STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

Docket DG 17-048

In The Matter Of: Liberty Utilities (EnergyNorth Natural Gas) Corp

Request for Change in Rates

Direct Testimony

of

Jayson P. Laflamme
Staff Utility Analyst, Gas And Water Division

and

Donna H. Mullinax
Consultant To Staff

November 30, 2017

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Introduction and Summary

Q. Please state your names, by whom you are employed, and your business addresses.

A. My name is Jayson P. Laflamme. I am employed by the New Hampshire Public Utilities Commission (NHPUC or "Commission"). My business address is 21 South Fruit Street, Suite 10, Concord, New Hampshire.

My name is Donna Hubler Mullinax. I am employed by Blue Ridge Consulting Services, Inc. I am a consultant to Staff. My business address is 114 Knightsridge Road, Travelers Rest, South Carolina 29690.

Q. Mr. Laflamme, what is your position at the NHPUC?

A. I am a Utility Analyst in the Gas and Water Division.

Q. Please describe your duties at the NHPUC.

A. I am responsible for the evaluation of rate and financing filings, including the recommendation of changes in revenue levels that conform to Commission-approved regulatory methodologies. I represent Staff in meetings with company officials, outside attorneys, and accountants relative to rate case and financing matters as well as the Commission's rules, policies, and procedures.

Q. Mr. Laflamme, please describe your educational background.

A. I received a Bachelor of Science Degree in Accounting from Lyndon State College in 1989. In 1998, I attended the NARUC Annual Regulatory Studies Program at Michigan State

University. In 2002, I attended the 22nd Annual Western Utility Rate School in San Diego, California.

Q. Mr. Laflamme, would you please describe your work experience?

A. In 1989, I was hired as a Staff Accountant by Driscoll & Company, a CPA firm located in Littleton, New Hampshire. I performed audits, reviews, and compilations as well as prepared tax returns for a variety of entities. I was eventually promoted to the position of Manager. In 1997, I was hired as a Utility Examiner in the Audit Division of the NHPUC. In that position, I participated in field audits of the books and records of regulated utilities in the electric, telecommunications, water, sewer, and gas industries. I examined reports and filings submitted to the Commission by regulated utilities and performed rate of return analyses. In 2001, I was promoted to my current position as a Utility Analyst in the Commission's Gas and Water Division.

Q. Mrs. Mullinax, 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), a 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 38 years of professional experience and have been a utility industry consultant for the last 24 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. I have included a description of my qualifications as Attachment JPL/DHM-1.

Q. Mrs. Mullinax, have you previously testified before the New Hampshire Public Utilities Commission?

A. Yes. I submitted pre-filed Direct testimony in DE 16-383 and DE 16-384.

Q. On whose behalf are you testifying?

A. We are testifying on behalf of the Staff of the New Hampshire Public Utilities Commission.

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

A. The purpose of our testimony is to address the revenue requirements and revenue deficiency proposed by Liberty Utilities (EnergyNorth Natural Gas) Corp., (“Liberty” or “Company”) and to present the impact of Staff’s recommended ratemaking adjustments on the Company’s revenue deficiency. The Company has requested a rate increase for its EnergyNorth Division and its Keene Division. Our testimony addresses the revenue requirement for the EnergyNorth Division.

Q. Please summarize Staff's position relative to the Keene Division's revenue requirement.

A. Per the testimony of Staff witness Stephen P. Frink, Staff is not making a revenue requirement recommendation for the Keene Division.

Q. Please summarize your revenue requirements adjustments for the EnergyNorth Division.

A. The following table summarizes Staff's recommended revenue requirement adjustments for the EnergyNorth Division.

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

	Staff's Recommended Rate of Return			6.42%
	Revenue Conversion Factor			1.65044
		Rate Base	**Operating Income**	**Revenue Deficiency**
Adjustment 1	Cash Working Capital	$ 108,493		$ 11,496
Adjustment 2	Remove Prepayments Included in Cash Working Capital	(2,704,979)		(286,614)
Adjustment 3	Adjust Materials and Supplies	(3,662,176)		(388,037)
Adjustment 4	Remove Concord Training Center	(3,455,670)	70,535	(482,570)
Adjustment 5	Modify Recovery Period of Theoretical Reserve Imbalance		1,506,639	(2,486,612)
Adjustment 6	Staff Audit Issue #17 Non-Recurring Expense		17,203	(28,392)
Adjustment 7	Modify Payroll, Payroll Taxes, and Benefits for Vacancies		139,086	(229,552)
Adjustment 8	Remove LTIP (PSU) Related to Shareholder Goals		31,510	(52,005)
Adjustment 9	iNATGAS Minimum Annual Transportation Quantity Adjustment		99,789	(164,695)
Adjustment 10	Modify Employee Pensions and Benefits	(121,476)	(14,885)	11,695
Adjustment 11	Adjust Revenue to Year-End Customer Count		563,197	(929,521)
Adjustment 12	Remove Out of Test Year Legal Fees and Degradation Fees		40,478	(66,806)
Adjustment 13	Remove Severance Associated with Resignations		52,569	(86,762)
Adjustment 14	Modify Amortization and Depreciation Accrual Rates	615,020	372,628	(549,832)
Adjustment 15	Interest Synchronization		(80,313)	132,552
	Impact of Staff's Recommended Cost of Capital			(3,874,422)
	iNATGAS Adjustment			(379,264)
		$ (9,220,789)	$ 2,798,435	$ (9,849,345)

Q. What revenue increase does Staff recommend for the EnergyNorth Division?

A. Staff recommends a base rate increase of no more than $4,045,589 (5.7 percent increase to Distribution Revenues) for the EnergyNorth Division, which includes an adjustment for iNATGAS supported by Staff witness Stephen P. Frink. The following table shows the Company's updated revenue deficiency request and Staff's recommendation.

Table 2: Staff's Recommended Revenue Deficiency-EnergyNorth

Company's Updated Revenue Deficiency (11/21/17)	$ 13,894,933
Staff's Recommended Adjustment	(9,849,345)
Staff's Recommended Revenue Deficiency	$ 4,045,589

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

A. Yes. Besides Mrs. Mullinax's qualifications already mentioned as Attachment JPL/DHM-1, Attachment JPL/DHM-2 includes Staff's EnergyNorth Division accounting schedules. Attachments JPL/DHM-3 through JLP/DHM-21 are copies of selected documents that are referenced in our testimony.

Q. How are Staff's accounting schedules organized?

A. Staff's accounting schedules, included in Attachment JPL/DHM-2, are organized into summary schedules and adjustment schedules. The schedules consist of Schedules 1, 1.1, 1.2, 2, 2.1, 3, and 3.1 through 3.15 and Schedule 4.

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 recommended adjustments and reflects the 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. 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 those recommended by Staff.

Q. What is shown on Schedule 3 and Schedules 3.1 through 3.15?

A. Schedule 3 summarizes Staff's adjustments to rate base and operating income (i.e., revenues less expenses). Schedules 3.1 through 3.15 provide further support and calculations for the adjustments Staff is recommending.

Q. What is shown on Schedule 4?

A. Schedule 4 presents Staff's adjustment to the Company's proposed Step Increase.

ENERGYNORTH DIVISION

Revenue Requirement

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

A. The Company's Application requested an increase in base rate revenues of $13,036,958, which represents an increase of 18.6 percent over the Company's Test Year Distribution Revenue under present rates.[1] The Company provided two corrections and updates. Staff's adjustments reflect the corrections and updates submitted by the Company on November 21, 2017, at the conclusion of discovery.[2] The Company's updated request is for an increase in base rates of $13,894,933,[3] or an additional $857,975 from the original request. This updated request represents an increase of 19.8 percent over pro forma test year Distribution Revenue.

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

A. The Company's updated revenue requirement included a "track changes" schedule that listed 33 changes in the September 20, 2017, correction and update schedules, and 15 changes reflected in the November 21, 2017, correction and update schedules submitted at the conclusion of discovery. The track change list is provided in Attachment JPL/DHM-03.[4]

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[1] Revenue Deficiency ($13,036,958) divided by Test Year Distribution Revenues ($70,218,715) per Schedule RR-EN-2 equals 18.6%.
[2] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03).
[3] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-1.
[44] Liberty supplemental response to Staff Tech 1-1 (Attachment JPL/DHM-03).

Q. When was the EnergyNorth Division's current Distribution revenue requirement established?

A. The EnergyNorth Division's current rates were established in Order No. 25,797 (June 26, 2015), based on a test year ending March 31, 2014, with rates effective on July 1, 2015. The parties did not agree on an overall rate of return or on the elements that comprised the Company's proposed $12.4 million increase. Nonetheless, the current rates were the result of a Settlement, resulting in an increase in distribution revenues of $10.5 million.[5] The rate change represented an increase of 6.6 percent of distribution revenues of $158.995 million.[6] The Company was also permitted an additional $1.9 million in annual revenue in the form of a step increase that took effect with service rendered on and after July 1, 2015.[7]

<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, 2016.[8] 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 financial results for the test year, excluding revenues and expenses related to the Cost of Gas and Local Distribution Adjustment (LDAC) and adjusted for known and measurable adjustments. The resulting test year pro forma net operating income reflects

[5] DG 14-180, Order No. 25,797, page 4 and 17.
[6] DG 14-180, Attachment SEM/HSG-2, Schedule RR-2.
[7] DG 14-180, Order No. 25,797, page 17.
[8] Liberty Direct Testimony of David B. Simek and Daniel S. Dane, page 6, lines 7-8.

normalized revenues at current rates, expense, and net operating income for ratemaking purposes.[9]

<u>Adjustments to Rate Base</u>

Q. What rate base has the Company proposed?

A. The Company's updated rate base is $249,735,328.[10]

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
- Concord Training Center
- Employee Pensions and Benefits

Cash Working Capital

Q. Please explain Staff's recommended adjustment regarding 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-

[9] Liberty Direct Testimony of David B. Simek and Daniel S. Dane, page 6, lines 7-13.
[10] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-1).

capital balance must be updated to reflect any adjustments. Therefore, Staff's adjusted Cash Working Capital reflects the impact of Staff's other recommended adjustments. Staff's adjustment to Cash Working Capital is provided in Schedule EN 3.1.

Prepayments

Q. Please explain Staff's recommended adjustment regarding 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 EN 3.2.

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."[11]
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> "Prepayments as a component of working capital represents an investment of funds that are generally included in the rate base if that investment has not been recognized elsewhere, such as in Cash Working Capital" [emphasis added].[12]

Q. What amounts did the Company include in Prepayments?

A. The Company included five-quarter average Prepayments in rate base comprised of the following balances:[13]

Table 3: Five Quarter Balances for Prepayments

	Property Taxes	Other Prepaids	Total
Balance as of 12/31/2015	$2,542,504	$ 499,267	$ 3,041,771
Balance as of 3/31/2016	1,110,476	442,603	1,553,079
Balance as of 6/30/16	3,180,606	166,819	3,347,425
Balance as of 9/30/16	1,698,031	132,102	1,830,133
Balance as of 12/31/16	3,625,473	127,015	3,752,488
Five Quarter Average	$2,431,418	$ 273,561	$ 2,704,979

The Other Prepaid amount of $273,561 includes the PUC and Gas Pipeline Assessments and other purchases.[14] Audit identified prepayments for Telvent, Itron Hardware Maintenance and Software, Ensyte, Ubisense, ESRI maintenance, Safe Software, Dimension Date, American Gas Association, Cogsdale maintenance accrual.[15]

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[11] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-1–5-2. (Attachment JPL/DHM-04).
[12] Robert L. Hahne and Gregory E. Aliff, *Accounting for Public Utilities* (LexisNexis, Release 32, December 2015), page 5-3. (Attachment JPL/DHM-04).
[13] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-EN-5-1).
[14] Liberty response to Staff 8-21 (Attachment JPL/DHM-05).
[15] Commission Audit of Liberty Utilities dated August 22, 2017, pages 59–60 (Attachment JPL/DHM-06).

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

A. Yes. The Company's Cash Working Capital is calculated based on adjusted operating expenses. Property Taxes and Other Prepaids in the table above are operating expenses. The Company included Property Taxes totaling $9,259,401 in operating expenses.[16] To avoid this double recovery, prepayments have been excluded in Staff's recommended adjustment.

Materials and Supplies (M&S)

Q. Please explain Staff's recommended adjustment regarding Materials and Supplies.

A. The Company included a five-quarter average of $6,833,143 for its pro forma Materials and Supplies using the balances in the following table. The table also compares the five-quarter average methodology to the 13-month average methodology.

Table 4: Materials and Supplies Balances by Month and by Quarter[17]

		Plant Supplies			Gas Stored Underground			Fuel Stock Propane			UG Storage - LNG		
Line	Period	Montlhy	5 Quarter Average	13 Month Average	Montlhy	5 Quarter Average	13 Month Average	Montlhy	5 Quarter Average	13 Month Average	Montlhy	5 Quarter Average	13 Month Average
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)	(J)	(K)	(L)	(M)
1	Dec-15	3,090,778	3,090,778	3,090,778	3,650,875	3,650,875	3,650,875	1,116,257	1,116,257	1,116,257	80,382	80,382	80,382
2	Jan-16	3,110,360		3,110,360	3,268,995		3,268,995	1,078,857		1,078,857	66,910		66,910
3	Feb-16	3,166,027		3,166,027	2,596,598		2,596,598	694,991		694,991	52,788		52,788
4	Mar-16	3,270,930	3,270,930	3,270,930	1,867,638	1,867,638	1,867,638	697,834	697,834	697,834	57,759	57,759	57,759
5	Apr-16	3,209,265		3,209,265	1,664,768		1,664,768	690,916		690,916	61,360		61,360
6	May-16	3,304,686		3,304,686	1,890,868		1,890,868	686,571		686,571	47,902		47,902
7	Jun-16	3,237,327	3,237,327	3,237,327	2,185,128	2,185,128	2,185,128	681,382	681,382	681,382	62,938	62,938	62,938
8	Jul-16	3,176,962		3,176,962	2,611,479		2,611,479	685,131		685,131	52,614		52,614
9	Aug-16	3,244,604		3,244,604	2,846,480		2,846,480	870,817		870,817	76,987		76,987
10	Sep-16	3,147,194	3,147,194	3,147,194	3,049,886	3,049,886	3,049,886	950,850	950,850	950,850	66,426	66,426	66,426
11	Oct-16	3,180,737		3,180,737	3,236,914		3,236,914	943,510		943,510	90,286		90,286
12	Nov-16	3,158,124		3,158,124	3,207,859		3,207,859	938,796		938,796	80,301		80,301
13	Dec-16	3,108,605	3,108,605	3,108,605	2,796,536	2,796,536	2,796,536	975,209	975,209	975,209	71,783	71,783	71,783
14	Averages		3,170,967	3,185,046		2,710,013	2,682,617		884,306	847,009		67,857	66,803
15													
16	Difference			14,079			(27,395)			(37,297)			(1,055)

As shown in the table above, when compared to the 13-month average, the use of the five-quarter average results in a high balance included in rate base for Gas Stored Underground, Fuel Stock Propane, and UG Storage-LNG.

[16] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-EN-2.1, Line 80, is included in the Cash Working Capital adjustment on Schedule RR-EN-5-2.
[17] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-EN-5-1 and Staff 8-31 (Attachment DHM-07).

Q. What do these accounts reflect?

A. The Company stated that the Gas Stored Underground account is for EnergyNorth gas stored underground by Tennessee Gas Pipeline Company. The Fuel Stock Propane account reflects propane. The UG Storage-LNG reflects stored LNG, although the LNG is stored above ground.[18] These accounts are non-distribution.

Q. What does Staff recommend regarding these non-distribution accounts?

A. Staff recommends that these gas-related items be removed from recovery through Distribution rates. Staff is also concerned that the Company selected to use the higher five-quarter average methodology (as opposed to the thirteen-month quarter methodology) to add these non-distribution accounts to rate base, which further inappropriately burdens Distribution customers. Staff has removed these three gas-related items from Materials and Supplies as shown on Schedule EN 3.3

Q. Why has the Company included fuel-related items in a Distribution case?

A. The Company's rationale for including these three inventory accounts within Materials and Supplies in Distribution rate base is that there is no other mechanism for the Company to receive a return on the average balance of these three inventory accounts. The Company argues that these three inventory items were included in Materials and Supplies in the Company's last Distribution rate case, Docket No. DG-14-180.[19]

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[18] Liberty response to Staff Tech 3-8 (Attachment JPL/DHM-08).
[19] Liberty response to Staff Tech 3-8 (Attachment JPL/DHM-08).

Concord Training Center

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

A. Staff's adjustment to remove the Concord Training Center from rate base is supported by Staff witness Iqbal Al-Azad. Also included in Staff's adjustment are various operating income items. The adjustment is shown on Schedule EN 3.4.

Employee Pension and Benefits

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

A. Staff's modification to Employee Pension and Benefits is supported by Staff witness James J. Cunningham, Jr. Also included in Staff's adjustment are various operating income items. The adjustment is shown on Schedule EN 3.10.

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's updated requested rate base was $249,735,328. Staff's recommended adjustments reduce the requested rate base to $240,514,539.

<u>Adjustments to Operating Income</u>

Q. What net operating income has the Company proposed?

A. The Company's updated operating income is $9,961,580.[20]

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:

- Concord Training Center
- Revenue to Year-End Customer Count
- iNATGAS Revenue
- Recovery of Theoretical Reserve Imbalance
- Amortization and Depreciation Accrual Rates
- Staff Audit Issue #17 Non-Recurring Expense
- Payroll and Benefits for Vacancies
- Incentive Compensation
- Severance
- Pension and Benefit
- Out of Test Year Legal Fees and Degradation Fees
- Interest Synchronization

Concord Training Center

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

[20] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-1.

A. Staff's adjustment for the Concord Training Center is supported by Staff witness Iqbal Al-Azad. The adjustment is shown on Schedule EN 3.4.

Revenue to Year-End Customer Count

Q. Please explain Staff's recommendation regarding Revenue to Year-End Customer Count.

A. Staff recommends that operating revenues should be based on a year-end customer count in order to be consistent with the recognition of year-end plant-in-service in rate base. The adjustment is shown on Schedule EN 3.11.

iNATGAS Minimum Annual Transportation Quantity Adjustment

Q. Please explain Staff's recommended adjustment regarding iNATGAS Minimum Annual Transportation Quantity Adjustment.

A. Staff's modification to iNATGAS Minimum Annual Transportation Quantity Adjustment is supported by Staff witness Stephen P. Frink. The adjustment is shown on Schedule EN 3.9.

Recovery of Theoretical Reserve Imbalance

Q. Please explain Staff's recommended adjustment regarding Recovery of the Theoretical Reserve Imbalance.

A. Staff's adjustment to modify the recovery period for the theoretical reserve impact is supported by Staff witness Iqbal Al-Azad. The adjustment is shown on Schedule EN 3.5.

Amortization and Depreciation Accrual Rates

Q. Please explain Staff's recommended adjustment regarding Amortization and Depreciation Accrual Rates.

A. Staff's adjustment to modify amortization and depreciation accrual rates is supported by Staff witness Iqbal Al-Azad. The adjustment is shown on Schedule EN 3.14.

Staff Audit Issue #17 Non-Recurring Expense

Q. Please explain Staff's recommended adjustment regarding Staff Audit Issue #17 Non-Recurring Expense.

A. Staff recommends that a non-recurring expense identified by Audit be removed as a test year expense and, instead be recovered over a three-year period. Audit identified $42,592 paid to Sussex Economic Advisors during the test year for professional services for the Liberty NED Supply Pipeline Capacity Analysis; a pipeline project that was canceled in 2016.[21] The expense was incurred for a proceeding that was before the Commission. Staff's adjustment is shown on Schedule EN 3.6.

Payroll and Benefits for Vacancies

Q. Please explain Staff's adjustment regarding the Company's 2017 pro forma adjustment for Payroll and Benefits.

A. The Company's pro forma payroll, payroll tax, and benefits adjustment was developed on an individual position basis and assumed a full complement of employees will be employed

[21] Commission Audit of Liberty Utilities dated August 22, 2017, pages 101–102, 151 (Attachment JPL/DHM-06).

during the twelve months of 2017. The initial application projected a full complement of 305 employees (which was later updated to a projected full complement of 310 employees). The pro forma did not consider the vacant positions that occur during the year. The initial application included 33 vacancies.[22] During 2017, the Company had an additional 24 positions become vacant and 12 newly created positons.[23]

Q. How does Staff recommend addressing the less-than-full complement of employees?

A. Staff's adjustment recognizes the dynamic nature of maintaining a full complement of employees by averaging the vacancies at the beginning of the test year with the most recent data available at the time of this testimony The Company stated it had three vacancies at the beginning of the test year (January 1, 2016). As of November 1, 2017, there were four vacant positions.[24] The average of vacancies was multiplied by the average wage calculated from the Company's pro forma adjustment. Staff's adjustment is shown on Schedule EN 3.7.

Q. How does Staff's adjustment compare to a simple calculation of increasing the test-year payroll expense by the authorized pay rate increase for union and non-union employees?

A. The Company's pro forma salary and wage expense resulted in an increase of 5.3 percent over the test year.[25] The average wage increase for 2014, 2015, and 2016 for non-union employees was 3.0 percent, and for union employees, the average increase was 2.6 percent.

[22] Liberty Direct Testimony of David B. Simek and Daniel S. Dane, page 10, lines 21–22 and Attachment DBS/DSD-2, Schedule RR-EN-3-2, line 27.
[23] Liberty response to Staff 8-15 (Attachment JPL/DHM-09).
[24] Liberty response to Staff Tech 3-13 (Attachment JPL/DHM-10).
[25] Liberty response to Staff Tech 1-1 (Attachment JPL/DHM-03), Schedule RR-EN-3-2, line 34.

For 2017, the Company budgeted a 3.0 percent increase for non-union and a 2.6 percent increase for union employees.[26] Staff performed a comparison between the Company's individual position full complement method and a simple calculation of applying the average wage and salary increase of 2.7 percent to the test-year wages and salary expense. The different methodologies results in a difference of $383,324. Staff's adjustment recognizes that the Company planned to increase its headcount, but also takes into account that the Company will not have a full complement of employees throughout the entire year. Using the Staff's average vacancy methodology results in an adjustment to wages and salaries of approximately half of the simple wage increase methodology as shown on Schedule EN 3.7 WP.

Q. Does this adjustment also reflect the impact of payroll taxes?

A. Yes. The Staff's adjustment 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 EN 3.7.

Q. Does this adjustment also reflect the impact to employee benefits?

A. Yes. The Company's pro forma employee benefits was derived from the pro forma wages and salaries assuming a full complement of employees. The adjustment for vacancies was also reflected in Staff's recommended adjustment for employee benefits as shown on Schedule EN 3.7.

[26] Liberty response to Staff 5-15 (Attachment JPL/DHM-11).

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, and (3) Long Term Incentive Plan, also known as the Performance Share Unit Plan (PSU).[27]

Q. Please describe the Short Term Incentive Plan (STIP).

A. The STIP is a discretionary short-term incentive cash bonus plan that applies to manager level and higher positions. Award is based on the achievement of two components: Balance Scorecard Achievement and Individual Performance Achievement. The weight for each component varies by position level.[28]

Table 5: 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. Award is generally determined by two factors

[27] DG 17-048 Filing Requirements Puc 1604.01(a)(15).
[28] DG 17-048 Filing Requirements Puc 1604.01(a)(15)(a) Short Term Incentive Plan.

similar to the STIP: (1) Company's performance measured against a scorecard and (2) employee's achievement of individual performance objectives.[29]

Q. What is included within the Balance Scorecard?

A. The Company modified the 2017 Balanced Scorecard. The Balanced Scorecard measures results in four major business objectives: (1) People, (2) Stakeholders, (3) Business Processes, and (4) Efficiency.[30] The 2017 Scorecard goals are listed in the following table.

[29] DG 17-048 Filing Requirements Puc 1604.01(a)(15)(b) Shared Bonus Pool.
[30] Liberty response to Staff 8-24 (Attachment JPL/DHM-17).

Table 6: 2017 Scorecard with Weightings

	Weighting
STAKEHOLDERS - Public and Employees	
Deliver World Class Safety Metrics in Operations (RIR)	7.5%
Deliver World Class Safety Metrics in Operations LTI)	7.5%
Complete execution against 2017 EH&S Plan	5.0%
Operate without any Notices of Violation	15.0%
Operate in Accordance with MVA Targets	10.0%
STAKEHOLDERS -*Customers and Communities*	
Achieve Targeted Customer Service Levels	10.0%
Achieve Targeted Customer Satisfaction Levels	10.0%
Deliver Targeted System Reliability	15.0%
Develop and Implement Central Billing and Billprint Plan	5.0%
Evaluate and control cost per customer metrics	5.0%
STAKEHOLDERS -*Capital Markets*	
Deliver on Adjusted FFO/Debt Metrics	15.0%
PEOPLE -*Engagement and Cultural Initiatives*	
Implement 2017 Cultural Initiatives	25.0%
Continue Engagement Plan Development / Implementation	25.0%
Implement Risk Culture Building Initiatives	10.0%
DBG/Reg/State Completion rate for Company Policy e-learning	5.0%
Complete Targeted Interconnection Hours for State/Reg/DBG	5.0%
PEOPLE -*Talent Development*	
Participation in Top Talent Programs	10.0%
PEOPLE -*Leadership*	
Succession Planning Program 2017	15.0%
Implement 2017 Leadership Development Plan	10.0%
Participation in Rollout of Career Planning Program	10.0%
EFFICIENCY -*Create Cost of Capital Efficiency*	
Deliver Targeted State Net Income	20.0%
Deliver Targeted State ROE	20.0%
Deliver EBITDA (State BG Profit)	25.0%
EFFICIENCY -*Create Operational Scale Efficiency*	
Deliver Targeted State Organic Growth	5.0%
Deliver Targeted Growth in Regional Operating Profit	10.0%
EFFICIENCY -*Create Operating Cost Efficiency*	
Distribution Operating Costs < Target QTR	15.0%
Distribution Operating Costs < Target FY	5.0%
BUSINESS PROCESSES -*Governance and Controls*	
Implementation of centralized capital planning system	10.0%
Implement and operate against SOX Compliance Plan	10.0%
Implement Liberty Way Initiative	10.0%
BUSINESS PROCESSES -*Planning and Forecasting*	
Minimize Regulatory complaints	15.0%
Development and Implement Compliance Program	10.0%
Continuing Emergency Preparation Evaluation	5.0%
BUSINESS PROCESSES -*Operational Initiatives*	
Complete Regional Structure Implementation	10.0%
Ensure Timing of Rate Case Filings (State Specific)	15.0%
Complete Development/Implementation of BCP	5.0%
Complete 2017 Capital Projects on-time/on budget	10.0%
Conduct Facilities Rehabilitation	10.0%

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 Balanced 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. 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 vests at the end of the three-year performance period. The performance criteria are as follows:[31]

- Efficiency—85 percent
- Safety—10 percent
- Customer Satisfaction—5 percent

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

A. The Efficiency performance criteria represents 85 percent of the total criteria associated with a PSU award. Based upon the 2017 Scorecard discussed earlier in our testimony, the Company's Efficiency goals are related to Net Income (20 percent), Return on Equity (20 percent), EBITDA-Earnings before Interest, Taxes, Depreciation and Amortization (25 percent), State Organic Growth (5 percent), Growth in Regional Operating Profits (10

[31] Liberty response to Staff 8-26 (Attachment DHM-12).

percent), and Distribution Operating Costs Quarterly (15 percent) and Fiscal Year (5 percent).

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

A. Staff recommends that the PSU that is related to the achievement of Efficiency goals directed toward shareholder benefit be transferred to the shareholders. These performance goals include Net Income (20 percent), Return on Equity (20 percent), EBITDA-Earnings before Interest, Taxes, Depreciation and Amortization (25 percent), and Growth in Regional Operating Profits (10 percent). These goals are focused on benefits for the Company's shareholders. These goals represent 75 percent of the Efficiency goals. Staff's adjustment removes 75 percent of the weighted Efficiency goals or 63.75 percent as shown in the following table.[32] This adjustment transfers the responsibility for funding the PSU to the shareholders where it belongs. The adjustment is shown on Schedule EN 3.8.

Table 7: Corporate Scorecard Efficiency Goals with Shareholder Focus

	Weighting			
	All	Shareholder Focused		
EFFICIENCY - *Create Cost of Capital Efficiency*				
Deliver Targeted State Net Income	20.0%	**20.0%**		
Deliver Targeted State ROE	20.0%	**20.0%**		
Deliver EBITDA (State BG Profit)	25.0%	**25.0%**		
EFFICIENCY - *Create Operational Scale Efficiency*				
Deliver Targeted State Organic Growth	5.0%			
Deliver Targeted Growth in Regional Operating Profit	10.0%	**10.0%**		
EFFICIENCY - *Create Operating Cost Efficiency*				
Distribution Operating Costs < Target QTR	15.0%			
Distribution Operating Costs < Target FY	5.0%			
	100.0%	**75.0%**	85%	63.75%

[32] Efficiency criteria weighting 85% x 75% shareholder focused criteria = 63.75%.

Severance

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

A. The Company included severance pay of $144,130 within the test year.[33] The Company indicated that reasons for the payment of severance included both layoffs and resignations. Staff's adjustment removes the portion related to resignations. Ratepayers should not bear the burden for severance payments to employees that resign voluntarily (e.g., to pursue another opportunity) or resign through mutual agreement (i.e., the Company desired the employee to leave). The adjustment is shown on Schedule EN 3.13.

Employee Pension and Benefits

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

A. Staff's modification to Employee Pension and Benefits is supported by Staff witness James J. Cunningham, Jr.. The adjustment is shown on Schedule EN 3.10.

Out of Test Year Legal Fees and Degradation Fees

Q. Please explain Staff's recommendation regarding Out of Test Year Legal Fees and Degradation Fees.

A. The Company proposes to amortize legal costs related to the City of Manchester and City of Concord court proceedings that took place over several years. As a result of those

[33] Liberty response to Staff 8-23 with Confidential Attachment (CONFIDENTIAL Attachment JPL/DHM-13).

proceedings, degradation fees were also paid.[34] Staff identified several invoices related to legal fees and degradation fees that were incurred by the Company during 2017, or beyond the end of the test period. These costs should not be included in the Company's proposed amortization. However, Staff does not oppose recovery of these 2017 costs through the Company's proposed Step Increase. Staff's adjustment is included in Schedule EN 3.12.

Interest Synchronization

Q. Please explain Staff's recommended adjustment regarding 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 EN 3.15.

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's updated operating income was $9,961,580. Staff's recommended adjustments increases operating income to $12,760,015.

<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 $4,045,589.

[34] Liberty response to Staff 8-6 (Attachment JPL/DHM-14).

<u>EnergyNorth Step Increase</u>

Q. Does Staff have any comments regarding the Step Increase?

A. Yes. Staff supports the Company's Step Increase with the following caveats and adjustments:

(1) The amounts presented by the Company represent budgeted amounts, not actual. Staff will only agree to the inclusion of actual amounts related to 2017 non-revenue producing plant additions which have been examined and verified by the NHPUC Audit Staff.

(2) The revenue requirement calculation reflects Staff's recommend rate of return and depreciation accrual rates.

(3) The Company provides a detailed reconciliation of any Pension-related changes from the FASB Financial Accounting Standards Update No. 2017-07.

(4) The Manchester/Concord Legal and Degradation Fees that were incurred after the end of the test year should be recovered through the Step Adjustment.

The Company proposed a Step Increase of $4,317,133. Staff recommends a Step Increase of $4,098,874. Staff's recommended Step Increase is provided in Schedule 4.

Q. Does this conclude your testimony?

A. Yes.