

STATE OF NEW HAMPSHIRE  
BEFORE THE  
PUBLIC UTILITIES COMMISSION

In the matter of

Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities

Docket No. DG 20-105

Petition for Permanent Rate Increase

DIRECT TESTIMONY

OF

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**Introduction**

**Q. Please state your name, occupation, and business address.**

A. My name is Al-Azad Iqbal, and I am employed by the New Hampshire Office of the Consumer Advocate as Economics/Finance Director. My business address is 21 South Fruit Street, Suite 18, Concord, New Hampshire, 03301.

**Q. Please summarize your educational and professional experience.**

A. My educational and professional backgrounds are summarized in Appendix A.

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

A. The purpose of my testimony is to provide recommendations on issues related to the Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities (Liberty, or the Company) rate proposal regarding 1) depreciation; 2) rate design, rate plan and; 3) other rate-related issues.

**Q. Please summarize your recommendations on these issues.**

A. I recommend that the depreciation reserve variance amortization, approved in the last rate case, be ceased until a new depreciation study is completed. The Company should follow the recommendations in the Review of Reserve Variance Deficiency for Liberty Depreciable Gas Plant done by Paul Normand and Marcy Stefan of Management Applications Consulting, Inc. (MAC); which is found at Testimony of Steven E. Mullen, Attachment SEM (Bates II 235-239)

1 in Liberty's initial filing of July 31, 2020, in this docket. I recommend certain updates in the rate  
2 design process concerning the treatment of decoupling and low-income discounts. I also raise  
3 concerns about the Company's proposed capital budget, and the rate plan with step adjustments.

#### 4 **Depreciation**

5 **Q. What is the significance of depreciation for purposes of this proceeding?**

6 A. As with all public utilities, EnergyNorth includes in its annual revenue requirement an  
7 amount that is, at least theoretically, equal to the decline in the value of the company's capital  
8 assets over a 12-month period. This is necessary because all capital assets decline in value over  
9 their period of usage. To account for that, the annual amount of depreciation is deducted from  
10 the utility's rate base (on which the utility receives a return on investment) and that same value  
11 becomes a recoverable operating cost. In this manner, the utility's shareholders receive both a  
12 return *on* their investment and, via depreciation charges, a return *of* their investment.

13 The accounting necessary to determine the amount recoverable from ratepayers as a  
14 depreciation expense is complicated. Utilities, including EnergyNorth, must constantly add new  
15 capital assets to their rate base. Meantime, operating conditions are not static and thus existing  
16 assets do not depreciate precisely as they were expected to at the time they first go into rate base.  
17 For this reason, a utility like EnergyNorth commissions a depreciation study from time to time,  
18 usually conducted by consultants who are expert in the field of depreciation. A depreciation  
19 study is a statistical exercise that takes into account the vintage of the utility's assets – that is, the  
20 year when each asset was placed into service – the pace at which specific assets are being retired

1 from service, and actuarial principles that are helpful in updating determinations of how much  
2 useful life remains in the rate-based assets. The depreciation experts use statistical techniques to  
3 make mathematical calculations of how the forces of retirement are acting upon each plant  
4 category and an estimate of the service life remaining in each such category.

5 **Q. When was the last depreciation study done for EnergyNorth?**

6 A. EnergyNorth's last depreciation study was done in Docket DG 17-048, the company's  
7 most recent rate case before this one. In that docket, the company's depreciation consultant --  
8 Management Applications Consulting (MAC) -- used a Simulated Plant Record (SPR) life  
9 analysis approach. The SPR approach is useful when a utility lacks sufficient records to develop  
10 actuarial data. In connection with this current docket, EnergyNorth again engaged Mr.  
11 Normand's firm. MAC did not conduct a complete depreciation study as it did for the previous  
12 rate case but, rather, reviewed the growth in the Company's plant with the goal of quantifying  
13 changes in the depreciation reserve imbalance (as required by the order issued in Docket DG 17-  
14 048 on April 27, 2018 (Order No. 26,122). The findings of Mr. Normand (along with his  
15 colleague, Marcy Stefan) are attached to Mr. Mullen's testimony as Attachment SEM 3.

16 **Q. What is a "depreciation reserve imbalance"?**

17 A. A utility's depreciation reserve is a fund the company accumulates annually, based on the  
18 probable replacement cost of its depreciable assets. The depreciation reserve -- also referred to as  
19 accumulated depreciation -- is equal to the total amount of depreciation charged against all of the  
20 utility's capital assets as stated on the utility's balance sheet. A depreciation reserve imbalance

1 occurs when there is a difference between the depreciation reserve on the company's balance  
2 sheet (booked reserve) and the calculated value of the accumulated depreciation (theoretical  
3 reserve). When a comparatively large depreciation reserve imbalance exists, it is necessary to  
4 determine how to correct it. The imbalance can be amortized over a relatively short period of  
5 time or it can be spread over the entire future remaining life of the plant in service.

6 **Q. Please describe the findings of Mr. Normand's and Ms. Stefan's review (as**  
7 **contained in Attachment SEM – 3).**

8 A. The depreciation consultants stated that even with the amortization of the reserve variance  
9 approved in the prior rate case, the reserve variance increased significantly. The biggest  
10 contributors to this increase are Mains (accounts 367 and 376), and Services (account 380),  
11 which were the same accounts that caused the reserve variance in the depreciation study done in  
12 Docket 17-048. In the report found at Attachment SEM-3, MAC identified three items affecting  
13 the reserve variance that should be examined in the context of a new depreciation study: 1)  
14 potential change in average service life (ASL); 2) replacement/retirement of large quantities of  
15 mains and services; and 3) the cost of removal portion of the Company's plant replacement  
16 activities.

17 MAC posited that a new study would derive longer ASLs for both mains and services  
18 which would impact the resulting reserve variance. Further, MAC stated: "... large growth in  
19 plant investments which has been occurring for many years, especially for key plant accounts  
20 related to mains and services, results in large amounts of unrecovered dollars being identified but

1 not recovered in the short term”.<sup>1</sup> MAC further stated: “In the last ten years, the rapid increase  
2 in plant replacement/retirement requirements had, in many cases, resulted in a more detailed  
3 review of these costs (COR) which has resulted in being modified to reflect a much lower 3 to  
4 5% range of costs to new plant investments.”<sup>2</sup>

5 Based on its review, MAC recommended that Liberty do a detailed review of COR and  
6 undertake a new depreciation study. As I explain more fully later, COR is an important aspect of  
7 depreciation because, obviously, when the useful life of an asset has been fully exhausted it must  
8 be physically removed, which has a cost that is properly included in the calculation of  
9 depreciation costs.

10 **Q. Is the recommendation for a detailed review of COR through a new depreciation**  
11 **study consistent with the goal of the depreciation study?**

12 A. Yes. In the last depreciation study, MAC discussed the relevant issues in the context of  
13 the whole life depreciation system (*see* Docket No. DG 17-048, Attachment PMN-2, Bates page  
14 431):

15 The whole life accrual rate is a function of two variables: the  
16 estimated net salvage (salvage less cost to retire) and the average  
17 service life of the group. The continued use of accrual rates properly  
18 developed at one point in time as a function of all circumstances  
19 known and projected at that time can be assumed to be appropriate for  
20 a limited number of years; however, if the lives and net salvage are  
21 not re-estimated periodically, the rates may not provide the

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1 See Attachment SEM-3, Bates page II-236.

2 *Id.*

1 appropriate recovery of capital.

2 He also stated:

3 Obviously, when a change in either net salvage or life expectations is  
4 observed, the book depreciation reserve compared to the computed or  
5 theoretical reserve immediately appears as either over or under  
6 accrued.

7 .....

8 In general, the variance in the reserve is simply the difference  
9 between theoretical reserve based on an updated set of factors as  
10 developed in a depreciation study and the existing book reserves  
11 which reflect the historical reserve adjustments previously approved.  
12 The theoretical reserve calculation, however, is based on a new set of  
13 accrual rates, and applying these results to the current plant balances  
14 as if they were constant historical factors will result in a variance.

15 He also explained:

16 ...statistical mortality studies of past retirement experience may  
17 provide historical indications of the dispersion of retirements and of  
18 average service life if there has been sufficient retirement activity over  
19 a reasonable period of time. Such information may provide some  
20 indication as to what to expect in the future; however, it should not be  
21 taken for granted that the future will mirror the past, especially when  
22 present policies, plans, or external circumstances indicate otherwise.

23 So Mr. Normand's recommendation is consistent with his overall approach to the depreciation  
24 study. The quotes I just provided also highlight the need to update the sets of factors as the data  
25 clearly indicates the current ASL, and CORs are not representing the characteristics of the  
26 company's assets.

27 **Q. What is your opinion about the Average Service Life issue?**

28 **A.** I agree with the consultant's analysis. Between 2007 and 2016, according to the two



1 depreciation studies, Liberty's plant balance for Gas Mains increased by 70%, and for Gas  
2 Services by 74%. Further, since the last depreciation study in Docket DG 17-048, which was  
3 based on 2016 balances, these account plant balances have increased by 35% and 28%,<sup>3</sup>  
4 respectively in the test year. Effectively, the characteristics of these assets have changed  
5 significantly in recent years. Given these balances have essentially doubled in the past 15 years  
6 or so, and given that the more recent plant additions are supported by more reliable accounting  
7 data that is available for study, we concur with the consultants' recommendation that a new  
8 depreciation study based on 2020 data be performed in early 2021 to evaluate the impact on  
9 ASLs.<sup>4</sup>

10 **Q. Please elaborate on the Cost of Removal issue.**

11 A. On this issue, I agree with Mr. Normand's and Ms. Stefan's analysis in Attachment SEM  
12 3. The current practice of applying a flat 10% (of plant investment) estimate for the cost of  
13 removal might not be reflecting the actual COR. MAC pointed out that in the last decade, more  
14 detailed reviews of COR have resulted in a much lower range ( 3% to 5%) for COR related to  
15 new plant investments. The COR is primarily labor costs. With industry improvements in  
16 automation, asset management technology, etc., the COR should be reduced over time. For  
17 example, GIS-based geocoding of the mains would make it possible to pinpoint the precise

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<sup>3</sup> See Attachment SEM-3, Bates page II-235.

<sup>4</sup> In the last study, MAC identified data problem for both Mains, and Services accounts and stated: "Our analyses of this account were based on total assets since the Company could not provide any historical details by material type for analyses. ... we note that the recording of retirements for the last two years has been backlogged." See Docket DG 17-048, Attachment PMN-2, at 35 and 37 (Bates pages 445 and 447).

1 location of an asset, which would reduce the need for unnecessary digging and corresponding  
2 labor costs. The century-old mains and services the Company is replacing now had very little  
3 documentation compared to today's accounting and documentation standards. As a result, the  
4 COR of new assets is expected to be more efficient, and applying the same blanket percentage  
5 (10%) to current investment costs would not be representative of those lower, future costs (when  
6 today's investments need to be removed).automation, asset management technology, etc., the  
7 COR should be reduced over time. For example, GIS-based geocoding of the mains would make  
8 it possible to pinpoint the precise location of an asset, which would reduce the need for  
9 unnecessary digging and corresponding labor costs. The century-old mains and services the  
10 Company is replacing now had very little documentation compared to today's accounting and  
11 documentation standards. As a result, the COR of new assets is expected to be more efficient,  
12 and applying the same blanket percentage (10%) to current investment costs would not be  
13 representative of those lower, future costs (when today's investments need to be removed).

14 **Q. Please explain how the Cost of Removal impacts depreciation expenses.**

15 A. The cost of removal is a component of the net salvage value. The net salvage component  
16 is an important factor in determining the annual accrual rate for each account. A COR represents  
17 the cost of disposing of an asset at the end of its life. For regulatory purposes, this cost is  
18 typically incorporated as a component of book depreciation. So a higher COR would require  
19 higher accrual rates and thus requires higher depreciation expenses.

20

1   **Q.     Please explain how the Cost of Removal impacts the reserve variance.**

2   A.     As previously mentioned, the reserve variance is the difference between theoretical  
3   reserves and existing book reserves. The theoretical reserve is based on an updated set of factors  
4   including COR. A change in COR would have a significant impact on the theoretical reserve,  
5   and thus on the variance. For example, if COR were reduced from 10% to 5% of the new  
6   investments as indicated in the review, it would reduce Net Salvage by approximately half.<sup>5</sup> If  
7   we adjust Net Salvage by half, the combined reserve variance from Mains and Services would  
8   change from a \$16.3 million shortfall to a \$4.5 million surplus. The same would have been true  
9   for the depreciation study from DG 17-048, and would have resulted in a surplus of \$5.7 million  
10   rather than the shortfall of \$9.9 million which is currently being amortized. When a reserve  
11   variance shortfall is amortized, the revenue requirement increases to the detriment of the  
12   ratepayers. When a reserve variance surplus is amortized, the revenue requirement decreases to  
13   the benefit of ratepayers.

14   **Q.     What is your recommendation?**

15   A.     It is obvious that the current set of factors (ASL and COR) need to be updated which will  
16   change the reserve variance significantly. So the amortization of the reserve variance which  
17   increases the revenue requirement by approximately \$1.5 million is unnecessary and  
18   unreasonable. I support MAC's recommendations regarding a new depreciation study and

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<sup>5</sup>For example, Mains net salvage would reduce to 7.5% from 15%.

1 recommend that the reserve amortization approved in the last rate case be discontinued in this  
2 case and any further amortization should be authorized only after the detailed COR and ASL  
3 evaluations MAC recommended are conducted, and/or a new depreciation study is completed. If  
4 this docket is completed before those studies are available, I recommend that the amortization be  
5 discontinued.

6 **Q. Please explain the rationale of your recommendation.**

7 A. As indicated by MAC, ASL and COR were the main factors cited in the last depreciation  
8 study as contributing to the reserve variance. Likewise, the current recommendation is to review  
9 the Mains and Services accounts. If ASL is increased and COR is reduced (as MAC's report at  
10 Attachment SEM-3, p. 2 suggest may be warranted), the reserve variance will be significantly  
11 reduced.

12 In the depreciation study in DG 17-048, Mr. Normand pointed out that the large swing in  
13 the reserve variance (from the prior study, which showed a reserve surplus) was the direct result  
14 of the very large, recent increases in investments in mains and services. The expectation in DG  
15 17-048 was that this level of investments would continue to be exhibited in a similar fashion as  
16 has been experienced in the past.<sup>6</sup> In DG 17-048, Mr. Normand mentioned, establishing a  
17 "collar" or a threshold bandwidth for the variance, such that no amortization would occur unless

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<sup>6</sup> See Attachment AMI-4; response to Staff 7-9(a) in DG 17-048: "The large deviation is a direct result of the very large plant dollar increases for these accounts (Mains \$98M, Services \$66M) driven primarily by the mandated replacement program (CIBS) which is expected to continue for some period of time. As a result, we expect that this behavior will continue to be exhibited in a similar fashion as has been experienced but at a lower level since the recent amortization from the last study will be terminated."

1 the variance was in excess of 5% -10% of the theoretical reserve level, as an option to minimize  
2 the swing.<sup>7</sup> The current reserve variance is below a 10% threshold, so no amortization would be  
3 done under that approach. In the last study, in Docket DG 17-048, the reserve balance was just  
4 above 6%. As indicated earlier, if ASL and COR are adjusted as a result of the reviews  
5 recommended in Attachment SEM-3, the variance would be lower and could be eliminated (i.e.,  
6 in surplus).

7 In DG 17-048, the Commission approved a variance amortization at an accelerated rate of  
8 6 years instead of 12 years approved in the case prior to DG 17-048. In addition, the  
9 Commission required that Liberty re-examine the reserve balance in its next case, as Mr.  
10 Normand and Ms. Stefan have done with the report submitted as Attachment SEM-3.  
11 Continuing to amortize the reserve variance at an accelerated rate as proposed by Liberty in this  
12 case without waiting for the results of the analyses recommended by the consultants in their  
13 report (Attachment SEM-3) is unreasonable, especially given Mr. Normand's and Ms. Stefan's  
14 suggestion that two specific areas (ASL and COR) are ripe for review and adjustment, and  
15 especially when a correction to these items could produce a variance that is much smaller (below  
16 5%), and could potentially lead to a significant reduction in rates.

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<sup>7</sup> See Attachment AMI-4; response to Staff 7-9(c)(2) in DG 17-048. "If maintaining the WL [whole life] approach is required, then consider establishing a collar or a threshold band width for the variance such that no amortization would occur unless the variance is in excess of 5 or 10% of the theoretical level."

**Rate Plan**

**Q. Please review some of the factors identified by the Company that led to the rate case filing in the current docket?**

A. Mr. Mullen stated at Bates Page II-198 of his testimony that the major factor driving the Company's current rate request is the lag in recovery of capital investments and increases in costs, such as property taxes. He also mentioned the following factors - 1) decoupling; 2) reclassification of C&I customers; and 3) year-end customer count adjustment.

**Q. Please address the decoupling issue cited by the Company.**

A. The Company states that an increase in use (of gas) per customer (usage per customer, or UPC) impacts the Company negatively, but provides no support for this conclusion. Conceptually, UPC should have no impact on revenue under the approved decoupling mechanism. Decoupling sets the revenue per customer (RPC) based on test year data, not actual data. If the UPC changes from year to year, RPC should not. An increase in UPC might increase a customer's bill but would not impact the Company's revenue allowed under decoupling because any variances between allowed and actual revenue due to changes in UPC would be captured as over-or-under collections and would be reconciled through the Local Distribution Adjustment Clause (LDAC) Revenue Decoupling Adjustment Factor (RDAF) mechanism.

The concept of decoupling is based on the assumption that energy efficiency policies and programs reduce the sales of a utility's commodity – in this case, gas sales – and thus negatively

1 affect the Company's earnings. Decoupling is designed to break this link between sales and  
2 revenues to eliminate any disincentive for utilities to implement EE programs based on the  
3 expectation that reductions in UPC result in associated reductions in revenue.

4 The reverse is also true – when UPC goes up, the revenue is not affected under  
5 decoupling. The Company's own review by its consultant (*see* Attachment AMI-1, OCA TS 1-  
6 7.3, Company Response to OCA DR TS 1-7) indicates that UPC does not impact the Company's  
7 revenue. Thus, I strongly disagree with the Company that decoupling warranted, or justifies, -  
8 the current rate case.

9 **Q. Please address the rate class reclassification issue.**

10 A. The Company claims that the reclassification of 1,598 commercial and industrial  
11 customers after the test year negatively impacted its revenue. The reclassification was the result  
12 of the Company's post-test year Rate Review process (Attachment AMI-2, Company Response  
13 to Staff DR 3-5.b). It is common practice for utilities to adjust customer rate classifications  
14 within a rate review process.

15 **Q. What is your opinion on how the rate reclassification impacted the Company?**

16 A. A rate classification adjustment could impact revenue, depending on the scale of  
17 migration from one class to another, because reclassification will determine the allowed revenue  
18 for those customers under decoupling. Usually, such migration patterns do not fluctuate  
19 significantly and impacts are negligible. If a customer migrates from a lower RPC class to a  
20 higher RPC class, the Company's allowed revenue would increase by the difference between the

1 two RPCs and *vice versa*. According to the Company's analysis, the impact of reclassification is  
2 a reduction in allowed revenue under decoupling of \$0.9 million. (Attachment AMI-2, Company  
3 Response to Staff DR 3-5.b).

4 The Company did not elaborate on the key reasons that could explain the somewhat large  
5 impact due to customer migration between rate classes. It matters how frequently the company  
6 reclassifies its customers. If the Company reclassifies its customers in a timely and diligent  
7 manner the impact due to reclassification cannot be substantive. The accuracy of the Company's  
8 test year revenues is important in any rate case filing. In this case, the Company claims a  
9 negative impact to its revenues, but in another situation the same factors might have a positive  
10 impact on its revenues.

11 **Q. Please explain the end of the year adjustment issue?**

12 A. Mr. Mullen described the end of year (EOY) adjustment issue as a methodology issue  
13 (Bates 11-199):

14 The revenue adjustment was performed in a simplified manner, but  
15 the results of that adjustment were found to vary significantly from  
16 the determination of revenues to be received from customers under  
17 the Company's decoupling structure that uses monthly RPC amounts  
18 that vary by class. Due to the significant variations in monthly RPC  
19 amounts, the simplified methodology in the year-end customer count  
20 adjustment overstated the amount of revenue to be received from new  
21 customers.

22 I believe Liberty is concerned about the EOY adjustment methodology, which was proposed by  
23 Staff in DG 17-048 and was ultimately approved by the Commission. I believe that the simple  
24 methodology which was used in the last rate case (and in many other electric and gas rate cases



1 and approved by the Commission) is reasonable. Usually, an EOY adjustment increases revenue  
2 and is applied to the test year sales number without any adjustment. In the rehearing process in  
3 DG 17-048, Staff identified the need for sales to be adjusted to ensure accurate rates. So while it  
4 is true that the application of the EOY adjustment to test year sales increase those sales for rate-  
5 setting purposes (which is consistent with using a year-end rate base in rate-setting) the same  
6 adjustment caused inflated rates in previous instances. This issue should be properly  
7 investigated where it is still used. In the current rate case, the EOY adjustment has been refined  
8 to address the data accuracy to a certain level. There might still be some room for improvement.  
9 OCA is open to improvements in the methodology, but supports the EOY adjustments as known  
10 and measurable adjustments that are consistent with using the year end rate base.

### 11 **Rate Plan/Step Adjustments**

12 **Q. Why is the Company proposing multi-year step adjustments?**

13 A. Mr. Mullen stated at Bates II-209 that “the largest negative impact on a utility’s earnings  
14 between rate cases is the regulatory lag between the time capital investments are made and the  
15 time that recovery of the revenue requirement associated with those capital investments begins,  
16 particularly when those investments are considered non-revenue producing or non-growth  
17 related.” He also pointed to the termination of the CIBS program and the need for an alternative  
18 method to obtain timely recovery of the costs involved with replacing leak-prone pipe on its  
19 distribution system.

1   **Q.     What is your opinion regarding non-revenue producing or non-growth related**  
2   **investment as a reason for multiple step adjustments?**

3   **A.**     Theoretically, investments that are not revenue producing or growth-related could be the  
4   basis for multiple step adjustments, but in this instance the planning and policy practices of  
5   Liberty undermine reliance on such investments as a reason for automatic rate increases outside  
6   of a rate case (when such planning and policy practices can be fully reviewed). Every utility  
7   faces regulatory lag. Customer growth provides an opportunity to minimize the impact of the  
8   regulatory lags, because customer growth produces increased revenue. Under decoupling, the  
9   revenue is stabilized for the Company but allowed to increase with customer growth. A  
10   reasonable utility would look for a balance between growth and non-growth capital investment  
11   so that the impact of regulatory lag would be manageable. Liberty's capital budget for the next  
12   five years (*see* Attachment AMI-3, Staff TS 3-9) shows an expansion in rate base from \$346  
13   million<sup>8</sup> at the end of 2019, plus a proposed \$49 million<sup>9</sup> in actual investments in 2020, plus an  
14   *additional* \$400 million in planned investments for 2021 through 2025, yet only 15% of its \$400  
15   million budget is growth-related and a lion's share of the non-growth, non-revenue-producing  
16   projects are discretionary. These amounts raise the question about Liberty's planning process,  
17   and management decisions – whether *doubling* the rate base in five years (while only 15% of that

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<sup>8</sup> *See* Bates II-132R, line 1.

<sup>9</sup> *See* Staff TS 3-31.

1 investment is growth related) is a sound approach and beneficial for customers or in the public  
2 interest.

3 When this case was filed in July 2020, Liberty presented its “integrated capital spending  
4 plan” as Attachment BF/RM/HT-2, (Bates II-189) which showed projected spending as: 2021 at  
5 \$34.7M; 2022 at \$54.1M; and 2023 at \$53.4M. In Data Response OCA 3-8, Liberty stated that  
6 its capital budget was: 2021 - \$49M; 2022 - \$38M, and 2023 - \$59M. Then in February 2021, in  
7 Response Staff TS 3-9 (*see* Attachment AMI-3), the Company provided a revised capital budget  
8 for the next 5 years which showed the capital budget as follows: 2021 - \$48M; 2022 - \$111M;  
9 2023 - \$74; 2024- \$93.5M; 2025 - \$75M. Without any explanation, Liberty’s capital budget has  
10 practically doubled since this case was filed.

11 Based on the last CIBS filing (DG 20-049, Attachment CAM-1) the average CIBS  
12 investment was \$4.6 million per year. Since the last rate case, the average was \$10 million per  
13 year. The proposed step adjustment asked for a recovery of 80% of the non-growth capital  
14 investments which translates to an average \$54 million per year based on the latest capital budget  
15 described earlier. It is more than ten times the average CIBS investment. Even 20% of the non-  
16 growth capital investment (equivalent to \$13.5 million per year) is more than the average CIBS  
17 investment of the last few years.

18 The OCA fundamentally questions whether such enormous increases in rate base are  
19 necessary. Such large increases in capital will exacerbate any inherent regulatory lag, but the  
20 OCA questions whether such large budgets with a huge non-growth discretionary investment are

appropriate for a rate plan involving a series of step increases as opposed to traditional rate review and recovery through test-year based rate setting.

### **Other Issues**

**Q. Do you have any observations regarding any inaccuracies or errors that might impact the Company's decision to file this rate case?**

A. I will address several issues regarding the Company's decision to file this rate case. The first issue is related to the low-income discount program. The second issue is related to the Company's treatment of decoupling that impacted its rate request. As this is the first rate case filing that Liberty has made since implementing the decoupling mechanism, the Company, Staff and the OCA worked together to address these issues through a settlement agreement in the temporary rates phase of this proceeding approved by the Commission.

**Q. Before discussing the issues, please explain how revenue requirement, revenue collected, and allowed revenues are different in a traditional rate filing as compared to a rate filing made after a decoupling mechanism has been implemented.**

A. Traditionally, any increase of revenue requirement allowed is added to a company's test year revenue when setting the new rates. If a company had \$1,000 in test year revenues and demonstrated a need to collect an additional \$300, then the company would design base rates to collect \$1,300. That is no longer true under decoupling. Decoupling involves two versions of revenue: a) the revenue actually collected at current rates, and b) the allowed revenue that the

1 company can retain under decoupling. Decoupling creates a separation between the revenue  
2 actually collected and the allowed revenue. The difference that is either returned to or collected  
3 from customers is identified by the company as “decoupling revenue” which could be surplus or  
4 deficit in any given year. In traditional rate filings, there is no such separation between the  
5 revenue actually collected and the allowed revenue. Under decoupling, in a rate case, if current  
6 rates collected more revenue than the company was allowed, and there was no revenue  
7 deficiency due to other factors (such as plant increases or O&M increases), the rate case would  
8 reduce revenues though reduced rates. If there is an increase in revenue requirement, and it is  
9 equal to the “decoupling revenue,” there would not be any change in rates (the base rate increase  
10 would be offset by the decoupling mechanism decrease). Only if the increase in revenue  
11 requirement is higher than the decoupling revenue would there be an overall rate increase.

12 **Q. Can you now please elaborate on the two issues?**

13 A. In its initial filings, the Company calculated its revenue increase based on its allowed  
14 revenue and applied the increase to the revenues collected at current rates. (*See* Petition  
15 Attachment 1, pp. 2-4.) This did not take into account that the current rates provide for a  
16 revenue collection above the allowed revenue. However, the request for an increase in revenue  
17 requirement must take into account *all* the revenues that are being collected under the current  
18 rates. The Company’s filing had two mistakes: 1) the revenue amount under current rates did not  
19 reflect the revenues from the Residential Low Income Assistance Program (RLIAP),<sup>10</sup> and 2) the

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<sup>10</sup> Currently known as the Gas Assistance Program (GAP).

1 Company translated an increase in revenue requirement directly to an increase in rates which  
2 incorrectly did not take into account that the current rates provide for a revenue collection above  
3 the allowed revenue, the difference that would have been returned to customers through the  
4 RDAF.

5 **Q. Please explain the first issue.**

6 A. The first issue is related to the low-income discount program. The Company collects  
7 low-income program discounts from all customers through the RLIAP as part of the LDAC. As  
8 a result, the Company's revenue is made whole when both the base rate and the LDAC collection  
9 of this discount are considered. However, in its initial rate filing in this case, the Company did  
10 not account for the low income discount revenue recouped through the RLIAP/ LDAC when  
11 calculating its required distribution revenue (revenue requirement).<sup>11</sup> Thus, to begin with, the  
12 Company missed approximately \$2 million in revenue in its earning calculations, rate of return,  
13 revenue increase required, etc. Inexplicably, the Company made mistakes in the rate model  
14 which resulted in an additional increase in the revenue requirement by the same amount. These  
15 errors reflected a roughly \$4 million impact.<sup>12</sup> Such a large figure might have influenced the  
16 Company's decision to file a rate case.<sup>13</sup>

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<sup>11</sup> This created a bigger issue in the rate design model which is discussed later.

<sup>12</sup> The \$4 million amount is significantly more than the \$0.9 million adjustment due to customer reclassification, which was stated as one of the reasons for the rate case.

<sup>13</sup> This error was corrected in the February 21, 2021 by the Company through an updated report of proposed rate changes and updated attachments. See Tab 32.

1     **Q.     Do you have any recommendations to correct this issue in the future?**

2     A.     Yes. The source of these errors is the integration of low-income discounts in the rate  
3     design model. I recommend that the Company treat all low-income customers as regular  
4     customers for all rates and revenue related matters, and reconcile the discount through the  
5     LDAC. First, all electric utilities and the one other gas utility in the state follow this  
6     methodology for their low income program-discounts costs and rate design and have not made  
7     similar errors in revenue calculations. Secondly, with the changes implemented in the recent low  
8     income program docket (DG 20-013), the discount is no longer offered year-round; instead, it is  
9     offered only for the winter season, and the discount now also applies to the supply portion of the  
10    bill (whereas before it was limited to the distribution portion). This approach would eliminate  
11    the possibility of errors in the complexity of rate design modeling, and would make it be easier to  
12    address program costs through the LDAC.

13   **Q.     Are you proposing to eliminate Rates-4 or low-income rates?**

14   A.     No. I am proposing to change the way those rates are presented in the rate design process.  
15   For rate design, R-4 (low-income) customers would be recognized at regular customer rates, and  
16   the Company will count the regular rates as revenue for rate design purposes. The discount will  
17   be given to the customers and the recoupment of that discount from all other customers will be  
18   accomplished through the LDAC.

19   **Q.     Please explain the second issue.**

20   A.     The second issue is more nuanced and new under decoupling. If there is an over-

1 collection above allowed revenue, the Company returns the excess revenue through its approved  
2 decoupling mechanism, the RDAF. In a decoupled environment, when there is a rate case the  
3 over-collection can be credited towards the required rate increase so that the revenue requirement  
4 is increased without changing the base distribution rates. As a result, the RDAF mechanism will  
5 be reset. So without increasing the distribution rates, the Company's revenue can be increased.  
6 This is accomplished by changing the revenue per customer (RPC). RPC calculations should be  
7 filed as part of the tariff compliance filing.

8 **Q. Has this adjustment been done before?**

9 A. Yes. That is what was done (at Staff's recommendation) in the temporary rate phase of  
10 this proceeding, *see* DG 20-105 Exhibits 5 and 6, where adjusted decoupling RPCs and usage per  
11 customer (UPC) were implemented. For the settlement agreement in the temporary rates phase  
12 the Company proposed and the Parties agreed to use current rates as temporary rates to provide a  
13 temporary allowed revenue increase. By increasing the allowed revenue in temporary rates by  
14 maintaining current rates, customers did not see an increase in rates but they also were no longer  
15 receiving the refund they would have received under the RDAF.

16 **Q. Do you think the approach taken in the temporary rates settlement agreement**  
17 **regarding decoupling should be replicated in the future?**

18 A. No. The OCA believes that the implementation of this method, which involved changing  
19 the usage per customer (UPC) during the temporary rates phase, is inappropriate. The UPC is  
20 part of what the rate case determines and it is premature to make that judgement at the temporary



1 rate phase because, to analyze the UPC properly, stakeholders need more time than the  
2 temporary rate phase allows. In the future, rate increases at the temporary rate phase should only  
3 be accomplished through a change in the RPC as occurs during CIBS or a step increase.

4 **Q. Please explain the rate design model issue you mentioned earlier.**

5 A. As discussed earlier, in its Rates-5 rate design schedule the Company did not include the  
6 approximately \$2 million in revenue that it collected through the LDAC. This oversight has two  
7 layers of impacts: 1) it inflates the required revenue increase, and 2) the revenue increase,  
8 applied to the deflated current revenue as the base, produces a higher percentage, which is then  
9 applied to the actual revenue when designing rates. For example, if the actual revenue is \$100,  
10 and the low income program discount is \$2, the Company is counting \$98 for rate design and all  
11 other rate case filing purposes. If we assume that a cost of service study shows a required  
12 revenue of \$105, then the rates model will show a revenue increase of \$7 (\$105 -\$98) needed, as  
13 compared to the actual required increase of \$5 ( (\$105 -\$100), with a difference of \$2. This is  
14 the first layer. When the percentage increase is calculated, the model uses \$98 as the base and \$7  
15 as the revenue increase, which is 7.14%. Then the Company applies this percentage to its actual  
16 current revenue of \$100, giving them a revenue of \$107.14, whereas it should be \$105. In  
17 actuality, only a 5% increase was required.

18 In Docket DG 17-048, and in the initial filing in this case, the Company added another  
19 wrinkle in its Rates-5 schedule. Specifically, the Company added the low income program  
20 amount above the approved revenue increase. Continuing the example I have been using,

1 assuming that the Commission approved the \$7 revenue increase (incorrectly), the Company  
2 added another \$2 to that revenue to recover the 'low-income program cost' so that the Rates-5  
3 schedule would reflect a revenue increase of \$9. Using the example previously given, the  
4 calculations will produce revenue of \$109.2, instead of the \$105.00 if everything were done  
5 correctly. Unfortunately, this mistake is what occurred in the last rate case DG 17-048 resulting  
6 in an increase in revenue currently reflected in the test year allowed revenue.

7 **Q. Did the Company correct these issues in its updated filing?**

8 A. Yes. Liberty updated its rate filing on February 25, 2021, which corrected how revenues  
9 under decoupling and the low-income discount program are accounted for when calculating  
10 revenue requirements, and designing rates, under a decoupling mechanism environment.

11 **Q. Do you have any additional observation on the updated filing?**

12 A. Yes. The updated filing requests an increase in delivery rates equivalent to \$2.9 million  
13 by allocating \$2 million to the production costs recovered in the Cost of Gas filings. In its  
14 original filing this \$2 million was part of delivery rates. As our colleague Jerome Mierzwa has  
15 testified, the OCA agrees with this shift based on the functional cost of service study. This is  
16 still a proposed \$4.9 million overall increase in rates.

17 The Company proposed revenue requirement increase, relative to the previously allowed  
18 revenue requirement, is actually \$9.9 million which is the \$4.9 million delivery and COG rate  
19 increases I just mentioned plus the of \$4.97 million "decoupling revenue" increase implemented  
20 during the temporary rate phase.

**Conclusion**

**Q. Please summarize your position?**

**A.** In summary, OCA recommends the following:

- The OCA recommends that the amortization of reserve deficiency approved in the last rate case be discontinued until the ASL and COR are revised and a new depreciation study is done.
- On the rate plan issue, the OCA is concerned about the balance between growth and non-growth capital investment by the company, and recommends that any rate plan should incorporate a reasonable balance.
- The OCA recommends that the low-income rate class should be treated as regular residential customers in all rate design and revenue related purposes, and the low-income program cost should be dealt with in the cost of gas or any related dockets.
- The OCA recommends that in the future the UPC should not be changed during the temporary rate phase.
- The OCA recommends that the RPC calculations be filed as part of the tariff compliance filing.

**Q. Does that conclude your testimony?**

**A.** Yes.