP had matured to 36 pages in length and provided significantly more depth regarding risk assessment, responsibilities, internal controls, reporting requirements, etc. One of the developments in the RMP 2007 version was Chapter 7, which specifies that "(o)n a periodic basis, the RMOC will review and mutually make a recommendation to the Officer Group on the adequacy of the RMP and any necessary changes." After six years of existence, the RMOC shifted its focus from systematic review of the RMP to periodic review of the RMP and redefined its charge as "monitoring the aggregate risks and ensuring they are managed in accordance with the RMP." The natural evolution of the RMOC to begin with risk document development and graduate to aggregate risk review and review of exposure and strategies is not the same as abdicating a commitment. Mr. Hyneman's misunderstanding of the breadth of the RMP at the time of Mr. Beecher's testimony has led Mr. Hyneman to falsely accuse Empire of not following through with its commitment to ensure the RMP is still applicable and effective. Currently, the RMP is 39 pages and has continued to evolve as Empire has faced new risks, most prominent of which is the commencement of the Southwest Power Pool ("SPP") Integrated Marketplace ("IM") and the transmission congestion market which necessitated a significant editing process and review by members of the RMOC.

Q. BOTH MR. RILEY AND MR. HYNEMAN ALLEGE THAT EMPIRE'S HEDGING POLICY IS TOO RIGID AND INFLEXIBLE. IS THIS TRUE?

A. No. On the contrary, one of the strengths of Empire's hedging policy is that it allows for flexibility within the strategy based on market conditions without requiring constant revisions to the policy.

Q. PLEASE EXPLAIN.

A. Our hedging policy provides a systematic manner in which volumes are to be hedged, referred to in the policy as progressive dollar-cost averaging. The current policy is structured as such:

-Hedge a minimum of 10% of year four expected gas burn

-Hedge a minimum of 20% of year three expected gas burn

-Hedge a minimum of 40% of year two expected gas burn

-Hedge a minimum of 60% of year one expected gas burn

Furthermore, current year hedging may reach up to 100% and any future year may reach up to 80% while remaining cognizant of volume risk. The strength of this structure is that it allows for strategic decisions to affect the amount of volume hedged up to a point, while still requiring some minimum level of hedging to occur.

Q. WHAT EVIDENCE DOES OPC PROVIDE TO DEMOSTRATE THE ALLEGED RIGIDITY AND INFLEXIBILITY OF EMPIRE'S NATURAL GAS FUEL HEDGING STRATEGY?

A. I find no evidence provided in OPC's Direct Testimony. Fourteen references are made between the Direct Testimonies of OPC witnesses Riley and Hyneman alleging Empire's natural gas hedging policy and/or RMP is too rigid or inflexible. However, each reference to Empire's "rigid" or "inflexible" natural gas hedging policy is simply just the statement that the policy is too rigid or inflexible. At one point, Mr. Riley attempts to demonstrate the rigidity and inflexibility of the policy by simply quoting the policy and suggesting that since the policy has not changed over the past 16 years it is by definition rigid and inflexible. By this logic, Empire could have had a policy that allowed for 0% hedging to 100% hedging any number of years out and he would have still found the policy to be rigid and inflexible, so long as it did not change. Not once does Mr. Riley or Mr. Hyneman provide any sort of evidence as to what a flexible and non-rigid policy entails. In fact, Mr. Hyneman asserts that the only prudent action in the current natural gas environment is to abandon hedging.

Q. IS IT TRUE THAT EMPIRE'S POLICY CONCERNING NATURAL GAS PURCHASES HAS NOT CHANGED IN 16 YEARS?

A. No. The concept of progressive dollar-cost averaging has stayed the same, but in the 2001 RMP Empire had different sets of requirements of hedges to obtain based on rates approved by the Commission, and even those limits varied from what is in the policy today. Below is an excerpt from the 2001 RMP regarding natural gas hedging:

If EDE can procure the rights to purchase natural gas through the approved instruments in the policy at rates equal to or below those included in the fuel costs approved by the Missouri Public Service Commission, EDE will utilize the following guidelines. (Year 1 is the next calendar year.)

A. Procure 20% of year four gas for regional market needs
B. Procure 40% of year three gas for regional market needs
C. Procure 60% of year two gas for regional market needs
D. Procure 80% of year one gas for regional market needs.

If EDE cannot procure the rights to purchase natural gas at rates equal to or below those included in the fuel costs approved by the Missouri Public Service Commission, EDE will utilize the following guidelines:

E. Procure 0% - 20% of year four gas for regional market needs
F. Procure 20% - 40% of year three gas for regional market needs
G. Procure 40% - 60% of year two gas for regional market needs
H. Procure 60% - 80% of year one gas for regional market needs.

Q. HOW DO YOU RESPOND TO MR. RILEY'S CHARGE THAT "IF A COMPANY LIKE EMPIRE IS HEDGING GREATER THAN 60% OF ITS GAS NEEDS, THEN ITS HEDGING PROGRAM IS A BUDGETING FORECASTER NOT A PRICE SPIKE MITIGATOR?

A. I am not certain what Mr. Riley means by a budget forecaster other than that hedging is locking in a certain amount of gas, presumably at a fixed cost if it is not procured at index, and the intent is to provide price certainty. However, a fixed cost hedge would indeed serve as a price spike mitigator. If Empire were looking to hedge solely as a budget forecaster then it would likely hedge 100% of its gas needs in advance of the operation year. Rather, Empire has been hedging toward the bottom of the aforementioned bands which still leaves approximately 40% subject to spot natural gas prices.

Q. DO YOU BELIEVE IT IS PRUDENT TO ABANDON EMPIRE'S NATURAL GAS HEDGING ACTIVITIES AT THIS POINT, AS ASSERTED BY OPC?

A. No. Empire's opinion is aligned with the Public Utilities Fortnightly article cited by Mr. Hyneman in his Direct Testimony. The article is attached to the Direct Testimony of Empire witness Mertens as Appendix BAM-1 and states on page 5 as follows (emphasis added):

> It is somewhat ironic that in today's market, as the price of hedging has declined, stakeholder support for hedging has waned. <u>The low-price and low market-volatility environment introduces opportunities to execute hedges at historically attractive price levels.</u> **<u>If utilities were to abstain from hedging until volatility increased and market prices rose, the cost of hedging would increase to the point where hedging could be deemed by regulators to be too costly for ratepayers</u>**.

When reading the article cited by Mr. Hyneman in its entirety, it provides substantial support for continued use of a hedging program in today's natural gas market.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes it does.

AFFIDAVIT OF ROBERT W. SAGER

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the __21st__ day of June, 2017, before me appeared Robert W. Sager, to me personally known, who, being by me first duly sworn, states that he is the VP of Finance and Admininistration 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

Robert W. Sager

Subscribed and sworn to before me this __21st__ day of June, 2017.

Sherri J. Blalock

Notary Public

My commission expires: Nov. 16, 2018.

SHERRI J. BLALOCK
Notary Public - Notary Seal
State of Missouri, Newton County
Commission # 14969626
My Commission Expires Nov 16, 2018