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February 16, 2018

BY E-PORTAL

Ms. Carlotta Stauffer
Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: DOCKET NO. 20170179-GU - Petition for rate increase and approval of depreciation study by Florida City Gas.

Dear Ms. Stauffer:

Attached, for electronic filing, please find the testimony and exhibits of Florida City Gas' rebuttal witness Mike Morley. (Document 1 of 10)

Sincerely,

Beth Keating
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ATTACHMENTS

cc:// Office of Public Counsel
FEA

Before the Florida Public Service Commission

Docket No. 20170179-GU: Petition for rate increase by Florida City Gas.

Prepared Rebuttal Testimony of Michael J. Morley

Date of Filing: February 16, 2017

Q. Please state your name, position and business address.

A. My name is Michael J. Morley and I am Managing Director, Regulatory Accounting & Reporting and Strategic Planning of Southern Company Gas. My business address is 10 Peachtree Place, Atlanta, Georgia 30309.

Q. Have you previously filed testimony in this proceeding?

A. Yes. I filed direct testimony on behalf of Florida City Gas ("FCG" or "Company") on October 23, 2017.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to several issues raised in the direct testimony of Marshall W. Willis on behalf of the Citizens of Florida ("OPC"). Specifically, I will respond to Witness Willis's observations and recommendations as they relate to the impact of the Tax Cuts and Jobs Act ("TCJA"), Revenue Expansion Factor, Refund of Interim rates, SAFE recovery, capitalized incentive compensation, as well as his proposal to further reduce depreciation expense by requiring that approved depreciation rates be deemed effective January 1, 2018, as opposed to the proposed date of August 1, 2018, which is the date following the study period.

Q. Are there other portions of Witness Willis's that you will not address or not address in detail?

A. Yes. There are certain issues involving adjustments proposed by OPC that will be addressed by other Company witnesses. These issues include the storm reserve, incentive compensation, the LNG facility, the impact of the TCJA on the Company's capital structure, FCG's request for additional employee positions and OPC witness Garrett's proposal to further reduce FCG's depreciation rates.

Q. Are you sponsoring any exhibits with your rebuttal testimony?

A. Yes. I am sponsoring Exhibit MJM-2, which is my revised Schedules G-3, page 2, G-4 and G-5, both of which were filed in the Company's response to OPC Interrogatory 8-175.

I. SAFE PROGRAM

Q. Please summarize Witness Willis's conclusions with regard to the Company's proposal to incorporate the SAFE surcharge in base rates?

A. Witness Willis acknowledges that, in approving the Company's SAFE program, the Commission clearly contemplated that the SAFE surcharge program would be included for recovery in base rates in a future rate proceeding. However, Witness Willis is apparently under the impression that the Company "may be inadvertently" recovering for the program twice by adding the SAFE test year revenues to the rate case revenue deficiency.[1] He suggests that the SAFE facilities have already been included in the calculation of the Company's revenue deficiency; thus, adding the surcharge revenue results in double recovery of that amount.[2]

Q. Do you agree with Witness Willis' conclusion?

A. No, I do not. Currently, the SAFE surcharge and associated revenues are separate from base rates. Upon approval by the Commission for new base rates, the Company will add the SAFE surcharge and revenues to base rates and base revenues. Therefore, this is merely a transfer between the SAFE surcharge and base rates. The net impact on customers will be the revenue deficiency of $12.3 million included in line 7 of my Exhibit MJM-2, page 1. When the Company sets the SAFE surcharge to zero, this will result in a base revenue deficiency of $15.8 million. The resetting of the SAFE surcharge to zero and adding it as a component of base rates has a net zero impact on customers. Therefore, the Company's proposal does not result in double recovery of the SAFE revenues. Rather, the Company is simply moving the SAFE surcharge to base rates in accordance with Commission Order PSC-2015-0390-TRF-GU.

Company witness Nikolich provides additional explanation and an illustrative example in his rebuttal testimony.

Q. Do you agree with Witness Willis's assertion that the SAFE revenues of $3.5 million should be adjusted to reflect the 21% federal tax rate effective

[1] Direct Testimony of Marshall W. Willis, 6:23 – 7:4.
[2] Direct Testimony of Marshall W. Willis, 7:4-9.

January 1, 2018?[3]

A. No. The $3.5 million in SAFE revenues forecasted for the test year represents the estimated 2018 SAFE revenues based on the current SAFE surcharge rate. The effect of the change in income taxes will not change the SAFE surcharge rate but will change the SAFE revenue requirement. By virtue of including all SAFE components of the revenue requirement – revenues, rate base, depreciation expense, etc. – in the determination of the revised revenue deficiency, the Company has adjusted the SAFE revenue requirement to reflect the impacts of the TJCA. However, the $3.5 million in forecasted test year SAFE revenues will not change since the SAFE surcharge will not be reset to zero until new base rates are approved.

II. Application of Lower Depreciation Rates

Q. What is Witness Willis's proposal as it relates to the application of new, lower depreciation rates?[4]

A. In addition to his proposed adjustment to reflect OPC Witness Garrett's recommendation, which will be addressed by FCG Witness Watson, he is also proposing that the projected test year 2018 should reflect a full year of reduced depreciation expense coinciding with revised depreciation rates, rather than the 5 months as reflected by FCG. He argues that this is consistent with the "matching principle."

Q. Do you agree with Witness Willis's recommendation?

A. No. For one thing, Witness Willis's recommendation would seem to

[3] Direct Testimony of Marshall W. Willis, 7:11-19.
[4] Direct Testimony of Marshall W. Willis, 21:8 – 22:17.

conflict with the Commission Rule on Depreciation Studies for Gas Utilities, Rule 25-7.045, which requires that data reflected in a depreciation study be brought to the effective date of the proposed depreciation rates and that the Company only reflect changes on its books and records upon approval of the depreciation study by the Commission. Furthermore, the Company's application of an effective date of August 1, 2018 and including only five months of the new depreciation rates impact to depreciation expense is consistent with other test year expense items. For example, the Company's proposal to include additional employee positions in the test year is not based on an annualized payroll and benefits expense of the employees. Rather, the payroll and benefits expense included in the test year is based upon when the employees will be hired and the actual expense expected to be incurred during the test year. If OPC's proposal to use an annualized depreciation expense for new depreciation rates is accepted, then, for purposes of consistency, other items in the test year such as payroll and benefits should also be adjusted to reflect an annualized level of expense.

III. Income Tax Expense and Deferred Income Taxes

Q. Has the Company recognized the impact of the Tax Cuts and Jobs Act ("TCJA")?[5]

A. Yes, we recognize that the implementation of the new law has a significant impact on FCG's projected test year. As such, we have provided revised MFRs in discovery responses that reflect the impact of the TCJA, as

[5] Direct Testimony of Marshall W. Willis, 22:19-23:11.

Witness Willis has acknowledged in his testimony and incorporated in his revenue requirement.

IV. Capital Structure

Q. Does FCG believe adjustments to its capital structure are necessary in response to the TCJA?

A. Yes. As reflected in FCG's discovery responses to OPC and my Exhibit MJM-2, page 3, the Company has included expected changes to the capital structure that will start in 2018 in response to the TCJA.

Q. Does Witness Willis take issue with these adjustments to the capital structure?

A. He does. Witness Willis contends that this adjustment is unsupported and not required by the Act.[6]

Q. Do you agree?

A. No, I do not. As discussed further in the rebuttal testimony of Company witness Vander Weide, the TCJA has a material, negative impact on the projected cash flows of Southern Company Gas in 2018 and beyond. The impact of the TCJA to the credit metrics of the utility industry has been well-documented and widely reported by rating agencies. The assertion that the TCJA does not have a direct impact on the capital structure of the Company is simply not true.

Q. Do you have any other comments in response to Witness Willis's testimony on capital structure?

A. Yes. Beginning on page 25, line 8 of Mr. Willis's testimony, he contends that the Company changed the "beginning book balances" of the balance

[6] Direct Testimony of Marshall W. Willis, 23:14-21.

sheet and claims the Company has changed the capital structure merely to a more preferable capital structure for the company. The Company did change the beginning ***forecasted*** balance at January 1, 2018 (book balance implies an actual balance as opposed to a forecast) to incorporate the corrections the Company made in the case through the course of discovery. These corrections, which were accepted by Witness Willis, required the Company to recapitalize the balance sheet for the test year so that the balance sheet would balance. In doing the recapitalization, the Company used the proposed updated capital structure of Southern Company Gas, which is consistent with how the company recapitalized the balance sheet in its initial filing.

As discussed previously in my testimony and in that of Company witness Vander Weide, the TCJA is more than just a reduction in the federal tax rate from 35% to 21% that reduces the amount a utility needs to recover for current income tax expense. The reduction to the tax rate also requires utilities to flow back excess deferred taxes to customers, and the TCJA also eliminates bonus depreciation. Both of these outcomes of the TCJA have real ramifications to the Company's cash flows that require Southern Company Gas to take action to mitigate the negative impacts on its credit ratings. The implication that the Company has revised its capital structure solely because the newly proposed capital structure is what "the Company now prefers," or that the proposal is not a direct result of the TCJA, is untrue and in direct contrast with the real world impact of the TCJA on our Company, as well as unsupported by the financial market's perception of that impact, as further addressed by Witness Vander Weide.

IV. Revenue Expansion Factor

Q. Does Witness Willis agree with the Company's revenue expansion factor?[7]

A. No. He suggests that the Bad Debt Rate utilized in the expansion factor is overstated. He bases this conclusion on the Company's response to Interrogatory No. 17 from the OPC, noting that the Company has been successful in lowering its bad debt in recent years.[8] He also suggests that the Revenue Expansion Factor should be adjusted to reflect the new tax rate applicable to FCG as a result of the TCJA.

Q. Do you agree with Witness Willis's proposal to use a lower Bad Debt Rate in the Revenue Expansion Factor?

A. No. The Company used a three-year average net bad debt write-off to revenues ratio in computing its proposed bad debt rate in the revenue expansion factor. The use of a three-year average incorporates fluctuations up or down that may occur over time. In this case, the three-year average includes the decreases in the bad debt rate that has taken place from 2014 – 2016. Witness Willis simply used the lowest bad debt rate in the full year data provided for the years 2012 – 2016. The Company considers an average approach as a more reasonable approach in determining the bad debt rate for the revenue expansion factor.

Q. Do you agree that the Revenue Expansion Factor should be adjusted to reflect the impact of the TCJA?[9]

[7] Direct Testimony of Marshall W. Willis, 26:22 – 28:19.
[8] Direct Testimony of Marshall W. Willis, 27:7-8.
[9] Direct Testimony of Marshall W. Willis, 28:3-8.

A. Yes. The Company included the impact of the TCJA in its revised revenue expansion factor in its response to OPC Interrogatory 175.

V. Capitalized Incentive Compensation

Q. Do you agree with Witness Willis's recommendation to eliminate capitalized incentive compensation from rate base in the amount of $558,275?

A. No, I do not. As discussed in the testimony of Company witness Garvie, FCG considers the incentive compensation incurred by the Company to be a prudently incurred cost and recoverable from customers. However, if the Commission agrees with Witness Willis's recommendation, the only amount that should be removed from rate base is the amount included in the test year.

Q. Why should only the amount included in the test year be excluded if the Commission agrees with Witness Willis's recommendation?

A. Witness Willis's recommendation is to eliminate capitalized incentive compensation from 2014 – 2018. Witness Willis references prior Commission orders in 2010 and 2011 pertaining to utilities other than FCG that disallow certain amounts of incentive compensation. I am not aware of any Commission order that has disallowed incentive compensation for FGC. Therefore, it is my view that elimination of capitalized incentive compensation amounts from rate base from 2014 – 2017 constitutes retroactive ratemaking.

Q. What is retroactive ratemaking?

A. The fundamental rule of utility ratemaking is that rates are set prospectively. Generally, reaching back to prior years by a utility or Commission to incorporate adjustments in a future period proceeding is considered retroactive ratemaking. In this instance, Witness Willis is recommending that the Company go back prior years – 2014-2017 – and adjust rate base by eliminating capitalized incentive compensation for those years.

Q. If the Commission agrees with Witness Willis's recommendation, how much should be disallowed in this proceeding.

A. As discussed previously, if the Commission agrees with Witness Willis, the only amount that should be disallowed is the 2018 test year amount of $124,703, which is the capitalized incentive compensation amount of $105,636 increased by the 18.05% load factor recommended by Witness Willis.

VI. Refund of Interim Rates

Q. Do you agree with Witness Willis' recommendation that the Company should be required to refund interim rates in the amount of $307,117 and for the impact of the TCJA?[10]

A. No. First, as supported in the testimony of company witness Garvie, the Company considers its total compensation reasonable and fully recoverable in this proceeding. Second, the interim rates, per statute, are

[10] Direct Testimony of Marshall W. Willis, 28:21 – 29:15.

calculated on a historic test year, which is not impacted by the TCJA. Third, the Company's interim rates are already subject to refund. Therefore, to the extent final approved rates are lower than interim rates, customers will be refunded any amounts owed going back to the effective date of the interim rates. Therefore, it is not necessary to adjust interim rates at this time.

Q. Does this conclude your pre-filed rebuttal testimony?

A. Yes, it does.

PIVOTAL UTILITY HOLDINGS, INC.
D/B/A FLORIDA CITY GAS
20170179-GU
EXHIBIT MJM 2
PAGE 1 OF 3

CALCULATION OF THE PROJECTED TEST YEAR - REVENUE DEFICIENCY
EXPLANATION: PROVIDE THE CALCULATION OF THE REVENUE DEFICIENCY FOR THE PROJECTED TEST YEAR.

PROJECTED TEST YEAR: 12/31/18

LINE NO.	DESCRIPTION	AMOUNT	AS FILED AMOUNT	CHANGE
1	ADJUSTED RATE BASE	$ 303,216,950	$ 299,278,151	$ 3,938,799
2	REQUESTED RATE OF RETURN	6.57%	6.32%	0.26%
				0
3	N.O.I. REQUIREMENTS	19,924,689	18,899,714	1,024,974
				0
4	LESS: ADJUSTED N.O.I.	10,823,447	9,290,482	1,532,965
5	N.O.I. DEFICIENCY	$ 9,101,242	$ 9,609,232	$ (507,990)
6	EXPANSION FACTOR	1.3522	1.6434	(0.2912)
7	REVENUE DEFICIENCY	$ 12,306,700	$ 15,791,812	$ (3,485,112)
8	ADD SAFE SURCHARGE SET TO ZERO	$ 3,509,729	$ 3,509,729	$ -
9	TOTAL BASE REVENUE DEFICIENCY	$ 15,816,429	$ 19,301,541	$ (3,485,112)

CALCULATION OF THE PROJECTED TEST YEAR - REVENUE EXPANSION FACTOR
EXPLANATION: PROVIDE THE CALCULATION OF THE REVENUE EXPANSION FACTOR.

PROJECTED TEST YEAR: 12/31/18

LINE NO	DESCRIPTION	%	AS FILED	CHANGE
1	REVENUE REQUIREMENT	100.00	100.00	0.00
2	REGULATORY ASSESSMENT RATE	0.5000	0.5000	0.0000
3	BAD DEBT RATE	0.4382	0.4382	0.0000
4	NET BEFORE INCOME TAXES (1)-(2)-(3)	99.0618	99.0618	0.0000
5	STATE INCOME TAX RATE	5.5	5.5	0.0
6	STATE INCOME TAX (4 X 5)	5.4484	5.4484	0.0000
7	NET BEFORE FEDERAL INCOME TAX (4)-(6)	93.6134	93.6134	0.0000
8	FEDERAL INCOME TAX RATE	0.21	0.35	(0.14)
9	FEDERAL INCOME TAX (7 X 8)	19.6588	32.7647	(13.1059)
10	REVENUE EXPANSION FACTOR (7)-(9)	73.9546	60.8487	13.1059
11	NET OPERATING INCOME MULTIPLIER (100% / LINE 10)	1.3522	1.6434	(0.2912)

PIVOTAL UTILITY HOLDINGS, I
D/B/A FLORIDA CITY GAS
20170179-GU
EXHIBIT MJM- 2
PAGE 3 OF 3

CALCULATION OF THE PROJECTED TEST YEAR - COST OF CAPITAL
EXPLANATION: PROVIDE A SCHEDULE CALCULATING A 13 MONTH AVERAGE COST OF CAPITAL FOR THE PROJECTED TEST YEAR

PROJECTED TEST YEAR: 12/31/18

			Adjustments							
Line No.	Description	Per Books	To Conform with Ratio of Investor Sources	Specific	Pro Rata	Adjusted	Ratio	Cost Rate	Weighted Cost	Consolidated Investor Sources
1	COMMON EQUITY	107,985,825	23,214,036	-	(6,168,555)	125,031,306	41.23%	11.25%	4.64%	49.19%
2	LONG TERM DEB	103,916,451	16,157,768	-	(5,645,467)	114,428,752	37.74%	4.69%	1.77% a	45.02%
3	SHORT TERM DE	54,804,462	(39,371,804)	-	(725,589)	14,707,069	4.85%	2.64%	0.13% a	5.79%
4	CUSTOMER DEP(	3,888,281	-	-	-	3,888,281	1.28%	2.73%	0.03% a	
5	DEFERRED TAXE	44,643,944	-	517,598	-	45,161,542	14.89%	0.00%	0.00%	
6	TAX CREDIT	-	-	-	-	-	0.00%	0.00%	0.00%	
7	TOTAL	315,238,963	-	517,598	(12,539,611)	303,216,950	100.00%		6.57%	

INTEREST SYNCHRONIZATION CALCULATION

RATE BASE			$ 303,216,950	
x WEIGHTED AVERAGE COST OF DEBT	(SUM OF "a")		1.93%	
SYNCHRONIZED INTEREST			5,861,487	
INTEREST PER BOOKS			5,300,998	
INTEREST PER BOOKS Less than SYNCHRONIZED INTEREST CALCU		-	560,488	
STATE TAX @	5.50%	-	30,827	- 30,827
		-	529,662	
FEDERAL TAX @	21.00%			- 111,229
TOTAL INCOME TAX ADJUSTMENT				($142,056)