

Exhibit No.
Issue: Stock Issuance Cost, Capital
Structure, Financing
Witness: Robert W. Sager
Type of Exhibit: Direct Testimony
Sponsoring Party: Empire District Gas
Case No.
Date Testimony Prepared: June 2009

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

Direct Testimony

of

Robert W. Sager

June 2009

****Denotes Highly Confidential****

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DIRECT TESTIMONY
OF
ROBERT W. SAGER
THE EMPIRE DISTRICT GAS COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO.

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

2 A. Robert W. Sager, 602 South Joplin Avenue, Joplin, Missouri 64801.

3 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS MATTER?**

4 A. I am appearing on behalf of The Empire District Gas Company (“EDG”). EDG is a
5 wholly owned subsidiary of The Empire District Electric Company (“Empire”) that
6 was formed to hold the Missouri gas utility assets acquired from Aquila, Inc. on June
7 1, 2006.

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

9 A. Empire is my employer. I hold the position of Director of Financial Services.

10 **Q. WHAT ARE YOUR RELEVANT QUALIFICATIONS AND PREVIOUS**
11 **WORK EXPERIENCES?**

12 A. I am a licensed Certified Public Accountant with a Bachelor of Science Degree in
13 Accounting from Pittsburg State University, Pittsburg, Kansas. I have been
14 employed by Empire since October of 2006. I worked for a regional public
15 accounting firm for approximately ten years prior to coming to Empire. While
16 practicing public accounting, I was a senior manager providing auditing and
17 consulting services to various clients including corporations that filed with the
18 Securities & Exchange Commission (“SEC”).

1 **Q. HAVE YOU PREVIOUSLY PARTICPATED IN ANY REGULATORY**
2 **PROCEEDINGS?**

3 A. Yes I have. I provided testimony before the Missouri Public Service Commission
4 (“Commission”) in Empire’s most recent electric rate case, Case No. ER-2008-0093.

5 **Q. PLEASE EXPLAIN THE PURPOSE OF YOUR TESTIMONY.**

6 A. My testimony will support the rate case adjustment related to stock issuance costs,
7 and I will describe the capital structure being proposed by EDG in this rate case.

8 **Q. PLEASE DESCRIBE THE STOCK ISSUANCE ADJUSTMENT.**

9 A. The adjustment for stock issuance costs considers the transactions recorded in
10 account 214100, Stock Issuance Costs, for the five year period ending 12/31/08.
11 Stock issuance costs prior to the acquisition of the gas business were assigned to the
12 electric business and included in Empire’s most recent electric rate case, Case No.
13 ER-2008-0093. Costs relating to Empire’s June 2006 stock issuance have been
14 assigned to our gas operations because this was part of the financing put in place to
15 acquire the gas operations from Aquila, Inc., and this assignment is consistent with
16 the allocations of these costs in Empire’s electric rate case, Case No. ER-2008-0093.
17 Subsequent stock issuance costs, mostly attributable to our December 2007 stock
18 offering, have been allocated between our electric and gas operations based on the
19 plant in service as of 12/31/08. This results in an adjustment increasing expense of
20 \$740,170 per year based on a five year amortization.

21 **Q. WHAT CAPITAL STRUCTURE IS EDG PROPOSING IN THIS RATE**
22 **CASE?**

1 A. EDG proposes the use of Empire's consolidated capital structure at December 31,
2 2008, with one adjustment.

3 **Q. PLEASE EXPLAIN THE PROPOSED ADJUSTMENT TO THE**
4 **CONSOLIDATED CAPITAL STRUCTURE.**

5 A. Consistent with previous Empire electric rate cases, EDG has excluded short-term
6 debt from the capital structure. In the past, this exclusion was accepted since the
7 balance of short-term debt was less than that of construction work in progress
8 ("CWIP"). At the end of the test year in this case, the balance in CWIP, which is
9 almost entirely due to our electric business construction cycle, exceeded the short-
10 term debt balance, and an adjustment of \$102,000,000 was made to eliminate short-
11 term debt from the capital structure.

12 **Q. HAS EMPIRE COMPLETED ANY FINANCIAL TRANSACTIONS SINCE**
13 **DECEMBER 31, 2008 THAT ALTERS ITS CAPITAL STRUCTURE?**

14 A. Yes, Empire issued \$75 million of its first mortgage bonds on March 27, 2009 under
15 its Indenture of Mortgage and Deed of Trust to repay short-term debt which was
16 incurred, in part, to fund Empire's current construction program.

17 **Q. HOW DOES THIS IMPACT EDG'S RECOMMENDATION IF THERE IS AN**
18 **UPDATE OR TRUE-UP IN THIS CASE?**

19 A. If there is an update or true up EDG continues to support using the December 31,
20 2008 actual capital structure. Alternatively EDG supports a pro forma capital
21 structure that places the equity to capitalization ratio at 48%.

1 **Q. WHY SHOULD A PROFORMA CAPITAL STRUCTURE BE USED IN THE**
2 **EVENT THE DECEMBER 31, 2008 ACTUAL CAPITAL STRUCTURE IS**
3 **NOT USED?**

4 A. Empire is currently engaged in a significant construction cycle for its electric
5 business which started in 2005. Empire has consistently stated that it intended to
6 finance this cycle with a relatively balanced mix of debt financing and equity
7 financing. Until the economic and market turmoil which occurred in the latter part
8 of 2008, Empire's financings were consistent with this stated objective. Due to
9 recent market turmoil, Empire was compelled to issue long-term debt in March of
10 2009 instead of equity. This is the first time Empire issued two long-term debt
11 financings consecutively during this electric construction cycle. Moreover, in the
12 month prior to the latest long-term debt issuance, Empire implemented an equity
13 shelf program ("ESP") that enables Empire to offer and sell up to \$60 million of
14 common stock through its agent, UBS Securities LLC. Because of current market
15 conditions, as of the date of this testimony Empire has not sold any common stock
16 under this program. **_____

17 _____
18 _____

19 _____** Consequently

20 EDG supports the use of a capital structure for this gas rate case based on Empire's
21 recent history, not a capital structure that is skewed at a specific moment in time due
22 to unprecedented economic conditions. That would indicate the December 31, 2008
23 actual capital structure, or a pro forma capital structure with 48% equity.

1 **Q. HOW DID YOU DETERMINE A 48% EQUITY TO CAPITALIZATION**
2 **RATIO WAS APPROPRIATE?**

3 A. I calculated the equity to capitalization ratios for each of the quarters ended during
4 2006, 2007 and 2008 and averaged these ratios, which is similar to the time frame of
5 this construction cycle and most relevant to our recent history. I excluded all short-
6 term debt and current maturities of long-term debt for purposes of the calculation.
7 The result was an average of approximately 48% equity.

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

9 A. Yes, it does.

AFFIDAVIT OF ROBERT W. SAGER

STATE OF MISSOURI)
) ss
COUNTY OF JASPER)

On the 4th day of June, 2009, before me appeared Robert W. Sager, to me personally known, who, being by me first duly sworn, states that he is the Director of Financial Services 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 4th day of June, 2009.

Sherril J. Blalock
Notary Public

My commission expires: Nov. 16, 2010

