STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DE 16-383

LIBERTY UTILITIES (GRANITE STATE ELECTRIC) CORP.

Petition for Rate Increase

Order Approving Temporary Rates

O R D E R N O. 25,917

June 30, 2016

APPEARANCES: Michael J. Sheehan, Esq., on behalf of Liberty Utilities (Granite State Electric) Corp. d/b/a Liberty Utilities; the Office of Consumer Advocate by Donald M. Kreis Esq., on behalf of residential ratepayers; Clifton Below on behalf of the City of Lebanon, NH; and Paul B. Dexter, Esq. and Suzanne Amidon, Esq., on behalf of Commission Staff.

In this order, the Commission approves a temporary increase of $2,354,980 in annual distribution revenues for Liberty Utilities (Granite State Electric) Corp. d/b/a Liberty Utilities ("Liberty" or "the Company"). The increase will result in an increase for the average residential ratepayer of approximately $ 2.62, or 2.12 percent of the total bill. At the end of this proceeding, the permanent rates approved will be reconciled back to the effective date of these temporary rates, July 1, 2016.

I. PROCEDURAL HISTORY

On April 29, 2016, Liberty filed a Petition for Permanent and Temporary Rates pursuant to RSA 378:27 and 378:28 in which Liberty requested a permanent rate increase of $5,328,583 in annual distribution revenues and a temporary increase of $3,180,666 in annual distribution revenues. The temporary rate request was proposed for effect for services rendered on and after July 1, 2016, and would have represented an increase for the average residential ratepayer using 650 kwh per month of $3.53 or 2.86 percent of the total bill. Exhibit 2 at 50.

With its petition, Liberty filed testimony and related exhibits, along with a motion for waiver of N. H. Code Admin. Rules Puc 1203.02(d) related to customer notice of the proposed rate increases. In addition, Liberty filed a motion for confidential treatment for compensation information for three of the Company's directors, and the Company's current and former president and the current and former secretary/treasurer, because the Company holds that information in confidence and the information has not previously been made available to the public.

On May 2, 2016, the Office of Consumer Advocate (OCA) notified the Commission that it would be participating in this proceeding on behalf of residential ratepayers pursuant to RSA 363:28. On May 10, 2016, the Commission issued Order No. 25,899 suspending the tariff and scheduling a prehearing conference and technical session for May 23, 2016. The City of Lebanon filed a Petition to Intervene on May 20, 2016. The Commission granted the City of Lebanon's Petition to Intervene at the May 23 pre-hearing conference. On May 31, the Commission issued a secretarial letter approving a procedural schedule that had been agreed to by the parties at the May 23 technical session. The schedule set a hearing on temporary rates for June 17, 2016. On June 15, Staff filed the testimony of Jay E. Dudley, Utility Analyst in the Electric Division.

At the June 17 hearing, the Commission heard argument and granted Liberty's motion for waiver of certain requirements for public notice under Puc Rule 1203.02(d) and also granted Liberty's motion for confidential treatment of certain executive compensation. Liberty presented two witnesses, Steven E. Mullen, Manager of Rates and Regulatory for Liberty Utilities Service Corp., and Christian P. Brouillard, Director of Engineering for Liberty Utilities Service Corp. Staff presented one witness, Jay E. Dudley.

II. POSITIONS OF THE PARTIES AND STAFF

A. Liberty

Liberty requested approval to implement temporary rates designed to collect $3,180,866 on an annual basis for effect July 1, 2016. Exhibit 2 at 5-9. Liberty stated that the primary driver of the need to increase rates is approximately $50 million in capital investments made by the Company since its last rate case. The Company proposed no change in revenue allocation or rate design in connection with its request for temporary rates. Liberty stated that for 2015, it earned a return of 5.93 percent on distribution rate base, which is below its last authorized return of 7.90 percent. Liberty stated that it based its request for temporary rates on the Company's financial statements for the year ending 2015, with adjustments to remove non-distribution revenue and costs, remove other non-recurring items, compute rate base, and normalize income tax expense. Liberty computed the revenue deficiency using the Company's actual cost of debt and the capital structure and return on equity approved by the Commission in DE 13-063, Liberty's most recent full distribution rate case.[1] Exhibit 2 at 7-8.

According to Liberty, the Company's earned rate of return for 2015 was 5.93% compared to its authorized return of 7.90%. Exhibit 2 at 11. The Company testified that there has been a significant increase in utility plant since its last rate case, while the number of customers served by Liberty has remained relatively flat on a company wide basis. Liberty also testified that providing a temporary rate at this point would provide for a smoother transition from current rates to permanent rates at the end of the permanent rate proceeding.

B. Office of Consumer Advocate

OCA argued that the Company's request for a temporary rate increase should be reduced due to current financial market conditions for capital costs. Exhibit 5. OCA stated that the

[1] *See* Docket DE 13-063, Order Number 25,638 (March 17, 2014) at 16.

Company's temporary rates should be based on a lower cost of equity than that approved in DE 13-063, which the OCA points out was set in the winter of 2014. OCA supports a capital structure of 50% equity and 50% debt for purpose of setting temporary rates.

C. Staff

Staff recommended a temporary rate increase of $1,400,000 on an annual basis. Staff calculated this rate amount by making three adjustments to the Company's proposed request of $3,180,866: one to the proposed capital structure used by Liberty, a second to the cost of debt, and a third to the rate base on which the temporary rates were calculated.

1. Capital Structure

Staff stated that Liberty did not propose using its actual capital structure for setting temporary rates because it consisted of 74.1% equity. Staff proposed using a capital structure of 51.67% equity and 48.33% debt, which is the mean capital structure from a proxy group of utilities provided by Liberty in the Testimony of Robert Hevert in the permanent rate case. Exhibit 6, p. 14. Staff argued that its proposal would be more appropriate for setting temporary rates than the capital structure approved in Liberty's last rate case settlement, because the proxy group is a more current benchmark of market conditions.

2. Cost of Debt

Staff agreed with Liberty that the historical average cost of debt of 5.88% should be applied to the actual debt on the Company's books of $32,000,000, but stated that for the imputed debt (required for ratemaking purposes because Liberty's actual capital structure consists of only 25.9% debt), a more recent cost should be used. Exhibit 6, p. 14. Staff proposed a rate of 4.46%, which is the weighted average of the cost of four inter-company loans made to Liberty in December 2012. Exhibit 6 at 13; Liberty FERC Form 1 at 257. Staff used the 4.46%

rate as a proxy for the imputed debt cost because Liberty stated than any new debt would be inter-company and the rate was more recent than the weighted cost of Liberty's entire debt portfolio. Exhibit 6 at 27 and 14.

Staff's two recommended changes to the capital structure and cost of debt result in a weighted average cost of capital of 7.55%, Exhibit 6 at15, as compared to the Company's proposed weighted cost of capital of 7.90%. Exhibit 2 at 14.

3. Capital Expenditures

Staff testified that Liberty's temporary rate request should not include any return on $13.8 million of capital expenditures that were the result of budget variances in 2014 and 2015, because the number and magnitude of budget variances caused Staff to doubt the books and records of the Company for purposes of calculating rates. Staff noted that $4.5 million of the budget variances related to information technology ("IT") investments had been taken out of rate base by Liberty for its temporary rate calculation. Thus, Staff's proposed return adjustment was for $9.3 million in capital expenditures. Exhibit 6 at 16-17.

Based on those three adjustments, Staff recommended a temporary rate increase of $1,400,000. *Id*. at 17.

B. Liberty Rebuttal

In rebuttal testimony, Liberty maintained that all of its capital expenditures were prudently incurred and should be included in rate base for the purposes of calculating temporary rates, despite any budget variances. Liberty stated that rates are not set on budgets, but on actual costs, and that the budget variances identified by Staff were not grounds to question the books and records of the Company when setting temporary rates. Further, Liberty stated that Staff's removal of those costs was flawed because Staff recommended removal of reliability investments that the Commission has already approved in annual Reliability Enhancement Plan ("REP") reviews. Further, Liberty stated that it had already removed $4.5 million of IT investments from its temporary rate calculation (Exhibit 2, p. 13, line 68) and while Staff also removed those IT costs, Staff removed them at the gross book value of $6.3 (Exhibit 6 at 20, line "IT" = $5,797,089 added to Exhibit 6 at 23, line "IT" = $506,293).

Concerning cost of debt and capital structure, Liberty stated that the Commission historically uses the capital structure, cost of debt, and cost of equity as approved in the Company's last rate case, because those values have been reviewed and approved by the Commission.

Liberty concluded that its entire temporary rate request should be approved.

III. COMMISSION ANALYSIS

RSA 378:27 requires the Commission to set reasonable temporary rates that are,

> 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.

As the New Hampshire Supreme Court has explained, "This standard is 'less stringent' than the standard for permanent rates, in that temporary rates shall be determined expeditiously, 'without such investigation as might be deemed necessary to a determination of permanent rates.'" *Appeal of the Office of Consumer Advocate*, 134 NH 651, 660 (1991) (citation omitted). Based on the record in this case, we find that a temporary revenue increase of $2,354,980 is just and reasonable, as calculated in Attachment 1 to this order.

A. Capital Structure

The temporary rate statute envisions rates based on reports of the company seeking the rate increase. In this case, Liberty has not proposed using its actual capital structure for rate setting. Since Liberty's actual capital structure is not useful for rate setting, the Commission must choose between Liberty's proposal, which is based on the capital structure used to calculate rates agreed to by settlement in Liberty's last rate case DE 13-063, or Staff's proposal, which borrows figures from Liberty's witness in the permanent rate case. Given the complexity of issues surrounding capital structure, especially when one must be imputed for rate making purposes, the Commission is hesitant to use Staff's figures, which have not yet been subject to Commission review. Thus, we approve temporary rates in this case using a capital structure of 55% equity and 45% debt, consistent with the imputed capital structure last approved by the Commission. As shown in the table in Attachment 1, the amount of imputed debt to reach the 55-45 ratio is $11,842,984.

B. Cost of Debt

Because the capital structure decided above includes a higher percentage of debt than Liberty's actual capital structure, the imputed debt element must be assigned a cost for purposes of calculating a weighted average cost of capital for ratemaking purposes. Liberty's proposal applies the weighted average cost of all its actual long term debt. Staff uses a weighted average of the more recently issued elements of Liberty's actual debt. We agree with Staff that the more recent inter-company debt is more reflective of Liberty's likely borrowing costs in the near future. We therefore adopt Staff's rate of 4.46% for the imputed debt of $11,842,984.

C. Capital Expenditures

The Commission is persuaded that the number and magnitude of budget variances set out in Exhibit 6 at 18-23 raise questions about the appropriateness of basing temporary rates on Liberty's recent investments. Liberty's own engineer, Mr. Brouillard, agreed at the hearing that the variances raise questions in his mind that warrant further investigation. Liberty attempted to explain the variances in rebuttal testimony, but given the limited time allotted for review of temporary rates, we find those explanations understandably cursory. We expect we will see rigorous examination of the Company's capital expenditures in the permanent phase of this case.

We accept two of Liberty's rebuttal arguments concerning capital expenditures. First, we agree with Liberty that any investments approved in REP dockets are appropriate for use in setting temporary rates in this case. From DE 16-277, Exhibit 3 at42 line 1, Columns "Actual CY 2014" and "Actual CY 2015," we see that Liberty spent $2,201,899 and $1,321,456 in REP investments on a gross book value basis and those values should be deducted from Staff's proposed reduction.

Second, we agree with Liberty that Staff based its revenue requirement reduction on gross book value of budget variances, which included IT costs. Then, Staff attempted to reflect the fact that Liberty had never included the IT costs in its temporary rate calculation and removed them, but did so at depreciated value, which is lower than gross book value. Exhibit 6 at 20 line "IT" = $5,797,089 added to Exhibit 6 at23 line "IT" = $506,293 yields $6,303,382, which we believe is the gross book value of these investments. Exhibit 2 at 13, line 68 shows $4,466,536 which Liberty stated is the net book value of these investments. For purposes of temporary rates, we adopt Liberty's position.

D. Summary

Having decided those three issues, we calculate the temporary rate revenue deficiency to be $2,354,980 as set forth on Attachment 1 to this decision. We find that rates designed to collect this recalculated revenue deficiency, with no change to rate design or rate class allocation, are just and reasonable as required by RSA 374:2, 378:5, and 378:7, pending a full investigation into the request for a permanent distribution rate increase. Consistent with RSA 378:29, the permanent rates approved will be reconciled back to the effective date of these temporary rates, July 1, 2016. We will decide how any over- or under- recovery will be treated following the determination of permanent rates.

Based upon the foregoing, it is hereby

ORDERED, that Liberty Utilities (Granite State Electric) Corp d/b/a Liberty Utilities is authorized to collect temporary rates designed to increase revenue by $2,354,980 on an annual basis as discussed herein effective July 1, 2016; and it is

FURTHER ORDERED, that Liberty shall file with the Commission properly annotated tariff pages consistent with this order within 10 days of the date of this order, as required by Puc Rule 1603.

By order of the Public Utilities Commission of New Hampshire this thirtieth day of June, 2016.

Martin P. Honigberg Chairman	Robert R. Scott Commissioner	Kathryn M. Bailey Commissioner

Attested by:

Debra A. Howland
Executive Director

Attachment 1

Approved Weighted Average Cost of Capital

Component	%	Amount	Cost	Weighted Avg.
Existing Debt	32.8%	$32,000,000	5.88%	1.92%
Imputed Debt	12.2%	$11,842,984	4.46%	0.54%
Equity	55.0%	$53,585,869	9.55%	5.25%
Total	100%	$97,428,853	------	7.71%

Rate Deficiency Comparison – Change to Weighted Average Cost of Capital

	Company	**Commission**
Rate Base	$97,428,853	$97,428,853
Rate of Return	7.9%	7.71%
Operating Inc. Required	$ 7,697,076	$7,511,765
Current Operating Income	$ 5,776,272	$ 5,776,272
Operating Inc. Deficiency	$ 1,920,804	$ 1,735,493
Income Tax Gross-up	1.6559	1.6559
Temp. Rate Deficiency	$ 3,180,666	$ 2,873,803
Proposed Rate Deficiency	$ 3,180,666	$ 3,180,666
Rate Deficiency Adjustment	$0	-$ 306,863

Reconciliation of Budget Variances

2014 Budget Variances	$12,282,899
2015 Budget Variances	$ 1,509,895
Total	$13,792,794
Less:	
2014 IT Expenditures	$ 5,797,089
2015 IT Expenditures	$ 506,293
2014 REP Expenditures	$ 2,201,899
2015 REP Expenditures	$ 1,321,456
Net Budget Variances	$ 3,966,057

Revenue Requirement – Net Budget Variances

	Commission
Budget Variance	$ 3,966,057
Authorized Return	7.9%
Return	$ 313,318
Income Tax Gross-up	1.6559
Return Disallowance	$ 518,823

Summary of Adjustments to Rate Deficiency

	Commission
Proposed Rate Deficiency	$3,180,666
Less:	
Weighted Average Cost of Capital	$ 306,863
Return on Net Budget Variances	$ 518,823
Approved Revenue Deficiency	$2,354,980