STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET NO. DE 19-064

IN THE MATTER OF: **LIBERTY UTILITIES (Granite State Electric) CORP. d/b/a LIBERTY UTILITIES**

DISTRIBUTION SERVICE RATE CASE

REDACTED VERSION

DIRECT TESTIMONY

OF

DONNA H. MULLINAX
CONSULTANT TO STAFF

December 6, 2019

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<u>Introduction and Summary</u>

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, and DG 17-048. 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 (Granite State Electric) Corp., d/b/a Liberty Utilities ("Liberty" 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)

	Staff's Recommended Rate of Return			7.11%
	Revenue Conversion Factor			1.37137
		Rate Base	**Operating Income**	**Revenue Deficiency (Sufficiency)**
	Company Updated Proposal	**$ 103,024,219**	**$3,571,373**	**$ 6,673,493**
Adjustment 1	Modify Plant in Service	$ (5,361,696)	$ 165,909	$ (750,310)
Adjustment 2	Cash Working Capital	(844,617)		(82,354)
Adjustment 3	Audit Issues-Placeholder		-	-
Adjustment 4	Proforma Payroll-CONFIDENTIAL		477,209	(654,428)
Adjustment 5	True-Up Payroll Taxes		48,169	(66,058)
Adjustment 6	Short Term Incentive Plan - Earnings Objective		233,260	(319,885)
Adjustment 7	Remove LTIP (PSU) Related to Shareholder Goals		154,990	(212,548)
Adjustment 8	Remove Severance		19,195	(26,324)
Adjustment 9	Non-Electric Distribution Related Charges		118,500	(162,507)
Adjustment 10	Allocated Cost to Liberty		559,001	(766,595)
Adjustment 11	Normalize Outside Legal Expense		8,599	(11,793)
Adjustment 12	Depreciation Reserve Deficiency Amortization Period		86,943	(119,231)
Adjustment 13	Disallowed Transition-Related Asset Depreciation (NG 11-040 - Acquisition)		900,102	(1,234,369)
Adjustment 14	Remove Additional Vegetation Management		485,847	(666,274)
Adjustment 15	Interest Synchronization		33,115	(45,413)
	Impact of Staff's Recommended Cost of Capital			(1,525,866)
	Staff Recommend Adjustments	**$ (6,206,314)**	**$3,290,841**	**$ (6,643,954)**
	Staff Recommended Totals	**$ 96,817,905**	**$6,862,213**	**$ 29,539**

Q. What revenue increase does Staff recommend?

A. Staff recommends a base rate increase of no more than $29,539. The following table shows the Company's updated revenue requirement request and Staff's recommendation.

Table 2: Staff's Recommended Revenue Requirement

Company's Updated Revenue Deficiency	$ 6,673,493
Staff's Recommended Adjustment	(6,643,954)
Staff's Recommended Revenue Deficiency (Sufficiency)	$ 29,539

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-18 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.

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 recommendation 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 3.14?

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.

Revenue Requirements

Liberty'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 $5,683,102. 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 $2,093,349.[1] On November 22, 2019, the Company filed a Technical Statement revising its revenue requirement schedules to reflect new or updated information that became available

[1] Liberty filing dated April 30, 2019, cover letter. Order No. 26,267 (June 28, 2019), page 1.

and to include any changes that were identified during the discovery process. This has been referred to as Liberty's Corrections and Update (CU) Filing. The Company's updated request is for an increase in base rates of $6,673,493, or an additional $990,390.[2]

Changes Made in Liberty's Corrections and Update (CU) Filing

Q. What changes did the Company make to its updated revenue requirement filing?

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

1. <u>Removal of Water Heater Assets from Test Year Plant</u>

   Several adjustments were made to reflect that the Company received approval to sell its water heater rental program to a third party and terminate the program in 2018 (DE-18-016). In 2018, the Company removed the original cost of these assets of $1,207,584, along with the associated depreciation reserve of $(1,207,584), resulting in a net $0 change in rate base.

2. <u>Removal of Test Year Depreciation Expense Associated with Water Heater Assets</u>

   The second Water Heater Asset adjustment *decreased* the Company's revenue requirement by $121,383.

3. <u>Removal of Revenue and Expense Associated with Water Heater Assets</u>

   For the third Water Heater Asset adjustment, the Company removed revenue of $11,712 and operating expenses of $73,923, resulting in a *decrease* to the Company's requested revenue requirement of $62,617.

[2] Technical Statement of Philip E. Greene and David B. Simek (November 22, 2019), page 1.

4. Correction to Revenue Normalization Adjustment

This correction removed the REP/VMP revenue that was included in error. The change *increased* the Company's requested revenue requirements by $16,283.

5. Update to Payroll Tax Adjustment

When Staff asked why the payroll tax rate of 10.5% was significantly higher than the statutory rates, the Company realized there was a disconnect in its methodology. The Company also realized that the adjustment considered only the O&M portion of payroll while it should have included the capitalized payroll. The Company correction results in a *decrease* in the Company's requested revenue requirements of $314,592.

6. Update to Pension and OPEB Cost Forecast

This adjustment reflects updated actuarial reports, resulting in an *increase* in the Company's requested revenue requirements of $319,333.

7. Update to LU Concord Training Center Rental Expense

This adjustment was based on the lease rate in effect May 1, 2019. The Company's update *increased* the Company's requested revenue requirements by $7,658.

8. Removal of Ratemaking Adjustment per DG 11-040

The Company made two adjustments to reflect that the acquisition assets would be fully amortized as of April 2019. First, the remaining unamortized value as of December 31, 2018, of $763,279 adjustment was removed from rate base. The change *increased* the Company's requested revenue requirements by $78,072.

9. Removal of Ratemaking Adjustment per DC 11-040

The second adjustment to reflect amortization adjusted depreciation expense by $(1,234,419). The change *increased* the Company's requested revenue requirement by $1,240,804.

10. Update to Pro Forma Adjustment for Property Taxes

The property tax estimate was updated to reflect current property tax bills. The change *decreased* the Company's requested revenue requirements by $43,987.

11. Removal of Lost Base Revenue Related to Energy Efficiency

The Company removed the lost base revenue that was recovered through another mechanism. The correction *increased* the Company's requested revenue requirements by $280,029.

12. Removal of EEI dues attributable to the EEI Edison Foundations

The Company removed a portion of the EEI dues included in the test year related to the influence of legislation. The change *decreased* the revenue requirements by $519.

13. Removal of Cost for Branding Advertisement

The Company removed the branding advertisement with FMG Publishing, Inc. The change *decreased* the Company's requested revenue requirements by $3,005.

14. Correct Lead/Lag Days

The Company corrected the lead/lag from 25.53 days to 24.4 days. The change *reduced* rate base by $129,157 resulting in a *reduction* to the Company's requested revenue requirement by $13,448.

15. Update Book ADIT Balance

The Company made several adjustments to ADIT:

a. First, the Company modified the ADIT related to Post-Acquisition Additions by account for state tax benefit for federal purposes, the impact of which *reduced* ADIT by $(163,805).

b. Second, the Company reflected the Net Operating Losses as they relate primarily to bonus depreciation; the impact *reduced* ADIT by $(3,647,425).

These changes *increased* the Company's requested revenue requirement by $389,842.

16. Removal of Goodwill from ADIT

For the third ADIT adjustment,[3] the Company added excess ADIT to the rate base calculation. The change results in a *decrease* in rate base of $5,640,079 and a *reduction* in the Company's requested revenue requirements of $576,910.

17. Removal of Goodwill from ADIT

A fourth ADIT adjustment removed Goodwill as a deferred tax asset. The change results in a reduction to rate base of $2,005,807, which *reduced* the Company's requested revenue requirements by $205,169.

18. Correction to Schedule of ADIT Adjustment per DE 16-383, Attachment 7

The fifth ADIT adjustment corrected the scheduled ADIT adjustment amounts. The change has no impact on the revenue requirement or rate base.[4]

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[3] The numbering system reflects how the revisions were labeled in the November 22, 2019, Technical Statement.
[4] Technical Statement of Philip E. Greene and David B. Simek (November 22, 2019), pages 2–7.

In summary, the Company updates and corrections resulted in a change in base rates from its original request of $5,683,102 to $6,673,493, an *increase* of $990,390.

Q. Does Staff agree with the revision the Company made to its revenue requirement in its Corrections and Updates?

A. Staff disputes the Company's update regarding Update #9 Removal of Ratemaking Adjustment per DG 11-040.

Q. What is the Ratemaking Adjustment per DG 11-040?

A. As part of the settlement in DG 11-040, Liberty agreed to an $8.1 million cap on recovery of transition-related IT capital investments as part of the transfer of ownership of Granite State Electric Company to Liberty Energy NH.[5] The Company stated in its testimony in this case, "Consistent with commitments with respect to transition costs related to the acquisition, the Company has included adjustments for ratemaking purpose only related to the cost of certain transition-related assets. Those adjustments appear on Schedules RR-3-08 and RR-5-4."[6] It is my understanding that the Ratemaking Adjustment per DG 11-040 removes transition-related IT capital investments that exceeded the $8.1 million cap on recovery. These assets have been disallowed for recovery and the Ratemaking Adjustment per DG 11-040 removes them from the base rates.

[5] Order No. 25,370, page 13 (Attachment DHM-18).
[6] Direct Testimony of P. Greene and D. Simek, 8:3–7. Schedule RR-3-08 is the Company's Depreciation Annualization and Rates adjustment. Schedule RR-5-4 is the Company's Rate Base Adjustment-Capital Additions.

Q. What is Staff's concern regarding the Company's treatment of these disallowed assets from the acquisition approved in DG 11-040?

A. The Company's original filing in this case included an adjustment to remove these disallowed assets from ratebase and from depreciation expense. In Liberty's Corrections and Update (CU) Filing, Item #8, the Company eliminated the adjustment removing the disallowed gross plant and accumulated depreciation from ratebase stating that the assets were fully amortized in 2019 and that the "effective reduction in rate base will not be included in the calculation of revenue requirements." The Company's position regarding ratebase treatment is not unreasonable. The disallowed assets were fully depreciated, and the net effect to ratebase is zero.

However, Staff disputes the Company's Update Item #9, which removes the corresponding reduction to depreciation expense. Staff is concerned that the Company Update results in the Company recovering depreciation expense associated with these disallowed assets. The Company calculates depreciation expense using gross plant. These disallowed assets remain in the historical gross plant balances, and as a result, depreciation is calculated on them. The Company's adjustment to remove the "Ratemaking Adjustment per DG 11-040 (Acquisition)" was after the total depreciation expense was calculated. (See line 40 of Schedule RR 3-08 Depreciation Adjustment). Thus, the depreciation expense associated with these disallowed expenses were in the total and had to be removed afterward. In the Update, the Company deleted the adjustment on Line 40. As a result, the Company has included depreciation expense for these assets that have been disallowed by the Commission. Depreciation expense is overstated by $1,234,419. As long as these disallowed assets remain in plant in service and the Company uses gross plant balances to calculate depreciation, an adjustment will be required to remove the depreciation expense associated with these disallowed assets. As shown on Schedule 3.13, Staffs adjustment *increases* Operating Income by $900,102.

Establishment of Current Distribution Revenue Requirement

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

A. Liberty's current rates were established in Order No. 26,005 (April 12, 2017), based on a test year of the 12 months ended December 31, 2015, with rates effective May 1, 2017. The current rates were the result of a Settlement, resulting in an increase in Distribution revenues of $3,750,000. The rate change was followed by three additional step adjustments to provide recovery for certain post-test year plant additions that were implemented on May 1, 2017 (an increase of $2,473,723),[7] June 1, 2018 (an increase of $289,348),[8] and May 1, 2019 (an increase of $169,912).[9]

<u>Test Year</u>

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

A. The Company has based its request for a revenue increase on a historical test year of the 12 months ended December 31, 2018.[10] Staff's calculations use the same historical test year.

[7] DE 16-383, Order No. 26,005 (April 12, 2017), page 17.
[8] DE 16-383, Order No. 26,141 (May 31, 2018), page 1.
[9] DE 16-383, Order No. 26,242 (April 30, 2019), page 1.
[10] Direct Testimony of P. Greene and D. Simek, 5:19–20.

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, 2018, and then it removed flow-through items (i.e., Purchased Power and Transmission Wheeling revenue and expenses) and adjusted for known and measurable changes. The resulting Test Year pro forma net operating income reflects normalized revenues at current rates, expense, and net operating income for ratemaking purposes.[11]

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

A. Staff's audit is ongoing, and it is my understanding that the final audit report will be complete by the end of the year (after Liberty has had an opportunity to comment on a draft audit report). Staff plans to re-calculate its proposed revenue requirement to reflect the results of the final audit report.

<u>Adjustments to Rate Base</u>

Q. What rate base had the Company proposed?

A. The Company originally requested a rate base of $106,180,186.[12] The rate base was revised to $103,024,219.[13]

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

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

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[11] Direct Testimony of P. Greene and D. Simek, 5:19–6:4.
[12] Attachment PEG/DBS-1, Schedule RR-1.
[13] Technical Statement of Philip E. Greene and David B. Simek (November 22, 2019), Attachment PEG/DBS-1, Schedule RR-1 (CU).

- Plant in Service
- Cash Working Capital

Plant in Service

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

A. Staff's overall adjustment to Plant in Service includes the individual adjustments that are supported by the testimonies of Staff witnesses Jay Dudley and Kurt Demmer.

Q. What is the effect of Staff's recommended adjustments to Plant in Service?

A. The effect of these adjustments and the associated adjustment to the accumulated depreciation *reduces* Rate Base by $5,361,696. The adjustments to Plant in Service will also *reduce* depreciation expense by $227,532, which increases Operating Income by $165,909. Staff's recommended adjustment is presented on Schedule 3.1.

Cash Working Capital

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

A. Staff's adjustment to Cash Working Capital (1) updates the revenue and expense components of the Company's lead-lag study to reflect Staffs adjustments that are discussed within this testimony and (2) removes depreciation expense from the Company's cash working capital calculation. As shown on Schedule 3.2, Staffs adjustment to Working Capital *reduces* jurisdictional Rate Base by $844,617.

Q. Please explain Staff's adjustment to update the revenue and expense components of the Company's lead/lag study to reflect Staff's adjustments.

A. Cash Working Capital was developed through the preparation of a lead-lag study. The lead-lag is applied to each component of the cost of service to quantify the cash working capital requirement associated with that cost of service item. The Cash Working Capital balance must be updated to reflect Staffs adjustments.

Q. Please explain Staff's recommended adjustment to remove depreciation expense from Cash Working Capital.

A. Depreciation expense has been included as one of the components in the Company's calculation of Cash Working Capital. Depreciation is a non-cash expense and should not be a component of Cash Working Capital. In the last base rate case, the Company agreed to remove depreciation expense from Cash Working Capital, but it was not removed in the Company's presentation in this proceeding. Staff recommends that depreciation expense be removed from the calculation of Cash Working Capital.

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 $103,024,219. Staff's recommended adjustments *reduce* the rate base to $96,817,905.

<u>Adjustments to Operating Income</u>

Q. What net operating income has the Company proposed?

A. The Company's revised operating income at current rates is $3,571,373.[14]

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

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

- Audit Issue Placeholder
- Payroll Expense
- Payroll Taxes
- Incentive Compensation
- Severance
- Non-Electric- and Non-Distribution-Related Charges
- Direct Charges from Corporate and Affiliates
- Legal Expense
- Depreciation Reserve Imbalance
- Interest Synchronization

Audit Issue Placeholder

Q. Please explain Staff's recommended adjustment Audit Issue Placeholder.

A. Staff's audit is ongoing, and it is my understanding that the final report will be complete by the end of the year. Staff's recommended revenue requirements will likely need to be

[14]Technical Statement of Philip E. Greene and David B. Simek (November 22, 2019), Attachment PEG/DBS-1, Schedule RR-1 (CU).

updated when the final audit report is available. Staff has included a placeholder on Schedule 3.3 for any audit findings that would affect the Company's requested rate increase.

Payroll Expense

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

A. Liberty is requesting to recover payroll costs for a full complement of employees at 2019 salary and wage rates. The adjustment reflects a 3% increase over the test year effective March 2019; payroll costs associated with temporary vacancies in 2018; and incremental headcount additions in 2019. The total payroll adjustment represents an increase of $947,257 as presented in the table below.

Table 3: Company Proposed Pro Forma Payroll[15]

Wage Increase - 3%	$ 188,902
2018 Headcount Vacancies	592,565
2019 Incremental Additions	208,900
Contractor Savings	(43,110)
Total Proforma Payroll	$ 947,257

Q. Does Staff have concerns with the Company's Pro Forma Payroll adjustment?

A. Yes. Staff disputes reflecting a full complement of employees because it is not reasonable to expect that every vacated position during a normal test year will be backfilled seamlessly, without periods of vacancy. While some positions may be replaced immediately due to internal transfers or advance notice, the Company's experience in 2018 shows vacancy periods for certain positions lasting up to nine months.[16]

[15] Attachment PEG/DBS-1, Schedule RR-3-01 and Liberty response to Staff DR 3-10.a, Confidential Attachment (Attachment DHM-03).
[16] Liberty response to Staff DR 3-10.a, Confidential Attachment, page 1 (Attachment DHM-03).

Q. Please discuss Staff's observations with respect to the trend in employee turnover and its impact on vacancy periods going forward.

A. The relationship between employee turnover and vacancy periods are naturally correlated. In 2016 and 2017, Liberty reported backfilling 13 positions consecutively. In 2018, the number of replacements increased to 37, and the Company expects the increasing trend in the number of replacements to continue, explaining "as our workforce ages, we expect those numbers to continue to increase in the years ahead, which will significantly add to our replacement count."[17]

Table 4: Replacements and Incremental Positions by Year

	2016	2017	2018
Replacements (i.e., Positions Backfilled)	13	13	37
Incremental Headcount Growth	17	14	19
Total New Hires	**30**	**27**	**56**

Q. How are costs associated with temporary vacancies accounted for in a normal test year?

A. To the extent the duties of the vacated positions are performed by temporary help, the cost associated with nonpermanent workers should be reflected in the test year under outside services expense. Where no temporary help is used, the workload is either borne by existing employees or left unperformed. If the Company incurs overtime expense, the incremental cost should be reflected in test year payroll expense.

Q. Has the Commission previously ruled on the appropriateness of setting payroll costs using a full employee complement?

A. Yes. Order No. 26,122 in Docket No. DG 17-048, Liberty's 2017 gas rate case states:

[17] Liberty response to Staff DR 6-1 (Attachment DHM-04).

> The Commission prefers a more traditional approach where a utility develops a reasonable test year payroll amount and then applies known and measurable percentage payroll increases to that normalized test year amount . . . Vacancies are a fact of doing business and should be accounted for when calculating a payroll figure for ratemaking purposes that includes a level of employees that is adjusted beyond the test year, as is the case here."[18]

Q. What modifications does Staff recommend to the Company's Pro Forma Payroll adjustment?

A. Staff recommends adopting the 3% wage rate increase effective March 2019 because it is known and measurable. The annual wage rate increase results in an increase in labor expense of $188,902. With respect to the 2018 vacancies, Staff recommends disallowing total proposed costs of $549,455. The amount includes prorated wages of $592,565, offset against $43,110 in contractor savings expected to be realized going forward. The adjustment is shown on Schedule 3.4.

Q. Does Staff have any other concerns regarding the costs associated with vacancies?

A. While Staff is recommending removal of the costs associated with *all* vacancies, Staff did observe that several of the vacancies' payroll costs have an allocation between expense and capital that appears to be skewed toward recovery as expense. The Company vacancy costs included several replacement positions, called "Line Worker," with 37% of the annual salary allocated to capital and 63% allocated to expense. Should any portion of the costs associated for vacancies be included, the Company should review the expense/capital allocation to confirm that this allocation appropriately reflects the activity these positions perform.

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[18] Docket No. DG 17-048, Order No. 26,122, page 11.

Q. Is Staff recommending an adjustment with respect to the 2019 incremental headcount additions?

A. Yes. The Company rate request includes six new positions, all but one of which has been filled. The Engineering Project Manager identified as "New Position, in support of construction" has remained open for more than a year. The Company states that the position was requested in October 2018. In addition, the Company has allocated 100% of the salary to O&M, which is inappropriate since the project description specifically states the position is "in support of construction." Staff recommends that the [**BEGIN CONFIDENTIAL**] $[redacted] [**END CONFIDENTIAL**] allocated expense[19] associated with this unfilled position be excluded as not known and measurable. The adjustment is shown on Schedule 3.4.

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 $654,455, which *increases* Operating Income by $477,209.

Payroll Taxes

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

A. The adjustment reflects the corresponding impact to payroll taxes of Staff's modification to the Company's payroll-related adjustments which includes both Payroll Expense and Short-Term Incentive Compensation discussed later. Staff's flow-through adjustment *reduces* payroll taxes by $66,061, which *increases* Operating Income by $48,169 as shown on Schedule 3.5.

[19] Liberty response to DR Staff 3-10.a, Confidential Attachment, page 1 (Attachment DHM-03).

Incentive Compensation

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

A. The Company sponsors three incentive programs. 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.[20]

Q. Did Staff recommend an adjustment to STIP and Shared Bonus Pool in the last base rate case?

A. No. In DE 16-383, the Company's 2015 Balanced Scorecard appropriately balanced the interests of ratepayers, employees, and shareholders. The "Efficiency" goals, which included

[20] Puc 1604.01(a) Copies of all officer and executive plans (Bates I-145–I-174) (Attachment DHM-05).

Business Group Profits, Net Income, and Return on Assets, represented 25% of the Balanced Scorecard.[21]

Q. What type of goals and objectives does the 2018 Balanced Scorecard incentivize?

A. The 2018 Balanced Scorecard measures the results of four primary business objectives: (1) Our Customers and Communities; (2) Our People and Team; (3) Our Efficiencies; (4) Our Processes. The 2018 objectives and goals along with weightings are listed below.

Table 1: 2018 Balanced Scorecard Weightings[22]

	% Weight
Customers and Communities	
Conduct Operations Safely and Responsibly	10
Annual Improvement in "All Injury" Results	5
Deliver a Satisfactory Customer Experience	5
Evaluate and Control Cost Per Customer Metrics	10
	30
People and Team	
Continue Engagement Plan Development / Implementation	10
Efficiencies	
Delivery of Targeted Cash Flow - BG Profit	20
Delivery of Targeted Earnings - ADJ EBT	20
Reduce Cost of Capital through Prudent Investment	5
	45
Processes	
Advance Customer First Business Process Overhaul	3
Efficient and Effective Management of Capital Re-investment	12
	15
Total Balance Scorecard	**100**

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

A. Yes. The Scorecard metrics are no longer balanced between the interests of ratepayers, employees, and shareholders. In the last base rate case, the goals that focused on earnings, profitability, and return of assets, which accrue entirely to investors, represented 25%. As

[21] Docket No. DE 16-38, Direct Testimony of Donna H. Mullinax, page 25 and Attachment DHM-12, page 23 of 24.
[22] Liberty response to Staff DR 3-16, Attachment Staff DR 3-16.b.3 (Attachment DHM-06).

shown in the above table, the 2018 Balanced Scorecard has transferred 45% of the performance goals to metrics labeled as "Efficiencies" that focus on earnings, profitability, and return of assets, which accrue entirely to investors. Moreover, financial performance targets are not designed to promote the interest of customers, and, at worst, can be in conflict when competing priorities must be balanced. Staff recommends shifting the burden for "Efficiencies" from customers to shareholders to appropriately align the cost-benefit given to whose interests are served.

Staff's adjustment *reduces* test year expense for the STIP and discretionary bonus pool by $319,898, or 36%. Staff's calculation multiplies an assumed 80% weight assigned to the Balanced Scorecard against the 45% weight assigned to "Efficiencies." The adjustment is shown on Schedule 3.6 and *increases* Operating Income by $233,260.

Q. Is Staff recommending an adjustment to the LTIP?

A. Yes. Staff recommends transferring a portion of the LTIP cost burden to shareholders for the same reason as supporting its position on the STIP and Shared Bonus Pool. The award criteria for the 2018 LTIP include (1) Safety-10%, (2) Customer Service-5%, and (3) Efficiency-85%.[23] Efficiencies, as defined by the performance metrics, incentivize the achievement of targeted earnings, profitability, and return on assets, which serve the interest of shareholders. Staff's adjustment *reduces* LTIP expense by $212,557 or 85%. The adjustment is shown on Schedule 3.7 and *increases* Operating Income by $154,990.

[23] Liberty response to OCA DR TS 2-12, Attachment OCA TS 2-12-3, pages 3–4 (Attachment DHM-07).

Severance

Q. Please describe the severance expense reflected in the test year.

A. The Company incurred severance expense of $70,986 in 2018.[24] The payments covered seven individuals and were expensed through the former employees' payroll. The Company stated the circumstances included a regional staff realignment and mutually agreed upon separations.[25]

Q. Does Staff recommend an adjustment for severance expense?

A. Yes. Consistent with its recommendation in DG 17-048, in which the Commission agreed, Staff recommends excluding severance paid to employees who were asked to resign. Ratepayers have already borne the costs of paying all the Company's employees to perform. If circumstances are such that employees are being asked to resign, ratepayers should not bear the costs. Shareholders should carry the cost of bad hiring decisions, and if the least cost means of removing employees is severance pay, Liberty should take that course to reduce its costs to shareholders. The Commission agreed with Staff and ruled

> The Commission is persuaded by Staff's position that ratepayers should bear the expense of payroll for services provided, but should not bear severance costs related to employees who resign to avoid being fired. Layoffs (where Staff did not recommend disallowance of related severance pay) could involve reductions in work force where the saved payroll expense would find its way into lower rates. Involuntary resignations, on the other hand, may involve subpar performance, and customers should not be required to bear an underperforming employee's payroll and the severance cost incurred to remove that same employee.[26]

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[24] Liberty revised response to OCA DR 1-29 (Attachment DHM-08).
[25] Liberty response to Staff DR 6-4 Redacted (Attachment DHM-09).
[26] DG 17-048, Order No. 26,122 (April 27, 2018), page 13.

For these reasons, Staff proposes to disallow severance expense of $26,324 in the test year for severance paid associated mutually agreed upon separations. The adjustment is shown on Schedule 3.8 and *increases* Operating Income by $19,195.

Non-Electric- and Non-Distribution-Related Charges

Q. Please discuss the Non-Electric- and Non-Distribution-related charges Staff identified in the Company's requested revenue requirement.

A. During discovery, Staff identified two instances where it appears that the Company included costs unrelated to electric distribution in its revenue requirement. The first instance relates to direct charges of $69,113, which settled to Cost Center 9853-Production/Dispatch/Control but originated in Account 735-Misc Production Expense.[27] By definition, account 735 includes "the cost of labor, materials used and expenses incurred in manufacturing gas production operations."[28] Clearly, gas production expenses should not be included in electric rates. The second instance relates to the inclusion of Energy Procurement costs totaling $93,401.[29] Such costs are not related to electric distribution and should be removed from rates in this case. If the Company has not already done so, it should seek to recover these costs through the Default Service docket.

The total impact of these two exclusions *reduces* operating costs by $162,514. The adjustment is shown on Schedule 3.9 and *increases* Operating Income by $118,500.

[27] Liberty response to Staff DR 6-31 (Attachment DHM-10).
[28] FERC Uniform System of Accounts.
[29] Liberty response to Staff DR 6-30 (Attachment DHM-11).

Direct Charges from Corporate and Affiliates

Q. Did Staff's examine the costs directly assigned to Liberty from Corporate and Other Affiliates.

A. Yes, Staff made an attempt to, but a detailed review of these costs proved very difficult. First, the costs were presented by account number, which provided no visibility into what the charges represent. The Company's responses to Staff's follow-up data request seeking clarification and additional detail and support were short, often referring to other data requests that proved ultimately to be non-responsive. In addition, aggregate direct charges to Liberty from Corporate and Affiliates increased by 80% from $1.6 million in 2017 to $2.9 million in 2018. When Staff requested an explanation of differences for certain line items, the Company declined to provide clarity even at a high level. The response Liberty provided to Staff DR 6-28, parts a through c, illustrates Staff's point:

> a. The costs involved would be directly related to the account number description. For the explanation in detail of the costs involved (including, for allocated affiliated payroll amounts, a detailed description of the services provided), please refer to Attachment OCA 2-31.[30]
>
> b. To provide the invoices and supporting documentation that explain the costs in detail would involve an inordinate amount of time to research as the totals represent numerous costs accumulated over the course of the year. Each account and amount listed above may have multiple invoices. It would be more beneficial and efficient to discuss in person to understand the information and processes involved rather than provide a multitude of invoices.
>
> c. A large number of the differences from 2017 relate to the general ledger account restructuring that has been discussed in several responses. In addition, please refer to the responses to parts a. and b. above.[31]

[30] For information, Liberty response to OCA DR 2-31 provided a copy of the Company's Cost Allocation Manual.
[31] Liberty response to Staff DR 6-28 (Attachment DHM-12).

Q. What does Staff recommend concerning the direct inter-company charges?

A. The direct charges from 2015 to 2018 vary significantly on an annual basis. The data responses indicate that an account restructuring took place during the test year. In order to reflect an appropriate annual level of these direct intercompany changes in rates, especially given the difficulty Staff encountered when trying to obtained details about these costs, Staff recommends using a three-year average from 2015 through 2017. Staff's proposal sets annual direct charges at $2,137,789 and *reduces* operating costs by $766,626. Table 5: Historical Annual Direct Costs Assigned to Liberty[32]

	2015	2016	2017	2018
Direct Charges from Corporate / Affiliates	1,987,612	2,809,996	1,615,758	2,904,415
% Annual Change	--	41.4%	-42.5%	79.8%
3-Year Average (2015–2017)			2,137,789	

The adjustment is shown on Schedule 3.10 and *increases* Operating Income by $559,001.

Legal Expense

Q. Please discuss Staff's proposed adjustment to legal expense.

A. The Company posted $54,620 to legal services during the test year. When asked to explain the significant increase in outside legal costs from 2017 to 2018, the Company stated that "outside legal services are variable due to events outside the Company's control, such as costs to defend lawsuits against the Company or to investigate such a claim prior to suit being filed."[33] Due to the variability from year to year, Staff recommends normalizing Legal

[32] Liberty response to Staff DR 6-27 (Attachment DHM-13).
[33] Liberty response to Staff DR 6-19 (Attachment DHM-14).

Services ensure the Company does not over recover between rate cases. Staff proposes to reduce Outside Services-Legal by $11,793 to the three-year average as shown below.

Table 6: Annual Outside Services-Legal[34]

	2016	2017	2018	Average
Outside Services-Legal	$ 41,784	$ 32,076	$ 54,620	$ 42,827
Annual Change	--	(9,708)	22,544	(11,793)
Percent Change	--	*-23.2%*	*70.3%*	*-21.6%*

The adjustment is shown on Schedule 3.11 and *increases* Operating Income by $8,599.

Depreciation Reserve Imbalance

Q. Does Staff have any recommendation with respect to the Company's Depreciation Study and related test year adjustment?

A. Yes. The Company depreciation study follows the Commission's long-standing precedent of straight-line, average life, whole life depreciation with an amortization period to recover any difference between book depreciation reserve and the theoretical depreciation reserve by account.[35] The Company proposes to amortize the depreciation imbalance of $1,399,800 into rates over 6 years, resulting in an additional accrual of $233,000 per year.[36] While the period between the current 2019 and the prior 2013 study was six years, Staff notes that before the 2013 study in Docket No. DE 13-063, an 18-year period had elapsed since its prior study in 1995 as shown below.

[34] PUC 1604.01(a)(1) at Bates I-031 and I-044 (Attachment DHM-15).
[35] Direct Testimony of Dane Watson, 4:5–9.
[36] Direct Testimony of Dane Watson, 16:2–6.

Table 7: Period Between Depreciation Studies[37]

	Year Study Performed		
Docket No.	Current	Prior	Period
DE 19-064	2019	2013	6
DE 13-063	2013	1995	18
		Average	**12**

Evaluating the period between studies over a longer time span shows that six years is not necessarily indicative of the appropriate amortization period. Staff recommends a 12-year amortization period, representing the average of the 6- and 18-year time intervals between the performance of depreciation studies from 1995 to 2019. Adoption of a 12-year amortization period *reduces* depreciation expense by $116,650 in the test year. The adjustment is shown on Schedule 3.12 and *increases* Operating Income by $86,943.

Removal of Additional Vegetation Management

Q. Please explain Staff's recommended adjustment regarding the Removal of Additional Vegetation Management.

A. Staff's adjustment related to the removal of additional vegetation management costs is supported by the testimony of Staff witness Kurt Demmer. The adjustment is shown on Schedule 3.14 and *increases* Operating Income by $485,847.

Interest Synchronization

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

[37] The 1995 Depreciation Study was submitted in Docket No. DE 95-169.

A. The interest synchronization adjustment synchronizes the rate base and cost of capital with the tax calculation using Staff's recommended weighted cost of debt. The adjustment is shown on Schedule 3.15.

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

A. The Company updated operating income is $3,571,373. Staff's recommended adjustments increase operating income to $6,862,213.

<u>Conclusions</u>

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

A. Staff is recommending that the Company be allowed an increase to its distribution base rates of no more than $29,539.

Q. Does this conclude your testimony?

A. Yes.