



**STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION**

Docket No. DG 14-180

Liberty Utilities (EnergyNorth Natural Gas) Corp. d/b/a Liberty Utilities
Distribution Service Rate Case

DIRECT TESTIMONY

OF

KEVIN M. MCCARTHY

August 1, 2014

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LIST OF ATTACHMENTS

Attachment KKM-1: Algonquin Power & Utilities Corp. Cost Allocation Manual

Attachment KKM-2: Re-calculation of Corporate Allocations Using the New CAM

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I. INTRODUCTION

Q. Would you please state your name and business address?

A. My name is Kevin M. McCarthy. My business address is 15 Buttrick Road, Londonderry, NH 03053.

Q. Mr. McCarthy, by whom are you employed?

A. I am employed by Liberty Energy Utilities (New Hampshire) Corp. (“Liberty Energy NH”).

Q. What is your job title?

A. My job title is Vice President of Finance. In this capacity, I am responsible for all of the financial, purchasing and IT activities for all of the Liberty Utilities New Hampshire entities.

Q. Please name the New Hampshire entities that receive these services.

A. I provide these services to Liberty Energy Utilities (New Hampshire) Corp., Liberty Utilities (EnergyNorth Natural Gas) Corp. (“EnergyNorth”) and Liberty Utilities (Granite State Electric) Corp. (“Granite State”).

Q. What is your professional experience?

A. Before working for Liberty Utilities, I held a number of positions in the energy industry. After graduating from college in 1978, I worked for a public accounting firm for four

1 years before joining Bay State Gas Company as a tax accountant. I was employed by Bay
2 State Gas Company for approximately 16 years holding the following additional
3 positions: Tax Supervisor, Manager of Compensation and Benefits, Director of Human
4 Resources, General Manager of Bay State and Northern Propane and Vice President and
5 Treasurer of EnergyUSA, Inc., a wholly-owned subsidiary of Bay State Gas Company.
6 After leaving Bay State Gas Company in 1998 I worked as a consultant for Portland
7 Natural Gas Transmission System ("PNGTS") during the construction phase of the
8 project. After the pipeline went into service, I was appointed Director of Accounting and
9 Finance and I was subsequently promoted to Chief Financial Officer. After leaving
10 PNGTS in 2005, I took a consulting position with Maine & Maritimes, Inc., owner of
11 Maine Public Service, and served as the Project Manager for its Sarbanes-Oxley
12 initiative. After completing this project, I took the position of Vice President, Chief
13 Financial Officer and Controller for Millennium Pipeline Company, LLC.

14
15 **Q. Do you have any professional designations?**

16 A. Yes, I am licensed in Massachusetts as a Certified Public Accountant and I am also a
17 Chartered Global Management Accountant.

18
19 **Q. What is your educational experience?**

20 A. I graduated cum laude from Merrimack College in 1978 with a Bachelor of Science in
21 Business Administration. I hold a Master's Degree in Taxation and an Advanced
22 Certificate in Taxation from Bentley College (now Bentley University). I completed 70%

1 of the course requirements.in the Master of Science in Finance program at Bentley
2 College.

3
4 **Q. Have you previously testified or participated in proceedings before the New**
5 **Hampshire Public Utilities Commission?**

6 A. No.

7
8 **Q. Have you previously testified or participated in proceedings before other regulatory**
9 **commissions?**

10 A. Yes, I have provided testimony to the Federal Energy Regulatory Commission in
11 connection with a PNGTS rate case proceeding.

12
13 **II. PURPOSE OF TESTIMONY**

14 **Q. What is the purpose of your testimony?**

15 A. The purpose of my testimony is to discuss the changes made to the Algonquin Power &
16 Utilities Corp. (“APUC”) Cost Allocation Manual (“CAM”) since the prior CAM was
17 adopted on July 3, 2012 when EnergyNorth was purchased from National Grid.

18
19 **Q. Are you sponsoring any attachments to support your testimony?**

20 A. Yes, I am sponsoring the following:

- 21 • Attachment KMM-1 – Algonquin Power & Utilities Corp. Cost Allocation
22 Manual

- Attachment KMM-2 – Re-calculation of Corporate Allocations Using the New CAM

III. COST ALLOCATION MANUAL

Q. What is the Algonquin Power and Utilities Corp. CAM?

A. As discussed in detail in Attachment KMM-1, the CAM outlines the methods of direct charge and cost allocations: (i) between APUC and its affiliates, Algonquin Power Company (“APCO”) and Liberty Utilities (Canada) Corp. (“LUCC”); (ii) between the shared services functions within LUCC and its affiliates (iii) between LUCC and its regulated utility subsidiaries; and (iv) between Liberty Utilities Service Corp. (“LUSC”) and its affiliates.

Q. When did the changes made to the Cost Allocation Manual become effective?

A. The changes to the CAM became effective January 1, 2014. I would note that page 13 of the CAM states that all US employees are employed by LUSC. My understanding is that US employees will not be moved to LUSC until later this year or early next year. The total amount of charges reflected on the books of EnergyNorth should not be affected by the transfer of employees to LUSC.

Q. Why was the CAM changed and why does it result in a better allocation?

A. The CAM was in need of an update to reflect the growth of APUC and its subsidiaries and to ensure that the cost drivers created at the time the CAM was adopted were still

1 properly representative of the cost drivers today. The previously used 3 factor formula
2 (used to allocate indirect costs from APUC and Liberty Algonquin Business Services
3 (“LABS”)¹, was out of date with the current cost drivers of the business. Likewise, the 4
4 factor formula (used to allocate indirect charges from APUC and LABS) was out of date
5 with the current cost drivers of the business.
6

7 **Q. Is the revised CAM consistent with regulatory principles?**

8 A. Yes, the CAM conforms with the NARUC Guidelines for Cost Allocations and Affiliate
9 Transactions, which are included as Appendix 1 to Attachment KMM-1. The objectives
10 of the CAM are to: (1) directly charge as much as possible to the entity that procures any
11 specific service; and (2) to ensure that inappropriate subsidization of unregulated
12 activities by regulated activities, and vice versa, does not occur.
13

14 **Q. Please describe the types of costs that are allocated with the CAM.**

15 A. As explained in more detail in Attachment KMM-1, costs charged and allocated in
16 connection with the CAM include direct labor, direct materials, direct purchased services
17 associated with the related asset or services and overhead amounts.
18

¹ In 2013, LABS was created to increase the efficient delivery of certain administrative services including Communications, Financial Reporting and Accounting Standards, HR, IT, Internal Audit, Legal, Procurement and Risk Management. LABS is not a separate entity but, rather, a broadly focused group of business professional and specialists at the Algonquin level committed to enhancing the operational excellence of APUC, and its subsidiaries. The employees that bill time through LABS are all employees of LUCC.

Q. Briefly describe the allocation methodology in place before and after January 1, 2014.

A. Wherever possible, costs are directly charged to the entity that procures services from the entity providing the service. For costs that cannot be directly charged, the CAM in place prior to January 1, 2014 used the following four factors and weightings to allocate charges from APUC and LABS to the regulated utility subsidiaries:

Utility Plant	50%
Customer Count	40%
Non-Labor Expense	5%
Labor	5%

Effective January 1, 2014 the factors and weightings were changed as follows:

Utility Plant	25%
Customer Count	25%
Non-Labor Expenses	25%
Labor	25%

As can be seen by comparing the two tables above, the cost allocation factors remained the same but the factors are now equally weighted. The Company believes that equally weighting the factors results in a more equitable allocation of costs.

Q. Please provide an illustration of the impact of changing from the prior CAM to the new CAM.

A. The net effect of the change from the prior CAM to the new CAM can be illustrated as

follows:

From (prior) CAM

Factor	Utility 1	Utility 2	Total All Utilities	Utility 1 % of Total	Factor Weight	Utility 1 Allocation
Utility Plant	727	371	1,098	66%	50%	33%
Customer Count	6,000	1,000	7,000	86%	40%	34%
Non-Labor	108	41	149	72%	5%	3%
Labor	57	32	89	64%	5%	4%
Total Allocation						74%

To (new CAM)

Factor	Utility 1	Utility 2	Total All Utilities	Utility 1 % of Total	Factor Weight	Utility 1 Allocation
Utility Plant	727	371	1,098	66%	25%	17%
Customer Count	6,000	1,000	7,000	86%	25%	21%
Non-Labor	108	41	149	72%	25%	18%
Labor	57	32	149	64%	25%	18%
Total Allocation						72%

As can be seen from the above two tables, in this particular illustration, the net effect of the change is that Utility 1's allocation decreased by 2% from 74% to 72% under the new CAM. In this case, Utility 1 is better off but Utility 2 will be allocated the difference. The change in the CAM results in a change in the distribution of the costs. This methodology was developed and utilized to better allocate costs, recognizing that larger

1 utilities require more time and management attention and incur greater costs than the
2 smaller utilities.

3
4 **Q. What was the actual impact on corporate allocations for this rate filing?**

5 A. As reflected on the Attachment KMM-2, the net effect of the new CAM on the test year
6 is an incremental allocation of \$123,168² from APUC and \$252,185³ from LABS.

7
8 **Q. Please explain Attachment KMM-2.**

9 A. Attachment KMM-2, page 1 of 2 titled, “Re-calculation of Corporate Allocations Using
10 the New CAM,” does exactly that for both LABS and APUC charges for the period April
11 1, 2013, through March 31, 2014, using the new CAM percentages. Page 1 of Attachment
12 KMM-2 shows the re-calculation of the corporate costs allocated to EnergyNorth for the
13 test period using the new approach. The columns under the heading “Test Year Costs”
14 show the actual corporate charges incurred for the period April 1, 2013, through March
15 31, 2014. As explained in Attachment KMM-1, which is the new CAM that became
16 effective in 2014, the nature of the charge (i.e. the function or department from which the
17 charge originates) determines the allocation methodology to be employed. Since the
18 charges are allocated to a number of entities, Liberty Utilities Co., a subsidiary of LUCC,
19 does not receive 100% of the charges. In this case, the amount allocated to the entire
20 Liberty Utilities Co. business segment is the amount reflected in the “Liberty Utilities

² Attachment KMM-2, page 2 of 2, line 4 in “Adjustment” column.

³ Attachment KMM-2, page 2 of 2, line 7 in “Adjustment” column.

1 Share” column. As an example, please refer to IT costs. For IT costs, Liberty Utilities
2 Co. is allocated 83.6% of the total from that shared services department. The remaining
3 16.4% is allocated to APUC. The allocation of IT costs is based on two factors - the
4 number of employees and operating costs. These two factors are weighted 90% and 10%,
5 respectively.

6
7 The Total column on the far right hand side of page 1 of Attachment KMM-2 shows the
8 total costs that would have been allocated to Liberty Utilities Co. using the new CAM
9 during the test year. On lines 32 – 34, the Liberty Utilities Co. cost that applies to
10 EnergyNorth is calculated. For LUC costs, EnergyNorth’s share or portion amongst all
11 Liberty Utilities Co. regulated utilities was 25.1% for 2013 and is 21.8% for 2014. The
12 amount of Liberty Utilities Co. charges allocated using the new CAM to EnergyNorth
13 would have been \$992,721. In the case of APUC charges, the percentage of Liberty
14 Utilities Co. charges allocated to EnergyNorth was 24.6% for 2013 and 21.8% for 2014
15 resulting in a total of \$735,670 being charged to EnergyNorth.

16
17 The recalculated LABS and APUC charges are carried over to page 2 of Attachment
18 KMM-2 and are reflected in the “Revised Amount” column on the right hand part of the
19 page. The other corporate allocation amounts either remained the same or changed very
20 slightly due to a minor change to the EnergyNorth allocation percentage and are reflected
21 on this schedule as well. As can be seen on line 19, the Net Adjustment for the test
22 period resulting from this change is an increase to EnergyNorth’s operating expenses of

1 \$245,835.

2

3 **Q. Is this increase in allocations to EnergyNorth just and reasonable?**

4 A. Yes. The change in the allocation methodology more fairly reflects EnergyNorth's share
5 of the allocable costs given its relative size to the other utilities in the group and the
6 current cost drivers.

7

8 **Q. Does this conclude your testimony?**

9 A. Yes.