Liberty Utilities

STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Docket No. DG 18-XXX

Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities
Fiscal Year 2018 Cast Iron/Bare Steel Replacement Program Results

DIRECT TESTIMONY

OF

DAVID B. SIMEK

AND

CATHERINE A. MCNAMARA

April 16, 2018

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I. <u>INTRODUCTION</u>

Q. Please state your full name and business address.

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

(CM) My name is Catherine A. McNamara. My business address is 15 Buttrick Road, Londonderry, New Hampshire.

Q. Please state by whom you are employed?

A. We are employed by Liberty Utilities Service Corp. ("Liberty") which provides service to Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities ("EnergyNorth" or the "Company").

Q. Please describe your educational background and your business and professional experience.

A. (DS) 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. In August of 2013, I joined Liberty as a Utility Analyst and I was promoted to Manager, Rates and Regulatory Affairs in August 2017. 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.

(CM) I graduated from the University of Massachusetts, Boston, in 1993 with a Bachelor of Science in Management with a concentration in Accounting. In November 2017, I joined Liberty as an Analyst in Rates and Regulatory Affairs. Prior to my employment at Liberty, I was employed by Eversource as a Senior Analyst in the Investment Planning group from 2015 to 2017. From 2008 to 2015, I was a Supervisor in the Plant Accounting department. Prior to my position in Plant Accounting, I was a Financial Analyst/General Ledger System Administrator within the Accounting group from 2000 to 2008.

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

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

(CM) No, I have not previously testified before the Commission.

II. <u>PURPOSE OF TESTIMONY</u>

Q. What is the purpose of your testimony?

A. The purpose of our testimony is to explain the Company's revenue requirement calculation associated with the CIBS main replacement program for the fiscal year starting April 1, 2017, and ending March 31, 2018 ("FY 2018").

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 2018. The Company proposes to recover this revenue requirement beginning July 1, 2018, through an increase in its base distribution rates.

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

A. The revenue requirement for FY 2018 is calculated in Attachment DBS/CAM-1 and is based on actual spending related to projects set forth in the final FY 2018 CIBS plan submitted to Staff in 2017. Attachment DBS/CAM-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 2019. Pursuant to a Staff request in a prior year's technical session, the Company has also included Attachment DBS/CAM-2, for informational 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 distribution rate case of Docket No. DG 10-017.

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

A. As shown in Attachment DBS/CAM-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 8.58 percent (the Company's current ROR of 6.85% adjusted for current federal and state income tax rates of 21% and 7.9%, 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 2018?

A. As shown on Attachment DBS/CAM-1, page 1, the cumulative CIBS revenue requirement for FY 2018 is $3,535,855 (line 35(j)), which corresponds to a $777,172 revenue deficiency, as provided on line 39(j).

Q. Please explain how you calculated the FY 2018 revenue requirement.

A. Page 1 of Attachment DBS/CAM-1 provides detail as to how the Company derived the FY 2018 revenue requirement. Lines 1(j) and 2(j) represent the FY 2018 CIBS program investment related to mains and services, respectively. These current year amounts are added together and reduced by the CIBS Base Amount of $527,275. For FY 2018, the net incremental amount of CIBS additions is $9,720,506, as shown on line 6(j). This amount is then added to the cumulative incremental CIBS program additions from July 1, 2009, to March 31, 2017, of $26,502,263, as shown on line 7(i), to derive the cumulative incremental CIBS program additions through March 31, 2018, of $36,222,769 as reported on line 7(j).

On lines 10(j) through 20(j) 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 our testimony, the cumulative tax depreciation on line 11(j) is equal to the cumulative incremental CIBS program spending of $36,222,769 from line 7(j). When compared to the accumulated depreciation of $3,310,822 on line 14(j), the resulting timing difference between book and tax depreciation is $32,911,947, as shown on line 17(j). This amount is then multiplied by the Company's current effective tax rate and the deferred tax reserve of $11,934,746 is shown on line 20(j). On lines 23(j) through 27(j), the Company calculates rate base by reducing the amount of cumulative incremental CIBS spending of $36,222,769 by $3,310,822 for accumulated depreciation and $11,934,746 for deferred tax reserves, resulting in a year end rate base of $20,977,200 (line 27(j)). The Company then multiplied the rate base amount times the pre-tax ROR of 8.58 percent, which resulted in the return and taxes amount of $1,799,844 on line 32(j). On lines 33(j) and 34(j), the Company added book depreciation of $814,476 and property taxes of $921,535. The resulting FY 2018 cumulative revenue requirement is $3,535,855, as shown on line 35(j). From this amount, the Company deducted the prior year revenue requirement of $2,758,683, as shown on line 37(j), to arrive at a revenue deficiency of $777,172 on line 39(j).

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 $777,172. Specifically, the cumulative revenue requirement for fiscal year 2017 amounts to $3,535,855, or $777,172 more than the $2,758,683 which is currently being billed, and as shown on Attachment DBS/CAM-1, page 1, line 35(i). Consistent with past adjustments, the Company will increase all distribution rate components on an equal percentage basis.

Q. How was the statutory tax rate of 27.24% on Attachment DBS/CAM-1, page 1, line 18, column j, calculated?

A. The statutory rate of 27.24% was calculated by using a 21% federal tax rate and a 7.9% tax rate for the State of New Hampshire (.21 + .079 – (.21 x .079) = .2724).

Q. How was the common equity weighted pre-tax rate of 6.360% on Attachment DBS/CAM-1, line 56(c) calculated?

A. The common equity pre-tax rate of 6.360% was calculated by dividing the 9.40% rate of return on common equity, proposed in Docket No. DG 17-048, by .7276 (1 – .2724 [statutory tax rate – see previous question]) and multiplied by 49.20% (ratio of debt to equity in DG 17-048) [.0940 / .7276 x .4920 = .0630].

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/CAM-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 27, and are used to calculate book depreciation expense for each vintage year. Lines 5 through 17, and 29 through 41 show the calculation of book depreciation expense using the depreciation rates set in the Company's last approved depreciation study. FY 2018 book depreciation expense of $585,632 and $228,843 for mains and services is shown on lines 17(j) and 41(j), respectively. These amounts, when combined, equal $814,476 as shown on line 48(j), which is carried forward to page 1, line 13(j). Cumulative book depreciation expense of $2,375,577 and $935,245 for mains and services are shown on lines 20(j) and 44(j), respectively. Line 50(j) is the sum of these two lines, amounting to $3,310,822, which is then used on page 1, line 14(j).

Property taxes are calculated on page 3 of Attachment DBS/CAM-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(m) shows the property tax expense for the prior calendar year. The property tax expense rate of 2.80% shown on line 12(m) is calculated by dividing line 10(m) by the average net plant shown on line 8(m). 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(j), resulting in the property tax amount of $921,535 on page 1, line 34(j).

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

A. Page 4 of Attachment DBS/CAM-1 shows the average bill impacts of the CIBS program. The annual CIBS-related increase for FY 2018 for an average Residential Heating customer using a total of 779 therms per year is $3.32, as shown on line 22(j).

Q. Does this conclude your testimony?

A. Yes, it does.

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