DEPARTMENT OF PUBLIC SERVICE REGULATION
MONTANA PUBLIC SERVICE COMMISSION

IN THE MATTER OF the Investigation of the Montana Public Service Commission into whether Mountain Water Company's rates are Just and Reasonable	REGULATORY DIVISION DOCKET NO. D2016.2.15

CITY OF MISSOULA'S MOTION FOR JUDICIAL NOTICE

The City of Missoula ("City") hereby moves the Montana Public Service Commission ("PSC") to take judicial notice of the final *Report and Order* in File No. GR-2014-0152 of the Public Service Commission of the State of Missouri ("Missouri PSC") pursuant to Rule of Evidence 202.

ARGUMENT

Actions before the PSC are governed by the Montana Rules of Evidence. Admin. R. Mont. 38.2.4201; Mont. Code Ann. § 2-4-612(4). Montana Rule of Evidence 202 mandates judicial notice of law when requested by a party and the party provides the appropriate information. Mont. R. Evid. 202(d). Such law includes "[o]fficial acts of the legislative, executive, and judicial departments of the United States and of this and any state of the United States." Mont. R. Evid. 202(b)(4). Judicial notice is limited "matters which are relevant to the issues at hand." *State v. Fish*, 204 P.3d 681, 683 (Mont. 2009).

On December 3, 2014, the Missouri PSC entered findings and conclusions regarding the rates of the wholly owned Algonquin Power & Utilities Corp. ("Algonquin")/Liberty Utilities Co. ("Liberty") subsidiary Liberty Utilities (Midstates Natural Gas) Corp. ("Liberty Midstates"). The ratemaking docket is File No. GR-2014-

0152 and the Missouri PSC *Report and Order* is attached as Exhibit A. The Missouri PSC used "double leveraging" to set the Liberty Midstates capital structure in line with that of Liberty. They noted "the appropriate capital structure is that of Liberty Utility Company's structure, the company that issues debt and equity on behalf of Liberty." (See Exhibit A at 18.) The Missouri PSC set the cost of capital at Liberty's debt rate of 4.5%. *Id.* at 19.

The Missouri PSC *Report and Order* is on-point and relevant to this proceeding. First, Liberty Midstates is, like Mountain Water, a subsidiary in the Algonquin\Liberty holding company structure. Second, Liberty Midstates argued in the Missouri PSC proceedings that double leveraging of Liberty's cost of capital should not be imposed on Liberty Midstates. The Missouri PSC disagreed and imposed a hypothetical rate structure identical to Liberty's and used Liberty's internal cost of debt. Similarly, testimony in this proceeding has centered around whether or not Liberty's debt costs should be imputed to Mountain Water. Mountain Water's Expert has argued the PSC should not use the "double leveraging" concept and that it is out of favor in regulatory commissions. The Montana Consumer Counsel's expert disagrees.

The Missouri PSC's December 3, 2014 decision illustrates how another regulatory jurisdiction has addressed the precise question before the PSC regarding an identically situated entity in the same holding company structure. As such, judicial notice of the Missouri PSC decision is appropriate and relevant. Therefore, the City respectfully moves the PSC to take judicial notice of the attached Missouri PSC order.

Dated this 2nd day of May 2016.

Natasha P. Jones

Scott M. Stearns
Natasha Prinzing Jones
BOONE KARLBERG P.C

Jim Nugent
City of Missoula

Attorneys for the City of Missoula

CERTIFICATE OF SERVICE

This is to certify that the foregoing was duly served by mail and email upon the following counsel of record at their addresses this 2nd day of May 2016:

Michael Green D. Wiley Barker CROWLEY FLECK PLLP P.O. Box 797 Helena, MT 59624-0797 mgreen@crowleyfleck.com wbarker@crowleyfleck.com tandreasen@crowleyfleck.com	John Kappes President & General Manager Mountain Water Company 1345 West Broadway Missoula, MT 59802-2239 johnk@mtnwater.com
Barbara Hall Legal Director The Clark Fork Coalition P.O. Box 7593 Missoula, MT 59801 Barbara@clarkfork.org	Dennis R. Lopach, P.C. Montana Consumer Counsel 4 Carriage Lane Helena, MT 59601 dennis.lopach@gmail.com
	Robert Nelson Montana Consumer Counsel Box 201703 Helena, MT 59620-1703 robnelson@mt.gov ssnow@mt.gov

Tina Sunderland

EXHIBIT “A”

EXHIBIT “A”

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities' Tariff Revisions Designed to Implement a General Rate Increase for Natural Gas Service in the Missouri Service Areas of the Company	)))))	**File No. GR-2014-0152**

REPORT AND ORDER

Issue Date: **December 3, 2014**

Effective Date: **January 2, 2015**

TABLE OF CONTENTS

Appearances **3**

Procedural History **4**

General Findings of Fact **7**

General Conclusions of Law **8**

The Issues

I. Cost of Capital **15**

A. Capital Structure **15**
Findings of Fact 15
Conclusions of Law 17
Decision 17

B. Cost of Debt **18**
Findings of Fact 18
Conclusions of Law 18
Decision 19

C. Cost of Equity **19**
Findings of Fact 19
Conclusions of Law 26
Decision 29

II. Contract Customers **29**

A. Authorization for Special Contracts **29**
Findings of Fact 29
Conclusions of Law 30
Decision 30

B. Tariff for Special Contracts **30**
Findings of Fact 31
Conclusions of Law 31
Decision 32

C. Rates for Special Contracts – Noranda and General Mills **32**
Findings of Fact 32
Conclusions of Law 34
Decision 34

D. Rates for Special Contract – SourceGas 35
Findings of Fact 35
Conclusions of Law 37
Decision 37

III. Depreciation 37

Findings of Fact 37
Conclusions of Law 38
Decision 38

Ordered Paragraphs..... 39

BEFORE THE PUBLIC SERVICE COMMISSION
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REPORT AND ORDER

APPEARANCES

James M. Fischer, Esq., and **Larry W. Dority, Esq.**, Fischer & Dority, P.C., 101 Madison Street, Suite 400, Jefferson City, Missouri 65101, for Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities.

Edward F. Downey, Esq., and **Diana M. Vuylsteke, Esq.**, Bryan Cave LLP, 221 Bolivar Street, Suite 101, Jefferson City, Missouri 65109, for Noranda Aluminum, Inc.

Jeremy Knee, Esq., Associate General Counsel, Missouri Department of Economic Development, P.O. Box 1157, Jefferson City, Missouri 656102, for The Missouri Division of Energy

Marc D. Poston, Esq., Chief Deputy Counsel, Office of the Public Counsel, 200 Madison Street, Suite 650, Post Office Box 2230, Jefferson City, Missouri 65102, for the Office of the Public Counsel and the public.

Kevin Thompson, Esq., Chief Staff Counsel, **Jeffrey A. Keevil, Esq.**, Senior Staff Counsel, and **Akayla J. Jones, Esq.**, Legal Counsel, Missouri Public Service Commission, Post Office Box 360, Jefferson City, Missouri 65102, for the Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: Ronald D. Pridgin, Deputy Chief

Procedural History

On February 6, 2014, Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities (hereafter "Liberty") submitted to the Commission proposed tariff sheets that are intended to implement a general rate increase for natural gas service provided in its Missouri service area. Liberty's proposed tariffs would increase its Missouri jurisdictional revenues by approximately $7.6 million, or by 15.9%. The Commission suspended the tariffs and issued an Order and Notice on February 7.[1]

The Commission received timely intervention requests from The Missouri Division of Energy and Noranda Aluminum, Inc. The Commission granted these requests.

The test year is the 12 months ending September 30, 2013, updated for known and measureable changes through March 31. The Commission held local public hearings in Jackson, Sikeston, Hannibal, Kirksville, and Butler. The evidentiary hearing went from September 8 until September 10.

Stipulations

On August 12, Liberty, the Staff of the Commission ("Staff"), and the Office of the Public Counsel ("OPC") filed a Partial Stipulation and Agreement as to Certain Issues. The stipulations resolved all issues except: cost of capital, depreciation, cost of removal, special contracts, ISRS, rate design, and energy efficiency and weatherization.

No parties objected. Therefore, as permitted by Commission Rule 4 CSR 240-2.115, the Commission treated the stipulation as unanimous, and approved it on August 20.

[1] Calendar dates refer to 2014 unless otherwise noted.

As the August 12 stipulation stated, Liberty and Staff were to jointly file a late-filed exhibit identifying the final amount of rate case expense to be included in revenue requirement. Liberty and Staff did so on November 19, offering Late-Filed Exhibit 63 into evidence. The exhibit requests a final amount of rate case expenses of $609,679 normalized over three years at $203,226 per year.

OPC responded on November 24, opposing Liberty and Staff's requests. OPC characterizes the request as excessive, claiming that the stipulation provided for $37,768 of rate case expense, and that Liberty requests an increase of $571,911 above the agreed-upon $37,768. Further, OPC claims Liberty's request is conclusory, completely lacking any support.

The Commission ordered Liberty and Staff to respond to OPC's opposition. Liberty and Staff responded on December 1.

Staff states that OPC misrepresents Liberty's request. First, Staff points out that the rate case expense is to be normalized over three years, so the revenue requirement for the requested rate case expense is $203,226, not $609,679. Secondly, Staff states that the $37,768 of additional rate case expense is in addition to the normalized amount of rate case expense already included in Staff's direct case. Staff included rate case expense of $51,210 in its direct case.[2] Thus, at the time of the August 12 stipulation, the total amount of rate case expense contemplated was $88,978. Finally, Staff included a Highly Confidential workpaper which Staff represents it emailed to OPC before its November 19 filing.

[2] Ex. 17, p. 7.

Liberty's response largely echoes Staff's response. Liberty also states that it does not suggest OPC acquiesced to a blank check for rate case expense when it signed the August 12 stipulation. Liberty states that it provided invoices to Staff to support its claim. Further, Liberty said that it understood Staff consulted with OPC while finalizing Staff's workpaper that became the basis for Late-Filed Exhibit 63.

The August 12 stipulation provides for possible inclusion of additional rate case expense. Liberty and Staff offered Exhibit 63 in support of the additional rate case expense. And while OPC clearly opposes this request, OPC did not object to the admission of Exhibit 63.

This is significant because "in fact, all probative evidence received without objection in a contested case must be considered in administrative hearings."[3] All parties waive objection to that evidence, even if they make a "specific and laborious objection" to that same evidence later in the hearing.[4] Thus, Exhibit 63 is admitted.

Based on the information presented in Exhibit 63 and in the verified pleadings of Staff and Liberty, the Commission approves as reasonable a final amount of rate case expenses of $609,679. The Commission also approves normalizing this amount over three years at $203,226 per year.

On September 5, Liberty, OPC and The Missouri Division of Energy ("DE") filed a Non-Unanimous Second Partial Stipulation and Agreement as to Certain Issues. Staff did not sign this stipulation, and asked for a hearing on one of the issues from that stipulation.

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[3] *See Dorman v. State Bd. of Registration of Healing Arts*, 64 S.W.3d 446, 454 (Mo. App. 2001); *see also* Section 536.070(8)("Any evidence received without objection which has probative value shall be considered by the agency along with the other evidence in the case.")

[4] *See Canania v. Director of Revenue*, 918 S.W.2d 310, 313 (Mo. App. 1996).

On September 10, Liberty, OPC and DE withdrew the September 5 stipulation. At the same time, Liberty, OPC, DE and Staff filed a Revised Second Partial Stipulation and Agreement. Noranda did not sign it. But the signatories represented that Noranda did not object, and did not request a hearing on the issues resolved by the September 10 stipulation. As permitted by Commission Rule 4 CSR 240-2.115, the Commission will treat the stipulation as unanimous, and will approve it.

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact and conclusions of law. The positions and arguments of all of the parties have been considered by the Commission in making this decision, and the Commission finds the rates resulting from this decision just and reasonable.

General Findings of Fact

1. Liberty began providing natural gas service in Missouri in 2012 after buying the natural gas assets of Atmos Energy Corporation. The Commission approved the sale in File No. GM-2012-0037.[5]

2. Liberty is a Missouri corporation, a gas corporation, and a public utility. Liberty's ultimate corporate parent is Algonquin Power and Utilities Corp., a Canadian corporation whose stock is traded on the Toronto Stock Exchange. Liberty provides natural gas service to approximately 85,000 customers in Missouri, Illinois, and Iowa. Approximately 55,000 of those customers are in Missouri.[6]

[5] Ex. 1, p. 3.
[6] Id. at 4.

3. Liberty serves its Missouri customers through three rate districts: Northeast (NEMO), Southeast (SEMO), and West (WEMO).[7]

General Conclusions of Law

1. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision. When making findings of fact based upon witness testimony, the Commission will assign the appropriate weight to the testimony of each witness based upon their qualifications, expertise and credibility with regard to the attested-to subject matter.[8]

2. Liberty is a gas utility and a public utility subject to Commission jurisdiction.[9] The Commission has authority to regulate the rates Liberty may charge for gas.[10]

3. The Commission is authorized to value the property of gas utilities in Missouri.[11] Necessarily, that includes property and other assets proposed for inclusion in rate base. In determining value, "the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . ."[12] The courts have held that this statute means that the Commission's determination of the proper rate

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[7] Id. at 6.

[8] Witness credibility is solely within the discretion of the Commission, who is free to believe all, some, or none of a witness' testimony. *State ex. rel. Missouri Gas Energy v. Public Service Comm'n*, 186 S.W.3d 376, 389 (Mo. App. 2005).

[9] Section 386.020(15), (42) RSMo Cum Supp. 2013 (all statutory cites to RSMo Cum. Supp. 2013 unless otherwise indicated).

[10] Section 393.140(11).

[11] Section 393.230.1.

[12] Section 393.270.4.

must be based on consideration of all relevant factors.[13] Relevant factors include questions raised by stakeholders about the prudency and necessity of utility construction decisions and expenditures.

4. In making its determination, the Commission may adopt or reject any or all of any witnesses' testimony.[14] Testimony need not be refuted or controverted to be disbelieved by the Commission.[15] The Commission determines what weight to accord to the evidence adduced.[16] "It may disregard evidence which in its judgment is not credible, even though there is no countervailing evidence to dispute or contradict it."[17] The Commission may evaluate the expert testimony presented to it and choose between the various experts.[18]

5. Where the evidence conflicts, the Commission determines which evidence is most credible. The Commission's determinations of credibility are implicit in the Commission's findings of fact.[19] No law requires the Commission to expound upon which portions of the record the Commission accepted or rejected.[20]

6. The Staff of the Commission is represented by the Commission's Staff Counsel, an employee of the Commission authorized by statute to "represent and appear for the commission in all actions and proceedings involving this or any other law [involving

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[13] *State ex rel. Missouri Water Co. v. Public Service Commission*, 308 S.W.2d 704, 719 (Mo. 1957); *State ex rel. Midwest Gas Users' Association v. Public Service Commission*, 976 S.W.2d 470, 479 (Mo. App., W.D. 1998); *State ex rel. Office of Public Counsel v. Public Service Commission of Missouri,* 858 S.W.2d 806 (Mo. App., W.D. 1993).
[14] *State ex rel. Associated Natural Gas Co. v. Public Service Commission*, 706 S.W.2d 870, 880 (Mo. App., W.D. 1985).
[15] *State ex rel. Rice v. Public Service Commission*, 220 S.W.2d 61, 65 (Mo. banc 1949).
[16] *Id.*
[17] *Id.*
[18] *Associated Natural Gas*, *supra,* 706 S.W.2d at 882.
[19] *Stone v. Missouri Dept. of Health & Senior Services*, 350 S.W.3d 14, 26 (Mo. banc 2011).
[20] *Stith v. Lakin*, 129 S.W.3d 912, 919 (Mo. App., S.D. 2004).

the commission.]"[21] The Public Counsel is appointed by the Director of the Missouri Department of Economic Development and is authorized to "represent and protect the interests of the public in any proceeding before or appeal from the public service commission[.]"[22] The remaining parties include an industrial consumer and a governmental entity.

Burden of Proof

7. "At any hearing involving a rate sought to be increased, the burden of proof to show that the increased rate or proposed increased rate is just and reasonable shall be upon the . . . gas corporation . . . and the commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible."[23]

Ratemaking Standards and Practices

8. The Commission is vested with the state's police power to set "just and reasonable" rates for public utility services,[24] subject to judicial review of the question of reasonableness.[25] A "just and reasonable" rate is one that is fair to both the utility and its

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[21] Section 386.071.

[22] Sections 386.700 and 386.710.

[23] Section 393.150.2.

[24] Section 393.130, in pertinent part, requires a utility's charges to be "just and reasonable" and not in excess of charges allowed by law or by order of the commission. Section 393.140 authorizes the Commission to determine "just and reasonable" rates.

[25] *St. ex rel. City of Harrisonville v. Pub. Serv. Comm'n of Missouri*, 291 Mo. 432, 236 S.W. 852 (Mo. banc. 1922); *City of Fulton v. Pub. Serv. Comm'n*, 275 Mo. 67, 204 S.W. 386 (Mo. banc. 1918), *error dis'd,* 251 U.S. 546, 40 S.Ct. 342, 64 L.Ed. 408; *City of St. Louis v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 509, 207 S.W. 799 (1919); *Kansas City v. Pub. Serv. Comm'n of Missouri*, 276 Mo. 539, 210 S.W. 381 (1919), *error dis'd,* 250 U.S. 652, 40 S.Ct. 54, 63 L.Ed. 1190; *Lightfoot v. City of Springfield*, 361 Mo. 659, 236 S.W.2d 348 (1951).

customers;[26] it is no more than is sufficient to "keep public utility plants in proper repair for effective public service, [and] . . . to insure to the investors a reasonable return upon funds invested."[27] In 1925, the Missouri Supreme Court stated:[28]

> The enactment of the Public Service Act marked a new era in the history of public utilities. Its purpose is to require the general public not only to pay rates which will keep public utility plants in proper repair for effective public service, but further to insure to the investors a reasonable return upon funds invested. The police power of the state demands as much. We can never have efficient service, unless there is a reasonable guaranty of fair returns for capital invested. * * * These instrumentalities are a part of the very life blood of the state, and of its people, and a fair administration of the act is mandatory. When we say "fair," we mean fair to the public, and fair to the investors.

9. The Commission's guiding purpose in setting rates is to protect the consumer against the natural monopoly of the public utility, generally the sole provider of a public necessity.[29] "[T]he dominant thought and purpose of the policy is the protection of the public . . . [and] the protection given the utility is merely incidental."[30] However, the Commission must also afford the utility an opportunity to recover a reasonable return on the assets it has devoted to the public service.[31] "There can be no argument but that the Company and its stockholders have a constitutional right to a fair and reasonable return upon their investment."[32]

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[26] *St. ex rel. Valley Sewage Co. v. Pub. Serv. Comm'n*, 515 S.W.2d 845 (Mo. App. 1974).
[27] *St. ex rel. Washington University et al. v. Pub. Serv. Comm'n*, 308 Mo. 328, 344-45, 272 S.W. 971, 973 (Mo. banc 1925).
[28] *Id.*
[29] *May Dep't Stores Co. v. Union Elec. Light & Power Co*., 341 Mo. 299, 107 S.W.2d 41, 48 (Mo. App. 1937).
[30] *St. ex rel. Crown Coach Co. v. Pub. Serv. Comm'n*, 179 S.W.2d 123, 126 (1944).
[31] *St. ex rel. Utility Consumers Council, Inc. v. Pub. Serv. Comm'n*, 585 S.W.2d 41, 49 (Mo. banc 1979).
[32] *St. ex rel. Missouri Public Service Co. v. Fraas*, 627 S.W.2d 882, 886 (Mo. App. 1981).

10. The Commission has exclusive jurisdiction to establish public utility rates,[33] and the rates it sets have the force and effect of law.[34] A public utility has no right to fix its own rates and cannot charge or collect rates that have not been approved by the Commission;[35] neither can a public utility change its rates without first seeking authority from the Commission.[36] A public utility may submit rate schedules or "tariffs," and thereby suggest to the Commission rates and classifications which it believes are just and reasonable, but the final decision is the Commission's.[37] Thus, "[r]atemaking is a balancing process."[38]

11. Ratemaking involves two successive processes: first, the determination of the "revenue requirement," that is, the amount of revenue the utility must receive to pay the costs of producing the utility service while yielding a reasonable rate of return to the investors.[39] The second process is rate design, that is, the construction of tariffs that will collect the necessary revenue requirement from the ratepayers.

12. Revenue requirement is usually established based upon a historical test year that focuses on four factors: (1) the rate of return the utility has an opportunity to earn; (2) the rate base upon which a return may be earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating expenses. The calculation of revenue requirement from these four factors is expressed in the following formula:

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[33] *May Dep't Stores*, *supra,*107 S.W.2d at 57.
[34] *Utility Consumers Council*, *supra*, 585 S.W.2d at 49.
[35] *Id.*
[36] *Deaconess Manor Ass'n v. Pub. Serv. Comm'n*, 994 S.W.2d 602, 610 (Mo. App. 1999).
[37] *May Dep't Stores*, *supra,*107 S.W.2d at 50.
[38] *St. ex rel. Union Elec. Co. v. Pub. Serv. Comm'n*, 765 S.W.2d 618, 622 (Mo. App. 1988).
[39] *St. ex rel. Capital City Water Co. v. Missouri Pub. Serv. Comm'n*, 850 S.W.2d 903, 916 n. 1 (Mo. App. 1993).

$$RR = C + (V - D)\,R$$

where:
- RR = Revenue Requirement;
- C = Prudent Operating Costs, including Depreciation Expense and Taxes;
- V = Gross Value of Utility Plant in Service;
- D = Accumulated Depreciation; and
- R = Overall Rate of Return or Weighted Cost of Capital.

13. The return on the rate base is calculated by applying a rate of return, that is, the weighted cost of capital, to the original cost of the assets dedicated to public service less accumulated depreciation.[40]

14. The Public Service Commission Act vests the Commission with the necessary authority to perform these functions. The Commission can prescribe uniform methods of accounting for utilities, and can examine a utility's books and records and, after hearing, can determine the accounting treatment of any particular transaction.[41] In this way, the Commission can determine the utility's prudent operating costs. The Commission can value the property of electric utilities operating in Missouri that is used and useful to determine the rate base.[42] Finally, the Commission can set depreciation rates and adjust a utility's depreciation reserve from time-to-time as may be necessary.[43]

15. The Revenue Requirement is the sum of two components: first, the utility's prudent operating expenses, and second, an amount calculated by multiplying the value of the utility's depreciated assets by a rate of return. For any utility, its fair rate of return is simply its composite cost of capital. The composite cost of capital is the sum of the

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[40] *See St. ex rel. Union Elec. Co.*, 765 S.W.2d at 622.
[41] Section 393.140.
[42] Section 393.230. Section 393.135 expressly prohibits the inclusion in electric rates of costs pertaining to property that is not "used and useful."
[43] Section 393.240.

weighted cost of each component of the utility's capital structure. The weighted cost of each capital component is calculated by multiplying its cost by a percentage expressing its proportion in the capital structure. Where possible, the cost used is the "embedded" or historical cost; however, in the case of common equity, the cost used is its estimated cost.

The Issues

I. Cost of capital

a. What capital structure should the Commission use in this case to determine a revenue requirement for Liberty?

Findings of Fact

4. Liberty's ultimate parent company is Algonquin Power & Utilities Corporation ("Algonquin"). One of Algonquin's business units is Liberty Utilities (Canada) Corp. ("LUC"), which owns 100% interest in Liberty Utilities Company ("LUCo"). Liberty, in turn, falls under Liberty Utilities Company. [44]

5. In the present case, Staff's recommended capital structure is the actual capital structure of Liberty's direct parent, LUCo. Liberty is part of a holding-company system; its book capital structure and capital costs are not a true reflection of the system's capital costs with respect to Liberty.[45]

6. LUCo is the entity that drives Liberty's cost of capital.[46]

7. Liberty does not have a credit rating.[47]

8. Liberty does not issue equity.[48]

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[44] Ex. 13, p. 3.
[45] Ex. 31, p. 4.
[46] Ex. 13, pp. 18-19.
[47] Id. at 16.
[48] Id. at 18-19.

9. Liberty does not issue long-term debt, and does not raise its own short-term debt.[49]

10. All of the items listed in paragraphs 7-9 above occur at the LUCo level.[50]

11. LUCo issues long-term debt to debt investors and issues equity indirectly to Algonquin. Then, it allocates portions of this capital to the operations that need capital at the time. Thus, Liberty's capital structure is an allocated capital structure or book capital structure.[51]

12. LUCo uses its internal finance department to manage and determine capital structures of its operations (including Liberty). Liberty's capital structure is an internally assigned capital structure that has no bearing on the cost of capital for Liberty.[52]

13. Liberty justifies using its book capital structure by noting Algonquin's actual capital structure is similar. However, Algonquin's operations are not similar to Liberty's; significantly, Algonquin's operations include both regulated and unregulated entities.[53]

14. DBRS (a Canadian credit rating agency) rates LUCo and APUC separately.[54]

15. DBRS gives LUCo a higher credit rating than Algonquin.[55]

16. A lower business risk subsidiary can issue more debt than the higher business risk subsidiary. Liberty's ratepayers should not have to pay an equity return on the higher equity ratio needed to offset Algonquin's higher business risk.[56]

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[49] Id. at 19.
[50] Ex. 31, p. 4.
[51] Id.
[52] Id. at 2.
[53] Ex. 13, p. 3.
[54] Ex. 32, p. 3.
[55] Id. at 4.
[56] Id. at 8.

Conclusions of Law

16. The Commission may disregard the actual book capital structure of a utility when it is deemed to be in the public interest to do so.[57]

17. There are two circumstances in which it is appropriate for the Commission to use a hypothetical capital structure.[58]

18. One circumstance is "when the utility's actual debt-equity ratio is deemed inefficient and unreasonable because it contains too much equity and not enough debt, necessitating an inflated rate of return."[59]

19. The second circumstance that justifies adopting a hypothetical construct occurs when the utility is part of a holding company system. In such situations, the utility's book capital structure and capital costs may not be a true reflection of the system's capital costs with respect to a particular operating company. Double leveraging represents one approach utilized by regulatory agencies to account for a utility's status as a subsidiary in a holding company system. Moreover, it is only the parent's alleged use of its low cost debt to purchase stock in its subsidiary that serves as the principle behind the application of double leveraging.[60]

Decision

The Commission finds this issue in favor of Staff. Liberty proposed a capital structure more like Algonquin's. But Algonquin's capital structure reflects its higher business risk due to its unregulated activities. Liberty, which is regulated, does not face the

[57] State ex. rel. Associated Natural Gas Co. v. Public Service Com'n of Missouri, 706 S.W.2d 870, 878 (Mo.App. W.D. 1985).
[58] Id.
[59] Id.
[60] Id. at 878-79.

same business risk as Algonquin. Thus, Liberty should not be able to charge its Missouri ratepayers as if it needed a more equity rich capital structure like Algonquin's. Thus, the appropriate capital structure is that of Liberty Utility Company's structure, the company that issues debt and equity on behalf of Liberty.

b. What is the appropriate embedded cost of debt that the Commission should apply in this case to determine a revenue requirement for Liberty?

Findings of Fact

17. Liberty does not issue debt.[61]

18. Liberty proposes a 4.5% cost of debt, which is its assigned cost of debt through its parent companies.[62]

19. LUCo issues debt, and passes debt capital out to subsidiaries as needed.[63]

20. The debt and debt cost on Liberty's books are products of the debt allocation process LUCo performs for its United States operations.[64]

Conclusions of Law

There are no additional conclusions of law.

[61] Ex. 13, p. 18.
[62] Ex. 6NP, p. 46.
[63] Id., at 19.
[64] Id. at 21.

Decision

The Commission finds this issue in favor of Staff. Liberty proposed a 4.5% cost of debt, which is its assigned cost of debt through its parent companies. Having chosen Staff's capital structure, which is based on Liberty Utilities Company's capital structure, it follows that the appropriate cost of debt should be based upon Liberty Utilities Company's embedded cost of debt.

c. What is the appropriate cost of equity that the Commission should apply in this case to determine a revenue requirement for Liberty?

Findings of Fact

21. Mr. Zephania Marevangepo is Staff's return on equity witness.[65]

22. The midpoint of Mr. Marevangepo's recommended return on equity range is 8.7%, which would give Liberty a return on equity more than 60 basis points lower than any return on equity at any state Commission in at least 30 years.[66] Staff's testimony did not support such a low return on equity. Thus, the Commission does not find this testimony persuasive.

23. Liberty's cost of capital witness is Robert Hevert.[67]

24. Because all return on equity models are subject to various assumptions and constraints, equity analysts and investors tend use multiple methods to develop their return requirements. Mr. Hevert therefore appropriately relied on three widely-accepted approaches to develop his return on equity ("ROE") recommendation: (1) the Discounted

[65] Tr. 182.
[66] Ex. 6, p. 3.
[67] Ex. 5, p. 2.

Cash Flow ("DCF") model, including the Quarterly Growth, Constant Growth, and Multi-Stage forms; (2) the Capital Asset Pricing Model ("CAPM"); and (3) the Bond Yield Plus Risk Premium approach.[68]

25. Since the ROE is a market-based concept, and Liberty is not a publicly traded entity, it is necessary to establish a group of comparable publicly-traded companies to serve as its "proxy." Even if Liberty were a publicly traded entity, short-term events could bias its market value during a given period of time. A significant benefit of using a proxy group is that it serves to moderate the effects of anomalous, temporary events associated with any one company.[69]

26. To select his proxy group, Mr. Hevert began with the universe of companies that Value Line classifies as Electric or Natural Gas Utilities, which includes a group of 58 domestic U.S. utilities, and applied the following screening criteria:

- He excluded companies that do not consistently pay quarterly cash dividends;
- All of the companies in the proxy group have been covered by at least two utility industry equity analysts;
- All of the companies have investment 1 grade senior unsecured bond and/or corporate credit ratings from Standard & Poor's ("S&P");
- Companies with at least 60.00 percent of consolidated net operating income derived from regulated natural gas utility operations; and
- Companies currently known to be party to a merger, or other significant transaction were eliminated.[70]

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[68] Ex. 5, p. 3.
[69] Id. at 6.
[70] Id. at 7-8.

27. The companies that met Mr. Hevert's screening criteria, which the Commission finds Mr. Hevert chose appropriately, were:[71]

Company	**Ticker**
AGL Resources	GAS
Atmos Energy	ATO
Laclede Group	LG
New Jersey Resources	NJR
Northwest Natural Gas	NWN
Piedmont Natural Gas	PNY
South Jersey Industries	SJI
Southwest Gas	SWX
Washington Gas Light	WGL

28. After selecting his proxy group, Mr. Hevert used a Discounted Cash Flow model. The DCF approach is based on the theory that a stock's current price represents the present value of all expected future cash flows. In its simplest form, the DCF model expresses the Cost of Equity as the sum of the expected dividend yield and long-term growth rate.[72]

29. The DCF model assumes that the total return received by investors includes the dividend yield, and the rate of growth. Under the model's assumptions, the rate of growth equals the rate of capital appreciation. That is, the model assumes that the investor's return is the sum of the dividend yield and the increase in the stock price.[73]

30. However, most dividend-paying companies, including utilities, pay dividends on a quarterly (as opposed to an annual) basis. The yield component of the Quarterly Growth DCF model, therefore, accounts for the quarterly payment of dividends. Thus, the

[71] Id. at 8.
[72] Id. at. 11.
[73] Id. at 11.

Quarterly Growth DCF model incorporates investors' expectation of the quarterly payment of dividends, and the associated quarterly compounding of those dividends as they are reinvested at investors' required ROE.[74]

31. To calculate the expected dividends over the coming year for the proxy companies, Mr. Hevert obtained the last four paid quarterly dividends for each company, and multiplied them by one plus the growth rate. He also used three averaging periods to calculate an average stock price to ensure the model's results are not skewed by anomalous events.[75]

32. Earnings growth projections have a statistically significant relationship to stock valuation levels, while dividend growth rates do not. Investors form their investment decisions based on expectations of growth in earnings, not dividends. Consequently, earnings growth not dividend growth is the appropriate estimate for the purpose of the Constant Growth DCF model.[76]

33. Mr. Hevert's quarterly growth DCF results, which the Commission finds to be reasonable, are:[77]

	Mean Low	***Mean***	***Mean High***
30-Day Average	8.05%	9.29%	10.76%
90-Day Average	8.05%	9.28%	10.76%
180-Day Average	8.03%	9.26%	10.74%

34. Mr. Hevert also used a Constant Growth DCF model. The Constant Growth DCF model assumes: (1) a constant average annual growth rate for earnings and

[74] Id.
[75] Id.
[76] Id. at 15.
[77] Id. at 17.

dividends; (2) a stable dividend payout ratio; (3) a constant price-to-earnings multiple; and (4) a discount rate greater than the expected growth rate. Under those assumptions, dividends, earnings, book value, and the stock price all grow at the same, constant rate.[78]

35. Mr. Hevert used the same projected earnings per share growth rates and the retention growth estimate that he used in his Quarterly Growth DCF analysis.[79]

36. Mr. Hevert's constant growth DCF results, which the Commission finds to be reasonable, are:[80]

	Mean Low	***Mean***	***Mean High***
30-Day Average	7.93%	9.12%	10.55%
90-Day Average	7.92%	9.12%	10.55%
180-Day Average	7.90%	9.10%	10.53%

37. In order to address certain limiting assumptions underlying the Constant Growth form of the DCF model, Mr. Hevert also used the Multi-Stage (three-stage) DCF Model. The Multi-Stage model is an extension of the Constant Growth model. It allows the analyst to specify growth rates over three distinct stages. As with the Constant Growth model, the Multi-Stage form defines the Cost of Equity as the discount rate that sets the current price equal to the discounted value of future cash flows. Unlike the Constant Growth form, however, the Multi-Stage model must be solved in an iterative fashion.[81]

38. The Multi-Stage model sets the subject company's stock price equal to the present value of future cash flows received over three "stages". In the first two stages, "cash flows" are defined as projected dividends. In the third stage, "cash flows" equal both

[78] Id. at 17.
[79] Id. at 18.
[80] Id. at 19.
[81] Id.

dividends and the expected price at which the stock will be sold at the end of the period *(i.e.,* the "terminal price").[82]

39. Since the model provides the ability to specify near, intermediate and long-term growth rates, for example, it avoids the sometimes limiting assumption that the subject company will grow at the same, constant rate in perpetuity. In addition, by calculating the dividend as the product of earnings and the payout ratio, the model enables analysts to reflect assumptions regarding the timing and extent of changes in the payout ratio to reflect, for example, increases or decreases in expected capital spending, or transition from current payout levels to long-term expected levels.[83]

40. Mr. Hevert's multi-stage growth DCF results, which the Commission finds to be reasonable, are:[84]

	Mean Low	***Mean***	***Mean High***
30-Day Average	9.58%	9.92%	10.36%
90-Day Average	9.58%	9.91%	10.36%
180-Day Average	9.56%	9.89%	10.34%

41. Mr. Hevert also used a Capital Asset Pricing Model ("CAPM") analysis. This method of estimating the cost of equity uses a risk-free return plus a risk premium.[85]

42. Because utility assets represent long-term investments, Mr. Hevert used two different measures of the risk-free rate: the current 30-day average yield on 30-year Treasury bonds (3.87%), and the projected 30-year Treasury yield (4.15%).[86]

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[82] Id.
[83] Id. at 20-21.
[84] Id. at 19.
[85] Id. at 25.
[86] Id. at 27.

43. Due to recent economic conditions, such as the 2008 Lehman Brothers bankruptcy filing, Mr. Hevert used a forward-looking estimate of the market risk premium, rather than a historical average.[87]

44. Mr. Hevert's CAPM results, which the Commission finds to be reasonable, suggest a return on equity of 10.21 to 12.78%. A summary of his results are below:[88]

	Bloomberg Derived Market Risk Premium	*Value Line Derived Market Risk Premium*
Average Calculated Beta Coefficient		
Current 30-Year Treasury (3.87%)	12.50%	11.40%
Near Term Projected 30-Year Treasury (4.15%)	12.78%	11.68%
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.87%)	11.96%	10.93%
Near Term Projected 30-Year Treasury (4.15%)	12.24%	11.21%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.87%)	11.14%	10.21%
Near Term Projected 30-Year Treasury (4.15%)	11.42%	10.49%

45. Mr. Hevert also employed a bond yield plus risk premium approach. It is based on the concept that equity holders' payments are subordinate to bondholders' payments, and, consequently, equity holders will require a premium to take on the risk of not being paid a return on investment.[89]

46. The results of Mr. Hevert's bond yield plus risk premium analysis, which the Commission finds to be reasonable, showed an estimated cost of equity between 10.19 and 10.69%.[90]

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[87] Id.
[88] Id. at 30-31.
[89] Id. at 31.
[90] Id. at 33-34.

47. Mr. Hevert's return on equity recommendation is 10.0% to 10.5%.[91]

Conclusions of Law

20. The Commission must estimate the cost of common equity capital. This is a difficult task, as academic commentators have recognized.[92] The United States Supreme Court, in two frequently cited decisions, has established the constitutional parameters that must guide the Commission in its task.[93] In the earlier of these cases, *Bluefield Water Works*, the Court stated that:

> Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the services are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property in violation of the Fourteenth Amendment.[94]

21. In the same case, the Court provided the following guidance as to the return due to equity owners:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.[95]

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[91] Ex. 6, p. 3.

[92] C.F. Phillips, Jr., *The Regulation of Public Utilities*, 390 (1993); Goodman, 1 *The Process of Ratemaking*, *supra,* at 606.

[93] *Fed. Power Comm'n v. Hope Nat. Gas Co.,* 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1943); *Bluefield Water Works & Improv. Co. v. Pub. Serv. Comm'n of West Virginia*, 262 U.S. 679, 43 S.Ct. 675, 67 L.Ed. 1176 (1923).

[94] *Bluefield, supra,* 262 U.S. at 690, 43 S.Ct. at 678, 67 L.Ed. at 1181.

[95] *Id*., 262 U.S. at 692-93, 43 S.Ct. at 679, 67 L.Ed. at 1182-1183.

22. The Court restated these principles in *Hope Natural Gas Company*, the later of the two cases:

> '[R]egulation does not insure that the business shall produce net revenues.' But such considerations aside, the investor interest has a legitimate concern with the financial integrity of the company whose rates are being regulated. From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.[96]

23. The Commission must draw primary guidance in the evaluation of the expert testimony from the Supreme Court's *Hope* and *Bluefield* decisions. Pursuant to those decisions, returns for Liberty's shareholders must be commensurate with returns in other enterprises with corresponding risks. Just and reasonable rates must include revenue sufficient to cover operating expenses, service debt and pay a dividend commensurate with the risk involved. The language of *Hope* and *Bluefield* unmistakably requires a *comparative method*, based on a quantification of risk.

24. Investor expectations are not the sole determiners of ROE under *Hope* and *Bluefield*; we must also look to the performance of other companies that are similar to Liberty in terms of risk. *Hope* and *Bluefield* also expressly refer to objective measures. The allowed return must be sufficient to ensure confidence in the financial integrity of the company in order to maintain its credit and attract necessary capital. By referring to confidence, the Court again emphasized risk.

25. The Commission cannot simply find a rate of return on equity that is "correct"; a "correct" rate does not exist. However, there are some numbers that the Commission can

[96] *Hope Nat. Gas Co., supra,* 320 U.S. at 603, 64 S.Ct. 288, 88 L.Ed. 345 (citations omitted).

use as guideposts in establishing an appropriate return on equity. The Commission stated that it does not believe that its return on equity finding should "unthinkingly mirror the national average."[97] Nevertheless, the national average is an indicator of the capital market in which Liberty will have to compete for necessary capital.

26. The Commission has described a “zone of reasonableness” extending from 100 basis points above to 100 basis points below the recent national average of awarded ROEs to help the Commission evaluate ROE recommendations.[98] Because the evidence shows the recent national average ROE for gas utilities is 9.69%,[99] that “zone of reasonableness” for this case is 8.69% to 10.69%.

27. The Commission has wide latitude in setting an ROE within the zone of reasonableness.[100] The zone of reasonableness is simply a tool to help the Commission to evaluate the recommendations offered by various rate of return experts. It should not be taken as an absolute rule that would preclude consideration of recommendations that fall outside that zone.

28. In the final analysis, the method employed to estimate the cost of common equity is unimportant, as long as the result that is reached satisfies the constitutional requirements.[101]

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[97] *In re Missouri Gas Energy*, 12 Mo.P.S.C.3d 581, 593 (*Report and Order* issued September 21, 2004).
[98] *Id.*
[99] Ex. 6, p. 19.
[100] *State ex. rel. Public Counsel,* 274 S.W.3d at 574 (*citing In re Permian Basin Area Rate Cases*, 390 U.S. 747, 767, 88 S.Ct. 1344, 20 L.Ed.2d 312 (1968))(“**courts are without authority** to set aside **any** rate selected by the Commission [that] is within a ‘zone of reasonableness’)(emphasis supplied).
[101] *State ex rel. Arkansas Power & Light Company v. Missouri Public Service Commission***,** 736 S.W.2d 457, 462 (Mo.App., W.D. 1987); *State ex rel. Associated Natural Gas Company v. Public Service Commission of Missouri,* 706 S.W.2d 870, 879 (Mo.App., W.D. 1985).

Decision

The Commission finds this issue in favor of Liberty. The Commission will set the return on equity at 10.0%, which is the bottom of the range Liberty proposed.[102] Such a return on equity is commensurate with returns of other corporations with corresponding risks, will ensure confidence in the financial integrity of the company, and is near the midpoint of the above-mentioned zone of reasonableness.

II. Contract Customers[103]

a. Is Liberty currently authorized to enter into special contracts at non-tariffed rates with its customers in Missouri, such as Noranda and General Mills?

Findings of Fact

48. Liberty has a special contract in place with Noranda, which is in Liberty's SEMO Division.[104]

49. The Noranda contract pre-dates the 2000 Atmos acquisition of Associated Natural Gas and was in effect during the test year.[105]

50. Noranda has the option to bypass Liberty and interconnect with the interstate pipeline operated by Texas Eastern Transmission Company (TETCO). The special contract keeps Noranda from switching, and ultimately benefits Liberty's customers.[106]

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[102] Ex. 5, p. 3.
[103] Much of the evidence for this issue is Highly Confidential. This Report and Order does not contain any Highly Confidential evidence, although the evidence it cites is often Highly Confidential.
[104] Ex. 2, p. 17.
[105] Ex. 3, p. 3.
[106] Ex. 2, p. 18.

51. Liberty also has a special contract in place with General Mills, which is in effect during the test year. General Mills is in Liberty's NEMO Division.[107]

52. The General Mills plant in the special contract is within 1400 feet of an interstate pipeline operated by Panhandle Eastern Pipeline Company (PEPL). Thus, the plant could bypass Liberty and connect to PEPL.[108]

53. These two special contracts provide two large customers that contribute to fixed and variable cost recovery of Liberty's cost of service. If Liberty lost those customers, Liberty's other customers would likely see a rate increase.[109]

54. Noranda uses over 20,000 times as much natural gas as an average residential customer in the SEMO Division.[110]

Conclusions of Law

There are no additional conclusions of law.

Decision

The Commission finds this issue in favor of Liberty. The Commission finds that Liberty stepped into the shoes of Atmos when it purchased Atmos' assets, and that Liberty had the right to charge Noranda and General Mills the rates it did during the test year.

b. If Liberty is not currently authorized to enter into special contracts at non-tariffed rates with its customers in Missouri such as Noranda and General Mills,

[107] Ex. 2, p. 17.
[108] Id. at 18-19., Ex. 3, p. 9.
[109] Id. at 19.
[110] Ex. 46, p. 6.

should the Commission authorize Liberty to adopt a tariff to allow it to enter into such special contracts? If yes, what should such tariff state?

Findings of Fact

55. Without a tariff, special contracts may be discriminatory since the contracts would give special treatment for some customers, completely at Liberty's discretion.[111]

56. Although Liberty submitted a specimen tariff, that tariff is ambiguous about the relationship between a special contract and Liberty's existing tariffs.[112]

57. Liberty's proposed tariff also has the title of "Negotiated Gas Sales Service", which applies to Liberty's sales service and alternative fuel customers. Thus, Liberty's proposed tariff is confusing as it is unclear if it is to deal with transportation service, sales service, or both.[113]

58. Also, Liberty's proposed tariff does not require a customer to give Liberty any evidence of the investment needed for the customer to take service directly from the bypass provider. Staff's proposed tariff, however, does impose such a requirement.[114]

Conclusions of Law

There are no additional conclusions of law.

[111] Ex. 13HC, p. 53.
[112] Ex. 39HC, p. 9.
[113] Id. at 9-10.
[114] Ex. 3HC, Sch. CDK-R7 and Ex. 39HC, Sch. DMS-5.

Decision

The Commission finds this issue in favor of Staff. Liberty should have to provide Staff some justification for its special contracts. Liberty can best do so through a tariff. The Commission finds Liberty should file a tariff as suggested by Staff.

c. What rate should the Commission use to calculate Liberty's revenues from Noranda and General Mills for purposes of this rate case?

Findings of Fact

59. Staff recommends calculating Liberty's revenues from Noranda and General Mills by imputing the Commission-approved tariff rate, rather than the discounted rate established in the special contracts with these customers.[115]

60. Staff does not believe Liberty should have charged Noranda and General Mills the full-tariffed rate on the first day Liberty began operating the Missouri districts.[116]

61. In a previous Atmos rate case, Staff recommended revenue imputation adjustments for Noranda and General Mills, but ultimately the settlement in the last Atmos rate case explicitly stated that there would be no imputation of revenues for Noranda or General Mills. Atmos, Staff, Public Counsel, and Noranda entered into the following agreement:

> 7. Special Contracts. The Signatories agree that revenues associated with special contracts shall not be imputed in this case. The Signatories agree that Atmos shall offer to extend the special contracts of Noranda and General Mills to expire on the effective date of rates approved in Atmos's next general rate case. The rates for such extended period shall be those in effect at the

[115] Ex. 23NP, pp. 2-3.
[116] Tr. 378.

> end of the respective contract's original term. This paragraph shall not be construed to limit the ability of Atmos and Special Contract customers: i) to accept alternative mutually agreeable contract provisions, or ii) to enter into alternative mutually agreeable contracts for service."[117]

62. The Commission approved this stipulation.[118]

63. According to the Agreement with Staff and Public Counsel, Atmos was required to extend those contracts and use the same rates that were in effect at the end of the respective contract's original term.[119]

64. The Agreement to use these specific rates in the Noranda and General Mills contracts was not discretionary with Atmos. The rate provisions were mandatory, and agreed to by Atmos, Staff, Public Counsel, and Noranda.[120]

65. Had Liberty charged the rates Staff suggests in this case, Liberty would have violated the stipulation from File No. GR-2010-0192.[121]

66. Liberty purchased Atmos' Missouri assets, and was obligated to comply with all Commission orders applicable to Atmos.[122]

67. The current cost to supply interruptible transportation service is about $0.03 per Mcf.[123]

68. Even if Noranda was treated as a firm transportation customer and the SEMO transmission network costs were allocated to Noranda, then Noranda's cost would be approximately $0.11 per Mcf.[124]

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[117] *Unanimous Stipulation and Agreement*, File No. GR-2010-0192 (August 11, 2010).
[118] Tr. 361.
[119] Tr. 362.
[120] Tr. 364.
[121] Tr. 273.
[122] *Order Approving Unanimous Stipulation and Agreement*, File No. GM-2012-0037 (March 14, 2012).
[123] Ex. 46HC, pp. 8-11.
[124] Id. at 10.

69. Regardless of whether Noranda is treated as an interruptible or a firm customer, Liberty charges Noranda more than its cost to serve Noranda.[125]

70. General Mills and Noranda would likely bypass Liberty's local distribution network, switch to alternative fuels, or substantially reduce their natural gas consumption if the full-tariffed rated were charged.[126]

71. During the test year, Liberty stepped into the shoes of Atmos and was required to charge Noranda and General Mills the same rates that were in the Atmos contracts with those customers.[127]

Conclusions of Law

There are no additional conclusions of law.

Decision

The Commission finds this issue in favor of Liberty. Imputing the revenue that Staff seeks to impute to Liberty would greatly reduce Liberty's revenue requirement. That, in turn, could force Liberty to raise rates for Noranda and General Mills to the point that they, having the legal right to seek an alternative energy provider and the practical and economic incentive to do so, would likely leave Liberty's system. This would ultimately cause financial harm to Liberty and to its customers.

The negotiated rates Liberty charged Noranda and General Mills were reasonable because those rates covered all variable costs and some fixed costs of serving these

[125] Id. at 4, 8-11.
[126] Ex. 2NP, pp. 17-18; Ex. 3HC, pp. 3-9; Ex. 4HC, pp. 9-10; Ex. 46HC, pp. 2-11; Ex. 57, p. 24; Ex. 58, pp. 3-9; Ex. 59, pp. 3-14.
[127] Tr. 361.

customers. Imputing the tariffed rate would not accurately reflect the historical revenues or the expected revenues as the new tariff for special contracts does not require the Company to use the tariffed rates. If in fact any entity believes future rates negotiated under the Company's special contract tariff are excessively discounted, those entities may file a Complaint under the Commission's Complaint procedures.

d. What rate should the Commission use to calculate Liberty's revenues from SourceGas for purposes of this rate case?

Findings of Fact

72. Liberty or its predecessor has provided interstate service to SourceGas (which was formerly known as Associated Natural Gas Company) since June 1, 2000, when ANG sold its Missouri assets to Atmos. At that time, the ANG local distribution system was being separated into a Missouri service territory operated by United Cities Gas, a division of Atmos, and an Arkansas service territory that would continue to be owned by ANG.[128]

73. For the Arkansas property to have a gas pipeline and gas supply, there needed to be an interstate arrangement between Atmos and ANG that would allow Atmos to provide interstate transportation service to ANG after the service area was separated. Atmos obtained authority to provide interstate transportation services to SourceGas under flex or discount rates.[129]

[128] Tr. 495-96; Ex. 12NP, p. 4.
[129] Tr. 494-96, 513

74. While Liberty was negotiating interstate transportation service terms with SourceGas at the Federal Energy Regulatory Commission ("FERC"), Liberty was also negotiating interstate transportation service terms with Atmos for its WEMO service territory in the Rich Hill-Hume area.[130]

75. For SourceGas, Liberty is the provider of the interstate transportation service. On the other side of Missouri, however, in the Rich Hill-Hume area, Liberty is the customer, and receives gas using the interstate transportation service provided by Atmos from its Kansas facilities.[131]

76. When Liberty acquired the Atmos properties in Missouri, it was necessary to file with the FERC for approval of an open access interstate transportation service. Under the new approved arrangement, the Liberty rate results in benefits for Liberty customers in the SEMO district.[132]

77. Liberty has on file with FERC an interstate transportation rate approved by the FERC in Docket No. CP12-42-000. That tariff allows Liberty to receive gas in Missouri and transport said gas across its SEMO distribution system to its state line interconnects with SourceGas. This transportation service is an open access service and is available to all similarly situated customers. The approved maximum transportation rate is $1.3938 per Dth and mirrors the current Large Customer transportation rate for SEMO.[133]

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[130] Ex. 12NP, p. 11.
[131] Tr. 524.
[132] Tr. 500; Ex. 12HC, p. 5.
[133] Ex. 12HC, p. 3-4.

Conclusions of Law

29. A "state utility commission setting retail prices must allow, as reasonable operating expenses, costs incurred as a result of paying a FERC-determined wholesale price."[134]

Decision

The Commission finds this issue in favor of Liberty. Although much of the evidence on this sub-issue is highly confidential, the Commission's review of this evidence finds that Liberty acted reasonably both with SourceGas and Atmos.

III. Depreciation

Findings of Fact

78. The depreciation rate in question is for hardware and software that is used at Liberty's corporate office in Jackson, Missouri and allocated to its divisions in Iowa, Illinois and Missouri jurisdictions.[135]

79. In its Order Approving the Unanimous Stipulation and Agreement in File No. GM-2012-0037, the Commission ordered Liberty to adopt Atmos' depreciation rates.[136]

80. Atmos, Liberty's predecessor, used Liberty's proposed rates for these accounts in its 2006 and 2010 rate cases.[137]

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[134] *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965 (1986).
[135] Ex. 10, p. 9.
[136] Ex. 13, p. 71; Tr. 588-89.
[137] Tr. 572.

81. Staff used a 14.29% rate for system and network hardware and software, and an 18.98% rate for personal computer hardware and software in the 2010 case.[138]

82. Thus, Liberty's depreciation rates are in line with Staff's rates for the most recent Atmos rate case.[139]

83. Staff's depreciation rate proposal of 4.75% reflects a 21-year life span for these assets. This is an unrealistically long life to apply to computer equipment and systems.[140]

84. This would imply that systems and equipment purchased today would, on average, still be in service in the year 2035.[141]

Conclusions of Law

There are no additional conclusions of law.

Decision

The Commission finds this issue in favor of Liberty. Given the speed at which technology develops and changes, depreciation rates of 21 years for computer hardware and software are unreasonably long.

[138] Ex. 36, pp. 1-2; Tr. 591-92.
[139] Ex. 11, p. 3.
[140] Id.
[141] Ex. 10, p. 11.

THE COMMISSION ORDERS THAT:

1. The Revised Second Partial Stipulation and Agreement filed by Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities Company, the Office of the Public Counsel, the Staff of the Commission and The Missouri Division of Energy on September 10, 2014, is approved, and the signatories are ordered to comply with its terms.

2. The proposed tariff sheets filed by Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities Company on February 6, 2014, Tariff No. YG-2014-0320, are rejected.

3. Liberty Utilities (Midstates Natural Gas) Corp. d/b/a Liberty Utilities shall file tariffs that comport with this Report and Order no later than December 10, 2014.

4. The Staff of the Commission shall file a recommendation regarding the tariffs ordered in paragraph 3 no later than December 11, 2014. Any party that wishes to object to the tariffs ordered in paragraph 3 shall do so no later than December 14, 2014.

5. All pending motions and other requests for relief not granted are denied.

6. This Report and Order shall become effective on January 2, 2015.

BY THE COMMISSION

Morris L. Woodruff
Secretary

R. Kenney, Chm., Stoll, W. Kenney, Hall, and Rupp, CC., concur and certify compliance with the provisions of Section 536.080, RSMo.

Dated at Jefferson City, Missouri, on this 3rd day of December, 2014.