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**

REPLY BRIEF OF LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. d/b/a LIBERTY UTILITIES

Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities ("Liberty" or "Company") respectfully submits its Reply Brief in accordance with the Commission's *Order Amending Briefing Schedule* issued in this matter on September 19, 2014.

I. INTRODUCTION

The Company has thoroughly discussed the issues in its *Initial Brief*, and it is unnecessary to re-iterate those arguments herein. However, a few of the parties have raised points in their *Initial Briefs* which require a brief response at this time.

As explained in the Company's *Initial Brief*, the issues remaining to be resolved by the Commission will have a large impact upon the Company and its customers. In particular, the cost of capital issues, including the capital structure, cost of debt, and return on equity, and the revenue imputation adjustments associated with special contracts are two issues that will have a substantial impact upon the financial health of the Company. Finally, the depreciation rates associated with computer hardware and software are important issues that need to be resolved with equity and fairness to continue

appropriate depreciation rates for these corporate allocated plant accounts until a depreciation study can be completed in the next rate case.

II. CONTESTED ISSUES

1. Cost of Capital:

a. What capital structure should the Commission use in this case to determine a revenue requirement for Liberty?

As explained in Liberty's *Initial Brief*, the Company is recommending that the Commission use the Company's actual capital structure which is as follows:

Liberty Actual Capital Structure

Equity:	58.34%
Debt:	41.66%

The cost of debt for Liberty is 4.50% and the Company is recommending a return on equity of 10.50%. (Ex. 5, Hevert Direct, pp. 44-49)

Liberty's actual equity ratio of 58.34% is also highly consistent with the 57.00% equity ratio Staff notes for Liberty's ultimate parent, APUC, which is the source of both LUCo and Liberty equity and the ultimate driver of their credit ratings. However, the **______** equity ratio recommended by Staff witness Marevangepo is inconsistent with both APUC's and Liberty's capital structures and is well below the range of equity ratios in place at the companies in both Mr. Marevangepo's and Mr. Hevert's proxy groups. (Ex. 6, Hevert Rebuttal, p. 42-43; Schedule RBH-R21). In addition, LUCo's capital structure is essentially a "hypothetical" capital structure since some of the debt instruments contained in LUCo's capital structure could not be used to fund the projects of Liberty in Missouri.

Staff and Public Counsel are recommending that the Commission utilize a confidential capital structure of LUCo, Liberty's intermediary parent. The Public Counsel succinctly summarized the position of Staff and Public Counsel on the issue of capital structure using the following points:

(1) Equity and debt is issued through LUCo, not Liberty Midstates;

(2) LUCo is the basis for rating agency reviews of risk, not Liberty Midstates;

(3) LUCo has a credit rating, not Liberty Midstates; and

(4) LUCo's capital structure is market tested, Liberty Midstates' is not.

(Public Counsel *Initial Brief* at 2)

Liberty's Response to Public Counsel and Staff

In response to the Public Counsel's bullet points, the Company would note the following:

(1) Equity and debt is issued through LUCo, not Liberty Midstates;

Response:

(a) Not all LUCo debt instruments can be used at the Midstates level. For instance, the bonds of **____
____
________________**(Tr. 224-25) Consequently, LUCo's capital structure is largely hypothetical as it relates to Liberty's Missouri operations.

(b) Liberty used Midstates debt to calculate debt cost. This is consistent with the principle that LUCo debt cannot be applied to Midstates.

(c) The only publicly issued equity is at the APUC level, not the LUCo level—a point never disputed by Staff. (Tr. 210)

(2) LUCo is the basis for rating agency reviews of risk, not Liberty Midstates.

Response:

(a) LUCo's risk is the sum of its operating units' risk, including Midstates.

(b) A return of 8.7% and an equity ratio of **______ **, as recommended by Staff, would increase Midstates' risk and, therefore, LUCo's risk.

(3) LUCo has a credit rating, not Liberty Midstates.

Response:

(a) Yes, but that is not a sufficient condition. LUCo may have a credit rating but it is inconsistent with industry practice as measured by the capital structures in place at the peer companies. LUCo's capital structure is not consistent with the capital structures of Liberty, APUC, or the capital structures of the Staff's proxy group of public utilities. (Tr. 219-23)

(b) If credit ratings are an important consideration for the Commission, then the Commission should utilize the capital structure of APUC. APUC has a credit rating and is the ultimate source of equity and whose capital structure is consistent with industry practice. (Ex. 13, Staff Cost of Service Report, pp. 19-20)

(4) LUCo's capital structure is market tested, Liberty Midstates' is not.

Response:

(a) Market-tested how? LUCo has privately-placed debt and no publicly-placed equity. Since the LUCo capital structure is not publicly known, it is difficult to understand how LUCo's capital structure could be "market-tested".

(b) Going back to a point noted above, if Midstates' companies were to receive ROEs of 8.7% and equity ratios of **______**, then the "market" would be expected to react adversely.

(c) Relying on LUCo's capital structure is misplaced for several reasons, but OPC's observation that it would reduce the cost of service is short-sighted. In the long-run, the dilution in the Company's financial profile – especially if the revenue imputation were to be accepted – would significantly increase the cost of capital (both debt and equity).

(d) Consequently, OPC's statement that Midstates' capital structure "is of no consequence to investors" is misguided – it is of significant consequence. If rates are set on the basis of Staff's recommendations, LUCo's credit metrics will deteriorate, which is of considerable consequence to both debt and equity investors.

As explained in Liberty's *Initial Brief*, Liberty's capital structure is highly consistent with the capital structure ratios reported in Schedule RBH-R21 (Hevert Rebuttal) for the proxy groups used by both Staff and Company. (Ex. 6, Hevert Rebuttal, p. 42). In fact, Staff candidly admits that Liberty's capital structure falls squarely within the range of equity and debt ratios of the companies in Staff's proxy group. (Tr. 223)

In its recently issued *Report And Order* in Re Summit Natural Gas, Case No. GR-2014-0086, p. 37 (issue October 29, 2014), the Commission stated: "The Commission is setting SNGMo's capital structure at 43 percent debt and 57 percent equity as SMGMo asks, because that is how SNGMo actually provided service during the test year." Similar analysis in this case would result in the adoption of Liberty's actual capital structure, as requested by Liberty, because that is how Liberty provided service during the test year.

If the Commission believes that the actual capital structure of Liberty is not appropriate for some reason, then the Commission should utilize the APUC capital structure for ratemaking purposes. The APUC capital structure meets Staff's stated criteria: (1) APUC is rated by credit rating agencies; (2) APUC issues its own debt; and (3) APUC issues its own equity. (Tr. 209-11) Staff also admitted that APUC is (1) the ultimate parent Company of Liberty and LUCo; (2) the primary basis for the rate that S&P assigns to LUCo, and (3) is publicly-traded and market tested. (Staff Ex. 13, Staff Report Revenue Requirement, p. 20).

b. What is the appropriate embedded cost of debt that the Commission should apply in this case to determine a revenue requirement for Liberty?

The Company's actual cost of debt was updated to 4.50 percent (from 4.78 percent) and should be utilized in connection with Liberty's actual capital structure. (Ex. 6, Hevert Rebuttal, p. 46).

Staff, on the other hand, recommends the imputation of LUCo's consolidated cost of debt under the assumption that it is "logistically consistent" with their recommendation to use LUCo's capital structure. LUCO's cost of debt associated with this capital structure is higher than the public utility's cost of debt. LUCO's updated cost of debt is **_____**. (Staff Ex. 31P, Marevangepo Rebuttal, p. 6)

For the reasons stated above, the Commission should utilize the Company's actual capital structure, including its actual embedded cost of debt.

c. What is the appropriate cost of equity that the Commission should apply in this case to determine a revenue requirement for Liberty?

Return On Equity Determination

In its *Initial Brief*, Staff makes the following fundamental point: "In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements." (Staff Br. at 12). What Staff fails to recognize or acknowledge is Staff's recommended range is outside the range of reasonableness and does not satisfy the constitutional requirements.

In this proceeding, the Company is recommending a 10.5% ROE, utilizing the actual capital structure of Liberty, the regulated public utility, taking into account its business risk as a small public utility. Staff is recommending an ROE in the range of

8.20% to 9.20% with a midpoint of 8.70%, a recommendation that is lower than any rate of return authorized by a regulatory agency in more than 34 years. (Tr. 192-94) However, as discussed in Liberty's *Initial Brief*, the Commission must reject such a drastic outcome and rely instead upon the recommendations of the expert with the most reasonable ROE range that is based upon generally accepted and reliable estimates of the returns that investors expect. The most prominent among those expert opinions in this proceeding is that of Liberty witness Robert B. Hevert who has testified before this Commission on several occasions. He recommends that the Commission consider a range of 10.0% to 10.5%.

Staff witness Marevangepo's recommendation of the range of 8.2% to 9.2% falls well below Mr. Hevert's range, and significantly below recent ROEs authorized by this Commission and other regulatory utility commissions. In fact, his entire range (before the credit rating differential adjustment) is below the lowest ROE authorized in at least 34 years. (Tr. 193-94) While there may be a handful of Commissions that authorized ROEs as low as the very highest ROE in Staff's range, there are no Commissions that have authorized ROEs approaching Staff's low end. Staff's recommendations are simply outside the mainstream, and do not meet constitutional muster. The Commission should reject Mr. Marevangepo's analysis and recommendations, as it has rejected other Staff ROE recommendations in the past.

After explaining the reliance of Staff witness Zephania Marevangepo upon the Constant Growth DCF method (checked for reasonableness using the Capital Asset Pricing Model and a Rule of Thumb method), Staff explained the more elaborate analysis of Liberty's witness Robert B. Hevert, including his reliance upon the

Quarterly Growth DCF model, the Constant Growth DCF model, the Multi-Stage DCF model, the Capital Asset Pricing Model, and Bond Yield Plus Risk Premium Approach. (Staff Br. at 14-21)

Staff's principle criticism of Mr. Hevert's analysis related to his use of certain growth rates. In his DCF analysis, Mr. Hevert used the Earnings Per Share ("EPS") growth rate as reported by Value Line, Zacks, First Call and the Retention Growth estimate for each proxy company in combination with the dividend yield for each of the proxy companies. (Ex. 6, Hevert Direct, p. 16) The average earnings growth rate for the Quarterly DCF, and Constant Growth DCF models was 5.34 percent. (Ex. 5, Hevert Direct, p. 16, Schedule RBH-1 & 2) For his Multi-Stage DCF model, Mr. Hevert used the long-term growth rate of 5.71 percent, based on the real GDP growth rate of 3.29 percent from 1929 through 2012, and an inflation rate of 2.35 percent. (Ex. 6, Hevert Direct, p. 22)

Staff, on the other hand, utilized a 4.00 percent to 5.00 percent growth rate estimate. Mr. Marevangepo considered the proxy group's historical and projected EPS, dividend per share ("DPS") and book value per share ("BVPS") growth rates as well as forecasts of GDP growth before selecting a growth rate range of 4.00 percent to 5.00 percent. (Staff Ex. 13NP, Cost of Service Report, pp. 24-31)

As an additional limiting factor, Staff stated that GDP growth rates represent an upper bound on a reasonable growth rate. (Staff Ex. 13NP, Cost of Service Report, p. 24-25) However, as explained in Liberty's *Initial Brief*, this position is not credible. Since 2000, the natural gas industry's growth rate has been increasing even as GDP growth has slowed, with gas utility growth actually exceeding GDP growth over the past few years. (Ex. 6, Hevert Rebuttal, p. 24) The recent

discovery of shale gas has made a huge impact on the natural gas industry. (Tr. 204). In fact, the Energy Information Administration's 2014 Annual Energy Outlook predicts that there will be a 56 percent increase in natural gas production from 2012 to 2040, and that natural gas will surpass coal as the nation's largest source of energy for electricity generation by 2035. (Tr. 201-02). Such expected growth for the natural gas industry is not reflected in Staff's reliance on historic growth patterns in nominal GDP.

Mr. Hevert's Quarterly DCF, Constant Growth DCF and the first-stage of Hevert's Multi-Stage DCF rely on analysts' earnings growth projections, as published by Zacks, First Call and Value Line, as well as a measure of Retention Growth. The long-term growth rate in Hevert's Multi-Stage DCF model reflects the assumption that gas distribution utilities' earnings growth will converge toward GDP growth over the long-term.

Mr. Marevangepo's analysis, on the other hand, reflects both historical and projected growth in DPS, BVPS, and EPS, as well as historical and projected GDP growth. As discussed in Liberty's *Initial Brief*, forward-looking earnings growth estimates are the relevant measure of growth. While it is reasonable to assume that gas distribution utilities' earnings will generally grow at the same rate as GDP over the long-term, it is not reasonable to assume that GDP growth will constrain the near and medium term growth rates for the natural gas industry.

Although Staff criticized Mr. Hevert's growth rate analysis, it is telling that the Staff chose to pass on its opportunity to ask Mr. Hevert any questions during cross-examination. (Tr. 175) Had Staff asked Mr. Hevert about his analysis, Mr. Hevert may have been able to address their remaining concerns.

Staff also argued that "Hevert's cost of equity model inputs. . . are diametrically contrary to existing practical investment expectations. . ." (Staff Br. at 21) This is an apparent reference to Mr. Marevangepo's allegation that "Staff has over time reviewed confidential asset and equity valuation reports that were provided in the context of merger, acquisition and other financial/investment advisor roles; and Staff has never seen growth rates greater than 4 percent being imputed in any of those analyses." (Staff Ex. 13NP, Marevangepo Rebuttal, p. 12)

As noted in Liberty's *Initial Brief*, the Commission has already rejected this criticism. *Report & Order*, pp. 69-70, Re Union Electric Company d/b/a Ameren Missouri, Case No. ER-2011-0028 (July 13, 2011) In addition, Mr. Marevangepo provided no specific references that can be reviewed and assessed.

Based upon the competent and substantial evidence in the record, the Commission should find that Staff's proposed growth rate of 4.00 percent to 5.00 percent is simply not credible and should be rejected. Instead, the Commission should rely on the growth estimates contained in Mr. Hevert's testimony in its analysis of the cost of capital issues in this proceeding.

As already explained in Liberty's *Initial Brief*, the United States Supreme Court has advised commissions to examine the returns being earned by companies "at the same time and in the same general part of the country" as the utility appearing before it. *Bluefield*, 262 U.S. at 692. According to Staff's direct case, the averaged authorized return on equity in the first quarter of 2014 for natural gas and electric utility companies were 9.54 percent (based on six decisions) and 10.23 percent (based on eight decisions)(Staff Ex. 13, Staff Cost of Service Report, p. 34)

The most recent RRA publication, dated July 10, 2014, reported allowed ROEs that range from 9.47 percent to 9.84 percent for the period covering the full 12 months of 2013 and the first 6 months of 2014 the average allowed ROEs of the first quarters of 2013 was 9.68 percent and for the first two quarters of 2014 was 9.7 percent, (Ex. 32, Marevangepo Surrebuttal, p. 14) During cross-examination, Staff witness Marevangepo acknowledged that the last four cases decided in June, 2014, had authorized returns on equity that exceeded 10.00 percent (i.e. 10.1% to 10.4%)(Tr. 193; Liberty Ex. 5, Hevert Direct, Schedule RBH-R19, p. 14)

Mr. Marevangepo's DCF results ranging from 7.80 percent to 8.80 percent (before credit rating adjustment) are largely outside the zone of reasonableness, based upon national average authorized returns on equity. The Commission should therefore reject Staff's proposed ROE recommendations. Instead the Commission should adopt the Company's recommended return on equity in the range of 10.00 percent to 10.50 percent which is clearly within the zone of reasonableness. Given the small size and business risk of Liberty, the upper end of this range is appropriate for purposes of this case.

2. SPECIAL CONTRACTS REVENUE ADJUSTMENTS

A. NORANDA AND GENERAL MILLS CONTRACTS

In its *Initial Brief*, Staff abandoned its attempt to argue that Liberty should have charged Noranda and General Mills a rate based upon the full-tariffed Large Transportation rate in lieu of the negotiated rates in the contracts that were in effect during the test year. Staff candidly admits that paragraph 7 of the Non-Unanimous Stipulation and Agreement in Case No. GR-2010-0192 ". . . applies to its contracts with Noranda and General Mills. . . " (Staff Br. at 24-25) Paragraph 7 clearly authorized and

required Atmos to continue to honor the Noranda and General Mills contracts and charge the specific rates included in those contracts.[1]

As explained in the Company's *Initial Brief*, Liberty stepped into the shoes of Atmos, as required by Staff and the Commission's order, and continued to charge Noranda and General Mills the same rates during the test year that were in the Atmos contracts with these large customers. (Tr. 361) In essence, Liberty also charged the same rates that Staff and Public Counsel required to be used for these customers. (*Id.*) Having required the use of these contract rates, it is disingenuous for Staff to argue in favor of the use of other rates that are substantially higher than the rates Staff required Atmos, and now Liberty, to use during the test year.

Even Ms. Kim Cox, Staff's sponsoring witness for these revenue adjustments, recognized that it would have been "inconsistent" with the terms of the stipulation in Case No. GR-2010-0192 if the Company had attempted to charge the full-tariffed rate during the test year:

> **Q. I'm asking whether we had started charging the full tariffed rate whenever they took over the system, whether that would have been inconsistent with the stipulation in the rate case?**
>
> A. Without providing the evidence? Without knowing the evidence that I know today, yes.
>
> **Q. It would have been inconsistent?**
>
> A. Without knowing the evidence that I know today, yes. (Tr. 381)

[1] Staff cites to the boiler plate language of Paragraph 14 of the Unanimous Stipulation And Agreement in Case No. GR-2010-0192 for the proposition that the stipulation terms did not apply to any future rate cases. (Staff Br. at 35 and 37) However, even the boiler plate paragraph included the exception, "Except as explicitly provided herein" which certainly includes the explicit agreements of Atmos, Staff, Public Counsel and Noranda to include specific rates in the Noranda and General Mills contracts.

As discussed in Liberty's *Initial Brief*, Staff's position that Liberty should have charged the full-tariffed rates for Noranda and General Mills during the test year is completely without merit. Having had their original position refuted, the Staff has now created new arguments at the eleventh hour to support Staff's continuing attempt to penalize the Company for following the requirements of the Stipulation and Agreement in Case No. GR-2010-0192.

In its *Initial Brief*, Staff has revised its underlying theory for these revenue imputation adjustments, and is now implying that the Commission should consider Staff's adjustments as "common annualization and normalization adjustments" or "known and measurable" changes. (Staff Br. at 38) These new arguments are not found in Staff's *Position Statement* and its supporting testimony in this case. (*Staff Position Statement*, pp. 3-4; Ex. 13HC, Staff Cost of Service Report, pp. 53-54; Ex. 22HC, Cox Rebuttal; Ex. 23HC, Cox Surrebuttal) Since Staff's new theories were apparently developed after the hearing, it is not surprising that there is no competent and substantial evidence in the record to support Staff's new theories.

Frankly, there is nothing "common" or "known and measurable" about Staff's attempt to use hypothetical revenues related to the Noranda and General Mills contracts to artificially lower the revenue requirement. The only rates that are <u>authorized</u> are the rates contained in the Noranda and General Mills contracts. There is nothing "known and measurable" about using any other rates than the ones required to be used by Liberty. If the Commission rejected the use of special contract rates for Noranda and General Mills in this proceeding, and required the charging of the full tariffed rates, as suggested by

Staff, the bills for these special contract customers would increase by **__________-______________________________** (Tr. 333, 275) Staff witness Cox testified that she expected that **____** (Tr. 342-43) Therefore, it would not be appropriate to "annualize" the revenues because there is no way to accurately determine the volumes that would be consumed or the amount of transportation service necessary if the rates changed as dramatically as recommended by Staff. There are no price elasticity studies or other reliable methods in the record of this case to predict how the Noranda and General Mills volumes would change if the Commission approved rates different from the contract rates utilized during the test year, especially rates at the levels being recommended by Staff and Public Counsel.

Staff also cites *Missouri Gas Energy* and *United Cities Gas Company* decisions that addressed revenue imputation adjustments related to special contracts. (Staff Br. at 30-31) In the *United Cities* case, the Commission specifically recognized the importance of allowing gas companies to respond to competitive pressures, including threats of bypass, and allowed "United Cities to negotiate and perform transportation contracts with rate flex sufficient to retain economically worthwhile customers on the system, without causing the subsidization by the remainder of the ratepayers." Re United Cities Gas Company, 4 Mo.P.S.C.3d 121, 130-31 (1995).

In the *United Cities* case, the Commission stated: "The Commission finds that the Staff has made a prima facie showing of imprudence and caused the burden of persuasion to shift to United Cities." *Id.* at 127-28. In stark contrast, Staff has not made a prima facie case of imprudence in this proceeding. In fact, Staff has not alleged any imprudence at all when Liberty charged Noranda the required contract rates. (Tr. 376-77):

> **Q. Is Staff suggesting that it was imprudent of Liberty to have charged Noranda the rates contained in the contract between Atmos and Noranda?**
>
> A. That's a no and a maybe question.
>
> **Q. I'm sorry. It's a -- I didn't hear you.**
>
> A. That's no or maybe. That's my answer. I don't -- as far as being prudent?
>
> **Q. Staff is not suggesting that Liberty was imprudent to have charged Noranda the contract rate; is that what you're saying?**
>
> A. I think it would have been prudent to show the cost justification.
>
> **Q. To Staff in the rate case.**
>
> A. Right.
>
> **Q. But at the time they charged the rate, are you saying it was imprudent to have charged the contract rate to Noranda?**
>
> A. No. I'm stating that in this case, they did not show any cost justification of charging that rate and going forward with that rate.
>
> **Q. So you -- you're not testifying it was imprudent for Liberty to have charged Noranda the contract rate? That's not your testimony? It was okay, it was prudent from your perspective; is that what you're saying?**
>
> A. No, that's not what I'm saying.
>
> **Q. Are you saying it was imprudent to have charged Noranda at the contract rate during the test year?**

A. I'm saying that Liberty provided no evidence that that rate was needed.

Q. Well, okay. Let me ask it this way:
What does Staff believe that Liberty should have done with Noranda when it began operating the Atmos system with regard to that Noranda contract?

A. What does Staff believe Liberty should have done?

Q. Yes

A. We believe that they should have filed a tariff.

(*See also* Tr. 234-35)

In the *United Cities* case, the Commission allowed the gas company to "flex its tariffed transportation rate to meet competition, but must recover all variable costs plus a reasonable contribution to its fixed costs during the course of the contract." Re United Cities Gas Company, 4 Mo.P.S.C.3d 121, 130-31 (1995). The competent and substantial evidence in this proceeding demonstrates Liberty will recover all variable costs plus make a reasonable contribution to its fixed costs using the contract rate contained in the new Noranda contract. Noranda's consultant, Maurice Brubaker, has filed testimony which estimates that the current cost to supply interruptible transportation service is about $0.03 per Mcf. The rate under the contract is **____________________**. The annual contribution to the fixed costs at that rate level is approximately **_______** per year. (Ex. 46HC, Brubaker Rebuttal, pp. 8-11). Even if Noranda was treated as a firm transportation customer and the SEMO transmission network costs were allocated to Noranda, then Noranda's cost would be approximately $0.11 per Mcf. (Id. at 10) At that level, Noranda would be providing a contribution of approximately **__________** (*Id.*) As a result, it is clear that the Noranda contract rates will recover all variable costs plus a reasonable contribution to its fixed costs during the course of the contract. The

Commission should therefore conclude that, even applying the standard mentioned in *United Cities* and *Missouri Gas Energy*, Noranda's contract rate is just and reasonable.

Staff also asserts that "Liberty's entire justification for the discounted rates given to Noranda and General Mills is simply the Company's 'belief'—unsupported by any real evidence or studies or analysis—that the customers 'might' leave the Liberty system if they were charged the full tariffed rate." (Staff Br. at 33) This assertion is simply not correct. Liberty was required by the Commission's previous orders and agreements with Staff, Public Counsel, and Noranda to charge the rates it charged during the test year. No further justification should be required. However, the evidence in the record in this case amply supports Liberty's concern that General Mills and Noranda would bypass the local distribution network, switch to alternative fuels, or substantially reduce their natural gas consumption if the full-tariffed rates were charged. (Ex. 2NP, Krygier Direct, pp. 17-18; Ex. 3HC, Krygier Rebuttal, pp. 3-9; Ex. 4HC, Krygier Surrebuttal, pp. 9-10; (Ex. 46HC, Brubaker Rebuttal, pp. 2-11; Ex. 57, Swogger Direct, p. 24; Ex. 58, Johnstone Direct, pp. 3-9; Ex. 59; Johnstone Rebuttal, pp. 3-14)

Liberty's evidence of this bypass concern is succinctly summarized in response to DR No. 0267 which was attached to the Ex. 23HC, Surrebuttal Testimony of Kim Cox, Schedule KC-2-1HC:

**____

NP

**

Company witness Krygier also summarized Liberty's concern in his rebuttal testimony as follows:

> Liberty Utilities and its predecessor companies have recognized that Noranda is a unique customer that would have the capability to bypass the Company's local distribution system (by obtaining a direct connection with Texas Eastern Transmission Company) or utilize an alternative fuel source, if the full Large Transportation rate was charged by the local distribution company. The Company believes that this customer might leave the Company's system or substantially reduce its throughput if the full Large Transportation rate were charged by the Company.

(Ex. 3NP, Krygier Rebuttal, p. 3)

Mr. Krygier expressed a similar concern with regard to General Mills:

> Again, Liberty Utilities and its predecessor companies have recognized that General Mills is a unique customer that would have the capability to bypass the Company's local distribution system or utilize an alternative fuel source if the full Large Transportation rate was charged by the local distribution company. The General Mills plant is located adjacent to

> Panhandle Eastern Pipeline Company ("PEPL"). The meter location at the plant is located within 1400 feet of PEPL's pipeline facilities. The Company continues to believe that it is necessary to offer this customer a reduced rate in an effort to prevent bypass and retain their business.

(Ex. 3NP, Krygier Rebuttal, p. 9)

Notwithstanding the competent and substantial evidence of this concern that has existed for years, Staff has chosen to ignore it, and instead proposed to charge Noranda and General Mills rates which are not sustainable over the long term. In addition, Staff has also ignored again in its *Initial Brief* the devastating financial impact that the adoption of Staff's proposed revenue imputation adjustments would have upon Liberty. During the hearing, it became apparent that no Staff witness was even assigned the task of evaluating the financial consequences of Staff's proposed revenue imputation adjustments. (Tr. 345-46; 233-35) Yet, the competent and substantial evidence (which remains totally unrebutted) demonstrated that the individual and cumulative effect of Staff's proposed revenue imputation adjustments would materially diminish the Company's ability to earn a reasonable return on equity. (Ex. 8HC, Hevert Rebuttal, pp. 2-12) The revenue imputation related to the Noranda and General Mills imputation would reduce the earned ROE by **___** basis points, and imputation of revenues related to the SourceGas contract would reduce the Company's earned ROE by an additional **___** basis points. The aggregate effect of Staff's proposed revenue imputation adjustments is to reduce the Company's expected ROE to just **____** percent. (Ex. 8HC, Hevert Rebuttal, pp. 2-12) Such a result would significantly deteriorate Liberty's financial integrity and materially increase its financial risk. For this

reason alone, the Commission would be justified in rejecting Staff's proposed revenue adjustments in this proceeding.

The policy issue that the Staff asserted needs to be decided by the Commission is "Whether Liberty should be authorized, on a going-forward basis, to enter special contracts like its Noranda and General Mills contracts. . . " (Staff Br. at 27) The Company believes that special contracts are essential to maintaining the flexibility to keep some customers on its system which benefits all customers, including residential and small commercial customers. Such contracts have been utilized in Missouri for years by gas and electric companies, and Liberty believes this tool should be kept in public utility companies' toolboxes. The Commission should not carve out a policy exception that applies only to Liberty as it considers the use of special contracts by public utilities in Missouri. Again, as explained in Liberty's *Initial Brief*, such a policy needs to be reviewed in the context of a rulemaking proceeding, and not a utility-specific rate case.

The Company, however, is not opposed to the establishment of an additional tariff that authorizes the use of special contracts. If the Commission believes that a new special contract tariff is necessary or appropriate, the Company has proposed the use of 1st Revised Sheet No. 34 (Negotiated Gas Sales Service) contained in Schedule CDK-R7 attached to the Rebuttal Testimony of Christopher D. Krygier. (Ex. 3NP, Krygier Rebuttal, pp. 4-5; Schedule CDK-R-7). However, Liberty adamantly believes it needs the discretion to determine when special contracts are appropriate, given the rapidly moving competitive and economic development environment that develops when customers are making business decisions regarding their fuel sources.

In the *Missouri Gas Energy* decision cited by Staff, the Commission quoted the language from an MGE tariff that addressed special contract authorizations. The MGE tariff provided flexibility for the gas company to determine when such contracts were appropriate:

> The Company may from time to time at is sole discretion reduce its charge for transportation service by any amount down to the minimum transportation charge for customers who have alternative energy sources, which on an equivalent BTU basis, can be shown to be less than the sum of the Company's transportation rate and the cost of natural gas available to the customer.
>
> Such reductions will only be permitted if, in the Company's sole discretion, they are necessary to retain or expand services to an existing customer, to re-establish service to a previous customer or to acquire new customers.
>
> The Company will reduce its transportation rate on a case by case basis only after the customer demonstrates to the Company's satisfaction that a feasible alternative energy source exists. If the Company reduces its transportation charge hereunder, it may, unless otherwise provided for by contract upon 2 days' notice to the customer, further adjust that price with the rates set forth above. Re Missouri Gas Energy, 4 Mo.P.S.C.3d 437, 448.

The Company has also recommended tariff language which would give Liberty such flexibility to address competitive situations. (Ex. 3NP, Krygier Rebuttal, pp. 4-5; Schedule CDK-R-7). Contrary to Staff's suggestion (Staff Br. at 29), the Commission should not order the adoption of the tariff set forth on Exhibit 39HC, Schedule DMS-5 because it would substantially restrict Liberty's ability to utilize special contracts, and limit its discretion to accept them. Under Staff's more restrictive proposal, formal affidavits would be required from customers, and evidence would be required from the customer to verify the investment required on the part of the customer in order to take gas service directly from the interstate or intrastate pipeline company. Such requirements would be considered onerous and intrusive by customers, would be more restrictive than

those tariff provisions used by other gas companies in Missouri, and should not be ordered in the case of Liberty.

In summary, the Commission should not change its policy regarding the Noranda and General Mills contracts after they have been effective for more than 12 years in the case of Noranda, and for about 8 years in the case of General Mills. It should not do anything in this proceeding to incent these customers to leave the Company's local distribution system.

SOURCEGAS IMPUTATION ADJUSTMENT

In Staff's *Initial Brief*, Staff concedes that "SourceGas is not a Missouri customer of Liberty. Rather, SourceGas is a natural gas distribution company located in the state of Arkansas." (Staff *Initial Brief* at 41) Apparently there is no dispute that Staff's SourceGas revenue imputation adjustment relates to a service that is solely and exclusively under the jurisdiction of the Federal Energy Regulatory Commission ("FERC"). Nevertheless, Staff re-iterates its position that the Commission should use the **__________________** for the interstate service provided to SourceGas, even though the FERC has approved the use of the discounted rate that has been charged by Liberty to SourceGas. For the reasons stated in Liberty's *Initial Brief*, Staff's revenue imputation adjustment related to SourceGas should be rejected.

In an apparent effort to justify an intrusion into the federal policies related to transportation rate discounting practices, the Staff cited to an *Order on Rehearing* in Re Arkansas Oklahoma Gas Corporation, FERC Docket No. PR04-8-001 for the proposition that the Commission should ensure that Missouri retail customers do not subsidize

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Liberty's interstate service. Contrary to the implications of Staff's argument, there is no competent and substantial evidence that Missouri's retail customers are subsidizing interstate services at all. Instead, the record reflects that Liberty was successful in **____

____** (Ex. 12, DaFonte Rebuttal, p. 10; Tr. 500) In the twelve years since Atmos began providing this interstate service to SourceGas, Staff never alleged that Missouri retail customers were subsidizing the interstate service to SourceGas. However, now that Liberty has been successful in negotiating a rate that is **_______________________

_____________** Staff is now arguing **________________________________

_______________** As explained by Liberty witness DaFonte, **_______________

____

______________________________________** if the Commission ordered the Staff's proposed rates and Liberty was able to pass them through to SourceGas. **________

____

____

____

____.** (Ex. 12HC, DaFonte Rebuttal, p. 10)

Finally, Staff totally ignored the implications of requiring the **_______

__________** for such services provided by **_____________________________

_____** of Missouri. If the Commission adopts the position of the Staff in this case, it

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may have adverse implications in the future for the **____________________

____.**

For all of the reasons stated in Liberty's *Initial Brief* and re-iterated herein, the Company respectfully requests that the Commission reject Staff's proposed revenue imputation adjustments for Noranda, General Mills and SourceGas.

3. Depreciation: What depreciation rates should be ordered by the Commission for corporate plant accounts 399.1, 399.3, 399.4 and 399.5?

Despite Public Counsel's unfounded protestations to the contrary, this issue involves the appropriate depreciation rates for corporate allocated plant accounts involving computer hardware and software, for which the Commission has never ordered depreciation rates. As Staff succinctly points out in its *Initial Brief*:

> These four accounts reflect computer hardware and software that Liberty Utilities uses across its Missouri, Illinois and Iowa jurisdictions, for which the Company's Missouri customers pay an allocated amount. **The Commission has never ordered depreciation rates for these corporate allocated plant accounts**, and Staff and Company disagree on what rate the Commission **should order** for those accounts in this case. (Initial Post-Hearing Brief of Staff, page 47; emphasis added).

Stepping into the shoes of Atmos by virtue of the Order Approving the Unanimous Stipulation and Agreement in Case No. GM-2012-0037, the Commission ordered Liberty Utilities to adopt the depreciation rates of Atmos." (Ex. 13, p. 71; Tr. 588-589). Whereas the depreciation rate schedule approved in Case No. GR-2006-0387 and continued in Case No. GM-2012-0037 includes no rates for corporate hardware and software, the Company continued the 14.29% and 18.98% rates utilized for many years and specifically in the two prior Atmos rate cases. However, rather than accept the status

quo, "Staff has supplemented the depreciation schedule with corporate allocated plant depreciation rates." (Ex. 13, p. 73, Tr. pp. 589-590). These "supplemental" rates happen to reflect an unrealistic depreciation rate of 4.75% for each disputed account, resulting in 21 year life spans for computer equipment and systems. Again, as Staff notes, ". . . the Commission has never ordered specific rates for subaccounts 399.1, 399.3, 399.4 or 399.5 for any of the Company's districts, which **according to the supplemented schedule of rates created of Staff for this case** is designated as corporate allocated plant." (Staff Brief, page 49; footnote omitted; emphasis added).

Public Counsel suggests that Company Witness Fallert "admitted during cross-examination that the best evidence for changing a depreciation rate is a depreciation study, which he acknowledged Liberty did not provide in this case." (Public Counsel's *Initial Brief*, page 10; footnote omitted). That, of course, is exactly the point. The Company has consistently advocated that while proposing to continue these historical rates inherited from Atmos in this case, the Company plans on performing a depreciation study of these accounts for its next case, at which time it would support any change or adjustment to the rates indicated by the study. (Ex.10, pp. 10-11).

> Absent a depreciation study being performed, Staff believes the next best evidence of what depreciation rates should be is those rates that are currently-ordered by the Commission. **However, when examining the most current Commission order in GM-2012-0037, a problem arises because the order did not assign specific depreciation amounts for each corporate plant account in dispute.** And as such, neither Staff nor Liberty Utilities have been able to find an ordered rate for corporate hardware and software. (footnote omitted) **The crux of the disagreement between Staff and the Company is what depreciation rates should be assigned to corporate allocated plant accounts when there is no previous Commission order, or depreciation study for guidance.** (Staff Brief, pages 50-51, emphasis added).

As thoroughly discussed in its *Initial Brief*, the Company believes that the "next best evidence" of what the subject depreciation rates should be is the utilization of those rates embraced by both Liberty's predecessor, Atmos, and the Staff, in the last two Missouri rate cases filed by Atmos. Staff would suggest that since those cases were stipulated with no resulting "order authorizing" the 14.29% and 18.98% rates, "any prior use of the rates by Staff or the Company in 2006 or 2010 in preparing its case, is of no import." (Staff Brief, page 52). While "Staff believes it inappropriate and bad public policy to implement depreciation rates in *a seemingly fortuitous way* without the depreciation rate being fully vetted by all the parties and ordered by the Commission,"[2] the Company would respectfully suggest that the Commission ask itself who is truly "fortuitous," when the Staff turns a blind eye to past practice and advocates the adoption of a 4.75% depreciation rate of a district general plant account (resulting in 21 year life spans for computer equipment and systems) that reduces Staff's revenue requirement recommendation by over $1 million dollars in this case.

Also discussed in Company's *Initial Brief*, the record evidence established that in another currently pending natural gas rate case, Case No. GR-2014-0086 (Summit Natural Gas of Missouri, Inc.), Staff's Witness recommended depreciation rates of 12.9% and 14.29% for computer equipment, which, according to testimony provided at hearing, conformed to current ordered rates for that company. A *Partial Stipulation and Agreement* filed in that case on August 18, 2014, and the *resulting Order Regarding Partial Stipulations and Agreements* entered by this Commission on September 3, 2014, adopted a depreciation rate of 12.9% for computer equipment, an average service life of

[2] Staff *Initial Brief*, page 54, emphasis added.

seven years. (Tr. 594-595). Attempting to minimize the import of computer equipment depreciation rates of another small natural gas distribution company, Staff argues that "Not only are rate cases extremely complex, but they also differ from one utility to another, therefore the 'one size fits all' approach explained by Mr. Fallert in his testimony is not appropriate for deciding complex cases." (Staff Brief, page 53). Ironically, Staff immediately pivots and goes on to cite other cases, ostensibly to prop up its 4.75% rate.

The Company respectfully submits that equity, fairness and good public policy supports the Commission's adoption of the depreciation rates currently utilized by the Company for these specific corporate allocated plant accounts, with the understanding that said rates will be reviewed in the context of a depreciation study filed by the Company in its next general rate proceeding.

CONCLUSION

Having fully addressed the arguments of Staff and Public Counsel, the Company respectfully requests that the Commission resolve in its favor the issues associated with cost of capital, including capital structure, return on equity, and cost of debt, revenue imputation adjustments associated with special contracts, and the depreciation rates for computer hardware and software. The Company believes that competent and substantial evidence on the record as a whole supports its position on the issues as described above. Resolution of these issues as the Company proposes will lead to just and reasonable rates that properly balance the interests of shareholders and customers, and that give the Company an opportunity to earn a reasonable rate of return following the conclusion of the case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand-delivered, emailed or mailed, First Class mail, postage prepaid, this 31st day of October, 2014, to all counsel of record in this matter.

/s/ James M. Fischer

James M. Fischer