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**

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

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Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities ("Liberty" or "Company") respectfully submits its Initial Brief in accordance with the Commission's *Order Amending Briefing Schedule* issued in this matter on September 19, 2014. This Initial Brief will address the remaining contested issues to be resolved by the Commission as identified in the *List of Issues*, *List And Order of Witnesses*, *Order of Opening Statements, and Order of Cross-Examination* filed by the Staff of the Commission ("Staff") on August 26, 2014.

I. INTRODUCTION

This is the first rate case for Liberty since the Commission authorized Liberty to purchase the Missouri assets of Atmos Energy Corporation ("Atmos") in Case No. GM-2012-0037. Since beginning operations in August 2012, Liberty has effectively stepped into the shoes of Atmos following the terms of the Stipulation and Agreement in that acquisition case.

The Company is engaged in the business of distributing and selling natural gas in the States of Missouri, Illinois and Iowa, serving approximately 85,000 customers. About 65% of those customers, or approximately 55,000, are located in Missouri. Liberty

Utilities' ultimate corporate parent, Algonquin Power and Utilities Corp. ("APUC"), is a Canadian corporation whose stock is traded on the Toronto Stock Exchange. Algonquin has two business units: (a) a power generation unit that owns or has interests in renewable energy facilities and thermal energy facilities representing more than 1100 MW of installed capacity, and (b) a utility services unit that owns and operates thirty regulated utilities located in ten states that provide retail water, sewer, electric and natural gas service.

On February 6, 2014, Liberty filed revised tariff sheets which set forth revised rate schedules and certain revised charges for all of Liberty's service territories in the state of Missouri, designed to produce an increase of approximately $7.6 million in revenues for the Company. Approximately $1.3 million of this amount is associated with the Company's Infrastructure System Replacement Surcharge ("ISRS") which has previously been approved. The ISRS will be reset to zero as a part of this case. Therefore, the Company is really requesting $6.3 million of new revenues in this case. This represents a 13% increase above test year revenues.

The timing of the rate case was due in part to the fact that Liberty agreed to a rate case moratorium in the acquisition case. That rate case moratorium ended on December 31 of last year. In addition, in order to continue its ISRS, the Company needed to file a general rate case no later than the middle of February of 2014. As a result, there was a short window of time between the rate case moratorium period and the time required by the ISRS statutes for the Company to file this general rate case.

As David Swain, the State President of Liberty, explains in his direct testimony, the Company is making substantial investments in furthering Liberty's local approach to management, service and support. As the Company explained to the Commission in the acquisition case, Liberty's philosophy is to emphasize local management and local customer service. (Ex. 1, Swain Direct, p. 7)

Liberty Utilities has constructed significant new facilities that will facilitate the Company's local emphasis in providing more responsive service to our customers. Such investments include accounting and billing software and the new regional headquarters in Jackson, Missouri as well as the continued investments in distribution facilities. (Ex. 1, Swain Direct, p. 9) Furthermore, the last rate case for Liberty's predecessor company included an updated period that ended on February 28, 2010, over four years ago.

While Liberty maintains a strong focus on cost control, it is not immune to increasing operating and maintenance expenses which need to be reflected in rates if the Company is to have an opportunity to earn a reasonable return on its investment. (*Id*.) Like other gas companies, Liberty has experienced declining revenues as the number of customers has declined and the existing customers have used less gas on a per capita basis as they weatherize their homes and use more efficient heating equipment.

The purpose of this case is to determine the just and reasonable rates after considering Liberty's significant investments and overall cost of service. The Commission should keep in mind as it reviews the competent and substantial evidence that Liberty has stepped into the shoes of Atmos, and followed the previous directives of the Commission as it began its operations in Missouri.

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?

The capital structure issue is an important real world financial issue since the use of hypothetical capital structure for ratemaking purposes may substantially affect the ability of the public utility to earn its authorized rate of return on investment. In practice, the capital structure should enable the Company to maintain or enhance its financial integrity, thereby enabling access to capital at competitive rates under a variety of economic and financial market conditions. (Ex. 5, Hevert Direct, p. 44) For example, if the equity ratio used for ratemaking purposes is lower than the actual equity ratio of the public utility, it may make it substantially more difficult for the public utility to earn its authorized return on equity.

The capital structure relates to financial risk, which is a function of the percentage of debt relative to equity (that relationship is often referred to as "financial leverage"). As the percentage of debt in the capital structure increases, so do the fixed obligations for the repayment of that debt and the risk that cash flows may not be sufficient to meet those obligations on a timely basis. Consequently, as the degree of financial leverage increases, the risk of financial distress (i.e. financial risk) also increases. Since the capital structure can affect the subject company's overall level of risk, it is an important consideration in establishing a just and reasonable rate of return. (Ex. 5, Hevert Direct, pp. 44-45)

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)

The Commission in the past has often used the actual capital structure of the public utility, or its ultimate parent when the ultimate parent is traded on the open market and is investment grade rated. *Report and Order*, pp. 11-17, Re Missouri Gas Energy, Case No. GR-2009-0355 (February 10, 2010); *Report and Order*, p. 26, Re: Kansas City Power & Light Company/KCP&L Greater Missouri Operations Company, Case Nos. ER-2012-0174/ER-2012-0175 (January 9, 2013); *Report and Order*, p. 63, Re Union Electric Company d/b/a Ameren Missouri, Case No. ER-2012-0166 (December 12, 2012).

COMPARISON OF CAPITAL STRUCTURES

The following table illustrates the various capital structures that will be discussed herein:

	Liberty Midstates	APUC	LUCo	Mean of Staff's Proxy Group[1]
Equity:	58.34%	57%	**______**	56.36%
Debt:	41.66%	43%	**______**	43.64%

[1] See Ex.6, Hevert Rebuttal, Schedule RBH-R21.

The Company's cost of capital expert, Mr. Robert Hevert, recommended the use of the actual capital structure of Liberty after he calculated the average capital structure for each of the proxy companies over the last eight fiscal quarters. As shown in Hevert's Schedule RBH-11, the proxy group average capital structure over that period includes a 56.40 percent equity ratio and 43.60 percent long-term debt ratio. (Ex. 5, Hevert Direct, pp. 44-45; Schedule RBH-11). After reviewing the proxy companies' capital structures, Mr. Hevert found the Company's actual capital structure to be appropriate for use in this rate case. (Ex. 5, Hevert Direct, pp. 45-46)

Staff, on the other hand, is recommending a dramatically different capital structure based upon a capital structure of Liberty Utilities Company ("LUCo"), the intermediary parent of Liberty:

LUCO Capital Structure

Equity:	**______**
Debt:	**______**

Staff's recommended capital structure is outside the range of capital structures of Staff's own proxy companies. Staff's proxy companies had equity ratios which ranged from 48.97 percent to 68.49 percent. (Ex. 6, Hevert Rebuttal, Schedule RBH-R21; Tr. 220). When compared to the proxy companies that Staff used for its cost of capital analysis, Staff's recommended equity ratio is more than **__________________________** than the lowest equity ratio of companies in Staff's proxy group of public utilities, and **____ ____** of the proxy companies. (Tr. 220)

Similarly, Staff's proxy companies had debt ratios which ranged from 51.03% to 31.51%. (Ex. 6NP, Hevert Rebuttal, Schedule RBH-R21; Tr. 221). When compared to the proxy companies that Staff used for its cost of capital analysis, Staff's recommended debt ratio is more than **______________________________** the highest debt ratio of companies in Staff's proxy group of public utilities, and **____** of the proxy companies. (Tr. 222)

As discussed below, Staff is recommending an ROE in the range of 8.20% to 9.20% with a midpoint of 8.70%. The highest end of Staff's range (before the credit rating adjustment of 0.38%) is lower than the lowest authorized rate of return on equity (i.e. 8.83%) issued by any regulatory agency in the last 34 years. (Tr. 193-94) LUCO's cost of debt associated with this capital structure is higher than the public utility's cost of debt. LUCO's cost of debt is **_____**. As explained below, the use of Staff's proposed capital structure and its stunningly low ROE recommendation will make it very difficult for the Company to actually earn a reasonable return on its investment.

Staff witness Zephania Marevangepo rejected the use of Liberty's actual capital structure because Liberty: (1) is not rated by credit rating agencies, (2) does not issue its own debt, and (3) does not issue its own equity. (Staff Ex. 13NP, p. 18; Marevangepo Rebuttal, pp.3- 4 ; Ex. 6, Hevert Rebuttal, p. 42)

Mr. Marevangepo's misgivings regarding the use of Liberty's actual capital structure are misplaced. 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)

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).

During the hearings, Mr. Marevangepo testified that if LUCo's capital structure had more equity, he would have still recommended it since it met Staff's criteria. (Tr. 218) Apparently, according to Staff, the Staff's capital structure recommendation is based upon Staff's criteria rather than the actual level of the equity or debt ratio:

> **____
> ____________________________________
> ____
> ____
> ____
> _______** (Tr. 231)

Nevertheless, Staff's direct report seems to imply that LUCo's equity ratio was only acceptable to Staff because it was lower than that of APUC. In Staff's Cost of Service Report (Ex. 13, p. 20), Staff stated:

> Staff did not audit all of the equity infusions APUC made into LUCo to determine whether these funds were raised through debt or equity capital issuances by APUC. If APUC's capital structure was more leveraged than LUCo's capital structure, then Staff would have been much more concerned about potential manipulation of LUCo's capital structure for purposes. Because APUC actually has a less leveraged capital structure than LUCo, Staff does not have this concern in this case.

Staff rejected the use of Liberty's actual capital structure because Liberty: (1) is not rated by credit rating agencies, (2) does not issue its own debt, and (3) does not issue its own equity. (Staff Ex. 13, pp. 18-19, Staff Ex. 31NP, Marevangepo Rebuttal, pp. 3-4 ; Ex. 6, Hevert Rebuttal, p. 42). Staff also "dismissed" APUC's capital structure for purposes of this case. (Staff Ex. 13, Staff Report Revenue Requirement, p. 21; Tr. 212) Instead, Staff chose to use LUCO's capital structure, despite the fact that LUCo does not issue its own equity (all equity comes from the parent, APUC) and therefore its capital structure does not meet the criteria that Staff used as a reason to reject Liberty's actual capital structure. The only capital structure that meets all of Staff's criteria is that of APUC.

Notwithstanding Staff's professed sole reliance upon its "criteria", Staff also dismissed the use of APUC's actual capital structure even though 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 public-traded and market tested. (Staff Ex. 13, Staff Report Revenue Requirement, p. 20).

Staff rejected the use of the APUC capital structure because "APUC is a Canadian corporation with largely diverse non-regulated operations primarily in Canada." (Staff Ex. 13, Staff Report Revenue Requirement, p. 20) In particular, Staff dismissed the APUC capital structure because "more than **__________** of APUC's consolidated cash flows were from non-regulated operations." (Staff Ex. 13, Staff Report Revenue Requirement, p. 21)

Mr. Hevert explained why Mr. Marevangepo's assertion that APUC's listing on the Toronto Stock Exchange and the size of its non-regulated operations make it an unsuitable benchmark for assessing the reasonableness of Liberty Utilities' capital structure, is misplaced:

> First, APUC's listing on the Toronto Stock Exchange does not invalidate its use as a benchmark to assess Liberty Utilities' capital structure. This is particularly true given that all of APUC's regulated operations and approximately 75.00 percent of its non-regulated operations are based in the United States. Second, APUC's non-regulated operations primarily consist of long-term contracted renewable energy generation and, therefore, would not be expected to substantially increase APUC's consolidated business risk profile. Moreover, APUC's 2013 Annual Report notes that over 88.00 percent of the non-regulated division's revenue is earned from large utility customers with BBB or better credit ratings.
>
> Contrary to Mr. Marevangepo's position, to the extent APUC's capital structure is consistent with the capital structures in place at the proxy group companies, it is a highly relevant benchmark. It is important to note, as Mr. Marevangepo states: "APUC is (1) the ultimate parent Company of Liberty Midstates and LUCo, (2) the primary basis for the rating that S&P assigns to LUCo, and (3) publicly–traded and market tested." (*footnotes omitted*)

(Ex. 6, Hevert Rebuttal, p. 43).

The Commission itself has utilized the ultimate parent's capital structure (58% equity) in a previous case involving a regulated water company, Algonquin Water

Resources of Missouri, Case No. WR-2006-0425. (Ex. 6, Hevert Rebuttal, p. 45). At that time, AWRM was a wholly owned subsidiary of the publicly-traded Algonquin Power Income Fund (traded on the Toronto Stock Exchange). In that case, the use of the ultimate parent company's capital structure was necessary because AWRM's actual capital structure was 100% equity. (*Id.*) (*Report & Order*, pp. 22-23, <u>Re: Algonquin Water Resources of Missouri, LLC</u>, Case No. WR-2006-0425 (March 13, 2007)

As Mr. Hevert explained in his Rebuttal Testimony, Staff's proposed capital structure would adversely affect the Company's financial integrity:

> Mr. Marevangepo's equity ratio recommendation of * * percent is substantially below both Liberty Utilities and APUC's current equity ratios. If the Commission were to adopt Staff's capital structure recommendation, it could place significant pressure on APUC's credit rating. S&P recently upgraded APUC and LUCo from * *, and DBRS currently rates APUC * *. Consequently, a one notch downgrade would place APUC at * * * *. Such a move could result in Liberty Utilities paying higher interest rates and cause investors to require a higher Cost of Equity for the Company.

In addition, during cross-examination, Staff witness Marevangepo was unable to verify that Liberty has access to the various debt instruments included in LUCo's capital structure. (Tr. 224-26) **

** (Tr. 229-30)

In conclusion, the equity ratio suggested by the Company is appropriate, but at a minimum, the Commission should utilize an equity ratio substantially higher than what Staff is recommending to reach a more balanced capital structure. If the Commission does not utilize the actual capital structure of the regulated public utility in this case, then a reasonable alternative that has slightly less equity and more debt would be to utilize the actual capital structure of the ultimate parent, APUC, which is 57% equity and 43% debt, as the Commission has done in the past.

An adequate capital structure is an important factor in maintaining access to financing. For utilities, which need to support large construction programs, consistent and reliable access to external capital is of paramount importance. As opposed to other industries, utilities do not have the option to avoid or defer many of their capital investments. As a practical matter, much of any utility capital investment program relates to replacement, is driven by reliability needs, or is mandated by law. In addition, many such capital investments (such as that related to replacement or reliability investments) do not directly generate incremental revenue or necessarily lower costs. Moreover, utilities must respond to external events such as storms, and their lack of geographic diversity can increase overall operating and business risk. Consequently, internally generated funds cannot be relied on as the only source of financing, and the maintenance of a credit profile that will enable capital access is extremely important. (Ex. 6, Hevert Rebuttal, p. 44).

For these reasons, the Company respectfully requests that the Commission utilize its actual capital structure, or in the alternative, the actual capital structure of APUC in this proceeding.

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 his 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?

<u>Return On Equity Determination</u>

In the wake of the continuing recovery from the Great Recession, with a slow but steady outlook for growth, the Commission must determine what return on equity ("ROE") will permit the Company to continue to attract capital and investors while balancing the concerns and interests of customers. The Commission must strike the appropriate balance with reference to a broad set of economic data and choose a point within the zone of reasonableness that reflects the risks faced by Liberty, a smaller than the average public utility contained in Staff's proxy group of companies. Such a point should also be consistent with ROEs determined by other regulatory utility commissions for comparable companies.

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 more detail below, 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) The Commission should reject Mr. Marevangepo's analysis and recommendations, as it has rejected other Staff ROE recommendations in the past.

Governing Legal Principles

As the Commission has recognized many times in the past, the United States Supreme Court established requirements for determining the reasonable rate of return in *Bluefield Waterworks & Improvement Co. v. Public Serv. Comm'n of West Virginia*, 262 U.S. 679, 692 (1923) ("*Bluefield*") and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) ("*Hope*"). In short, the fixing of "just and reasonable" rates involves a balancing of investor and consumer interests. *Hope,* 320 U.S. at 603. "What annual rate will constitute just compensation depends upon many circumstances, and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts." *Bluefield*, 262 U.S. at 692.

A reasonable rate of return is one that closely approximates the profits upon capital invested in other undertakings where the risk involved and other conditions are similar. *Bluefield*, 262 U.S. at 689-90. "A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties . . . ." *Bluefield*, 262 U.S. at 692.

A key concern in setting the appropriate return on common equity is that the return be reasonably sufficient to maintain the financial health of the utility, including attracting capital from investors for its operations. *Bluefield*, 262 U.S. at 693; *Hope*, 320 U.S. at 603. "The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield*, 262 U.S. at 693. As the *Hope* Court explained:

> [T]he investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

Hope, 320 U.S. at 603.

The *Bluefield* Court stressed this point, declaring:

> Investors take into account the result of past operations, especially in recent years, when determining the terms upon which they will invest in such an undertaking. Low, uncertain, or irregular income makes for low prices for the securities of the utility and higher rates of interest to be demanded by investors.

Bluefield, 262 U.S. at 694.

In *Bluefield*, the West Virginia Commission ordered a rate of return of 6%. The Supreme Court found that while a 6% rate of return had been reasonable in the recent past, the record in that case showed that the utility's rate of return had been suffering long before that rate case was brought. 262 U.S. at 695. With investors in mind, the Court held that a 6% rate of return "is substantially too low to constitute just compensation for the use of the property employed to render the service." *Id.* The Supreme Court, therefore, reversed the state appellate court that had affirmed the decision of the West Virginia Commission.

In the *Report & Order* in Re: Kansas City Power & Light Company, Case No. ER-2010-0355 (April 12, 2011), pp. 120-24, the Commission described its role in determining the return on equity as follows:

> 32. The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's Hope and Bluefield decisions. Pursuant to those decisions, returns for GPE's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of Hope and Bluefield unmistakably requires a comparative method, based on a quantification of risk.
>
> 33. Investor expectations are not the sole determiners of ROE under Hope and Bluefield; we must also look to the performance of other companies that are similar to KCP&L in terms of risk. Hope and Bluefield also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.
>
> 34. The Commission cannot simply find a rate of return on equity that is "correct"; a "correct" rate does not exist. However, there are some numbers that the Commission can use as guideposts in establishing an appropriate return on equity. The Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the national average." Nevertheless, the national average is an indicator of the capital market in which MGE will have to compete for necessary capital.
>
> 35. The Commission has described a "zone of reasonableness" extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations. Because the evidence shows the recent national average ROE for electric utilities is 10.34%, that "zone of reasonableness" for this case is 9.34% to 11.34%. (*footnotes omitted*)

The Commission should follow a similar approach for the establishment of Liberty's return on equity in this proceeding and adopt the recommendations of the Company related to cost of capital issues.

The Company's Recommendation: Witness Robert B. Hevert

Liberty witness Robert B. Hevert is a well-qualified economic and financial consultant who has provided testimony on strategic and financial matters before numerous state utility commissions and the Federal Energy Regulatory Commission (FERC) on approximately 100 occasions, often addressing the cost of capital issue. Mr. Hevert holds a Bachelor's degree in Business and Economics from the University of Delaware, and an MBA with a concentration in Finance from the University of Massachusetts; Mr. Hevert also holds the Chartered Financial Analyst designation. He has worked in regulated industries for over twenty-five years, having served as an executive and manager with consulting firms, a financial officer with a publicly-traded natural gas utility (at the time, Bay State Gas Company), and an analyst at a telecommunications utility. He has advised numerous energy and utility clients on a wide range of financial and economic issues, including corporate and asset-based transactions, asset and enterprise valuation, transaction due diligence, and strategic matters. A summary of Mr. Hevert's professional and educational background, including an extensive list of testimony in prior proceedings, is included in Attachment A to his Direct Testimony. (Liberty Ex 5, Hevert Direct, pp. 1-2; Attachment A, Page A-1 through Page A-13).

To develop his cost of equity recommendation, Mr. Hevert conducted several standard analyses – quarterly growth discounted cash flow (DCF), constant growth DCF analyses, multi-stage DCF analyses, a capital asset pricing model (CAPM) analysis, and a Bond Yield Plus Risk Premium analysis. (Ex. 5, Hevert Direct, pp. 3-4; 9-34)

Mr. Hevert updated his analyses in his rebuttal testimony to take into account changing capital market conditions, and he applied his analyses to a proxy group that was the same as Staff's proxy group with one additional company.[2] (Ex. 6, Hevert Rebuttal, pp. 9-10) The results of Mr. Hevert's analyses, set forth on Tables 6, 7 and 8 of his rebuttal testimony, support his recommended ROE range of 10.0% to 10.5%, and his ROE point recommendation of 10.5%. (Ex. 6, Hevert Rebuttal, pp. 47-50):

Table 6: Summary of DCF Model Results[3]

	Mean Low	***Mean***	***Mean High***
Quarterly Growth DCF Results			
30-Day Average	7.81%	9.17%	10.98%
90-Day Average	7.92%	9.29%	11.10%
180-Day Average	8.01%	9.38%	11.19%
Constant Growth DCF Results			
30-Day Average	7.69%	9.02%	10.77%
90-Day Average	7.80%	9.13%	10.88%
180-Day Average	7.88%	9.21%	10.96%
Multi-Stage DCF Results			
30-Day Average	9.30%	9.62%	10.08%
90-Day Average	9.41%	9.74%	10.21%
180-Day Average	9.49%	9.83%	10.31%

[2] Staff did not include South Jersey Industries in its proxy group because less than two analyst long-term earnings per share growth estimates were available. (Liberty Ex. 6, Hevert Rebuttal, pp. 9-10)
[3] DCF results presented in Table 6 are unadjusted (*i.e.*, prior to any adjustment for flotation costs).

Table 7: Summary of CAPM Results

	Bloomberg Derived Market Risk Premium	*Value Line Derived Market Risk Premium*
Average Calculated Beta Coefficient		
Current 30-Year Treasury (3.40%)	11.36%	10.84%
Near Term Projected 30-Year Treasury (3.95%)	11.91%	11.39%
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.40%)	11.19%	10.69%
Near Term Projected 30-Year Treasury (3.95%)	11.74%	11.23%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.40%)	10.97%	10.48%
Near Term Projected 30-Year Treasury (3.95%)	11.52%	11.03%

Table 8: Summary of Bond Yield Risk Premium Results

Treasury Yield	**Return on Equity**
Current 30-Year Treasury (3.40%)	10.08%
Near Term Projected 30-Year Treasury (3.95%)	10.20%
Long Term Projected 30-Year Treasury (5.45%)	10.77%

Finally, Mr. Hevert compared Liberty to the proxy group of companies based on the following factors: (1) the relatively small size of Liberty; and (2) flotation costs. (Ex. 5, Hevert Direct, pp. 34-37) Mr. Hevert found that Liberty is significantly smaller than the proxy group, both in terms of number of customers and annual revenues. Rather than proposing a specific premium to account for Liberty's relatively small size, Mr. Hevert considered the small size of Liberty in his assessment of business risks in order to determine where, within a reasonable range of returns, Liberty's required ROE appropriately falls. In that regard, Mr. Hevert concluded that

"Liberty Utilities' comparatively small size further supports my conclusion that an ROE at the upper end of my recommended range is reasonable." (Ex. 5, Hevert Direct, p. 35) With regard to floatation costs, Mr. Hevert found that an adjustment of 0.15 percent (i.e., 15 basis points) reasonably represents floatation costs for the Company. However, rather than making this adjustment for floatation costs, Mr. Hevert considered the effect of floatation costs, in addition to the Company's other business risks, in determining where the Company's ROE falls within the range of results. (Ex. 5, Hevert Direct, pp. 36-37)

Based upon this analysis, Mr. Hevert concluded that the reasonable range of ROE estimates is from 10.00 percent to 10.50 percent, and within that range 10.50 percent is a reasonable and appropriate estimate of the Company's Cost of Equity. (Ex. 6, Hevert Rebuttal, p. 50)

Staff's Recommendation: Witness Zephania Marevangepo

Zephania Marevangepo is the Utility Auditor II of the Financial Analysis Unit of the Staff. He holds a Bachelor of Science degree in business administration from Columbia College, and a MBA with an emphasis in Accounting from Lincoln University in Jefferson City. During his MBA studies, Mr. Marevangepo took two (2) courses in finance consisting of six (6) credit hours. (Tr. 182)

Prior to his employment with the Commission Staff, he was employed at ABB, the electric transformer manufacturer, in Jefferson City, Missouri. (Tr. 182-83) He has worked on the Commission Staff since 2008. He has filed testimony before the Commission in nine proceedings. (Staff Ex. 13, Staff Cost of Service Report at Appendix 1 at 22-23) Prior to this case, Mr. Marevangepo has been cross-examined on one occasion on cost of capital and rate of return issues in a proceeding involving the Emerald Pointe Water & Sewer Company, a small water and sewer company with approximately 400 customers. (Tr. 184)

In contrast to the extensive experience of the Company's witness, Mr. Marevangepo's work experience is more limited. He has never worked for another regulatory commission, public utility, or financial institution. Nor has he ever advised any clients other than the staff on financial or economic issues. (Tr. 182-83)

In this proceeding, Mr. Marevangepo testified that "Staff believes the cost of equity for regulated natural gas utilities is somewhere between 7 to 8 percent range. . ." (Staff Ex. 32, Marevangepo Surrebuttal, p. 15) However, he quickly walked away from this range, and instead recommended an ROE range of 8.2% to 9.2%, which is still substantially below the returns allowed for other similarly situated utilities by this Commission, as well as other public utility commissions. (Staff Ex. 13, Staff Cost of Service Report, p. 35)

Mr. Marevangepo's analysis produced DCF results ranging from 7.80 percent to 8.80 percent. (Staff Ex. 13NP, Cost of Service Report, p. 31 and Appendix 2, Schedule 11). Not only is Mr. Marevangepo's highest DCF result 89 basis points below the average authorized ROE for natural gas utilities since the beginning of 2013, there has not been a single case in which an ROE as low as 8.80 percent (the high end of Mr. Marevangepo's DCF range) was authorized for a gas utility since at least 1980. (Ex. 6, Hevert Rebuttal, p. 11 and Schedule RBH-R23; Tr. 193) In order to move his range to a higher level, Mr. Marevangepo added 0.38% to his DCF range to reflect the fact that **________________________** than Staff's proxy group of public utilities. (Tr. 185-86)

Staff's low DCF results are largely explained by (1) the growth rates that Mr. Marevangepo has applied in his analysis, and (2) his failure to consider the results of a multi-stage DCF model which may better reflect investor expectations in the current economic environment. (Ex. 6, Hevert Rebuttal, p. 11)

<u>Growth Rates</u>

In his DCF analysis, Mr. Hevert used the maximum 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. Heverty 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 ("BBPS") 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's 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, this position is not credible either. 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) During cross-examination, Mr. Marevangepo conceded that 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.

In his rebuttal testimony, Mr. Hevert summarized the differences in approach between the Company and Staff related to the selection and application of growth rates in DCF analyses:

> My Quarterly DCF, Constant Growth DCF and the first-stage of my 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 my 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 my Direct Testimony, it is my view that forward-looking earnings growth estimates are the relevant measure of growth. While I agree that it is reasonable to assume that gas distribution utilities' earnings will generally grow at the same rate as GDP over the long-term, I disagree with Mr. Marevangepo's application of a growth rate constrained to GDP growth in the near and medium-terms. In that regard, if Mr. Marevangepo is concerned that near-term analyst earnings estimates do not appropriately reflect investor's long-term growth expectations, it would have been appropriate for him to consider a multi-stage form of the DCF model, as I have.
>
> In addition, I believe the GDP growth estimates Mr. Marevangepo relies on do not have sufficiently long time horizons. It is important to remember that, as Mr. Marevangepo notes, "the constant growth rate is assumed to last in perpetuity." Quite simply, the term of even the longest GDP forecast considered by Mr. Marevangepo does not reflect the perpetual nature of the terminal growth assumed in the DCF

model. (*footnote omitted*)

Mr. Hevert also disagreed with Mr. Marevangepo's position that dividend or book value growth rates are appropriate inputs to the DCF model. Earnings are the fundamental driver of a company's ability to pay dividends and there is substantial academic research that indicates earnings growth rates are the appropriate growth measure for estimating equity returns using the DCF model. Given that investors tend to value common equity on the basis of P/E ratios, the required return on equity is a function of the long-term growth in earnings, not dividends or book value. (Ex. 6, Hevert Rebuttal, pp. 13-14)

With regard to Staff's long-term growth estimates of GDP growth, Mr. Marevangepo has again low-balled his estimate. The long-term geometric average of nominal GDP growth from 1929 to 2013 was 6.23 percent, and arithmetic average was 6.47 percent. Those observed growth rates are as much as 147 basis points above the high end of the 4.00 percent to 5.00 percent growth rate range on which Mr. Marevangepo relies as a measure of long-term expected growth. (Ex. 6, Hevert Rebuttal, p. 17) As Mr. Hevert pointed out, Mr. Marevangepo's long-term growth projections can be assessed in the context of authorized ROEs. The average authorized natural gas ROE since the beginning of 2013 for natural gas utilities was 9.69 percent. In the context of the Constant Growth DCF model, the return includes income from dividends and expected growth. Assuming Staff's proxy group average dividend yield of 3.78 percent as the average industry dividend yield, the average reported authorized ROE of 9.69 percent would imply an expected long-term growth rate of 5.91 percent. (Ex. 6, Hevert Rebuttal, p. 19)

In his rebuttal testimony, Mr. Marvangepo asserted that:

> Staff unreservedly notes that Robert Hevert's growth rates diametrically contradict the reality of practical investment assumptions made by investors and investment advisors in regulated utilities. 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. , Marevangepo Rebuttal, p. 12)

Mr. Marevangepo provided no specific references that can be reviewed and assessed. For example, it is unclear whether the growth rates referred to by Mr. Marevangepo are real or nominal growth rates.

Mr. Hevert explained the fallacy of Staff's assertion on this point:

> Mr. Marevangepo is conflating discount rates developed for the purpose of mergers and acquisitions or asset valuations with the Cost of Equity of an equity market investor. The former may reflect a valuation premium associated with the benefit of gaining a controlling interest in a company (often referred to as a "control premium") which would not be reflected in an individual equity investors' required return. Consequently, the fair value of a company to a prospective buyer purchasing the entire company will often be higher than the market value to minority investors in the subject company's debt and equity. . . (Ex. 7, Hevert Surrebuttal, p. 22)

The Commission reviewed a similar allegation in a recent Ameren Missouri rate case, and found that Staff reliance on such information was misplaced:

> In an effort to support his low recommended return on equity, (Staff witness) Murray points to various valuation analyses regarding Ameren Missouri done by financial analysts for purposes other than the establishment of rates. Murray reports that in general, experts in the field of asset valuation consistently apply a much lower cost of equity to cash flows generated from regulated utility operations as compared to the estimates of cost of equity from rate of return witnesses in the utility ratemaking process. Murray's clear implication is that aside from him, all other rate of return witnesses are getting it wrong.

> Murray's reliance on valuation analyses to support the reasonableness of his return on equity recommendation is misplaced. Murray acknowledged that he has no experience in asset valuation. In his surrebuttal testimony, Robert Hevert explained in great detail why the valuation analyses cited by Staff are different than the analysis necessary to evaluate a reasonable return on equity in the rate making process. The Commission is persuaded by that explanation and accepts Mr. Hevert's explanation without repeating his arguments.
>
> *Report & Order*, pp. 69-70, Re Union Electric Company d/b/a Ameren Missouri, Case No. ER-2011-0028 (July 13, 2011)(footnotes omitted)

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.

Multi-Stage DCF Model

Staff's analysis is also less credible than Liberty's evidence since Mr. Marevangepo has not performed a Multi-Stage DCF analysis. (Staff Ex. 13NP, Cost of Service Report, p. 7, fn 1) As Mr. Hevert explained in his rebuttal testimony, the Multi-Stage DCF model enables the analyst to address the sometimes limiting assumption that companies may increase or decrease capital spending levels over time, or transition from current payout levels to long-term expected payout levels. (Ex. 6, Hevert Rebuttal, p. 25) Mr. Hevert's 180-day average Multi-Stage DCF model indicates the cost of equity is 9.49% to 10.31%.

ROEs Authorized by Other Public Utility Commissions

This Commission has always compared its ROE analysis with those of other commissions to make certain that it was not out of the mainstream. Although it does not "slavishly follow the national average in awarding a return on equity"[4] or "unthinkingly mirror the national average,"[5] the Commission has concluded that "the national average is an indicator of the capital market" in which a utility "will have to compete for necessary capital." See *Report and Order,* Re Kansas City Power & Light Co., p. 122, Case No. ER-2010-0355 (Apr. 12, 2011); *Report and Order*, Re KCP&L Greater Mo. Operations Co., p. 148, Case No. ER-2010- 0356 (May 4, 2011).

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, (Staff 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 , Hevert Direct, Schedule RBH-R19, p. 14)

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[4] *Report And Order*, p. 67, In re Union Elec. Co., Case No. ER-2011-0028 (July 13, 2011).
[5] *Report And Order*, p. 19, Re Missouri Gas Energy, Case No. GR-2004-0209 (September 21, 2004).

The Commission generally sets the zone of reasonableness at 100 basis points above and below the national average ROE authorized for similarly-situated utilities. See *State ex rel. Public Counsel v. PSC*, 274 S.W.3d 569, 574 (Mo. App. W.D. 2009). This methodology for setting the zone of reasonableness was upheld by the Missouri Court of Appeals as recently as 2012, holding as reasonable an ROE that "falls within the zone of reasonableness for returns on equity based on the national average authorized return on equity for gas utilities." *State ex rel. Office of the Public Counsel v. PSC*, 367 S.W.3d 91, 110-11 (Mo. App. S.D. 2012).

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

In this proceeding, the Staff is recommending "**________________________ __________________** revenues and/or "**________________________**" for three long standing contract customers of Liberty and its predecessor Atmos: (1) Noranda Aluminum, (2) General Mills, and (3) SourceGas (formerly known as Associated Natural Gas Company)(Staff Ex. 13HC, Staff Cost of Service Report, pp. 52 and 55; Tr. 512).

Staff is proposing to make revenue **____________** or otherwise to **____________________** to the Company in the customers in the following amounts:

Noranda **__________** (Tr. 303)

General Mills **________** (Staff Ex. 13HC, Staff COS Report, pp. 54)

SourceGas **_______** (Staff Reconciliation HC)

Total **__________**

For the reasons stated below, the Commission should reject Staff's proposed revenue adjustments related to these customers.

<u>NORANDA AND GENERAL MILLS CONTRACTS</u>

According to the *Staff Position Statement*, Staff is recommending that "The Commission should use the rate which has been authorized and approved by the Commission, i.e., the tariff rate which was approved by the Commission in the last rate case." (Staff Position Statement, p. 4) Staff is arguing 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, and have been in effect for more than 10 years in the case of Noranda, and more than eight years in the case of General Mills. Staff's singular justification for its recommendation is that **____** (Staff Ex. 13HC, Staff Cost of Service Report, p. 54, lines 22-23)

The Staff Position Statement also indicates that "Staff believes that whether or not Liberty should be authorized to continue providing service to select customers pursuant to special contracts is a policy decision for the Commission." (*Staff Position Statement*, pp. 3-4)

Staff's position should be summarily rejected by the Commission because (1) Liberty was required by previous Commission orders to charge Noranda and General Mills the exact rates that the Company charged these customers during the test year; (2) Staff, Public Counsel and Noranda agreed the rates charged to Noranda and General Mills during the test year were appropriate in a previous stipulation and agreement; (3) Staff's proposed revenue imputation would cause immediate financial harm to the Company; (4) approving Staff's proposed revenue imputation or revenue adjustments would create disincentives for future special contracts that would otherwise benefit the Company and its customers; and (5) approving the Staff's proposed imputation of revenue adjustments would send the wrong price signal to the Company's contract customers. (Ex. 3NP, Krygier Rebuttal, pp. 2-9)

Company witness Christopher D. Krygier explained in his rebuttal testimony that the genesis of the Noranda Contract predates when Atmos operated the SEMO system. Atmos' predecessor, Associated Natural Gas Company was the original public utility that entered into a contract with Noranda in the late 1990s. Liberty 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.

Similarly, for the General Mills contract, Liberty 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 from PEPL's pipeline facilities. As explained by Mr. Krygier, Liberty continues to believe that it is necessary to offer this customer a reduced rate in an effort to prevent bypass and retain its business. (Ex. 3NP, Krygier Rebuttal, p. 9)

POLICY ISSUE

During the hearings, it was sometimes difficult to discern the position that Staff is now espousing related to the special contract issue. According to Staff witness Kim Cox, the policy issue before the Commission is whether Liberty should be allowed to enter into special contracts with its customers at all. (Tr. 314) Given the widespread use of special contracts throughout the gas and electric industries in Missouri, it would be remarkable for the Commission to prohibit Liberty from entering into special contracts while allowing other regulated public utilities to do so.

During cross-examination, Ms. Cox also testified that she did not know if Staff wants the Commission to set a policy related to special contracts in this case. (Tr. 322) She did not know if the Staff wanted the "policy" related to special contracts to apply to (1) Liberty only; (2) other gas utilities; (3) electric utilities; or (4) be a policy of general applicability throughout the state. (Tr. 321-24) She also did not know if the Staff opposes the use of special contracts by other gas or electric companies. (Tr. 325)

Finally, she clarified that the main policy issue was whether Liberty should have a tariff related to special contracts, not whether Liberty should be permitted to have special contracts at all. (Tr. 326)

Liberty believes that this rate case proceeding is not the appropriate case to establish a new generic policy for special contracts for Liberty and other public utilities. If a new policy is necessary or desirable, it should be considered in a rulemaking proceeding in which all regulated companies would be given notice of the Commission's proposed rule, and given the opportunity to comment and participate in the proceeding.

APPROPRIATE RATES DURING THE TEST YEAR

Staff's position regarding the appropriate rates that should have been charged by Liberty during the test year was also difficult to discern during the hearings. In its direct case, Staff recommended that the Commission adopt the revenue adjustments discussed above that represent the revenue difference between the rates contained in the Noranda and General Mills contracts and the rates contained in the standard Large Transportation tariffs. (Staff Ex. 13HC, Staff Cost of Service Report, p. 54) Staff also argued in its *Position Statement* that the Commission should use the full-tariffed rate which was approved by the Commission in the last rate case in calculating Liberty's revenues from Noranda and General Mills. (*Staff Position Statement*, p. 4).

During the hearings, Staff's position became "muddled" (Tr. 620-21) regarding what rate Staff believes Liberty should have charged Noranda or General Mills during the test year. According to the *Staff Position Statement*, the full-tariffed rate should be used to calculate the revenues for Noranda and General Mills. (*Staff Position Statement*, p. 4) However, during cross-examination, Staff witness Kim Cox testified that Staff did not believe that Liberty should have charged Noranda and General Mills the full-tariffed rate on the first day that Liberty began operating the Missouri districts (Tr. 378):

> **Q. Let me ask you the question again.
> What does Staff believe that Liberty should have
> done with Noranda when it began operating the Atmos
> system with regard to the Noranda contract?**
>
> A. Again, I believe they should have
> filed a tariff, because at that time they're
> stating they weren't negotiated sales customers.
>
> **Q. Well, does Staff believe that Liberty
> should have begun charging Noranda the full rate on
> the first day that Liberty began operating the SEMO
> district?**
>
> A. No.
>
> **Q. Does Staff believe that Liberty
> should have begun charging General Mills the full
> tariffed rate on the first day that Liberty began
> operating the NEMO district?**
>
> A. No. Staff believes that a tariff
> should have been filed in order to provide that
> discounted rate.

As previously mentioned, since Liberty stepped into the shoes of Atmos when it began operating the Missouri properties in August, 2012, Liberty was required by previous Commission orders to charge Noranda and General Mills the exact rates that the Company charged these customers during the test year. In addition, Staff, Public Counsel and Noranda had agreed that the rates charged to Noranda and General Mills during the test year were appropriate in a previous stipulation and agreement. It is inappropriate for Staff and Public Counsel to now allege that those rates were not reasonable, given that

Staff and Public Counsel both supported the use of those rates in a previous stipulation and agreement.

In a previous Atmos rate case, Staff had recommended revenue imputation adjustments for Noranda and General Mills, but ultimately the settlement in the last Atmos rate case explicitly stated that there would be no imputation of revenues for Noranda or General Mills. In the *Unanimous Stipulation and Agreement*, p. 3, Case No. GR-2010-0192 (filed August 11, 2010), Atmos, Staff, Public Counsel, and Noranda entered into the following agreement:

> 7. Special Contracts. The Signatories agree that revenues associated with special contracts shall not be imputed in this case. The Signatories agree that Atmos shall offer to extend the special contracts of Noranda and General Mills to expire on the effective date of rates approved in Atmos's next general rate case. The rates for such extended period shall be those in effect at the end of the respective contract's original term. This paragraph shall not be construed to limit the ability of Atmos and Special Contract customers: i) to accept alternative mutually agreeable contract provisions, or ii) to enter into alternative mutually agreeable contracts for service."

Under this Stipulation And Agreement ("Agreement"), the Signatories, including the Staff and Public Counsel, agreed that the revenues associated with the Noranda and General Mills contracts should not be imputed. Second, the Signatories, including Staff and Public Counsel, agreed that Atmos should be required to extend the special contracts of Noranda and General Mills to expire on the effective date of rates approved in Atmos's next general rate case. Third, the Signatories, including Staff and Public Counsel, specified the rates that should be used in the Noranda and General Mills Contracts. According to the Agreement with Staff and Public Counsel, Atmos was required to extend those contracts and use the same rates that were in effect at the end of the respective contract's original term. (Tr. 362)

The Agreement to use these specific rates in the Noranda and General Mills contracts was not discretionary with Atmos. The rate provisions were mandatory, and agreed to by Atmos, Staff, Public Counsel, and Noranda. (Tr. 364) Staff witness Kim Cox conceded that Staff agreed that the rates included in the Noranda and General Mills contracts shall be the same rates that existed in the Noranda and General Mills contracts at the end of the term of those respective contracts. (Tr. 363) She also expressed her opinion that Staff "always proposes just and reasonable rates and if they felt there was an issue, they would have brought it up." (Tr. 364)

This Agreement among Atmos, Staff, Public Counsel, and Noranda was also approved by the Commission itself. (Tr. 361) In its *Order Approving Stipulation and Agreement*, the Commission specifically incorporated all of the provisions of the agreement related to the Noranda and General Mills contracts, including the agreement that specific rates should be charged to Noranda and General Mills. (Tr. 361) Approving the Agreement, the Commission stated:

> The Commission has compared the substantial and competent evidence on the whole record with the Agreement as to both rate adjustment and rate design. <u>The Commission independently finds and concludes that Atmos has met its burden of proof that the rates proposed in the Agreement are just and reasonable rates. Additionally, upon review of the record and the Agreement, the Commission independently finds and concludes that the Agreement's proposed terms support safe and adequate service</u>. (*emphasis added*)

When Liberty began operating the Missouri gas properties of Atmos in August 2012, it effectively stepped into the shoes of Atmos, and Liberty was bound by agreements made by Atmos in previous stipulations before the Missouri Commission. In the *Unanimous Stipulation And Agreement*, p. 3, Case No. GM-2012-0037, the Signatories, including Staff and Public Counsel, specifically addressed Liberty's obligations with regard to previous Atmos Stipulations:

> 8. Adherence to Previous Commission Orders and Stipulations and Agreements
>
> Liberty-Midstates shall comply with all requirements resulting from all Commission Approved stipulation and agreements and Commission Orders in all cases applicable to Atmos, which are still in force, from the effective date of the Commission's Order approving Atmos' acquisition of Greeley Gas Company in Case No. GM-94-6. . .

The *Unanimous Stipulation And Agreement* was also approved by the Commission in its *Order Approving Unanimous Stipulation and Agreement*, Case No. GM-2012-0037 (issued March 14, 2012)

In the *Staff Memorandum In Support of the Unanimous Stipulation and Agreement* in Case No. GM-2012-0037, Staff counsel Bob Berlin explained this provision as follows:

> 16. Adherence to Previous Commission Orders and Stipulations and Agreements:
>
> This condition puts Liberty in the shoes of Atmos with respect to previous Commission orders and stipulations and agreements and it reinforces compliance with the Commission's Cold Weather Rule, Gas Safety rules and Affiliate Transactions rules.

During the test year, 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 that were in the Atmos contracts with these large customers. (Tr. 361) In reality, Liberty charged the same rates that Staff and Public Counsel required to be used for these customers. (*Id*.)

Yet, now in this case, Staff and Public Counsel are arguing that those rates which they required Atmos and now Liberty to use were not appropriate and reasonable. Instead, Staff is arguing it was Liberty's choice to discount the rate (Staff Ex. 23NP, Cox Surrebuttal, p. 3) and that this agreed upon rate should have been substantially higher than the rate they required the Company to use.

The incongruity of Staff's position was succinctly captured in Commissioner Hall's questions of the Staff witness Cox:

> **Q. Is there any question as to whether or not Liberty violated the law, the tariff or a Commission order when it charged the discounted special contract rate during the 2013 test year?**
>
> A. I believe without them having a tariff, they did violate. They chose to offer a discounted rate to Noranda without having a tariff that allowed them to do so.
>
> **Q. And that is your position even though there is a Commission order that in my view specifically allows that contract rate?**
>
> A. Yes.
>
> **Q. I find that astounding. . .** (Tr. 398)

In summary, the competent and substantial evidence demonstrates that Liberty charged Noranda and General Mills the appropriate rates during the test year. The Commission should therefore reject the Staff's position that a revenue adjustment is appropriate in this proceeding related to the Noranda and General Mills contracts.

TARIFF ISSUES

In the *Unanimous Stipulation and Agreement* signed by Staff and Public Counsel in Case No. GM-2012-0037, p. 8, there was also a provision that required Liberty to adopt the Atmos tariff verbatim upon closing of the Atmos/Liberty transaction:

> 9. Tariffs
>
> Atmos has Commission approved tariffs. Liberty-Midstates shall formally adopt in whole Atmos' tariffs verbatim upon the closing of the transaction. These tariffs shall remain in effect until changed by Order of the Commission or by operation of law.

Pursuant to the agreement with Staff and Public Counsel in Case No. GM-2012-0037, Liberty filed its Adoption Notice on July 2, 2012 which stated in part:

> In accordance with the terms of said Stipulation and Order, Liberty Energy (Midstates) Corp. d/b/a Liberty Utilities hereby adopts, ratifies and makes its own, in every respect as if the same had been originally filed by it, all tariffs filed with the Public Service Commission, State of Missouri, by or adopted by Atmos Energy Corporation, currently on file with and approved by the Commission. (Liberty Original Adoption Notice, Effective August 1, 2012)

In this proceeding, Staff has recommended that the Company include tariff language similar to other public utilities which would specifically authorize the use of special contracts. (Staff Ex. 13NP, Staff Cost of Service Report, p. 5; Staff Ex.28; Imhoff Direct NP, p. 5) Having stepped into the shoes of Atmos, the Company believes it has been authorized to continue to honor the terms of the Noranda and General Mills Contracts.

Liberty's current tariffs include a Negotiated Gas Sales Service for Service under this rate schedule is available to those Customers who qualify for service under the LARGE FIRM GENERAL SERVICE, INTERRUPTIBLE LARGE VOLUME

GAS SERVICE, or TRANSPORTATION SERVICE tariff sheets and who have entered into a written contract with the Company under this rate schedule in order to retain an alternative fuel Customer. The tariff sheet includes a minimum rate of $0.0035 per Ccf. (Liberty Tariff Sheet No. 35)

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).

Staff witness David M. Sommerer has suggested that the new tariff should not replace the existing Negotiated Gas Sales Service tariff, but instead adopt a tariff that specifically is designed to deal with transportation service bypass issues. (Staff Ex. 39NP, Sommerer Surrebuttal, p. 10) The Company is not opposed to the approval of an additional tariff sheet that might be entitled: "Contract Rates". However, Liberty would recommend that the following language should be include the tariff:

AVAILABILITY:

> Service under this rate schedule is available to those Customers who certify to the Company (in a form acceptable to the Company), and the Company is convinced that: (i) Liberty Utilities faces bypass by an intrastate or interstate upstream pipeline; and (ii) without the Company's lowering the Distribution Commodity Rate for Transportation Service, the Customer will bypass Liberty Utilities.

NEGOTIATED GAS SERVICE RATES:

> Company may, in instances where it faces bypass from interstate or intrastate pipelines, enter into special transportation rate contracts with

> industrials or other large consumers on such terms and conditions as may be agreed upon by the parties and which, in the Company's sole discretion, are deemed necessary to retain services to an existing customer or, to reestablish service to a previous customer or to acquire new customers. The rates agreed upon by Company and customer shall not exceed the maximum Distribution Commodity Rate for Transportation Service nor be less than 1.0¢ per Ccf (the "Flexed Distribution Commodity Rate").
>
> The right to charge a Flexed Distribution Commodity Rate shall be exercised on a case-by-case basis at the discretion of the Company without Commission approval.
>
> All executed contracts shall be furnished to the Commission staff and the Office of Public Counsel and shall be subject to the Commission's jurisdiction. Ratemaking treatment of any Flexed Distribution Commodity Rate will be reviewed and considered by the Commission in subsequent rate proceedings.
> Rules and Regulations.
>
> Service will be rendered in accordance with the Company's Rules and Regulations for Gas Service on file with the Missouri Public Service Commission.

(Ex. 3NP, Krygier Rebuttal, pp. 4-5; Schedule CDK-R-7).

COMMISSIONER HALL'S REQUESTS FOR BRIEFING

During the hearings, Commissioner Hall inquired of counsel about the authority of Noranda or General Mills to bypass the local distribution network without approval from the Missouri Public Service Commission. (Tr. 139, 115) Counsel for the Company and Staff both replied that they believed that no state authority would be required. (Tr. 115, 139). This understanding is confirmed by the holding of the United States Court of Appeals (Tenth Circuit) in *Cascade Natural Gas Corporation v. Federal Energy Regulatory Commission*, 955 F.2d 1412 (1992) where the court held that allowing interstate pipeline to construct tap and meter facilities to deliver natural gas directly to two industrial customers came within the jurisdiction of the FERC, and the state utility commission did not have concurrent jurisdiction.

Commissioner Hall also inquired regarding what the Commission should do in the event that the Commission found that the rate charged Noranda and General Mills during 2013 was appropriate. (Tr. 620). As Liberty has stated above, in the event the Commission finds and concludes that Liberty charged Noranda and General Mills the appropriate rates during the test year (which it should), then the Commission should reject Staff's proposed revenue imputation adjustments.

Liberty has also exercised its authority under the *Unanimous Stipulation and Agreement* in Case No. GR-2010-0192 "to enter into alternative mutually agreeable contracts for service" with Noranda. The Noranda Contract is attached to the Rebuttal Testimony of Christopher D. Krygier, Schedule CDK-R6 HC which would become effective as of the date of new rates and tariffs in this proceeding. **______________

____

_______________** (*Id*. at 2)

The Commission has continuing jurisdiction and authority to review such contracts, and may do so in the future. As a part of the *Revised Second Unanimous Stipulation And Agreement* filed in this proceeding on September 10, 2014, Liberty has committed to perform a class cost of service study and file it as part of its next rate case. The Commission has the authority to review the rates of all customers, including special contract customers, in light of the results of the Company's Class Cost of Service Study in the next rate case.

The competent and substantial evidence in this proceeding supports the continuation of the existing rate for Noranda. 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)

If the Commission rejected the use of special contracts for Noranda and General Mills in this proceeding, and required the charging of the full tariff rates, the bills for these special contract customers would increase by **____** (Tr. 333, 275) Staff witness Cox testified that she expected that **____** (Tr. 342-43) Such a result would not be in the public interest and would adversely affect the Company's remaining customers.

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

A new revenue imputation adjustment that is being proposed for the first time in this case by Staff involves an interstate transportation service a version of which has been provided to SourceGas for many years by Atmos. (Tr. 532, 536) The Staff is proposing to impute **________** of hypothetical revenue related to this interstate service in this case. (Ex. 12HC, DaFonte Rebuttal, p. 5) Currently, SourceGas pays approximately **______________** for this interstate service. (Ex. 12HC, DaFonte Rebuttal, p. 10)

If the Commission adopted Staff's approach and concluded that Liberty should be charging SourceGas the full tariffed interstate rate, **__________________________

____

____

____

____** (Ex. 12HC, DaFonte Rebuttal, pp. 10-11) Of course, if Liberty could not increase the rate to SourceGas, then its shareholders would have to absorb or eat the full amount of the **______________ _______** adjustment.

HISTORY OF SOURCEGAS CONTRACT

This interstate service was provided to SourceGas (which was formerly known as Associated Natural Gas Company) since June 1, 2000 when ANG sold its Missouri assets to Atmos which of course is the predecessor to Liberty Utilities. At that time, the ANG local distribution system was being separated into a Missouri service territory operated by

United Cities Gas, a division of Atmos, and an Arkansas service territory that would continue to be owned by ANG. (Tr. 495-96; 512-13; Ex. 12NP, DaFonte Rebuttal, p. 4)

In order for the Arkansas property to have a gas pipeline and gas supply, there needed to be an interstate arrangement between Atmos and ANG whereby Atmos would provide an interstate transportation service to ANG after the service area was separated. Atmos obtained authority to provide interstate transportation services to SourceGas under flex or discount rates. (Tr. 494-96; 513) This arrangement was never questioned by Staff in any previous rate case over the last 12 years, and it continued until August 1, 2012. (Tr. 513-14)

During the On-the-Record presentation to the Commission on November 28, 2012 in the Liberty/Atmos acquisition case, the Company discussed with the Commission that Liberty needed to continue to have an interstate service with SourceGas in Arkansas similar to the service previously provided by Atmos to SourceGas. In addition, the Company discussed at the hearing that Liberty itself also needed a similar interstate service from Atmos' Kansas pipeline to serve Liberty's Missouri customers on the western side of the state at Rich Hill and Hume, Missouri. (Ex. 12NP, DaFonte Rebuttal, p. 4)

In the Arkansas situation, Liberty is the provider of the interstate transportation service. In the Rich Hill-Hume situation, Liberty receives gas using the interstate transportation service provided by Atmos from its Kansas facilities. (Tr. 524) Both arrangements are subject to the exclusive jurisdiction of the FERC and are provided under interstate tariffs which allow for negotiated discounts.

In this case, Staff is not suggesting that Atmos should be charging Liberty and its Missouri customers the full tariffed interstate rate rather than the negotiated discounted tariff rate for Rich Hill and Hume customers. (Tr. 525) However, Staff is suggesting in this case that **____

____**

In other words, from Staff's perspective, Liberty should be **_____________

____**, but Staff is apparently quite content to have Missouri customers on the western side of the state receive a discounted rate for interstate services provided by Atmos.

When Liberty acquired the Atmos properties in Missouri, it was necessary to file with the FERC for approval of an open access interstate transportation service. (*Unanimous Stipulation And Agreement*, Case No. GM-2012-0037, p. 15, paragraph 16). Under the new approved arrangement, the Liberty rate is **___________________

______** (Tr.500) than the prior rate charged by Atmos for the same service resulting in **__________________________________** (Tr. 500) that will benefit Liberty customers in the SEMO District.

Staff never proposed adjustments in previous rate cases related to the lower rate that was provided by Atmos to ANG. However, now that Liberty has been successful in negotiating a rate that is **_________** than charged by Atmos, Staff is now suggesting **____**

____

______________________________________** (Ex. 12HC, DaFonte Rebuttal, p. 10) Mr. DaFonte testified that **____

NP

____

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

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____________** (Ex. 12HC, DaFonte Rebuttal, p. 9) **______

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____________** (Ex. 12HC, DaFonte Rebuttal, p. 13)

**____________________________________

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______________** (Ex. 12HC, DaFonte Rebuttal, p. 12) **_____

____

____________________** (Ex. 12HC, DaFonte Rebuttal, p. 12)

Since these services are interstate services under the FERC's exclusive jurisdiction, this Commission has questionable legal authority to second guess the interstate discounting policy of FERC under the Filed Rate Doctrine and traditional principles of state and federal jurisdiction. Longstanding federal preemption principles under the Supremacy Clause and filed rate doctrine would govern here. In short, local consumers may not get discounts or otherwise benefit because a state utility commission thinks federally-approved wholesale costs (or similarly federally-approved discounting practices) are not "just and reasonable". A "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price." *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965 (1986). Similar principles would prevent this Commission from second-guessing federally-approved FERC discounting policies in this case.

FINANCIAL IMPACT OF STAFF'S REVENUE IMPUTATION ADJUSTMENTS

Robert Hevert, Liberty's cost of capital expert, has analyzed the financial impact of Staff's revenue imputation adjustments. As Mr. Hevert testifies, 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)

If the combined effects of Staff's proposed revenue imputation adjustments, ROE and capital structure recommendations are considered, then those Staff recommendations would drive the expected earned Return on Equity from 10.50 percent to approximately **________________________________**. (Ex. 8HC, Hevert Rebuttal, pp. 11-12) Such a result would significantly deteriorate Liberty's financial integrity and materially increase its financial risk. The Company would therefore respectfully request 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?

Liberty is in agreement with Staff's proposed depreciation rates, with the exception of rates for corporate computer hardware and software. This is hardware and software that is used at the Company's corporate office in Jackson, Missouri and allocated to its divisions in Iowa, Illinois and Missouri jurisdictions. (Ex. 10, p. 9). The

Company recommends continuation of the 14.29% rate (7 years) for system hardware and software and implementation of the rate of 18.98% (5.3 years) for PC hardware and software. These rates are consistent with rates used by Atmos, they are consistent with the requirement in the acquisition case that Liberty adopt those depreciation rates, and they provide a realistic useful life for these systems. 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 adjustment to the rates indicated by the study. (*Id*., pp. 10-11).

Once again stepping into the shoes of Atmos, "in its 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). As reflected in the Staff's Statement of Position, "all of the accounts in dispute concern corporate allocated plant depreciation rates for which there are no currently ordered depreciation rates." (Emphasis added, Tr. 588). Indeed, as the Company's expert witness, James Fallert, readily agreed, 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. Accordingly, as discussed below, 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. As Mr. Fallert observed, ". . . 21 years is an unrealistically long life to apply to computer equipment and systems. This would imply that systems and equipment purchased today would, on average, still be in service in the year 2035. In the fast changing world of information systems, this assumption strains credulity." (Ex. 10, p. 11). Nevertheless, by using such a long life, Staff is able to lower its revenue requirement recommendation by over $1 million.[6]

As the record evidence reveals, Atmos utilized the Company's proposed rates for these accounts in its previous 2006 and 2010 rate cases, and it appears that Staff utilized those same rates as well. There is absolutely no dispute that Staff utilized the 14.29%

[6] *Partial Stipulation and Agreement As To Certain Issues*, Paragraph D.17, p. 9: Depreciation – Rates to be utilized for corporate plant accounts 399.1, 399.3, 399.4 and 399.5, Value: $1,060.358.

depreciation rate for system and network hardware and software, and the 18.98% depreciation rate for personal computer hardware and software, in the 2010 Atmos rate case. Staff's witness affirmed this fact in pre-filed testimony and on the stand. (Ex. 36, pp. 1-2; Tr. 591-592). As Company witness Fallert explained:

> The rates of 14.29% for General Office server and network hardware and software and 18.98% for PC hardware and software comport with the Staff's accounting schedule 8 from Case No. GR-2010-0192 (the most recent 2010 Atmos rate case). A copy of this schedule is attached as **Schedule JF-S4**. Staff's direct report in that case stated that "Staff annualized depreciation expense <u>by applying currently authorized rates</u> times the February 28, 2010 plant in service balances." (Ex. 11, p. 3; Tr. 581, Emphasis added).

(*See* also, Tr. 580).

While Staff (and OPC) wish to focus on the singular evidence of the 2006 depreciation schedule, it is important to note that Staff, itself, has recommended two primary changes. First, Staff consolidated the seven districts in that existing schedule into three districts consistent with the Company's current configuration, a consolidation supported by the Company. As Staff's witness testified, "When the merger occurred Liberty Utilities received plant in service and accumulated reserve balances by the three consolidated districts with a set of depreciation rates for each consolidated district." (Ex. 35, p. 2). And, as Staff's witness acknowledged, as a result of that consolidation some of those rates did change. (Ex. 13, p. 73; Tr. 595-596). Second, as discussed above, Staff attempted to remedy the lack of evidence of ordered rates for corporate accounts by adding a supplement to the existing schedule of district rates. Indeed, Staff is now seeking a new "order" conforming to its 4.75% rate for those corporate accounts. "Staff recommends that the Commission's Report and Order in this case <u>officially order such</u>

depreciation rates for the three divisions and for the corporate allocated plant." (*Id*., Emphasis added).

As fully discussed at the hearing, the Company clearly believes it is unrealistic to think that the Company's computer equipment and software will last for twenty-one years given the pace of technological obsolescence for computers today. 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 seven years. (Tr. 594-595).

For all of the above reasons, the Commission should adopt the Company's position on this issue.

CONCLUSION.

The issues that remain in this case to be resolved by the Commission will have a large impact upon the Company and its customers. As discussed above, 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 will have a substantial impact upon the financial health of the Company. 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 10th day of October, 2014, to all counsel of record in this matter.

/s/ James M. Fischer

James M. Fischer