STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DOCKET NO. DE 16-383

PUBLIC SERVICE COMPANY OF NEW HAMPSHIRE

LIBERTY UTILITIES (GRANITE STATE ELECTRIC) CORP. d/b/a LIBERTY UTILITIES

DISTRIBUTION SERVICE RATE CASE

DIRECT TESTIMONY OF

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NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION

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I. INTRODUCTION AND QUALIFICATIONS

Q. Mr. Dudley, please state your full name and business address.

A. My name is Jay E. Dudley. My business address is 21 South Fruit Street, Suite 10, Concord, NH 03301.

Q. Please state your employer and your position.

A. I am employed by the New Hampshire Public Utilities Commission ("Commission") as a Utility Analyst for the Electric Division.

Q. Please describe your professional background.

A. I started at the Commission in June of 2015 as a Utility Analyst in the Electric Division. Before joining the Commission, I was employed at the Vermont Public Service Board ("PSB") for seven years as a Utility Analyst and Hearing Officer. In that position I was primarily responsible for the analysis of financing and accounting order requests filed by all Vermont utilities, including review of auditor's reports, financial projections, and securities analysis. As Hearing Officer, I managed and adjudicated cases involving a broad range of utility-related issues including rate investigations, energy efficiency, consumer complaints, utility finance, construction projects, condemnations, and telecommunications. Prior to working for the PSB, I worked in the commercial banking sector in Vermont for twenty years where I held various management and administrative positions. My most recent role was as Vice President and Chief Credit Officer for Lyndon Bank in Lyndonville, Vermont. In that position I was responsible for directing and administering the analysis and credit risk management of the bank's loan portfolio, including internal loan review, regulatory compliance, and audit. In performing those responsibilities, I also provided oversight for the commercial and retail lending functions with detailed financial analysis of large corporate relationships, critique of loan proposals and loan structuring, consultation on business development efforts, and advised the Board of Directors on loan approvals and loan portfolio quality. Prior to my role as Chief Credit Officer, I held the position of Vice President of Loan Administration. In this position, I was responsible for directing and administering the underwriting, processing, and funding of all commercial, consumer, and residential mortgage loans. My responsibilities also included the management of loan processing and loan origination staff and partnering with the Compliance Officer to monitor and ensure compliance with all banking laws, regulations, and the bank's lending policy. Previous to my position as Loan Administration Vice President, I held the position of Assistant Vice President of Commercial Loan Administration with Passumpsic Savings Bank in St. Johnsbury, Vermont. In that role, I was responsible for supervising loan administration and loan operations within the commercial lending division of the bank.

Q. Please describe your educational background?

A. I received my Bachelor of Arts degree in Political Science from St. Michael's College. Throughout my career in banking, I took advantage of numerous CPE opportunities involving college level coursework in the areas of accounting, financial analysis, real estate and banking law, economics, and regulatory compliance. Also, during my tenure with the PSB I took advantage of various CPE opportunities including the Regulatory Studies Program at Michigan State University (sponsored by the National Association of

Regulatory Utility Commissioners "NARUC"), and Utility Finance & Accounting for Financial Professionals at the Financial Accounting Institute.

Q. Have you previously testified before the Commission?

A. Yes. I previously submitted Staff testimony to the Commission in Docket No. DE 14-238 and Docket No. DE 15-137.

II. SUMMARY OF TESTIMONY

Q. Please describe the purpose of your testimony today.

A. The purpose of my testimony is to provide Staff's recommendation involving Liberty Utilities (Granite State Electric) Corp. d/b/a Liberty Utilities' ("Granite State" or the "Company") request filed on April 29, 2016, to implement a temporary rate increase to be effective on and after July 1, 2016, pending the Commission's final determination on the Company's request for a permanent rate increase. Based on the reports of the Company filed with the Commission, and Staff's concerns involving the Company's capital expenditures, cash flow, and proposed capital structure, Staff cannot provide the Commission with a positive recommendation that the increase in temporary rates as proposed by the Company is just and reasonable.

III. DISCUSSION OF TEMPORARY RATE REQUEST

Q. What is the statutory foundation for a request for temporary rates?

A. Temporary rates are specifically allowed pursuant to RSA 378:27 which reads as follows:

> **378:27 Temporary Rates.** – In any proceeding involving the rates of a public utility brought either upon motion of the commission or upon complaint, the commission may, after reasonable notice and hearing, if it be of the opinion that the public interest so

> requires, immediately fix, determine, and prescribe for the duration of said proceeding reasonable temporary rates; provided, however, that such temporary rates shall be sufficient to yield not less than a reasonable return on the cost of the property of the utility used and useful in the public service less accrued depreciation, as shown by the reports of the utility filed with the commission, unless there appears to be reasonable ground for questioning the figures in such reports.

Following the completion of the full proceeding, a "permanent rate" level is determined, and the difference between the temporary rate level and the permanent rate level is then reconciled through either collection from or refund to customers.

Q. Please describe Granite State's request for the temporary increase in rates.

A. According to Granite State, the Company has been unable to earn its authorized rate of return under existing rates because of a deficiency in distribution revenue of $5,328,583 as of fiscal year-end 2015. As a result, Granite State's return on rate base for 2015, related to the distribution portion of the business, declined to 5.93% as compared with the Company's authorized return of 7.90%. Granite State is seeking recovery of the $5.3 million revenue deficiency in permanent rates; however, to allow the Company to earn at least a portion of its authorized return until the Commission makes its final determination on permanent rates, the Company is proposing a temporary rate increase of approximately 60% of that amount, or $3,180,666 in additional distribution revenue.[1] This temporary rate amount constitutes an annual increase of 9.01% in distribution revenue and, in terms of rate impact for the average residential ratepayer (650 kWh), results in an increase to the total bill of 2.86% or $3.53 per month as of July 1, 2016, including an increase in the Customer Charge of $1.07.[2]

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[1] Mullen/Gorman Testimony on Temporary Rates at 4 (Bates 0006).
[2] Mullen/Gorman Testimony; Attachment SEM/HSG-TEMP-3 at 1 (Bates 0050).

IV. CAPITAL EXPENDITURES AND RELATED COST OVERRUNS

Q. What explanation does the Company provide for the decrease in its revenues and the resultant downward pressure on its rates of return?

A. Granite State testifies that the primary driver behind the need for an increase in rates is approximately $50 million in capital investments made by the Company over the last three years.[3]

Q. Did Staff detect any apparent irregularities or abnormalities with Granite State's capital expenditures during the course of its review?

A. Yes. The last clause of the Temporary Rates statute referenced above states "unless there appears to be reasonable ground for questioning the figures in such reports." As it relates to this case, Staff believes there are reasonable grounds for questioning some of the figures. On May 27, 2016, Staff issued its first set of data requests to the Company and the Company filed its responses on June 3, 2016. Data Request Staff 1-3, asked Granite State to provide its itemized construction budgets for 2014 and 2015 showing originally budgeted amounts and the final cost for each project.[4] In its response, the Company provided both the 2014 and 2015 budgets in Attachment Staff 1-3.xlsx which I have attached to my testimony as Attachment JED-1.[5] A line-by-line examination of the Attachment, specifically the capital budget for 2014, reveals a significant number of very large variances involving projects that were over-budget or not originally budgeted at all. Some of the more substantial variances are provided below:

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[3] Mullen/Gorman Testimony on Temporary Rates at 4 (Bates 0006).

[4] Granite State submitted its proposed capital budget for 2016 as part of its rate case filing. Full Rate Case Filing Requirements, Tab 23 (Bates 0172).

[5] An additional Data Request, Staff 2-2 sought more specific accounting details of the cost overruns listed here. Granite State filed its response on June 10, 2016, in the form of Attachment Staff 2-2.xlsx; however, the additional information provided lacked sufficient detail for Staff to change its conclusions on temporary rates in this testimony.

Project #	2014 Budget	Actual	Variance
8830-CNN015	$193,000	$1,716,402	$1,523,402
8830-CNN016	$ 26,000	$ 780,409	$ 754,409
8830-CNN014	$ 500,000	$1,896,007	$1,396,007
8830-CNN017	$ 220,000	$1,111,296	$ 891,296
8830-FINANCE	$ 0	$2,414,654	$2,414,654
8830-CNN010	$ 569,000	$ 910,508	$ 341,508
8830-C18603	$ 800,000	$1,883,152	$1,083,152
8830-C18720	$ 250,000	$1,447,179	$1,197,179
8830-IT	$ 0	$5,797,089	$5,797,089
8830-CD0376	$1,300,000	$2,305,671	$1,005,671

The variances for 2015 are still large but less numerous:

Project #	2015 Budget	Actual	Variance
8830-CNN014	$ 400,000	$2,050,909	$1,650,909
8830-CNN015	$ 100,000	$ 957,039	$ 857,039
8830-C36435	$ 50,000	$ 550,444	$ 500,444
8830-CNN	$ 575,000	$1,848,086	$1,273,086

As presented in my Attachment, the total amount budgeted in 2014 of $18.4 million was exceeded in actual expenditures by $12.3 million for a total of $30.7 million, or 60% over budget. For 2015, the overage was less severe with a total amount budgeted of $10 million exceeded in actual expenditures by $1.5 million for a total of $11.5 million. All of the capital improvements and additions to plant represented by these expenditures are now in Granite State's rate base which, for the purposes of this temporary rate case, the Company calculates to be $97.4 million. Attachment SEM/HSG-Temp-1 (Bates 0011).

Q. Does Staff have any concerns associated with the cost overruns outlined above?

A. Yes. First, the amount of capital expenditures since 2013, approximately $50 million, and the timeframe over which it was invested and work completed, reflects a highly aggressive posture by Granite State in its capital planning and budgeting process. This is intriguing given that none of these projects were driven by an appreciable increase in consumer demand or load growth.[6] Although the utility business is known to be capital-intensive by nature, the magnitude of Granite State's approach to capital planning, with a multitude of substantial projects occurring on multiple levels, constitutes a daunting task for any small utility and increases the potential where diligent and timely management of projects and budgets on a consistent basis may not always be achievable.

Second, in terms of budget variances and cost overruns, Staff found the size and quantity of the overages incurred by Granite State to be significant, raising some concerns as to whether the Company acted in a manner consistent with the performance of other similarly-situated utilities. Typically, when a utility pursues intensive capital investments of this nature, accompanied by rapid cost escalation, a process of reassessment will take place to determine root causes and consider alternative designs or strategies. Once the doubling or tripling of project costs have taken place, it should be clearly foreseeable by project management that costs are spiraling and some remediating action would need to be taken. However, in Granite State's case, given the increasing number of overages, which in many instances increased original budgeted costs several times over, it appears that such self-assessment may have been limited.

V. CASH FLOW DEPLETION

Q. Did Staff find any other areas of concern based on its review of the reports filed by the Company?

A. Yes. Granite State also discloses that most of its capital expenditures are funded by internally generated cash flow.[7] Typically a utility will not rely exclusively on its internal cash to fund the majority of its capital projects. Rather, a utility will access a short-term credit line facility for the majority of its funding needs, thus preserving cash flow for other corporate expenditures such as debt repayment or unforeseen contingencies.[8] Once a project(s) is complete, the utility will convert its short-term borrowing into long term debt or a combination of debt and equity. This is a common financing cycle for many similarly sized utilities. However, in Granite State's case, because it relies so heavily on internal cash flows, the degree of cash depletion within the Company is substantial. For example, a quick review of Granite State's statement of cash flows and its balance sheet for year-end 2015, as reflected in its FERC F-1 statements filed with the Commission (attached to my testimony as Attachment JED-2), reveals that the Company had only $48.00 left in cash as of December 31, 2015, and only $534.00 in 2014. By comparison, filings with the Commission from other utilities typically show cash balances in the thousands or hundreds of thousands of dollars.[9] Not surprisingly, the F-1 statements also reveal that Granite State's net cash flows from investing activities for

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[6] Brouillard/Hall Testimony at 5 (Bates 0363).

[7] Attachment JED-3.

[8] In response to Data Request Staff 2-5(c), Granite State asserts to the existence of a revolving line of credit, which appears to contradict the response provided in Data Response Staff 1-4. An examination by Staff of the 2015 FERC F-1 balance sheet did not reveal any information to indicate the existence of a revolving credit line; i.e. balances for notes payable of $0, long-term debt of $32 million, and paid-in capital of $75.98 million have remained constant since 2014.

[9] Prior to embarking on its recent capital plan, Granite State reported $796,686 in cash for year-end 2013. *See* FERC Form No. 1, 2013/Q4, Granite State Electric Co., at 110.

2015 and 2014 were -$11.6 million and -$27.7 million respectively, serving as an additional indication of the high rate of cash consumption and depletion.

VI. DISCUSSION OF PROPOSED CAPITAL STRUCTURE

Q. Please describe Granite State's proposed capital structure and overall cost of capital that it provided in support of its proposal for temporary rates.

A. Attachment SEM/HSG-TEMP-1, Schedule T, page 4 ("TEMP-1") (Bates 0014), provided in Mr. Mullen's and Mr. Gorman's joint testimony incorporates a hypothetical capital structure and overall cost of capital approved by the Commission in Granite State's last rate case Docket No. DE 13-063. That capital structure is 55% equity and 45% debt with the cost of equity component being 9.55% and the cost of debt component being 5.88%, resulting in an overall weighted average cost of capital of 7.90%.

Q. Does Staff accept Granite State's proposed capital structure and overall cost of capital as appropriate for purposes of computing temporary rates?

A. No. The Company's response to Staff Data Request 1-4 raises some question as to whether or not the proposed cost of debt of 5.88% is reasonable for setting temporary rates. In the response, Granite State indicates that it will not seek outside financing for its additional capital projects and that any future borrowings, if needed, will be provided internally by Liberty Utilities Co. or affiliated companies. This is consistent with the testimony of the Company's witness Mr. Hevert in his "Table 9: Weighted Cost of Debt" where he itemizes Granite State's current long term debt obligations and associated cost of debt. Staff has reproduced Mr. Hevert's table below:[10]

[10] Hevert Testimony at 57 (Bates 0433).

Table 9: Weighted Cost of Debt

Face Amount	*Face Amount*	*Rate*	*Weighted Average*
Liberty Utilities Co.	$3,434,343.43	3.51%	0.38%
Liberty Utilities Co.	$7,898,989.90	4.49%	1.11%
Liberty Utilities Co.	$4,121,212.12	4.89%	0.63%
Liberty Utilities Co.	$1,545,454.55	4.89%	0.24%
First Colony Life	$5,000,000.00	7.37%	1.15%
First Colony Life	$5,000,000.00	7.94%	1.24%
Paul Revere Life	$5,000,000.00	7.30%	1.14%
TOTAL	**$32,000,000.00**		**5.88%**

As outlined in the table, the Company currently has on its books outside bond debt totaling $15 million held by various life insurance companies and priced at above current market rates of between 7.3% and 7.94%.[11] The Company also has $17 million in internally provided financing which is priced more in line with current market rates of between 3.51% and 4.89%. Given the internal availability to Granite State of relatively inexpensive long-term financing on a going forward basis (enhanced by the fact of little or no issuance costs), and the fact that its existing weighted cost of debt includes some seasoned higher cost debt, it is appropriate to adjust the Company's cost of debt accordingly for purposes of calculating temporary rates in the this proceeding. In addition, Granite State's equity portion of its proposed capital structure appears to be on the high side at 55%. Staff believes that in terms of temporary rates, until a more thorough review of Granite State's overall rate request can be completed, a more appropriate capital structure, and one that would be fair and reasonable for ratepayers, is the mean capital structure for the proxy group developed by Mr. Hevert which is 51.67% equity and 48.33% debt. Attachment RBH-13, p. 1-2 (Bates 0528-0529). In his testimony, Mr. Hevert states that using the capital structure of the proxy group is a reasonable approach.[12]

It is also important to note that both capital structures for temporary rates (Mullen/Gorman and Staff) are hypothetical because Granite State's current capital structure is heavily weighted toward equity at 74.1% and 25.88% debt.[13] Thus for rate-making purposes, the imputed capital structure recommended by Staff has a higher than per books debt component and this imputed debt component must be assigned a cost. The Company indicated that if it were to incur new debt, it would likely obtain financing from internal sources. Data Request Staff 1-4. Accordingly, Staff costed the imputed debt at 4.46% consistent with the more recent internal borrowings as shown on Hevert's Table 9 (Bates 0433). Granite State's proposed rate base as provided by Mr. Mullen and Mr. Gorman is $97.4 million. Based on this, Staff imputed additional debt of $15 million priced at a rate of 4.46% and applied the Company's current cost of equity of 9.55%.

Staff's proposed capital structure and weighted cost of capital are provided below:

[11] For example, the 10-year U.S. Treasury is currently priced at 1.625% and the Prime Rate is 3.50%.
[12] Hevert Testimony at 55-56; Attachment RBH-13 (Bates 0431).

Staff Imputed Weighted Average Cost of Capital

Component	%	Amount	Cost	Weighted Avg.
Existing Debt	32.84%	$32,000,000	5.88%	1.93%
New Debt	15.49%	$15,087,365	4.46%	0.691%
Equity	51.67%	$50,341,488	9.55%	4.93%
Total	100%	$97,428,853	-----	7.55%

As shown in the table above, Staff preserved Granite State's cost of debt calculation for the existing debt portion and its cost of equity, but applied the likely cost of debt of any new borrowing at 4.46% based on current rates received for inter-company debt. As a result, Staff's weighted average cost of capital comes out lower at 7.55% as opposed to 7.90% calculated by the Company in TEMP-1. Applying this lower cost of capital to the rate base, using the same methodology as depicted in TEMP-1, provides the following results:

Rate Base	$97,428,853
Return	7.55%
Operating Inc. Req.	$7,355,878
Current Operating Inc.	$5,776,272
Operating Inc. Deficiency	$1,579,606
Income Tax Gross-Up	1.6559
Temp. Rate Deficiency	$2,615,669
Proposed Rate Deficiency	$3,180,666
Difference	-$ 564,997

VII. CONCLUSIONS AND RECOMMENDATIONS

[13] Attachment JED-4.

Q. What conclusions and recommendations does Staff draw from its analysis of Granite State's temporary rate increase request?

A. First, Staff believes that the extent of the Company's capital expenditures and the level of cost overruns outlined above, raise questions and concerns regarding Granite State's capital planning and budgeting process. Although the limited time frame involved with the review of temporary rates precludes Staff from conducting a full prudence review, which would include an in-depth examination of plans, work orders, change orders, and internal correspondence, Staff finds that the size and frequency of the cost overruns casts a cloud of doubt over Granite State's capital budgeting and spending and the appropriateness of basing a temporary rate increase on these plant figures. Accordingly, Staff recommends that the Commission delay allowing Granite State to earn a return on the total amount of the cost overruns, approximately $9.33 million,[14] until such time as a full prudency review of the Company's capital expenditures and capital budgeting process can be undertaken during the permanent rates portion of this proceeding. Based on Staff's calculations, utilizing Granite State's current authorized return on rate base of 7.90%, and applying its gross-up factor for income taxes of 1.6559%, results in a $1.2 million (rounded) decrease in the requested temporary rate revenue requirement of $3.2 million. Staff's calculation is as follows:

Cost Overruns	$9,326,258
Authorized Return	7.90%
Return $	$ 736,774
Income Tax Gross-Up	1.6559%
Return (Suspended)	$1,220,024

Secondly, as indicated in Staff's review and analysis of capital structure above, Staff finds that an imputed capital structure of 51.67% equity and 48.33% debt is more appropriate for temporary ratemaking purposes resulting in a lower cost of capital of 7.55% and a corresponding downward adjustment to the temporary rate revenue requirement of an additional $564,997.

This, combined with the suspended return amount of $1.2 million, provides a total adjustment to Granite State's temporary revenue requirement of -$1.78 million (rounded) as depicted below:

Proposed Temporary Rate Deficiency	$3,180,666
Capital Structure Adjustment	-$ 564,997
Return Adjustment	-$1,220,024
Revised Temporary Rate Deficiency	$1,395,645

Consequently, Staff is recommending a decrease in the amount of $1.78 million to the requested $3.2 million in temporary rates, resulting in a revised temporary rate revenue requirement of $1.4 million (rounded).

Q. Does that conclude your testimony?

A. Yes, it does.

[14] During a Technical Session held on June 8, 2016, Granite State stated that it had already deducted $4.47 million for IT expenditures from the rate base. The Company referenced TEMP-1 (Bates 0013, line 68). Accordingly, Staff reduced the total amount of overages from $13.8 million to $9.33 million.