

Exhibit No. 121
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Deficiency; Property Taxes; & Capital
Structure
Witness: Robert W. Sager
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Sponsoring Party: Empire District Electric
Case No.: ER-2014-0351
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**Before the Public Service Commission
of the State of Missouri**

Direct Testimony

of

Robert W. Sager

August 2014



SERVICES YOU COUNT ON

Empire Exhibit No. 121
Date 4-14-15 Reporter XF
File No. ER-2014-0351

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DIRECT TESTIMONY
OF
ROBERT W. SAGER
THE EMPIRE DISTRICT ELECTRIC COMPANY
BEFORE THE
MISSOURI PUBLIC SERVICE COMMISSION
CASE NO. ER-2014-0351

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DIRECT TESTIMONY
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1 **INTRODUCTION**

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

3 A. Robert W. Sager; 602 South Joplin Avenue, 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.
6 I hold the positions of Controller, Assistant Treasurer, and Assistant Secretary.

7 **Q. WHAT ARE YOUR QUALIFICATIONS AND PREVIOUS WORK**
8 **EXPERIENCES?**

9 A. I am a licensed Certified Public Accountant and hold a Bachelor of Science
10 Degree in Accounting from Pittsburg State University, Pittsburg, Kansas. I have
11 been employed by Empire since October of 2006 and was the Director of
12 Financial Services prior to being named to my current positions in August of
13 2011. I worked for a regional public accounting firm for approximately ten years
14 prior to coming to Empire. While practicing public accounting, I was a senior
15 manager providing auditing and consulting services to various clients including
16 corporations that filed with the Securities and Exchange Commission ("SEC").

17 **Q. HAVE YOU PREVIOUSLY PARTICIPATED IN ANY REGULATORY**
18 **PROCEEDINGS?**

1 A. Yes, I have. I provided testimony before the Missouri Public Service Commission
2 (“Commission”) in several of the Company’s previous electric rate cases, Case
3 Nos. ER-2012-0345, ER-2011-0004, ER-2010-0130, and ER-2008-0093, and The
4 Empire District Gas Company’s last rate case, Case No. GR-2009-0434.

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

6 A. I will support the financial aspects of rate case adjustments related to the early
7 retirements of Riverton Unit 7 and Asbury 2, property tax adjustments, and the
8 overall capital structure of the Company.

9 **RIVERTON UNIT 7 AND ASBURY 2 RETIREMENTS AND RESERVE**

10 **DEFICIENCY**

11 **Q. WHEN WAS ASBURY 2 RETIRED?**

12 A. Asbury 2 was retired on December 31, 2013. No adjustment to rate base was
13 required to reflect the units’ retirement in this case.

14 **Q. HOW DOES THE ASBURY 2 RETIREMENT IMPACT EMPIRE’S RATE
15 BASE IN THIS CASE?**

16 A. There is essentially no rate base impact as plant in service was reduced
17 approximately \$3.3 million and the provision for accumulated depreciation was
18 reduced by \$3.3 million.

19 **Q. PLEASE EXPLAIN THE ADJUSTMENT TO RATE BASE FOR THE
20 RETIREMENT OF RIVERTON UNIT 7.**

21 A. Riverton Unit 7 experienced an unscheduled outage in June 2014. Operations
22 personnel assessed the cause of the outage and determined it was not in Empire’s,
23 or its ratepayers’ best interest to repair the unit, considering the unit was

1 scheduled to be retired in 2016, when Empire's Riverton 12 unit is scheduled to
2 come on line as a combined cycle.

3 **Q. HOW DOES THE RIVERTON UNIT 7 RETIREMENT IMPACT**
4 **EMPIRE'S RATE BASE IN THIS CASE?**

5 A. The initial financial information used as the basis for this case is based on a test
6 year ending April 30, 2014. Empire has adjusted the April 30, 2014, property
7 investment to account for the retirement of Unit 7 that occurred in June 2014, by
8 crediting FERC account 101 – Electric Plant in Service and debiting 108 –
9 Accumulated Provision - Electric Plant, for \$10.6 million total company. This
10 entry does not result in a net change to rate base.

11 **Q. DO THE RETIREMENTS OF RIVERTON 7 AND ASBURY 2 CAUSE**
12 **OTHER ADJUSTMENTS?**

13 A. Yes. Since the units are no longer included in plant in service accounts, Empire no
14 longer records depreciation expense for the units on its general ledger. Empire has
15 included the annual depreciation associated with these units as part of its cost of
16 service in this case in the amount of \$342,574, on a total company basis.

17 **Q. PLEASE EXPLAIN WHY THIS ADJUSTMENT IS NECESSARY.**

18 A. During Case No. ER-2012-0345, depreciation rates for Riverton Units 7 and 8
19 were increased, so that the remaining net book value of these assets would be
20 reduced by 2016 to more accurately reflect their scheduled retirement. As the
21 retirement date for Riverton Unit 7 has changed (approximately two years earlier
22 than scheduled), we are proposing that the annual depreciation continue to be

1 collected from customers for that unit so that the original intent of the
2 depreciation rates established in Case No. ER-2012-0345 can be preserved.

3 **Q. DOES THIS ADJUSTMENT IMPACT RIVERTON UNIT 8?**

4 A. No. The adjustment is solely attempting to continue collecting depreciation on
5 Unit 7, even though the Company normally would not record such depreciation
6 given the unit's early retirement.

7 **Q. IF THE ADJUSTMENT IS GRANTED FOR RIVERTON UNIT 7, WILL**
8 **THE UNIT BE FULLY DEPRECIATED BY THE ORIGINAL**
9 **ANTICIPATED 2016 RETIREMENT DATE?**

10 A. No. We expect both Riverton Units 7 and 8, plus the associated "common" plant,
11 will have a reserve deficiency in 2016 as originally estimated. This was noted as
12 part of the Nonunanimous Stipulation and Agreement for Case ER-2012-0345,
13 item 6, whereby Empire could request an accounting authority order pertaining to
14 the depreciation reserve.

15 **Q. IS EMPIRE REQUESTING AN ACCOUNTING AUTHORITY ORDER**
16 **ON THAT MATTER IN THIS CASE?**

17 A. No. We are proposing to address the potential reserve deficiency for Riverton
18 Units 7 and 8 in 2016, when it is expected that Unit 8 will be retired. For purposes
19 of this case, Empire is recommending to continue collecting annual depreciation
20 on Unit 7 until new base electric rates are established to account for the Riverton
21 12 combined cycle conversion in 2016.

1 **PROPERTY TAXES**

2 **Q. WHAT ADJUSTMENT IS BEING MADE BY EMPIRE FOR PROPERTY**
3 **TAXES IN THIS RATE CASE?**

4 A. The test year property tax expense included in the case does not reflect the level
5 of property taxes Empire will be incurring beginning January 1, 2015, due to
6 increased levels of plant in service at December 31, 2014. We have adjusted the
7 annualized property tax expense by \$548,342, to recognize the increase in
8 property tax assessments which Empire will incur due to an increased level of
9 electric plant in service at December 31, 2014.

10 **Q. DID EMPIRE CALCULATE THIS ADJUSTMENT CONSISTENT WITH**
11 **PRIOR CASES?**

12 A. Empire's calculation is consistent with previously submitted cases; however, it is
13 not consistent with how the Commission Staff has typically estimated property
14 taxes in previous Empire cases.

15 **Q. WHAT IS THE SIGNIFICANT DIFFERENCE BETWEEN EMPIRE'S**
16 **METHODOLOGY AND THAT USED BY THE COMMISSION STAFF IN**
17 **EMPIRE'S RECENT CASES?**

18 A. In recent cases, the Commission Staff has utilized a 5-year average to develop the
19 tax rate to apply to the taxable plant in service balances included in its base case.
20 This methodology has consistently understated the level of property taxes actually
21 incurred by the Company. A summary of how the tax rate has increased over the
22 last five years is presented below.

ROBERT W. SAGER
DIRECT TESTIMONY

	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>2013</u>
Total Property ¹	1,474,964,391	1,601,466,677	1,871,561,118	1,986,379,117	2,069,528,266
Property Taxes Paid	11,475,404	12,441,785	14,687,002	15,947,648	18,465,019
Ratio of Amt Paid to Total Property	0.7780%	0.7769%	0.7847%	0.8029%	0.8922%

1 **1 Total property represents plant in service plus fuel stock, materials and supplies less items**
2 **not included in determining property tax assessments such as capital leases for unit trains**

3 **Q. WHY HAS THE PROPERTY TAX RATE INCREASED SO MUCH IN**
4 **RECENT YEARS?**

5 A. The valuation methodology employed by the Missouri Department of Revenue
6 (“Department”) appears to be the most significant reason behind the increasing
7 tax rate. The Department uses several factors to determine Empire’s assessment.
8 One factor that has been driving the assessment higher is the Department’s use of
9 the “income stream” approach to valuation. This is an approach that involves the
10 use of a company’s income as a factor in the establishment of valuation levels. As
11 Empire’s net income has risen due to its increasing investment in electric plant,
12 the “income stream” approach has played a bigger role in the increase in Empire’s
13 overall property tax assessment.

14 **Q. WILL THE PROPERTY TAX RATE CONTINUE TO INCREASE?**

15 A. Yes. We expect our property tax rate to continue to be assessed in relationship to
16 our income and plant investment. Each of these factors will increase over the
17 next few years, and as these increase, we expect the property tax rate to increase.

18 **Q. HOW DOES THE ADJUSTMENT MADE BY EMPIRE IN ITS CASE**
19 **ADDRESS THIS ISSUE?**

1 A. Empire is utilizing the most recent property tax rate instead of a 5-year trailing
2 average. Annualizing property tax expense using the most current property tax
3 rate will not understate the property tax rate as much compared to the 5-year
4 trailing average.

5 **CAPITAL STRUCTURE**

6 **Q. WHAT CAPITAL STRUCTURE IS EMPIRE PROPOSING IN THIS**
7 **RATE CASE?**

8 A. Empire's filing is based upon the Company's consolidated capital structure at
9 April 30, 2014, with one adjustment. The capital structure, as adjusted, is as
10 follows:

Pro Forma Capital Structure:	Amount Outstanding	% of Total	Cost Rate	Weighted Return on Tariffs Filed
Long-term Debt	\$722,146,144	48.55%	5.60%	2.717%
Common Equity	765,315,001	51.45%	10.15%	5.222%
Short-term Debt	0	0.00%	0.38%	0.000%
Total	\$1,487,461,144	100.00%		7.940%

11 **Q. PLEASE EXPLAIN THE PROPOSED ADJUSTMENT TO THE APRIL 30,**
12 **2014 CONSOLIDATED CAPITAL STRUCTURE.**

13 A. Consistent with the Company's previous electric rate cases, Empire has excluded
14 short-term debt from the capital structure. In past rate cases, this exclusion was
15 accepted, since the balance of short-term debt was assumed to fund construction
16 work in progress ("CWIP") and was less than the thirteen month average balance
17 of CWIP. Like short-term debt, CWIP has been excluded from the calculation of
18 revenue requirement in the rate case.

1 **Q. SHOULD THE CAPITAL STRUCTURE FOR PURPOSES OF THIS CASE**
2 **BE UPDATED THROUGH THE REQUESTED TRUE-UP PERIOD?**

3 A. Yes. Empire seeks an update to the capital structure as of the requested true-up
4 date of December 31, 2014. Empire also expects to complete a bond financing
5 transaction in the near term and believes that the impact of this transaction should
6 be included as a component of the case.

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

8 A. Yes, it does.

