Exhibit No.:	
Issue(s):	*Operating Expense, Transition & Transaction Costs, Business Development Costs, Excess ADIT, CWC Tax Leads, Allocations, C1 O&M, Plant & Reserve*
Witness:	*Lisa M. Ferguson*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Surrebuttal Testimony*
Case No.:	*GR-2024-0106*
Date Testimony Prepared:	*September 19, 2024*

MISSOURI PUBLIC SERVICE COMMISSION

FINANCIAL & BUSINESS ANALYSIS DIVISION

AUDITING DEPARTMENT

SURREBUTTAL TESTIMONY

OF

LISA M. FERGUSON

LIBERTY UTILITIES (Midstates Natural Gas) CORP., d/b/a Liberty

CASE NO. GR-2024-0106

Jefferson City, Missouri
September 2024

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SURREBUTTAL TESTIMONY

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LISA M. FERGUSON

LIBERTY UTILITIES (Midstates Natural Gas) CORP.,
d/b/a Liberty

CASE NO. GR-2024-0106

Q. Please state your name and business address.

A. Lisa M. Ferguson, 111 N. 7th Street, Suite 105, St. Louis, MO 63101.

Q. By whom are you employed?

A. I am employed by the Missouri Public Service Commission ("Commission") as a member of the Auditing Staff ("Staff").

Q. Are you the same Lisa M. Ferguson who filed Direct Testimony on July 18, 2024 as well as Rebuttal Testimony on August 22, 2024 in this case?

A. Yes, I am.

Q. What is the purpose of your Surrebuttal testimony in this proceeding?

A. My surrebuttal testimony will address the rebuttal testimony of the following Liberty Midstates Gas witnesses: Charlotte T. Emery regarding operating expense levels (with inclusion of a 5% amortization rate for FERC[1] account 303), capitalized transition/transaction costs, non-labor business development costs, and the regulatory liability proposed by Staff related to the Tax Cuts and Jobs Act (TCJA) federal income tax stub period; Timothy S. Lyons regarding federal and state income tax expense lead/lags within cash working capital; Jill Schwartz regarding allocation factors and Staff's removal of allocated test year

[1] Federal Energy Regulatory Commission (FERC).

costs (and its association with Liberty Midstates' proposed non-recoverable expense removal and Staff witness Blair Hardin's proposed miscellaneous expense removal); Liberty Midstates Gas witness Michael McCuen regarding excess accumulated deferred income tax and the TCJA federal income tax stub period calculation; and Charlotte T. Emery and Lauren Preston regarding annualization of the Customer First Operations & Maintenance Expense. My surrebuttal testimony will also address the Office of the Public Counsel ("OPC") witness John A. Robinett regarding certain plant and accumulated reserve issues within Staff's accounting schedules.

OPERATING EXPENSE

Q. On pages 3 and 4 of Ms. Emery's rebuttal testimony she discusses that Staff's overall proposed operating expense is less than that recommended in Liberty Midstates' last rate case. Does it make logical sense that the operating expenses annualized for this current rate case would be less than Liberty Midstates' last general rate case six years ago, GR-2018-0013?

A. No. Staff acknowledges that due to the general increase in costs over time and possible inflation, it does not logically make sense that overall operating expenses would be less. However, Staff believes much of this difference is due to the data Liberty Midstates has provided that is different than the data the Company is itself using to annualize certain large costs.

Q. Do you agree with witness Emery that it appears that the drivers of the lower expense and the significant portions of the differences between Company and Staff are in the areas of Payroll, Payroll Taxes, Employee Benefits and Pension and Other Post-Employment Benefits ("OPEB") expenses?

A. Yes. Staff is aware of some corrections that were calculated and applied to the capital piece of employee benefits, and pension and OPEBs, as part of Staff's rebuttal case. However, there are still differences between Staff and Liberty Midstates outside of those capital issues as it relates to payroll, payroll taxes, and employee benefits. Staff continues to review its payroll and payroll tax positions as there appears to be a bigger difference between Staff and Liberty Midstates than what would be expected based upon the known differences in position regarding that issue. Staff witness Benjamin H. Burton further addresses payroll and payroll taxes in his surrebuttal testimony and Staff witness Jane C. Dhority further addresses employee benefits within her surrebuttal testimony. In addition, Staff inadvertently omitted applying the amortization rate of 5% to the annualized plant for FERC account 303, Intangible Plant. This amount of amortization expense has now been included in Staff's cost of service and is worth approximately $960,000 in revenue requirement for both rate districts.

CAPITALIZED TRANSITION AND TRANSACTION COSTS

Q. On page 6 of Charlotte Emery's rebuttal testimony she disagrees with the removal of capitalized transition and transaction costs that stem from Liberty Midstates' rate case, GR-2014-0152. Please explain the situation regarding this.

A. The transition and transaction costs that are still currently capitalized on Liberty Midstates' books and records were first addressed as part of the case regarding Liberty Midstates' acquisition of the Atmos Gas properties. Staff's review and analysis from Liberty Midstates' first rate case subsequent to that acquisition case stated:

> As part of the Stipulation and Agreement in the Liberty Utilities Acquisition Case, Case No. GM-2012-0037, transaction and transition costs were contemplated as being costs that would be incurred by Liberty Utilities as a result of the acquisition. Transaction costs as defined in the stipulation and agreement are costs relating to gaining regulatory approval, development of transaction documents, investment banking

> costs, costs related to raising equity incurred prior to closing of the transaction, communication costs regarding the ownership change, and name change costs. As part of the Stipulation and Agreement in the acquisition case, Liberty Utilities agreed that it would not seek recovery of any transaction costs related to the acquisition. Staff reviewed Liberty Utilities' books and records for the test year ending September 30, 2013 and has removed what is defined by the stipulation as transaction costs. These included costs to rename certain assets and the cost of customer notifications related to the change in ownership. As part of Staff's review of these costs, Staff has made an adjustment to remove certain advertising costs related to customer notifications. In addition, it was agreed that any transition costs could be placed on Liberty Utilities books for consideration in future rate cases. Most transition costs have historically been determined to be non-recurring in nature and therefore are typically removed from the utility's cost of service. Liberty Utilities removed several transition costs as part of the adjustments made to its direct filed case such as expenses related to the Continuing Services Agreement with Atmos to provide services related to the transition of customer billing. Staff has reviewed these costs as part of its analysis of transition costs and included an adjustment to remove costs related to transition items which should not be included in the ongoing cost of service. These included costs such as the expenses related to the Continuing Services Agreement in place for part of the test year with Atmos Energy Corporation to assist with the transition to Liberty Utilities.

Liberty Midstates settled the GR-2014-0152 rate case wherein rate base values were stated within the Stipulation & Agreement that was agreed to, accepted and ordered by the Commission. In Liberty Midstates' next rate case, GR-2018-0013, the Company had not written off these costs from its books and records so Staff again proposed to remove these costs so as not to include them in Liberty Midstates' rate case:

> In Liberty Midstates - MO's prior rate case (Case No. GR-2014-0152), Staff removed certain transition and transaction costs from plant-in-service and depreciation reserve that were associated with Liberty Midstates - MO's acquisition of Atmos Energy Corporation's Missouri assets and operations. Liberty Midstates - MO agreed with those adjustments and also agreed to a specific rate base value for each separate rate district that excluded Staff's capitalized transition and transaction costs. As part of its audit conducted in this rate case, Staff discovered that Liberty Midstates - MO has not removed any of the capitalized transition and transaction costs and corresponding depreciation reserve balances from its property records. Therefore, Staff has made adjustments that

> exclude these prior rate case capitalized transition and transaction plant balances and corresponding depreciation reserve balances that still exist on Liberty Midstates - MO's books at the end of the December 31, 2017, update period. Staff will update these adjustments to remove balances that exist at the March 31, 2018, true-up cutoff as established by the Commission in this rate case. Furthermore, Staff has confirmed that no transition or transaction costs that resulted from The Empire District Electric Company acquisition case (Case No. EM-2016-0213) have been assigned to Liberty Midstates - MO and therefore none of those costs are included in the cost of service calculation in this rate case.

Liberty Midstates' last rate case was ultimately settled by Stipulation & Agreement, again reflecting certain agreed upon rate base balances that were agreed upon by the parties and ordered by the Commission. In the current rate case, Liberty Midstates has not written off these transition and transaction costs and thus, Staff proposed to remove the plant costs and updated depreciation reserve amounts associated with that plant.

Q. Liberty Midstates' witness Emery mentions on page 6, lines 17-20 of her rebuttal testimony, that the Company does not agree to the removal of these costs as it utilizes a Commission Order as authorization to remove balances from its books and records and that no such order has been issued to date. Does Staff agree that no such order has been issued to date?

A. No. Due to the specific delineation of rate base that was agreed to by the parties to the preceding Liberty Midstates' rate case and the subsequent order approving that Stipulation in prior rate cases, it is understood that the removal of the capitalized transition and transaction costs are reflected in those specific rate base balances. However, if Liberty Midstates believes that it needs more distinct language, if disposition of this current case is accomplished via a Stipulation & Agreement, specific language can be spelled out that Liberty Midstates will write off these capitalized costs that can then be subsequently ordered by the Commission.

NON-LABOR BUSINESS DEVELOPMENT COSTS

Q. On page 15, lines 1-11, of Charlotte Emery's rebuttal testimony she disagrees with Staff's proposed removal of test year business development non-labor costs because this is a normal part of the Company's business which has a goal to increase customers, thereby spreading costs and reducing rates for all customers. Does Staff agree with this explanation?

A. Partially. While it is true that increasing the customer count, all things equal, tends to reduce the cost of service for existing customers, this only happens if the customers are actually onboarded and if those revenues from new customers offset any increase in expense or increase in rate base that occurs from serving those new customers. Even then, the labor and non-labor costs associated with utility acquisitions or economic development would be borne by existing customers, and not necessarily new customers, absent any removal of those costs from the cost of service. This would happen regardless as to if potential customers actually became customers of Liberty Midstates. The other aspect that witness Emery does not state here is that the utility will benefit by increased return on investment in rate base if those new customers come on, simply by an increase in net rate base. If the non-labor business development costs would be included in rates, Liberty Midstates stands to benefit from recovery of the costs of business development and possibly an increase in rate base if new customers are onboarded. If new customers are not onboarded and the non-labor business development costs would be included in rates, then the Company still recovers the business development cost with no new customers to spread that increase in costs to. Existing customers would more than likely not benefit either way if the costs are included.

Q. What activities did the business development team perform during the test year?

A. The business development team performed activities related to renewable natural gas (RNG) development and utility acquisitions. It has been Staff's position that research & development costs, such as RNG development, should be proven to ultimately produce some benefit to customers that outweighs the costs or there is simply an increase in costs to customers. Staff's position regarding acquisition costs typically depends on what types of acquisition costs there are, but customers should not bear the cost for Liberty Utilities or Liberty Midstates to seek out an acquisition.

Q. Liberty Midstates' witness Emery also mentions that as of the end of the update period, December 31, 2023, the business development responsibilities included providing assistance to companies and organizations that are contemplating new business or expanding business in Missouri, which helps foster economic development in Missouri. Does this change Staff's position with regard to removal of test year labor and non-labor costs relating to business development?

A. No. As these activities are described to be occurring at the end of the update period, those costs are not being proposed for removal in this case. Until ongoing activities and costs associated with those activities can be fully reviewed, understood and determined to be ongoing, the test year costs related to unexecuted RNG development and acquisitions will be removed. It is not the customer's choice to see an increase in their bills due to costs incurred related to "possible" RNG development and "possible" cost reduction through acquisitions of other utilities. This position protects customers and this is also why, during acquisition cases, Staff recommends non-recovery for transaction costs and may include transition related costs to the extent that the benefits outweigh the costs. However, Staff already allows costs for chamber of commerce dues which should assist in economic development.

TCJA AND MO EXCESS ACCUMULATED DEFERRED INCOME TAX STUB PERIOD

Federal Income Tax Stub Period

Q. As mentioned on page 18, lines 18-24 and page 19, lines 1-3, of Charlotte Emery's rebuttal testimony, please explain why Staff included a regulatory liability and associated amortization related to the TCJA federal income tax reduction.

A. As discussed in my direct testimony, for the federal tax rate change resulting from the TCJA, the income tax rate was initially calculated assuming a 35% rate but after January 1, 2018 the ADIT[2] was overstated as the new tax rate was only 21%. Staff included the ongoing federal tax rate of 21% in its calculation of current income taxes in Liberty Midstates' last rate case so as of the effective date of rates in the last case (June 30, 2018), the revenue requirement, including ADIT, moving forward would have been valued at the lower tax rate. However, since the tax rate change occurred January 1, 2018 but rates did not change to enact the lower current tax rate until June 30, 2018, this creates a stub period of federal excess income taxes from the period of January 1, 2018 through June 30, 2018.

Q. Would Staff have been aware of the potential stub period in the last general rate case?

A. Yes, but only partially. The tax change occurred in the midst of the ongoing rate case and there was a question as to whether Liberty Midstates would have the ability to value the protected, plant related, ADIT tax impact utilizing the Average Rate Assumption Method or the Reverse South Georgia method. However, I would argue that Liberty Midstates would also have been aware of the stub period and also did not propose to rightfully return the stub period revenue requirement amount to customers. Customers were paying a higher tax in their

[2] Accumulated Deferred Income Tax (ADIT).

customer rates until rates changed, this was their money they had paid based on the cost of service at the higher tax rate that was no longer in effect. As legislation is what determined this lower tax rate, customers should not have been penalized for this change; just as the utility should not be penalized if there would be an increase in the tax rate. As Ms. Emery mentions in her rebuttal, Liberty Midstates, other Liberty affiliates and other utility stakeholders, participated in the working group, AW-2018-0174[3], answered questions and provided an estimated valuation of the tax change. As it states in Staff's recommendation, the TCJA would likely result in windfall profits for all Missouri regulated public utilities and that was not the intention of the TCJA. As stated in my testimony in Liberty Midstates' last rate case, GR-2018-0013, it was Staff's intention to include all income tax effects within that rate case. Staff did not propose to include the stub period in the last rate case due to the uncertainty surrounding valuation of the protected ADIT (as that would have had to have been known) and assumed that this amount would be deferred with the rest of the excess accumulated deferred taxes starting at January 1, 2018.

Q. Ms. Emery states in another section in her testimony that it is only fair that Liberty Midstates be treated the same as other utilities. Did other Missouri utilities return the stub period tax reduction to their customers?

A. Yes.

Q. On page 19, lines 15-18 of Ms. Emery's rebuttal testimony she discusses that in the last rate case, no stub period regulatory liability was set out in the Stipulation & Agreement

[3] AW-2018-0174 (Working Group): In the Matter of the Revenue Effects Upon Missouri Utilities of the Tax Cuts and Jobs Act of 2017.

approved by the Commission in the case. What language was contained within the Stipulation regarding taxes?

A. The following language, specific to income taxes, was included within the Stipulation and Agreement in GR-2018-0013:

> Taxes 13. The Parties agree that the revenue requirement of $4,600,000 recommended in this case should and does reflect the full impact of the reduction in corporate tax rates from 35% to 21% resulting from the Tax Cuts and Job Acts of 2017 (the "Tax Act"). It does not include any allowance for the return of excess accumulated deferred taxes, which issue will be evaluated in the Company's next rate case. Liberty Utilities shall establish a regulatory liability to account for the tax savings associated with excess Accumulated Deferred Income Taxes ("ADIT").
>
> A. Liberty Utilities will record a regulatory liability for the difference between the excess ADIT balances included in current rates, which was calculated using the 35% federal corporate income taxes, versus the now lower federal corporate income tax rate of 21%.
>
> B. Liberty Utilities is in the early stages of evaluating the cost and ability to use the Average Rate Assumption Method ("ARAM") as a method for computing and normalizing excess ADIT. If Liberty Utilities determines that it is unable to use the ARAM, Liberty Utilities shall notify the Parties within thirty (30) days of such determination. Liberty Utilities shall provide testimony and support in its next general rate case of its proposed methodology in dealing with the balances.
>
> C. The calculation of the Regulatory Liability of excess ADIT will begin as of January 1, 2018.
>
> D. The Parties intend to appropriately reflect excess ADIT in future customer rates using a methodology consistent with the tax normalization requirements specified by IRS normalization principles. The Parties agree that, in the event the IRS asserts that the terms of this Stipulation and Agreement create a violation of normalization requirements, this Stipulation and Agreement shall be amended to cure and prevent any normalization violation.

Staff clearly understood the Stipulation language to mean something different than what Liberty Midstates understood it to mean and now the Company is claiming retroactive ratemaking. I assume it is the phrase "The Parties agree that the revenue requirement of $4,600,000 recommended in this case **should and does reflect the full impact of the reduction**

in corporate tax rates from 35% to 21% resulting from the Tax Cuts and Job Acts of 2017 (the "Tax Act")" that the Company believes absolves them of returning the stub amount.

Q. Has Staff capitulated its position regarding inclusion of the excess federal income tax stub period regulatory liability and associated amortization?

A. Yes; only because of the wording in the Stipulation & Agreement from the last rate case "…the revenue requirement of $4,600,000 recommended in this case should and does reflect the full impact of the reduction in corporate tax rates from 35% to 21% resulting from the Tax Cuts and Job Acts of 2017 (the "Tax Act")." This is because the statement could be construed to mean that the stub amount had already been considered within the revenue requirement reduction and the fact that Staff did not include language specifically addressing a stub period amount to be returned to customers in Liberty Midstates' next rate case (this case).

Q. On page 6, lines 1-11, of Liberty Midstates' witness Michael McCuen's rebuttal testimony he describes what a "stub period" calculation entails. Do you agree with his description?

A. Generally, yes. A stub period measures the change in the revenue requirement from the cost of service valued at the original tax rate as compared to the new tax rate. However, that was the problem with including the stub period as part of the last rate case because the true-up cutoff in that case included investment through March 31, 2018. I do agree that the plant additions after March 31, 2018 would not have been considered in the calculation, but I do not agree with Mr. McCuen that the ADIT had nothing to do with the calculation of the stub period amount. The current tax rate wasn't the only item that would have had to be restated in the revenue requirement to determine the stub amount, the ADIT would have had to be revalued past December 31, 2017 because the true-up cutoff date in Liberty's last rate case was

March 31, 2018. This would have required Liberty Midstates to determine if ARAM or the Reverse South Georgia Method (RSGM) would be used. They did not know at the time, hence the need to establish a deferral for the return of the excess ADIT itself.

Q. Did Staff miscalculate the stub period in its direct case?

A. Unfortunately, yes. After reviewing the stub period calculation methods utilized for other Missouri utilities, the stub amount should have been calculated differently than I proposed in my direct workpapers.

State Income Tax Stub Period

Q. On page 6, lines 12-21, Mr. McCuen explains that Liberty Midstates generally agrees with some of what Staff describes regarding the state income tax reduction, but that there is disagreement on the amount of the net operating loss (NOL) to offset the excess accumulated deferred income tax (EADIT). Is that correct?

A. Yes. I discuss this in more detail later in this testimony.

Q. On page 6, lines 18-21, of his rebuttal testimony, Mr. McCuen states his understanding that the Commission has not requested that Missouri Investor Owned Utilities (IOUs) establish a regulatory liability associated with the decrease in state taxes. Is that correct?

A. No. The state tax reduction has been reflected as a regulatory liability with an associated amortization amount that reduced revenue requirement at many, if not most, other Missouri IOU's. Those regulatory liabilities and associated amortizations are currently reflected in customer rates at those utilities.

Q. Does Staff recommend the Commission order Liberty Midstates to establish a deferral beginning with the effective date of rates in this case that reflects the "stub" period for the state income tax rate change?

A. Yes. Staff wishes to avoid the situation that occurred and is discussed above regarding the federal income tax stub period. As I mentioned in my direct testimony, Staff recommends that Liberty Midstates establish a deferral taking into account the stub period for the state tax rate change that began January 1, 2020 through the effective date of rates in this case, when the lower rate of 4% is reflected in the cost of service moving forward. That amount needs to be deferred and returned to customers in Liberty Midstates' next rate case.

Q. In your direct testimony you stated that "Staff has included the federal EADIT stub period return to customers in the current rate case and has also included the state EADIT through December 31, 2023 in this case. The stub period amount for state EADIT for the period of January 1, 2024 through the effective date of rates in this case will need to be deferred and returned to customers in Liberty Midstates' next rate case." Did you, in fact, include an amount reflecting the change in the revenue requirement for the state income tax for the period of January 1, 2020 through December 31, 2023 in Staff's direct cost of service?

A. No. Staff mentioned that it was included in the cost of service in testimony but Staff inadvertently omitted the value from the cost of service. Staff included the state excess ADIT balance in the cost of service but not the revenue requirement change that would need to be reflected since customers have been paying the higher state income tax rate since January 1, 2020 in rates. That higher tax rate will be included in customer rates until rates change in this case. Since Staff inadvertently omitted this value from direct, out of respect for all parties' abilities to have time to analyze and determine if there is agreement on the amount of the reduction to include in rates, Staff proposes Liberty Midstates calculate and defer the entire state income tax stub amount for the period of January 1, 2020 through the effective date of rates in this case, to be determined in the next rate proceeding.

<u>INCOME TAX EXPENSE LAGS – CASH WORKING CAPITAL</u>

Q. On page 2, lines 19-22 and page 3, lines 1-6, of Liberty Midstates' witness Timothy S. Lyons' rebuttal testimony, he discusses his disagreement with increasing the expense lead/lag days for federal and state tax payments in cash working capital (CWC) from 37 days to 365 days because it does not reflect the Internal Revenue Service's (IRS) payment schedule for corporations, specifically IRS Publication 542. Does Staff's proposed expense lead/lag days for federal and state tax follow IRS publication 542?

A. Yes and no. While what Mr. Lyons says is true, Liberty Midstates must follow IRS publication 542 for paying estimated taxes to the affiliate group based on the tax allocation agreement and the payment schedule set out in IRS publication 542, Liberty Midstates Gas is not actually making payments to the affiliated group. As I discussed in direct, Liberty Utilities (America) Corp. is the overall parent that files a consolidated income tax return on behalf of its affiliate subsidiaries. The rules and expectations of the affiliates in respect of income taxes is lined out in the tax allocation agreement. Liberty Midstates Gas, like other Liberty Utilities subsidiaries, is expected to pay estimated tax or provide its portion of a net operating loss to the parent on the quarterly basis, utilizing one of the methods described in IRS publication 542. However, based upon Liberty Midstates' response to Staff Data Request Nos. 0098 and 0353, Liberty Midstates Gas has a net operating loss for tax years 2022 and 2023, and even before that time period. As explained within the response to Staff Data Request No. 0353, due to Liberty Utilities (America) Corp. and Liberty Midstates Gas both being in net operating loss positions for the tax years 2022 and 2023, there was no income tax liability for those years and an estimated income tax payment calculation was not necessary. Cash working capital measures the amount of cash necessary for a utility to pay its day to day expenses that are incurred to provide service to its ratepayers. No cash was necessary for Liberty Midstates to pay to the affiliate group and thus the increase in the expense lead is consistent with prior case precedent established by the Commission.

ALLOCATIONS

Test Year Allocated Cost Removal/Non-Recoverable Cost

Q. Liberty Midstates' witnesses Charlotte T. Emery and Jill Schwartz discuss Staff's proposed adjustments for test year allocated costs, miscellaneous expense and non-recoverable costs. Can you delineate what each of these topics consist of and identify which Staff witness will address each?

A. Yes. In Liberty Midstates' direct testimony and related workpapers, the Company proposed removal of certain test year costs, that were labeled as "non-recoverable" expense. These adjustments related to items that were allocated down to Liberty Midstates from other Liberty affiliate entities. Staff ultimately agreed with Liberty Midstates' proposed adjustments, as reflected in the direct workpapers of Staff witness Blair Hardin. However, witness Hardin also reviewed other costs recorded in Liberty Midstates' books and records and also proposed disallowance of some promotional item costs. Staff witness Hardin's surrebuttal testimony will further address her proposed disallowance of costs, beyond those that were proposed by Liberty Midstates, that were accepted by Staff.

I reviewed the allocation factors and allocated costs that were ultimately allocated to Liberty Midstates. Staff endeavored not to overlap in its proposed test year disallowances either with each other's proposed adjustments or Liberty Midstates' proposed adjustments; however, that exercise was not successful. It does appear from Liberty Midstates' workpapers on this issue, that there were some allocated costs for which I proposed disallowance that the Company has also proposed for removal. Staff has reviewed these allocated cost items and has removed the duplicitous adjustments from the cost of service.

Q. On page 9, lines 6-15, of witness Schwartz's rebuttal testimony she discusses that Liberty Midstates proposed removal for meals and entertainment costs that Staff did not propose to remove. Do you agree this is the case?

A. No, or at least that was not the intention. After review of the costs that were proposed for removal from the cost of service, it was Staff's intention to accept all of the removals that Liberty Midstates proposed, as we agreed with the removal. After reviewing the workpapers, Staff did propose to remove those items, but Staff also proposed to remove additional items.

Q. Are there still allocated test year items that Liberty Midstates does not agree with but Staff maintains that removal from the cost of service is appropriate?

A. Yes. Staff has removed costs associated with late fees Liberty Midstates incurred for untimely payments for services it received, car allowances, housing allowances, advertising expenses, and awards and gifts. I will address each of these separately.

- **Late Fees:** Late fees should never occur in a properly run business and thus, rate payers should not pay for these avoidable costs.
- **Advertising Expenses:** According to the response to Staff Data Request No. 0354 the advertising expenses are related to investor relations activities such as market surveillance and analysis and no copies of this documentation can be provided for review. Staff would argue that these costs could be related to securing capital for use by the regulated or unregulated portions of the Company or could be

considered a stock holder cost and should not be borne by the rate payer. Since there is no documentation to review, it is hard to distinguish if these costs are driven more by shareholders needs or are a proper cost that ratepayers should completely bear.

- **Car and Housing Allowance:** In relation to the car allowances and house allowances, Liberty Midstates explains that there is no company policy regarding car or housing benefits and that these amounts are based on specific employee agreements. However, the car allowance benefits are for executive level employees and are described as part of their compensation package. The housing allowance may be provided to senior level management based on a relocation or travel requirement. Staff argues that most customers of Liberty Midstates do not have their car or house, even partially paid for as part of their compensation package, nor do all of the employees of Liberty Midstates have access to this type of benefit. If Liberty Midstates wishes to offer these "perk" benefits to a certain segment of its employees, shareholders should fund that cost. According to Liberty Midstates' response to Staff Data Request No. 0113, there were no relocation costs incurred by Liberty Midstates Gas during the test year ending December 31, 2022, so the housing allowance must not be related to relocation. This would mean that the housing was related to a travel requirement. Staff has no way of knowing what type of travel would require housing; if housing were necessary (as there is no company policy on the subject), that would be different than hotel or travel related costs. Staff also has no cost analysis from Liberty Midstates demonstrating least cost options were used or considered.

- **Awards/Gifts:** According to responses to discovery[4] Liberty Midstates explains that there are two types of awards/gifts: expense report transactions for gifts purchased by a manager for an employee or Spark awards and service awards. The general ledgers show individual transactions labeled as "awards/gifts", however there is not always detail included within the general ledger to determine if the cost is associated with a gift, service award or Spark award. In fact, the term

[4] Response to Staff Data Request No. 0354.

"Spark award" is not mentioned in the general ledger that I am aware of, so it is difficult for Staff to determine whether a cost is a service award or Spark award. Staff was unaware of the Spark award program until Staff received the response to Data Request No. 0354. Staff attempted not to remove costs associated with service rewards as Staff understands that this is necessary for employee recognition and retention. Staff and Company have agreed on removal of at least some of the costs for several instances of gifts associated with expense report transactions, but some remain. As far as the Spark awards, employees already receive base salaries, employee benefit packages and incentive compensation of which most amounts are included in customer rates. The Spark award program description describes the award criteria as the following:

- Growing our people and their capabilities to support the evolving needs of the business.
- Get our Regulated business running as one optimized business, including SAP.
- Meet our financial targets.
- Complete the sale of our Renewables business (unregulated business).
- There are also seven guiding principles that contribute to the level of the Spark award: Customer centric, integrity, entrepreneurial, teamwork, owner mindset, outcome focused, continuous learning.

Without comparing the above criteria list with that of each of the specific goals of Liberty Midstates' incentive compensation plans these awards seem excessive and duplicative of incentive compensation and the cost should be borne by shareholders. In general, the goal of incentive compensation is to incent an employee to go above and beyond typical job duties. The criteria described for the Spark Awards appears to do the same thing, not to mention that some of the criteria are earnings driven and some of the criteria are related to unregulated business.

Allocation Factors

Q. On page 7, lines 13-24 and page 8, lines 1-4 of Liberty Midstates' witness Jill Schwartz's rebuttal testimony, she describes Staff's review of Liberty Utilities' corporate allocation factors for the period of 2018 through 2023 and disagrees with Staff's proposal to restate test year allocated costs based upon 2023-2024 allocation factors. Did Staff propose to restate test year allocated expense based upon 2023-2024 allocation factors?

A. Yes. While each year's allocation factors are developed based upon costs that were actually incurred through May to April of any given year (allocation factors are reset annually in April unless a material change occurs), the costs are simply used to develop allocation factors that are representative of the cost drivers. The costs included in rates moving forward should represent the levels of costs that are expected to occur when rates are in effect. That would mean reflecting allocation factors that are the most representative of how the Company is structured and how costs are incurred when rates are in effect.

Q. Does Staff agree with Ms. Schwartz's assertion that ongoing allocated costs should be included in rates based upon factors that were effective for that period and that period alone?

A. No, not necessarily. It depends upon operating changes or other material changes that have occurred during the periods that would have a direct impact on how the allocation factors were calculated and whether those changes occurred before, during, or after the test year. A main aspect of ratemaking in Missouri includes setting rates that are generally reflective of a utility's company structure, operating conditions and levels of investment, revenue and expense that is thought will be experienced when rates are in effect. This is to be based on known and measurable data. This is accomplished by adjusting historical test year amounts to appropriate levels based on historical information. Many times, there are fluctuations in costs from year to year and changes in corporate structure that if not fully experienced in the test year would not be representative of costs moving forward.

Q. Per Liberty Midstates' witness Schwartz's Rebuttal testimony[5], did Staff "cherry-pick" and choose to recalculate the allocated costs using 2023 allocation factors"?

A. No. Hence the analysis I discussed in my direct testimony regarding the cost drivers, the calculation of the allocation factors for each affiliate, annual cost levels, and material changes to the corporate structure for the period of 2018-2023, since the last rate case. If Staff had simply wished to take the lowest allocation factor, no analysis would be needed.

Q. Can you describe the review and thought process you utilized when reviewing the allocation factors and proposing your adjustment?

A. Yes. Staff reviewed all allocation factors for all levels of costs that are allocated down to Liberty Midstates Gas. As explained in Liberty Midstates' cost allocation manual, each affiliate entity has its own drivers that determine the percentage used to allocate costs to each Liberty Utilities entity. Please refer to my direct testimony for a full discussion on the CAM allocation methodology. As part of its review of the allocation factors, Staff reviewed the cost drivers used to develop each allocation factor, the amounts used to determine the factor, the corporate structure at that point in time, amongst other things.

Q. Why did Staff propose to reset test year allocation factors to 2023-2024 in this case?

A. Staff proposed to utilize the 2023-2024 factors due to the fact that APUC/Liberty Utilities acquired another regulated utility in January 2022. Since the allocation factors

[5] Page 7, lines 22-24.

changed beginning April 2022, an entire year of costs and drivers for the allocation factors prior to April 2022 was not expected to be fully representative of the latest acquisition. Utilizing the 2023-2024 factors would include an entire year of costs experienced with the addition of serving this new utility so not only would the cost levels be more representative but the changes in allocation factors based on that acquisition would also be more representative. Resetting the test year dollars to the 2023-2024 allocation factors would have the effect of normalizing the allocated costs.

Q. Has Staff proposed in other utility rate cases to reset allocation factors for allocated costs?

A. Yes, as this is a part of normalizing test year costs to an appropriate level.

<u>EXCESS ADIT REGULATORY LIABILITY AND AMORTIZATION</u>

Q. Does Staff agree that a portion of the net operating loss (NOL) should offset the excess ADIT that is to be returned to customers because a portion of the EADIT due to accelerated depreciation has not been realized due to tax deductions exceeding tax revenue?

A. Yes. Staff agrees that a portion of the NOL related to accelerated depreciation should offset the EADIT related to protected, plant related, ADIT. The question is how much of the NOL is related to accelerated depreciation. This is not a simple answer because all deductions reduce taxable income at once, what deduction was the tipping point that took taxable income negative? Staff's method in direct was to determine for each year 2012-2017, what amount of the loss existed and at what point was depreciation deducted from gross receipts. Staff determined a percentage [taxable income (loss)/total loss after all deductions] to apply to the loss that existed prior to other deductions during each year and then multiplied that percentage against Missouri's portion of the NOL for that year. Staff believed this was conservative because of the way that Liberty Midstates treated depreciation in its standalone tax returns and the fact that depreciation was not the only item it chose to include in cost of goods sold (COGS) that was then used to reduce gross receipts prior to application of the additional deductions.

Q. How did Liberty Midstates reflect its depreciation within its stand-alone tax returns?

A. For tax years 2012 through 2016, Liberty Midstates treated its depreciation as a cost of goods sold item along with labor costs, repairs & maintenance expense, cost of removal, contributions in aid of construction ("CIAC"), and other operating costs such as property taxes and insurance expense. Cost of goods sold is not considered a deduction, even though it functions like a deduction, because it is included in the process of adjusting gross receipts to determine gross income. Gross income is what deductions are removed from to determine the final amount for which to apply the income tax rate. Cost of goods sold is typically seen in tax returns of businesses that manufacture and/or sell products; not a business that provides a service. This is because cost of goods sold is a return of basis or, put another way, a method to allocate basis to the inventory/property that created the gross receipts or income. It is deducted from gross receipts in the tax returns prior to application of any other deductions that reduce taxable income. Cost of goods sold essentially recognizes that "it takes money to make money" so COGS allows for costs to be accounted for in producing income prior to imposing tax on that net income.

In tax year 2017, Liberty Midstates changed course and removed depreciation from cost of goods sold and started to reflect the depreciation expense as a separate deduction from taxable income, reflecting the fact that it is a utility providing a service.

Q. On page 2, lines 19-24 and page 3, lines 1-4, of Michael McCuen's rebuttal testimony he states that Staff's approach in determining the NOL offset to EADIT would cause a normalization violation. Does Staff agree?

A. No. However, I understand Mr. McCuen's concern as Staff does not want to cause a normalization violation and deprive Liberty Midstates and its customers the ability to deduct future accelerated depreciation. Staff is aware of the IRS' interpretation of the law in regards to this issue. The IRS has been consistent in its interpretation of the law that the net operating loss carryforward ("NOLC") must be taken into account for normalization purposes and that if all or a portion of the NOL resulted from taking accelerated depreciation rather than book depreciation; then "the amount and time of the deferral of tax liability shall be taken into account in such appropriate time and manner as is satisfactory to the district director". This language provides no specific mandate on the method to determine how much of the loss is attributed to accelerated depreciation, but it is stated that any other method utilized outside of the "with or without method" does not have the same assurance of preventing a flow through of the tax benefit. The common method is the "with or without method" and according to the IRS is designed to ensure that the portion of the NOLC attributable to accelerated depreciation is taken into account by maximizing the amount of the NOL by offsetting the EADIT with the lower of the amount of depreciation or the NOL in a certain tax year. Liberty Midstates is treating the depreciation as a separate deduction for all tax years, which causes a higher portion of the loss to offset EADIT. However, Staff disagrees with this treatment because Liberty Midstates' tax returns reflect a treatment of depreciation as COGS for tax years 2012-2016. If COGS was not considered different for income tax purposes than a separate depreciation deduction, why have COGS? There is COGS because the return of basis determines any gain or loss that will ultimately be charged to the utility should the assets used in the business (that is creating gross revenue) be sold. The depreciation amount included in the COGS is typically book depreciation, while the accelerated depreciation is typically treated as a deduction. For tax years 2012-2016, the accelerated depreciation was included in COGS for Liberty Midstates. Staff believes that creates a distinction between how the depreciation is treated in creation of the NOL and ultimately the amount of the loss that is related to depreciation for offsetting the EADIT. Staff has not been able to obtain a private letter ruling (PLR) or locate other IRS codification analysis where depreciation was treated as COGS, rather than a separate deduction where a loss results, for specific guidance on the issue.

Q. On page 4, Mr. McCuen cites several PLRs for his belief that Staff's method will create a normalization violation and that there is no wiggle room regarding how to measure the NOL related to accelerated depreciation. Does a PLR apply to all utilities or businesses?

A. No, each PLR is requested and issued for a certain party and each PLR officially states that the ruling is directed only to the taxpayer who requested it …and may not be used or cited as precedent. Due to this, Staff does not rely on the ruling but rather analyzes and takes into account the IRS' own interpretations of their laws that are explained and cited within the PLR. Due to this, Staff has re-reviewed its analysis of how to calculate the amount of NOL to offset EADIT in an attempt to alleviate any normalization violation concerns.

Q. Please explain your further analysis and recalculation of the NOL to offset EADIT.

A. Staff has taken a somewhat similar approach to how it looked at EADIT in terms of accelerated depreciation in its direct case, but also took into account the "with or without" method. The reason for this hybrid approach is due to Liberty Midstates treating its depreciation as cost of goods sold for tax years 2012-2016 and then changing the treatment to a separate deduction in tax year 2017. Rather than developing a percentage – Staff looked at when the depreciation was utilized in the income tax calculation and also what effect it had. For example, a basic income tax calculation is:

Step 1: Gross Receipts – Cost of Goods Sold = Gross Profit (Total Income)

Step 2: Gross Profit – Separate Deductions = Taxable Income

For the years in which Liberty Midstates treated depreciation as cost of goods sold, the amount of loss after offset of cost of goods sold was compared to the NOL and the lower of the two amounts was considered in the total offset to EADIT. This assumes that depreciation caused the gross profit to become negative (not another COGS item such as labor). For the tax year that the depreciation was treated as a separate deduction, Staff included the depreciation deduction amount in the NOL as it was less than the overall loss that year (utilizing the "with or without" method). The amounts within the stand-alone tax return are total Liberty Midstates which means that once the NOL offset amount was determined, it was factored down to Missouri's portion, netted against the Missouri portion of EADIT, grossed up for taxes and amortized.

Q. Does this same calculation you describe above apply to the state EADIT balance?

A. Yes.

CUSTOMER FIRST OPERATIONS & MAINTENANCE EXPENSE

Q. Have Staff and Liberty Midstates' come to an agreement regarding the proper level of Customer First (C1) operations & maintenance (O&M) expense to be included in the cost of service?

A. I am uncertain. At the bottom of page 10 of Liberty Midstates' witness Emery's rebuttal testimony, she reflects a chart of items that summarizes income statement adjustments/balances that she states the Company does not oppose. One of those items listed, is customer first operations & maintenance expense. However, Liberty Midstates' witness Lauren Preston discusses on page 6, lines 20-22 and page 7, lines 1-6 that the Company continues to believe that the budgeted amount of $765,885 is a more accurate indication of the on-going O&M related to C1 based upon the agreements in place.

Q. What level of C1 O&M expense does Staff currently have included in the rate case?

A. As Staff mentioned in its Rebuttal testimony, Staff corrected the inadvertent removal of test year information technology (IT) O&M that will continue to be incurred subsequent to the test year that is above and beyond the O&M for C1. Staff has included an annualized level of $655,254 in the cost of service based upon actual recorded costs that are known and measurable. The amount cited by witness Preston is a budgeted amount and is not known and measurable.

PLANT AND ACCUMULATED RESERVE – OPC CONCERNS

Q. OPC witness John A. Robinett discusses on page 1, lines 11-19 that there are some plant accounts/subaccounts with negative plant-in-service in totality for the account. What is driving those amounts?

A. First, Staff wants to clarify that the adjustments to plant that were included in prior versions of Staff's Accounting Schedules were misaligned by one account number. Staff has corrected this issue as reflected in Staff's Accounting Schedules filed concurrently with this testimony. However, even after correction, Mr. Robinett is correct in his assessment of some accounts having negative ending balances. The ending amounts in these accounts are very minor and are negative simply because of my proposed removal of capitalized transition and transaction costs discussed earlier in this testimony. As is discussed further below, Liberty Midstates has shifted plant from minor accounts to major accounts due to Liberty Midstates' Customer First software transition and Staff's capitalized transition transaction adjustments did not shift accounts with the rest of the plant.

Staff has noticed that with the transition in software stemming from the Customer First transition there is less detail in the data, specifically the general ledger data. For example, in the investment and expense accounts under the old software, the FERC major accounts were broken down into more detail by minor account. This is important for investment, in that a FERC major account may have multiple minor accounts and each minor account may include slightly different investment that would require different depreciation rates. For expenses, in the old general ledger software it was easier to tell what affiliate costs were being allocated to Liberty Midstates from each affiliate as well as more detail about certain costs themselves, because a FERC major account would then be broken down by a minor account letting Staff know what each type of cost was and where it came from. Staff would recommend the Commission require Liberty Midstates to maintain its general ledger with detail similar to that which was used with the old general ledger format through minor accounts or certain coding for future rate reviews.

Q. OPC witness Robinett discusses concern with large negative plant in service adjustments within Staff's accounting schedules. What are causing these adjustments and are they truly reductions to the plant accounts?

A. These large negative plant in service adjustments are partially due to the plant adjustment problem I discuss above, but also due to the issue I just spoke about above regarding Liberty Midstates' Customer First transition. The old software included FERC major accounts for investment and then further broke some of those FERC major accounts down into minor accounts. Due to the transition, the large negative adjustments are removing amounts that were previously booked into multiple minor accounts into one major FERC account.

These FERC major accounts need to be redistributed to minor accounts, especially if there are different depreciation rates that apply to the different assets within the FERC account. Mr. Robinett gives a good example of why this rollup of plant amounts from minor accounts into a single major account is concerning on pages 2-4 of his rebuttal testimony when he discusses FERC accounts 376.1, Transmission & Distribution Mains – Steel and 376.2 Transmission & Distribution Mains – Plastic. In the old software format these two minor accounts are separate and reflect different depreciation rates because the assets themselves are made of different material with different lives, but in the new software format all of the dollars from these two minor accounts has been combined in a single major account 376 and a single depreciation rate would not be appropriate to apply.

Q. Is this same rollup of dollars from minor accounts into a single major account also occurring in the accumulated reserve accounts?

A. Yes, as accumulated reserve is the accumulation of the depreciation that has been incurred since the plant was put into service and should follow the plant whether that plant is recorded in minor and major accounts.

Q. Does this conclude your Surrebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Request of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Areas of the Company	)))))	Case No. GR-2024-0106

AFFIDAVIT OF LISA M. FERGUSON

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

COMES NOW LISA M. FERGUSON and on her oath declares that she is of sound mind and lawful age; that she contributed to the foregoing *Surrebuttal Testimony of Lisa M. Ferguson*; and that the same is true and correct according to her best knowledge and belief.

Further the Affiant sayeth not.

Lisa M. Ferguson
LISA M. FERGUSON

JURAT

Subscribed and sworn before me, a duly constituted and authorized Notary Public, in and for the City of St. Louis, State of Missouri, at my office in St. Louis, on this 17th day of September 2024.

Cheryl A Eck
Notary Public

CHERYL A ECK
Notary Public - Notary Seal
State of Missouri
Commissioned for St. Louis County
My Commission Expires: December 19, 2025
Commission Number: 13837618