STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET DE 16-383

IN THE MATTER OF: LIBERTY UTILITIES (GRANITE STATE ELECTRIC) CORP, D/B/A LIBERTY UTILTIIES

REQUEST FOR CHANGE IN RATES

DIRECT TESTIMONY

OF

DONNA H. MULLINAX
CONSULTANT TO STAFF

DECEMBER 16, 2016

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Introduction and Summary

Q. Please state your full name?

A. My name is Donna Hubler Mullinax.

Q. By whom are you employed and what is your business address?

A. I am employed by Blue Ridge Consulting Services, Inc. My business address is 114 Knightsridge Road Travelers Rest, SC 29690.

Q. Please summarize your education and professional work experience.

A. I graduated with honors from Clemson University with a Bachelor of Science in Administrative Management and a Master of Science in Management. I am a Certified Public Accountant (CPA), Certified Internal Auditor (CIA), a Certified Financial Planner (CFP), and a Chartered Global Management Account (CGMA) designation holder. I am a member of the South Carolina Association of Certified Public Accountants, the American Institute of Certified Public Accountants, and the Institute of Internal Auditors.

I have over 37 years of professional experience and have been a utility industry consultant for the last 23 years. My consulting assignments include numerous rate cases for natural gas and electric utilities and litigation support for various construction claims. Other project experience includes management, financial, and compliance audits, due diligence reviews, prudence reviews, and economic viability and financial studies. I have worked with public service commissions, attorneys general, and public advocates in Arizona, Colorado, Connecticut, Delaware, District of Columbia, Hawaii, Illinois, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New Hampshire, New York, North Dakota, Ohio, Oregon, and Utah.

Q. Have you included a more detailed description of your qualifications?

A. Yes. A description of my qualifications is included as Attachment DHM-1.

Q. Have you previously testified before the New Hampshire Public Utilities Commission?

A. Yes. I submitted pre-filed Direct testimony in DE 16-384.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Staff of the New Hampshire Public Utilities Commission ("Commission").

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to address the revenue requirements and revenue deficiency proposed by Liberty Utilities (Granite State Electric) Corp., d/b/a Liberty Utilities (Liberty or "Company") and to present the impact of Staff's recommended ratemaking adjustments on the Company's revenue deficiency.

Q. Please summarize your recommendations.

A. The following table summarizes Staff's recommendations regarding revenue requirements and revenue deficiency.

Table 1: Summary of Staff's Recommended Adjustments and the Impact on Rate Base, Operating Income, and Revenue Deficiency

	Staff's Recommended Rate of Return			7.12%
	Revenue Conversion Factor			1.65590
		Rate Base	**Operating Income**	**Revenue Deficiency**
Adjustment 1	Cash Working Capital	$ (1,681,675)		$ (198,270)
Adjustment 2	Remove Prepayments Included in Cash Working Capital	(756,325)		$ (89,171)
Adjustment 3	Adjust Materials and Supplies for Unusually High Balance	(101,536)		$ (11,971)
Adjustment 4	Audit Issues Not Corrected in Update		2,500	$ (4,140)
Adjustment 5	Payroll and Benefits - New Hires 2016 in Update		313,914	$ (519,811)
Adjustment 6	Remove LTIP (PSU) Related to Shareholder Goals		17,224	$ (28,521)
Adjustment 7	Remove Severance		28,669	$ (47,473)
Adjustment 8	Employee Pensions and Benefits		448,662	$ (742,940)
Adjustment 9	Remove Concord Training Center		88,507	$ (146,559)
Adjustment 10	Non-Recurring Costs to Reduce Billing Backlog		20,813	$ (34,464)
Adjustment 11	Employee Misconduct Due to Insuffient Supervision		3,804	$ (6,299)
Adjustment 12	Modify Plant in Service	(5,612,278)	115,299	$ (852,614)
Adjustment 13	True-Up Payroll Taxes for Other Adjustments		27,327	$ (45,251)
Adjustment 14	Interest Synchronization		(85,492)	$ 141,566
	Impact of Staff's Recommended Cost of Capital			(1,903,238)
		$ (8,151,814)	$ 981,227	$ (4,489,156)

Q. What revenue increase does Staff recommend?

A. Staff's recommends a base rate increase of no more than $1,196,150. The following table shows the Company's updated revenue deficiency request and Staff's recommendation.

Table 2: Staff's Recommended Revenue Deficiency

Company's Updated Revenue Deficiency	$ 5,685,306
Staff's Recommended Adjustment	(4,489,156)
Staff's Recommended Revenue Deficiency	$ 1,196,150

Q. Are you presenting any exhibits with your direct testimony in this proceeding?

A. Yes. Besides my qualifications already mentioned as Attachment DHM-1, Attachment DHM-2 includes Staff's accounting schedules, and Attachments DHM-3 through DHM-21 are copies of selected documents that are referenced in my testimony.

Q. How are Staff's accounting schedules organized?

A. Staff's accounting schedules, included in Attachment DHM-2, are organized into summary schedules and adjustment schedules. The schedules consist of Schedules 1, 1.1, 1.2, 2, 2.1, 3, 3.1 through 3.14.

Q. What is shown on Schedule 1?

A. Schedule 1 is a summary comparison of the Company's and Staff's computation of the revenue requirement and the revenue deficiency. The schedule summarizes the impact of all of Staff's recommendation adjustments and reflects revenue requirement needed for the Company to have the opportunity to earn Staff's recommended rate of return on Staff's proposed rate base.

Q. What is shown on Schedule 1.1?

A. Schedule 1.1 provides additional detail by major rate base and operating income categories and shows how Staff's recommended adjustments are applied to the Company's updated filings to obtain Staff's recommended revenue requirement and revenue deficiency.

Q. What is shown on Schedule 1.2?

A. Schedule 1.2 presents the calculation of the revenue conversion factor. The revenue conversion factor grosses up the Income Deficiency amount for income taxes to obtain the Revenue Deficiency amount. The conversion is needed to reflect that more than one dollar in gross revenue is needed for each dollar of net operating income because of the imposition of taxes on those earnings.

Q. What is shown on Schedules 2 and 2.1?

A. Schedule 2 summarizes the capital structure and cost of capital proposed by the Company and the capital structure and cost of capital recommended by Staff witness, J. Randall Woolridge. The cost of equity has been further modified as supported by the testimony of Amanda Noonan. Schedule 2.1 isolates the impact on the revenue deficiency for the difference in the Company's proposed capital structure and cost of capital and that recommended by Staff.

Q. What is shown on Schedule 3 and Schedules 3.1 through 3.14?

A. Schedule 3 summarizes Staff's adjustments to rate base and operating income (i.e., revenues less expenses). Schedules 3.1 through 3.14 provide further support and calculations for the adjustments Staff is recommending.

<u>Revenue Requirements</u>

Q. What revenue increase has been requested by the Company?

A. The Company's Application requested an increase in base rate revenues of $5,328,583, which represents an increase of 15.1 percent over the Company's Test Year Distribution Revenue under present rates.[1] On November 21, 2016, the Company filed an update to the revenue requirements. The Company's updated request is for an increase in base rates of $5,685,306, or an additional $356,723.[2]

Q. What was the Company's explanation for the increase in rates in its updated filing?

A. The Company provided a Technical Statement explaining the changes within its updated revenue requirement filing. In summary, the update reflects the following changes:

1. Correct Amortization of Pension Expense Debt on Acquisition-increased revenue requirement by $42,971
2. Include Portion of Account 925 in Historic Year Expense-decreased revenue requirement by $691,622
3. Remove double count of Workers Compensation insurance-decreased revenue requirement by $132,033
4. Correct Understated Historic Year 2015 Contract Labor expense-decreased revenue requirement by $20,813
5. Remove double count of Capitalization of Benefits in Update Historic Year-increased revenue requirement by $1,087,859
6. Update Book ADIT Balance-decreased revenue requirement by $79,928
7. Correct Book Accumulated Depreciation for excluded balances for Excess Accumulated Depreciation and Accumulated Amortization-decreased revenue requirement by $22,983

[1] Revenue Deficiency ($5,328,583) divided by Test Year Distribution Revenues ($35,296,845) per Schedule RR-2 equals 15.1%.
[2] Liberty Updated Filing dated November 18, 2016, Schedule RR-1 (CU).

8. Correct Lead/Lag Days for overlooked bi-weekly payroll-decreased revenue requirement by $10,774
9. Update allocation of Algonquin/Liberty support costs to actual costs to reflect Park Water acquisition-decreased revenue requirement by $130,737
10. Update Pension and OPEB costs-increased revenue requirement by $142,444
    a. Updated to reflect projected ongoing run rate labor complement
    b. Updated to reflect August 2016 actuarial reports
11. Corrected Payroll Taxes to reflect the 2015 Social Security Wage Limit of $118,500 per employee-decreased revenue requirement by $2,923
12. Update Labor costs-increased revenue requirement by $194,342
    a. Corrected allocation of time to Company for three employees
    b. New Hires
    c. Reflects changes to Pension, OPEB, and other benefits
13. Audit Adjustments-decreased revenue requirement by $61,067
    a. Audit Issue #10 – Below the Line Travel and Expense Reimbursement for mileage and tolls for employee that received monthly car allowance
    b. Audit Issue #12 – Insurance Policies and Premiums converted from Canadian dollars to US dollars and correction of Brokerage Fee
    c. Audit Issue #17 – Remove non-recurring former employee transition costs
14. Audit Issue #3 related to Balance Sheet Reclassification-decreased revenue requirement by $10,526 (Accounts have slightly different depreciation rates)
15. Rent on Londonderry facility-increased revenue requirement by $52,513

16. Adjust Plant accounts-no effect on revenue requirements.[3]

Q. When was the Company's current Distribution revenue requirements established?

A. Liberty's current rates were established in Order No. 25,638 (March 17, 2014), based on a test year ending December 31, 2012, with rates effective on April 1, 2014. The current rates were the result of a Settlement, resulting in an increase in distribution revenues of $9.760 million. The rate change represented an increase of 36 percent of distribution revenues of $26.543 million. The Company was also permitted an estimated additional $1.115 million in annual revenue in the form of a step increase that took effect with service rendered on and after April 1, 2014.[4]

<u>**Test Year**</u>

Q. What test year is being used in this case?

A. The Company has based its request for a revenue increase on a historical test year of the 12 months ended December 31, 2015.[5] Staff's calculations use the same historical test year.

Q. Did the Company adjust its historical test year?

A. Yes, the Company stated that the revenue requirement was computed by starting with the Company's income statement for the Test Year, then removed flow-through items and then adjusted for known and measureable changes. The resulting Test Year proforma income

[3] Liberty Updated Filing dated November 18, 2016, Technical Statement.
[4] DE 13-063, Order No. 25,638, pages 10-11.
[5] Liberty Direct Testimony of Steven E. Mullen and Howard S. Gorman, page 6, line 8.

statement reflects normalized revenues at current rates, expenses, and net operating income for ratemaking purposes.[6]

Adjustments to Rate Base

Q. What rate base has the Company proposed?

A. The Company's updated rate base is $96,585,330.[7]

Q. Is Staff proposing any adjustments to the Company's proposed rate base?

A. Yes. Staff is recommending adjustments to the following rate base components:

- Cash Working Capital
- Prepayments
- Materials and Supplies
- Plant in Service

Cash Working Capital

Q. Please explain Staff's recommended adjustment: Cash Working Capital.

A. Cash Working Capital is one of the Working Capital components of rate base. The Company's Cash Working Capital was developed through the preparation of a lead-lag study. The lead-lag is applied to each component of the cost of service to quantify the cash working capital requirement associated with that cost of service item. The cash working capital balance must be updated to reflect any adjustments. Staff has five adjustments to Cash Working Capital.

[6] Liberty Direct Testimony of Steven E. Mullen and Howard S. Gorman, page 6, lines 8-13.
[7] Liberty Schedule RevReq-1 (CU).

Q. Please explain Staff's first adjustment to Cash Working Capital.

A. Staff's first adjustment corrects an oversight by the Company. When the Company updated its revenue requirements, the impact of those adjustments on income taxes did not flow through its cash working capital calculation. The Company's original Cash Working Capital included Adjustment for Income Taxes of ($122,528).[8] This amount was hard coded within the Cash Working Capital calculation and was not updated.[9] The Adjustment for Income Taxes should have been updated to match the Company's updated schedules that included the Adjustment for Income Taxes of ($297,649).[10] The difference is $175,121 which results in the Company overstating Income Taxes in its Cash Working Capital.

Q. Please explain Staff's second adjustment to Cash Working Capital.

A. Staff's second adjustment removes Depreciation Expense from the Company's cash working capital calculation. Depreciation is a non-cash expense and should not be a component of cash working capital.

Q. Did the Company include Depreciation in its computation of Lead/Lag Days?

A. Yes. The Company stated that Depreciation Expense was included within the Lead/Lag computation and was assigned zero days. The Company attempted to justify this error by stating that if depreciation expense had been excluded, the Lead/Lag days would have been 33.94 and the Cash Working Capital (applied to Distribution expense excluding

[8] Liberty Schedule RR-5-3, line 3.
[9] Liberty Schedule RR-5-3 (CU), line 3.
[10] Liberty Schedule RR-2 (CU), line 16.

Depreciation) would have been greater than the amount in the revenue requirement.[11] The Lead/Lag computation is addressed by Richard Chagnon. Staff's calculation for Cash Working Capital incorporates his recommendation for lead/lag days.

Q. Please explain Staff's third adjustment to Cash Working Capital.

A. Staff's third adjustment removes the Storm Cost accrual from the Company's cash working capital. The Company has already collected and accrued $1.5 million in storm costs. This accrual is a non-cash component and should not be included in cash working capital.

Q. What was the Company's response for including accrued Storm Costs in its cash working capital calculation?

A. The Company agreed that Storm Costs are an accrual, but did not explain why an accrual should be included within Cash Working Capital. The Company stated, "Actual cash expenditures each year may be more (possibly much more) or it may be less. Because Storm Costs vary greatly each year, an average amount is in rates and an average amount should also be in the revenue requirement."[12] Staff agrees with the Company's statement, but the Company did not address the issue that it will pay for these storm repair costs with funds it has already received through the ratepayers' annual funding of the Storm costs. The Company has a balance established with ratepayer funds to pay for any costs associated with storm repairs. Staff believes that it is not appropriate to include non-cash accrual in cash working capital.

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[11] Liberty response to Staff 10-26 (Attachment DHM-3).
[12] Liberty response to Staff 10-27 (Attachment DHM-4).

Q. Please explain Staff's fourth adjustment to Cash Working Capital.

A. Staff's fourth adjustment removes Transmission Expenses. This is a Distribution rate case and Transmission expenses and related costs should not be included within this case.

Q. Please explain Staff's fifth adjustment to Cash Working Capital.

A. Staff's fifth adjustment to Cash Working Capital reflects the impact of Staff's other recommended adjustments. Staff's adjustments are provided in Schedule 3.1.

Prepayments

Q. Please explain Staff's recommended adjustment: Remove Prepayments Also Included in Cash Working Capital.

A. Like Cash Working Capital, Prepayments are another Working Capital component. The Company has included prepaid items for categories of expenses that are also included in its Cash Working Capital resulting in an overstatement of rate base. By including both Prepayments and Cash Working Capital in rate base, the Company is requesting a double recovery of its return on these items. Staff's adjustment removes the Prepayments from rate base to eliminate the double count. The adjustment is shown on Schedule 3.2.

Q. Please elaborate.

A. The Company included five-quarter average prepayments of $756,325 for property taxes, PUC Assessment, and other purchases. By prepaying these items, as opposed to leaving the funds in cash until the expense is due to be paid, the Company is requesting the ratepayers pay a return of 8.31% on these balances. In today's interest rates, 8.31% is significantly more than the Company would earn if these funds were left in cash or even invested in a Treasury Bill which are earning less than 1.0%. If allowed, this double recovery would be similar to the Company using the ratepayers as a bank and requesting a significant amount of interest for these prepaid funds. The difference in the return is significant enough to encourage the Company to prepay items without a legitimate business reason. Since the funds to pay property taxes, PUC Assessment, and other purchases are a component of distribution expense and are included in Cash Working Capital, the Company is earning a return on the lead of these payments. Including both Cash Working Capital and Prepayments in rate base means the ratepayers are paying a return on the same items twice.

Q. Is Staff's recommendation to exclude Prepayments from rate base consistent with sound ratemaking principles.

A. Yes. Staff's recommendation is supported by *Accounting for Public Utilities.*

> "For ratemaking purposes, working capital is a measure of the amount of funding needed to satisfy the level of the daily operating expenditures and a variety of non-plant investments that are necessary to sustain the on-going operations of the utility. The ratemaking measure of working capital is designed to identify these ongoing average funding requirements over a test period. Regulatory commissions vary as to the identification of individual components of working capital; however, in general, the components are: (1) fuel inventory; (2) materials and supplies (M&S); (3) prepayments; and (4) cash working capital."[13]
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> "Prepayments as a component of working capital represents an investment of funds that are generally included in the rate base <u>if that investment has not been recognized elsewhere, such as in Cash Working Capital</u>" [emphasis added].[14]

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[13] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-1-5-2.
[14] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-3.

Q. What amounts did the Company include in Prepayments?

A. The Company included a five-quarter average of prepayments in rate base comprised of the following balances:

Table 3: Five-Quarter Balances for Prepayments

	Property Taxes	Other Prepaid	Total
Balance as of 12/31/14	$ 750,114	$ -	$ 750,114
Balance as of 3/31/15	374,611	-	374,611
Balance as of 6/30/15	957,734	-	957,734
Balance as of 9/30/15	237,806	272,516	510,321
Balance as of 12/31/15	925,930	262,918	1,188,847
Five Quarter Average	$ 649,239	$ 107,087	$ 756,325

The Other Prepaid amount of $107,087 includes the PUC Assessment and other purchases.

Q. Does Cash Working Capital also include these categories of expenses?

A. Yes. The Company's Cash Working Capital is calculated based on adjusted operating expenses. Property taxes and other prepaid in the table above are operating expenses. The Company included Property Taxes totaling $3,679,928 in operating expenses.[15] To avoid this double recovery, Prepayments have been excluded in Staff's recommended adjustment.

Materials and Supplies (M&S)

Q. Please explain Staff's concern regarding Materials and Supplies?

A. The Company included a five-quarter average of $1,739,095 for its pro-forma materials and supplies using the balances in the following table.

[15] Liberty Schedule RR-3-11 (CU), line 49.

Table 4: Materials and Supplies Balances by Month and by Quarter[16]

	Balance	
Date	**Monthly**	**Quarterly**
Dec-14	$ 2,074,781	$ 2,074,781
Jan-15	$ 1,587,313	
Feb-15	$ 1,625,802	
Mar-15	$ 1,643,269	$ 1,643,269
Apr-15	$ 1,646,521	
May-15	$ 1,706,770	
Jun-15	$ 1,654,641	$ 1,654,641
Jul-15	$ 1,698,004	
Aug-15	$ 1,736,103	
Sep-15	$ 1,717,265	$ 1,717,265
Oct-15	$ 1,735,736	
Nov-15	$ 1,686,730	
Dec-15	$ 1,605,519	$ 1,605,519
Average	**$ 1,701,420**	**$ 1,739,095**

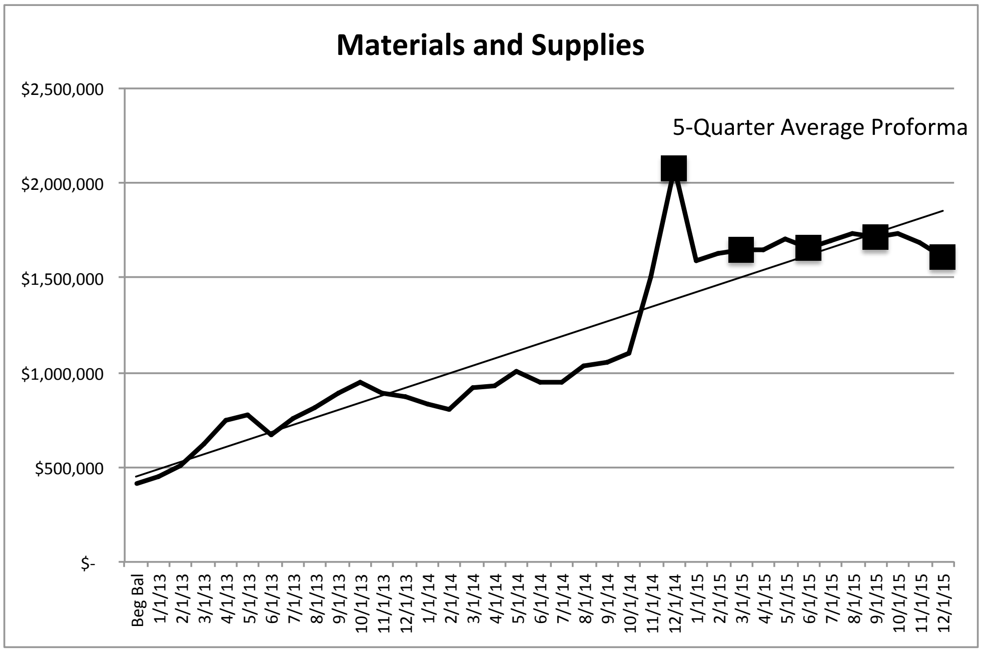
As shown in the table above, when compared to the use of a 13-month average, the use of the five-quarter average placed extra weight on the abnormally high value in December 2014.

Q. Please explain why Staff believes that the December 2014 value is abnormally high.

A. The following table shows the balances for Materials and Supplies from 2013 through 2015. The high point is the balance as of December 31, 2014, and it is abnormally high compared to the other values and the trend line. This abnormal amount is given equal weighting to the other values used in the five-quarter average calculation resulting in a higher proforma amount in the Company's Materials and Supplies.

[16] Liberty response to Staff 6-38 (Attachment DHM-5) and Schedule RR-5-1 (CU).

Table 5: Materials and Supplies Balances 2013-2015[17]



Q. Why is the December 31, 2014, amount so much higher than the other months' balances?

A. The total Materials and Supplies as of December 31, 2014, was $2,074,781. The Company stated that the balance was significantly higher than the other quarters due to the purchase of $507,680 for cable, which was pre-ordered for substation work scheduled to commence in 2015.[18] The cable was purchased for the following projects:

- 6L2 Hanover Getaway – completed in 2014
- 14L4 Pelham Getaway – will be completed in 2016
- 16L3 Mt. Support Getaway – will be completed in 2016[19]

[17] Graph developed from information provided in Liberty response to Staff 6-38 (Attachment DHM-5) and Schedule RR-5-1 (CU).
[18] Liberty response to Staff 6-39 (Attachment DHM-6).
[19] Liberty response to Staff 10-24 (Attachment DHM-7).

Q. Why did the Company buy cable in 2014 for a project that will not use the cable until 2016?

A. The Company explained that "the cable for the 16L3 job was originally scheduled to be installed earlier in the project schedule, but construction complexities inside the substation warranted waiting until later stages of the project to install the cable from the substation to the riser pole."[20]

Q. Does Staff have a concern about the timing of the purchase of the cable?

A. Yes. It appears that the Company may have failed to use reasonable care in keeping its M&S costs low.

Q. What is Staff's recommendation regarding this cable that was purchased for construction activities?

A. Staff recommends that the cable costs be excluded from Materials & Supplies. In addition, to the concern regarding the timing of this abnormally large expenditure that should have been excluded as an outlier, the cable was purchased for construction activity. Including the cable costs in rate base is like including Construction Work in Progress (CWIP) in rate base. Since CWIP is not allowed to earn a current return, M&S inventory for construction activities should also not be allowed to earn a current return. The adjustment is shown in on Schedule 3.3.

Plant in Service

Q. Please explain Staff's recommended adjustment to Plant in Service.

[20] Liberty response to Staff 10-24 (Attachment DHM-7).

A. Staff's adjustment to Plant in Service is supported by Staff witness Jay Dudley. The adjustment is shown on Schedule 3.12.

Impact of Staff's Adjustments on Rate Base

Q. What is the impact of Staff's recommended adjustments to the Company's updated rate base?

A. The Company updated requested rate base was $96,585,330. Staff's recommended adjustments reduced the rate base to $88,433,515.

Adjustments to Operating Income

Q. What net operating income has the Company proposed?

A. The Company's updated operating income is $4,592,885.[21]

Q. Is Staff proposing any adjustments to the Company's proposed net operating income?

A. Yes. Staff is recommending adjustments to the following expense components:

- Audit Issues Not Corrected in Update
  - Audit Issue #10 Below the Line
  - Audit Issue #11 Intercompany Transactions
  - Audit Issue #13 Overpaid MetLife Invoices
- Payroll and Benefits – New Hires in 2016
- Incentive Compensation
- Severance

[21] Liberty Schedule RR-1 (CU), line 7.

- Employee Pension and Benefits
- Concord Training Center
- Billing Backlog
- Employee Misconduct
- Depreciation Expense
- True-Up Payroll Taxes for Other Adjustments
- Interest Synchronization

Audit Issues Not Corrected in Update – Audit Issue #10 Below-the-Line

Q. Please explain Staff's recommended adjustment: Audit Issue #10 Below-the-Line.

A. The Commission Audit identified three invoices for employee appreciation luncheons for a total of $2,136 that the Audit recommended should be moved below-the-line. The Company's response was "The Audit Staff has not identified any rule or other guidance supporting its recommendation that the costs for the employee appreciation luncheons should be booked below-the-line. Any employee appreciation luncheon is a low-cost way of maintaining employee morale, and be provided in a way that does not interrupt the normal work day to allow employees to maintain productivity. The Company considers the cost of employee appreciation luncheons to be legitimate business expenses, since such events are common occurrences in any business."[22] The Audit Staff reiterated its finding that the amount should be moved below-the-line. The Company did not remove the expense in its updated filing. Staff's adjustment removes these expenses as shown on Schedule 3.4.

[22] Commission Audit of Liberty Utilities dated November 14, 2016, page 95 (Attachment DHM-8).

Q. Were other below-the-line expenses identified by the Commission Audit?

A. Yes. The Commission Audit identified a Travel and Expense reimbursement of $425 for a president for mileage and toll reimbursement. The employee also received a monthly car allowance and the Audit recommended that the individual should not also receive reimbursement for mileage and tolls. The Company stated that the referenced individual's employment agreement included negotiated terms related to personal travel preference which involved a vehicle allowance as well as reimbursement for mileage circumstances. However, the Company stated, given the amount at issue, it would remove the $425 from the rate case filing.[23] The Company's updated filing removed $925.[24] Staff's adjustment adds back the $500 that was over adjusted. The adjustment is shown on Schedule 3.4.

Audit Issues Not Corrected in Update – Audit Issue #11 Intercompany Transactions

Q. Please explain Staff's recommended adjustment: Audit Issue #11 Intercompany Transactions.

A. The Commission Audit identified several intercompany charges that should not be charged to the utility. The Audit recommended that $457 be removed out of the utility account into a more appropriate account.[25] The update did not include this adjustment. Staff's adjustment is shown on Schedule 3.4.

Audit Issues Not Corrected in Update – Audit Issue #13 Overcharged Group Benefits

Q. Please explain Staff's recommended adjustment: Audit Issue #13 Overcharged Group Benefits.

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[23] Commission Audit of Liberty Utilities dated November 14, 2016, page 95 (Attachment DHM-8).
[24] Liberty Schedule RR-3-06 (CU), line 14.
[25] Commission Audit of Liberty Utilities dated November 14, 2016, page 99 (Attachment DHM-8).

A. The Commission Audit found that the December union MetLife invoice was overpaid. The Company agreed to remove the $2,027.50, but it was not removed in the updated provided by the Company. Staff's adjustment is shown on Schedule 3.4.

Audit Issues Not Quantifiable – Audit Issue #2 Retirements

Q. Please explain Staff's concerns regarding Audit Issue #2 Retirements.

A. Staff was unable to make an adjustment for Commission Audit Issue #12. The Audit found that a relatively small amount of retirements had been booked since the last audit. The Company's records reflected total additions of $62.6 million, but had only recorded $763,825 in retirements. The Company stated that a backlog had accumulated. The Company also stated that the amount to be retired is unknown, but that it did not impact ratebase.[26]

Q. Do you agree with the Company's assessment that retirements do not impact ratebase?

A. While the backlog in retirements does not change net plant, failure to timely record retirements impact other components of revenue requirements. Of significance is that depreciation continues to be accrued on both the new asset that was put in service and the asset that should have been retired. Depreciation expense will be overstated, since the assets will continue to be depreciated until they are retired. Since the Company did not provide the volume of retirements in its backlog, the impact could not be quantified.

Audit Issues Not Quantifiable – Audit Issue #15 Payroll Registers

Q. Please explain Staff's concerns regarding Audit Issue #15 Payroll Registers.

[26] Commission Audit of Liberty Utilities dated November 14, 2016, page 82 (Attachment DHM-8).

A. The Commission Audit was unable to verify the payroll amount of $16.7 million included within the Company's revenue requirement schedules.[27] To develop its revenue requirement, the Company stated that it started with the Company's income statement for the Test Year. All components of the income statement must have underlying documentation that supports the amounts and can stand up to the test of an audit. Payroll expense is a significant expense. The Company's inability to supply a breakdown or reconciliation to allow the Auditors to verify payroll amounts is alarming and puts into question the completeness and accuracy of the Company's payroll expenses.

Audit Issues Not Quantifiable – Audit Issue #18 Payroll Taxes

Q. Please explain Staff's concerns regarding Audit Issue #18 Missing Information.

A. The Commission Audit was unable to verify the payroll taxes included within the Company's schedules. The Company stated that it does not have New Hampshire specific payroll tax returns as returns are filed by Liberty Utilities Service Corp and includes payroll for multiple entities/states. The Audit Staff was provided with documentation of the payroll reconciliation process that is performed for each week or biweekly pay period. However, there is a concern that there is no breakdown or reconciliation of the NH payroll taxes included within the schedules to the General Ledger. Similar to the concern mentioned in Audit Issue #15 regarding the payroll registers, the Company's inability to supply a breakdown or reconciliation between the payroll tax returns and the income statement to allow the Auditors to verify payroll tax amounts is alarming and puts into question the completeness and accuracy of the Company's payroll tax expenses.

[27] Liberty Schedule RR-3-01, line 4.

Payroll and Benefits – New Hires in 2016

Q. Please explain Staff's concerns related to the Company's New Hires in 2016 proforma adjustment.

A. The Company's initial Payroll proforma adjustment included 210 employees and 21 new hires for a total of 231 employees expected as of the end of 2016.[28] During discovery, it was determined that of the 210 employees, the Company had included two employees identified as Gas-Union and Gas-Non-Union that erroneously charged the Company for services.[29]

In addition, the proforma adjustment included 21 new hires for 2016. It was determined that two of these new hires, a Project Engineer and a Supervisor, Customer Metering Services, should not have been included in the proforma.[30] With these four expected adjustments identified during discovery and agreed to by the Company, it was expected that the total of employees at the end of 2016 would have been reduced from 231 to 227 employees. However, the Company's updated filing increased the headcount to 232 as shown in the following table.

Table 6: Change in Headcount from Initial Filing to Updated Filing

	Initial Filing Headcount	Adjustments from Discovery	Expected Headcount	Updated Headcount	Unexpected Change
Labor Complement at 12/31/15	210	(2)	208	207	(1)
New Hires for 2016	21	(2)	19	25	6
Total Employees During 2016	231	(4)	227	232	5

[28] Liberty Schedule RR-3-01, lines 2, 17, and 25.
[29] Liberty response to Staff 10-3 (Attachment DHM-9).
[30] Liberty responses to Staff 6-26 (Attachment DHH-10) and Staff 10-1 (Attachment DHM-11).

Q. Why is Staff concerned about the increase in headcount between the Company's initial Payroll proforma adjustment and its update?

A. Staff has several concerns. First, the Company's initial filing included New Hires for 2016 of 21 employees. During discovery, the Company provided the positions, salaries, timing of the hiring, whether the new hire was a replacement or incremental, and other information related to the circumstances involved with the new hire. The discovery response also stated that of the 21 new hires, 20 positions were filled and one position was not yet filled.[31] The Company's response to Staff's data request resulted in the identification of two new hires that should not be included in the Company's Payroll proforma. Staff was comfortable with the analysis and expected an adjustment reducing the new hires from 21 to 19. When the Company filed its update on November 22, 2016, the update included 25 new hires, not the expected 19 employees. The Company did not discuss this increase during discovery nor explain why new hires increased in the Company's Technical Statement that provided a description of the revision in its revenue requirement update.

Q. What is Staff's other concern regarding the Company's increase in new hires?

A. Staff's second concern is that two of the new hires for 2016 appear to be a transfer from an allocated position that was initially included in A&G Non-Union to a direct employee of the Company.

Table 7: Change in Category from Initial Filing to Updated Filing

	Operations Non-Union	Billing Non-Union	A&G Non-Union	Total
Initial Filing	3	16	2	21
Updated Filings	6	19	-	25
Change	3	3	(2)	4

[31] Liberty response to Staff 6-26 (Attachment DHM-10).

This reclassification in the middle of a rate case with no explanation is unacceptable. The Company should have updated its responses to discovery explaining the change in positions between an allocated A&G position to a direct charge position.

Q. Does Staff have other concerns regarding the unexplained increase in new hires in 2016?

A. Yes. The Company's change from its initial 21 new hires in 2016 to its updated 25 new hires resulted in a significant increase in its Payroll proforma as shown in the following table.

Table 8: Increase in Salaries for 2016 New Hires from Initial Filing to Updated Filing

	Proforma Headcount	Proforma Salaries
Initial Filing	21	$ 127,271
Updated Filings	25	585,990
	4	$ 458,719

An increase of $458,719 merits a full explanation. The Company did not update discovery related to the new hires nor did it provide an explanation for the significant increase in its updated filing.

Q. What is Staff's recommended adjustment regarding the unexplained increase in new hires in 2016?

A. Staff recommends that the increase for the unexplained New Hires in 2016 be denied. Staff's adjustment impacts Payroll and the associated Pension and Benefits Expense as shown on Schedule 3.5.

Incentive Compensation

Q. What incentive compensation plans does the Company sponsor?

A. The Company has three incentive plans: (1) Short Term Incentive Plan ("STIP"); (2) Discretionary Shared Bonus Pool; (3) Long Term Incentive Plan, also known as the Performance Share Unit Plan ("PSU)."

Q. Please describe the STIP.

A. The STIP is a discretionary short-term incentive cash bonus plan that applies to manager level and higher positions.[32] Award is based on the achievement of two components, Balance Scorecard Achievement and Individual Performance Achievement. The weights for each component vary by position level.[33]

Table 9: STIP Component Weighting by Position

Component	Typical Manager Weighting	Typical Director Level	Typical VP Level
Balance Scorecard Achivement	80%	85%	90%
Individual Performance Achievement	20%	15%	10%

Q. Please explain the Discretionary Shared Bonus Pool.

A. The Discretionary Shared Bonus Pool applies to all other non-union employees that do not participate in the STIP and union employees.[34] Award is generally determined by two factors similar to the STIP: (1) Company's performance measured against a scorecard and (2) employee's achievement of individual performance objectives.[35]

[32] Liberty response to Staff 6-30 (Attachment DHM-12).
[33] Liberty response to Staff 6-30, Attachment 6-30.a.1, page 1 (Attachment DHM-12).
[34] Liberty response to Staff 6-30 (Attachment DHM-12).
[35] Liberty response to Staff 6-30, Attachment 6-30.a.2, page 1 (Attachment DHM-12).

Q. What is included within the Balance Scorecard?

A. The Balance Scorecard measures results in four major business objectives: (1) Efficiency, (2) Operations, (3) Customer, and (4) Employees. The Balance Scorecard objectives are allocated a weighting and together, the total allocation equals 100%.[36] Thus, each of the four business objectives has a weighting of 25 percent. The 2015 Scorecard goals are listed in the following table.

[36] Liberty response to Staff 6-30, Attachment 6-30.a.1, page 2 (Attachment DHM-12).

1 **Table 10: 2015 Scorecard with Weightings**

	Weighting Individual	Weighting Major
EFFICIENCY		**25%**
Business Group Profit	30%	
Net Income (Earnings Before Taxes)	40%	
Return on Assets	30.0%	
	100%	
OPERATIONS		**25%**
Safety		
Achieve World Class LTI Performance	5%	
Roll-out of Enterprise wide EHS&S Plan	5%	
Close Calls	5%	
RAR	5%	
Notices of Violation	5%	
Motor Vehicle Accident Targets	5%	
Implementation of Ethics Training program	5%	
	35%	
Initiaties		
Implement Liberty/APCo Way Initiative	5%	
Conduct Facilities Rehabilitation	5%	
Continuing Emergency Preparation Evaluation	5%	
Execute State plan to maximize ROE	10%	
Complete CAPEX projects on budget	5%	
Achieve LU State Asset Growth	5%	
	35%	
Planning		
Complete 2016 Budget Process	5%	
Accuracy of Quarterly Budget/Forecasting Model	20%	
Implementation of centralized capital planning system	10%	
Implementation of centralized billing system	5%	
	40%	
CUSTOMER		**25%**
Customer		
Quantitative Customer Satisfaction Study	10%	
Customer Service Level	10%	
Billing Timeliness	10%	
Bad Debt as a percentage of Gross Revenue	3.3%	
Bad Debt versus Budget	3.3%	
Bad Debt versus PUC allowance	3.3%	
Cost per Customer	5%	
Saidi/Saifi, Unplanned Disruptions	10%	
Update Liberty Utilities Website	0%	
Collect >50% of customer email addresses	5%	
	60%	
Regulatory		
Regulatory Complaints	10%	
Compliance	10%	
Execute Exec /state / Municipal govt outreach program	5%	
	25%	
Community		
Community Outreach	10%	
Liberty Day hours	5%	
Conservation Program Execution	5%	
	20%	
EMPLOYEE		**25%**
Engagement		
Voluntary Turnover rate	10%	
Complete Training Hours Targets	10%	
Minimum Spirit Submissions	10%	
Interconnect Hours	5%	
Development Plans for all HIPOS	10%	
Onboarding program launch	5%	
	50%	
Survey		
Employee satisfaction survey participation	5%	
Development of Employee Survey Action Plans	5%	
Communication Enhancement Program (>5% improvement)	5%	
Implementation of L&D Program	15%	
	30%	
Initiatives		
Implementation of Succession Planning Framework	5%	
Implementation of Legal Requirements for Diversity Plan	5%	
Implementation of On-line Policy Training Program, Test and Employee Acknowledgem	5%	
Implement HRIS Phase 2 (including performance management)	5%	
	20%	

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Q. Is Staff recommending an adjustment for the STIP and Discretionary Shared Bonus Pool?

A. No. Staff is not recommending an adjustment to the Company's STIP and Discretionary Bonus Pool. The Balance Scorecard appropriately balances the interests of ratepayers, employees, and shareholders.

Q. Please describe the Performance Share Unit ("PSU") Plan.

A. Performance Share Unit Plan ("PSU") is a long-term incentive plan that is applicable to director level and higher positions.[37] The plan award is a performance share that is based on the market value of stock at the end of year preceding the award plus additional units from dividends paid. The PSU vest at the end of the three-year performance period. The performance criteria are as follows:[38]

- Efficiency – 85%
- Safety – 10%
- Customer Satisfaction – 5%

Q. What type of performance is awarded in the Efficiency criteria?

A. Based upon the 2015 Scorecard discussed earlier in my testimony, the Company's Efficiency goals are related to Business Group Profits, Net Income (Earnings Before Taxes), and Return on Assets.

[37] Liberty response to Staff 6-30 (Attachment DHM-12).
[38] Liberty response to Staff 8-33 (Attachment DHM-13).

Q. Please explain Staff's recommended adjustment for the PSU?

A. Staff recommends that the 85 percent of the PSU that is related to the achievement of Efficiency goals [Business Group Profits, Net Income (Earnings Before Taxes), and Return on Assets] be transferred to shareholders. These goals are focused on benefit for the Company's shareholders. Staff's adjustment transfers the responsibility for funding the PSU to the shareholders where it belongs. The adjustment is shown on Schedule 3.6.

Severance

Q. Please explain Staff's recommended adjustment: Severance.

A. The Company included $47,473 of severance pay within the test year.[39] The Company stated that the severance was paid as a result of releasing employees due to job performance or a decision to make leadership changes. The positions involved were the President-NH, the Manager Environment, Health, Safety and Security, and the Manager Meter Data Services.[40] This expense is non-recurring and should be removed. The adjustment is shown on Schedule 3.7.

Q. Did the Company's update include an audit adjustment for a similar expense?

A. Yes. The Commission Audit Issue #17 identified a general ledger entry for $54,000 for "former employee transition." The Company explained that the purpose was a financial agreement with a former employee to be paid out over a number of pay periods. The Company agreed that the expense was non-recurring[41] and it was removed in the Company's

[39] Liberty response to Staff 6-32 (Attachment DHM-14).
[40] Liberty response to Staff 10-2 (Attachment DHM-15).
[41] Commission Audit of Liberty Utilities dated November 14, 2016, page 108 (Attachment DHM-8).

updated revenue requirements filing.[42] Due to different amounts and accounts in which they were identified, Staff believes that the severance Staff removed in its adjustment of $47,473 is in addition to the amount identified in the audit of $54,000.

Employee Pension and Benefits

Q. Please explain Staff's recommended adjustment to Employee Pension and Benefits.

A. Staff's modification to Employee Pension and Benefits is supported by Staff witness James J. Cunningham. The adjustment is shown on Schedule 3.8.

Remove Concord Training Center

Q. Please explain Staff's recommended adjustment Remove Concord Training Center.

A. Staff's adjustment for the Concord Training Center is supported by Staff witness Iqbal Al-Azad. The adjustment is shown on Schedule 3.9.

Billing Backlog

Q. Please explain Staff's recommended adjustment: Billing Backlog.

A. The Company reduced its billing backlog of accounts on hold over 60 days from a total of 1,318 accounts in January 2015 to zero by early September 2015.[43] The Company reduced the backlog of unbilled accounts starting in January 2016 by increasing overtime for its existing permanent labor force and bringing on temporary labor. The costs incurred are included within the Test Year and should be excluded from the Company's revenue deficiency calculation as non-recurring costs. The adjustment is shown on Schedule 3.10.

[42] Liberty Updated Filing dated November 18, 2016, Schedule RR-3-06 (CU), line 11.
[43] Liberty Direct Testimony of Susan Houghton-Fenton, page 4, lines 17-18.

Employee Misconduct

Q. Please explain Staff's recommended adjustment: Website Disallowance.

A. The Liberty Consulting Group audit dated August 12, 2016, included a conclusion that "Supervision at satellite offices and call monitoring have not been sufficient to support optimization of performance." Specifically, the audit stated:

> LU operates three satellite offices staffed with CSRs who serve walk-in customers, answer incoming customer calls, and perform other desk duties in between customers. Providing local officers for customs is a key customer service strategy for Liberty Utilities. Insufficient supervision has led to issues in quality and employee misconduct in the satellite offices.
>
> Since opening four offices in New Hampshire, LU has been forced to close two of the four offices at different points to address employed misconduct. Management closed the Lebanon office from September 2015 through February 2016, releasing the majority of customer service employees reporting to that location and rehiring and training replacements. The Tilton office experienced issues."[44]

Staff's adjustment removes the costs associated with the hiring and termination of the Staff involved in the employee misconduct due to insufficient supervision in the Lebanon and Tilton offices. The costs reflect the amounts associated with recruiting, pre-employment drug testing, and background checks. These costs are non-recurring and should not be borne by the ratepayers. The adjustment is shown on Schedule 3.11.

Depreciation Expense

Q. Please explain Staff's recommended adjustment to Depreciation Expense.

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[44] The Liberty Consulting Group, "Final Report on a Management and Operations Audit of the Customer Service and Accounting Functions of Liberty Utilities," (August 12, 2016) page II-32.

A. Staff's adjustment to Plant in Service also has an impact on Depreciation Expense. Staff has used the composite depreciation rate to calculate depreciation and the resultant impact to the Accumulated Depreciation and Amortization. The adjustment is shown on Schedule 3.12.

True-Up Payroll Taxes for Other Adjustments

Q. Please explain Staff's recommended adjustment: True-Up Payroll Taxes for Other Adjustments.

A. Payroll taxes reflects the effective tax rate for the Company's Social Security and Medicare taxes that correspondingly change as a result of Staff's adjustments to employee compensation. The adjustment is shown on Schedule 3.13.

Interest Synchronization

Q. Please explain Staff's recommended adjustment Interest Synchronization.

A. The interest synchronization adjustment synchronizes the rate base and cost of capital with the tax calculation using Staff's recommended weighted cost of debt. The adjustment is shown on Schedule 3.14.

Impact of Staff's Adjustments on Operating Income

Q. What is the impact of Staff's recommended adjustments to the Company's updated operating income?

A. The Company updated operating income was $4,592,885. Staff's recommended adjustments increased operating income to $5,574,112.

<u>Conclusions</u>

Q. In conclusion, what is Staff's recommended increase to base revenue?

A. Staff is recommending that the Company be allowed an increase to its distribution base rates of no more than $1,196,150.

<u>Step Adjustment</u>

Q. Does Staff have any comments regarding the first Step Adjustment?

A. Yes. Staff supports the Company's first Step Adjustment (subject to the recommendations in Staff Witness Michael Cannata's testimony) with the following modifications to the calculation:

- Exclude the costs for Fiduciary Liability, Employment Practices, Workers Comp, and the related portion of Brokerage Fees from the Step computation. These types of insurance are not appropriate to include when the Step Increase is based on plant in service.[45]
- Increasing the Deferred Tax Balance to reflect first year bonus depreciation for tax purposes.[46]

Q. Does the conclude your testimony?

Yes.

[45] Liberty response to Staff 10-22 (Attachment DHM-22).
[46] Liberty response to Staff 10-23 (Attachment DHM-23).