Liberty Utilities

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. DG 17-XXX

Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities
Fiscal Year 2017 Cast Iron/Bare Steel Replacement Program Results

DIRECT TESTIMONY

OF

DAVID B. SIMEK

April 14, 2017

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I. INTRODUCTION

Q. Please state your full name and business address.

A. My name is David B. Simek. My business address is 15 Buttrick Road, Londonderry, New Hampshire.

Q. Please state by whom you are employed and your position?

A. I am a Lead Utility Analyst for Liberty Utilities Service Corp. ("Liberty") which provides service to Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities ("EnergyNorth" or the "Company"). I am responsible for providing rate-related services for the Company.

Q. Please describe your educational background and training.

A. I graduated from Ferris State University in 1993 with a Bachelor of Science in Finance. I received a Master's of Science in Finance from Walsh College in 2000. I also received a Master's of Business Administration from Walsh College in 2001. In 2006, I earned a Graduate Certificate in Power Systems Management from Worcester Polytechnic Institute.

Q. What is your professional background?

A. In August of 2013, I joined Liberty as a Utility Analyst and I was promoted to a Lead Utility Analyst in December 2014. Prior to my employment at Liberty, I was employed by NSTAR Electric & Gas ("NSTAR") as a Senior Analyst in Energy Supply from 2008 to 2012. Prior to my position in Energy Supply at

NSTAR, I was a Senior Financial Analyst within the NSTAR Investment Planning group from 2004 to 2008.

Q. Have you previously testified in regulatory proceedings before the New Hampshire Public Utilities Commission (the "Commission")?

A. Yes, I have testified on numerous occasions before the Commission.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the Company's revenue requirement calculation associated with the CIBS main replacement program for the fiscal year starting April 1, 2016 and ending March 31, 2017 ("FY 2017"), and the degradation fees imposed by the Cities of Concord and Manchester.

III. REVENUE REQUIREMENT CALCULATION

Q. Please describe the revenue requirement calculation and the proposed recovery period.

A. The revenue requirement calculation includes the CIBS program spending through FY 2017. The Company proposes to recover this revenue requirement beginning July 1, 2017 through an increase in its base distribution rates.

Q. What amounts are included in the CIBS revenue requirement?

A. The revenue requirement for FY 2017 is calculated in Attachment DBS-1 and is based on actual spending related to projects set forth in the final FY 2017 CIBS plan submitted to Staff in 2016. Attachment DBS-1 also includes, for illustrative purposes, a projection of the estimated revenue requirement including CIBS-eligible expenses that the Company expects to incur in FY 2018. Pursuant to a Staff request in a prior year's technical session, the Company has also included Attachment DBS-2, for information purposes only, which provides a calculation of the total revenue requirement associated with the CIBS program from its inception in FY 2009. This calculation includes CIBS investment amounts through June 30, 2009 that became part of the permanent rate base established in the Company's last distribution rate case, Docket No. DG 10-017.

Q. Please explain how the CIBS revenue requirement is calculated.

A. As shown in Attachment DBS-1, eligible CIBS investments are split into two categories: mains and services. Recoverable book depreciation expense is calculated based on these investment amounts using the depreciation rates established in the Company's last depreciation study (which was filed in Docket No. DG 08-009). The depreciation expense amount is used to calculate the deferred tax reserve associated with the effects of the timing difference between book and tax depreciation. The deferred tax reserve, along with accumulated book depreciation, reduces the rate base on which the Company is eligible to earn a return. The adjusted rate base is multiplied by the pre-tax rate of return of 9.87 percent (the Company's current ROR of 6.84% adjusted for current federal and state income tax rates of 34% and 8.5%, respectively) to arrive at the return on rate base and taxes. Added to the return and taxes are the actual calculated depreciation expense and property taxes. The property tax rate is calculated annually and is based on prior calendar year municipal property tax expense as a percentage of the average of the prior two calendar year's net plant in service.

Q. What is the CIBS revenue requirement for fiscal year 2017?

A. As shown on Attachment DBS-1, page 1, the cumulative CIBS revenue requirement for FY 2017 is $2,764,057 (line 35(i)), which corresponds to a $694,182 revenue deficiency, as provided on line 39(i).

Q. Please explain how you calculated the FY 2017 revenue requirement.

A. Page 1 of Attachment DBS-1 provides detail as to how the Company derived the FY 2017 revenue requirement. Lines 1(i) and 2(i) represent the FY 2017 CIBS program investment related to mains and services, respectively. These current year amounts are added together and reduced by the CIBS Base Amount of $520,965. For FY 2017, the net incremental amount of CIBS additions is $5,940,951, as shown on line 6(i). This amount is then added to the cumulative incremental CIBS program additions from July 1, 2009 to March 31, 2016 of $20,609,287, as shown on line 7(h), to derive the cumulative incremental CIBS program additions through March 31, 2017 of $26,550,238 as reported on line 7(i).

On lines 10(i) through 20(i) of page 1, the Company shows the calculations for book and tax depreciation, and the resulting deferred tax reserve. Because the CIBS program spending is expected to be 100 percent tax deductible, as discussed later in my testimony, the cumulative tax depreciation on line 11(i) is equal to the cumulative incremental CIBS program spending of $26,550,238 from line 7(i). When compared to the accumulated depreciation of $2,497,512 on line 14(i), the resulting timing difference between book and tax depreciation is $24,052,726, as shown on line 17(i). This amount is then multiplied by the Company's current effective tax rate and the deferred tax reserve of $9,527,285 is shown on line 20(i). On lines 23(i) through 27(i), the Company calculates rate base by reducing the amount of cumulative incremental CIBS spending of $26,550,238 by $2,497,512 for accumulated depreciation and $9,527,285 for deferred tax reserves, resulting in a year end rate base of $14,525,441 (line 27(i)). The Company then multiplied the rate base amount times the pre-tax ROR of 9.87 percent, which resulted in the return and taxes amount of $1,433,661 on line 32(i). On lines 33(i) and 34(i), the Company added book depreciation of $601,598 and property taxes of $728,798. The resulting FY 2017 cumulative revenue requirement is $2,764,057, as shown on line 35(i). From this amount, the Company deducted the prior year revenue requirement of $2,069,876, as shown on line 37(i), to arrive at a revenue deficiency of $694,182 on line 39(i).

Q. Please explain the rate design the Company intends to use to recover the proposed increase in the revenue requirement.

A. The Company will design rates that will result in an increase in annual revenues of $694,182. Specifically, the cumulative revenue requirement for fiscal year 2017 amounts to $2,764,057, or $694,182 more than the $2,069,876 which is currently being billed, and as shown on Attachment DBS-1, page 1, line 35(h). Consistent with past adjustments, the Company will increase all rate components on an equal percentage basis.

Q. How was the statutory tax rate of 39.61% on Attachment DBS-1, page 1, line 18, column g, calculated?

A. The statutory rate of 39.61% was calculated by using a 34% federal tax rate and an 8.5% tax rate for the State of New Hampshire (.34 + .085 – (.34 x .085) = .3961).

Q. How was the common equity pre-tax rate of 7.659% on Attachment DBS-1, line 56(e) calculated?

A. The common equity pre-tax rate of 7.659% was calculated by dividing the 9.25% rate of return on common equity, authorized in DG 14-180, by .6039 (1 – .3961 [statutory tax rate – see previous question]) and multiplied by 50% (ratio of debt to equity in DG 14-180) [.0925 / .6039 x .50 = .07659]. *See* Order No. 25,797 at 4 (June 26, 2015).

Q. Can you explain the repairs tax deduction as it applies to projects completed under the CIBS program?

A. In 2009, the Internal Revenue Service issued guidance under Internal Revenue Code ("IRC") Section 162 regarding the eligibility of certain repair and maintenance expenses for an immediate deduction for income tax purposes, but capitalized by the Company for book purposes. This tax deduction has the effect of increasing deferred taxes and lowering the current revenue requirement that customers will pay under the CIBS program. Based on IRC §263(a) and §162, repairs resulting in the replacement of less than 20 percent of an original unit of property qualify for a repairs tax deduction. A gas company's gas subsystem is considered a "unit of property" for the purposes of the repairs tax deduction. Replacement pipe cannot be more than 2 additional inches in diameter from the original pipe, and to the extent that a length of replacement pipe is longer than the pipe being retired, the increase in length must be no more than 5 percent of the subsystem for it to be eligible for the repairs tax deduction.

Based on these criteria, all of the projects included in the CIBS program are considered repairs by the Company and are expected to be fully deducted from the tax return for the year that they occur. Therefore, in computing the revenue requirement, the Company is currently reflecting tax deductibility of 100 percent for all CIBS jobs. This tax deductibility results in a greater deferred tax reserve which reduces the rate base and resulting revenue requirement charged to customers.

Q. How are book depreciation expense and property tax expense calculated?

A. Book depreciation expense is calculated on page 2 of Attachment DBS-1. The actual spending for mains and services is referenced on page 1, lines 1 and 2, respectively. These amounts are reduced on a pro rata basis by the CIBS Base Amount. The net amounts for mains and services are shown on page 2, lines 3 and 26 and are used to calculate book depreciation expense for each vintage year. Lines 6 through 16 and 29 through 39 show the calculation of book depreciation expense using the depreciation rates set in the Company's last approved depreciation study. FY 2017 book depreciation expense of $424,995 and $176,604 for mains and services is shown on lines 16(i) and 39(i), respectively. These amounts, when combined, equal $601,598 as shown on line 46(i), which is carried forward to page 1, line 13(i). Cumulative book depreciation expense of $1,790,640 and $706,872 for mains and services are shown on lines 19(i) and 42(i), respectively. Line 48(i) is the sum of these two lines, amounting to $2,497,512, which is then used on page 1, line 14(i).

Property taxes are calculated on page 3 of Attachment DBS-1. Net plant is calculated using plant in service as reported on the Company's Annual Report (Form F-16G) less the reserve for accumulated depreciation and amortization. An average of the most recent two years of net plant is then calculated on lines 6 through 8. Line 10(l) shows the property tax expense for the prior calendar year. The property tax expense rate of 3.03% shown on line 12(l) is calculated by dividing line 10(l) by the average net plant shown on line 8(l). This property tax rate is then carried forward to page 1, line 34 and is multiplied by net plant in service found on page 1, line 25(i), resulting in the property tax amount of $728,798 on page 1, line 34(i).

Q. What is the average bill impact of this year's CIBS revenue requirement?

A. Page 4 of Attachment DBS-1 shows the average bill impacts of the CIBS program. The annual CIBS-related increase for FY 2017 for an average Residential Heating customer using a total of 763 therms per year is $2.83, as shown on line 22(i).

IV. DEGRADATION FEES

Q. Please provide an update on the litigation with the Cities of Concord and Manchester over the Company's challenge to the Cities' road opening fee ordinances.

A. The trial court issued an order in July 2015, which struck down the penalty provisions in each ordinance for excavating new pavement, but otherwise upheld the ordinances. Both parties appealed to the New Hampshire Supreme Court. The Supreme Court heard oral argument in November 2016, and the Company expects a decision before the summer of 2017.

Q. How will the Company address any refunded road degradation fees if it prevails in its litigation against the Cities of Concord and Manchester?

A. During fiscal years 2011 through 2017, the Company included a total of $1,143,789 in degradation fees as part of the costs of the CIBS program as shown in Table 1 below.

Table 1

Period	City of Concord	City of Manchester		Total
Fiscal 2011	$19,856	$275,035		$294,891
Fiscal 2012	$37,960	$39,885		$77,845
Fiscal 2013	$9,747	$382,335		$392,082
Fiscal 2014	$48,350	-0-	(1)	$48,350
Fiscal 2015	$75,541	-0-	(1)	$75,541
Fiscal 2016	$129,773	-0-	(1)	$129,773
Fiscal 2017	$125,308	-0-	(1)	$125,308
Total	$446,535	$697,255		$1,143,789

(1) Excludes FY 2014 through FY 2017 accrued Manchester degradation fees in the amount of $246,449, $236,710, $202,250 and $512,650, respectively from the calculation of the revenue requirement.

If the Company prevails in the litigation, the Company will reflect the refunds it receives from Concord and the accrual reversal for Manchester in the revenue requirement calculation in the fiscal year (or years) in which those refunds are received. Customers will receive the benefit of those refunds through a reduction to rate base (and corresponding decrease in return and taxes) and a reduction in ongoing depreciation expense and property tax expense in the same year that the Company is reimbursed by the communities. Attachment DBS-3 shows the illustrative calculation of the estimated impact on the revenue requirement of such a refund. Based on degradation fees paid to date and included in the cumulative CIBS investment, the impact on the revenue requirement in the year such fees are refunded to the Company is estimated at approximately ($122,819) as shown on page 1, line 32(b) of Attachment DBS-3. It is estimated that the Concord and Manchester degradation fees to be incurred during the FY 2018 construction season will be $245,140 and $1,011,640, respectively.

Q. If the Company does not prevail in the litigation, what impact will that have on customers?

A. If the Company does not prevail in the litigation, the Company will pay the City of Manchester FY 2014 through FY 2017 degradation fees of $1,198,059. These amounts have an estimated revenue requirement of $128,646 as shown on page 1, line 32(b) of Attachment DBS-4. The annual CIBS-related increase for an average Residential Heating customer using a total of 763 therms per year would be $0.53, as shown on page 4, line 17(b) of Attachment DBS-4.

Q. Does this conclude your testimony?

A. Yes it does.

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