

Exhibit No.:  
Issue: Various Cost of Service Issues  
Witness: James Fallert  
Type of Exhibit: Rebuttal Testimony  
Sponsoring Party: Liberty Utilities (Midstates  
Natural Gas) Corp.  
d/b/a Liberty Utilities  
Case No.: GR-2014-0152  
Date Testimony Prepared: July 30, 2014

**MISSOURI PUBLIC SERVICE COMMISSION**

**CASE NO.: GR-2014-0152**

**REBUTTAL TESTIMONY**

**OF**

**JAMES FALLERT**

**ON BEHALF OF**

**LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP.  
D/B/A LIBERTY UTILITIES**

**July 30, 2014**

**\* Denotes Proprietary Information \***

**NP**

**REBUTTAL TESTIMONY  
OF  
JAMES FALLERT**

**CASE NO. GR-2014-0152**

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **JAMES FALLERT**

4 **CASE NO. GR-2014-0152**

5  
6 **I. POSITION AND QUALIFICATIONS**

7  
8 **Q. PLEASE STATE YOUR NAME, BUSINESS AFFILIATION AND BUSINESS**  
9 **ADDRESS.**

10 A. My name is James Fallert. I am doing business as James Fallert Consultant LLC and my  
11 business address is 3507 Burgundy Way Dr., St. Louis, MO 63129.

12 **Q. ON WHOSE BEHALF IS YOUR TESTIMONY PRESENTED?**

13 A. Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities (“Company” or  
14 “Liberty Utilities”).

15 **Q. ARE YOU THE SAME JAMES FALLERT WHO SUBMITTED DIRECT**  
16 **TESTIMONY ON BEHALF OF LIBERTY UTILITIES IN THIS CASE ON**  
17 **FEBRUARY 6, 2014?**

18 A. Yes.

19  
20 **II. PURPOSE OF TESTIMONY**

21  
22 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS**  
23 **CASE?**

1 A. The purpose of my testimony is to address the direct testimony of various Staff witnesses  
2 regarding the issues listed below. I would note that no other parties filed direct testimony  
3 regarding these issues.

- 4 - Pensions and OPEBs
- 5 - Uncollectible Accounts
- 6 - Cash Working Capital
- 7 - Depreciation Rates
- 8 - Depreciation Capitalized
- 9 - 401K Expense
- 10 - Interest on Customer Deposits
- 11 - Direct Labor Expense
- 12 - Other Items

13 **Q. ARE YOU SPONSORING ANY SCHEDULES IN CONNECTION WITH YOUR**  
14 **TESTIMONY?**

15 A. Yes. I am sponsoring **Schedules JF-R1 and JF-R2** attached to this testimony.

16

17 **PENSIONS AND OPEBs**

18

19 **Q. WHAT AMOUNTS DID LIBERTY INCLUDE IN COST OF SERVICE FOR**  
20 **PENSIONS AND OPEBs IN ITS DIRECT FILING?**

21 A. The Company calculated an overall level of benefits as a percent of payroll, and applied  
22 this percentage to the normalized payroll levels in this case. The resulting normalized

1 O&M expense as it related to pensions and OPEBs was \$138,389 and \$422,303,  
2 respectively.

3 **Q. WHAT DO THESE AMOUNTS REPRESENT?**

4 A. These are the actual amounts for pension and OPEB expense recorded in the test year,  
5 with an adjustment for additional costs associated with higher payroll levels included in  
6 normalized expense.

7 **Q. WHAT WAS STAFF’S RECOMMENDATION?**

8 A. Staff recommended \* \* in cost of service for these items. Staff based this  
9 recommendation on the fact that Liberty \*

10 \*

11 **Q. IS THIS AN APPROPRIATE METHOD FOR SETTING RATES IN THIS CASE?**

12 A. No. Staff’s recommendation is not representative of these plans’ costs going forward on  
13 either a funding basis or financial reporting basis.

14 **Q. PLEASE ELABORATE.**

15 A. Following are the estimated future minimum funding requirements calculated by the  
16 Company’s actuary in its most recent reports dated January 2014 (and adjusted to include  
17 only the portion applicable to Missouri):

18	Year	Pension	OPEB
19	2014	*	*
20	2015	*	*
21	2016	*	*
22	2017	*	*
23	2018	*	*

1 It is apparent that basing rates on a single year's funding levels is problematic in an  
2 environment where changes of the magnitude of those above occur. Rates set at \* \*  
3 today would likely result in the necessity for significant increases in the future, and  
4 would not recognize that employees are working and earning these benefits now.

5 **Q. PLEASE EXPLAIN.**

6 A. Funding levels at this point in time are not representative of the annual costs being  
7 incurred for these plans. The available funding amounts for pensions in 2013 range from  
8 \* \*. While the  
9 minimums are currently \* \*, our actuaries anticipate a significant increase in 2016.  
10 OPEB liabilities are not required to be funded until paid, so they are low at this point  
11 since we don't yet have many retirees in the plans. Employees are earning benefits under  
12 these plans as they work, but Staff's proposed recovery based on \*

13 \* fails to provide for these costs in current rates. This means that these  
14 current costs would be borne in future rates.

15 **Q. WHAT DO YOU SUGGEST AS AN ALTERNATIVE?**

16 A. We recommend that rates be set on the basis of expense as determined by our actuaries  
17 for financial reporting purposes. These amounts are \$153,977 for pensions and \$491,286  
18 for OPEBs (these are the amounts allocated to Missouri).

19 **Q. WHY IS THIS BASIS PREFERABLE TO STAFF'S PROPOSAL TO BASE COST**  
20 **OF SERVICE ON 2013 FUNDING LEVELS?**

1 A. The 2013 funding level is not representative of ongoing expected levels, and does not  
2 represent the true cost of providing these benefits. The financial reporting calculations  
3 obviate these problems.

4 **Q. BUT IF RATES ARE BASED ON THESE FINANCIAL REPORTING LEVELS,**  
5 **WON'T THE COMPANY'S CUSTOMERS BE PROVIDING MORE CASH IN**  
6 **RATES THAN THE COMPANY IS CONTRIBUTING TO ITS PLANS?**

7 A. That is a concern in the initial years, which is why Liberty is willing to commit to  
8 contributing the financial reporting amounts in the future in the event that such amounts  
9 are allowed in rates. In the case of the OPEBs, this would be done pursuant to Missouri  
10 Statute (Section 386.315.2, RSMo).

11 **Q. DO YOU HAVE ANY ADDITIONAL PROPOSALS?**

12 A. Yes. Our goal in proposing the use of financial reporting amounts for both  
13 expense and funding purposes is to provide a basis for stability and appropriate  
14 rate recovery of pension and OPEB costs. We believe that these goals would be  
15 greatly enhanced with the implementation of a pension and OPEB tracking  
16 mechanism similar to that currently in place for numerous other Missouri  
17 utilities. Attached as **Schedule JF-R1** is a proposed tracking mechanism  
18 modeled after others currently utilized in Missouri.

19 **Q. DO YOU HAVE ANY ADDITIONAL COMMENTS?**

20 A. Yes. Our goal is to not only provide for appropriate rate recovery for our pension and  
21 OPEB plans in this case, but to also establish a methodology that will provide the

22

1 opportunity for stability in funding, expense, and ratemaking well into the future. We  
2 believe that the proposed combination of establishing rates based on financial reporting  
3 calculations of our actuary, funding these amounts, and establishing a pension/OPEB  
4 tracking mechanism as proposed herein provide the best available method to accomplish  
5 these goals.

6  
7  
8 **UNCOLLECTIBLE ACCOUNTS**

9  
10 **Q. PLEASE DESCRIBE THE ADJUSTMENTS TO UNCOLLECTIBLE ACCOUNTS**  
11 **EXPENSE MADE IN THIS CASE.**

12 A. Both the Company's and Staff's adjustments based the amount of uncollectible  
13 accounts expense included in cost of service on the amount allowed in the prior  
14 2010 Atmos rate case.

15 **Q. ARE THERE ANY DIFFERENCES BETWEEN STAFF'S CALCULATION**  
16 **OF UNCOLLECTIBLE EXPENSE AND LIBERTY'S?**

17 A. Yes. We have also included an adjustment to include the impact of the additional  
18 revenue requirement requested in this case on write-offs. This adjustment was calculated  
19 by first determining a percent of revenues written-off by comparing the normalized write-  
20 offs (prior to this adjustment) to revenues. The resulting percentage of 0.98% was then  
21 multiplied by the revenue requirement request. Staff did not include this adjustment. We  
22 believe that there is a clear relationship of uncollectible accounts to revenues, and  
23 therefore that it is appropriate for the commission to increase any revenue requirement  
24 increase granted in this case by 0.98% to account for the impact of the increase on



1 uncollectibles. The Company will incur this expense with implementation of rates from  
2 this case and so it should be reflected as part of the cost of service.

3  
4 **CASH WORKING CAPITAL**

5  
6 **Q. PLEASE DESCRIBE YOUR CALCULATION OF CASH WORKING CAPITAL**  
7 **IN THIS CASE.**

8 A. Liberty's billing and collection practices have been evolving since purchase of the  
9 properties in August 2012. Additionally, the test period in this case was billed under two  
10 different billing systems since billing was handled by Atmos until March 1, 2013. Under  
11 the circumstances, we were concerned that performing the full lead/lag study normally  
12 employed in Missouri for determining cash working capital would not provide results that  
13 could reasonably be expected to be indicative of normal operations going forward. Staff  
14 evidently agreed, since they did not perform a lead/lag study either.

15 **Q. HOW DID LIBERTY ADDRESS THIS ISSUE IN ITS DIRECT FILING?**

16 A. We considered adopting the leads and lags determined in the 2010 Atmos case since this  
17 is the most recently available data for this service area. However, this data is very  
18 unrepresentative of the current situation given differences in billing and collection  
19 practices, change-over in systems from Atmos to Liberty, and the passage of time.

20 **Q. HOW THEN DID YOU ADDRESS THIS ISSUE?**

21 A. We took a two pronged approach. First, we looked to other jurisdictions for simpler  
22 methods that might provide an indication of a reasonable one-time approach for this case.

1 Second, we looked for a means to verify the reasonableness of the resulting answer using  
2 a simplified update of collection lags currently being experienced.

3 **Q. PLEASE CONTINUE.**

4 A. First, we found that some jurisdictions use a “1/8 rule” as a proxy to simplify the  
5 calculation of a cash working capital adjustment. The “1/8 rule” multiplies the operating  
6 expenses (excluding gas costs, depreciation, and taxes) in a case by 1/8 to produce an  
7 estimated cash working capital adjustment. The 1/8 multiplier is based on observations  
8 that detailed cash working capital studies frequently produce results consistent with its  
9 results. The “1/8 rule” resulted in cash working capital of \$1,250,226 in our direct filing.  
10 Second, we reviewed the results of the previous study used in Atmos’ 2010 rate case, and  
11 performed a simplified comparison of revenues and accounts receivable balances during  
12 the test year in the previous case to this current case. This analysis indicated that  
13 collection lags appear to have increased markedly, providing directional support for an  
14 increase from 2010. In fact, this analysis indicated that adjusting the collection lags in  
15 the 2010 case to these longer levels would have resulted in cash working capital of about  
16 \$1.6 million.

17 **Q. WHAT WAS STAFF’S APPROACH TO THIS ISSUE?**

18 A. Staff simply applied the leads and lags determined in 2010 to the current case, and thus  
19 arrived at a result very similar to that case.

1 **Q. WHY IS STAFF’S APPROACH INAPPROPRIATE?**

2 A. As discussed earlier, Staff’s approach makes no accommodation for the many changes in  
3 circumstances that have occurred since the last detailed lead/lag study was performed in  
4 the 2010 Atmos case.

5 **Q. ARE YOU ADVOCATING THAT THE COMMISSION ADOPT THE 1/8**  
6 **METHOD GOING FORWARD?**

7 A. No, not at all. We are only advocating its use in this single case due to the unusual  
8 circumstances. We recognize the value of a full lead/lag study and plan to perform one  
9 for our next case. We also recognize that these unusual circumstances have made it  
10 difficult for the Staff and Commission to determine an appropriate approach for this case.  
11 Under the circumstances for this issue only we believe that it would be reasonable for the  
12 Commission to “split the difference” between Staff’s and the Company’s positions. This  
13 would result in cash working capital of \$343,820 in this case (the midpoint between  
14 Liberty’s level of \$1,250,226 and Staff’s of negative \$562,585). .

15

16 **DEPRECIATION RATES**

17

18 **Q. WHAT IS THE ISSUE IN REGARD TO NORMALIZED DEPRECIATION**  
19 **EXPENSE?**

20 A. Liberty is in agreement with Staff’s proposed depreciation rates, with the exception of  
21 rates for corporate hardware and software. This is hardware and software that is used at  
22 the Company’s corporate office in Jackson, Missouri and allocated to its divisions in  
23 Iowa, Illinois and Missouri jurisdictions.

1 **Q. WHAT RATES IS LIBERTY CURRENTLY USING FOR THESE ITEMS?**

2 A. These items are being depreciated at a rate of 14.29%, or about 7 years.

3 **Q. WHAT IS THE SOURCE OF THAT 14.29% RATE?**

4 A. This rate was adopted consistent with rates used by Atmos although we have been  
5 unable to identify an ordered rate for corporate hardware and software. Nevertheless, it  
6 is the rate that we believe is consistent with the requirement in the acquisition case that  
7 Liberty continue Atmos' then-current depreciation rates. We discovered in the course of  
8 this current rate case that while Atmos used the 14.29% rate for its system and network  
9 hardware and software, the rate for personal computer hardware and software was  
10 actually 18.98%.

11 **Q. PLEASE EXPLAIN.**

12 A. The rates of 14.29% for General Office server and network hardware and software and  
13 18.98% for PC hardware and software appear to comport with the Staff's accounting  
14 schedules from the 2010 Atmos rate case, providing us reasonable assurance that the  
15 aforementioned depreciation rates would keep us in compliance.

16 **Q. WHAT RATES IS LIBERTY RECOMMENDING IN THIS CASE?**

17 A. The Company recommends continuation of the 14.29% rate (7 years) for system  
18 hardware and software and implementation of the rate of 18.98% (5.3 years) for PC  
19 hardware and software. These rates are consistent with rates used by Atmos and provide  
20 a realistic useful life for these systems. We believe that it would be reasonable to  
21 continue these historical rates inherited from Atmos in this case, but plan on performing

1 a depreciation study of these accounts for our next case, at which time we would support  
2 any adjustment to the rates indicated by the study.

3 **Q. WHAT RATE HAS STAFF RECOMMENDED FOR THESE ITEMS?**

4 A. Staff applied a rate of 4.75% (21 years) to corporate hardware and software.

5 **Q. PLEASE COMMENT ON THIS PROPOSED RATE.**

6 A. In my opinion, 21 years is an unrealistically long life to apply to computer equipment and  
7 systems. This would imply that systems and equipment purchased today would, on  
8 average, still be in service in the year 2035. In the fast changing world of information  
9 systems, this assumption strains credulity.

10

11 **DEPRECIATION CAPITALIZATION**

12

13 **Q. WHAT IS DEPRECIATION CAPITALIZATION?**

14 A. Depreciation capitalization provides for depreciation expense associated with certain  
15 power operated equipment accounts to be transferred to capital accounts, on the theory  
16 that this equipment is used in building capital assets and therefore the depreciation  
17 associated with its use for this purpose should be capitalized as part of the value of the  
18 asset.

19 **Q. HAS LIBERTY ADOPTED DEPRECIATION CAPITALIZATION**  
20 **ACCOUNTING?**

21 A. To this point the Company has not implemented this accounting refinement.

22 **Q. WHAT DID STAFF PROPOSE IN THIS CASE?**

1 A. Staff recalculated plant balances as if this method had been in effect since the Company's  
2 inception in Missouri on August 1, 2012, and made corresponding adjustments in its  
3 direct case.

4 **Q. WHAT IS YOUR RESPONSE?**

5 A. The Company agrees to adopt depreciation capitalization accounting, with the caveat that  
6 the Order in this case should specify that such accounting is to be implemented  
7 retroactive to August 1, 2012 with corresponding adjustment of plant balances and  
8 depreciation expense. This will insure that all plant added since the Company's inception  
9 is accounted for in a consistent manner and that the Company's books match the balances  
10 used to determine revenue requirement in this case. **Schedule JF-R2** attached to this  
11 testimony provides suggested ordered language to accomplish this objective.

12

13

**401K PLAN**

14

15 **Q. PLEASE DESCRIBE THE COMPANY'S 401K PLAN.**

16 A. This plan allows employees to defer a portion of their wages into a tax-deferred  
17 retirement plan. The Company matches the employee contributions up to a limit of \* \*  
18 of pay.

19 **Q. DID LIBERTY INCLUDE AN ADJUSTMENT TO COST OF SERVICE IN THIS**  
20 **CASE FOR THE 401K PLAN?**

21 A. Yes. Since the 401K match is a percent of payroll, an adjustment should be made to  
22 account for the impact of payroll increases on the matching 401K expense. The

1 Company included this effect as part an adjustment for overall benefits as mentioned  
2 earlier in this testimony.

3 **Q. DID STAFF INCLUDE SUCH AN ADJUSTMENT?**

4 A. No.

5 **Q. WHAT DO YOU RECOMMEND AS A REMEDY?**

6 A. There should be two adjustments to Staff's case. First, any increased payroll included in  
7 cost of service should be increased by \* \* to account for the impact of that increase on  
8 the 401K match. Second, Staff's calculation of normalized payroll indicated that 57% of  
9 normalized payroll is applicable to operations and maintenance, as opposed to 52%  
10 during the test year. Test year 401K expense should be further adjusted to include the  
11 effect of this change.

12 **Q. PLEASE EXPLAIN WHY YOU RECOMMENDED A \* \* MATCHING**  
13 **PERCENT FOR 401K EXPENSE.**

14 A. The \* \* match is available to eligible individuals who choose to participate in the plan.  
15 We looked at actual activity for all employees during a twelve month period in order to  
16 account for employees who are ineligible, choose not to participate, or contribute less  
17 than a full \* \*. This resulted in the \* \* actual matching rate recommended above.

18

19

1 INTEREST ON CUSTOMER DEPOSITS

2

3 **Q. HOW DID STAFF PROPOSE TREATING THE COMPANY’S INTEREST ON**  
4 **CUSTOMER DEPOSITS IN ITS DIRECT TESTIMONY?**

5 A. Staff made an adjustment to the level of expense expected to be incurred by the  
6 Company.

7 **Q. DOES THE COMPANY TAKE ISSUE WITH THE ADJUSTMENT MADE BY**  
8 **STAFF?**

9 A. Not the normalized level itself, rather the base test year level. Essentially the original test  
10 year amount of expense incurred, \$47,032, was left out of the cost of service itself. The  
11 Company does not believe this was an intentional omission but rather simply an oversight  
12 since the Company records this expense below-the-line.

13 DIRECT LABOR EXPENSE

14

15 **Q. HOW DID STAFF PROPOSE TREATING THE COMPANY’S LABOR**  
16 **EXPENSE IN ITS ANALYSIS?**

17 A. Staff performed a detailed analysis of the Company’s employees to arrive at an  
18 appropriate level of normalized and test year expense for the Company.

19 **Q. DID THE COMPANY HAVE ANY ISSUE WITH HOW STAFF PERFORMED**  
20 **ITS ANALYSIS OF THE WAGE ANNUALIZATION?**

21 A. Similar to interest on customer deposits, the Company did not have an issue with the  
22 level of expense the Staff calculated on a going forward basis but rather how the  
23 annualization is calculated.



1 **Q. WHAT DO YOU MEAN?**

2 A. Typically after a level of normalized expense is calculated, that expense level is  
3 compared to what was incurred in the test year and the difference is the adjustment. In  
4 this case, Staff compared normalized payroll calculated in detail by employee to test year  
5 labor amounts included in operation & maintenance accounts. However, we found that  
6 some of the accounts labelled “labor” defined labor more broadly than the employee  
7 payroll included in this adjustment. For example, labor for outside contractors is  
8 included in the accounts but would not be an item subject to an adjustment of Liberty  
9 employee payroll.

10 **Q. WHAT WAS THE IMPACT OF THIS DIFFERENCE?**

11 A. Since normalized payroll for Liberty employees was compared to test year labor amounts  
12 including other non-payroll items, the adjustment was understated. We don’t believe  
13 that this was in any way intentional but occurred because of confusion over the labelling  
14 of the accounts. An adjustment with test year and normalized payroll on a consistent  
15 basis would be appropriate.

16

17 **OTHER ITEMS**

18

19 **Q. PLEASE EXPLAIN THE ISSUE WITH OTHER ITEMS.**

20 A. There are various minor issues with which we have differences with Staff over the  
21 manner in which the adjustment was computed. I mention them here because we have  
22 not yet reached a final understanding with Staff regarding the proper computations and

1            would reserve the right to continue the issue if necessary. However, we believe that we  
2            should be able to resolve these issues, and therefore will not describe each one in detail.

3    **Q.    WHAT ARE THESE ISSUES?**

4    A.    These issues include, without limitation, dues & donations, ESPP O&M expense,  
5           transition costs, pipeline rebranding costs, and cost of debt.

6

7    **Q.    DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY IN THIS**  
8           **PROCEEDING?**

9    A.    Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In the Matter of Liberty Utilities )  
(Midstates Natural Gas) Corp. d/b/a )  
Liberty Utilities' Tariff Revisions Designed )  
To Implement a General Rate Increase )  
For Natural Gas Service in the Missouri )  
Service Areas of the Company. )

Case No. GR-2014-0152

**AFFIDAVIT OF JAMES FALLERT**

**STATE OF MISSOURI** )  
) ss  
**COUNTY OF ST. LOUIS** )

James Fallert, being first duly sworn on his oath, states:

1. My name is James Fallert. I am doing business as James Fallert Consultant LLC and my business address is 3507 Burgundy Way Dr., St. Louis, Missouri 63129.
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony on behalf of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities consisting of sixteen (16) pages and Schedules JF-R1 and JF-R2, all of which having been prepared in written form for introduction into evidence in the above-captioned docket.
3. I have knowledge of the matters set forth therein. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded, including any attachments thereto, are true and accurate to the best of my knowledge, information and belief.

  
\_\_\_\_\_  
James Fallert

Subscribed and sworn before me this 30<sup>th</sup> day of July, 2014.

  
\_\_\_\_\_  
Notary Public

My commission expires: 06-15-15



**BRENDA K. LUEBBERS**  
My Commission Expires  
June 15, 2015  
St. Louis County  
Commission #11421805