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Witness: Jill Schwartz
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Case No.: GR-2024-0106
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Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

Jill Schwartz

on behalf of

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

August 22, 2024

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LIBERTY UTILITIES (MIDSTATES NATURAL GAS) CORP. D/B/A LIBERTY
BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Jill Schwartz. My business address is 602 South Joplin Ave., Joplin, MO 64801.

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

A. I am employed by Liberty Utilities Service Corp. ("LUSC") as the Senior Director Regulatory Policy and Strategy.

Q. On whose behalf are you testifying in this proceeding?

A. I am testifying on behalf of Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty" or "Company").

Q. Please describe your educational and professional background.

A. In 2001, I completed my Bachelor of Science in Accounting from the John E. Simon School of Business at Maryville University in St. Louis, Missouri. From May 2001 to February 2015, I was employed by The Boeing Company in a variety of accounting capacities. I joined Liberty Utilities in February 2015 as the Manager of Rates and Regulatory Affairs for Liberty Utilities (Midstates Natural Gas) Corp. In February 2017, I was promoted to Senior Manager of Rates and Regulatory Affairs for Liberty Utilities' Central Region, where I was responsible for the regulatory matters involving the electric, natural gas and water utilities in Missouri, Arkansas, Illinois, Iowa, Kansas and Oklahoma. In August 2019, I transitioned to the Corporate Regulatory department, where I provided support for the Cost Allocation Manual ("CAM") and corporate costs to the Company's affiliate operating utilities across the U.S. and Canada. In December 2020, I was promoted to Director of Regulatory Shared Services, and in May 2022, I was promoted to my current position.

Q. Have you previously testified before the Missouri Public Service Commission ("MPSC" or "Commission") or before any other utility regulatory agency?

A. Yes. I have provided written and oral testimony before the MPSC in numerous cases including, but not limited to, rate cases for the Company (Case No. GR-2018-0013), The Empire District Electric Company (Case Nos. ER-2019-0374 and ER-2021-0312), and Liberty Utilities (Missouri Water) LLC (Case No. WR-2018-0170). I have also testified before public utility commissions in Arizona, Arkansas, Illinois, Iowa, Kentucky and New York, as well as the New Brunswick Energy and Utilities Board in Canada.

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. In this testimony, I will respond to certain parts of the direct testimonies of Staff witnesses Jane Dhority and Lisa Ferguson. Specifically, I will rebut Ms. Dhority's testimony related to incentive compensation, supporting the reasonableness of the Company's incentive compensation plans, as well as correcting flaws in Ms. Dhority's calculation of her proposed adjustment to remove a portion of the incentive compensation costs from the Company's cost of service calculation. In addition, I will respond to Ms. Ferguson's direct testimony related to corporate allocations and affiliate transactions, including the proposed adjustments to exclude additional costs.

III. <u>INCENTIVE COMPENSATION</u>

Q. Please summarize Staff's recommendations regarding the recovery of incentive compensation costs in this case.

A. While Ms. Dhority states Staff does not intend to make adjustments to union incentive compensation payouts associated with collective bargaining agreements between the Company and its union employees, Ms. Dhority did propose adjustments to remove earnings-based incentive compensation from the Company's revenue requirement calculation in this case. Specifically, Ms. Dhority proposes to remove all long-term incentive compensation paid to employees, all compensation related to stock purchases, and the amount of short-term incentive compensation paid to non-union employees Staff believes is related to financial performance metrics.

Q. Did Staff explain the basis for its proposed adjustments?

A. Not in detail. Ms. Dhority only states that she proposes to remove <u>long-term incentive compensation because it is tied to growth objectives, employee share purchase plan costs because they are related to stock purchases, and compensation tied to financial performance metrics (through the short-term incentive plan ("STIP") and shared bonus pool ("SBP") because they create a perverse incentive to decrease operating expenses</u>. In addition, Ms. Dhority proposes to remove all capitalized short-term incentive compensation paid out in 2018 and 2019 because they were unable to determine how much of the amounts pertained to each incentive compensation plan.

Q. Do you agree with Staff's proposed adjustments to incentive compensation?

A. No. There are a number of reasons why incentive compensation costs should be recoverable in the rates for utility service. First, it is important to keep in mind that incentive compensation plans, like those offered by APUC and its subsidiaries, are routine and widely-accepted mechanisms for motivating employees to strive for excellence in whatever service, function, task or activity they are undertaking on behalf of the business and the customers it serves. In fact, it is a compensation element so widely offered to employees in the modern business environment that it has become a necessary part of overall compensation packages in order to retain and attract employees.

Q. Does incentive compensation based on financial performance metrics or goals benefit customers?

A. Yes. There are two main aspects of utility service that are of paramount interest to customers – the quality of the utility service they receive and the cost of that service. By approving incentive compensation based on operation or service goals, the Commission has recognized that such incentive can benefit customers by improving the quality, timeliness or other customer-centric attributes of the service they receive. However, customers can also benefit when employees respond positively to financial-based incentives. Whether that response results in increased revenues or decreased costs, producing better earnings in the short-term, customers ultimately reap the benefits through lower rates when such increased revenues or reduced costs are captured in the cost of service.

Q. Are there other reasons why it is appropriate to include financial-based incentive compensation in rates?

A. Yes. In providing incentive compensation, it is very important to have a "balanced scorecard" that emphasizes both service- and cost-related goals, rather than just one to the exclusion of the other. If only service goals are emphasized, service-related improvements may be achieved, but the costs for doing so and the cost of service generally may become exorbitant. On the other hand, if a company only focuses on financial-based goals, costs may be lower but service may deteriorate to unacceptable levels. Having a balanced scorecard that emphasizes both of these goals is critical to avoiding such distortions.

Q. Has the Commission previously authorized recovery of incentive compensation costs partially based on financial metrics through rates?

A. Yes. In a 2009 decision (Ameren rate case, Case No. ER-2008-0318), the Commission appropriately recognized that it was reasonable and appropriate to permit recovery of earnings-based incentive payments as long as they were made pursuant to a balanced scorecard that included a combination of operational, service and earnings-based goals. While the Company believes all of its incentive compensation payments should be recoverable in rates, at a minimum, these considerations support inclusion of all of the incentive compensation payments made in connection with the SBP and STIP plans, as well as those associated with the Variable Pay Plan ("VPP") that Staff has already accepted.

Q. Please summarize your rebuttal testimony with regards to incentive compensation.

A. The incentive compensation paid to employees and included in the Company's revenue requirement is reasonable and provides balance and benefits for customers. The Commission should reject Staff's proposed adjustments to disallow any portion of the incurred incentive compensation costs.

IV. CORPORATE ALLOCATIONS & AFFILIATE TRANSACTIONS

Q. Please summarize Staff's testimony and recommendations related to corporate allocations and affiliate transactions.

A. Ms. Ferguson summarized Staff's audit in five categories: 1) costs borne by the cost causer, 2) external reviews of the CAM and indirect overhead studies, 3) allocation factors and supporting calculations, 4) assignment of costs, and 5) adjustments to allocated costs. I address each category in turn.

Q. Are corporate costs borne by the cost causer?

A. Yes. As Ms. Ferguson states, the affiliate transaction rule is premised on the idea that allocated costs should be directly charged to the extent possible, leaving minimal costs to be indirectly allocated. The underlying premise of the APUC CAM is to direct charge to the maximum extent practicable.

Q. Does Ms. Ferguson suggest that the Company was inappropriately allocating costs that should have been directly assigned to another entity?

A. No. Ms. Ferguson simply states that there are no directly assigned costs from APUC.

Q. Why are there no directly charged costs from APUC?

A. As Ms. Ferguson describes in her direct testimony, as the ultimate corporate parent company, APUC provides financial and strategic management, corporate governance, and oversight of administrative and support services to the entire organization. The reality is that APUC executives have broad responsibilities to set the strategic direction of APUC and the companies within the corporate family and ensure that financial, regulatory, legal, investor and other matters central to the effective and appropriate operation of a modern corporation. Given these broad obligations, the time, duties, and services provided by these executives are broadly applicable and beneficial to all subsidiaries and cannot be isolated to one entity through time sheets. As such, costs are allocated based on allocation principles that are fair and appropriate for all APUC subsidiaries.

Q. Does Staff accept the third-party reviews of the CAM and indirect time studies?

A. Yes. Ms. Ferguson noted that PricewaterhouseCoopers' ("PwC") review of the CAM determined that the mechanics of the allocation processes were working as designed and in accordance with the CAM, and there were no instances of redundancy or overlap identified. Furthermore, Ms. Ferguson did not separately suggest that Staff identified any flaws in the allocation processes or instances of overlap or redundancy in corporate services. Ms. Ferguson also acknowledged and did not dispute the fact that both external reviews of the indirect overhead capitalization rates resulted in opinions that the rates utilized were reasonable.

Q. Please summarize Staff's review and recommendations with regards to allocation factors.

A. Staff reviewed allocation factors provided by the Company for 2018 through 2023 and determined that the appropriate allocation factors to utilize for calculating the cost of service were the 2023 allocation factors.

Q. Do you agree with Staff's adjustment to reallocate costs incurred by shared services affiliates in 2022 using 2023 allocation factors?

A. Absolutely not. In accordance with the defined allocation methodologies described in the CAM, costs were incurred and allocated based on the calculated cost allocation factors effective for that period. It is not appropriate to cherry-pick and choose to recalculate the allocated costs using 2023 allocation factors because Liberty Midstates' allocation percentage decreased. The 2022 allocation factors that were used to allocate the costs included in the Company's calculated cost of service accounted for all material changes to the APUC/Liberty structure since the Company's prior general rate case in 2018. As Ms. Ferguson highlighted in her direct testimony, the allocation factors were updated for several corporate acquisitions from 2019 through 2022.[1]

Q. Does Staff believe costs are fairly assigned to the Company?

A. Ignoring Staff's adjustment to reallocate costs based on allocation factors from a different period, Ms. Ferguson states that costs appear to be fairly assigned/allocated between regulated and unregulated operations based on the CAM. Ms. Ferguson did note that Staff identified and adjusted a small amount of acquisition-related travel costs incurred and allocated to the Company during the test year.

Q. Do you agree with Staff's adjustment to remove the acquisition-related travel costs?

A. Yes. Unfortunately, these costs were not included in the Company's adjustment to its direct filing to remove non-recoverable costs from the cost of service.

Q. Did Staff make additional adjustments to remove allocated costs from the Company's test year costs?

A. Yes.

Q. Do you agree with Staff's additional adjustments?

A. Only one. Staff's adjustment included a few additional charitable contributions that were inadvertently excluded from the Company's adjustment included in its direct filing to remove non-recoverable costs. The Company agrees these should be removed from the revenue requirement.

[1] Ferguson direct testimony, pages 34-35.

On the other hand, Staff's adjustment included several transactions that were already included in the Company's non-recoverable adjustment in the direct filing and excluded several transactions that the Company removed. Staff's adjustment is essentially removing certain transactions twice but doesn't add back the transactions that the Company removed but Staff's adjustment did not remove.

Q. Can you provide an example of a transaction type that Staff did not include in their adjustments to remove costs?

A. Yes. The Company's adjustment removed Liberty Midstates' allocation of several transactions related to meals and entertainment. More specifically, the Company's adjustment removed costs associated with employee parties. While the Company firmly believes these costs are a necessary, appropriate, and important part of doing business, boosting employee morale, and retaining employees, we did not seek to recover those costs from customers. Although Staff's adjustment did not seek to remove all of the transactions that the Company included in its adjustment, we still believe it is appropriate to exclude these costs.

Q. Can you provide examples of transaction types that Staff included in their adjustments, that the Company disagrees with?

A. Yes. Staff excluded certain transactions related to advertising, benefits paid to employees (e.g., car and housing allowances), awards paid to employees through defined recognition programs, and various other expenses without any explanation in Ms. Ferguson's direct testimony. These costs are reasonable and prudent costs incurred by the Company to attract and retain a talented workforce and should be recovered through rates.

Q. Does this conclude your rebuttal testimony at this time?

A. Yes.

VERIFICATION

I, Jill Schwartz, under penalty of perjury, on this 22nd day of August, 2024, declare that the foregoing is true and correct to the best of my knowledge and belief.

/s/ Jill Schwartz