*Exhibit No.:*
*Issues:* *Cash Working Capital, Rate Case Expense, Bad Debt Expense, Capitalized Depreciation, True-Up*
*Witness:* *Jason Kunst*
*Sponsoring Party:* *MoPSC Staff*
*Type of Exhibit:* *Surrebuttal / True-Up Direct Testimony*
*Case No.:* *GR-2018-0013*
*Date Testimony Prepared:* *May 9, 2018*

# MISSOURI PUBLIC SERVICE COMMISSION

## COMMISSION STAFF DIVISION

## AUDITING DEPARTMENT

## SURREBUTTAL / TRUE-UP DIRECT TESTIMONY

## OF

## JASON KUNST

## LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP., d/b/a LIBERTY UTILITIES

## CASE NO. GR-2018-0013

*Jefferson City, Missouri*
*May 2018*

** Denotes Confidential Information **

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**SURREBUTTAL / TRUE-UP DIRECT TESTIMONY**

**OF**

**JASON KUNST**

**LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP.,**
**d/b/a LIBERTY UTILITIES**

**CASE NO. GR-2018-0013**

Q. Please state your name and business address.

A. Jason Kunst, 111 N. 7th Street, Suite 105, St. Louis, MO 63101.

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission ("Commission") as a Utility Regulatory Auditor IV.

Q. Are you the same Jason Kunst who contributed to Staff's Cost of Service Report ("Staff Report") filed in this case on March 2, 2018?

A. Yes.

## EXECUTIVE SUMMARY

Q. Please provide a brief summary of the purpose of your surrebuttal / true-up direct testimony.

A. My surrebuttal testimony will address the rebuttal testimony filings of Liberty Midstates – MO witnesses Charles Evans regarding rate case expense, capitalized depreciation, and bad debt expense, and Timothy S. Lyons regarding cash working capital.

In addition, my testimony will address Staff's true-up positions regarding customer growth, other revenues, bad debt expense, rate case expense, and capitalized depreciation.

Finally, I address the increase in Staff's adjusted revenue calculation due to the increased operations of a Liberty Midstates – MO customer.

## CAPITALIZED DEPRECIATION

Q. What is "capitalized depreciation?"

A. Utilities use certain assets, such as power operated equipment and transportation equipment, as part of construction projects. When the utilities use power operated equipment and transportation equipment in construction activities, it is appropriate to capitalize the portion of the depreciation expense for these assets that were used in capital projects. For those projects in which the same assets were used for maintenance activities, the associated depreciation charges should be recorded as expense. For example, if during the year a backhoe was used 40% of the time to install new gas mains and 60% of the time to make small repairs then it would be permissible to capitalize 40% of the annual depreciation on the backhoe as part of the capitalized gas mains investment. The remaining 60% of annual depreciation on the backhoe would be recorded as depreciation expense. For natural gas utilities, the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA") provides instructions to utilities and regulators with regard to properly accounting for these costs, including requirements for capitalization of depreciation under certain circumstances.

Q. What is Liberty Midstates – MO witness Evans' position regarding capitalized depreciation?

A. Mr. Evan's rebuttal testimony advocates for capitalized depreciation for assets that were addressed by the *Partial Stipulation and Agreement As To Certain Issues*

("Partial Stipulation and Agreement") that was approved by the Commission on August 20, 2014, as part of Liberty Midstates –MO's prior rate case, Case No. GR-2014-0152. Liberty Midstates – MO has capitalized a portion of the depreciation expense for transportation equipment, shop equipment, tools, and power operated equipment that were used in construction activities, which is consistent with the Partial Stipulation and Agreement from Case No. GR-2014-0152 and also with the FERC USOA for gas utilities. Staff does not dispute the ratemaking treatment for any of these items.

However, Mr. Evans goes on to explain that the utility has also capitalized a portion of the depreciation expense for the two structures which are operations facilities, one located in Jackson, Missouri and the other in Malden, Missouri beginning in October 2014 through present.

Q. Has Liberty Midstates – MO provided any documentation or authoritative guidance that supports its position to capitalize a portion depreciation expense on buildings?

A. No. Staff Data Request No. 360 requested a copy of all supporting documentation that Liberty Midstates – MO relied upon to support its decision to capitalize a portion of depreciation expense for buildings. Liberty Midstates - MO's response was to see pages 7-10 of Mr. Evan's rebuttal testimony.

Q. What is Staff's position with regard to Mr. Evan's proposal to capitalize depreciation for these two operation facilities?

A. It is Staff's position that it is not appropriate or reasonable to capitalize a portion of depreciation expense for either of these structures because this accounting treatment is not permitted by the FERC USOA for natural gas utilities. Furthermore, capitalizing the depreciation on these assets which are not used directly in the construction process creates an illogical result of increasing the cost of the installation of a new gas main by including a portion of the depreciation expense for a building as part of the overall cost of the main investment. Therefore, Staff removed all capitalized depreciation recorded by Liberty Midstates – MO on its property records for these two buildings from plant-in-service as well as all corresponding depreciation reserve balances for the period covering October 1, 2014, and through March 31, 2018.

Q. What is the FERC's USOA guidance for capitalizing a portion of the depreciation expense as part of construction costs?

A. On page 632 of the FERC USOA for gas utilities applicable to Liberty Midstates – MO, a list of items is provided that are eligible for capitalized depreciation as part of a discussion of account 403, Depreciation Expense:

> Note B: Depreciation expenses applicable to transportation equipment, shop equipment, tools, work equipment, power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation.

On pages 561 through 564, the FERC USOA for gas utilities provides specific "Gas Plant Instructions" describing all components of construction costs. Please refer to attached Schedule JK-s1 for a complete copy the referenced sections of the USOA that provides instructions for the capitalized depreciation. The FERC USOA for gas utilities provides no specific authority for a natural gas utility to capitalize a portion of depreciation expense associated with buildings as part of a component of capitalized construction costs.

Q. Does similar guidance for the appropriate treatment of capitalized depreciation exist for electric utilities and even water utilities?

A. Yes. The FERC USOA for electric utilities provides exactly the same guidance for capitalizing depreciation expense. Specifically the FERC USOA for electric utilities stated the following on page 399:

> Note B: Depreciation expense applicable to transportation equipment, shop equipment, tools, work equipment and power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation.

The same exact language exists on page 98 in the National Association of Regulatory Utility Commissioner's 1973 Uniform System Accounts for Class A & B Water Utilities as revised in 1976 which states the following for account 403 Depreciation Expense:

> Note B. – Depreciation expense applicable to transportation equipment, shop equipment, tools, work equipment and power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation.

Q. Do either of the aforementioned FERC Electric USOA or NARUC water USOA above state that the depreciation on buildings that house construction equipment may be charged to clearing accounts and be transferred to the cost of any construction project?

A. No. Staff found no reference in either of these USOAs that permitted such treatment.

Q. Is Staff aware of any other utilities that capitalize depreciation for power operated and transportation equipment?

A. Yes. Union Electric Company, d/b/a Ameren Missouri ("Ameren Missouri"), Spire Missouri, and The Empire District Electric Company all capitalize a portion of the depreciation expense for power operated and transportation equipment that is used for construction projects.

Q. Do any of the utilities listed above capitalize a portion of the depreciation on buildings that house construction equipment?

A. No. These utilities appropriately capitalized depreciation for only the assets listed in the respective USOAs.

Q. Does Staff believe it is appropriate to go back to the periods prior to the test year to remove from the accumulated depreciation reserve the portion associated with capitalized depreciation for buildings?

A. Yes. It is necessary to remove all amounts of capitalized depreciation expense and corresponding depreciation reserve associated with these two buildings. Liberty Midstates – MO capitalized a portion of the depreciation expense inconsistent with FERC USOA instructions and without any basis or Commission order authorizing them to do so. By leaving these amounts in rate base it would allow Liberty Midstates – MO to inappropriately receive a return of and on these inappropriately capitalized amounts. Staff requests that the Commission adopt all of Staff's plant-in-service and depreciation reserve adjustments that address this issue.

**RATE CASE EXPENSE**

Q. How does Staff propose to treat rate case expense in this case?

A. Staff is recommending that the prudently incurred rate case expenses be shared between the ratepayers and the shareholders using the method ordered by the Commission in Kansas City Power & Light Company ("KCP&L") Case No. ER-2014-0370, which allows the utility to recover a percentage of the rate case expense incurred based upon the amount ultimately awarded by the Commission divided by the amount initially requested by the Company. Commission required items such as the depreciation study and costs associated with customer notices should not be subject to rate case expense sharing. In addition, the impact of the recently enacted Tax Cut and Jobs Act ("TCJA") on Liberty Midstates – MO's cost of service should also not be subject to the sharing formula. Staff then proposes to normalize the rate case expense allocated to the ratepayers over four years, which is consistent with the interval of time between Liberty Midstates – MO's prior rate case and the current rate case. Finally, Staff would alternatively support a 50/50 sharing of rate case expense consistent with the Commission's *REPORT AND ORDER* that was issued in the recent Spire Missouri rate cases, Case Nos. GR-2017-0215 and GR-2017-0216.

Q. Why has Staff chosen to normalize the rate case expense rather than amortize the expense?

A. Staff performs normalization adjustments to include a "normal" level of expense in the cost of service calculation. Staff has chosen to normalize rate case expenses so as to treat them like the majority of the other expenses incurred by Liberty Midstates – MO.

Q. What was Liberty Midstates - MO's recommendation for the treatment of rate case expense as part of its direct testimony filing sponsored by witness Charlotte T. North?

A. At the time of its direct filing Liberty Midstates – MO had an estimated rate case expense of $973,572. At that time, Liberty Midstates - MO requested that all actual rate case expense incurred in this case be amortized over three years, including the cost of the depreciation study which is required by Commission rule every five years.[1]

Q. Please summarize Liberty Midstates – MO's position with regard its proposed treatment for rate case expense that was part of its rebuttal testimony filing.

A. Liberty Midstates – MO witness Evans sponsors rebuttal testimony that supports an adjustment to exclude the impact of the TCJA, which was signed into law after the time that the rate case was filed, from the calculation of allowable rate case expense. In addition, Mr. Evans also recommends that the cost of the Class Cost of Service Study ("CCOS") be excluded from the rate case sharing as well. Mr. Evans supports Staff's exclusion of the depreciation study from the sharing mechanism since this study is required to be conducted by Commission rule at least every five years. Finally, Mr. Evans agrees with Staff's position to exclude the lead/lag study that was required by the Revised Second Partial Stipulation And Agreement As To Certain Issues that was approved by the Commission in Liberty Midstates – MO's last general rate case.[2]

Q. Has Staff modified its position to exclude the impact of the TCJA from rate case expense sharing?

A. Yes. Staff has modified its position to exclude the impact of the TCJA from rate case expense sharing in response to Mr. Evan's rebuttal testimony. At the time of its filing, Liberty Midstates - MO could not have anticipated the reduction in federal income tax rate and the resulting decrease to its requested revenue requirement, all else held equal.

[1] 4 CSR 240-3.255 (1) (A).
[2] GR-2014-0152.

Q Has Staff modified its position to also exclude from the rate case expense sharing the cost of the CCOS study that was performed by a consultant in this case?

A. Yes. Staff agrees that Liberty Midstates – MO was required to perform a cost of service study as part of this rate case, based upon the *Revised Second Partial Stipulation And Agreement As To Certain Issues* that was approved by the Commission in the previous rate case, Case No. GR-2014-0152. Therefore, Staff has removed the cost of the CCOS study from the proposed rate case expense sharing. Staff recommends that the full amount of the costs incurred for the cost of service study should be normalized over a four year period based upon the interval between the last rate case and this rate case.

Q. Does Staff recommend that Liberty Midstates – MO conduct a CCOS study internally as part of its next rate case?

A. Yes. To date Liberty Midstates – MO has spent approximately $60,000 for the CCOS that was performed by witness Timothy Lyons. Since Liberty Midstates – MO now has the CCOS study in its possession, someone within the Company could be actively learning how to conduct such an analysis and to make CCOS recommendations in the future.

Q. Is Staff recommending that cash working capital lead/lag study provided by outside experts in the current case be excluded from rate case expense sharing?

A. Yes, but only for the purposes of this rate case. Since Liberty Midstates – MO now has the framework, workpapers, and analysis for preparing the lead/lag study to use as guidance in future rate cases. Staff would anticipate these items to be performed internally in future rate cases. Similar to the CCOS study, someone with Liberty Midstates – MO could be actively learning how to conduct such an analysis and to develop a cash working capital analysis in the future.

Q. Has Liberty Midstates - MO provided Staff with invoices for costs related to customer notices that have been issued in the current case?

A. Yes. Staff has not included the costs for the required customer notices in the amount proposed for sharing. Staff is recommending that the full amount of costs for the notices be normalized over a four year period.

Q. What is the impact of the changes described above?

A. Staff is now recommending that Liberty Midstates - MO be allowed to recover approximately 56% of its prudently incurred rate case expenses consistent with the rate case sharing mechanism ordered by the Commission in ER-2014-0370.

Q. Mr. Evans states on page 4 of his rebuttal that neither Staff nor any other party has asserted that the level of rate case expense is unreasonable or excessive. Does Staff have concerns about Liberty Midstates – MO's estimated amount of rate case expense in the current rate case, especially as compared to past Liberty Midstates – MO and Atmos Energy Corporation ("Atmos") rate cases?

A. Yes. Staff is concerned by the one million dollar estimate of rate case expense. In its prior rate case, Case No. GR-2014-0152, Liberty Midstates - MO estimated rate case expense to be $400,000 in its direct filing. Ultimately, Liberty Midstates – MO spent $609,679. Atmos, the predecessor to Liberty Midstates - MO, estimated rate case expenses of $285,000 in GR-2010-0192. In the current case, Liberty Midstates – MO estimated rate case expense to be $973,572 in its direct filing, which is twice what it estimated in the previous case and three times what Atmos estimated for the 2010 case. As of March 31, 2018, Liberty Midstates – MO has spent $299,763 for the current rate case.

Q. Please provide a breakdown of the rate case costs through the true-up date and estimated rate case expenses anticipated by Liberty Midstates – MO.

A. The following chart summarizes the actual rate case expense as of March 31, 2018, and estimated rate case expense through filing of briefs:

**

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Q. Has the Commission ordered the sharing of rate case expense between shareholders and ratepayers in previous cases?

A. Yes. The Commission ordered the sharing of rate case expenses in the KCP&L rate case, No. ER-2014-0370, and more recently in the Spire rate cases, Nos. GR-2017-0215 and GR-2017-0216. Additionally, the Commission has approved stipulations and agreements which stated that rate case expense was to be shared between ratepayers and shareholders in the Missouri-American Water Company rate case, No. WR-2015-0301, and The Empire District Electric Company rate case, No. ER-2016-0023.

Q. Are the facts and circumstances in this case similar to those in which the Commission authorized the sharing of rate case expense?

A. Yes. In the *Report and Order* for ER-2014-0370, the Commission stated the following:

> The evidence shows that the expenses in this case are driven primarily by issues raised by KCPL, which has complete control over the content and methodologies proposed when it files its rate cases. In this case, KCPL has requested three new trackers, two of which have never been requested before in Missouri…
>
> Each of these issues are unique to KCPL, and while KCPL always has the opportunity to pursue new and unique issues in a rate case, the decision to do is entirely with KCPL's power. In addition, KCPL has pursued some issues that only directly benefit shareholders such as La Cygne accounting authority, and of course a higher ROE…

Additionally, the *Report and Order* in GR-2017-0215 and GR-2017-0216 stated the following:

> Additionally, a number of these litigated issues were unique shareholder-focused ratemaking tools, such as the revenue stabilization mechanism, the requested high rate of return of 10.35 percent, three new tracking mechanisms to limit shareholder risk, and earnings based incentive compensation which has been consistently denied by the Commission. It was Spire Missouri's decision and entirely within Spire Missouri's power to pursue these issues and to file this rate case and the shareholders stood to benefit from those issues.

In the current case, Liberty Midstates – MO has requested four new tracking mechanisms that can operate to limit shareholder risk: (1) a capital reliability tracker, (2) an ad valorem tax tracker, (3) a bad debt tracker, and (4) a right of way maintenance tracker. In addition to the tracking mechanisms, Liberty Midstates – MO has requested a revenue decoupling mechanism, the Volume Balancing Rider. Liberty Midstates - MO has requested a high ROE at 10.25 percent, which is similar to the high ROEs requested by Spire Missouri and KCP&L in the aforementioned rate cases. Similar to Spire Missouri, Liberty Midstates – MO is also seeking to recover earnings based incentive compensation in rates.

Q. On pages 4 and 5 of his rebuttal testimony, Liberty Midstates – MO witness Evans suggests that Liberty Midstates – MO is unique because it relies upon outside experts and counsel to prepare testimony, accounting schedules, and other various rate case related tasks. Does Staff believe that is an accurate statement?

A. It is true that Liberty Midstates – MO is in the current case using outside counsel and expert witnesses for some of the rate case related tasks. However, it is not unique in doing so. Among others, Ameren Missouri, Spire Missouri, KCP&L, and Missouri American Water typically utilize outside expert witnesses for ROE recommendations and other issues. Additionally, those utilities frequently employ outside counsel to aid in presenting their rate case requests to the Commission.

Q. Please summarize Staff's position with regard to the appropriate treatment for rate case expense in this rate case.

A. Staff recommends that the Commission authorize the rate case expense be shared between the ratepayers and the shareholders of Liberty Midstates – MO using the actual increase awarded by the Commission divided by the adjusted revenue increase requested by Liberty Midstates – MO.[3] Staff recommends that expenses required by Commission rule and items that were required in the stipulations and agreements in the previous case, GR-2014-0152, be excluded from the sharing mechanism.

**<u>BAD DEBT EXPENSE</u>**

Q. What was Liberty Midstates – MO's position in direct testimony with respect to bad debt expense?

[3] Adjusted for the impact of the Tax Cut and Jobs Act.

A. In its direct filing, Liberty Midstates – MO witness Charlotte North supported a normalized level of bad debt expense which was determined by calculating a percentage of the bad debt expense that was derived by dividing "accrued" or estimated bad debt expense by the actual unadjusted revenues for the three year period of July 2013 through June 2016. The resulting percentage was then multiplied by Liberty Midstates – MO's normalized revenues resulting in a normalized level of estimated bad debt expense of $471,092.

Q. Has Liberty Midstates – MO updated its position regarding bad debt expense?

A. Yes. Liberty Midstates – MO witness Evans provided Staff with updated workpapers that normalized bad debt expense using a percentage of bad debt expense that was calculated by dividing "accrued" or estimated bad debt expense by the actual unadjusted revenues for the calendar years 2014, 2015, 2016, and 2017. The resulting percentage was again multiplied by Liberty Midstates – MO's normalized revenues, which resulted in a normalized level of estimated bad debt expense of $356,606. Staff refers to Liberty Midstates – MO's proposed adjustment as "estimated" because it relies on an accrued amount which is an estimate of expected future bad debt expense, rather than using actual net write offs to determine its adjustment. Bad debt accruals should not be relied upon for ratemaking purposes. Even if Liberty Midstates – MO were to substitute actual net write offs for accrued or estimated amounts in its calculations, Staff would still recommend that such an analysis be rejected by the Commission.

Q. On page 3, lines 7 and 8 of his rebuttal testimony, Liberty Midstates – MO witness Evans recommends that bad debt expense "includes a factor up for an increase granted in this case." Has Liberty Midstates - MO provided any analysis supporting its recommendation to include a factor up for bad debt expense for any increase granted in the current case?

A. No. Liberty Midstates – MO did not provide Staff with any analysis supporting the inclusion of a bad debt factor up in the current case. In fact, Liberty Midstates – MO did not request the factor up as part of its direct filing.

Q. Why does Staff believe that even if Liberty Midstates - MO's substituted actual net write offs into its analysis that it still should not be relied upon?

A. Actual net write offs and actual unadjusted revenues do not have a direct relationship, nor are they necessarily correlated. The following table provides Liberty Midstates - MO's actual unadjusted revenues compared to the time period in which actual net write offs would be applicable:

| 12 Months Ending | Net Write Offs | 12 Months Ending | Revenues |
|---|---|---|---|
| March 31, 2015 | $ 1,582,683 | October 31, 2014 | $ 58,502,811 |
| March 31, 2016 | $ 355,549 | October 31, 2015 | $ 56,888,990 |
| March 31, 2017 | $ 239,325 | October 31, 2016 | $ 42,826,422 |
| March 31, 2018 | $ 157,847 | October 31, 2017 | $ 42,299,504 |

| 12 Months Ending | Net Write Offs | 12 Months Ending | Revenues |
|---|---|---|---|
| September 30, 2014 | $ 1,048,934 | April 30, 2014 | $ 58,418,087 |
| September 30, 2015 | $ 1,229,130 | April 30, 2015 | $ 57,178,209 |
| September 30, 2016 | $ 372,445 | April 30, 2016 | $ 45,229,297 |
| September 30, 2017 | $ 64,979 | April 30, 2017 | $ 40,877,358 |

This table shows that there are times when actual net write offs go down when actual revenues are increasing. Changes in economic conditions such as high unemployment rates, inflation, a significant reduction in federal income taxes, funding from community action agencies, and variety of other reasons could explain why this phenomenon occurs. These two variables, net bad debt write-offs and total revenues, can and do have a demonstrated history of moving in opposite directions.

Q. Please refer to page 3, lines 8 - 10 of Mr. Evans' rebuttal testimony where he proposes to factor up bad debt expense to take into account any increase ultimately granted in this rate case.

A. For the reasons explained above, many other factors can cause actual net write offs to trend in an opposite direction of actual revenues. Therefore, it is Staff's position that it is inappropriate to assume that just because the Company stands to collect higher revenues as a result of this rate case that it will automatically incur higher levels of actual net write offs.

Q. How did Staff determine its recommended level of bad debt expense in this case?

A. Staff reviewed the amounts of actual net write offs that were incurred by Liberty Midstates - MO for the period of April 2013 through December 2017 in determining the normalized amount of bad debt expense to include in rates. In its direct filed position Staff recommended including the actual net write offs for the calendar year ending 2017 as the normalized amount of bad debt expense to include in rates.

Q. What are actual net write offs?

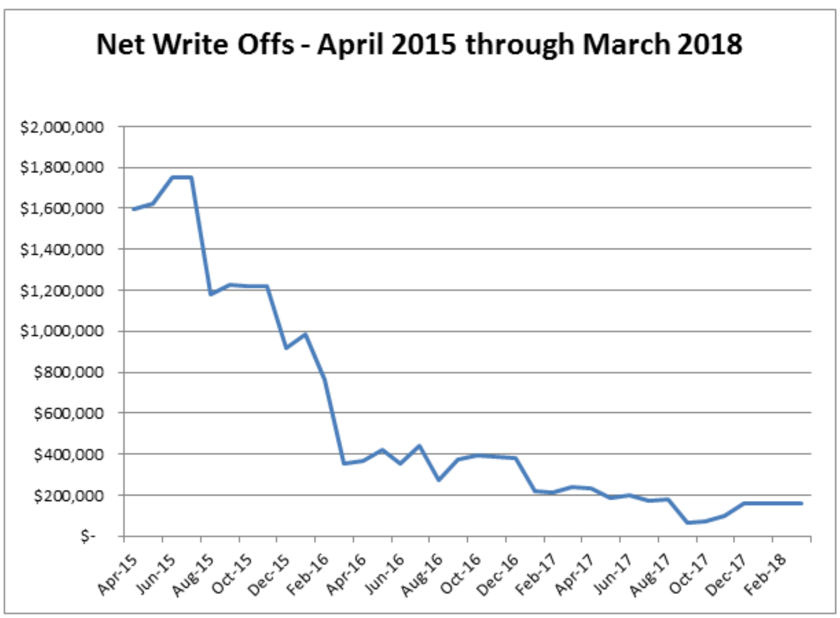
A. Write offs are accounts receivable that Liberty Midstates – MO determines are truly uncollectable. These accounts are then passed on to third party collection agencies for collection purposes. If the collection agencies are later able to collect any of the accounts that are written off, the proceeds are then used to offset the write offs, resulting in "net write offs."

Q. Why does Staff recommend using actual net write offs and not the percentage of bad debt expense methodology used by Liberty Midstates - MO?

A. The actual net write offs represent the actual bad debt incurred by Liberty Midstates – MO.

Q. Why is Staff now recommending that the actual net write offs for the 12 months ending March 31, 2018, be used as the annualized amount of bad debt expense to include in rates?

A. As shown on the following chart, the amount of actual net writes offs for Liberty Midstates – MO has been trending downwards over the previous 36 months:




Because of the steady downward trend, Staff recommends including the most recent known and measurable amount as the normalized level of bad debt expense.

Q. In previous cases has Staff recommended using a single twelve month period for the normalized amount of bad debt?

A. Yes. Staff has recommended including a single twelve month period for bad debt expense in several cases in the past including Spire Missouri cases Nos. GR-2017-0215 and GR-2017-0216 and Ameren Missouri Case No. ER-2016-0179. Staff determines the amount of bad debt expense to include in rates based upon the individual facts and circumstances in each case. Given the downward trend in net write offs and the evolving policies put in place by Liberty Midstates – MO, as described in more detail below, Staff believes that the twelve months ending March 31, 2018, best represents the current ongoing level of bad debt expense.

Q. Has Liberty Midstates – MO indicated that its bad debt policies have been "evolving?"

A. Yes. In the previous rate case, Case No. GR-2014-0152, Liberty Midstates – MO witness Jim Fallert stated on page 9, lines 7-10 that "Liberty's billing and collection practices subsequent to the acquisition of the subject properties in August 2012 have been evolving. Therefore, we do not believe that recent bad debt write-off experience is in any way indicative of a reasonable normalized level going forward."

Q. Please describe the recent evolutions to Liberty Midstates – MO's collection practices.

A. ** ______________________________________________

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**CASH WORKING CAPITAL**

Q. Does Liberty Midstates – MO witness, Timothy S. Lyons, address any specific Staff recommendations in his rebuttal testimony regarding cash working capital ("CWC")?

A. Yes. Mr. Lyons opposes Staff's recommendation to decrease the accounts receivable ("A/R") balance for accounts that will eventually become uncollectable and will be included in bad debt expense; Staff's recommendation that billing lag be reduced to reflect the implementation of AMRs; and Staff's recommendation that bad debt expense lag be set equal to the revenue lag.

Q. Please explain Mr. Lyons' position with regard to Staff's elimination of the bad debt in the calculation of the collection lag?

A. Mr. Lyons takes the position that bad debt expense only recovers bad debt expense and not the revenue lag associated with the bad debt expense. He suggests there is "bad debt lag," which he calls a carrying cost, from the time the bill in sent to the customer until the bill is considered uncollectable and charged to bad debt expense.

Q. What is Liberty Midstates - MO's position with regards to the lag associated with bad debt expense?

A. Mr. Lyons states on page 10, on lines 3-5 that "there is a cash working capital requirement associated with bad debt expense from the time a customer bill is considered uncollectible and charged to bad debt expense to the time payments are received from customers."

Q. Does the utility have a cash outlay or payout for bad debt expense?

A. No. There is no cash flow associated with bad debt expense, as it is a non-cash item. Thus, there is no cash exchange when Liberty Midstates – MO incurs bad debt expense.

Q. Do you agree with Mr. Lyons' suggestion on page 8, lines 7-16 of his rebuttal testimony that Staff's calculation of the bad debt removed in the calculation of the collection lag is inconsistent?

A. No. Mr. Lyons is suggesting that the test year bad debt expense be restated in the collection lag calculation. Staff believes it is appropriate to use the actual bad debt expense that was booked in the test year.

Q. Has Staff made an adjustment to reduce the billing lag for Liberty Midstates – MO for the efficiencies provided by the installation of the automatic meter readers ("AMRs")?

A. ** ______________________________________________

______________________________________________

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Q. Is Staff aware of any other investor owned gas utilities that installed AMRs?

A. Yes. Spire Missouri – East completed the installation of AMRs in 2009 and was able to reduce its billing lag from 3.17 days to 2.17 days. Staff would anticipate a similar decrease in the billing lag for Liberty Midstates – MO in the future.

Q. Are there any other issues that need to be addressed related to CWC?

A. Yes. Mr. Lyons' rebuttal testimony addressed two corrections that needed to be made to Staff's CWC recommendation. The corrections were related to the expense lags for the Missouri PSC assessment and the medical and dental benefits. Staff was made aware of these errors and has made the appropriate adjustments.

## TRUE-UP AUDIT

### BAD DEBT EXPENSE

Q. Has Staff updated its position as part of its true-up filing?

A. Yes. Staff is now recommending to include the actual net write offs for the 12 months ending March 31, 2018, as the normalized level of bad debt expense to include in rates.

### RATE CASE EXPENSE

Q. Has Staff made any adjustments to its direct filed position regarding rate case expense?

A. Yes. Staff has adjusted its calculation to include all prudently incurred rate case expenses through March 31, 2018. Staff will continue to evaluate rate case expense incurred through the date of reply briefs in this case.

As for the sharing mechanism, Staff has updated the calculation to include its recommended revenue increase through the true-up date of March 31, 2018.

### CAPITALIZED DEPRECIATION

Q. Has Staff updated its position through the true-up date in this case?

A. Yes. Staff has updated the annualized amount of capitalized depreciation for changes through the true-up date. Additionally, Staff has updated the adjustment to remove the capitalized depreciation from the buildings from plant in service and accumulated depreciation reserve through the true-up date.

**OTHER REVENUES**

Q. Has Staff made any adjustments to the other revenues for the true-up audit?

A. Yes. Staff discovered that Liberty Midstates – MO was booking revenue from the lease of a parking lot that is included in the plant in service for the NEMO district below-the-line. Staff has made an adjustment to include that revenue in its cost of service calculation.

**REVENUES – CUSTOMER GROWTH**

Q. Has Staff made any adjustments to annualize the level of customers included in its calculation of revenues?

A. Yes. Staff has reviewed customer information through the March 31, 2018, true-up date and is now recommending using the actual customer counts as of March 31, 2018.

Q. Are there any specific developments with regard to customer growth that impact the calculation of revenues?

A. ** ______________________________________________________________

______________________________________________________________

______________________________________________________________

______________________________________________________________

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Q. **

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A. **

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Q. Does this complete your surrebuttal / true-up direct testimony?

A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

| | | |
|---|---|---|
| In the Matter of Liberty Utilities<br>(Midstates Natural Gas) Corp. d/b/a<br>Liberty Utilities' Tariff Revisions<br>Designed to Implement a General Rate<br>Increase for Natural Gas Service in the<br>Missouri Service Areas of the Company | )<br>)<br>)<br>)<br>)<br>) | Case No. GR-2018-0013 |

**AFFIDAVIT OF JASON KUNST, CPA**

STATE OF MISSOURI )
) ss.
CITY OF ST. LOUIS )

**COMES NOW JASON KUNST, CPA,** and on his oath declares that he is of sound mind and lawful age; that he contributed to the foregoing Surrebuttal Testimony and True-Up Direct Testimony, and that the same is true and correct according to his best knowledge and belief.

Further the Affiant sayeth not.

**JASON KUNST, CPA**

**JURAT**

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the City of St. Louis, State of Missouri, at my office in St. Louis, on this 7th day of May, 2018.

LISA M. FERGUSON
Notary Public - Notary Seal
State of Missouri
Commissioned for St. Louis County
My Commission Expires: June 08, 2020
Commission Number: 16631502

Lisa M Ferguson
Notary Public

other expenditures occasioned solely by such form of payment.

D. The gas plant accounts shall not include the cost or other value of gas plant contributed to the company. Contributions in the form of money or its equivalent toward the construction of gas plant shall be credited to the accounts charged with the cost of such construction. Plant constructed from contributions of cash or its equivalent shall be shown as a reduction to gross plant constructed when assembling cost data in work orders for posting to plant ledger of accounts. The accumulated gross costs of plant accumulated in the work order shall be recorded as a debit in the plant ledger of accounts along with the related amount of contributions concurrently being recorded as a credit.

3. *Components of construction cost.* A. The cost of construction properly includable in the gas plant accounts shall include, where applicable, the direct and overhead costs as listed and defined hereunder:

(1) "Contract work" includes amounts paid for work performed under contract by other companies, firms, or individuals, costs incident to the award of such contracts, and the inspection of such work.

(2) "Labor" includes the pay and expenses of employees of the utility engaged on construction work, and related workmen's compensation insurance, payroll taxes and similar items of expense. It does not include the pay and expenses of employees which are distributed to construction through clearing accounts nor the pay and expenses included in other items hereunder.

(3) "Materials and supplies" includes the purchase price at the point of free delivery plus customs duties, excise taxes, the cost of inspection, loading and transportation, the related stores expenses, and the cost of fabricated materials from the utility's shop. In determining the cost of materials and supplies used for construction, proper allowance shall be made for unused materials and supplies, for materials recovered from temporary structures used in performing the work involved, and for discounts allowed and realized in the purchase of materials and supplies.

NOTE: The cost of individual items of equipment of small value (for example, $500 or less) or of short life, including small portable tools and implements, shall not be charged to utility plant accounts unless the correctness of the accounting therefor is verified by current inventories. The cost shall be charged to the appropriate operating expense or clearing accounts, according to the use of such items, or, if such items are consumed directly in construction work, the cost shall be included as part of the cost of the construction.

(4) "Transportation" includes the cost of transporting employees, materials and supplies, tools, purchased equipment, and other work equipment (when not under own power) to and from points of construction. It includes amounts paid to others as well as the cost of operating the utility's own transportation equipment. (See item 5 following.)

(5) "Special machine service" includes the cost of labor (optional), materials and supplies, depreciation, and other expenses incurred in the maintenance, operation and use of special machines, such as steam shovels, pile drivers, derricks, ditchers, scrapers, material unloaders, and other labor saving machines; also expenditures for rental maintenance and operation of machines of others. It does not include the cost of small tools and other individual items of small value or short life which are included in the cost of materials and supplies. (See item 3, above.) When a particular construction job requires the use for an extended period of time of special machines, transportation or other equipment, the net book cost thereof, less the appraised or salvage value at time of release from the job, shall be included in the cost of construction.

(6) "Shop service" includes the proportion of the expense of the utility's shop department assignable to construction work except that the cost of fabricated materials from the utility's shop shall be included in "materials and supplies."

(7) "Protection" includes the cost of protecting the utility's property from fire or other casualties and the cost of preventing damages to others, or to the property of others, including payments

for discovery or extinguishment of fires, cost of apprehending and prosecuting incendiaries, witness fees in relation thereto, amounts paid to municipalities and others for fire protection, and other analogous items of expenditures in connection with construction work.

(8) "Injuries and damages" includes expenditures or losses in connection with the construction work on account of injuries to persons and damages to the property of others; also the cost of investigation of and defense against actions for such injuries and damages. Insurance recovered or recoverable on account of compensation paid for injuries to persons incident to construction shall be credited to the account or accounts to which such compensation is charged. Insurance recovered or recoverable on account of property damages incident to construction shall be credited to the account or accounts charged with the cost of the damages.

(9) "Privileges and permits" includes payments for and expenses incurred in securing temporary privileges, permits or rights in connection with construction work, such as for the use of private or public property, streets, or highways, but it does not include rents, or amounts chargeable as franchises and consents for which see account 302, Franchises and Consents.

(10) "Rents" includes amounts paid for the use of construction quarters and office space occupied by construction forces and amounts properly includible in construction costs for such facilities jointly used.

(11) "Engineering and supervision" includes the portion of the pay and expenses of engineers, surveyors, draftsmen, inspectors, superintendents and their assistants applicable to construction work.

(12) "General administration capitalized" includes the portion of the pay and expenses of the general officers and administrative and general expenses applicable to construction work.

(13) "Engineering services" includes amounts paid to other companies, firms, or individuals engaged by the utility to plan, design, prepare estimates, supervise, inspect, or give general advice and assistance in connection with construction work.

(14) "Insurance" includes premiums paid or amounts provided or reserved as self-insurance for the protection against loss and damages in connection with construction, by fire or other casualty, injury to or death of persons other than employees, damages to property of others, defalcation of employees and agents, and the nonperformance of contractual obligations of others. It does not include workmen's compensation or similar insurance on employees included as "labor" in item 2, above.

(15) "Law expenditures" includes the general law expenditures incurred in connection with construction and the court and legal costs directly related thereto, other than law expenses included in protection, item 7, and in injuries and damages, item 8.

(16) "Taxes" includes taxes on physical property (including land) during the period of construction and other taxes properly includible in construction costs before the facilities become available for service.

(17) "Allowance for funds used during construction" includes the net cost for the period of construction of borrowed funds used for construction purposes and a reasonable rate on other funds when so used, not to exceed without prior approval of the Commission allowances computed in accordance with the formula prescribed in paragraph (a) below, except when such other funds are used for exploration and development or leases acquired after October 7, 1969, no allowance on such other funds shall be included in these accounts. No allowance for funds used during construction charges shall be included in these accounts upon expenditures for construction projects which have been abandoned.

(a) The formula and elements for the computation of the allowance for funds used during construction shall be:

$$A_i = s\left(\frac{S}{W}\right) + d\left(\frac{D}{D+P+C}\right)\left(1-\frac{S}{W}\right)$$

$$A_e = \left[1-\frac{S}{W}\right]\left[p\left(\frac{P}{D+P+C}\right)+c\left(\frac{C}{D+P+C}\right)\right]$$

$A_i$=Gross allowance for borrowed funds used during construction rate.

$A_e$=Allowance for other funds used during construction rate.

$S$=Average short-term debt.
$s$=Short-term debt interest rate.
$D$=Long-term debt.
$d$=Long-term debt interest rate.
$P$=Preferred stock.
$p$=Preferred stock cost rate.
$C$=Common equity.
$c$=Common equity cost rate.
$W$=Average balance in construction work in progress less asset retirement costs (See General Instruction 24) related to plant under construction.

(b) The rates shall be determined annually. The balances for long-term debt, preferred stock and common equity shall be the actual book balances as of the end of the prior year. The cost rates for long-term debt and preferred stock shall be the weighted average cost determined in the manner indicated in subpart D of part 154 of the Commission's Regulations Under the Natural Gas Act. The cost rate for common equity shall be the rate granted common equity in the last rate proceeding before the ratemaking body having primary rate jurisdiction. If such cost rate is not available, the average rate actually earned during the preceding three years shall be used. The short-term debt balances and related cost and the average balance for construction work in progress shall be estimated for the current year with appropriate adjustments as actual data becomes available.

NOTE: When a part only of a plant or project is placed in operation or is completed and ready for service but the construction work as a whole is incomplete, that part of the cost of the property placed in operation, or ready for service, shall be treated as "Gas Utility Plant" and allowance for funds used during construction thereon as a charge to construction shall cease. Allowance for funds used during construction on that part of the cost of the plant which is incomplete may be continued as a charge to construction until such time as it is placed in operation or is ready for service, except as limited in item 17, above.

(18) "Earnings and expenses during construction" includes (a) all revenues derived during the construction period from property which is included in the cost of a project under construction and (b) all expenses which are attributable to the revenues received.

(19) "Training costs". When it is necessary that employees be trained to operate or maintain plant facilities that are being constructed and such facilities are not conventional in nature or are new to the company's operations, these costs may be capitalized as a component of construction cost. Once plant is placed in service, the capitalization of training costs shall cease, and subsequent training costs shall be expensed. (See Operating Expense Instruction 4.)

(20) "Line pack gas." Line pack includes the first cost of that quantity of gas introduced into the utility's system necessary to bring the system up to its designed operating capacity or increases therein and which must be maintained in the system in order to sustain such design operating capacity.

(21) LNG "heel" is the first cost of that minimum quantity of liquefied natural gas necessary to be retained in holding tanks and other facilities for purposes of temperature and/or pressure maintenance.

(22) "Studies" includes the costs of studies such as operational, safety or environmental studies relative to plant under construction. Studies mandated by regulatory bodies relative to facilities in service, shall be charged to Account 183.2, Other Preliminary Survey and Investigation Charges.

(23) "Asset retirement costs." The costs recognized as a result of asset retirement obligations incurred during the construction and testing of utility plant shall constitute a component of construction costs.

4. *Overhead construction costs.* A. All overhead construction costs, such as engineering, supervision, general office salaries and expenses, construction engineering and supervision by others than the accounting utility, law expenses, insurance, injuries and damages, relief and pensions, taxes and interest, shall be charged to particular jobs or units on the basis of the amounts of such overheads reasonably applicable thereto, to the end that each job or unit shall bear its equitable proportion of such costs and that the entire cost of the unit, both direct and overhead, shall be deducted from the plant accounts at the time the property is retired.

B. As far as practicable, the determination of pay roll charges includible in construction overheads shall be based on time card distributions thereof. Where this procedure is impractical, special studies shall be made periodically of the time of supervisory employees devoted to construction activities to the end that only such overhead costs as have a definite relation to construction shall be capitalized. The addition to direct construction costs of arbitrary percentages or amounts to cover assumed overhead costs is not permitted.

C. The record supporting the entries for overhead construction costs shall be so kept as to show the total amount of each overhead for each year, the nature and amount of each overhead expenditure charged to each construction work order and to each utility plant account, and the bases of distribution of such costs.

5. *Gas plant purchased or sold.* A. When gas plant constituting an operating unit or system is acquired by purchase, merger, consolidation, liquidation, or otherwise, after the effective date of this system of accounts, the costs of acquisition, including expenses incidental thereto properly includible in gas plant, shall be charged to account 102, Gas Plant Purchased or Sold.

B. The accounting for the acquisition shall then be completed as follows:

(1) The original cost of plant, estimated if not known, shall be credited to account 102, Gas Plant Purchased or Sold, and concurrently charged to the appropriate gas plant in service accounts and to account 104, Gas Plant Leased to Others, account 105, Gas Plant Held for Future Use, 105.1, Production Properties Held for Future Use, and account 107, Construction Work in Progress—Gas, as appropriate.

(2) The depreciation, depletion, and amortization applicable to the original cost of the properties purchased, shall be charged to account 102, Gas Plant Purchased or Sold, and concurrently credited to the appropriate account for accumulated provision for depreciation, depletion or amortization.

(3) The cost to the utility of any property includible in account 121, Nonutility Property, shall be transferred thereto.

(4) The amount remaining in account 102, Gas Plant Purchased or Sold, shall then be closed to account 114, Gas Plant Acquisition Adjustments.

C. If property acquired in the purchase of an operating unit or system is in such physical condition when acquired that it is necessary substantially to rehabilitate it in order to bring the property up to the standards of the utility, the cost of such work, except replacements, shall be accounted for as a part of the purchase price of the property.

D. When any property acquired as an operating unit or system includes duplicate or other plant which will be retired by the accounting utility in the reconstruction of the acquired property or its consolidation with previously owned property, the proposed accounting for such property shall be presented to the Commission.

E. In connection with the acquisition of gas plant constituting an operating unit or system, the utility shall procure, if possible, all existing records relating to the property acquired, or certified copies thereof, and shall preserve such records in conformity with regulations or practices governing the preservation of records of its own construction.

F. When gas plant constituting an operating unit or system is sold, conveyed, or transferred to another by sale, merger, consolidation, or otherwise, the book cost of the property sold or transferred to another shall be credited to the appropriate utility plant accounts, including amounts carried in account 114, Gas Plant Acquisition Adjustments. The amounts (estimated if not known) carried with respect thereto in the accounts for accumulated provision for depreciation, depletion, and amortization and in account 252, Customer Advances for Construction, shall be charged to such accounts and the contra entries made to account 102, Gas Plant Purchased or Sold. Unless otherwise ordered by the Commission, the difference, if any, between (a) the net amount of debits and credits and (b) the consideration received for the property (less commissions and other expenses of making the sale) shall be included in account 421.1, Gain on Disposition of Property, or account 421.2, Loss on Disposition of Property. (See

**402 Maintenance expense.**

There shall be shown under this caption the total amount included in the gas maintenance expense accounts provided herein.

**403 Depreciation expense.**

A. This account shall include the amount of depreciation expense for all classes of depreciable gas plant in service except such depreciation expense as is chargeable to clearing accounts or to account 416, Costs and Expenses of Merchandising, Jobbing and Contract Work.

B. The utility shall keep such records of property and property retirements as will reflect the service life of property which has been retired and aid in estimating probable service life by mortality, turnover, or other appropriate methods; and also such records as will reflect the percentage of salvage and cost of removal for property retired from each account, or subdivision thereof, for depreciable gas plant.

NOTE A: Depreciation expense applicable to property included in account 104, Gas Plant Leased to Others, shall be charged to account 413, Expenses of Gas Plant Leased to Others.

NOTE B: Depreciation expense applicable to transportation equipment, shop equipment, tools, work equipment, power operated equipment and other general equipment may be charged to clearing accounts as necessary in order to obtain a proper distribution of expenses between construction and operation.

**403.1 Depreciation expense for asset retirement costs.**

This account shall include the depreciation expense for asset retirement costs included in gas utility plant in service.

**404.1 Amortization and depletion of producing natural gas land and land rights.**

A. This account shall include charges for amortization and depletion of producing natural gas land and land rights. (See account 111, Accumulated Provision for Amortization and Depletion of Gas Utility Plant).

B. The charges to this account shall be made in such manner as to distribute the cost of producing natural gas land and land rights over the period of their benefit to the utility, based upon the exhaustion of the natural gas deposits recoverable from such land and land rights.

**404.2 Amortization of underground storage land and land rights.**

A. This account shall include charges for amortization of land and land rights of underground storage projects for natural gas. (See account 111, Accumulated Provision for Amortization and Depletion of Gas Utility Plant.)

B. The charges to this account shall be made in such manner as to distribute the cost of amortizable land and land rights over the period of their benefit to the utility, and with respect to any land or land rights which include native gas in the storage reservoir, such amounts shall be amortized or depleted on the basis of production of such native gas after the volume of stored gas has been withdrawn from the reservoir.

**404.3 Amortization of other limited-term gas plant.**

This account shall include amortization charges applicable to amounts included in the gas plant accounts for limited-term franchises, licenses, patent rights limited-term interests in land, and expenditures on leased property where the service life of the improvements is terminable by action of the lease. The charges to this account shall be such as to distribute the book cost of each investment as evenly as may be over the period of its benefit to the utility. (See account 111, Accumulated Provision for Amortization and Depletion of Gas Utility Plant.)

**405 Amortization of other gas plant.**

A. When authorized by the Commission, this account shall include charges for amortization of intangible or other gas utility plant, which does not have a definite or terminable life and which is not subject to charges for depreciation expense.

B. This account shall be supported in such detail as to show the amortization applicable to each investment being amortized, together with the book cost of the investment and the period over which it is being written off.