STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET NO. DG 20-105

IN THE MATTER OF: LIBERTY UTILITIES (EnergyNorth Natural Gas) CORP. d/b/a LIBERTY UTILITIES

DISTRIBUTION SERVICE RATE CASE

DIRECT TESTIMONY

OF

DONNA H. MULLINAX
CONSULTANT TO STAFF

March 18, 2021

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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 40 years of professional experience and have been a utility industry consultant for the last 25 years. My consulting assignments include numerous rate cases filed by public 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, Kentucky, Illinois, Maryland, Massachusetts, Michigan, Missouri, Nebraska, New Hampshire, New York, North Dakota, Ohio, Oregon, Pennsylvania, 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 have testified before this Commission in Docket Nos. DE 16-383, DE 16-384, DG 17-048, DE 19-057, and DE 19-064. In addition, Blue Ridge has provided analysis and reported on our findings in Docket Nos. DG 17-070, DW 18-047, DW 18-054, and DW 18-056.

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 proposed by Liberty Utilities (EnergyNorth Natural Gas) Corp., d/b/a Liberty Utilities ("EnergyNorth" or "Company") and to present the effect of Staff's recommended ratemaking adjustments on the Company's revenue requirements.

Q. Please summarize your recommendations.

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

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

		Rate Base	Operating Income	Revenue Deficiency
	Staff's Recommended Rate of Return			6.67%
	Revenue Conversion Factor			1.37137
Adjustment 1	Normalize M&S Reflected in Rate Base	$ (849,232)		(77,679)
Adjustment 2	Cash Working Capital	(72,407)		$ (6,623)
Adjustment 3	Modify Amortization of Non-Protected EADIT	-	$ 533,216	(731,234)
Adjustment 4	Payroll Expense - 2020 Increase		68,201	(93,528)
Adjustment 5	Normalize CSR 2019 Ratification Bonus Over Term of Contract		10,500	(14,399)
Adjustment 6	**Long-Term Incentive Compensation**		183,978	(252,301)
Adjustment 7	Payroll Tax		297,051	(407,365)
Adjustment 8	Sharing of D&O Liability Insurance		10,410	(14,275)
Adjustment 9	Property Tax-Remove Doubled State of NH TRUE UP		168,225	(230,698)
Adjustment 10	**Remove Additional Keene Production Costs**		3,874	(5,313)
Adjustment 11	Modify Presentation of Pelham Risk Sharing		(47,092)	64,580
Adjustment 12	Remove Amortization of Depreciation Reserve Imbalance		1,119,705	(1,535,526)
Adjustment 13	Capitalized Fleet Depreciation	(445,959)	(325,180)	405,149
Adjustment 14	Not Used			-
Adjustment 15	Interest Synchronization		26,043	(35,714)
	Impact of Staff's Recommended Cost of Capital			(3,797,586)
	Pelham Risk Sharing			(95,837)
	iNATGAS			(301,742)
	Keene Risk Sharing			(43,742)
		$ (1,367,598)	$ 2,048,930	$ (7,173,832)

Q. What revenue increase does Staff recommend?

A. Staff recommends a *decrease* of $2,240,114 for the EnergyNorth Distribution base rates, which includes adjustments for Pelham Risk Sharing, iNATGAS, and Keene Risk Sharing supported by Staff witness Stephen P. Frink. The following table shows the Company's updated revenue requirement request and Staff's recommendation.

Table 2: Staff's Recommended Revenue Deficiency (Sufficiency)

Company's Updated Revenue Deficiency (2/25/21)	$ 4,933,718
Staff's Recommended Adjustment	(7,173,832)
Staff's Recommended Revenue Deficiency (Sufficiency)	$ (2,240,114)

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

A. Yes. Besides my qualifications already mentioned as Attachment DHM-1, Attachment DHM-2 includes Staff's revenue requirement schedules, and Attachments DHM-3 through DHM-23 are copies of selected documents that are referenced in my testimony.

Q. How are Staff's revenue requirement schedules organized?

A. Staff's revenue requirement 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 3.15, and Schedule 4, 4.1, and 4.2.

Q. What is shown on Schedule 1?

A. Schedule 1 is a summary comparison of the Company's and Staff's computations of the revenue requirement and the revenue deficiency. The schedule summarizes the impact of all 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 between 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 Schedules 4, 4.1, and 4.2?

A. Schedule 4 summaries Staff's adjustments to the Company's proposed Step Increase. Schedule 4.1 and 4.2 are supporting workpapers.

<u>Revenue Requirements</u>

EnergyNorth's Requested Revenue Increase

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

A. The Company's Application requested an increase in annual operating revenues of $13,497,250. To provide time for the review of the Company's request, the Company also requested, and the Commission approved, a temporary increase in distribution rates of $6.5 million. The Company also requested a step increase of $5.68 million annually to begin recovering the revenue requirement associated with capital projects completed and in service during the twelve-month period ending December 31, 2020.[1]

On March 1, 2021, the Company filed corrected and updated rate schedules that revised its revenue requirement schedules to reflect new or updated information that became available and to include any changes that were identified during the discovery process. The Company's updated request is for an increase in base rates of $4,933,718,[2] or a $8,563,532 reduction from the Company's original request of $13,497,250. The Company's requested Step Increase changed from $5,680,641 to $5,646,985.[3]

Changes Made in EnergyNorth's Revenue Requirement Filings

Q. What changes has the Company made to its revenue requirement filings following discovery?

A. The Company made a number of revisions to its revenue requirement schedules that are summarized below:

[1] Liberty Application (July 31, 2020) page 1 and 2. Order No. 26,412 (September 30, 2020), page 1.
[2] Notice of Intent to File Rate Schedules (March 1, 2021), correction and updated schedules.
[3] Notice of Intent to File Rate Schedules (March 1, 2021), correction and updated schedules.

Table 3: Company's Corrections and Updates to Original Revenue Requirement[4]

Liberty Utilities (EnergyNorth)
Track Changes
Rate Year Ending December 31, 2020

Ref	Version	Rev Req	Increase	Change from prior	Step Increase Total	Change from prior	NOTES
a	**July 31, 2020, Application**		**13,497,250**		**5,680,641**		**Application**
1	September 10, 2020 Model, as corrected	101,306,034	6,451,180	(7,046,070)	5,680,641	-	Staff Request TS 3-7
2	Exclude GSE Related Costs	101,304,648	6,449,795	(1,386)	5,680,641	-	Audit Issue #2
3	Include Short Term EDIT	101,283,022	6,428,168	(21,626)	5,680,641	-	Audit Issue #5
4	Include Account 482.1 in Revenues	101,283,039	6,418,586	17	5,680,641	-	Audit Issue #6
5	Correct Pembroke Property Tax	100,572,920	5,708,467	(710,119)	5,647,754	(32,887)	Audit Issue #7
6	Calculate Property Tax on Second Half Only	100,895,826	6,031,373	322,906	5,647,754	-	Audit Issue #7
7	Nashua Education Tax Removal	100,904,084	6,039,631	8,258	5,646,985	(769)	Audit Issue #8
8	Non-Utility Plant Property Tax Removal	100,900,553	6,036,100	(3,531)	5,646,985	-	Audit Issue #9
9	Remove NHPUC Penalty Expenses	100,815,142	5,950,688	(85,412)	5,646,985	-	Audit Issue #10, Staff Request 3-69 (k)
10	Include EDIT Gross-up in Rate Base	99,849,659	4,985,205	(965,483)	5,646,985	-	Staff Request 2-49
11	Exclude Lobbying Expense	99,846,644	4,982,191	(3,015)	5,646,985	-	Staff Request 3-69 (a) & (k)
12	Correct Keene Cost Adjustment	99,849,477	4,985,023	2,833	5,646,985	-	Staff Request 1-6 (a)
13	Remove Charitable Contributions from ADIT/EDIT	99,834,462	4,970,008	(15,015)	5,646,985	-	Staff Request TS 3-22
14	CBIZ, E&Y and KPMG Adjustment	99,828,113	4,963,660	(6,349)	5,646,985	-	Staff Request TS 3-23
15	Remove Non-Recoveable Advertising Expenses	99,787,005	4,922,551	(41,109)	5,646,985	-	Staff Request TS-3-21
16	CNG Station Revenue Requirement Adjustment	99,786,984	4,933,718	(20)	5,646,985	-	Staff Request TS 3-6
17	Update Increase Related to Indirect Expenses in COG	99,786,984	4,933,718	-	5,646,985	-	Increase assigned to COG changed to $2,033,855

The Company's corrections and updates resulted in a requested increase in base rates of $4,933,718, or a reduction from the Company's original request of $8,563,532.

Establishment of Current Distribution Revenue Requirement

Q. When was the Company's current distribution revenue requirement established?

A. Order No. 26,122 (April 27, 2018) established EnergyNorth's current rates based on a test year of the 12 months ended December 31, 2016, with rates effective May 1, 2018 in Docket No. 17-048. OCA and the Company had signed a settlement agreement addressing all contested issues in that case. In opposing the adoption of that settlement, Staff stated that, in its view, the settlement would not result in just and reasonable rates. The Commission's ultimate decision resulted in current rates reflecting an increase in Distribution revenues of $8,060,117 (the Company's revised requested revenue deficiency was $14.5 million) and a step increase effective the same date estimated to be $4,729,953 for certain non-revenue-producing investments made during 2017, offset by a

[4] Liberty Combined Revenue Requirement Model – 2019 TY Corrections FTI v4, Tab Track (Attachment DHM-4).

$2,394,065 reduction due to tax reform. The Order also approved, for the first time in New Hampshire, a decoupling mechanism, which allows rate adjustments for weather, energy efficiency, economic effects, and other variables and allows Liberty to earn distribution revenues on a per customer basis, thus eliminating substantial revenue risks.[5]

Test Year

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, 2019.[6] Staff's calculations use the same historical test year.

Q. Did the Company make adjustments to 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 calendar year ended December 31, 2019, then excluding revenues and expenses related to the Cost of Gas and the Local Delivery Adjustment Clause (LDAC), and adjusting for known and measurable changes. The resulting Test Year net operating income reflects normalized revenues at current rates, expense, and net operating income for ratemaking purposes.[7]

Q. Did the Commission's Audit Staff audit the Company's historical test year results?

A. Yes. Staff's audit recommended several adjustments. The Company adopted several of the recommendations in its corrected and updated revenue requirements. The Company

[5] DG 17-048, Order No. 26,122 (April 27, 2018), pages 1–4.
[6] Direct Testimony of David Simek and Kenneth Sosnick 4:9–10 (Bates II-110).
[7] Direct Testimony of David Simek and Kenneth Sosnick, 5:18–6:4 (Bates II-111–II-112).

did not agree with some of the audit recommendations that affect the revenue requirements, which are discussed later. The audit report is included as Attachment DHM-3.

Adjustments to Rate Base

Q. What rate base had the Company proposed?

A. The Company originally requested a rate base of $356,411,727.[8] The Company revised its requested rate base to $346,149,831.[9]

Q. The Company's revised rate base is significantly lower than the rate base proposed in the original application. Please explain the reason for the $10.3 million reduction in rate base.

A. The most significant portion of the reduction in the Company's proposed rate base is the Company's correction to Excess Accumulated Deferred Income Taxes (EADIT) following discovery, increasing EADIT by $10,491,365. EADIT is a reduction to rate base. The correction reflects the proper recording of the EADIT balance grossed-up for taxes, including the short-term EADIT, and removing charitable contributions that are not recovered in rates.

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

A. Yes. Staff proposes adjustments to the following rate base items.

- Materials and Supplies (M&S)

[8] Attachment DBS/KAS-1, Schedule RR-1 (Bates II-132).
[9] Attachment DBS/KAS-1, Schedule RR-1 (Bates II-132R).

- Cash Working Capital

Material & Supplies

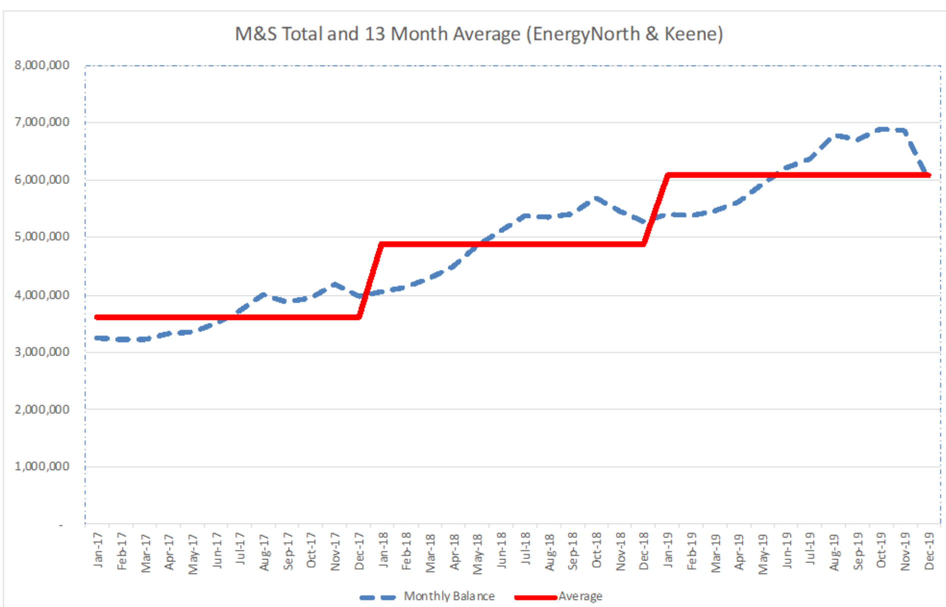
Q. Please explain Staff's recommended adjustment to Materials and Supplies.

A. The Company's rate base includes $5.936 million in Materials and Supplies ("M&S") based on the average of five quarterly balances.[10] Staff requested the monthly M&S balances for 2016 through 2019 and found a significant increase in the M&S amounts over the last few years as shown in the following table and graph.

Table 4: EnergyNorth and Keene 13-Month Average M&S 2017–2019

	2017	2018	2019
EnergyNorth	3,484,106	4,792,587	5,910,148
% Increase		37.6%	23.3%
Keene	118,226	91,898	156,927
% Increase		-22.3%	70.8%

Figure 1: M&S Total and Average (EnergyNorth and Keene)



[10] Attachment DBS/KAS-1, Schedule RR-EN-5 (Bates II-151R).

Q. What was the Company's explanation for the increases in the M&S balances?

A. The Company provided the reasons for the M&S balance increases:

> During 2017, the Company was informed that one of the suppliers of regulators was moving to Mexico. The Company made additional purchases in order to avoid any potential delays in the delivery of meter sets and assemblies arising from the supplier's move. The Company also increased its inventories to accommodate for the expected increase in main replacement associated with the CIBS program.
>
> During 2019, the Company added an additional contractor to provide sufficient resources to meet the increased pipeline replacement. To meet that requirement, the Company purchased additional materials to support the new contractor.

Q. Does the Company expect the reasons for the increases to continue such that an M&S balance comparable to 2019 is expected during the rate effective period?

A. No. The Company stated that pipeline replacement is leveling off and the Company expects to see some improvements in materials planning as a result of moving toward an integrated system under SAP.

Q. What is Staff's recommendation?

A. Since the higher levels of M&S are not expected to continue during the rate effective period **(the 12 months beginning August 1, 2021)**, Staff recommends that the amount reflected in rate base be adjusted downward. Staff recommends reflecting an M&S balance of $5,086,928 (year-end average for years 2017 through 2019) in rate base. As shown on Schedule 3.1, rate base is *reduced* by $849,232.

Cash Working Capital

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

A. Cash Working Capital was developed through the preparation of a lead-lag study. The lead-lag study shows a net lag of 25.72 days.[11] 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. Staff's adjustment to Cash Working Capital updates the revenue and expense components of the Company's lead-lag study to reflect Staff's adjustments that are discussed within this testimony. As shown on Schedule 3.2, Staff's adjustment to Working Capital *reduces* Rate Base by $72,407.

Staff's Recommended Rate Base

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

A. The Company's updated requested rate base was $346,149,831.[12] Staff's recommended adjustments *reduce* the rate base to $344,782,233.

<u>**Adjustments to Net Operating Income**</u>

Q. What net operating income has the Company proposed?

A. The Company's revised net operating income at current rates is $22,259,725.[13]

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

[11] Attachment DBS/KAS-1, Schedule RR-EN-5-2 (Bates II-153R). The net lag in EnergyNorth's last base rate case, DG 17-048 was 26.53 days (Attachment DBS/DSD-2, Schedule RR-EN-5-2, Bates 072),
[12] Attachment DBS/KAS-1, Schedule RR-1 (Bates II-132R).
[13] Attachment DBS/KAS-1, Schedule RR-1 (Bates II-132R).

A. Yes. Staff is recommending adjustments to net operating income components:

- Modify Amortization of Non-Protected EADIT
- Add 2020 Increase to Payroll Expense
- Normalize CSR 2019 Ratification Bonus Over Term of Contract
- Adjust Long-Term Incentive Compensation
- Adjust Payroll Tax
- Incorporate Sharing of D&O Liability Insurance
- Remove Doubled State of NH TRUE UP of Property Tax
- Remove Additional Keene Production Costs
- Modify Presentation of Pelham Risk Sharing
- Remove Amortization of Depreciation Reserve Imbalance
- Capitalize Fleet Depreciation
- Interest Synchronization

Staff also has recommendations regarding advertising expenses included in the Company's rate request.

Non-Protected Excess Accumulated Deferred Income Taxes (EADIT) Amortization

Q. Please explain Excess Accumulated Deferred Income Taxes.

A. Provisions in the tax law permit companies to reduce taxable income by accelerating certain expense deductions (e.g., depreciation and repair allowances) on their tax returns; the impact reduces taxes payable in earlier periods when the accelerated expense for tax purposes exceeds the actual book expense for financial reporting. The difference between book tax expense and cash taxes remitted to the government is accounted for using the

Accumulated Deferred Income Tax (ADIT) balance. Because utilities typically recover book tax expense in rates, which again does not reflect accelerated deductions (through a ratemaking convention referred to as "tax normalization" or "inter-period tax allocation"), the ADIT liability is included as an offset in rate base to recognize customer-supplied capital.

The 2017 Tax Cuts and Jobs Act (TCJA) reduced the federal corporate income tax rate from 35 percent to 21 percent. The tax rate change reduced the valuation of future income tax liabilities owed to the federal government. The revaluation created an excess ADIT balance, which represents deferred income taxes collected from customers in the past that the utilities are not expected to remit to the government in the future. The excess ADIT must be returned to customers.

Q. What is the issue in this proceeding?

A. Staff identified several concerns regarding the amount of EADIT due to customers. The Company corrected the balance in its Update and Corrections filing. Staff and the Company agree that the total EADIT due to customers is $37,855,214. The remaining issue is determining the amortization period over which the EADIT balance should be returned to customers. The Company proposes to return the $37,855,214 of EADIT to customers over 28.93 years.

Q. How did the Company decide that the EADIT should be returned over 28.93 years?

A. There are three classes of EADIT, which are based on the nature of underlying assets being depreciated: (1) Protected Property, (2) Non-Protected Property, and (3) Non-

Protected Non-Property. To simplify an arcane topic, I will not discuss in detail the differences between each class, except to mention that state commissions do not have latitude to decide the treatment of the Protected Property class. The internal revenue code (IRC) requires utilities to handle the Protected Property class in accordance with specific prescribed methods, either the Average Rate Assumption Method (ARAM) if data is available or, if a utility does not have sufficient data to calculate weighted average remaining life using the ARAM, the Reverse South Georgia Method (RSGM). EnergyNorth used RSGM and determined that its Protected EADIT should be returned to customers over 28.93 years. The Company proposes to also return the Non-Protected Property and Non-Protected Non-Property over 28.93 years. Under the Company's proposal, the total EADIT of $37,855,214 due to customers would be returned to customers (amortized) over 28.93 years, which results in a reduction to the revenue requirement in this case of $1,308,216.

Q. Although the IRC prescribes the Protected Property EADIT amortization, does the Commission have discretion over the amortization of the Non-Protected Property and Non-Protected Non-Property?

A. Yes. While the IRC prescribes Protected Property EADIT amortization, the Commission can determine the amortization of the Non-Protected Property and Non-Protected Non-Property. Staff recommends that the Non-Protected Property and Non-Protected Non-Property be recovered over five years. The following table compares the results of the Company's proposal and Staff's recommendation.

Table 5: Protected and Unprotected EADIT Amortization

	Protected Property	Unprotected Property	Unprotected Non-Property	Total
EADIT Balance	$ (33,434,927)	$ (644,443)	$ (3,775,845)	$ (37,855,214)
Company Proposed:				
Recovery	28.93	28.93	28.93	
Amortization	$ (1,155,718)	$ (22,276)	$ (130,517)	$ (1,308,511)
Staff's Recommendation:				
Recovery	28.93	5.00	5.00	
Amortization	$ (1,155,718)	$ (128,889)	$ (755,169)	$ (2,039,776)
Difference				$ (731,265)

Q. Why does Staff recommend recovery of the non-protected items over five years?

A. First, the Non-Protected Non-Property related balance is predominantly attributable to book-tax differences derived from regulatory assets on the Company's balance sheet. Unlike utility plant, regulatory assets are characteristically short-lived.

Second, while use of the average remaining life of the plant balances is not unreasonable for the Non-Protected Property class, all of the EADIT balances were originally supposed to begin amortizing in 2018 with the rate effective date of last general rate case; at the Company's request, the amortization was delayed so that it could investigate whether it had the data to implement the ARAM. Given the circumstances, it is equitable to flow back the benefits of the Non-Protected Property class more expeditiously to customers.

Q. How was this issue addressed in the recent Granite State Electric (Liberty's sister electric utility) rate case (Docket No.19-064)?

A. In the Granite State Electric rate case, the Company proposed to recover the entire EADIT balance of $5.6 million over 20.87 years, which would result in an amortization of $(196,018) reflected in rates.[14] That case concluded when the Commission approved a comprehensive settlement that contained a total revenue requirement increase but did not specifically address the amortization of EADIT. Thus, Staff disagrees with Liberty's position in this case its EADIT amortization proposal in DE 19-064 was "approved" by the Commission."[15]

Q. Is EADIT an important issue in this proceeding?

A. Yes, the EADIT for EnergyNorth is significantly larger than it was for Granite State Electric. The EnergyNorth balance is $37.9 million in this proceeding, while the amount in the Granite State Electric case was $5.6 million.

Q. Please summarize Staff's recommendation.

A. The amount to be returned to customers should increase from $1.3 million to $2.04 million. As shown on Schedule 3.3, Staff's recommended adjustment *increases* Total Amortization Due to customers by $731,265, which *increases* Operating Income by $533,216.

Payroll Expense

Q. Please describe the Pro Forma Payroll adjustment proposed by the Company.

A. In general terms, the Company bases its pro forma payroll upon the test year labor

[14] Docket No. 19-064 Attachment PEG/DBS-1 Schedule RR-5 (CU) and Schedule RR-3-05 (CU) (Attachment DHM-5).
[15] Liberty response to Staff 3-40 (Attachment DHM-6).

expense charged to EnergyNorth, adjusted for a three-year average level of vacancies[16] and multiplied by an estimated increase of 3.0 percent.[17]

Q. Does Staff agree with the Company's approach to calculate the pro forma payroll?

A. Yes, assuming the Company expects no significant changes to headcount during the rate effective period, the Company's calculation methodology is reasonable. However, Staff believes that the Company's estimated payroll increase of 3.0 percent should be updated to reflect the actual increase in 2020.

Q. Please elaborate.

A. At the time the Company prepared its payroll adjustment, the Company knew the contractual increases for its union employees (which ranged from 2.5% to 2.8%) but did not know the non-union actual 2020 merit increase, which could not be provided until late February 2021. The actual non-union merit increase for 2020 is 2.0 percent.[18] Thus, the 3.0 percent used by the Company is higher than the actual increase.

Q. How did Staff determine the actual payroll increase for 2020?

A. The Company provided a list of positions and the union membership. I used this information and the contractual union wage increases and actual merit increase to develop a pro-rata percentage increase to apply to the test year labor expense charged to

[16] Liberty response to Staff TS 3-15 Vacancy workpaper, Summary Non-Confidential Tab only (Attachment DHM-8).
[17] The payroll adjustment also makes an adjustment to recognize that the first two months in 2019 did not contain the 2019 annual wage increase and, also, recognizes that the 2020 wage increase does not go into effect until March 2002. Liberty response to Staff 2-8b (Attachment DHM-9).
[18] Liberty revised response to Staff TS 3-16 (Attachment DHM-7).

EnergyNorth, adjusted for vacancies. The pro-rata actual 2020 increase is 2.47 percent as shown in the following table.

Table 6: Pro-Rated 2020 Salary Increase–Union and Non-Union

Description	2019 FTE	2020 Increase	Prorated Increase	Source
Liberty - New Hampshire - IBEW 326	17	2.70%	0.12%	Staff 3-65
Liberty - New Hampshire - IBEW 486	19	2.70%	0.13%	Staff 3-65
Liberty - New Hampshire - USW 12012_03	106	2.80%	0.77%	Staff 2-30
Liberty - New Hampshire - USW 12012_09	46	2.50%	0.30%	Staff 2-30
Liberty - New Hampshire - USW 12012_10	6	10.00%	0.16%	Staff 2-30
Liberty - New Hampshire - UWUA 369	3	2.80%	0.02%	Staff 3-65
Non Union	187	**2.00%**	0.97%	Staff TS 3-16
Liberty - New Hampshire - USW 12012_11	1		0.00%	
Totals	385		2.47%	

Source: Staff 2-23, Attachment Staff 2.23.xlsx

While using actual wages and salaries instead of headcount to develop the actual increase may result in a different pro-rata amount, Staff's approach should provide a reasonable proxy for the increase that should be reflected during the rate effective period. What is certain is that the 3.0 percent used by the Company is too high and should be adjusted downward.

Q. What is the effect of Staff's recommended adjustments to Payroll Expense?

A. As shown on Schedule 3.4, Staff's recommended adjustment *reduces* Payroll Expenses by $93,531, which *increases* Operating Income by $68,201.

Customer Service Representative (CSR) Ratification Bonus

Q. Please explain the CSR Ratification Bonus.

A. The Company provided the amount of the Customer Service Group 2019 wages that the Company is seeking to recover in this proceeding. Included within the 2019 CSR wages was $18,000 for a Ratification Bonus.[19] The Company explained the Ratification Bonus:

> The ratification bonus is a component of compensation paid to members of a collective bargaining unit and acts as an incentive during contract negotiations to increase the likelihood that the union membership will accept the proposed agreement between union representatives and the Company. The ratification bonus is a total payment by the Company that is distributed to all members of the collective bargaining unit. These **<u>onetime</u>** ratification bonuses are paid as part of collective bargaining negotiations in lieu of agreeing to higher wage increases that will be compounded with every subsequent wage increase going forward. As such, the ratification bonus is a cost-effective way of reducing total costs over the contract period. [Emphasis added.][20]

Q. What does Staff recommend regarding any Ratification Bonuses that the Company has included in its rate request?

A. Staff recommends that all ratification bonuses, which reflect one-time payments, be normalized over the term of the contracts. The CSRs are represented by Local 12012-09, which recently ratified a five-year contract.[21] Thus, Staff recommends that this one-time $18,000 payment of the Ratification Bonus included in the Company's rate request be spread over five years.

Q. Are there other ratification bonuses for other unions included in the Company's rate request?

A. Staff found information on the CSR's ratification bonus late in the proceeding. Due to the late identification of this item, Staff did not verify whether ratification bonuses were paid to the other unions in 2019 and, if there are, the amounts included in this rate case. However, we did review the current contracts, and USW 12012–03 (106 FTEs) and USW 12012-10 (6 FTEs) appear to have ratified contracts during the test year. Thus, the

[19] Liberty response to OCA 4-10 (Attachment DHM-10).
[20] Liberty response to Staff TS 3-17 (Attachment DHM-11).
[21] Liberty response to Staff 2-31, Attachment Staff 2-31.b.2 (Attachment DHM-12).

Company's rate request likely reflects additional ratification bonuses. Staff recommends that the Company remove any ratification bonuses included in test year expenses and amortize those costs over the term of the contract(s).

Q. What is the effect of Staff's recommended adjustments to normalize the one Ratification Bonus that Staff identified?

A. As shown on Schedule 3.5, Staff's recommended adjustment *decreases* payroll expense by $14,400 and *increases* Operating Income by $10,500. As discussed earlier, the actual amount is likely much higher as the recommended adjustment represents only one union.

Long-Term Incentive Compensation

Q. Please describe the Incentive Compensation Plans reflected in the Company's test year.

A. The Company sponsors three incentive programs. The first two, the Short Term Incentive Plan (STIP) and Shared Bonus Pool, award annual cash bonuses for the achievement of Balanced Scorecard objectives and individual performance. The STIP covers employees in manager level and higher positions, while the Shared Bonus Pool provides for non-management employees in union and non-union positions. The two plans weigh achievement of the Balanced Scorecard more highly than individual performance at between 80% and 90%, depending on position level.

The third program is the Performance and Restricted Share Unit Plan, also known as the Long Term Incentive Plan (LTIP). The LTIP compensates executive employees for the achievement of corporate objectives in the form of performance and restricted share units tied to the value of the Company's stock at the end of the year preceding the award. Conferred share units vest over a three-year performance period.[22]

Q. Is Staff recommending an adjustment to the Company's incentive compensation plans in this proceeding?

A. Staff is not recommending a change to the amount requested by the Company for STIP and Shared Bonus Pool. The awards under these plans are based on the Company's performance measured against a scorecard and employee's achievement of individual performance objectives.[23] Staff reviewed the scorecards provided by the Company that drive the awards under the STIP/Shared Bonus Pool and found that they appropriately balance the interests of ratepayers, employees, and shareholders.

However, Staff is recommending an adjustment to exclude from rates the awards under the Company's LTIP.

Q. Please explain why it is appropriate to remove from customer rates the awards made under the LTIP.

A. The Company's LTIP is, in the words of the parent company, Algonquin Power & Utilities Corp., "intended to induce and reward behavior that creates long-term value for Shareholders by aligning the interests of executives with long-term Shareholder interests." The LTIP compensation is in the form of performance and restricted share units tied to the value of the Company's stock. The realization of the common stock value

[22] Puc 1604.01(a) Copies of all officer and executive plans (Bates I-121–I-151).
[23] Puc 1604.01(a)15(b) page 1 (Bates I-127).

is dependent on "the achievement of performance-vesting criteria and share price growth." The full quote is shown below.

> The LTIP element of compensation for the NEOs consists of participation in the Stock Option Plan and in the Share Unit Plan as described below. **The LTIP is intended to induce and reward behavior that creates long-term value for Shareholders by aligning the interests of executives with long-term Shareholder interests**. To achieve this, the future value of the LTIP awards to executives is **tied to the value of the Common Shares**. The **realization of such value depends on the achievement of performance-vesting criteria and share price growth**, making the LTIP portion of executive compensation truly "at risk" and linked to performance intended to also benefit Shareholders.[24] [Emphasis added.]

Management receives a significant monetary incentive to focus efforts on increasing the value of Performance and Restricted Share Unit Plan awards. The LTIP rewards behavior that promotes the interest of shareholders. Excessive focus on increasing profitability and share price growth can harm customers. Staff recommends that all the costs of the LTIP included in the Company's rate request be transferred to shareholders.

Q. Please explain how excessive focus on share price growth might not be beneficial to customers?

A. A utility could take many actions that increase profitability while at the same time do not benefit customers. For example, requests for rate increases can be based on inflated pro forma revenue requirements. Investments included in rate base can be based on decisions to retire and replace assets that are financially driven rather than risk driven. Between rate cases, during periods of slow revenue growth, a company will reduce expenses to maintain profitability. While reducing expenses can and should benefit ratepayers, taken

[24] Algonquin Power & Utilities Corp. Notice of Annual Meeting of Common Shareholders to be Held on June 4, 2020, and Management Information Circular, page 63 (Attachment DHM-13).

to an extreme, it can harm customers. For example, expenses can be reduced to increase profitability by deferring utility plant maintenance (resulting in safety issues or outages). Further, expenses can be reduced by failing to adequately staff Customer Services, which could lead to difficulties in, for example, accessing customer service to report leaks or outages. Customer services would also have long wait times for other inquiries or complaints if the Company were understaffed in order to reduce costs and drive up profitability. Staff is not claiming in this case that Liberty took of any of these actions during the test year but Staff raises these potential areas of concern to stress the importance of utilities establishing incentive compensation programs that balance behaviors that benefit customers, employees, and shareholders. Liberty's LTIP does not exhibit that necessary balance.

Q. What is Staff's recommended adjustment?

A. The Company included $252,311 of LTIP costs in its rate request.[25] Staff recommends removing these costs. Staff's adjustment *increases* Operating Income by $183,978, as shown on Schedule 3.6.

Payroll Taxes

Q. Please explain Staff's adjustment to Payroll Taxes.

A. Staff's adjustment has two parts. First, Staff corrected the Company's pro forma payroll tax rate to reflect the statutory rate that the Company pays. The Company derived its 11.11 percent pro forma payroll tax rate by dividing the Unadjusted Test Year Labor

[25] Liberty response to Staff 2-22 (Attachment DHM-22).

Expense by the Unadjusted Test Year Payroll Tax Expense. This calculation resulted in an overstated payroll tax.

Q. Did Liberty make a similar error in its Granite State rate case (Docket No. 19-064)?

A. Yes. Liberty used the same methodology in its Granite State case that resulted in a 10.5 percent rate. Liberty corrected it in its Corrections and Update filing in Docket No. 19-064. The Company apparently overlooked the correction when it filed testimony in this docket.

Q. What payroll tax rate should the Company use?

A. The statutory payroll rate is 15.3 percent for wages up to $137,700 for the 2020 calendar year, with the obligation for these taxes equally divided between employers and employees at 7.65 percent (6.2 percent for Social Security and 1.45 percent for Medicare). There are other payroll-related taxes, such as Federal and State Unemployment taxes, that should also be included in the overall rate. To account for these other items, Staff used Liberty's corrected combined payroll tax of 8.91 percent used in the Granite State rate case (Docket No. 19-064).[26] Staff's adjustment modifies the payroll rate of 11.11 percent used by the Company to 8.91 percent.

Q. What is the second part of Staff's Payroll Tax Adjustment?

A. In the second part, Staff reflects the impact to payroll taxes corresponding to Staff's modification of the Company's payroll-related adjustments, which includes both Payroll Expense and the CSR Ratification Bonus discussed earlier.

[26] Docket No. DE 19-064, Technical Statement of Philip E. Greene and David B. Simek, page 3 of 7 (Attachment DHM-14).

Q. What is the total effect of Staff's adjustments to Payroll Taxes?

A. Staff's adjustments *reduce* payroll taxes by $407,382, which *increase* Operating Income by $297,051 as shown on Schedule 3.7.

Sharing of Directors and Officers ("D&O") Lability Insurance

Q. Please explain Staff's recommended adjustment regarding the sharing of Directors and Officers (D&O) Liability Insurance.

A. The Company carries D&O Liability insurance and has reflected $28,553 in O&M expense in its rate request. An additional $13,486 has been capitalized.[27] Staff's adjustment removes one-half of the D&O Liability Insurance expense. The 50% removal reflects a sharing of this insurance between shareholders and ratepayers. As shown on Schedule 3.8, Staff's adjustment *increases* Operating Income by $10,410.

Q. Why should the cost of D&O Liability Insurance Expense be shared between shareholders and ratepayers?

A. The Company stated that the D&O Liability insurance covers

> Directors and Officers and all persons who were, now are, or shall be Directors or Officers of the company and of any Subsidiary, and all persons serving in a functionally equivalent role for the Parent Company or Subsidiary operating or incorporated outside of Canada are covered under this policy.[28]

The Company provided the D&O Liability Insurance policy, which described its coverage:

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[27] Liberty response to Staff 2-46 (Attachment DHM-15).
[28] Liberty response to Staff 2-46 (Attachment DHM-15).

I. INSURING AGREEMENT

(A) The INSURER shall pay on behalf of the DIRECTORS and OFFICERS all ULTIMATE NET LOSS for which the INSURED ORGANIZATION has not provided indemnification and which arises from a CLAIM first made against the DIRECTORS or OFFICERS during the POLICY PERIOD or during the DISCOVERY PERIOD, if purchased, for a WRONGFUL ACT which takes place before or during the POLICY PERIOD and is actually or allegedly caused, committed or attempted by the DIRECTORS or OFFICERS while acting in their respective capacities as DIRECTORS or OFFICERS.

(B) The INSURER shall pay on behalf of the INSURED ORGANIZATION all ULTIMATE NET LOSS for which the INSURED ORGANIZATION has, to the extent required or permitted by applicable law, granted indemnification to the DIRECTORS and OFFICERS and which arises from a CLAIM first made against the DIRECTORS or OFFICERS during the POLICY PERIOD or during the DISCOVERY PERIOD, if purchased, for a WRONGFUL ACT which takes place before or during the POLICY PERIOD and is actually or allegedly caused, committed or attempted by such DIRECTORS or OFFICERS while acting in their respective capacities as DIRECTORS or OFFICERS.

(C) The INSURER shall pay on behalf of the INSURED ORGANIZATION all ULTIMATE NET LOSS which arises from a SECURITIES CLAIM first made against the INSURED ORGANIZATION during the POLICY PERIOD or during the DISCOVERY PERIOD, if purchased, for a WRONGFUL ACT which takes place before or during the POLICY PERIOD.

II. DERIVATIVE INVESTIGATION COST COVERAGE

The INSURER shall pay all INVESTIGATIVE EXPENSE incurred by an independent committee of the board of directors or equivalent governing body of the INSURED ORGANIZATION in response to a SHAREHOLDER DERIVATIVE DEMAND, provided the SHAREHOLDER DERIVATIVE DEMAND is first made during the POLICY PERIOD or the DISCOVERY PERIOD, if purchased, and the alleged WRONGFUL ACT giving rise to the SHAREHOLDER DERIVATIVE DEMAND takes place before or during the POLICY PERIOD.[29]

[29] Liberty response to Staff 2-46, Attachment Staff 2-46 (Attachment DHM-15).

As shown by the policy coverage above, D&O Liability Insurance protects the Company and the personal assets of officers and directors from the costs of lawsuits that may be initiated for alleged wrongful acts in managing the Company.

When required to be utilized, shareholders benefit from payouts under the policy that would offset costs (that is, damage awards or expenses due to actual or alleged wrongful acts) that would likely not be recoverable from ratepayers. On the other hand, ratepayers benefit because having the insurance enables the directors and officers to make decisions without fear of personal liability. Considering the shared benefits, it is reasonable for shareholders and ratepayers to share the cost of D&O Liability Insurance.

Q. Did Liberty seek recovery of D&O Liability Insurance expense in the recent Granite State Electric base rate case?

A. Liberty stated during discovery in the recent Granite State Electric rate case (Docket No. DE 19-064) that no amount for D&O liability insurance was included in the base year and forecasted period.[30] Staff relied upon Liberty's response and did not suggest an adjustment in DE 19-064. In the current proceeding, the Company stated that Liberty's response in DE 19-064 was inaccurate and that D&O insurance was included in the rate request.[31]

[30] Docket No. DE 19-064 Liberty response to Staff 3-23 (Attachment DHM-16).
[31] Liberty response to Staff TS 3-20 (Attachment DHM-17).

Advertising

Q. Please explain Staff's concern regarding the recovery of Advertising expenses.

A. During discovery, Staff found several campaign/advertisements that did not comply with Commission rules which restricts recovery of certain types of advertising.[32] When asked about how the Company records and tracks advertising expenses that are eligible for recovery from ratepayers and those that are not, the Company explained its process. In general, the Company uses separate job codes to separately track the recoverable costs (Account 909) from uncoverable costs (Account 913).

- Account 909 is for informational and instructional advertising expenses, "which primarily convey information as to what the utility urges or suggests customers should do in utilizing gas service to protect health and safety, to encourage environmental protection, to utilize their gas equipment safely and economically, or to conserve natural gas."

- Account 913 is for "expenses incurred in advertising designed to promote or retain the use of utility service, except advertising the sale of merchandise by the utility."

However, when preparing its revenue requirement, the Company included both the recoverable (Account 909) and unrecoverable (Account 913) costs. The Company agreed that the promotional-related advertising costs should not have been included. In addition to the specific charges questioned by Staff,[33] the Company reviewed all its advertising-related invoices greater than $1,000 and identified and removed $40,910 of non-

[32] Puc 510 Utility Advertising.

[33] Staff questioned several EE related advertisements. The Company stated that the response to Staff 3-68 incorrectly noted the expenses as EE costs. However, one Staff questioned charge was related to EE and the Company stated that those EE advertising costs should have been forwarded to the Energy Efficiency department for processing through the LDAC surcharge. The charge was recorded to Account 913 and removed in the Corrections and Update filing.

recoverable advertising expenses (Account 909—$14,426 and (Account 913—$26,484)[34] in its Corrections and Update filing.[35]

Q. Does Staff agree with the Company correction?

A. Yes; however, a concern remains that there may be additional costs that should have been removed. When asked to confirm that the advertising for which recovery was sought was in compliance with Commission rules, the Company stated that due to the number of invoices, it reviewed only invoices over $1,000.[36] Therefore, other non-recoverable advertising expenses, which had not been reviewed and identified by the Company, could still remain in the Company's rate request. The following table summarizes what was in the Company's initial request for recovery and what was removed in the Corrections and Update filing.

[34] Staff Audit Issue #12 identified $3,000 booked to account 913 related to a Best of NH event sponsorship. Since the Company removed the expenses booked to Account 913, this finding was addressed in the Company's Correction and Update filing.
[35] Liberty response to Staff TS 3-21 (Attachment DHM-18).
[36] Liberty response to Staff TS 3-21 (Attachment DHM-18).

Table 7: Advertising Expenses

Advertising Accounts	2019
Account 909	
Labour Expense :	
8840-2-9865-69-5010-9090 Info & Insr Advertising - Labor	$ 21,409
Other Expense:	
8840-2-9865-69-5390-9090 Info & Insr Advertising Expense	71,881
8843-2-0000-69-5390-9090 Informational & instructional advertising expenses	2,566
Total Account 919	$ 95,856
Removed in the Corrections and Update Filing	(14,426)
Remaining balance	$ 81,429
Account 913	
Other Expense:	
8840-2-0000-69-5390-9130 Advertising Expenses	$ (27)
8840-2-9865-69-5390-9130 Advertising Expenses	26,514
Total Account 913	$ 26,487
Removed in the Corrections and Update Filing	(26,484)
Remaining balance	$ 3

Staff understands that there are legitimate advertising expenses in the Company's rate request. However, an after-the-fact review of only the larger invoices does not provide a level of comfort that all non-recoverable advertising expenses have been removed. Within the $81,429 included in Account 909 that remains in the rate request, there could be additional charges that should be removed. However, Staff is not recommending an adjustment at this time but does recommend that the Company modify its process to ensure that in future filings, non-recoverable advertising expenses are clearly identified and excluded.

Q. What steps is the Company taking to ensure that the non-recoverable advertising expenses are not reflected in future base rate requests?

A. The Company stated that both Accounts 909 and 913 are above the line for FERC accounting purposes. As a result, both accounts were included in the determination of the revenue requirement when the financial schedules were pulled together for the rate case. The Company is "having internal discussions regarding potentially establishing new job codes for NHPUC unrecoverable advertising costs that would post to account 426 (below-the-line) to more clearly recognize the incongruity between FERC accounting rules and the prohibitions on certain advertising cost recovery contained in the Commission's administrative rules and assure exclusion of the costs going forward."[37]

Q. Does Staff have a recommendation?

A. Yes. Staff recommends that the Company report on the process change it makes to ensure that non-recoverable costs are not included in future rate case filings.

Property Taxes

Q. Please explain Staff's recommended adjustment regarding Property Taxes.

A. Staff adjustment removes the doubling of the State of NH True Up and reduces property taxes by $230,708.

Q. Please explain why the State of NH True Up should not be doubled when determining the pro forma property taxes.

A. State of NH Property Taxes are paid in two installments. The first installment is only an estimate because it is based on the prior year's notice of valuation. The second installment, however, is based on the current year's notice of valuation. Any difference between the estimate and the actual valuation for the first installment is trued up. In this instance, the true-up is the difference between the estimated taxes paid during 2019

[37] Liberty response to Staff TS 3-21 (Attachment DHM-18).

(using the 2018 December notice of valuation) and the December 2019 notice of valuation. The Company calculates its pro forma property taxes by using the second installment amount calculated based on current-year valuation and multiplying it by two. However, since the Company used the *total* property tax from the second installment in its derivation of the pro forma property tax amount (which included not only the second installment based on current-year valuation but also the State of NH True Up for the first installment), the State of NH True Up was also multiplied by two. It is not appropriate to double the true up as if it relates to the full year (rather than just the first half). As shown on Schedule 3.9, Staff's adjustment *reduces* Property Taxes by $230,708, and *increases* Operating Income by $168,225.

Additional Keene Production Cost

Q. Please explain Staff's adjustment regarding Additional Keene Production Costs.

A. As discussed in the testimony of Staff witness Stephen P. Frink, the Company removed $211,561 related to Keene production costs. An additional $5,313 was identified and removed. As shown on Schedule 3.10, Staff's adjustment *increases* Operating Income by $3,874.

Pelham Risk Sharing

Q. Please explain Staff's adjustment regarding Pelham Risk Sharing

A. As discussed in the testimony of Staff witness Stephen P. Frink, the Company increased revenue by $64,583 to reflect Pelham Risk Sharing on Schedule RR-EN-3-1, Bates II-138. Staff removes this revenue increase to modify the presentation of the Pelham Risk

Sharing. Staff also increases the amount to allocate more Pelham-related shortfall to Liberty. As shown on Schedule 3.11, Staff's removal of this $64,583 revenue adjustment *reduces* Operating Income by $47,092. Staff also allocates a $95,837 shortfall to Liberty, which is reflected as a revenue requirement *reduction* after the determination of the revenue deficiency (sufficiency) on Schedule 1.1.

Depreciation Reserve Imbalance

Q. What is Staff's adjustment regarding the amortization of the Depreciation Reserve Imbalance?

A. Discussion of Staff's adjustment for the amortization of the depreciation reserve imbalance is in the testimony of Stephen P. Frink. The adjustment is shown on Schedule 3.12. The adjustment *decreases* Depreciation Expense by $1,535,588 and *increases* Operating Income by $1,119,705.

Capitalization of Fleet Depreciation

Q. Please explain Staff's concern regarding the Capitalization of Fleet Depreciation.

A. The concern regarding the Company's practice of capitalizing fleet depreciation was identified in the recent Granite State Electric rate case audit (DE 19-064), Staff Audit Issue #3:

DE 19-064 Audit Issue #3
Capitalizing Fleet Depreciation

<u>Background</u>
Audit reviewed the 2018 overhead burden calculations. The Capitalized Fleet overhead represents the capitalized monthly fleet, allocated on a pro-rata basis. The capitalization is the monthly depreciation expense of grouped asset 8830-3920, multiplied by the

quarterly fleet depreciation rate capitalized by CWIP job through the BRD

Audit Issue
In 2018, the Company began capitalizing a portion of depreciation expense associated with fleet assets through inclusion of the result within the BRD burden applied to capital jobs. Audit understands that the income statement overall is impacted.

However, the capitalized portion of the depreciation expense is credited to account 8830-XXX-xx-XXXX-922X rather than 8830-2-0000-80-8610-4030 Depreciation Expense.

As a result, the depreciation expense is overstated and the Accumulated Depreciation understated.

Audit Recommendation
The Company should not be capitalizing a portion of the depreciation expense, and should quantify the impact and adjust the filing.

Company Response
The transportation (fleet) overhead and the vehicle depreciation capitalization on construction vehicles are two distinct transactions which appear to have been combined in the above write-up of the Audit Issue.

Transportation (fleet) overhead includes costs that are accumulated in the transportation clearing account. Fleet charges such as maintenance and fuel charges are spread from a clearing account proportionately based on labor dollars. The entry for the fleet overhead allocation is credited to capitalized credits, account 922, and cleared to the qualifying jobs.

The capitalization of depreciation on construction vehicles to account 107 balance is appropriate under the guidance set forth by US GAAP standard ASC 360. The entry to capture the capitalization of vehicle depreciation used in construction activities is a debit to CWIP, account 107 and a credit to depreciation expense account 403. Thus, the depreciation expense is not overstated and the Accumulated Depreciation is not understated.

Audit Comment
As acknowledged by Liberty in response to Audit Issue #7, the Company must comply with FERC for regulatory purposes.[38]

[38] DE 19-064 Granite State Electric Staff Audit Report (January 16, 2020), page 121 (Attachment DHM-19).

Q. Why did the issue come up again?

A. The recent Granite State Electric 2019 Storm Fund Report (DG 06-107) Audit report identified Repeat Audit Issue #1:

DE 06-107 Repeat Audit Issue #1
Capitalizing Fleet Depreciation

__**Background**__
The Capitalized Fleet overhead represents the capitalized monthly fleet, allocated on a pro-rata basis. The capitalization is the monthly depreciation expense of grouped asset 8830-3920, multiplied by the quarterly fleet depreciation rate capitalized by CWIP job through the BRD. The Company now includes the Capitalized Fleet overhead within the BRD burden allocation. The Capitalized fleet represents the capitalized monthly fleet, allocated on a pro-rata basis. The capitalization is the monthly depreciation expense of grouped asset 8830-3920, multiplied by the quarterly fleet depreciation rate capitalized by CWIP job through the BRD.

__**Audit Issue**__
An **Audit Issue** included within the DE 19-064 rate case audit report indicated that the Company began capitalizing a portion of depreciation expense associated with fleet assets through inclusion of the result within the BRD burden applied to capital jobs.

The Capitalized fleet represents the capitalized monthly fleet, allocated on a pro-rata basis. The capitalization is the monthly depreciation expense of grouped asset 8830-3920, multiplied by the quarterly fleet depreciation rate capitalized by CWIP job through the BRD. The BRD applies to capitalized jobs, thus not to the Storm deferral account.

"The transportation (fleet) overhead and the vehicle depreciation capitalization on construction vehicles are two distinct transactions which *appear to have been combined in the above write-up of the Audit Issue."*

Transportation (fleet) overhead includes costs that are accumulated in the transportation clearing account. Fleet charges such as maintenance and fuel charges are spread from a clearing account proportionately based on labor dollars. The entry for the fleet overhead allocation is credited to capitalized credits, account 922, and cleared to the qualifying jobs.

The capitalization of depreciation on construction vehicles to account 107 balance is appropriate under the guidance set forth by US GAAP standard ASC 360. The entry to capture the capitalization of vehicle depreciation used in construction activities is a debit to CWIP, account 107 and a credit to depreciation expense account 403. Thus, the depreciation expense is not overstated and the Accumulated Depreciation is not understated.

The Company has stated in the current audit response that this is still being done.

Audit Recommendation

The Company should not be capitalizing a portion of the depreciation expense, and should quantify the impact and adjust the filing. As acknowledged by Liberty in response to the previous Audit Issue, the Company must comply with FERC for regulatory purposes.

Company Response

The Company repeats its prior response and, with regard to compliance with the FERC Chart of Accounts, the Company asserts that it is in compliance and supplements that prior response as follows:

The FERC Chart of Accounts specifically provides for the capitalization of depreciation expense in item 3 "Components of Construction Cost" of the Electric Plant Instructions:

> (5) Special machine service includes the cost of labor (optional), materials and supplies, *depreciation*, and other expenses incurred in the maintenance, operation and use of special machines, such as steam shovels, pile drivers, derricks, ditchers, scrapers, material unloaders, and other labor saving machines; also expenditures for rental, maintenance and operation of machines of others. It does not include the cost of small tools and other individual items of small value or short life which are included in the cost of materials and supplies. (See item 3, above.) When a particular construction job requires the use for an extended period of time of special machines, transportation or other equipment, the net book cost thereof, less the appraised or salvage value at time of release from the job, shall be included in the cost of construction. (Emphasis added)

<u>The Audit Staff's implication that Liberty apparently agreed with this recommendation in response to the DE 19-064 Audit Report and that it would comply with the FERC accounting guidance did not relate to the subject of this Audit Issue. The Company maintains that is has been and continues to be in compliance with the FERC Chart of Accounts</u>.

> **<u>Audit Comment</u>**
> Because the FERC information above relates to the maintenance, operation and use of special machines, or the extended use of cars, trucks or trailers (transportation equipment), Audit reiterates the issue that inclusion of a portion of the depreciation expense for fleet assets in the BRD burden rate, for capitalization on a pro rata basis, should not be done in the manner outlined.[39]

Based upon the Company's response to the Storm Fund audit report, the issue is still unresolved.

Q. Please summarize Staff's concern.

A. Staff is concerned that Liberty is accumulating its fleet costs in an account that gets spread to various O&M accounts and Capital projects through a burden allocation. The burden includes depreciation on vehicles, so that some fleet depreciation ends up in capital. Depreciation is an expense item, and the Company should not be using it to grow rate base on which a return is applied.

Q. Does Staff have an estimate of the amount of vehicle depreciation that may have been included in Capital projects that are reflected in rate base in this proceeding?

A. Audit Staff provided the following information from the EnergyNorth and Keene detailed general ledger that shows that the Company capitalized $437,863 for EnergyNorth and $8,096 for Keene. These amounts are likely reflected in rate base in this proceeding.

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[39] DG 06-107 Liberty Utilities (Granite State Electric) Corp 2019 Storm Fund Report, FINAL Audit Report (September 30, 2020), page s 15–16 (Attachment DHM-20).

Table 8: Fleet Depreciation Capitalized 2017–2019

	12/31/17	12/31/18	12/31/19
Total debits to ENG CWIP-107 through "Cap Depr to 401X-BRD"	$ -	$ 350,083	$ 437,863
Total debits to Keene CWIP-107 through "Cap Depr to 401X-BRD"	-	1,115	8,096
	$ -	$ 351,198	$ 445,959

Audit Staff also found that during 2019, monthly credits for "capitalized depreciation" were posted to the depreciation expense accounts. Thus, it appears that depreciation expense may not be overstated.

Q. What does Staff recommend?

A. Staff recommends that the Company remove the fleet depreciation that it has capitalized through its burdens. Depreciation should be recovered as an expense. As shown on Schedule 3.13, Staff's adjustment *reduces* Rate Base by $445,959. The adjustment *increases* depreciation expense by $445,959, which *reduces* Operating Income by $325,180.

Interest Synchronization

Q. Please explain Staff's recommended adjustment to 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 *increases* net operating income by $26,043 and is shown on Schedule 3.15.

Staff's Recommended Net Operating Income

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

A. The Company updated net operating income is $22,259,725.[40] Staff's recommended adjustments *increase* operating income to $24,308,656.

<u>Property Tax Recovery Mechanism</u>

Q. Please explain why the Company is proposing a Property Tax Recovery Mechanism.

A. HB 700 (codified as RSA 72:8-d and -e) establishes a new methodology for valuing utility distribution assets for property tax purposes and requires the Commission to establish a rate recovery mechanism for a for any public utility owning property that meets the definition of "utility company assets." The mechanism will "adjust annually to recover all property taxes paid by each such utility on such utility company assets" or "be established in an alternative manner acceptable to both the utility and the public utility commission." The Company has provided a proposal to capture the changes in property taxes that will occur under RSA 72:8-d for the Commission's consideration.

Q. Please summarize the Company's proposed Property Tax Recovery Mechanism.

A. The Company proposes a full property tax recovery mechanism that compares the most recent municipal and state property tax bills to the amount currently collected in distribution rates each year.[41] The Company proposes to include property taxes levied on both "utility company assets" as that term is defined in the statute, and on assets that are not covered by the statute, which for purposes of this testimony I will refer to as non-

[40] Attachment DBS/KAS-1, Schedule RR-1 (Bates II-132R).
[41] Direct Testimony of Steven E. Mullen, 13:19–21 (Bates II-207).

"utility company assets."[42] Liberty's proposal does away with this distinction and covers all property taxes Liberty pays.[43]

A deferral account would be established to track the increases and decreases that may occur as the property tax year progresses and to capture the recoveries and timing differences between tax billing periods, the start of recovery, and collection.[44]

The Company proposes that the adjustment for the first property tax year of April 1, 2020, through March 31, 2021, take effect coincident with the August 1, 2021, implementation date of permanent rates at the conclusion of this proceeding. Thereafter, the effective date for subsequent property tax years would occur earlier in the calendar year.[45]

Q. What is your concern regarding the Company's proposed mechanism?

A. The statute states that the "Commission shall by order establish a rate recovery mechanism for any public utility owning property that meets the definition of *utility company assets*."[46] (Emphasis added.) The Company has expanded the proposed mechanism to include both "utility company assets" and non-"utility company assets" in its recovery mechanism.

Q. Does the statute define "utility company assets"?

A. The statute specifically defines "utility company assets":

[42] An example of an asset that is used in the utility business, but is not a "utility company asset" as defined in the statute is an office building.
[43] Direct Testimony of Steven E. Mullen, 14:1–4 (Bates II-208).
[44] Direct Testimony of Steven E. Mullen, 15:6–10 (Bates II-209).
[45] Direct Testimony of Steven E. Mullen, 15:11–21(Bates II-209).
[46] N.H. Rev. Stat. §72:8-e.

> (b) "Utility company assets" means the following property not exempt under RSA72:23:
>
> (2) For a gas company providing gas service to retail customers: distribution pipes, fittings, meters, pressure reducing stations, buildings, contributions in aid of construction (CIAC), construction works in progress (CWIP) and land rights including use of the public rights of way, easements on private land owned by third parties and land owned in fee by the gas company.[47]

Q. Does the statute address non-"utility company assets" that are not required to be covered by the mechanism?

A. The statute also states that::

> (c) "Utility company assets" shall not include:
>
> (3) Gas transmission pipeline facilities regulated by FERC and associated land rights, whether in fee or easement.
>
> …
>
> (5) Fee-owned land, office buildings, garages, and warehouses.

Q. Does the Company provide examples of non-"utility company assets" that it proposes to include in its proposed Property Tax Recovery Mechanism?

A. The Company stated that examples of assets that are not encompassed in the definition of "utility company assets" include transmission plant, production plant, and general plant, such as office buildings.[48]

Q. Did the Company provide a list of the non-"utility company assets"?

A. Yes. The Company identified property taxes of $23,607 related to non-"utility company assets."[49] This represents 0.2 percent of the total property taxes reflected in the Company's rate request.

[47] N.H. Rev. Stat. §72:8-d.
[48] Direct Testimony of Steven E. Mullen, 15:1–5 (Bates II-209).

Table 9: Property Taxes for Non-"Utility Company Assets"

Line	Municipality	Parcel	Tax Year 2019 Total Due	
51	Concord	109/1/3	1,188	Non-Utiltiy Company Asset
52	Concord	109/1/3	1,188	Non-Utiltiy Company Asset
59	Concord	109/2/4	1,932	Non-Utiltiy Company Asset
60	Concord	109/2/4	1,932	Non-Utiltiy Company Asset
69	Concord	202Z/21	545	Non-Utiltiy Company Asset
70	Concord	202Z/21	545	Non-Utiltiy Company Asset
81	Keene	116039000000000	16,276	Non-Utiltiy Company Asset
			23,607	

Q. What is Staff's recommendation regarding inclusion of the non-"utility company assets" in the Property Tax Recovery Mechanism?

A. Staff opposes inclusion of non-"utility company assets" in the Property Tax Recovery Mechanism. Staff recognizes that these are a minor component in the Company's proposal at this time (~ 0.2 percent). However, the statute excludes non-"utility company assets", and they should not be included in the Property Tax Recovery Mechanism.

Q. Does Staff have any other concerns regarding the Company's request of items to include in the Property Tax Recovery Mechanism?

A. Yes. The Company proposes to include State of NH property taxes in the Property Tax Recovery Mechanism. The statute specifically addresses locally assessed assets and does not address assets taxed by the State of NH. Staff recommends that the State of NH property taxes be excluded.

[49] Liberty response to Staff TS 3-24 (Attachment DHM-23).

Q. Did the Company provide a list of the State of NH property taxes?

A. Yes. The Company identified $2.67 million of State of NH property taxes. This amount represents 21.4% percent of the total property taxes reflected in the Company's rate request.

Table 10: State of NH Property Taxes

Line	Municipality	Parcel	Tax Year 2019 Total Due	
77	State of NH	TRUE UP	230,708	State Taxes
78	State of NH	NH DRA 1-2	1,210,134	State Taxes
79	State of NH	NH DRA 3-4	1,210,134	State Taxes
84	State of NH	NH DRA 1-2	7,716	State Taxes
85	State of NH	NH DRA 3-4	7,716	State Taxes
			2,666,407	

Q. What is Staff's recommendation regarding inclusion of State of NH property taxes in the Property Tax Recovery Mechanism?

A. Staff opposes inclusion of State of NH property taxes in the Property Tax Recovery Mechanism. The statute was written to address locally assessed property taxes and not State of NH property taxes.

Q. Has the Commission approved other property tax recovery mechanisms for other utilities?

A. Yes. In the recent Eversource Distribution rate case (DE 19-057), the Commission approved a settlement that included a provision to implement an annual regulatory reconciliation adjustment (RRA) mechanism that included, among other things, recovery or refund of property tax expenses, as compared to the amounts in base rates.[50] Specifically, the agreement stated

[50] Docket No. DE 19-057, Order No. 26,433, page 14.

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(c) Property tax expenses, as compared to the amount in base rates. Consistent with RSA 72:8-e, property tax over- or under-recoveries as compared to the amount in base distribution rates shall be adjusted annually through the RRA. The amount included in base distribution rates for property tax expense shall be $45,186,407 based on property tax expense as of December 2019, normalized to exclude any credits related to property tax settlement proceeds for tax years preceding the test year. On an annual basis, actual property tax expense for the prior calendar year shall be compared against the amount in base rates and any variances will be reconciled through the RRA mechanism. Annual actual property tax expense shall be normalized to adjust for any credits received due to abatement settlement proceeds received for tax years preceding the test year. The RRA shall recover any over- or under- recoveries beginning in calendar year 2020.[51]

Q. How much property tax has Liberty reflected in its filing in this proceeding that would be the "currently collected in distribution rates," or base from which future property taxes would be compared?

A. The Company's updated filing reflects a pro forma property tax amount of $12,454,039,[52] which reflects the most recent property tax bills reached for each parcel of land on which it is taxed. Staff's recommended base excluding the non-utility company assets and State of NH property taxes[53] is $9,764,026.

Table 11: Property Tax Recovery Mechanism Base

Company Property Tax Included in Rate Request	$ 12,454,039
Non-Utiity Company Asset Taxes	(23,607)
State of NH Taxes	(2,666,407)
Property Tax Recovery Mechanism Base	$ 9,764,026

[51] Docket No. DE 19-057 Public Service Company of New Hampshire d/b/a Eversource Energy Settlement Agreement on Permanent Distribution Rates, October 9, 2020, page 16.
[52] Attachment DBS/KAS-1, Schedule RR-EN-3-7 (Bates II-146R).
[53] Because Staff is recommending excluding State of NH taxes from the base to be used in the Property Tax Recovery Mechanism, Staff's adjustment to remove the doubled the State of NH True up will not affect Staff's recommended base.

Q. Please summarize Staff's recommendation regarding the Property Tax Recovery Mechanism proposed by the Company?

A. Staff recommends accepting the Company's Property Tax Recovery Mechanism with modifications. Staff recommends that only locally assessed "utility company assets" be included in the Property Tax Recovery Mechanism. Non-"utility company assets" and State of NH property taxes should be excluded and collected through standard rate-making processes.

Staff recommends accepting the Company's proposal to establish a deferral account to track the increases and decreases that may occur as the property tax year progresses and to capture the recoveries and timing differences between tax billing periods, the start of recovery, and collection.

Staff recommends accepting the adjustment for the first property tax year of April 1, 2020, through March 31, 2021, to take effect coincident with the August 1, 2021, implementation date of permanent rates at the conclusion of this proceeding. Thereafter, the effective date for subsequent property tax years would occur earlier in the calendar year.

Step Adjustment

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

A. Yes. As discussed by Staff witness Stephen Frink, Staff supports the Company's 2021 Step Increase with the following caveats and adjustments:

1) The amounts presented by the Company represent budgeted amounts, not actual. Staff supports the inclusion of only actual amounts related to 2021 non-revenue producing plant additions that have been examined and verified by the NHPUC Audit Staff.
2) The Step Adjustment revenue requirement calculation should reflect the Commission-approved rate of return in this proceeding.
3) The Step Adjustment should reflect a $44,000 reduction to reflect Staff's position regarding the Keene Risk Sharing.

The Company revised its Step Increase revenue requirement of $5,646,985.[54] At this time, subject to adjustment as discussed in items 1-3 above, Staff recommends a Step Increase of $5,157,187. Staff's recommended Step Increase is provided in Schedule 4.

Conclusions

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

A. Staff is recommending a *decrease* to Distribution base rates of $2,240,114.

Q. Does this conclude your testimony?

A. Yes.

[54] Notice of Intent to File Rate Schedules (March 1, 2021), correction and updated schedules.