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Witness: Timothy S. Lyons
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(Midstates Natural Gas) Corp.
d/b/a Liberty Utilities
Case No. GR-2018-0013
Date Testimony Prepared: May 9, 2018

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

Timothy S. Lyons
ScottMadden, Inc.

On Behalf Of

Liberty Utilities (Midstates Natural Gas) Corp.
d/b/a Liberty Utilities

May 2018

SURREBUTTAL TESTIMONY
OF
TIMOTHY S. LYONS
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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Timothy S. Lyons. I am a Partner at ScottMadden, Inc. My business address is 1900 West Park Drive, Suite 250, Westborough, Massachusetts 01581.

Q. ARE YOU THE SAME TIMOTHY S. LYONS WHO PREVIOUSLY SPONSORED DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes, I am. I provided direct testimony ("Direct Testimony") and rebuttal testimony ("Rebuttal Testimony") before the Missouri Public Service Commission (the "Commission") on behalf of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities ("Liberty" or the "Company").

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this surrebuttal testimony ("Surrebuttal Testimony") is to address: issues raised in the Rebuttal Testimonies of the Staff of the Missouri Public Service Commission's ("Staff") witness Michael L. Stahlman regarding the Volume Balancing Account ("VBA")/ Weather Normalization Adjustment Rider

("WNAR"), Staff witness Mark L. Oligschlaeger regarding the proposed trackers, and the Missouri Department of Economic Development – Division of Energy ("DE") witness Martin R. Hyman regarding rate design, including inverted or inclining block rates.

Q. HAVE YOU PREPARED SCHEDULES SUPPORTING YOUR REBUTTAL TESTIMONY?

A. No.

III. SUMMARY OF POSITIONS

Q. PLEASE SUMMARIZE STAFF'S POSITION REGARDING THE PROPOSED VOLUME BALANCING ACCOUNT RIDER ("RIDER VBA").

A. Staff's position regarding the proposed Volume Balancing Account Rider ("Rider VBA") is summarized below.

1. Staff recommends rejection of Rider VBA. Staff believes that the proposed mechanism does not conform to RSMo §386.266.3, the Missouri statute that authorizes revenue decoupling mechanisms.[1]
2. While Staff does not recommend a rider in this case, Staff offers that a Weather Normalization Adjustment Rider ("WNAR") modeled after the rider approved in Spire's most recent rate cases, GR-2017-0215 and GR-2017-0216, would meet the statutory requirements of RSMo §386.266.3 since it would adjust only revenues on the basis of weather.[2]

[1] Rebuttal Testimony of Michael Stahlman, pg. 2
[2] *Ibid.*, pg. 5

3. Staff limits its WNAR to only the residential class. Staff raises rate continuity concerns related to the SGS class because of the proposed 50 percent increase in SGS's rates. Staff cites this factor as a basis for limiting the WNAR to only the residential class – as well as the uncertainty of the exact impact of the WNAR.[3]

4. Staff offers specimen tariff sheets for a WNAR, which are substantially similar to those in my Rebuttal Testimony in Schedule TSL-R2.[4]

Q. WHAT IS THE COMPANY'S RESPONSE TO STAFF'S POSITION?

A. The Company generally supports Staff's WNAR; however, the Company believes that Staff's concerns regarding the applicability to the SGS class can be adequately addressed and thus proposes to include the SGS class in the WNAR.

Specifically, the Company supports a WNAR in the context of a rate design solution that would include: (a) partial consolidation of residential rates in this proceeding consistent with Staff's proposal, (b) a phased approach to achieving full consolidation through annual increases in SEMO's residential customer charge and corresponding decreases in NEMO, SEMO and WEMO's volumetric charges in a manner that would be revenue neutral to the authorized revenue requirements in this proceeding; and (c) a pilot program to introduce inverted or inclining block rates in the WEMO district.

Q. PLEASE SUMMARIZE DE'S RATE DESIGN RECOMMENDATIONS.

A. DE's rate design recommendations are summarized below.

[3] *Ibid.*, pgs. 5-6
[4] Schedule MLS-r1

1. DE recommends a district-specific rate design because it follows cost-causation and minimizes possible adverse bill impacts for some districts if there is a uniform block rate design across districts.
2. DE recommends no increase in the residential customer charge, recommending instead that any revenue increase be applied to the volumetric charges to ensure price signals are accurate.
3. DE recommends a three-step, inverted block rate structure in the winter for the residential class.
4. DE states that Staff's alternative residential rate design (*i.e.*, a two-step, inverted block rate structure for summer usage) is reasonable, except that May should be moved to the winter months and that some modifications should be made to mitigate potential bill impacts on high use customers.
5. DE recommends that the Company and Staff should provide their rate designs based on each other's revenue requirements in order to facilitate comparative bill impact analyses.

Q. WHAT IS THE COMPANY'S POSITION ON DE'S RATE DESIGN PRINCIPLES AND RECOMMENDATIONS?

A. The Company generally agrees with DE's rate design principles, including: (a) price signals that encourage efficiency, (b) rate continuity or gradualism, (c) ensuring affordability, (d) charges that relate to cost-causation; and (e) ease of understanding and administration. These rate design principles are common throughout the utility industry.

The Company, however, does have a few concerns regarding DE's recommendations.

1. The Company does not agree with DE's analysis used to support its opposition to district pricing. DE's analysis compares only capital costs rather than the total cost of service across the three districts. The analysis excludes, for example, operations and maintenance expenses, depreciation expense and taxes – which represent a significant portion of the overall cost of service. In addition, the analysis compares the district cost of service rather than the rate class cost of service for each district. The cost of service varies significantly across each rate class and thus distorts the comparison across districts.

   The Company's analysis used to support its proposed consolidated rates compares the total cost of service for each rate class across the three districts and shows that such class cost of service is similar across the three districts.

2. The Company does not agree with DE's recommendation to not increase – or in effect 'freeze' – the residential customer charges. The Company believes that the rate design should reflect the underlying cost of service, which would include customer charges that reflect customer-related costs. The current residential customer charges are well below the customer-related costs; thus, the Company proposes to increase the residential customer charges to better reflect the underlying customer-related costs.

   While the Company recognizes DE's suggestion that the rate design should consider the price signal to consumers to help ensure that the products and services are used in an efficient manner, the Company believes that such

consideration should be balanced against other rate design objectives, including fairness and equity. One of the important benefits of increasing the residential customer charges is that it reflects a fair and more equitable rate design because it better aligns rates and the underlying cost of service.

3. The Company does not agree with DE's recommendation for a three-step, inverted block rate structure in the winter. First, the recommendation is not well supported. For example, there is no study that supports that the cost of service for consumption in the 3rd step is higher than in the 2nd step or in the 1st step. In fact, the opposite is likely to be true. Customer-related costs not recovered through the customer charge – which is the case under the proposed rate designs – would be recovered through volumetric charges. A three-step, inverted block rate structure would therefore mean that high-use customers would pay a disproportionate share of customer-related costs than low use customers.

Second, DE's recommendation does not include evaluation of customer impacts, particularly related to customer understanding and customer bill impacts. While the testimony discusses approaches to the rate design including possible block breaks, there is no specific rate design proposal nor bill impact analysis to evaluate the recommendation.

Finally, we are not aware of a gas utility in the country that has such a three-step, inverted block rate structure. In fact, we are aware of only a few gas utilities with an inverted block rate structure, one of which has proposed in its ongoing rate case to eliminate its two-step, inverted block rate structure

following recent regulatory decisions in that state to eliminate inverted block rates.

Nevertheless, the Company proposes on a limited basis inverted block rates during the summer months, similar to the rates approved in Spire's most recent rate cases, GR-2017-0215 and GR-2017-0216.

4. Specifically, the Company proposes to implement Staff's alternative rate design in the WEMO district during the summer months of May through October. DE agrees that such alternative rate design is reasonable, except that DE would move May to the winter months and make some modifications to mitigate potential bill impacts on high use customers. The Company believes that May should remain in the summer months since residential use per customer per day in May is more closely aligned to the summer period than the winter period.

5. The Company supports DE's recommendation that the Company and Staff provide their rate designs based on each other's revenue requirement recommendations in order to facilitate comparative bill impact analyses. The Company's Rebuttal Testimony provided rate designs and bill impact analyses under the Company and Staff's revenue requirements.

Q. PLEASE SUMMARIZE STAFF'S POSITION REGARDING THE TRACKER ACCOUNTS.

A. Staff's position regarding the tracker accounts is that they are justified only under certain circumstances, including: (a) when the applicable costs demonstrate significant fluctuation and up-and-down volatility over time; (b) new costs for

which there is little or no historical experience, and for which accurate estimation is accordingly difficult; (c) costs improved upon utilities by newly promulgated Commission rule; and (d) costs that are material in amount.

Staff's opposition to the Company's proposal for tracker accounts is as follow:

1. Capital Rider Tracker ("CR Tracker") – Staff raises several concerns with the CR Tracker, including (a) the CR Tracker does not take into account changes in other aspects of its operations that might have an offsetting impact, and (b) the CR Tracker does not consider the impact of the growth in a utility's depreciation and deferred tax reserves.
2. Property Tax Tracker ("AV Tracker") – Staff raises several concerns with the AVT Tracker, including (a) the AVT tracker recovers costs that are incurred according to a regular schedule, usually associated with increases to plant-in-service, (b) the historical property taxes have not been volatile but show a steady increase; (c) the Company has some ability to take steps to control the level of property taxes (with reference to at least two utilities that have achieved reductions from an appeal of their property tax assessment); and (d) the Commission has not approved a tracker for property tax expense in the past.
3. Bad Debt Tracker ("BD Tracker") – Staff raises several concerns with the BD Tracker, including (a) bad debt expense is incurred on a routine basis; (b) bad debt expense is not material, representing approximately 1.4% of total adjusted O&M expenses; and (c) Staff is aware of only one reason for a sharp

decline in bad debt expense over the past three years; a change in its write-off policy.

Q. WHAT IS THE COMPANY'S RESPONSE TO STAFF'S POSITION?

A. The Company continues to believe that the proposed trackers are necessary and provide significant benefits to the Company and its customers; nevertheless, the Company supports elimination of one tracker (*i.e.*, the Vegetation Management/ Right-of-Way Tracker) and modifications to another (*i.e.*, the CR Tracker) to address Staff concerns. That said, while the Company recognizes Staff's concerns regarding the proposed trackers and has tried to address them where it can, the Company believes that it is important to note the critical reason for trackers; i.e., to help mitigate the impact of cost variances that are beyond the Company's reasonable control. This has been the long-standing purpose of tracker accounts (including Fuel and Purchase Gas Adjustment Clauses) – and is the primary purpose that the Company has proposed the tracker accounts in this proceeding.

IV. RIDER VBA/ WEATHER NORMALIZATION

Q. PLEASE SUMMARIZE THE COMPANY'S POSITION ON RIDER VBA/ THE WNAR.

A. The Company continues to support Rider VBA. However, to address Staff's concerns regarding Rider VBA, the Company supports as part of a comprehensive rate design solution implementation of Staff's WNAR that is modeled after the rider approved in Spire's most recent rate cases, GR-2017-0215 and GR-2017-

0216; however, the Company believe that Staff's WNAR should be modified to reflect applicability to both the Residential and SGS classes.

Specifically, the Company supports the WNAR in the context of a rate design solution that would include: (a) partial consolidation of residential rates in this proceeding consistent with Staff's proposal, (b) a phased approach to achieving full consolidation through annual increases in SEMO's residential customer charge and corresponding decreases in NEMO, SEMO and WEMO's volumetric charges in a manner that would be revenue neutral to the authorized revenue requirements in this proceeding; and (c) a pilot program to implement two-step, inverted block rates in WEMO in the summer.

Q. PLEASE SUMMARIZE STAFF'S CONCERNS ON APPLICABILITY TO THE SGS CLASS.

A. Staff limits its WNAR to only the residential class. Staff raises rate continuity concerns related to the SGS class because of the proposed 50 percent increase in SGS's rates. Staff cites this factor as a basis for limiting the WNAR to only the residential class – as well as the uncertainty of the exact impact of the WNAR.[5]

Q. WHAT IS THE COMPANY'S RESPONSE TO STAFF'S CONCERNS?

A. The Company shares Staff's concerns. The Company is equally concerned about the impact of the proposed SGS rate increase. However, the Company also believes that the WNAR will help mitigate, rather than exacerbate SGS bill impacts.

[5] *Ibid.*, pgs. 5-6

Q. PLEASE EXPLAIN HOW THE WNAR WOULD HELP MITIGATE SGS BILL IMPACTS.

A. The WNAR would help mitigate SGS bill impacts since the WNAR is designed to lower customer bills as a result of colder-than-normal weather (when customer bills are typically higher) and raise customer bills as a result of warmer-than-normal weather (when customer bills are typically lower).

Q. HAS THE COMPANY PREPARED ANALYSIS TO SIMULATE THE IMPACT OF THE WNAR ON SGS CUSTOMER BILLS?

A. Yes, the Company prepared analysis to simulate the impact of the WNAR on SGS bills by utilizing actual heating degree days ("HDDs") over the past six years (2012 through 2017, inclusive). The analysis assumes that normal HDDs, normal usage and the number of customers remain the same over the analysis period.

Q. WHAT DOES THE ANALYSIS SHOW?

A. The analysis shows the following:

- WNAR amounts represent a relatively small portion of the total bill, ranging from 1.7 percent to a negative 1.3 percent of the total bill.
- WNAR amounts help to mitigate and offset in certain years higher bills experienced during colder-than-normal weather.
- WNAR amounts help to offset in certain years lower bills experienced during warmer-than-normal weather, while continuing to provide customers with a lower total bill than under normal weather conditions.

Q. PLEASE DESCRIBE THE COMPANY'S APPROACH TO THE WNAR ANALYSIS.

A. The Company's approach to the WNAR analysis was consistent with Staff's specimen tariff[6] and Spire's WNAR that was recently approved by the Commission[7].

Specifically, the WNAR revenue adjustment was based on the difference between Actual and Normal HDDs, a β coefficient that measures the change in use per customer per day resulting from a change in HDDs per day, number of customers, and commodity charge. The β coefficients used in the analysis are included in Figure 1. Development of the β coefficients was discussed in my Rebuttal Testimony.

Figure 1: WNAR Heating Coefficients

Heating Coefficients (β)	NEMO	SEMO	WEMO
Residential Service	0.1142597	0.1108690	0.1181620
SGS	0.2442405	0.2371604	0.2474069

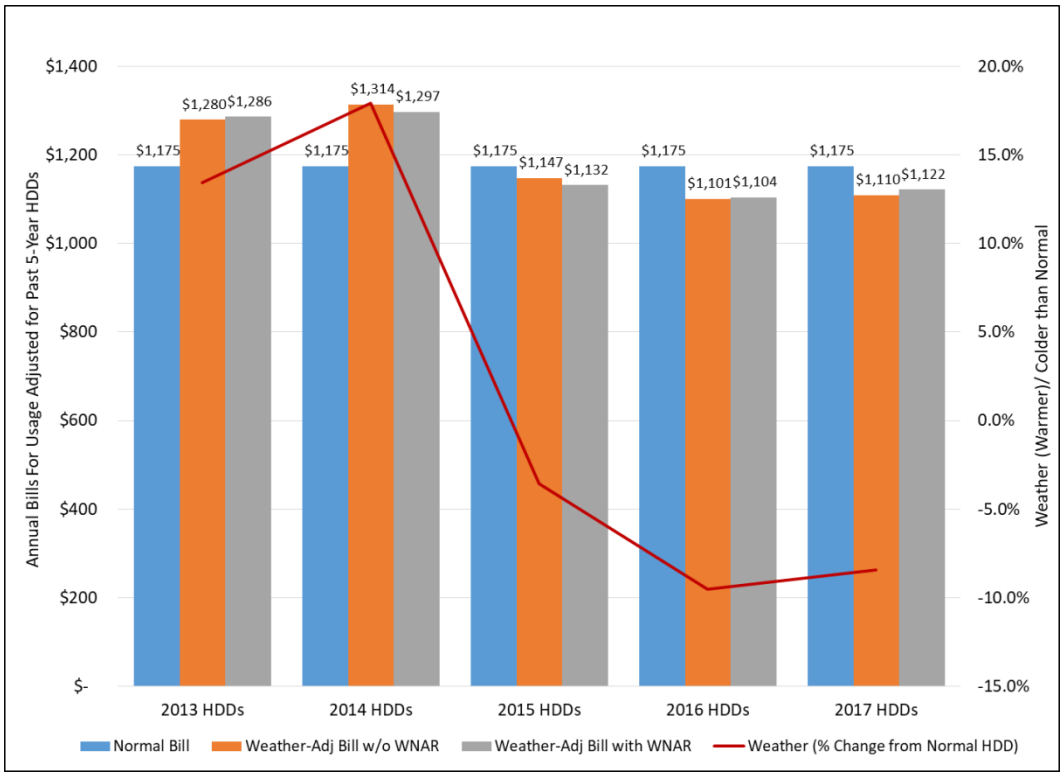
WNAR factors were calculated on a semiannual basis (March-August, and September-February) and applied to the subsequent 12 months.

Q. PLEASE SUMMARIZE THE RESULTS OF COMPANY'S ANALYSIS.

A. The results of Company's analysis are summarized in Figure 2. The Figure shows that the WNAR factors do not have a significant impact on SGS customer bills and that WNAR credits under certain conditions help mitigate and offset higher bills under colder-than-normal weather conditions and offset lower bills under warmer-than-normal weather conditions.

[6] Schedule MLS-r1
[7] See *Report and Order* at pages 83-85; issued February 21, 2018, in File Nos. GR-2017-0215 and GR-2017-0216

Figure 2: Impact of WNAR Application on SGS Customer Bills (NEMO)



Q. CAN WEATHER VARIATIONS FROM ONE HEATING SEASON IMPACT CUSTOMER BILLS IN THE SUBSEQUENT HEATING SEASONS?

A. Yes. As shown in Figure 2, due to the lag between calculation of the WNAR in one period and its application to customer bills in subsequent periods, it is possible that customers could receive credits in warmer-than-normal years and surcharges in colder-than-normal years, although the impact on customer bills is not significant, as shown in Figure 2.

There are two possible ways to address this situation: (a) shorten the lag between calculation and application of the WNAR from 6-months to 3-months; and (b) reduce the application period from 12-months to 6-months. However, the

Company proposes neither approach as the impact on customer bills is not significant.

V. RATE DESIGN

Q. PLEASE SUMMARIZE THE PRINCIPLES USED BY THE COMPANY TO DESIGN ITS PROPOSED RATES.

A. As described in my Direct Testimony, the proposed rate design was guided by several principles common throughout the industry, including: (a) rates should recover the overall cost of providing service; (b) rates should be fair, minimizing inter- and intra-class inequities to the extent possible; and (c) rate changes should be tempered by rate continuity concerns.[8] In addition, the proposed rate design was guided by a Company-specific proposal to move toward a single set of rates for each rate class across the three regions; i.e., one set of rates for Residential, SGS, MGS, LGS and Interruptible customers across the three regions.

Because these principles can conflict, the rate design process also includes a level of judgment to balance these principles.

Q. DO YOU AGREE WITH DE'S ANALYSIS THAT SHOWS THERE ARE SIGNIFICANT COST DIFFERENCES ACROSS THE DISTRICTS?

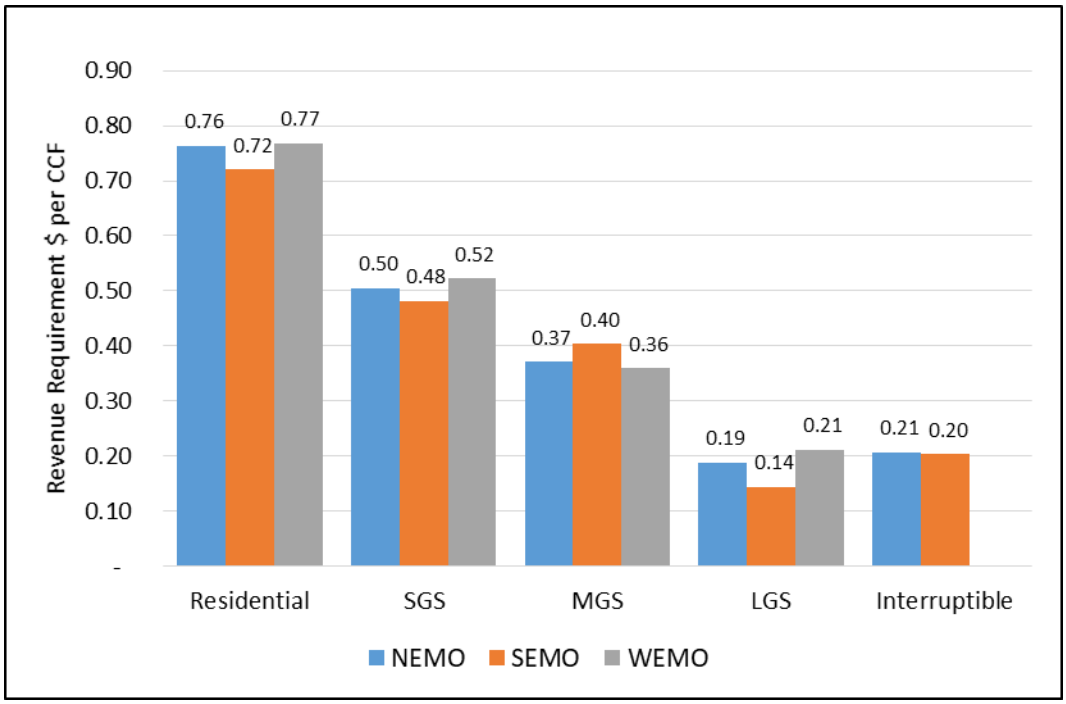
A. No, the Company does not agree with DE's analysis used to support its opposition to district pricing. DE's analysis compares only capital costs rather than the total cost of service across the three districts. The analysis excludes, for example, operations and maintenance expenses, depreciation expense and taxes – which

[8] See Bonbright, James, Danielsen, Albert, and Kamerschen, David. "Principles of Public Utility Rates." Public Utilities Reports, Inc. pp. 377-407 (2nd Ed. 1988).

represent a significant portion of the overall cost of service. In addition, DE's analysis compares the district cost of service rather than the rate class cost of service for each district. The cost of service varies significantly across each rate class. DE's analysis also compares costs on a per customer basis rather than on a sales basis.

The Company's analysis used to support consolidated rates compares the total cost of service for each rate class across the three districts. The Company's analysis is summarized in Figure 3 and shows that each class's cost of service is similar across the three districts

Figure 3: Class Cost of Service across Districts ($/CCF)



Q. WHY IS IT APPROPRIATE TO COMPARE DISTRICTS ON THE TOTAL COST OF SERVICE RATHER THAN ONLY PLANT-IN SERVICE?

A. The Company believes that it is appropriate to compare districts on the basis of total cost of service rather than only plant-in-service since customer rates are based on total cost rather than only plant-in-service – or any other individual cost component. In addition, a comparison of total cost limits potential distortions from using select cost components, as shown in Figure 4.

Figure 4: Net Plant and O&M Comparison across Districts ($/CCF)

	NEMO	SEMO	WEMO
Total Plant in Service	$ 69,963,238	$ 82,456,146	$ 12,691,901
Accumulated Depreciation	$ (20,927,991)	$ (20,771,385)	$ (4,443,776)
Net Plant in Service	$ 49,035,246	$ 61,684,762	$ 8,248,125
Total O&M Expenses	$ 4,600,004	$ 6,619,679	$ 986,834
Sales	24,336,983	36,783,781	4,713,793
Net Plant per CCF	$ 2.01	$ 1.68	$ 1.75
O&M Expenses per CCF	$ 0.19	$ 0.18	$ 0.21

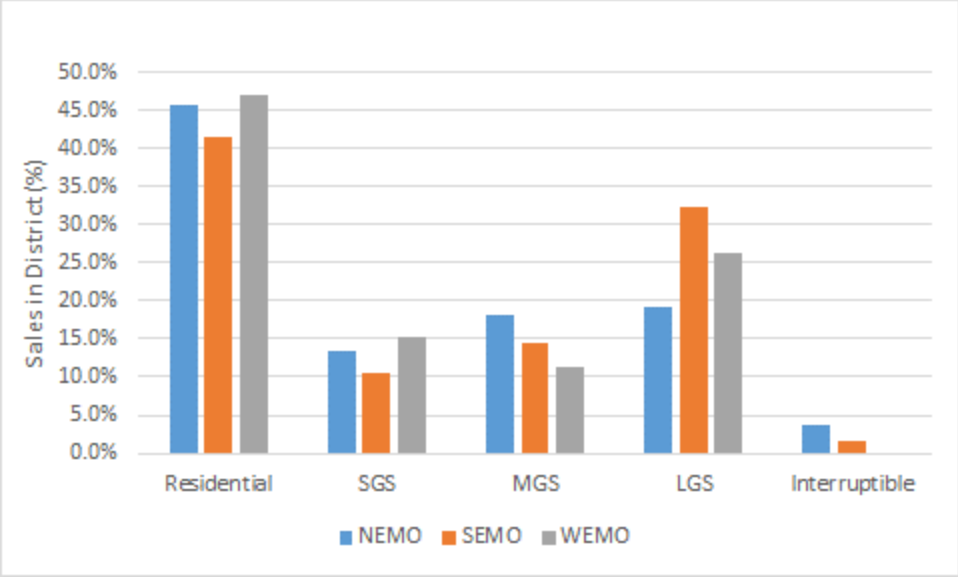
The Figure shows, for example, that Net Plant in Service in NEMO is $2.01 per CCF as compared to $1.68 per CCF in SEMO, or 17.0 percent higher. However, O&M Expenses in NEMO are $0.19 per CCF as compared to $0.18 per CCF in SEMO, or only 5.0 percent higher.

Q. WHY IS IT APPROPRIATE TO COMPARE THE DISTRICTS ON THE BASIS OF THE RATE CLASS COST OF SERVICE RATHER THAN THE DISTRICT COST OF SERVICE?

A. The Company believes that it is appropriate to compare the districts on the basis of the rate class cost of service rather than the district cost of service because

customer rates are based on the rate class cost of service. In addition, the rate class comparison limits potential distortions, as shown in Figure 5.

Figure 5: Differences in Customer Sales within Each Region



The Figure shows that there are substantial differences in sales profile across the districts. For example, residential customers in NEMO represent 45.7 percent of sales as compared to only 41.4 percent in SEMO. In addition, Large General Service ("LGS") customers in NEMO represent 19.1 percent of sales as compared to 32.2 percent of sales in SEMO. These differences have a significant impact on the district cost of service since there are significant differences in the rate class cost to service, as shown in Figure 3. Specifically, the cost to serve a residential customer is approximately 4 times the cost to serve an LGS customer. Thus, sales differences across the districts create cost differences across districts even if the class cost of services are identical.

In short, since LGS sales in SEMO are significantly higher than in NEMO and the cost of serving LGS customers is significantly less than other rate classes,

then all other things the same it is not surprising that the district cost of service in SEMO is less than that in NEMO.

Q. WHY IS IT APPROPRIATE TO COMPARE THE DISTRICTS ON THE BASIS OF SALES RATHER THAN CUSTOMERS?

A. The Company believes that it is appropriate to compare the districts on the basis of sales rather than customers since sales represent a significant driver of the cost of service. We agree with DE's statement in their Rebuttal Testimony,

> "One primary driver of the usage and cost differences between districts is probably the number of heating degree days….A higher number of heating degree days results in higher demand for space heating, all else being equal; this higher demand translates into higher usage and higher cost to serve that usage."[9]

Q. WHY IS THE COMPANY OPPOSED TO DE'S PROPOSAL TO FREEZE RESIDENTIAL CUSTOMER CHARGES?

A. The Company does not support DE's proposal to freeze residential customer charges because it does not appropriately balance the rate design principles discussed above, including fairness and equity. One of the important benefits of the Company's proposed customer charges is that it better aligns rates and cost recovery to ensure that the Company's rates recover the underlying cost of service. For example, the Company's CCOS shows that the residential customer cost to serve is $38.29 per month in the NEMO region. To the extent that residential customer charges are less than the customer cost, as would be the case

[9] Rebuttal Testimony of Martin R. Hyman at page 10

if the Company did not increase its customer charge, then the remaining amount would be recovered in the consumption change. In this case, there would be a misalignment between the Company's rates and the underlying cost of service. Recovery of customer-related costs would then be transferred from the customer charge to the consumption charge resulting in a shift in cost recovery from low use customers to high use customers. The Company's proposed increase in the customer charge helps corrects for this misalignment.

Q. DOES A HIGHER CONSUMPTION CHARGE HELP INCREASE A CUSTOMER'S INCENTIVE TO CONSERVE?

A. All other things the same, a higher volumetric rate increases a customer's incentive to conserve. However, all other things are not the same. There are other principles that need to be considered in establishing the Company's rate design. If the only goal of the rate design, for example, were to maximize a customer's incentive to conserve, then customer charges would be set at the lowest possible level and the consumption charges would be set at the highest possible level. This type of rate design, however, would be unfair since there would be misalignment between a customer's rates and its underlying cost of service.

A better approach is to set rates equal to the underlying cost of service such that the consumption rates reflect the underlying cost of service. Under this approach, the incentive to conserve is based on the underlying cost of service and reflects economic efficiency.

Q. WHY IS THE COMPANY OPPOSED TO DE'S PROPOSAL TO ESTABLISH A THREE-STEP, INVERTED OR INCLINING BLOCK RATE DESIGN?

A. The Company does not support DE's recommendation for a three-step, inverted block rate structure in the winter. First, the recommendation is not well supported. There is no study that supports that the cost of service for consumption in the 3rd step is higher than in the 2nd step or in the 1st step. In fact, the opposite is likely to be true. Customer-related costs not recovered through the customer charge – which is the case with the proposed rate designs – would be recovered through the volumetric charges. A three-step, inverted block rate structure would therefore mean that high-use customers would pay a disproportionate share of customer-related costs than low use customers.

Second, DE's recommendation does not include evaluation of customer impacts, particularly related to customer understanding and customer bill impacts. While the testimony discusses approaches to the rate design including possible block breaks, there is no specific rate design proposal nor bill impact analysis to evaluate the recommendation.

Finally, we are not aware of a gas utility in the country that has such a three-step, inverted block rate structure. In fact, we are aware of only a few gas utilities with an inverted block rate structure, one of which has proposed in its

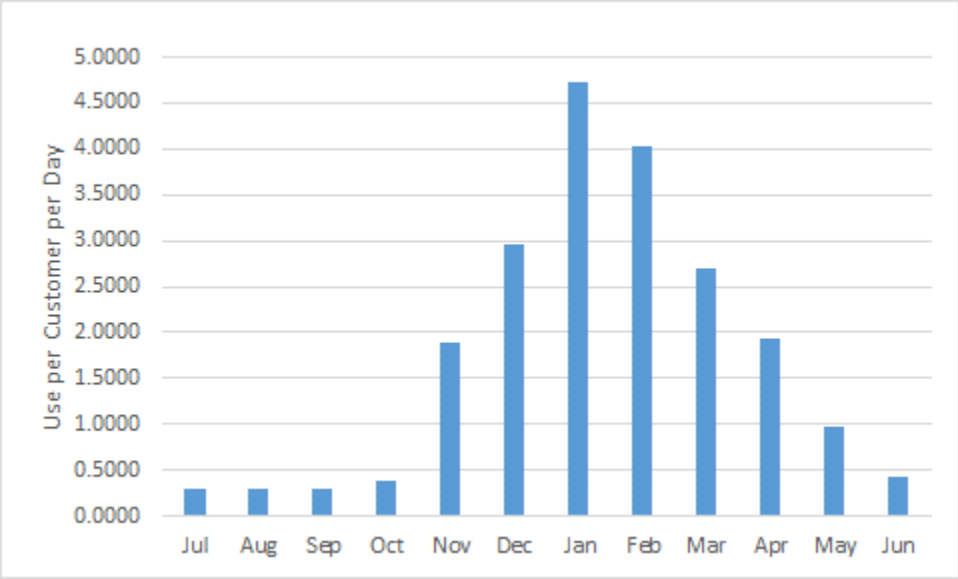
ongoing rate case to eliminate its two-step, inverted block rate structure following regulatory decisions in that state to eliminate inverted block rates.[10]

Q. WHY DOES THE COMPANY SUPPORT IMPLEMENTATION OF AN INVERTED RATE DESIGN ON A LIMITED BASIS?

A. The Company proposes on a limited basis to adopt Staff's alternative rate design (*i.e.*, inverted block rates during the summer months).

However, the Company does not support DE's proposal to move May to the winter month. The Company believes that May should remain in the summer months since residential use per customer per day in May is more closely aligned to the summer period than the winter period, as shown in Figure 6.

Figure 6: Use per Customer per Day (NEMO)



[10] For example, see discussion by Massachusetts Department of Public Utilities in D.P.U. 13-75, at 361; D.P.U. 13-90, at 249; D.P.U. 15-155, at 463. The Department mentions multiple concerns against inverted rates including that (1) the rate difference between the head block and tail block is not significant; (2) the inclining block structure only affects the base distribution rates, whereas commodity and other adjustment factors resulting from reconciling mechanisms often comprise more than half the total bill; and (3) customers do not know when they are reaching the first block threshold in a given billing month such that they can change their usage behavior to avoid or minimize usage at the tail block, which has a higher rate.

The Figure compares monthly residential use per customer per day in NEMO. The Figure shows that May's residential use is 0.9 CCF per customer per day as compared to the average of November through April use of 3.0 CCF per customer per day. In comparison, the average of June through October use is 0.3 CCF per customer per day.

It is worth noting that the May through October summer period is consistent with Spire's summer period for inverted rates.

VI. COST TRACKERS

Q. DO YOU AGREE WITH STAFF'S LIST OF CIRCUMSTANCES UNDER WHICH THE USE OF TRACKERS MAY BE JUSTIFIED?

A. Partially. The Company agrees with Staff on certain situations referenced in testimony, such as when costs are new or difficult to estimate accurately. In addition, the Company agrees with Staff that the use of trackers should reflect costs that have a substantial impact on the Company's financial performance. However, the Company believes that it is critical to note the primary reason for trackers; i.e., to help mitigate the impact of cost variances that are beyond the Company's reasonable control. This has been the long-standing purpose of trackers (including Fuel and Purchase Gas Adjustment Clauses) – and is the primary purpose that the Company has proposed the tracker accounts in this proceeding.

Q. DO YOU AGREE THAT TRACKERS ARE JUSTIFIED FOR ONLY THOSE COSTS THAT DEMONSTRATE UP-AND-DOWN VOLATILITY?

A. No, as mentioned earlier, the Company believes trackers should be used to mitigate the impact of cost variances that are beyond the Company's reasonable control regardless of whether the cost variances tend to increase or decrease over time.

The Company believes that trackers are as applicable to cost variances that tend to increase over time are as they are to cost variances that tend to decrease over time. However, the tendency of cost variances to increase or decrease over time should not be a sufficient reason to accept or reject a tracker. For example, the Company's salaries, wages and benefits expenses tend to increase over time, but the Company has not proposed a tracker for those expenses since the Company believes that such expenses are within its reasonable control.

This position would be the equivalent to saying that since federal tax reform has tended to result in only a decrease in federal income taxes, (then all things the same) utility rates should not be adjusted due to federal tax reform.

Q. DO YOU BELIEVE THAT THE PROPOSED O&M EXPENSE TRACKERS WOULD TEND TO UNREASONABLY SKEW THE RATEMAKING RESULTS?

A. No, the proposed O&M expense trackers would not unreasonably skew the ratemaking results since the premise of this position assumes that the O&M expenses associated with the proposed trackers are within the Company's reasonable control and that the Company's approach to selecting which O&M expense trackers to propose was based on covering those costs that would tend to increase while excluding those costs that would tend to decrease.

While we appreciate Staff's concern that theoretically there could be a set of trackers that could unreasonably skew the ratemaking results, this was not the Company's approach and is not specific to the Company's proposed trackers. Instead, the Company's approach was to identify those O&M expenses that were beyond the Company's reasonable control and have had, or reasonably could have, a significant impact of the Company's financial performance.

Q. DO YOU BELIEVE THAT THE PROPOSED O&M EXPENSE TRACKERS WOULD TEND TO AFFECT A UTILITY'S INCENTIVE TO OPERATE EFFICIENTLY?

A. No, the proposed O&M expense trackers would not tend to affect a utility's incentive to operate efficiently since this position, again, assumes that the O&M expenses associated with the proposed trackers are within the Company's reasonable control in the first place.

While the Company appreciates Staff's concern that theoretically there could be a set of O&M expense trackers that could affect a utility's incentive to operate efficiently, this was not the Company's approach and is not specific to the Company's proposed trackers.

However, to address the Staff's position, the Company would support including in the proposed O&M expense trackers an incentive mechanism to ensure that the Company would continue to have an incentive to reduce any costs that may be within its control, such as appeal of property tax increases. The incentive mechanism would, for example, provide an incentive for the successful appeal of property tax increases. While it would support such an incentive

mechanism, the Company believes it has an inherent incentive to keep its costs as low as reasonably possible while providing safe, reliable and affordable service to customers.

Q. DO YOU BELIEVE THAT AN IMPORTANT BENEFIT OF TRACKERS IS THE ABILITY TO DEFER RATE CASES?

A. Yes, rate cases require significant resources to prepare, file and litigate. Thus, to the extent a utility is able to defer filing of a rate case for even one year, such a result provides significant benefits for the utility, its customers, its regulators and other stakeholders.

Q. PLEASE SUMMARIZE THE COMPANY'S POSITION REGARDING ITS PROPOSED CR TRACKER.

A. The Company continues to support the CR Tracker. However, to address Staff's concerns regarding the CR Tracker, the Company would support modifying the CR Tracker to apply to the safety-related work that the Company believes is most critical, namely the replacement of Polyvinyl Chloride ("PVC") pipe. Alternatively, the Company would support the Commission recognizing the safety-related rationale for replacing PVC pipe on a more accelerated basis so that the costs of doing so could be recovered through the ISRS mechanism. As discussed in my Rebuttal Testimony, the absence of a specific Commission determination that PVC pipe should be replaced for safety related reasons, limits its eligibility for ISRS treatment.[11] Determining, as the Company has, that PVC

[11] Lyons Rebuttal Testimony at page 29-30

pipe should be replaced on a similar basis as cast-iron/ bare-steel main to provide safe and reliable services to customers would remove this barrier.

The Company believes that many of Staff's concerns related to the CR Tracker would be addressed through a clarification that PVC pipe should be replaced on an accelerated basis and that the safety rationale for doing so makes such costs eligible for the ISRS mechanism.

Q. DO YOU AGREE THAT PROPERTY TAX INCREASES OVER TIME ARE NOT A SUFFICIENT REASON FOR THE AVT/ PROPERTY TAX TRACKER?

A. No, as mentioned earlier, the Company does not agree that because property tax have increased over time, this is a sufficient reason to reject the AVT Tracker. In fact, there are a number of reasons why such treatment is appropriate. First, property tax increases, with limited exceptions such as appeals, is generally beyond Company's reasonable control and, where there is some limited control, an incentive mechanism could be adopted to ensure such control is exercised in an effective manner. Second, property tax increases represent a significant O&M expense that could have a substantial impact on the Company's financial performance. Third, property tax trackers have been approved for other utilities.[12]

Q. WHAT ARE THE PRIMARY FACTORS THAT IMPACT THE LEVEL OF BAD DEBT EXPENSE OVER TIME?

[12] See for example approval of a Property Tax Tracker for Puget Sound Energy by Washington Utilities and Transportation Commission in Dockets UE-121697 and UE-121705.

A. Bad debt expenses generally increase or decrease over time due to: (a) changes in customer rates, including changes in the Purchase Gas Adjustment; (b) changes in the economy, especially related to employment (or unemployment) levels and household income; and (c) changes in weather. These factors are beyond the Company's reasonable control. In addition, utility collection practices and policies can have an impact on the level of bad debt expenses. While changes in utility collection practices and policies are within the Company's reasonable control (albeit, subject to Commission policies and regulations), the degree to which these can impact the level of bad debt expenses over time relative to the changes listed above is generally not as significant.

The Company continues to support its proposed BD Tracker for multiple reasons. First, there is some uncertainty regarding the baseline used to set rates in this proceeding. The Company's average bad debt expense over the past three years has been $0.5 million. However, bad debt expense in each of the past three years has been $0.9 million, $0.4 million and $0.2 million in 2015, 2016 and 2017, respectively. Thus, if the Company sets rates in the proceeding on the average bad debt expense over the past three years there is a potential for over- or under-recovery of costs relative to historical bad debt expense. The Company believes that a better approach is to mitigate the potential over- or under-recovery of such bad debt expense through a tracker. Under this approach, customers incur only actual bad debt expense over time rather than an amount.

It is worthwhile to note that one of Staff's criterion that justifies a tracker is difficulty in estimating cost accurately. The Company believes that bad debt

expense meets that criterion not only for the volatility of bad debt expense over the past three years, but also for the uncertain regarding the recent increase in customer rates. For example, SEMO PGA rates have increased twofold over the past two years from $2.46 per Mcf in 2016 to $5.46 per Mcf in 2018.[13] We believe that such increases, all other things the same, would place upward pressure on bad debt expense.

Finally, while we note Staff's reference to the lack of a BD tracker in Missouri, it is important to also note that a BD tracker has been approved for 64 natural gas utilities in 26 jurisdictions.[14]

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

[13] https://missouri.libertyutilities.com/uploads/MO%20PGA%20Rates%202018.05.pdf
[14] Hevert Direct Schedule RBH-1 at page 15

AFFIDAVIT OF TIMOTHY S. LYONS

STATE OF VERMONT)
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On the _____ day of May, 2018, before me appeared Timothy S. Lyons, to me personally known, who, being by me first duly sworn, states that he a partner at ScottMadden, Inc and acknowledges that he has read the above and foregoing document and believes that the statements therein are true and correct to the best of his information, knowledge and belief.

Timothy S. Lyons.

Timothy S. Lyons

Subscribed and sworn to before me this 8th day of May, 2018.

Notary Public
Matt LaBerge

My commission expires: 2/10/19